CPI inflation- May 2020

Event Update

Amidst anticipation, whether the data on inflation based on Consumer Price Index (CPI) for May 2020 would be released or not, the government only released partial data on account difficulties in data collection due to Covid-19 lockdown in the country. This was the second month in a row that the government did not release the complete data on retail inflation as was also the case for April 2020 inflation data. For the month of May 2020, in case of food inflation, data on certain items was not available. As per the available data, CPI food inflation decelerated and stood at 9.28% YoY for May 2020, as against 10.49% YoY in April 2020. Within the food basket most of the internal items witnessed a decline in annual inflation; barring two items that witnessed a rise in annual inflation, which included ‘Oils and fats’ and ‘Non-alcoholic beverages’. Inflation in vegetable prices declined sharply and came in at 5.31% YoY in May 2020 as against 23.61% YoY in April 2020.

Data on Core inflation (ex Food and Fuel, but including ‘Transport and communication’), which represents the demand side of the economy, was also not available. As per the available data, inflation in housing segment stood at 3.66% YoY in May 2020 as against 3.94% YoY in the previous month; whereas that for the health segment rose to 4.29% YoY in May 2020 as against 2.80% YoY in the previous month. Inflation in the ‘Fuel and light’ segment continued to decelerate in May 2020 and stood at 1.43% YoY in May 2020 as against 2.93% YoY in April 2020 and 6.59% YoY in March 2020.

While in the absence of availability of complete data it is difficult to gauge the exact impact of the current situation on inflation; weak demand and lower international crude oil prices could have continued to weigh down upon the inflation. Going forward, continued subdued demand, expected lower crude oil prices and better monsoons augur well for lower inflation. Also, the RBI in its recent monetary policy had mentioned that it expects inflation to fall below the medium term inflation target of 4% in Q3 and Q4 of FY21. Thus, inflation trajectory in the near terms seems to be on the declining trend. However, given its recent upmove and hikes by the oil marketing companies, the trajectory of fuel prices; along with progress of monsoon and supply side issues will have to be tracked very closely going forward in regards to inflation.

Fixed income view:
While the RBI expects the inflation to come within its medium term inflation target, even in case of temporary/transient uptick in inflation, the RBI is likely to look through the same, as restoring economic growth is a larger concern for both RBI as well as the government. Also, the RBI governor stated in monetary policy, that if inflation trajectory evolves on expected lines, more monetary policy space can open up to support growth. Going forward, while bond yields are trading with a downward bias, the trajectory of bond yields is likely to be dependent on the extent of fiscal slippage and increase in government borrowings and, the quantum and timing of RBI’s support measures.

Fixed Income Mutual Fund Strategy:- Investors who want to invest at the relatively shorter end of the yield curve and are looking to benefit from relatively better accruals, can look at Banking and PSU Funds and Corporate Bond Funds that have allocation to higher credit quality bonds, with an investment horizon of 15 months and above. Investors who want to take advantage of relatively higher term spreads and can take volatility, may look at Medium Duration Funds for a horizon of 15 months and above; and Dynamic Bond Funds with an investment horizon of 24 months and above. Investors who want to invest for a shorter horizon can continue to look at Ultra Short Duration Funds/Low Duration Funds/Money Market Funds and Arbitrage Funds for a horizon of 3 months and above. Whereas, for a horizon of upto 3 months investors can consider Overnight Funds and Liquid Funds.

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