

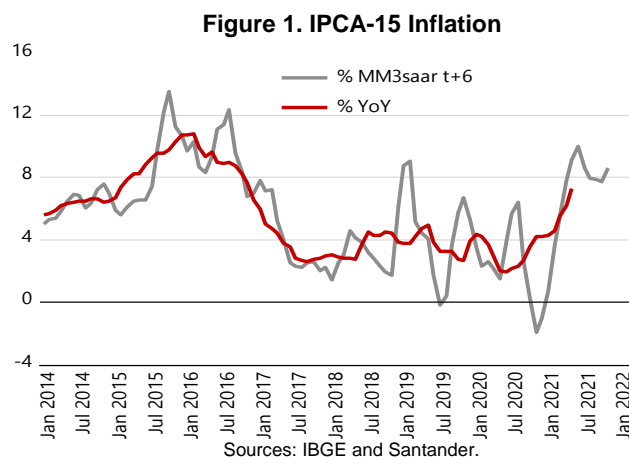
## IPCA-15 May: Don't Get Fooled by Lower than Expected Headline

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- The IPCA-15 for May increased 0.44% MoM (7.27% YoY), well below the market's median expectation of 0.55% and our 0.56%.
- However, the downside surprise was concentrated in one (extremely volatile) item and excluding that item we read the number, once again, as quite unfavorable in qualitative terms.
- In particular, we highlight the persistent high core values at the margin (+5.0% 3mma-saar) and the high level of the diffusion index (72.3%, seasonally adjusted); these values are of concern to us regarding whether the shocks will be contained to their primary sources of impact or if a spread to general prices will occur (second order effects).
- We have maintained our IPCA 2021 and 2022 forecasts at 5.9% and 3.9%, respectively, but we change our view of the balance of risks from symmetric to tilted to the upside once again.

### Headline Downside Surprise Was Concentrated and Upward Pressures Remain Strong

May's IPCA-15 increased 0.44% MoM (7.27% YoY), well below the market's median expectation of 0.55% and also our call of 0.56%. The headline accelerated from 7.7% in Apr-21 to 8.6% on a 3mma-saar basis, showing that the upward pressure at the margin remains strong.



**The downside surprise was concentrated in one (extremely volatile) item.** Airline tickets fell 28.85% MoM, while we were expecting -0.50%; this surprise alone contributed -12bps to the headline forecast deviation. Other relevant downside surprises came from residential rents (-3bps of deviation to the headline) and vehicle insurance (-2bps of deviation). Basically, those three items were responsible for the -18bps error in the headline inflation forecast attributed to the services group (we forecasted a mild rise of 0.13% and the group fell 0.38%). Indeed, services prices are still pretty contained and remain one of the few positive highlights of inflation, but we don't see this surprise as a sign of further disinflation or of a slower recovery of prices for the group for the next few months, but rather just as a one-off surprise. Besides, industrial goods (+7bps of deviation to the headline) and food-at-home (+2bps) surprised to the upside; administered prices surprised just a bit to the downside (-2bps).

### IMPORTANT DISCLOSURES/CERTIFICATIONS ARE IN THE "IMPORTANT DISCLOSURES" SECTION OF THIS REPORT.

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Figure 2. IPCA-15 by groups and forecasting errors

