SUPPORTING LIQUIDITY IN EMERGING MARKETS

Dollar index slipping below 100 augurs well for India

India largest recipient of FPI flows YTD among emerging mkts

ASHLEY COUTINHO
Mumbai, July 18

THE DECLINE IN the dollar index to below 100 may augur well for emerging markets such as India.

The dollar index, which was at 104 levels at the beginning of June, slipped to below 100 in the previous week, touching 15-month lows, and stayed below 100 for the past four sessions.

The rapid fall in the dollar index and a slide in the US 10-year yield are supporting liquidity in emerging markets, according to experts. The disappointing economic growth in China and improvement in the US market outlook are drawing attention to the Indian markets.

"The decline in the dollar index to below 100 on Friday, the lowest level in one year, is favourable to emerging markets. India is the largest recipient of FPI flows year to date among emerging markets. The selling in China continues and FPIs were sellers in emerging markets like Thailand and Vietnam recently," said VK Vijayakumar, chief investment strategist at Geojit Financial Services.

A declining dollar is a powerful trigger that can sustain FPI inflows, added Vijayakumar. FPI flows have gained momentum in the last three months, with flows in excess of $15 billion since May. The year-to-date flows now stand at $13.5 billion. FPIs continue to invest in financials, automobiles, capital goods, realty and FMCG.

The direction of the US dollar has closely been linked with the performance of emerging market assets historically. During periods of prolonged dollar strength, emerging market equities typically underperform.

Emerging markets are reliant on foreign investment and foreign capital, both of which can evaporate when the dollar gains in value.

"When the dollar strengthens, emerging market economies typically feel pressure to raise interest rates to defend their currencies, which often proves to be a negative for equity market performance," according to a note by Fidelity International.

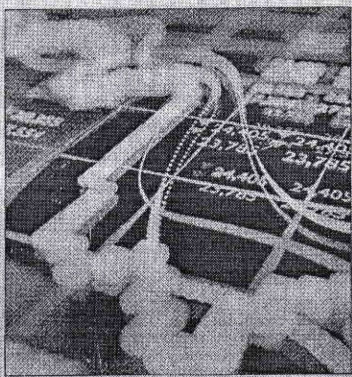
This certainly was the pattern in 2018, where the aggressive hiking cycle from the US Federal Reserve put many EM currencies under considerable pressure, with some falling to record or near-record lows, according to the note. This forced many EM central banks to raise interest rates, following the lead of the US Fed.

The benchmark indices continued their record-breaking rally on Tuesday, with the Sensex breaching the 67,000 levels intraday, amid fresh foreign fund inflows and buying in banking counters. Technical analysis suggests consolidation with support at 19,500 for the Nifty and resistance at 19,827 and 20,000.

"The concern is the rising valuations which are getting stretched. The valuations in China (PE is 9) is hugely attractive now compared to valuations in India (PE is around 20) and, therefore, the 'Sell China, Buy India' policy of FPIs cannot continue for long," said Vijayakumar.

A BOOST TO FPI INFLOWS

- Dollar index, which was at 104 levels at the beginning of June, slipped to below 100 in the previous week, **touching 15-month lows, and stayed below 100 for the past four sessions**
- Rapid fall in the dollar index and a slide in the **US 10-year yield** are supporting liquidity in emerging markets
- A declining dollar is a **powerful trigger** that **can sustain FPI inflows**, say experts
- Emerging markets are reliant on **foreign investment** and **foreign capital**, both of which can evaporate when the dollar gains in value



US dollar Index