

CHAPTER 6 : PRICES

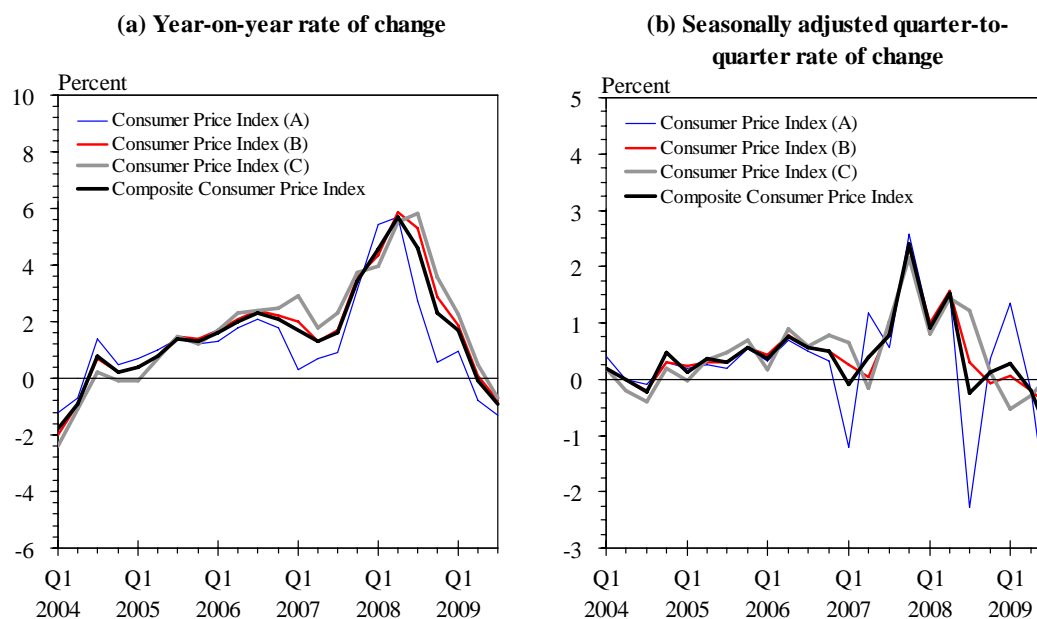
Summary

- *Inflationary pressure continued to recede in the third quarter of 2009 amidst the slack economic conditions, as both local and global economic activities were still notably below the levels before the financial tsunami. The headline Composite Consumer Price Index⁽¹⁾ (CCPI) declined by 0.9% in the third quarter from a year earlier. After netting out the effects of Government's one-off relief measures, underlying inflation also turned slightly negative, at -0.3%.*
- *The year-on-year decline in headline CCPI mainly reflected the electricity charge subsidy, softening food prices, continued falls in prices of durable goods and miscellaneous services, and slower rise in housing cost. Also, fuel prices, despite the recent rebound, were still distinctly below the levels a year earlier.*
- *Local business costs were contained. Wages were under downward pressure and business rental costs also decelerated. Meanwhile, imported inflation was virtually absent, as import prices in overall terms were lower than a year earlier.*

Consumer prices

6.1 The year-on-year decline in the headline *Composite Consumer Price Index* (CCPI) enlarged slightly from 0.1% in the second quarter of 2009 to 0.9% in the third quarter. Yet the headline index for September reverted to an increase of 0.5%, as the effects of the Government's subsidy on electricity charges began to fade out. Inflationary pressures were subdued, as import prices remained soft due to a weak global economy and as local business costs were also tamed. In fact, many other economies also recorded negative consumer price inflation in the third quarter⁽²⁾. Netting out the effects of Government's one-off relief measures, underlying consumer price inflation also turned slightly negative, to -0.3% in the third quarter from 1.2% in the second quarter. On a seasonally adjusted basis, the underlying deflationary pressures had tended to stabilise towards the end of the quarter.

Diagram 6.1 : Inflationary pressure continued to recede in the third quarter of 2009



**Table 6.1 : Consumer Price Indices
(year-on-year rate of change (%))**

		Composite CPI		CPI(A)	CPI(B)	CPI(C)
		Underlying ^(a)	Headline			
2008	Annual	5.6	4.3	3.6	4.6	4.7
	H1	5.3	5.1	5.6	5.1	4.7
	H2	5.8	3.5	1.6	4.1	4.7
	Q1	4.9 (2.0)	4.6 (0.9)	5.4 (1.0)	4.3 (1.0)	3.9 (0.8)
	Q2	5.7 (1.5)	5.7 (1.5)	5.7 (1.5)	5.9 (1.6)	5.5 (1.4)
	Q3	6.3 (1.3)	4.6 (-0.2)	2.7 (-2.3)	5.3 (0.3)	5.8 (1.2)
	Q4	5.4 (0.4)	2.3 (0.1)	0.6 (0.4)	2.9 (-0.1)	3.6 (0.1)
	2009	H1	2.1	0.8	0.1	1.0
	Q1	3.1 (-0.2)	1.7 (0.3)	1.0 (1.3)	1.9 (0.1)	2.2 (-0.5)
	Q2	1.2 (-0.3)	-0.1 (-0.2)	-0.8 (-0.2)	0.1 (-0.2)	0.5 (-0.3)
	Q3	-0.3 (-0.1)	-0.9 (-1.1)	-1.3 (-2.8)	-0.8 (-0.5)	-0.7 (0.1)

