

Levels Are Still High, but Improvements in Underlying Inflation Have Been Consistent

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- **IPCA rose 0.41% MoM in November, well below the consensus (0.53%) and below our forecast (0.50%). The YoY change reached 5.9%, down from 6.5% YoY previously. The trend (3MMA-saar) has been rebounding modestly, as the downward effect of the recent tax cuts fades — reaching 0.0% 3MMA-saar (vs. -1.4% in October and a low of -4.3% in September).**
- **In the breakdown, the biggest downward surprise came in industrial goods (-7 bps of error in the headline), driven by stronger-than-expected Black Friday-related discounts in some items (mostly electronics and perfume/skin care items). Food-at-home (+2 bps) and regulated prices (-2 bps) had minor errors that offset each other, while services were mostly in line with expectations (just a -1 bp error).**
- **Broad qualitative measures also continued to improve (more than expected) at the margin. Although the average of the main core gauges is still high compared to the Central Bank's (BCB) mid-target, the deceleration has been swift, as the gauge reached 5.7% 3MMA-saar in November (from 6.9% in October and a peak of 12.7% in July), the fourth month in a row that it has run below the YoY change (9.4% YoY).**
- **We recognize that improvements in underlying inflation have been surprising and are starting to pile up, so we continue to expect inflation to reach the 4.0-5.0% YoY level quickly. However, we still believe the road from 4.0-5.0% to 3.0% (the BCB's mid-target) could be bumpy, with services inflation (more inertial) continuing to create challenges in a tight job market environment (and with more fiscal expansion at the margin).**

IPCA rose 0.41% MoM in November, well below the consensus (0.53%) and below our forecast (0.50%). The YoY change reached 5.9%, down from 6.5% YoY previously. The trend (3MMA-saar) has been rebounding modestly, however, as the downward effect of the recent tax cuts fades — reaching 0.0% 3MMA-saar (vs. -1.4% in October and a low of -4.3% in September).

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In trend terms, services decelerated to 5.3% 3MMA-saar (from 6.8% in October and a peak of 12.9% in July), with its core also declining to 6.4% 3MMA-saar (from 7.3% last month and a peak of 11.9% in July). The deceleration in wage-related items (falling to 3.3% 3MMA-saar from 7.1% last month) and in items where prices tend to be sticky (declining to 5.8% 3MMA-saar from 7.5%) is the highlight, as we did not expect such a deceleration at this point in the cycle.

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The industrial goods trend dropped to 3.5% 3MMA-saar (from 5.7% last month and a peak of 15.8% in April), while its core saw a sharp decline to 7.4% 3MMA-saar (from 13.7% previously). Food-at-home fell just a bit at the margin, decreasing from 0.3% to -0.8% 3MMA-saar, while regulated prices continued to rebound as the downward effect of the recent tax cuts ended, although remaining in negative territory (-1.5% 3MMA-saar vs. -12.4% in October).

Broad qualitative measures also continued to improve (more than expected) at the margin. Although the average of the main core gauges is still high compared to the BCB's mid-target, the deceleration has been swift, as the gauge reached 5.7% 3MMA-saar in November (from 6.9% in October and a peak of 12.7% in July), the fourth month in a row that it has run below the YoY change (9.4% YoY). The EX3 core gauge, the one that is most correlated with the output gap and that has been more resilient at high levels recently, saw a sharp drop to 8.0% 3MMA-saar (from 9.9%) — but part of that was driven by the Black Friday effects. Even the diffusion index — which had stopped improving in the past couple of readings — resumed a downward trend and reached 60.1% s.a. (from 64.7%); despite the improvement, however, the level still surpasses (by nearly 2 standard deviations) the average for the years of low inflation (2017-2020).

We recognize that improvements in underlying inflation have been surprising and are starting to pile up, so we continue to expect inflation to reach the 4.0-5.0% level quickly. However, we still believe the road from 4.0-5.0% to 3.0% (the BCB's mid-target) could be bumpy, with services inflation (more inertial) continuing to create challenges in a tight job market environment (and with more fiscal expansion at the margin).

