

CHAPTER 6 : PRICES

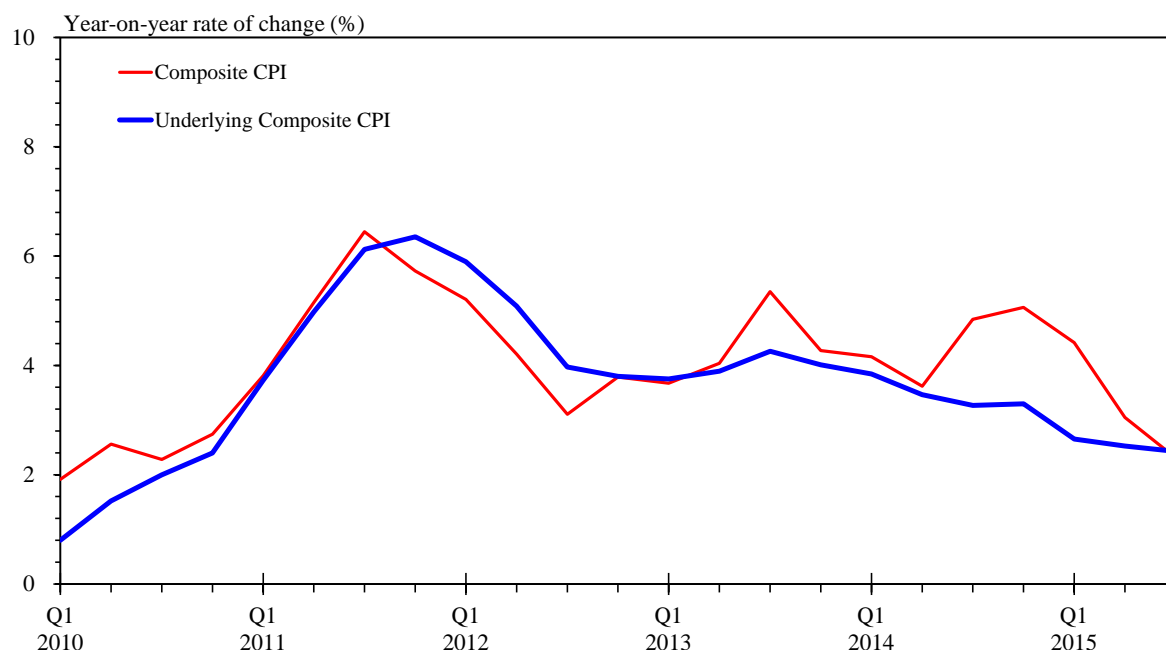
Summary

- *Inflation eased slightly further in the third quarter of 2015, as the rises in domestic costs stayed contained and imported inflation pressures were muted. The Composite Consumer Price Index (Composite CPI)⁽¹⁾ rose by 2.3% in the third quarter over a year earlier, down from the 3.0% increase in the second quarter. Netting out the effects of the Government's one-off relief measures to more accurately reflect the underlying inflation trend, underlying Composite CPI inflation was 2.4%, down by 0.1 percentage point from the preceding quarter.*
- *Domestic cost pressures remained generally in check. Increases in labour costs were largely steady under a modest economic growth scenario, while the passing-through of the faster increases in fresh-letting private residential and commercial rentals this year into the CPIs was still rather modest and gradual in the third quarter. Meanwhile, the pricing power of retailers was generally constrained by the slower retail sales. The special fuel rebate since mid-August also drove the electricity prices distinctly lower over the period.*
- *External price pressures receded further in the third quarter, thanks to the continued fall-off in international commodity prices, the rather benign inflation in our major import sources, and the strength of the US dollar.*
- *Looking ahead, the upside risks to consumer price inflation should remain limited in the near term, in view of the moderate cost pressures from both domestic and external fronts.*

