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Latam Daily: Colombia's Higher Inflation Likely to Bring Rate Hikes Forward

- **Colombia: Inflation in 2021 stood at 5.62%, the highest in five years**

COLOMBIA: INFLATION IN 2021 STOOD AT 5.62%, THE HIGHEST IN FIVE YEARS

Monthly CPI inflation was 0.73% m/m in December 2021, according to DANE data published on Wednesday, January 5. This result is well above the median forecast in BanRep's survey (0.45% m/m), Bloomberg's survey (0.53% m/m), and Scotiabank Economics' projection (0.54% m/m). Food prices posted the highest contribution to inflation.

December's CPI result brings annual headline inflation to 5.62% y/y, the highest in five years, up from 5.26% y/y in November (chart 1), and above the ceiling of BanRep's target range (2%–4%) for the fifth month in a row. Core inflation also increased, from 3.36% y/y to 3.44% y/y, while ex-food and regulated goods inflation came in at 2.49% y/y (down from the 2.54 % in the previous month). 2021 CPI and a minimum wage increase of 10.07% imply high indexation effects ahead of 2022, increasing the probability of a hawkish call for BanRep's January meeting.

Our basecase scenario is now a 75 bps rate hike at the January 28 monetary policy meeting. We expect inflation in Q1-2022 to surpass 6%, with a moderate downward trend after April. That said, for now, we maintain our expectation of a terminal monetary policy rate of 5%.

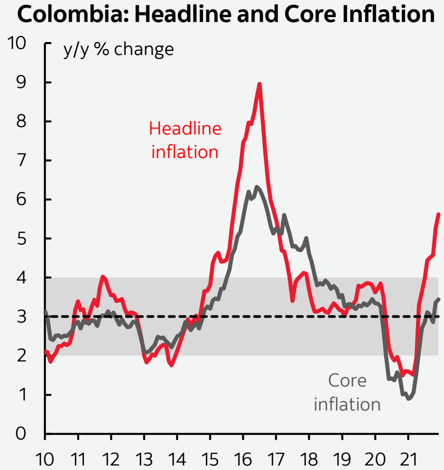
Looking at the December inflation numbers in detail, only 3 out of 12 sectors saw price declines (charts 2 and 3). Once again, foodstuff inflation posted the highest gains. The main highlights are:

- Foodstuff sectors had the largest contribution (+36 bps). Inflation of +2.08% m/m, with the main gains coming from meat (+2.69% m/m), milk (+2.32% m/m), potatoes (+20.52% m/m) and eggs (+4.04% m/m). Rising input prices and FX depreciation are driving food prices higher with more persistence, especially imported commodities such as soy and corn. Restaurant & hotel inflation contributed 10 bps again on the back of higher input prices but also due to the economic activity recovery and holidays.

- In the lodging & utilities sector, the increase in utility fees (+1.30% m/m) reflected higher costs for electricity (+1.88% m/m) and water (+1.27% m/m). Rental fees increased by 0.04% m/m, while tradable housing goods increased by 1.16% m/m.

Chart 1

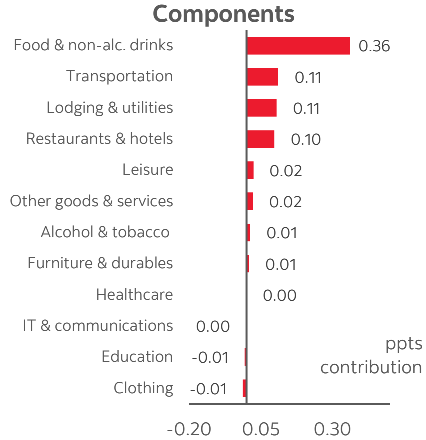
Colombia: Headline and Core Inflation



Sources: Scotiabank Economics, DANE.

Chart 2

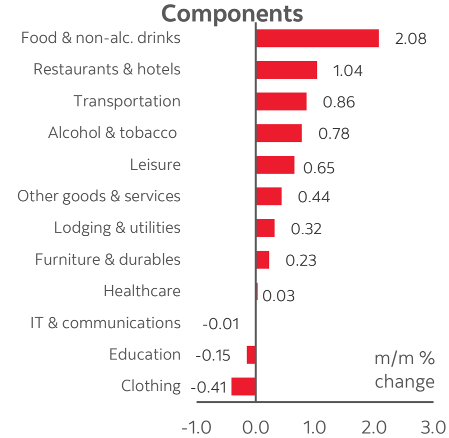
Colombia: Consumer Price Index Components



Sources: Scotiabank Economics, DANE.

Chart 3

Colombia: Consumer Price Index Components



Sources: Scotiabank Economics, DANE.

- Transportation (+0.86% m/m and +11 bps) is showing the effect of higher gasoline prices (+2.09% m/m) and the FX depreciation through higher prices in vehicles (+1.42% m/m).
- Price declines were registered in clothing (-0.41% m/m and -1 bps), on the back of new discounts ahead of year-end holidays, and education (-0.15% m/m, and -1 bps).

Looking at annual inflation across major categories, goods inflation decreased to 3.31% y/y (versus 3.79% y/y in November), while services inflation increased by 11 bps from 2.07% y/y to 2.18% y/y. Regulated-price inflation jumped 54 bps to 7.10% y/y.

All in all, half of total inflation in 2021 was explained by food inflation, and around a quarter of total inflation was on four items: meat (+33% y/y), chicken (+26.4% y/y), potatoes (+111% y/y), and cooking oil (+48% y/y). All of these items were affected by higher input prices and currency depreciation.

A second effect that led to 2021 inflation was the normalization in the economic activity which led to higher prices in services and rent fees.

Looking ahead, indexation effects are a source of concern, which we think could lead to inflation closing above 4% this year.

In terms of monetary policy, the Board is likely to be more hawkish in the January meeting, increasing its rate by 75 bps to 3.75% in a still-split decision. We expect the central bank's policy rate to reach its terminal level of 5% in April's meeting, by which time inflation should begin to moderate given base-level effects. However, this scenario would change if new price shocks emerge.

—Sergio Olarte & Jackeline Piraján