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Chart 1

Colombia: Average Headline Inflation Expectations



Sources: Scotiabank Economics, BanRep.

Latam Daily: Colombia—BanRep Survey of Expectations; November Economic Activity

- **Colombia: Hiking cycle expected to continue in H1-2022; Economic activity continued to improve in November**

COLOMBIA: HIKING CYCLE EXPECTED TO CONTINUE IN H1-2022; ECONOMIC ACTIVITY CONTINUED TO IMPROVE IN NOVEMBER

I. BanRep expectations survey: Analysts expect a 75 pbs hike in January on higher inflation expectations; terminal rate is expected around 5.50%

On Friday, January 14, the central bank, BanRep, published its monthly survey of economic expectations. Inflation expectations (IE) for the end of 2022 increased by 51 bps, probably incorporating higher indexation effects but also, recently announced increases on other relevant key prices. By the end of 2022, consensus expects on average a 4.42%, still above the ceiling of the target range (between 2% and 4%). In the previous context, the hiking cycle is expected to continue in 2022 at a faster pace. For the January 28 monetary policy meeting, consensus points to a 75 bps hike, while for the March and April meetings, the expectation is for 50 bps hikes. The potential terminal rate is anticipated at 5.50% reaching this level in December. In Scotiabank Economics Colombia a 75 bps hike is expected in January, meanwhile, the terminal rate is still estimated at 5%.

- **Short-term inflation expectation.** For January is 0.89% m/m, which places annual inflation at 6.10% year-on-year (from 5.62% in December). That said, the dispersion of the survey is significantly high with a minimum expectation of 0.36% m/m and a maximum of +1.38% m/m. Scotiabank Economics expects monthly inflation for December to be +1.11% m/m and 6.36% y/y, especially due to indexation effects.
- **Medium-term inflation.** Inflation expectations rose to 4.42% y/y for December 2022, 51 basis points above last month's survey (table 1). Current higher inflation now is showing a more long-lasting effect as by the end of 2022 the inflation would hover above the ceiling of the central's bank target range (2%–4%). IE for 1-year ahead stood at 4.03% y/y (above last month's reading of 3.91% y/y); and the 2-year forward was also above the target range of 3.38% y/y, which underscores that expectations remained broadly anchored for the monetary policy horizon (chart 1). Scotiabank Economics expects CPI inflation to close 2022 between 4.3%–4.5% y/y. It is worth noting that the potential indirect effects of the 10.07% increase in the minimum wage are reflected in this new forecast.
- **Policy rate.** On average, the consensus expects a 75 bps rate hike in January, to leave the rate at 3.75% (from the current 3.0%) (chart 2); Scotiabank Economics' forecast is in line with the consensus, however a split vote showing a more hawkish bias is not discarded. For 2022, the consensus expects a policy rate of 5.50% by the end of the year, an increase compared to the previous survey (4.75%). Scotiabank Economics' forecast is for a terminal rate of 5.0% in April, assuming a path of 75 basis points hikes

Table 1: Colombia—Headline Inflation Expectations

	Average	Change vs previous survey, bps
Jan-2022, m/m % change	0.89	...
Dec-2022, y/y % change	4.42	51
1-yr ahead, y/y % change	4.03	12
Dec-2023, y/y % change	3.51	22
2-yr ahead, y/y % change	3.38	8

Sources: Scotiabank Economics, BanRep.

until the March meeting and then increases of 50 bps in April. Previous forecast is assuming that the headline inflation starts to go down since April/May.

- **FX.** The USDCOP projections for the end of 2022 were located at 3,827. By December 2023, respondents think, on average, that the peso will end the year at USDCOP 3,818, and in 2024 at 3,688. We believe that the USDCOP would appreciate by the end of the year to 3,755.

II. In November economic activity continued improving but with mixed results; employment still lags the recovery

On Friday, January 14, Colombia’s statistical agency (DANE) released its monthly economic surveys for November. Indicators showed a positive balance, pointing to a strong end of the year 2021. Manufacturing activity surprised to the upside, while retail sales slowed down despite the VAT holiday. On the other side, services and hotels continued picking up as a result of the consolidation of the reopening. Previous results skew our current economic growth forecast for 2021 of 9.6% to the upside, since a strong dynamic by the end of 2021 would lead the economy to grow probably above 10%. However, despite this positive news in terms of activity, the employment recovery remains a concern, due to the number of jobs but also, regarding its quality.

Manufacturing Production

Manufacturing production increased by 13.9% y/y (above the market consensus +10.6%), and compared to the same pre-pandemic period (November 2019), the index grew by an also strong 13.6% (chart 3). On the employment side, the sector still shows a contraction of 1.2% versus pre-pandemic levels, especially concentrated in the clothing sector. On the YTD basis, manufacturing grew by 16.1% y/y, with better gains in the employment side +2.5% versus Jan–November 2020. On a monthly basis, manufacturing expanded by 0.7% m/m (chart 3, again), as a result of higher production anticipating the strong demand for some products due to the holiday season of December but also due to the consolidation of the reopening in services-related sectors.

The best performing sectors in this stage of the recovery are those related to beverages (+12.5% y/y), chemical products (+36.9% y/y), clothing (+26.7% y/y) and, plastics (+20.7% y/y), all of the previous sectors are showing the effect of the reopening in activities such as massive events, among other which are triggering demand for personal beverages and also are increasing the demand of other goods such as clothes. On the negative side, we highlighted that in the YTD up to November, vehicles manufacturing (-2.3% y/y) has been impacted by logistic bottlenecks and chips scarcity that are having a negative impact on the production process.

