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DATA ANALYSIS – INFLATION

October's IPCA: Peak Turning into a Plateau, with Slower Disinflation Ahead

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- **October's IPCA registered a 1.25% MoM change (10.67% YoY—exactly the same level of Dec-2015), much above the consensus (1.06%) and our call (1.09%).**
- **Most of the surprise came in industrial goods and regulated prices, but services also came above expectations. The 3MMA-saar trend of all groups continue to remain at hefty levels, much above the targets.**
- **All in all, we see this as yet another unfavorable reading and remain cautious on the inflation outlook. We continue to see the balance of risks tilted to the upside, especially with the recent rise in domestic risk and with the constantly occurring global shocks.**
- **We have revised our high-frequency tracking to 10.5% (from 9.6%) for IPCA 2021, to 5.8% (from 5.2%) for IPCA 2022 maintained IPCA 2023 at 3.5%. Instead of foreseeing a clear peak, we now estimate inflation YoY to plateau between 10.5-10.7% until 1Q22.**

A major upside surprise, with underlying measures still under upward pressure

October's IPCA registered a 1.25% MoM change (10.67% YoY—exactly the same level of Dec-2015), much above the consensus (1.06%) and our call (1.09%). The headline accelerated to 14.4% 3MMA-saar (from 13.6%), highlighting that the upward pressure remained strong at the margin.

Most of the surprise came in industrial goods and regulated prices, but services also came above expectations. Industrial goods contributed +6 bps to the headline forecast error, with the trend remaining at the high level of 12.6% 3MMA-saar; the industrial's core gauge trend also continued remain at the hefty level of 8.5% 3MMA-saar. It is worth noticing that inflation for industrial goods is proving to be more persistent than most economists predicted. In regulated prices (+6 bps of deviation to the headline forecast error), medicines were a highlight, contributing +3 bps with the error—there is a significant backlog of price rises at the wholesale level that might continue to reach consumers, turning the balance of risks for medicines at the IPCA tilted to the upside. In regulated prices, electrical energy and gasoline also surprised to the upside (contributing +2 and +1 bps to the headline forecast error, respectively). Services contributed +3 bps to the headline forecast error and its trend accelerated further to 9.5% 3MMA-saar (from 8.6%), reaching 2013-2016's levels. Services core gauge also accelerated, reaching 7.5% 3MMA-saar—still below 2013-2016's level, but a risky level, nonetheless. In terms of the main four services' groups, only the ones more linked to the job market (and wages) decelerated a bit in trend levels, while the other three (inertial services, services more linked to economic activity and volatile services) accelerated, showing that inflation has spread in the services sector. Finally, food-at-home came in line with expectations, meaning that its trend continued to hovering at the high level of 18% 3MMA-saar.

Broad qualitative measures still deteriorated further at the margin. The average of the main five core measures followed by the Brazil Central Bank (BCB) rose to 9.7% 3MMA-saar (from 8.9% before) and it is hovering above the target (and distancing further from it) for thirteen 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. The EX3 core gauge (a combination of the industrials and services core gauges) is the only one of the main five measures that did not accelerate further at the margin, but it did not cool down either, remaining at 8.0% 3MMA-saar. The "less negative" news is that diffusion saw some relief, falling to 62.9% (seasonally adjusted) from 65.4% previously—although this is still above the level of 50-55%, which is the one compatible with inflation close to the target.

All in all, we see this as another unfavorable reading and we remain cautious on the inflation outlook, continuing to see the balance of risks tilted to the upside (especially with the recent rise of domestic risk and with new global shocks constantly). We were cautiously expecting IPCA inflation to peak for the last three months (or more), but we are now expecting inflation to hover between 10.5-10.7% until the end of 1Q22, turning the peak into a plateau, pointing to a slower disinflation process ahead.

We have revised our high-frequency tracking to 10.5% (from 9.6%) for IPCA 2021, to 5.8% (from 5.2%) for IPCA 2022 maintained IPCA 2023 at 3.5%. It is worth remembering that the BCB's target is 3.75% for 2021, 3.50% for 2022 and 3.25% for 2023 (±1.50% tolerance interval for each year), and our forecasts are above the targets for all horizons and with upside risks.