Consumer prices

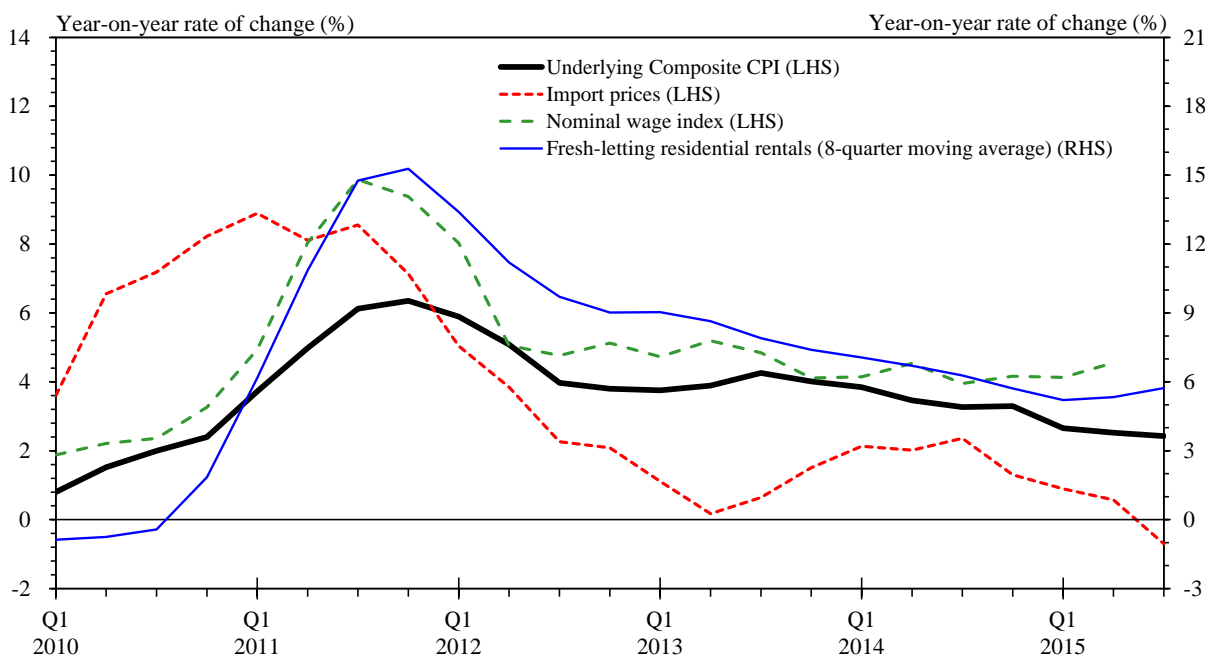
6.1 Underlying inflation eased slightly further in the third quarter of 2015, as local cost pressures remained moderate and imported price pressures subsided. Locally, wages continued to increase at a steady pace, supported by the broadly stable labour market conditions. While fresh-letting residential rentals saw faster increases this year, the passing-through effect to the private housing component in the CPI in the third quarter was still modest. The continued slowdown in inbound tourism and related segments also weakened the pricing power of retailers and other operators. Meanwhile, external price pressures were muted against the backdrop of the fall-off in energy and raw material prices over a year earlier, lower inflation in many of Hong Kong's major import sources⁽²⁾, and the strength of US dollar.

Diagram 6.1 : Underlying inflation eased slightly further in the third 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 : Price pressures from both domestic and external fronts were moderate



6.2 Underlying consumer price inflation, in terms of the year-on-year rate of change in the underlying Composite CPI, which nets out the effects of the Government's one-off relief measures to more accurately reflect the underlying inflation trend, went down slightly to 2.4% in the third quarter of 2015, from 2.5% in the second quarter. Headline consumer price inflation, as measured by the year-on-year rate of change in the Composite CPI, eased to 2.3% in the third quarter of 2015, from 3.0% in the preceding quarter. The larger decline in headline inflation mainly reflected the end of the temporarily lower base of comparison in the third quarter of 2014, when the effect of the Government's one-off electricity subsidy waned. For the first three quarters of 2015 as a whole, the headline and underlying consumer price inflation rates averaged 3.3% and 2.5% respectively, both lower than those of 4.4% and 3.5% for 2014 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>			
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	H1	2.6	3.7	5.3	3.3	2.3
	Q1	2.7	4.4	6.5	3.9	2.6
	Q2	2.5	3.0	4.2	2.7	1.9
	Q3	2.4	2.3	2.8	2.3	1.8

(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
	Q2	0.6	-0.6	-1.4	-0.5	*
	Q3	0.6	-0.2	-1.5	0.4	0.5

