

Economic Analysis

Colombia | Inflation closed 2022 at its highest level in 23 years: 13.1%

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In December, monthly inflation rose to 1.26% and annual inflation reached 13.12%, accelerating by 59 bps from the previous month's figure and again exceeding market analysts' expectations of 12.64% (according to Banco de la República's survey of analysts' expectations). Food inflation accelerated the most, reaching an annual change of 27.8%, 72 bps above November's figure, while core inflation accelerated by 51 bps to 9.99% in annual terms (Graph 1). Thus, annual inflation closed 2022 at a historical peak in the last 23 years, leading to an average 10.15% increase in the cost of living for Colombians compared to 2021.

Food registered the greatest pressures in 2022

Food inflation reached 27.8% at the end of this year, also breaking the highs of this century, with levels not seen since 1988 in this division. Thus, average food inflation in 2021 was 24.89% (Graph 2), close to double the highest so far this century (13.2% for July 2016). Although the basket did not register notable accelerations during the year, it remained at high levels throughout 2022, contrary to analysts' initial expectations.

The main causes for the dynamics of this division were associated with the high prices faced by farmers for imported inputs, not only due to the bottlenecks caused by the pandemic, but also because of the war in Ukraine, which impacted the supply of raw materials produced by the main players involved. This was compounded by the "La Niña" phenomenon, which lasted longer than expected, at least until the last month of the year, impacting the supply of agricultural products.

The above is reflected more directly on the sub-basket of perishable foods, which in December reached 37.6% (Graph 3), accelerating by 213 bps compared to the previous month, driven by products such as eggs (33.68% annual), bananas (64.12% annual), onions (106.8% annual), potatoes (33.77% annual) and fresh fruits (22.8% annual). This sub-basket maintained the highest level of inflation throughout the year, averaging 35.5% despite ending 2022 with declines. The effect of the high costs that were transmitted to the final consumer is also perceived through the producer price index (PPI) for the agricultural and forestry sector, whose average annual variation was 21.9%.

The processed products sub-basket seems to continue rising: it closed 2022 at 28.4%, accelerating less strongly than in previous months, by just 50 bps compared to November, and driven by products such as rice (54.05% y/y), milk (36.65% y/y), bread (30.36% y/y) and cheese (27.45% y/y). Some of these increases are associated with higher input costs. Thus, this sub-basket shows a continuity in pressures that are also influenced by the external prices of cereals, which are imported as raw materials for several of the products of this sub-basket. However, its average for the year was 20.69%.

The meat sub-basket closed December with an annual inflation of 18.4%, decelerating by 18 bps compared to November, partly as a result of a statistical effect, as inflation at the end of 2021 was at high levels, so in the

comparison it decreases even though the monthly variation was 1.64%. Unlike the previous ones, this basket registered a moderation throughout 2022 showing decelerations, despite it remains at high levels.

Within core inflation, the largest acceleration is seen in the basket of goods, although the largest contribution is from services

As expected, core inflation continued to rise in December 2022, with an annual change of 9.99%, accelerating by 51 bps from November's figure. In historical terms, this figure is the highest since 2000, reflecting that although the main protagonist was food in 2022, the increase in the price level is being affected by additional factors, among which stand out not only supply-side effects, due to the shortage of some products, but also a solid demand, with high consumption levels that allowed for the consolidation of higher prices.

In December, inflation of the basket of goods recorded the highest acceleration within core inflation, increasing by 111 bps compared to November's measurement, thus closing 2022 with an annual change of 15% (Graph 4). The largest contributions this month continue to be associated with imported products, including vehicles (20.94%), household cleaning products (37.89%), body care articles (17.23%) and beer and soft drinks (8.60%). In the case of the first three, they face high costs at the international level, which are passed on to consumers along with a high exchange rate.

Overall, this basket also reflected the strongest accelerations in 2022. Bottlenecks played an important role, with higher costs being passed on to products that reduced their supply globally, as was the case with vehicles for most of the year, as well as household and personal care products in the face of a shortage of inputs. This was compounded by a high exchange rate that continued to rise to historic levels during the second half of the year, making the cost of imported goods more expensive. However, it was high demand that facilitated this increase: consumption exceeded market analysts' expectations in most of the year's forecasts. Examples are the large current account deficit, import growth and accelerating household indebtedness.

The services basket had annual inflation of 7.4% in December 2022, the lowest inflation within core inflation. While food services associated with restaurants and hotels are integrated in this basket and their inflation was one of the most relevant during the month, their increase was decimated by many other groups maintaining low inflations. This was also the general dynamic throughout 2022, a year in which there was a reactivation of the demand for services, mainly those associated with recreation (restaurants, hotels, bars, concerts) and which in the disaggregate have managed to consolidate high prices in the face of robust consumption. In contrast, services such as renting, which is a major component of the basket, closed with inflation close to the Bank of the Republic's target of 3.6%, while information and communication services registered lower increases than renting, in the context of the entry of competition in this sector, which facilitated lower price increases in the industry. Thus, the basket of services closed with an average inflation rate of 4.95% in 2022, however higher than the 2021 rate of 1.60%.

The administered prices basket closed the year with an annual inflation rate of 11.8%, down 18 bps from November, mainly associated with increases in fuel (10.7%), gas (21.93%), water supply (11.44%) and urban transport (6%), while electricity countered with a small negative contribution, although lower than expected after the implementation of tariff adjustments in the different links of the electricity supply chain. Overall, in 2022 this basket maintained an acceleration rate similar to that of 2021 and closed with an average annual inflation of 10%, higher than the 4.52% it exhibited in 2021.

