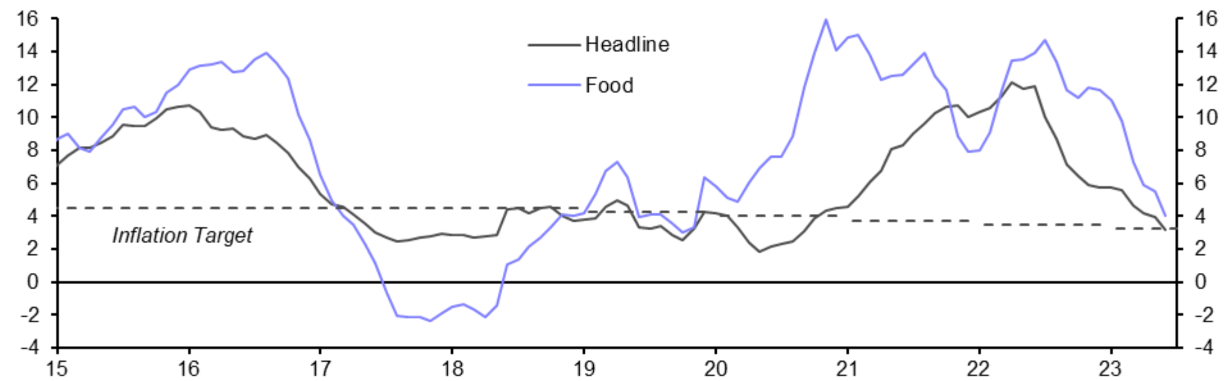
LATIN AMERICA RAPID RESPONSE

Brazil IPCA (June 2023)

Inflation plunge seals the deal on an August rate cut

- **The sharp fall in Brazilian inflation to just 3.2% y/y last month makes it almost certain that the central bank will kick off its easing cycle at its next meeting on 2nd August. We have pencilled in a 25bp reduction in the Selic rate (to 13.50%) but, if anything, the risks are starting to tilt towards a larger 50bp move.**
- The outturn was in line with consensus expectations (although a touch above our own forecast of 3.1% y/y) and was down from 3.9% y/y in May. This was the weakest inflation reading since September 2020 and the headline rate is now *below* the central bank's target (3.25% for this year). (See Chart 1.)
- The fall in inflation was helped by a m/m decline in transport and food prices. The 0.7% m/m fall in food prices was unseasonally large – it was the biggest drop in any June since 2010. The statistics office's press release noted large declines in the prices of beef, soy oil, milk and fruits.
- **But price pressures appear to have eased quite broadly**. Year-on-year inflation in most price categories (other than housing) declined between May and June. (See Table 1.) That suggests that core inflation has softened further.
- **This reading marks the trough for inflation** – the current low rates are being helped in part by favourable base effects (particularly in energy inflation) which will begin to unwind. And we expect the headline rate to rise to more than 5% by the end of the year. **But even so, today's data will seal the deal on an interest rate cut at the next central bank meeting (as flagged in the minutes to the June meeting).**
- We expect the central bank to begin the easing cycle with a 25bp move, reducing the Selic rate to 13.50%. **Policymakers have talked of a 'parsimonious' easing cycle and Copom members are clearly still concerned about inflation risks. But given how far inflation has fallen, the probability of a 50bp first step is increasing.**

Chart 1: Brazil IPCA (% y/y)



Sources: Refinitiv, IBGE

Table 1: Brazil IPCA

	Headline		Food & Bev.	Housing	Pers. Exp.	Transp.	Health	Educ.	Clothing
	% m/m	% y/y	% y/y	% y/y	% y/y	% y/y	% y/y	% y/y	% y/y
Mar-23	0.7	4.7	7.3	0.0	7.3	-1.6	12.0	8.2	13.4
Apr-23	0.6	4.2	5.9	1.6	7.0	-2.9	11.7	8.3	12.9
May-23	0.2	3.9	5.5	4.0	7.1	-4.8	11.6	8.3	11.1
Jun-23	**-0.1**	**3.2**	**4.0**	**4.3**	**7.0**	**-5.7**	**10.4**	**8.3**	**9.7**

Sources: Refinitiv, IBGE

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