Figure 1. IPCA by Group and Forecasting Errors

	MoM			YoY	
	Oct-21	Santander	Dev.	Sep-21	Oct-21
IPCA	1.25	1.09	0.16	10.2	10.7
Food and beverage	**1.17**	**1.21**	**-0.01**	**12.5**	**11.7**
Food-at-home	1.32	1.30	0.00	14.7	13.3
Food service	0.78	1.00	-0.01	7.4	7.8
Housing	**1.04**	**0.92**	**0.02**	**14.0**	**14.8**
Electrical energy	1.16	0.85	0.02	28.8	30.3
Household articles	**1.27**	**0.60**	**0.03**	**12.6**	**12.3**
Apparel	**1.80**	**1.74**	**0.00**	**7.0**	**7.8**
Transportation	**2.62**	**2.17**	**0.09**	**17.9**	**19.6**
Airline tickets	33.86	34.35	0.00	56.8	50.1
Gasoline	3.10	3.00	0.01	39.6	42.7
Health and personal care	**0.39**	**0.22**	**0.02**	**3.7**	**3.8**
Personal spending	**0.75**	**0.83**	**-0.01**	**3.7**	**4.2**
Education	**0.06**	**0.07**	**0.00**	**3.1**	**3.2**
Communication	**0.54**	**0.31**	**0.01**	**1.3**	**1.6**
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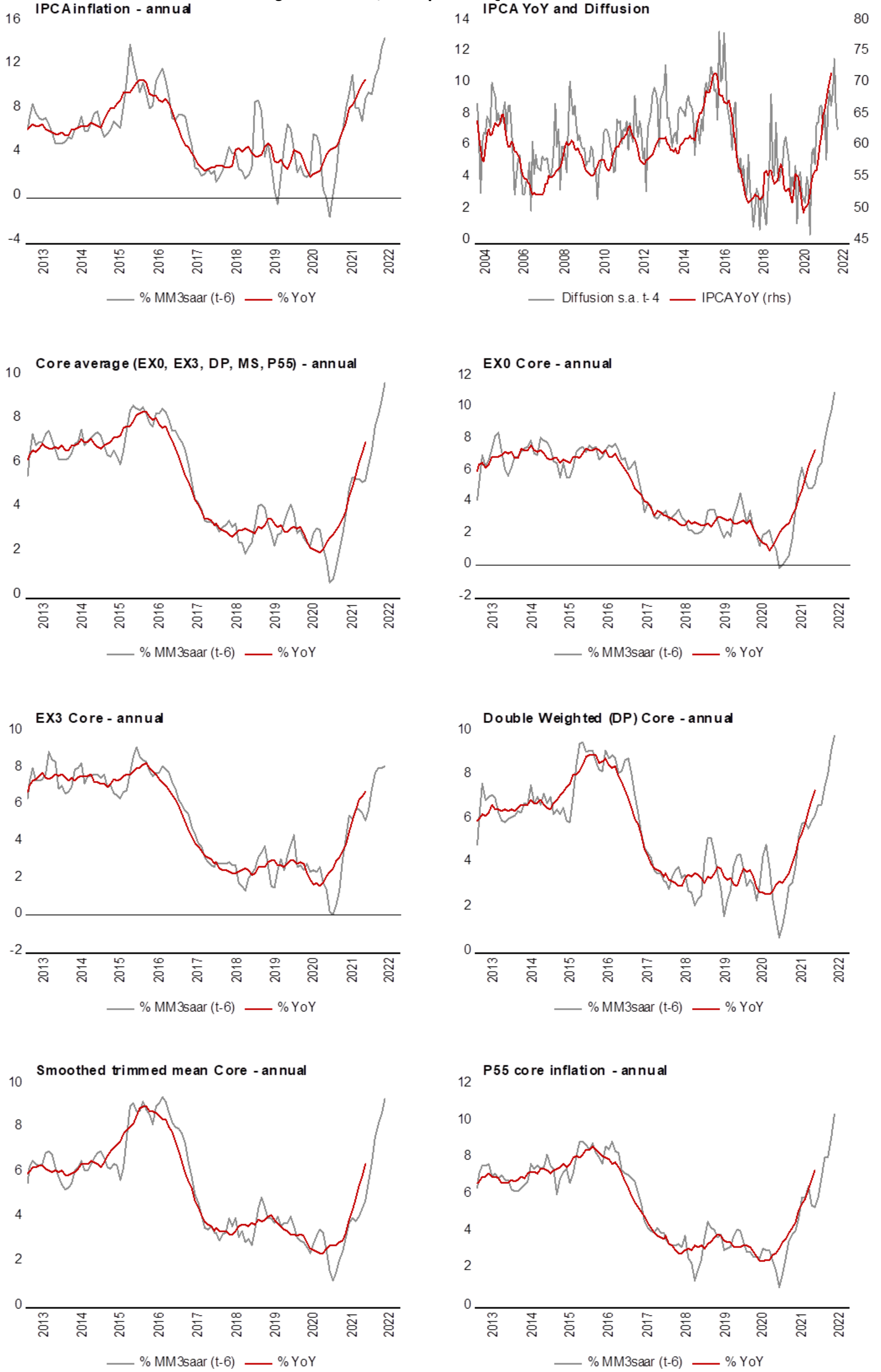
Administered	**1.35**	**1.12**	**0.06**	**15.7**	**17.0**
Free	**1.21**	**1.07**	**0.10**	**8.3**	**8.5**
Food-at-home	1.32	1.30	0.00	14.7	13.3
Industrial goods	1.40	1.13	0.06	10.6	11.1
Services	1.04	0.95	0.03	4.4	4.9
EX3 Core	**0.92**	**0.87**	**0.02**	**6.4**	**6.6**
Average of cores	**0.95**	**-**	**-**	**6.5**	**-**