Notes : (a) The underlying consumer price inflation rates are calculated by netting out the effects of all relevant one-off measures, including the lower base effect of public housing rental waiver in February 2007, the rates concession of up to \$5000 per quarter in the second and third quarters of 2007, in 2008 and in the first quarter of 2009, up to \$1500 per quarter in the second and third quarters of 2009, Government's payment of public housing rentals for August to October 2008, August to September 2009, five-years' suspension of Employees Retraining Levy as from August 2008, and subsidies for household electricity charges as from September 2008.

Figures in brackets are the seasonally adjusted quarter-to-quarter rates of change.

6.2 Among the major components of the Composite CPI, the fall in electricity charges made a large contribution to the year-on-year decline in the Composite CPI in the third quarter. This mainly reflected the effect of Government's subsidy for household electricity charges, though it began to fade out in September. The drop in the prices of basic foodstuffs also contributed notably to the fall in CCPI, as did the prices of durable goods, miscellaneous services and transport. Private housing rentals decelerated further, reflecting the feed-through of the earlier correction of market rentals after the outbreak of the financial tsunami. In contrast, prices of miscellaneous goods, clothing and footwear, and alcoholic drinks and tobacco rose in the third quarter.

**Table 6.2 : Composite Consumer Price Index by component
(year-on-year rate of change (%))**

<u>Expenditure component</u>	<u>Weighting (%)</u>	<u>2008</u>				<u>2009</u>		
		<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>
Food	26.94	10.0	11.2	10.6	8.8	4.6	1.5	-0.5
<i>Meals bought away from home</i>	16.86	5.4	6.3	6.4	5.6	3.4	1.7	0.7
<i>Other foodstuffs</i>	10.08	17.4	19.2	17.2	13.8	6.5	1.2	-2.3
Housing ^(a)	29.17	3.9	5.9	3.9	2.7	6.6	4.5	1.7
		(5.0)	(6.0)	(7.8)	(8.3)	(6.6)	(4.1)	(1.4)
<i>Private dwellings</i>	23.93	3.5	8.0	9.5	6.4	7.7	5.1	2.0
		(6.9)	(7.9)	(9.5)	(9.9)	(7.7)	(4.7)	(1.6)
<i>Public dwellings</i>	2.49	14.4	-13.0	-63.6	-39.5	-0.2	0.6	-7.0
		(-10.8)	(-10.8)	(-3.7)	(0.2)	(0.2)	(0.2)	(0.2)
Electricity, gas and water	3.59	7.2	7.7	-5.3	-34.9	-42.7	-42.7	-26.1
		(7.2)	(7.7)	(7.3)	(1.7)	(-8.1)	(-8.2)	(-7.3)
Alcoholic drinks and tobacco	0.87	0.5	0.6	-0.2	-0.6	7.6	22.6	22.9
Clothing and footwear	3.91	1.6	1.6	0.7	-0.5	1.8	2.5	2.6
Durable goods	5.50	-3.5	-2.3	-1.0	-1.1	-2.9	-3.3	-3.1
Miscellaneous goods	4.78	4.6	5.3	5.6	4.7	3.2	2.3	1.7
Transport	9.09	1.3	2.5	4.0	2.1	0.7	-0.7	-2.4
Miscellaneous services	16.15	1.3	1.2	0.8	-0.3	-1.7	-3.0	-2.8
		(1.3)	(1.2)	(0.9)	(0.1)	(-1.1)	(-2.3)	(-2.1)
All items	100.00	4.6	5.7	4.6	2.3	1.7	-0.1	-0.9
		(4.9)	(5.7)	(6.3)	(5.4)	(3.1)	(1.2)	(-0.3)

