

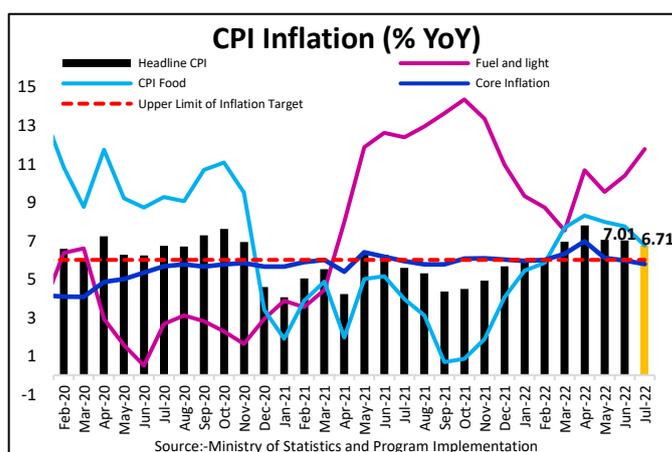


CPI inflation- July 2022

Event Update

India's retail inflation based on Consumer Price Index (CPI) for the month of July 2022 declined and came in at 6.71% YoY as compared to 7.01% YoY in June 2022, led by decline in CPI food inflation. While the slowdown in the inflation momentum is a welcome relief, it remained above the upper end of the RBI's flexible inflation target of 4% (+2%) for the seventh straight month. On a month on month (MoM) basis, CPI inflation declined to 0.46% in July 2022 from 0.52% in June 2022. Inflation in Consumer Food Prices declined to 6.75% YoY in July 2022 as against 7.75% YoY in June 2022. On a MoM basis, food inflation declined to sharply to 0.06% from 0.99% in the previous month. While Core CPI inflation (ex Food and Fuel but including 'Transport and communication') declined to a level of at 5.79% YoY in July 2022 as compared to 5.96% YoY in the previous month, it continued to remain sticky.

In case of the CPI food basket, those items that witnessed relatively larger decline in YoY inflation included Vegetables, 'Meat and fish' and 'Oils and fats'. Inflation in these items for July 2022 stood at 10.90% YoY, 3.00% YoY and 7.52% YoY respectively, as against 17.31% YoY, 8.61% YoY and 9.36% YoY respectively in June 2022. Prices of edible oils softened, thanks to the decline in international prices as well as the measures taken by the government. However, inflation in 'Cereals and products' rose further in July 2022 and stood at 6.90% YoY from 5.66% YoY in June 2022. Prices of Fruits also rose sharply, wherein inflation stood at 6.41% YoY in July 2022 as against 3.10% YoY in the previous month. For Core CPI inflation, most of the internal items of the index witnessed a decline in YoY inflation. The items that saw a rise in inflation on a YoY basis, included Clothing, 'Recreation and amusement' and Education. Some of these items have higher weightage in the overall CPI inflation. Inflation in 'Fuel and light' increased to 11.76% YoY in July 2022 from 10.14% YoY in June 2022.



The decline in prices of several commodities recently and consolidation in some, is a positive development and is likely to have a softening impact on the inflation prints in the near term. Also, slowdown in some of major economies of the world, could put further downward pressure on commodity prices. Additionally, as sustained higher prices impact the households' incomes and spending ability, the government has been undertaking supply side measures that have also helped on the inflation front. That being said it is important to note that the decline in inflation in July 2022 was led by food inflation, which is a volatile segment, and a lot also depends on the monsoon rains and food production, which will continue to be a key monitorable risk. In this context, the monsoon rains have shown an uneven progress across the country. While most of the states have seen normal to excess rainfall, some of the major agricultural states such as Uttar Pradesh, Bihar and west Bengal have seen deficient rains. Another variable, that needs consideration while trying to judge the direction of the inflation is the currency exchange rate. Rupee has been under pressure due to global risk off sentiments, though the RBI has ensured orderly movement in the Rupee exchange rate. The rising trade deficit though, is making things difficult on this front as well. This is important as depreciation in the Rupee increases the risk of imported inflation. Overall, we believe while inflation may possibly have peaked and could soften from here on, it is likely to stay elevated and above the RBI's flexible inflation target in the near term. Remember the RBI has also retained its inflation forecast in the August 2022 policy and expects it to remain above 6% till Q3FY23 (6.7% YoY in FY23, with Q2FY23 at 7.1%; Q3FY23 at 6.4%; and Q4FY23 at 5.8%). Thus, uncertainties regarding the inflation trajectory continues to remain and needs close tracking.

Fixed income view:

The bond markets have reacted positively to the CPI inflation data for July 2022, as seen from the movement in the bond yields. Yield on the 10 year benchmark, the 6.54% G-sec 2032 bond, declined sharply to a level of 7.18% at the time of writing this note as against its previous close of 7.29%. Going forward, the RBI is likely to continue with the monetary policy tightening unless it sees a structural decline in domestic inflation. Given the fact that even the US Fed is likely to continue with faster monetary policy tightening despite the recent decline in US CPI inflation, other nations grappling with high inflation albeit with relatively better growth rates could also adopt a similar approach to tame the current unbridled inflation. In the near to medium term, the trajectory of yields and the yield curve is likely to be determined by the growth-inflation dynamics, commodity prices and energy prices (including food prices), as well as the domestic G-sec demand-

supply dynamics. However, inclusion of Indian bonds in any of the global bond indices if materialised, is likely to be positive for the domestic bond markets. The flattening of the yield curve is likely to continue given the interest rate hikes by RBI and tightening liquidity conditions.

Fixed Income Mutual Fund Strategy:- For investors looking for accrual strategies, they can consider Target Maturity Index Funds that invest in a mix of better quality bonds with investment horizons matching the maturity of the funds. Investors could also look at funds oriented towards the shorter end of the yield curve for stabler returns in the near term and to benefit from the reset in interest rates on the higher side. For this one can look at Short Duration Funds, Money Market Funds, Ultra Short Duration and Low Duration Funds for a horizon of 12 months and above. Investors can gradually move up the yield curve to benefit from better accruals at higher rates. Investors with a horizon of 15 months and above can start looking at Corporate Bond Funds and Banking & PSU Debt Funds. Investors who are comfortable with volatility and have a longer investment horizon could look at Dynamic Bonds for a horizon of 24 months and above. For a horizon of 3 months and above Arbitrage and Money Market Funds can be considered. Whereas, for a horizon of up to 3 months investors can consider Overnight Funds and Liquid Funds. Investors should invest in line with their risk profile and product suitability.

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