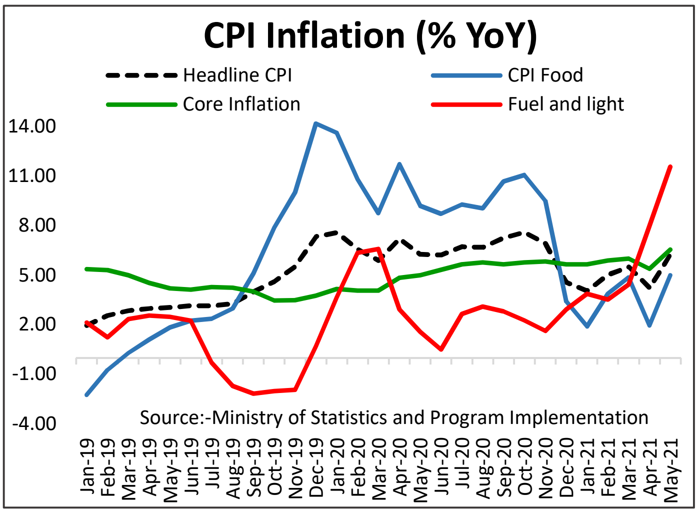
# CPI inflation- May 2021

*Event Update*

India's retail inflation based on Consumer Price Index (CPI) for the month of May 2021, rose above the RBI's target range of 2%-6%, breaching even the general market expectations and came in at 6.30% YoY. The CPI inflation had eased in the month of April 2021 to a level of 4.23% YoY (revised from 4.29% YoY released earlier). The market expectations on CPI inflation for May 2021 was at ~5.4% YoY. A sharp rise in inflation in May 2021, was on account of a broad based rise in prices across various sub segments, as well as an unfavorable base effect. Core CPI inflation (ex Food and Fuel, but including 'Transport and communication') also rose sharply in May 2021 and came in at 6.55% YoY as against at 5.39% YoY in April 2021. Inflation in Consumer Food Prices also came in higher at 5.01% YoY in May 2021 as against 1.96% YoY (revised from 2.02% YoY released earlier) in April 2021.




Within the CPI Food segment, most of the sub-segments witnessed a rise in inflation on a YoY basis barring 'Meat and fish' and 'Non-alcoholic beverages'. The deflation in vegetable prices declined sharply to 1.92% YoY in May 2021 2021 as against a deflation of 14.53% YoY in April 2021. Inflation in fruit prices came in 11.98% YoY in May 2021 as against 9.67% YoY in the previous month. The deflation in 'Cereals and products' which has the highest weightage in the CPI food basket, also declined in May 2021 at 1.42% as against a deflation of 2.96% YoY in April 2021. In case of Core CPI inflation, all the sub segments witnessed a rise in YoY inflation in May 2021. Inflation in the Health segment continued to remain elevated, and stood at 8.44% YoY in May 2021 as against 7.70% YoY in the previous month. The rise in Inflation in 'Fuel and light' has picked up pace over the last couple of prints, wherein prices witnessed a rise of 11.58% YoY in May 2021 as against 7.98% YoY in April 2021.

While the rise in inflation was expected, the rise has been much higher than forecasts and expectations. The rise in input costs and the supply side issues on account of the localized lockdowns induced by the pandemic, have been impacting prices over the past couple of months. Fuel Prices have also increased, with international crude oil prices being elevated on one hand, and higher fuel excise duties on the other hand. Apart from crude oil, prices of other key commodities also continue with the upward trend. The sharp rise in Wholesale Price Index (WPI) inflation over the past few months reflects the pressure on input costs. WPI inflation in the month of May 2021 also rose and stood at 12.94% YoY as against 10.49% YoY in April 2021. The RBI had forecasted CPI inflation of 5.2% YoY for Q1FY22; and so far for Q1FY22 the average CPI inflation stands at ~5.26% YoY, marginally higher than the RBI's forecast. While there has been demand destruction on account of income losses, a surprise sharp rebound in demand (as was seen post the first wave of the pandemic) cannot be ruled out. Another variable that is important to track, is the progress of monsoon (which has been good so far), which can have a bearing on the crop sowing as well as production, there by having an effect on food inflation. Thus, overall the possibility of the inflation being higher than RBI's forecast for Q1 cannot be ruled out, given that the inflation pressures mentioned above are likely to continue in the near term.

While the RBI in its June 2021 monetary policy has reiterated its commitment to support growth, the minutes of the Monetary Policy Committee's (MPC) June 2021 meeting (due to be released within the next few days), could paint a cautious picture on inflation. On one hand, price stability is very important especially at the current juncture, wherein there been loss of income and prices have been rising at the same time; and on the other hand, it is also important to keep the monetary policy easy to push the economy out of the impact of the pandemic. Thus, the trajectory of inflation over the next couple of months, along with the sequential data on high frequency growth indicators, become extremely crucial to gauge, if the RBI would start to consider normalizing the surplus liquidity conditions. The central banks of the developed economies are also currently choosing to overlook the recent spurts in inflation, citing the rise being transient in nature, to continue supporting their economies. However, should the inflation turn out to be not transient, the global central bankers may then start reconsidering their monetary policy stance.

**Fixed income view:**

Yield of the 10-year benchmark G-sec, 5.85% 2030 bond was trading at a level of 6.03% at the time of writing this note, as compared to its previous close of 6%. While the rising inflation has potential to put an upward pressure on bond yields, the RBI is likely to prevent any meaningful spike in yields to ensure an orderly evolution of the yield curve. Even if the RBI does decide to normalise surplus liquidity conditions to rein in inflation, by conducting longer tenor Variable Rate Revere Repo (VRRR); RBI's bond purchases through G-SAP - Government Securities Acquisition Program, Open

Market Operations (OMOs) and secondary market intervention may limit the impact on bond yields. Overall, in the near to medium term bond yields are likely to move sideways, at least until the second wave of the pandemic normalises. While the pressure points on bond yields may arise on account of inflation and expectations of rise in government's borrowing, these pressure points can throw tactical opportunities to exploit.

**Fixed Income Mutual Fund Strategy: - Currently investors should look at Arbitrage Funds for a horizon of 3 months and above. Investors with an investment horizon of 12 months and above can look at Short Duration Funds, Corporate Bond Funds and Banking and PSU Funds. Whereas, for a horizon of upto 3 months investors can consider Overnight Funds and Liquid Funds. Investors should invest in line with their risk profile and product suitability.**



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