

Brazil | Inflation peaked at 10.7% YoY in December

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Inflation closed 2015 at 10.67% YoY, somewhat lower than expected, but well above the target range (2.5%-6.5%). After trending up last year, inflation will start to decline in January, due to lower (although still high) pressure from regulated prices. Inertia and the effect of a weaker currency cast doubt over the convergence of inflation to the target range in 2016.

Increases in food, housing and transport prices accounted for 71% of inflation in 2015

Annual inflation reached 10.67% YoY, somewhat below expectations (BBVAe: 10.8% YoY; consensus: 10.7% YoY) and significantly above the 6.5% ceiling of the target range. This is the highest figure since November 2013. By groups of products, the main contributors to the increase of inflation from 6.4% in 2014 to 10.67% YoY in 2015 were food, housing and transport prices. They contributed to annual inflation with 3.0, 2.7 and 1.9 percentage points respectively. Therefore, these three groups together accounted for 71% of inflation in 2015. The "normalization" of regulated prices, which increased 18.1% YoY in 2015 after a period at artificially low levels, is directly related to abnormally high inflation in the housing and transport groups. Moreover, it is one of the factors -together with the impact of the exchange rate depreciation and some other supply shocks- that help us to understand the 12.0% YoY increase in food prices in 2015. Finally, it is worth to note that non-regulated prices augmented 8.5% YoY in 2015 (in comparison to 6.7% in 2014).

Monthly inflation reached 0.96% MoM in December

The monthly inflation figure was lower in December than in November, when it reached 1.01% MoM, because of lower pressure from the food and housing groups (inflation in the former declined from 1.8% MoM to 1.5% MoM while housing inflation decelerated from 0.8% MoM to 0.5% MoM) and in spite of a higher variation in transport prices (1.4% MoM in December versus 1.1% MoM in November). Anyway, monthly inflation was significantly higher than in the same month last year (0.78% MoM).

We expect inflation to converge to the target range in 2016

After the sharp adjustment observed in 2015, a significant part of the process of alignment of administered prices is now over, which means that these set of prices will increase less in 2016 than they did in 2015. Anyway, regulated prices will continue to grow above the 6.5% YoY level, implying that they will continue to be an obstacle for the convergence of inflation to the 2.5%-6.5% target range. On top of that, 2016 inflation will also be pressured by inertia and by the still unfinished process of depreciation of the exchange rate. In spite of that, we expect inflation to moderate over the year and close 2016 around 6.1% YoY, within the target range, mainly as a consequence of the sharp and still-far-from-its-end recession that the country is going through. Even though inflation's downward surprise in December is good news for the BCB, which we expect to leave the Selic rate unchanged in its monetary policy meeting on January 20, an extra dose of monetary tightening should not be ruled out.

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