CHAPTER 6 : PRICES

Summary

- *The economy experienced a moderate climb-up in inflationary pressure in the second quarter of 2010, amid a sustained strong revival in activities. The headline Composite Consumer Price Index rose faster, by 2.6% in the second quarter over a year earlier. Part of such faster increase was nevertheless due to a distinctly low base caused by the significant loading of Government relief measures in the second quarter of 2009. After netting out the effects of the Government's one-off relief measures, underlying inflation as a more accurate indicator of the inflation trend picked up only modestly, from 0.8% in the first quarter to 1.5% in the second quarter.*

- *Wages and salaries resumed modest increases, while rentals for retail premises and offices advanced further. Yet both labour and rental costs remained largely commensurate when matched against the concurrent brisk growth in business volume and in labour productivity.*

- *Import prices in overall terms rose quite notably in the second quarter, adding inflationary pressure from the external front. The faster year-on-year increase again reflected partly the lower base of comparison a year earlier but the trend of higher prices for raw materials and fuels in the world markets was still evident. Import prices of foodstuffs and consumer goods also accelerated moderately.*

Consumer prices

6.1 Headline consumer price inflation, as measured by the year-on-year rise in the headline *Composite Consumer Price Index*[(1)] (Composite CPI), notched up further from 1.9% in the first quarter to 2.6% in the second quarter. Netting out the effects of the Government's one-off relief measures to give a more accurate indicator of the inflation trend, underlying consumer price inflation, as measured by the year-on-year increase in the underlying Composite CPI, notched up from 0.8% in the first quarter to 1.5% in the second quarter. The effect of the electricity charge subsidy, which faded out progressively, largely accounted for the difference between the headline and underlying inflation rates. The higher inflationary pressure in the second quarter took place under the backdrop of the increasingly entrenched recovery of the local economy and a vibrant consumption market. Moreover, the robust performance of Asian economies also contributed to somewhat stronger price pressure in the region[(2)].

Diagram 6.1 : Inflationary pressures edged up further in the second quarter of 2010

(a) Year-on-year rate of change **(b) Seasonally adjusted quarter-to-quarter rate of change**

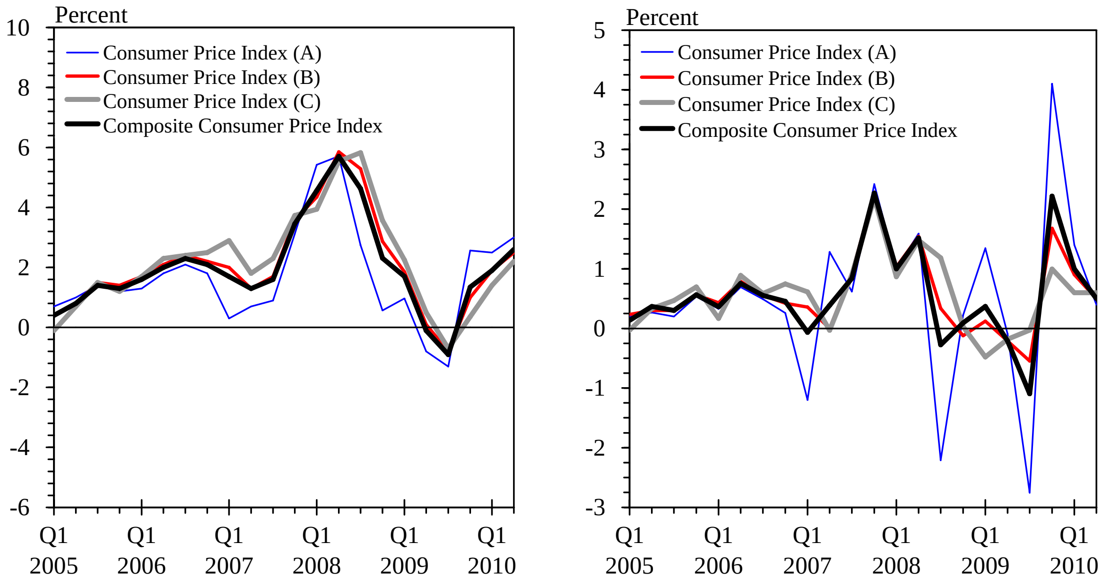


Table 6.1 : Consumer Price Indices
(year-on-year rate of change (%))

