Scotiabank

GLOBAL ECONOMICS

LATAM DAILY

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Latam Daily: Colombia's Activity Indicators; BanRep's Expectations Survey

- **Colombia: Economic activity remains resilient; inflation expectations rise, with policy rate expected to follow**

COLOMBIA: ECONOMIC ACTIVITY REMAINS RESILIENT; INFLATION EXPECTATIONS RISE, WITH POLICY RATE EXPECTED TO FOLLOW

I. Economic activity remains resilient in May with some moderation

On Friday, July 15, the Statistical Agency of Colombia (DANE) published its monthly survey of economic activity for May, which revealed that manufacturing production and retail sales registered stronger-than-expected record-high expansions. These results are explained by a low statistical base on y/y comparisons owing to the nation-wide strike which depressed activity a year ago. DANE also published confidence figures showing that companies remain optimistic, albeit to a lesser extent than previously because of persistent supply chain problems, especially in the construction and manufacturing sectors. While commodity prices are expected to rise further, firms nevertheless anticipate that prices will stabilize over the forecast horizon.

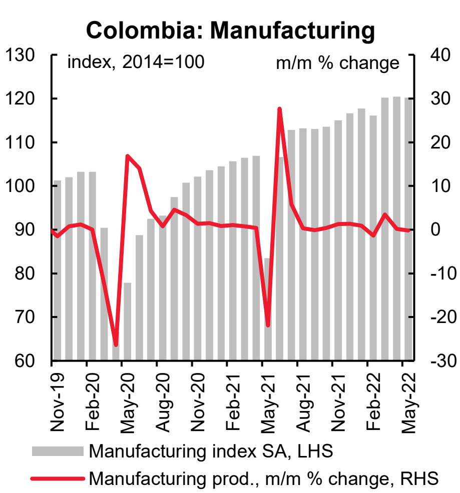
Retail sales in May were exceptional, explained in part by a base effect attributable to the strikes a year ago, but also continued solid consumption. Our current GDP growth forecast of 6.3% in 2022 reflects an economy that continues to surprise with the consolidation of consumption despite high inflation and an increase in credit expansion.

Manufacturing production

Manufacturing production increased 46.2% y/y (above market consensus +30.4% y/y), but with a contraction of -0.2% m/m sa compared to the previous month (chart 1). Manufacturing activity was adversely affected by disruptions in the supply chains of some sub sectors. Production has grown by 18.6% year-on-year, and remains strong because of solid demand.

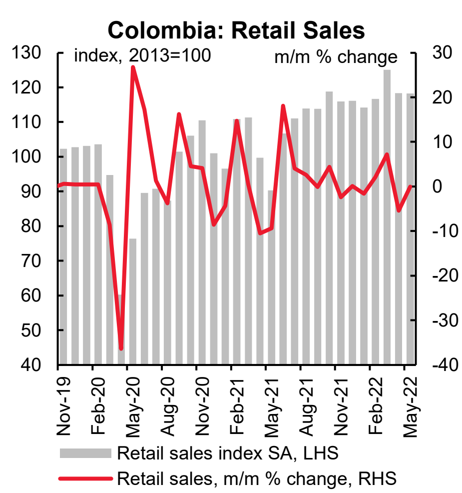
In y/y terms, the best performing sectors were beverages (+43.3% y/y), soaps, cleaning products, and perfumes (+82.5 y/y), and paper production (+103.9 % y/y). Sugar and panela (+822.4 y/y) had the largest y/y rebound, as production was most affected by the blockages in the southwest of the country in 2021, contributing 13.4 ppts (29% of the total expansion). The economy continues to benefit from the return to normality, with all sectors registering gains in activity.

Chart 1



Sources: Scotiabank Economics, DANE.

Chart 2



Sources: Scotiabank Economics, DANE.

Employment grew 4.3% y/y. In monthly terms, employment increased by 0.6%. This is a positive sign for the recovery of the labor market, and we highlight that the manufacturing sector employment already exceeds pre-pandemic levels.

Retail

Retail sales increased 34.8% y/y in May (chart 2), the Bloomberg survey consensus (+37.9% y/y), while employment increased 3.4% y/y. On a seasonally adjusted basis, retail sales (excluding other vehicles) showed a slight contraction of -0.1%% m/m. The increase in retail sales on a year-over-year basis reflects a statistical base effect from the strikes a year ago. That said, demand continues to show a positive dynamic owing to the return to the offices of more activities.

Compared to May 2022, the expansion in retail sales is explained by sales of fuels (+53.2% y/y), vehicles and motorcycles (+64.3% y/y), parts for vehicles (+61.9% y/y) and books, stationery (45.1% y/y), which contributed about 18.2 ppts to the total expansion. All components contributed to growth, though food sales (+6.6% y/y) showed a lower contribution explained by the high prices in the basic basket.

Looking ahead, we expect a slowdown in private consumption growth to more sustainable rates in the second half of the year, as high inflation and the cost of consumer credit constrain demand.