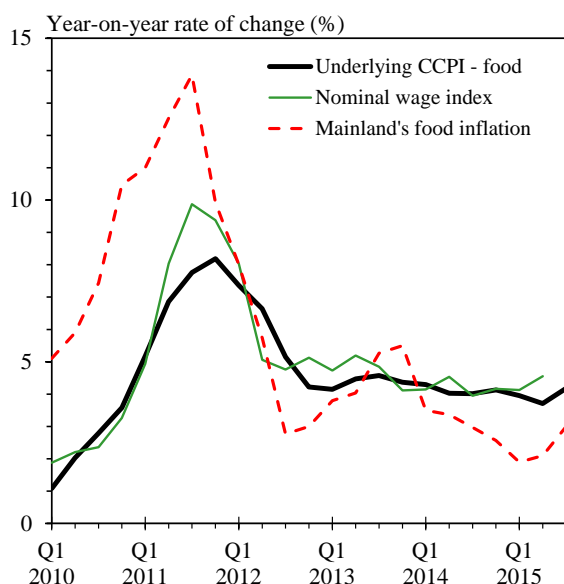
Notes : (a) Underlying consumer price inflation is calculated by netting out the effects of all relevant one-off measures introduced since 2007, including the waiver and Government's payment of public housing rentals, rates concession, suspension and subsequent abolition of Employees Retraining Levy,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

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

6.3 Analysing inflation by major components of the underlying Composite CPI showed that the abatement of price pressures was still generally widespread. On the two largest components by weight, food inflation in the first three quarters of 2015 combined remained modest, notwithstanding fluctuations in the monthly prices of some basic foodstuffs. Rental inflation likewise stayed contained, as the private housing rental component held very stable in latest quarters. As to other components, prices of clothing and footwear continued to decline, reflecting subdued imported inflation, and the pressure to cut prices in a bid to boost sales. The still-low international oil prices, plummeted from year-ago levels, also contributed to a visible fall in prices of motor fuel within the transport component. The price fall-off in the electricity, gas and water component was particularly distinct, from 0.7% year-on-year in the second quarter to 6.1% in the third quarter, thanks to the special fuel rebate in electricity starting from mid-August. Meanwhile, the secular downtrend in durable goods prices continued with a faster pace of decline, conceivably due to a distinctly lower yen and euro. Price pressures on miscellaneous goods and services also eased further on a broad front amid muted import price pressures and modest economic expansion locally.

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

(a) Food inflation remained moderate in the third quarter of 2015



(b) Rental inflation has been stable in recent period

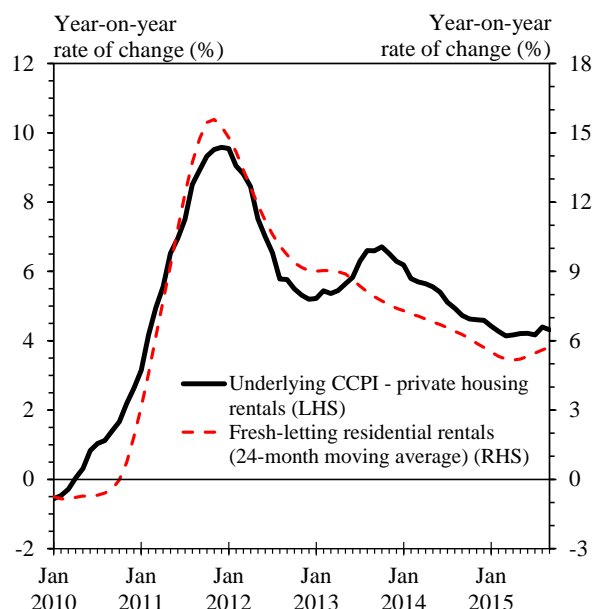


Diagram 6.4 (a) : The price changes in major components in the underlying Composite CPI showed mixed movements