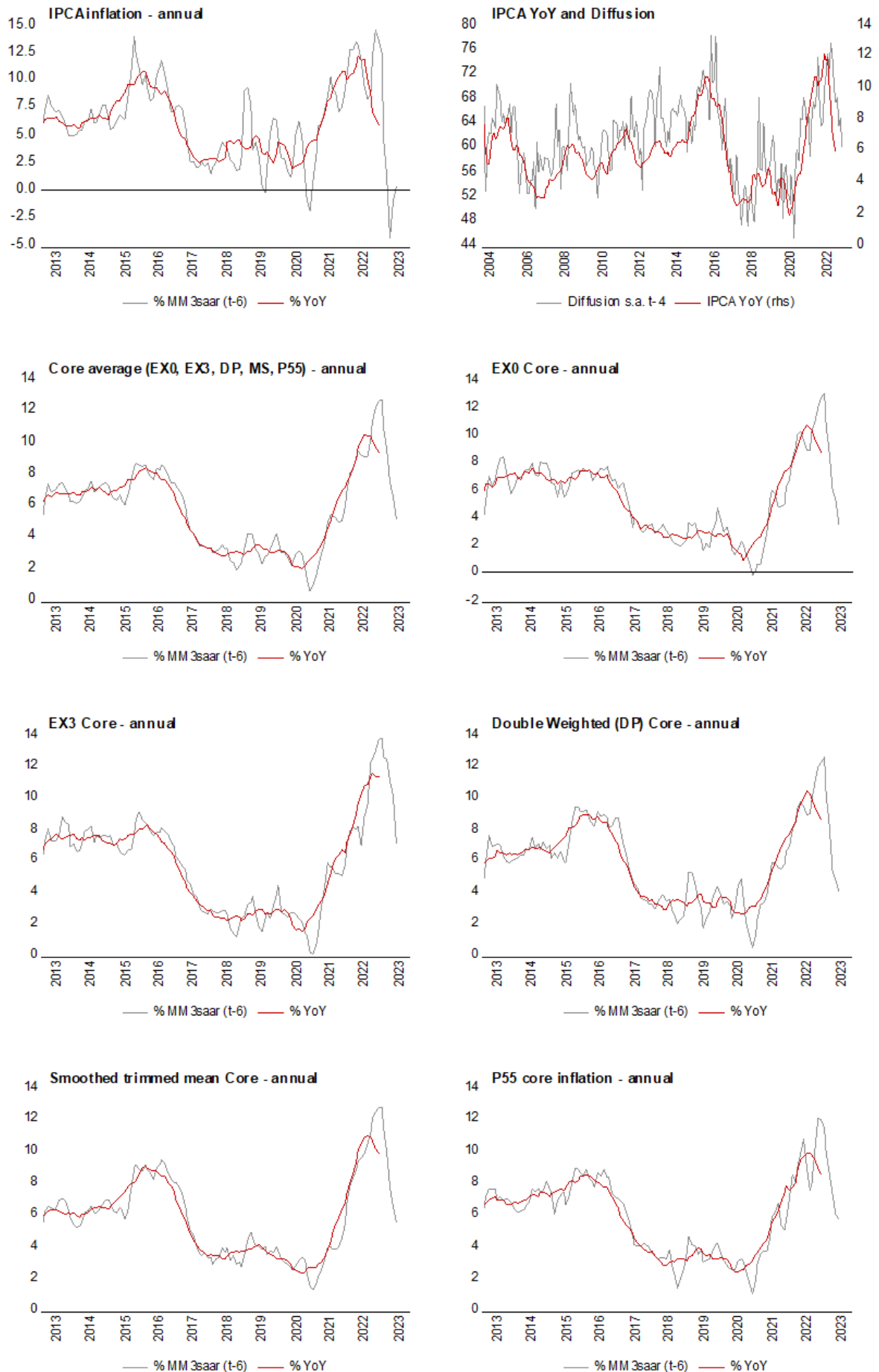
Figure 1. November's IPCA Details (%)

	MoM			YoY		3MMA-saar	
	Nov-22	Santander	Desv.	Oct-22	Nov-22	Oct-22	Nov-22
IPCA	0.41	0.50	-0.09	6.5	5.9	-1.4	0.0
Food and beverage	0.53	0.48	0.01	11.2	11.8		
Food-at-home	0.58	0.48	0.02	12.7	13.3	0.3	-0.8
Food service	0.39	0.50	-0.01	7.3	8.0		
Housing	0.51	0.57	-0.01	1.1	0.6		
Electrical energy	0.56	0.75	-0.01	-18.2	-18.8		
Household articles	-0.68	0.28	-0.04	10.5	8.7		
Apparel	1.10	0.85	0.01	18.5	18.6		
Transportation	0.83	0.97	-0.03	1.5	-0.9		
Airline tickets	-9.80	-9.48	0.00	40.5	35.0		
Gasoline	2.99	3.00	0.00	-22.3	-25.5		
Health and personal	0.02	0.17	-0.02	9.8	10.5		
Personal spending	0.21	0.24	0.00	8.1	7.7		
Education	0.02	0.06	0.00	7.3	7.3		
Communication	-0.14	0.12	-0.01	-0.9	-1.2		
Administered	1.00	1.08	-0.02	-2.8	-4.0	-12.4	-1.5
Free	0.22	0.31	-0.07	9.9	9.7		
Food-at-home	0.58	0.48	0.02	12.7	13.3	0.3	-0.8
Industrial goods	0.11	0.40	-0.07	10.8	9.8	5.7	3.5
Services	0.13	0.17	-0.01	8.1	8.0	6.8	5.3
EX3 Core	0.28	0.37	-0.03	11.3	11.3	9.9	8.0
Average of cores	0.33	-	-	9.7	9.4	6.9	5.7

