

CHAPTER 6 : PRICES

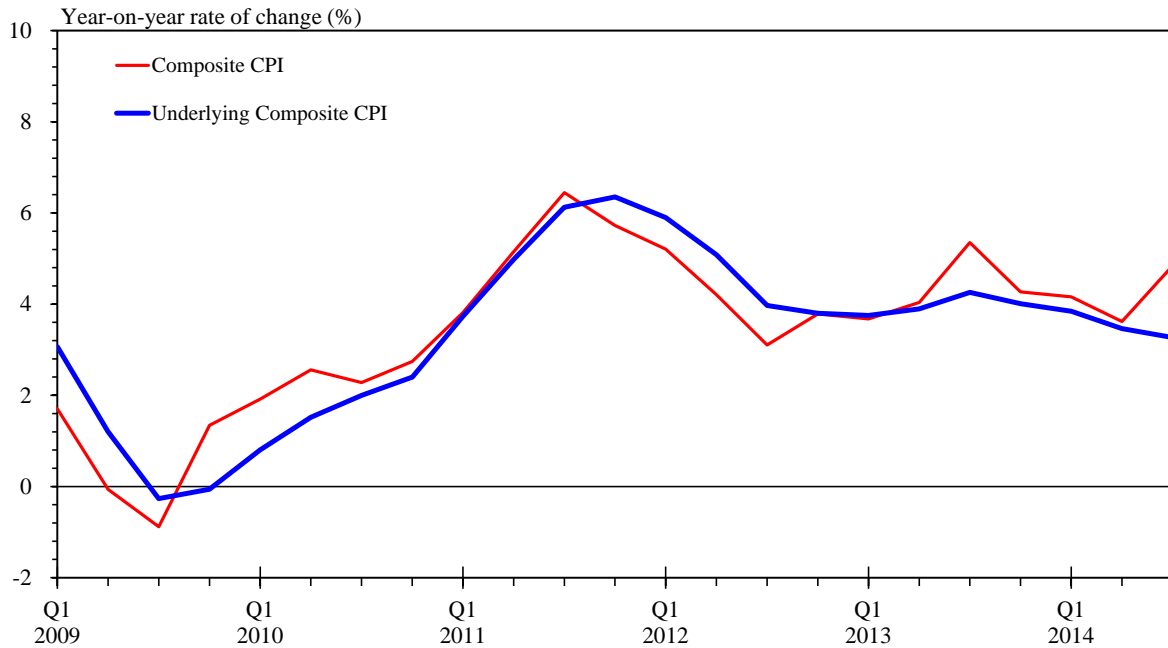
Summary

- *Underlying inflation trended lower in the third quarter of 2014, reflecting the moderate domestic cost pressures and still-mild imported inflation. Although the Composite Consumer Price Index (Composite CPI)⁽¹⁾ rose by 4.8% in the third quarter over a year earlier, up from the 3.6% increase in the second quarter, it was merely affected by a lower base of comparison resulting from the Government's payment of public housing rentals in September 2013, and the gradual depletion of the Government's one-off electricity charge subsidy. Indeed, after netting out the effects of the Government's one-off relief measures to more accurately reflect the underlying inflation trend, underlying Composite CPI increase narrowed further to 3.3% in the third quarter, from 3.5% in the second quarter.*
- *Local cost pressures remained tame in the third quarter. Fresh-letting private residential rentals rose mildly year-on-year, and their stabilising effect kept feeding through to the CPI. Meanwhile, the shop and office rental pressures moderated further, while increases in labour costs held broadly steady, both helping to mitigate business cost burden.*
- *External price pressures were largely kept at bay in the third quarter. The rise in import prices, despite a modest rebound, was still rather benign in overall terms, thanks mainly to the softer energy and raw material prices in the international markets and generally tame inflation in major import sources.*
- *In view of moderated rental cost pressures, steady wage growth, and still-benign imported inflation, upside risks to inflation should be limited in the rest of this year.*

