

Economic analysis**Headline annual inflation started 2022 at 6.94%**

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In January, headline inflation acceleration was not only driven by foodstuffs

Inflation started the year with an upward surprise with a monthly print of 1.67% for January and annual change of 6.94% above both, BBVA Research forecast and market expectations (0.89% in the BanRep survey, and even above the maximum estimate of 1.38%). Monthly core prices increased by 1.21%, with an annual variation of 4.47%, also showing a surprise against analysts' expectations (0.66% on average in the BanRep survey for the month).

Food inflation, meanwhile, displayed a strong rebound in the month, considerably higher than anticipated by analysts, with a monthly variation of 3.79%. It was the second highest in at least the last decade (surpassed only by the one observed in May 2021, in the middle of the national strike and logistic complications); with that, the annual record was 19.94%. Within the food group, the vegetables, fruits, tubers and milk division showed the strongest monthly variation, with a rise of 8.4%. To a large extent, this rebound in agricultural goods is due to the impact of high input prices on costs, especially in imported goods. Besides, this impact is accentuated by the accumulated weakness of the Colombian peso. Pressures on this front could be maintained as indicated by the increase in the PPI for transitory agricultural crops, with a 34.2% annual increase in January. On the other hand, lagged effects of the rainy season wave at the end of 2021 were also observed in some products. Thus, some moderation could be expected starting in the second quarter of the year, but this would be gradual.

Meanwhile, tradable goods inflation continues to accelerate, partly due to the accumulated depreciation of the Colombian peso, especially at the end of the year. The inflation of those goods rose also due to a delayed effect of global bottlenecks on products at the national level. Its annual variation was 5.37%, increasing more than 201 bps in comparison to the previous month. Among the items that stand out for their increase in the month are men's and women's clothing (monthly variation of 6.6% and 6.1%), cleaning and maintenance products (6.3%) and body hygiene items (1.9%).

In addition to external factors, there was an upward impact due to the effects of the normalization of the measurement of "VAT-free days" in the last quarter of 2021. This had an important effect, among others, on the clothing and footwear division, which registered a monthly variation of 4.03%. This phenomenon may continue for a couple months, as well as the effect of prices of school uniforms as public schools return to face-to-face schooling in February.

Other phenomena to be monitored at the beginning of the year are the potential effect of high inflation at the end of 2021 and the increase in the minimum wage on price formation in 2022. On this front, high inflation

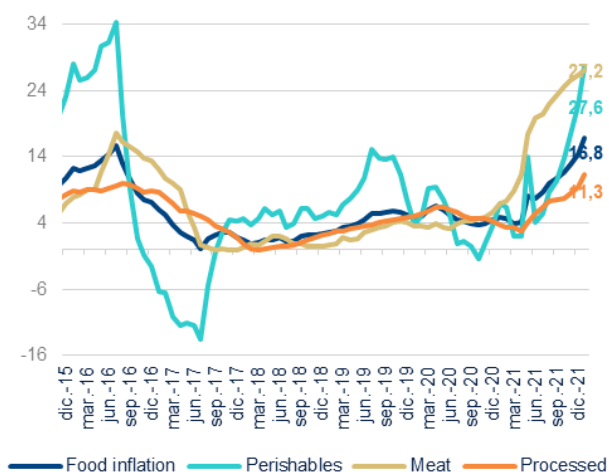
was observed in goods indexed (directly or indirectly) to the minimum wage, with an annual variation of 8.9% in January compared to a variation of 7.3% in December.

The high inflation in January is a demanding starting point for the evolution of inflation in the coming months and in 2022 in general. Although it is normal to observe relatively higher monthly inflation in the first months of the year (due to indexation phenomena and the tradition of price formation in Colombia), the current phenomenon could generate a combination of higher than usual indexation, robust local and external demand and a series of supply shocks that contribute to a stronger impact that tends to last longer. This could generate non-negligible impacts on the purchasing power of families and the production and investment decisions of the productive sector.

In addition, there is a possible stronger response from the Central Bank, which, in its most recent policy meeting, expressed its concern about high inflation at the end of 2021, the possible effects of indexation and an increase in inflation expectations, which will surely be accentuated with the January inflation figure.

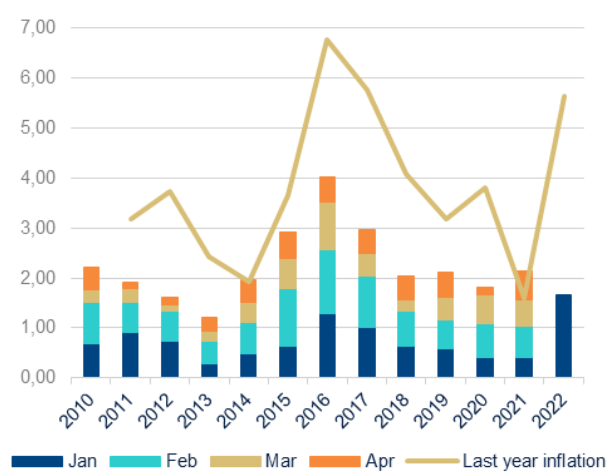
For the month of February, we expect the pressure on inflation to be maintained due to, among other things, the pending adjustments in the normalization of the measurement of the VAT-free day of 2021 and the adjustment of goods and services with a high indexed component (Education, for example). Furthermore, we have the expectation that the shock in the food group will be somewhat more permanent than initially forecasted. The above indicates that the upside risk on our annual inflation projection of 4.8% for the end of 2022 would be materializing.

Graph 1. **FOOD INFLATION AND MAIN COMPONENTES (ANNUAL CHANGE, %)**



Source: BBVA Research with DANE data.

Graph 2. **HEADLINE MONTHLY INFLATION FOR THE FIRST 4 MONTHS (ANNUAL CHANGE, %)**



Source: BBVA Research with DANE data.

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