

US INFLATION READING TRUMPS LOCAL NUMBERS

Hopes of Fed Hike Pause Fuel Gains in GSecs and Rupee

Local unit rises 10 p
to dollar, yield on
benchmark 10-year
paper falls 5 bps

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Mumbai: Government bonds and the rupee notched up firm gains on Thursday as a lower-than-expected US inflation reading strengthened anticipation of rate hikes finally coming to an end in the world's largest economy, leading to weakness in the dollar and lower US bond yields.

The strength in the domestic currency and sovereign debt came despite a higher-than-expected local inflation reading, which clouds the picture as far as monetary easing by the Reserve Bank of India is concerned.

The yield on the 10-year benchmark government bond closed at 7.07% on Thursday, five basis points lower than the previous close. Bond prices rise when yields fall. One basis point is 0.01 percentage point.

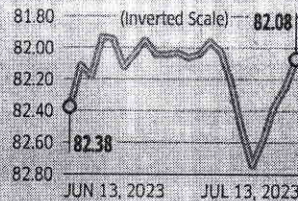
Easing government bond yields drive down borrowing costs for corporates raising funds through debt.

The rupee gained 10 paise to close at 82.08 to the dollar on Thursday. Intraday, the local currency strengthened past the 82 mark for the first time since July 4, touching a high of 81.95.

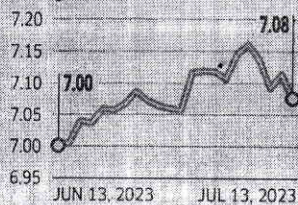
"The breakdown in the US dollar index to a fresh 15-month low is a major trigger for further appreciation in the Indian rupee. Now, how much will depend on how aggressive the RBI is in its buying of US dollars," said Anindya Banerjee, vice president-currency derivatives at Kotak Securities.

Currency traders said that the RBI had likely stepped in to purchase dollars once the rupee strengthened past the 82 mark to the dollar so as to rein in excess volatility in the exchange rate.

Rupee vs Dollar



10-yr Bond Yield



Banerjee estimated dollar purchases worth around \$1 billion by the central bank, spread out between the spot and forwards markets. In the near term, the rupee is seen in a band of 81.60-82.40, traders said.

CONTRASTING DATA

Data released after Indian trading hours on Wednesday showed that India's headline retail inflation was at 4.81% in June, sharply higher than 4.31% in May. The RBI's target for inflation is 4% and its tolerance band is 2-6%.

Ordinarily, rising inflation would push up yields on local fixed-income products but data released just after the domestic price data showed that US annual headline inflation was at 3% in June, the lowest since March 2021.

"It is likely that more and more Fed officials turn sceptical of further hikes being needed beyond one more at the July meeting. A continuation of the disinflationary trend makes it likely that the Fed will pause after the July meeting," said Madhavi Arora, economist at Emkay Global.

Higher US interest rates exert pressure on emerging market assets as global funds flow towards the world's largest economy.