Glass Half Full: Broad Core Gauges Improve; Glass Half Empty: Core Services Deteriorate

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- **The IPCA fell 0.08% MoM in June, above the consensus estimate (-0.10%) and our forecast (-0.14%). The YoY change decelerated to 3.16% (from 3.9% in May), the lowest reading since September 2020.**
- **Overall, broad qualitative measures continued to improve at the margin. Four out of the five main cores followed by the BCB decelerated at the margin, with the average reaching 4.7% 3MMA-saar (from 5.4%). Additionally, the diffusion index fell to 52.9% s.a. (from 56.6%), a level compatible with inflation below 4.0% in the medium term.**
- **On the negative side, services and all its components, except for telecom, deteriorated at the margin. Moreover, the EX3 core increased slightly.**
- **All in all, the print continues to show that inflation is improving at the margin, but with its stickier part (mainly services) with a worse dynamic, as pointed above. In annual terms, IPCA should begin to rise again in 12-month terms in July due to base effects. Our tracking was kept unchanged at 4.9% for IPCA 2023 and 3.9% for IPCA 2024.**
- **As for the main risk we were seeing, the de-anchoring of inflation expectations, the scenario has improved, with a partial re-anchoring of expectations.**
- **For monetary policy, the combination of a partial re-anchoring of long-term expectations, alongside the uneven improvement of current inflation, reinforces our call for a cautious beginning of the easing cycle by -25 bps in August.**

The IPCA fell 0.08% MoM in June, above the consensus estimate (-0.10%) and our forecast (-0.14%). The YoY change decelerated to 3.16% (from 3.9% in May), the lowest reading since September 2020. The headline trend (3MMA-saar) decelerated to 5.3% (from 5.9%).

In the breakdown, monitored prices came in line with expectations, food-at-home surprised downward (contributing -3 bps to the headline forecast error), while industrial goods and services surprised upward (contributing +6 bps and +3 bps, respectively). For industrial goods, the surprise was led by new cars, in which the discounts form the government-supported policy did not kick in as much as we expected. The uncertainty now is whether it is taking longer to be seen in the CPI print or it will not impact as much as expected (we are leaning more toward the latter).

Overall, broad qualitative measures continued to improve at the margin. Industrial goods core fell again, reaching 4.4% 3MMA-saar (from 4.9%). Four out of the five main cores followed by the BCB decelerated at the margin, with the average reaching 4.7% 3MMA-saar (from 5.4%). Additionally, the diffusion index fell to 52.9% s.a. (from 56.6%), a level compatible with inflation below 4.0% in the medium term.

On the negative side, services and all its components, except for telecom, deteriorated at the margin. Moreover, the EX3 core increased slightly. In numbers, services core accelerated to 6.8% 3MMA-saar (from 6.1%), inertial services advanced to 7.3% 3MMA-saar (from 6.1%), services linked to activities increased to 5.3% 3MMA-saar (from 3.3%), and services linked to wages rebounded to 5.6% 3MMA-saar (from 4.1%). Thus, the EX3, which encompasses services core and industrial goods core, moved up to 5.8% 3MMA-saar (from 5.7%). Both gauges are closely followed by the BCB as they tend to capture more of the dynamic of cyclical (or more monetary policy-linked) prices.

All in all, the print continues to show that inflation is improving at the margin, but with its stickier part (mainly services) with a worse dynamic, as pointed above. Looking ahead, we project that there is still room for further relief in volatile prices, mainly the ones related to commodity prices in BRL terms. As for stickier, more core-related prices, we also see a downward trend, but at a slower pace, as the tight job market tends to keep services prices high. In annual terms, IPCA should begin to rise again in 12-month terms in July due to base effects. Our tracking was kept unchanged at 4.9% for IPCA 2023 and 3.9% for IPCA 2024.

As for the main risk we were seeing, the de-anchoring of inflation expectations, the scenario has improved. L**ong-term expectations fell between -40 to -50 bps in the last few weeks** (in line with the estimates we showed in the report *How Much Could Inflation Expectations Fall If the Target Is Reaffirmed at 3.0%?"*[1]*,* May 23, 2023"), coming from a peak of 4.0% to 3.5%, although this level is still +50 bps above the 3.0% target.

For monetary policy, the combination of a partial re-anchoring of long-term expectations, alongside the uneven improvement of current inflation (broad core gauges decelerating, but core services accelerating) reinforces our call for a cautious beginning of the easing cycle by -25 bps in August, leaving Selic at 13.50% p.y. (and should reduce the market's discussion of a possibility of a -50 bps cut).

