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Core Measures Improving; Headline Deteriorating

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- **IPCA-15 rose 0.55% MoM in January, slightly above both, the consensus estimate of 0.51% and our forecast of 0.52%. The YoY change was stable at 5.9%. The trend (3MMA-saar) has been rebounding as (i) the downward effect of the tax cuts is fading and (ii) the Black Friday-related prices are starting to recover after the sales — reaching 4.6% 3MMA-saar (from 2.4%).**
- **In the breakdown, the biggest upward surprise came in services. The deviation was mostly concentrated in communication's services and airline tickets, both items that tend to be volatile, and hence we do not see it as a major sign of worry for services inflation. Regulated prices also surprised slightly upwards, with vehicles licensing as the highlight. On the other hand, industrial goods and food-at-home were downward surprises.**
- **Broad qualitative measures saw another marginal improvement. The EX3 core gauge, which correlates the most with the output gap and was more resilient at high levels recently, saw a sharper drop to 5.7% 3MMA-saar (from 6.7%)—this happened even with the rebound of prices after the Black Friday sales. Even the diffusion index—that had stopped improving in the past couple of readings—resumed the downward trend and reached 58.1% s.a. (from 62.8%); despite the improvement, the level still surpasses the average for the years of low inflation (2017-2020).**
- **All in all, we are currently seeing a dichotomy: core measures are continuing to improve (with some favorable surprises at the margin), while headline inflation and medium-term expectations are deteriorating. We are revising our IPCA 2023 tracking to 5.9% (from 5.6%) given the surprise in vehicles licensing (vehicles licensing's pricing trend seen in January will continue through the year) and the adjustment in gasoline inflation (it was recently announced that prices at the refineries were adjusted). We are also revising our IPCA 2024 tracking to 3.7% (from 3.5%) on the back of a stronger impact from inertia.**

IPCA-15 rose 0.55% MoM in January, slightly above both, the consensus estimate of 0.51% and our forecast of 0.52%. The YoY change was stable at 5.9%. The trend (3MMA-saar) has been rebounding as (i) the downward effect of the tax cuts is fading and (ii) the Black Friday-related prices are recovering after the sales — reaching 4.6% 3MMA-saar (from 2.4%),.

In the breakdown, the biggest upward surprise came in services (contributing + 6 bps to the headline error). The deviation was mostly concentrated in communication's services and airline tickets, both items that tend to be volatile, and hence we do not see it as a major sign of worry for services inflation. Regulated prices also surprised slightly upwards (+2 bps), vehicles licensing as the highlight, because the methodology for this item implies that the yearly adjustment done in January (21%) is simply distributed throughout the year, adding around +30 bps of upward adjustment in our IPCA 2023 forecast. On the other hand, industrial goods (-3 bps) and food-at-home (-1 bp), surprised downwards.

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In trend terms, headline services were mostly stable at 3.2% 3MMA-saar (from 3.0%), but the core decelerated further to 3.9% (from 4.8%). It is worth mentioning that the services' sub-groups that we consider more important to assess the quality of inflation continued decelerating: inertial services 3.1% 3MMA-saar from 4.7%, services more linked to economic activity 5.1% 3MMA-saar from 6.0%, and services more linked to wages did not decelerate, but remained stable at the very low level of 0.7% 3MMA-saar (from 0.3%). Additionally, volatile services also decelerated to -2% 3MMA-saar (from 3.0%). Therefore, the only subgroup actually pressuring services inflation was communication, reaching 10.9% 3MMA-saar (from -0.8% and a trough of -14.2% 3MMA-saar after the tax cuts).

Industrial goods trend rose to 6.6% 3MMA-saar (from 4.8%), but its core decelerated to 8.5% 3MMA-saar (from 9.1% previously). It is worth noting that durable goods continued in the negative camp, at -0.9% 3MMA-saar (from -2.7%) and semi-durable goods (that were being stickier) cooled down to 9.8% 3MMA-saar (from 11.9%). The only industrial goods' subgroup really pressuring the sector was non-durable goods, that reached 12.7% 3MMA-saar (from 9.0%), due to the fact that this subgroup encompasses a great part of the most volatile (Black Friday-related items), like perfume and make-up.

Food-at-home accelerated just to 3.0% 3MMA-saar (from 2.0%), while its core softened to 6.5% 3MMA-saar (from 6.8%). Also, regulated prices continued to "normalize" after the tax cut effects fades, reaching 6.0% 3MMA-saar (from 1.0%).

