

Box 1

The recent behavior of the rent CPI in Colombia

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Rent is the most important CPI component for Colombian households, representing approximately one-fourth of the household's index expenditures. Price increases for this component exhibit significant inertia because they are indexed to the headline inflation of the prior year. In turn, this introduces a greater persistence to inflationary phenomena, slows down the convergence of inflation to the target and, consequently, could result in higher costs of monetary policy actions concerning economic activity.¹

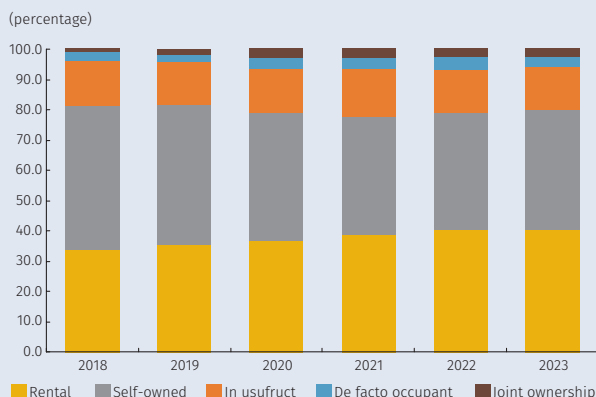
In recent years, the rent CPI has shown high yearly adjustments, followed by a slow deceleration of these prices. In September 2024, year-on-year change was 7.9% for this measure, amid a backdrop of high headline inflation indexation (well above 3%), the reversal of some temporary rent relief measures adopted during the pandemic,² and a stagnant new and used housing market, among other factors. The combined effect of the latter has placed upward pressure on rents, thus limiting the possibility for annual prices in the services basket to assume a downward trajectory and contributing to maintaining headline and core inflation at levels above the target.

This box describes the rental market in Colombia, its measurement relative to consumer prices and its recent behavior in light of the evolution of some of its determinants.

1. Housing rent in Colombia

Renting constitutes the foremost avenue for households in Colombia to access housing. According to DANE's Quality of Life Survey (ECV for its Spanish acronym), in 2023 around 40% of households lived in rented housing, being the segment with the highest share among the types of housing tenure and the one that has gained the most prevalence in recent years (Graph B1.1). In contrast, the share of households who own their primary residence has decreased, despite the higher number of households living under this type of tenure in 2022

Graph B1.1
Distribution of households by housing tenure type



Sources: DANE (ECV); own calculations.

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1 For a more detailed analysis of the effects of indexation in Colombia, see Box 2: "Economic effects of indexation and its prevalence in Colombia", of the July 2023 Report by the Board of Directors to Congress, available only in Spanish at: <https://www.banrep.gov.co/es/publicacionesinvestigaciones/informe-junta-directiva-congreso/julio-2023>.

2 Decree 579 of 2020 of Colombia's Ministry of Housing, City, and Territory established a series of temporary measures for rental contracts to address the crisis associated with the COVID-19 health emergency. These measures included suspending rent payment adjustments between April and June 2020 and extending rental agreements that were set to end during said period, among others.

and 2023 (Graph B1.1). In addition, around 90% of households living in rented housing fall in socioeconomic strata 1, 2, and 3, and more than half have an informal rental contract.³

Law 820 of 2003 regulates rental contracts in the national territory and establishes their requirements, obligations of the parties, and other significant features. Concerning housing rental rates, the law stipulates that the monthly rental may not exceed 1% of the commercial appraisal of the property, must be renewed each year, and the annual increase must not exceed headline inflation recorded at the end of the previous year. Consequently, under this legal framework, price increases in Colombia's residential rental market are often indexed to headline inflation at the conclusion of the prior year, particularly in the context of written formal contracts.

2. How is the residential rent CPI measured?

According to DANE, the rent CPI quantifies the fluctuations in the price of the residence reported by both renter and/or owner households. This component represents 25.2% of the total CPI basket and is especially significant for the low-income household segment, for whom its share is 31.6%.

