

₹ logs biggest weekly gain in two months

Hope of reduced Fed rate hikes, lack of RBI dollar buys drive gains

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The rupee ended the current week with hefty gains, strengthening 1.7 per cent over the last five days, with Friday's appreciation driven by a fall in US inflation which stoked anticipation of the Federal Reserve slowing down the pace of rate hikes.

The domestic currency closed at 81.34 per US dollar on Friday as against 81.55 per dollar at previous close. The rupee had closed at 82.73 per US dollar on January 6. The gains for the currency this week are the highest since the week ended November 11, traders said. Data released after Indian market hours on Thursday showed that US year-on-year inflation declined to 6.5 per cent in December from 7.1 per cent the previous month.

The data makes a case for the Federal Reserve to consider a reduced quantum of monetary tightening at its policy statement early next month, currency traders said, pointing out that Fed fund futures were indicating strong chances of a 25-basis point (bp) rate hike by the US central bank.

The Fed raised rates by a massive 425 bps in 2022, with most of the rate hikes being in tranches of 75 bps. Higher US interest rates lead to a stronger dollar, exerting pressure on emerging market currencies like the rupee. The US dollar index, a gauge of the currency against six major currencies, dropped sharply after the latest inflation data, with the index at 102.17 at 3:30 pm IST on Friday. The index was at 103.09 the same time on Thursday.

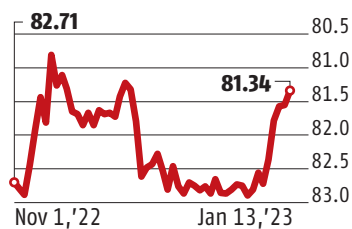
"The Indian rupee gained all five days of the week and registered the biggest weekly gains after November 11 on the back of foreign fund inflows, better-than-expected economic data, and broad-based weakness in the dollar," HDFC Securities Research Analyst Dilip Parmar said.

"Risk assets globally rallied and had dollar slumps after US inflation readings came lower than expected. The near-term outlook for USD/INR remains bearish (for the dollar) as long as it trades below 82.10 while on the downside, one can see 81.10 and 80.70," he said. Traders said a lack of significant dollar purchases by the RBI had also played a role in the rupee's appreciation versus the greenback this



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₹ vs \$ (inverted scale)



Source: Bloomberg

week. The central bank had been said to have been buying US dollars to replenish its foreign exchange reserves through November and parts of December. The rupee had sharply underperformed its emerging market peers in the previous month.

While the rupee notched up gains, domestic government bonds remained largely unaffected by data showing a decline in India's consumer price index based inflation. Yield on the 10-year benchmark government bond settled at 7.29 per cent on Friday as against 7.30 per cent at previous close. Bond prices and yields move inversely. Data released Thursday showed that India's CPI inflation fell to 5.72 per cent in December as against 5.88 per cent in November.

While inflation has over the past couple of months fallen within the RBI's tolerance band of 2-6 per cent, bond traders said the market's lukewarm reception to the data was owing to the fact that core inflation, which strips out the volatile components of food and fuel, remained elevated around 6 per cent. In its last policy statement, the RBI had flagged elevated core inflation as a key risk.

"The bond market was largely prepared for a fall in inflation; the issue here is that core inflation remains high. The RBI has clearly signalled that core inflation is a major focus area now so as such it is difficult to rule out another rate action by the RBI in February," Naveen Singh, head of trading at ICICI Securities Primary Dealership, said.