CPI Inflation – December 2023

Consumer Price Index (CPI) based inflation for December 2023 accelerated to 5.69% YoY, higher than the previous month's growth rate of 5.55% YoY but lower than the market expectations of 5.9% YoY. While inflation inched higher, it continues to remain within the RBI's target band of 2-6%.

CPI inflation accelerated primarily due to low base and elevated food inflation. However, the correction in vegetable prices on a sequential basis has limited the rise in inflation.

Food Inflation as depicted by Consumer Food Price Index (CFPI), rose to 9.53% YoY in December 2023 versus 8.70% YoY in the previous month. In the food basket, the annual growth rate of prices of vegetables, pulses, fruits, and spices continues to remain in double digits due to higher prices and an unfavourable base effect.

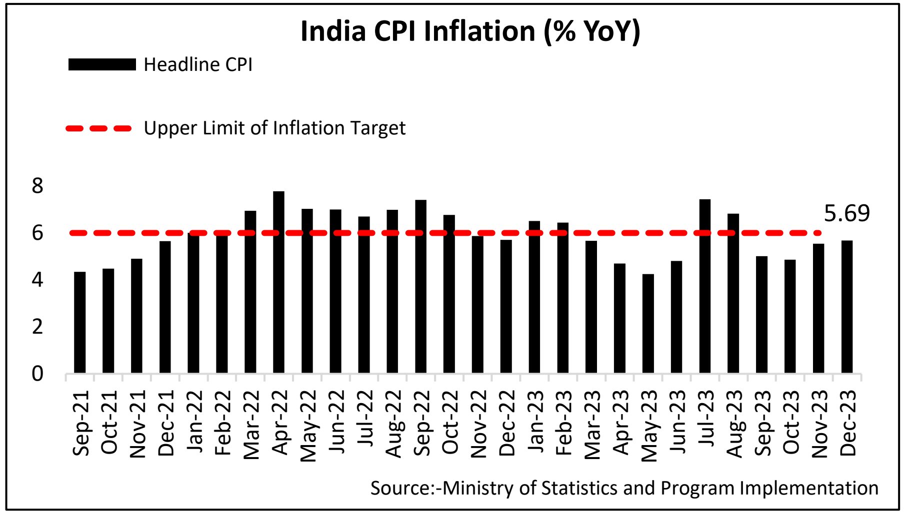
Core CPI inflation (ex-Food and Fuel) further fell to 3.89% YoY in December 2023 as against 4.09% YoY in the previous month. Thus, highlighting the slowing down of durable inflation, which the RBI keenly monitors.

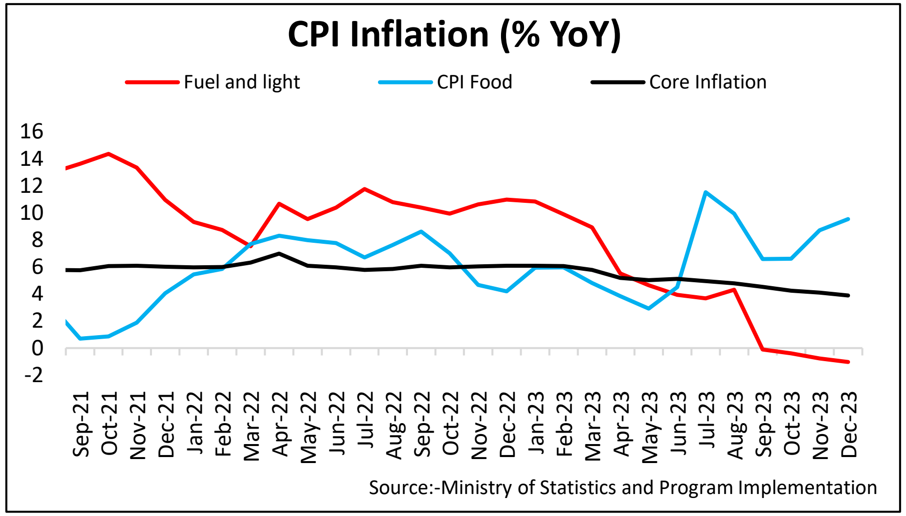
Expectations:- While vegetable prices have declined on a MoM basis and are likely to further moderate with the onset of fresh produce in the market, the rise in cereals and pulses prices remains a cause of concern as it can be intransient and can have second-round effects on other sources of proteins. Going forward, more upside risks are emerging on food prices as Rabi sowing may fall short of the target due to low reservoir levels, patchy rains, and a low base. In this context, the government's measures to ease the supply-side issues need to be keenly monitored.

Implication on Monetary Policy:- With inflation remaining higher than the target rate of 4%, the RBI is likely to maintain the status quo and keep monetary policy tight as it remains committed to bringing headline inflation below its target rate on a durable basis. The RBI is likely to manage liquidity to keep overnight rates at their desired levels in order to rein in the demand side inflationary pressure.

Implication on Markets:- The higher inflation print was already factored in by the market, however, with inflation remaining below the market expectation, the market may react positively in the near term. In the medium term, the market is likely to track the US market and the flows related to the JP Morgan bond index inclusion for cues along with liquidity-curbing or liquidity-easing measures of the RBI.

Fixed Income Mutual Fund Investment Strategy:- While headline inflation remained below the market expectations, it continues to trend higher than the RBI's target rate of 4%, thus the yields may remain range-bound in the near term. With a relatively flat yield curve and uncertainty about the timing of the rate cuts, staying invested at the short end could be better from a risk-reward perspective currently. Furthermore, if the yields spike up again, it will give investors a tactical opportunity to invest at the longer end. Corporate Bond Funds, which typically have a higher yield to maturities, look a safe bet at the current juncture. Additionally, with tight liquidity and a higher supply of corporate bonds and SDLs, the corporate bond spreads and SDL spreads are widening vs the G-secs, thus providing accrual opportunity, and making the case for Corporate Bond Funds and SDL Index Funds. Hence, investors can look at Corporate Bond Funds and Short duration funds for a horizon of 15 months and above. Investors who are comfortable with volatility and have a longer horizon of 24 months and above can take exposure to Dynamic Bond Funds and longer-tenor SDL Index Funds. For lower volatility and a horizon of 3 months and above, investors can consider Arbitrage Funds. Whereas for a horizon of up to 3 months, investors can consider Overnight Funds and Liquid Funds. Investors can also look at Multi-asset allocation funds for a horizon of 36 months and above. Investors should invest in line with their risk profile and product suitability.





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