

## CHAPTER 7 : PRICES

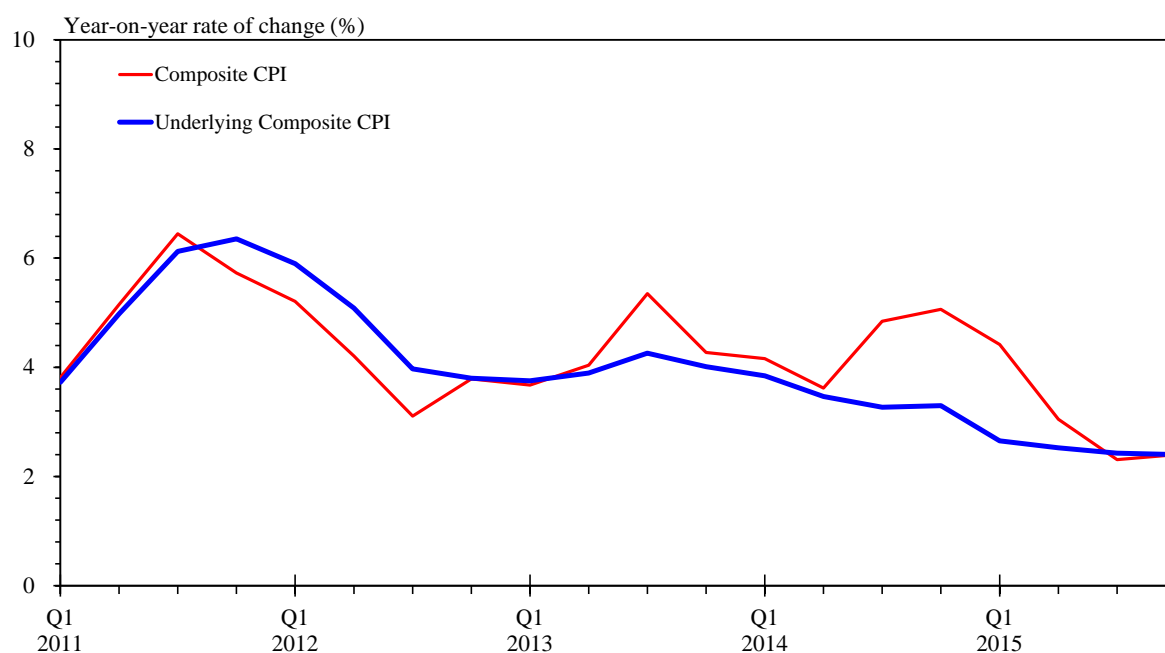
### *Summary*

- *Inflation continued to recede during 2015, amid soft import prices and moderate domestic cost pressures. The increase in underlying Composite Consumer Price Index (Composite CPI)<sup>(1)</sup>, which nets out the effects of the Government's one-off relief measures to more accurately reflect the underlying inflation trend, eased to a modest 2.5% in 2015 from 3.5% in 2014. This also marked the fourth consecutive year of falling underlying inflation. Likewise, the headline Composite CPI inflation averaged 3.0% in 2015, down from 4.4% in 2014.*
- *Domestic cost pressures were tame in 2015 against the background of modest pace of local economic expansion. Wages and salaries continued to rise steadily, as the labour market largely maintained full employment, but productivity gains have kept labour cost pressures moderate on a unit cost basis. Rental inflation held generally stable during most of 2015, but tended to ease towards the end of the year given the weakening consumption market and the consolidation of the property market. The weaker consumption market, largely impaired by the slowdown of inbound tourism, also restrained the pricing power of retailers and other related businesses.*
- *Imported inflation was muted in 2015, attributable mainly to the further declines in international food and commodity prices under the weight of subdued global economic growth, the continued fall in inflation in our major import sources, and the strength of the US dollar.*
- *The upside risks to CPI inflation are limited in the near term. The still-austere global economic conditions should keep international commodity prices at bay. Domestic costs will also be contained by a quieter property market and the sub-par performance of the local economy. Nevertheless, the possibility of abrupt changes in international oil and food prices, with implications for the inflation outlook, cannot be entirely ruled out, as supply could be disrupted by geopolitical risks and extreme weather conditions.*

