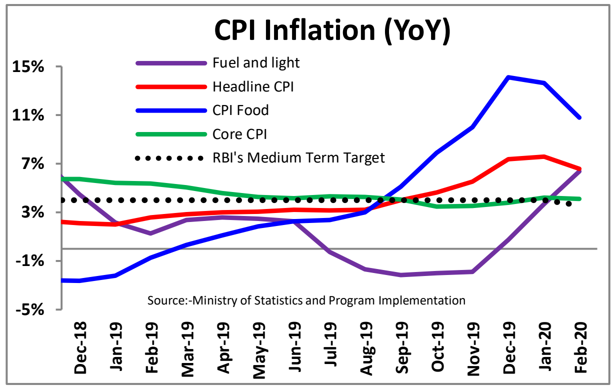
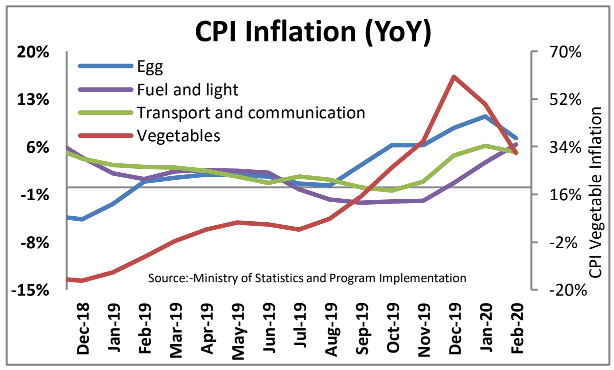
CPI inflation- February 2020

Event Update

Inflation based on Consumer Price Index (CPI) declined in February 2020 for the first time in the last seven months helped by lower rise in annual prices of vegetables and decline in the Core CPI inflation (ex food and fuel but including 'Transport and communication'). Inflation based on Consumer Price Index (CPI) for February 2020 came in at 6.58% YoY compared to 7.59% YoY for January 2020. Core CPI inflation also declined after witnessing a rise for three months in a row, and stood at 4.09% YoY in February 2020 as against 4.19% YoY in the previous month.





Helped by a slower pace of rise in annual inflation in vegetable prices, the consumer food price inflation came in at 10.81% YoY in February 2020 as against 13.63% YoY in January 2020. Vegetables which account for over 6% in the CPI basket saw an annual inflation of 31.61% in February 2020 as against 50.04% in the previous month. Within the Consumer Food Index, most of the items witnessed a decline in annual inflation barring 'Milk and products', 'Oils and fats' and Spices. On the Core CPI inflation front, movement in the inflation in the internal items was mixed; while segments like 'Pan, tobacco and intoxicants', Clothing, Housing, Household goods and services witnessed a rise in inflation on a YoY basis, items like Footwear, Health, 'Transport and communication', 'Recreation and amusement', and 'Personal care and effects' witnessed a decline in inflation on a YoY basis. Inflation in 'Fuel and light' segment increased and stood at 6.36% YoY as against 3.66% YoY in the previous month.

While the inflation has declined in line with expectations, it continues to remain above the RBI's flexible inflation target of 4% (+-2%). Though, the decline in vegetable prices is a relief, the decline in prices of food items like 'Meat and fish' and Egg could have been on account of the fears of Coronavirus, which could continue in the near term. Decline in the Core CPI inflation after three months, may also be reflecting an impact of the spread of the Coronavirus on the demand conditions in the economy. Going forward the inflation outlook has become somewhat uncertain, given that the spread of Coronavirus is impacting various variables, that impact inflation trajectory. That being said, to begin with, the sharp decline in the Crude oil prices and weakness in demand could put downward pressure on the domestic inflation, which may help in bringing down the CPI inflation faster than anticipated earlier. Additionally, the good Rabi crop production could also help in bringing down the overall food inflation along with the seasonal decline in the food prices.

Fixed income view:

Despite the lower CPI inflation data for February 2020, the bond yields rose today, wherein, the 10 year benchmark G-sec 6.45% 2029 bond yield rose to 6.32% at the time of writing this note, as against its previous close of 6.24%. This was largely on account of decline in value of Rupee against the USD in light of the recent risk-off sentiments and also lack of announcement of a rate cut by the RBI. The markets have been expecting the RBI to announce a rate cut mid policy in light of the impact of coronavirus on domestic growth. However, with the expectations of earlier than anticipated decline in inflation, the space for easing monetary policy rates could open up as early as the April 2020 monetary policy. This may happen not just because of the anticipated decline in the inflation, but also because the RBI may have to step in to provide support the economy. The RBI may also take cues from the other major central bankers of the world who have responded by either reducing the interest rates or announcing other measures to infuse liquidity in the system. Given that the economic growth the world over is likely to be hit by the virus spread, the likelihood of lower interest rates for longer has gone up, and this is likely to keep a downward bias on the bond yields in the near term.

Fixed Income Mutual Fund Strategy:- 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 or Long Duration funds with an investment horizon of 24 months and above. Investors who are looking to benefit from relatively better accruals with lower volatility, can look at Corporate Bond Funds and Banking and PSU Funds for 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 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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