

September's IPCA: Still an Unfavorable Outlook, but with Less Negative News at the Margin

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- September's IPCA registered a 1.16% MoM change (10.25% YoY), below our estimate (1.30%) and the consensus forecast (1.25%).
- A major part of the downward surprise came from food-at-home, with “less negative” news from core-related groups. In particular, the core services gauge saw a pause in its upward trend and the diffusion index fell.
- All in all, while we remain cautious on the inflation outlook and continue to see upside risks to our forecasts, we recognize some marginal reliefs might have turned the balance of risks slightly less tilted to the upside.
- We maintain our high-frequency tracking at 9.0% for IPCA 2021 and 4.5% for IPCA 2022.

An unfavorable picture, but with a downside surprise

September's IPCA registered a 1.16% MoM change (10.25% YoY), below our estimate (1.30%) and the consensus forecast (1.25%). The headline accelerated to 13.3% 3MMA-saar (from 11.6%), highlighting that the upward pressure remained strong at the margin.

A major part of the downward surprise came from food-at-home, with “less negative” news from core-related groups. Food-at-home contributed -7 bps to the headline forecast error and its core gauge decelerated from 13.4% to 10.8% 3mma-saar. Services—more related to core measures—contributed -3bps to the error and, despite an acceleration of the headline to 7.8% 3MMA-saar (from 6.8% in August), **the core services gauge saw a pause in its upward trend, reaching 7.1% 3MMA-saar from 7.3% last month.** Additionally, industrial goods came in line with our call, implying that its trend stayed at the high level of 12.0% 3MMA-saar. **That is, headline industrials trend has not been accelerating for at least around 4 months now and, more importantly, core industrials gauge saw even some deceleration to 8.5% 3MMA-saar (from 9.5% before).**

Broad qualitative measures deteriorated further at the margin, but the EX3 core at least saw a pause in its upward trend, with diffusion cooling down slightly. The average of the five core measures followed by the Brazil Central Bank (BCB) rose to 8.7% 3mma-saar (previously 8.2%) and is hovering above the target (and distancing further from it) for twelve months now. This is evidence of spreading of the primary shocks (commodities, FX, supply chain disruption, etc.) to the general prices and the persistency at these high levels is risky. **However, the EX3 core gauge (the combination of the services' and industrials' core) stayed at 7.7% 3MMA-saar—a high level, but at least not an acceleration at the margin; moreover, the diffusion index fell from 73.4% (seasonally adjusted) to 67.3%.**

We estimate this reading is the YoY peak of inflation, very close to the 10.7% high of December 2015. The peak should be driven mostly by a base-effect: the very high monthly readings from 4Q20 will start to leave the 12-months sample, creating space for lower readings from now on. **The cooling down at the margin (MoM) further ahead, on the other hand, should not be major, as we expect the 3MMA-saar measure to reach 5% in December and then remain relatively stable at this high level until at least mid-2022.**



Balance of risks is still skewed to the upside, but now there some downside risks too

All in all, while we remain cautious on the inflation outlook and continue to see the balance of risks tilted to the upside (specially with new shocks arriving each day), we now believe that the market might see some relief with less negative news at the margin. We were seeing only upside risks (and surprises) for more than a year and now a few factors have changed: 1) this was the first downside surprise that also reached qualitative measures, 2) IPCA YoY probably peaked at this reading, 3) if IPCA YoY peaked, the market would be surprised to the downside from now on¹, 4) some downside risks appeared in food and electrical energy. **To reinforce, this is just one reading and we do not change our view that inflation outlook is still quite unfavorable, but we recognize some marginal reliefs that might have turned the balance of risks slightly less tilted to the upside.**

For now, we maintain our high-frequency tracking at 9.0% for IPCA 2021 and from 4.5% for IPCA 2022. 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

