

August IPCA: A Major Upward Surprise Reinforces the Difficult Inflation Outlook

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

- August's IPCA registered a 0.87% MoM change (9.68% YoY), considerably above our call and consensus, both at 0.71%.
- The major upward surprise came from volatile items, but core-related groups also showed significant upside surprises. In particular, the core services gauge advanced to 7.3% 3MMA-saar, with items that usually present more inertia, accelerating to 8.1% 3MMA-saar.
- As a result, composition was once again unfavorable. The average of the main broad cores followed by the Brazil Central Bank (BCB) rose to 8.1% 3MMA-saar. The diffusion index reflected a new recent high of 74% (seasonally adjusted), close to the high of 2016, thereby implying that inflation is widespread.
- IPCA forecasts are currently under revision, with an upside potential, particularly because inertia seems to be gaining traction, making it more difficult for the recent shocks to fade quickly.

Inflation Outlook Continues to Deteriorate; Inertia Appears to Gain Traction

August's IPCA registered a 0.87% MoM change (9.68% YoY), considerably above our call and consensus, both at 0.71%. The headline remained at the high level of 11.1% in 3MMA-saar terms, implying that the upward pressure remains strong at the margin.

The major upward surprise came from volatile items, but core-related groups also showed significant upside surprises. Food-at-home contributed +5 bps to the headline forecast error, while gasoline contributed +6 bps—both volatile items. However, industrial goods also contributed to the forecast error with +2 bps, which left the 3MMA-saar measure at 11.5% (slightly below last month, but still a high level). Moreover, the core industrial goods also remained under upward pressure, at 9.6% 3MMA-saar (from 10.1% in July).

More importantly, services contributed +2 bps to the headline surprise and accelerated to 6.7% 3MMA-saar (from 5.2% in July) and, the services core gauge accelerated even further, to 7.3% 3MMA-saar (from 6.4% in July). In services, we highlight that all of the four major groups continued to accelerate: inertial services, services more linked to wages, services more linked to economic activity and volatile services (airline tickets and food-service). In particular, inertial services are already at 8.1% 3MMA-saar, which is a cause of concern, in our view.

Broad qualitative measures deteriorated further at the margin, reinforcing our view of an unfavorable inflation outlook for the short term. The average of the five core measures followed by the BCB rose to 8.1% 3MMA-saar (from 7.8% in July and is not only hovering above the target, but has been distancing further from it, for eleven months now. This is evidence of the spreading of the primary shocks (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, reached a new recent high of 74% (seasonally adjusted)—close to the all-time high of 78% (in 2015-2016) and evidencing the risks of even higher inflation for the year end. The diffusion is also another sign of the spreading of shocks.

IMPORTANT DISCLOSURES/CERTIFICATIONS ARE IN THE "IMPORTANT DISCLOSURES" SECTION OF THIS REPORT. U.S. investors' inquiries should be directed to Santander Investment Securities Inc. at (212) 583-4629 / (212) 350-3918.

* Employed by a non-US affiliate of Santander Investment Securities, Inc. and is not registered/qualified as a research analyst under FINRA rules.



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).

We believe IPCA inflation might be close to a peak in YoY terms, mainly due to a considerable base-effect (coming from the high levels of Oct-20 to Dec-20 prints), and not because of a clear cooling down of inflation prints at the margin. Moreover, the deceleration process might be much slower than we currently assume (inertia seems to be gaining traction), adding upside risks to our forecasts. More importantly, the composition of the deceleration might be unfavorable, as volatile groups decelerate more sharply, while services inflation picks up and accelerates for the next few months.

IPCA forecasts are currently under revision, with an upside potential, particularly because inertia seems to be gaining traction making it more difficult for the recent shocks to fade quickly. 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.