Sources: Brazilian Central Bank, IBGE, Santander.



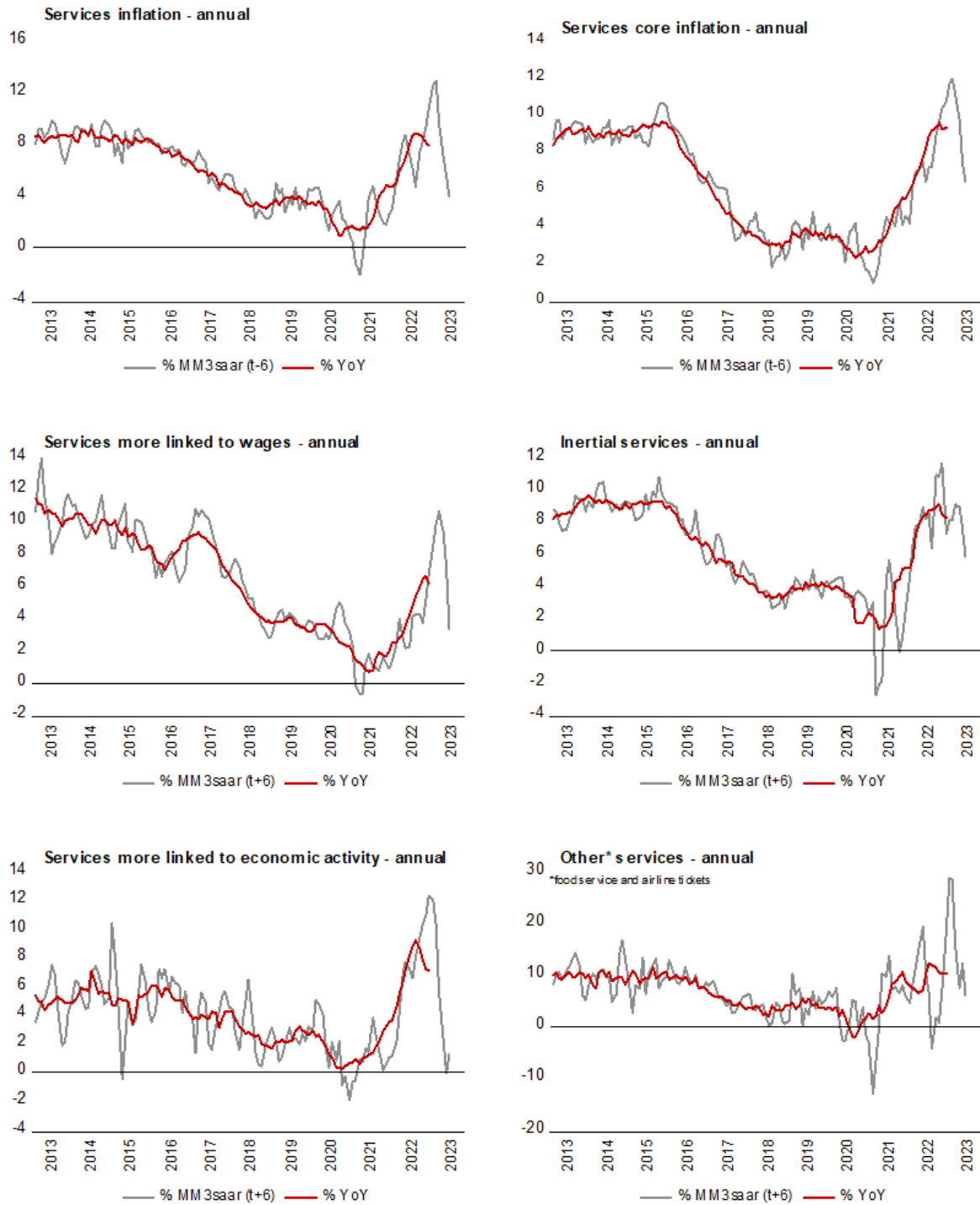
Figure 2. IPCA, Groups and Qualitative Measures



Sources for all charts: IBGE and Santander.



