

Brazil- September inflation and commentary

October 8, 2021

Bottom line: the September inflation data was in line with expectations at 1.16% for the month and 10.25% in the last 12. The monthly number for headline was the highest in -at least- 10 years making it the third month in a row of record prints. A mild consolation was that diffusion indices moderated. The average of the 5 monthly core measures produced by Bacen stood at 75bp, which annualizes at 9.4%. News on annual inflation were not better. The average of core measures accelerated to 6.6% while my estimation of core services printed 5%. All of these indicators are way above the top of the very generous inflation tolerance band. Forward momentum in the main categories of inflation, headline, core, services, core services is intact and strong. All of this said, there were a couple of “less bad news”. We saw monthly deflation (yes, deflation) in the IGPM and both components of the IPA -wholesale price index for industrial and agricultural products- that are resulting in a declining non-core inflation -that is IPCA excluding food and energy. This may be an early glimmer of hope in that annual non-core inflation may be reverting to more normal levels. On net, however, I don’t see that today’s print changes the policy outlook, and in fact it reinforces the need to stay the course. The ex-ante real policy rate is now at 84bp and still below neutral. Governor Campos latest communication has been unexpectedly hawkish. He reiterated in three occasions that Bacen was looking at meeting the 3.5% target of 2022, not later. I believe that this is unwarranted. Given the lags with which policy operates, to get to 3.5% in 15 months seems aggressive and should elevate expectations of the terminal rate and lower those for growth, maybe even a recession. I believe that his communication is broadly consistent with my call of a terminal nominal Selic of 10.25% at 100bp per meeting with no pauses. A long hold period should follow. To the extent that Bacen continues to add carry, the more appealing asset is the BRL. Please see supporting charts below.

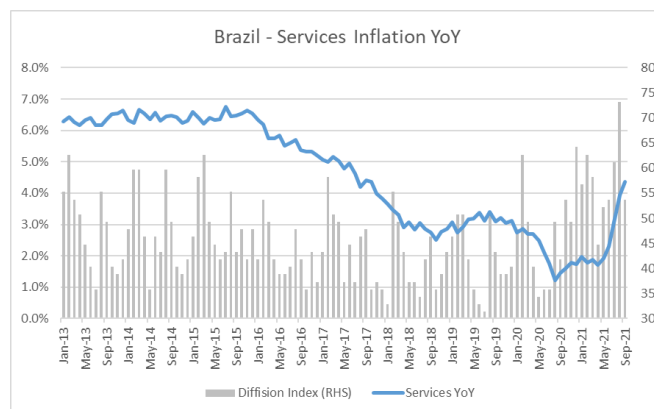
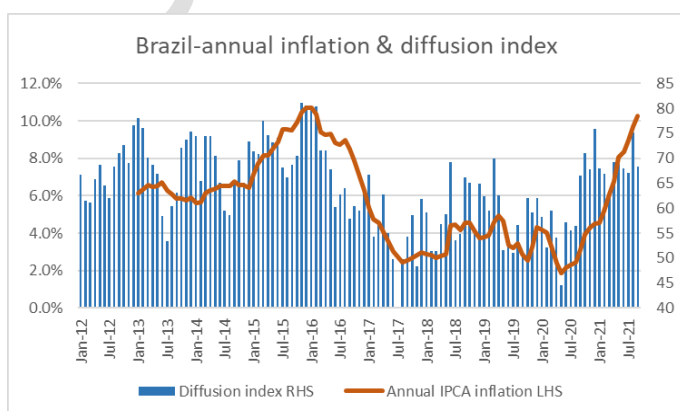
Monthly inflation: while expected, today’s print was high (1.16%) by any standard. It was also the highest since at least the last 10 years for September. This is the third month in a row in which the monthly prints are the highest of -at least- the last 10 years. The main contributions came in Housing (41bp), Transportation (38bp), and Food and beverage (21bp); together these 3 categories account for 58% of the IPCA. We had outsized increases in airfares, app-based transportation services and electricity (6.5%). Mildly positive news came in the decline of diffusion indices for the general IPCA and services, but both remain high. News today that wholesale prices of gasoline and propane will increase by 7.2% as of