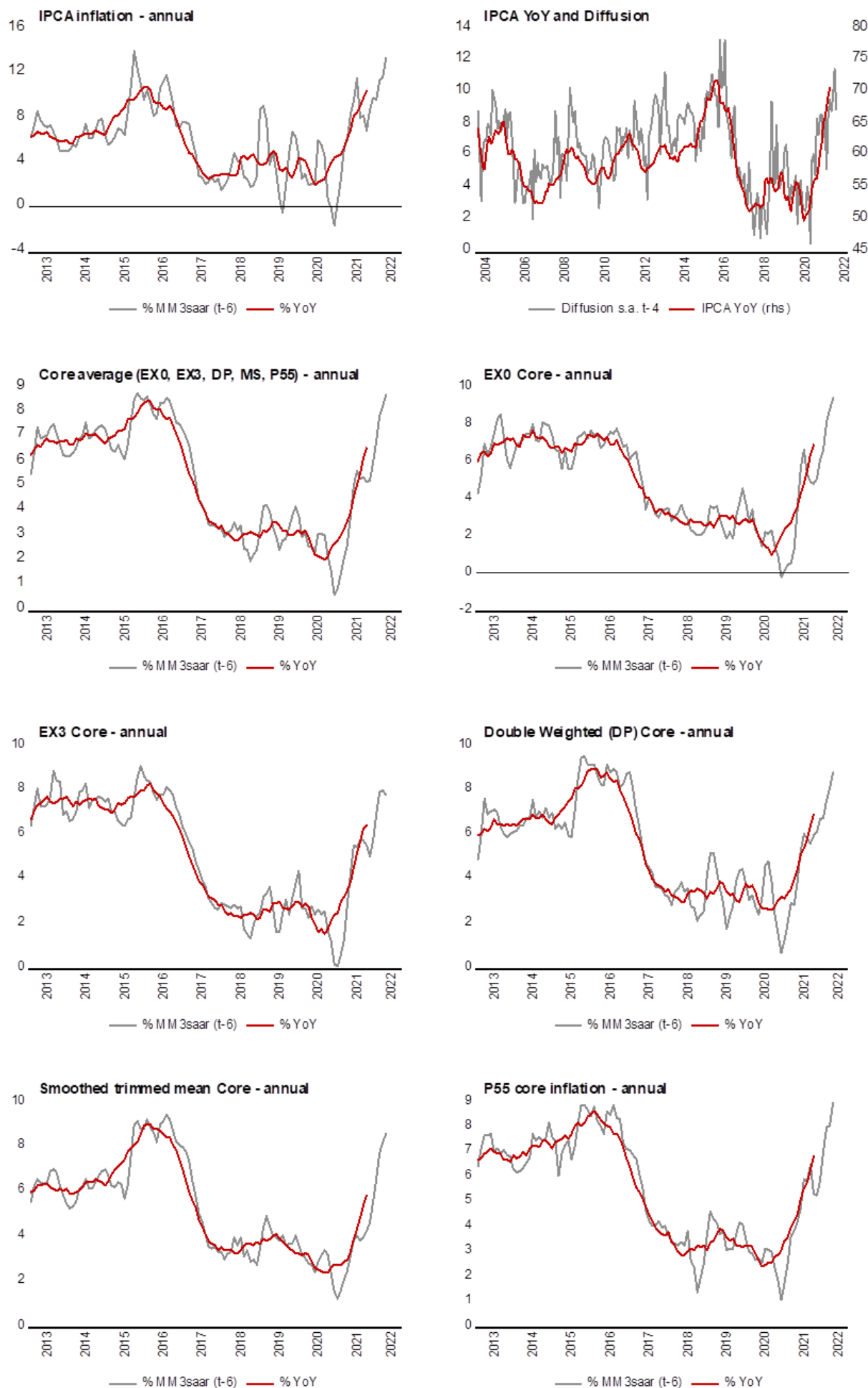
	MoM			YoY	
	Sep-21	Santander	Contrib.	Aug-21	Sep-22
IPCA	1.16	1.30	-0.14	9.7	10.2
Food and beverage	1.02	1.36	-0.07	14.0	12.5
Food-at-home	1.19	1.62	-0.07	16.6	14.7
Food service	0.59	0.70	-0.01	7.6	7.4
Housing	2.56	2.77	-0.03	11.6	14.0
Electrical energy	6.47	6.91	-0.02	21.1	28.8
Household articles	0.90	1.20	-0.01	12.7	12.6
Apparel	0.31	0.61	-0.01	7.1	7.0
Transportation	1.82	1.95	-0.03	16.6	17.9
Airline tickets	28.19	28.76	0.00	30.2	56.8
Gasoline	2.32	2.20	0.01	39.1	39.6
Health and personal care	0.39	0.41	0.00	2.6	3.7
Personal spending	0.56	0.40	0.02	3.2	3.7
Education	-0.01	-0.01	0.00	3.0	3.1
Communication	0.07	0.05	0.00	1.4	1.3
Administered	1.93	2.09	-0.04	13.7	15.7
Free	0.88	1.01	-0.10	8.3	8.3
Food-at-home	1.19	1.62	-0.07	16.6	14.7
Industrial goods	1.04	1.07	-0.01	10.1	10.6
Services	0.63	0.71	-0.03	3.9	4.4
EX3 Core	0.52	0.61	-0.10	6.2	6.4
Average of cores	0.68	-	-	6.1	-

Sources: IBGE and Santander.

