

Brazil Macro: IPCA Inflation

Daniel Karp*
daniel.karp@santander.com.br
(+55 11) 3553 9828

IPCA October: No News on the Margin

- October's IPCA registered a 0.86% MoM change (3.92% YoY). The result was a bit above the market's median expectation (0.84% MoM) and in line with our forecast (0.87% MoM).
- As expected and as already seen in the most recent readings (particularly October's IPCA-15), the pressure on industrial goods prices continued strong. This pushed core measures upward, making the qualitative read a little worse, although less than we expected (core rose 0.55% MoM, whereas we expected 0.67%)—probably because services surprised to the downside. Finally, food inflation also continued to experience pressure, but surprised to the downside.
- We have not changed our high-frequency tracking for IPCA 2020, which continues to stand at 3.3%, but we continue to see upside risks.
- Looking further ahead, we continue to anticipate a benign scenario for inflation, with most of the upward pressures 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.
- In that scenario, we believe core measures will continue to run at a low level, along with the headline, which we forecast at 2.9% for IPCA 2021 (although short-term pressures pose an upside risk for 1Q21, which could inch our year-end forecast a bit higher).

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Figure 1. IPCA Breakdown and Santander Forecast

	MoM			YoY	
	oct/20	Santander	Contrib.	sep/20	oct/20
IPCA	0.86	0.87	-0.01	3.1	3.9
Food and beverage	1.93	2.06	-0.03	11.8	13.9
Food-at-home	2.57	2.68	-0.02	15.4	18.4
Food service	0.36	0.57	-0.01	4.5	4.7
Housing	0.36	0.31	0.01	0.8	1.8
Electrical energy	0.03	0.07	0.00	-5.6	-2.4
Household articles	1.53	1.14	0.01	0.8	2.4
Apparel	1.11	0.97	0.01	-1.9	-1.4
Transportation	1.19	1.19	0.00	-0.6	0.2
Airline tickets	39.83	39.90	0.00	-44.9	-24.4
Gasoline	0.85	0.40	0.02	0.8	0.4
Health and personal care	0.28	0.42	-0.02	2.0	1.9
Personal spending	0.19	0.24	0.00	2.5	2.5
Education	-0.04	-0.02	0.00	1.0	1.0
Communication	0.21	0.14	0.00	3.2	3.4

Administered prices	0.23	0.18	0.01	1.1	1.5
Free prices	1.08	1.12	-0.03	3.8	4.8
Food-at-home	2.57	2.68	-0.02	15.4	18.4
Industrial goods	0.97	0.94	0.01	1.4	2.1
Services	0.55	0.62	-0.03	1.1	1.4
EX3 core	0.66	0.68	-0.02	1.7	2.1
New Average of cores	0.55	0.67	-0.13	2.2	2.4

Sources: Santander, IBGE.

Upward Pressures Continue, but We Continue to Believe They Will Fade Next Year

October's IPCA registered a 0.86% MoM change (3.92% YoY). The result was a bit above the market's median expectation (0.84% MoM) and in line with our forecast (0.87% MoM). The print was similar to IPCA-15 in terms of breakdown and qualitative measures.

Industrial goods and administered prices surprised a bit to the upside (+1bps of error each). Industrial goods are still experiencing upward pressure, as more of the economy is gradually reopening, the government's emergency aid is still in place, the BRL is still devalued, and there are some (temporary) supply shortages. In administered prices, the surprise was concentrated in gasoline. In contrast, food-at-home surprised to the downside (-2bps), although the print was still high (2.57% MoM). Services also surprised to the downside (-3bps of error), even with the high number for airline tickets (already expected), and are still running at a low rate (1.4% YoY).

The new average of core measures used by the BCB registered a 0.55% MoM change, with the annualized (and seasonally adjusted) three-month moving average accelerating, increasing to 3.8% from 2.6%; 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, to 4.6% MM3saar. These pressures on cores are being driven mostly by industrial goods, and it is important to note that the movement is more of a rebound from the steep fall during the initial phase of the pandemic than a genuine acceleration, in our view. Also, as we have been arguing, we believe those pressures will cool off throughout 2021.

Additionally, the diffusion index stood at 63.6% on a seasonally adjusted basis, higher than in the previous months, but this can be expected when there is a shock in food, because the food group has numerous items in IPCA.

