



July IPCA: Composition Worsens Again, with Underlying Inflation Deteriorating Further

Daniel Karp*
daniel.karp@santander.com.br
+5511 3553 9828

- July's IPCA registered a 0.96% MoM change (8.99% YoY), in line with our call and consensus, both at 0.95%.
- There were no major surprises in the main groups, but it does not mean that results were favorable in terms of inflation dynamics, as core gauges deteriorated further.
- In particular, services core inflation accelerated to 6.1% 3MMA-saar, while the average of the main broad cores followed by the BCB rose even higher, to 7.6% 3MMA-saar. The diffusion index also stood at the high level of 69.1%.
- For now, we are keeping our high-frequency tracking at 7.3% for IPCA 2021 and 4.1% for IPCA 2022, but we are seeing upside risks for both horizons.

Inflation Composition Continues to Worsen, with Services Accelerating While Industrial Goods Remain Under Upward Pressure

July's IPCA registered a 0.96% MoM change (8.99% YoY), in line with our call and consensus, both at 0.95%. The headline accelerated further to 10.6% in 3MMA-saar terms, providing evidence of the upward pressure remaining strong at the margin.

There were no major surprises in the main groups. Services contributed just -1 bp to the headline forecast error, while food contributed +1 bp, industrial goods -1 bp and regulated prices +3 bps. However, this does not mean that results were favorable in terms of inflation dynamics for each group. Industrial goods remained under strong pressure, accelerating from 12.1% to 12.5% 3MMA-saar, while services — that used to be the bright side a few months ago — accelerated from 2.7% to 5.1% 3MMA-saar. More importantly, despite a small downside surprise (driven by food-service), services' core also accelerated to the considerably high level of 6.1% from 4.2% 3MMA-saar. It is worth remembering that the BCB is watching this measure closely to decide the next steps of monetary policy. Food also went up to 6.0% 3MMA-saar, which despite being well below the annual measure (signaling some deceleration further ahead), is not a low level (and it is the second month of acceleration in a row). Finally, administered prices stood still at 16% 3MMA-saar.

Qualitative measures deteriorated further at the margin, reinforcing our view of an unfavorable inflation outlook for the short term (and our call for another 100-bp Selic hike in the next Copom meeting). All of the five main core gauges rose further at the margin, with the average of them going from the already high level of 6.7% to 7.6% in 3MMA-saar terms, and it has been hovering above the target (and distancing further from it) for 10 months now. This is evidence of primary shocks spreading (commodities, FX, supply chain disruption, etc.) to the general prices and the persistency at these high levels is risky. Also in the same tone, the diffusion index, which is a leading indicator of annual inflation, remained at the high level of 69.1% (seasonally adjusted) — a reading we see compatible with an IPCA of -10.0% YoY a few months from now. The diffusion is also another sign of the spreading of shocks.

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Forecasts Remain Well Above the BCB's Target and Risks Continue Tilted to the Upside

Our worries regarding the inflation outlook keep piling up for two key reasons: (i) We see a large backlog of prices at the wholesale level that should still come to the consumers; and (ii) we are seeing the second-order effects (primary shocks spreading to general prices) getting stronger, which could worsen once the economy picks up as the pandemic starts to fade (especially in services). In particular, we are already seeing services inflation picking up, while industrial goods inflation remains upwardly pressured at the margin, which is an unfavorable composition for IPCA inflation (both groups are closely related to core measures).

For now we are keeping our high-frequency tracking at 7.3% for IPCA 2021 and 4.1% for IPCA 2022, but we are seeing upside risks for both horizons. It is worth remembering that the BCB's target is 3.75% for 2021 ($\pm 1.50\%$ tolerance interval) and 3.50% for 2022 (same tolerance interval), and our forecasts are above the targets for both years.

