



August IPCA-15: Underlying Inflation Rises Further, Services Gain Steam

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- August's IPCA-15 registered a 0.89% MoM change (9.30% YoY), above our and consensus estimates, both at 0.83%.
- The major upside surprise came in industrial goods, a core-related group. Moreover, the services group continued to show upside pressure, with its core measure accelerating to 7.9% 3MMA-saar.
- As a result, composition was once again unfavorable. The average of the main broad cores followed by the BCB rose to 8.2% 3MMA-saar. The diffusion index showed a new recent high at 73% (seasonally adjusted), which is very close to the high of 2016.
- We are revising our high frequency tracking for IPCA 2021 to 7.8% (from 7.5%), while keeping IPCA 2022 unchanged at 4.2%. We continue to see upside risks, particularly for IPCA 2021, as electricity costs could rise further.

Headline Upside Surprise Combined with Deterioration of Composition

August's IPCA-15 registered a 0.89% MoM change (9.30% YoY), above our and consensus estimates, both at 0.83%. The headline accelerated further to 11.3% in 3MMA-saar terms, showing that the upward pressure remains strong.

The major upside surprise came in industrial goods, a core-related group. Industrial goods rose 0.92% MoM (vs. 0.65% estimated), contributing +6 bps to the headline forecast error. Despite this upward surprise, there was a very slight bright side for industrials, as the trend measure showed a small deceleration from 12.4% to 11.7% 3MMA-saar. However, we do not think this deceleration is enough to generate optimism regarding industrial goods inflation, as we continue to see some supply-chain problems worsening at the margin. Moreover, the deceleration in the industrial goods core measure was even slighter, passing just from 10.4% to 10.1% 3MMA-saar.

Turning to services, inflation for this group was basically in line with our estimate, but this was enough to push the headline services trend to 6.8% 3MMA-saar (from 5.0%) and, more important, the core services gauge accelerated from 6.2% to 7.9% 3MMA-saar. Furthermore, there were some qualitatively important movements, with items related to the reopening of the economy gaining traction, such as personal services and recreation. In general, the main services groups are accelerating at the margin, with particular importance of inertial, salaries and economic activity-related groups, which are gaining steam.

Broad qualitative measures deteriorated further, reinforcing our view of an unfavorable inflation outlook for the short term. The average of the main five core measures followed by the BCB rose to 8.2% 3MMA-saar (from 7.5% before) and it is hovering above the target (and distancing further from it) for eleven months now. This is evidence of spreading of the primary shocks (commodities, FX, supply chain disruption, etc.) to general prices, and the persistence at these high levels is risky, in our view. Also on that tone, the diffusion index—a leading indicator of annual inflation—made a new recent high at 73% (seasonally adjusted), close to the all-time high of

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76% (in 2016) —evidencing the risks of even higher inflation for year end. In addition, the diffusion is also another sign of the spreading of shocks.

Forecasts Remain Well above the BCB's Target and Risks Remain 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 be passed on to consumers; and (ii) we are seeing stronger second-order effects (primary shocks spreading to general prices), 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 continues to show upside pressure, which is an unfavorable composition for IPCA inflation (both groups are closely related to core measures).

We are revising our high frequency tracking for IPCA 2021 to 7.8% (from 7.5%), while keeping IPCA 2022 unchanged at 4.2%. We continue to see upside risks, particularly for IPCA 2021, as electricity costs could rise further. 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.

