

Will a weaker US dollar entail significant risks to Hong Kong's CPI inflation?

Executive summary

1. There is some concern that the US dollar may weaken significantly in the medium to long run on its mounting debt and fragile nature of recovery. With the linked exchange rate system, a significant weakening of the US dollar may translate into higher import prices for Hong Kong, which could in turn add to CPI inflation.
2. Looking at data from the past 20 years and from Granger causality tests, exchange rate movement is indeed a key factor affecting Hong Kong's import prices. However, compared with many other Asian economies, Hong Kong's import prices have been more stable and increased at a slower pace since the inception of the linked exchange rate system in 1983 and even the US dollar's latest downtrend in 2002. In fact, Hong Kong's import prices have risen in line with world commodity prices, at an average annualised rate of 1.0% over the past 26 years.
3. Moreover, as borne by the experience of Korea and Thailand, a more stable exchange rate underpinned by the dollar peg may have shielded Hong Kong's import prices from periods of extreme volatility such as the Asian Financial Crisis, as import price volatility is usually associated with extreme exchange rate volatility.
4. If past experience is anything to go by, imported inflation is rarely a major source of Hong Kong's consumer price inflation. Hong Kong's CPI inflation is driven more by domestic costs than import prices. From our ballpark estimation, even assuming 100% pass through, the contribution of imported inflation to consumer price inflation over the past 10 years is merely 0.2 percentage point. The long-term average covering the 19 years from 1990-2009 is likewise insignificant, also at around 0.2 percentage point. Except for 2007 and 2008 when Hong Kong faced a food-led inflation amidst the global wide surge in food prices, imported inflation seldom led to an upsurge in inflation in Hong Kong.
5. That the US dollar is bound to weaken is not necessarily a one-way bet, because the EU and Japan all have their own economic problems. Moreover, unless the US dollar were to depreciate drastically, the threat to Hong Kong's CPI inflation should not be that significant. Some weakening in the US dollar would in fact help Hong Kong's exports and hence GDP growth, though it may also entail some pick-up in Hong Kong's imported inflation.
6. Overall, while exchange rate movements are a relevant factor affecting import prices, our past experience suggests that Hong Kong's import prices have fared better than many Asian economies both in terms of stability and rate of increase, despite the US dollar's rough ride over the past 26 years.

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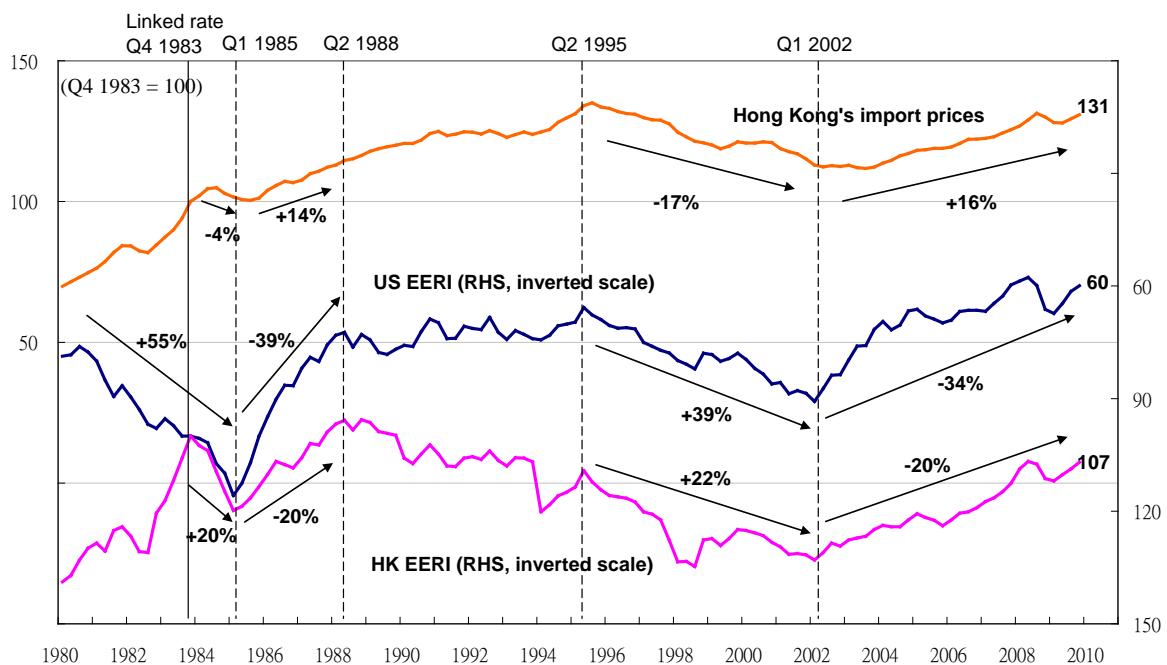
Introduction

There has been considerable concern that the US dollar would weaken significantly in the medium to long term because of the expected protracted sluggishness in the US economy and the deterioration in public finance. Naturally, this has given rise to worries about a depreciating Hong Kong dollar and the ensuing surge in imported inflation. By reviewing the past experience, this article tries to gauge the extent to which Hong Kong's import prices and consumer price inflation are influenced by exchange rate movements. It also gives a brief comparison with the experiences of other Asian economies.

