

# Brazil Flash

## Inflation continued to fall in May, but downward trend is expected to end soon.

Yearly inflation dropped to 4.99%/y/y in May from 5.11%/y/y in April. Inflation has been declining uninterrupted since September 2011. We expect this downward trend to end in June, leaving the Central Bank in a less comfortable situation to continue cutting interest rates.

- **Downside surprise in May**

After having surprised to the upside in April, inflation figures (4.99%/y/y; 0.36%/m/m) surprised markets to the downside in May (BBVA forecasts were 5.09%/y/y and 0.45%/m/m; market consensus was 5.06%/y/y and 0.43%/m/m). Food prices peaked up in May at 0.73%/m/m (compared to 0.51%/m/m in April), but its impact on headline inflation was offset by a deflation in some groups (transportation: -0.58% m/m; communication: -0.19% m/m; and education: -0.01% m/m).

- **We expect yearly inflation to increase in June and to be within 5.0%-5.4% in H2 2012**

Even though monthly inflation will continue to decline in June (to around 0.20%/m/m from 0.36%/m/m in May and 0.64%/m/m in April), at a large extent due to seasonal factors, we expect inflation to increase in yearly terms for the first time in nine months and to reach 5.05%/y/y in June. In the second half of the year, we forecast yearly inflation to be in the 5.0%-5.4% range. Less positive base effects and some economic activity recovery will, in our view, put an end in inflation's downward trend. That would leave the Central Bank in a less comfortable situation to continue cutting the SELIC rate, which does not necessarily imply that the monetary adjustment will end in July at 8.25% (which is our call for the SELIC) as the materialization of external or domestic risks could, clearly, trigger additional easing.

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