

CHAPTER 6 : PRICES

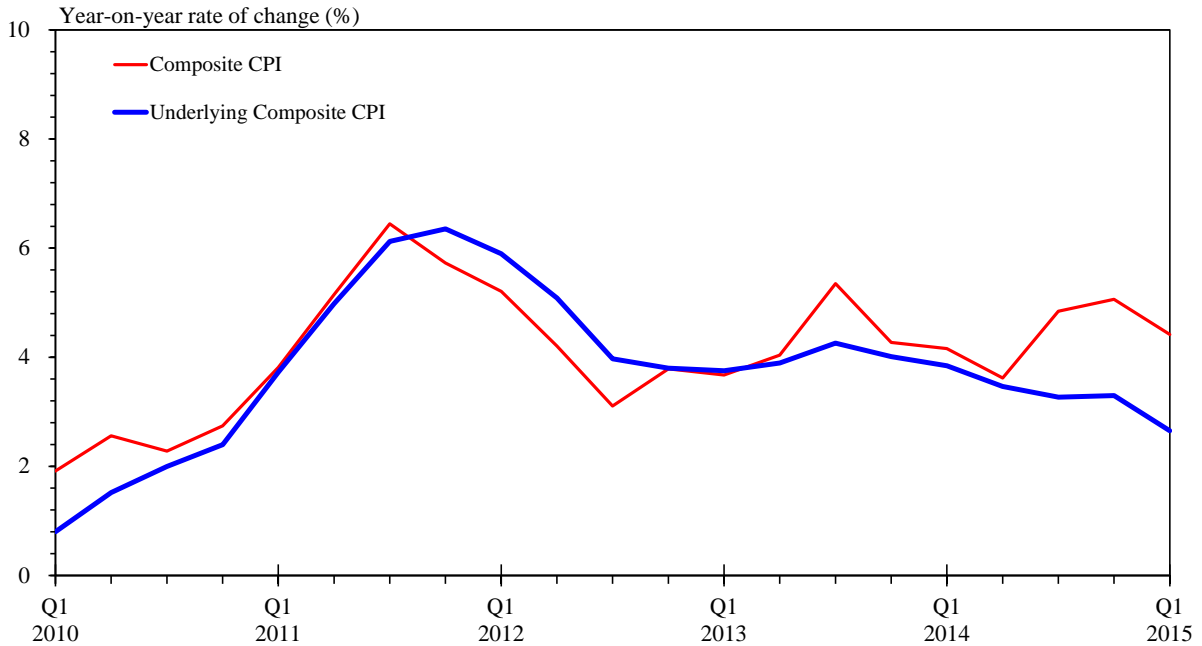
Summary

- *Inflation receded further in the first quarter of 2015, as domestic cost pressures were largely contained and imported inflation stayed benign. The year-on-year increase in the underlying Composite Consumer Price Index (Composite CPI)⁽¹⁾, which nets out the effects of the Government's one-off relief measures to more accurately reflect the underlying inflation trend, went down to 2.7% in the first quarter of 2015, from 3.3% in the fourth quarter of 2014. Likewise, the headline Composite CPI inflation abated from 5.1% to 4.4% over the same period.*
- *Domestic cost pressures remained generally in check. Labour earnings continued to register steady increases. Although fresh-letting residential and commercial rentals saw somewhat faster growth in the more recent months, the rental pressures on inflation were still largely kept at bay in the first quarter, as their moderate increases during most of 2014 continued to feed through to the Composite CPI.*
- *External price pressures remained tame. The rise in import prices was mild in overall terms, mainly attributable to softer food and commodity prices in the international markets, and also easing inflation in the major import sources. The strengthening of the US dollar against many other currencies, despite to a lesser extent, also helped contain Hong Kong's imported inflation.*
- *Looking ahead, upside risks to inflation should stay limited in the near term given the mild imported inflation amid the uneven and subpar growth of the global economy, as well as moderate local cost pressures.*