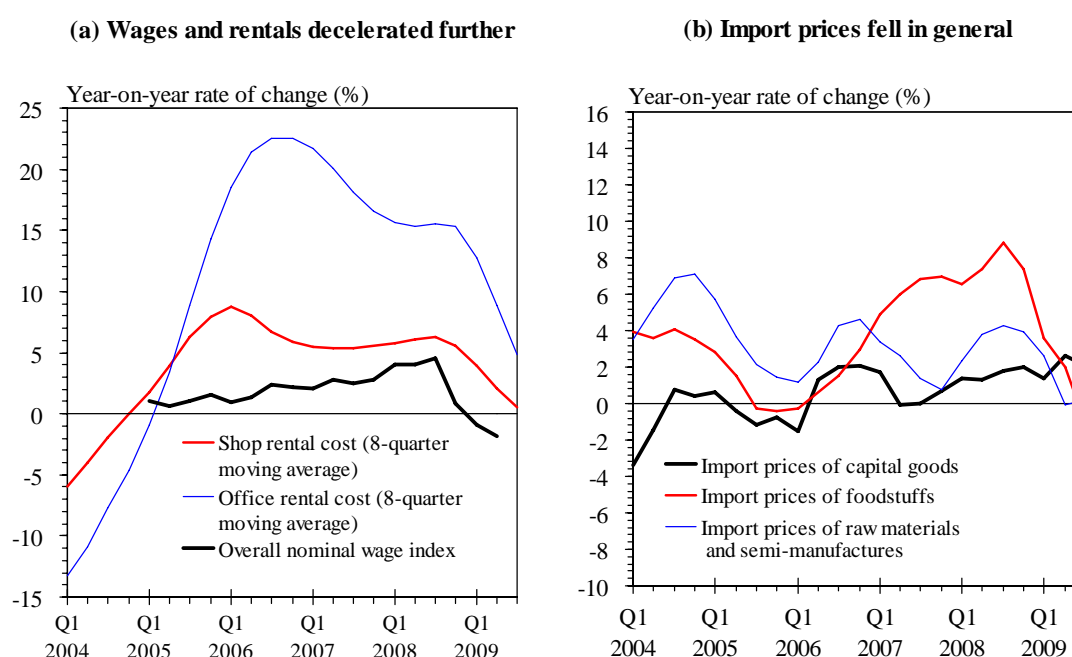
Notes : (a) The housing component covers rents, rates, Government rent, maintenance costs and other housing charges. Its sub-components on private and public dwellings as presented here, however, cover rents, rates and Government rent only. Hence, the combined weighting of private and public dwellings is slightly less than the weighting of the entire housing component.

Figures in bracket represent the underlying rate of change after netting out the effect of Government's one-off relief measures.

Costs of factor inputs and import prices

6.3 Business costs remained contained. The latest available statistics indicated that wages fell modestly in overall terms in June over a year earlier, while rental costs for retail premises and offices decelerated further. Indeed, market rentals in September, particularly for office space, were still below the peaks in mid-2008. As the economy was going through the necessary adjustments in the aftermath of the global financial crisis, wages and rentals, exhibiting remarkable flexibility, should help to increase the resilience of the local businesses and ensure a speedy recovery.

Diagram 6.2 : Costs of factor inputs and import prices



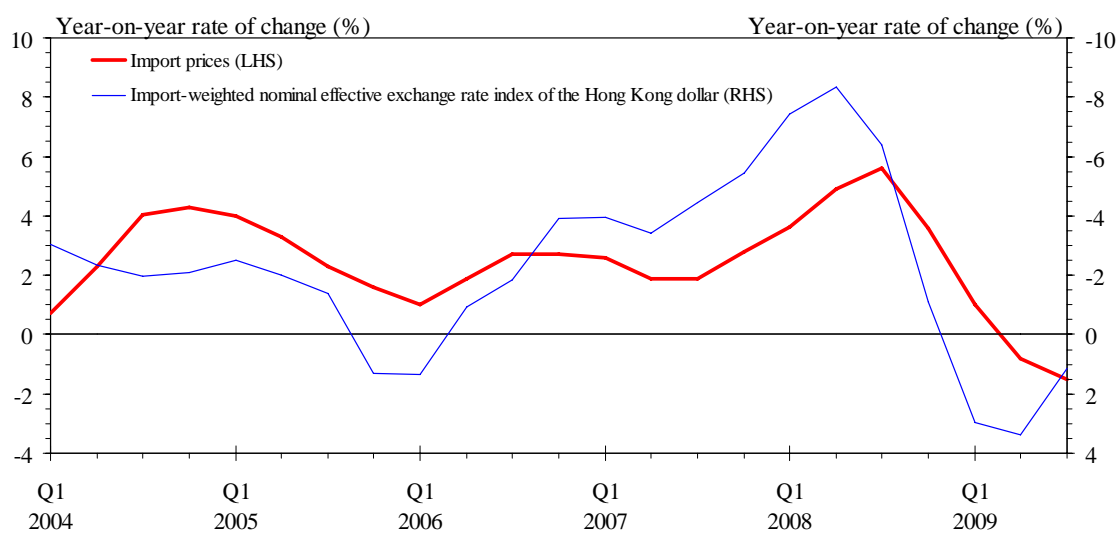
6.4 On the external front, import prices of most end-use categories fell in the third quarter over a year earlier, reflecting a weak global economy. As for individual end-use categories, import prices of foodstuffs and consumer goods turned into small declines, whereas those of raw materials registered a slight increase. Import prices of fuels were still markedly lower than a year earlier. On the other hand, import prices of capital goods continued to post a modest increase.

