October's IPCA-15: Underlying Inflation Cooling Down Further

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- **IPCA-15 rose 0.16% MoM, above the consensus (0.09%), but in line with our call (0.15%). The YoY change reached 6.9%, down from 8.0% YoY previously, and the trend fell to -3.7% 3MMA-saar (from -2.8%).**
- **In the breakdown, the biggest upward surprise came in services (+8 bps), but it was concentrated in one highly volatile item, airline tickets. Industrial goods (-3 bps) and regulated prices (-4 bps), on the other hand, surprised downwards. Finally, food-at-home came exactly in line with our expectations.**
- **In trend (3MMA-saar) terms, services, industrial goods and food-at-home are decelerating. Regulated prices remained in the negative camp, but it was basically stable.**
- **Moreover, broad qualitative measures also continued improving at the margin. It is worth noticing that all the five main core gauges decelerated at the margin—including the EX3, the one more correlated to the output gap, that is now with its trend (3MMA-saar) also running below the YoY change.**
- **Our high-frequency tracking was revised down to 5.4% YoY (from 5.5%) for IPCA 2022. For IPCA 2023, we kept the high-frequency tracking unchanged at 5.0%.**
- **It is also worth noticing the pattern of inflation surprises (as we have been highlighting in our IGPs pieces): once IPCA YoY has peaked, the trend is for upward surprises to reduce, which is indeed happening. We find this important because inflation surprises tend to influence medium-term inflation expectations.**

IPCA-15 rose 0.16% MoM, above the consensus (0.09%), but in line with our call (0.15%). The YoY change reached 6.9%, down from 8.0% YoY previously, and the trend fell to -3.7% 3MMA-saar (from -2.8%). In the breakdown, the biggest upward surprise came in services (+8 bps), but it was concentrated in one highly volatile item, airline tickets. Industrial goods (-3 bps) and regulated prices (-4 bps), on the other hand, surprised downwards. Finally, food-at-home came exactly in line with our expectation.

In trend (3MMA-saar) terms, services are decelerating. Headline services reached 6.4% MM3-saar (from 7.2%) and, most important, core services (which excludes volatile items such as airline tickets) decelerated to 7.9% 3MMA-saar (from 10.0%). Possibly both headline and core services have reached the peak in year-over-year terms. Breaking down the services group, we highlight the surprising performance of the subgroup more correlated to economic activity, which is running at 0.3% 3MMA-saar after a peak of 13.4% in June 2022—something we did not expect given that the job market seems tight. Also, the services for which wage is the main cost are decelerating at the margin, reaching 7.6% 3MMA-saar (from a possible peak of 11.1% in August 2022). The riskier dynamic—as expected—is coming from the more inertial services (the one for which price adjustments follow past inflation) as it is running relatively stable around 8.3% 3MMA-saar, without a clear downward trend. The last subgroup—the more volatile services prices—also does not present a clear downward trend and it is running around 12% 3MMA-saar, but being more volatile, they are less relevant for the broad trend of inflation.

Industrial goods are also decelerating in trend terms. Headline industrial goods went down to just 2.5% 3MMA-saar (from 4.7%)—still influenced by the downward effect of the tax cut in ethanol—but core industrial goods (which excludes ethanol among other volatile items) decelerated to 11.7% 3MMA-saar (from 12.8%). Headline industrial goods have peaked, and its core is likely on the verge of peaking in year-over-year terms. Breaking down the industrial goods group, we highlight the surprising performance of durable goods (no influence of the recent tax cuts here), which decelerated to -0.6% 3MMA-saar after a peak of 20.8% 3MMA-saar in February 2022. Non-durable goods are also running close to 0.0% 3MMA-saar, but ethanol enters that group, so this downward trend has been mostly influenced by the tax cut. Semi-durable goods started to cool down more clearly, going to 13.9% 3MMA-saar (from 16.1%), but are still running higher, mostly because of clothing.

In trend terms, headline food-at-home also saw a relief, going to 2.0% 3MMA-saar (from 10.0%) and its core gauge also cooled down, reaching 8.4% 3MMA-saar (from 11.2%). Finally, regulated prices remained in the negative camp, but it was basically stable at -25.0% 3MMA-saar, as the effects of tax cuts in fuels, electricity, and telecom are fading.

