

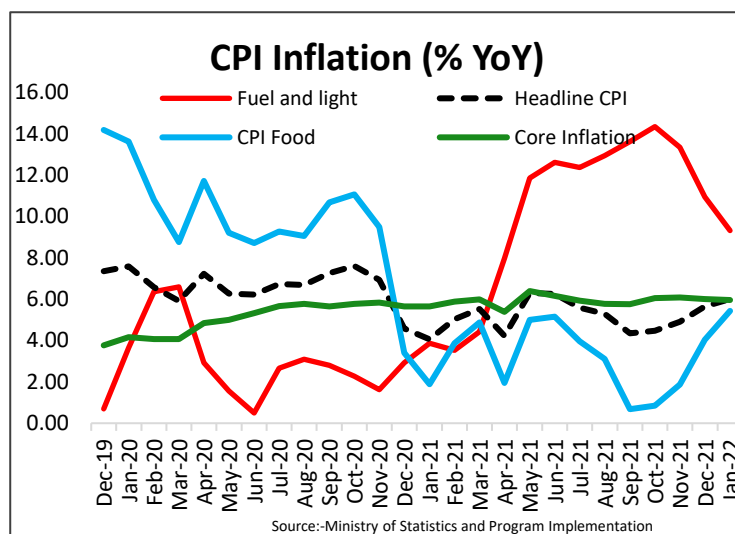


CPI inflation- January 2022

Event Update

India's retail inflation based on Consumer Price Index (CPI) rose for fourth consecutive month in January 2022 and came in at 6.01% YoY, as against 5.66% YoY (revised upwards from 5.59% YoY) in December 2021. An unfavorable base effect, coupled with rise in food inflation led to the higher retail inflation in January 2022. CPI Food inflation rose and came in at 5.43% YoY in January 2022 as compared to 4.05% YoY in December 2021. While Core CPI inflation (ex Food and Fuel but including 'Transport and communication') for January 2022 declined marginally it continued to remain elevated and came in at 5.96% YoY compared with 6.01% YoY in December 2021. Core CPI inflation declined for the second month in a row.

Within the food basket, the rise in inflation in January 2022 was largely broad-based, and a lot of food items that have higher weightage in the CPI witnessed higher inflation in January 2022 as compared to the previous month. Vegetable prices were witnessing deflation on a YoY basis till December 2021; however, prices rose on a YoY basis in January 2022 and witnessed an inflation of 5.19% YoY. In December 2021, vegetable prices had deflated by 3.04% YoY. Some of the other major food items that witnessed a rise in inflation on a YoY basis in January 2022, included 'Cereals and products', 'Meat and fish', and 'Milk and products'. Inflation in some of the food items such as 'Oils and fats' and Fruits saw a decline in inflation in January 2022 on a YoY basis. Though Core CPI inflation remained elevated in January 2022, it witnessed a marginal decline. Within Core CPI some of the items that saw a rise in inflation in January 2022 included 'Clothing and footwear', 'Household goods and services' and Education. Most of the other segments of Core CPI witnessed decline in inflation in January when compared with a year ago period. Inflation in 'Fuel and Light' segment moderated to a level of 9.32% YoY in January 2022 from 10.95% YoY in December 2021.



In line with expectations, the low base of the last year has started putting upward pressure on CPI inflation. On a sequential MoM basis however, the CPI inflation witnessed a decline for the second month in a row in January 2022. The unfavorable base effect is likely to continue for the next few months, thereby preventing the CPI inflation from moderating. Additionally, there is uncertainty on the trajectory of crude oil prices on account of factors such as global economic recovery, as well as geo-political tensions that are leading to a rise in prices. Another factor that could prevent the headline inflation from moderating is the elevated Core CPI inflation, which may continue to be stubborn given the economic growth focus of the policy makers. These factors are likely to continue imparting uncertainty and upward pressure to the inflation outlook. On the positive side, the likely seasonal decline in food prices, that generally happens in the winter months can help in taking some pressure off the headline inflation. The upward pressure on inflation is expected to continue in the near to medium term, which may keep the headline inflation closer to the upper side of RBI's flexible inflation target of 2%-6%.

Fixed income view:

In the latest monetary policy, the RBI highlighted the loss of momentum in economic activity as reflected in the high frequency indicators and also stated that recovery in domestic economic activity is yet to be broad-based. On the other hand, the RBI also believes, that headline inflation is expected to peak in Q4FY22 within the tolerance band and then moderate closer to target in H2FY23, providing room for monetary policy to remain accommodative. For FY23, the RBI expects CPI inflation to be at 4.5% YoY. Thus, the RBI is likely to continue with its focus on supporting economic growth while looking through the rise in CPI inflation. This has provided comfort to the fixed income markets, as the RBI may go relatively slow on normalizing the loose monetary policy unlike the major global central banks. Bond yields have already declined since the RBI's monetary policy in early February 2022. However, should the inflation trajectory deviate from the RBI's forecasts on the higher side on a sustained basis, RBI's narrative could change, which could have negative implications on the bond markets.

Fixed Income Mutual Fund Strategy: - Thus, currently investors with an investment horizon of 12 months and above can look at Short Duration Funds and Corporate Bond Funds. Investors who would like to lock in current available yields and are not comfortable with volatility, can look at relatively longer tenor Fixed Maturity Plan (FMPs). Investors who have relatively longer investment horizon could look at Target Maturity Index Funds that invest in PSU Bonds plus SDLs, with funds having maturities in the years 2025, 2026 and 2027. 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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