Macro Brazil

September 26, 2024

Quarterly Inflation Report: forecasts consistent with further hikes

- The September 2024 Inflation Report (IR) showed an increase in inflation projections, moving further away from the target throughout the entire relevant horizon. According to the report, this upward revision in projections over the relevant horizon can attributed to currency depreciation, increased inflation expectations, and, most importantly, stronger-than-expected economic activity. This resulted in an estimated increase in the output gap, shifting from values around neutrality to a positive level.
- In our view, this scenario reinforces the expectation that the recently initiated interest rate hike cycle will extend over the coming months, heading towards our forecast of 12% per year by the end of the cycle.
- Regarding the studies featured in this report, we highlight the box on complementary labor market indicators, where the bottom-line is that the unemployment rate has dropped surprisingly and is close to historic minimum levels. The increase in employment, especially formal employment, accompanied by a real increase in wages, is behind the drop in unemployment this year. Workers have found it easier to find better job opportunities, leading to a higher turnover rate and an increase in dismissals on request. Meanwhile, in construction and services, there has been an increase in mentions of the shortage of qualified labor as a factor limiting the expansion of production.

Central Bank forecasts

The table below shows the inflation estimates released for the IR reference scenario[1].

	Central Bank inflation (IPCA) forecasts														
	2023		2024				2025				2026				2027
	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV	I
IPCA	5.2	4.6	3.9	4.2	4.6	4.3	4.0	3.8	3.5	3.7	3.5	3.5	3.4	3.3	3.2
Difference to previous IR (pp)	0.0	0.0	0.0	-0.2	0.5	0.3	0.2	0.5	0.1	0.3	0.2	0.3	0.2	0.1	-
Market-set prices	3.5	3.1	3.1	3.5	4.3	4.4	4.3	4.1	3.8	3.6	3.4	3.3	3.2	3.1	3.1
Difference to previous IR (pp)	0.0	0.0	0.0	-0.2	0.2	0.5	0.7	1.0	0.7	0.4	0.2	0.2	0.1	0.0	-
Regulated prices	10.2	9.1	6.4	6.4	5.3	4.2	3.3	2.8	2.5	4.0	3.9	4.1	3.8	3.8	3.6
Difference to previous IR (pp)	0.0	0.0	0.0	0.2	1.2	-0.2	-0.8	-1.3	-1.6	0.0	0.2	0.6	0.3	0.3	-

*Painted area = forecasts.

Source: Central Bank

Compared to the estimates presented in the June Inflation Report (IR), inflation projections have increased for 2024, 2025, and 2026, to 4.3% from 4.0%, to 3.7% from 3.4%, and to 3.3% from 3.2%, respectively, widening the gap from the 3.0% target – a scenario consistent with the continuation of the recently initiated monetary tightening cycle (we project a Selic rate hike to 12.00% per year). According to the report, this upward revision in projections over the relevant horizon can attributed to currency depreciation, increased inflation expectations, and, most importantly, stronger-than-expected economic activity. This resulted in an estimated increase in the output gap, shifting from values

[1] The IR presents inflation forecasts up to a certain horizon. In the procedure that had been used until the previous IR, the horizon extended until the last year for which an inflation target was defined. However, with the Decree 12.709/2024, starting in January 2025, the target refers to the accumulated inflation over 12 months, calculated month by month, also known as the "continuous target". The window of the projection horizon was set at ten quarters.

around neutrality to a positive level, at 0.5% for the second and third quarters of 2024 (versus 0.0% and -0.2%, respectively, in the June publication). The estimated output gap for the last quarter of 2024 is 0.3% (versus -0.4% in the previous report). It is expected that the gap will narrow due to restrictive monetary conditions, with a projected -0.3% for the first quarter of 2026.

Addressing the recent past, the BCB notes that consumer price inflation in the quarter ending in August did not diverge much from expectations, but its composition differed, with upward surprises in industrial goods, services, and regulated prices, offset by a significant downward surprise in at-home food prices. Looking ahead to the coming months, the monetary authority anticipates higher monthly inflation rates, with a major positive contribution from food prices due to seasonality and weather conditions, along with pressure on prices of industrial goods and services. The IR projects monthly inflation rates of 0.57%, 0.36%, 0.04%, and 0.44% for the period from September to December, accumulating a 4.3% increase for the year. This figure may have a slight downward bias after the recent surprise decline in the September IPCA-15 (we revised our estimate for the full month to 0.48% from 0.56% following the release).

Regarding other variables, the GDP growth estimate for 2024 rose from 2.3% to 3.2% (above our estimate of 3.0%). According to the report, the revision is mainly due to the strong positive surprise in the second quarter. This version also brought the projection for 2025 to 2.0% (in line with our estimate), with variations in the supply and demand components reasonably homogeneous and, in general, smaller than those expected for 2024.

There was an improvement in the credit projections for 2024 (reflecting the stronger growth and the tighter labor market), maintaining the expectation of a slight deceleration in 2025. Regarding the external accounts, there was an improvement in expectations for 2024 (reflecting an expectation of a larger trade balance, only partially offset by larger expected deficits in the primary income accounts and, mainly, services), but the authorities continue to expect a worsening of the deficit for 2025, with a deceleration in the trade balance.

