

Brazil Flash

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Economic Analysis

Brazil

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Inflation rises in February, marking the beginning of a new upward trend

Annual inflation reached 5.68% YoY in February, above both the previous reading (5.59% YoY) and expectations (BBVA: 5.61% YoY; consensus: 5.64% YoY). In our view, this increase is the beginning of a new upward trend which should take inflation to around 6.4% YoY in 3Q14, before it eases somewhat and closes 2014 at 5.9% YoY.

- **In monthly terms, inflation increased from 0.55% MoM in January to 0.69% MoM in February**

Stripping out seasonality effects, the increase in monthly inflation was more significant: from 0.31% to 0.55%. As expected, the main pressures on February inflation came from education and food prices. The former increased 5.97% MoM, contributing with 0.27p.p. to monthly inflation, due to the seasonal adjustment of school tuition. Food prices increased 0.56% MoM, less than in January (0.84% MoM), but high enough to contribute with 0.14p.p. to inflation. The average of the core inflation measures increased from 0.53% MoM in January to 0.70% MoM in February.

- **February inflation adds more pressure on the BCB**

Inflation is benefiting from some slowdown in wages and the more restrictive tone of economic policies (accordingly, non-tradable inflation declined from 9.1% YoY in February of 2013 and 7.5% YoY in January of 2014 to 6.4% YoY in February). However, the impact of these benign effects is being – and, in fact, will continue to be – compensated by the impact of a weaker currency (especially on tradable inflation, which reached 6.0% YoY in February vs. 5.6% YoY in January and 6.4% one year ago), the practical impossibility to maintain administered price inflation as low as in 2013 (3.4% YoY in February in comparison to 2.1% YoY in the previous reading and 1.5% YoY one year ago), and resilient inflation expectations (which reflects the cost this BCB is paying for being perceived as tolerant of inflation in the past). Moreover, the recent drought should add pressure on inflation through higher food prices. Considering all this, we expect inflation to reach 6.0% YoY by the end of 2Q14 and then converge to around 6.4% YoY in 3Q14. Some moderation is expected at the end of the year, thanks to positive base effects and the lagged impact of the recent monetary tightening. In spite of the unfavorable outlook for inflation, we expect the BCB to put an end to the ongoing monetary tightening cycle soon. We still see more likely that the BCB decides to maintain the SELIC stable at 10.75% in its next monetary meeting at the beginning of April (before March inflation figures are released) and then uses other tools (such as macroprudentials, exchange rate interventions...) to try to prevent inflation from running out of control. Nonetheless, February inflation figures increase the probability of another +25bp adjustment in April.

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La inflación sube en febrero y marca el comienzo de una nueva tendencia al alza

La inflación anual alcanzó el 5,68% a/a en febrero, por encima tanto del dato anterior (5,59% a/a) como de las previsiones (BBVA: 5,61% a/a; consenso: 5,64% a/a). En nuestra opinión, este incremento es el comienzo de una nueva tendencia al alza que debería llevar la inflación a cerca del 6,4% interanual en 3T14, antes de que ceda un poco y cierre 2014 en el 5,9% a/a.

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