Consumer prices

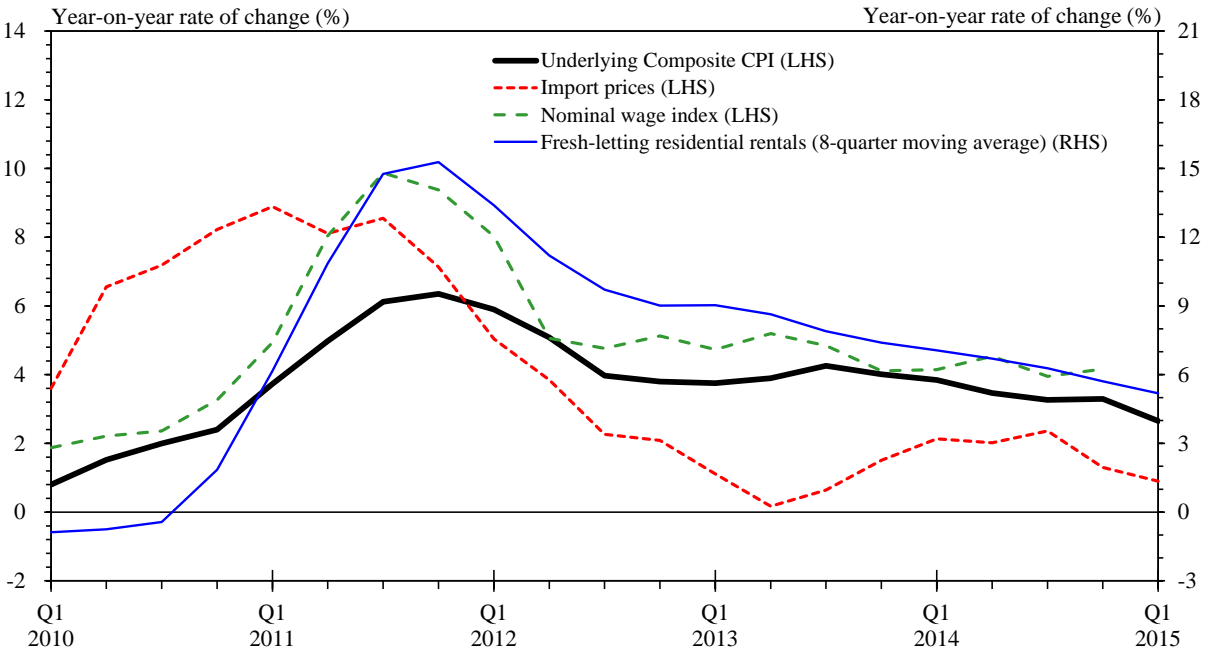
6.1 Inflation eased further in the first quarter of 2015, as local cost pressures were largely contained and imported inflation remained tame. Domestically, labour earnings continued to register steady growth. The lagged effect of the milder increases in fresh-letting residential rentals during most of 2014 also helped moderate the rental rise in private housing component of the CPI. Externally, imported inflation stayed benign, given the easing inflationary pressures in Hong Kong's major import sources⁽²⁾, softer international food and commodity prices, and to a certain extent, the strengthening of the Hong Kong dollar, along with the US dollar, against many other currencies.

Diagram 6.1 : Underlying inflation eased further in the first quarter of 2015



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 were largely in check and imported inflation remained benign



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, averaged 2.7% in the first quarter of 2015, moderated from 3.3% in the preceding quarter. Headline consumer price inflation, as measured by the year-on-year rate of change in the Composite CPI, also receded to 4.4% in the first quarter of 2015, from 5.1% in the preceding quarter. The headline inflation rate was higher than the underlying inflation rate, because of the Government's rates concession in the first quarter of 2014 that created a lower base of comparison for the headline figure and the gradual depletion of the Government's one-off electricity charge subsidy by some households over the period.

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

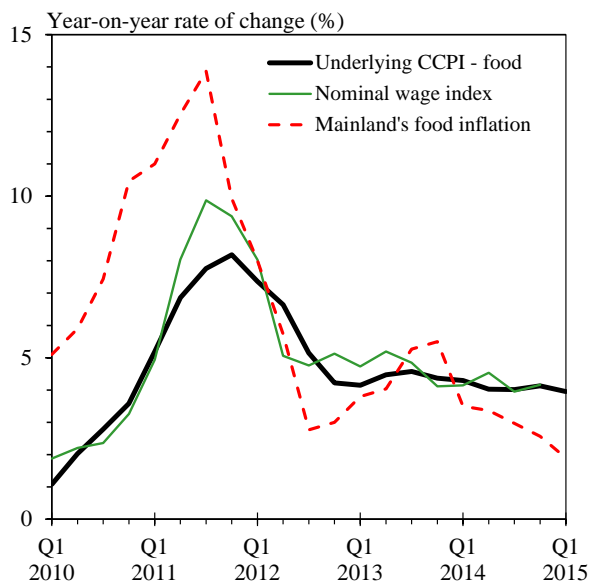
		Composite CPI		CPI(A)	CPI(B)	CPI(C)
		Underlying ^(a)	Headline			
2014	Annual	3.5	4.4	5.6	4.2	3.5
	H1	3.7	3.9	4.0	4.0	3.7
	H2	3.3	5.0	7.1	4.4	3.4
	Q1	3.8	4.2	4.3	4.3	3.9
	Q2	3.5	3.6	3.8	3.8	3.5
	Q3	3.3	4.8	7.2	4.1	3.3
	Q4	3.3	5.1	7.0	4.6	3.4
2015	Q1	2.7	4.4	6.5	3.9	2.6
(seasonally adjusted quarter-to-quarter rate of change (%))						
2014	Q1	0.9	0.9	1.1	0.9	0.8
	Q2	0.7	0.7	0.7	0.7	0.7
	Q3	0.7	0.5	-0.2	0.9	0.8
	Q4	0.9	2.9	5.4	2.0	1.1
2015	Q1	0.3	0.3	0.5	0.3	0.1

