

Economic Analysis

Total annual inflation stopped 13 months of declines in May and stood at 7.16%

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Total annual inflation remained stable after 13 consecutive months of declines

In May, monthly inflation was 0.43% and annual inflation was 7.16%, close to market analysts' expectations, according to Banco de la República's survey (0.41%) and below our forecast (0.51%). With this, annual inflation remained stable for the first time since it began its recent cycle of declines in April 2023. This result is the product of two conflicting trends, as it was in April. On the one hand, annual food inflation accelerated significantly, reaching 4.4% (+140bp vs. April's figure), and on the other hand, non-food inflation declined less sharply, reaching 7.8% (-36bp vs. April's figure).

As expected, annual food inflation accelerated for the second consecutive month, mainly due to a strong base effect. Monthly food inflation stood at 0.51%, significantly above the -0.85% recorded for the same month last year. However, there was also some pressure from perishable foods, which, although monthly inflation was lower than that reported in the previous two months, reached an atypically high level for this time of the year. Among the products in this sub-basket, potatoes stood out with a monthly price increase of 20%, tree tomatoes with a monthly increase of 9.9% and bananas with a monthly increase of 5.0%, among others. However, the annual price variation of perishables accelerated from 3.8% to 9.9%, while on the other hand, processed foods maintained a relatively stable annual inflation, at 2.9%.

This trend in food inflation could continue for at least one more month, as a result of the base effect of the negative monthly variation in June 2023. To the above, some pressure could be added as a result of the delayed effects of the "El Niño" phenomenon, and pressures from the effects on road infrastructure and crops caused by the wave of rains are not ruled out. However, the trend should moderate again in the second part of the year.

On the other hand, non-food inflation continued its downward trend with a 36 bps reduction, reaching an annual inflation rate of 7.8%, the lowest since August 2022, although the moderation was also the weakest so far this year. This result was the result of a combination of a significant reduction in the annual inflation of regulated goods and goods and a meager reduction in services. Regulated goods showed, for the second consecutive month, a significant moderation, reaching an annual inflation of 13.7% (-85 bps compared to April). On this occasion, price variations in most public services were limited, except for gas, which showed a strong monthly increase of 1.29%, driven mainly by a sharp increase in tariffs in Bucaramanga and despite a reduction in tariffs in Bogota. On the other hand, electricity showed an increase of 0.78% in the month, lower than in April, but still significant and in line with expectations. However, tariff reductions have already been observed in some cities, which allows us to anticipate a gradual moderation of inflation in this service, which has caused strong pressures, especially in the northern coast of the country.

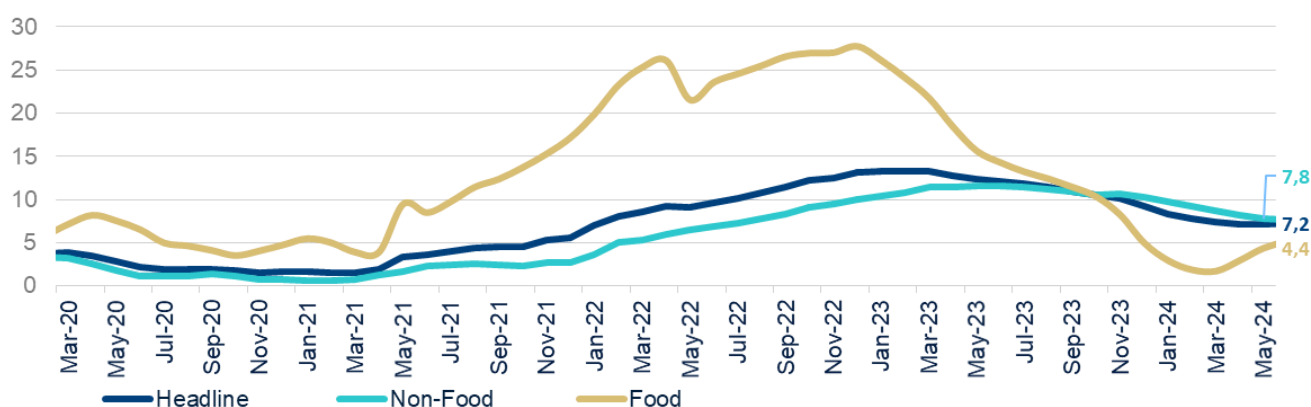
The basket of goods also continued to contribute to the reduction of inflation with a negative monthly variation of -0.1% and an annual variation of 1.7%, the lowest since April 2021 and with a reduction of 66 bps compared to