US dollar went through several rounds of ups and downs since the 1980s

2. **Chart 1** shows the movements of the US dollar and Hong Kong dollar in terms of their nominal effective exchange rate index in inverted scale, juxtaposed against those of Hong Kong's import prices. The inverted scale is to reflect the inverse relationship between exchange rate and import price movements.

Chart 1: The US dollar has gone through several major ups and downs, and so have the HK dollar and import prices*



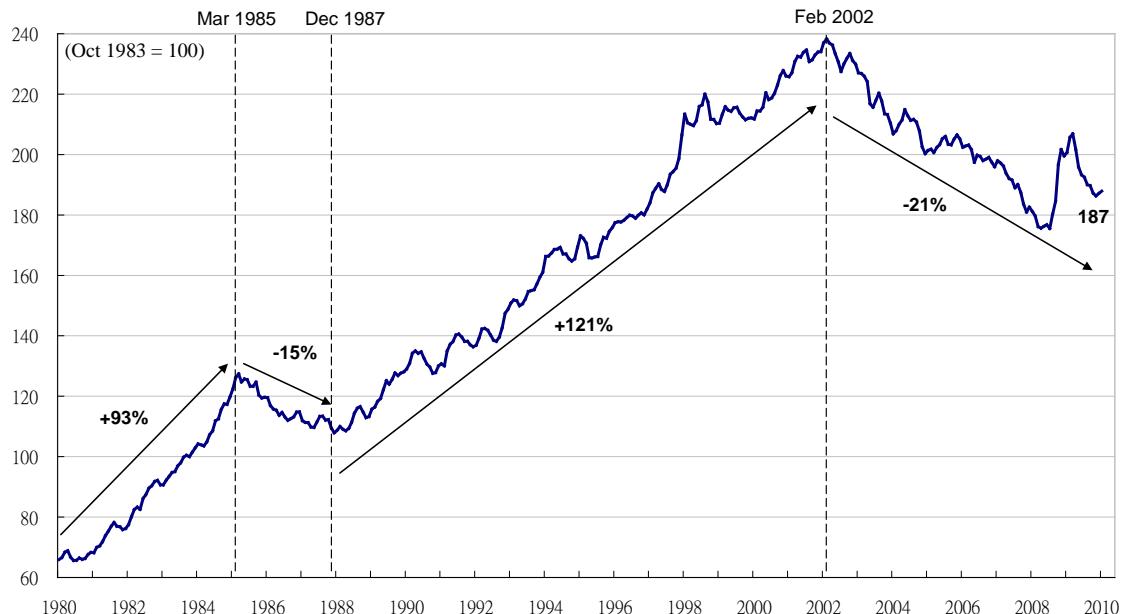
(*) The chart shows the quarterly movements of the US trade-weighted major currencies effective exchange rate index (EERI) and the import-weighted HK EERI, and the corresponding peak-to-trough or trough-to-peak percentage changes.

3. The US dollar went through several rounds of major ups and downs over the past decades. It appreciated sharply by 55% from 1980 to 1985, driven by the success of a tight monetary policy to rein in inflation and by the higher real interest rate resulting

from an expansionary fiscal policy. The strong dollar, however, hurt exports and worsened the trade balance. In September 1985, the US reached the Plaza Agreement with France, the then West Germany, Japan and the UK (the then Group of Five) to manage the depreciation of the US dollar against the Japanese yen and the deutschemark, and the dollar fell. Eventually in February 1987, the Louvre Agreement was convened by the then G-6 nations of West Germany, France, the UK, Japan, Canada and the US to stop the slide of the dollar and achieve currency price stability through the coordination of macroeconomic fiscal and monetary policy. The US dollar depreciated by 39% from 1985 to 1988, which helped to reduce the current account deficit, and experienced a lingering period of modest depreciation from 1988 to 1995 on the back of a strong deutschemark and a strong yen. From 1995 to 2002, it rose by 39% on a strong dollar rhetoric and a robust economic outlook after the IT-led investment boom in the 1990s that boosted productivity. Then sentiment switched, and thereafter the dollar was on a downtrend, falling by a cumulative 34% between 2002 and mid-2008 amid mounting concerns over its deteriorating trade deficit.

4. The trend is even more drastic with the US dollar broad effective exchange rate index (**Chart 2**), which includes the currencies of Latin American, emerging Asian and Middle Eastern economies as well. Unlike the major currencies index, the broad index trended strongly upward from 1988 to 1995, the main reason being that several of the currencies excluded from the major currencies index (notably the Latin American ones) depreciated sharply because of hyper inflation in those economies, culminating in the “tequila crisis” of 1994-1995 with the sudden devaluation of the Mexican peso in December 1994.