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 major component of the underlying Composite CPI, the easing of inflationary pressures was widespread. Food prices and housing rentals, the two largest components by weight in the Composite CPI, both saw narrower year-on-year increases in the first quarter of 2015. Local food inflation (including costs of dining out) receded slightly from 4.1% in the fourth quarter of 2014 to 4.0% amid soft global food prices. The increase in the private housing rental component decelerated from 4.6% to 4.3% over the same period, mostly benefitting from the feed-through of the slower rises in fresh-letting residential rentals during most of 2014. The slump in international oil prices also led to a visible decrease in local motor fuel prices, which was reflected in the transport component. Charges for package tours fell markedly amid the large depreciations of some major foreign currencies, resulting in a much slower price increase in miscellaneous services. The subpar overall economic growth, coupled with mild imported inflation, also helped mitigate the price pressures on a broad front. Meanwhile, the prices of durable goods continued their secular downtrend.

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

(a) Food inflation stayed contained in the first quarter of 2015



(b) Softer fresh-letting rentals continued to feed through

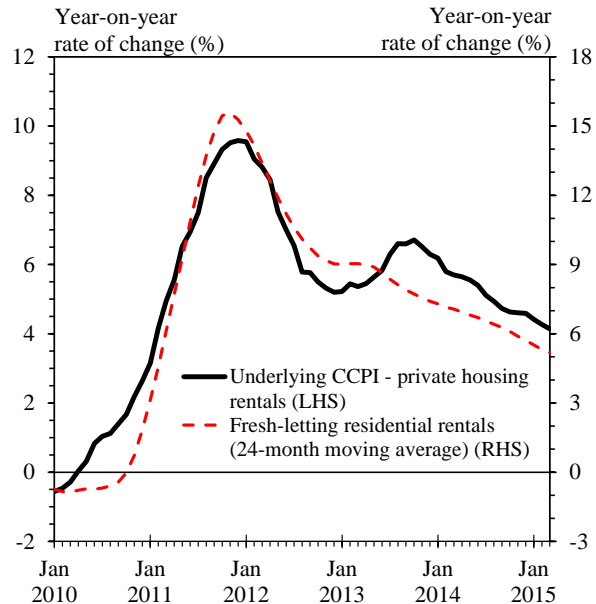


Diagram 6.4 (a) : The price increases in many major components in the underlying Composite CPI remained mild