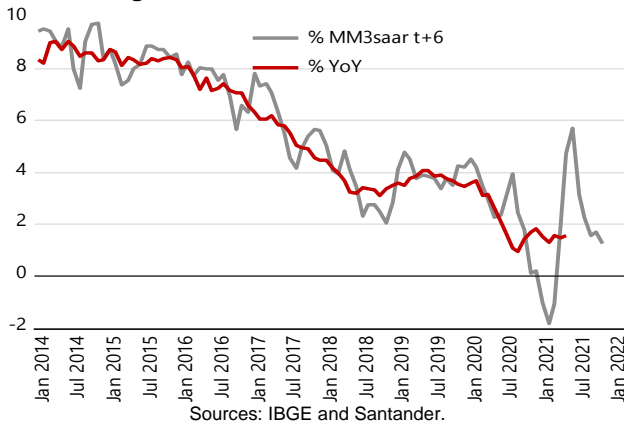
	MoM			YoY	
	May-21	Santander	Dev.	Apr-21	May-21
<b>IPCA-15</b>	<b>0.44</b>	<b>0.56</b>	<b>-0.12</b>	<b>6.2</b>	<b>7.3</b>
<b>Food and beverage</b>	<b>0.48</b>	<b>0.37</b>	<b>0.02</b>	<b>12.2</b>	<b>12.2</b>
Food-at-home	0.50	0.40	0.02	15.1	15.0
Food service	0.43	0.32	0.01	5.5	5.8
<b>Housing</b>	<b>0.79</b>	<b>1.13</b>	<b>-0.05</b>	<b>5.3</b>	<b>6.4</b>
Electrical energy	2.31	2.95	-0.03	4.8	8.0
<b>Household articles</b>	<b>0.89</b>	<b>0.51</b>	<b>0.01</b>	<b>11.8</b>	<b>12.3</b>
<b>Apparel</b>	<b>1.42</b>	<b>0.63</b>	<b>0.03</b>	<b>0.2</b>	<b>1.9</b>
<b>Transportation</b>	<b>-0.23</b>	<b>0.38</b>	<b>-0.13</b>	<b>9.7</b>	<b>13.0</b>
Airline tickets	-28.85	-0.50	-0.12	-19.4	-21.4
Gasoline	0.29	-0.10	0.02	29.1	41.6
<b>Health and personal care</b>	<b>1.23</b>	<b>1.15</b>	<b>0.01</b>	<b>2.4</b>	<b>3.8</b>
<b>Personal spending</b>	<b>0.09</b>	<b>0.07</b>	<b>0.00</b>	<b>1.1</b>	<b>1.3</b>
<b>Education</b>	<b>0.08</b>	<b>0.04</b>	<b>0.00</b>	<b>-1.2</b>	<b>-1.1</b>
<b>Communication</b>	<b>0.03</b>	<b>0.37</b>	<b>-0.02</b>	<b>3.0</b>	<b>2.8</b>
Administered	1.06	1.12	-0.02	8.1	11.3
Free	0.22	0.36	-0.10	5.5	5.9
Food-at-home	0.50	0.40	0.02	15.1	15.0
Industrial goods	0.99	0.70	0.07	6.3	7.4
Services	-0.38	0.13	-0.18	1.5	1.6
EX3 Core	0.45	0.41	0.04	3.7	4.1
Average of cores	0.37	-	-	3.7	4.1

Sources: IBGE and Santander.

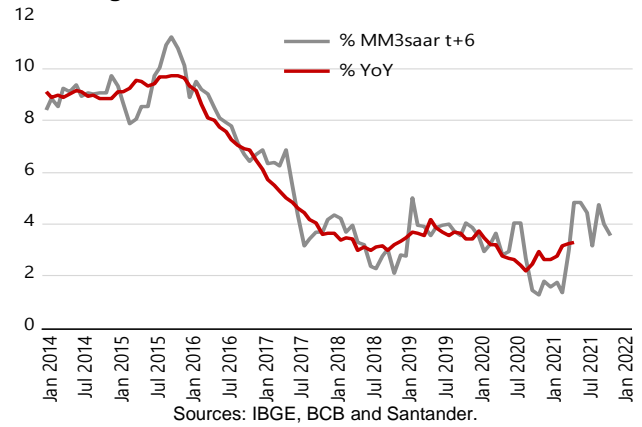
**Despite the major downside surprise, we see the number as quite unfavorable in qualitative terms.** Even with the downside surprise in headline services, core services rose at a 3.5% 3mma-saar; it has been hovering between 3.0% and 4.8% on a 3mma-saar for eight months now, showing a persistent high level at the margin and the YoY already rose from a trough of 2.2% in Sep-20 to 3.3% in May-21. This is basically the same level it has been hovering around since before the pandemic and the persistence of the 3mma-saar at high levels indicate the YoY can rise even further. Moreover, industrial goods surprised considerably to the upside and rose further to 10.1% in 3mma-saar terms (from 10.0% in Apr-21); in YoY terms, the group increased 7.4%, the highest since 2005 (!), and the continuing pressure at the margin (3mma-saar) shows there is no sign of relief yet.



