

September's IPCA-15: Another Upside Surprise, with Core Gauges Rising Further

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- September's IPCA-15 registered a 1.14% MoM change (10.05% YoY), considerably above our call and consensus, both at 1.04%.
- A major part of the surprise came from services and industrial goods, that is, core-related groups. As a result, broad qualitative measures deteriorated further at the margin, with the average of the main five core measures followed by the Brazil Central Bank (BCB) accelerating from 8.3% to 8.8% 3MMA-saar.
- We are revising our high-frequency tracking from 8.5% to 9.0% for IPCA 2021 (8.5%) and from 4.3% to 4.5% for IPCA 2022.
- Although inflation is probably close to the peak in YoY terms and although we are now tracking some possible downside risks (after nearly a year), the usual inflation determinants, particularly inertia and expectations, still point to an upwardly skewed balance of risks for both years.

Short-term outlook continues to remain unfavorable, while medium-term outlook is not any better

September's IPCA-15 registered a 1.14% MoM change (10.05% YoY), considerably above our call and consensus, both at 1.04%. The headline accelerated to 12.5% 3MMA-saar (from 11.8%), highlighting that the upward pressure remains strong at the margin.

A major part of the surprise came from services and industrial goods, that is, core-related groups. Services contributed +2 bps to the headline forecast error and accelerated from 7.0% to 7.9% 3MMA-saar. Industrial goods contributed +3 bps to the headline forecast error and rose to 12.4% 3MMA-saar (from 11.9%). Two "less negative" results were that services' and industrial goods' core gauges both saw a slight relief: core services passed from 7.9% to 7.0% 3MMA-saar, while core industrial goods passed from 10.1% to 9.9% 3MMA-saar. Additionally, while food-at-home came nearly in line with our forecast, it accelerated to 22% 3MMA-saar (from 16%), highlighting renewed pressure at the margin, after some months of cooling down. Finally, regulated prices remained under pressure, still pressured by electrical energy and gasoline: the two groups (i.e., services and industrial goods) together contributed +4 bps to the headline forecast error.

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 main core measures followed by the BCB rose to 8.8% 3MMA-saar (from 8.3% before) and it is hovering above the target (and distancing further from it) for twelve months now. This is an evidence of the spreading of primary shocks (commodities, FX, supply chain disruption, etc.) to the general prices and the persistency at these high levels is risky. Also, the diffusion index—a leading indicator of annual inflation—remained at the high level of 70% (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. In addition, the diffusion is also another sign of the spreading of shocks.

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Balance of risks is still skewed to the upside

For the last two weeks, we were analyzing a possible reduction of the upward asymmetry in the balance of risks of our inflation outlook, based on possible downside risks for food and electrical energy. Moreover, we continue to project the YoY IPCA will peak in the next reading. **However, current inflation and its unfavorable underlying measures do not point to a reduction in upward asymmetry.**

All in all, this was another unfavorable inflation reading and when we analyze the usual inflation determinants, particularly inertia and expectations, **we continue to see upside risks for both the short and medium term.** Moreover, problems with the global supply chain continue to occur and a new recent shortage of natural gas might push oil prices up, being another source of upside risk.

As a result, we are revising our high-frequency tracking from 8.5% to 9.0% for IPCA 2021 (8.5%) and from 4.3% to 4.5% for IPCA 2022. In our view, risks are still tilted to the upside, and if the downside risks, which we mentioned before (food and energy), do not materialize, the disinflation process could be risky.

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.

