

Economic Analysis

Inflation managed to close to single digits in 2023: 9.3%

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Total annual inflation advanced in its reduction in 2023, achieving a decrease of 3.84 percentage points, going from 13.12% to 9.28% in the comparison of December 2022 with December 2023. The moderation was largely favored by the reduction in annual food inflation, which took a leading role by falling by 22.84 percentage points to 5.0% in the annual variation at the end of the year. In the latter, the easing of food production costs due to lower prices of agricultural inputs at the global level led to lower pressures, to which was added the effect of the high inflation bases of the previous year. On the other hand, non-food inflation peaked in June, reaching a level of 11.6%, from which it began a moderation that led it to close 2023 at 10.3%. Despite the moderation observed, its record ended up being 34 bp higher than that observed in December 2022.

From a more conjunctural perspective, the December figure was below that expected by the average of market analysts, who according to the Banco de la República survey predicted a monthly variation of 0.64%, 21 basis points above the observed variation (0.45%). This month confirms the trends previously described, with annual food inflation consolidating its largest decline since April, falling by 3.25 percentage points compared to November's annual variation. In turn, non-food inflation showed a moderate reduction of 28 bps in annual inflation compared to November.

Food inflation materialized a strong adjustment between 2022 and 2023, making the largest contribution to inflation moderation

The relevant decrease in food inflation in 2023 was explained, at the sub-basket level, by a reduction of 36 percentage points in the inflation of perishables, so that the basket closed with annual inflation at 1.6%, down from its highest level of the century in December 2022, when it reached 37.7%. The sub-classes that most contributed to the adjustment were bananas, onions, cassava and potatoes, with annual variations of -15.2%, -18.8%, -28.8% and -9.8%, respectively. It is noteworthy that December was the month in which the most important adjustment in perishable inflation was recorded, with a reduction of 7.87 percentage points in the annual variation compared to November.

The processed products sub-basket, on the other hand, recorded the second largest adjustment in the year within the food basket, moderating by 20.8 percentage points compared to the figure at the end of 2022, and ending 2023 with an annual inflation rate of 7.6%. As in the perishables sub-basket, the processed food sub-basket reached its highest point in the current cycle in December 2022, when it reached 28.4%, starting to decline as of January 2023, thanks to lower cost pressures. The greatest contributions to the decrease in inflation in its interior came from the subclasses of edible oils, dried vegetables and corn and its derivatives, with annual variations of -7.7%, -10.4% and -10.9%, respectively. In particular, in the month of December, inflation in this subbasket decreased by 1.4 percentage points, at a rate similar to that of previous months.

The meat sub-basket showed the smallest adjustments in the year, decreasing by 13.8 percentage points in the December vs. December 2022 to 2023 comparison. However, it closed with the lowest inflation among its peers, at

just 4.6%. This is largely explained by the fact that this basket peaked earlier than the others, reaching 27.3% in March 2022, which means it has a longer adjustment path. In the December versus November comparison, the annual figure was reduced by 1.4 percentage points, accelerating the pace compared to the reductions of previous months.

To a large extent, the significant reduction in annual food inflation in 2023 was associated with the moderation of costs faced by agricultural producers since 2022 in the midst of Russia's invasion of Ukraine, which extended its effects in 2023. The above is also reflected in the agricultural Producer Price Index (PPI) of domestic supply, which, although it did not show significant reductions, stopped its growth, closing the year with an annual variation of -0.78%. In addition to this phenomenon, there is also the effect of a high food inflation base in 2022, which is not repeated in 2023 and helps to moderate annual inflation.

Non-food inflation lags the decline and stiffens the aggregate figure

Non-food inflation, on the other hand, began 2023 continuing its upward trend of 2022. In June, it reached its peak, reaching an annual variation of 11.6%, and began its decline towards the second half of the year, closing 2023 at 10.33%, 0.34 percentage points above the previous year's closing figure, but 1.30 percentage points below its peak. Specifically, in December this inflation moderated slightly compared to November's figure, from 10.61% to 10.33% (a reduction of only 0.28 percentage points).

The dynamics during the year was largely explained by administered prices inflation, a basket that weighs 17.3% of total inflation and showed an upward trend during 2023. Services inflation, on the other hand, although registering smaller increases in the year-end to year-end comparison, remained at high levels, putting pressure on total inflation due to its 48.9% weight within it. Goods inflation, which weighs close to 18.8% of total inflation, contributed to a great extent to moderation, counteracting the positive trend of the regulated basket.

Annual inflation of the administered prices basket rose 5.5 percentage points, from 11.8% in December 2022 to 17.2% in December 2023, with increases due to several factors. The most important was the increase in the price of gasoline, which generated significant upward pressures within the basket, contributing 114 bp to annual inflation in 2023. Another was the finalization of measures applied during the pandemic, which impacted subclasses such as utilities (mainly electricity, followed by water and gas), urban transportation and to a lesser extent education. Specifically, for December, the regulated basket contributed with upward pressures by increasing by 32 basis points compared to the annual variation observed in November, with pressures from electricity and urban transportation.

The services basket reached an annual inflation in 2023 of 9.0%, 1.6 percentage points above the 2022 inflation of 7.4%. This increase was favored by the upward trend in the inflation of rents and services related to co-ownership, which were pressured by indexation factors and possibly by supply factors. On the other hand, the moderation of the basket trend in the second part of 2023 may be associated with a decreasing trend in the inflation of meals prepared outside the home and meals in table service establishments, which came from high levels pressured by high food prices. This dynamic was consolidated in the month of December, when the annual variation decreased by only 0.07 percentage points compared to November's figure.