Chart 2: The movement of the US dollar broad effective exchange rate index is even more drastic *



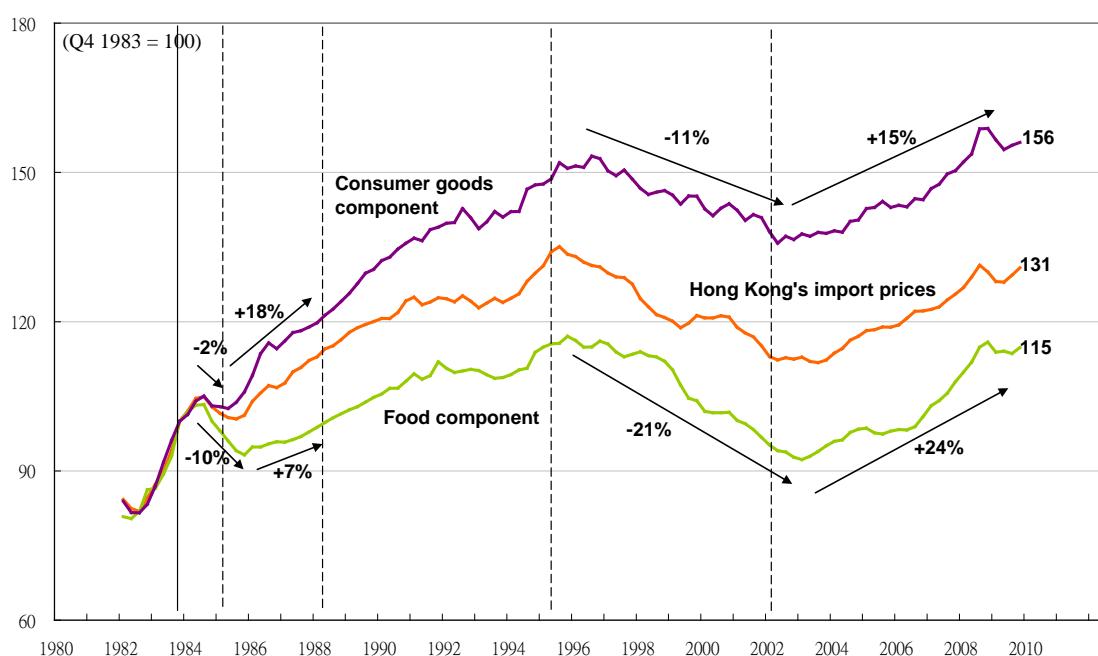
(*) Monthly data.

Exchange rate movements indeed a key factor affecting Hong Kong's import prices

5. The Hong Kong dollar has generally moved in tandem with but to a smaller extent than the US dollar. There was some divergence in movements during the period 1988-1995, mainly due to difference in trade compositions and divergent movements of the currencies of major trading partners. At that time, China took up roughly 30% of the Hong Kong effective exchange rate index and the renminbi had been depreciating gradually until the unification of renminbi exchange rates in 1994.

6. From **Chart 1**, it can be seen that the movements of Hong Kong's import prices correspond roughly to the movements of the US dollar and Hong Kong dollar against their major trading partners. A further look is taken at the components of import prices by end-use categories that are more relevant to final consumption. **Chart 3** shows that the consumer goods and food components of import prices have tended to broadly follow the overall import price movements.

Chart 3: Consumption related components of import prices have tended to follow the overall import price movement*



(*) Based on quarterly data.

7. The results of Granger causality tests likewise suggest that exchange rate movements are one of the relevant factors influencing Hong Kong's import prices⁽¹⁾. Further analysis confirms Granger causality from exchange rate movements to the

(1) Granger causality tests were run using quarterly data from Q1 1983 to Q3 2009 and four lag periods. The results suggest significant Granger causality relationships of US and Hong Kong dollar exchange rates on Hong Kong's import prices, at the 5% and 1% levels respectively.

import prices of consumer goods, but little evidence of causality from exchange rates to import prices of food⁽²⁾. The latter is due to the fact that food prices are also significantly affected by global supply and demand conditions apart from exchange rate factors. For example, the surge in food prices in 2007-2008 was more of a worldwide phenomenon triggered by low levels of world cereal stocks, crop failures in major exporting countries, and rapidly growing demand for agricultural commodities for biofuels, according to the UN's Food and Agriculture Organization (FAO).

Hong Kong's import prices generally more stable than those economies adopting flexible exchange rate regime

8. Looking at data since the inception of the linked exchange rate system in 1983, there is however little evidence to suggest that Hong Kong's import prices have exhibited greater volatility or larger increases than those of many other Asian economies, or global inflation for that matter (*Table 1*). Indeed, Hong Kong's import prices have been rising generally in tandem with world commodity prices, and actually are less volatile than the import prices of other Asian economies adopting flexible exchange rate regime.

