NARROWING RATE DIFFERENTIAL with India stemming from hawkish US action and demand from oil importers take local unit to 82.51/$; analysts project 82.80 levels on continued weakness

US Fed Talk of More Hikes Drags Rupee to Weakest Monthly Close

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Mumbai: The rupee on Thursday closed at its weakest level versus the US dollar in almost a month as the minutes of the Federal Reserve's latest meeting indicated that monetary policy would continue to be tightened in the world's largest economy, thus narrowing the rate differential with India.

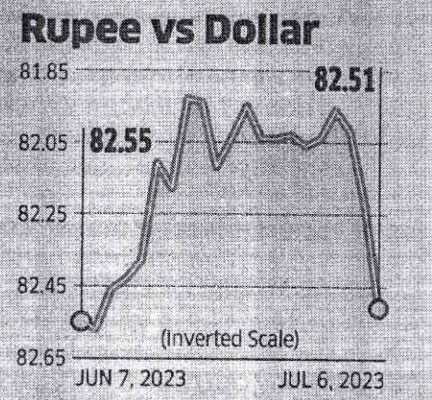
The domestic currency closed at 82.51 per US dollar down 22 paise from the previous day's close. Thursday's level is the weakest closing for the rupee since June 8 while the price action marks the sharpest single-day decline for the rupee since June 5, Bloomberg data showed.

So far in 2023, the local currency has appreciated 0.3% against the greenback versus a depreciation of around 10% the previous year.

The minutes of the Fed's June 13-14 meeting, released after Indian trading hours on Wednesday, suggested that while the US central bank had paused rate hikes in June, concerns over persistently elevated inflation were large enough to likely prompt fresh rate increases later in 2023.

Key US market gauges indicate a close-to-90% chance of the Fed raising interest rates at its next meeting this month. The Fed has raised interest rates by 500 basis points since March 2022. Higher interest rates in the US typically lead to a flow of global capital away from emerging market economies, exerting pressures on their currencies.

"The Indian rupee registered its biggest single-day loss in a month against the US dollar following the hawkish June FOMC minutes and short covering from the rupee bulls. The local unit depreciated around a percentage point from Monday's low of 81.76 to today's high of 82.55," said Dilip Parmar, research analyst at HDFC Securities.



Parmar sees the rupee weakening further and heading towards 82.80 per dollar in the coming days.

Firm demand for dollars from oil importers exacerbated the stress on the rupee which already suffered volatility as traders scrambled to cover short bets on the greenback.

Meanwhile dollar-rupee forward premia, which represent the interest rate differential between the US and India, plummeted as exporters sold the US unit and hedged exposures. Shrinking forward premia reduce hedging costs for importers but reduce the returns exporters earn from selling dollars.

"Oil companies raised the dollar demand and took the dollar higher to 82.55 and exporters got another chance to hedge their dollar receivables after a hawkish Fed. However, forward premiums fell to 1.60% from a recent high of 1.87% as exporters hedged their receivables," said Anil Kumar Bhansali, head of treasury at Finrex Treasury Advisors.