Regarding employment, despite having seen an improvement in jobs creation in November, around 75% of new jobs are temporary, which still is a source of concern over the medium term.

In the forthcoming months, we expect manufacturing to continue showing gains, as normality is consolidated. However, an important risk to keep an eye on is the impact of international bottlenecks in logistics and higher input prices in the production process of some industries. Another relevant issue is going to be sustainability in employment recovery.

Retail Sales

Retail sales expanded by 7.4% y/y, below Bloomberg’s survey (+10.6% y/y); and, compared to pre-pandemic levels (November 2019), retail sales are now 12% higher (chart 4). On a YTD basis, retail sales increased by 8.5% relative to pre-pandemic (Jan–November 2019). However, on a seasonally adjusted basis, retail sales (excluding other vehicles) contracted by 2.5% m/m. We attribute this weaker than expected results to three factors: 1) despite we had a new VAT holiday as we had one in October and November 2020, some households

Chart 2

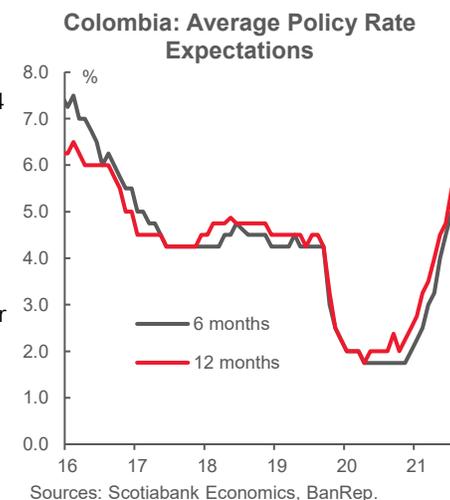


Chart 3

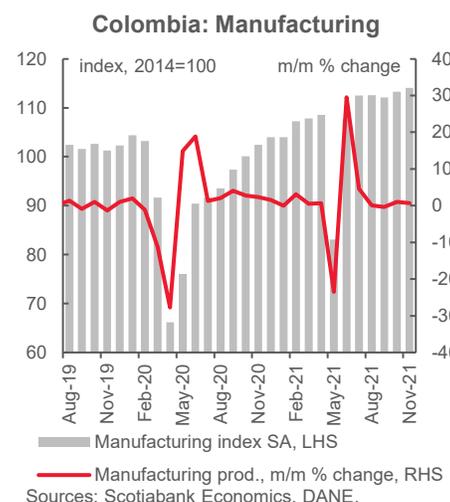
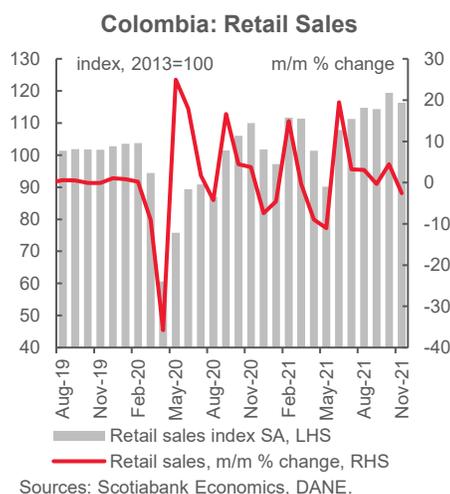


Chart 4



January 17, 2022

had a moderate demand for durable items such as home appliances and furniture; 2) this November we had fewer holidays than one year ago; and 3) households are now facing higher prices and probably it is impacting consumption decisions.

From the sector's perspective, in November, the best performing is those items related to mobility fuel oil (+16.2% y/y); vehicles (+23.3% y/y), and auto parts (+23.6% y/y). While other items such as electronic devices (-33.9% y/y), home appliances (-11.4 % y/y), and food (-3.4% y/y) are showing contractions, in some cases related to the normalization of the consumption habits after the reopening.

Regarding employment, compared with the pre-pandemic, jobs stood 4.6% below from pre-pandemic levels, especially in the commerce related to food, clothing, and entertainment. However, we highlight that in the case of retail sales job creation has shown better quality than in manufacturing.

In December we expect a strong rebound in the retail sales as we broadly resume normal operation in 100% of the economy. However, the effect of inflation is a thing to keep an eye on ahead of 2022.

Services & Hotels

Services activities showed further improvements especially in sectors related to entertainment. On the employment side, logistics (+3.6% y/y), telecom (+3.8% y/y), and programming and other computing services (+7.7% y/y) are the best performers, while we see still a lag in the employment of filming industries (-29.3% y/y), restaurants (-3.2% y/y) and activities related with tv edition (-10.7%y/y).

Regarding hotels, in November hotel occupancy reached 55.6%, above from Novembers 2019 levels of 53.3%. However, business trips are lagging the recovery, and also domestic tourism is leading to the better performance in the sector.

All in all, activity indicators point to a possibility of a better performance in the Colombian economy by the end of 2021, skewing our current 9.6% GDP growth forecast to the upside. Additionally, it affirms our expectation of a 75 bps hike in BanRep's January 28 meeting. Ahead of 2022, the effect of inflation and international logistics is a thing to keep an eye on. In the same vein, employment recovery is still a source of concern.

—Sergio Olarte & Jackeline Piraján

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