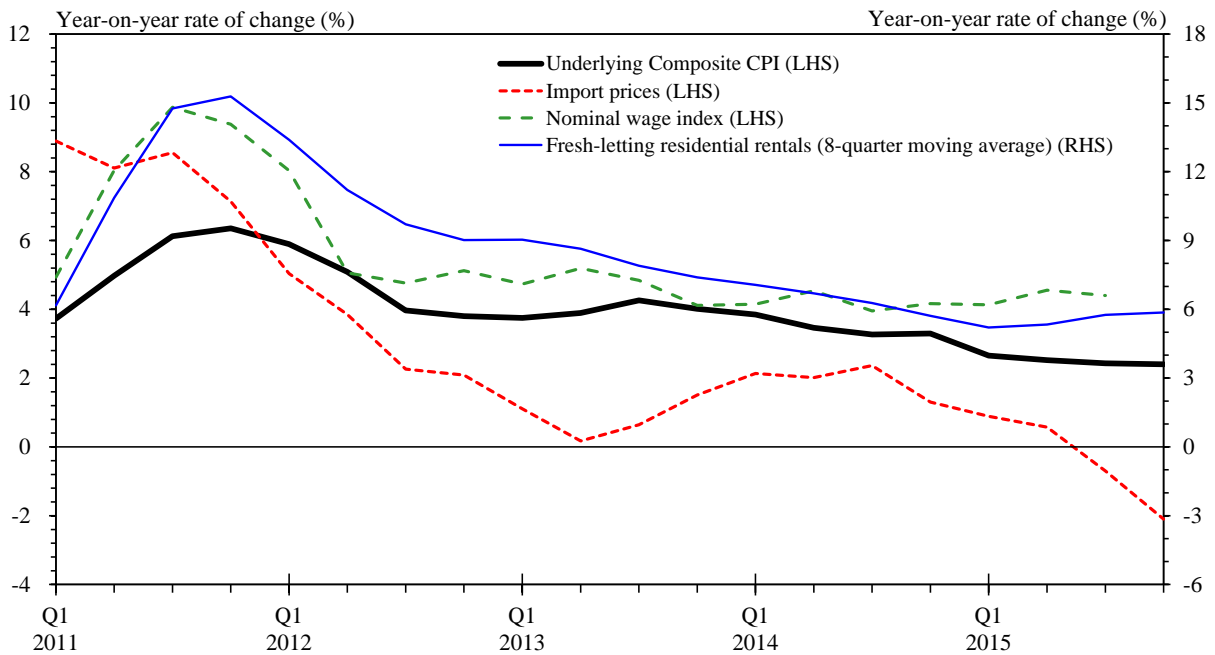
## Consumer prices

7.1 Inflation pressures stayed on an easing trend for the fourth consecutive year in 2015. Locally, labour cost pressures remained largely moderate along with the steady rises in wages and salaries. Meanwhile, rental inflation held largely stable during most of 2015, but tended to moderate in the latter part of the year on account of a weaker consumption market and quieter property market. The slowdown in inbound tourism, with notable adverse impacts on retail and tourism-related businesses, also weakened the pricing power of the operators concerned. Externally, import prices eased further in 2015, thanks to the still-weak international food and commodity prices, the widespread receding of inflationary pressures in Hong Kong's major import sources<sup>(2)</sup>, and the persisted strength of the US dollar.

**Diagram 7.1 : Underlying inflation continued to ease in 2015**



**Diagram 7.2 : Imported inflation abated further and domestic cost pressures remained in check**



7.2 Underlying consumer price inflation, as measured by 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 genuinely reflect the underlying inflation trend, largely followed an easing path during 2015, falling from 2.7% in the first quarter to 2.5% in the second quarter, and slightly further to 2.4% in both the third and fourth quarters. For 2015 as a whole, underlying inflation averaged 2.5%, down from 3.5% in 2014. Headline consumer price inflation, likewise, abated from 4.4% in 2014 to 3.0% in 2015. Headline inflation returned to a level more in line with underlying inflation in the second half of 2015, when the temporarily lower base of comparison caused by the Government’s one-off electricity subsidy ended in the third quarter of 2014.

**Table 7.1 : 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<sup>(a)</sup></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	Annual	2.5	3.0	4.0	2.8	2.1
	H1	2.6	3.7	5.3	3.3	2.3
	H2	2.4	2.4	2.7	2.4	1.9
	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
	Q4	2.4	2.4	2.7	2.4	2.1

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

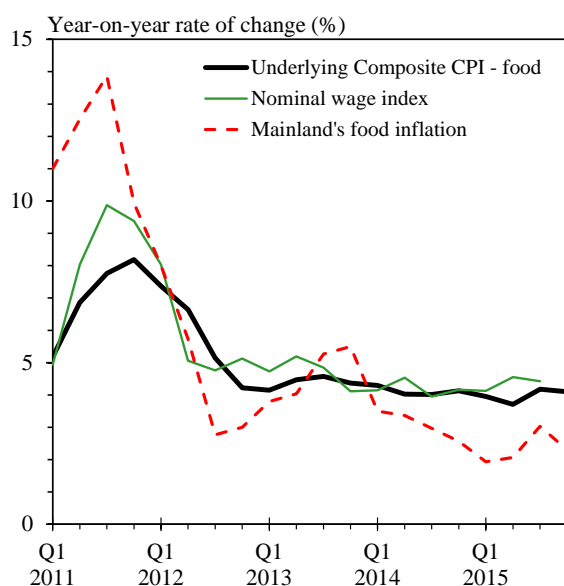
2014	Q1	1.0	1.0	1.1	1.0	0.8
	Q2	0.8	0.8	0.8	0.7	0.8
	Q3	0.6	0.4	-0.2	0.9	0.6
	Q4	0.8	2.8	5.3	2.0	1.2
2015	Q1	0.4	0.4	0.5	0.4	0.1
	Q2	0.7	-0.6	-1.4	-0.5	0.1
	Q3	0.6	-0.2	-1.6	0.3	0.4
	Q4	0.8	2.9	5.1	2.2	1.4

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.