**Table 6.3 : Prices of imports by end-use category
(year-on-year rate of change (%))**

		<u>Foodstuffs</u>	<u>Consumer goods</u>	<u>Raw materials</u>	<u>Fuels</u>	<u>Capital goods</u>	<u>All</u>
2008	Annual	7.5	4.8	3.6	33.0	1.6	4.4
	H1	7.0	3.9	3.1	51.2	1.3	4.3
	H2	8.0	5.8	4.1	18.1	1.9	4.6
	Q1	6.6	3.7	2.3	41.5	1.4	3.6
	Q2	7.4	4.1	3.8	59.3	1.3	4.9
	Q3	8.8	6.1	4.3	49.0	1.8	5.6
	Q4	7.4	5.6	3.9	-7.6	2.0	3.6
2009	H1	2.8	1.7	1.1	-41.5	2.1	*
	Q1	3.6	2.9	2.6	-38.8	1.4	1.0
	Q2	2.0	0.6	-0.1	-43.2	2.6	-0.8
	Q3	-1.1	-2.1	0.2	-37.6	2.1	-1.5

Note: (*) Change of less than 0.05%.

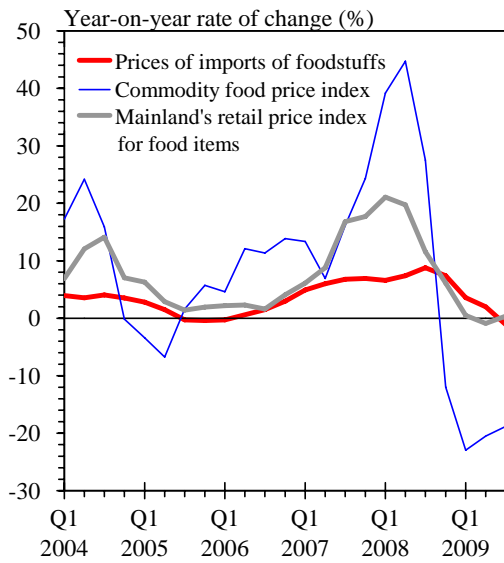
Diagram 6.3 : Import prices down further, mainly reflecting a weak global economy although exchange rates also contributed



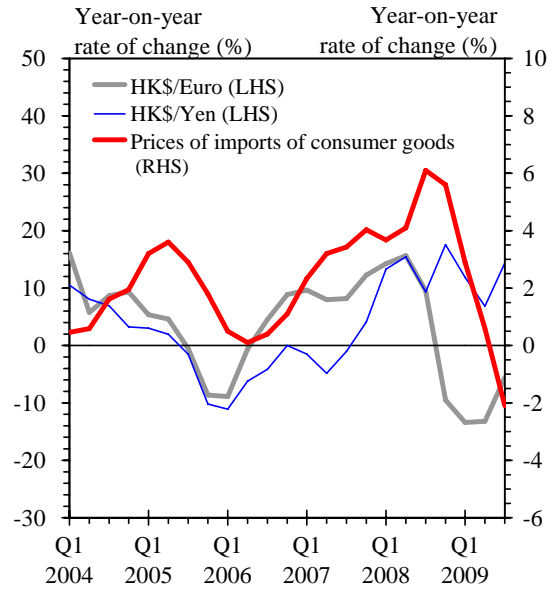
Note: An increase in the nominal EERI indicates strengthening of the Hong Kong dollar. The y-axis of nominal EERI in this graph is inverted for easier comprehension.

Diagram 6.4 : Import prices by end-use categories

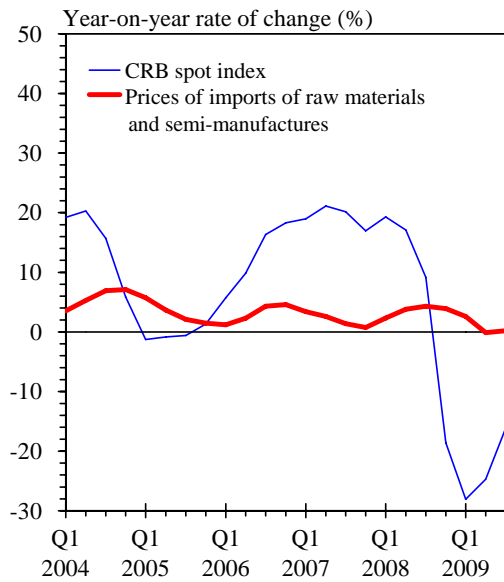
(a) Import prices of foodstuffs fell slightly



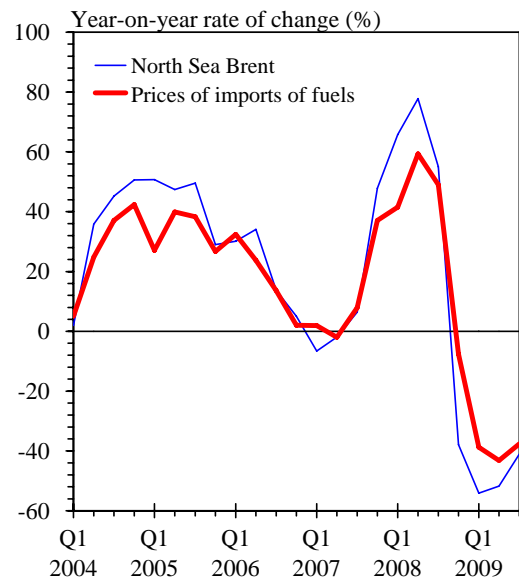
(b) Import prices of consumer goods decreased modestly