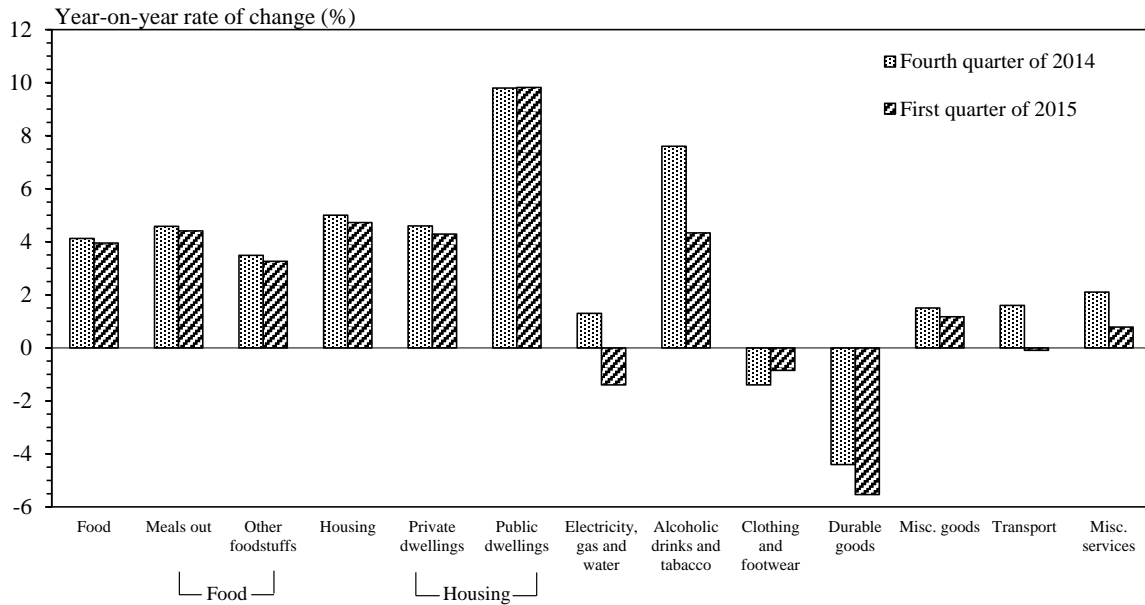
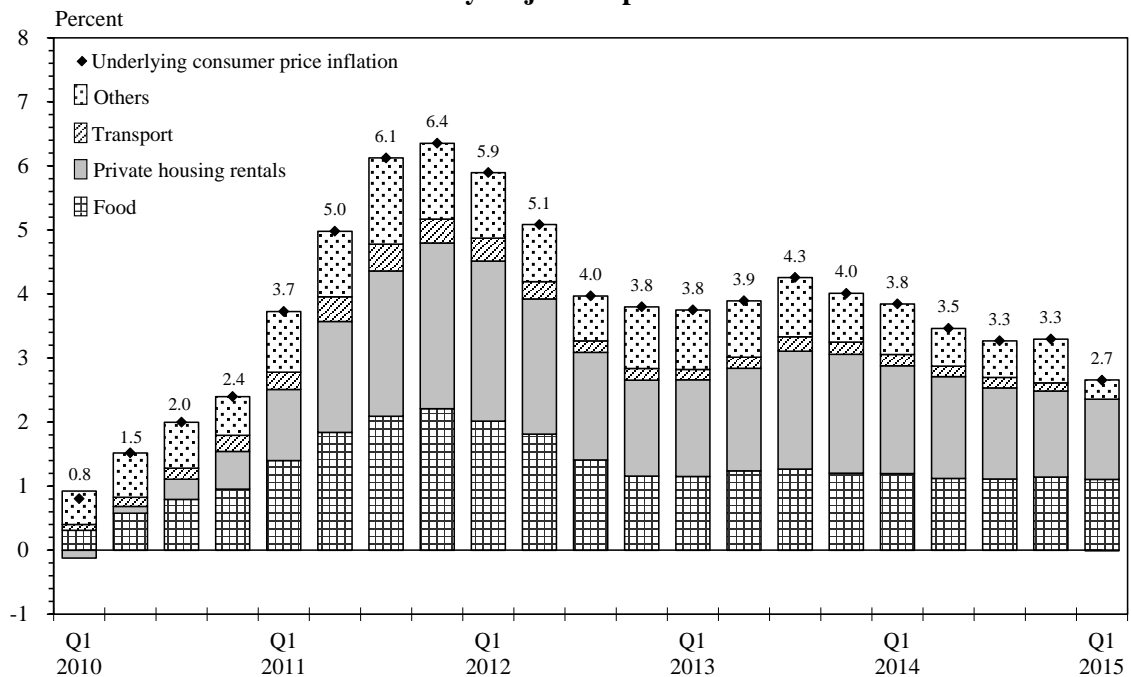


Diagram 6.4 (b) : Contribution to underlying consumer price inflation by major component



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>Annual</u>	<u>2014</u>				<u>2015</u>
				<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>	<u>Q1</u>
Food	27.45	4.4	4.1	4.3	4.0	4.0	4.1	4.0
<i>Meals bought away from home</i>	17.07	4.4	4.6	4.5	4.7	4.6	4.6	4.4
<i>Other foodstuffs</i>	10.38	4.4	3.4	4.0	3.1	3.1	3.5	3.3
Housing ^(a)	31.66	6.7 (5.8)	6.7 (5.0)	5.6 (5.3)	5.0 (5.0)	7.6 (4.8)	8.5 (5.0)	8.2 (4.7)
<i>Private dwellings</i>	27.14	6.3 (6.0)	6.0 (5.2)	6.4 (5.9)	5.6 (5.5)	4.9 (4.9)	7.1 (4.6)	6.8 (4.3)
<i>Public dwellings</i>	2.05	16.0 (6.0)	18.3 (3.4)	-1.8 (-0.1)	-0.9 (0.4)	101.4 (3.6)	29.0 (9.8)	29.0 (9.8)
Electricity, gas and water	3.10	6.9 (5.1)	14.9 (2.5)	5.5 (4.4)	3.4 (2.7)	24.9 (1.6)	25.5 (1.3)	21.5 (-1.4)
Alcoholic drinks and tobacco	0.59	1.5	6.5	3.3	7.6	7.4	7.6	4.3
Clothing and footwear	3.45	1.7	0.9	2.1	2.2	0.8	-1.4	-0.8
Durable goods	5.27	-4.3	-3.4	-3.3	-2.7	-3.3	-4.4	-5.5
Miscellaneous goods	4.17	2.2	2.3	3.1	2.0	2.4	1.5	1.2
Transport	8.44	2.3	2.0	2.2	2.1	2.1	1.6	-0.1
Miscellaneous services	15.87	3.7 (3.2)	3.0 (2.3)	4.4 (3.1)	3.2 (2.0)	2.3 (1.9)	2.1 (2.1)	0.8 (0.8)
All items	100.00	4.3 (4.0)	4.4 (3.5)	4.2 (3.8)	3.6 (3.5)	4.8 (3.3)	5.1 (3.3)	4.4 (2.7)