Broad qualitative measures saw another marginal improvement. Although the average of the main core gauges is still at a high level if compared to the Brazil Central Bank's (BCB) mid-target, the deceleration trend has been robust, as the gauge reached 5.0% 3MMA-saar now (from 5.1%), the sixth month in a row that it has run below the YoY change (8.7% YoY). The EX3 core gauge, the one which correlates the most with the output gap and was more resilient at high levels recently, saw a sharper drop to 5.7% 3MMA-saar (from 6.7%)—this happened even with the rebound of prices after the Black Friday sales. Even the diffusion index—that had stopped improving in the past couple of readings—resumed the downward trend and reached 58.1% s.a. (from 62.8%), despite the improvement, the level still surpasses the average for the years of low inflation (2017-2020).

All in all, we are currently seeing a dichotomy: core measures continue improving (with some favorable surprises at the margin), while headline inflation and medium-term expectations are deteriorating. We are revising our IPCA 2023 tracking to 5.9% (from 5.6%) given the surprise in vehicles licensing (vehicles licensing's pricing trend seen in January will continue through the year) and the adjustment in gasoline inflation (it was recently announced that prices at the refineries were adjusted). We are also revising our IPCA 2024 tracking to 3.7% (from 3.5%) on the back of a stronger impact from inertia.



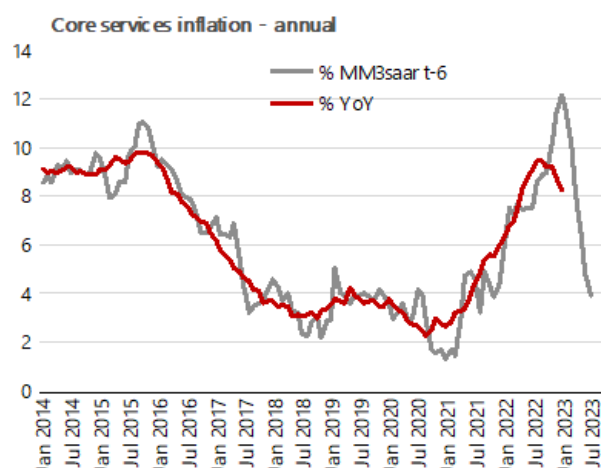
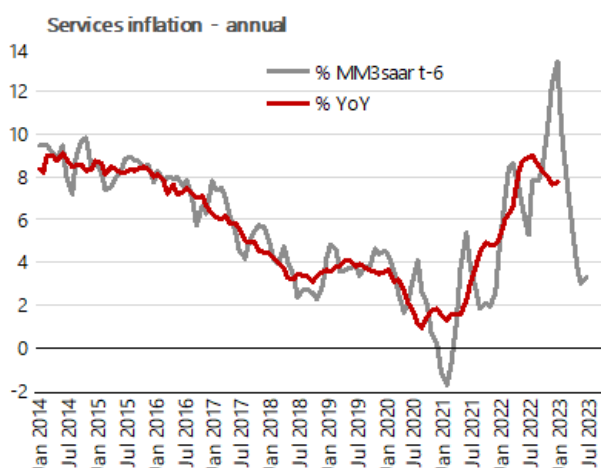
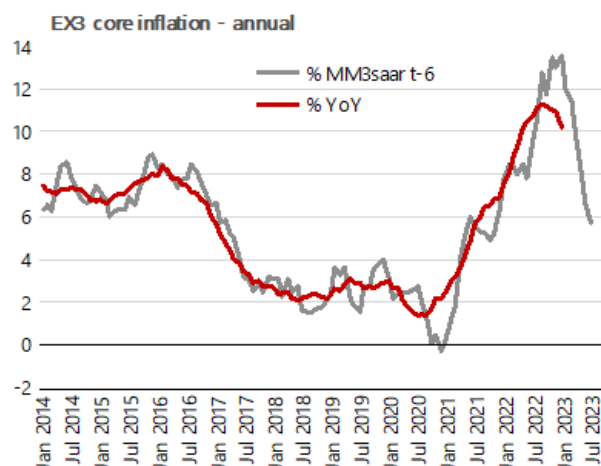
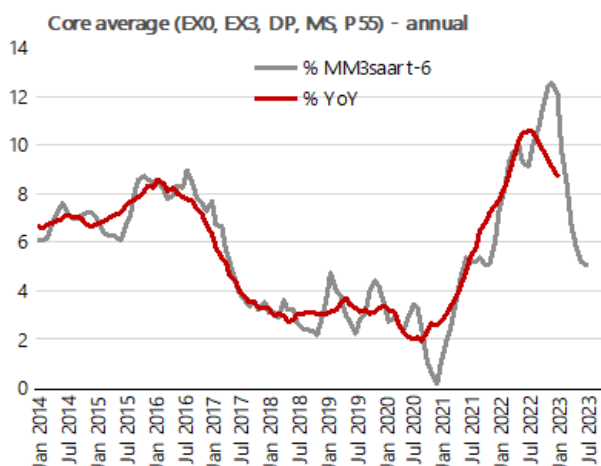
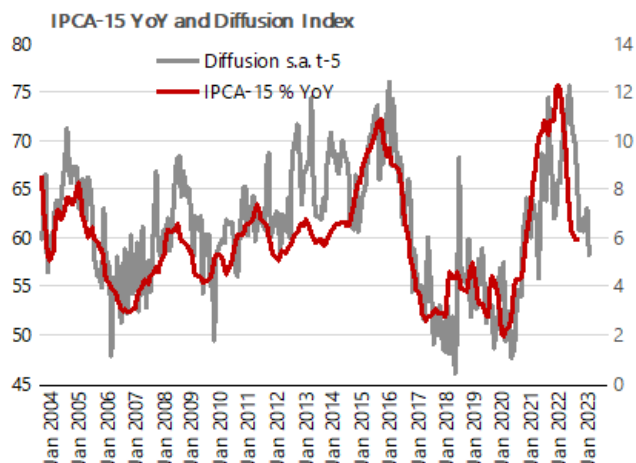
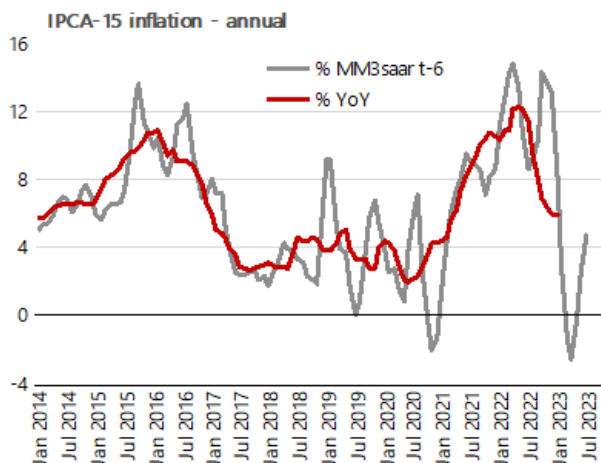
Figure 1. January's IPCA-15 Details (%)

