Brazil | Times of two-digit inflation are over

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After declining for the first time in a long period in February, inflation eased again and reached 9.39% in March. The ongoing downward trend, which is mainly due to the moderation in administered prices and the contraction in domestic demand, will likely continue moving forward. We expect inflation to converge to 6.8% at the end of 2016 and to 4.5% at the end of 2017.

Lower-than-expected inflation in March

After remaining for some month above the 10.0% level, annual inflation declined to 9.39% in March. The figure was not only below previous figures (10.36% in February and 10.71% in January, for example), but also lower than expectations (BBVA: 9.49%; consensus: 9.42%). In monthly terms inflation declined to 0.46% MoM, the lowest figure since August 2015. Even though pressure from food prices remain well-alive (13.2% YoY, 1.2% MoM), less pronounced adjustments in administered prices and the impact of the weakening of domestic demand are allowing inflation to move downwards. More precisely, administered-price inflation dropped to 10.8% YoY in March from 14.9% YoY in February and 18.1% YoY in December 2015, as most of the misalignment in the prices of the goods and services regulated by the government is now over. Moreover, the weakness of economic activity is finally having a more significant on prices. Service inflation, for example, decreased to 7.5% YoY in March from 7.8% YoY in February and 8.1% YoY in December. It is worth to note that service inflation reached in March the lowest level since 2010.

Inflation will continue to ease, but should only converge to within the target range in 2017

Lower increases in administered prices, the impact of a weakening domestic demand and a more appreciated exchange rate than previously expected should pave the way for further decreases in annual inflation in the next few months. More precisely, we expect it to decline to 8.4% in June, 8.0% in September and 6.8% YoY in December. Therefore, in spite of the expected deceleration, the most likely is that inflation will remain above the 6.5% target ceiling during 2016. In our view, that will prevent the BCB from starting a monetary easing this year. We expect the Selic rate to be cut only at the beginning of 2017, when inflation will likely move into the target range. Looking further ahead, we forecast inflation to close 2017 around 4.5%, mainly due to lack of demand pressures.