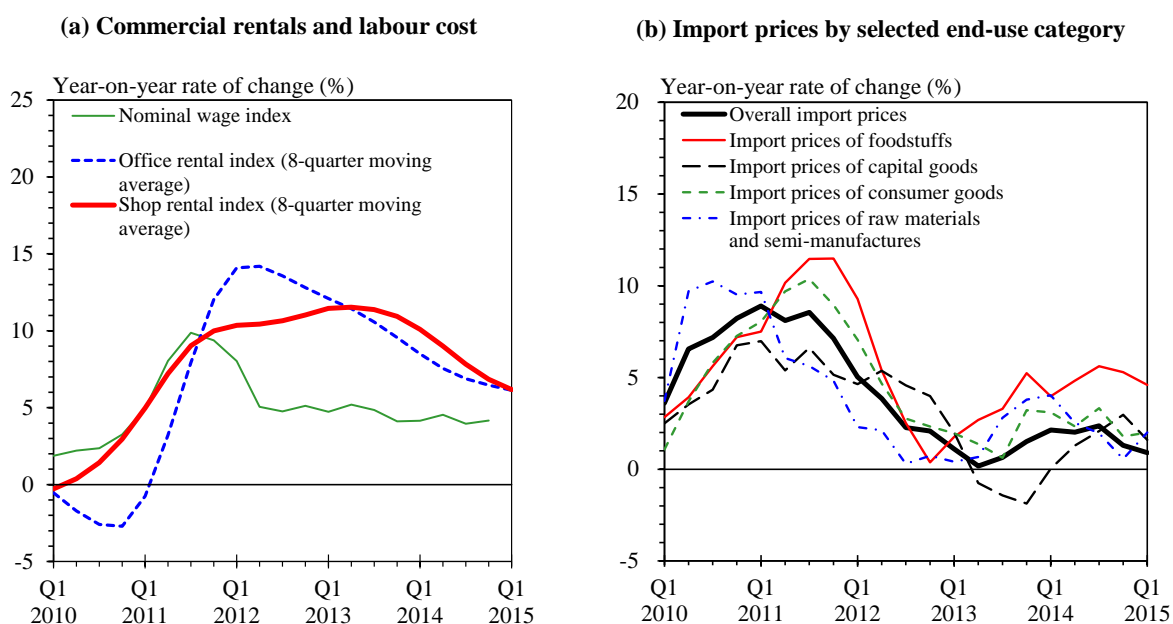
Notes : (a) The housing component covers rents, rates, Government rent, maintenance costs and other housing charges. Its sub-components on private and public dwellings as presented here, however, cover rents, rates and Government rent only. Hence, the combined weighting of private and public dwellings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

() Figures in brackets 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 were largely kept at bay in the first quarter of 2015 along with the below-trend growth of the local economy. Labour earnings growth remained largely steady at around 4% in recent quarters. While office and shop rentals showed somewhat faster year-on-year increases in the first quarter of 2015, their increases on an eight-quarter-moving-average basis continued to exhibit an easing trend.

Diagram 6.5 : Domestic cost pressures were largely contained, while imported price pressures saw further abatement



6.5 Externally, import price pressures further abated in the first quarter of 2015. Overall import prices increased mildly by 0.9% in the first quarter over a year earlier, moderated from a 1.3% rise in the preceding quarter, against the backdrop of still soft international food and commodity prices, benign inflation in major import sources and the weaker Asian currencies. Analysed by end-use category on a year-on-year comparison, import prices of foodstuffs increased by 4.6%, slightly slower than the 5.3% in the preceding quarter, helped by the moderation in international meat prices. The rises in import prices of consumer goods and capital goods were also moderate, by 2.0% and 1.6% respectively. As for raw materials and semi-manufactures, the increase in import prices also stayed low at 2.0%, due in part to the softer international commodity prices and the subdued global demand. Reflecting the international oil price slump during the second half of last year, import prices of fuels plunged by 32.8% in the first quarter of 2015 from a year earlier, after a 17.4% decrease in the preceding quarter.

