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DATA ANALYSIS – INFLATION

September's IPCA: Preliminary Improvement in Underlying Inflation Continues

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- **IPCA fell -0.29% MoM in September, a bit above our call (-0.34%) and the market's consensus (-0.33%). The YoY change reached 7.2%, down from 8.7% YoY previously, and the trend fell to -5.7% 3MMA-saar (from -0.6%).**
- **The relevant upward surprises came in services (+3 bps) and industrial goods (+4 bps). Despite these unfavorable marginal surprises, both groups continue to decelerate in annual trend terms: services went down to 8.1% 3MMA-saar (from 9.7%) and industrial goods to 4.9% 3MMA-saar (from 6.9%).**
- **Moreover, qualitative measures improved further at the margin. The diffusion index fell to 63.6% s.a. (from 68.0%) and the average of the main core gauges decelerated to 7.5% 3MMA-saar (from 9.3%), both starting to run below the YoY change and suggesting further deceleration ahead.**
- **All in all, although a major part of the recent improvements in inflation is related to the ad-hoc tax cuts, we are seeing some improvements in underlying inflation as well, which makes our outlook a bit less gloomy for the short term. Indeed, our high-frequency tracking was revised to 5.5% (from 5.8%) for IPCA 2022.**
- **However, we still believe the road towards the center of the target could be bumpy, with services inflation (more inertial) still putting challenges in a scenario of a tight job market. For IPCA 2023, we maintain the high-frequency tracking at 5.0%, above the 3.25% target for the year. We continue to foresee the convergence to the mid-target in IPCA 2024, at 3.0%.**

IPCA fell -0.29% MoM in September, a bit above our call (-0.34%) and the market's consensus (-0.33%). The YoY change reached 7.2%, down from 8.7% YoY previously, and the trend fell to -5.7% 3MMA-saar (from -0.6%).

The most relevant upward surprises came in services (+3 bps) and industrial goods (+4 bps). In services, tax cuts effects in some telecom items had a lower impact than we estimated. Also, some personal services came above expectations. In industrial goods, the main surprise was in clothing, as the sector is still lagging the pandemic-related shocks and was only able to start to pass-through them more intensely recently, after the economy re-opened. Additionally, regulated prices (+4 bps) also surprised upwards, as we overestimated the downward impact of tax cuts in these items for this reading. Finally, food-at-home surprised downwards (-5 bps).

The fact that the slight upward surprises were in services and industrial goods is marginally unfavorable, as these groups are more related to core gauges. However, in trend terms both groups continued to decelerate, showing a more favorable outlook at the margin. Services reached 8.1% 3MMA-saar (from 9.7%), running a tad below the 8.5% YoY change, while its core gauge (that excludes volatile items and telecom items impacted by tax cuts, for example) decelerated to 10.0% 3MMA-saar (from 11.1%), still running a bit above the 10.0% YoY change. Industrial goods decelerated to 4.9% 3MMA-saar (from 6.9%), well below the 11.5% YoY change, while its core gauge saw a smaller relief, reaching 13.3% 3MMA-saar (from 14.6%), still running around the 14.2% YoY change.

Moreover, broad qualitative measures also continued improving at the margin. The diffusion index fell to 63.6% s.a. (from 68.0%) and the average of the main core gauges decelerated to 7.5% 3MMA-saar (from 9.3%), the third month in a row running below the 10.1% YoY change, suggesting further deceleration ahead. It is worth noting that all the five main core gauges decelerated at the margin—including the EX3, the one more correlated to the output gap, although this is still running a bit above the YoY change.

All in all, although a major part of the recent improvements in inflation are related to the ad-hoc tax cuts, we are seeing some improvements in underlying inflation too, which makes the outlook a bit less gloomy for the short term. However, we still believe the road towards the center of the target could be bumpy, with services inflation (more inertial) still putting challenges in a scenario of a tight job market.