(c) Import prices of raw materials edged up slightly



(d) Fuel prices rebounded but were still markedly lower than a year ago

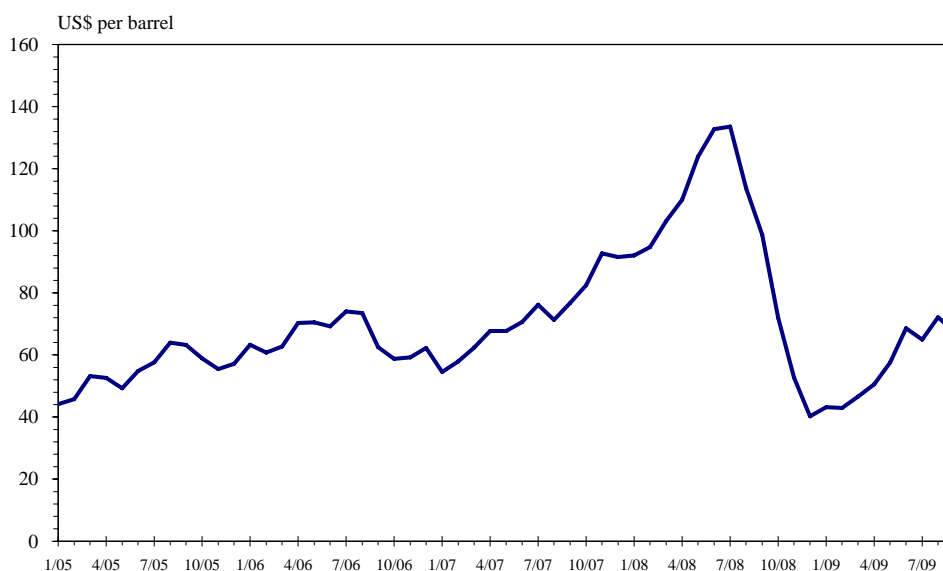


Box 6.1

Impact of recent oil price movements on consumer price inflation

International oil prices, like many other commodity prices, are usually volatile, and sensitive to changes in economic climate. Since the late 1990s, crude oil prices had been on an uptrend amidst large fluctuations, as a result of the fast growing demand from the emerging economies and the tight demand-supply balance. Despite the slowdown in the major advanced economies since early 2008, crude oil prices ran up further and reached a historic high in July 2008, before the correction set in. The outbreak of the global financial tsunami and the subsequent global synchronised recession also accelerated the fall in oil prices. The spot price of Brent crude oil, for instance, plummeted within six months from its peak of around US\$145 per barrel to a trough of less than US\$40 per barrel in December 2008. Crude oil prices then rebounded notably since March this year as global economic outlook improved. Over the past several months, oil prices fluctuated at around US\$70 per barrel, with a further advance to around US\$75 towards the end of October.

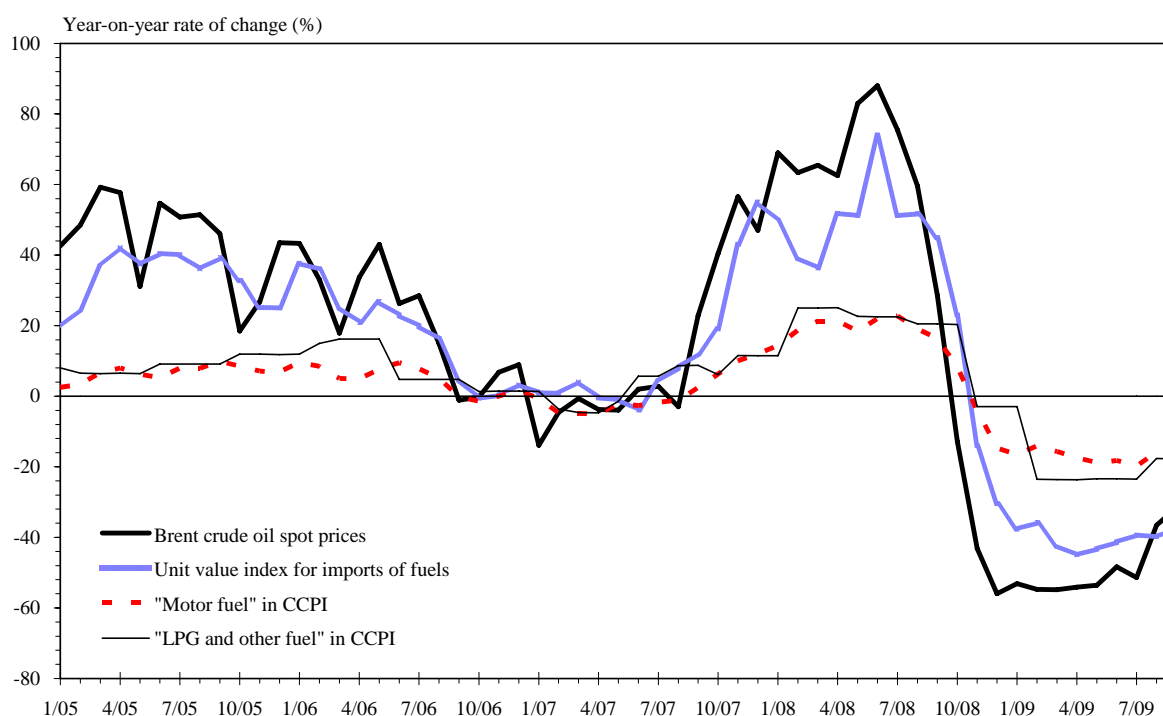
Chart 1 : The spot price of Brent crude oil (monthly average)



