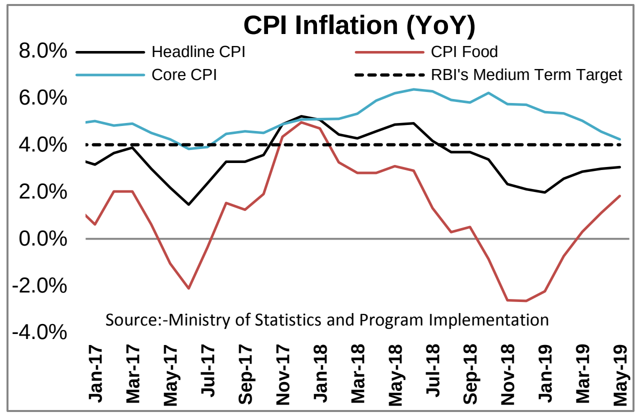
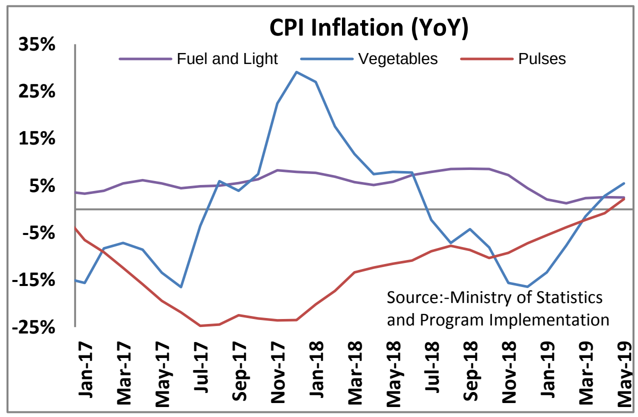
CPI inflation- May 2019

Event Update

As per the general market expectations, the domestic inflation based on Consumer Price Index (CPI), came in higher for the month of May 2019 as compared to the previous month. CPI inflation, for May 2019, stood at 3.05% YoY compared to 2.99% (revised) YoY for April 2019. The pickup in inflation in the food segment, continued to impart an upward trajectory to the headline CPI inflation numbers. Also as expected, core inflation (inflation ex food and fuel) continued to decline and came in at 4.24% YoY for May 2019, compared to 4.56% YoY in April 2019.



Annual inflation in food prices continued to inch up in May 2019 and came in at 1.83% YoY compared to 1.10% YoY in April 2019. Prices of vegetables rose sharply in May 2019 at 5.46% YoY compared to 2.87% YoY in April 2019. More notably, the prices of 'Pulses and products' which deflated on year on year (YoY) basis for over two years, witnessed an increase in May 2019; the inflation in this segment stood at 2.13% YoY in May 2019 compared to deflation of 0.81% YoY in April 2019. Fruit prices continued to decline by 5.17% YoY in May 2019 as against 4.89% YoY in April 2019. On a month on month basis the annual inflation in 'Sugar and Confectionary' segment rose the most and came in at 0.27% YoY as against a deflation of 4.05% in April 2019; this segment has been witnessing deflation in prices for about 15 months till April 2019. Core inflation declined for four consecutive months in May 2019. Baring segments like 'Housing' and 'Recreation and amusement' which witnessed a rise in inflation, all the other items in the Core inflation basket saw a decline in prices year on year. Inflation in 'Fuel and light' segment continued to remain muted and even declined in May 2019, coming in at 2.48% YoY as against 2.56% YoY in April 2019, reflecting the decline in international crude oil prices.



Helped by muted demand conditions in the economy, decline in crude oil prices and largely contained food prices, the overall CPI inflation continues to remain comfortable at this juncture. While there are risks like sudden and sharp rise in crude oil prices and possibility of below normal monsoon, headline retail inflation may remain muted in the near term, possibly due to; 1.) with the global geopolitical tensions hurting global economic growth, demand for crude oil prices may remain muted and thus, the prices too; and 2.) with the government managing the food supply and prices well, the impact of possible sub normal monsoon may remain contained. However, any shocks in crude oil prices and/or food prices could still be risks to inflation. It will also be important to note the government's fiscal stance in the Budget due to be announced in July 2019. Though, the RBI seems comfortable with the government's efforts so far on fiscal discipline, it's a matter of time to know if the government revises the fiscal deficit target on the higher side and by how much.

Fixed income view:

Yield on the benchmark 10 year G-sec 7.26% 2029 bond closed at 7.01% on 13 June 2019, flat compared to its previous close. With inflation remaining benign, impetus to economic growth is now the priority of the government as well the central bank, not just domestically but also globally. Thus, the scope for further interest cuts and easier monetary policies remains strong going forward.

Fixed Income Mutual Fund Strategy:- Investments in Medium Duration Funds can be considered by moderate and aggressive investors with a horizon of 15 months and above. Investors, who are comfortable with intermittent volatility, can also look at strategies that focus at the longer end of the yield curve. i.e. Long duration funds, with a horizon of 24 months and above. Investments into Short Duration Funds can be considered with an investment horizon of 12 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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