Scotiabank.

GLOBAL ECONOMICS

LATAM DAILY

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Latam Daily: Inflation Surges in Colombia; Mixed Indicators in Mexico

- **Colombia: January 6.94% inflation highest since Sept-2016**
- **Mexico: Indicators send mixed messages**

COLOMBIA: JANUARY 6.94% INFLATION HIGHEST SINCE SEPT-2016

Monthly CPI inflation was 1.67% m/m in January 2022, according to DANE data published on Saturday, February 5. This result is well above the median forecast in BanRep's survey (0.91% m/m), and Scotiabank Economics' projection (1.11% m/m). Food prices again posted the biggest increases with all items posting positive m/m contribution. January's CPI result brings annual headline inflation to 6.94% y/y, the highest in 5 years, up from 5.62% y/y in December (chart 1), and above the ceiling of BanRep's target range (2%–4%) for the sixth month in a row.

Core inflation also increased from 3.44% y/y to 4.47% y/y, while ex-food and regulated goods inflation came in at 3.47% y/y (up from the 2.49 % in the previous month). January's inflation reflects a new significant shock to food prices due to higher input costs, but also the effects of indexation on core components.

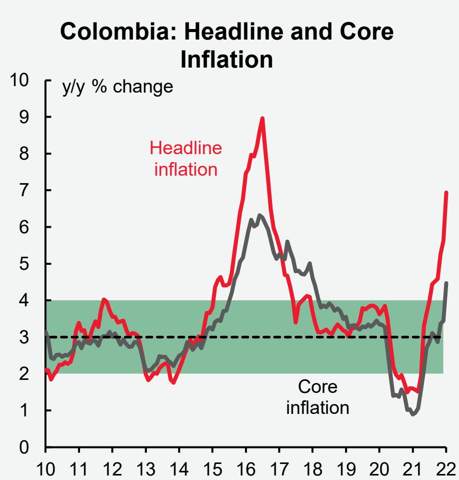
We continue to expect a 100 bps rate hike in March's monetary policy meeting and that headline inflation will start to moderate in H2-2022. Having said that, since the balance of risks is clearly to the upside for both headline and core inflations, if CPI does not begin to converge on target in Q2-2022, we would revise our forecast with a higher-than-expected terminal rate, which we currently estimate at 5.75%

Looking at the January's numbers in detail, every component but education showed positive contributions to inflation (charts 2 and 3). Once again, foodstuffs posted the highest gains. The main highlights are:

- **Foodstuffs prices** (+3.79% m/m) had the largest contribution to overall inflation (+67 bps), with the main gains coming from meat (+2.66% m/m), milk (+4.25% m/m), potatoes (+25.34% m/m) and bananas (+15.53% m/m). Rising input prices and FX depreciation are driving food prices higher, especially imported commodities such as soy and corn. Other important items in the production process such as fertilizers also increased.

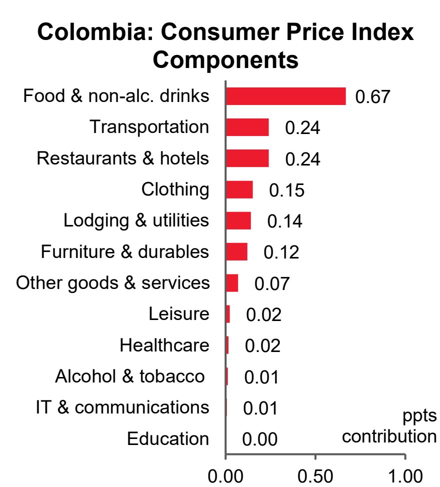
- **Transport group** (+1.85% m/m and +24 bps) posted the second major contribution to January's inflation. This component was affected by the effect of higher gasoline

Chart 1



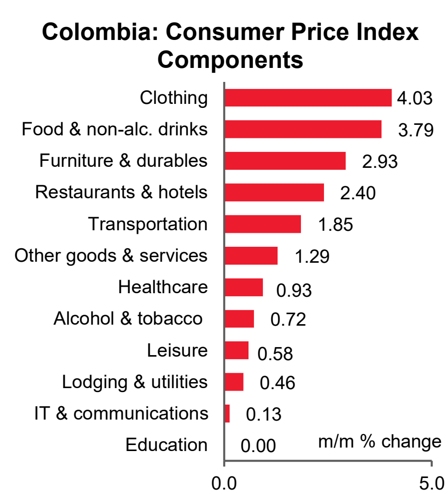
Sources: Scotiabank Economics, DANE.

Chart 2



Sources: Scotiabank Economics, DANE.

Chart 3



Sources: Scotiabank Economics, DANE.

prices (+1.84% m/m), the FX depreciation through higher prices in vehicles (+0.78% m/m), and the effect of the public transport system fee increases (+3.23% m/m).

- **Restaurants and hotels** component was the third largest contribution (+24 bps and +2.40%m/m), showing the effect of higher food prices, but also the effect of the minimum wage.
- **Lodging & utilities sector** inflation stood at 0.46% m/m due to utility fees (+1.16% m/m), especially electricity (+1.92% m/m). Rental fees increased by 0.26% m/m, which is a moderate increase given the expected indexation.
- **The rest of the components** showed the effect of usual price increases that take place at the beginning of the year and contributed to the highest inflation in recent years. **The clothing group** particularly showed the reversal effect from the VAT holiday contributing bps to the overall figure.

Looking at annual inflation across major categories, goods inflation jumped to 5.29% y/y in January, while services inflation increased by 61 bps from 2.18% y/y to 2.79% y/y. Regulated-price inflation jumped 121 bps to 8.31% y/y.