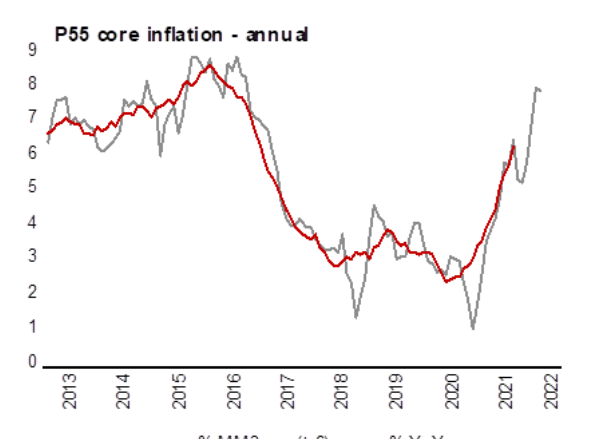
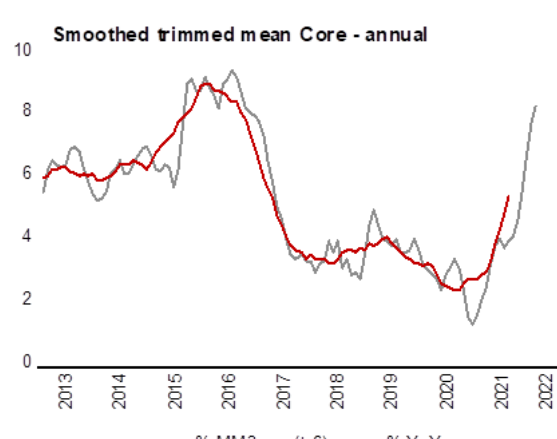
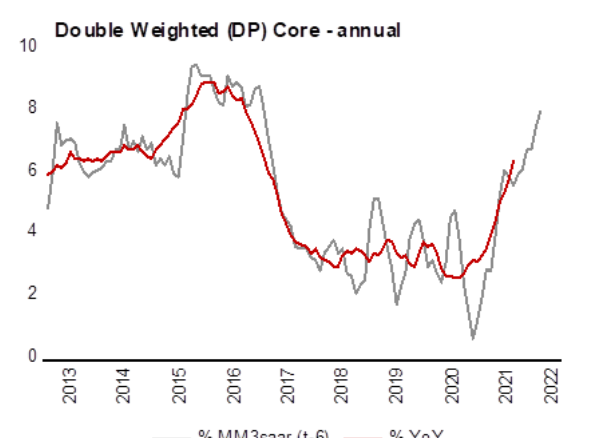
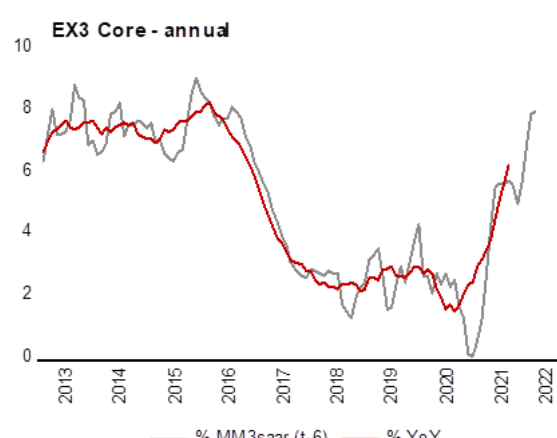
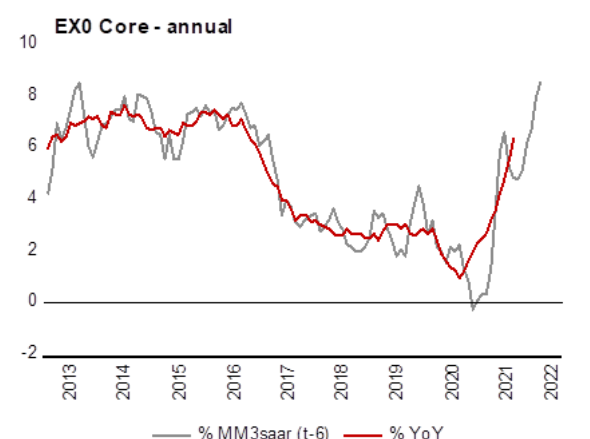
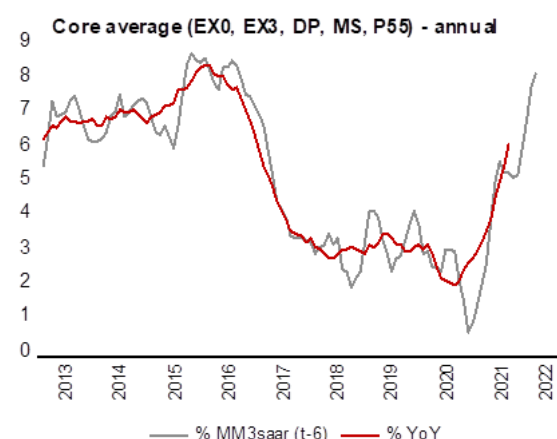
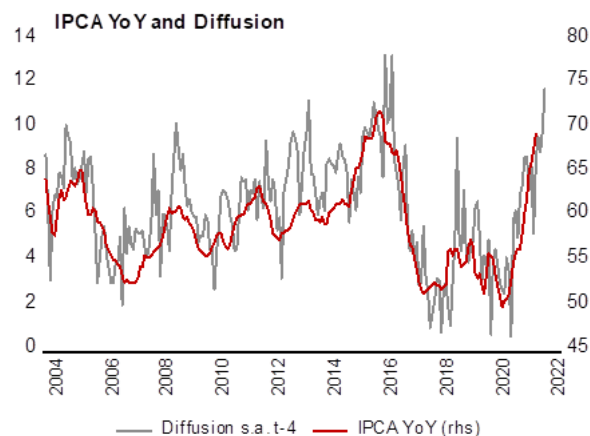
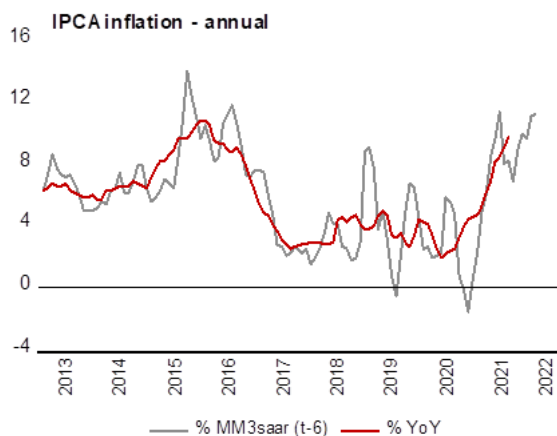
Figure 1. IPCA by Group and Forecasting Errors