Consumer prices

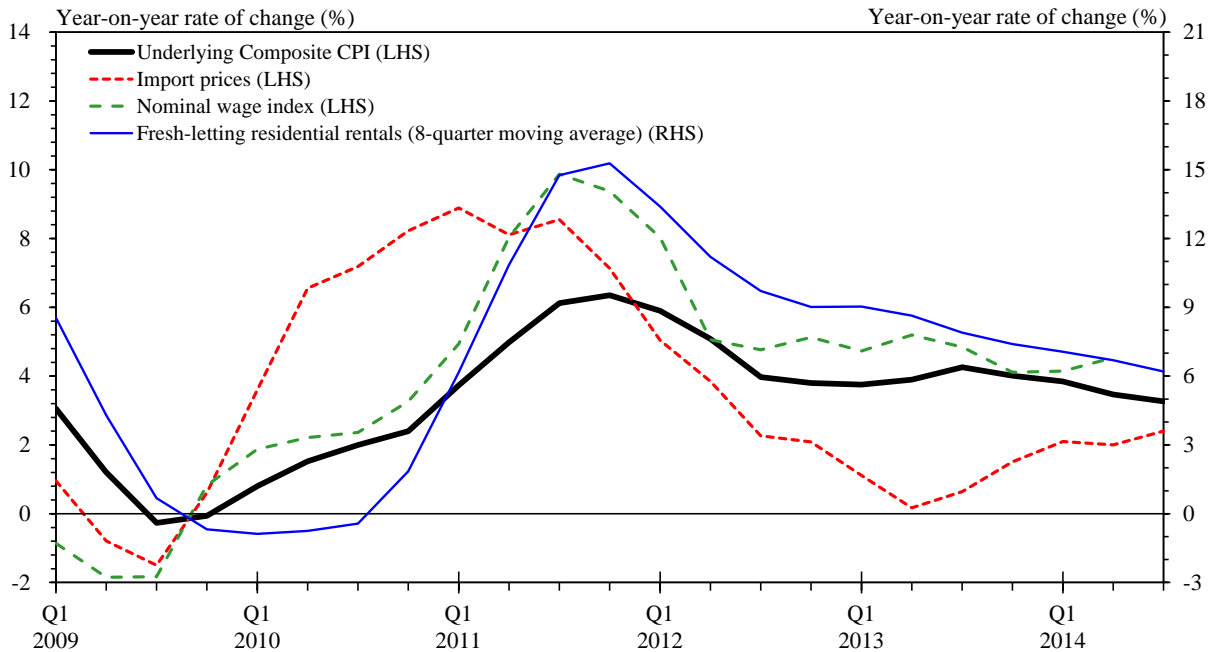
6.1 The underlying inflation rate eased further in the third quarter of 2014, as local cost pressures and imported inflation both remained moderate in overall terms. Domestically, rental cost pressures were still tame, and the feed-through of the milder increase in fresh-letting rentals in earlier quarters continued to trim the rise in the private residential rentals component in the CPI. Increases in labour costs also held largely stable. Externally, the softer energy and raw material prices, modest inflation in the major import sources⁽²⁾ and, to a lesser extent, the earlier strengthening of the US dollar against some major currencies, helped keep the increases in import prices moderate.

Diagram 6.1 : Underlying inflation sustained the easing trend in the third quarter of 2014



Note : The year-on-year rates of change of the Consumer Price Indices from the fourth quarter of 2010 onwards are computed from the 2009/10-based series, and those before that from the 2004/05-based series. Splicing has been applied to the indices to maintain continuity.

Diagram 6.2 : Domestic cost pressures and imported inflation both stayed moderate



6.2 Underlying consumer price inflation, which nets out the effects of the Government's one-off relief measures to more accurately reflect the underlying inflation trend, eased further to 3.3% in the third quarter of 2014 from 3.5% in the second quarter. Nevertheless, headline consumer price inflation, as measured by the year-on-year rate of change in the Composite CPI, rebounded visibly to 4.8% in the third quarter of 2014, up from 3.6% in the preceding quarter. The rise in the headline inflation rate was mainly due to the temporary influence of a lower base of comparison stemming from the Government's payment of public housing rentals in September last year. Also relevant here was the gradual depletion of the Government's one-off electricity charge subsidy by some households during the third quarter. For the first three quarters of 2014 as a whole, the headline and underlying consumer price inflation rates stood at 4.2% and 3.5% respectively, both lower than those of 4.3% and 4.0% for 2013 as a whole.

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

		<u>Composite CPI</u>		<u>CPI(A)</u>	<u>CPI(B)</u>	<u>CPI(C)</u>
		<u>Underlying^(a)</u>	<u>Headline</u>			
2013	Annual	4.0	4.3	5.1	4.1	3.8
	H1	3.8	3.9	4.4	3.6	3.5
	H2	4.1	4.8	5.8	4.5	4.1
	Q1	3.8	3.7	4.2	3.5	3.3
	Q2	3.9	4.0	4.6	3.8	3.6
	Q3	4.3	5.3	7.3	4.6	4.2
	Q4	4.0	4.3	4.4	4.4	4.1
2014	H1	3.7	3.9	4.0	4.0	3.7
	Q1	3.8	4.2	4.3	4.3	3.9
	Q2	3.5	3.6	3.8	3.8	3.5
	Q3	3.3	4.8	7.2	4.1	3.3

(seasonally adjusted quarter-to-quarter rate of change (%))