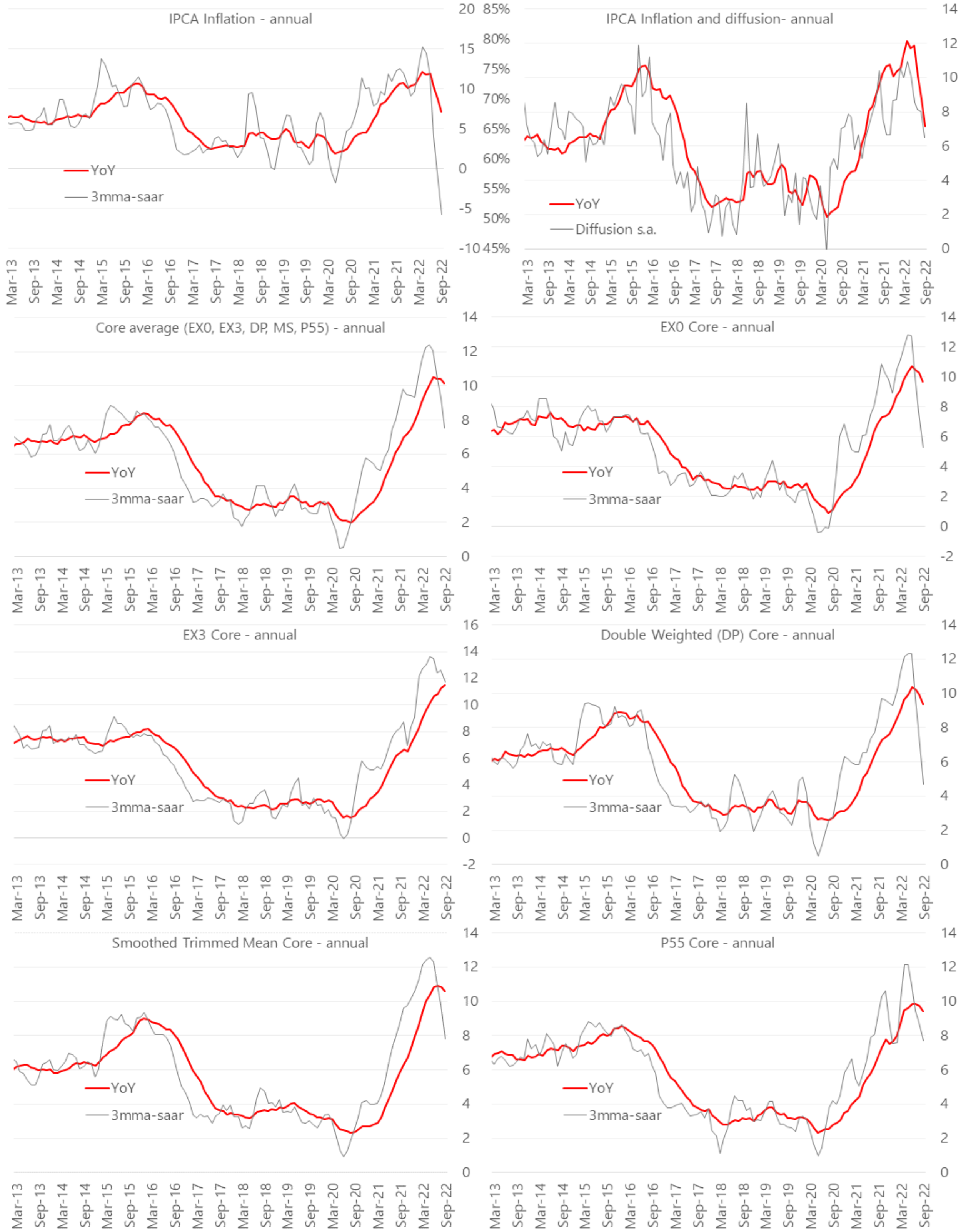
Our high-frequency tracking was revised down to 5.5% (from 5.8%) for IPCA 2022. We note that we consider oil prices coming back to above 100 USD/bbl by year-end with BRL at 5.30, but in simulation considering that oil prices remain stable in BRL terms, we estimate IPCA 2022 could reach as low as 5.3%. 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; on the other, we still consider a reinstation of part of the tax cuts done this year (the PIS/Cofins in gasoline), which may not happen. For IPCA 2024, we continue to forecast inflation returning 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.

