CPI inflation- April 2020

Event Update

While the markets keenly awaited the retail inflation data based in Consumer Price Index (CPI) for April 2020, the government could not release the complete inflation data, due to problems in data collection post the Covid-19 affected lockdown in the country. On the other hand, the CPI inflation for March 2020 was revised downwards to 5.84% YoY from 5.91% YoY released in the previous month. For the month of April 2020, in case of food inflation, data on certain items like 'Meat and fish' was not released. As per the available data, CPI food inflation stood at 10.49% YoY for April 2020, as against 8.76% YoY in March 2020. Within the food segment, most of the internal items witnessed an increase in inflation compared to the previous month. For Core CPI inflation (ex Food and Fuel, but including 'Transport and communication'), data for most of the internal items was not released.

As communicated earlier, the actual impact of the pandemic on inflation trajectory may not be clear yet. While supply side difficulties in availability of goods and services may lead to some rise in inflation in specific segments; weak demand and sharp decline in crude oil prices may put some downward pressure on the overall inflation. Additionally, expectation of normal monsoon in the current year, may also help in keeping food inflation under check. Thus, in the near to medium term, retail inflation may remain within the RBI's flexible inflation target of 4% (+-2%).

Fixed income view:
Though the RBI's objective is to achieve the medium-term target for Consumer Price Index (CPI) inflation of 4% within a band of +/- 2%, while supporting growth; in the current situation, the RBI is likely to pay more attention on supporting the economy, given the impact Covid-19 spread on the economy. Intermittent rise in inflation if any, is likely to be looked through by the RBI, to ensure support to economic growth, through various measures. We expect RBI to continue with its support measures, in various forms, including further interest rate cuts, liquidity infusion, ensuring availability of credit, amongst others. RBI measures are likely to be positive for the bond markets. While the revision in government borrowings and likely rise in the fiscal deficit for FY21, may lead to volatility in yields; however expected support from RBI on the fiscal deficit front, may help in containing the volatility. Additionally, ample surplus liquidity in the system is also likely to keep interest rates on the lower side, over the medium term.

Fixed Income Mutual Fund Strategy:- Investments into Short Duration Funds can be considered with an investment horizon of 12 months and above. Investors who are looking to benefit from relatively better accruals can look at Corporate Bond Funds and Banking and PSU Funds for a horizon of 15 months and above. Investments in Medium Duration Funds can be considered with a horizon of 15 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 Overnight Funds and Liquid Funds. While Ultra Short Duration Funds/Arbitrage funds can be considered for a horizon of 3 months and above.

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