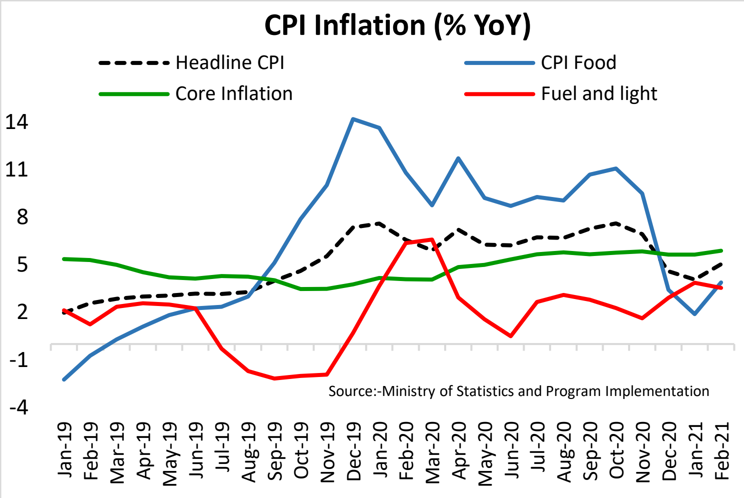
CPI inflation- February 2021

Event Update

India's retail inflation based on Consumer Price Index (CPI) rose in the month of February 2021, after witnessing a decline for three consecutive months. CPI inflation for the month of February 2021 came in at 5.03% YoY as against 4.06% YoY in January 2021. The pickup in retail inflation was on account of higher CPI food inflation, which came in at 3.87% YoY in February 2021 as against 1.96% YoY in January 2021. Core CPI inflation (ex Food and Fuel, but including 'Transport and communication'), also aided the rise in retail inflation in February 2021. Core CPI inflation rose in February 2021 and stood at 5.88% YoY as against 5.65% YoY in the previous month.



Within the CPI food basket, the deflation in vegetable prices declined in February 2021 and stood at 6.27% YoY as against a deflation of 15.84% YoY seen in January 2021. Inflation in prices of fruits rose in February 2021 and came in at 6.28% YoY as compared to 4.96% YoY in January 2021. Most of the protein food items however, continued to witness a decline in inflation on a YoY basis in the month of February 2021. Inflation in prices of pulses also declined and stood at 12.54% YoY in February 2021 as against 13.32% YoY in the previous month. Prices of 'Cereals and Products' deflated by 0.35% YoY in February 2021 as against an inflation of 0.14% YoY in the previous month. Inflation in this segment had been declining for the past seven consecutive months till January 2021. In case of Core CPI, most of the internal items witnessed a broad-based increase in inflation on a YoY basis as compared to the previous month. Inflation in 'Fuel and light' declined in the month of February 2021 and stood at 3.53% YoY as against 3.87% YoY in January 2021. Inflation in housing segment declined marginally and stood at 3.23% YoY in February 2021, as against 3.25% YoY in January 2021.

In line with expectations the CPI inflation has inched up in February 2021. The favorable base effect seen in December 2020 and January 2021 had helped the inflation to decline in these months. However, in the months of February and March 2021, the base effect is likely to be unfavorable and hence we may see the inflation rising in the month of March 2021 as well. Vegetable and fruit prices that generally follow seasonal movement in prices, have started witnessing an increase in prices, which may continue in the coming few months. Additionally, Core inflation is continuing to stay sticky; and the uptick seen in February 2021 may continue going forward, given the fiscal push provided by the government in the FY22 Union Budget, to support economic recovery. With the vaccination drive having started in India and currently in full swing, could also help push the demand further in the economy. To add to the inflation woes, commodity prices including crude oil, have continued to rise gradually. Thus, inflation pressures are likely to continue in the near term.

Fixed income view:

Yield of the 10-year benchmark G-sec, 5.85% 2030 bond was trading at a level of 6.23% at the time of writing this note, same as that of its previous close. Though inflation has risen in the month of February 2021, the Index of Industrial Production (IIP – a high frequency economic growth indicator) has witnessed contraction in January 2021. Thus, the Monetary Policy may have to look through the inch up in inflation to continue supporting growth, which is need of the hour. Also, so far the inflation numbers for Q4FY21 have stayed within the RBI's forecast of 5.20% YoY for the quarter. However, the volatility in bond yields is likely to continue tracking higher supply of G-secs, as well as domestic and global macro variables. To that effect, RBI's G-sec supply absorption measures are likely to play an important role, as far as the trajectory of bonds yields is concerned.

Fixed Income Mutual Fund Strategy: - Given the expected volatility in bond markets, 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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Mutual fund investments are subject to market risks, read all scheme related documents carefully.