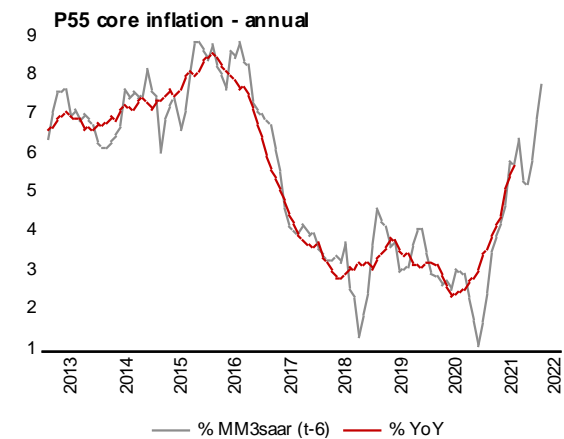
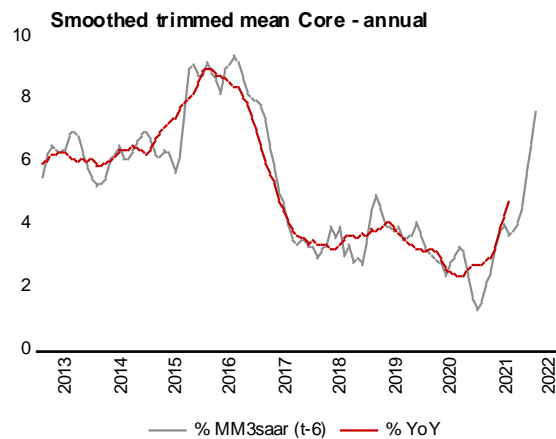
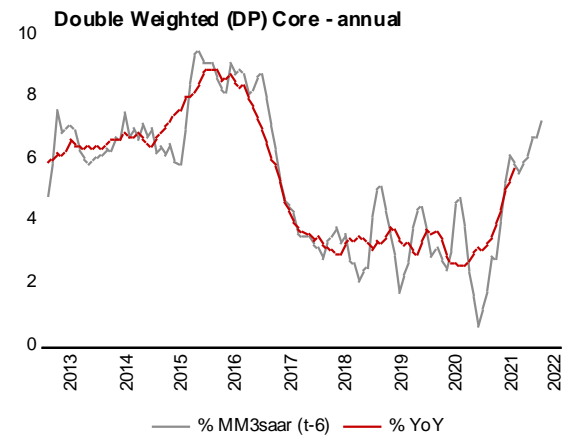
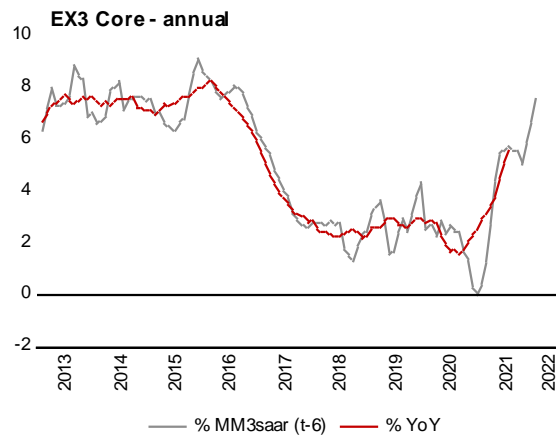
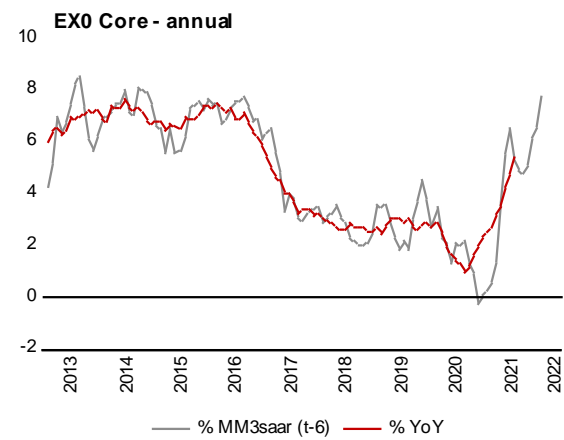
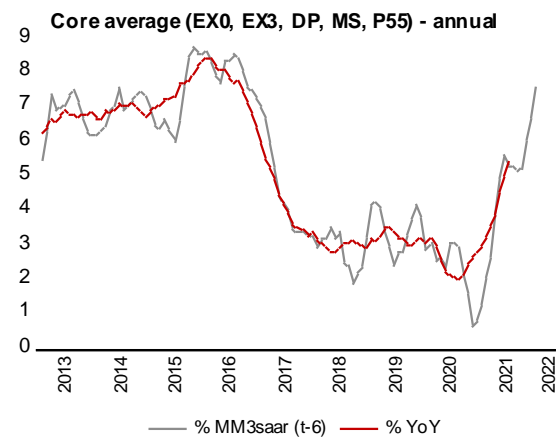
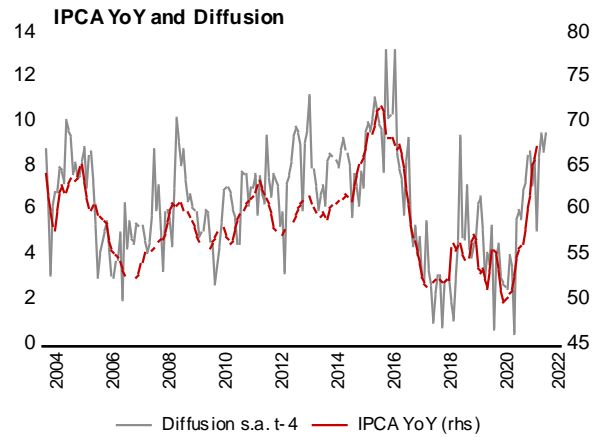
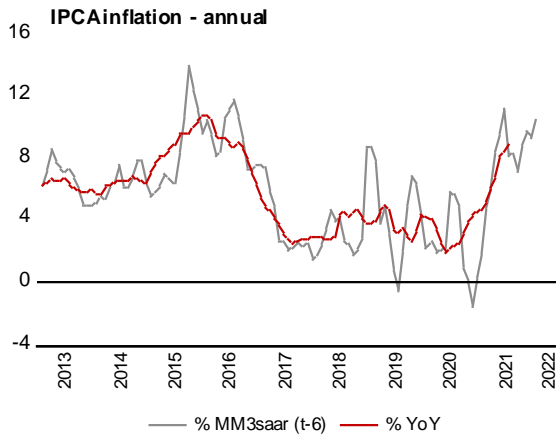
Figure 1. IPCA by Group and Forecasting Errors