	MoM		Desv.	YoY		3MMA-saar	
	Jan-23	Santander		Dec-22	Jan-23	Dec-22	Jan-23
IPCA-15	0.55	0.52	0.03	5.9	5.9	2.4	4.6
Food and beverage	0.55	0.67	-0.03	12.0	11.5		
Food-at-home	0.61	0.69	-0.01	13.6	13.1	2.0	3.0
Food service	0.39	0.62	-0.01	8.0	7.5		
Housing	0.17	0.19	0.00	0.2	-0.2		
Electrical energy	-0.16	-0.50	0.01	-18.7	-18.8		
Household article	0.38	0.63	-0.01	8.4	7.3		
Apparel	0.42	0.80	-0.02	18.4	17.2		
Transportation	0.17	0.13	0.01	-1.0	-0.4		
Airline tickets	-0.22	-6.00	0.04	24.0	51.3		
Gasoline	-0.59	-0.30	-0.01	-25.5	-24.6		
Health and personal	1.10	1.13	0.00	11.2	11.4		
Personal spending	0.57	0.70	-0.01	7.6	7.5		
Education	0.36	0.14	0.01	7.4	7.5		
Communication	2.36	0.56	0.09	-1.2	0.1		
Administered	0.34	0.24	0.02	-3.7	-3.0	1.0	6.0
Free	0.62	0.61	0.01	9.5	9.2		
Food-at-home	0.61	0.69	-0.01	13.6	13.1	2.0	3.0
Industrial goods	0.69	0.83	-0.03	9.7	8.9	4.8	6.6
Services	0.58	0.42	0.06	7.6	7.7	3.0	3.2
EX3 Core	0.66	0.80	-0.05	10.9	10.2	6.7	5.7
Average of cores	0.58	-		9.1	8.7	5.1	5.0

Sources: Brazilian Central Bank, IBGE, Santander.



