

Despite Upward Surprises in the Headline, Core Gauges Are Still Trending Down

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- **IPCA-15 for December registered a 0.52% MoM change, above our call (0.44%) but mostly in line with consensus (0.54%). The YoY change reached 5.9%, down from 6.2% YoY in November. The trend (3MMA-saar) has been rebounding modestly — reaching 3.1% 3MMA-saar (vs. 0.3% in November and a low of -4.3% in September).**
- **Compared to our forecast, upward surprises were concentrated in industrial goods, mostly in Black Friday-related items (a recomposition of prices after the sales). Some volatile food items also surprised upward, as did some regulated prices. On the other hand, services surprised downward, but with the bulk of the surprise coming from airline tickets, also a volatile item.**
- **Meanwhile, qualitative measures keep improving, with the trend (3MMA-saar) of core services and core industrial goods inflation decelerating. Broad core measures also continued cooling down, with the average of the main gauges reaching 5.0% 3mma-saar (from 5.4% in November).**
- **All in all, we highlight that the improvements in underlying inflation have been surprising and are starting to pile up, so we continue to forecast inflation quickly reaching 4.0-5.0%. However, we still believe the road from 4.0-5.0% to 3.0%, the Central Bank's (BCB) mid-target, could be bumpy, given another likely round of fiscal expansion that could keep demand hot.**

IPCA-15 for December registered a 0.52% MoM change, above our call (0.44%) but mostly in line with the consensus (0.54%). The YoY change reached 5.9%, down from 6.2% YoY in November. The trend (3MMA-saar) has been rebounding modestly — reaching 3.1% 3MMA-saar (vs. 0.3% in November and a low of -4.3% in September) — due to the end of the downward impact from the tax cuts.

Compared to our forecast, upward surprises were concentrated in industrial goods (+9 bps of error in the headline), mostly in Black Friday-related items (a recomposition of prices after the sales). Some volatile food items also surprised upward (+3 bps), as did some regulated prices (+5 bps). On the other hand, services surprised downward (-9 bps), but with the bulk of the surprise coming from airline tickets (-7 bps), also a volatile item. The bottom line is that surprises (both ways) were in volatile items that are not good leading indicators of future inflation.

In trend terms, services decelerated to 4.8% 3MMA-saar (from 5.3% in November and a peak of 12.9% in July), with its core also declining to 5.6% 3MMA-saar (from 6.9% last month and a peak of 11.9% in July). The industrial goods trend rose to 5.7% 3MMA-saar (from 5.2% last month and a peak of 15.8% in April), while its core saw a decline to 9.9% 3MMA-saar (from 11.2% in November). Food-at-home increased at the margin from -0.7% to 4.2% 3MMA-saar, while regulated prices continued to rebound as the downward effect of the recent tax cuts ended (-0.1% 3MMA-saar vs. -6.6% in November).

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Meanwhile, qualitative measures keep improving, with the trend (3MMA-saar) of core services and core industrial goods inflation decelerating. Broad core measures also continued cooling down, with the average of the main gauges reaching 5.0% 3mma-saar (from 5.4% previously). The diffusion index remained relatively stable at 65% s.a. Both measures are still above the level compatible with the medium-term inflation target (3.0%), but the downward trend gives us confidence that the worst is behind us.

All in all, we highlight that the improvements in underlying inflation have been surprising and are starting to pile up, so we continue to forecast inflation quickly reaching 4.0-5.0%. However, we still believe the road from 4.0-5.0% to the 3.0% BCB mid-target could be bumpy, given another likely round of fiscal expansion that could keep demand hot. Our high-frequency tracking for IPCA 2022 is at 5.6% (from 5.5%) and for IPCA 2023 is at 5.5% (unchanged).