		Composite CPI		CPI(A)	CPI(B)	CPI(C)
		Underlying[(a)]	Headline			
2009	Annual	1.0	0.5	0.4	0.5	0.6
	H1	2.1	0.8	0.1	1.0	1.4
	H2	-0.2	0.2	0.6	0.1	-0.1
	Q1	3.1 (-0.1)	1.7 (0.4)	1.0 (1.3)	1.9 (0.1)	2.2 (-0.5)
	Q2	1.2 (-0.3)	-0.1 (-0.2)	-0.8 (-0.1)	0.1 (-0.2)	0.5 (-0.2)
	Q3	-0.3 (-0.2)	-0.9 (-1.1)	-1.3 (-2.8)	-0.8 (-0.5)	-0.7 (*)
	Q4	-0.1 (0.5)	1.3 (2.2)	2.6 (4.1)	1.0 (1.7)	0.4 (1.0)
2010	H1	1.2	2.2	2.8	2.2	1.8
	Q1	0.8 (0.7)	1.9 (1.0)	2.5 (1.4)	1.9 (0.9)	1.4 (0.6)
	Q2	1.5 (0.5)	2.6 (0.5)	3.0 (0.4)	2.5 (0.5)	2.2 (0.6)

Notes : (a) Underlying consumer price inflation is calculated by netting out the effects of all relevant one-off measures introduced since 2007, including the waiver and Government's payment of public housing rentals, rates concession, suspension of Employees Retraining Levy, and subsidies for household electricity charges.

( ) Seasonally adjusted quarter-to-quarter rate of change.

(*) Change of less than 0.05%.

6.2 On a year-on-year comparison, most major components of the underlying Composite CPI recorded price increases. Food prices showed a larger increase, partly due to the general uptrend in international prices, as well as the adverse weather conditions in some import sources of basic foodstuffs. Prices of miscellaneous services also showed a faster increase, mainly driven by higher prices for package tours, as well as other entertainment and holiday expenses. Private housing cost resumed a marginal increase, reflecting the gradual feed-through from the continued increase in market rentals after the first quarter of 2009. The faster increases in the prices of the transport component and the component of electricity, gas and water were due mainly to higher utility and fuel prices. In contrast, the increase in the prices of alcoholic drinks and tobacco tapered notably from the earlier surge arising from higher duty on cigarettes. Meanwhile, the secular downtrend of prices for durable goods continued.

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

Expenditure component	Weighting (%)	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2
Food	26.94	4.6	1.5	-0.5	-0.3	1.1	2.0
Meals bought away from home	*16.86*	3.4	1.7	0.7	0.6	0.8	1.4
Other foodstuffs	*10.08*	6.5	1.2	-2.3	-1.5	1.5	2.8
Housing[(a)]	29.17	6.6	4.5	1.7	1.9	-0.1	0.3
		(6.6)	(4.1)	(1.4)	(-0.2)	(-0.4)	(0.2)
Private dwellings	*23.93*	7.7	5.1	2.0	0.0	0.0	0.4
		(7.7)	(4.7)	(1.6)	(-0.4)	(-0.4)	(0.4)
Public dwellings	*2.49*	-0.2	0.6	-7.0	45.4	0.6	-0.3
		(0.2)	(0.2)	(0.2)	(0.0)	(0.0)	(-0.2)
Electricity, gas and water	3.59	-42.7	-42.7	-26.1	32.3	61.1	64.0
		(-8.1)	(-8.2)	(-7.3)	(-2.9)	(5.3)	(6.4)
Alcoholic drinks and tobacco	0.87	7.6	22.6	22.9	22.0	13.1	0.8
Clothing and footwear	3.91	1.8	2.5	2.6	3.7	1.4	2.0
Durable goods	5.50	-2.9	-3.3	-3.1	-2.8	-1.7	-1.6
Miscellaneous goods	4.78	3.2	2.3	1.7	1.9	2.0	2.3
Transport	9.09	0.7	-0.7	-2.4	-1.0	1.1	1.7
Miscellaneous services	16.15	-1.7	-3.0	-2.8	-0.7	0.5	2.1
		(-1.1)	(-2.3)	(-2.1)	(-0.1)	(1.1)	(2.5)
All items	100.00	1.7	-0.1	-0.9	1.3	1.9	2.6
		(3.1)	(1.2)	(-0.3)	(-0.1)	(0.8)	(1.5)