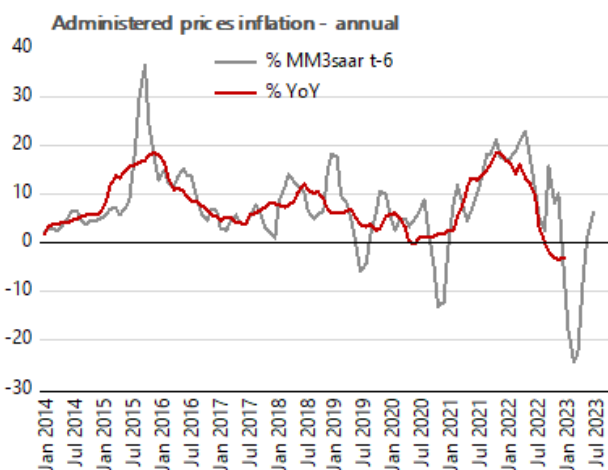
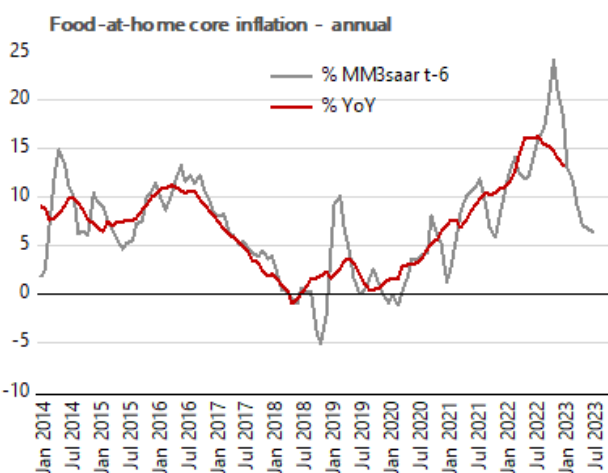
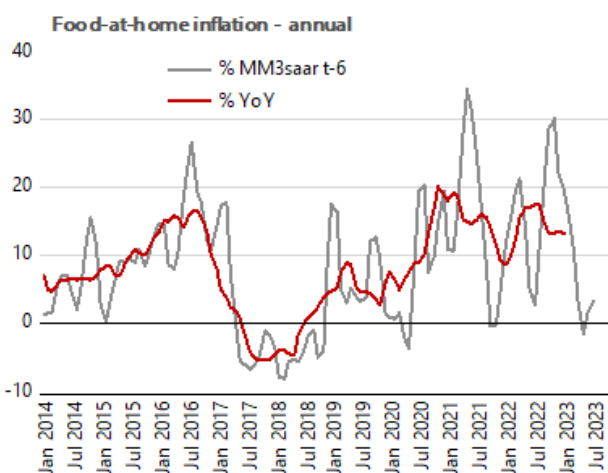
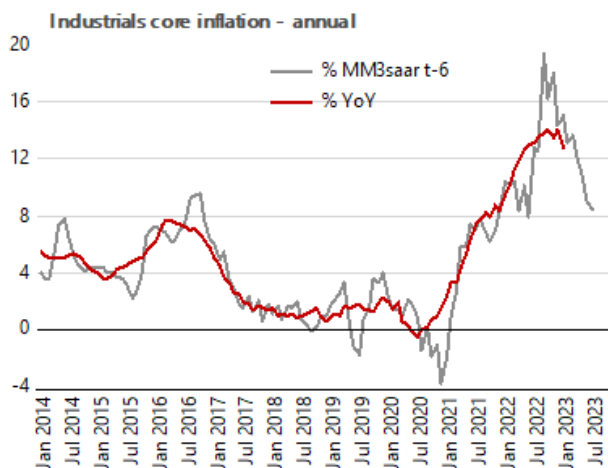
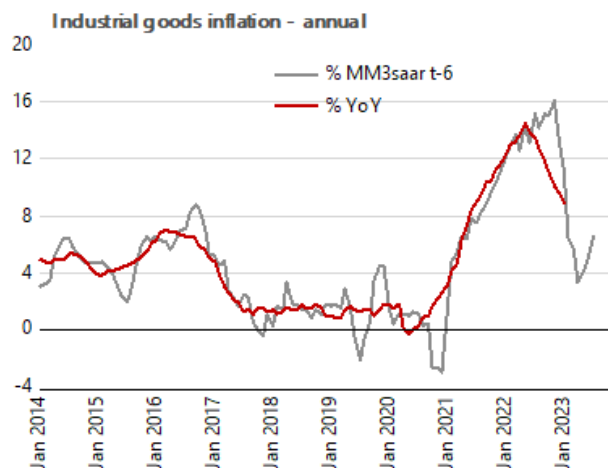
Figure 2. IPCA, Groups and Qualitative Measures