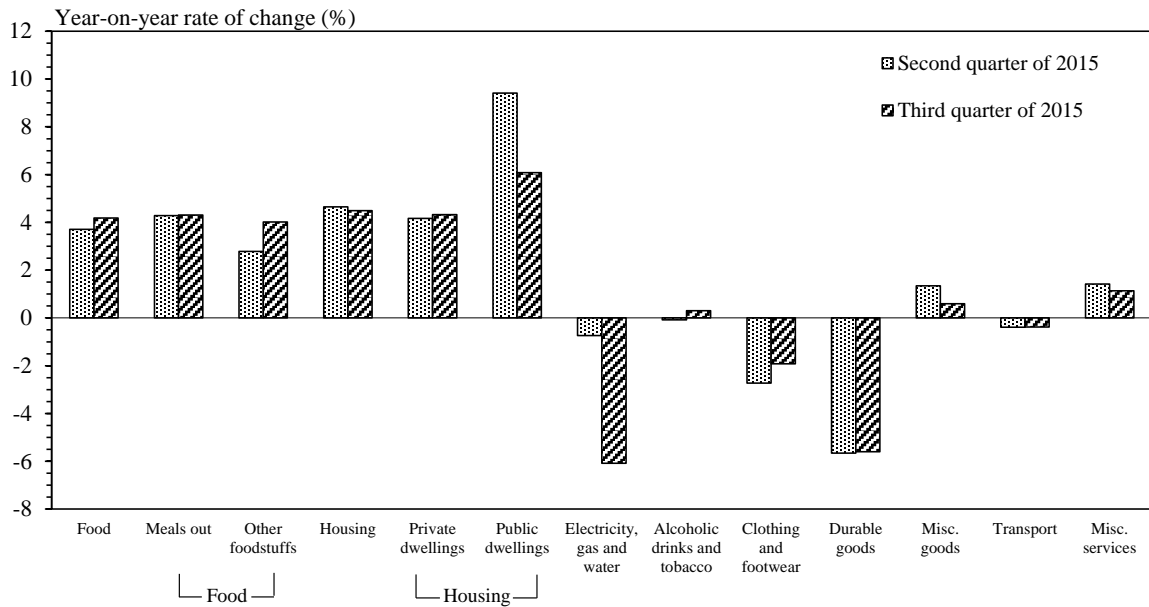
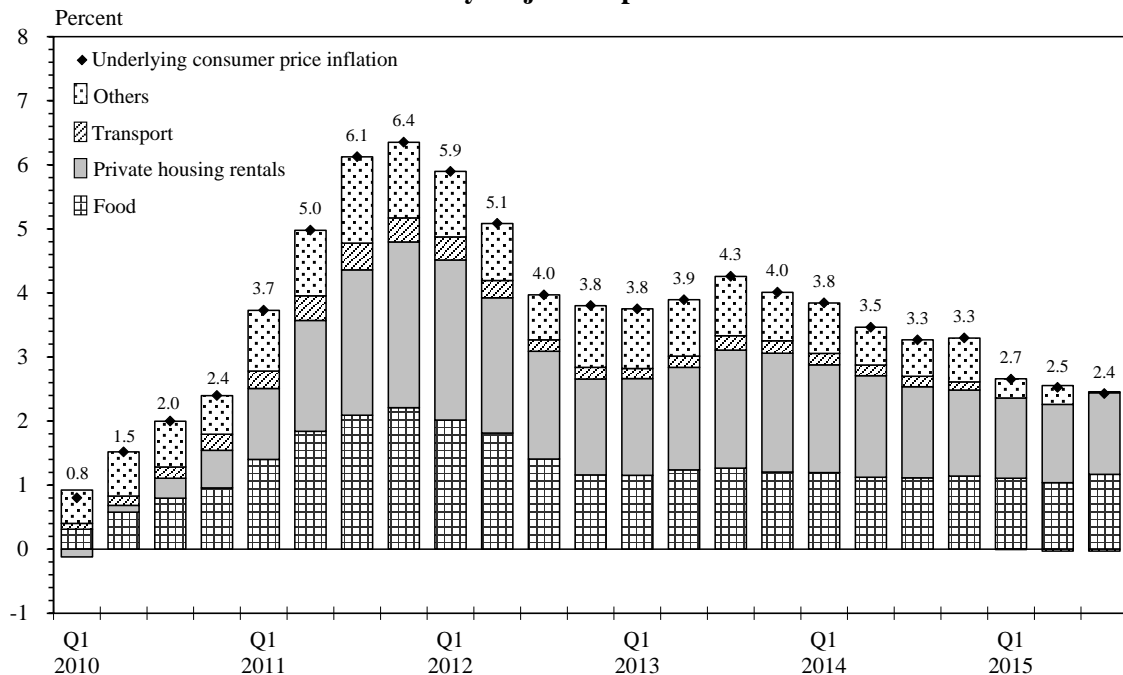


Diagram 6.4 (b) : Contribution to underlying consumer price inflation by major component



