**Economic Analysis**

# Inflation continues its upward trend, in February it reached 8.01%

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## Domestic and external factors add pressure on inflation. February results exceeded market and analysts' expectations

The monthly variation of the price level for February was 1.63% and the annual variation 8.01%, increasing by 107 bp compared to January, surprising, once again, the average consensus by analysts (1.23% monthly and 7.58% annual, according to the BanRep survey) and BBVA Research (1.48% monthly and 7.85% annual). Core Inflation stood at 1.28%, the highest monthly variation for February in the last decade. The data suggest that, although the pressure from the food division has led to increases in recent months, the effects of high international input costs and local indexation are driving the overall prices of the remaining divisions.

Regarding the main groups, the food and non-alcoholic beverages division was the largest contributor to the result in February. Monthly change in that basket was 3.26%, 53 bps down from January, however, it maintained a considerably higher record than analysts anticipated. In this division, perishable foods are still playing a leading role with high monthly variations in products such as potatoes (16.1%), onions (12.9%), tomatoes (12.4%) and bananas (10.1%), although lower than those recorded in January, a trend also shown by meats (1.1%). On the other hand, processed products such as rice (4.3%) and pasta (3.9%) showed more pronounced increases than in the first month of the year. Thus, perishables accumulated an annual variation of 35.5%, followed by meats (27.8%) and processed products (13.3%) (Graph 1). The increases continue to be explained by a dynamic of high agro-input costs and bottlenecks, in addition to a decrease in the supply of products, as it is the case of meats.

In line with the above, the restaurants and hotels division also showed an important increase in February, with a variation of 2.22% due to pressures derived from food prices and the increase in costs related to the provision of the service, as well as a possible additional effect resulting from the normalization of tax collection in the sector.

The shelter and utilities division was the second largest contributor to the price increase in February, with a variation of 0.71%. In this case, energy and gas rates changed by 2.6% and 2.2% amid new rate adjustments that include charges for losses in the Caribbean region (in the case of electricity) and indexation to the exchange rate (in the case of gas). Shelter (0.4%) showed a gradual acceleration in their annual inflation, in line with their adjustment to inflation caused in 2021.

The education division had a significant increase in February (4.5%), as usual, but it was lower than anticipated. This was due to the fact that public higher education institutions are still affected by government's free tuition measures and private enrollments showed a lower indexation to inflation than usual, in an environment of gradual return to normalcy, so that the monthly variation was almost 40 bps lower than that of the same month in the pre-pandemic period. These impacts are also evident in the annual variation, which continues to be negative (-4.1%).

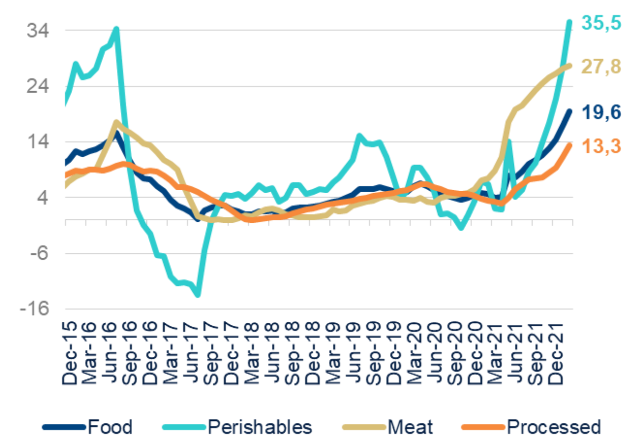
Regarding the economic baskets, the tradable goods showed a significant monthly variation of 1.6% in the second month of the year, pressured by the high exchange rate and by factors such as the high cost of inputs for the production of some of the goods it includes, as is the case of cleaning and maintenance products (4.9%), toiletries (3.6%) and body hygiene items (1.6%). Administered prices, on the other hand, showed a variation of 1.2% m/m; services within which, apart from the surges already mentioned in utilities, there were increases in transportation, with rises in tolls of 3.2% due to pending increases in some road corridors, followed by urban transportation (1.1%), which finished picking up the increases reported throughout the previous month, mainly in Cali, Armenia, Medellin and Bogota.

As for the basket of non-tradable goods, these reflect a slower increase than that of tradable goods and administered prices, which is associated with a slower reopening some of this sectors, persistent policy measures that moderate price impact and an incipient shift of demand from goods to services, for the time being. Despite the overall result, there are marked differences among its components. On the one hand, some services and goods that are closely related to minimum wage have seen an important increase and their inflation already surpasses the 10% change in minimum wage. On the other hand, shelter, despite starting to increase in price, still shows a low inflation which adds to negative inflation in education to compensate and drive the groups average to its current low levels of 1,5% y/y. This group is expected to continue its gradual trend of normalization in the coming months, in particular after some base effects fade in the second half of the year.

Inflation is expected to remain under pressure in the following months due to the bottlenecks that still remain at the international and local levels, as well as factors inherent to price formation and expectations that are yet to be materialized. In addition to the above, the high uncertainty caused by Russia's invasion of Ukraine has already produced a considerable rise in the prices of several basic goods and threatens to deepen global bottlenecks. On the other hand, the recent appreciation of the exchange rate may moderate the transfer to prices of some factors, especially external ones, and it is expected that with the implementation of the VAT-free day in March, some transitory moderation in the prices of semi-durable goods, especially, will be registered again. Finally, the government's recent measures to reduce tariffs on agricultural products, will bring relief in the medium term to food production costs.

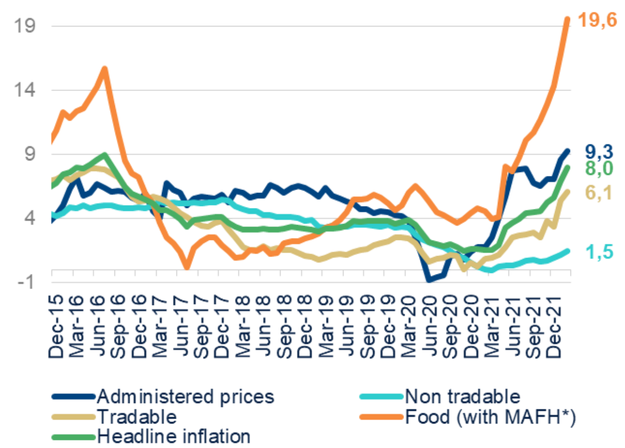
In this context, Banco de la República faces a complex scenario with the combination of a strong upward trend in both total and core inflation, with the risk of greater persistence in global and local shocks and their probability of spilling over to medium-term expectations, and on the other hand, the uncertain effects of the conflict in Europe. In this regard, we maintain our forecast for a rate hike of 150 bps at its next policy meeting.

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




Source: BBVA Research with DANE data.

Graph 2. **MAIN INFLATION BASKETS** (ANNUAL CHANGE, %)




Source: BBVA Research with DANE data. (*) Meal Away From Home

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