April's figure. The monthly inflation of this basket is even below the historical average. The reduction in the prices of vehicles, audio, sound and telephone equipment, among others, have contributed to this result and are strongly linked to a marked annual appreciation of the exchange rate and a still weak demand for durable and semi-durable goods. On the other hand, the basket of services showed a meager reduction in its annual inflation, standing at 7.9% (7 bps below April's figure). This result ratifies the persistence of services inflation. The monthly variation stood at 0.62%, while its main item, rents (25% of the total basket), presented a monthly variation of 0.75%, lower than that reported both in April of this year and in May 2023, but still much higher than its average for the month of May (0.39%).

Nonetheless, non-food inflation continues its downward trend, mainly due to the base effect in the regulated baskets and, to a lesser extent, in the services basket. For the second part of the year, services inflation is expected to moderate as a result of weaker demand and the dilution of the indexation effects of the minimum wage and past inflation. However, gains on account of the basket of goods, which will face better demand and some exchange rate depreciation in the second part of the year, will be reduced. Finally, the uncertainty surrounding the behavior of regulated products persists, mainly due to the manner and time in which diesel price adjustments will be made; lags in energy tariffs in the very short term, but also the possibility of observing significant moderations in tariffs on this front in the second half of the year.

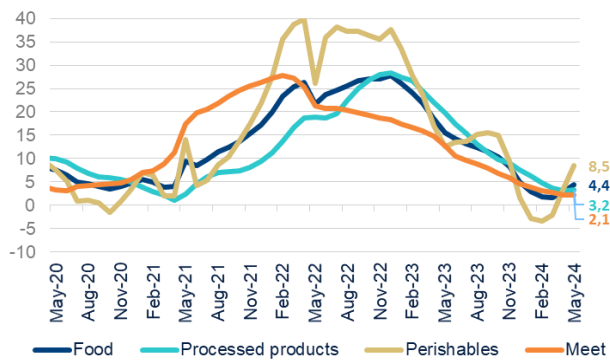
At BBVA Research we expect food inflation to continue to accelerate in June and maintain high levels in the third quarter; however, we believe that the effect will be transitory and will not affect inflation at the end of the year. On the contrary, we believe that non-food inflation will continue to show relief, which will shift from goods to services as the year progresses, although still with high uncertainty from regulated goods and persistence in some services such as rents. All in all, we expect inflation to remain around the current level in the coming months, and to resume its downward trend in the second part of the year, reaching a level of 5.4% by the end of 2024. It should be noted that uncertainty about inflation in the very short term will continue to play a relevant role in the Issuer's decision making. Therefore, with this data and the expectation for June, we do not anticipate changes in the current stance of gradual reductions of 50 bps in the Central Bank's rate.

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



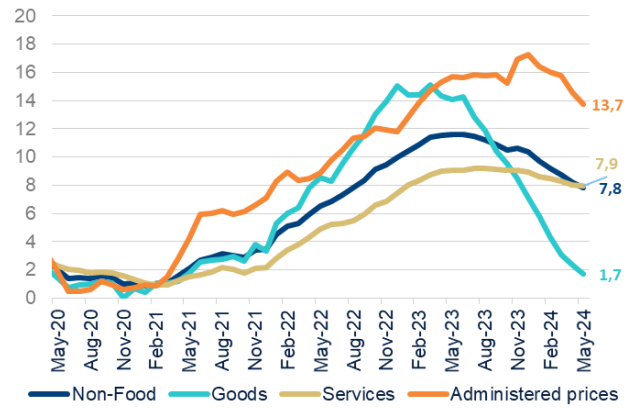
Source: BBVA Research with data from DANE

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



Source: BBVA Research with data from DANE

Figure 3. **NON-FOOD INFLATION MAIN BASKETS**
(ANNUAL CHANGE, %)



Source: BBVA Research with data from DANE

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