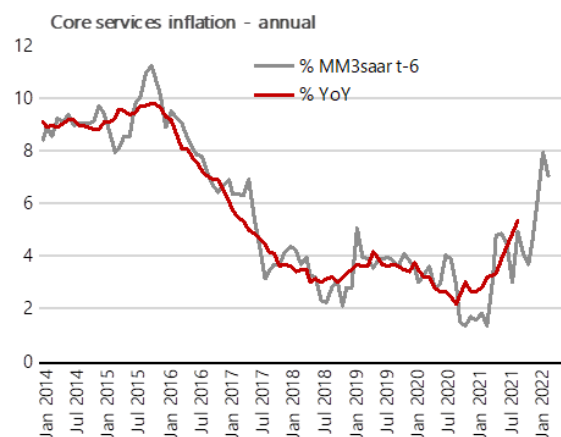
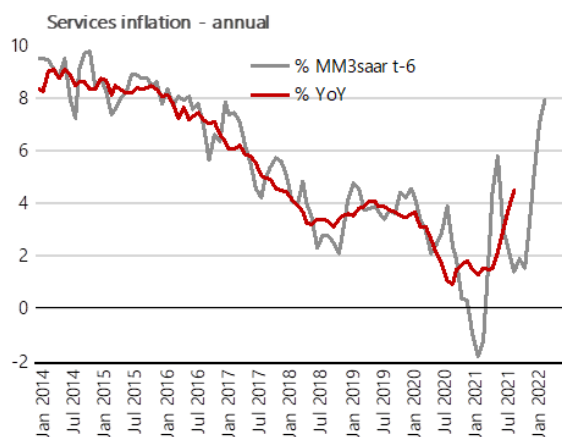
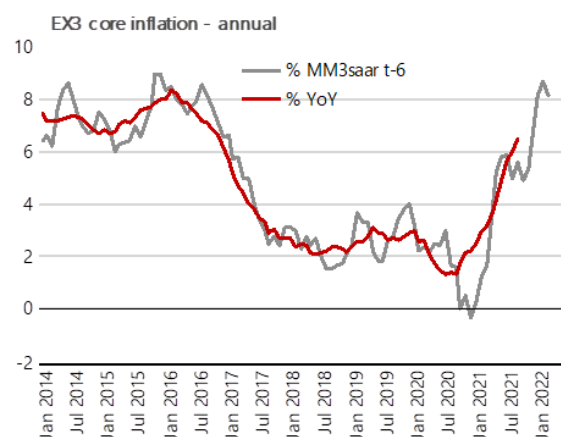
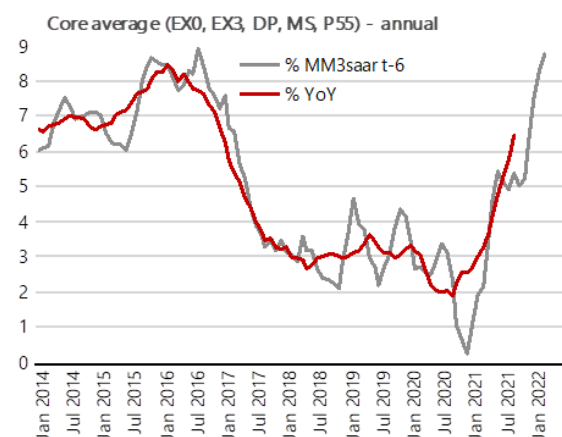
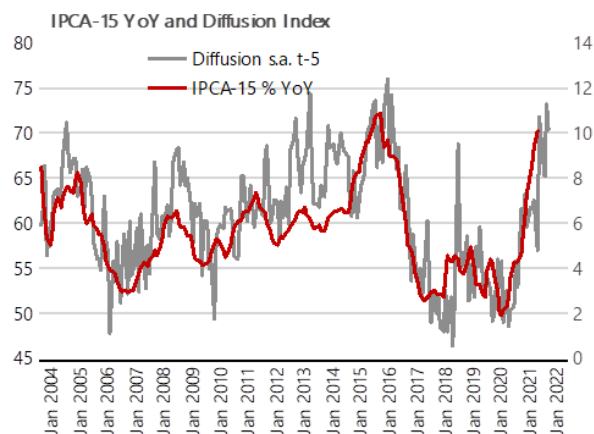
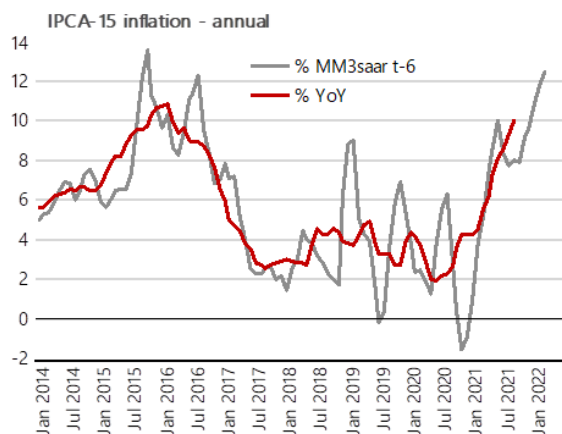
Figure 1. IPCA by Group and Forecasting Errors