Table 1: Hong Kong import price has been more stable and tame than other Asian economies and global inflation

Between 1983 Q4 and 2009 Q4 (26 years)

	<u>Cumulative change</u> (%)	<u>Average annualised change</u> (%)	<u>Standard deviation[#]</u> (%)
Global inflation			
World Bank's estimate*	232.4	5.6	5.5
IMF's estimate	1201.8	10.4	7.8
Hong Kong's import prices	30.8	1.0	4.1
Compared with import prices of:			
Korea	79.6	2.3	13.2
Singapore	-15.4	-0.6	4.9
Thailand	176.1	4.0	12.2
Taiwan	12.4	0.4	7.5
World commodity prices	48.5	1.5	11.2

(2) Granger causality tests were run using quarterly data from Q1 1983 to Q3 2009 and four lag periods. The results suggest significant Granger causality relationships of the US and Hong Kong dollar exchange rates on Hong Kong's import prices of consumer goods, both at the 1% level, but not on import prices of food.

Table 1 (Cont'd)
Between 2002 Q1 and 2009 Q4 (8 years)

	<u>Cumulative change</u> (%)	Average annualised <u>change</u> (%)	Standard deviation [#] (%)
Global inflation			
World Bank's estimate*	31.0	4.1	1.5
IMF's estimate	33.0	3.7	1.1
Hong Kong's import prices	15.8	1.9	2.6
Compared with import prices of:			
Korea	40.4	4.5	17.5
Singapore	4.2	0.5	5.0
Thailand	12.9	1.6	5.6
Taiwan	46.2	5.0	7.6
World commodity prices	85.5	8.3	13.7

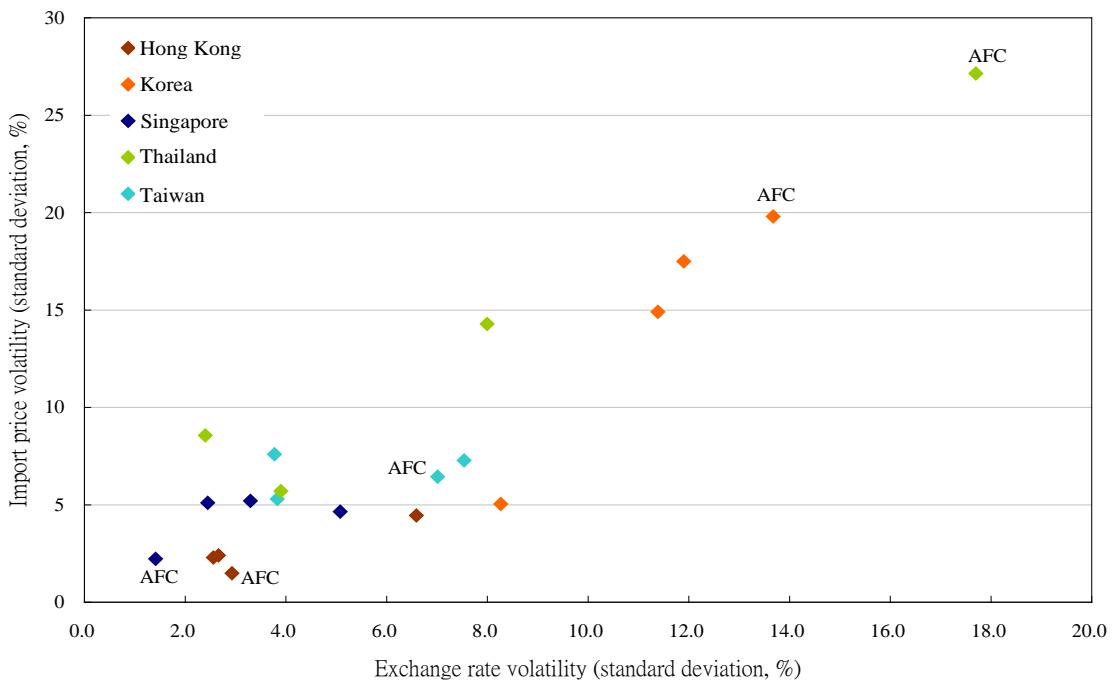
(**Annual data up to 2008.*

(#) *Standard deviation of the year-on-year % change.*

Import price volatility is often associated with exchange rate volatility for many Asian economies