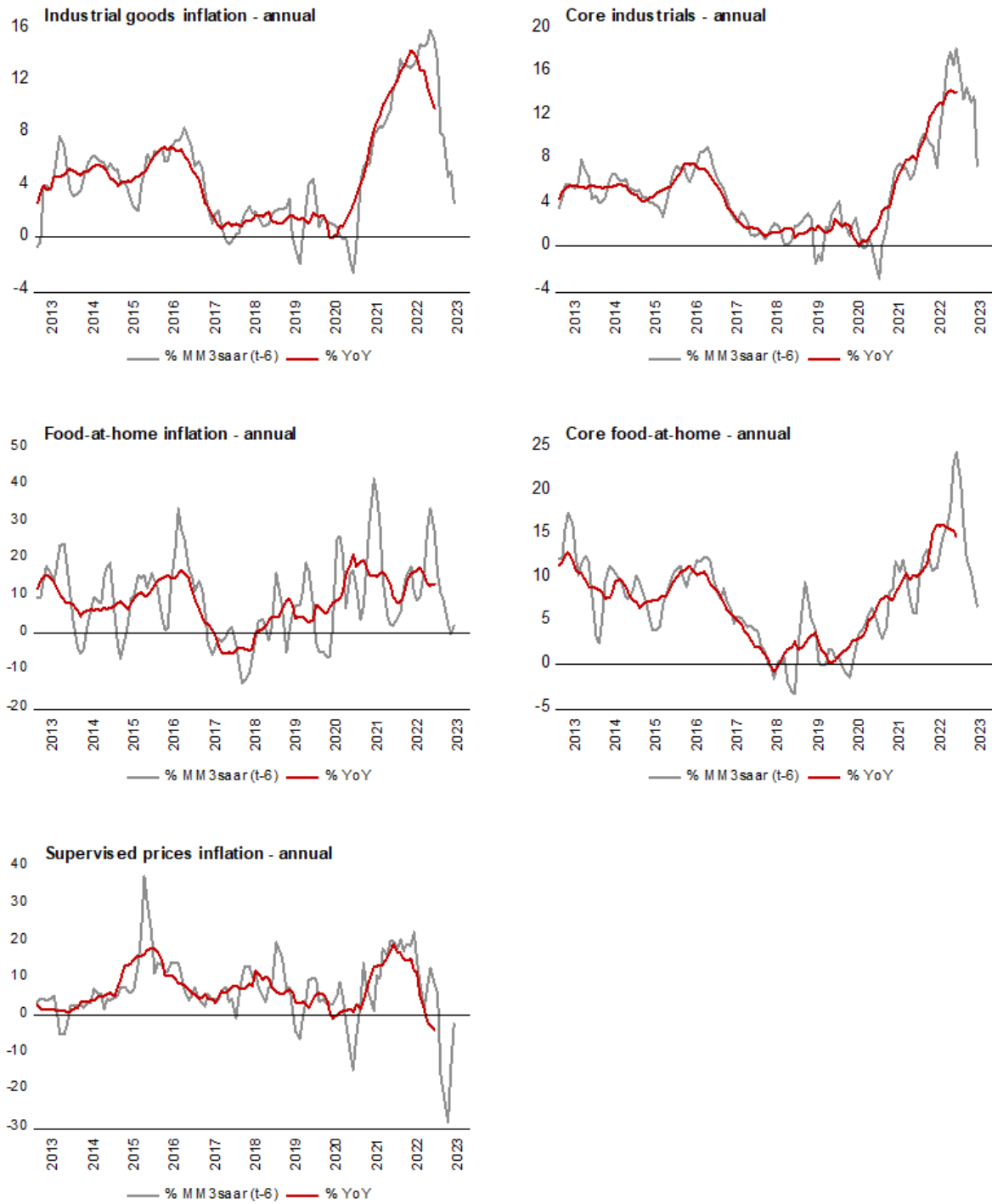
Figure 2. IPCA, Groups and Qualitative Measures (continued)



Sources for all charts: IBGE and Santander.



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