The total rent basket includes two basic components, called effective rent and imputed rent. Effective rent is the price paid in rent during the rental period minus any applicable discounts or incentives, quantified through a survey given to residents of houses, apartments, and rooms for rent. Imputed rent quantifies the price of expenses associated with the services produced by owner-occupied housing, and is calculated exclusively based on the behavior of apartment and house rentals. Thus, imputed rent is not collected, so its total change is built from the variations for effective rent collected and weighted according to the magnitudes assigned to spending on owner-occupied housing services, in houses and apartments, by city and income level.⁴

The design for collecting rental prices through the CPI is based on a probabilistic sampling operation, in which dwellings are chosen through a selection performed by DANE of cartographic blocks, where the monitored unit is the residence, not the household or family, consistent with the recommendations of multiple international organizations.⁵

Finally, the data from each informant in the rental group is collected on a four-monthly basis;⁶ that is, the total sample is divided into four groups and the rental fee information is collected monthly from only one of the groups. This implies that the entire sample of residences is used to construct the indicator, but only 25% would have new information and 75% would show no change from one month to another.⁷

3 Measures households reporting having a verbal rental contract.

4 These weights, derived from the National Household Budget Survey (ENPH for its Spanish acronym), are obtained from the rent equivalence framework. In this rent approach, rents of residences actually rented are taken as a measure of the cost of use. In this approach, a price is imputed to owner-occupied housing, which is equal to the rental price of equivalent housing in the same period.

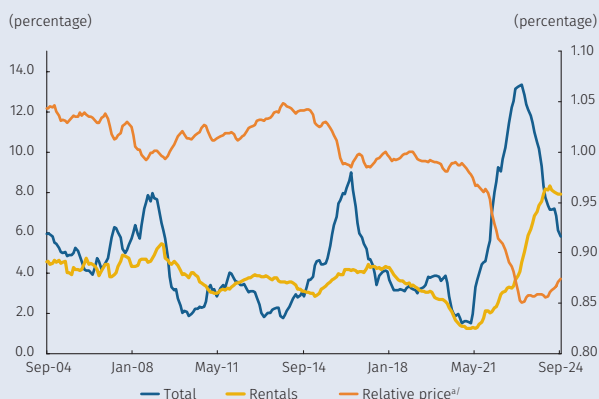
5 ILO, IMF, WB and OECD: *Consumer Price Index Manual: Theory and Practice*; International Monetary Fund's (IMF) *Data Quality Assessment Framework (DQAF)*; *Norma para el cálculo de un índice armonizado de precios al consumidor para los países miembros de la Comunidad Andina* (Standard for the Calculation of a Harmonized Consumer Price Index for the Member Countries of the Andean Community), and the *European Statistics Code of Practices* by Eurostat.

6 For example, it is assumed that the source is a private home that is visited in January, which, in this order of ideas, must be visited again in May, September, and January of the following year (four-monthly periodicity).

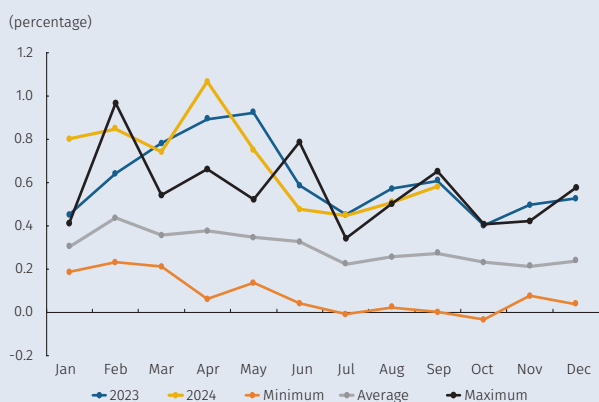
7 This implies changes to the data collected during the month were smoothed.