Services & Hotels

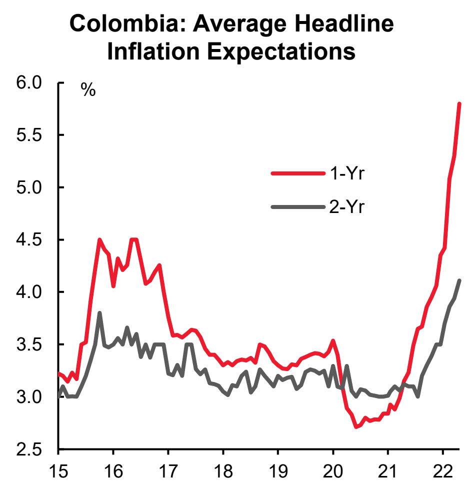
In May, all service activities expanded, with the most robust growth being in the film and television-related industry (+ 44.9%y/y). In terms of employment, publishing activity continues to lag behind (-2.5% y/y), while employment growth was particularly concentrated in IT-related activities and restaurants and bars.

In the hotel sector, revenues in May increased 112.7% y/y, and employment increased by 35.4% y/y. Hotel occupancy was slightly lower than in April, at 50% in May. Business travel continued to recover this month, accounting for 37.7% of total occupancy, while leisure travel accounted for 53.5%.

All in all, activity indicators showed a positive surprise in May amid further consolidation of the dynamics of the new normal, as confidence surveys show that companies are cautious about the future owing to the impact of inflation on their margins and the effects on the supply of inputs due to the international context.

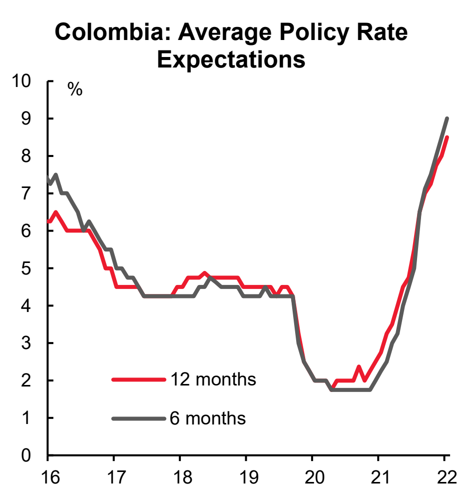
Our base case scenario remains that the economy will continue to show robust performance, with growth of 6.3% in 2022. However, we expect private consumption to moderate in H2-2022 as a result of tighter monetary policy. **We now expect BanRep to increase the policy rate by 100 bps in the July 29 meeting to 8.5%, although the increase may be greater if inflation expectations rise and global price pressures continue to increase. This leads us to anticipate a terminal rate of 9%.**

Chart 3



Sources: Scotiabank Economics, BanRep.

Chart 4



Sources: Scotiabank Economics, BanRep.

II. BanRep survey shows inflation expectations up; 9% terminal rate

On Friday, July 15, BanRep published its monthly expectations survey, with inflation expectations for end-2022 up 54 bps (chart 3). Inflation expectations at end-2023 (5.33%) further deviate from the inflation-target ceiling target, as current high inflation is expected to have indexation effects going forward. **At Scotiabank Economics, we anticipate June inflation above the market consensus (0.63% m/m) and year-end inflation at 9.74%.**

The hiking cycle is expected to continue in 2022, with a 150 bps hike in July, to reach 9.00% as the terminal rate (+50 bps from the previous survey) (chart 4). We expect a 100 bps hike at the July 29 meeting, but a more aggressive move is possible. The higher rate is expected to last around one year before starting to reverse.

- **Short-term inflation expectations.** For July, the consensus is 0.53% m/m, which places annual inflation at 9.90% year-on-year (from 9.67% in June). That said, the dispersion of the survey remains high, with the bottom expectation at 0.23% m/m and a maximum of +1% m/m. Scotiabank Economics expects monthly inflation for July to be +0.63% m/m and 10% y/y.

- **Medium-term inflation.** Inflation expectations rose to 9.32% y/y for December 2022, 54 basis points above last month's survey (table 1), suggesting that the recent announcement of a gradual increase in gasoline prices has affected expectations. High input prices remain the main risk for headline inflation. One-year ahead expectations stood at 5.86% y/y (above last month's reading of 5.48% y/y); while the two-year forward increased 22 bps to 4.27% y/y, reflecting uncertainty regarding BanRep's ability to return inflation to the inflation target range in the medium term.

Table 1: Colombia—Headline Inflation Expectations

	Average	Change vs previous survey, bps
July-2022, m/m % change	0.53	…
Dec-2022, y/y % change	9.32	54
1-yr ahead, y/y % change	5.86	38
Dec-2023, y/y % change	5.33	46
2-yr ahead, y/y % change	4.27	22

Sources: Scotiabank Economics, BanRep.

- **Policy rate.** Consensus expects a 150 bps rate hike in July's meeting, up from the current 7.50%, which would leave the consensus terminal rate at 9%. (In contrast, Scotiabank Economics expects a 100 bps hike in July and 50 bps rise in September.) The monetary policy rate is expected to close 2022 at 9%, and at 7% by end-2023, at which point monetary policy will become contractive in the future.

- **Exchange rate.** The latest USDCOP projection for end-2022 is 4204 pesos (above to the previous survey 3838 pesos). Respondents to BanRep's survey think that the peso will be at USDCOP 4056 BY END-2023, and 3984 at end-2024. We rhink the USDCOP is likely to close 2022 around 3950 pesos.

—Sergio Olarte, Maria (Tatiana) Mejía & Jackeline Piraján