Rising, but still negative

Our Itaú Inflationary Surprise Index rose to -0.16 in December, coming from -0.28 in November. Overall, surprise indexes for most countries turned less negative in the last month of 2017. In Mexico, inflation surprised to the upside in November, pressured by electricity prices. The recent inflation data suggests that meeting the 3% target in 2018 is becoming more challenging. In Brazil, the IPCA-15 index came in line with the median of expectations, while private indexes were mixed. In Colombia, the monthly CPI gain came in slightly above the Bloomberg market consensus. In spite of weak internal demand, the inflation slowdown is been restricted by the inertia prevalent in the Colombian economy.

The inflation surprise index compares trends in inflation indicators released during the month to what analysts had been expecting for them. The inflation index is a GDP-weighted average of separate indices for Brazil, Mexico, Chile, Colombia and Peru. The inflation index, however, possesses fewer indicators for each country (vis-à-vis our proprietary Activity Surprise Indexes) due to the limited number of inflation indices that are consistently forecasted by agents. As usual, an above-zero reading means inflation overshoot estimates. A below-zero reading means inflation came in lower than expected. The index is presented as a three-month moving average in order to avoid excess volatility.

Brazil’s index increased to -0.11 in December, coming from -0.25 in November. The mid-month inflation preview (IPCA-15) climbed 0.35% in December, in line with our estimate and the median of market expectations. The index ended 2017 up by 2.94%, down substantially from 6.58% in 2016. Market-set prices rose 0.24% in December and 1.3% in 2017 (6.9% in 2016). Regulated prices climbed 0.69% during the month and 8.0% in 2017 (5.6% in 2016). In turn, the IPCA rose 0.28% in November, below the lowest of market expectations (median: 0.35%). The year-over-year change accelerated to 2.80% from 2.70% in October. Year-to-date, the IPCA climbed 2.50% - the lowest reading since 1998. The costs for food consumed at home declined 0.72% in November - the seventh straight month of deflation -, and the year-over-year slide deepened to -5.3% (-5.1% yoy in October). Indeed, prices for food consumed at home surprised to the downside last year. This supply shock imparts downside risks to 2018 inflation in the form of possible second-round effects, not only on services that are linked to food consumed away from home, but especially through the inertial effect of past inflation. Looking forward, IPCA inflation is expected to increase slightly, but to continue at comfortable levels, particularly due to substantial slack in the economy.

Mexico’s index rose to -0.04 in December, coming from -0.26 in November. Mexico’s CPI came in higher than expected in November, registering a monthly gain of 1.03%, slightly above median market expectations (1.01%, as per Bloomberg). The main source of the pressure were electricity prices (up by 24.69%), which are always hiked in October and November of every year. Nevertheless, the rise of electricity was higher than usual, exceeding the 5-year median variation by 251bps, likely explained by the increase of fuel prices (which have increased operational costs for the stated-owned electricity company, according to fiscal reports of the Ministry of Finance). Likewise, CPI came in above market expectations in the first half of December: the consumer price...
index rose 0.44% relative to the second half of November (mkt: 0.39%). Air fares jumped 41% (contributing 10bps for total inflation), which is high even considering seasonality. Meanwhile, gasoline prices and non-processed food were also important inflation drivers. While inflation has been surprising to the upside, we note that at the margin inflation is far lower than year-over-year readings. Therefore, a substantial decline of annual inflation will likely come in January, though these recent figures suggest that meeting the 3% target next year is becoming more challenging.

**Chile’s** index increased to **-0.33** in December (-0.46 in the previous month), owing to the moving average effect. At the margin, consumer prices gained 0.1% from October to November, in line with the Bloomberg market consensus. As a result, annual inflation was stable at 1.9%, although the breakdown shows that tradable inflation continues to be less of a drag, whereas non-tradable inflation moderated to 3.1%. Looking ahead, we see inflation ending this year at 2.2%, and staying near 2% for the first half of 2018. Nevertheless, a pickup to 2.8% for 2018 is still likely as the output gap narrows, the Chilean Peso weakens somewhat, and food price inflation returns to historical patterns.

