

**Brazil Macro: IPCA inflation**

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**Pressure Intensifies for 2020, but Still a Benign Scenario for 2021**

- October's IPCA-15 registered a 0.94% MoM change (3.52% YoY), considerably above the market's median expectation (0.83% MoM) and a bit above our forecast (0.89% MoM).
- Pressure on industrial goods has intensified, pushing core measures upwards and making the qualitative read a little worse. We have raised our IPCA 2020 high-frequency tracking further to 3.3%.
- Looking further ahead, however, we continue to anticipate a benign scenario for inflation, with most of the pressures previously cited subsiding throughout 2021, while services inflation should continue to run at low rates, as we expect a weak job market. We believe that well-anchored inflation expectations could also play an important role in Brazil's price dynamics.
- Therefore, we continue to anticipate a benign inflation scenario in the medium term, with core measures running at a low levels; we forecast 2021 headline IPCA at 2.7% (although short-term pressures pose an upside risk to 1Q21, which could inch our year-end forecast closer to 3.0%).

**Figure 1. IPCA Breakdown and Santander Forecast**

	MoM			YoY	
	out/20	Santander	Contrib.	set/20	out/20
<b>IPCA</b>	0.94	0.89	0.05	2.7	3.5
<b>Food and beverage</b>	2.24	2.57	-0.07	9.9	12.7
Food-at-home	2.95	3.37	-0.06	13.0	16.8
Food service	0.54	0.71	-0.01	3.8	4.3
Housing	0.40	0.36	0.01	0.6	1.3
Electrical energy	0.11	0.05	0.00	-5.2	-3.7
Household articles	1.41	1.02	0.01	-0.1	1.5
Apparel	0.84	0.86	0.00	-2.2	-1.5
Transportation	1.34	1.01	0.07	-0.9	0.1
Airline tickets	39.90	51.00	-0.03	-44.7	-24.3
Gasoline	0.85	0.00	0.04	0.1	0.2
Health and personal care	0.28	0.11	0.02	2.0	1.5
Personal spending	0.14	0.15	0.00	2.6	2.6
Education	-0.02	0.01	0.00	1.1	1.0
Communication	0.23	0.15	0.00	3.1	3.3

Administered prices	0.30	0.11	0.05	1.0	1.2
Free prices	1.16	1.16	0.00	3.2	4.4
Food-at-home	2.95	3.37	-0.06	13.0	16.8
Industrial goods	0.90	0.65	0.06	1.1	1.8
Services	0.64	0.64	0.00	0.9	1.4
EX3 core	0.65	0.44	0.20	1.4	1.8
New Average of cores	0.54	0.47	0.07	1.9	2.2

Source: Santander, IBGE.