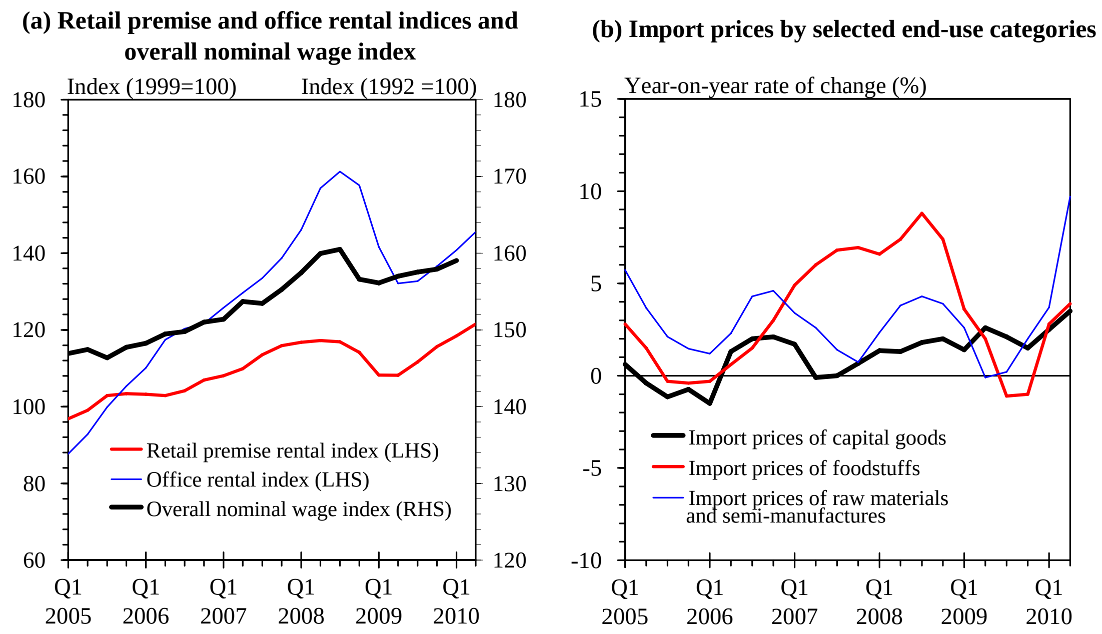
Notes : (a) The housing component covers rents, rates, Government rent, maintenance costs and other housing charges. Its sub-components on private and public dwellings as presented here, however, cover rents, rates and Government rent only. Hence, the combined weighting of private and public dwellings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

( ) 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 Wages and salaries rose modestly further in the first quarter of 2010, after resuming slight increases in the final quarter of last year. In the second quarter, rents of both retail premises and offices also picked up further. Nonetheless, the pressures on business costs arising from higher wages and rentals should still be largely contained on a unit cost basis, judging from the fast pace of expansion in business volume as well as productivity growth across many sectors in the second quarter.

Diagram 6.2 : Local cost pressures increased slightly but still remained contained, while import prices picked up further



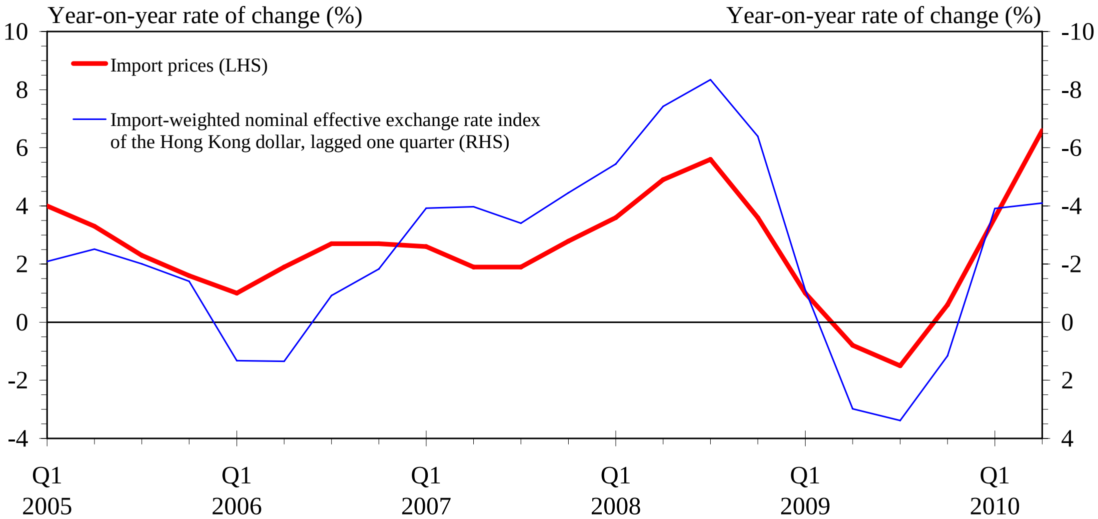
6.4 On the external front, import prices increased by 6.6% in the second quarter over a year earlier, faster than the 3.6% increase in the first quarter. Import prices of most major end-use categories saw larger year-on-year increases in the second quarter, particularly those of raw materials. This was conceivably due to the robust performance of the Asian economies, exerting stronger price pressures on raw materials on a region-wide basis. Import prices of consumer goods and foodstuffs accelerated moderately, partly reflecting the weaker Hong Kong dollar and partly higher global food prices. Meanwhile, import prices of fuels continued to increase markedly in the second quarter, when compared against the low base of comparison in the same period last year (***Box 6.1***).