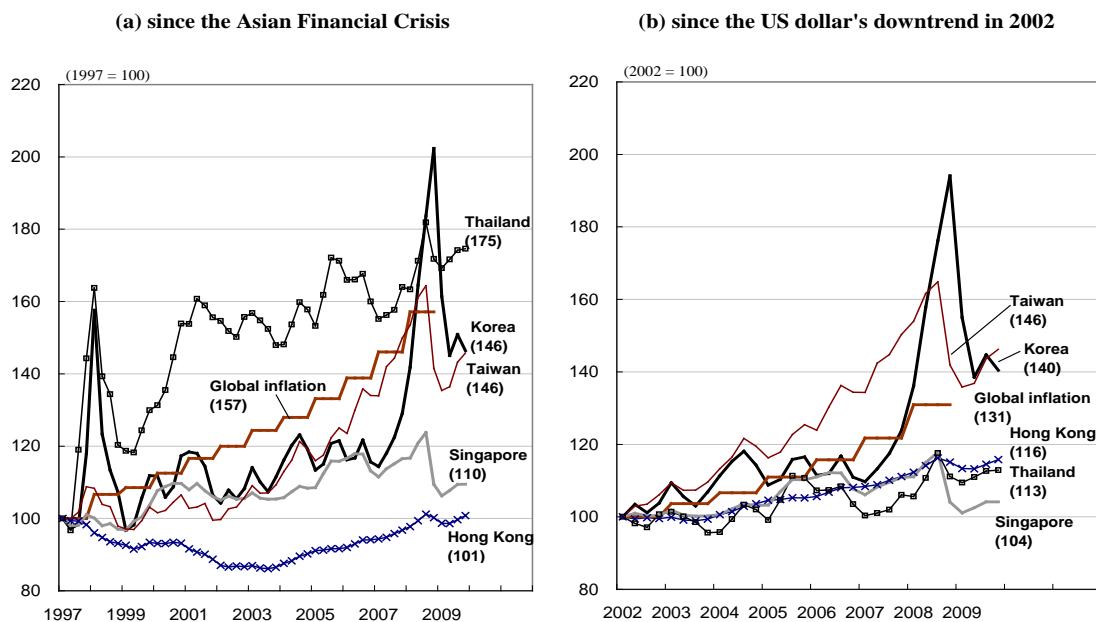
9. Indeed, the linked exchange rate system may have shielded Hong Kong's import prices from the sharp volatilities experienced by Thailand and Korea in their import prices during 1997-98, when the Asian financial crisis struck. **Chart 4** shows that there is a strong correlation between exchange rate volatility and import price volatility across economies over time, even with the outlier data points during the Asian Financial Crisis (AFC) period. Hong Kong displays relatively low volatilities for both exchange rate and imported prices. The anecdotal evidence seems to suggest that the more stable trend of Hong Kong's import prices is associated with the less volatile exchange rate movements as anchored by the dollar peg.

Chart 4: Hong Kong's exchange rate and import price volatilities have been lower compared with many other Asian economies (1983 Q4-2009 Q4)



10. Looking at different time periods to discern the US dollar's influence on Hong Kong's import prices more closely, it is found that in the past 13 years after the Asian Financial Crisis during which most Asian currencies were de-linked with the US dollar, Hong Kong's import prices had barely moved compared with the 1997 level whereas other Asian economies had seen their import prices fluctuate wildly and increase at a rapid pace (**Chart 5a**).

Chart 5: Hong Kong's import prices rose more slowly than some Asian economies*



(*) Import prices are based on quarterly data; global inflation on annual data from the World Bank.

11. Even in more recent years after 2002, when the US dollar embarked on a persistent downtrend, and along with this the Hong Kong dollar correspondingly declined, the increase in Hong Kong's import prices had been slower than those of many other Asian economies, and also global inflation (*Chart 5b*). This suggests that while exchange rate is a prominent factor affecting import prices, other factors such as global inflation, world commodity prices and the changing pattern of import sources have also been in play. In particular, the Mainland has been instrumental in holding import prices down, thanks to our increasing trade ties with the hinterland.

To what extent is Hong Kong's CPI inflation explained by imported inflation?

12. To see how inflation volatility may be related to currency movements, the standard deviations of movements of exchange rate, import prices and consumer price inflation over different periods were compared (*Table 2*).

Table 2: Comparing the volatilities of exchange rates, import prices and consumer price inflation for different Asian economies¹

	From 1983 Q4 to 1996 Q4 (dollar peg)	From 1997 Q1 to 1998 Q4 (Asian Financial Crisis)	From 1999 Q1 to 2002 Q1	From 2002 Q2 to 2009 Q4 (dollar's downtrend)	From 2000 Q1 to 2009 Q4 (past 10 years)
Effective exchange rate index ² :					
US (broad)	6.6	3.6	2.9	5.6	5.7
US (major currencies)	7.9	2.7	4.2	7.3	7.7
HK	6.6	2.9	2.6	2.7	3.0
Korea	8.3	13.7	11.4	11.9	11.0
Singapore	5.1	1.4	3.3	2.4	2.3
Thailand ³	2.4	17.7	8.0	3.9	4.3
Taiwan	7.5	7.0	3.8	3.8	4.0
Import prices:					
HK	4.5	1.5	2.3	2.4	2.7
Korea	5.0	19.8	14.9	17.5	15.9
Singapore	4.6	2.2	5.2	5.1	5.3
Thailand	8.6	27.1	14.3	5.7	7.4
Taiwan	7.3	6.4	5.3	7.6	7.1
Consumer price inflation:					
HK	2.5	1.9	1.7	2.8	2.9
Korea	2.4	1.9	1.5	0.9	0.9
Singapore	1.4	1.4	0.9	2.2	2.0
Thailand	1.8	2.2	1.1	2.4	2.2
Taiwan	1.9	0.9	0.7	1.7	1.5

1. Volatility in terms of standard deviation of the year-on-year rates of change.

2. Due to data availability, the nominal effective exchange rate index was used for Korea, Singapore and Thailand, while the real effective exchange rate index was used for Taiwan.