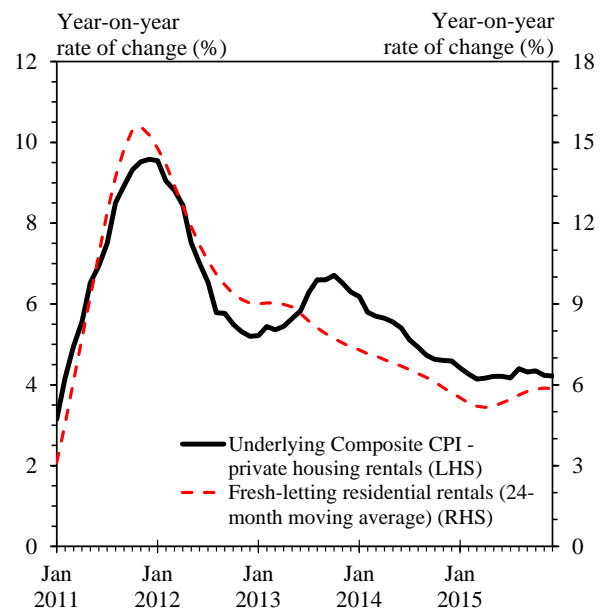
7.3 The abatement of price pressures was generally seen across major components in the underlying Composite CPI. Food and private housing rentals, the main inflation contributors which accounted for over 90% of the increase in the underlying Composite CPI in 2015, both registered milder price increases in 2015 than in the preceding year. Alongside the fall in global food prices, local food inflation (including costs of dining out) eased slightly to 4.0% in 2015 from 4.1% in 2014. The increase in the private housing rental component also moderated to 4.3% from 5.2%, as the feed-through of the increases in fresh-letting residential rentals during most of the 2015 was found to be gradual. Also, the impact of the consolidation of the residential property market in the latter part of the year on fresh-letting rentals had yet to feed through to the CPIs. The prices of many other components likewise saw decelerated increases in 2015, or reverted to declines of varying degrees, largely reflecting the sub-par economic growth and the receding import price pressures. Meanwhile, prices of durable goods stayed on the secular downtrend.

**Diagram 7.3 : Food and private housing rental components of the underlying Composite CPI**

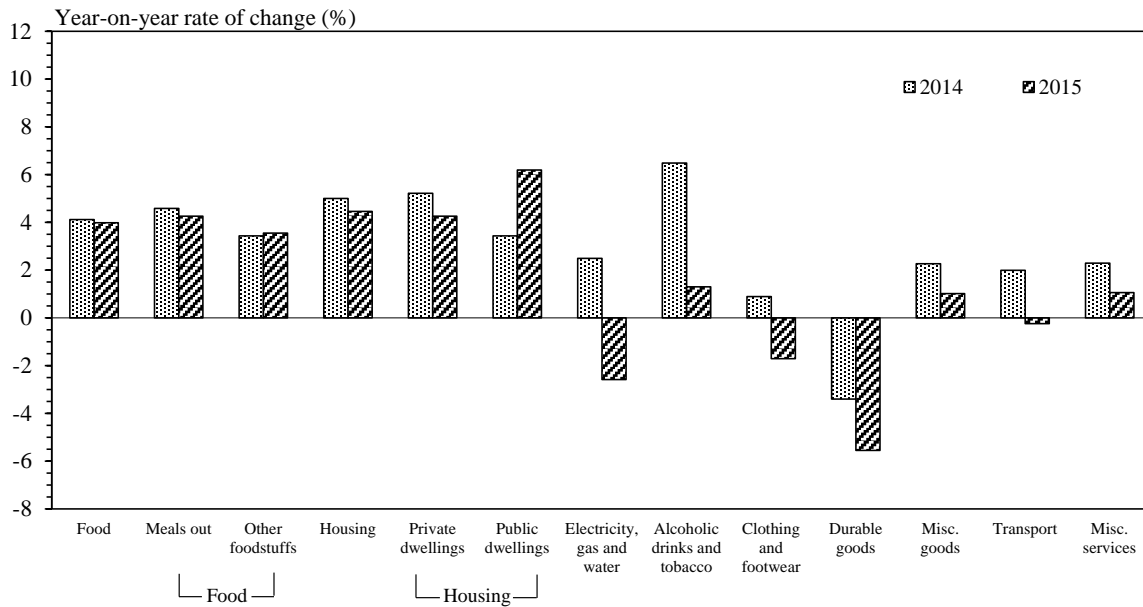
**(a) Food inflation edged down in 2015**



