

A Significant Upward Surprise, but a Not-So-Unfavorable Reading

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- **IPCA for December registered a 0.62% MoM change, considerably above our call (0.40%) and the consensus forecast (0.45%). IPCA 2022 ended at 5.8%, a sizeable deceleration from the 10.1% inflation of 2021, but still markedly above the mid-target of 3.5% (and even above the upward tolerance band of 5.0%).**
- **Despite the upward surprise, we do not see the monthly reading as particularly unfavorable, as the bulk of the surprise was concentrated in the rebound in industrial goods prices after the Black Friday sales (and hence, in theory, was a one-off move).**
- **While temporary, this change affected some core gauges, and the average of cores stabilized at 5.1% 3MMA-saar in trend terms. Now we need to track whether it is indeed a stabilization or if it is just a pause in the downward trend we have seen so far.**
- **In trend terms, the bright side was services inflation, which decelerated, with its core also declining. On the other hand, the industrial goods trend rose, with its core also rising — both affected by the end of Black Friday sales. Food-at-home increased at the margin, while regulated prices continued to rebound as the downward effect of the recent tax cuts ended.**
- **All in all, despite the pause in the improvements in underlying inflation that we have seen recently, we continue to forecast a rapid deceleration in IPCA (both headline and core) to around 5.0%. However, we still believe the road from 4.0-5.0% to the 3.0% BCB mid-target could be bumpy, given another round of fiscal expansion that could keep demand hot. Our high-frequency tracking for IPCA 2023 is at 5.6% (from 5.5% previously) with risks reasonably balanced, but our tracking for IPCA 2024 is at 3.5% with upward risks.**

IPCA for December registered a 0.62% MoM change, considerably above our call (0.40%) and the consensus forecast (0.45%). IPCA 2022 ended at 5.8%, a sizeable deceleration from the 10.1% inflation of 2021, but still markedly above the mid-target of 3.5% (and even above the upward bound of the tolerance band, at 5.0%). The trend (3MMA-saar) has been rebounding — reaching 4.8% 3MMA-saar (vs. 1.9% in November and a low of -3.4% in September) — and the next readings (without noise caused by tax changes) will be important for assessing the direction of the trend (although we could see more tax changes from March onward).

Despite the upward surprise, we do not see the monthly reading as particularly unfavorable, as the bulk of the surprise was concentrated in the rebound of industrial goods prices after the Black Friday sales (and hence, in theory, was a one-off move). The error in the forecast for industrial goods contributed +14 bps to the error of the headline forecast. Administered prices (+1 bp of error), food-at-home (+2 bps of error), and services (+3 bps of error) also contributed to the underestimation of headline inflation.

While temporary, this upward surprise in the wake of Black Friday affected some core gauges; in particular, the average of cores stabilized at 5.1% 3MMA-saar in trend terms. Now we need to track whether it is indeed

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a stabilization or if it is just a pause in the downward trend we have seen so far. This Black Friday-related effect also helped push the diffusion index up to 62.8% s.a. (from 60.2%).

Regarding the core inflation outlook, in trend terms, the bright side was services inflation, which decelerated to 2.8% 3MMA-saar (from 3.7% in November and a peak of 12.8% in July), with its core also declining, to 4.9% 3MMA-saar (from 6.3% last month and a peak of 11.9% in July). The industrial goods trend, however, rose to 6.0% 3MMA-saar (from 2.8% last month and a peak of 15.5% in April), with its core also rising to 10.5% 3MMA-saar (from 7.5% in November) — both driven by the impact of the end of Black Friday sales. Food-at-home increased at the margin from 2.0% to 9.0% 3MMA-saar, while regulated prices continued to rebound as the downward effect of the recent tax cuts ended (3.0% 3MMA-saar vs. -2.0% in November).

All in all, despite the pause in the improvements in underlying inflation that we have seen recently, we continue to forecast a rapid deceleration in IPCA (both headline and core) to around 5.0%. However, we still believe the road from 4.0-5.0% to the 3.0% BCB mid-target could be bumpy, given another round of fiscal expansion that could keep demand hot. Our high-frequency tracking for IPCA 2023 is at 5.6% (from 5.5%), with risks reasonably balanced, but our tracking for IPCA 2024 is at 3.5%, with upward risks.



