

Contributors

Guillermo Arbe, Head Economist, Peru
+51.1.211.6052 (Peru)
guillermo.arbe@scotiabank.com.pe

Sergio Olarte, Head Economist, Colombia
+57.1.745.6300 Ext. 9166 (Colombia)
sergio.olarte@scotiabankcolpatria.com

Jorge Selaive, Head Economist, Chile
+56.2.2619.5435 (Chile)
jorge.selaive@scotiabank.cl

Eduardo Suárez, VP, Latin America Economics
+52.55.9179.5174 (Mexico)
esuarezm@scotiabank.com.mx

TODAY'S CONTRIBUTORS:

María (Tatiana) Mejía, Economist
+57.1.745.6300 (Colombia)
María1.Mejía@scotiabankcolpatria.com

Jackeline Piraján, Senior Economist
+57.1.745.6300 Ext. 9400 (Colombia)
jackeline.pirajan@scotiabankcolpatria.com

Latam Daily: Colombia's Inflation Sends Mixed Messages

- Colombia: Headline inflation moderates, but core highest since December 2003

COLOMBIA: HEADLINE INFLATION MODERATES, BUT CORE HIGHEST SINCE DECEMBER 2003

According to DANE data published on Saturday June 4, monthly CPI inflation was **0.84% m/m in May 2022**, close to the BanRep's survey (0.82% m/m) and aligned with Scotiabank Economics' projection (0.84% m/m). The May inflation reading was almost 2.5 times the average monthly inflation observed since 2016 (0.33% m/m) and brings annual headline inflation to 9.07% y/y, down from 9.23% y/y in April (chart 1). Annual food inflation eased from 26.2% y/y to 21.60% y/y, exhausting the upside effect of the nationwide strike one year ago, as the only element of the CPI basket contributing to the deceleration of inflation on a year-over-year basis.

In contrast, core inflation increased again, from 5.94% y/y to 6.50% y/y, the highest rate since December 2003, while ex-food and regulated goods inflation came in at 5.87% y/y (up from 5.26% the previous month), the highest level since August 2016.

These results show upside pressures on key prices owing to indexation effects in items such as rent fees and utilities. The consolidation of economic activity, meanwhile, is probably fueling further price rises; in fact, consumption credit demand is increasing above 18% y/y pace, which points to still-strong demand.

Higher core inflation should, in our opinion, motivate a 150 bps rate hike at the June 30th monetary policy meeting. Since the last meeting, economic activity has shown stronger-than-expected results, while inflation is driven by upside pressures in core components. We expect June's y/y headline inflation to increase again, due to the negative statistical base effect on the back of the normalization in food prices after the nationwide strike one year ago. It will be interesting to see if the VAT holiday (June 17th) moderates the expected spike. That said, we will only have confirmation of a downward path after the July releases. For now, we affirm our expectation of the hiking cycle ending at 8.5% in July, with the rate easing to 6% by the end of 2023, provided inflation moderates in H2-2022 and drops more rapidly in 2023.

Looking at the May numbers in detail, all 12 components of the CPI index contributed to higher inflation (charts 2 and 3). The main highlights are:

- Foodstuffs had the largest contribution (+29 bps), with inflation of +1.56% m/m, coming from meat (+9 bps), tomatoes (+7 bps), and rice (+5 bps), with other products showing upside pressures from higher input prices. Having said that, food

Chart 1

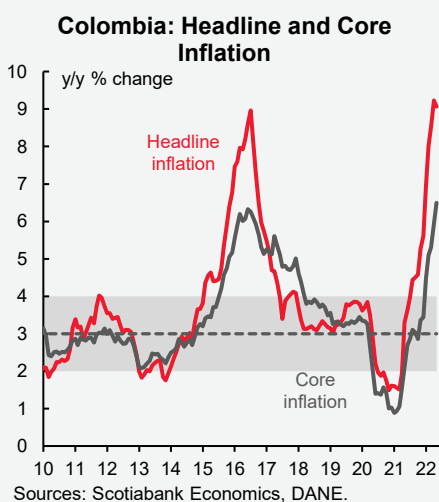


Chart 2

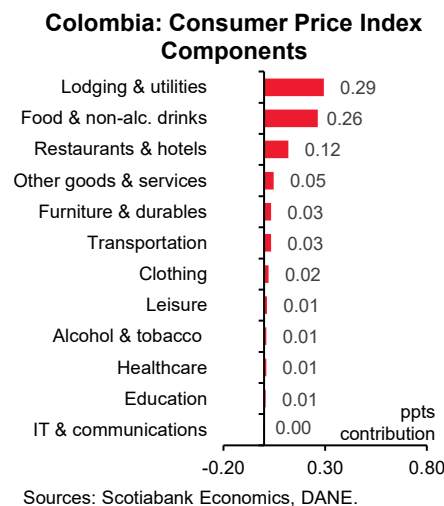
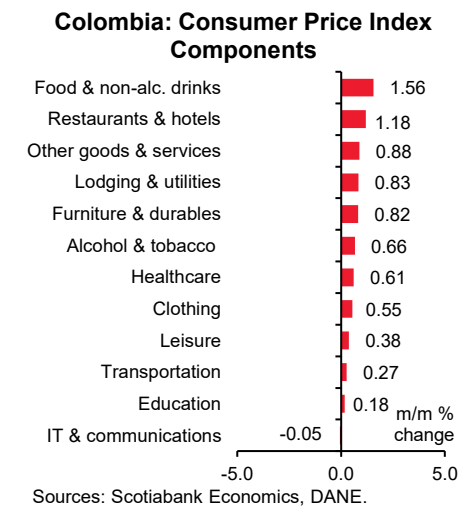


Chart 3



June 6, 2022

inflation slowed down from its previous record level of 26.2 % y/y in April. Moreover, in May, the PPI showed pressures on fertilizer process that are likely to continue to be reflected in the CPI numbers for foodstuffs in coming months.

- **Food inflation will have a high statistical base in June resulting from the normalization after the nationwide strike in 2021, which led to a 1.02% m/m contraction.** This base effect should again contribute to an increase in headline inflation. However, if food inflation remains above an average of 0.80% m/m for the rest of the year, inflation would continue accelerating after June. Therefore, the risk of closing 2022 with inflation above 8.50% is high, which would lead to higher indexation effects that would delay the expected y/y reduction of inflation in 2023.
- **Lodging and utilities (+26 bps) was the second-largest contributor to headline inflation.** In May, rents rose 0.54% m/m, reflecting stronger indexation effects compared with previous months. Utility fees jumped by 1.78% m/m, led by electricity (+2.86% m/m), and water (+1.44% m/m). These increases are a source of concern, since they can continue to push inflation up as indexation rules are consistently triggered.
- **Across other groups, inflation reflected upside contributions from tradable goods reflecting FX depreciation,** and, more importantly, international bottlenecks that are also propagating price pressures in other core components.

Looking at annual inflation across major categories, goods inflation jumped 68 bps to 8.51 % y/y in April, while services increased from 4.29% y/y to 4.87% y/y. Regulated-price inflation increased 35 bps to 8.85% y/y.

All in all, May inflation showed an expected moderation. However, core components continued to rise in a concerning pattern. In May, meat, electricity, and rent fees were the main contributors to the prices' increase, while other components also showed a strong dynamic of indexation and the effect of the current strong economic activity. **All of the above lead us to expect the central bank to hike the monetary policy rate in June by 150 bps, with an end to the hiking cycle at 8.50% in July.**

—Sergio Olarte, Maria (Tatiana) Mejía & Jackeline Piraján

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