In 2023, inflationary pressures are expected to continue, mainly towards the beginning of the year, with moderations in the second semester

We expect that, given the year-end data, inflation will have an upward impact at the beginning of the year with elements such as the increase in the minimum wage, the rise in fuel prices, the end of the tax exemption for hotels and restaurants and with consumption that, although falling, does so slower and later than initially expected. Thus, during the first part of 2023 price transmissions may continue to consolidate, particularly in services and some goods, while food inflation could be alleviated by base effects and a more favourable climate. For the second half of the year, however, moderating demand is expected to allow price pressures to ease and facilitate a faster decline in the path.

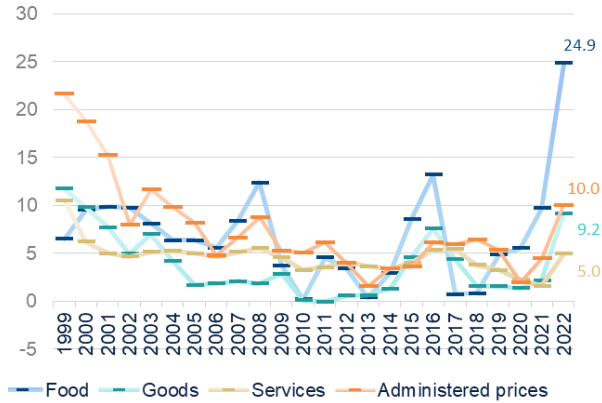
The surprise of the December figure may echo in the expectations of economic agents, while at the same time putting greater pressure on the Central Bank, which must evaluate how to apply increases in the intervention rate in order to achieve an adjustment in inflation that does not stifle the economy. Thus, the result increases the probability that the Bank will have to raise the intervention rate by more than 50 bps, our forecast before the December inflation figure was released.

Figure 1. **HEADLINE AND CORE INFLATION (ANNUAL CHANGE %)**



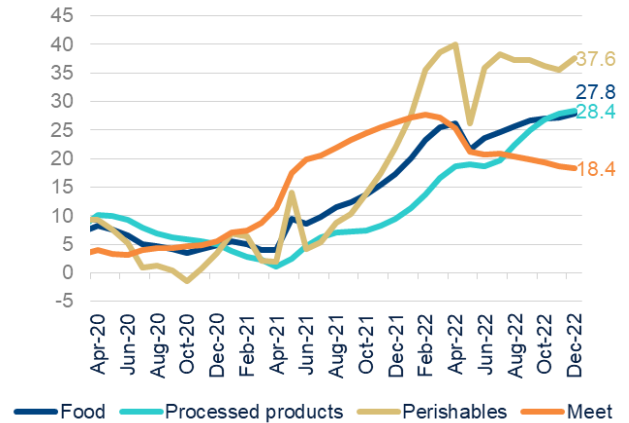
Source: BBVA Research with data from DANE

Figure 2. **AVERAGE ANNUAL INFLATION PER SUB-BASKETS (ANNUAL CHANGE %)**



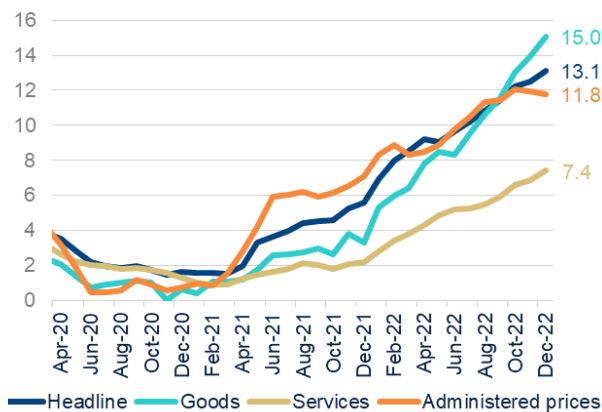
Source: BBVA Research with data from DANE

Figure 3. **FOOD INFLATION AND MAIN SUB-BASKETS (ANNUAL CHANGE %)**



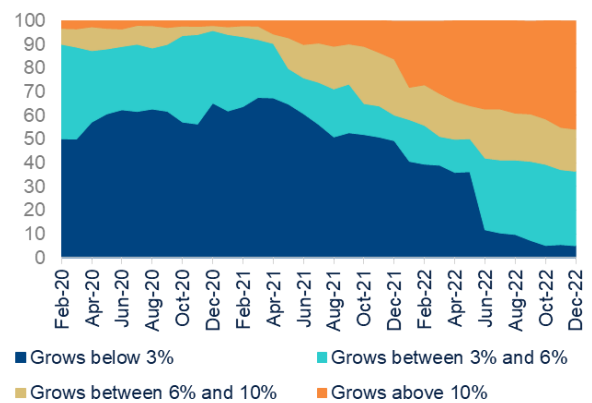
Source: BBVA Research with data from DANE

Figure 4. **HEAD INFLATION MAIN SUB-BASKETS (ANNUAL CHANGE %)**



Source: BBVA Research with data from DANE

Figure 5. **PERCENTAGE OF TOTAL BASKET THAT GROWS ABOVE CERTAIN RATES (ANNUAL CHANGE %)**



Source: BBVA Research with data from DANE

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