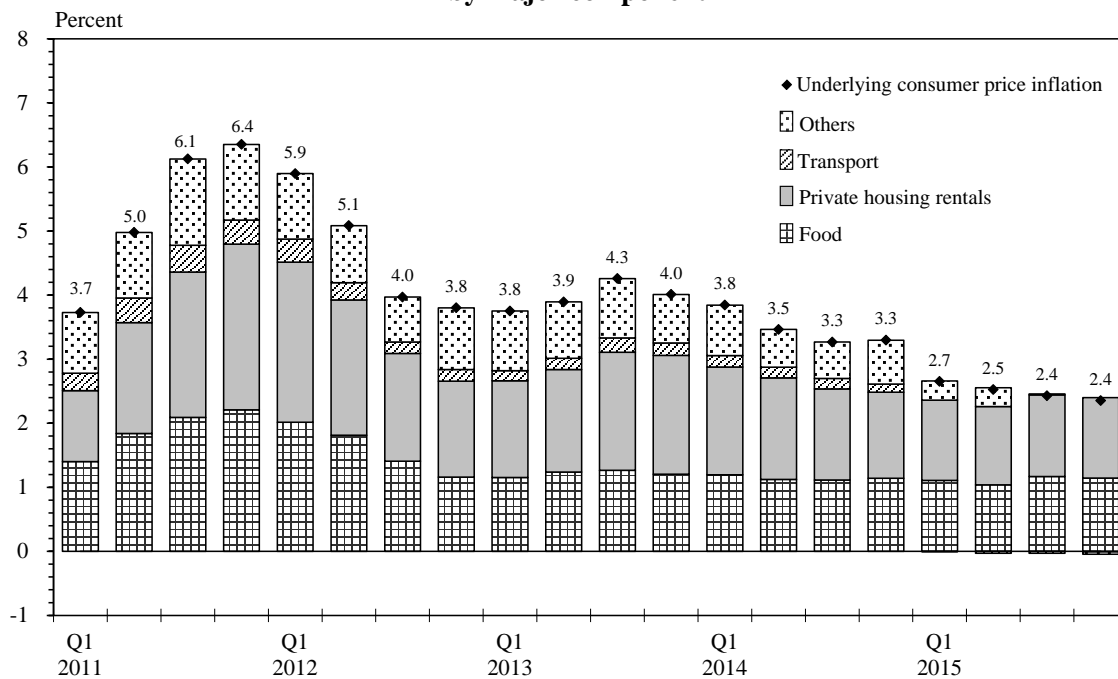
**(b) Rental inflation likewise turned softer**



**Diagram 7.4 (a) : The easing of price pressures was widespread across the underlying Composite CPI components**



**Diagram 7.4 (b) : Contribution to underlying consumer price inflation by major component**



**Table 7.2 : Underlying Composite Consumer Price Index by component  
(year-on-year rate of change (%))**

<u>Expenditure component</u>	<u>Weighting (%)</u>	<u>2014</u>	<u>Annual</u>	<u>2015</u>			
				<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>
Food	27.45	4.1	4.0	4.0	3.7	4.2	4.1
<i>Meals bought away from home</i>	17.07	4.6	4.3	4.4	4.3	4.3	4.0
<i>Other foodstuffs</i>	10.38	3.4	3.5	3.3	2.8	4.0	4.1
Housing <sup>(a)</sup>	31.66	5.0 (6.7)	4.5 (5.1)	4.7 (8.2)	4.7 (4.2)	4.5 (4.1)	4.0 (4.0)
<i>Private dwellings</i>	27.14	5.2 (6.0)	4.3 (4.6)	4.3 (6.8)	4.2 (3.8)	4.3 (3.9)	4.3 (4.3)
<i>Public dwellings</i>	2.05	3.4 (18.3)	6.2 (10.9)	9.8 (29.0)	9.4 (10.0)	6.1 (6.4)	0.1 (0.1)
Electricity, gas and water	3.10	2.5 (14.9)	-2.6 (8.5)	-1.4 (21.5)	-0.7 (22.8)	-6.1 (-4.6)	-2.1 (-0.9)
Alcoholic drinks and tobacco	0.59	6.5	1.3	4.3	-0.1	0.3	0.8
Clothing and footwear	3.45	0.9	-1.7	-0.8	-2.7	-1.9	-1.3
Durable goods	5.27	-3.4	-5.6	-5.5	-5.7	-5.6	-5.4
Miscellaneous goods	4.17	2.3	1.0	1.2	1.3	0.6	1.0
Transport	8.44	2.0	-0.2	-0.1	-0.4	-0.4	-0.1
Miscellaneous services	15.87	2.3 (3.0)	1.1 (1.1)	0.8 (0.8)	1.4 (1.4)	1.1 (1.1)	0.9 (0.9)
All items	100.00	3.5 (4.4)	2.5 (3.0)	2.7 (4.4)	2.5 (3.0)	2.4 (2.3)	2.4 (2.4)