	MoM			YoY	
	Jul-21	Santander	Contrb.	Jun-21	Jul-21
IPCA	0.96	0.95	0.01	8.3	9.0
Food and beverage	0.60	0.74	-0.03	12.6	13.3
Food-at-home	0.78	0.84	-0.01	15.3	16.0
Food service	0.14	0.50	-0.02	6.2	6.7
Housing	3.10	3.03	0.01	8.7	11.2
Electrical energy	7.88	7.90	0.00	14.2	20.1
Household articles	0.78	0.72	0.00	12.4	12.2
Apparel	0.53	0.41	0.01	4.1	5.2
Transportation	1.52	1.13	0.08	15.1	15.9
Airline tickets	35.22	35.64	0.00	1.2	42.9
Gasoline	1.55	0.90	0.04	42.2	39.7
Health and personal care	-0.65	-0.05	-0.08	4.3	3.2
Personal spending	0.45	0.36	0.01	1.9	2.5
Education	0.18	0.13	0.00	-1.1	-0.8
Communication	0.12	0.03	0.00	2.2	1.8
Administered	1.68	1.58	0.03	13.0	13.5
Free	0.70	0.72	-0.01	6.8	7.4
Food-at-home	0.78	0.84	-0.01	15.3	16.0
Industrial goods	0.69	0.65	0.01	8.8	9.2
Services	0.67	0.70	-0.01	2.2	3.0
EX3 Core	0.54	0.65	-0.11	5.1	5.6
Average of cores	0.59	-	-	5.0	5.5

Sources: IBGE and Santander.