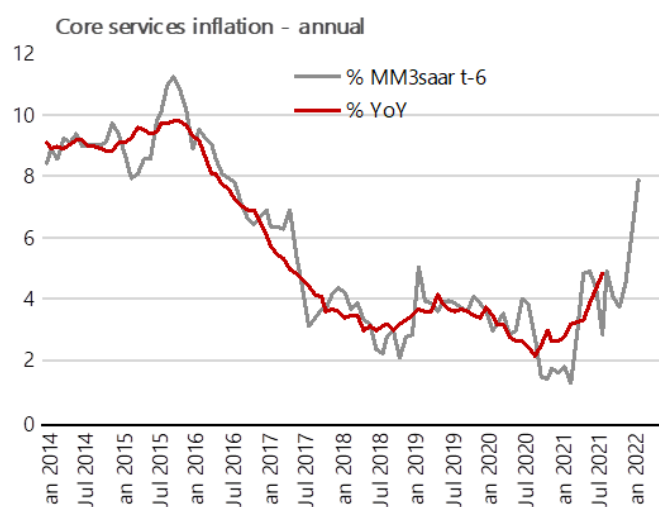
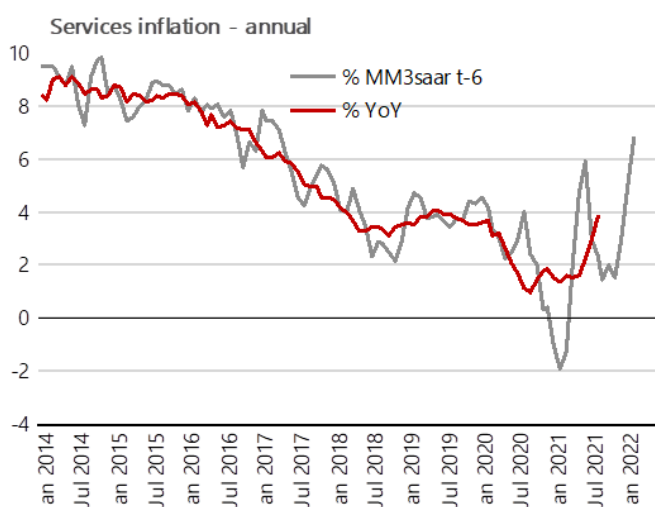
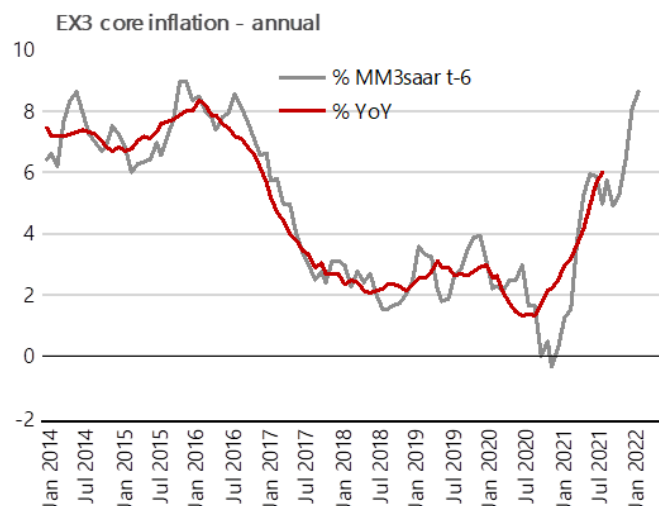
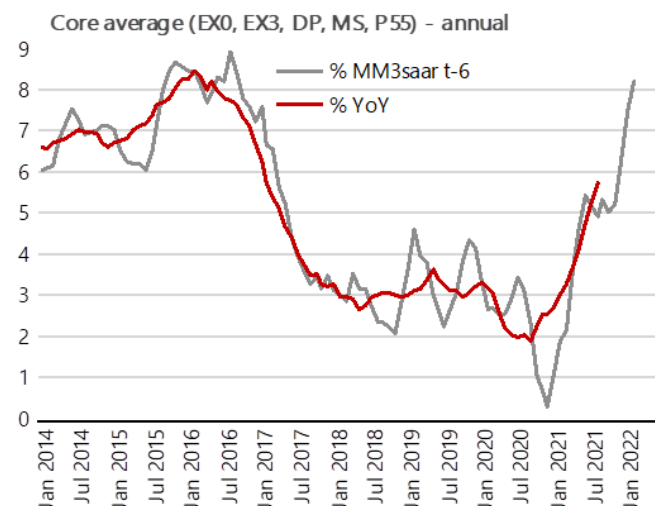
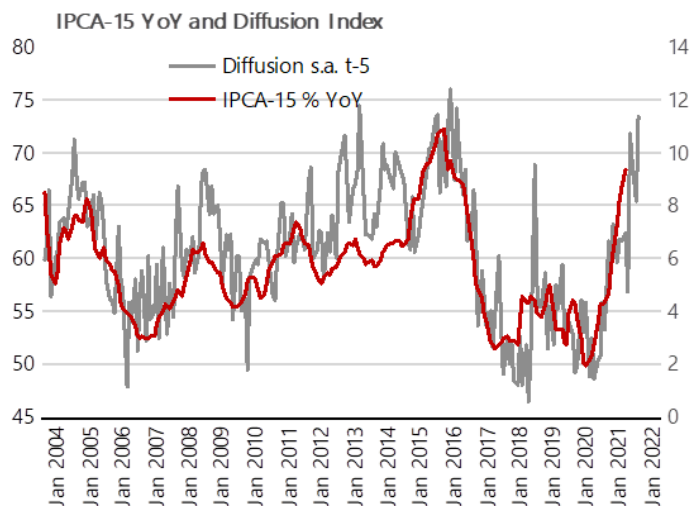
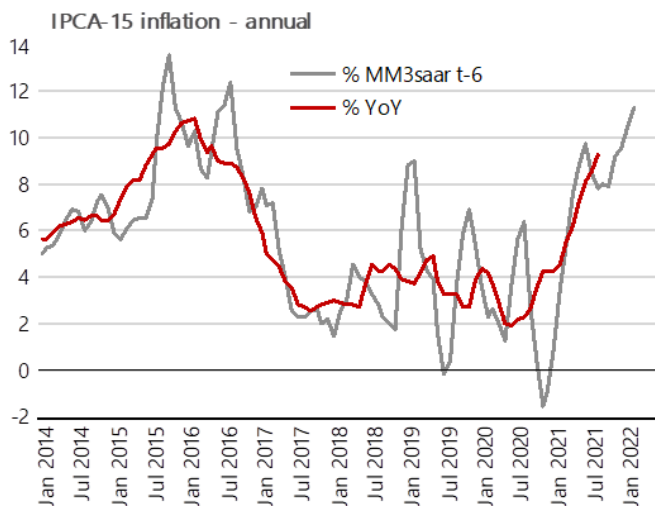
Figure 1. IPCA by Group and Forecasting Errors