Sources for all charts: IBGE and Santander.



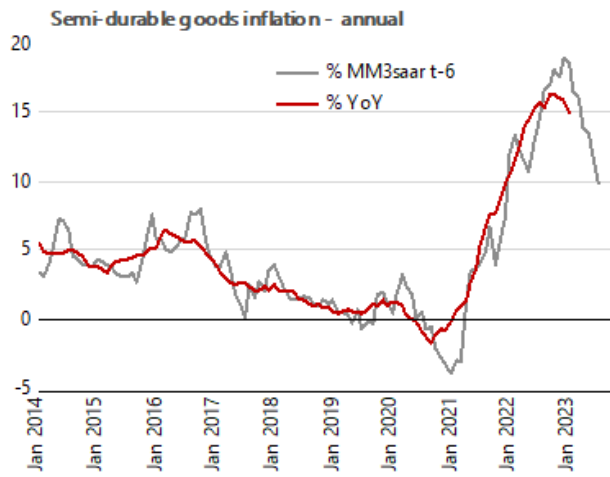
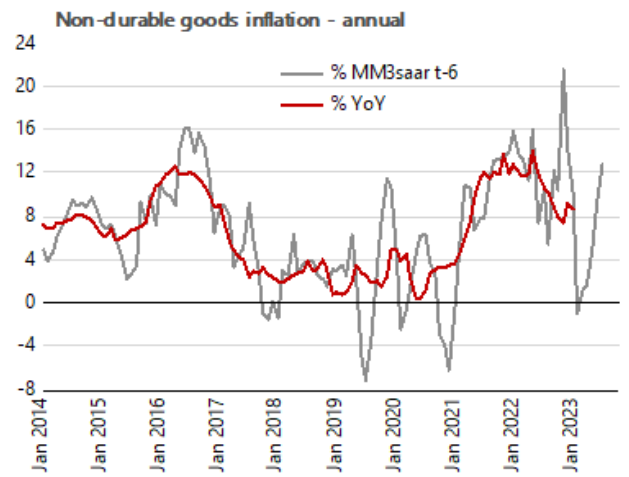
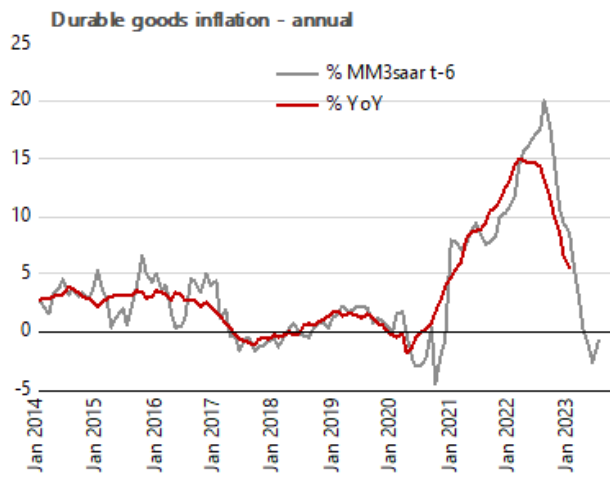
Figure 3. IPCA, Groups and Qualitative Measures (continued)



