

**Brazil Macro Compass**

**Fueling Higher Inflation**

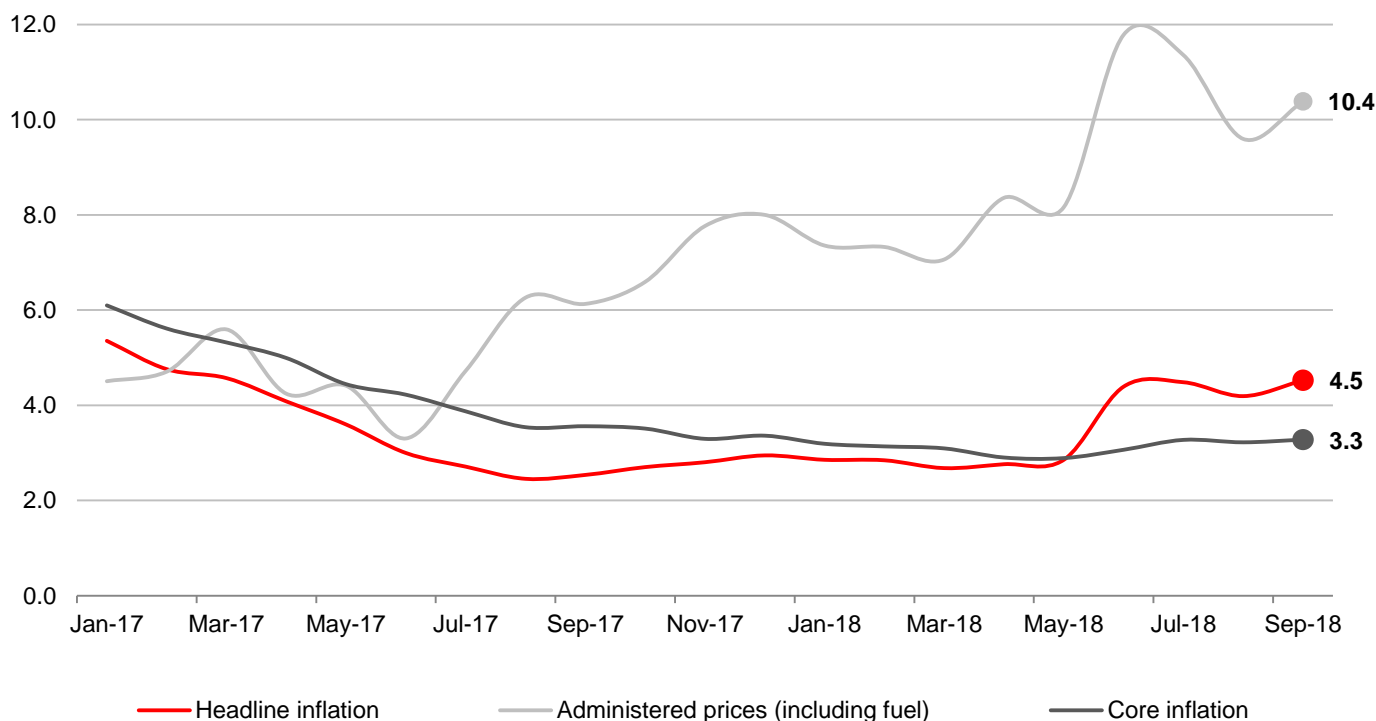
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**What's New: Fuel Prices Leading to Higher Headline Inflation; Revising Our 2018 CPI Forecast**

According to inflation data released on October 5, Brazil's CPI came in at 0.48% m/m in September (Santander: 0.36% m/m; consensus: 0.44% m/m). The CPI breakdown revealed food & beverages and transportation were the main drivers. We highlight that fuel prices contributed 24 bps to the overall increase (half of September's CPI). In light of the BRL's recent appreciation, we expect fuel prices to decelerate throughout this month, pushing downward October's CPI. However, we expect the BRL depreciation from the end of August through the beginning of October to boost monthly inflation rates for the remainder of 2018. As a result, we are revising our 2018 year-end CPI forecast to 4.1% y/y from 3.9% y/y. For 2019 CPI, however, we are maintaining our forecast of 4% due to well-behaved core inflation and our expectation of a continued moderate economic recovery.