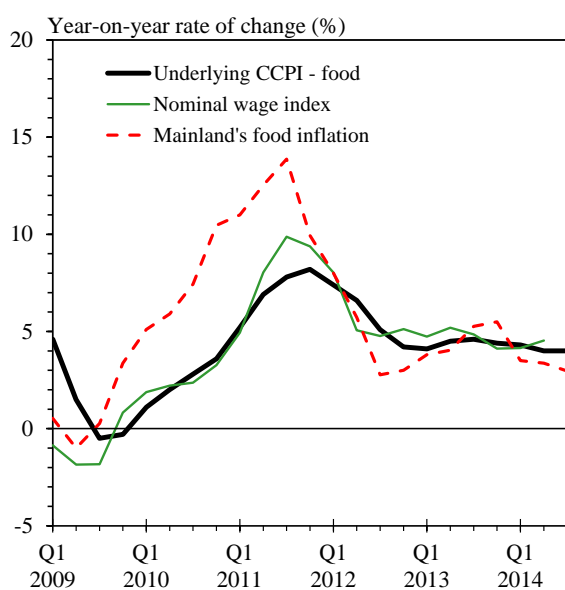
2013	Q1	1.1	1.1	1.2	1.1	1.0
	Q2	1.1	1.3	1.3	1.2	1.2
	Q3	0.8	-0.8	-3.4	0.3	0.8
	Q4	1.0	2.7	5.5	1.7	1.0
2014	Q1	0.9	1.0	1.1	1.0	0.8
	Q2	0.7	0.7	0.8	0.6	0.7
	Q3	0.7	0.4	-0.2	0.9	0.7

Note : (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 and subsequent abolition of Employees Retraining Levy, and subsidies for household electricity charges.

6.3 Analysed by the major components of the underlying Composite CPI, food prices and private housing rentals remained the two largest contributors to inflation, although the increase in the latter had narrowed in recent quarters. Local food inflation (including costs of dining out) held steady at 4.0% in the third quarter of 2014, same as that in the preceding quarter. On the other hand, as the slower increases of fresh-letting residential rentals in earlier quarters progressively fed through, the year-on-year rise in the private housing rental component decelerated notably further to 4.9% in the third quarter from 5.5% in the second quarter. Many other components in the underlying Composite CPI showed milder price increases in the third quarter, and the prices of durable goods also stayed on a secular downtrend.

Diagram 6.3 : Food and private housing rental components of the underlying CCPI

(a) Food inflation held broadly stable in the third quarter of 2014



(b) The slower increases in fresh-letting rentals continued to feed through

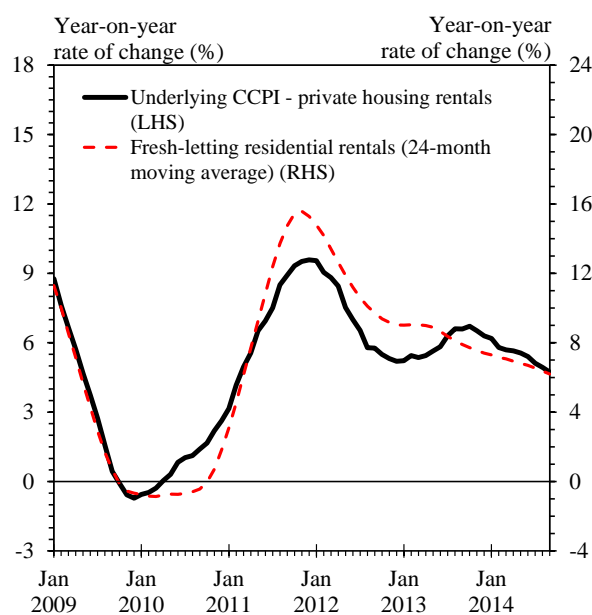


Diagram 6.4 (a) : The price increases in many major components in the underlying Composite CPI remained mild