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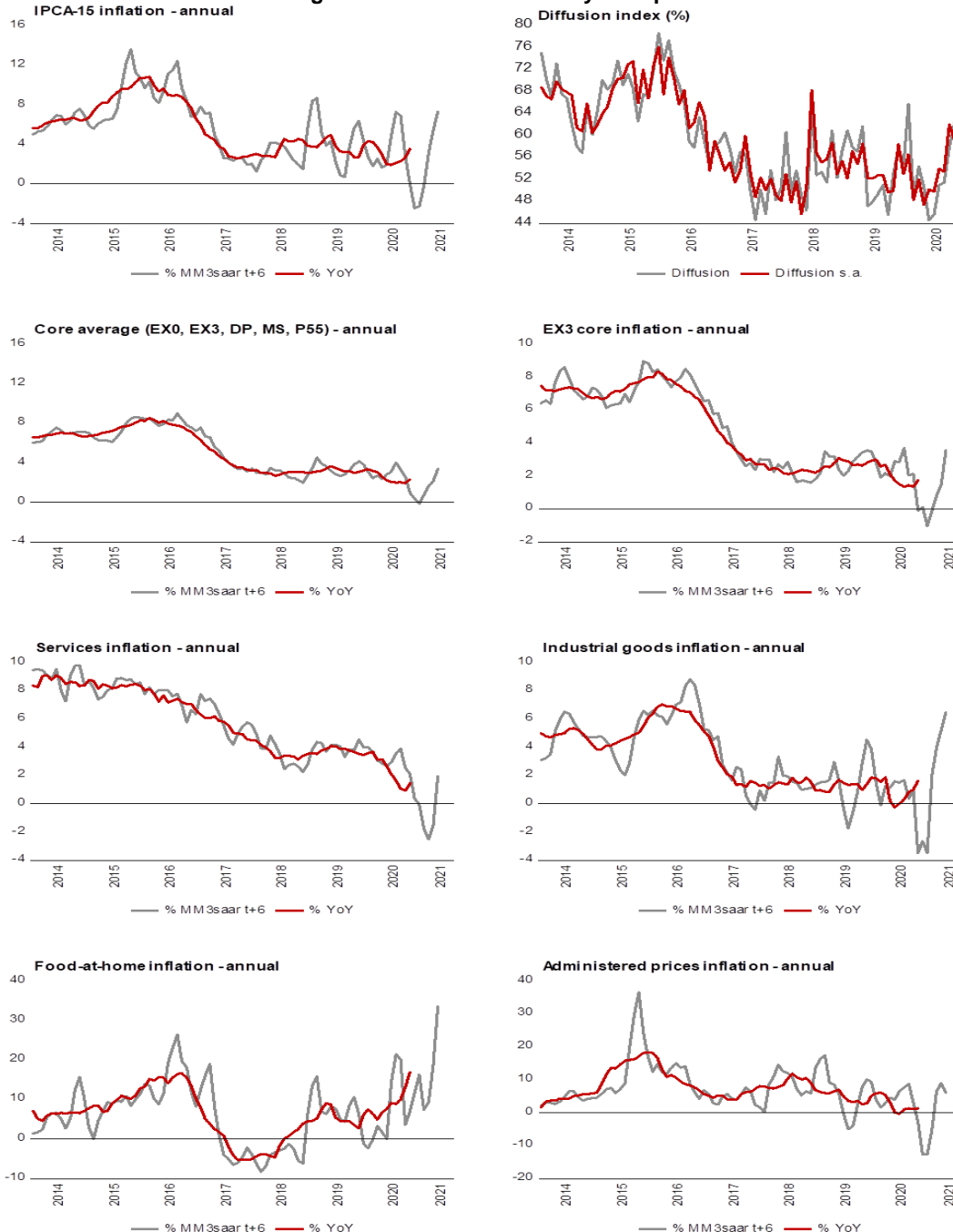


## Year-End Pressure Intensifies

October's IPCA-15 registered a 0.94% MoM change (3.52% YoY), considerably above the market's median expectation (0.83% MoM) and a bit above our forecast (0.89% MoM).

Gasoline surprised on the upside (+4bps), along with industrial goods (+6bps). On industrial goods, we have argued that the economy's reopening (increasing demand), ongoing government emergency aid (supporting income), continued BRL depreciation and some (temporary and ~~located~~-specific) supply shortages are spurring short-term upward pressure. However, we note that *perfume* (a highly volatile item that usually is not a reliable sign of a trend) was behind much of the surprise, but the print was high anyway. On the other side, food-at-home, which has also upwardly pressured the IPCA, surprised to the downside (-6bps), and the surprise was widespread (both in fresh food, proteins and industrialized items), thereby reducing a bit of the upside risk we are anticipating for the group, but it is still tilted to the upside. Finally, services were in line with our expectation, with particular pressure on airline tickets—something that we do not expect to hold in the medium term.

Figure 2. IPCA Breakdown by Groups



Source: IBGE and Santander.



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Core measures' (EX0, E3, DP, MS, and P55) new average registered a 0.54% MoM change, with the annualized (and seasonally adjusted) three-month moving average accelerating, passing from 2.1% to 3.4%, while the target for 2020 is 4.00%. In particular, the trend for the IPCA EX3 core gauge—a measure highly correlated with the output gap—also accelerated considerably, from 1.4% to 3.5% MM3saar. Additionally, the diffusion index stood at 60.1% on a seasonally adjusted basis, still close to the lowest historical levels, although it has been rising a bit.

### **2021 Scenario Still Very Benign**

Given the upward surprise, we raised our IPCA 2020 high-frequency tracking further to 3.3%, owing to industrial goods, in light of the previously stated pressures that tend to continue until year-end. Moreover, we continue to see upside risks for food; specifically, a new risk has been rising: the climate (La Niña, in particular), which could delay the deceleration of the group. Looking further ahead, however, we continue to anticipate a benign inflation scenario, with most of the previously cited pressures subsiding throughout 2021, while services inflation should continue to run at low rates, as we expect the job market to be weak. We believe that well-anchored inflation expectations could also play an important role in Brazil's price dynamics. Therefore, we continue to anticipate a benign inflation scenario in the medium term, with core measures running at low levels, and we forecast 2021 headline IPCA at 2.7% (although short-term pressures pose an upside risk to 1Q21, which could inch our year-end forecast closer to 3.0%).



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