Graph B1.2
Headline and rent CPI

A. Annual changes and relative price

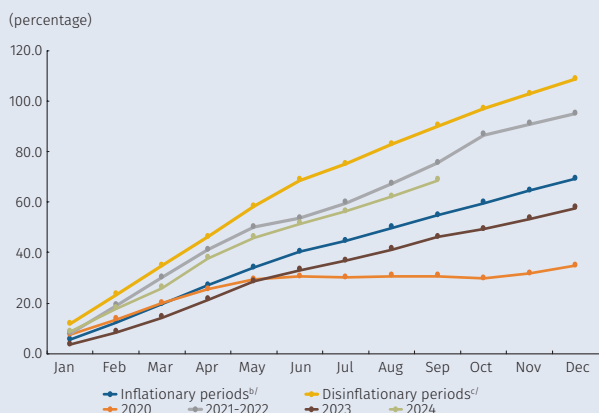


B. Monthly changes^{b/}



a/ Rent CPI as a percentage of total CPI.
b/ Monthly minimum, average, and maximum rent CPI change calculations use data from 2004 to 2022.
Sources: DANE; own calculations.

Graph B1.3
Month-to-month transmission of headline inflation to the year-to-date rent CPI changes^{a/}



a/ Transmission is understood as the coefficient between the year-to-date change of the rent CPI and headline inflation at the end of the immediately preceding year.
b/ Is the average transmission observed each month during the inflationary periods before Law 830 of 2003, including those of 2007-2008 and 2015-2016.
c/ Is the average transmission observed each month during the disinflationary periods before Law 830 of 2003, including those of 2009-2010 and 2017-2018.
Sources: DANE; own calculations.

3. Recent behavior of the rent CPI

Between 2020 and 2022, the rent CPI registered year-on-year adjustments of less than 4%⁸ and consistently fell below the figures observed for headline inflation. This was reflected in a relative rental price that presented significant drops during this period (Graph B1.2, Panel A). This occurred in a context of prices indexed to relatively low levels of inflation⁹ and transitory price assistance policies established by the National Government during the pandemic that remained in force. Moreover, aggregate demand remained weak during a good portion of that time, which would not only have generated downward pressure on prices but likewise limited the transmission of headline inflation to the annual change of the rent CPI. Likewise, the new home purchase market that reached historic highs during these years also would have placed downward pressure on the rent CPI and played a significant role in expanding the supply of residential real estate, helping to alleviate demand pressures in the rental segment. Finally, improvements were also recorded in the availability of used rental housing in the main cities for the upper socioeconomic strata.

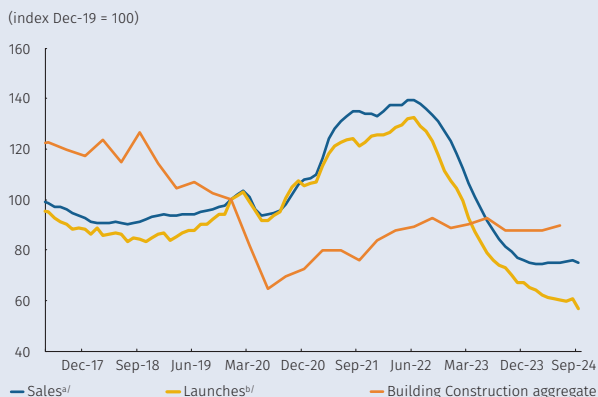
In recent years, rental prices have exhibited high annual growth and significant inflationary inertia, which has contributed to greater persistence of still-high adjustments above the 3% headline and core inflation. In particular, throughout 2023 and until the beginning of 2024, annual changes in the rent CPI rebounded, reaching 8.3% in April of this year, the highest of the past two decades. From that peak until September, the strong inertia exhibited by rent prices has restricted inflation's decline, maintaining annual adjustments in this segment at levels close to 8% (Graph B1.2, Panel A). Monthly variances in rents have systematically exceeded the average observed between 2004 and 2022 and, in some months, have registered new historical highs (Graph B1.2, Panel B). This, together with the fall of headline inflation, led to a stabilization of the relative price of rents, with some upsurges seen in recent months, and annual increases in the rent CPI that have exceeded those of the household goods and services basket since the beginning of this year (Graph B1.2, Panel A).