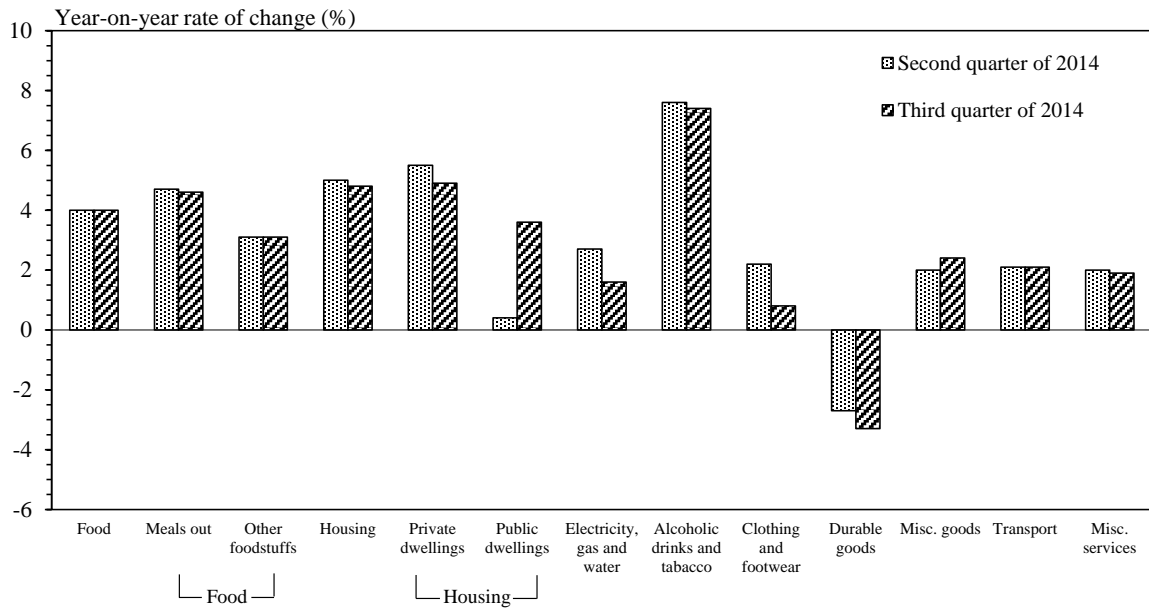
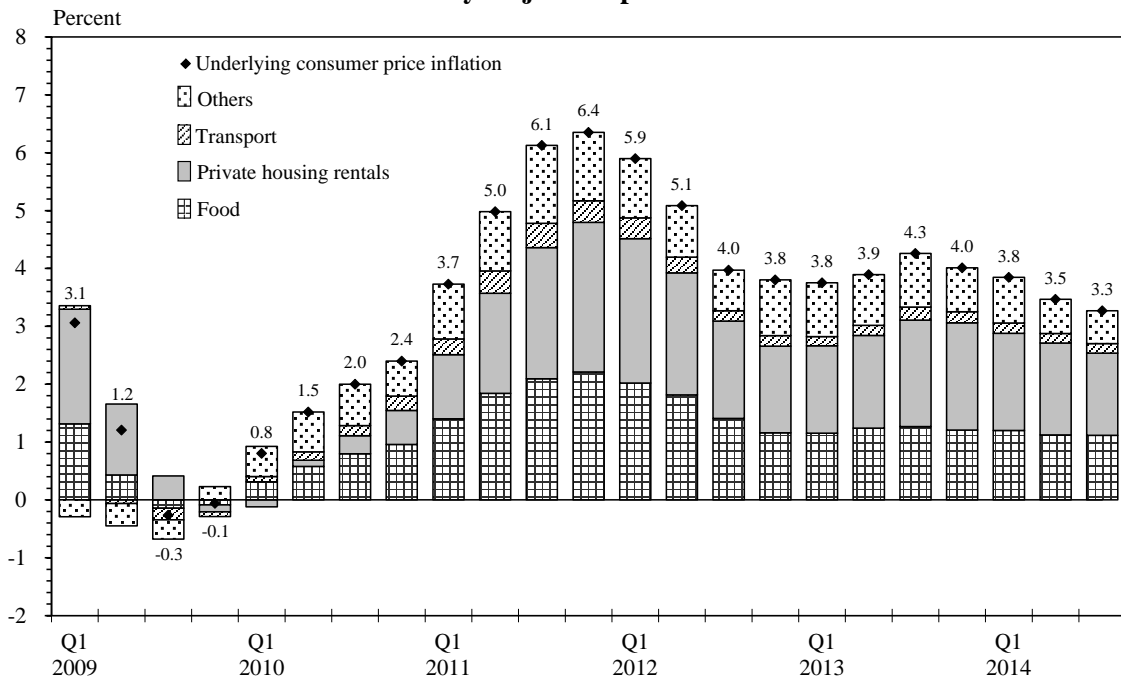


Diagram 6.4 (b) : Contribution to underlying consumer price inflation by major component



Note : The year-on-year rates of change of the Composite CPI from the fourth quarter of 2010 onwards are computed from the 2009/10-based series, and those before that from the 2004/05-based series.

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

<u>Expenditure component</u>	<u>Weighting (%)</u>	<u>2013</u>					<u>2014</u>		
		<u>2013</u>	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>
Food	27.45	4.4	4.1	4.5	4.6	4.4	4.3	4.0	4.0
<i>Meals bought away from home</i>	17.07	4.4	4.4	4.3	4.3	4.5	4.5	4.7	4.6
<i>Other foodstuffs</i>	10.38	4.4	3.6	4.8	4.9	4.1	4.0	3.1	3.1
Housing ^(a)	31.66	6.7 (5.8)	5.2 (5.5)	6.1 (5.8)	9.4 (6.3)	6.1 (5.8)	5.6 (5.3)	5.0 (5.0)	7.6 (4.8)
<i>Private dwellings</i>	27.14	6.3 (6.0)	5.0 (5.4)	6.1 (5.7)	7.0 (6.5)	7.0 (6.5)	6.4 (5.9)	5.6 (5.5)	4.9 (4.9)
<i>Public dwellings</i>	2.05	16.0 (6.0)	9.7 (9.5)	8.9 (9.2)	777.6 (5.9)	-1.8 (-0.1)	-1.8 (-0.1)	-0.9 (0.4)	101.4 (3.6)
Electricity, gas and water	3.10	6.9 (5.1)	4.9 (3.6)	5.9 (4.4)	9.6 (7.2)	7.1 (5.3)	5.5 (4.4)	3.4 (2.7)	24.9 (1.6)
Alcoholic drinks and tobacco	0.59	1.5	1.6	1.9	1.4	1.1	3.3	7.6	7.4
Clothing and footwear	3.45	1.7	1.5	1.0	1.7	2.5	2.1	2.2	0.8
Durable goods	5.27	-4.3	-3.5	-5.0	-4.7	-4.0	-3.3	-2.7	-3.3
Miscellaneous goods	4.17	2.2	1.4	2.2	2.5	2.7	3.1	2.0	2.4
Transport	8.44	2.3	2.0	2.2	2.8	2.4	2.2	2.1	2.1
Miscellaneous services	15.87	3.7 (3.2)	3.5 (3.5)	3.1 (3.1)	3.9 (3.1)	4.3 (3.1)	4.4 (3.1)	3.2 (2.0)	2.3 (1.9)
All items	100.00	4.3 (4.0)	3.7 (3.8)	4.0 (3.9)	5.3 (4.3)	4.3 (4.0)	4.2 (3.8)	3.6 (3.5)	4.8 (3.3)

