Editorial

Inflation in Colombia and Possible Future Scenarios

Inflation is the continuous and sustained increase in the general level of prices, and its control is one of the fundamental objectives of economic policy in any country, given the effects it has on the economy and society. In the first place, it affects people's purchasing power, to the extent that their purchasing power is reduced, that is, they will have less income to cover their expenses. In this way, inflation acts as a regressive tax, to the extent in which it affects the income of the population, especially the poorest, who see how these resources are reduced. Second, it generates a forced redistribution of income because the producers pass on the price increase to the final consumer; this result has more notorious repercussions on employees, especially on those who have low levels of remuneration. Third, it inevitably affects the competitiveness of a country, since if inflation is higher than that of its trading partners, the country's goods and services that have high prices will not be attractive in international markets.

Inflation, which was at low levels in recent years, intensifies when economies reactivate, after partially mitigating the effects of the pandemic caused by COVID-19. During this period, it was normal for there to be a higher demand for goods, but the supply chain was interrupted, and this generated shortages, which led to prices increasing; later, in February 2022, the war in Ukraine fueled the inflationary process.

In all countries, inflation levels are out of control. In the United States, Colombia's first trading partner, it reached a level of 8.3% per year until April, a figure that had not been recorded for 40 years. In the Eurozone it has reached 75.%, and it is possible that it will increase even more, given the eventual shortage of oil and gas, which makes energy more expensive and impacts the general level of prices. In the case of some Latin American countries, the data is also disturbing, if one takes into account that the figures for annual inflation in May are Brazil 12.1%, Chile 10.5%, Peru 9.47% and Mexico 7.7%.

This substantial increase in the price level also affected Colombia. The annual variation of accumulated inflation up to April was 9.23%, the highest level recorded in the last 22 years. In May, as forecast, it fell very little and was 9.07%; so far this year is 6.55%. The rising behavior of the cost of living in the country began in March 2021, reaching the maximum figure in April of this year. When comparing the annual variation in May 2021, which was of 3.30%, with that observed in May 2022, the increase is 5.77%, which, without a doubt, is a remarkable figure. According to the National Administrative Department of Statistics (DANE, by its acronym in Spanish), inflation in May 2022 was 0.84%, with the food item standing out as the one with the greatest variation with 1.56% and, therefore, the one that contributed the most in the price increase.

Although inflation is a global phenomenon, it is hardly normal for each country to take measures to combat it. In the case of Colombia, different policies have been applied, one of them is the increase in the de interest rate set by the Board of Directors of the Banco de la República, in order to reduce demand and thus control the increase in prices. This is how this variable has gone from 1.75% in September 2021 to 7.5% in June of this year and it is expected that the Board of Directors will continue to increase it.

Given that one of the factors that has most pressured the increase in the cost of living is the behavior of food prices, the Colombian government issued decrees 307 and 504 between March and April of this year, by means of which it reduced zero tariff on more than 200 inputs from the agricultural sector so that food production costs do not continue to rise and, therefore, increase inflation. Despite this, and in the opinion of Jorge Enrique Bedoya, president of the Colombian Farmers' Society (SAC), the result in the importation of corn and soybeans to produce concentrate feed for animals is null, since before these standards, the tariff was already zero, to which is added that more than 94% of imported fertilizers did not have taxes.

A third measure to combat inflation in Colombia was to keep, since January of this year, the prices of liquid fuels (gasoline and diesel) unchanged, despite the fact that the international price of oil has tended to rise. This measure led the Fuel Price Stabilization Fund (FEPC) to increase its deficit by 2.7 billion pesos and it is currently 14.2 billion.

This last strategy was reconsidered on Tuesday, June 14, when the Ministry of Finance presented the Medium-Term Fiscal Framework, in which increases are projected in the gallon of regular gasoline and in diesel or ACPM of 200 Colombian pesos in June and July and 250 in August. From September, the increases will be gradual and sequential of 400 in gasoline and 250 in diesel "until the compensation differentials are closed” which, in the case of gasoline, will be in August 2023 and in the case of ACPM in June 2024.

Of the three measures outlined above, the first will be implemented by the Banco de la República, which, by constitutional mandate, “will ensure the maintenance of the purchasing power of the currency”, therefore, it is expected that the institution will continue to increase the interest rate and that may end this year, according to the analysts Gómez and Montenegro, between 7.5% and 9%, respectively. This measure, aimed at reducing demand, may be ineffective and may lead to inflation continuing to rise, negatively affecting the population. For the director of DANE, Juan Daniel Oviedo, the impact on the increase in the cost of living depends on the economic stratum and the products that are consumed: for poor families it is 11.26%, for the vulnerable of 11.07 %, for those of middle class of 9.46%, and for those of high income of 7.46%.

The current government’s measure of not increasing fuel prices so far this year and, in this way, cushioning inflation, is a political decision. The Executive is interested in an electoral year (parliamentary elections and presidential election) to show that the inflationary process that the country was experiencing was caused more by external causes than by internal factors. If these prices had increased, inflation would currently be higher, because the price of fuel does not only affect transportation, but also the production of the different goods, transferring the increase in costs to the final consumer. Studies by the Ministry of Finance show that “for every 1,000 pesos that the price of fuel increases, inflation would rise 1%.” On the other hand, Hernán Rincón Castro, researcher at Banco la República, “estimates that a 10 % shock to the prices of gasoline and ACPM increases inflation by 1.31%.”

The next government will necessarily have to raise fuel prices, otherwise the country’s fiscal situation will be unmanageable; this decision will inevitably lead to an increase in inflation, but the political costs will no longer be borne by the current government, but by the next one, which, recently installed, will have to face an even more complicated situation, due to the large gap between internal prices of fuels and international oil prices.

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