

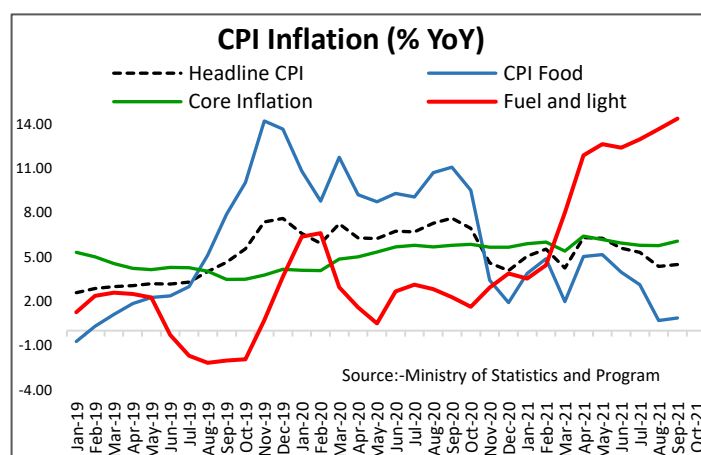


## CPI inflation- October 2021

Event Update

India's retail inflation based on Consumer Price Index (CPI) for October 2021 surprised the markets and came in marginally higher than market expectations as well as the previous month. That said retail inflation remained within the RBI's flexible inflation target of 2%-6% for the fourth consecutive month. CPI inflation for October 2021 stood at 4.48% YoY as against 4.35% YoY in September 2021. The market participants were expecting CPI inflation at ~4.20% YoY. The rise in retail inflation in October 2021 was on account of rise in major sub-groups of the CPI like Food CPI, Core CPI and 'Fuel and Light'. CPI food inflation rose to 0.85% YoY in October 2021 as against 0.68% YoY in September 2021. Core CPI inflation (ex Food and Fuel but including 'Transport and communication') stood higher at 6.06% YoY in October 2021 as against 5.76% YoY in the previous month. Inflation in 'Fuel and Light' also rose to a level of 14.35% YoY in October 2021 from 13.63% YoY in September 2021.

While within the Food CPI basket, the movement in inflation was mixed, rise in some items that have higher weightage in the headline index, led to a rise in the overall Food inflation. Inflation in the prices of 'Cereals and products' (weightage of ~10% in CPI) stood at 0.41% YoY in October 2021, as against a deflation of 0.61% YoY in September 2021. This segment witnessed a rise in prices in a YoY basis for the first time after eight months of deflation. Prices of vegetables (weightage of ~6% in CPI) deflated by a lower percentage of 19.43% YoY in October 2021 as against a deflation of 22.42% YoY in September 2021. Other food items with relatively higher weightage in the CPI that witnessed a rise in inflation included 'Milk and products' and 'Prepared meals, snacks, sweets etc.' Some of the items that witnessed a decline in inflation on a YoY basis included 'Meat and fish', 'Oils and fats' and 'Pulses and products'. In the Core CPI basket, rise in inflation was largely broad-based October 2021. Within Core CPI, the only items that witnessed a decline in inflation on a YoY basis included 'Housing', 'Health' and 'Recreation and amusement'.



As seen from the CPI inflation for October 2021, higher fuel prices are indeed exerting upward pressure on the headline inflation. Additionally, the impact of the unseasonal rains on crops may also have contributed to the rise in CPI food inflation. While the festive season demand pickup could have led to the uptick in the Core CPI inflation, elevated fuel prices may also be seeping into the overall inflation. Thus, the recent cut in the excise duty on fuel by the central government and the reduction in Value Added Tax (VAT) by several state governments, may help in taking off some pressure from retail inflation. However, the favorable base effect will start weaning off from December 2021 onwards, which could lead to an uptick in inflation. A host of other factors are also imparting uncertainty to the inflation outlook. These factors include: - sustained rise in crude oil prices; elevated commodity prices; shortages of input materials and; rising global inflationary expectations. Domestic Core CPI inflation has also remained sticky which indicates that the headline inflation may continue to have an upward bias to it.

### Fixed income view:

The markets showed a muted reaction to the slight uptick in the retail inflation, wherein yield on the 10-year benchmark, the 6.10% G-sec 2031 closed at 6.34% today, as compared to its previous close of 6.37%. Going forward, the volatility in the bond yields is likely to continue as globally central banks move closer to the normalization of the very loose monetary policies, on account of inflation concerns and pickup in economic growth. Domestically also, the trajectory of inflation and economic growth will guide the movement in bond yields as the same would be important from the perspective of monetary policy decisions of the RBI. Additionally, factors like the Union Budget announcement for FY23, from the perspective of domestic fiscal deficit and government borrowings estimates; and RBI's guidance on monetary policy will also be very important for the trajectory of domestic fixed income markets. In terms of the yield curve, it may witness Bear Flattening as the short term rates may move faster and by larger amount as compared to the long term rates, on account of the active liquidity management by the RBI.

**Fixed Income Mutual Fund Strategy:** - From fixed income investment strategy perspective, currently investors who have relatively longer investment horizon could look at Target Maturity Index Funds that invest in PSU Bonds plus SDLs. 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 with an investment horizon of 12 months and above can look at Short Duration Funds and Corporate Bond Funds. Investors who are comfortable with volatility and who want to take advantage of opportunities available at the longer end of the yield curve can look at Dynamic Bond Funds with an investment 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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