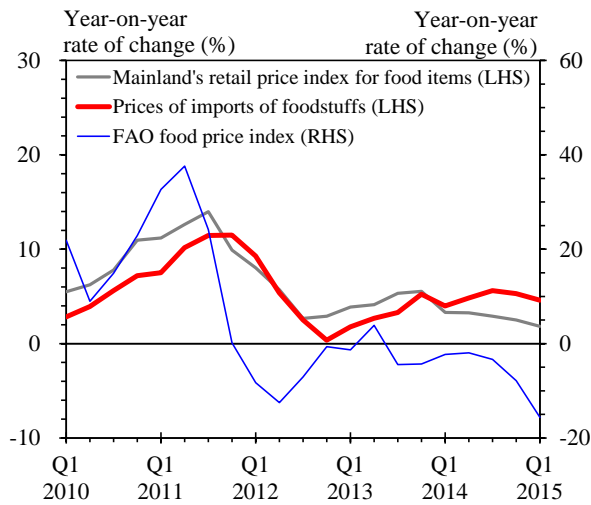
**Table 6.3 : Prices of imports by end-use category
(year-on-year rate of change (%))**

		<u>Foodstuffs</u>	<u>Consumer goods</u>	<u>Raw materials and semi-manufactures</u>	<u>Fuels</u>	<u>Capital goods</u>	<u>All</u>
2014	Annual	4.9	2.6	2.2	-6.1	1.7	1.9
	H1	4.4	2.7	3.2	-2.2	0.7	2.1
	H2	5.4	2.6	1.3	-9.9	2.5	1.8
	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
	Q4	5.3	1.8	0.6	-17.4	3.0	1.3
2015	Q1	4.6	2.0	2.0	-32.8	1.6	0.9

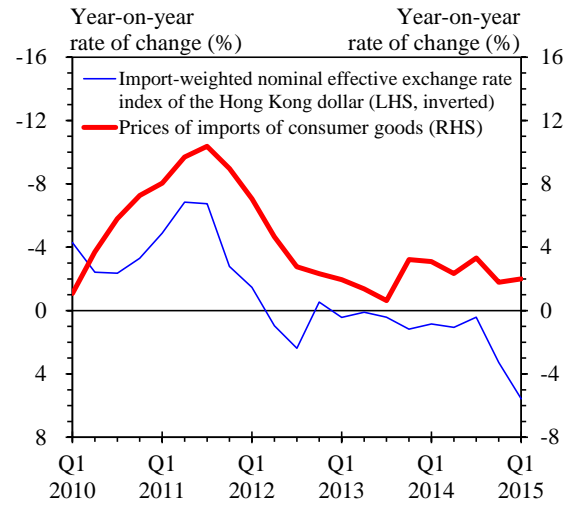
Note : (*) Change within $\pm 0.05\%$.

Diagram 6.6 : Import prices by end-use category

(a) Imported food inflation remained contained

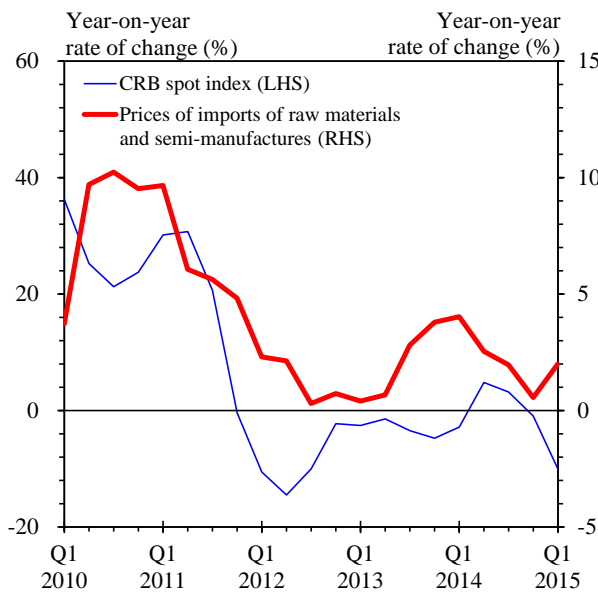


(b) Import prices of consumer goods rose moderately

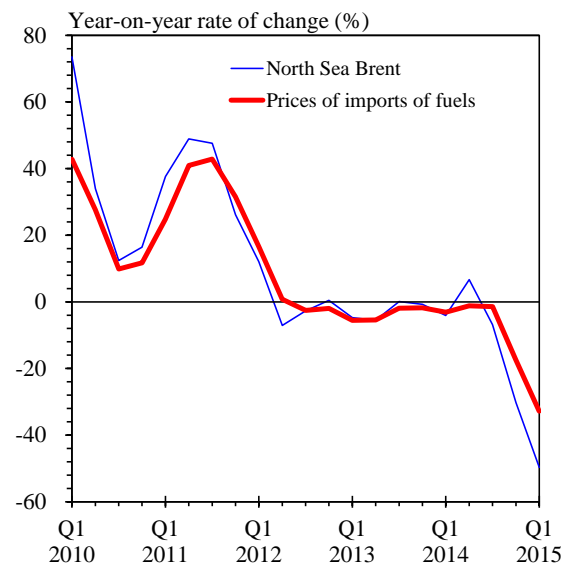


Note : An increase in the nominal EERI indicates strengthening of the Hong Kong dollar. The y-axis of nominal EERI in this graph is inverted for easier comprehension.