¹ Please refer to our report "The Anatomy of Inflation Expectations in Brazil", April 19, 2021 <https://bit.ly/3Fwy4ww>



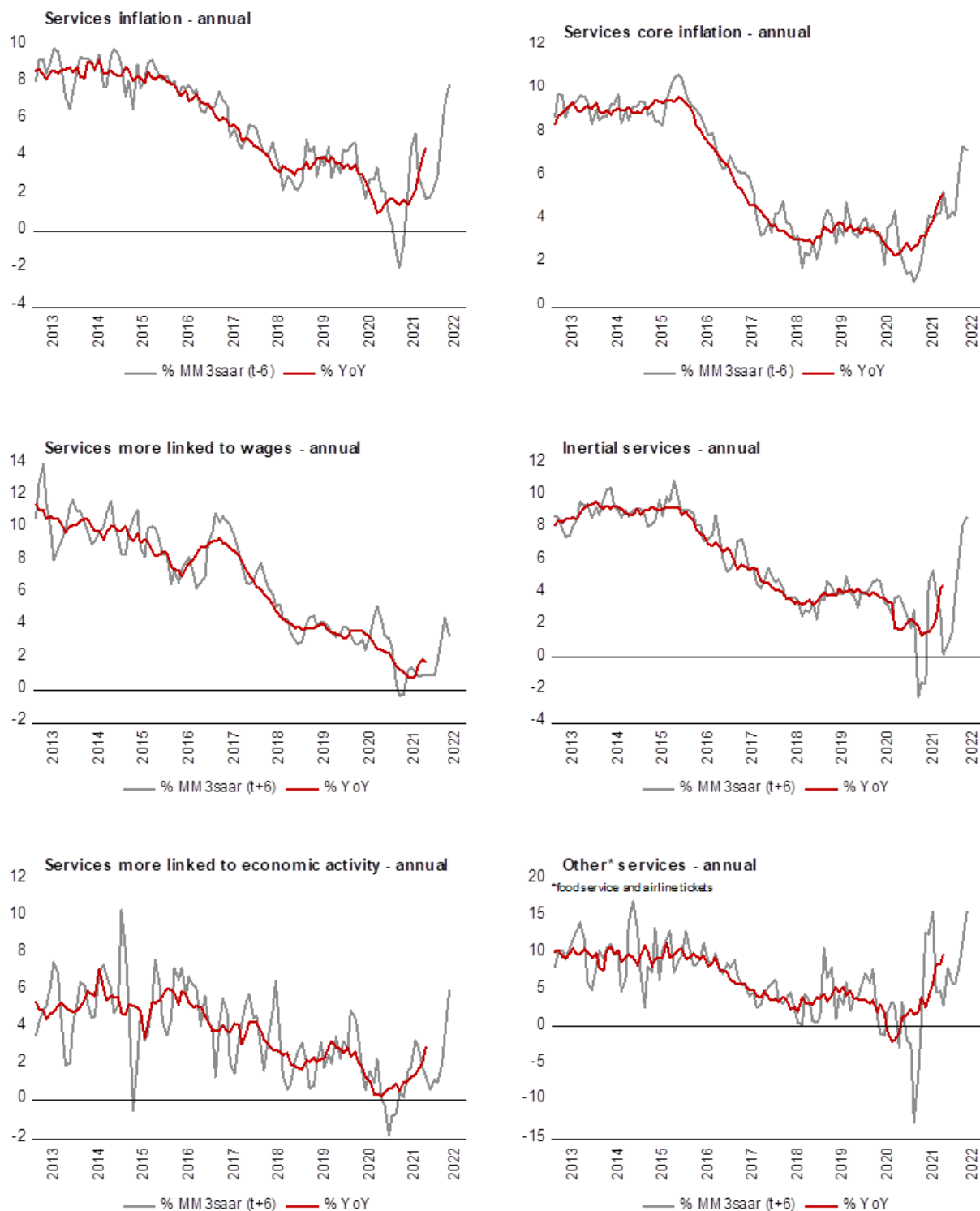
Figure 2. IPCA, Groups and Qualitative Measures



Sources for all charts: IBGE and Santander.