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

		Foodstuffs	Consumer goods	Raw materials	Fuels	Capital goods	All
2009	Annual	0.9	-0.2	1.2	-32.1	2.0	-0.1
	H1	2.8	1.7	1.1	-41.5	2.1	*
	H2	-1.0	-1.9	1.1	-23.1	1.8	-0.5
	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
	Q4	-1.0	-1.8	2.0	-3.6	1.5	0.6
2010	H1	3.4	2.4	7.0	35.0	3.0	5.2
	Q1	2.8	1.1	3.7	42.8	2.5	3.6
	Q2	3.9	3.7	9.7	27.7	3.5	6.6

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

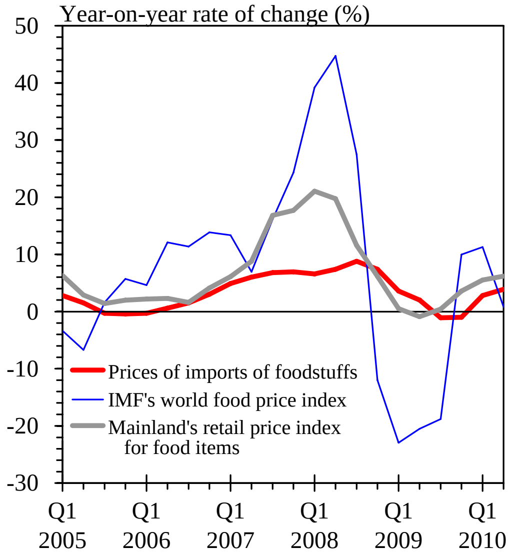
Diagram 6.3 : Import prices rose faster in the second quarter, partly due to a weaker Hong Kong dollar



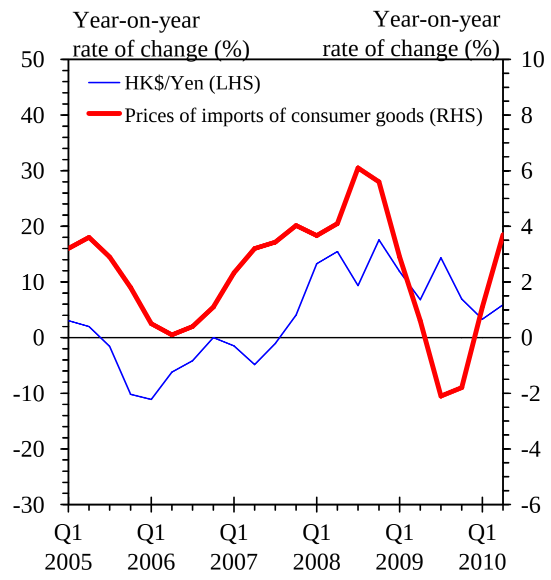
Note: An increase in the nominal EERI indicates strengthening of the Hong Kong dollar. The y-axis of nominal EERI in this graph is inverted for easier comprehension.

Diagram 6.4 : Import prices by end-use categories

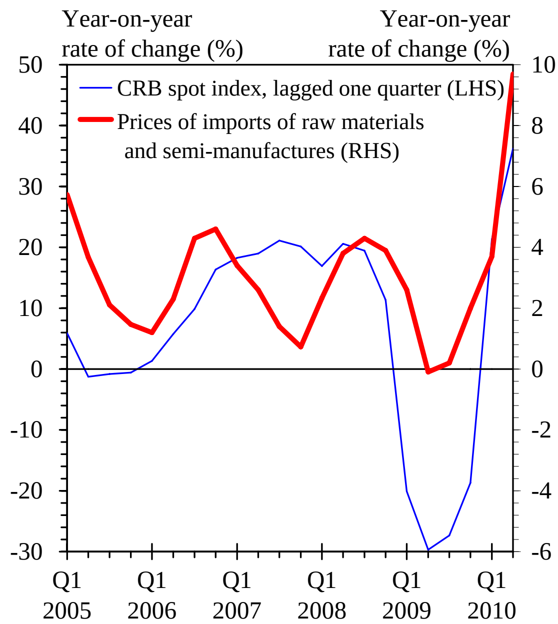
(a) Import prices of foodstuffs increased further along with world food prices