(c) Imported raw materials and semi-manufactures inflation remained low alongside softer international commodity prices



(d) Import prices of fuels went down further



Output prices

6.6 Output prices, as measured by the *Producer Price Indices*⁽³⁾, exhibited mixed movements across sectors in 2014. Yet, given the weaker economic growth, the pressures on price increases were generally limited. For the manufacturing sector, output prices registered a mild decline in 2014, conceivably reflecting the still subdued demand on local manufactured products. Among the service sectors, output prices for accommodation services and land transport rose moderately in 2014 as a whole. While the output prices for water transport and courier services increased modestly, those for air transport declined slightly. Separately, output prices for telecommunications services maintained the downward trend over the course of the year, reflecting continued adoption of cost-saving technologies and intense competition.

Table 6.4 : Producer Price Indices for the manufacturing sector and selected service 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>Annual</u>	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>
Manufacturing	-3.1	0.6	-2.4	-5.2	-5.5	-1.7	-6.2	-0.4	1.3	-1.2
Selected service sectors ^(a)										
Accommodation services	2.4	2.5	2.8	1.7	2.6	2.1	2.2	3.9	4.0	-1.3
Land transport	1.7	0.6	1.0	2.4	2.7	2.8	2.5	3.0	2.9	3.0
Water transport	-2.5	7.3	-14.8	1.8	-1.9	0.8	-2.9	-0.6	2.5	4.6
Air transport	1.0	4.0	-2.4	0.1	2.5	-0.7	-0.6	-1.8	1.9	-2.2
Telecommunications	-1.9	-1.6	-1.8	-1.7	-2.6	-3.7	-2.9	-3.4	-4.2	-4.2
Courier services	2.7	2.7	3.1	3.3	1.8	1.7	1.9	1.4	0.9	2.5

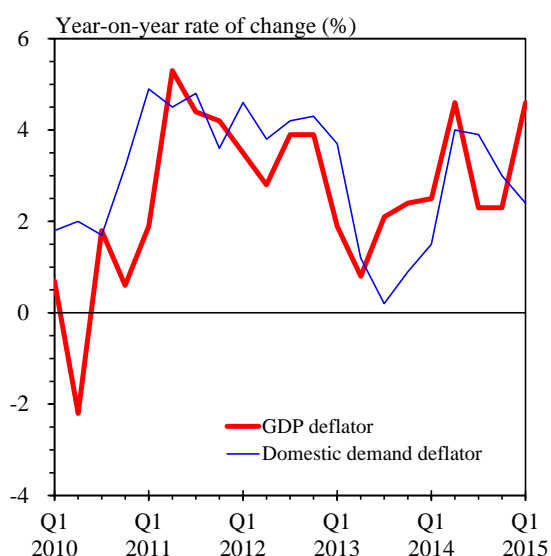
Note : (a) Producer Price Indices for other service sectors are not available, due to the difficulties involved in defining and delineating the various types of services and hence in measuring their respective price changes. This is particularly so for such sectors as banking and insurance, where the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

GDP deflator

6.7 As a broad measure of the overall change in prices in the economy, the *GDP deflator*⁽⁴⁾ rose by 4.6% in the first quarter of 2015 over a year earlier, up from the 2.3% increase in the fourth quarter of 2014. This was mainly because the *terms of trade*⁽⁵⁾, a dominant item in the GDP deflator, registered an visible improvement given the larger declines in import prices over a year earlier. Taking out the external components, the year-on-year increase of domestic demand deflator slowed further to 2.4% in the first quarter of 2015, from the 3.0% increase in the preceding quarter.

