

Brazil Flash

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Economic Analysis

Brazil

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Inflation eases (temporarily) at the beginning of the year

Annual inflation declined to 5.59% YoY in January from 5.91% YoY in December, favored by positive base effects. We do not expect this easing to continue ahead. The impact of a weaker exchange rate, the difficulties to maintain administered-price inflation as low as in 2013 and less favorable base effects should drive annual inflation up during, at least, the first half of the year. However, just as the inflation rebound in December determined a 50bp hike (rather than 25bp) of the SELIC rate by the COPOM in January, the moderation of inflation in January -although temporary- should trigger a 25bp (instead of 50bp) adjustment in February.

- **January inflation was lower than expected**

The reduction of inflation in January was more significant than forecasted (BBVA 5.69% YoY; consensus: 5.66% YoY). In monthly terms, inflation dropped to 0.55% MoM from 0.92% MoM in December (0.86% MoM in January of 2013). The monthly moderation with respect to December is largely due to lower pressures from the communication, apparel and, especially, transportation groups.

- **We expect inflation to trend upwards during, at least, the first half of 2014**

The moderation of inflation in January is related to positive base effects that will wane during the next few months. In addition, the on-going depreciation of the exchange rate and the impossibility to maintain administered-price inflation as low as in 2013 will add pressure on inflation ahead. Taking these effects into account, we expect annual inflation to remain practically unchanged in February and then to converge to around 6.0% YoY by June (and to around 6.3% YoY during 3Q2014). In spite of non-favorable inflation expectations, we expect the BCB to focus on the January's inflation easing and the recent signs showing that domestic activity remain weak to adopt a smaller (25bp) adjustment of the SELIC in the next monetary policy meeting at the end of February. In our view, with this adjustment the BCB will bring the on-going monetary tightening cycle to an end. We see likely, however, that the monetary authority and the government will use other tools (such as macro-prudential policies, more FX intervention, additional control of administered-prices and even fiscal policy) to try to keep inflation under control. All that said, we acknowledge that the BCB may be forced to adopt a tighter monetary than we are expecting.

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La inflación se modera (temporalmente) al inicio del año

La inflación anual se redujo a 5,59% a/a en enero de 5,91% a/a en diciembre, favorecida por un efecto base positivo. No esperamos que esta moderación continúe de aquí en adelante. El impacto de un tipo de cambio más débil, las dificultades para mantener la inflación de los precios administrados tan baja como en 2013 y efectos base menos favorables deben empujar la inflación anual al alza durante los próximos meses. Sin embargo, al igual que el repunte de la inflación en diciembre determinó que el COPOM aumentara la tasa SELIC en 50 p.b. (en lugar de 25 p.b.) en enero, la moderación de la inflación en enero –aunque temporal– debería desencadenar un ajuste de 25 p.b. (en lugar de 50 p.b.) en febrero.

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