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>Annual</u>	<u>2014</u>				<u>2015</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	4.1	4.3	4.0	4.0	4.1	4.0	3.7	4.2
<i>Meals bought away from home</i>	17.07	4.6	4.5	4.7	4.6	4.6	4.4	4.3	4.3
<i>Other foodstuffs</i>	10.38	3.4	4.0	3.1	3.1	3.5	3.3	2.8	4.0
Housing ^(a)	31.66	6.7 (5.0)	5.6 (5.3)	5.0 (5.0)	7.6 (4.8)	8.5 (5.0)	8.2 (4.7)	4.2 (4.7)	4.1 (4.5)
<i>Private dwellings</i>	27.14	6.0 (5.2)	6.4 (5.9)	5.6 (5.5)	4.9 (4.9)	7.1 (4.6)	6.8 (4.3)	3.8 (4.2)	3.9 (4.3)
<i>Public dwellings</i>	2.05	18.3 (3.4)	-1.8 (-0.1)	-0.9 (0.4)	101.4 (3.6)	29.0 (9.8)	29.0 (9.8)	10.0 (9.4)	6.4 (6.1)
Electricity, gas and water	3.10	14.9 (2.5)	5.5 (4.4)	3.4 (2.7)	24.9 (1.6)	25.5 (1.3)	21.5 (-1.4)	22.8 (-0.7)	-4.6 (-6.1)
Alcoholic drinks and tobacco	0.59	6.5	3.3	7.6	7.4	7.6	4.3	-0.1	0.3
Clothing and footwear	3.45	0.9	2.1	2.2	0.8	-1.4	-0.8	-2.7	-1.9
Durable goods	5.27	-3.4	-3.3	-2.7	-3.3	-4.4	-5.5	-5.7	-5.6
Miscellaneous goods	4.17	2.3	3.1	2.0	2.4	1.5	1.2	1.3	0.6
Transport	8.44	2.0	2.2	2.1	2.1	1.6	-0.1	-0.4	-0.4
Miscellaneous services	15.87	3.0 (2.3)	4.4 (3.1)	3.2 (2.0)	2.3 (1.9)	2.1 (2.1)	0.8 (0.8)	1.4 (1.4)	1.1 (1.1)
All items	100.00	4.4 (3.5)	4.2 (3.8)	3.6 (3.5)	4.8 (3.3)	5.1 (3.3)	4.4 (2.7)	3.0 (2.5)	2.3 (2.4)

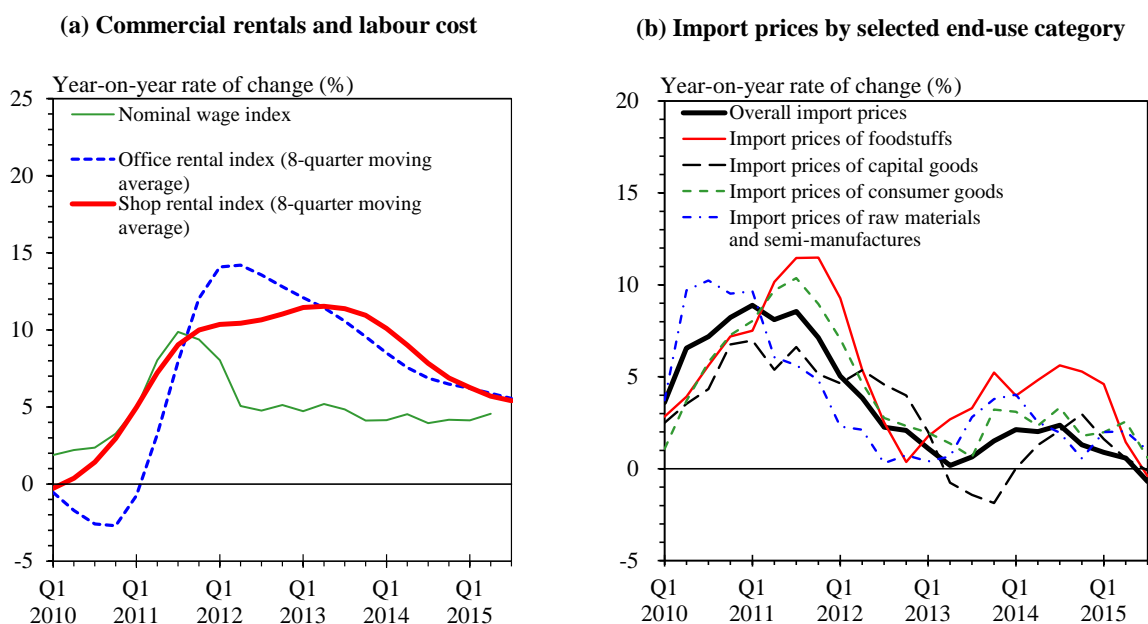
Notes : (a) The housing component covers rents, rates, Government rent, maintenance costs and other housing charges. Its sub-components on private and public dwellings as presented here, however, cover rents, rates and Government rent only. Hence, the combined weighting of private and public dwellings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

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

Costs of factor inputs and import prices

6.4 Domestic cost pressures were generally in check in the third quarter. On labour costs, nominal wage growth held largely steady in the past few quarters. On rental costs, although office and shop rentals rose somewhat faster in recent months, their year-on-year increases, when analysed on an eight-quarter-moving-average basis, were still on a moderating trend.