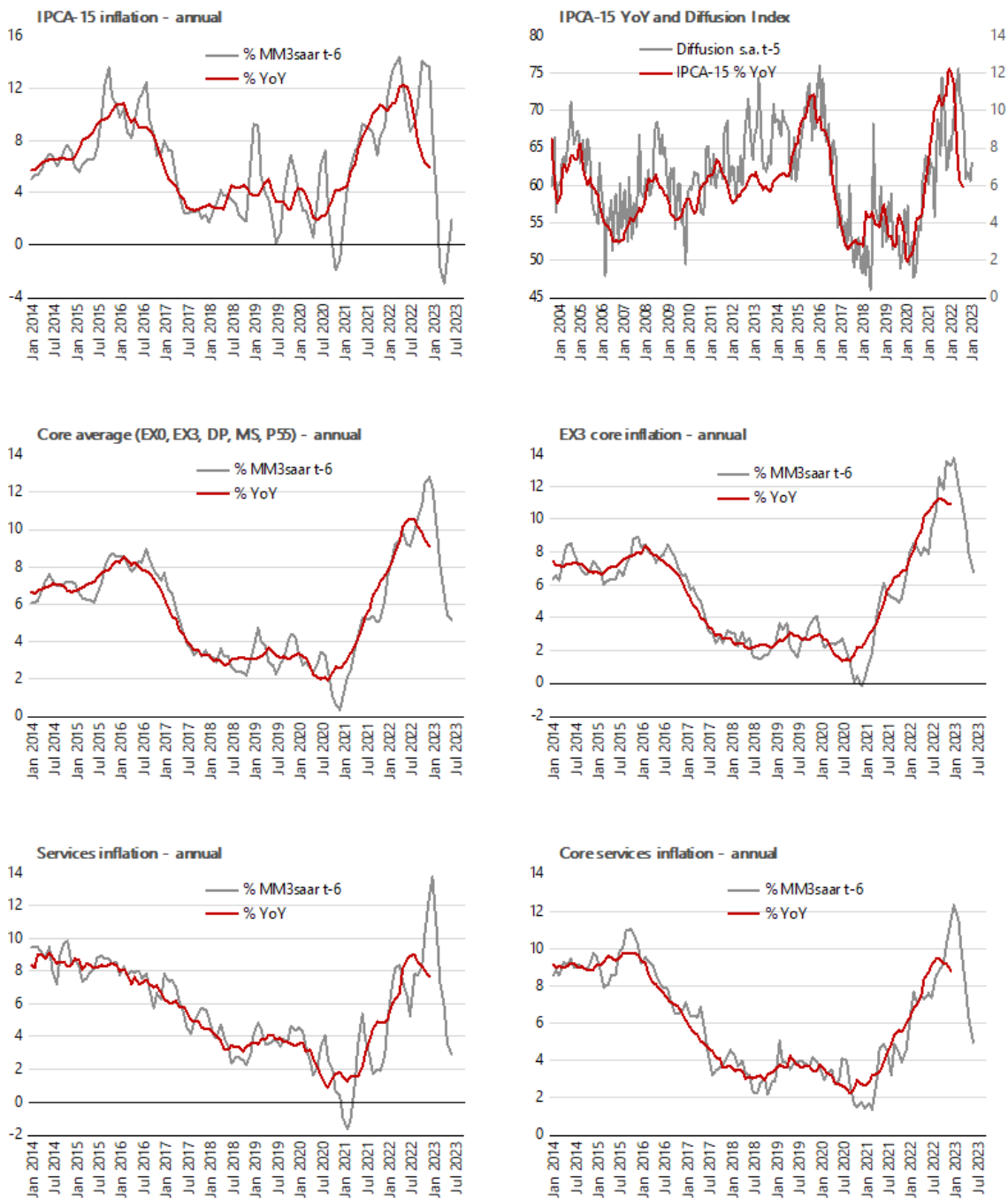
Figure 1. December's IPCA-15 Details (%)