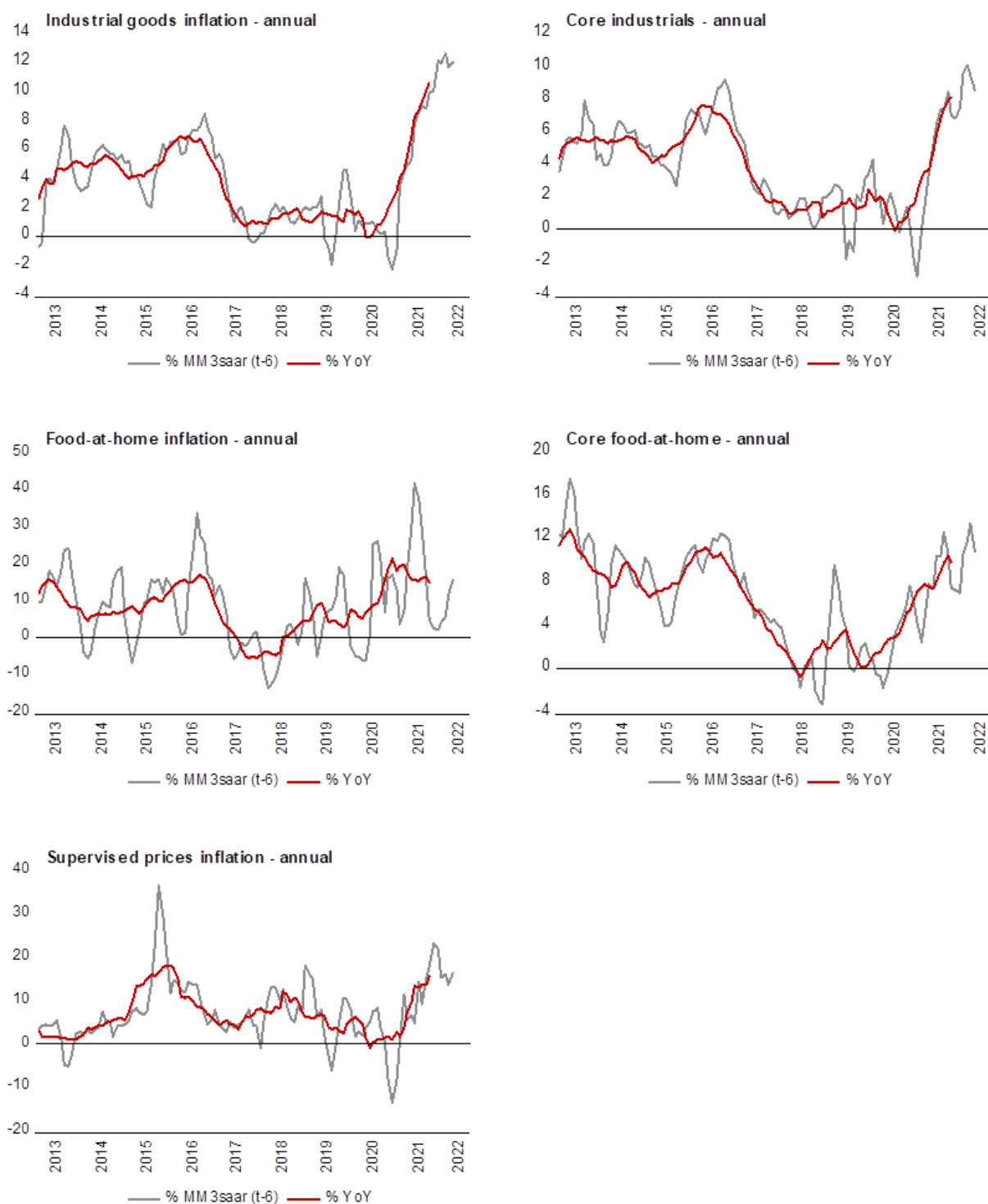
Figure 3. IPCA, Groups and Qualitative Measures continuation



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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