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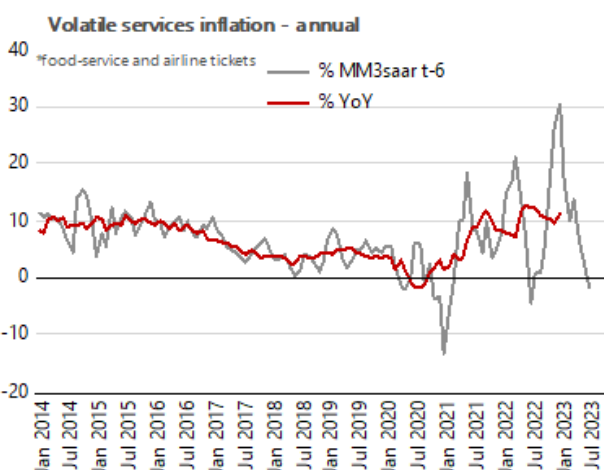
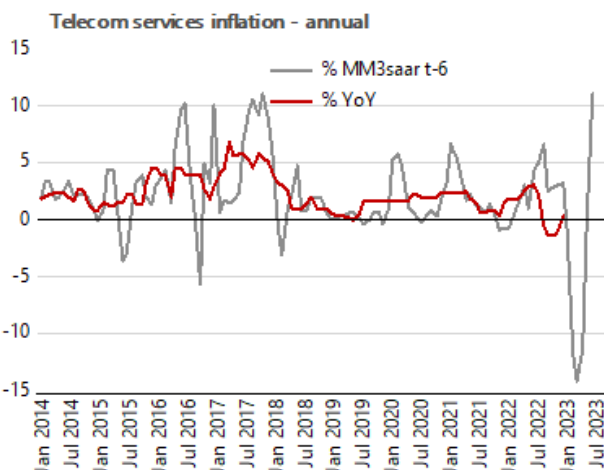
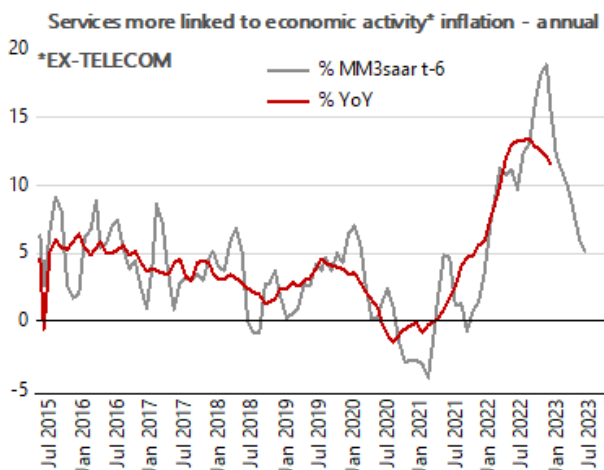
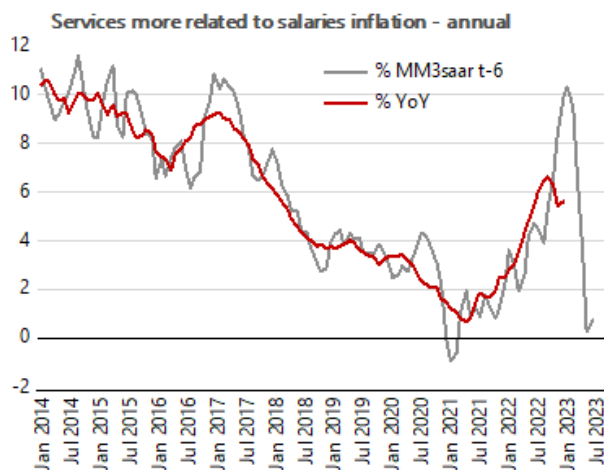
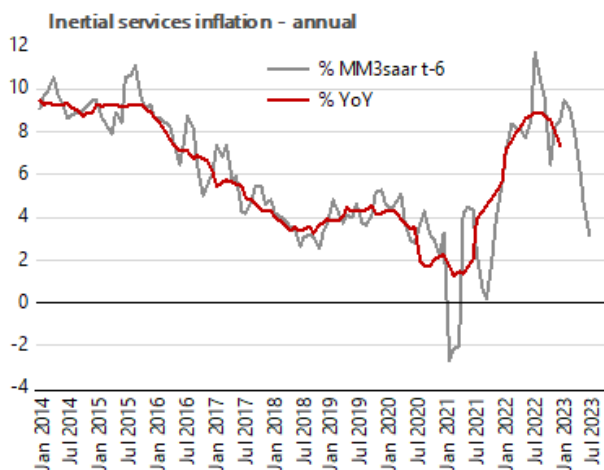
Figure 4. IPCA, Groups and Qualitative Measures (continued)



Sources for all charts: IBGE and Santander.



Figure 5. IPCA, Groups and Qualitative Measures (continued)



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