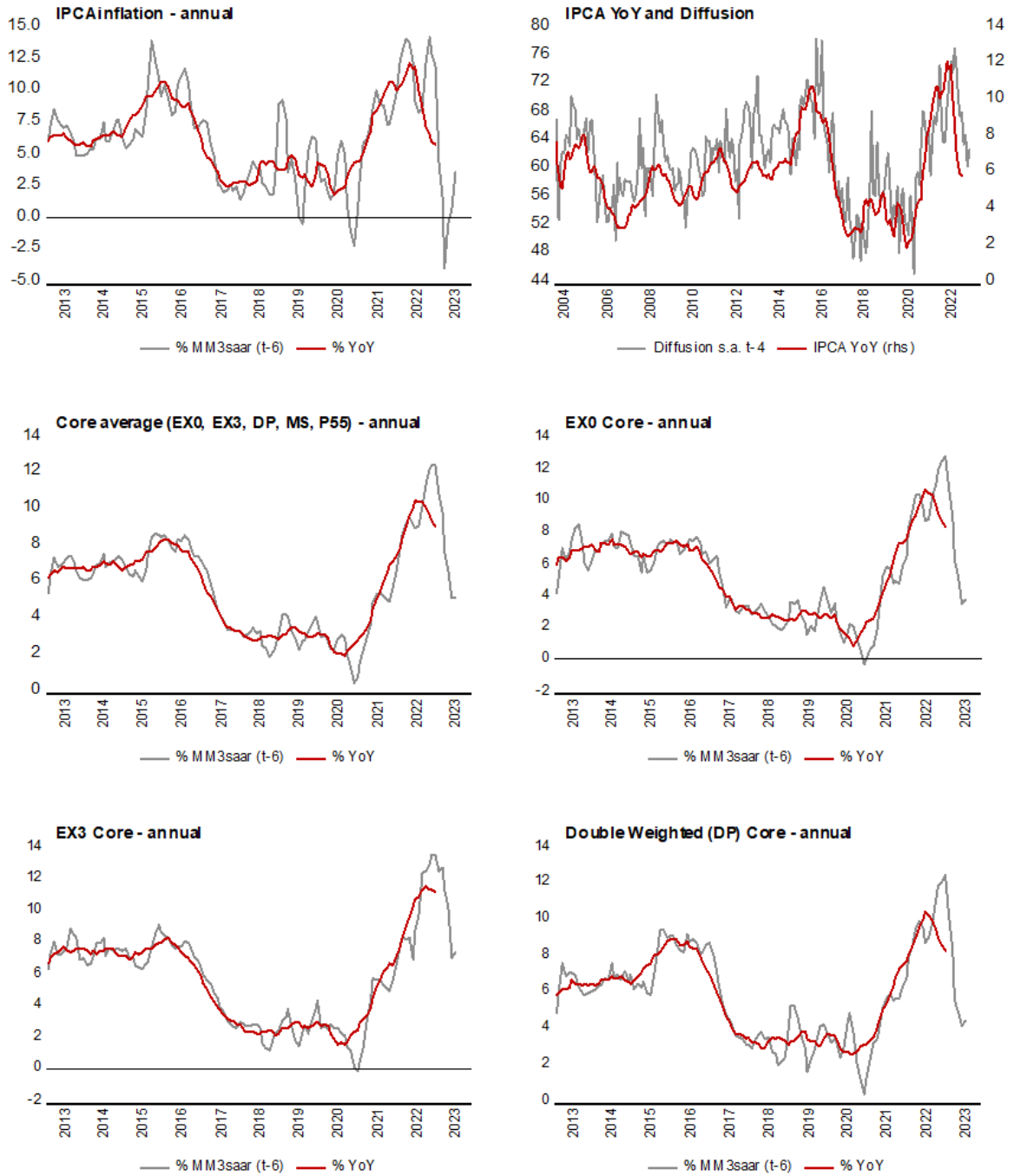
Figure 1. December's IPCA Details (%)