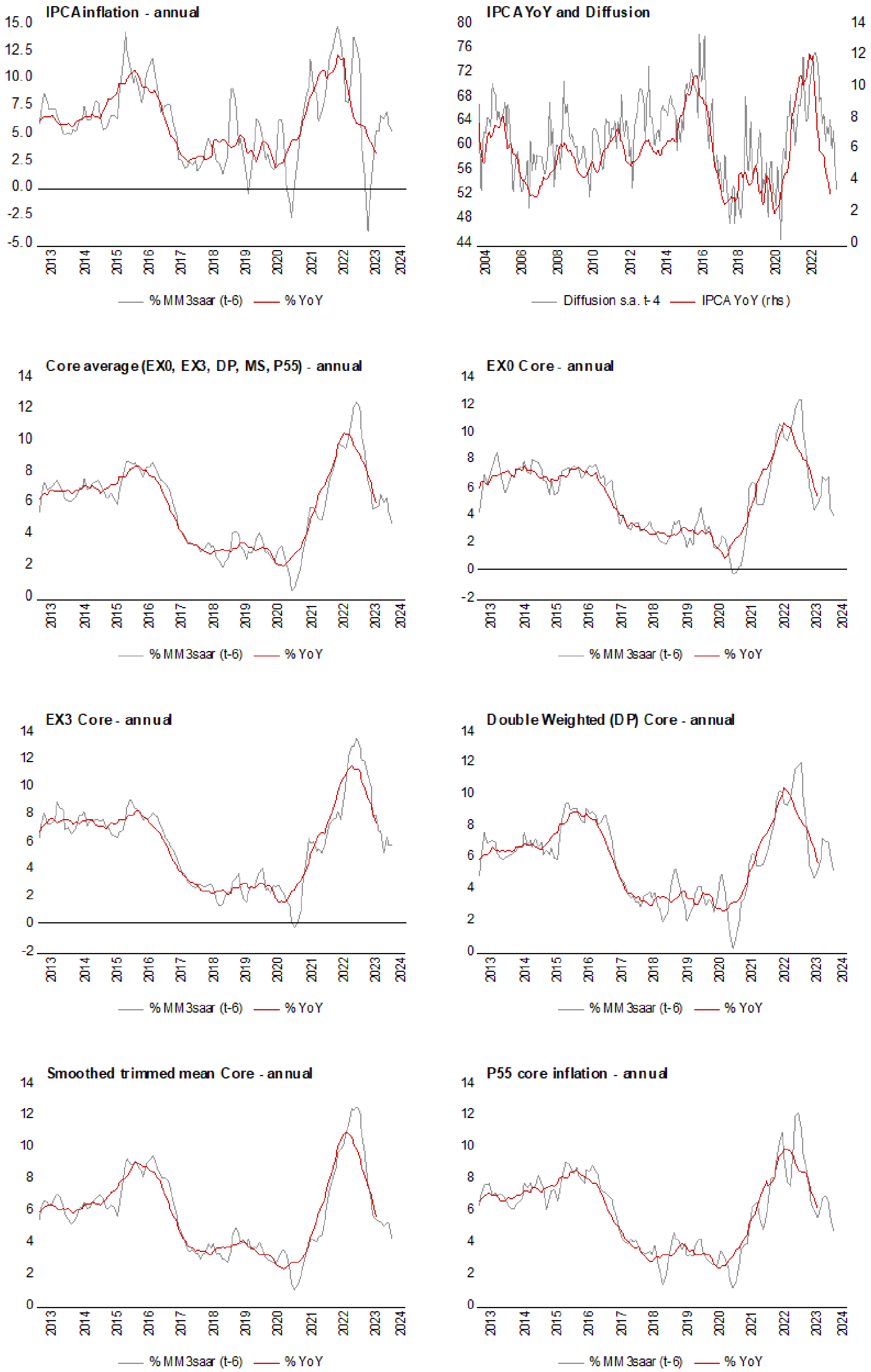
[1] **Santander Brazil Special Report: "How Much Could Inflation Expectations Fall if the Target is Reaffirmed at 3.0%?"** – May 23, 2023 – Available on: https://bit.ly/Std-special-052323

Figure 1. June's IPCA Details (%)