Diagram 6.7 : GDP deflator

(a) The rise in the GDP deflator strengthened in the first quarter of 2015



(b) Terms of trade improved visibly, mainly attributable to larger declines in import prices

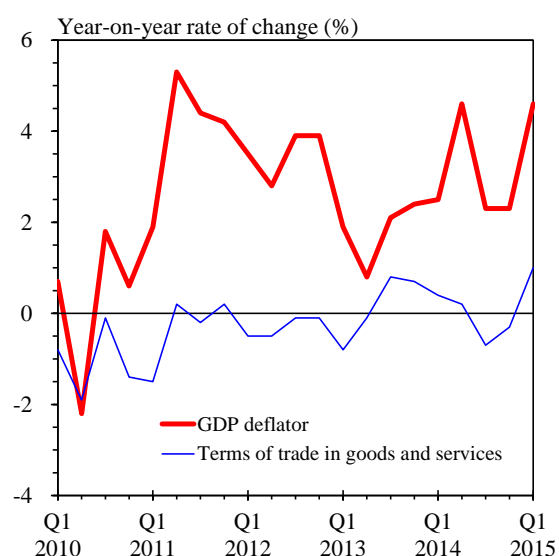


Table 6.5 : GDP deflator and the main expenditure component deflators
(year-on-year rate of change (%))

	2013		2014				2015
	Annual [#]	Annual [#]	Q1 [#]	Q2 [#]	Q3 [#]	Q4 [#]	Q1 ⁺
Private consumption expenditure	2.8	2.7	2.7	3.3	3.2	1.8	1.7
Government consumption expenditure	4.3	4.7	4.0	5.2	4.9	4.8	4.7
Gross domestic fixed capital formation	-2.8	3.6	-2.3	4.6	5.2	6.0	3.3
Total exports of goods	-0.3	0.8	-0.1	0.1	1.9	1.0	0.6
Imports of goods	-0.4	0.9	-0.5	-0.2	2.5	1.5	-0.1
Exports of services	0.6	0.8	0.3	0.8	1.5	0.6	0.5
Imports of services	1.1	1.0	0.5	2.6	2.6	-1.2	-2.8
Gross Domestic Product	1.9	2.9	2.5	4.6	2.3	2.3	4.6
			<0.1>	<1.2>	<0.4>	<0.6>	<2.4>
Total final demand	0.4	1.5	0.5	1.4	2.5	1.6	1.2
Domestic demand	1.5	3.1	1.5	4.0	3.9	3.0	2.4
Terms of trade in goods and services	0.2	-0.1	0.4	0.2	-0.7	-0.3	1.0

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.

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>2013</u>					<u>2014</u>					<u>2015</u>
	<u>Annual</u>	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>	<u>Annual</u>	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>	<u>Q1</u>
Selected developed economies											
US	1.5	1.7	1.4	1.6	1.2	1.6	1.4	2.1	1.8	1.2	-0.1
Canada	0.9	0.9	0.8	1.1	0.9	2.0	1.4	2.2	2.1	1.9	1.1
EU	1.5	2.0	1.6	1.5	1.0	0.6	0.8	0.7	0.5	0.2	-0.3
Japan	0.4	-0.6	-0.3	0.9	1.4	2.7	1.5	3.6	3.3	2.5	2.3
Major emerging economies											
Mainland China	2.6	2.4	2.4	2.8	2.9	2.0	2.3	2.2	2.0	1.5	1.2
Russia	6.8	7.1	7.2	6.4	6.4	7.8	6.4	7.6	7.7	9.6	16.2
India [#]	10.1	10.7	9.5	9.7	10.4	6.6	8.2	7.8	6.7	4.1	5.2
Brazil	6.2	6.4	6.6	6.1	5.8	6.3	5.8	6.4	6.6	6.5	7.7
Selected Asian economies											
Hong Kong	4.3	3.7	4.0	5.3	4.3	4.4	4.2	3.6	4.8	5.1	4.4
Singapore	2.4	4.0	1.6	1.8	2.0	1.0	1.0	2.2	1.0	*	-0.3
Taiwan	0.8	1.8	0.8	*	0.6	1.2	0.8	1.6	1.5	0.8	-0.6
Korea	1.3	1.6	1.2	1.4	1.1	1.3	1.1	1.6	1.4	1.0	0.6
Malaysia	2.1	1.5	1.8	2.2	3.0	3.1	3.5	3.3	3.0	2.8	0.7
Thailand	2.2	3.1	2.3	1.7	1.7	1.9	2.0	2.5	2.0	1.1	-0.5
Indonesia	6.4	4.5	5.1	8.0	8.0	6.4	7.8	7.1	4.4	6.5	6.5
Philippines	3.0	3.2	2.6	2.4	3.5	4.2	4.1	4.4	4.7	3.6	2.4
Vietnam	6.6	6.9	6.6	7.0	5.9	4.1	4.8	4.7	4.3	2.6	0.7
Macao	5.5	5.4	5.1	5.6	5.9	6.0	6.1	6.2	5.9	6.0	5.1

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

(#) Figures for 2013 are 2010-based, figures for 2014 onwards are 2012-based.

- (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.