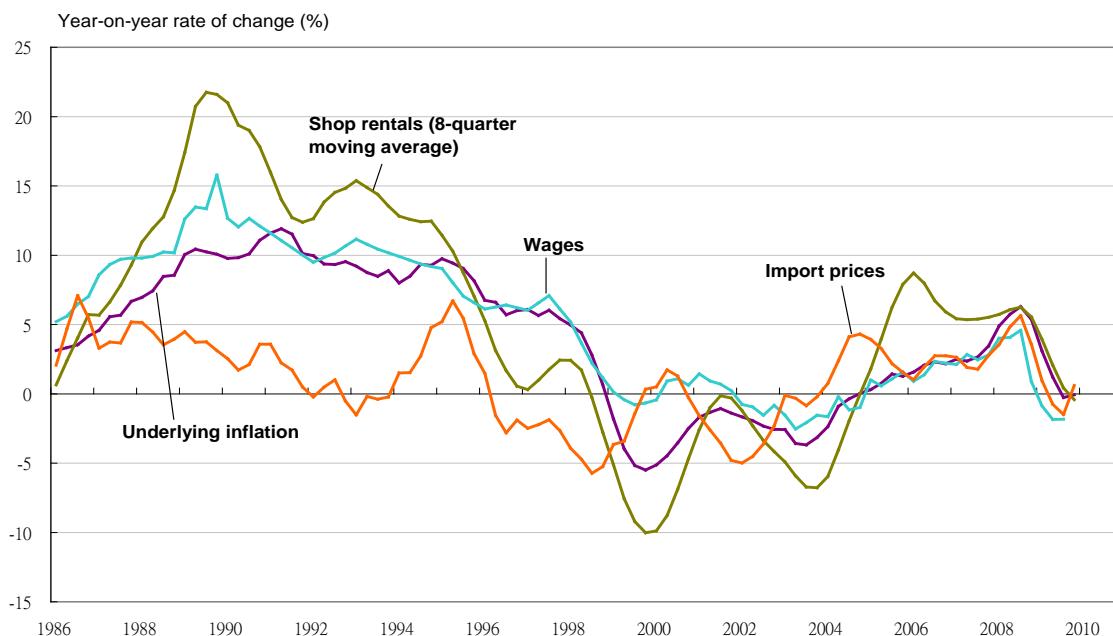
3. For Thailand, data are available only from 1990.

13. The currencies of Thailand and Korea were the most volatile across different periods, as they were the most vulnerable to speculative attack during the Asian financial crisis in 1997 due to the peg to the dollar, and de-linked from the dollar afterwards. The currencies of Singapore and Taiwan have been relatively more stable. While we have seen earlier that the volatility of import price movements for different economies is associated with exchange rate movements, inflation volatility is not necessarily a result of exchange rate and hence import price volatility. **For Hong Kong specifically, consumer price inflation generally exhibited slightly greater volatility than the other Asian economies, even though our import prices were more stable.** This is not surprising, which can be explained partly by the fact that imported inflation constitutes only a minor source of Hong Kong's CPI inflation (paragraph 14). The results are in fact consistent with the Granger causality tests (footnote (3) below) that point to a statistically insignificant linkage from import prices to consumer price inflation.

Decomposition of Hong Kong's CPI inflation

14. If imported inflation is not a major source of Hong Kong's consumer price inflation, then what is? **Chart 6** shows that Hong Kong's consumer price inflation is mainly driven by domestic costs (for details, please see **Table 3**). The results of Granger causality tests confirm that Hong Kong's consumer price inflation is largely explained by domestic factors such as wages and rentals⁽³⁾. Indeed, the surge in inflation in the 1990s was mainly a result of the buoyant economy, marked by sustained double-digit increases in both wages (10% per annum between 1987 and 1997) and rentals (11% per annum).

Chart 6: Hong Kong's consumer price inflation is driven more by domestic costs than import prices



(3) Granger causality tests were run using quarterly data from Q1 1983 to Q3 2009 and four lag periods. The results suggest significant Granger causality from wages and rentals to consumer price inflation both at the 1% level, but not from import prices.