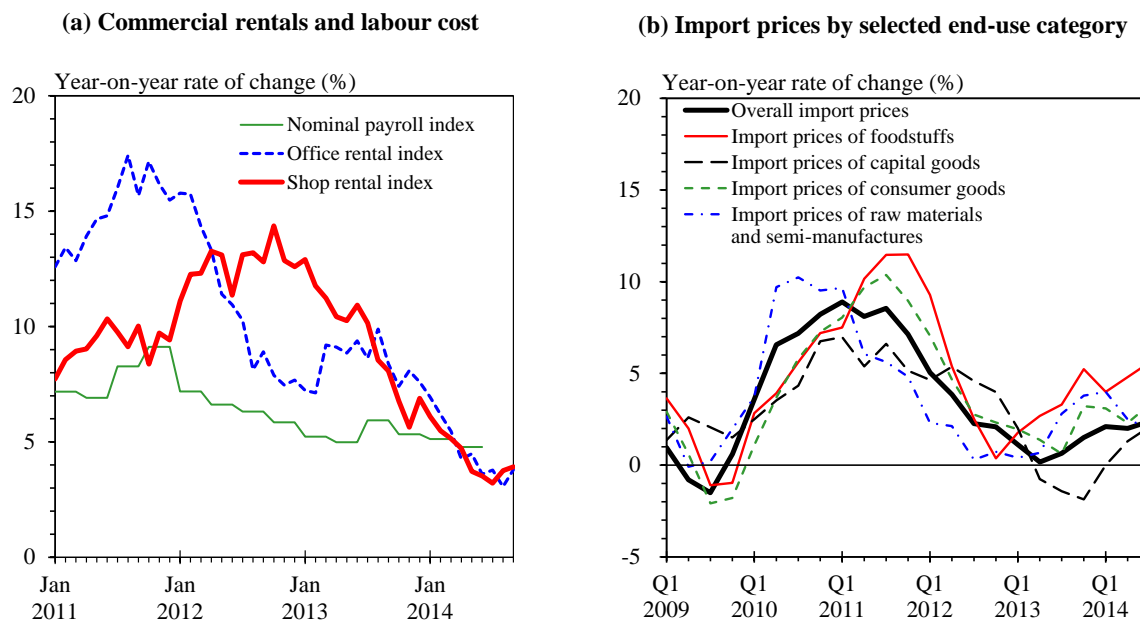
Notes : (a) The housing component covers rents, rates, Government rent, maintenance costs and other housing charges. Its sub-components on private and public dwellings as presented here, however, cover rents, rates and Government rent only. Hence, the combined weighting of private and public dwellings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

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

Costs of factor inputs and import prices

6.4 Domestic cost pressures remained in check in the third quarter of 2014. The year-on-year increases of both shop rentals and office rentals moderated further in the third quarter, staying at low single-digit levels. Meanwhile, labour cost increases were rather steady in recent periods.

Diagram 6.5 : Domestic cost pressures, particularly rentals, stayed relatively mild, as did the imported price pressures



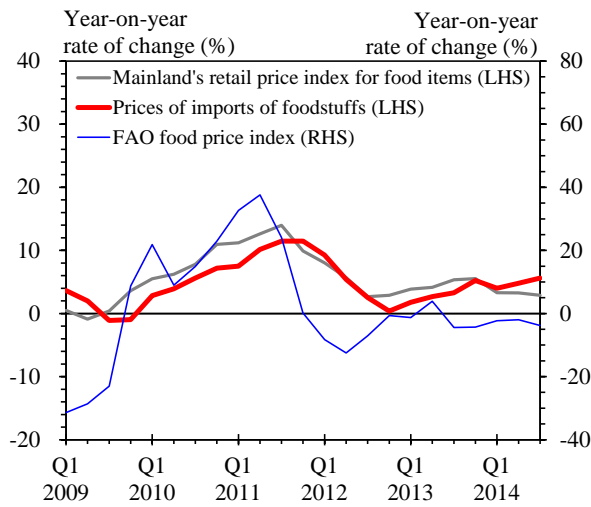
6.5 External inflationary pressures stayed relatively moderate in the third quarter of 2014, thanks to the benign global commodity prices trend, largely contained inflation in major import sources and, to a lesser extent, the earlier depreciation of some major currencies against the US dollar. Overall import prices rose by 2.4% over a year earlier in the third quarter, somewhat faster than the 2.0% rise in the second quarter, but by a varying degree among different end-use categories. Import prices of foodstuffs still posted the largest increase in the third quarter, mirroring the faster price increases of meat and beverage in the international markets. Import prices of consumer and capital goods also showed faster, albeit still moderate increases. On the other hand, the increase in import prices of raw materials eased, as international industrial materials and metal prices remained soft. Meanwhile, import prices of fuels fell further, following the retreat in crude oil prices, as the recovery of global demand remained mediocre, and geopolitical tensions in the Middle East and Eastern Europe had thus far not led to supply disruptions.