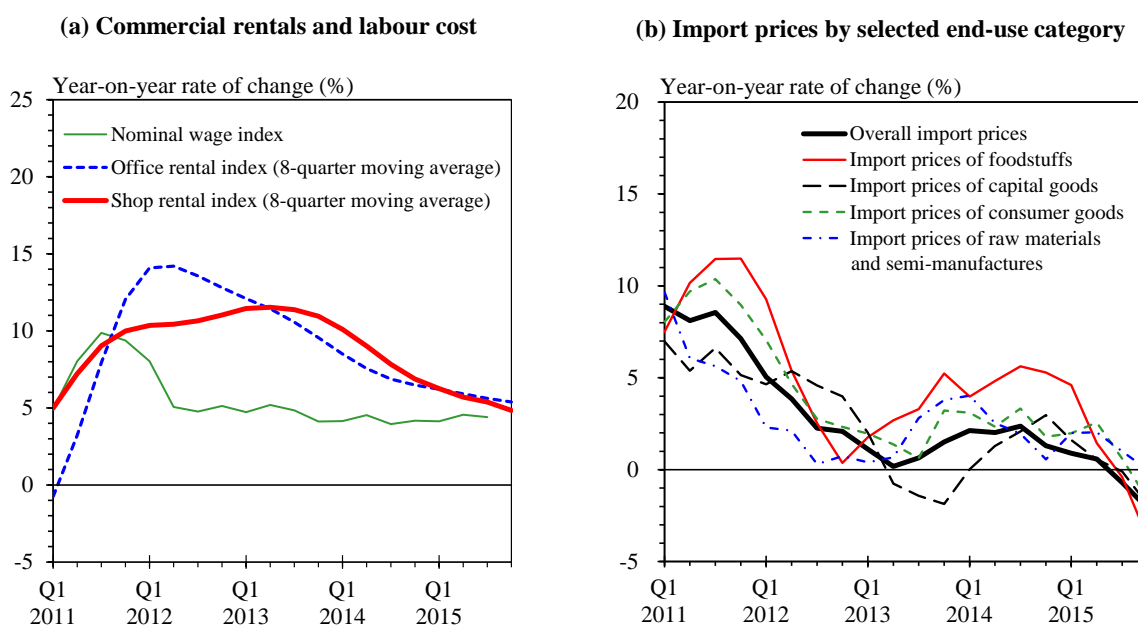
Notes : (a) The housing component covers rents, rates, Government rent, maintenance costs and other housing charges. Its sub-components on private and public dwellings as presented here, however, cover rents, rates and Government rent only. Hence, the combined weighting of private and public dwellings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

( ) Figures in brackets represent the headline rates of change before netting out the effect of Government's one-off relief measures.

## Costs of factor inputs and import prices

7.4 Domestic cost pressures were largely in check in 2015. Supported by a broadly stable labour market, wages and earnings growth held largely steady throughout the year, at around 4% year-on-year in the past few quarters. The upward adjustment of the Statutory Minimum Wage rate in May 2015 was found to have minimal impact on the cost-push inflation. Continued labour productivity gains should also have helped to keep labour cost pressures moderate on a unit cost basis. Meanwhile, the year-on-year increases in commercial rentals still followed an easing trend on an eight-quarter-moving-average basis. The slowdown in retail sales amid weaker inbound tourism also helped further lessen the price pressures on shop rentals towards the end of 2015.

**Diagram 7.5 : Cost pressures from both domestic and external fronts were moderating**





7.5 Against the backdrop of the continued fall-off in international food and commodity prices, the generally widespread abatement of inflation in our major import sources amid a slow-growing global economy, as well as the strengthening of the US dollar against many other currencies, import price pressures continued to dissipate gradually on a broad front over the course of the year. Overall import prices fell by 1.4% year-on-year in the second half, reversed from the 0.7% increase in the first half. This gave rise to a marginal decline of 0.4% in overall import prices for 2015 as a whole, in contrast to the 1.9% rise in 2014. When analysed by end-use category, the easing of import prices was across-the-board. Import prices of fuels fell significantly by an average of 34.8% in 2015, amid the continued plunge in international oil prices. Import prices of capital goods dipped by 0.1%, while that of foodstuffs rose only marginally by 0.3%, both reflecting the very modest imported inflation. Similarly, the increases in import prices of consumer goods, and raw materials and semi-manufactures moderated by varying degrees, to only 0.8% and 1.2% respectively in 2015.