Gross domestic product forecasts (accumulated in the year)

	December	March	June	September	
	2024	2024	2024	2024	2025
GDP (current prices)	1.7%	1.9%	2.3%	**3.2%**	**2.0%**
Agriculture and livestock	1.0%	-1.0%	-2.0%	**-1.6%**	**2.0%**
Industry	1.7%	2.2%	2.7%	**3.5%**	**2.4%**
Services	1.9%	2.0%	2.4%	**3.2%**	**1.9%**
Household consumption	2.3%	2.3%	3.5%	**4.5%**	**2.2%**
Government consumption	1.1%	1.9%	1.8%	**2.7%**	**2.0%**
Gross fixed capital formation	1.0%	1.5%	4.5%	**5.5%**	**2.0%**
Exports	1.5%	0.5%	0.5%	**3.2%**	**2.5%**
Imports	2.5%	3.0%	6.0%	**11.3%**	**2.5%**

Source: Central Bank.

Credit balance forecasts (12-month change)					
	December	March	June	September	
	2024	2024	2024	2024	2025
Total	8.8%	9.4%	10.8%	**11.1%**	**10.3%**
Non-earmarked	8.1%	8.9%	10.0%	**10.5%**	**10.2%**
Households	9.0%	10.0%	11.5%	**12.0%**	**11.0%**
Corporations	7.0%	7.5%	8.0%	**8.5%**	**9.0%**
Earmarked	9.7%	10.0%	12.0%	**12.0%**	**10.5%**
Households	10.0%	10.5%	10.5%	**12.0%**	**10.5%**
Corporations	9.0%	9.0%	15.0%	**12.0%**	**10.5%**
Total households	9.4%	10.2%	11.0%	**12.0%**	**10.8%**
Total corporations	7.7%	8.0%	10.5%	**9.7%**	**9.5%**

Source: Central Bank.

External accounts forecasts (USD billion)					
	December	March	June	September	
	2024	2024	2024	2024	2025
Current account	-35	-48	-53	**-51**	**-60**
Trade balance	73	59	59	**68**	**64**
Exports	343	330	335	**335**	**341**
Imports	270	271	276	**267**	**277**
Services	-40	-40	-43	**-48**	**-49**
Primary income	-68	-68	-71	**-72**	**-75**
Investment - liabilities	80	80	75	**102**	**85**

Source: Central Bank.

Summary of the IR studies

We present below summaries of the studies published in the IR, with links for the complete reports.

- ### Complementary labor market indicators
  Full study (only in Portuguese) here.

  - This study presents several indicators, including alternative measures and different breakdowns from those usually used, which, as a whole, corroborate the assessment that the job market is tight.
  - To this end, different sections are shown for the unemployment rate, percentage of underemployed workers, discouragement rate, turnover data, sentiment surveys, voluntary dismissal and formalization and salary measures.

- The bottom-line is that the unemployment rate has dropped surprisingly and is close to historic minimum levels. The increase in employment, especially formal employment, accompanied by a real increase in wages, is behind the drop in unemployment this year. Workers have found it easier to find better job opportunities, leading to a higher turnover rate and an increase in dismissals on request. Meanwhile, in construction and services, there has been an increase in mentions of the shortage of qualified labor as a factor limiting the expansion of production.

- **Governance for communicating the inflation projection horizon**
  Complete study here (in Portuguese).

  - This box establishes a new governance for communicating the horizon of inflation projections in order to adapt its system to the new continuous target, to be adopted by the monetary authority from 2025.

  - According to the international experience, there are two procedures typically used in quarterly inflation publications, one with a variable-length horizon ending in a calendar year and another with a fixed-length horizon, in which a certain size is set for the horizon of the forecasts to be published. In the current QIR, the governance adopted was the fixed projection horizon, thus advancing one quarter with each publication, with a horizon fixed ten quarters ahead.

  - Therefore, this report brought inflation forecasts up to the first quarter of 2027, while the December edition will bring up to the second quarter of the same year and so on. According to the text, there was no discontinuity relative to the previous QIR, as the horizon there ended in the last quarter of 2026. Finally, it was highlighted that this governance can be changed if its need.

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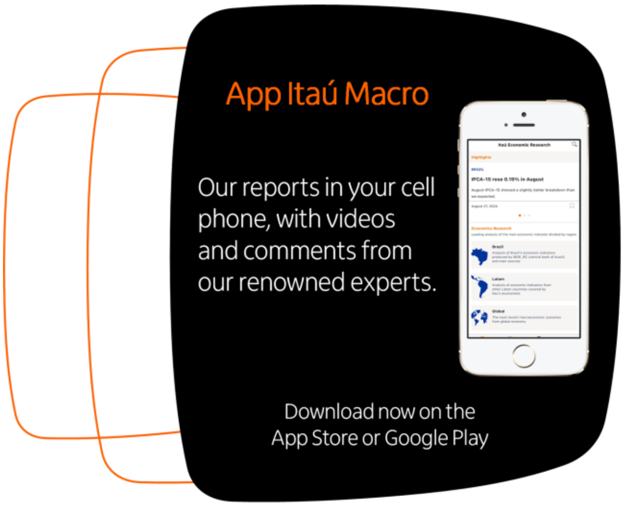

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