Table 3: Rates of change in local costs and import prices

	Underlying CPI inflation	Year-on-year % change					Domestic	
		Import prices					Housing cost	Wages
		Food	Consumer goods	Food and consumer goods combined ¹	Fuel ²			
2003 Q1	-2.6	-3.1	-0.3	-1.3	8.9	-2.3	-1.5	
Q2	-3.6	-1.2	1.0	0.4	4.4	-3.4	-2.5	
Q3	-3.7	0.1	0.6	0.6	1.7	-7.9	-2.1	
Q4	-3.2	2.5	0.9	1.2	3.4	-5.6	-1.5	
2004 Q1	-2.4	3.9	0.5	1.6	3.2	-7.7	-1.6	
Q2	-0.9	3.6	0.6	1.3	5.0	-6.7	-0.2	
Q3	-0.4	4.1	1.6	2.2	8.6	-2.3	-1.2	
Q4	0.0	3.5	1.9	2.4	9.5	-3.9	-1.0	
2005 Q1	0.3	2.8	3.2	3.1	4.6	-2.6	1.0	
Q2	0.8	1.5	3.6	3.1	7.6	-0.9	0.6	
Q3	1.4	-0.3	2.9	2.0	8.1	1.1	1.1	
Q4	1.3	-0.4	1.8	1.1	9.6	2.8	1.6	
2006 Q1	1.6	-0.3	0.5	0.3	8.7	4.2	0.9	
Q2	2.1	0.6	0.1	0.1	7.6	4.9	1.4	
Q3	2.3	1.5	0.4	0.7	7.7	4.8	2.3	
Q4	2.2	3.0	1.1	1.8	-6.8	4.8	2.2	
2007 Q1	2.5	4.9	2.3	3.1	-4.2	4.8	2.1	
Q2	2.3	6.0	3.2	4.0	-5.7	4.6	2.8	
Q3	2.7	6.8	3.4	4.2	-5.5	4.3	2.5	
Q4	3.5	6.9	4.0	4.9	9.4	4.2	2.8	
2008 Q1	4.9	6.6	3.7	4.5	15.2	5.0	4.0	
Q2	5.7	7.4	4.1	5.0	16.9	6.0	4.1	
Q3	6.3	8.8	6.1	6.8	15.7	7.8	4.6	
Q4	5.4	7.4	5.6	6.2	-0.8	8.3	0.9	
2009 Q1	3.1	3.6	2.9	3.1	-16.6	6.6	-0.9	
Q2	1.2	2.0	0.6	1.1	-18.2	4.1	-1.9	
Q3	-0.3	-1.1	-2.1	-1.8	-16.3	1.4	-1.8	
Q4	-0.1	-1.0	-1.8	-1.4	-7.1	-0.2	N.A.	
Annual growth (%):								
2000	-3.9	-4.5	-1.6	-2.5	8.7	-8.2	0.5	
2001	-1.4	-3.0	-0.9	-1.5	0.6	-3.1	0.8	
2002	-2.1	-4.8	-3.1	-3.5	-1.3	-5.7	-1.0	
2003	-3.2	-0.4	0.6	0.2	4.6	-4.8	-1.9	
2004	-0.9	3.8	1.2	1.9	6.5	-5.2	-1.0	
2005	0.9	0.9	2.9	2.3	7.5	0.1	1.1	
2006	2.0	1.2	0.5	0.7	4.1	4.7	1.7	
2007	2.8	6.2	3.2	4.1	-1.7	4.5	2.6	
2008	5.6	7.5	4.9	5.6	11.5	6.8	3.4	
2009	1.0	0.8	-0.1	0.2	-14.7	2.9	-1.1	
Annual average trend growth (%):								
Before crisis (08/03)	2.1	3.9	2.5	2.9	5.5	2.1	1.5	
Past 5 years (09/04)	2.4	3.3	2.3	2.6	0.9	3.7	1.5	
Past 10 years (09/99)	0.0	0.7	0.7	0.7	2.3	-0.9	0.5	
Past 19 years (09/90)	3.0	0.4	0.8	0.7	3.7	3.7	3.5	

1. The combined series is weighted by the respective shares of food and consumer goods in the trade value of retained imports for local use in the base period.

2. Fuel-related subcomponents include motor fuel, LPG and towngas.

The computation cannot be traced back to years earlier than 1990, because the retained imports series used as weights in the base period start from 1989 only.

15. Assuming 100% of the import cost is passed through to the CPI level, the contribution of imported inflation to underlying inflation can be crudely estimated on the basis of the import contents of food, consumer goods and fuel in the consumption basket and their respective rates of change over time (**Table 4**).

Table 4: Decomposition of underlying CPI inflation into domestic and import sources