Figure 1. September's IPCA Details (%)

	MoM			YoY		3MMA-saar	
	Sep-22	Santander	Desv.	Aug-22	Sep-22	Aug-22	Sep-22
IPCA	-0.29	-0.34	0.05	8.7	7.2	-0.6	-5.7
Administered	-1.21	-1.36	0.05	1.5	-1.7	-24.0	-30.8
Free	0.02	0.00	0.01	11.4	10.4		
Food-at-home	-0.86	-0.52	-0.05	15.6	13.3	14.0	5.5
Industrial goods	0.05	-0.11	0.04	12.6	11.5	6.9	4.9
Services	0.40	0.32	0.03	8.8	8.5	9.7	8.1
EX3 Core	0.69	0.42	0.10	11.3	11.5	12.6	11.7
Average of cores	0.41	-	-	10.4	10.1	9.3	7.5

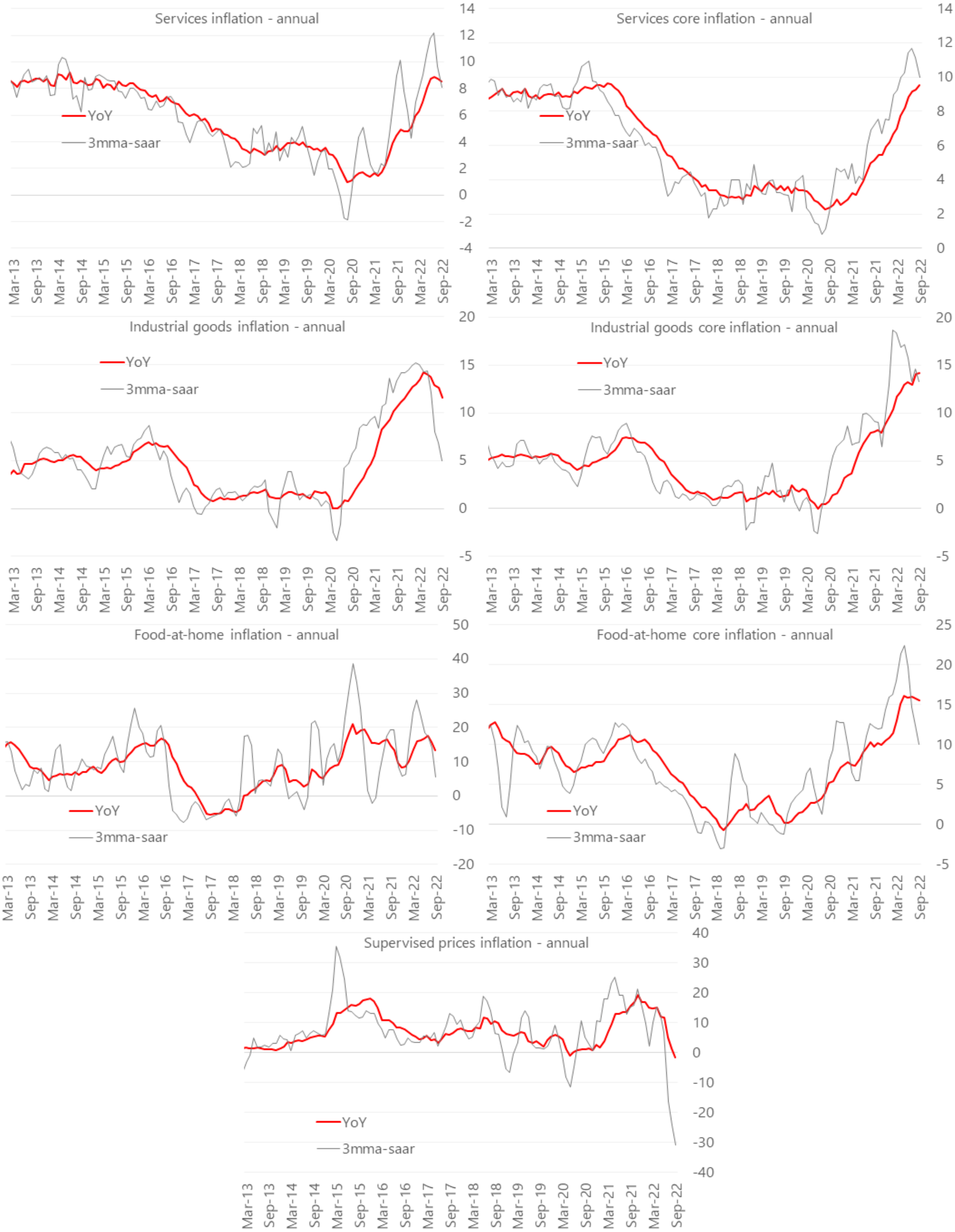
Sources: Brazilian Central Bank, IBGE, Santander.

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.

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