We continue to believe that 2019 inflation expectations are the most important component of the Brazil Central Bank's reaction function. Since we still forecast inflation below the target midpoint for that period and assume that the recent improvement in financial market variables (especially the BRL) will be extended until the next monetary policy meeting (on October 31) and beyond, we reinforce our call for a stable Selic rate until 2H19 (for more details, see our report *Worse Financial Conditions at the Margin Reinforce the Likelihood of Selic Remaining "Low for Long"*, August 30, 2018).

**Brazil CPI Inflation (% y/y)**



Sources: IBGE, Brazil Central Bank, Santander.

**IMPORTANT DISCLOSURES/CERTIFICATIONS ARE IN THE "IMPORTANT DISCLOSURES" SECTION OF THIS REPORT.**

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## Upcoming Data: IBC-Br and Services

Next week closes the cycle of economic activity indicators from August. We believe IBC-Br, the Central Bank monthly GDP proxy, have stayed flat in the month (+1.7% y/y), signaling weak GDP growth in 3Q18. IBGE's volume of services indicator should grow 0.3% m/m, according to our forecasts.

## In-Depth Research: The True Country Risk

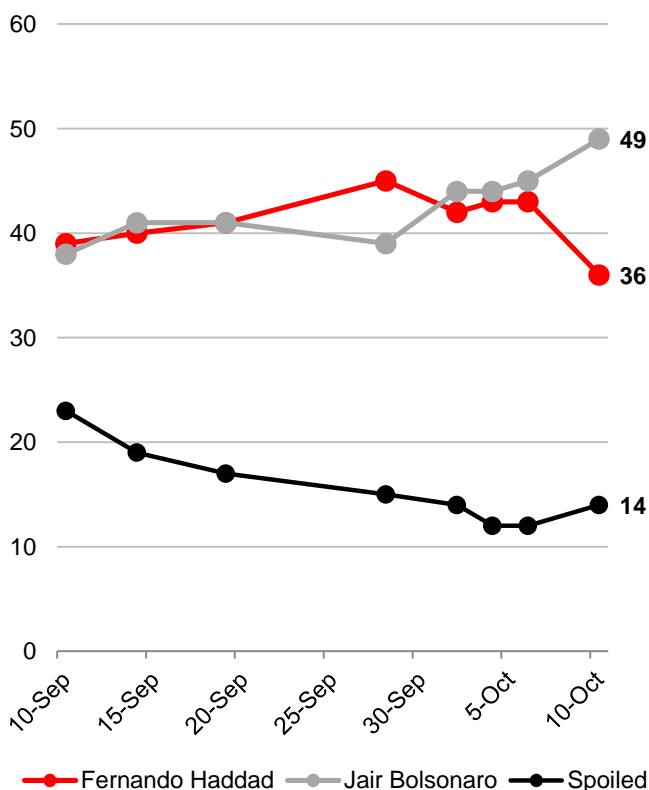
In *Risk Premium: Apples and Oranges* (October 9, 2018), we presented the results of a simple model that tries to extract the idiosyncratic (residual) component of Brazil's country risk, after discounting external variables such as commodity prices, US Treasury yields, and global risk appetite. We found that, after the rally that followed the first-round voting, this component is negligible, which in our view suggests high optimism regarding the outcome of the elections in terms of reforms and fiscal sustainability.