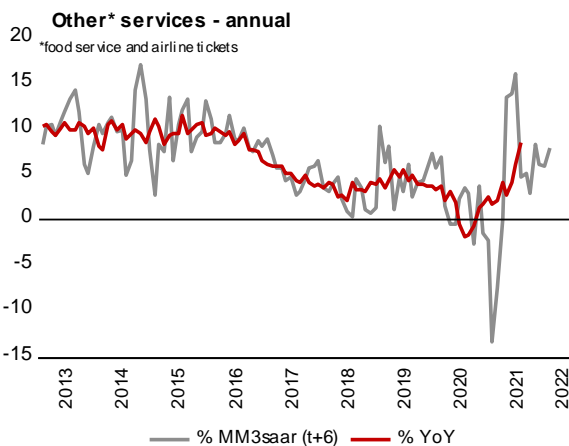
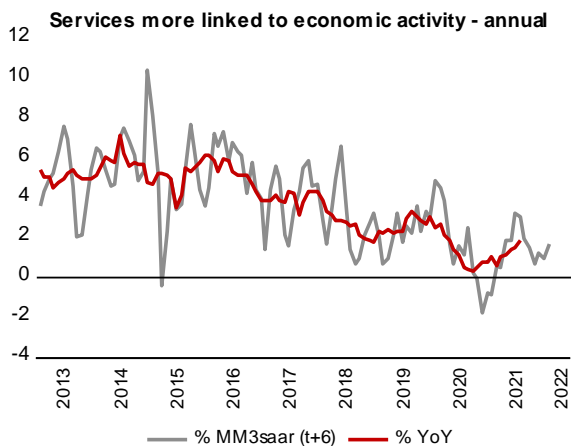
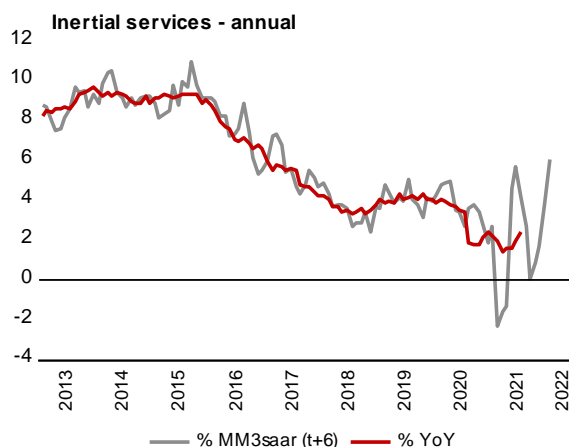
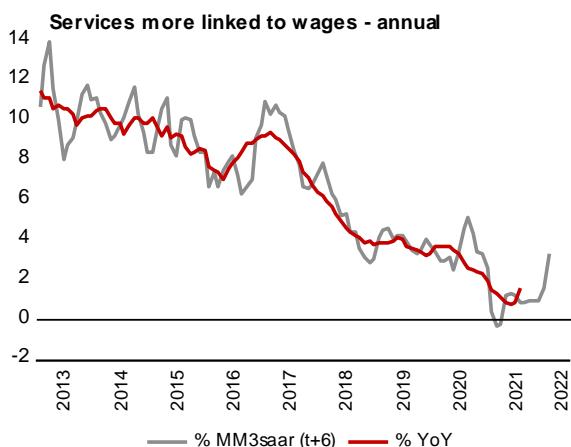
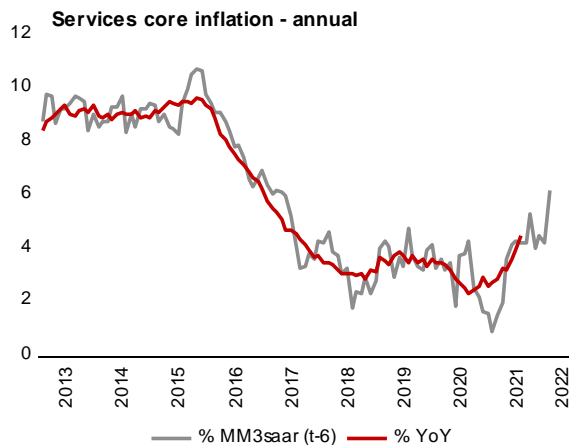
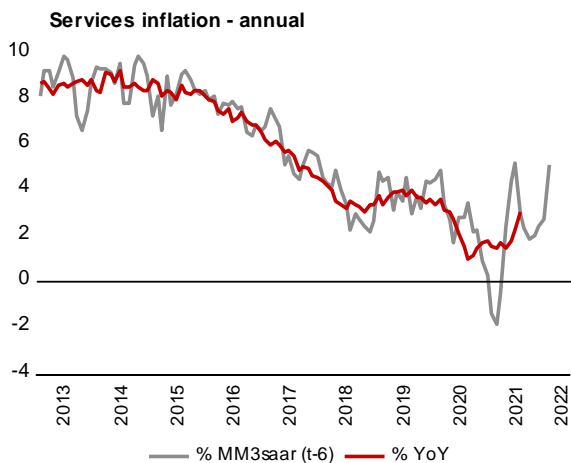
Figure 2. IPCA, Groups and Qualitative Measures