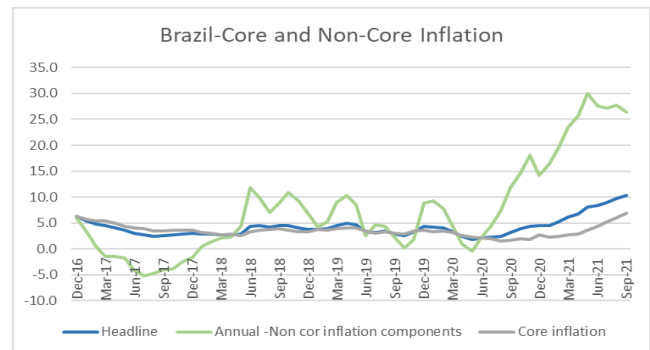
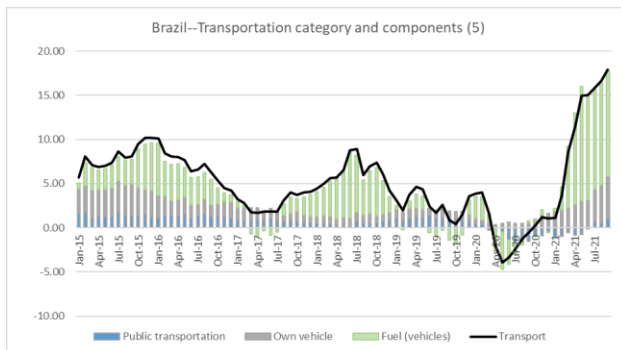
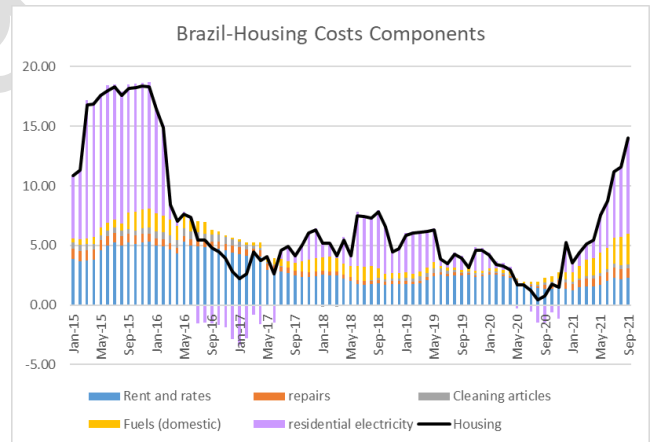
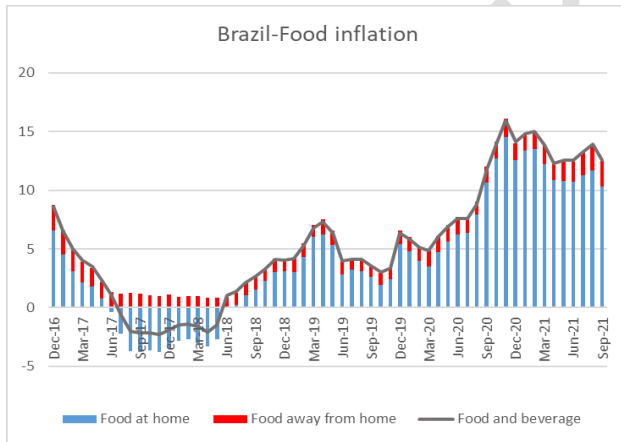
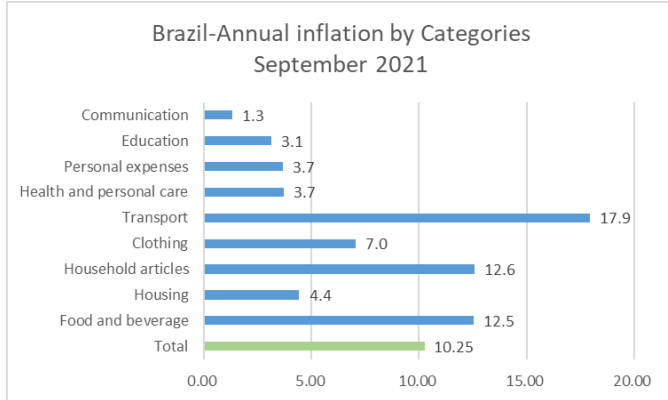
next week will have an impact on Housing and Transportation sectors in October. In its latest inflation report Bacen forecast a 1.1% inflation for September and 45 bp and 41bp for October and November respectively.