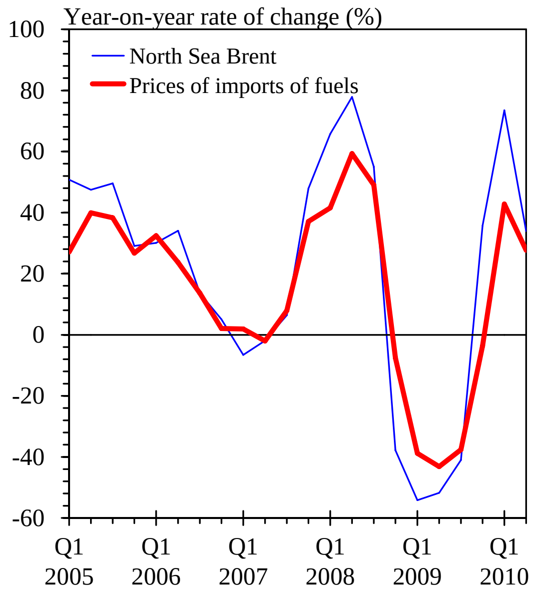
(b) Import prices of consumer goods picked up moderately



(c) Import prices of raw materials went up notably



(d) Fuel prices were distinctly higher than the low base a year earlier, but still markedly below the 2008 peaks



Box 6.1

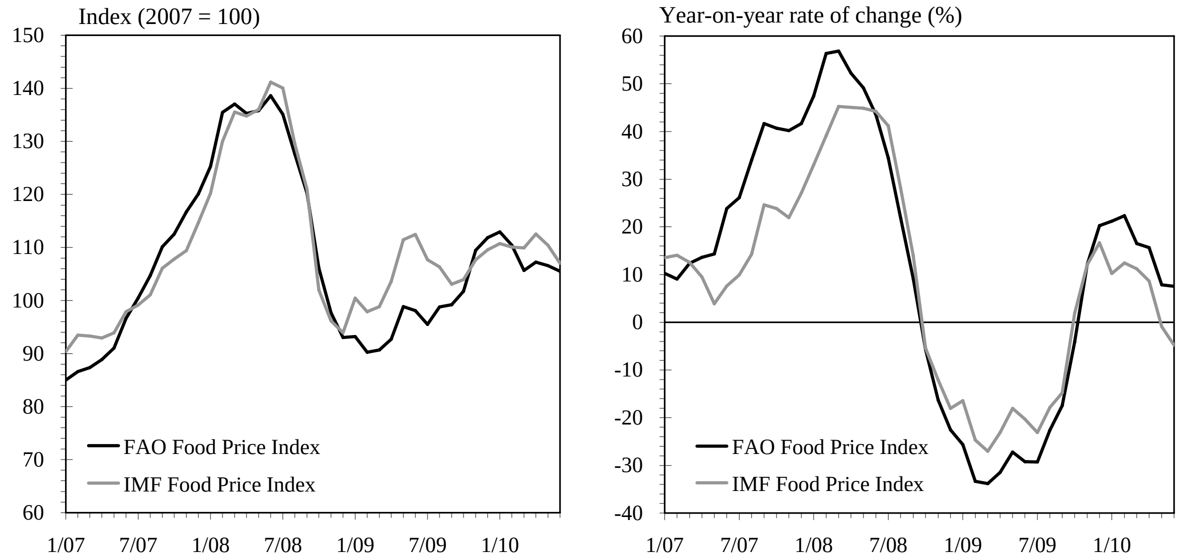
Recent movements of global food and fuel prices

With the global economy struck by the "Great Recession" in 2008-09 followed by the subsequent recovery, global food and fuel prices also showed much volatility over the period. Given that the movements of these prices bear implications on the relevant consumer prices in Hong Kong, a survey on their recent movements can be indicative of the likely price pressure in Hong Kong from these sources in the near term.

Charts 1(a) and (b) illustrate the movements of global food prices since January 2007, as indicated by the relevant indices compiled by the International Monetary Fund (IMF) and the Food and Agriculture Organization of the United Nations (FAO). Food prices rose sharply during 2007 and the first half of 2008 upon a spate of supply and demand factors (see **Box 6.1 of Half-yearly Quarter Economic Report 2008**), but retreated to levels comparable to that in early 2007 towards end-2008 as the global financial crisis struck. Then, as the free-fall in the global economy was arrested in early 2009, food prices began to bottom out. Since then, global food prices rebounded notably amid some fluctuations over the course of 2009, alongside the global recovery. However, global food prices turned more stable on entering 2010. As in June 2010, global food prices were still around 24% lower than the peak in mid-2008. According to the FAO[(1)], the main contributory factor for the relatively stable global food prices in overall terms in recent months was from the supply side, as the earlier rally in prices spurred agricultural production, resulting in a recovery in inventories. Yet due to successive rise-back during 2009, in the first half of 2010 global food prices were on average around 15% higher than in the same period last year.