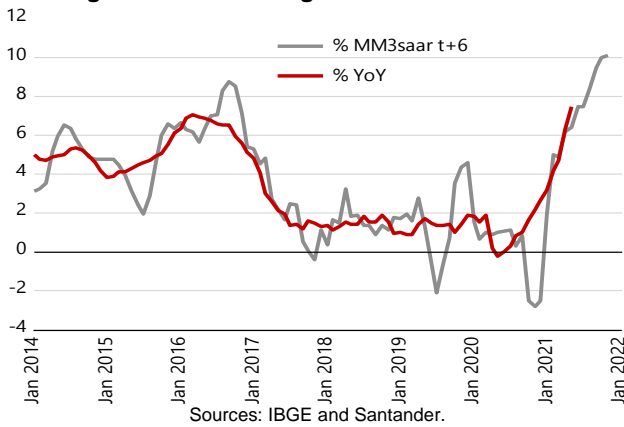
**Figure 3a. Services inflation IPCA-15**



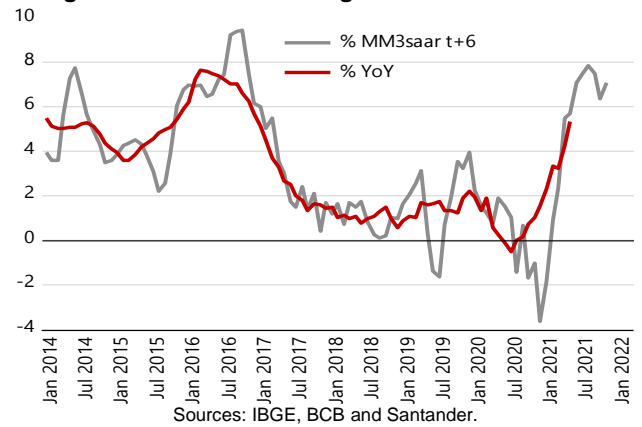
**Figure 3b. Core services inflation IPCA-15**



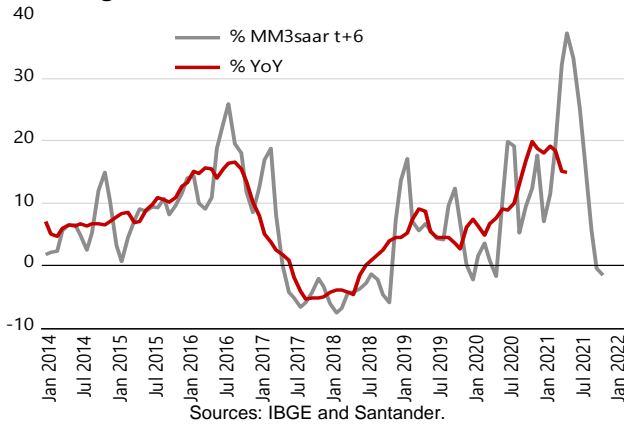
**Figure 4a. Industrial goods inflation IPCA-15**



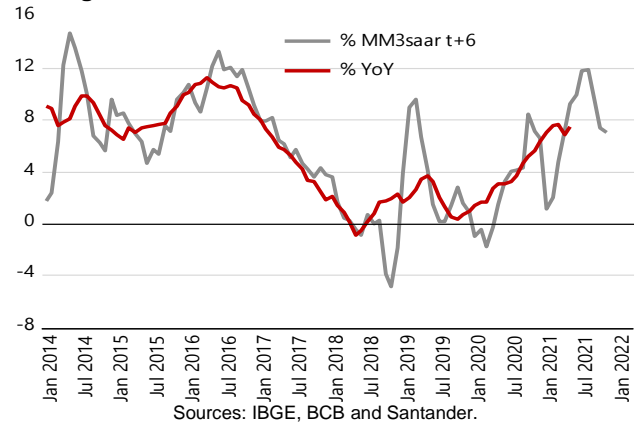
**Figure 4b. Core industrial goods inflation IPCA-15**



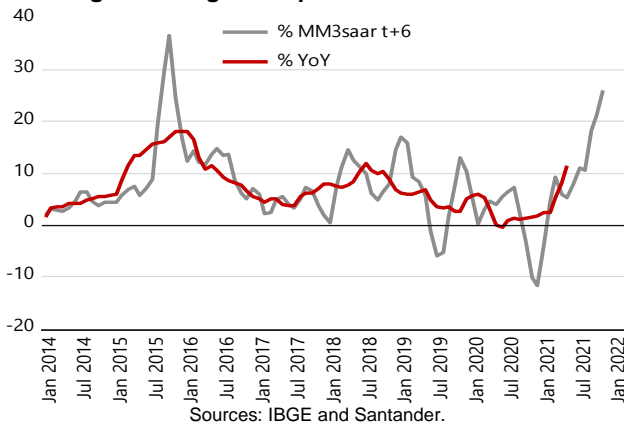
**Figure 5a. Food-at-home inflation IPCA-15**