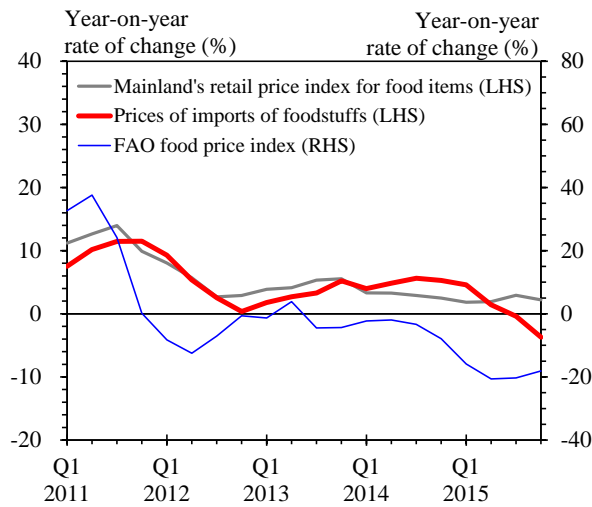
**Table 7.3 : Prices of imports by end-use category  
(year-on-year rate of change (%))**

		<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	Annual	0.3	0.8	1.2	-34.8	-0.1	-0.4
	H1	3.0	2.3	2.0	-32.0	1.1	0.7
	H2	-2.2	-0.5	0.5	-38.0	-1.0	-1.4
	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
	Q4	-3.7	-1.6	*	-37.2	-1.9	-2.1

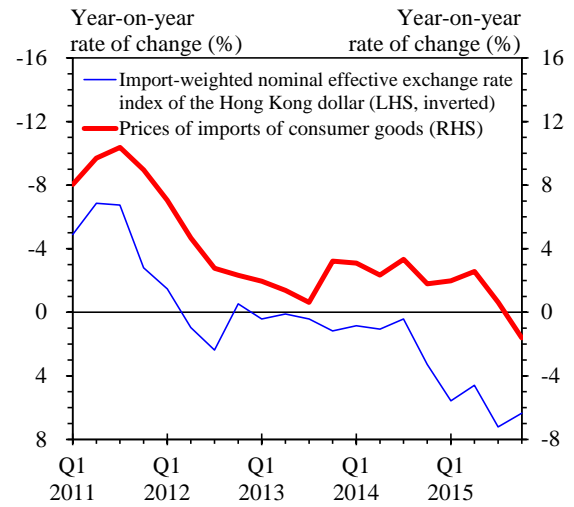
Note : (\*) Change within  $\pm 0.05\%$ .

### Diagram 7.6 : Import prices by end-use category

(a) Import prices of food continued an easing trend

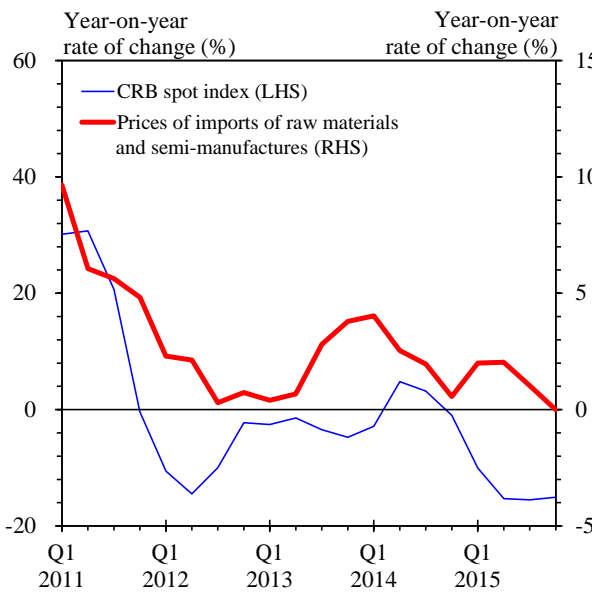


(b) Import prices of consumer goods also fell towards end-2015

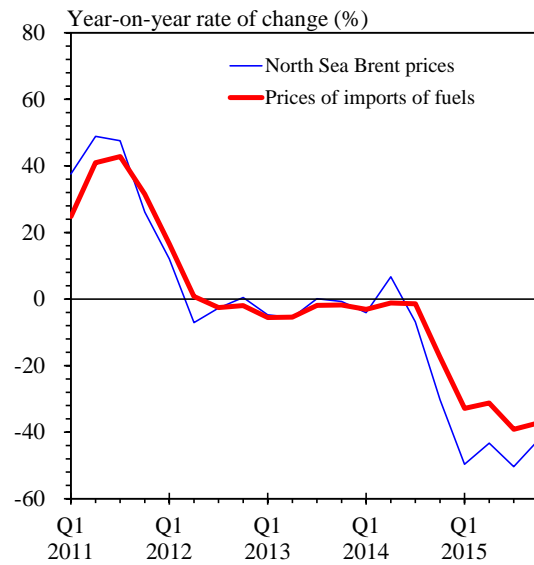


Note : An increase in the nominal EERI indicates strengthening of the Hong Kong dollar. The y-axis of nominal EERI in this graph is inverted for easier comprehension.

