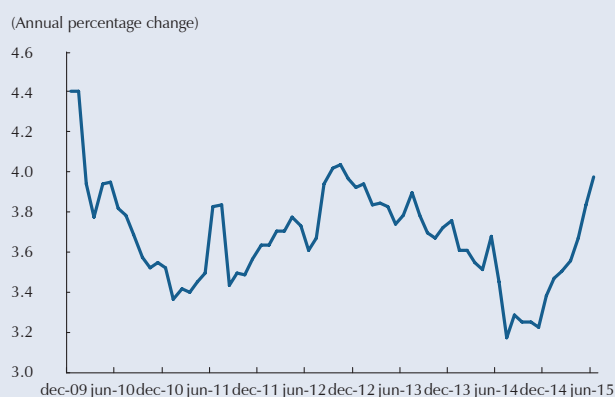


BOX 2 WHAT EXPLAINS THE ACCELERATION IN THE CPI FOR NON-TRADABLES, EXCLUDING FOOD AND REGULATED ITEMS?

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Since July last year and after several quarters of steady declines, the annual change in the consumer price index (CPI) for non-tradables, excluding food and regulated items (NT-EFR), tended to stabilize up to November 2014, then adopted a rising trend that became more pronounced at the start of 2015 (Graph B2.1). This occurred at the same time as economic growth and aggregate demand experienced a setback and with an output gap that has entered negative territory, according to the estimates shown in Chapter 4 of this report.

Graph B2.1
Non-tradable CPI Excluding Food and Regulated Items



Source: DANE; Banco de la República's calculations

Price increases for non-tradable goods and services are usually attributed to demand-pulled pressures. However, in the absence of such pressures, the question is: Why the upward trend in NT-EFR? Finding an answer requires looking at other variables that might be affecting inflation in this segment of the CPI. A new classification for NT-EFR is proposed in this section to explain that behavior, one with more economic

meaning, to help identify the factors that are influencing its performance.

In the absence of demand-pulled pressures, prices in this segment of the CPI should be responding to other relevant economic variables, such as depreciation of the peso, indexing to past inflation and to wages, and temporary supply shocks. With this in mind, the CPI for NT-EFR was broken down into the following subgroups:

1. **Rental fees:** These consist of basic rental expenses, effective and imputed. As a whole, they constitute the sub-basket that represents the largest share of NT-EFR (18.59% of total CPI and 60.9% of NT-EFR). In addition to being affected by demand, this sub-basket also responds to legislation,¹ to indexing factors such as actual inflation in the recent past, and to the inflation target. This component also is indirectly related to the momentum in the price of houses and land since, technically, it is accepted that leases tend to reflect a percentage of home prices. In this case and considering its weight in the CPI, a separate subgroup was created for rental fees.
2. **Indexed items (other than rent):** These are influenced by the momentum in demand, but they also tend to form their prices based on actual inflation, the inflation target and wages. Their weight in the total CPI is 8.14%, which is equivalent to 26.7% of NT-EFR.
3. **Items affected by the exchange rate:** These account for 7.5% of NT-EFR and 2.29% of the CPI overall. They are items with prices that are affected directly (by being imported or exported) or indirectly (through production costs and investment financing) by the momentum in the nominal exchange rate against the dollar. The country's increased exposure to foreign trade in

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¹ Pursuant to Law 820/2003, Article 10, the increase in rental prices stipulated in leases signed after July 10, 2003 may not exceed inflation in the CPI for the preceding year. The adjustment for leases entered into prior to July 10, 2003 may not exceed the midpoint of the target range that is in force, as determined by Banco de la República's Board of Directors. Some exceptions apply in special cases.

the last fifteen years has made prices for a number of tradables far more sensitive to changes in the exchange rate than in past decades, when price sensitivity was very low.