**Figure 5b. Core food-at-home inflation IPCA-15**



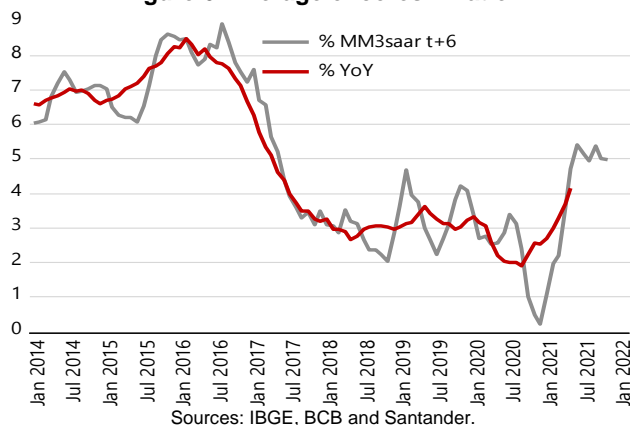
**Figure 6. Regulated prices inflation IPCA-15**



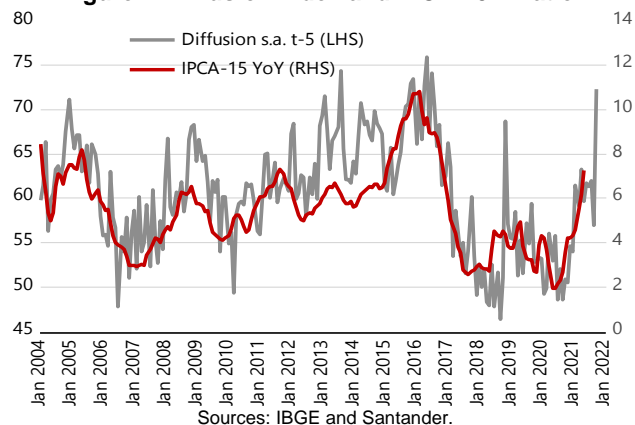


**Cores remained stable at a high level in 3mma-saar terms and the diffusion index (seasonally adjusted) was also quite high.** The average of cores followed by the BCB accelerated from 3.6% YoY to 4.1% and the 3mma-saar remained stable at 5.0% suggesting upward pressures remain strong at the margin and that relief is not yet in sight. Additionally, the diffusion index (seasonally adjusted) rose from 56.9% to 72.3%; it is worth remembering that the diffusion usually anticipates headline IPCA inflation by five months and, by just looking at this indicator, the level is compatible with inflation close to 11% YoY in the following months. Also worth remembering, both the cores and the diffusion are measures of spreading of ordinary shocks to the general prices, the second-order effects that the BCB is always monitoring closely.

**Figure 6. Average of cores inflation**



**Figure 7. Diffusion index and IPCA-15 inflation**



### Unchanged (High Level) Inflation Forecasts, Despite the Downside Surprise

**We continue worry about short-term inflation, as shocks remain strong and persistent at the margin and as the distortion of relative prices continue to indicate considerable pressure coming from the producer level to still reach the consumer.** Despite the downside surprise from this reading, we maintained our IPCA 2021 and 2022 year-end forecasts unchanged at 5.9% and 3.9%, respectively. Our IPCA 2021 is above the upper bound of the tolerance interval of the BCB's target (mid-target 3.75%,  $\pm 1.50\%$ ) and our IPCA 2022 is above the mid-target (3.50%,  $\pm 1.50\%$ ). We were seeing the balance of risks as more symmetric around our year-end forecasts, but this qualitatively worse reading makes us lean again towards more upside risks.

However, we did make some minor downward adjustments for IPCA May, from 0.82% MoM to 0.76%, basically because of technical issues related to IBGE's methodology. The price survey for some items is simply repeated from IPCA-15 to IPCA, particularly for airline tickets and also residential rents and car insurance; as a result, we already know that the big negative change of IPCA-15 will be repeated in IPCA for May. IPCA June and July remained roughly unchanged at 0.50% and 0.46% MoM.



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