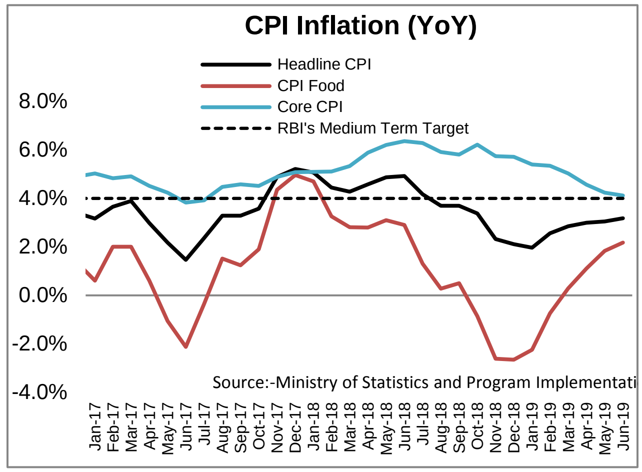
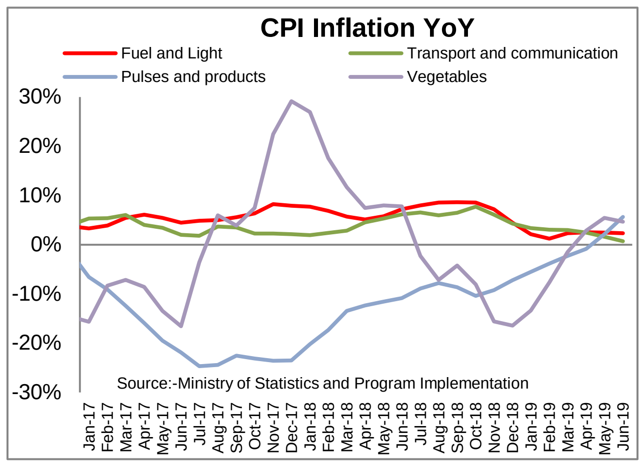
CPI inflation- June 2019

Event Update

Domestic inflation based on Consumer Price Index (CPI), inched up yet again in June 2019, tracking rise in food prices on a year on year basis. However CPI inflation remained below the 4% mark (RBI's medium term inflation target) for the eleventh consecutive month. CPI inflation for June 2019 came in at 3.18% YoY compared with 3.05% YoY in May 2019. The pickup in inflation, in the food segment, continued to give an upward push to the headline inflation. Core CPI inflation (ex Food and Fuel) continued to follow a downward path for the past nine months in a row, and came in at 4.11% YoY in June 2019 as against 4.24% YoY in May 2019.

Inflation in the Food segment rose in June 2019 and came in at 2.17% YoY as against 1.83% YoY in May 2019. Inflation in vegetable prices however, declined 4.66% YoY in June 2019 as against 5.46% YoY in May 2019. Prices of 'Pulses and products' jumped as much as 5.68% YoY in June 2019 compared to 2.13% YoY in May 2019; this segment had witnessed deflation for about 29 months till April 2019 and the prices have started to turn around since May 2019. Within Core inflation, most of the internal items witnessed, a decline in annual inflation, baring 'Housing' and 'Recreation and amusement'. Decline in inflation in 'Transport and communication' was more pronounced, wherein annual inflation came in at 0.73% YoY in June 2019 as against 1.63% YoY in May 2019. Inflation in 'Fuel and light' segment also declined in June 2019 and came in at 2.32% YoY as against 2.48% YoY in May 2019.





The last time CPI inflation was above the 4% mark, was in July 2018 at 4.17% YoY; exactly a year ago. From there, CPI inflation declined to a low of 1.97% YoY in Jan 2019. Can the CPI inflation inch up further from here? Yes it can. But the rise is likely to be gradual instead of sharp. Also, even if the CPI inflation inches closer to 4% or higher, the RBI is likely to be tolerant, as currently the RBI's target range of inflation is 4% within a band of +/- 2%, while supporting growth. Thus, with slower pace of economic growth and benign inflation the RBI is likely to undertake further monetary easing. While the markets are pricing in a rate cut in the next monetary policy by the RBI in August 2019, it will be important to see whether the RBI wants to wait and watch the impact of the cumulative rate cut of 75 bps or acts with another rate cut to kick start the growth engine. The risks to inflation trajectory in the near term can be in the form of monsoons being below normal, thus impacting food prices; and any sudden and sharp spike in the crude oil prices.

Fixed income view:

Yield on the benchmark 10 year G-sec 7.26% 2029 bond closed at 6.43% on 15 July 2019, compared to its previous close of 6.49%. Given the current state of domestic as well as global macro-economic variables, more interest rate cuts could be expected domestically; globally as well, major central banks may start easing monetary policies soon. Thus, the bias for bond yields is likely to be on the declining side. Intermittently movement in crude oil prices and the global developments could impart some volatility to the bond yields.

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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