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

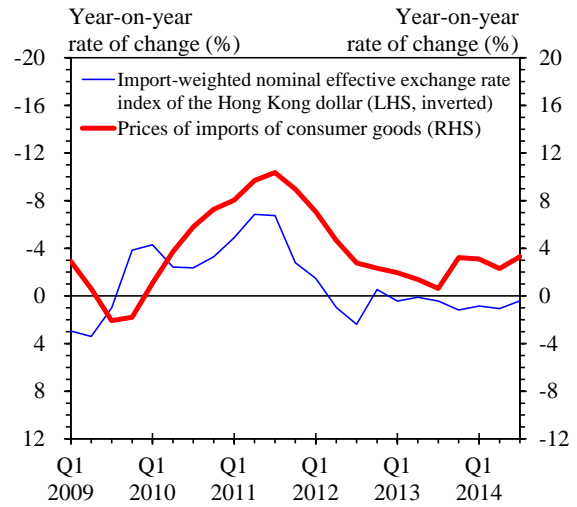
		<u>Foodstuffs</u>	<u>Consumer goods</u>	<u>Raw materials and semi-manufactures</u>	<u>Fuels</u>	<u>Capital goods</u>	<u>All</u>
2013	Annual	3.3	1.8	2.0	-3.6	-0.6	0.9
	H1	2.2	1.7	0.5	-5.4	0.6	0.6
	H2	4.4	1.9	3.3	-1.8	-1.6	1.1
	Q1	1.8	2.0	0.4	-5.5	2.0	1.1
	Q2	2.7	1.4	0.7	-5.4	-0.8	0.2
	Q3	3.3	0.6	2.8	-1.9	-1.4	0.6
	Q4	5.2	3.2	3.8	-1.8	-1.9	1.5
2014	H1	4.4	2.7	3.2	-2.2	0.7	2.1
	Q1	4.0	3.1	4.0	-3.1	*	2.1
	Q2	4.8	2.3	2.5	-1.2	1.3	2.0
	Q3	5.6	3.3	2.0	-1.4	2.1	2.4

Diagram 6.6 : Import prices by end-use category

(a) Imported food inflation accelerated somewhat

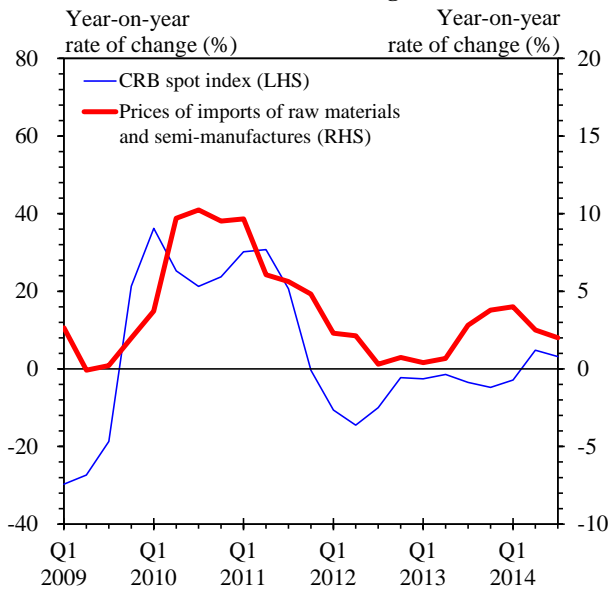


(b) Import prices of consumer goods rose slightly faster

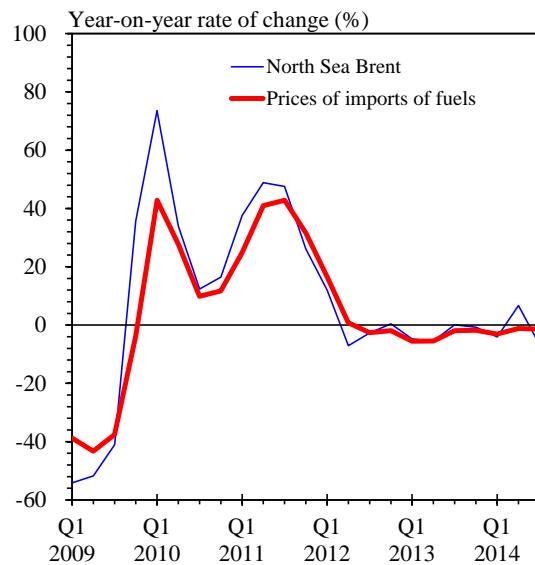


Note : An increase in the nominal EERI indicates strengthening of the Hong Kong dollar. The y-axis of nominal EERI in this graph is inverted for easier comprehension.