Chart 1: After the rally of food prices, the international food market slowly returned to balance since late-2009

(a) FAO and IMF food price index **(b) Year-on-year rate of change of FAO and IMF food price index**



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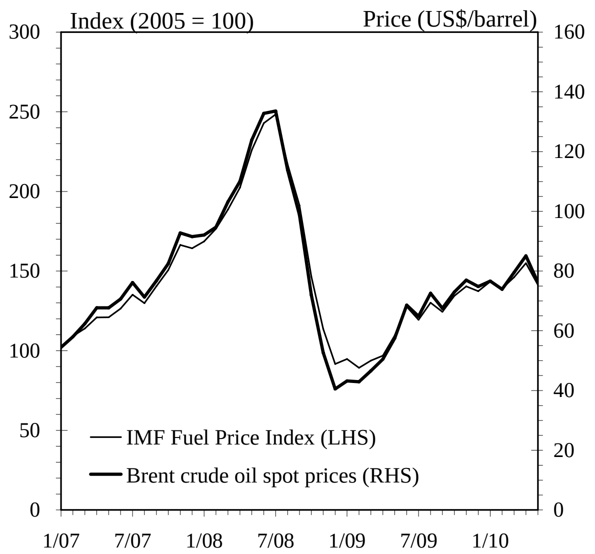
(1) Food Outlook, Global Market Analysis (June 2010 issue), FAO

Box 6.1 (Cont'd)

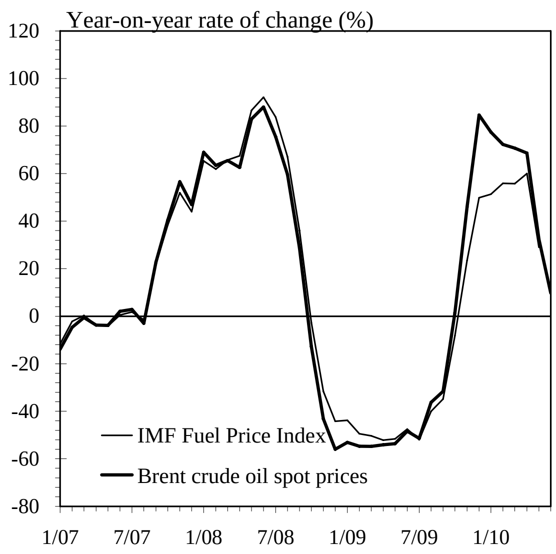
The movements of fuel prices in the international markets showed a similar pattern in recent years, as shown in **Charts 2(a) and (b)**. For example, Brent crude oil price, after reaching the historical peak in July 2008, averaging at around US$134 per barrel in that month, it experienced a sharp decline of over 70% towards the end of 2008 amid the global financial crisis. After languishing at around US$40 per barrel in late 2008 and early 2009, it rose back and moved within a narrow range of around US$70-80 per barrel in the past several months. The gradual recovery in industrial production activities and the general improvement in financial market sentiments since the second quarter of 2009 were the factors driving the bounce-back in crude oil prices.

Chart 2: Fuel prices bottomed out since early 2009, mainly the result of recovery of industrial production and improved market sentiments

(a) IMF fuel price index and Brent crude oil spot prices



(b) Year-on-year rate of change of IMF fuel price index and Brent crude oil spot prices

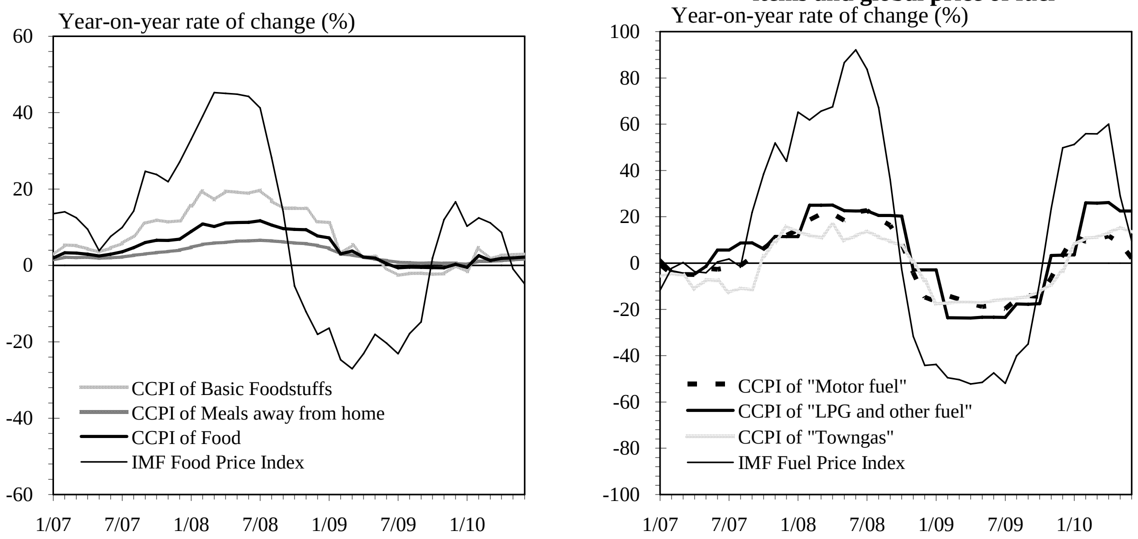


Box 6.1 (Cont'd)