Moreover, broad qualitative measures also continued improving at the margin. The average of the main core gauges decelerated to 6.4% 3MMA-saar (from 7.9%), the third month in a row running below the YoY change, reinforcing that core inflation has peaked and is going to continue decelerating in YoY terms ahead. It is worth noticing that all the five main core gauges decelerated at the margin—including the EX3, the one correlated the most to the output gap, that is now with its trend (3MMA-saar) also running below the YoY change. The less positive news in the qualitative measures was that the diffusion index did not fall and remained relatively stable at 61.1% s.a. However, the diffusion ex-food-at-home continued falling to 61% s.a. (from 68%).

Although we still believe that the road towards the center of the target could be bumpy with services inflation (more inertial) still putting challenges in a tight job market scenario, we recognize that the preliminary signs of improvement in underlying inflation are starting to consolidate, as it is becoming clearer that broad core gauges have peaked (and are still on a downward trend) and that even services inflation (our main concern for the medium-term, particularly its core gauge) could be peaking shortly.

Our high-frequency tracking was revised down to 5.4% YoY (from 5.5%) for IPCA 2022. We note that we consider oil prices coming back to above 100 USD/bbl by year-end with BRL at 5.30, but in simulation considering that oil prices remain stable in BRL terms, we estimate IPCA 2022 could reach levels closer to 5.0%. For IPCA 2023, we kept the high-frequency tracking unchanged at 5.0%. For IPCA 2023, we see the risks more balanced: on one side, services (sticky prices) inflation could be higher than we estimate, on the back of the tight job market—although at the margin, the performance of services inflation has been surprising favorably; on the other side, we still consider a reinstation of part of the tax cuts done this year (the PIS/Cofins in gasoline), which is not certain to happen. For IPCA 2024, we continue to forecast inflation coming back to the center of the target, at 3.0%, but we see upward risks coming from the possibility that the fiscal adjustment process falls short of what is needed to re-anchor expectations, creating more inertia and leading to a more difficult disinflation process ahead.

It is also worth noticing the pattern of inflation surprises (as we have been highlighting in our IGPs pieces): once IPCA YoY has peaked, the trend is for upward surprises to reduce, which is indeed happening. We find this important because inflation surprises tend to influence medium-term inflation expectations. As a result, with big upward surprises halting and even downward surprises starting to appear (five out of the last 10 prints surprised downwards), upward adjustments in medium-term inflation expectations should be curbed and downward adjustments could gain traction (which is actually happening).

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

	MoM			YoY	
	Oct-22	Santander	Dev.	Sep-22	Oct-22
IPCA-15	**0.16**	**0.15**	**0.01**	**8.0**	**6.9**
Food and beverage	**0.21**	**0.26**	**-0.01**	**12.7**	**11.4**
Food-at-home	0.14	0.14	0.00	14.7	13.1
Food service	0.37	0.59	-0.01	7.9	7.3
Housing	**0.28**	**0.48**	**-0.03**	**2.9**	**1.3**
Electrical energy	0.07	0.25	-0.01	-15.1	-18.2
Household articles	**-0.35**	**-0.19**	**-0.01**	**12.3**	**11.3**
Apparel	**1.43**	**1.52**	**0.00**	**18.3**	**18.5**
Transportation	**-0.64**	**-0.99**	**0.07**	**5.6**	**2.8**
Airline tickets	28.17	9.00	0.13	47.3	40.6
Gasoline	-5.92	-5.35	-0.03	-13.9	-20.5
Health and personal care	**0.80**	**0.88**	**-0.01**	**9.0**	**9.9**
Personal spending	**0.57**	**0.68**	**-0.01**	**8.3**	**8.1**
Education	**0.19**	**0.04**	**0.01**	**7.2**	**7.3**
Communication	**-0.42**	**-0.55**	**0.01**	**-0.1**	**-0.9**
Administered	**-0.78**	**-0.63**	**-0.04**	**0.1**	**-2.1**
Free	**0.47**	**0.40**	**0.05**	**10.8**	**10.1**
Food-at-home	0.14	0.14	0.00	14.7	13.1
Industrial goods	0.20	0.32	-0.03	11.9	11.0
Services	0.80	0.58	0.08	8.5	8.3
EX3 Core	**0.63**	**0.77**	**-0.05**	**11.3**	**11.2**
Average of cores	**0.49**	**-**	**-**	**10.2**	**-**

Sources: Brazilian Central Bank, IBGE, Santander.