	MoM			YoY		3MMA-saar	
	Dec-22	Santander	Desv.	Nov-22	Dec-22	Nov-22	Dec-22
IPCA-15	0.52	0.44	0.08	6.2	5.9	0.3	3.1
Food and beverag	0.69	0.56	0.03	11.6	12.0		
Food-at-home	0.78	0.58	0.03	13.2	13.6	-0.7	4.2
Food service	0.45	0.50	0.00	7.6	8.0		
Housing	0.40	0.44	-0.01	0.7	0.2		
Electrical energy	0.87	0.75	0.00	-18.6	-18.7		
Household article	-0.46	-0.35	0.00	10.2	8.4		
Apparel	1.16	1.08	0.00	18.3	18.4		
Transportation	0.85	1.00	-0.03	0.4	-1.0		
Airline tickets	0.47	10.00	-0.07	35.9	24.0		
Gasoline	1.52	1.20	0.01	-24.2	-25.5		
Health and person	0.40	-0.25	0.08	10.0	11.2		
Personal spending	0.39	0.50	-0.01	7.7	7.6		
Education	0.00	0.03	0.00	7.4	7.4		
Communication	0.18	-0.26	0.02	-1.2	-1.2		
Administered	0.83	0.64	0.05	-3.4	-3.7	-6.6	-0.1
Free	0.42	0.37	0.03	9.7	9.5		
Food-at-home	0.78	0.58	0.03	13.2	13.6	-0.7	4.2
Industrial goods	0.33	-0.06	0.09	10.1	9.7	5.2	5.7
Services	0.32	0.57	-0.09	8.0	7.6	5.3	4.8
EX3 Core	0.35	0.16	0.07	11.0	10.9	8.7	7.3
Average of cores	0.40	-	-	9.4	9.1	5.9	5.7

Sources: Brazilian Central Bank, IBGE, Santander.



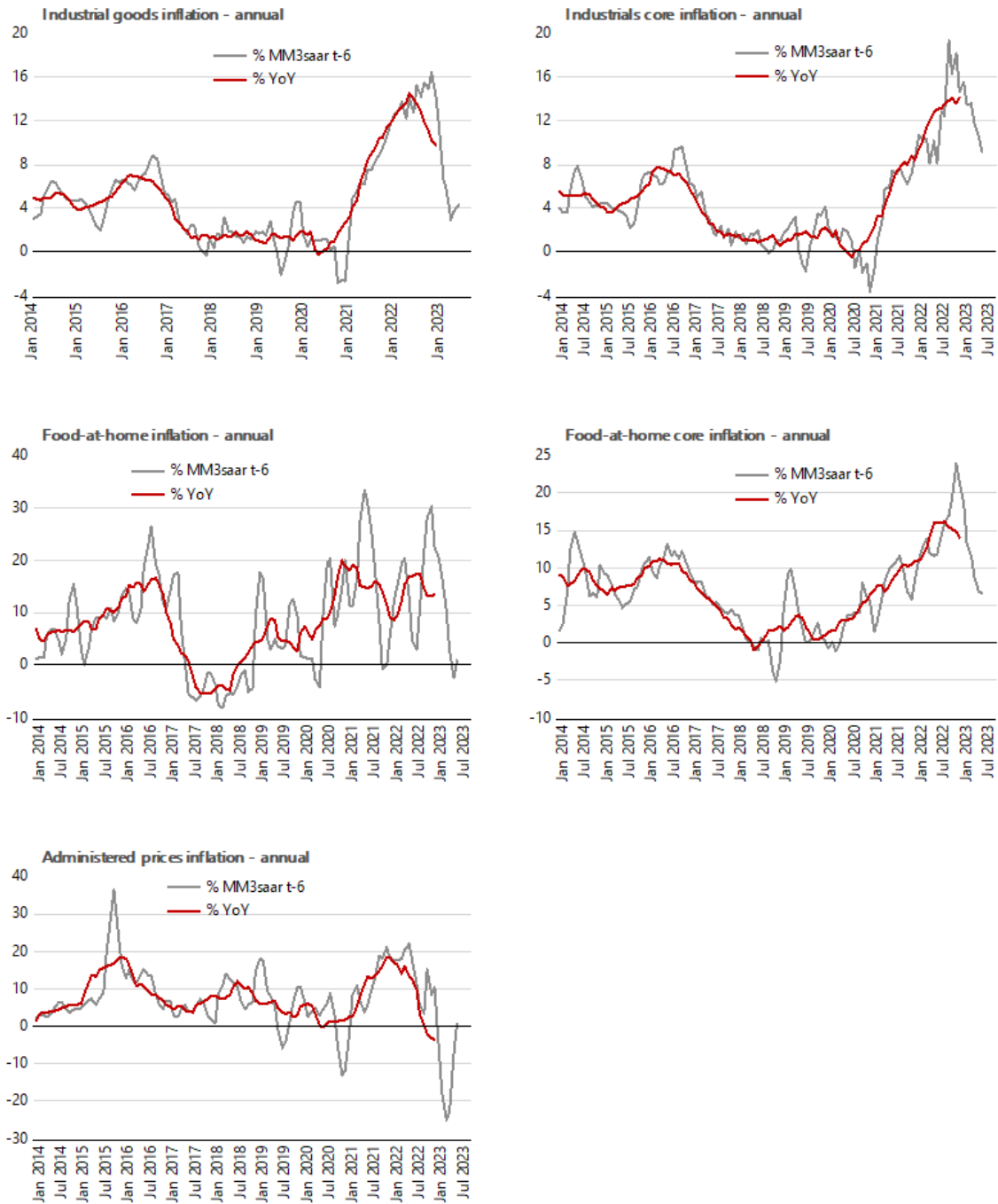
Figure 2. IPCA, Groups and Qualitative Measures