	MoM			YoY	
	Aug-21	Santander	Contrib.	Jul-21	Aug-21
IPCA-15	0.89	0.83	0.06	8.6	9.3
Food and beverage	1.02	1.06	-0.01	12.8	13.6
Food-at-home	1.29	1.33	-0.01	15.3	16.0
Food service	0.35	0.40	0.00	7.2	7.9
Housing	1.97	1.93	0.01	10.0	11.5
Electrical energy	5.00	4.84	0.01	16.9	20.8
Household articles	1.05	0.65	0.02	12.5	12.7
Apparel	0.94	0.49	0.02	4.5	6.1
Transportation	1.11	1.02	0.02	15.3	15.7
Airline tickets	-10.90	-6.50	-0.01	42.1	29.0
Gasoline	2.05	2.03	0.00	40.3	39.5
Health and personal care	-0.29	-0.11	-0.02	3.6	2.7
Personal spending	0.68	0.36	0.03	2.3	2.9
Education	0.30	0.36	0.00	-0.9	2.7
Communication	0.19	0.09	0.01	1.8	1.1
Administered	1.44	1.37	0.02	12.9	13.5
Free	0.69	0.63	0.04	7.1	7.8
Food-at-home	1.29	1.33	-0.01	15.3	16.0
Industrial goods	0.92	0.65	0.06	9.0	9.4
Services	0.29	0.33	-0.01	2.9	3.8
EX3 Core	0.50	0.50	0.00	5.6	6.0
Average of cores	0.56	-	-	5.3	5.7

Sources: IBGE and Santander.



