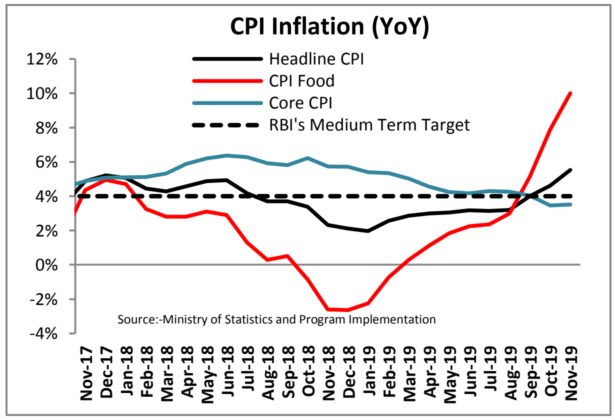
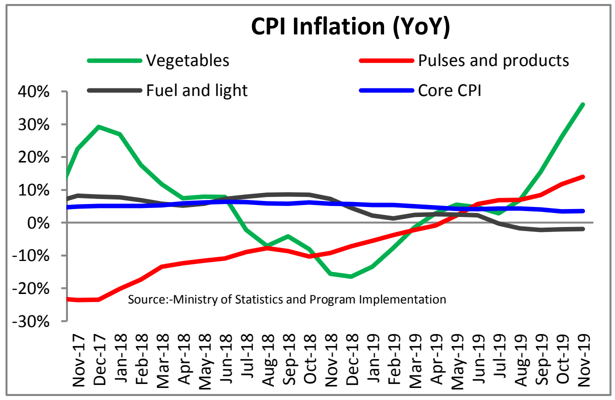
CPI inflation- November 2019

Event Update

Domestic retail inflation, based on Consumer Price Index (CPI) continued with its upward trend even in the month of November 2019 and rose to a forty month high. CPI inflation for November 2019 came in at 5.54% Year on Year (YoY) as against 4.62% YoY in October 2019 wherein the rise was largely on account sharp rise in food prices which was mainly driven by higher vegetable prices. Core CPI inflation (ex food and fuel), continued to remain muted in November 2019 and came in at 3.50% YoY as against 3.46% YoY in October 2019.

In line with expectations, retail food prices continued to rise in November 2019, wherein food inflation came in at 10.01% YoY in November 2019 compared with 7.89% YoY in the previous month. Within the food segment, prices of vegetables witnessed a sharp rise on a YoY basis, wherein inflation stood at 35.99% YoY as against 26.10% YoY in the previous month. Inflation in prices of 'Pulses and Products' also came in higher at 13.94% YoY versus 11.72% YoY in the previous month. Within Core CPI, annual inflation in most of the items declined, barring 'Transport and communication' and 'Personal care and effects'. The 'Fuel and light' segment continued to witness deflation in prices on a YoY basis; however, the yearly decline in prices was lower as compared to the previous month.





The headline CPI inflation has not only risen above the RBI's medium term inflation target of 4%, but is now closer to the higher side of its target band of 4% +/- 2%. The volatile food inflation has acted as a spoil sport, as food inflation typically witnesses a seasonal decline during the winter months; this has been on account of supply disruption tracking unseasonal rains affecting food crops. The rise in food inflation needs to be tracked very closely, as a sustained rise in the food inflation could find its way into the Core CPI inflation. Progress of Rabi crop sowing would be a key in the near term as far as food inflation is concerned. It will also be important to see the impact of the recent measures taken by the government to curb the rise in onion prices. Additionally, the impact of sustained surplus liquidity on inflation in a scenario of lack of growth recovery currently, also needs to be kept a watch on. In the December 2019 monetary policy, the RBI revised the inflation forecast upwards to 5.1%-4.7% for H2FY20 and 4.0%-3.8% for H1FY21, with risks broadly balanced; from a forecast of 3.4% for Q2FY20, 3.5-3.7% for H2FY20 and 3.6% for Q1FY21 given in October 2019 monetary policy. While the RBI expects, that the rise in inflation is likely to moderate below its target by Q2FY21, the RBI seems to have turned cautious on inflation, as it not only paused on interest rates, but also stated that it is prudent to carefully monitor incoming data to gain clarity on the inflation outlook.

Fixed income view:

While the 10 year benchmark G-sec yield rose during the day, the yield settled at 6.79% level, almost similar to its previous close. Going forward the market participants are likely to turn their attention back to the fiscal deficit situation of the government. This is because, in the December 2019 monetary policy, RBI indicated that it is looking for clarity on both trajectory of inflation as well as the trajectory of the government's fiscal deficit. While it is widely expected that there could be an upward revision on the fiscal deficit target for FY20, the bond yields could remain volatile unless clarity emerges on this front. Also, we have one more CPI inflation print for January 2020, before the next monetary policy of the RBI scheduled in February 2020. While it is expected that RBI may continue to maintain a pause on interest rates in February 2020, the data on retail inflation for January 2020 may give more insight into the trajectory of inflation for the near term.

Fixed Income Mutual Fund Strategy:- Investors who are looking to benefit from relatively better accruals can look at Corporate Bond Funds and Banking and PSU Funds for a horizon of 15 months and above. 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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HDFC Bank House, 1 st Floor, C.S. No. 6 \ 242, Senapati Bapat Marg, Lower Parel, Mumbai 400 013. Phone: (91)-22-66521000, ext 1311, Fax: (91)-22-24900983 \ 24900858