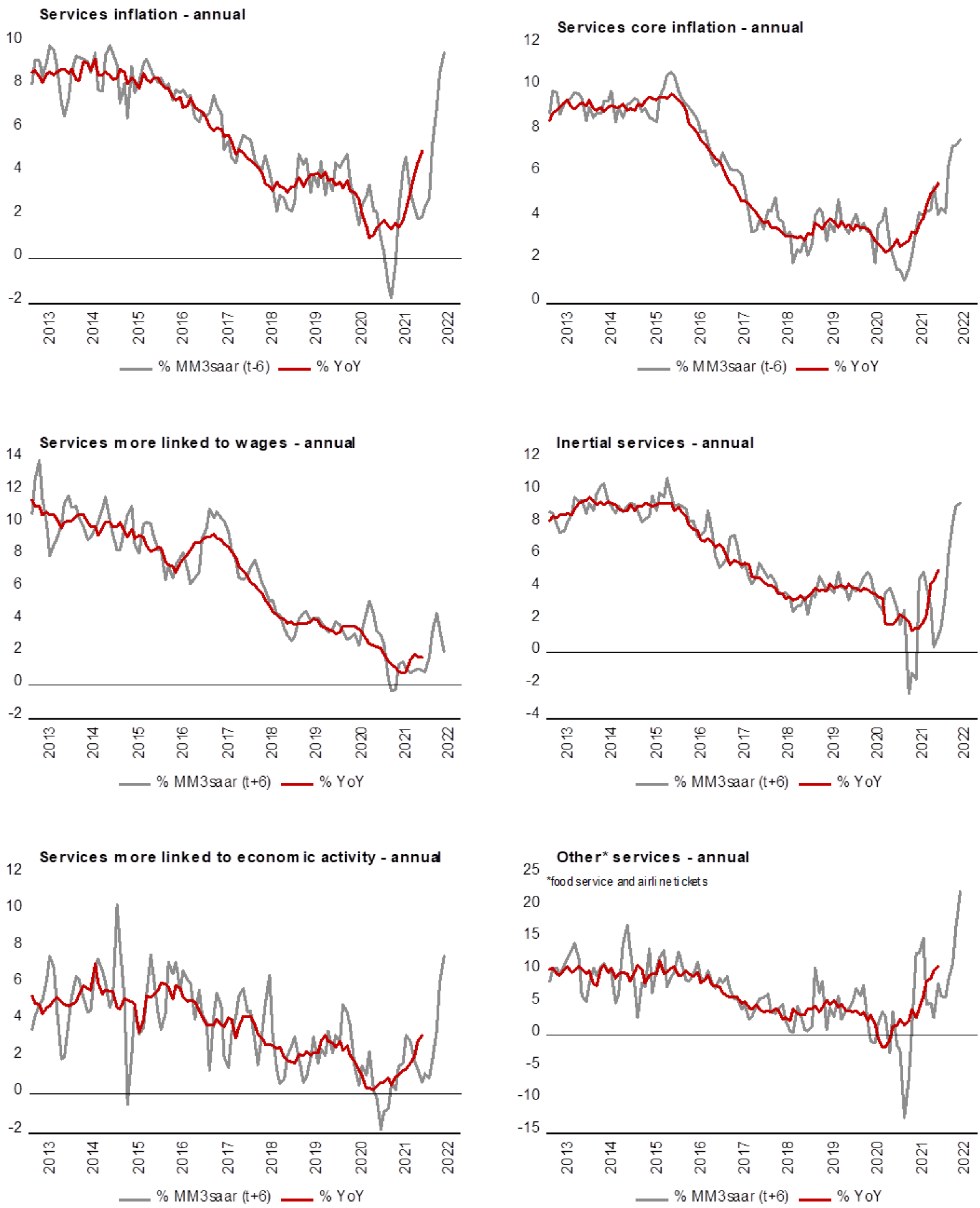
Sources: IBGE and Santander.