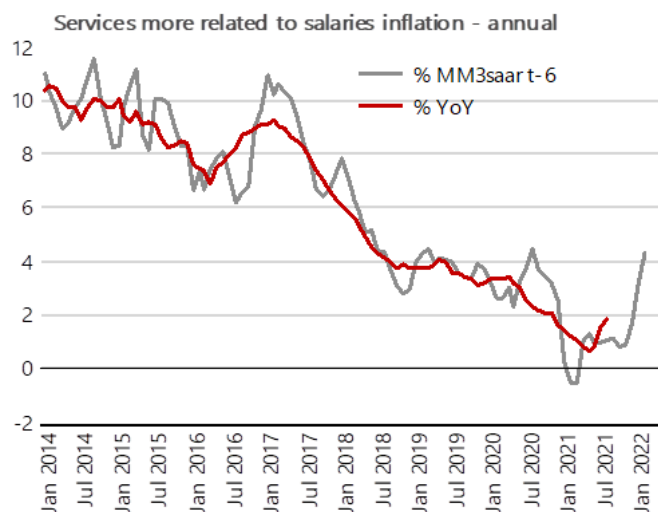
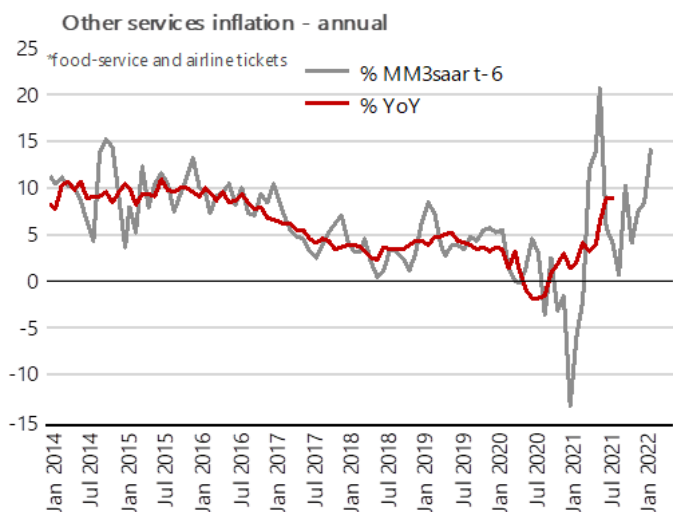
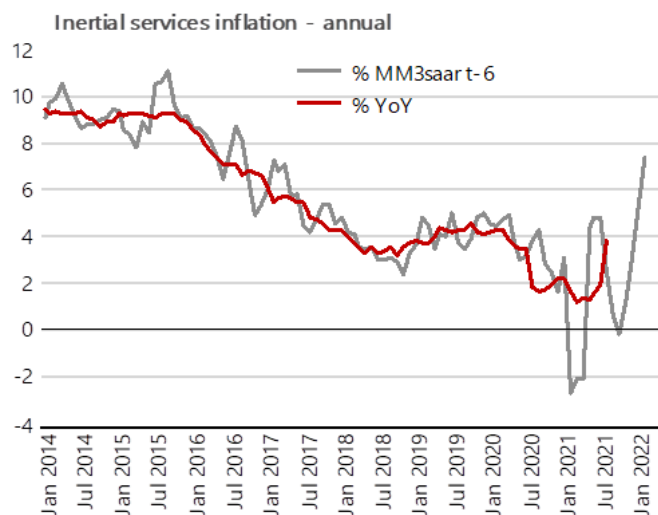
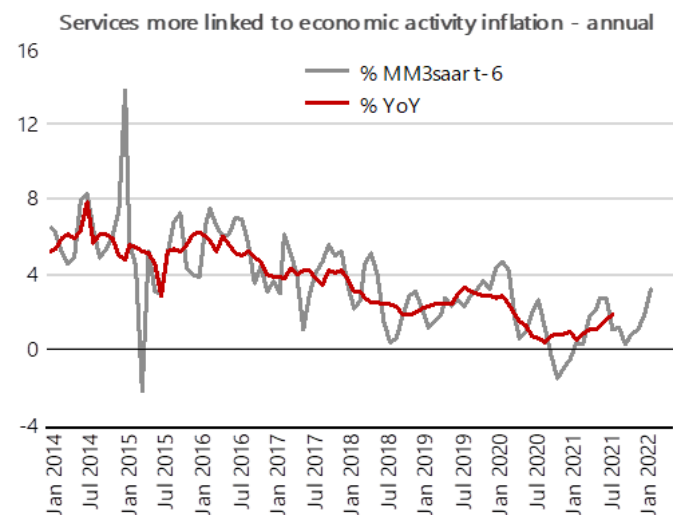
Figure 2. IPCA, Groups and Qualitative Measures



Sources for all charts: IBGE and Santander.