	MoM			YoY	
	Jun-23	Santander	Contrib.	May-23	Jun-23
IPCA	-0.08	-0.14	0.06	3.9	3.2
Food and beverage	**-0.66**	**-0.58**	**-0.02**	**5.5**	**4.0**
Food-at-home	-1.07	-0.89	-0.03	4.6	2.9
Food service	0.46	0.25	0.01	8.0	7.2
Housing	**0.69**	**0.71**	**0.00**	**4.0**	**4.3**
Electrical energy	1.43	1.47	0.00	-1.3	1.2
Household articles	**-0.42**	**0.08**	**-0.02**	**1.8**	**0.8**
Apparel	**0.35**	**0.48**	**-0.01**	**11.1**	**9.7**
Transportation	**-0.41**	**-0.92**	**0.10**	**-4.8**	**-5.7**
Airline tickets	10.96	10.70	0.00	4.3	4.0
Gasoline	-1.14	-1.70	0.03	-26.5	-26.8
Health and personal care	**0.11**	**0.05**	**0.01**	**11.6**	**10.4**
Personal spending	**0.36**	**0.29**	**0.01**	**7.1**	**7.0**
Education	**0.06**	**0.05**	**0.00**	**8.3**	**8.3**
Communication	**-0.14**	**0.00**	**-0.01**	**0.7**	**0.4**
Administered	0.06	0.04	0.00	-0.9	-1.3
Free	-0.13	-0.20	0.06	5.7	4.8
Food-at-home	-1.07	-0.89	-0.03	4.6	2.9
Industrial goods	-0.60	-0.84	0.06	5.2	4.0
Services	0.62	0.55	0.03	6.5	6.2
EX3 Core	0.42	0.34	0.03	8.0	7.4
Average of cores	0.20	0.18	-	6.7	-

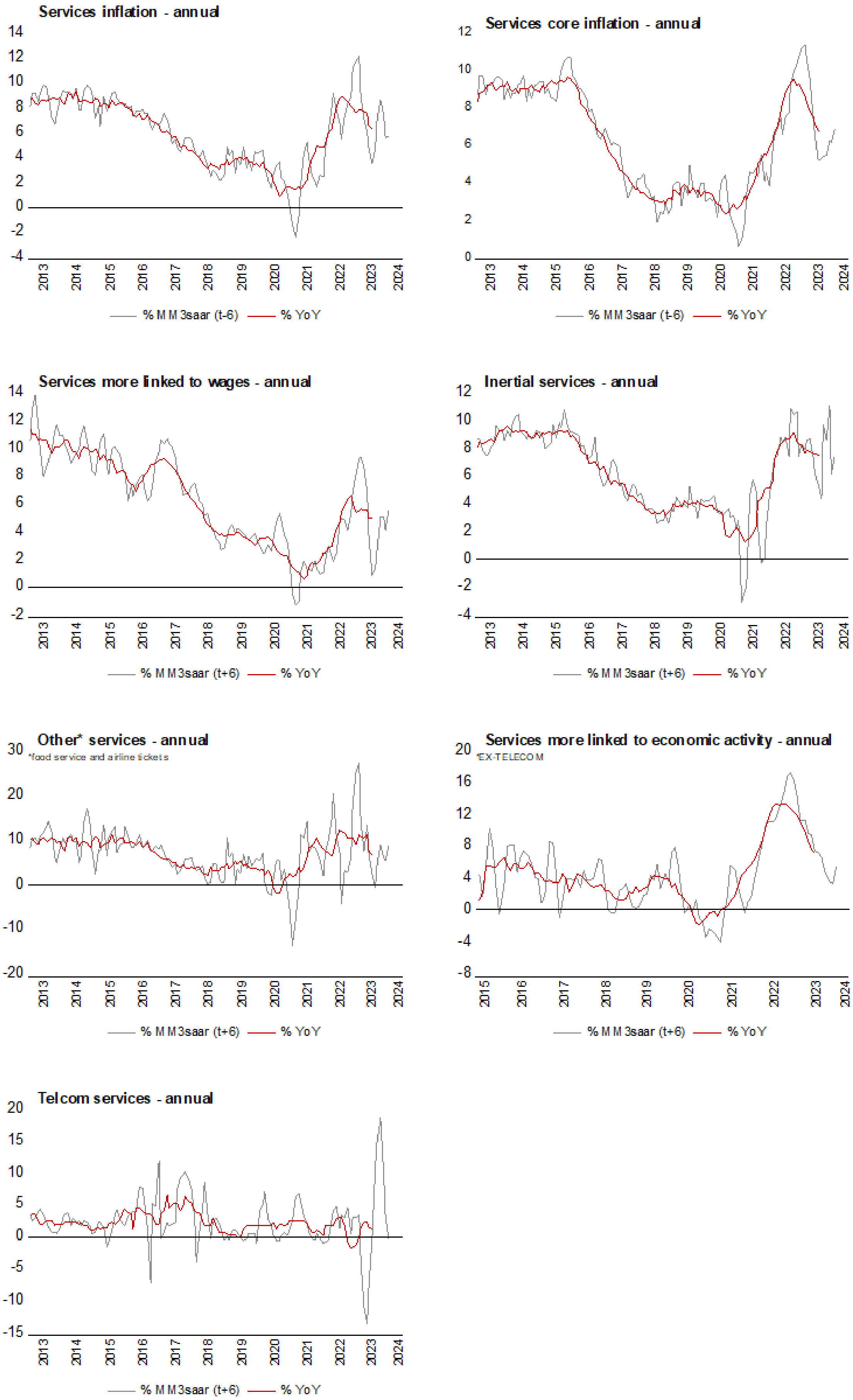
Sources: Brazilian Central Bank, IBGE, Santander.

