Consumer inflation accelerated in September, but core prices remain subdued

Overview

- **Consumer inflation reached 0.48% in September, reflecting higher fuel prices rose and receding pressure from food prices.** In line with seasonal patterns, fresh food prices fell at a slower pace, helping explain part of the increase in headline inflation for the month. When it comes to fuel, international oil prices have been surging over the past few weeks, which also puts upward pressure on domestic prices. Both of these factors should continue to drive inflation in October. However, core prices remain at low levels or, as the Central Bank put it in its last report, at "appropriate levels," with inflation converging to the center of the target. The 3-month inflation rate for average core prices came in at 4.3%. We expect this rate to reach 4.7% by the end of the year, while the 12-month rate will reach 3.2%. Therefore, we believe that primary shocks are still largely responsible for the uptick in inflation. As for next year, with core prices continuing their upward trend and the secondary effects from the shocks, we expect the Central Bank to raise the interest rate from 6.5% to 8.0%.
- **Economic recovery continues at a sluggish pace in the second half of the year.** Industrial production fell 0.3% in August, marking the second consecutive month of decline following the rebound from the truck drivers' strike. As a result, production levels have remained practically stable since the beginning of the second semester. Recent data, including early September indicators, support our GDP growth forecasts of 0.3% for the third quarter and 1.1% for the year.
- **Underpinned by a robust labor market, U.S. growth has intensified the debate on further rate hikes.** We now believe the U.S. Fed Funds rate will reach 3% next year, but the pace of growth and a strengthening labor market may lead to additional tightening. Fed Chairman Powell said last week that current levels are still well below the neutral interest rate. That opens up the possibility of interest rates rising above 3% in order to prevent the economy from overheating and inflation from spiking. In fact, the U.S. labor market is particularly strong, with non-farm payrolls growing by 134,000 in September (and revised higher for the previous months), and annual wage growth at 2.8%. However, as the impact of this year's fiscal stimulus measures are starting to dissipate and the short-term effects of the trade war begin to materialize, we believe growth will start to decelerate, and A Fed Funds rate of 3% may be sufficient. Another important factor is the new trade agreement negotiated by Canada, the United States and Mexico to replace NAFTA, which will be known as USCMA. The deal appears to have helped ease global trade tensions, at least in the short term. We will continue to monitor the dynamics between China and the United States until the end of the year, since there could be new tensions emerging and more tariffs being announced.

Weekly outlook

- **The week's highlight the first round of elections to be held Sunday, which will already determine the composition of Congress.** In economic data, we expect August's retail sales to show a 0.7% increase at the margin, which would return some of the losses in previous months. This figure would be consistent with our 0.3% growth forecast for the quarter. The September IGP-DI should continue to be pressured, reflecting the exchange rate depreciation and rising international oil prices.
- **Internationally, markets will be on the lookout for Chinese activity indicators and U.S. inflation data.** The Chinese activity indicators expected to be released next week include data on the country's credit market and balance of trade, providing additional information on the domestic reaction after the stimulus measures enacted over the past few months. As for the U.S., markets will be watching consumer price data closely following confirmations that the labor market continues to heat up, and after the Fed chairman's statement that the current interest rate is still somewhat below the neutral level. If inflation shows signs of taking off, there will be increased talk of new interest rate hikes.

Time	Country	Event	Forecast (Bloomberg)	Forecast (Depec)
Monday 10/08				
08:00	Brazil	FGV: IGP-DI (Sep)		1.58% (MoM)
08:00	Brazil	FGV: Consumer Price Index (IPC-S) (weekly)		
08:25	Brazil	BCB: Focus Survey		
15:00	Brazil	MDIC: Trade Balance (weekly)		
03:00	Germany	Industrial Production (Aug)		
-	EUA	National Holiday - Closed markets		
Tuesday 10/09				
05:00	Brazil	FIPE: Consumer Price Index (weekly)	0.29%	0.43%
09:00	Brazil	IBGE: Industrial Production - regional (Aug)		
Wednesday 10/10				
08:00	Brazil	FGV: IGP-M (1st preview) (Oct)		
12:30	Brazil	BCB: Currency Flows (weekly)		
Thursday 10/11				
09:00	Brazil	IBGE: Agricultural production Survey (Set)		
09:00	Brazil	IBGE: Retail sales (PMC) (Aug)		0.7% (MoM)
09:00	Brazil	Conab: 1st Grains crop survey 2018/2019		
09:30	USA	CPI (Sep)	0.2% (MoM)	
09:30	USA	Initial Jobless Claims - Weekly		
20:00	Peru	Central bank meeting	2.75%	2.75%
-	USA	USDA: World Agricultural Supply and Demand Estimates		
Friday 10/12				
-	Brazil	National Holiday - Closed markets		
03:00	Germany	CPI (Sep - F)		
06:00	Eurozone	Industrial Production (Aug)		
11:00	USA	University of Michigan Sentiment (Oct - P)	100.0	
During the week				
-	China	Trade Balance (Sep)	US$ 24.5 b	

	2016	2017	2018	2019
Consumer inflation - IPCA (%)	6.29	2.95	4.40	4.25
GDP growth (%)	-3.6	1.0	1.1	2.5
Industrial Production (%)	-6.4	2.5	1.5	2.7
Retail Sales (%)	-8.7	4.0	5.0	4.5
Unemployment Rate (% of labor force, avg)	11.5	12.7	12.5	12.3
Outstanding Credit Growth (%)	-3.5	-0.5	4.0	8.3
Trade Balance (USD bn)	45.0	64.0	60.4	61.1
Current Account (USD bn)	-23.5	-9.8	-9.9	-8.5
Exchange Rate (BRL/USD, eop)	3.26	3.31	3.90	3.80
Selic Rate (%, eop)	13.75	7.00	6.50	8.00
Primary Balance (BRL bn)	-155.8	-111	-132.7	-94.9
Gross Debt (% of GDP)	70.0	74.0	75.7	76.5

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