Finally, the basket of goods recorded annual inflation of 7.1% at the end of 2023, down 7.9 percentage points from the previous year's figure of 15.0%. This significant adjustment was led by the subclass of private vehicles, which

managed to alleviate cost pressures following the normalization of the vehicle trade and the inputs for their production. Similarly, cleaning and maintenance items, personal hygiene products and other personal care products registered reductions in inflation, following cost pressures due to high prices of raw materials for their production. In particular, in December, this basket continued to show a good pace of decreases, falling by 1.3 percentage points compared to November, favored by the effects of a high base of comparison in 2022.

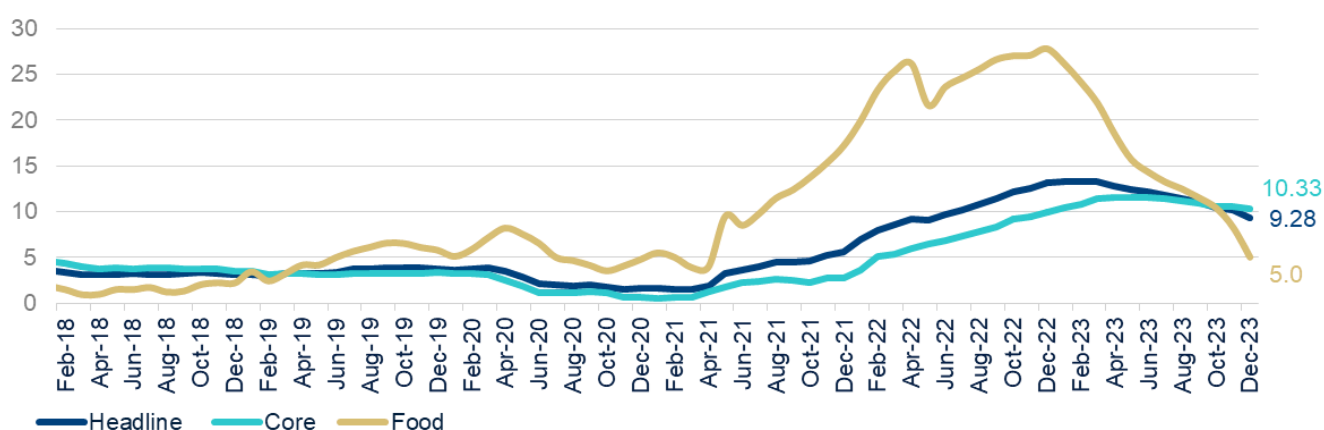
Thus, non-food inflation was driven by both upward and downward trends, with some predominance of the latter, which was, however, slowed by the former.

By 2024, inflation will continue to decline, moving closer to the target range

Looking ahead to 2024, we can expect food inflation to show new pressures at the beginning of the year, which may include pressures from El Niño phenomenon. However, it is possible that the downward trend in annual terms will continue, supported by the high levels of comparison at the beginning of 2023. In addition, if El Niño phenomenon occurs, it is possible that food prices will show significant downward adjustments towards the second part of the year, although a rebound effect cannot be ruled out.

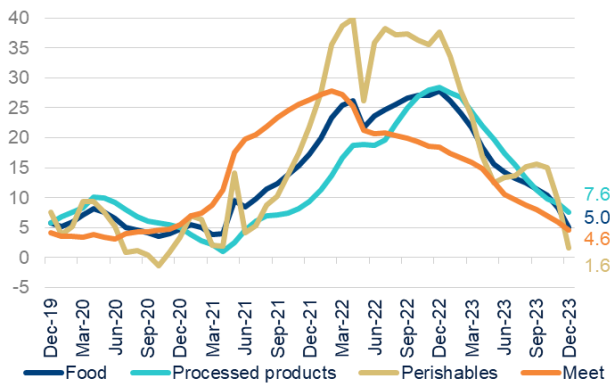
In terms of non-food inflation, moderation is expected to continue, although it is likely that the indexation dynamics at the beginning of the year will generate additional pressures on the services and administered prices baskets and limit the pace of reduction during the first months of the year. Towards the second part of the year, a moderation in economic dynamics will limit the transmission of high prices, so that core inflation will continue on a downward path. With the above, total inflation can be expected to continue to decline in 2024.

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



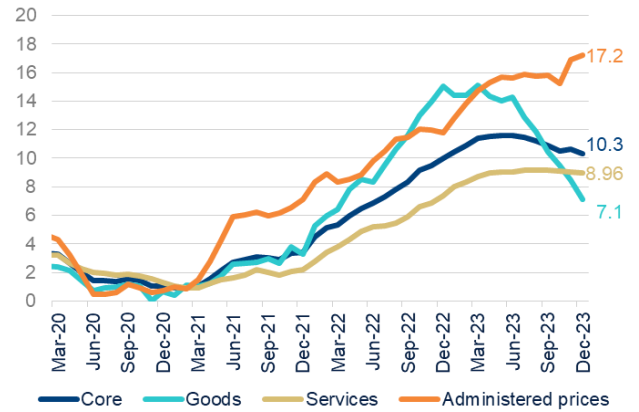
Source: BBVA Research with data from DANE

Figure 2. **FOOD INFLATION AND MAIN SUB-BASKETS (ANNUAL CHANGE, %)**



Source: BBVA Research with data from DANE

Figure 3. **CORE INFLATION AND MAIN BASKETS INFLATION (ANNUAL CHANGE, %)**



Source: BBVA Research with data from DANE

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