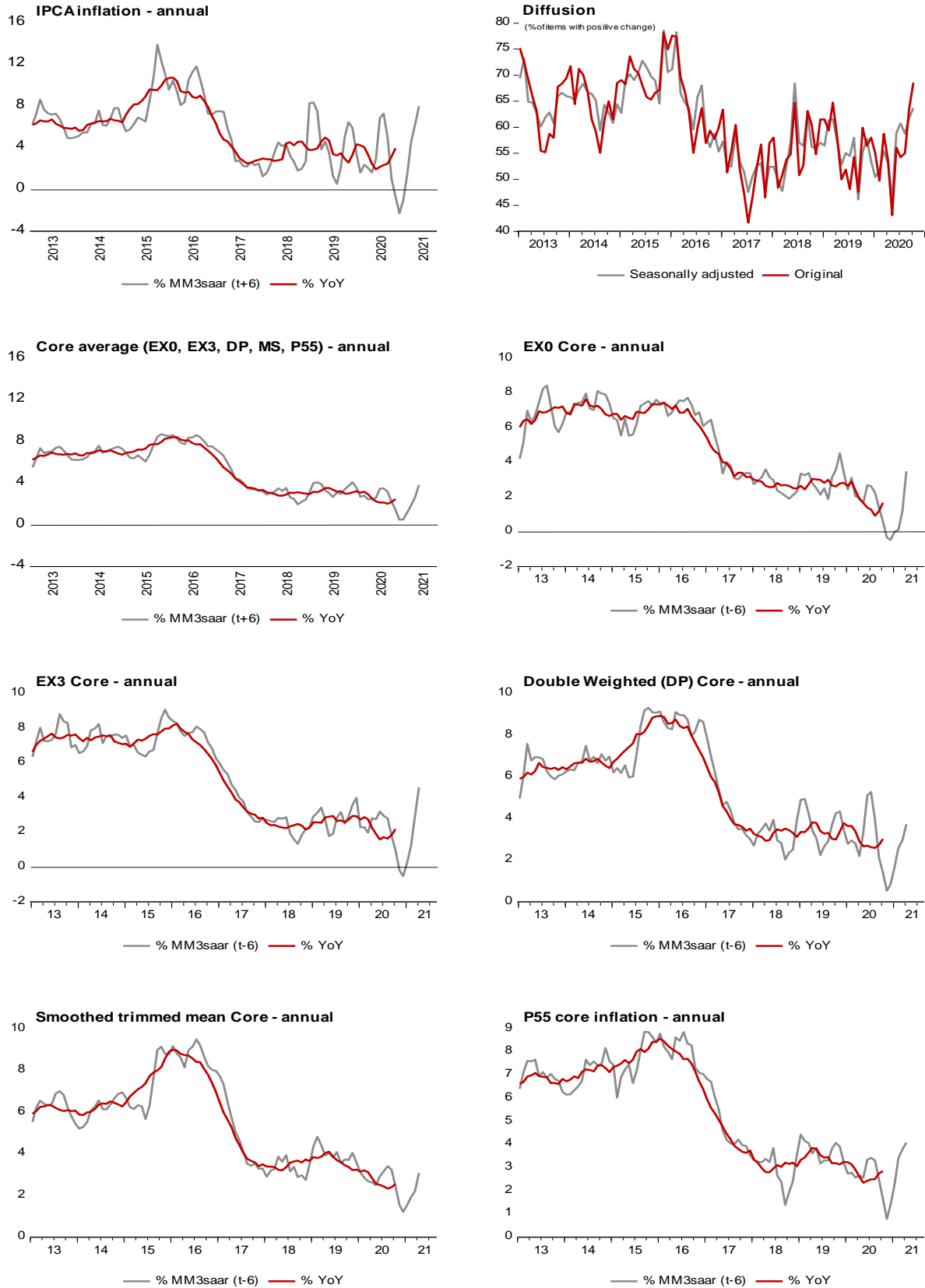
Although we continue to see some upside risks for the short term, we decided not to update our tracking for IPCA 2020, which is at 3.3%. The risks come especially from food and industrial goods—the economy's reopening is causing demand



to increase, as income is still supported by the government's emergency aid, while the BRL continues devalued; moreover, in the case of food there is also a climate risk (La Niña) that might delay the deceleration of the group, in our view. Looking further ahead, however, we continue to anticipate a benign scenario for inflation, with most of the pressures cited previously cooling off throughout 2021, while services inflation should continue to run at low rates, as the job market is expected to be weak. We believe the well-anchored inflation expectations should also play an important role in price dynamics in Brazil. Therefore, in that scenario, we believe core measures will continue to run at a low level, along with the headline, which we forecast at 2.9% for IPCA 2021 (although short-term pressures pose an upside risk for 1Q21, which could inch our year-end forecast a bit higher).