Figure 2. IPCA, Groups and Qualitative Measures

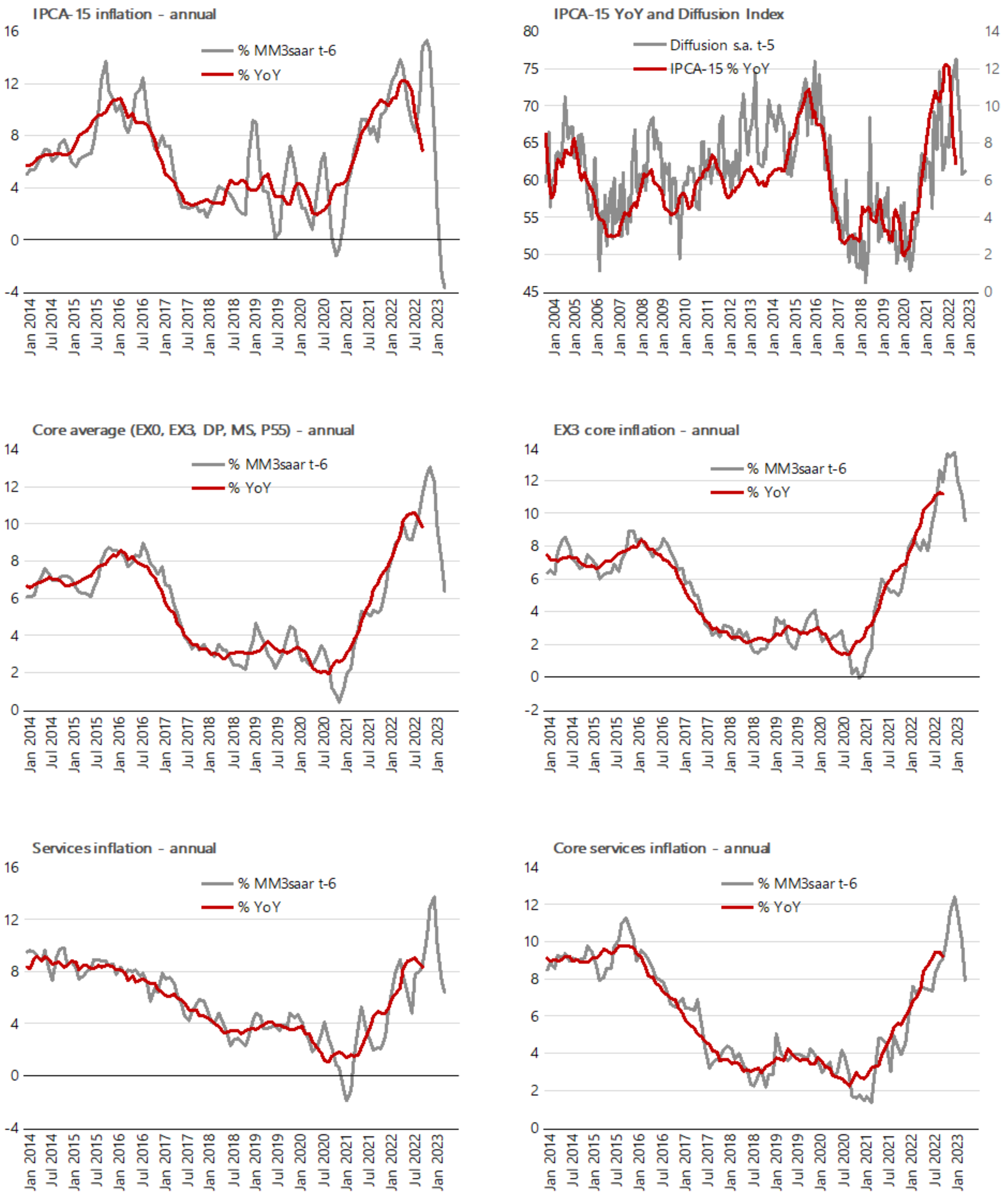
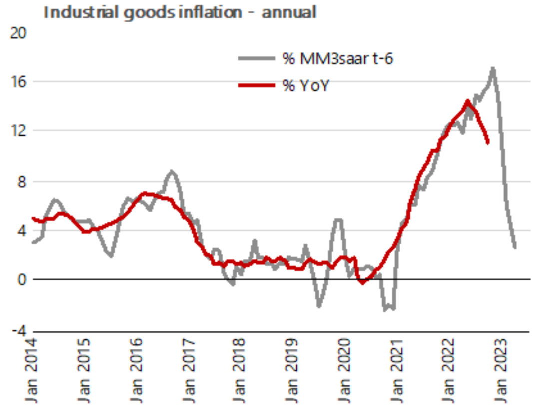