	Aug-21	Santander	Contrib.	Jul-21	Aug-21
IPCA	0.87	0.71	0.16	9.0	9.7
Food and beverage	1.39	1.10	0.06	13.3	14.0
Food-at-home	1.63	1.28	0.05	16.0	16.6
Food service	0.76	0.66	0.01	6.7	7.6
Housing	0.68	0.78	-0.02	11.2	11.6
Electrical energy	1.10	1.07	0.00	20.1	21.1
Household articles	0.99	0.78	0.01	12.2	12.7
Apparel	1.02	0.99	0.00	5.2	7.1
Transportation	1.46	1.01	0.09	15.9	16.6
Airline tickets	-10.69	-10.90	0.00	42.9	30.2
Gasoline	2.80	1.80	0.06	39.7	39.1
Health and personal care	-0.04	-0.14	0.01	3.2	2.6
Personal spending	0.64	0.63	0.00	2.5	3.2
Education	0.28	0.27	0.00	-0.8	3.0
Communication	0.23	0.16	0.00	1.8	1.4
Administered	0.95	0.68	0.07	13.5	13.7
Free	0.84	0.71	0.09	7.4	8.3
Food-at-home	1.63	1.28	0.05	16.0	16.6
<i>Food-at-home core</i>	1.13	1.22	0.00	9.7	10.4
Industrial goods	1.02	0.92	0.02	9.2	10.1
<i>Industrial goods core</i>	0.59	0.58	0.00	7.4	7.9
Services	0.39	0.34	0.02	3.0	3.9
<i>Services core</i>	0.64	0.52	0.02	6.0	6.6
EX3 Core	0.62	0.55	0.03	5.6	6.2
Average of cores	0.67	-	-	5.5	-

