

Brazil Flash

Inflation moderates in line with expectations

Inflation reached 7.0%/y/y (0.43%/m/m) in October, down from 7.3%/y/y (0.53%/m/m) in September. This was the first time that yearly inflation moved downwards since July of 2010. Although we expect the moderation to continue in coming months, inflation should continue over the 4.5%/y/y target for a long period.

- **No surprises this month.**

Inflation figures in October (7.0%/y/y; 0.43%/m/m) were in line with BBVA and markets expectations (BBVA: 7.0%/y/y and 0.45%/m/m; consensus: 7.0%/y/y; 0.42%). Inflation's monthly decline was even clearer when we strip out seasonal factors from the series: in October prices increased 0.43% in comparison to 0.58%/m/m in September and 0.55%/m/m in average between January and August. Inflation, therefore, declined in October in spite of negative seasonality, which is at some extent due to the recent slowdown of the economy. In yearly terms, the drop from 7.3%/y/y to 7.0%/y/y is at a large extent due to some high-base effects (as inflation was equal to 0.75%/m/m in October of 2010 due to supply shocks).

- **Inflation to reach 6.4% at the end of 2011 and 5.4% at the end of the next year.**

We expect the recent moderation of economic activity (in Brazil and abroad) to impact positively the inflation dynamics in the end of this year. More precisely, we expect inflation to be in the 0.4%/m/m - 0.5%/m/m range in the next couple of months and to close the year at 6.4%/y/y. In 2012, inflation should gradually lose steam, but the relative strength of the Brazilian economy (GDP expect to grow 3.6%), inertial mechanisms, and a laxer monetary policy should prevent inflation from meeting the 4.5%/y/y target. It is interesting to note that in the previous crisis inflation declined from 6.4% in October of 2008 to 4.3% in December of 2009. At that time, however, the country faced a short recession (GDP dropped 0.6% in 2009) and monetary policy was tighter than it will probably be this time. This does not mean that inflation cannot converge to the target in 2012, but that it would only happen if the external environment deteriorates as much as in 2008-2009, which is clearly not incorporated in our base scenario.

For more on Brazil, [click here](#)

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