4. All others: These include all the other items that do not respond in a clear and unique way to the factors outlined above. Entertainment services are a particularly important component of the subgroup, as they make it highly volatile and very much affected by the price of soccer tickets (especially in the final stages of national and international competition involving Colombian teams). The weight of this subgroup comes to

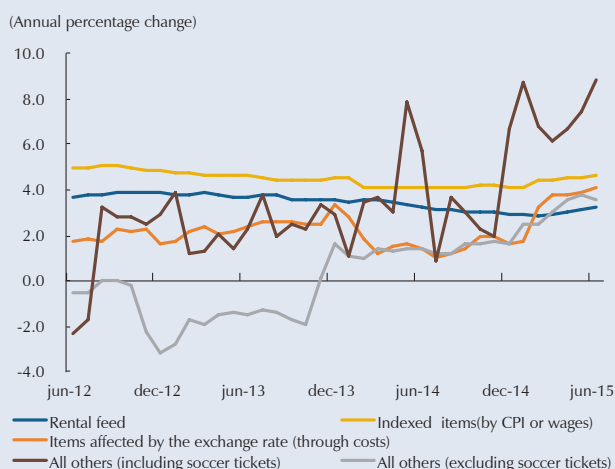
1.51% in the overall CPI and 4.9% in the NT-EFR basket.

As illustrated in Graph B2.2 and Table B2.1, the subgroup “all others” is the one most responsible for the build-up in annual inflation in NT-EFR since the start of the upward trend in the CPI-NT-EFR since July 2014 (3.17%) and up to June (3.98%), followed by those items affected by the exchange rate, indexed items and, to a lesser extent, rent.

The “all other” segment, which includes entertainment services (which, in turn, includes soccer tickets), is highly volatile due to the professional soccer finals involving Colombian teams. This subgroup was responsible for 48.0% of the acceleration in annual inflation during the period in question, with the annual change in the subgroup having gone from 0.83% in July 2014 to 8.8% in June 2015. Annual variations in this segment of the CPI reflect the sharp fluctuations caused by the end of the Colombian soccer season. For example, the annual increase in this subgroup came to 1.97% in November 2014 and 6.74% one month later.

More recently, the Colombian soccer finals in June brought the annual change in the “all other” subgroup to 8.8%, which is more than in May (7.4%) and March (6.2%). Therefore, the high volatility observed in this segment during the last two quarters is linked closely to how the soccer season ended in 2014 and the start of the tournament in 2015, respectively. When teams from the big cities, with considerable weight in the CPI, reach the finals, especially if they are from the nation’s capital city (as in the tournament of the

Graph B2.2
Non-tradable CPI Excluding Food and Regulated Items, by Groups



Source: DANE; Banco de la República’s calculations

Table B2.1
Contribution to the Acceleration in the Annual Change of the Non-tradable CPI Excluding Food and Regulated Items

Description	Share in the CPI	Annual change (Percentage)		Contribution		Contribution to the acceleration	
		Jul-14	Jun-15	Jul-14	Jun-15	Percentage points	Percentage
Non-tradables excluding food and regulated items	30.52	3.17	3.98	1.02	1.28	0.26	100.00
Rental fees	18.59	3.17	3.27	0.61	0.63	0.02	7.43
Indexed items	8.14	4.11	4.62	0.37	0.42	0.05	19.58
Items affected by the exchange rate	2.29	1.03	4.06	0.02	0.09	0.07	25.02
All others	1.51	0.83	8.80	0.01	0.14	0.13	47.97

Source: DANE; Authors’ calculations

first half of 2014), the hikes usually are very abrupt. As such, the upward pressures from the “all others” group could be akin largely to temporary pressures that would tend to disappear between late this year and the end of 2016.

The NT-EFR segment, which has been affected by the exchange rate, via costs, accounts for 25.0% of the surge in inflation during the period in question. The annual change to this subgroup went from 1.03% in July 2014 to 1.61% in December, ending at 4.06% in June. This pattern can be attributed to the impact the depreciation of the Colombian peso against the dollar has had on these prices. It started strongly in July 2014, but did not begin to pass through to prices noticeably until the end of last year.

Finally, in the case of rental fees, with lower annual changes during the second half of last year and in-

dexed items being relatively stable in the final six months of 2014, it is confirmed these subgroups began to pressure the prices of non-tradables as of early this year. This explains the build-up in the annual changes in NT-EFR to 7.4% and 19.6%, respectively, during the period in question (Table B2.1). The annual variation in rental fees was 3.17% in July 2014, fell to 2.86% in February and ended June at 3.27%. This upward behavior in the group that carries the most weight in the total CPI (18.59%) would be associated with added indexing of new items that were updated to reflect inflation last year, which was high (3.66%), and the inflation target for year (3.0%) (See footnote 1). Indexed items were boosted by higher inflation last year and by the increase in the minimum wage (4.6%). They have followed an upward trend so far this year, after remaining stable at around 4.1% between June 2014 and January 2015, and ending the first six months at 4.62%.