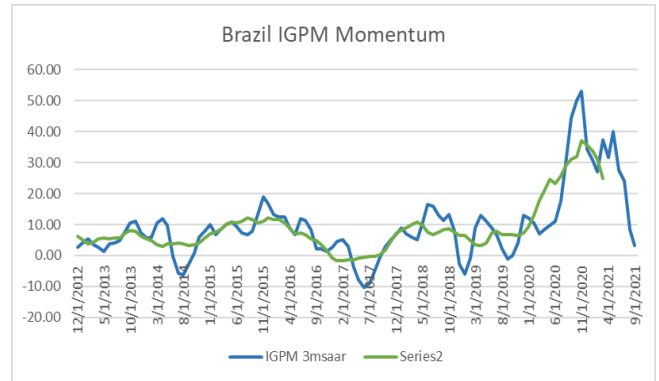
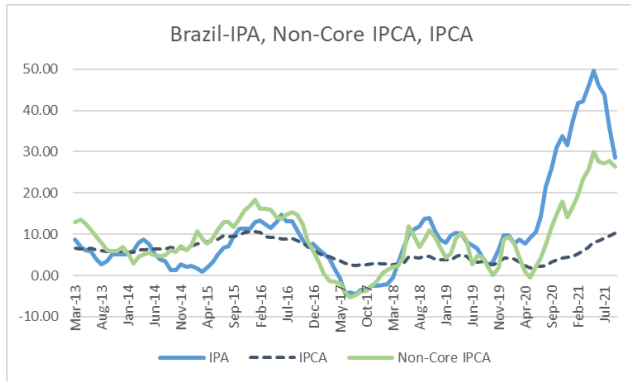
Annual inflation: headline reached 10.25% and the average of the five measures of core that Bacen produces at 6.6% both accelerating quite a bit. My estimation of core services reached 5%, and above headline services that came at 4.4%; both also accelerated. So, nowhere to hide. The forward momentum of headline, core and services remains intact.

But not all is lost. There are some preliminary signs that some areas of inflation may be softening. For instance, the IGPM declined (-64bp) in September courtesy of a decline of both wholesale prices of industrial and agricultural products -both part of the IPA or wholesale price indices - and so annual non-core inflation seems to have turned the corner. The correlation between IPA and non-core is quite strong and suggests that we may be reverting to more normal levels albeit at a slow pace.

Weight	Category	MoM			MoM - Contribution		
		Jul-21	Aug-21	Sep-21	Jul-21	Aug-21	Sep-21
100	Total	0.96	0.87	1.16	0.96	0.87	1.16
20.9	Food and beverage	0.60	1.39	1.02	0.13	0.29	0.21
15.9	Housing	3.10	0.68	2.56	0.48	0.11	0.41
3.9	Household articles	0.78	0.99	0.90	0.03	0.04	0.03
4.3	Clothing	0.53	1.02	0.31	0.02	0.04	0.01
21.0	Transport	1.52	1.46	1.82	0.32	0.30	0.38
12.8	Health and personal care	(0.65)	(0.04)	0.39	(0.09)	(0.01)	0.05
10.0	Personal expenses	0.45	0.64	0.56	0.05	0.06	0.06
5.8	Education	0.18	0.28	(0.01)	0.01	0.02	(0.00)
5.4	Communication	0.12	0.23	0.07	0.01	0.01	0.00







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