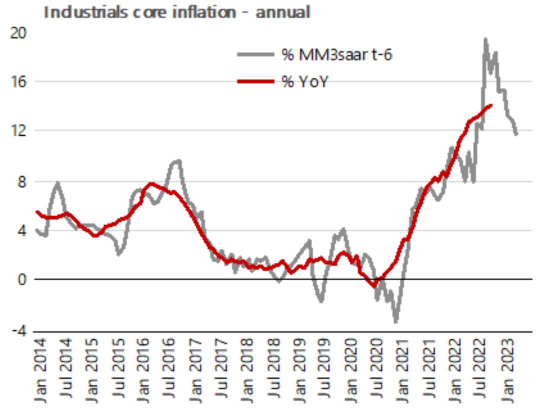
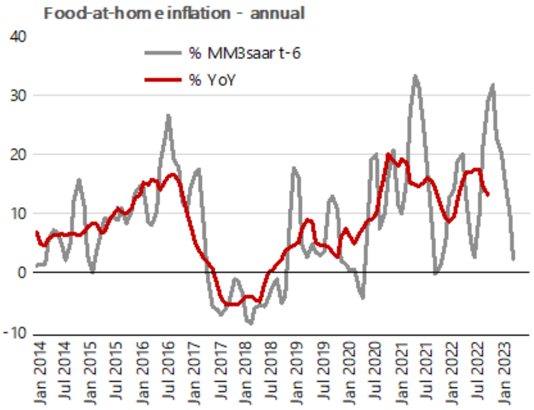
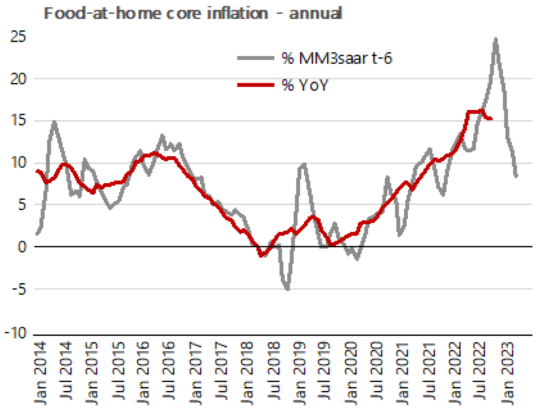