Sources for all charts: IBGE and Santander.



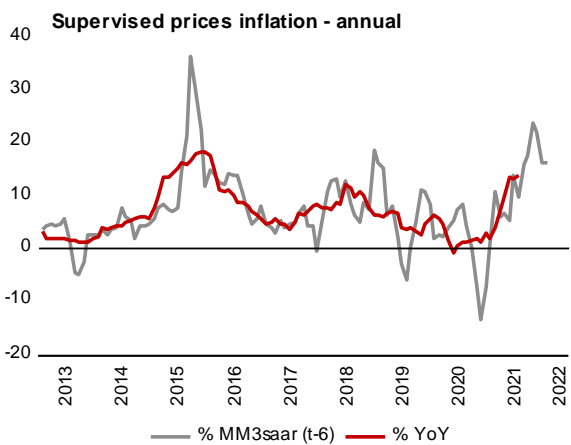
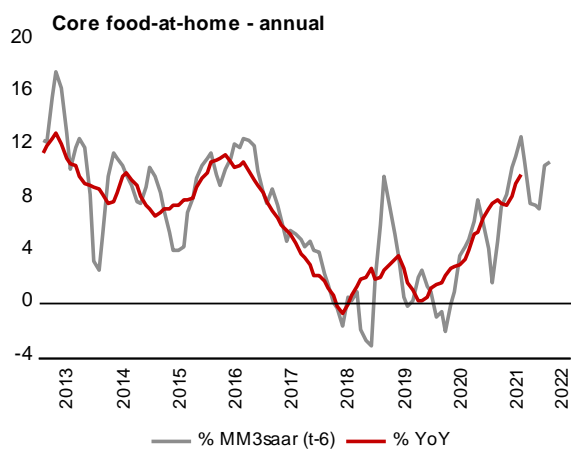
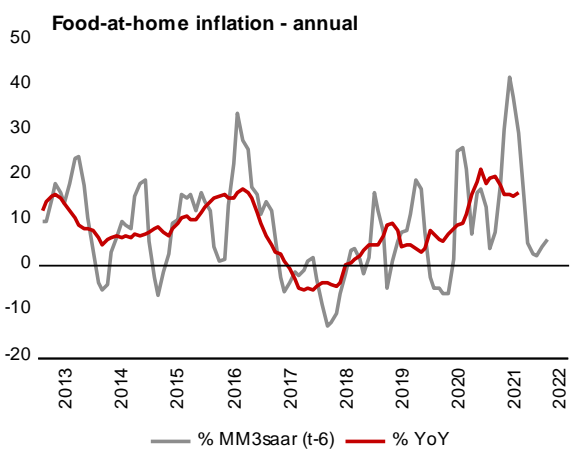
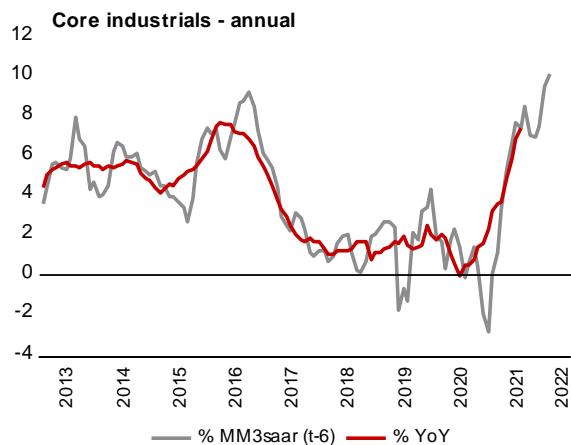
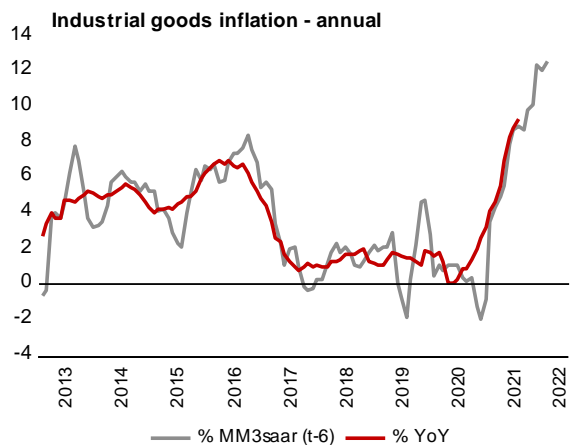
Figure 3. IPCA, Groups and Qualitative Measures continuation