## Political Agenda and Chart of the Week: Getting Ready for the Run-Off

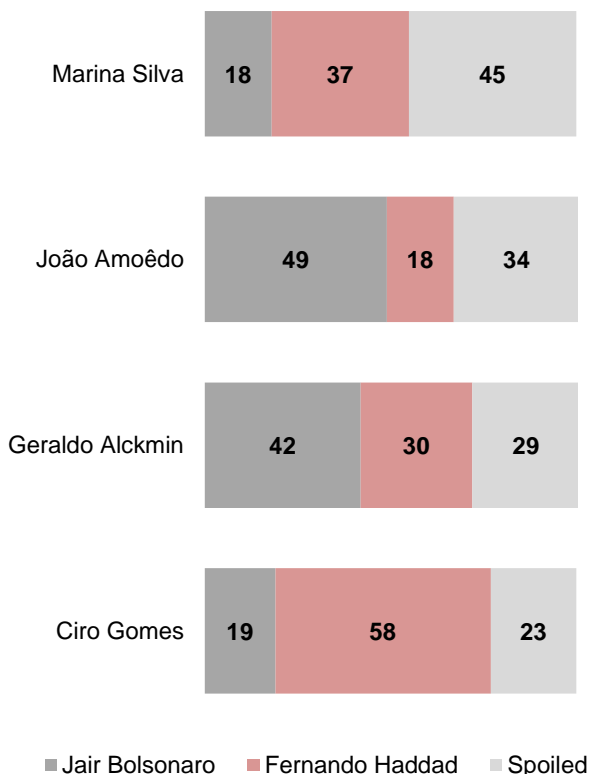
Our "Chart of the Week" highlights the Datafolha poll released on October 10, the first poll after the first-round voting that gave Jair Bolsonaro a solid lead over the runner-up, Fernando Haddad (46% vs. 29% of valid votes). The poll suggests that Bolsonaro should win the second round, and thus the presidency, with 58% of valid votes, with Fernando Haddad finishing with 42%. The votes that went for other candidates in the first round seemed to be almost equally split, with Bolsonaro attracting most of the former Alckmin and Amoêdo voters and Haddad getting the lion's share of Ciro Gomes's previous votes.

Ibope is expected to release a new poll on Monday, October 15.

### Second-Round Voting Intention (% of Total Votes)



### Transferred Votes from First-Round Candidates (Share of Total Votes)



Source: Datafolha.



## Number of the Week

**BRL**  
**41.89**

MDB's former Finance Minister Henrique Meirelles has spent BRL 54 million to finance his own bid for the presidency. He ended up with a little less than 1.3 million votes, which implies a cost of BRL 41.89 per vote, or more than USD 10.00.

## Quote of the Week

*"If we had confidence in the electronic voting system, we would already know the name of the future president."*

— **Jair Bolsonaro**, in interview following the release of the results of first-round voting on October 7.

## What We've Been Reading

- "Structural Reform Priorities for Brazil," by Nina Biljanovska and Damiano Sandri (*IMF Working Papers*, October 8, 2018). The IMF economists advise Brazil to prioritize banking sector reforms as a way to generate productivity gains with public support.
- "Donald Trump sets his sights on Brazil," by Nicolás Albertoni (*Global Americans*, October 10, 2018). Brazil may be the next in Trump's list of adversaries in his trade wars.
- "Investors would be wise to wait out Brazil's presidential election," by Jonathan Wheatley (*Financial Times*, October 10, 2018). Wheatley advises caution to those thinking of jumping into Brazilian assets.
- "Brazilian voters wanted change — and they got it. Now what happens?" by Jorge Antonio Alves (*Monkey Cage*, October 10, 2018). A nice briefing on what happened in the elections last Sunday.
- "What to Expect from Jair Bolsonaro," by Brian Winter (*Americas Quarterly*, October 9, 2018). After following the Bolsonaro family for more than two years, Winter reports his findings.
- "The Decline and Fall of Brazil's Political Establishment," by Eduardo Mello (*Foreign Affairs*, October 1, 2018). The defeat of the political establishment in the elections for Congress should be an opportunity for deeper political reforms, the author argues.

## Recent Publications (Available on Our Website)

- *Risk Premium: Apples and Oranges* (October 9, 2018)
- *BRL: Between Common and Idiosyncratic Factors* (September 26, 2018)
- *Copom: Hoping for the Best but Prepared for the Worst* (September 17, 2018)
- *Standby Mode* (September 12, 2018)
- *Worse Financial Conditions at the Margin Reinforce the Likelihood of Selic Remaining "Low for Long"* (August 30, 2018)



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