

## CHAPTER 6 : PRICES

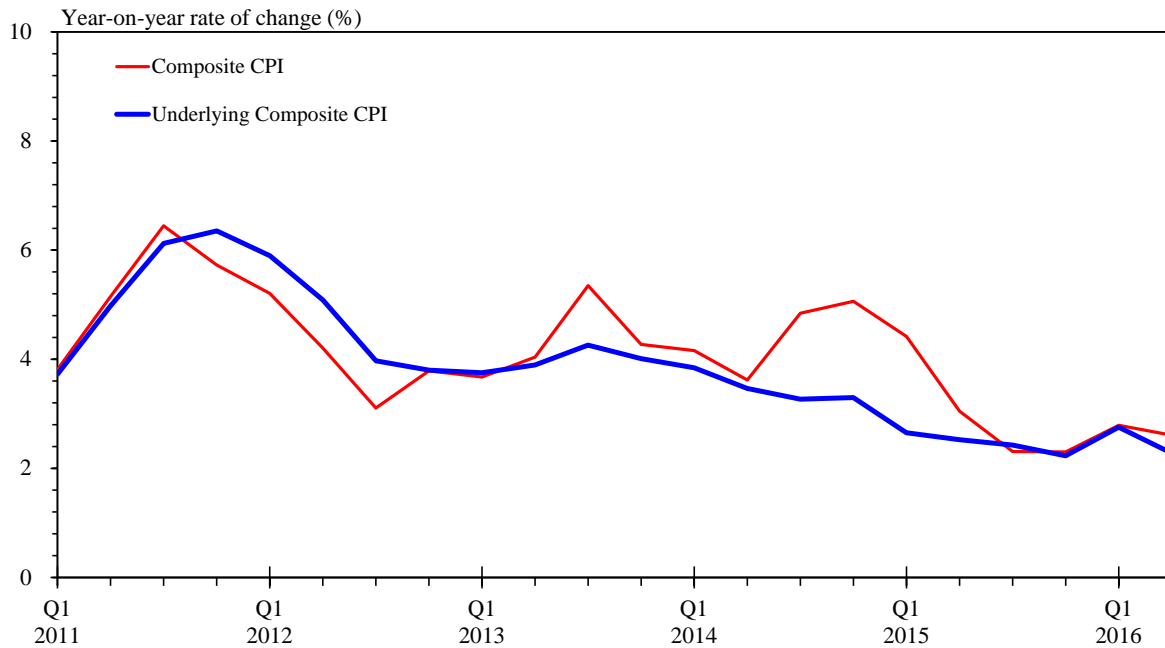
### *Summary*

- *Inflation pressure was largely moderate in the first half of 2016, in the face of a slow-growing economy. The 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, rose by 2.3% in the second quarter over a year earlier, easing back from the 2.8% increase in the first quarter. Over the same period, the headline Composite CPI inflation likewise moderated from 2.8% to 2.6%.*
- *The cost pressures from domestic sources tended to ease further. In the midst of a below-trend economic expansion, wages and earnings saw slightly slower increases. Although the property market stabilised somewhat in the second quarter, the feed-through of the earlier declines in fresh-letting residential and commercial rentals helped contain the rental inflation. The persistent weakness of the retail market also directly softened some of the related price items in the CPI.*
- *Meanwhile, external cost pressures were kept at bay, thanks to the still relatively low international energy and commodity prices, and the tame inflation in our major import sources. The relative strength of the Hong Kong dollar against many other currencies, to some extent, also contributed to lower import prices over the period.*
- *Looking ahead, given the subdued global inflation, moderate local cost pressures and weakness in import prices, consumer price inflation in Hong Kong should remain modest in the near term.*