	Sep-21	Santander	Desv.	Aug-21	Sep-21
IPCA-15	1.14	1.04	0.10	9.3	10.1
Food and beverage	1.27	1.22	0.01	13.6	13.4
Food-at-home	1.51	1.41	0.01	16.0	15.5
Food service	0.69	0.73	0.00	7.9	8.2
Housing	1.55	1.44	0.02	11.5	12.9
Electrical energy	3.61	3.48	0.01	20.8	25.2
Household articles	1.23	0.75	0.02	12.7	13.2
Apparel	0.54	0.83	-0.01	6.1	7.0
Transportation	2.22	1.98	0.05	15.7	17.3
Airline tickets	28.76	22.50	0.02	29.0	56.6
Gasoline	2.85	2.40	0.03	39.5	39.1
Health and personal care	0.33	0.17	0.02	2.7	3.8
Personal spending	0.48	0.55	-0.01	2.9	3.3
Education	-0.01	0.05	0.00	2.7	2.8
Communication	0.02	0.08	0.00	1.1	1.0
Administered	1.49	1.36	0.03	13.5	14.8
Free	1.01	0.93	0.06	7.8	8.4
Food-at-home	1.51	1.41	0.01	16.0	15.5
Industrial goods	1.11	1.00	0.03	9.4	10.3
Services	0.74	0.68	0.02	3.8	4.5
EX3 Core	0.61	0.60	0.01	6.0	6.5
Average of cores	0.80	-	-	5.7	-

Sources: IBGE and Santander.



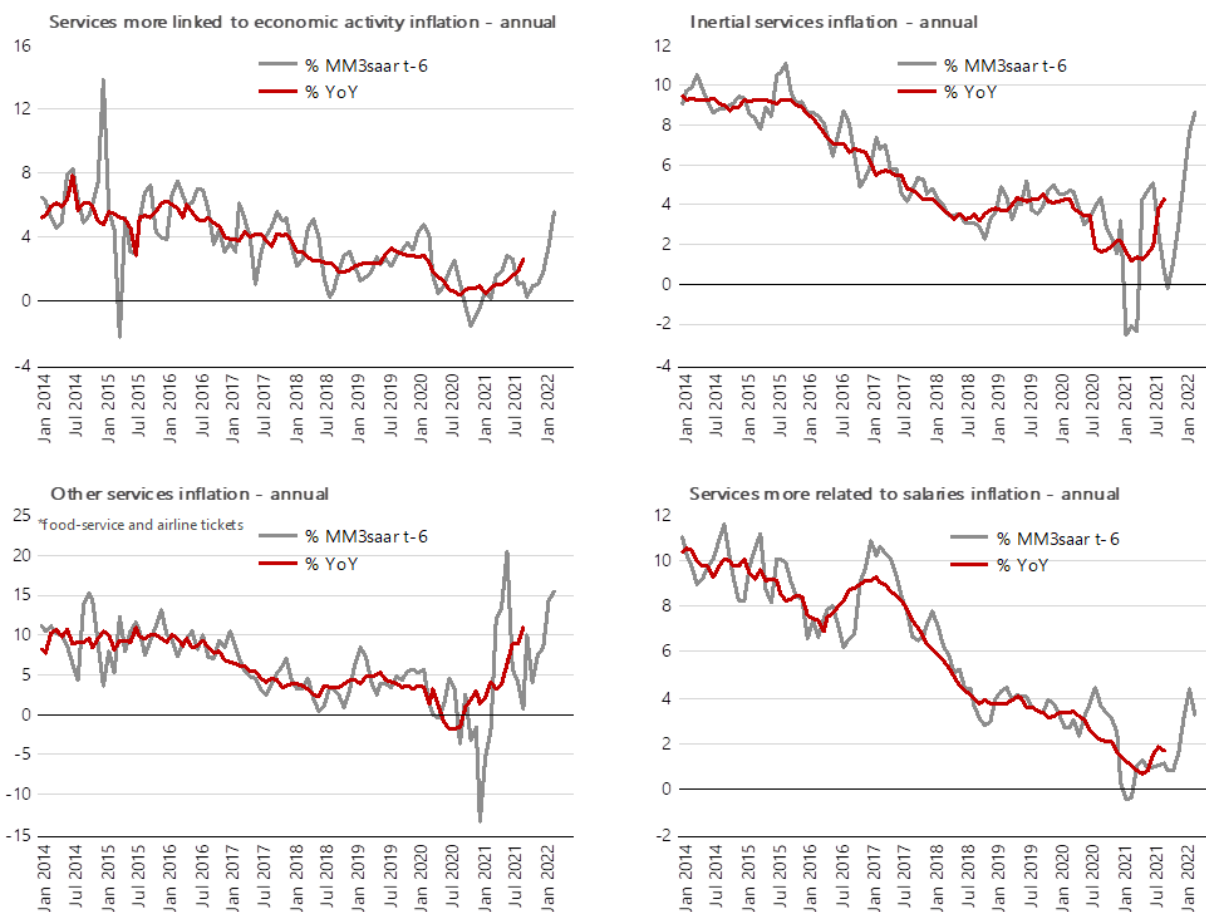
Figure 2. IPCA, Groups and Qualitative Measures



Sources for all charts: IBGE and Santander.