As shown in **Charts 3(a) and (b)**, local retail prices of both food and fuel-related items generally moved broadly in line with their counterparts in the global markets, though with a notably smaller degree of volatility. This is because local retail prices also depend on such factors as local wage, rental and other business cost movements.

Chart 3: The movements of local retail prices of food and oil-related products generally followed the movments of global food and oil prices, yet with a much lower degree of volatility

(a) Local consumer prices and global price of food **(b) Local consumer prices of fuel-related items and global price of fuel**



Generally speaking, because food items account for a large share of household spending, large fluctuations in food prices can have a rather noticeable impact on local consumer price inflation, as in 2007 and 2008. By contrast, oil-related items account for only a small share of household spending. This, together with the fact that Hong Kong is not an oil-dependent economy, suggests that local consumer price inflation is less susceptible to oil price fluctuations. Although global food and oil prices have held relative stable in overall terms in recent months, they can turn more volatile in the period ahead, considering the high degree of uncertainty surrounding the global economic outlook and the volatile nature of these prices. In case of food prices, the adverse weather conditions and exchange rate movements in the key supplier economies can also cause upward price pressures. Therefore the upside risk to local consumer price inflation from these sources need to be monitored closely.

Output prices

6.5 Output prices, measured by *Producer Price Indices*[(3)], rose in most sectors in the first quarter of 2010. Prices of local manufacturing output reversed to an increase, reflecting the recovery in demand from overseas markets. Prices of air and maritime transport rebounded notably amidst the normalization of global trade flows. Prices of accommodation services also resumed a year-on-year increase, supported by the robust expansion of inbound tourism. The fall in prices of telecommunication services persisted, in tandem with the keen competition in the industry and the sustained productivity growth.

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

	2009					2010
Industry group	Annual	Q1	Q2	Q3	Q4	Q1[@]
Manufacturing	-1.7	-1.4	-3.0	-2.0	-0.3	4.0
Selected services sector[(a)]						
Accommodation services	-8.1	-7.0	-10.8	-10.5	-4.3	4.4
Land transport	-1.0	-0.6	-1.5	-2.0	0.2	0.1
Maritime transport	-16.2	-12.7	-21.0	-20.8	-10.5	13.0
Air transport	-8.7	-10.3	-13.6	-15.2	4.7	13.9
Telecommunications	-2.5	-2.5	-2.8	-2.5	-2.0	-2.3
Courier services	2.0	2.1	1.9	1.9	2.1	1.6

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 in the economy, the *GDP deflator*[(4)] dropped by 0.6% in the second quarter of 2010 from a year earlier, after a 2.0% increase in the previous quarter. This was due to the further deterioration in the *terms of trade*[(5)], a dominant item in the GDP deflator, with import prices rising faster than export prices. Taking out the external components, the domestic demand deflator increased by 2.6% over a year earlier in the second quarter, slightly faster than the 2.4% increase in the first quarter.