	MoM			YoY		3MMA-saar	
	Dec-22	Santander	Desv.	Nov-22	Dec-22	Nov-22	Dec-22
IPCA	0.62	0.40	0.22	5.9	5.8	1.9	4.8
Food and beverage	0.66	0.57	0.02	11.8	11.6		
Food-at-home	0.71	0.57	0.02	13.3	13.2	-0.4	6.0
Food service	0.51	0.55	0.00	8.0	7.5		
Housing	0.20	0.24	-0.01	0.6	0.1		
Electrical energy	0.20	0.38	-0.01	-18.8	-19.0		
Household articles	0.64	-0.13	0.03	8.7	7.9		
Apparel	1.52	1.00	0.03	18.6	18.0		
Transportation	0.21	0.10	0.02	-0.9	-1.3		
Airline tickets	0.89	0.47	0.00	35.0	23.5		
Gasoline	-1.04	-1.20	0.01	-25.5	-25.8		
Health and personal services	1.60	1.02	0.07	10.5	11.4		
Personal spending	0.62	0.32	0.03	7.7	7.8		
Education	0.19	0.02	0.01	7.3	7.5		
Communication	0.50	0.31	0.01	-1.2	-1.0		
Administered	0.27	0.21	0.01	-4.0	-3.8	-1.6	3.8
Free	0.74	0.47	0.20	9.7	9.4		
Food-at-home	0.71	0.57	0.02	13.3	13.2	-0.4	6.0
Industrial goods	1.19	0.59	0.14	9.8	9.6	4.1	6.9
Services	0.44	0.34	0.03	8.0	7.6	5.1	3.6
EX3 Core	1.02	0.60	0.16	11.3	11.1	8.1	8.3
Average of cores	0.66	-	-	9.4	9.1	5.9	6.1

Sources: Brazilian Central Bank, IBGE, Santander.



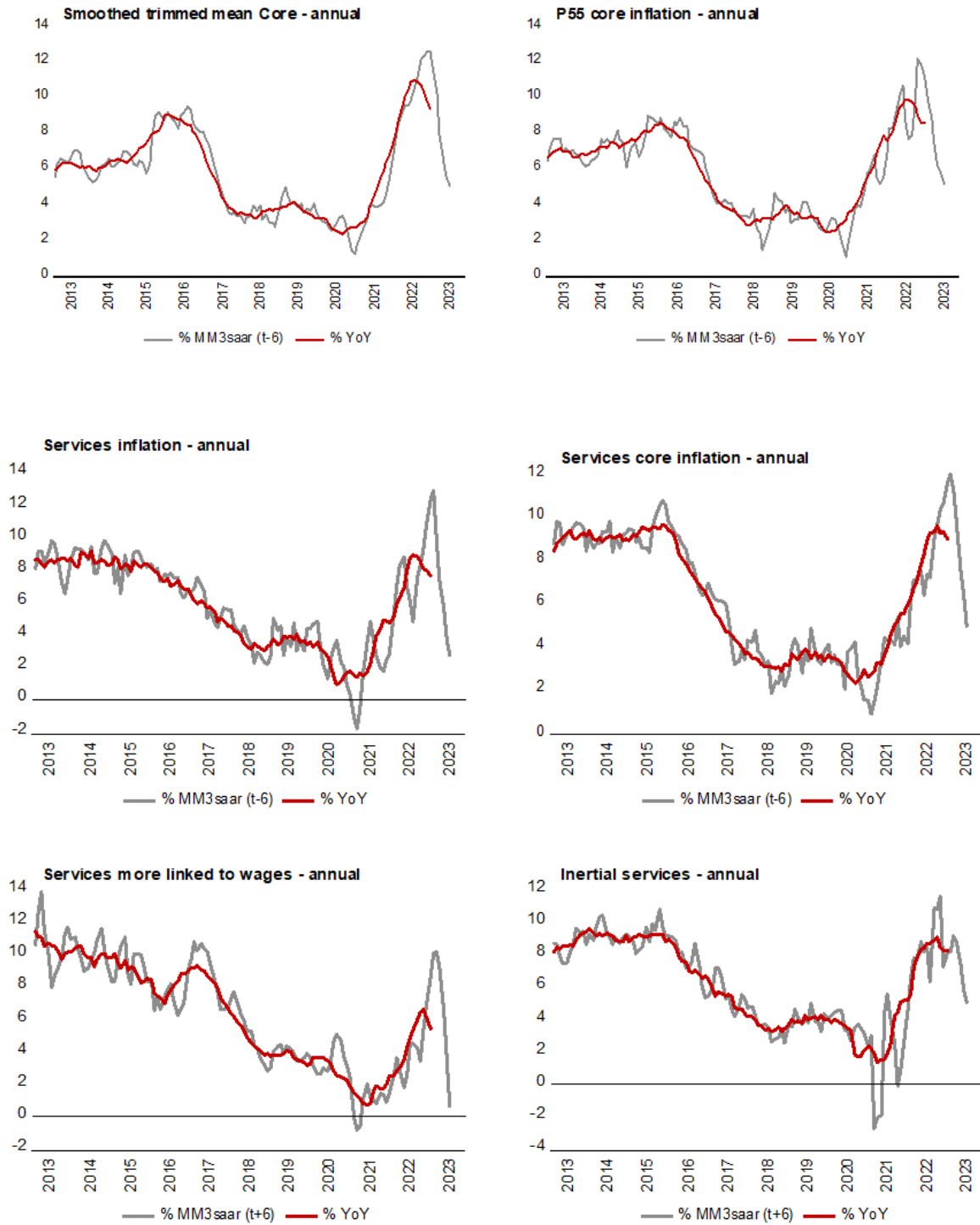
Figure 2. IPCA, Groups and Qualitative Measures



Sources for all charts: IBGE and Santander.