	Underlying CPI inflation	% share of retained imports of food and consumer goods in private consumption expenditure	Contribution to underlying inflation from (% pt):			Domestic sources [#]
			Imported sources	Fuel [@]	Combined	
2003 Q1	-2.6	21.3	-0.3	0.2	-0.1	-2.5
Q2	-3.6	20.3	0.1	0.1	0.2	-3.7
Q3	-3.7	23.6	0.1	0.0	0.2	-3.9
Q4	-3.2	22.6	0.3	0.1	0.3	-3.5
2004 Q1	-2.4	21.5	0.3	0.1	0.4	-2.8
Q2	-0.9	23.1	0.3	0.1	0.4	-1.3
Q3	-0.4	23.8	0.5	0.2	0.7	-1.0
Q4	0.0	20.5	0.5	0.2	0.7	-0.7
2005 Q1	0.3	21.9	0.7	0.1	0.7	-0.4
Q2	0.8	20.5	0.7	0.1	0.8	-0.1
Q3	1.4	24.0	0.5	0.1	0.6	0.8
Q4	1.3	22.3	0.2	0.2	0.4	0.9
2006 Q1	1.6	22.3	0.1	0.2	0.2	1.3
Q2	2.1	22.5	0.0	0.1	0.2	1.9
Q3	2.3	22.0	0.2	0.1	0.3	2.0
Q4	2.2	19.0	0.4	-0.1	0.3	1.9
2007 Q1	2.5	20.4	0.7	-0.1	0.6	1.9
Q2	2.3	22.0	0.9	-0.1	0.8	1.6
Q3	2.7	22.3	0.9	-0.1	0.8	1.9
Q4	3.5	20.3	0.9	0.2	1.1	2.4
2008 Q1	4.9	23.1	0.9	0.3	1.2	3.7
Q2	5.7	23.4	1.1	0.3	1.4	4.3
Q3	6.3	22.6	1.5	0.3	1.8	4.5
Q4	5.4	21.4	1.2	0.0	1.2	4.1
2009 Q1	3.1	18.0	0.7	-0.3	0.4	2.7
Q2	1.2	20.0	0.3	-0.4	-0.1	1.3
Q3	-0.3	23.3	-0.4	-0.3	-0.7	0.5
Q4	-0.1	24.6	-0.3	-0.1	-0.4	0.4
Annual growth (%):						
2000	-3.9	20.9	-0.5	0.1	-0.4	-3.6
2001	-1.4	21.2	-0.3	0.0	-0.3	-1.1
2002	-2.1	21.3	-0.7	0.0	-0.8	-1.4
2003	-3.2	22.0	0.1	0.1	0.1	-3.4
2004	-0.9	22.2	0.4	0.1	0.5	-1.4
2005	0.9	22.2	0.5	0.1	0.6	0.3
2006	2.0	21.4	0.2	0.1	0.2	1.8
2007	2.8	21.3	0.9	0.0	0.8	1.9
2008	5.6	22.6	1.2	0.2	1.4	4.2
2009	1.0	21.6	0.0	-0.3	-0.2	1.2
Annual average trend growth (%):						
Before crisis (08/03)	2.1	21.8	0.6	0.1	0.7	1.3
Past 5 years (09/04)	2.4	21.9	0.6	0.0	0.6	1.9
Past 10 years (09/99)	0.0	21.5	0.2	0.0	0.2	-0.2
Past 19 years (09/90)	3.0	22.9	0.2	0.1	0.2	2.8

(^) The contribution is crudely estimated by multiplying the rates of change of imported prices of food and consumer goods by the import content as proxied by the share of retained imports of food and consumer goods in private consumption expenditure in the base period.

(@) Actual figures extracted directly from fuel-components in the CPI series.

(#) The contribution by domestic sources is derived as residual.

16. Over the past ten years from 2000 to 2009, imported inflation contributed roughly around 0.2 percentage point to Hong Kong's underlying CPI inflation, assuming that import price changes are fully reflected in consumer prices. Except for 2007 and 2008 when Hong Kong was affected by a significant acceleration in food-led inflation caused by the global wide surge in food import prices, imported inflation was rarely a key source of Hong Kong's inflation. In fact, **the majority of contribution to consumer price inflation has for most of the time come from sources other than the imported components, i.e. the domestic components.** In particular, **for the past 19 years from 1990 to 2009, the average contribution of imported inflation to overall consumer price inflation is merely 0.2 percentage point out of the trend CPI inflation of around 3%.**

Concluding remarks

17. There is some concern over whether the linked exchange rate system and a renewed weakening of the US dollar may mount on Hong Kong's consumer price inflation, as a weaker Hong Kong dollar alongside the US dollar will mean higher import prices for Hong Kong. However, looking at past experience, Hong Kong's import prices have not exhibited greater volatility or larger increases compared with many other Asian economies, whether since the adoption of the dollar peg or the US dollar's latest downtrend in 2002. In fact, over the past 20 years or so, Hong Kong's import prices have tended to rise in line with world commodity prices, and the linked exchange rate system may have shielded Hong Kong's import prices from periods of extreme volatility such as the Asian Financial Crisis.

18. If past experience is anything to go by, imported inflation is rarely a major source of Hong Kong's consumer price inflation. Hong Kong's CPI inflation is driven more by domestic costs than import prices. From our ballpark estimation, even assuming 100% pass through, the contribution of imported inflation to consumer price inflation over the past 10 years is merely 0.2 percentage point. The long-term average covering the 19 years from 1990-2009 is likewise insignificant, also at around 0.2 percentage point. Except for 2007 and 2008 when Hong Kong faced a food-led inflation amidst the global wide surge in food prices, imported inflation seldom led to an upsurge in inflation in Hong Kong.

19. That the US dollar is bound to weaken is not necessarily a one-way bet, because the EU and Japan all have their own economic problems. So, unless the US dollar were to depreciate drastically, the threat to Hong Kong's CPI inflation should not be that significant. Some weakening in the US dollar would in fact help Hong Kong's exports and hence GDP growth, though it may also entail some pick-up in Hong Kong's imported inflation. Overall, while exchange rate movements are a relevant factor affecting import prices, our past experience suggests that Hong Kong's import prices have fared better than many Asian economies both in terms of stability and rate of increase, despite the US dollar's rough ride over the past 26 years.