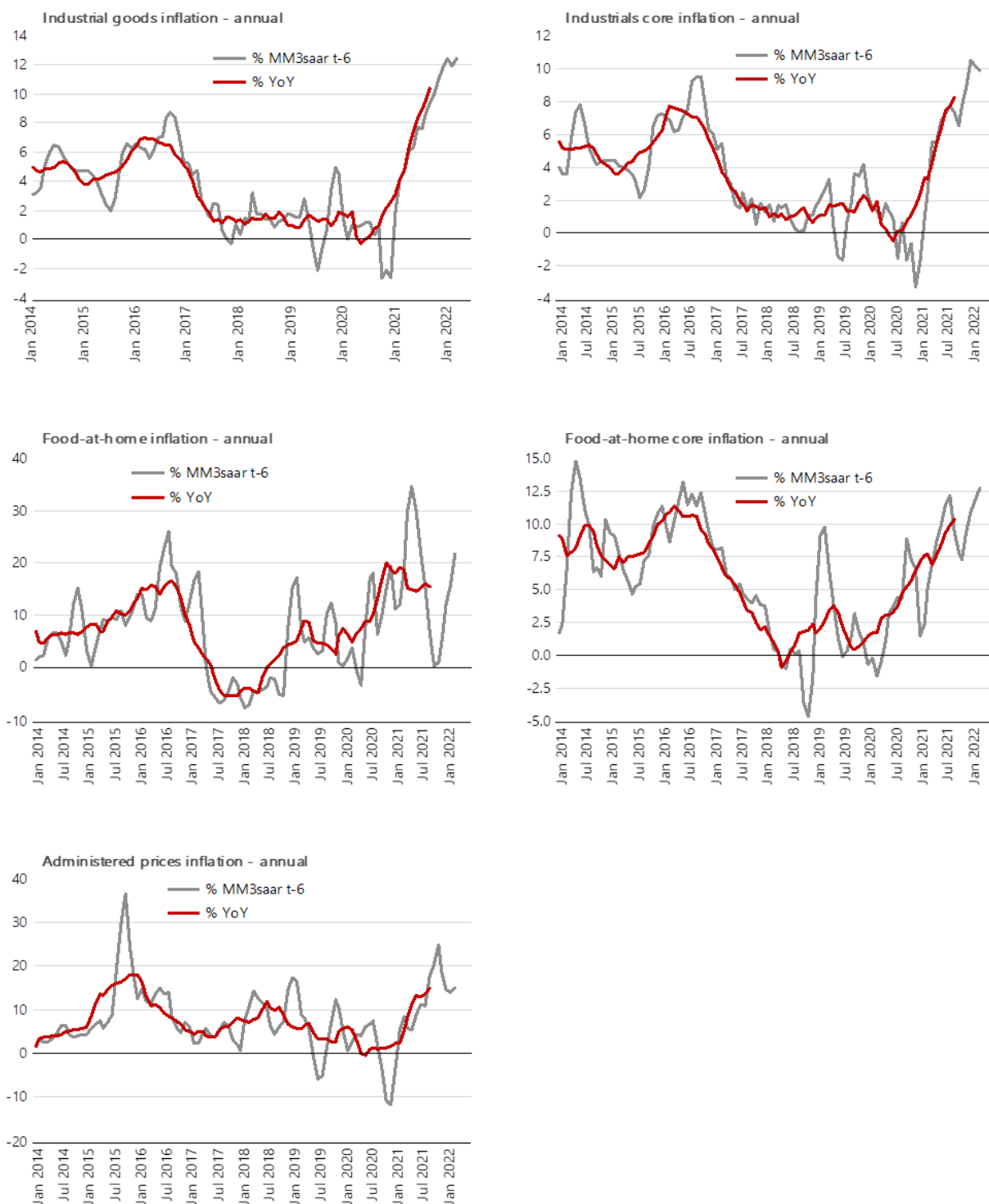
Figure 3. IPCA, Groups and Qualitative Measures continuation



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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