(c) Increase in import prices of raw materials and semi-manufactures was mild



(d) Import prices of fuels remained on a visible decline in 2015



## Output prices

7.6 Output prices, as measured by the *Producer Price Indices*<sup>(3)</sup>, in most sectors exhibited a moderating trend in the first three quarters of 2015. The year-on-year decline in output prices for the manufacturing sector enlarged to 4.4% in the third quarter of 2015, reflecting the softness in demand for locally produced goods. Among the selected service sectors, output prices for accommodation services continued to decline over the same period, in face of the slowdown in visitor arrivals. Upon the austere external trading environment and lower international oil prices, output prices for different transport services eased by various extents in the third quarter of 2015. While the rise in output prices for land transport softened somewhat to 2.1%, the output prices for water and air transports saw more notable declines of 10.4% and 9.2% respectively. Meanwhile, output prices for telecommunications continued its secular downtrend, given the intense competition and continuous cost reduction from technology advancement.

**Table 7.4 : 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-Q3</u>	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>
Manufacturing	-1.7	-6.2	-0.4	1.3	-1.2	-2.6	-0.6	-2.8	-4.4
Selected service sectors <sup>(a)</sup>									
Accommodation services	2.1	2.2	3.9	4.0	-1.3	-3.9	-1.6	-5.4	-4.8
Land transport	2.8	2.5	3.0	2.9	3.0	2.5	2.9	2.3	2.1
Water transport	0.8	-2.9	-0.6	2.5	4.6	-4.8	-0.2	-3.5	-10.4
Air transport	-0.7	-0.6	-1.8	1.9	-2.2	-6.8	-3.4	-7.9	-9.2
Telecommunications	-3.7	-2.9	-3.4	-4.2	-4.2	-4.4	-3.9	-4.4	-4.7
Courier services	1.7	1.9	1.4	0.9	2.5	4.6	4.2	4.8	4.7

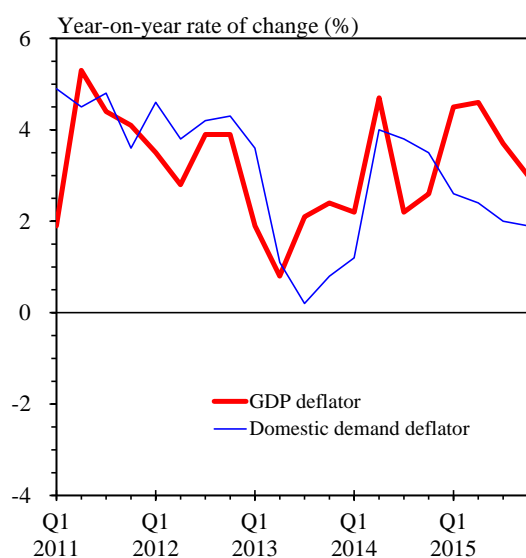
Note : (a) Producer Price Indices for other service sectors are not available, due to the difficulties involved in defining and delineating the various types of services and hence in measuring their respective price changes. This is particularly so for such sectors as banking and insurance, where the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

## GDP deflator

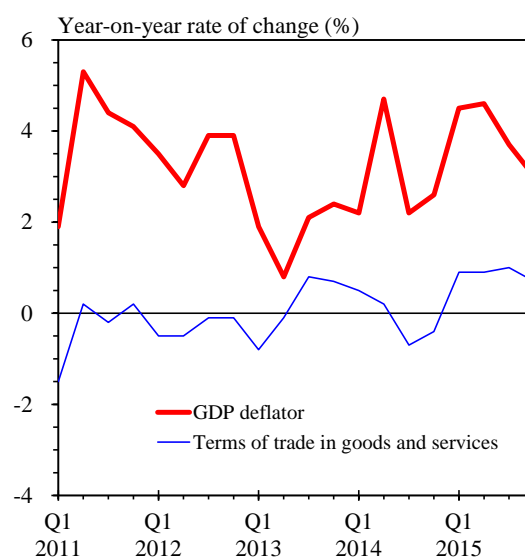
7.7 As a broad measure of the overall change in prices in the economy, the *GDP deflator*<sup>(4)</sup> rose by 3.9% in 2015, faster than the 2.9% increase in 2014. This was mainly driven by the improvement in *terms of trade*<sup>(5)</sup>, which was particularly distinct in the first half of 2015. The year-on-year increase in the GDP deflator slowed afterwards, to 3.0% in the fourth quarter, when the gains in terms of trade tapered amid an accelerated decline in export prices. Taking out the external components, the increase in the domestic demand deflator abated from 3.1% in 2014 to 2.2% in 2015.