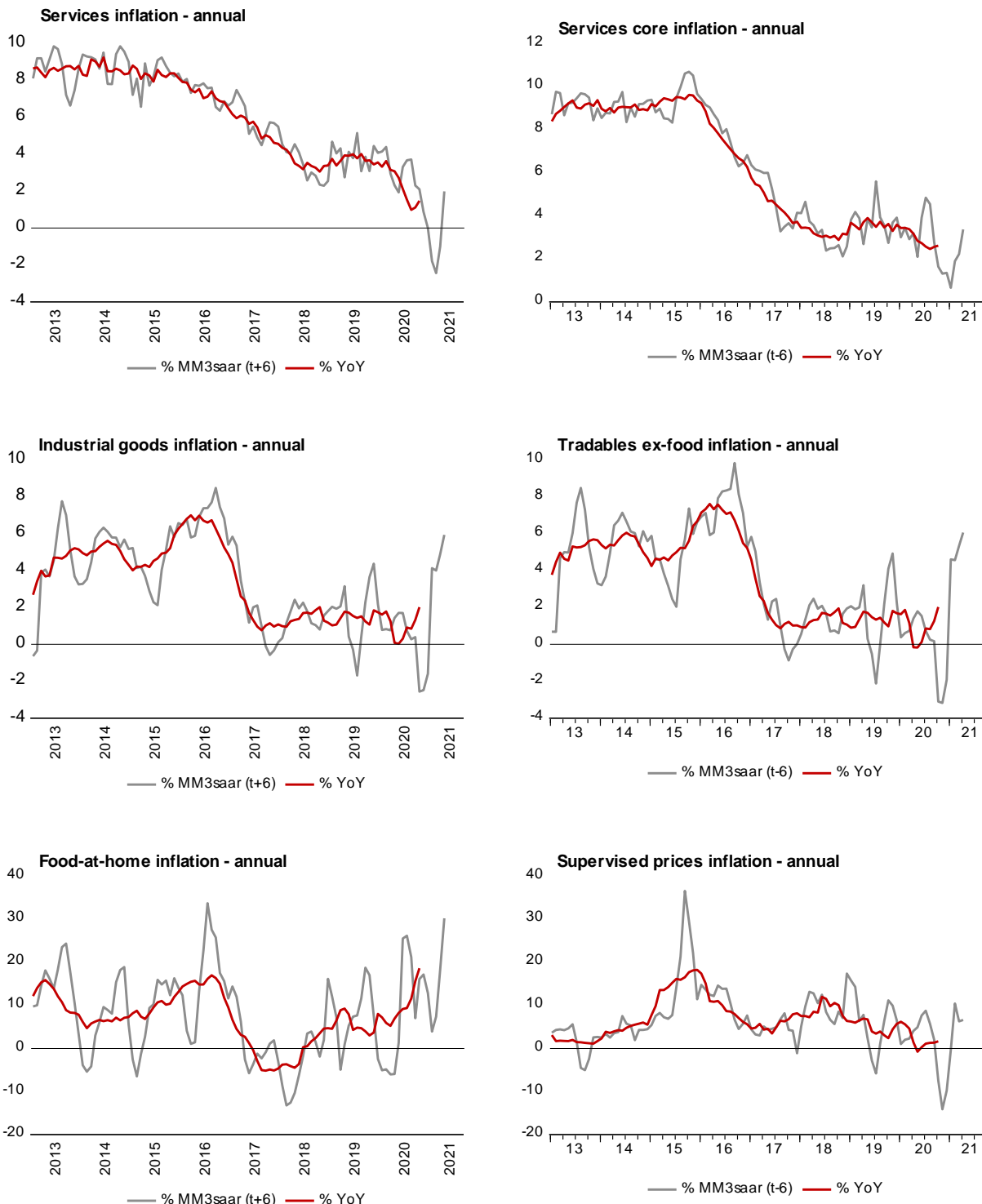
Figure 2a. IPCA and Qualitative Measures



Sources: IBGE and Santander.



Figure 2b. IPCA Breakdown by Groups



Sources: IBGE and Santander.



CONTACTS / IMPORTANT DISCLOSURES

Macro Research

Maciej Reluga*	Head Macro, Rates & FX Strategy – CEE	maciej.reluga@santander.pl	48-22-534-1888
Juan Cerruti *	Senior Economist – Argentina	jcerruti@santander.com.ar	54 11 4341 1272
Ana Paula Vescovi*	Economist – Brazil	anavescovi@santander.com.br	5511-3553-8567
Juan Pablo Cabrera*	Economist – Chile	jcabrera@santander.cl	562-2320-3778
Guillermo Aboumrad*	Economist – Mexico	gjaboumrad@santander.com.mx	5255-5257-8170
Piotr Bielski*	Economist – Poland	piotr.bielski@santander.pl	48-22-534-1888

Fixed Income Research

Juan Arranz*	Chief Rates & FX Strategist – Argentina& FX	jarranz@santanderrio.com.ar	5411-4341-1065
Mauricio Orenge*	Senior Economist/Strategist – Brazil	mauricio.oreng@santander.com.br	5511-3553-5404
Juan Pablo Cabrera*	Chief Rates & FX Strategist – Chile	jcabrera@santander.cl	562-2320-3778

Equity Research

Miguel Machado*	Head Equity Research Americas	mmachado@santander.com.mx	5255 5269 2228
Alan Alanis*	Head, Mexico	aalanis@santander.com.mx	5552-5269-2103
Andres Soto	Head, Andean	asoto@santander.us	212-407-0976
Claudia Benavente*	Head, Chile	claudia.benavente@santander.cl	562-2336-3361
Walter Chiarvesio*	Head, Argentina	wchiarvesio@santanderrio.com.ar	5411-4341-1564
Daniel Gewehr*	Head, Brazil	dhgewehr@santander.com.br	5511-3012-5787

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