(c) Import prices of raw materials saw further moderated growth



(d) Import prices of fuels continued to decline



Output prices

6.6 Output prices, as measured by the *Producer Price Indices*⁽³⁾, showed mixed movements in the second quarter of 2014. For the manufacturing sector, the year-on-year rate of decline in output prices narrowed, amid a lower base of comparison and improved export performance in that quarter. As for the service sectors, output prices for accommodation services showed slightly faster increase on the back of sustained solid expansion in visitor arrivals. In tandem with the recent pick-up in trade flows, output prices for land transport and courier services increased moderately further in the second quarter. While prices for air transport reverted to a mild year-on-year increase, those for water transport fell less. Separately, output prices for telecommunications services stayed on a downtrend, largely attributable to continued enhancements in cost-saving technologies and keen competition.

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

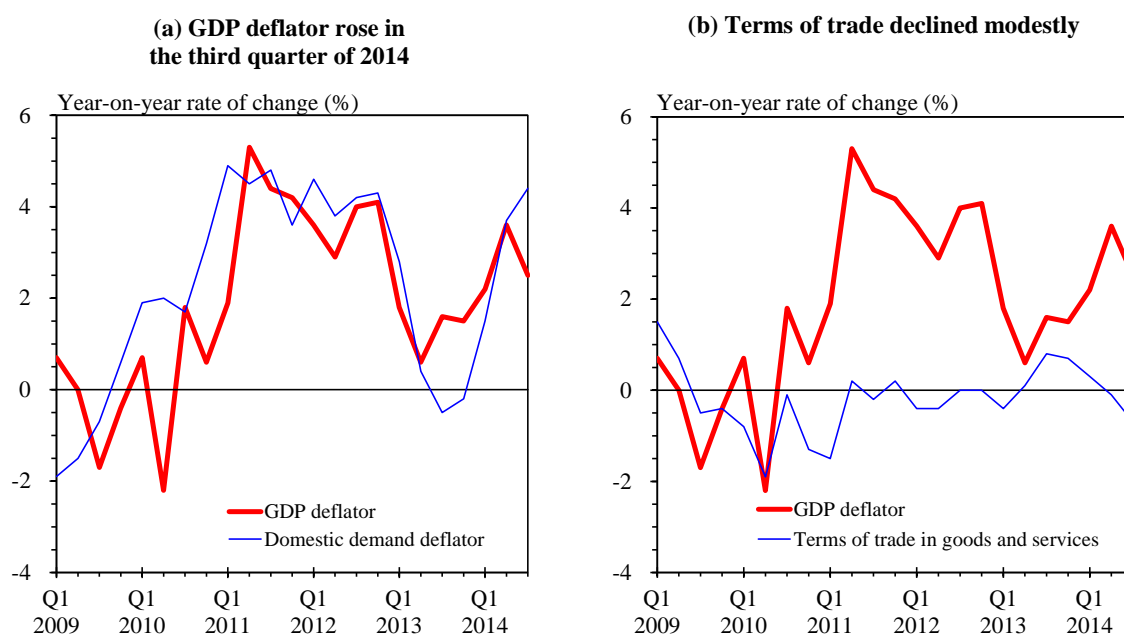
<u>Industry group</u>	<u>Annual</u>	<u>2013</u>				<u>2014</u>	
		<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>	<u>Q1</u>	<u>Q2</u>
Manufacturing	-3.1	0.6	-2.4	-5.2	-5.5	-6.2	-0.4
Selected services sectors ^(a)							
Accommodation services	2.4	2.5	2.8	1.7	2.6	2.2	3.9
Land transport	1.7	0.6	1.0	2.4	2.7	2.5	3.0
Water transport	-2.5	7.3	-14.8	1.8	-1.9	-2.9	-0.6
Air transport	1.0	4.0	-2.4	0.1	2.5	-0.6	1.8
Telecommunications	-1.9	-1.6	-1.8	-1.7	-2.6	-2.9	-3.4
Courier services	2.7	2.7	3.1	3.3	1.8	1.9	1.4

Note : (a) Producer Price Indices for other services 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.

GDP deflator

6.7 As a broad measure of the overall change in prices in the economy, the *GDP deflator*⁽⁴⁾ rose by 2.5% in the third quarter of 2014 over a year earlier, lower than the 3.6% increase in the preceding quarter. Within the GDP deflator, the *terms of trade*⁽⁵⁾ declined modestly in the third quarter from a year earlier, while the domestic demand deflator increased by 4.4% after a 3.7% rise in the preceding quarter.