The prices of several items in the consumer price indices, such as “motor fuel” and “LPG and other fuel”, are directly affected by or closely related to the movements of oil prices. These items together, however, have a small combined weighting of 0.89% in the Composite CPI. The changes in crude oil prices affect the import prices of fuels, which in turn lead to the adjustments in the prices of the fuel-related items at the consumer level. Past experience, as indicated in *Chart 2*, suggests that crude oil prices, import prices of fuels and the prices of fuel-related items at the consumer level tend to move broadly together. Nevertheless, as illustrated in *Chart 2*, the prices of fuel-related items at consumer level usually exhibit a much smaller degree of fluctuations than crude oil prices and import prices of fuels, mainly because the purchase costs of fuels only make up a fraction of the retail prices of the fuel-related products for final consumption. Other factors also account for the incomplete feed-through of the changes in crude oil prices to the local consumer prices of the fuel-related items: (1) exchange rates of Hong Kong dollar against the currencies of the import sources; and (2) movements in refinery and production costs as reflected by differences between prices of crude oil and refined oil products.

Box 6.1 (Cont'd)

Chart 2 : Movements of fuel-related consumer prices, import prices of fuels and international oil prices



Given the highly service-oriented nature of the Hong Kong economy, the direct impacts of oil prices on consumer prices are usually not significant. In the second quarter of 2008, when the underlying Composite CPI inflation rate was 5.7% and oil prices had significant increases over a year earlier, the contribution from the fuel-related products to the inflation rate was just 0.19 percentage point.

As oil prices were still notably lower than their year-ago levels in the third quarter of 2009, the contribution of fuel-related items to consumer price inflation had turned negative. Yet with the underlying inflation rate coming down to very low levels, at -0.3% in the third quarter, the negative contribution from the fuel-related items to consumer price inflation, at -0.18 percentage point, became relatively more evident.

The risks of a sustained price surge from current levels should be largely contained by large excess capacity and high inventories, unless there is a significant change in the oil market outlook. If crude oil prices are to stay at the recent levels of US\$70-80 per barrel in the coming months (the IMF assumed a simple average price of US\$76.5 per barrel in 2010 for UK Brent, Dubai and West Texas Intermediate crude oil in its latest World Economic Outlook), they will be notably higher than the year-ago levels and the contribution of fuel-related items to consumer price inflation will likely turn from negative to positive, reducing to some extent the deflationary pressure in the economy.

Output prices

6.5 Output prices, as measured by *Producer Price Indices*⁽³⁾, fell further in the second quarter of 2009 across a wide range of economic sectors. Prices of manufacturing output fell in recent periods, reflecting the weakened import demand throughout the world. Among the service sectors, most of them recorded decreases in output prices in the second quarter. Output prices of accommodation services fell notably, due to the weak inbound tourism amidst concerns about human swine flu in that quarter. Output prices of land, maritime and air transport also declined markedly, promptly in response to the plunge in global trade flows after the outbreak of the financial tsunami. Meanwhile, the secular downtrend in the prices of telecommunications services continued. In contrast, prices of courier services posted a slight increase.

Table 6.4 : Producer Price Indices for the local manufacturing sector and selected service sectors (year-on-year rate of change (%))

<u>Industry group</u>	<u>Annual</u>	<u>2008</u>				<u>2009</u>	
		<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>	<u>Q1</u>	<u>Q2</u> ^(@)
Manufacturing	5.6	5.9	6.9	5.8	3.9	-1.4	-3.0
Selected services sector ^(a)							
Accommodation services	7.8	11.1	10.7	10.7	-0.5	-7.0	-10.8
Land transport	0.4	0.6	1.5	1.1	-1.5	-0.6	-1.5
Maritime transport	2.1	5.3	3.1	3.4	-3.1	-12.7	-20.4
Air transport	5.1	3.3	8.8	9.0	-0.5	-10.3	-17.5
Telecommunications	-2.6	-1.8	-2.0	-3.4	-3.2	-2.5	-2.8
Courier services	3.5	3.9	4.4	4.1	1.8	2.1	1.9

