CPI Inflation – May 2024

Consumer Price Index (CPI) based inflation for May 2024 decelerated to 4.75% YoY, lower than the previous month's growth rate of 4.83% YoY and better than the market expectations of 5% YoY. The headline inflation eased to a 12-month low and remains within the RBI's target band of 2-6%.

CPI inflation came in lower as food inflation, especially vegetable prices, remained under control. Furthermore, moderation in housing, clothing & footwear, and miscellaneous categories accentuated the disinflation.

Food Inflation, as depicted by the Consumer Food Price Index (CFPI), remained almost steady at 8.69% YoY in May 2024 compared to 8.70% YoY in the previous month. Even though the vegetable prices continue to remain elevated, they didn't surge due to heat waves, which relieved some of the inflationary pressure. However, the uptick in cereals and pulses remains a cause of concern and continues to keep food inflation elevated.

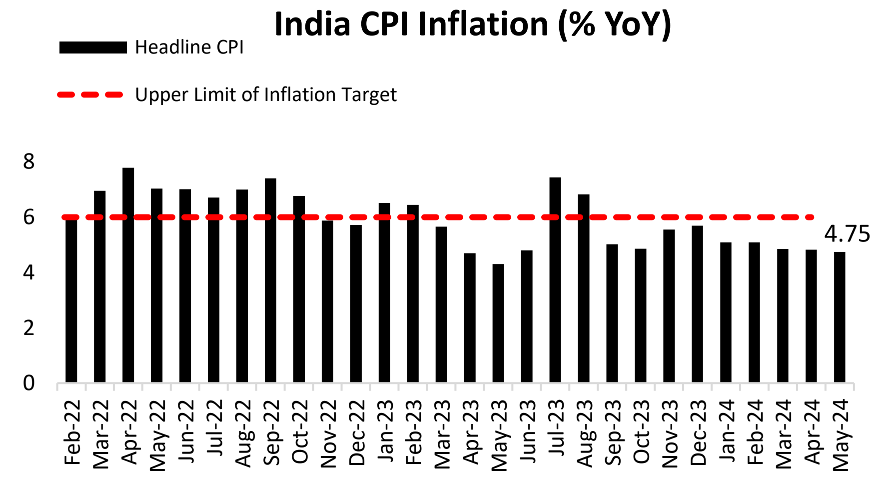
Core CPI inflation (ex-Food and Fuel) further eased to 3.12% YoY in May 2024 as against 3.23% YoY in the previous month. The decline in core inflation remains positive for the bond market as the RBI monitors the durable inflation.

Expectations:- The lower inflation print for May 2024 may undershoot the RBI's inflation target for Q1 FY25. Due to the base effect and likely moderation in food inflation, inflation will also likely remain better in Q2 FY25. Additionally, the downward revision in the RBI's inflation forecast suggests that inflation is likely to ease in the long term.

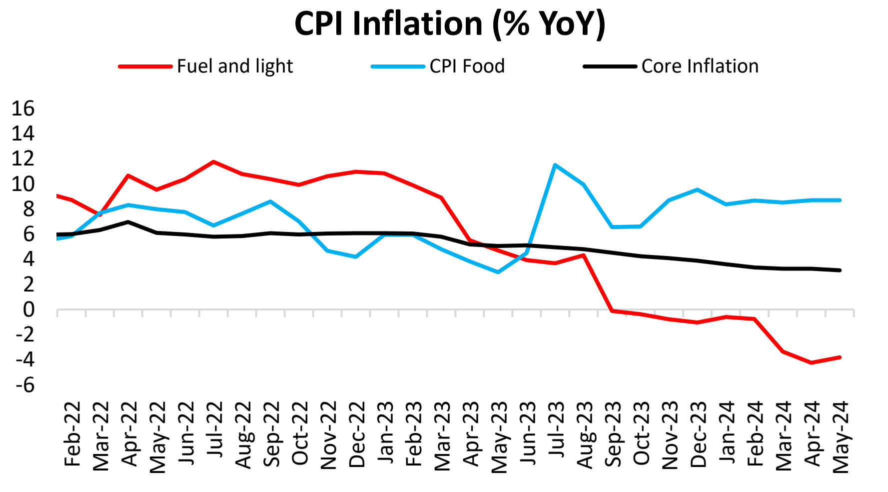
Implication on Monetary Policy:- While the elevated food inflation may warrant the RBI to remain disinflationary as volatility in food prices can significantly impact inflation, the lower print may provide confidence that inflation is trending downwards. If the inflation trends lower in the upcoming prints also, then this may nudge the RBI to ease liquidity into the system.

Implication on Markets:- In the very near term, the better-than-expected inflation print remains positive for bond market. The market would also be looking forward to US CPI print as it would impact the Fed's guidance in the upcoming FOMC meeting, due this week. In the medium term, the market is likely to take cues from the Union budget for the government's pace of fiscal consolidation, the flows related to the JP Morgan bond index inclusion, the US market, and the liquidity measures of the RBI. The trend of food inflation and spatial distribution of upcoming monsoon, and geopolitical tensions are also likely to affect the domestic G-sec yields.

Fixed Income Mutual Fund Investment Strategy:- Domestically, more members of the RBI's MPC are now inclined towards easing conditions, so the RBI may start to ease liquidity into the system. Hence, the shorter end of the yield curve may react more than the longer end, which has already reacted due to favourable supply-demand dynamics. Furthermore, the longer end of the yield curve may remain volatile as the market expects a possible deceleration in the speed of fiscal consolidation due to the formation of a coalition government at the centre; in this context, the upcoming Union Budget is likely to give further cues. Accrual opportunities at the 2-4-year segment of the curve remain attractive for incremental investment from a risk-reward perspective until fresh triggers appear to suggest a further decline in yields at the longer end. As corporate bonds are available at reasonable spreads of similar tenor G-Secs, Corporate Bond Funds continue to look like a safe bet at the current juncture for investors looking to invest in shorter-tenure funds. Hence, investors can look at Corporate Bond Funds and Short duration funds for a horizon of 15 months and above. For 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.



Source:-Ministry of Statistics and Program Implementation



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