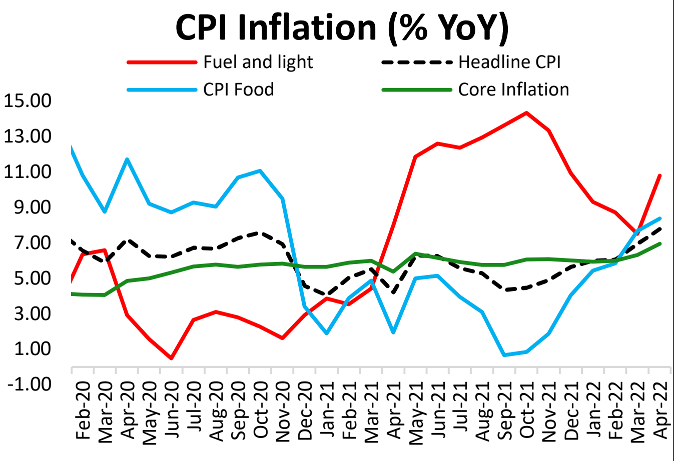
HDFC Bank Research May 13, 2022

CPI inflation- April 2022

Event Update

Continuing with its upward trend, India's retail inflation based on Consumer Price Index (CPI) rose sharply in April 2022 and came in at 7.79% YoY, as against 6.95% YoY in March 2022. Retail inflation beat market expectations and remained above the upper end of RBI's inflation target of 2-6% for four months in a row. The general market expectation for April 2022 inflation was at ~7.50% YoY. Inflation in all major sub-segments of the CPI (Food, Fuel and Core CPI) rose in April 2022 resulting in the sharp rise in the headline inflation. More importantly on a month on month (MoM) basis also, prices of all the items (baring Eggs and Vegetables) in CPI, witnessed a rise in April 2022. CPI food inflation came in at 8.38% YoY in April 2022 compared to 7.68% YoY in March 2022. Fuel and Light inflation also rose sharply and stood at 10.80% YoY from 7.52%. Core CPI inflation (ex Food and Fuel but including 'Transport and communication') rose further to 6.97% YoY in April 2022 as compared to 6.32% YoY in the previous month.

Within the retail food basket, YoY inflation in prices of vegetables, cereals and dairy products that have higher weightage in the CPI index, rose and stood at 15.41%, 5.96% and 5.47% respectively in April, from 11.64%, 4.93% and 4.71% respectively a month ago. However, on a MoM basis amongst these items, prices of vegetable witnessed a marginal decline. Tracking the rise in edible oil prices, the 'Oils and fats' segment of the food basket witnessed a MoM rise of 2.47% in inflation. Amongst food items, prices of fruits saw the highest sequential rise at 9.52% MoM in April 2022. Within Core CPI most of the items witnessed a rise in prices on a MoM basis in April 2022, indicating that demand conditions remained strong. The impact of fuel price hikes that started in March 2022 onwards, was reflected in the rise in inflation in the 'Fuel and light' segment, which came in higher at 3.11% MoM.



Source:-Ministry of Statistics and Program Implementation

Inflation is witnessing upward pressure across the board, as several factors are simultaneously pushing prices higher both on sequential as well as YoY basis. Some of these factors include shortages of input materials and supply chain disruptions due to the Russia-Ukraine war, passing on of the input cost increases by companies to the end consumers, strong demand conditions domestically and rise in crude oil and other commodity prices. Additionally, the current heat wave impacting crop yields is also pushing food prices higher. Due to persistence for a longer period, most of these factors are threatening to lead to a structural rise in inflation. However, central banks and their monetary policy tightening alone cannot solve the problem of persistently high inflation. The governments will also have to step in and step up their efforts in resolving supply side issues, which may not be easy to address at the current juncture, given that it's a global problem. While such high levels of inflation should discourage demand thereby helping a very gradual decline in prices, given the pent-up demand post the opening up of the economy, it may take relatively longer. This means that elevated inflation is here to stay for the time being. Thus, CPI inflation is likely to stay above the upper end of the RBI's inflation target of 2%-6% in the near term. From the monetary policy perspective, this strengthens the expectations that the RBI's policy tightening is likely to be faster and sharper, in line with some of the major global central banks.

Fixed income view:

The bond markets reacted negatively to the CPI inflation data for April, as it is likely to fuel expectations that the RBI could hike the Repo rate by more than 25 bps in the June monetary policy. Yield on the 10 year benchmark, the 6.54% G-sec 2032 bond, was trading higher at 7.32% at the time of writing this note as against its previous close of 7.24%. Bond yields are likely to remain volatile and trade with an upward bias as the RBI increases interest rates and undertakes withdrawal of liquidity surplus to tame inflation and ensure financial market stability amidst global monetary policy tightening. Higher supply of G-secs is also likely to put upward pressure on bond yields. Over the next 12 months inflation is likely to be remain a key monitorable. Besides inflation, the level of RBI's Forex Reserves, Current Account Balance and government's fiscal deficit for FY23 will also need to be tracked very closely going forward.

Fixed Income Mutual Fund Strategy: - Thus, investors who have relatively longer investment horizon could look at Target Maturity Index Funds that invest in a mix of high credit quality securities. Investors with an investment horizon of 12 months and above can look at Short Duration Funds, Money Market Funds, Ultra Short Duration and Low Duration Funds. With the rise in yields at longer end of the yield curve, investors who are comfortable with volatility and have a longer investment horizon could gradually start looking at Dynamic Bonds for a horizon of 24 months and above. For a horizon of 3 months and above Arbitrage Funds can be considered. 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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