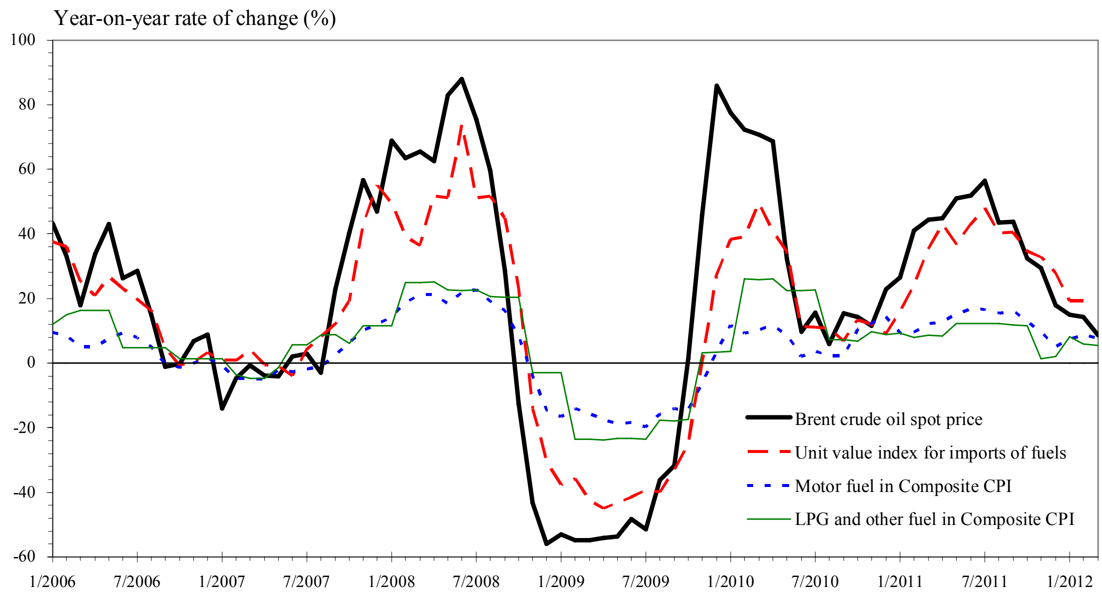
Box 6.1

Impact of oil price hikes on consumer price inflation in Hong Kong

International oil prices have undergone huge gyrations in recent years amid the fast-changing global economic environment as well as the occurrence of bouts of supply shocks emanating from the oil-producing countries. Such drastic swings in oil prices have been one of the key factors in driving the rise and fall of consumer price inflation in many economies around the globe over the past few years.

As Hong Kong's energy supplies are almost entirely from external sources, the fluctuations in international oil prices, which affect the import prices of fuels, will inevitably have some bearing on the consumer price inflation in Hong Kong. Among the components in the Composite CPI, "motor fuel" and "LPG and other fuel" are the two items directly affected by or closely associated with the movements of the oil prices in the international markets (**Chart 1**). Yet, taken together, these two items have a combined weighting of only 0.77% in the Composite CPI. Indeed, these two items contributed only 0.09 percentage point to the underlying inflation rate of 5.3% in 2011, while Brent crude oil price was on average nearly 40% higher than a year earlier. As such, the direct impact of international oil price movement on the Composite CPI should be rather limited.

Chart 1: Movements of oil-related consumer prices, import prices of fuel and international oil prices



There would also be some indirect or spill-over effects on consumer price inflation, when business operators pass part or all of the increase in fuel costs onto their customers should oil prices stay elevated for a period of time. The extent of pass-through will in turn be influenced by the prevailing demand conditions. Nevertheless, Hong Kong is a highly service-oriented economy and not very oil-dependent, with fuel cost accounting for an average of around 4% of the total business operating cost (or around 6% if labour cost is excluded) in 2010. Although the more energy-intensive industries such as transport services, accommodation and food services and fishery are more affected by oil price hike, the indirect impacts on business costs and inflation from higher oil prices should be rather moderate for the economy as a whole.

Box 6.1 (Cont'd)

Yet, the indirect impacts on local inflation from rising oil prices could also be manifested through other channels, such as higher price pressures from our major import sources as well as higher international food prices. For instance, higher oil prices could raise the costs along the supply chain of a multitude of products, including the expenses on packaging and transportation. Oil price hikes could also bolster the incentives in producing biofuel, thereby boosting the demand and hence prices of a number of food products, such as corn and sugar. In fact, the movements of the international food prices have been broadly in line with the ebb and flow of the oil prices over the past few years (**Chart 2**). All in all, higher oil prices might render some notable impacts on the local inflationary pressures at some point in time by directly pushing up the prices in oil-related products, and indirectly, also business costs and import prices. Given the notable price volatilities in the oil markets of late, we will continue to closely monitor the movements of global oil prices, and their possible impacts on the inflation in Hong Kong.

Chart 2: Movements of international oil and food prices