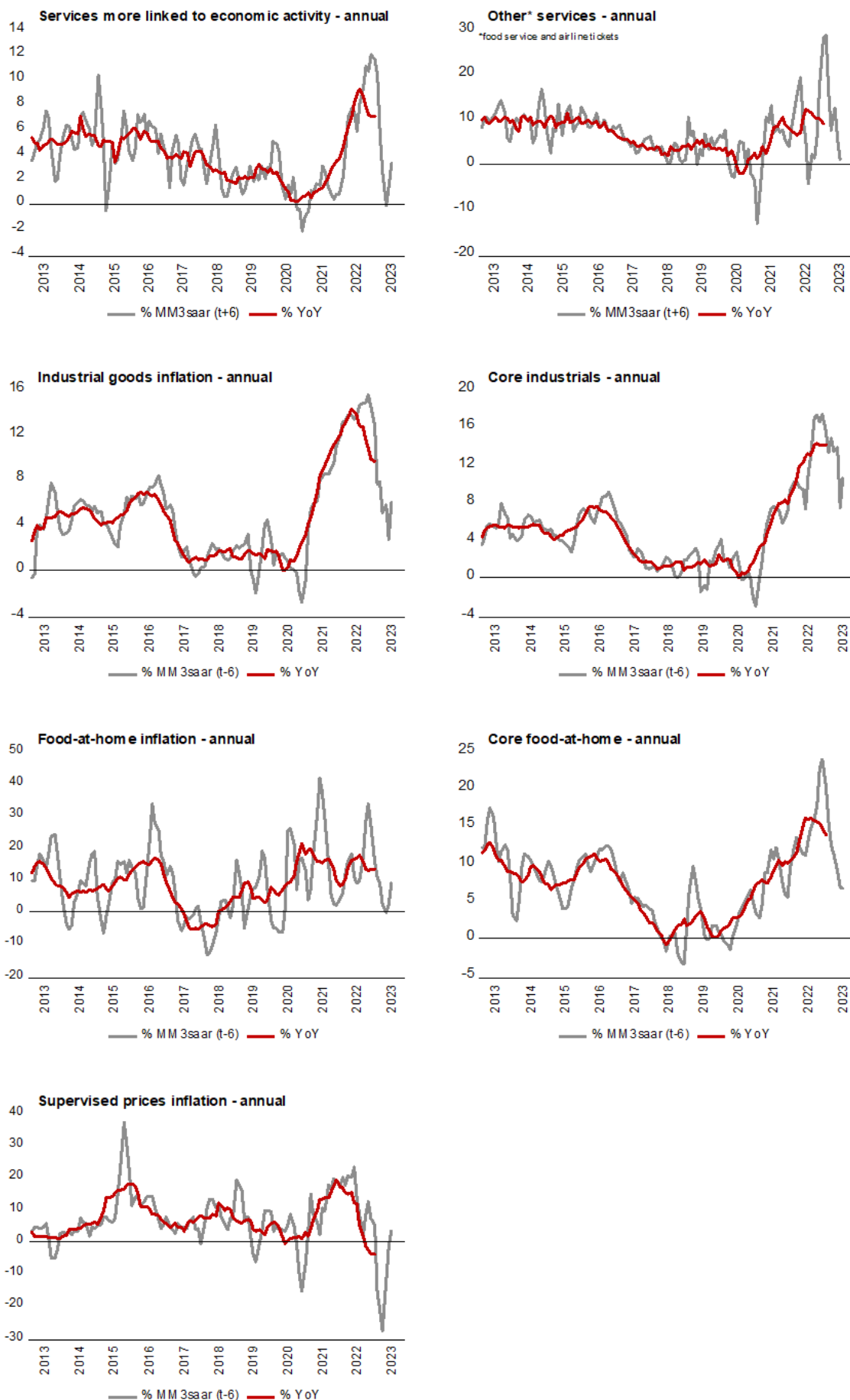
Figure 2. IPCA, Groups and Qualitative Measures (continued)



Sources for all charts: IBGE and Santander.



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