Sources: IBGE and Santander.



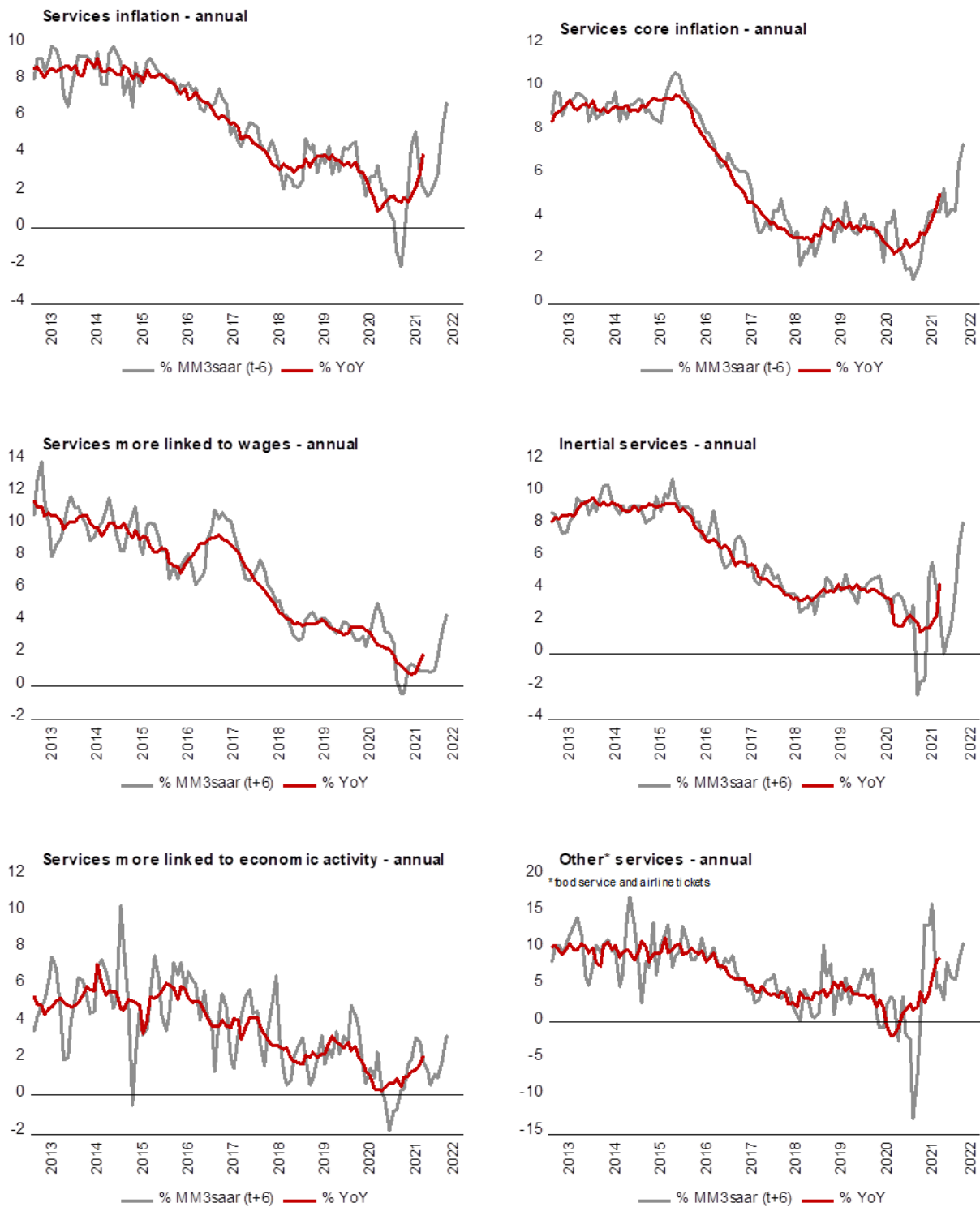
Figure 2. IPCA, Groups and Qualitative Measures



