Ahead of monetary policy, RBI steps in with heavy dollar intervention

The Reserve Bank of India (RBI) stepped in to break speculative positions in the currency market by intervening heavily, as the rupee approached 74 a dollar level a day before the monetary policy announcement. The rupee had crossed 73 a dollar on Wednesday. This prompted the central bank to announce a special facility for oil marketing companies (OMCs) to enable them to directly access up to $10 billion from foreign markets without the need for hedging. But the companies must have a board-approved risk policy, the RBI had said.

Clearly, the market was unimpressed, given the annual dollar demand by OMCs is more than $120 billion. A direct dollar swap, according to market sources, was denied by the RBI. “The RBI intervened heavily at least twice in the day,” said a senior currency dealer with a foreign bank. At around 73.75-level, the RBI, through a clutch of nationalised banks, sold dollars in the market. Had the RBI not intervened in the market, the rupee could have crossed the 74-level, dealers said. The rupee fell to 73.82 a dollar in intraday trade, but recovered to close at 73.58. It had closed at 73.34 a dollar on Wednesday.

The rise in crude oil prices is riling the emerging market currencies. The Indonesian rupiah was the worst performer in Asia on Thursday, but on a cumulative basis, the rupee is the worst performer, having fallen 13.2 per cent against the dollar so far this year. Oil prices continued to climb and were at $86 a barrel on Thursday in the international market. “The rupee and crude prices are now moving directly. If oil prices touch $90, the rupee will easily cross 75 a dollar,” said Pramit Brahmbhatt, chief executive officer of Veracity, a currency consultant.

Brahmbhatt says even if crude oil prices fall due to pressure from the US, the rupee weakness would take at least a quarter to get addressed, as oil supply doesn’t increase overnight. “In December, the Organization of the Petroleum Exporting Countries met to limit supply, but we didn’t feel the pressure till March. If they have to increase supply now, crude oil prices would take time to come down. Till then, the pressure on the rupee would continue,” said Brahmbhatt.

However, the retail prices of oil would get some respite as prices would go down by at least Rs 2.50 after the government cut excise duty and told OMCs to take a hit of Rs 1 per litre. More such announcements are expected to come by the end of this month or early next month as states go for elections. The bond market spiked, reacting to the US 10-year yield climbing to 3.161 per cent, the highest since July 2011. The domestic 10-year bond yield, which was at 7.98 per cent on Monday, closed at 8.157 per cent on Thursday. Its previous close was at 8.11 per cent.

The rise in yields and the rupee would pose a huge challenge for the six-member monetary policy committee (MPC) scheduled to announce its rates on Friday. The market expectations have also been volatile, as is evident in the six months and the one-year swap rates. “Till recently, expectations were of a hike of around 50 basis points (bps), which then got tempered, to 25 bps when the non-banking financial companies (NBFCs) scare broke out in the market. However, with Brent touching 86, the dollar index crossing 96, and the US bond yields crossing 3.20 per cent, there is again an increasing expectation of a 50-bps hike priced in the swap market,” said B Prasanna, group executive and head of markets at ICICI Bank.

However, it could also be risky to hike the rates too sharply. “Had the NBFC funding crisis not broken out, a 50-bps hike might have been a sure outcome. The hike can be counterproductive if the market panics. The MPC will have to balance it out,” Prasanna said. Once again, the government and the RBI stepped in to curb rupee loss. This time, by offering a special window for OMCs. This would be useful in the medium to long term. “Firstly, the OMCs have not been raising the funds from external commercial borrowings (ECBs) channel and have preferred replacing the ECBs with foreign currency bonds or other options. Secondly, a prudent risk management policy may call for hedging. Thirdly, if one adds the estimated hedging cost of 4.50 per cent, the effective cost of raising ECBs is likely to be 8.62 per cent,” said Soumyakanti Ghosh, chief economist at State Bank of India (SBI) group. In comparison, the SBI’s three-year lending rate stands at 8.70 per cent.

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