### **Consumer prices**

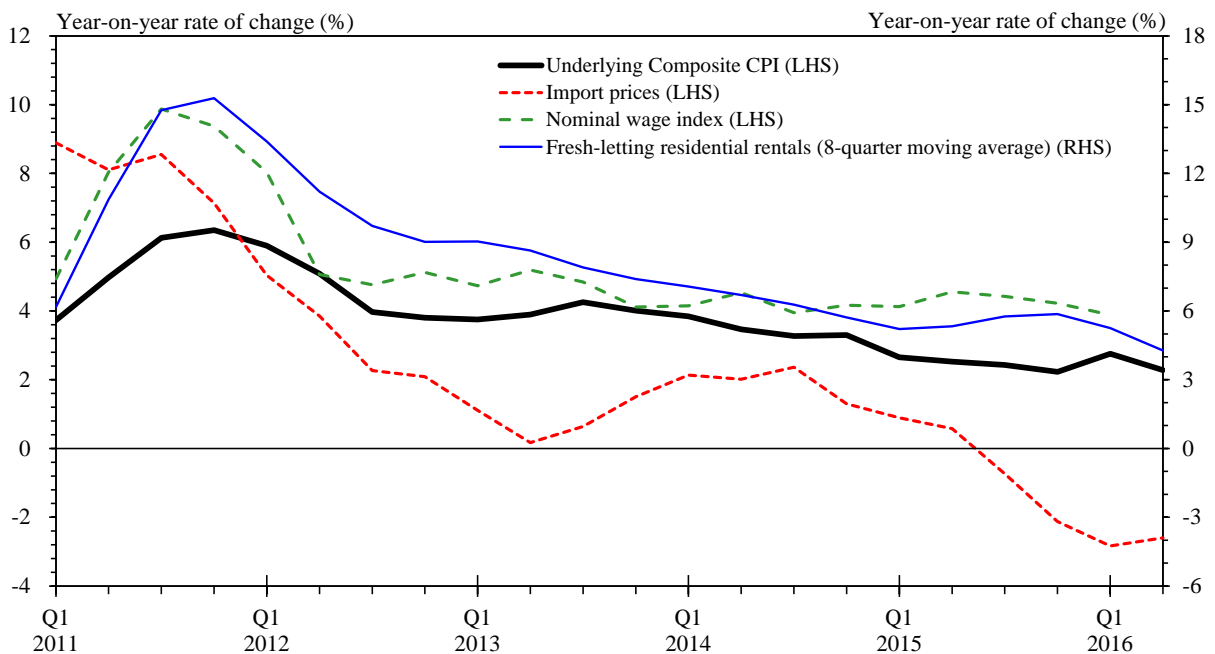
6.1 Inflation held largely moderate during the first half of 2016. On the domestic front, the increases in labour costs slowed slightly in the midst of a below-trend economic growth. Notwithstanding some signs of stabilisation in the property market in the second quarter, the earlier declines in fresh-letting residential and commercial rentals helped stabilise the rental inflation. On the external front, the still relatively low international energy and commodity prices, modest inflation in many of Hong Kong's major import sources<sup>(2)</sup>, and to a certain extent, the relative strength of the Hong Kong dollar against many other currencies, helped keep external price pressures at bay.

**Diagram 6.1 : Underlying inflation stayed moderate in the first half of 2016**



Note : The year-on-year rates of change of the CPIs from the fourth quarter of 2015 onwards are computed from the new 2014/15-based series, and those before are from the old 2009/10-based series.

**Diagram 6.2 : External price pressures remained absent, while domestic cost pressures eased further**



Note : The year-on-year rates of change of the CPI from the fourth quarter of 2015 onwards are computed from the new 2014/15-based series, and those before are from the old 2009/10-based series.

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, eased back to 2.3% in the second quarter, having risen to 2.8% in the first quarter mainly on account of higher basic food prices amid the bad weather conditions in early 2016. Over the same period, headline consumer price inflation, as measured by the year-on-year rate of change in the Composite CPI, likewise turned softer, easing from 2.8% to 2.6%. For the first half of 2016 as a whole, underlying and headline consumer price inflation averaged 2.5% and 2.7% respectively, somewhat higher than in the second half of 2015, when both measures averaged 2.3%.

**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<sup>(a)</sup></u>	<u>Headline</u>			
2015	Annual	2.5 <sup>(b)</sup>	3.0 <sup>(b)</sup>	4.0 <sup>(b)</sup>	2.9 <sup>(b)</sup>	2.1 <sup>(b)</sup>
	H1	2.6	3.7	5.3	3.3	2.3
	H2	2.3 <sup>(b)</sup>	2.3 <sup>(b)</sup>	2.7 <sup>(b)</sup>	2.3 <sup>(b)</sup>	1.9 <sup>(b)</sup>
	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	2.2	2.3	2.5	2.4	2.0
2016	H1	2.5	2.7	2.9	2.7	2.5
	Q1	2.8	2.8	3.1	2.8	2.5
	Q2	2.3	2.6	2.7	2.7	2.4
<b>(seasonally adjusted quarter-to-quarter rate of change (%))</b>						
2015	Q1	0.3	0.3	0.4	0.3	0.1
	Q2	0.6	-0.6	-1.1	-0.5	-0.1
	Q3	0.5	-0.1	-1.1	0.5	0.5
	Q4	0.9	2.7	4.4	2.1	1.5
2016	Q1	0.7	0.7	1.0	0.6	0.6
	Q2	0.2	-0.7	-1.4	-0.5	-0.2

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.

