



CPI inflation- August 2019

Event Update

Continuing to stay within the RBI's comfort zone for about 19 months, inflation based on Consumer Price Index (CPI) for August 2019 came in at 3.21% YoY as compared with 3.15% YoY in July 2019. CPI inflation also came in lower than market the expectations of ~3.4% YoY. The rise in the CPI inflation was largely on account of rise in retail food prices. Retail food prices rose by 2.99% YoY in August 2019 as against a rise of 2.36% YoY in July 2019. After breaking the declining trend in July 2019, the Core CPI (Ex Food and Fuel) inflation declined again in August 2019 and came in at 4.27% YoY as against 4.31% YoY in July 2019 and 4.16% YoY in June 2019.

Within the food basket, prices of vegetables rose sharply by 6.90% YoY in August 2019 as against a rise of 2.82% YoY in July 2019. While items like 'Milk and products', Fruits, Vegetables, 'Pulses and products' and Spices witnessed an increase in inflation on a year on year basis, other items witnessed a decline in the food segment; which shows that the rise in inflation within the food segment was not broad-based. Most of the internal items of Core CPI witnessed a broad-based decline in annual inflation, barring certain items like 'Personal care and effects' wherein inflation witnessed a rise as compared to July 2019. The 'Fuel and light' segment continued to witness deflation for the second month in a row. Prices in the 'Fuel and light' segment, deflated annually by 1.70%, as against a deflation of 0.29% YoY in July 2019; reflecting the impact of muted international crude oil prices.

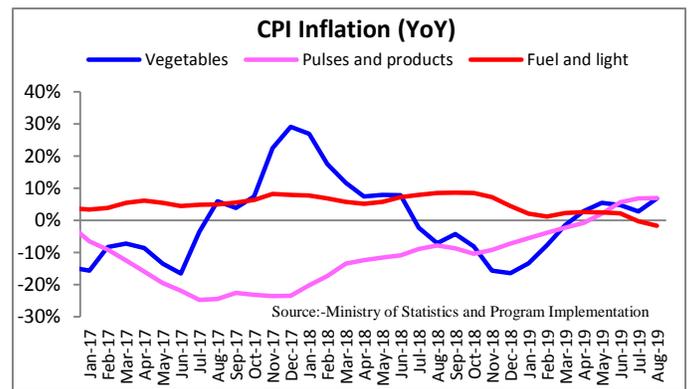
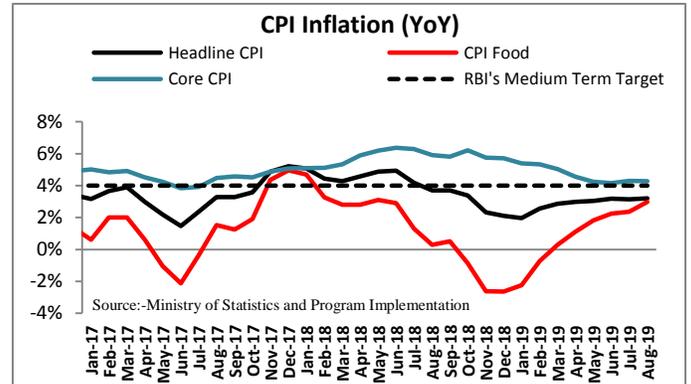
While, the CPI inflation in August 2019 rose to about 10 months' high, the rising trajectory of the inflation, is something that was already priced into the expectations. What is more noteworthy is that after rising in the month of July 2019, Core CPI declined again in August 2019, reflecting muted domestic demand conditions. Remember, how market participants were worried about the unexpected rise in the Core inflation in July 2019; thus, the August 2019 Core CPI inflation data may sooth the market nerves on that regard. Cumulative rainfall on an overall basis, from June to August 2019 has been near normal. However, the impact of the uneven distribution and erratic behavior in some parts of the country on Kharif crop production needs to be tracked very closely. That said any meaningful spike in the food inflation is unlikely as the food prices globally are at lower levels, and government's buffer stocks are at robust levels. While core inflation saw a rise in July 2019, given the subdued demand conditions, it is also likely to remain muted in the near to medium term. Thus, the overall trajectory of inflation at this point seems to be comfortable in the near to medium term.

Fixed income view:

Yield on the benchmark 10 year G-sec 7.26% 2029 bond closed at 6.64% on 13 September 2019, compared to its previous close of 6.66%. Debt markets have reacted positively to the lower CPI inflation for August 2019, as this strengthens the expectations of further interest rate cuts by the RBI. Also the CPI inflation data has to be looked at, in light of the Q1FY20 GDP growth data which came in substantially lower at 5% YoY. Thus, while the case for further interest rate cuts still remains strong, the timing and quantum needs to be watched out for. This is because, only interest rate cuts by the RBI may not be enough for growth revival and may need further support by the government; which is why the market fears of the government breaching its fiscal deficit target for FY20 (also another important variable to keep an eye on). Overall, we expect yields to remain range bound in the near term, with a declining bias, given the global as well as domestic scenario of easy interest rate and monetary policies.

Fixed Income Mutual Fund Strategy:- Investments in Medium Duration Funds can be considered with a horizon of 15 months and above. Investments into Short Duration Funds can be considered with an investment horizon of 12 months and above. Investors, who are comfortable with intermittent volatility, can also look at strategies that have allocation to the longer end of the yield curve, through Dynamic Bond Funds with an investment horizon of 24 months and above. Investors looking to invest with a horizon of up to 3 months can consider Liquid Funds, while Ultra Short Duration Funds and Arbitrage can be considered for a horizon of 3 months and above.

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