Diagram 6.5 : Domestic cost pressures were largely in check, while imported inflation abated further



6.5 Imported inflation pressures receded faster in the third quarter, on the back of the fall-off in international commodity prices, tame inflation in major import sources, and strength of the US dollar. Overall import prices declined by 0.7% over a year earlier in the third quarter, down from the 0.6% rise in the second quarter, and marking the fourth consecutive quarter of deceleration. Analysed by end-use category, the easing of import price pressures was generally broad-based.

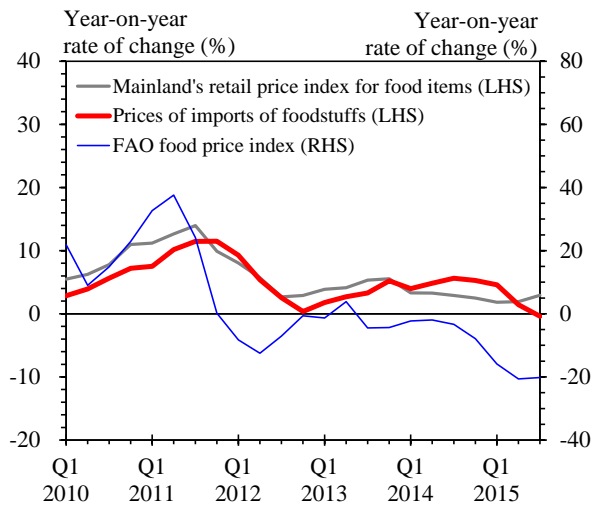
**Table 6.3 : Prices of imports by end-use category
(year-on-year rate of change (%))**

		<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	H1	3.0	2.3	2.0	-32.0	1.1	0.7
	Q1	4.6	2.0	2.0	-32.8	1.6	0.9
	Q2	1.4	2.6	2.0	-31.2	0.6	0.6
	Q3	-0.4	0.6	1.0	-39.2	-0.1	-0.7

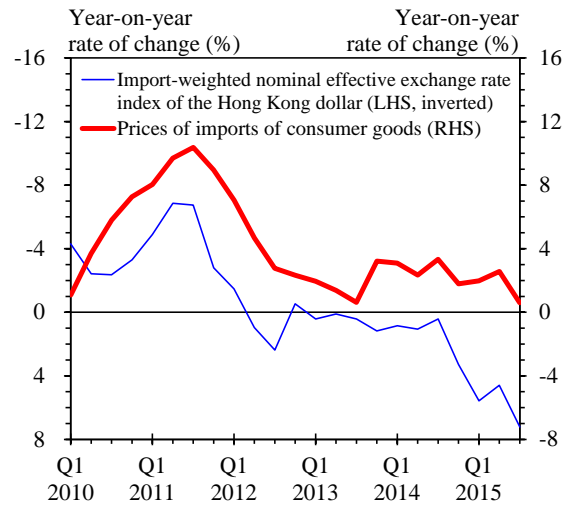
Note : (*) Change within $\pm 0.05\%$.