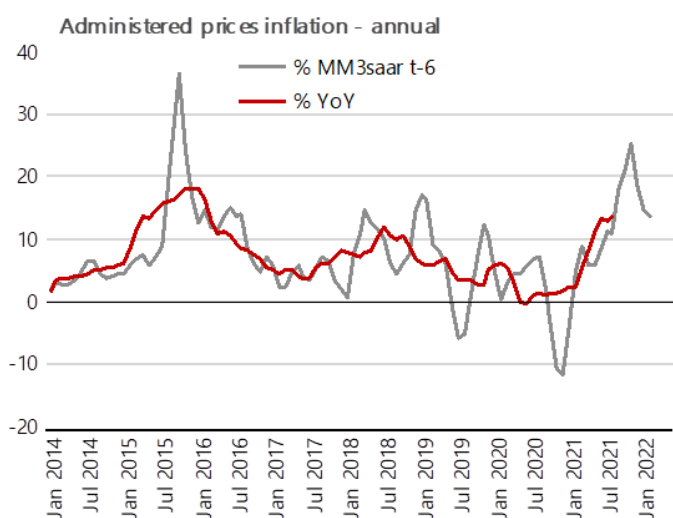
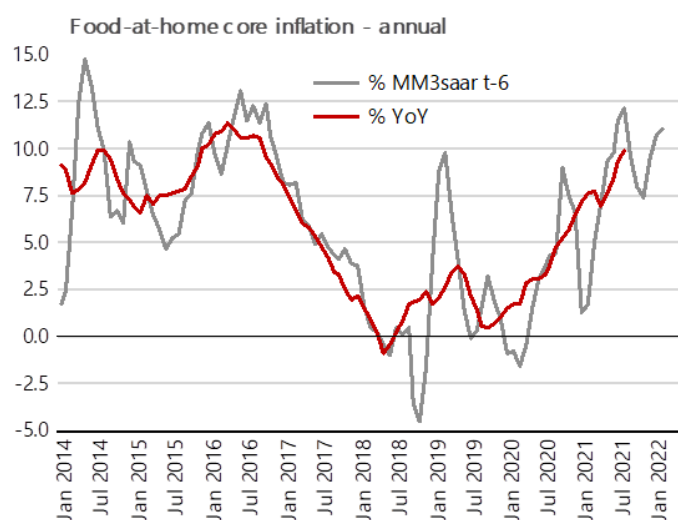
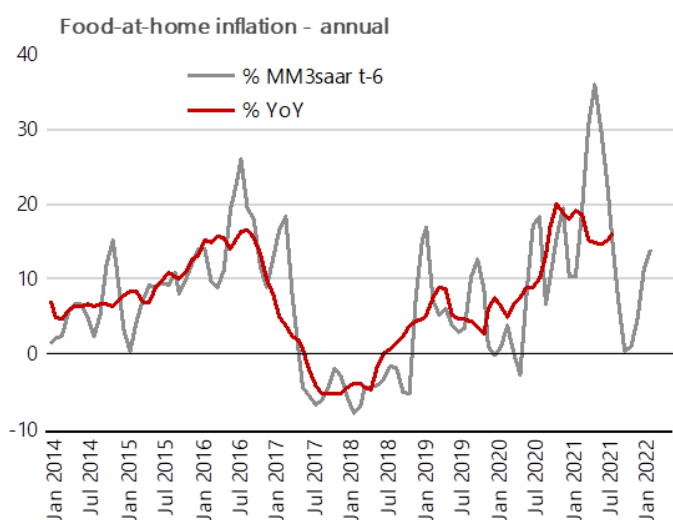
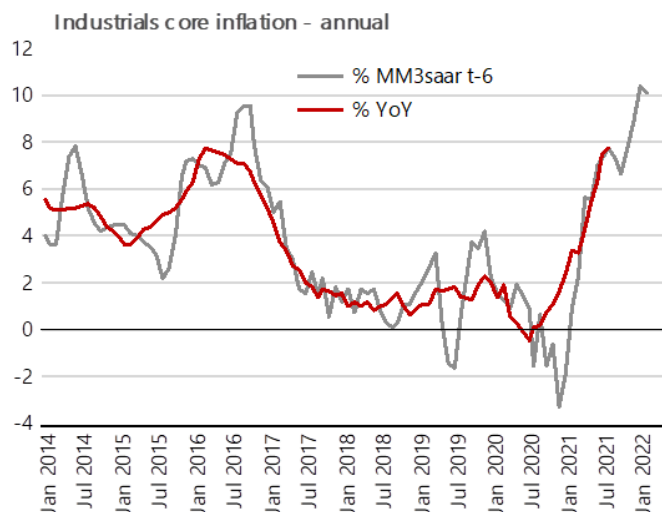
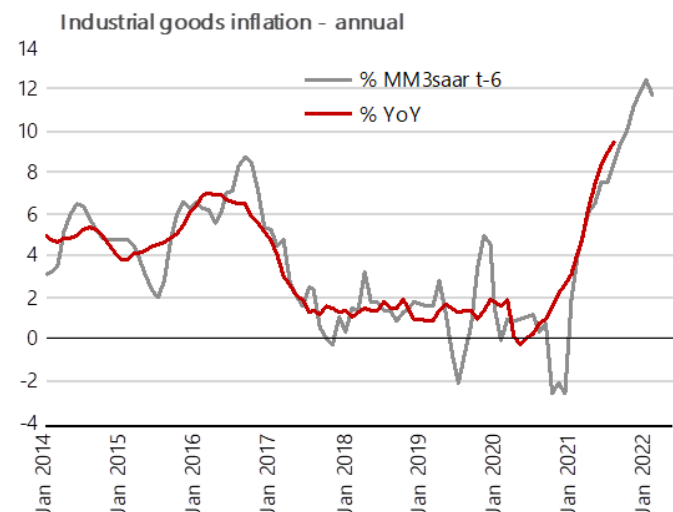
Figure 3. IPCA, Groups and Qualitative Measures (continuation)



Sources for all charts: IBGE and Santander.



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



Sources for all charts: IBGE and Santander.



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