Figure 2. IPCA, Groups and Qualitative Measures



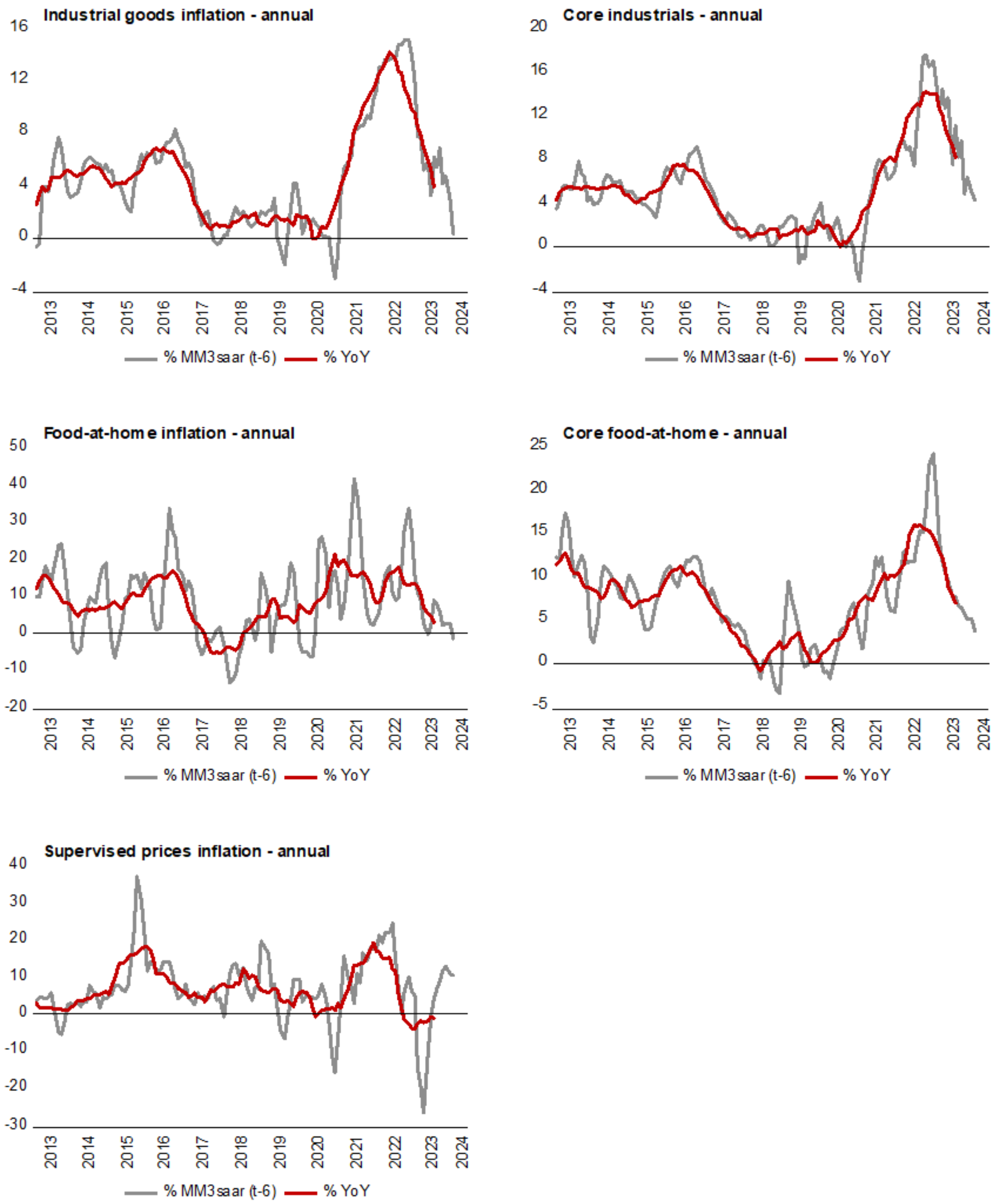
Sources for all charts: IBGE and Santander.

Figure 3. IPCA, Groups and Qualitative Measures



Sources for all charts: IBGE and Santander.

Figure 4. IPCA, Groups and Qualitative Measures



Sources for all charts: IBGE and Santander.

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