The recent behavior of the rent CPI would be associated with the dissipating of the factors that gave rise to the low annual variations of this indicator between 2020 and 2022. Primarily, the end of the price relief decreed during the COVID-19 health emergency could have triggered the growth of this basket segment as contract renewals took place. Then, within a setting of multiple inflationary shocks that drove inflation upwards in 2022 (13.1%) and 2023 (9.3%), price indexation mechanisms to these higher values would have driven higher rent adjustments over the past two years. Likewise, to date in 2024, there has been a significant pass-through of past headline inflation in the annual change of the rent CPI, consistent with behavior observed in past periods of disinflation (Graph B1.3). Furthermore, the observed decline in the relative price of rents in 2021 and 2022 partially accounts for the inertia in annual rent growth, with a gradual recovery of prices to long-term levels due to regulatory constraints on the magnitude of adjustments permitted in contract renewals.

8 In 2020, 2021, and 2022, the annual increase in the rent CPI was 1.3%, 2.0%, and 3.6%, respectively.

9 During this period, the benchmark indexation values were 3.8%, 1.6%, and 5.6%, consistent with headline inflation observed in the immediately preceding years.

Graph B1.4
Aggregate building construction and new housing market indicators

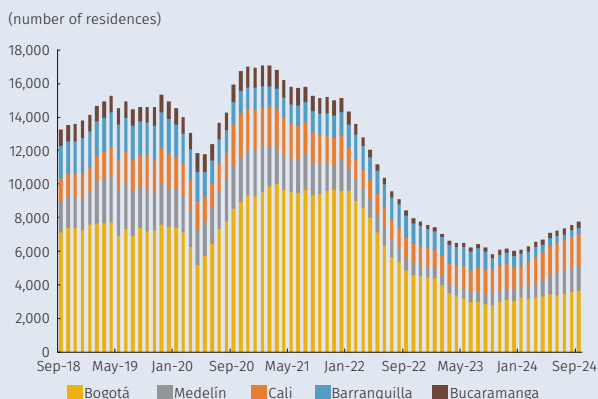


a/ 12-month aggregate of units sold in the market.
b/ 12-month aggregate of new units launched in the market.
Sources: DANE; own calculations.

Additional factors influencing the rent CPI concern the housing market. On the demand side, the recent correction in the housing purchase market, following a substantial increase in 2021 and 2022, may contribute to additional inflationary pressures on rents. In particular, lower demand for new housing (Graph B1.4) would reflect a restructuring in the preferences of the housing demand towards rents amid a backdrop where a substantial segment of Colombian families is requiring housing, coupled with an ongoing process of household formation.¹⁰ On the supply side, significant and persistent drops in various new housing supply generation indicators (Graph B1.4) could be signs of limited housing availability in the rental market and inflationary supply pressures on rents. It is worth noting that the weak performance of the new housing market could be explained by several causes, including higher construction costs (materials and labor), uncertainty surrounding the subsidy policy, lower market incentives, and high financing costs. Finally, the used housing market in the main cities for the upper strata has also experienced limited availability of rental properties, especially in Bogotá, with levels that have fallen in the last two years to below those observed in 2019 (Graph B1.5). This is despite improvements in the margin observed in recent months.

To summarize, annual fluctuations in the rent CPI have predominantly been influenced by a significant degree of indexation to headline inflation rates well above the 3% target. This would have been exacerbated by further inflationary pressures originating from the new and used housing markets. In a situation where the possible determinants of rents have not exhibited any signs of improvement and where inflation - despite its recent decrease- continues exceeding the 3 percent target, the Consumer Price Index (CPI) for rents remains a source of upside risk for the inflation forecast for the remainder of 2024, as outlined in this Report. In the future, indexation to lower headline inflation and potential improvements in the housing market, significantly influenced by lower interest rates, would encourage more marked reductions in this segment of the services basket during the forecast period.

Graph B1.5
Available supply of used housing for rent in major cities in strata 4, 5, and 6



Sources: La Galería Inmobiliaria (real estate data analytics); own calculations.

¹⁰ According to DANE, in 2021, 31% of households in Colombia faced a housing deficit situation. This is equal to 5.2 million households requiring improved housing (qualitative deficit) or a new residence (quantitative deficit). In addition, forecasts of the 2018 National Population and Housing Census suggest that approximately 900,000 new households will be formed between 2023 and 2024.