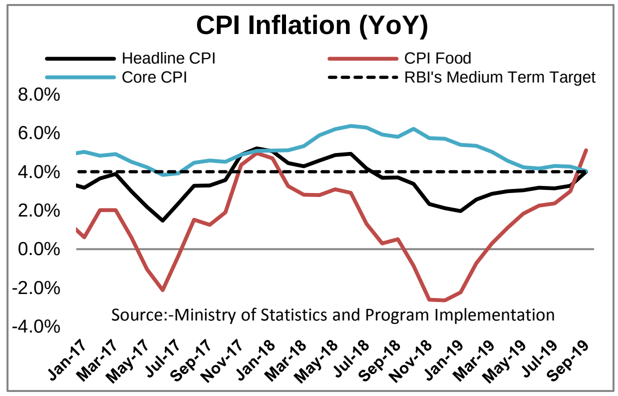
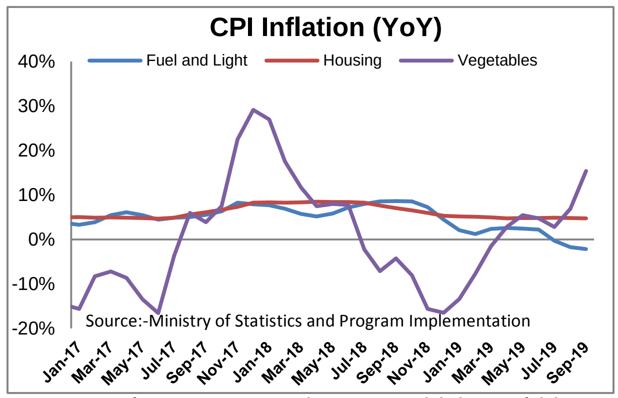
CPI inflation- September 2019

Event Update

Domestic inflation based on Consumer Price Index (CPI) rose higher than expectations in September 2019 following sharp rise in food prices. CPI inflation for September 2019 came in at 3.99% YoY a tad lower than the RBI's medium term inflation target of 4%. Market participants were expecting it to be closer to 3.8% YoY. CPI inflation for August 2019 was revised upwards to 3.28% YoY from 3.21% YoY released earlier. Core CPI inflation on the other hand continued with its downward trend in September 2019 as well and came in at 4.04% YoY as against 4.27% YoY in August 2019.





The Food segment, which comprises over 47% of the CPI index, witnessed a broad based rise in inflation, with vegetable prices witnessing a sharp rise amongst other internals of the food segment. Inflation in vegetable prices came in at 15.40% YoY in September 2019 as against 6.90% YoY in August 2019. Vegetable prices rose sharply tracking impact on supply on account of erratic rains during September 2019. A low base effect also contributed to the sharp rise in vegetable prices. Apart from vegetable prices, the rise in inflation in the protein rich items was also more pronounced in September 2019. Internals of Core CPI on the other hand witnessed a broad based decline baring 'Education' and 'Personal care and effects, which saw a rise in inflation in September 2019. Items like 'Transport and communication' witnessed a relatively sharper decline in inflation in September 2019 when compared with August 2019. The 'Fuel and light' segment continued to see deflation in prices in September 2019, where prices deflated by higher quantum of 2.18% YoY as against 1.70% YoY in August 2019, reflecting relatively muted crude oil prices. Inflation in the Housing segment declined marginally in September 2019 at 4.75% YoY as against 4.84% YoY in the previous month.

While the rise in CPI inflation was expected, the rise was higher than markets expectations. While food inflation could come down in the coming months due to seasonality (food prices generally come down in winter months), the low base effect may continue to remain for a few months. Remember that Vegetable prices had stayed in deflation between July 2018 - March 2019, which could keep the low base effect on vegetable prices. That said, come the winter months, the prices of food items may normalize. A normal monsoon and better crop sowing this year could also help the food inflation to remain under control in the near to medium term. Core inflation which reflects the demand side conditions of economy has been declining implicating that the demand side has been muted. Crude oil prices have seen volatility with prices rising due to geo-political; however, any sustained rise has been prevented due to subdued demand conditions the world over following global growth slowdown. Thus, the overall outlook on inflation at this juncture seems to be comfortable.

Fixed income view:

The 10 year benchmark G-sec yield opened the trading session marginally higher today tracking the higher than expected CPI inflation; however the yield has come off the day's high so far, as the markets may have taken solace in the lower Core CPI inflation. Additionally, recent the data on Index of Industrial Production (IIP) and Wholesale Price Index (WPI) inflation paint a picture of continued slowdown in the economy. Though the headline inflation is now almost at the RBI's medium term inflation target of 4%, the RBI in its latest monetary policy had stated that "...there is policy space to address the growth concerns by reinvigorating domestic demand within the flexible inflation targeting mandate…" Thus, the RBI's flexible inflation targeting stance could mean that the RBI may look through the temporary rise in inflation. The RBI also stated that "The MPC also decided to continue with an accommodative stance as long as it is necessary to revive growth, while ensuring that inflation remains within the target." Hence, some more easing of the monetary policy can still be expected from the RBI as it focuses on supporting the government in bringing the economic growth back on track.

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 Funds can be considered for a horizon of 3 months and above.

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