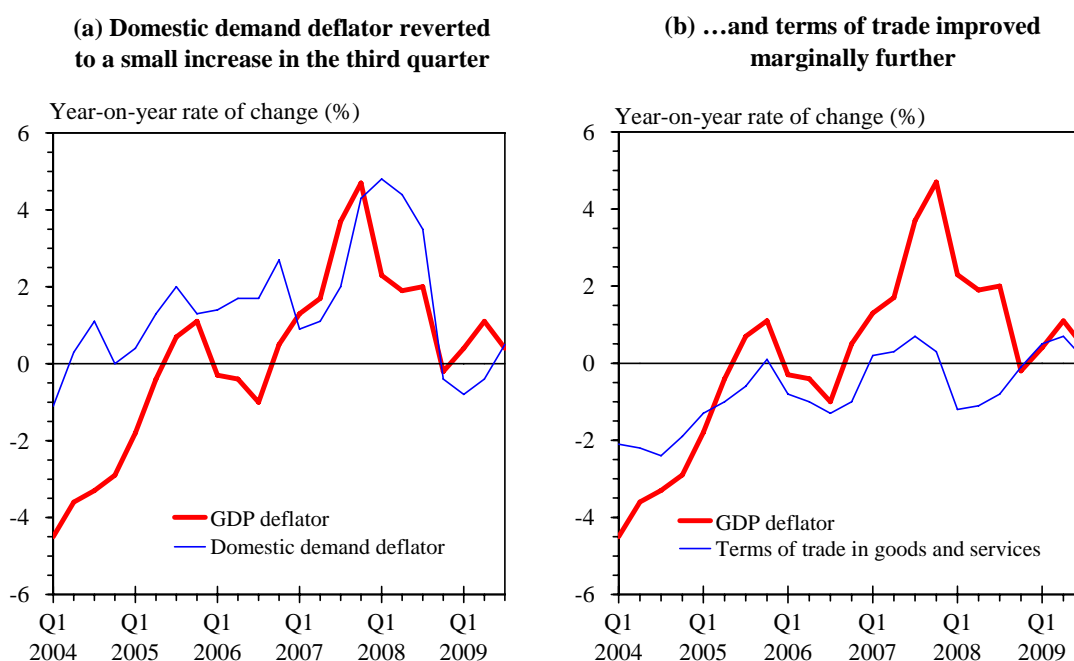
Notes: (a) Producer Price Indices for other service sectors are not available, due to the difficulties involved in defining and delineating the various types of services and hence in measuring their respective price changes. This is particularly so for such sectors as banking and insurance, where the producers often do not charge their customers explicitly.

([@]) Provisional figures except manufacturing.

GDP deflator

6.6 As a broad measure of the overall change in prices of the economy, the *GDP deflator*⁽⁴⁾ increased slightly by 0.4% year-on-year in the third quarter of 2009, after an increase of 1.1% in the second quarter. The domestic demand deflator increased by 0.5% in the third quarter of 2009, largely reflecting the increase in the price deflator for machinery and equipment investment. Meanwhile, as prices of exports of goods and services decreased slightly more slowly than those of imports, the *terms of trade*⁽⁵⁾ improved marginally by 0.1% over a year earlier.

Diagram 6.5 : GDP deflator



**Table 6.5 : GDP deflator and the main expenditure component deflators
(year-on-year rate of change (%))**

	<u>2008</u>					<u>2009</u>		
	<u>Annual</u>	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>	<u>Q1</u>	<u>Q2[#]</u>	<u>Q3⁺</u>
Private consumption expenditure	2.8	4.9	5.2	3.3	-1.4	-1.0	-1.8	-2.0
Government consumption expenditure	5.2	4.2	5.5	6.0	5.0	4.2	0.7	-0.2
Gross domestic fixed capital formation	1.8	4.9	-0.3	3.0	0.3	-2.3	4.7	8.5
Total exports of goods	3.4	2.3	3.4	4.4	3.3	1.8	-0.3	-1.0
Imports of goods	4.1	3.4	4.6	5.4	3.1	-0.1	-2.2	-2.1
Exports of services	3.0	3.6	4.4	5.0	-0.6	-7.3	-8.0	-6.3
Imports of services	4.1	6.3	6.2	5.4	-1.1	-6.1	-5.9	-3.0
Gross Domestic Product	1.4	2.3	1.9	2.0	-0.2	0.4	1.1	0.4
		<-1.5>	<0.6>	<0.9>	<-0.2>	<-0.8>	<1.3>	<0.1>
Total final demand	3.2	3.2	3.9	4.3	1.7	-0.5	-1.4	-1.4
Domestic demand	3.0	4.8	4.4	3.5	-0.4	-0.8	-0.4	0.5

Notes : Figures are derived based on the new series of chain volume measures of GDP. They are subject to revisions when more data become available.

(#) Revised figures.

(+) Preliminary figures.

< > Seasonally adjusted quarter-to-quarter % change.