Sources for all charts: IBGE and Santander.



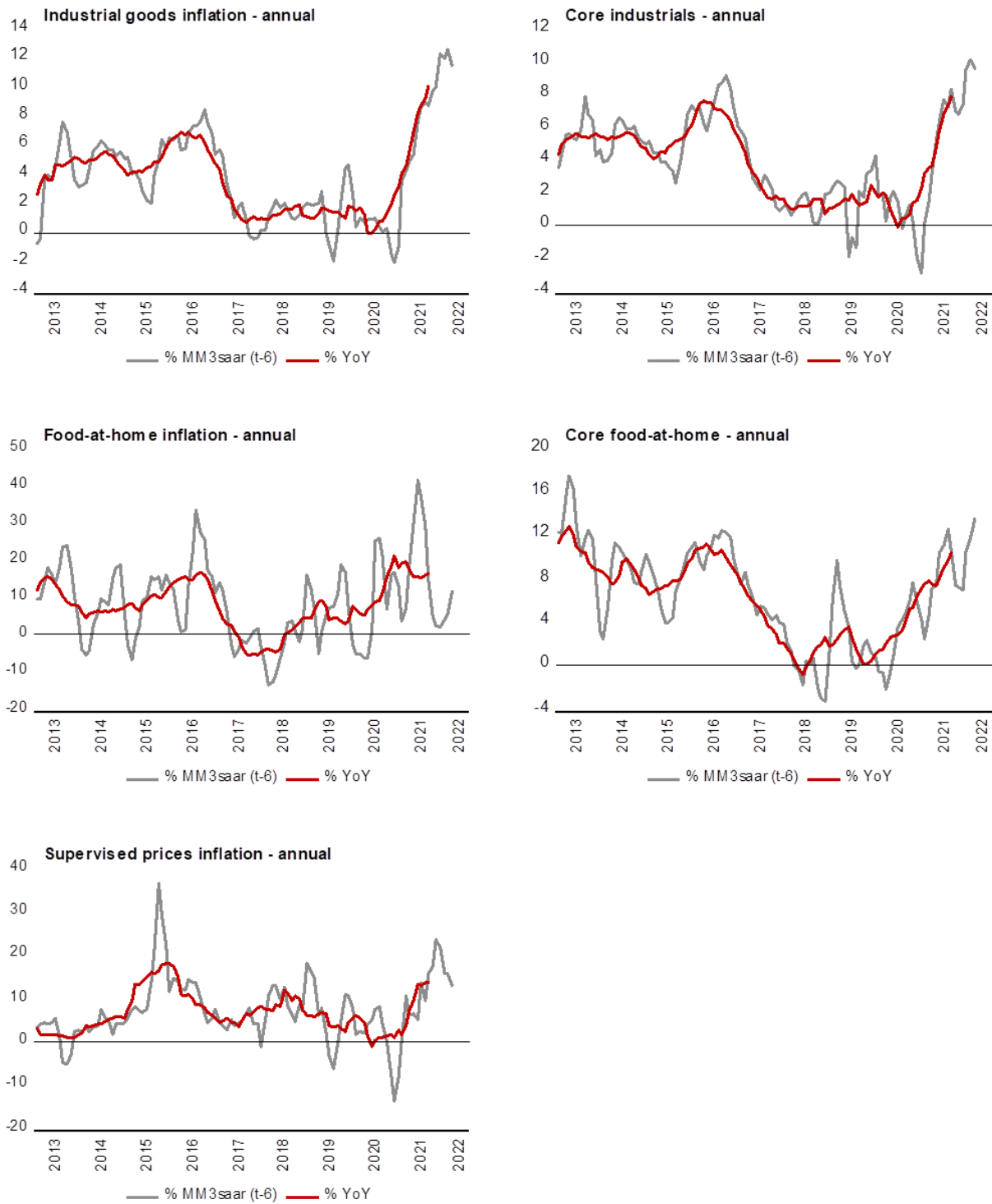
Figure 3. IPCA, Groups and Qualitative Measures continuation



