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GLOBAL ECONOMICS

LATAM FLASH

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Colombia—Inflation Finally Reaches Single Digits to Close Out 2023

- **Headline inflation fell to single digits for the first time since mid-2022. Food prices were the main source of disinflation in 2023.**

Monthly CPI inflation in Colombia stood at 0.45% m/m in December, according to DANE data released on Tuesday. The result was below economists' expectations of 0.64% m/m in the latest BanRep survey, but it was closer to our forecast of 0.47 % m/m. Year-on-year headline inflation declined for the eight month in a row, from 10.15% in November to 9.28% in December (chart 1), returning to single digits for the first time since June 2022.

Core inflation (ex-food) decreased from 10.61% y/y in November to 10.33% in December, while inflation excluding food and energy prices stood at 8.81% y/y. Core inflation metrics are reflecting a disinflation trend, especially in durable goods where the 16.10% y/y recorded in Dec 2022 turned into a 3.24% y/y record in Dec 2023. This could be attributed to the COP's appreciation and weaker domestic demand. In the case of services inflation, we observed an acceleration from 7.35% in late-2022 to 9.33% in late-2023 as a result of indexation effects in labour-intensive services. Still, overall core inflation will continue decreasing in 2024 as indexation effects will be more moderate than in 2023.

In 2023, three groups accounted for 66% of headline inflation: Housing and utilities contributed 2.84 ppts, Transport added +1.96 ppts, and Restaurant and Hotels contributed 1.38 ppts. In 2023, seven out of the twelve inflation groups decelerated (chart 2), but the main source of disinflation was food: its contribution to headline inflation was 0.99 ppts in 2023 (5,0% y/y), well below its 33% share of 2022 inflation (4.88 ppts recording 27.81% y/y). On the other hand, Housing & Utilities and Transport groups accelerated versus 2022. Housing reflected high indexation effects but also a spike in utility fees, while in the transport group, the increase of more than 50% y/y in gasoline prices contributed the most. We expect indexation effects to decelerate in 2024 due to lower minimum wage increment (+12% in 2024 vs +16% in 2023) and lower year end inflation in December 2023 (9.28% y/y) versus 2022 (13.12% y/y), which is a relevant reference for setting rent fees. Therefore, we think annual inflation will decelerate further, especially during the first half of the year.

All in all, 2023 inflation reflected mixed effects, a disinflationary contribution from good-related items, not only food but also tradable goods. On the other hand, services inflation remained sticky, reflecting indexation effects.

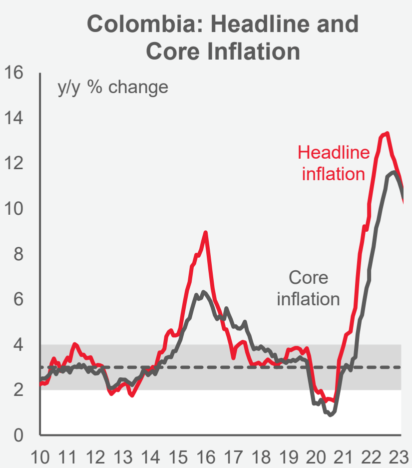
We think that reaching the single-digit mark again is good news for the central bank, and it maintains a potential rate cut between 25 and 50 bps on the cards. The next BanRep meeting will be on Wednesday, January 31st. We expect the central bank to continue the easing cycle probably at a moderate pace; however, as stressed before, we do expect inflation will continue going down at a faster pace, especially in the 1Q-2024 amid significant statistical base effects in food inflation, but also because of lower indexation compared with 2023. In that sense, we think the central bank could speed up the easing cycle between March and June since, by this period, inflation could go below the 7% mark. Economic activity numbers also affirm the base case scenario for BanRep continuing the easing cycle in 2024. We expect the monetary policy rate to close in 2024 at 7%.

Looking at the December figures in detail, food inflation is the group that applied the greatest downside pressure on inflation during the month (charts 3 and 4).