All in all, 40% of total inflation was explained by food inflation, the remainder being a combination of usual indexation effects and the reversal of the VAT holiday. January's inflation result skews year-end 2022 inflation to 5%, which would lead to even more indexation effects for 2023.

In terms of monetary policy, we anticipate that the board will continue with a 100 bps hike in March's meeting, raising the policy rate to 5%. We project a terminal rate of 5.75%, provided that headline inflation begins to moderate in coming months.

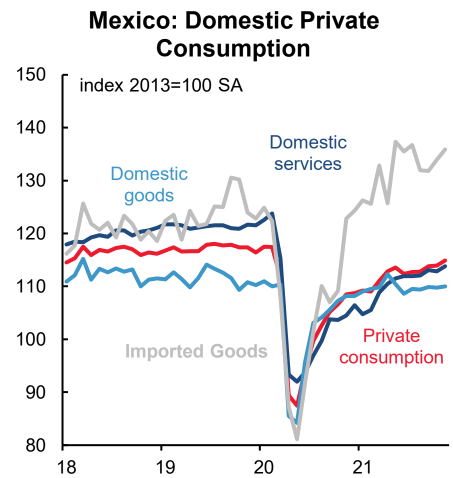
—Sergio Olarte & Jackeline Piraján

MEXICO: INDICATORS SEND MIXED MESSAGES

I. Private consumption continues recovery in November

According to INEGI, seasonally-adjusted private consumption increased 0.7% m/m in November, stringing together five consecutive increases (chart 4). Consumption of domestic goods increased 0.2% m/m, while imported goods increased 1.2% m/m. At the retail level, domestic goods increased 0.2% m/m and services 0.7% m/m. In real annual terms, on a non-seasonally adjusted basis, consumption increased 7.5% (5.8% previously), with goods advancing 3.5% and services rising 8.9%, in line with lower restrictions (Mexico was under a partial COVID-19 lockdown in November) and boosted by the sales from "El Buen Fin". Going forward, we expect consumption growth to moderate owing to high inflation levels and the recent rebound in caseloads.

Chart 4



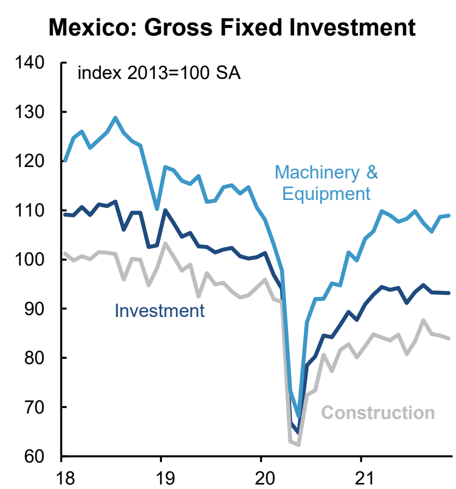
Sources: Scotiabank Economics, INEGI.

II. Gross fixed investment remains sluggish, with no signs of recovery

INEGI also released the gross fixed investment index, which registered its third consecutive monthly decline in November, -0.1% m/m. Gross fixed investment started to decline in November 2018 and still remains below pre-pandemic levels (chart 5). Construction dropped -0.7% m/m in November, making three consecutive declines. Residential construction fell again (-0.7% m/m), which was not offset by a modest increase in non-residential construction (1.0% m/m). On the other hand, machinery and equipment posted an advance of 0.2% m/m, driven by an increase in imported machinery and equipment of 12.0% m/m, as the domestic counterpart decreased -5.9%m/m. On a year-over-year basis, gross fixed investment rose 4.3%, with construction up 1.4% y/y and machinery and equipment 7.3% y/y, mainly due to a base effect.

As noted in our comment on Banxico's survey of expectations, the majority of respondents consider it a bad time to make investments and that the business climate for private sector productive activities will remain the same or worsen in the next six months. Consequently, we don't expect investment to recover in the short term.

Chart 5



Sources: Scotiabank Economics, INEGI.

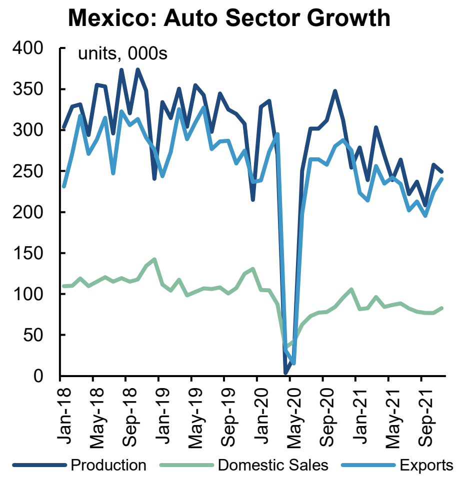
III. Weak start to the year in the auto industry

The automotive industry continued to contract in January, albeit at a slower pace. While recording the seventh consecutive decline, production contracted at a lower rate, falling -9.1% y/y (average previous declines -24.0%), pointing to persistent problems in supply chains. Sales also declined at a slower pace, -3.8% y/y (average four previous declines -7.9%), while exports fell -3.1% y/y (average six previous declines -20.2%), in line with the shortage of inputs and inventories. In terms of the number of units, these are the lowest levels for a similar month since: 2013 for sales (78,585 units in 2022); 2015 for production (253,366 units in 2022); and 2017 for exports (216,630 units in 2022) (chart 6).

In the short term, we expect sales to recover in line with private consumption, while supply chain disruptions normalize in the coming months. Accordingly, automotive production and exports should start to recover in the second half of the year.

—Luisa Valle & Miguel Saldaña

Chart 6



Sources: Scotiabank Economics, INEGI.