**Colombia’s** index increased to **-0.27** in December, from -0.35 in the previous month. In November, prices gained 0.18% from the previous month, with food prices still dragging inflation down. The monthly gain came in slightly above the Bloomberg market consensus of 0.12%. The resulting annual inflation tick up to 4.12%, from 4.05% in October, is partly affected by unfavorable base effects. Non-tradable inflation (excluding food and regulated prices) has remained broadly stable for nine months at 5.3%, reflecting that in spite of weak internal demand, the inflation slowdown is been restricted by the inertia prevalent in the Colombian economy. Going forward, we see inflation falling in the months ahead, reaching 3.4% for 2018. An inflation slowdown is likely, amid negative output gap, moderate currency depreciation and less inertia.

**Peru’s** index plunged to **-1.23** in December, coming from -0.47 in November. In fact, the CPI fell 0.20% month-over-month, below the median of market expectations surveyed by Bloomberg (0%). Food prices, which account for 38% of the CPI basket, fell 0.74%, subtracting 30bps from the CPI print. Annual CPI inflation fell to 1.54% year-over-year in November (from 2.04% in October), marking the first time in more than seven years that inflation printed below the Central Bank’s 2% target. In our view, annual inflation will continue decreasing in the next months, probably falling below 1% in March (because of El Niño base effects) but then climb to 2.5% by the end of 2018.

**Luka Barbosa**  
**Eduardo Marza**
Itaú Inflationary Surprise Index – January 3, 2018

Surprise Index: Brazil

Index is measured as the number of standard deviations of data surprises from the mean (3MMA)

Source: Bloomberg, Itaú

Surprise Index: Mexico

Index is measured as the number of standard deviations of data surprises from the mean (3MMA)

Source: Bloomberg, Itaú

Surprise Index: Chile

Index is measured as the number of standard deviations of data surprises from the mean (3MMA)

Source: Bloomberg, Itaú

Surprise Index: Colombia

Index is measured as the number of standard deviations of data surprises from the mean (3MMA)

Source: Bloomberg, Itaú

Surprise Index: Peru

Index is measured as the number of standard deviations of data surprises from the mean (3MMA)

Source: Bloomberg, Itaú
Methodology Note

Our Itaú Inflationary Surprise Index compares trends in inflation indicators to what analysts had been expecting for them each month. The index considers the month that each indicator is released. For instance, February’s inflation reading released in March will be incorporated to March’s surprise index.

The index is a GDP-weighted average of separate indices for Brazil, Mexico, Chile, Colombia and Peru. An above-zero reading means inflation overshot estimates. Below zero means inflation came in below expectations. The index is a three-month average in order to avoid excess volatility.

We build the inflation surprise index for each country using inflation indicators for which consensus estimates are normally provided in the Bloomberg survey. The weight of each indicator in the index depends on its importance for the economy. For example, headline consumer inflation numbers enjoy a higher weight than regional inflation indicators or wholesale price indices.

We use the deviation of the actual print from the consensus estimate (surprise), subtract the result from the historical average deviation and then divide the result by the standard deviation of the surprise. This methodology provides a better sense of how important was the surprise in each month.

The weight of each country in the aggregate inflation index depends on the size of its GDP. Brazil has the highest weight, followed by Mexico.

It’s worth noting that, due to revisions in the economic indicators and as lagged announcements, the surprise indices may be revised.

Indicators on which the index is built:

- **Brazil**: IPCA (Headline CPI) (30%), IPCA-15 (30%), IGP-10 (10%), IGP-M (10%), IGP-DI (10%), IPC-S (5%), IPC-FIPE (5%)
- **Mexico**: Headline CPI (50%), Bi-Weekly CPI (50%)
- **Chile**: Headline CPI (100%)
- **Colombia**: Headline CPI (100%)
- **Peru**: Headline CPI (100%)

Macro Research – Itaú
Mario Mesquita – Chief Economist

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