Figure 3. IPCA, Groups and Qualitative Measures (continued)









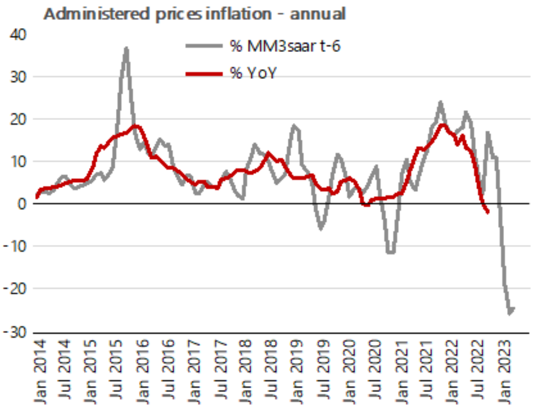
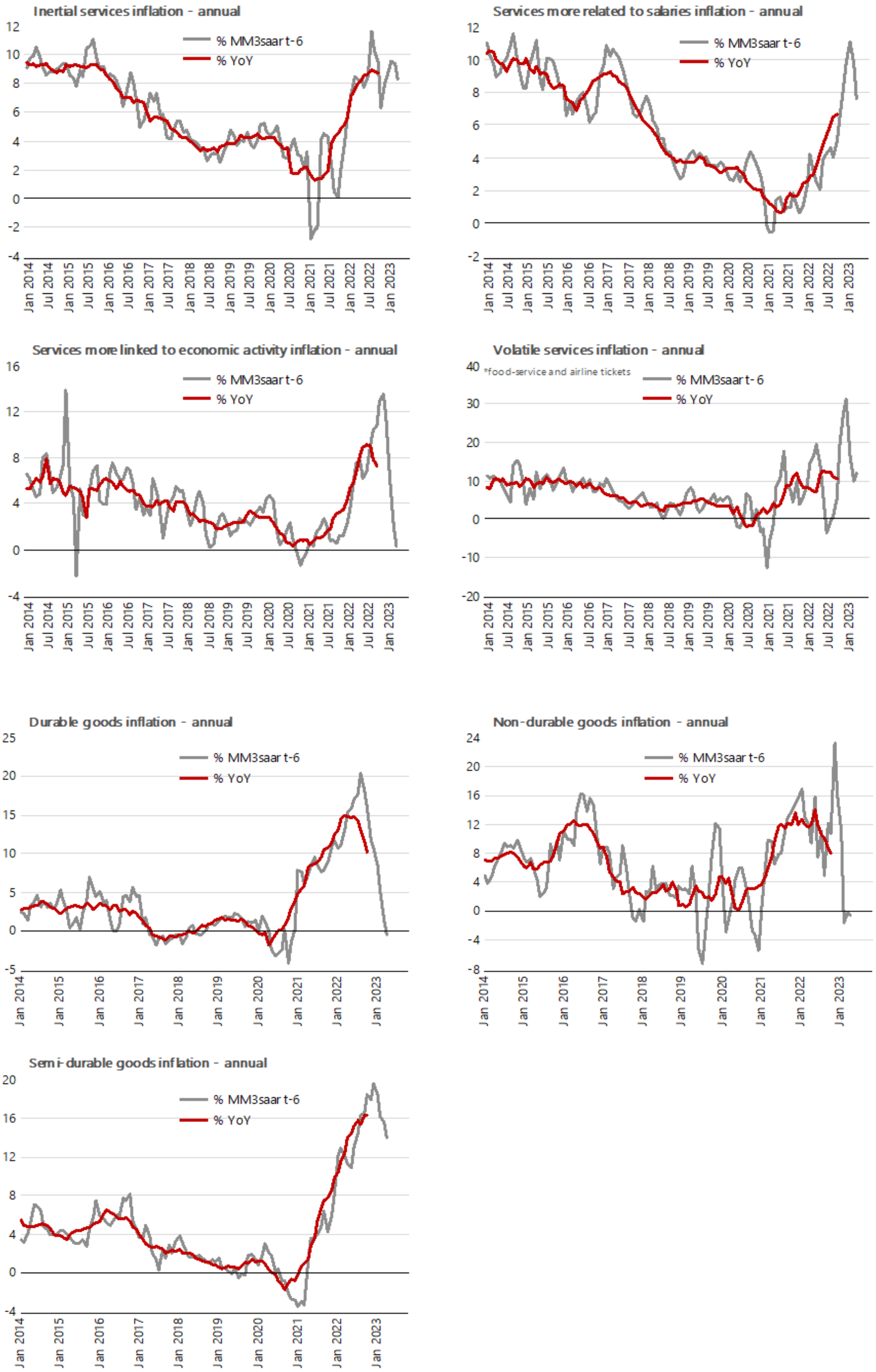
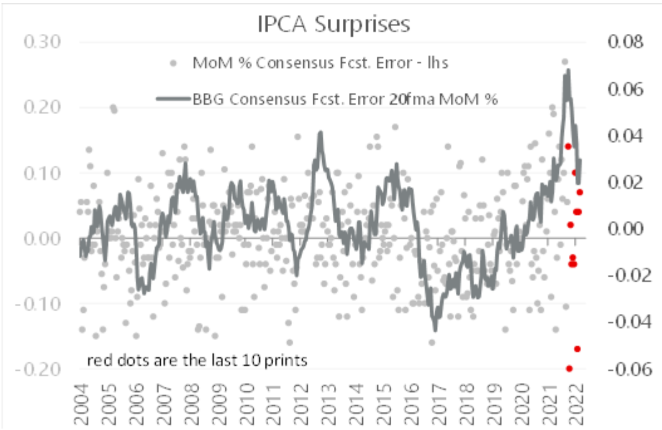


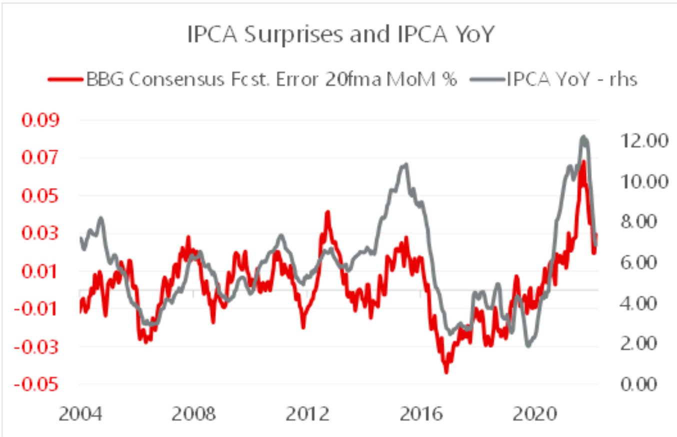
Figure 4. IPCA, Groups and Qualitative Measures (continued)



Sources for all charts: IBGE and Santander.

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





Sources for all charts: IBGE and Santander.

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