OTHER HIGHLIGHTS:

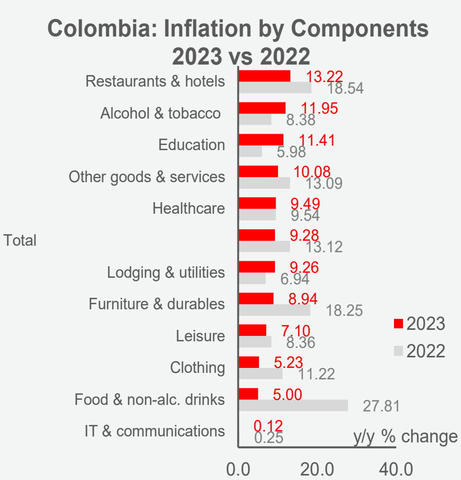
- The lodging and utilities group was the main contributor to monthly inflation. The group recorded +0.86% m/m inflation and +26 bps contribution. Rent fees continued

Chart 1



Sources: Scotiabank Economics, DANE.

Chart 2

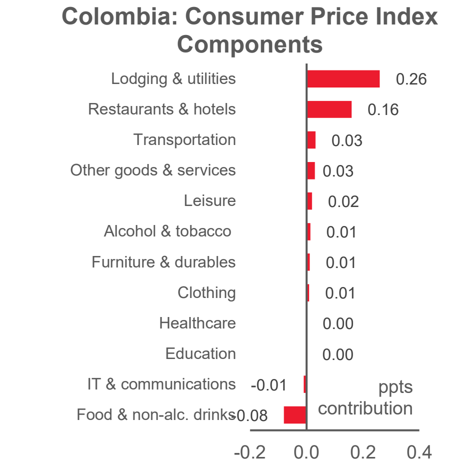


Sources: Scotiabank Economics, DANE.

reflecting the impact of indexation, while in terms of utilities, electricity fees increased moderately. In 2024, rent fees will be allowed to increase up to 9.28% y/y, which is a significantly lower indexation versus 2024 (13.12% y/y), we anticipate this phenomenon to be one of the main source of disinflation in 2024.

- The second main monthly contributor was restaurants and hotels (+1.50% m/m with a contribution of 16 bps), reflecting the usual year-end high demand for those services. However, it is worth noting that in 2023, this group was the third main contributor to headline inflation, and one reason for that was indexation to the minimum wage increase. This indexation will continue in 2024. However, it will be lower compared with what we observed in 2023.
- Food recorded a -0.42% m/m inflation and subtracted to the headline eight bps. Food inflation posted an atypical behavior given the holiday season. However, some price correction is fueled by the lower FX. During 2023, we saw some normalization in some food prices. The most significant deceleration was in products such as milk, fruits, meat, and chicken.
- Regarding price reductions (negative inflation), the leading products were bananas, onions, cooking oil, and potatoes. All the previous products have something in common: they need imported inputs for their production, or in fact, some are imported. In that sense, normalization in international food prices, fertilizers, and lower effects are helping to see significant disinflationary pressure. In 2024, we expect food inflation to normalize to the average inflation, which, in any case, will help to reduce headline annual inflation in the first quarter amid significantly high statistical base effects, while in the second half of 2024, the contribution to the disinflation will be moderate.
- Tradable goods are expected to contribute to disinflation in 2024. Durable goods inflation closed the year at 3.24% y/y, decelerating from the maximum recorded in March 2023 of 16.76% y/y. Weaker domestic demand and significant FX appreciation are pushing down some key prices, especially vehicles, and we expect part of this effect to continue in 2024. On the other side, services inflation has decreased moderately to 9.33% y/y in December from its peak of 9.51% in September 2023; part of this behaviour is explained by still decent demand for "lower-ticket services," which allows indexation effects to transmit in final prices. Despite this indexation will continue in 2024, we expect this pressure to be more moderate compared with 2023.

Chart 3



Sources: Scotiabank Economics, DANE.

Chart 4

Sources: Scotiabank Economics, DANE.

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