

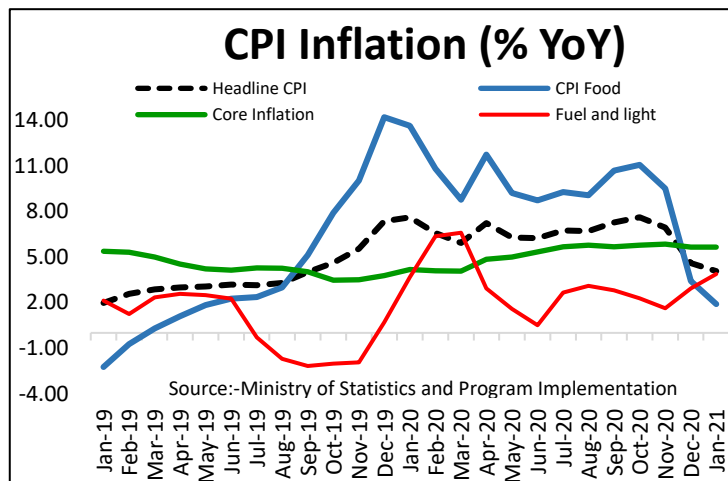


CPI inflation- January 2021

Event Update

India's retail inflation based on Consumer Price Index (CPI) declined for the third consecutive month in January 2021 and declined near to the RBI's medium term inflation target of 4% (the flexible inflation target being 2%-6%). In January 2021, CPI inflation stood at 4.06% YoY as against 4.59% YoY in December 2020. The decline in headline inflation was mainly on account of decline in retail food inflation as well as the base effect. Inflation in Consumer Food Price Index declined to 1.89% YoY in January 2021, as against 3.41% YoY in December 2020. Core CPI inflation (ex Food and Fuel, but including 'Transport and communication') continued to remain sticky and stood at 5.65% YoY in January 2021, same as that in the previous month.

Within the retail food basket, there was a broad based decline in inflation in January 2021. Vegetable prices which had been exerting upward pressure on the CPI food inflation over the past few months, witnessed a contraction in inflation for the second month in a row. Vegetable prices deflated by 15.84% YoY in January 2021 as against a deflation of 10.51% YoY in December 2020. Inflation in most of the protein food items also continued to decline in January 2021. Inflation in prices of fruits however rose and came in at 4.96% YoY in January 2021 as against 2.68% YoY in the previous month. In case of Core CPI, while most of the internals witnessed a marginal rise in inflation, items like 'Household goods and services', Education and 'Personal care and effects' saw inflation decline in January 2021 as compared to the previous month. Inflation in 'Fuel and light' came in higher in January 2021 and stood at 3.87% YoY as against 2.92% YoY in December 2020. Housing inflation witnessed a marginal increase in January 2021 and stood at 3.25% YoY as against 3.21% YoY in the previous month.



In the February 2021 Monetary Policy, the RBI forecasted CPI inflation to be at 5.2% YoY in Q4FY21. The inflation print for the first month of Q4FY21 has come comfortably below the RBI's forecast for the entire quarter. However, going forward retail inflation may witness upward pressures. While the base effect played an important role in pulling down the overall inflation in January 2021, the favourable base effect will not be available over the course of the next few months. Additionally, food prices which witness seasonal patterns, could see upward movement, as the winters come to an end. Core inflation which represents the demand side of the economy has also remained sticky, and the large fiscal push given by the government in the FY22 Union Budget for economic growth, could also lead to pressure on Core inflation. Commodity prices have also been witnessing a gradual rise, which could be another pressure point for the headline inflation.

Fixed income view:

Yield of the 10-year benchmark 5.85% 2030 bond closed at 6.02% today as against its previous close of 5.99%. While decline in the retail inflation is likely to be positive for bond market sentiments, higher supply of G-secs has been leading to caution amongst the market participants. Going forward, the trajectory of bond yields, is likely to continue to get impacted by the large government market borrowing programme. RBI's G-sec supply absorption support would be a very crucial factor in ensuring financial market stability. While RBI's reassurance regarding the same is positive for the bond markets, the timing and the quantum of RBI's measures would be an important variable. Additionally, while RBI's has reiterated that it will remain accommodative for as long as necessary, with the signs of economic recovery now visible, any uptick in inflation well beyond the RBI's forecast could alter the course of the monetary policy. Thus growth-inflation dynamics would require close monitoring to gauge the trajectory of bond yields going forward.

Fixed Income Mutual Fund Strategy: - Given the expected volatility in bond markets, currently investors should look at Ultra Short Duration Funds/Low Duration/Money Market/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.