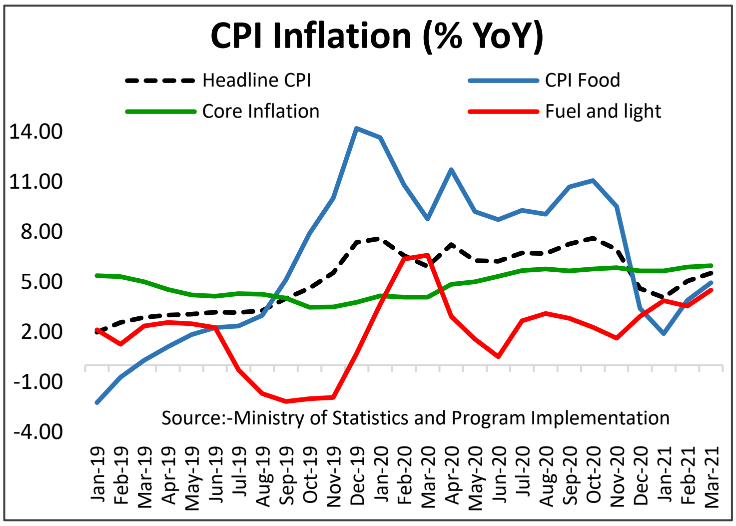
CPI inflation- March 2021

Event Update

Domestic retail inflation based on Consumer Price Index (CPI) rose in the month of March 2021, and came in at 5.52% YoY, as against 5.03% YoY in February 2021. While the rise in inflation was largely expected, it was higher than consensus expectations of ~5.40% YoY. There was a broad-based rise in inflation across most of the segments of CPI in the month of March 2021, which along with an unfavorable base effect led to rise in inflation. CPI food inflation rose and came in at 4.94% YoY in March 2021 as against 3.87% YoY in the previous month. Core CPI inflation (ex Food and Fuel, but including 'Transport and communication') continued to remain sticky and stood at 5.96% YoY in March 2021, compared with 5.88% YoY in February 2021.



Within the CPI food basket, most of the internal items saw rise in prices on a YoY basis, barring items like 'Cereals and products', Eggs, 'Milk and products' and Spices. Deflation in vegetable prices declined and stood at 4.83% YoY in March 2021 as against a deflation of 6.27% YoY in February 2021. Inflation in prices of fruits stood at 7.86% YoY in March 2021 as against 5.99% YoY in the previous month. Inflation in prices of 'Meat and fish' rose in March 2021, after witnessing a decline for the past four consecutive months, and came in at 15.09% YoY as against 11.46% YoY in the previous month. Within Core CPI inflation, the only three segments that witnessed a decline in YoY inflation were 'Pan, tobacco and intoxicants', Health and 'Personal care and effects'. Inflation in 'Transport and communication' increased to 12.55% YoY in March 2021 from 11.36% YoY in February 2021. Inflation in 'Fuel and light' stood at 4.50% YoY in March 2021 as against 3.53% YoY in the previous month.

The average CPI inflation for Q4FY21 (at ~4.87%) is within the RBI's latest forecast of 5% YoY for the quarter. In the very near term, the base effect is favorable for the month April 2021, and hence inflation could see some decline in the month. However, inflationary pressures are likely to continue going forward. These inflationary pressures could come from 1. Seasonal movement in food prices (prices generally rise in summer months); 2. Localised lockdowns that could impact the supply of goods and services, thereby leading to rise in prices; 3. Rise in commodity prices including Crude oil, leading to further rise in input costs and; 4. Rise in global inflationary trend. Additionally, the sticky and rising Core inflation could also continue to put upward pressure on the headline inflation.

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 6.01%. Going forward in the near to medium term, while the rise in inflation is expected and even RBI has upped its inflation forecast marginally, the RBI is likely to stay accommodative and use various tools available at its disposal for the smooth functioning of the financial markets and to support the economic recovery. This was made amply clear in the latest monetary policy in April 2021. Thus, given the near term visibility on the monetary policy stance, bond yields may trade in a range and any major spike is likely to be contained, with the help of RBI's support measures (most prominent being the G-SAP). However, the second wave of Covid-19 infections domestically, has brought in some amount of uncertainty on various macro-economic variables (growth, inflation, fiscal deficit, currency movement amongst others); the interplay of which may have implications on the monetary policy, as well as movement of bond yields. Thus, further developments in the second wave of Covid-19 infections, the progress of the vaccination drive and their impact on the macro variables need to tracked very closely, to gauge the movement in bond yields going forward.

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. 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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