Sources for all charts: IBGE and Santander.



Figure 4. IPCA, Groups and Qualitative Measures continuation



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CONTACTS / IMPORTANT DISCLOSURES

Brazil Macro Research

Ana Paula Vescovi*	Chief Economist	anavescovi@santander.com.br	5511-3553-8567
Mauricio Oreng*	Head of Macro Research	mauricio.oreng@santander.com.br	5511-3553-5404
Jankiel Santos*	Economist – External Sector	jankiel.santos@santander.com.br	5511-3012-5726
Ítalo Franca*	Economist – Fiscal Policy	italo.franca@santander.com.br	5511-3553-5235
Daniel Karp*	Economist – Inflation	daniel.karp@santander.com.br	5511-3553-9828
Tomas Urani*	Economist – Global Economics	tomas.urani@santander.com.br	5511-3553-9520
Lucas Maynard*	Economist – Economic Activity	lucas.maynard.da.silva@santander.com.br	5511-3553-7495
Felipe Kotinda*	Economist – Credit	felipe.kotinda@santander.com.br	5511-3553-8071
Gabriel Couto*	Economist – Special Projects	gabriel.couto@santander.com.br	5511-3553-8487
Gilmar Lima*	Economist – Modeling	gilmar.lima@santander.com.br	5511-3553-6327

Global Macro Research

Maciej Reluga*	Head Macro, Rates & FX Strategy – CEE	maciej.reluga@santander.pl	48-22-534-1888
Juan Cerruti *	Senior Economist – Argentina	jcerruti@santander.com.ar	54 11 4341 1272
Ana Paula Vescovi*	Economist – Brazil	anavescovi@santander.com.br	5511-3553-8567
Juan Pablo Cabrera*	Economist – Chile	jcabrera@santander.cl	562-2320-3778
Guillermo Aboumrad*	Economist – Mexico	gaboumrad@santander.com.mx	5255-5257-8170
Piotr Bielski*	Economist – Poland	piotr.bielski@santander.pl	48-22-534-1888
Mike Moran	Head of Macro Research, US	mike.moran@santander.us	212-350-3500

Fixed Income Research

Juan Arranz*	Chief Rates & FX Strategist – Argentina	jarranz@santander.com.ar	5411-4341-1065
Mauricio Oreng*	Senior Economist/Strategist – Brazil	mauricio.oreng@santander.com.br	5511-3553-5404
Juan Pablo Cabrera*	Chief Rates & FX Strategist – Chile	jcabrera@santander.cl	562-2320-3778

Equity Research

Miguel Machado*	Head Equity Research Americas	MMAchado@santander.com.mx	5255 5269 2228
Alan Alanis*	Head, Mexico	aalanis@santander.com.mx	5552-5269-2103
Andres Soto	Head, Andean	asoto@santander.us	212-407-0976
Claudia Benavente*	Head, Chile	claudia.benavente@santander.cl	562-2336-3361
Walter Chiarvesio*	Head, Argentina	wchiarvesio@santander.com.ar	5411-4341-1564
Mariana Cahen Margulies*	Head, Brazil	MMArgulies@santander.com.br	5511 3553 1684

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