Diagram 6.5 : GDP deflator

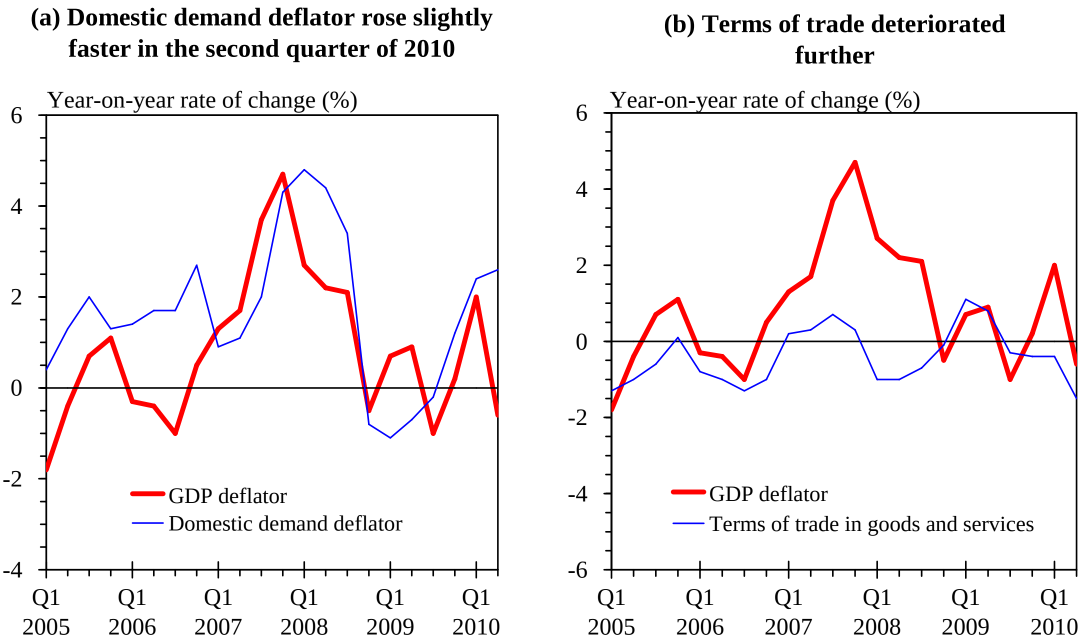


Table 6.5 : GDP deflator and the main expenditure component deflators

(year-on-year rate of change (%))

	2009					2010	
	Annual	Q1	Q2	Q3	Q4	Q1#	Q2+
Private consumption expenditure	-1.5	-1.1	-2.2	-2.5	*	0.1	-0.2
Government consumption expenditure	0.1	3.3	-0.9	-1.6	-0.6	-0.9	-0.1
Gross domestic fixed capital formation	3.9	-2.6	4.5	7.9	5.0	11.1	11.3
Total exports of goods	0.5	1.8	0.1	-0.9	0.9	2.8	4.1
Imports of goods	-1.3	-0.8	-2.3	-2.1	-0.1	3.9	7.1
Exports of services	-7.0	-7.6	-9.8	-8.4	-2.9	7.9	10.2
Imports of services	-2.5	-6.2	-6.0	-3.3	5.2	7.3	4.9
Gross Domestic Product	0.2	0.7 <0.2>	0.9 <0.2>	-1.0 <-0.6>	0.2 <0.4>	2.0 <2.0>	-0.6 <-2.4>
Total final demand	-0.9	-0.6	-1.5	-1.9	0.4	3.4	4.4
Domestic demand	-0.2	-1.1	-0.7	-0.2	1.2	2.4	2.6

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

(#) Revised figures.

(+) Preliminary figures.

< > Seasonally adjusted quarter-to-quarter rate of change.

(*) Change of less than 0.05%.

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:

	Approximate proportion of households covered (%)	Average monthly expenditure range during Oct 2004 to Sep 2005 ($)
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:

Expenditure Component	Composite CPI (%)	CPI(A) (%)	CPI(B) (%)	CPI(C) (%)
Food	26.94	32.10	27.32	20.41
Meals bought away from home	*16.86*	*18.63*	*17.65*	*13.74*
Other foodstuffs	*10.08*	*13.47*	*9.67*	*6.67*
Housing	29.17	30.54	27.70	29.66
Private dwellings	*23.93*	*22.07*	*23.89*	*26.11*
Public dwellings	*2.49*	*6.18*	*1.25*	--
Maintenance costs and other housing charges	*2.75*	*2.29*	*2.56*	*3.55*
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.

	2009	2010				
	Annual	Q1	Q2	Apr	May	Jun
Selected developed economies						
US	-0.4	2.4	1.8	2.2	2.0	1.1
Canada	0.3	1.6	1.4	1.8	1.4	1.0
EU	1.0	1.7	2.0	2.1	2.0	1.9
Japan	-1.4	-1.2	-0.9	-1.2	-0.9	-0.7
Major emerging economies						
Mainland China	-0.7	2.2	2.9	2.8	3.1	2.9
Russia	11.7	7.2	5.9	6.1	6.0	5.8
India	10.9	15.3	13.7	13.3	13.9	13.7
Brazil	4.9	4.9	5.1	5.3	5.2	4.8
Selected Asian economies						
Hong Kong	0.5	1.9	2.6	2.4	2.5	2.8
Singapore	0.6	0.9	3.1	3.2	3.2	2.7
Taiwan	-0.9	1.3	1.1	1.3	0.7	1.2
South Korea	2.8	2.7	2.6	2.6	2.7	2.6
Malaysia	0.6	1.3	1.6	1.5	1.6	1.7
Thailand	-0.8	3.7	3.2	2.9	3.4	3.3
Indonesia	4.8	3.7	4.4	3.9	4.2	5.0
Philippines	3.2	4.3	4.2	4.4	4.3	3.9
Vietnam	6.7	8.5	9.0	9.2	9.1	8.7
Macao	1.2	1.5	2.7	2.6	2.8	2.7

(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.