

Brazil Flash

January inflation comes in line with expectations

The IPCA was equal to 0.56%/m/m in January, broadly in line with forecasts (BBVA: 0.60%/m/m; consensus: 0.57%/m/m). Stripping out seasonal factors, inflation continued to trend downwards in January (see Chart 1 below). It has some room for continue doing so in the next months, but in yearly terms it will remain above the target, which will not prevent the CB from taking real interest rates below neutral levels.

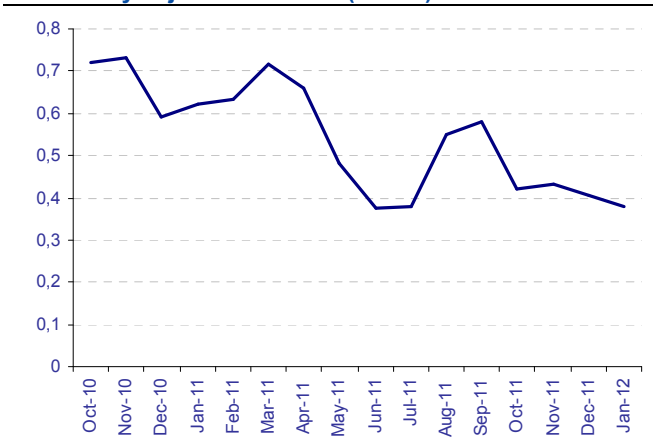
- Yearly inflation dropped from 6.5% in December to 6.2% in January**

Yearly inflation declined for the fourth month in a row after having peaked in September of 2011 (when it reached 7.3%). This downward trend is explained by high base effects, domestic demand's recent moderation, and a slight drop in the domestic price of a basket of relevant commodities. Today's release was the first after the implementation of IPCA's new weights which are in line with more updated consumer habits (see Chart 2 below). The impact of IPCA's new weights was practically null as monthly inflation would have been around the same (0.56%/m/m) if old weights had been used. Over the year, we expect this change to have a small but positive effect on inflation.

- Inflation above target and SELIC below the neutral rate**

Looking forward, inflation has still some room (mainly in the first semester) to trend down. Later in the year, however, inflation will be more pressured by the renewed dynamism of domestic demand. We expect inflation to near 5.0% by the middle of the year and then to close 2012 at 5.4%. In spite of inflation remaining above the target, the CB will continue adjusting the SELIC down in the next few months. Our call is for two additional 50 bps cuts and stability at 9.50% from then on. With a SELIC at this level, the real interest rate will be around 4%, below the most optimistic estimations of neutral interest rate for the country (around 5%). Regarding 2013, we expect inflation to remain robust (around 5.6% by the end of the year) and see a very significant probability of the CB keeping the interest rates below neutral levels.

Chart 1
Seasonally adjusted inflation (m/m%)



Source: BBVA Research

Chart 2
Inflation: values and weights

	Weights Dic/11	Weights Jan/12	January Inflation (m/m%)
Food products and beverages	23,5	23,1	0,86
Housing	13,3	14,6	0,53
Household articles	3,9	4,7	0,16
Apparel	6,9	6,7	0,07
Transportation	18,7	20,5	0,69
Health and personal care	10,8	11,1	0,30
Personal expenses	10,5	9,9	0,71
Education	7,2	4,4	0,39
Communication	5,3	5,0	0,21

Source: IBGE

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