Figure 2. IPCA, Groups and Qualitative Measures



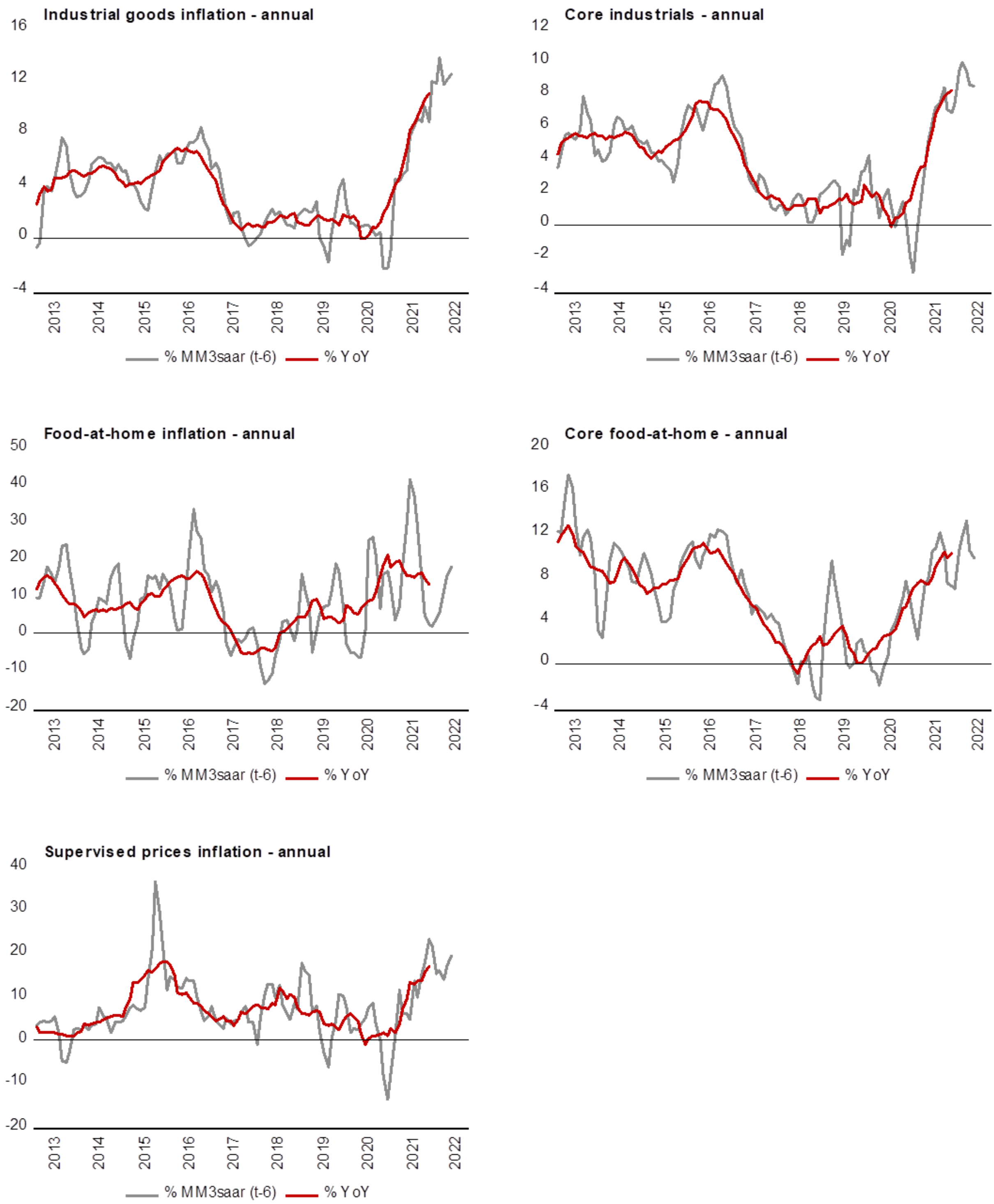
Sources for all charts: IBGE and Santander.

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.

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