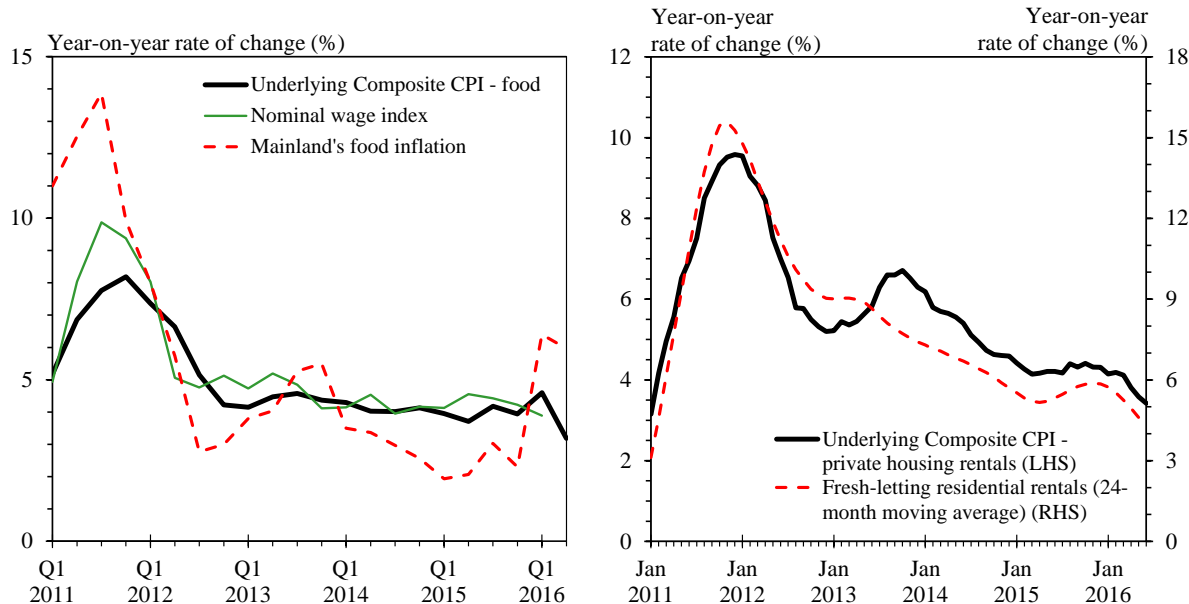
(b) The year-on-year rates of change of the CPIs from the fourth quarter of 2015 onwards are computed from the new 2014/15-based series, and those before are from the old 2009/10-based series. Splicing has been applied to the indices in order to obtain better estimates of the rates of change for the year 2015 and H2 of 2015.

6.3 Analysed by major component of the underlying Composite CPI, the abatement in inflationary pressures was observed on a broad front. Food and private housing rentals, the two largest components by weight in the average household consumption basket, both saw decelerated year-on-year price increases in the first half of 2016. After rising to 4.6% in the first quarter, local food inflation (including costs of dining out) eased back to 3.2% in the second quarter as prices of fresh vegetables softened after the unusual upsurge in the first quarter. While the property market stabilised somewhat in the second quarter, the earlier declines in fresh-letting residential rentals continued to feed through into the private housing rental component of the CPI, the price increase of which eased further from 4.2% in the first quarter to 3.6% in the second quarter. Reflecting the sluggishness of the retail market, the prices of clothing and footwear declined rather visibly over a year ago. Meanwhile, the prices of durable goods continued their secular downtrend, while the price pressures of other components were also muted in the face of modest economic growth.