Sources for all charts: IBGE and Santander.



Figure 4. IPCA, Groups and Qualitative Measures continuation



Sources for all charts: IBGE and Santander.



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	gjaboumrad@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

Electronic

Bloomberg
Reuters

SIEQ <GO>
Pages SISEMA through SISEMZ

This report has been prepared by Santander Investment Securities Inc. ("SIS"; SIS is a subsidiary of Santander Holdings USA, Inc. which is wholly owned by Banco Santander, S.A. "Santander"), on behalf of itself and its affiliates (collectively, Grupo Santander) and is provided for information purposes only. This document must not be considered as an offer to sell or a solicitation of an offer to buy any relevant securities (i.e., securities mentioned herein or of the same issuer and/or options, warrants, or rights with respect to or interests in any such securities). Any decision by the recipient to buy or to sell should be based on publicly available information on the related security and, where appropriate, should take into account the content of the related prospectus filed with and available from the entity governing the related market and the company issuing the security. This report is issued in Spain by Santander Investment Bolsa, Sociedad de Valores, S.A. ("Santander Investment Bolsa"), and in the United Kingdom by Banco Santander, S.A., London Branch. Santander London is authorized by the Bank of Spain. This report is not being issued to private customers. SIS, Santander London and Santander Investment Bolsa are members of Grupo Santander.

ANALYST CERTIFICATION: The following analysts hereby certify that their views about the companies and their securities discussed in this report are accurately expressed, that their recommendations reflect solely and exclusively their personal opinions, and that such opinions were prepared in an independent and autonomous manner, including as regards the institution to which they are linked, and that they have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report, since their compensation and the compensation system applying to Grupo Santander and any of its affiliates is not pegged to the pricing of any of the securities issued by the companies evaluated in the report, or to the income arising from the businesses and financial transactions carried out by Grupo Santander and any of its affiliates: Daniel Karp*. *Employed by a non-US affiliate of Santander Investment Securities Inc. and not registered/qualified as a research analyst under FINRA rules, and is not an associated person of the member firm, and, therefore, may not be subject to the FINRA Rule 2242 and Incorporated NYSE Rule 472 restrictions on communications with a subject company, public appearances, and trading securities held by a research analyst account.

The information contained herein has been compiled from sources believed to be reliable, but, although all reasonable care has been taken to ensure that the information contained herein is not untrue or misleading, we make no representation that it is accurate or complete and it should not be relied upon as such. All opinions and estimates included herein constitute our judgment as at the date of this report and are subject to change without notice.

Any U.S. recipient of this report (other than a registered broker-dealer or a bank acting in a broker-dealer capacity) that would like to effect any transaction in any security discussed herein should contact and place orders in the United States with SIS, which, without in any way limiting the foregoing, accepts responsibility (solely for purposes of and within the meaning of Rule 15a-6 under the U.S. Securities Exchange Act of 1934) for this report and its dissemination in the United States.

© 2021 by Santander Investment Securities Inc. All Rights Reserved.