Sources for all charts: IBGE and Santander.



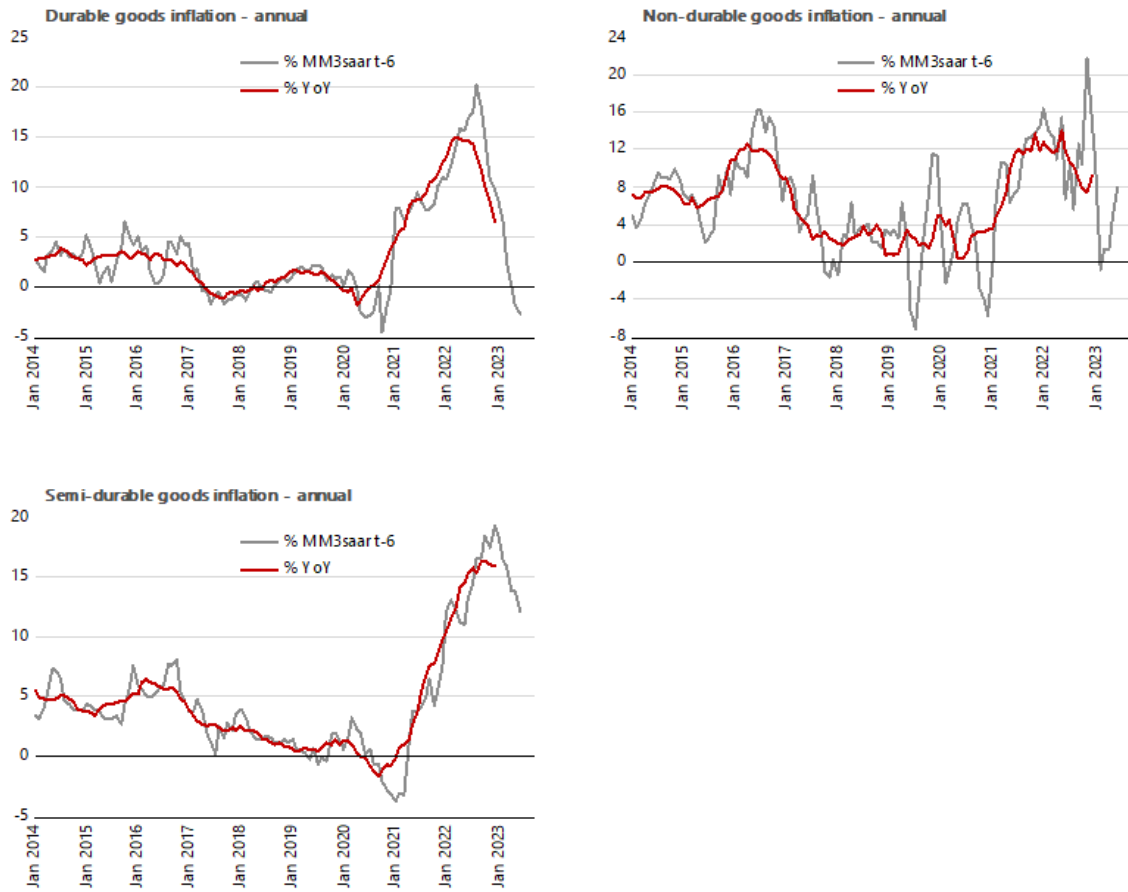
Figure 3. IPCA, Groups and Qualitative Measures (continued)



Sources for all charts: IBGE and Santander.