Diagram 6.6 : Import prices by end-use category

(a) Import prices of food declined slightly

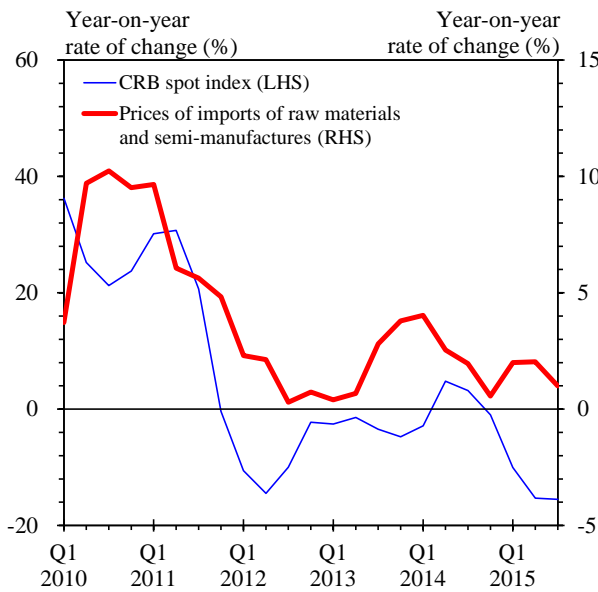


(b) Rise in import prices of consumer goods slowed

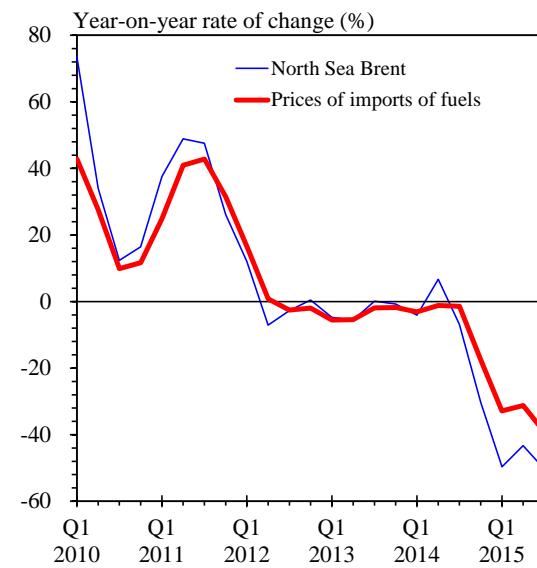


Note : An increase in the nominal EERI indicates strengthening of the Hong Kong dollar. The y-axis of nominal EERI in this graph is inverted for easier comprehension.

(c) Import prices of raw materials and semi-manufactures also decelerated



(d) Import prices of fuels continued to fall visibly



Output prices

6.6 Output prices, as measured by the *Producer Price Indices*⁽³⁾, showed varied movements in the second quarter of 2015. For the manufacturing sector, the year-on-year decline in output prices widened to 2.8%. As for the selected service sectors, the output prices for accommodation services fell more notably by 5.4% over a year earlier, conceivably due to a more competitive pricing strategy adopted amid the slowdown in inbound tourism. Alongside the subdued regional trade flows and the recent faltering of our merchandise trade, the year-on-year declines in output prices for water and air transport accelerated and land transport also saw a slower increase in output prices. Separately, the output prices for courier services rose somewhat faster, possibly reflecting the increasing popularity of internet purchases. Meanwhile, the output prices for telecommunications services continued to stay on its secular downtrend, due to cost reduction from technological advancement and intense competition in the sector.

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

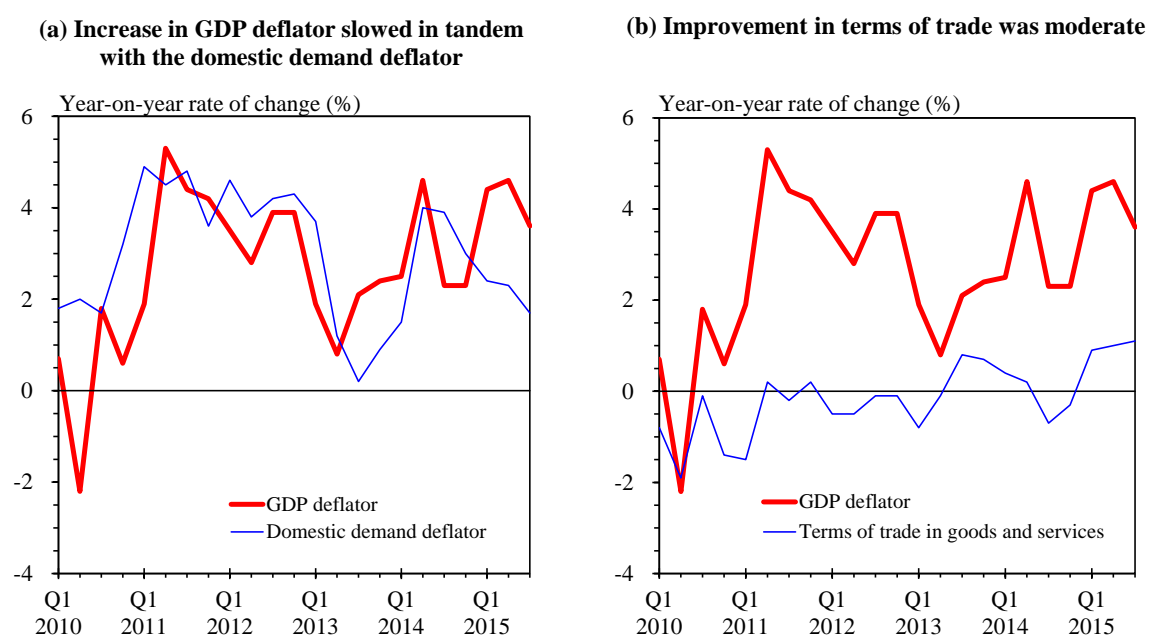
<u>Industry group</u>	<u>Annual</u>	<u>2014</u>				<u>2015</u>	
		<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>	<u>Q1</u>	<u>Q2</u>
Manufacturing	-1.7	-6.2	-0.4	1.3	-1.2	-0.6	-2.8
Selected service sectors ^(a)							
Accommodation services	2.1	2.2	3.9	4.0	-1.3	-1.6	-5.4
Land transport	2.8	2.5	3.0	2.9	3.0	2.9	2.3
Water transport	0.8	-2.9	-0.6	2.5	4.6	-0.2	-3.5
Air transport	-0.7	-0.6	-1.8	1.9	-2.2	-3.4	-7.9
Telecommunications	-3.7	-2.9	-3.4	-4.2	-4.2	-3.9	-4.4
Courier services	1.7	1.9	1.4	0.9	2.5	4.2	4.8