Diagram 7.7 : GDP deflator

(a) Increase in GDP deflator slowed alongside the domestic demand deflator in the second half of 2015



(b) Improvement in terms of trade tapered in the fourth quarter of 2015



**Table 7.5 : GDP deflator and the main expenditure component deflators**  
(year-on-year rate of change (%))

	<u>2014</u>					<u>2015</u>				
	<u>Annual</u> <sup>#</sup>	<u>Q1</u> <sup>#</sup>	<u>Q2</u> <sup>#</sup>	<u>Q3</u> <sup>#</sup>	<u>Q4</u> <sup>#</sup>	<u>Annual</u> <sup>+</sup>	<u>Q1</u> <sup>#</sup>	<u>Q2</u> <sup>#</sup>	<u>Q3</u> <sup>#</sup>	<u>Q4</u> <sup>+</sup>
Private consumption expenditure	2.9	2.5	3.5	3.2	2.4	1.0	1.7	1.3	0.5	0.7
Government consumption expenditure	4.6	3.9	5.1	4.7	4.8	4.4	4.7	4.5	4.4	4.2
Gross domestic fixed capital formation	3.1	-3.7	4.3	5.0	5.8	4.6	5.1	4.8	5.7	3.4
Total exports of goods	0.8	-0.1	0.1	1.9	1.0	-0.8	0.6	0.2	-1.1	-2.6
Imports of goods	0.9	-0.5	-0.2	2.5	1.5	-1.6	-0.1	-0.8	-2.1	-3.1
Exports of services	0.8	0.6	0.7	1.5	0.2	-1.6	-0.2	-1.1	-2.6	-2.5
Imports of services	1.0	0.6	2.3	2.6	-1.3	-3.8	-3.2	-2.4	-4.7	-4.6
<b>Gross Domestic Product</b>	<b>2.9</b>	<b>2.2</b>	<b>4.7</b>	<b>2.2</b>	<b>2.6</b>	<b>3.9</b>	<b>4.5</b>	<b>4.6</b>	<b>3.7</b>	<b>3.0</b>
		<-0.5>	<1.3>	<0.8>	<1.1>		<1.4>	<1.1>	<0.1>	<0.4>
Total final demand	1.5	0.4	1.4	2.4	1.7	*	1.2	0.8	-0.4	-1.2
Domestic demand	3.1	1.2	4.0	3.8	3.5	2.2	2.6	2.4	2.0	1.9
Terms of trade in goods and services	-0.1	0.5	0.2	-0.7	-0.4	0.8	0.9	0.9	1.0	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>	17.07	19.23	17.90	13.55
<i>Other foodstuffs</i>	10.38	14.45	9.26	7.32
Housing	31.66	32.19	31.43	31.36
<i>Private dwellings</i>	27.14	24.78	28.13	28.45
<i>Public dwellings</i>	2.05	5.49	0.72	--
<i>Maintenance costs and other housing charges</i>	2.47	1.92	2.58	2.91
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>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>
Selected developed economies										
US	1.6	1.4	2.1	1.8	1.2	0.1	-0.1	*	0.1	0.5
Canada	2.0	1.4	2.2	2.1	1.9	1.1	1.1	0.9	1.2	1.3
EU	0.5	0.8	0.7	0.5	0.2	*	-0.3	0.1	*	0.1
Japan	2.7	1.5	3.6	3.4	2.5	0.8	2.3	0.5	0.2	0.3
Selected major emerging economies										
Mainland China	2.0	2.3	2.2	2.0	1.5	1.4	1.2	1.4	1.7	1.5
Russia	7.8	6.4	7.6	7.7	9.6	15.5	16.2	15.8	15.7	14.5
India	6.6	8.2	7.8	6.7	4.1	4.9	5.3	5.1	3.9	5.3
Brazil	6.3	5.8	6.4	6.6	6.5	9.0	7.7	8.5	9.5	10.4
Selected Asian economies										
Hong Kong	4.4	4.2	3.6	4.8	5.1	3.0	4.4	3.0	2.3	2.4
Singapore	1.0	1.0	2.2	1.0	*	-0.5	-0.3	-0.4	-0.6	-0.7
Taiwan	1.2	0.8	1.6	1.5	0.8	-0.3	-0.6	-0.7	-0.3	0.3
Korea	1.3	1.1	1.6	1.4	1.0	0.7	0.6	0.5	0.7	1.1
Malaysia	3.1	3.5	3.3	3.0	2.8	2.1	0.7	2.2	3.0	2.6
Thailand	1.9	2.0	2.5	2.0	1.1	-0.9	-0.5	-1.1	-1.1	-0.9
Indonesia	6.4	7.8	7.1	4.4	6.5	6.4	6.5	7.1	7.1	4.8
Philippines	4.1	4.1	4.4	4.7	3.6	1.4	2.4	1.7	0.6	1.0
Vietnam	4.1	4.8	4.7	4.3	2.6	0.6	0.7	1.0	0.5	0.3
Macao	6.0	6.1	6.2	5.9	6.0	4.6	5.1	4.8	4.5	3.9

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.