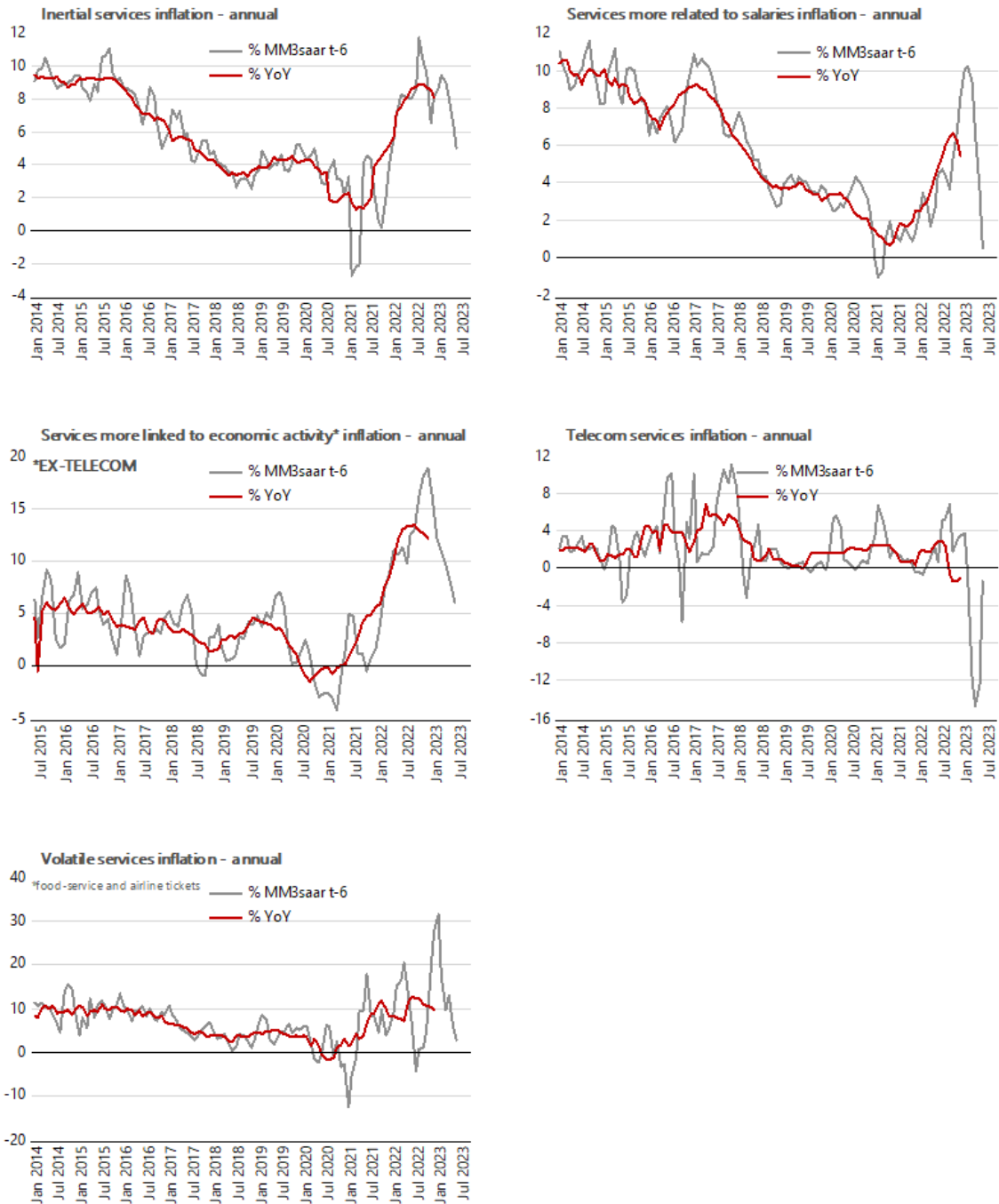
Figure 4. IPCA, Groups and Qualitative Measures (continued)



Sources for all charts: IBGE and Santander.



Figure 5. IPCA, Groups and Qualitative Measures (continued)





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