Notes :

- (1) The Consumer Price Indices (A), (B) and (C) are compiled by reference to the average expenditure patterns for different groups of households as obtained from the Household Expenditure Survey. Then, by aggregating the expenditure patterns of all the households covered by the above three indices, a Composite CPI is compiled.

The expenditure ranges of the households covered in the 2004/05-based CPIs are shown below:

	<u>Approximate proportion of households covered</u>	<u>Average monthly expenditure range during Oct 2004 to Sep 2005</u>
	(%)	(\$)
CPI(A)	50	4,000 to 15,499
CPI(B)	30	15,500 to 27,499
CPI(C)	10	27,500 to 59,999

The weightings of the various components in the 2004/05-based CPIs are as follows:

<u>Expenditure Component</u>	<u>Composite CPI</u>	<u>CPI(A)</u>	<u>CPI(B)</u>	<u>CPI(C)</u>
	(%)	(%)	(%)	(%)
Food	26.94	32.10	27.32	20.41
<i>Meals bought away from home</i>	<i>16.86</i>	<i>18.63</i>	<i>17.65</i>	<i>13.74</i>
<i>Other foodstuffs</i>	<i>10.08</i>	<i>13.47</i>	<i>9.67</i>	<i>6.67</i>
Housing	29.17	30.54	27.70	29.66
<i>Private dwellings</i>	<i>23.93</i>	<i>22.07</i>	<i>23.89</i>	<i>26.11</i>
<i>Public dwellings</i>	<i>2.49</i>	<i>6.18</i>	<i>1.25</i>	<i>--</i>
<i>Maintenance costs and other housing charges</i>	<i>2.75</i>	<i>2.29</i>	<i>2.56</i>	<i>3.55</i>
Electricity, gas and water	3.59	4.84	3.37	2.45
Alcoholic drinks and tobacco	0.87	1.35	0.79	0.42
Clothing and footwear	3.91	2.81	4.28	4.67
Durable goods	5.50	4.01	5.67	6.99
Miscellaneous goods	4.78	4.68	4.76	4.91
Transport	9.09	8.07	9.05	10.35
Miscellaneous services	16.15	11.60	17.06	20.14
All items	100.00	100.00	100.00	100.00

- (2) The table below presents the year-on-year rates of consumer price inflation in selected economies.

	<u>2008</u>		<u>2009</u>				
	<u>Annual</u>	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Jul</u>	<u>Aug</u>	<u>Sep</u>
Selected developed economies							
US	3.8	*	-1.2	-1.6	-2.1	-1.5	-1.3
Canada	2.3	1.2	0.1	-0.9	-0.9	-0.8	-0.9
EU	3.7	1.6	0.9	0.4	0.2	0.6	0.3
Japan	1.4	-0.1	-1.0	-2.2	-2.2	-2.2	-2.2
Major emerging economies							
Mainland China	5.9	-0.6	-1.5	-1.3	-1.8	-1.2	-0.8
Russia	14.1	13.7	12.4	11.4	12.0	11.6	10.7
India	8.3	9.4	8.9	11.8	11.9	11.7	11.6
Brazil	5.7	5.8	5.2	4.4	4.5	4.4	4.3
Selected Asian economies							
Hong Kong	4.3	1.7	-0.1	-0.9	-1.5	-1.6	0.5
Singapore	6.5	2.1	-0.5	-0.4	-0.5	-0.3	-0.4
Taiwan	3.5	*	-0.8	-1.3	-2.3	-0.8	-0.9
South Korea	4.7	3.9	2.8	2.0	1.6	2.2	2.2
Malaysia	5.4	3.7	1.3	-2.3	-2.4	-2.4	-2.0
Thailand	5.5	-0.2	-2.8	-2.2	-4.4	-1.0	-1.0
Indonesia	9.8	8.6	5.6	2.8	2.7	2.8	2.8
Philippines	9.3	6.9	3.2	0.3	0.2	0.1	0.7
Vietnam	23.1	14.4	6.2	2.6	3.3	2.0	2.4
Macao	8.6	3.3	1.8	-0.2	0.2	0.4	-1.0

Note: (*) Change of less than 0.05%.

- (3) The Producer Price Index is designed to reflect changes in the prices of goods and services received by local producers. Producer prices refer to the transacted prices, net of any discounts or rebates allowed to the buyers. Transportation and other incidental charges are not included.
- (4) The implicit price deflators of GDP and its main expenditure components are derived by dividing GDP at current prices by the corresponding chained-dollar figures. The rate of change in the GDP deflator may differ substantially from that in the Composite CPI over the same time span. The Composite CPI covers consumer price inflation in particular. Yet the GDP deflator is a much broader measure of inflation for the entire economy, and takes into account all the price changes related to consumption, investment, exports and imports. Also, the rate of change in the GDP deflator may differ appreciably from that in the total final demand deflator, depending on the movement in the prices of final demand and imports. Likewise, the rate of change in the GDP deflator may differ appreciably from that in the domestic demand deflator, depending on the movement in the prices of imports and exports.
- (5) The terms of trade is defined as the ratio of the prices of total exports to the prices of total imports.