Diagram 6.7 : GDP deflator



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

	<u>2012</u>		<u>2013</u>				<u>2014</u>		
	<u>Annual</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	3.2	2.4	2.1	2.1	3.0	2.4	2.0	3.0	3.1
Government consumption expenditure	6.2	4.4	6.1	4.1	3.7	3.7	4.0	5.0	4.7
Gross domestic fixed capital formation	6.4	-5.1	3.1	-4.7	-9.4	-7.7	-1.6	3.4	7.0
Total exports of goods	3.1	-0.3	-0.5	-0.4	-0.3	-0.1	-0.6	-0.1	1.3
Imports of goods	3.8	-0.6	0.2	-0.5	-1.1	-0.8	-0.8	-0.1	2.1
Exports of services	4.3	0.5	1.2	-0.2	0.7	0.3	0.6	0.8	1.8
Imports of services	1.9	0.5	0.9	0.4	0.2	0.4	1.1	3.0	2.7
Gross Domestic Product	3.7	1.4	1.8	0.6	1.6	1.5	2.2	3.6	2.5
			<-0.7>	<*>	<1.7>	<0.5>	<0.1>	<1.5>	<0.3>
Total final demand	3.6	0.1	0.8	-0.1	-0.2	*	0.3	1.2	2.3
Domestic demand	4.2	0.6	2.8	0.4	-0.5	-0.2	1.5	3.7	4.4
Terms of trade in goods and services	-0.2	0.3	-0.4	0.1	0.8	0.7	0.3	-0.1	-0.7

Notes : Figures are derived based on the 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 within $\pm 0.05\%$.

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 2009/10-based CPIs are shown below:

	<u>Approximate proportion of households covered</u> (%)	<u>Average monthly expenditure range during Oct 2009 to Sep 2010</u> (\$)
CPI(A)	50	4,500 to 18,499
CPI(B)	30	18,500 to 32,499
CPI(C)	10	32,500 to 65,999

The weightings of the various components in the 2009/10-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	27.45	33.68	27.16	20.87
<i>Meals bought away from home</i>	<i>17.07</i>	<i>19.23</i>	<i>17.90</i>	<i>13.55</i>
<i>Other foodstuffs</i>	<i>10.38</i>	<i>14.45</i>	<i>9.26</i>	<i>7.32</i>
Housing	31.66	32.19	31.43	31.36
<i>Private dwellings</i>	<i>27.14</i>	<i>24.78</i>	<i>28.13</i>	<i>28.45</i>
<i>Public dwellings</i>	<i>2.05</i>	<i>5.49</i>	<i>0.72</i>	<i>--</i>
<i>Maintenance costs and other housing charges</i>	<i>2.47</i>	<i>1.92</i>	<i>2.58</i>	<i>2.91</i>
Electricity, gas and water	3.10	4.36	2.84	2.03
Alcoholic drinks and tobacco	0.59	0.91	0.56	0.29
Clothing and footwear	3.45	2.60	3.45	4.39
Durable goods	5.27	3.73	5.73	6.39
Miscellaneous goods	4.17	3.87	4.17	4.49
Transport	8.44	7.22	8.35	9.93
Miscellaneous services	15.87	11.44	16.31	20.25
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>2012</u>		<u>2013</u>				<u>2014</u>		
	<u>Annual</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>
Selected developed economies									
US	2.1	1.5	1.7	1.4	1.6	1.2	1.4	2.1	1.8
Canada	1.5	0.9	0.9	0.8	1.1	0.9	1.4	2.2	2.1
EU	2.6	1.5	2.0	1.6	1.5	1.0	0.8	0.7	0.5
Japan	*	0.4	-0.6	-0.3	0.9	1.4	1.5	3.6	3.3
Major emerging economies									
Mainland China	2.6	2.6	2.4	2.4	2.8	2.9	2.3	2.2	2.0
Russia	5.1	6.8	7.1	7.2	6.4	6.4	6.4	7.6	7.7
India	9.7	10.1	10.7	9.5	9.7	10.4	8.4	8.1	7.4
Brazil	5.4	6.2	6.4	6.6	6.1	5.8	5.8	6.4	6.6
Selected Asian economies									
Hong Kong	4.1	4.3	3.7	4.0	5.3	4.3	4.2	3.6	4.8
Singapore	4.6	2.4	4.0	1.6	1.8	2.0	1.0	2.4	0.9
Taiwan	1.9	0.8	1.8	0.8	*	0.6	0.8	1.6	1.5
Korea	2.2	1.3	1.6	1.2	1.4	1.1	1.1	1.6	1.4
Malaysia	1.7	2.1	1.5	1.8	2.2	3.0	3.5	3.3	3.0
Thailand	3.0	2.2	3.1	2.3	1.7	1.7	2.0	2.5	2.0
Indonesia	4.0	6.4	4.5	5.1	8.0	8.0	7.8	7.1	4.4
Philippines	3.2	3.0	3.2	2.6	2.4	3.5	4.1	4.4	4.7
Vietnam	9.2	6.6	6.9	6.6	7.0	5.9	4.8	4.7	4.3
Macao	6.1	5.5	5.4	5.1	5.6	5.9	6.1	6.2	5.9

Note : (*) Change within $\pm 0.05\%$.

- (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.