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 3.6% in the third quarter of 2015 over a year earlier, having increased by 4.5% in the first half of 2015. Within the GDP deflator, the *terms of trade*⁽⁵⁾ continued to improve modestly amid the strength of the US dollar. Taken out the external components, the domestic demand deflator increased mildly by 1.7% year-on-year, moderated from 2.3% in the previous quarter.

Diagram 6.7 : GDP deflator



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

	<u>2013</u>		<u>2014</u>				<u>2015</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	2.8	2.7	2.7	3.3	3.2	1.8	1.6	1.8	0.7
Government consumption expenditure	4.3	4.7	4.0	5.2	4.9	4.8	4.7	4.5	4.3
Gross domestic fixed capital formation	-2.8	3.6	-2.3	4.6	5.2	6.0	3.3	3.3	4.2
Total exports of goods	-0.3	0.8	-0.1	0.1	1.9	1.0	0.6	0.2	-1.1
Imports of goods	-0.4	0.9	-0.5	-0.2	2.5	1.5	-0.1	-0.8	-2.1
Exports of services	0.6	0.8	0.3	0.8	1.5	0.6	*	-0.9	-2.2
Imports of services	1.1	1.0	0.5	2.6	2.6	-1.2	-3.2	-2.3	-4.6
Gross Domestic Product	1.9	2.9	2.5 <0.1>	4.6 <1.2>	2.3 <0.4>	2.3 <0.6>	4.4 <2.3>	4.6 <1.3>	3.6 <-0.6>
Total final demand	0.4	1.5	0.5	1.4	2.5	1.6	1.1	0.8	-0.4
Domestic demand	1.5	3.1	1.5	4.0	3.9	3.0	2.4	2.3	1.7
Terms of trade in goods and services	0.2	-0.1	0.4	0.2	-0.7	-0.3	0.9	1.0	1.1

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>2013</u>		<u>2014</u>				<u>2015</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	1.5	1.6	1.4	2.1	1.8	1.2	-0.1	*	0.1
Canada	0.9	2.0	1.4	2.2	2.1	1.9	1.1	0.9	1.2
EU	1.5	0.6	0.8	0.7	0.5	0.2	-0.3	0.1	*
Japan	0.4	2.7	1.5	3.6	3.4	2.5	2.3	0.5	0.2
Major emerging economies									
Mainland China	2.6	2.0	2.3	2.2	2.0	1.5	1.2	1.4	1.7
Russia	6.8	7.8	6.4	7.6	7.7	9.6	16.2	15.8	15.7
India [#]	10.1	6.6	8.2	7.8	6.7	4.1	5.3	5.1	3.9
Brazil	6.2	6.3	5.8	6.4	6.6	6.5	7.7	8.5	9.5
Selected Asian economies									
Hong Kong	4.3	4.4	4.2	3.6	4.8	5.1	4.4	3.0	2.3
Singapore	2.4	1.0	1.0	2.2	1.0	*	-0.3	-0.4	-0.6
Taiwan	0.8	1.2	0.8	1.6	1.5	0.8	-0.6	-0.7	-0.3
Korea	1.3	1.3	1.1	1.6	1.4	1.0	0.6	0.5	0.7
Malaysia	2.1	3.1	3.5	3.3	3.0	2.8	0.7	2.2	3.0
Thailand	2.2	1.9	2.0	2.5	2.0	1.1	-0.5	-1.1	-1.1
Indonesia	6.4	6.4	7.8	7.1	4.4	6.5	6.5	7.1	7.1
Philippines	3.0	4.1	4.1	4.4	4.7	3.6	2.4	1.7	0.6
Vietnam	6.6	4.1	4.8	4.7	4.3	2.6	0.7	1.0	0.5
Macao	5.5	6.0	6.1	6.2	5.9	6.0	5.1	4.8	4.5

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.