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

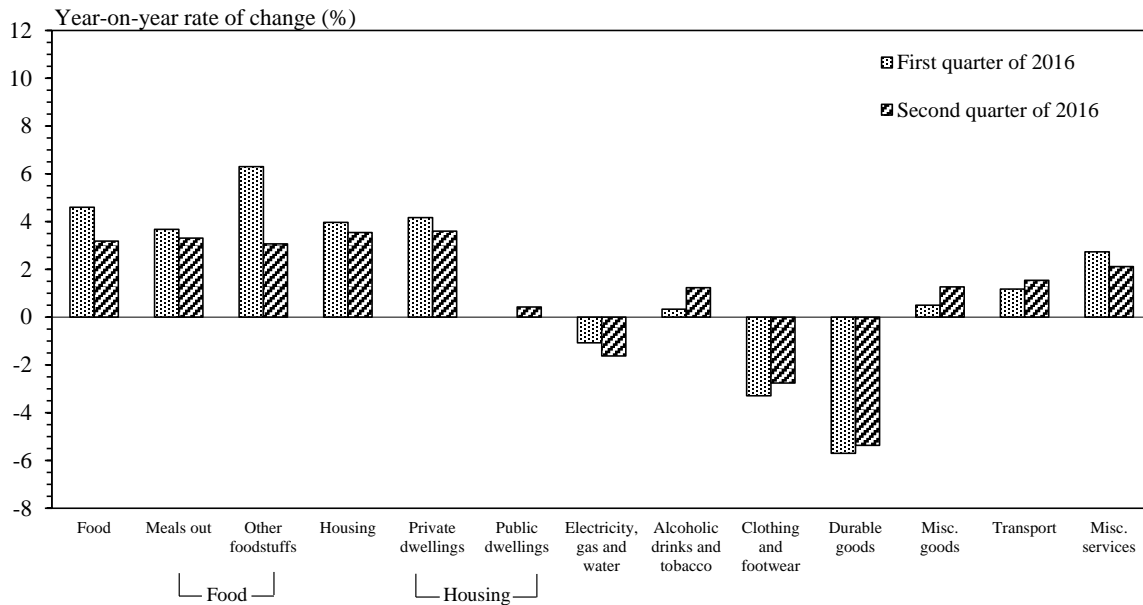
**(a) Food inflation softened again in the second quarter**

**(b) Rental inflation eased further**

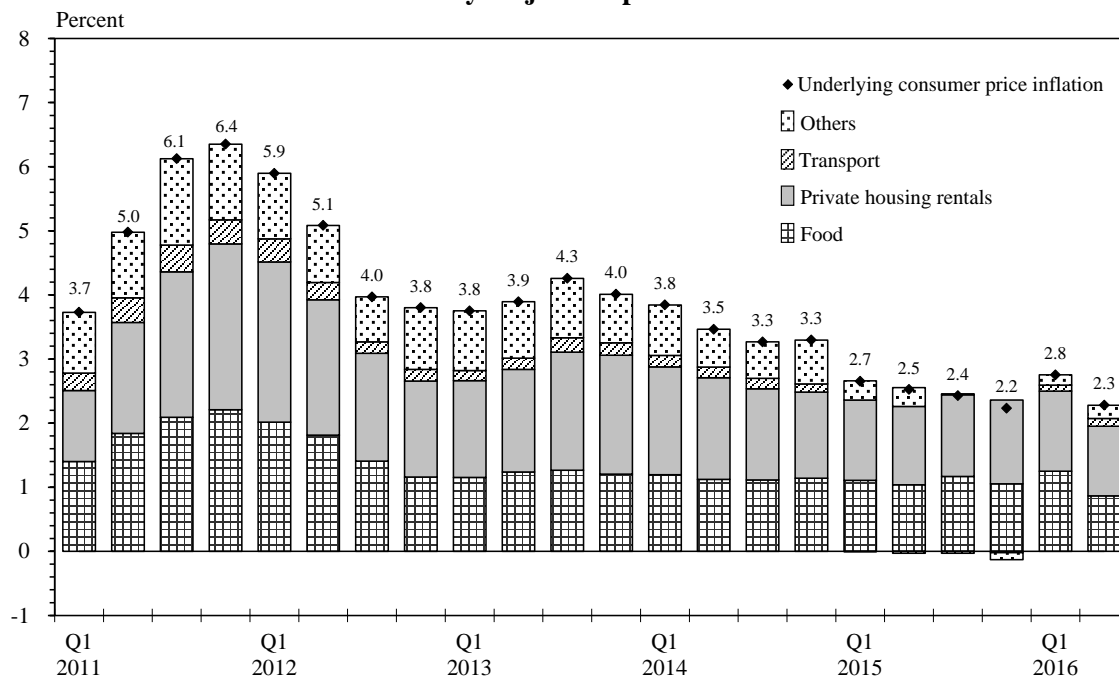


Note : The year-on-year rates of change of the CPIs from October 2015 onwards are computed from the new 2014/15-based series, and those before are from the old 2009/10-based series.

**Diagram 6.4 (a) : Price pressures in many of the underlying Composite CPI components were subdued**



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



Note : The year-on-year rates of change of the Composite CPIs from the fourth quarter of 2015 onwards are computed from the new 2014/15-based series, and those before are from the old 2009/10-based series.

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

<u>Expenditure component</u>	<u>Weighting (%)</u>	<u>Annual</u>	<u>2015</u>				<u>2016</u>	
			<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>	<u>Q1</u>	<u>Q2</u>
Food	27.29	4.0 <sup>(b)</sup>	4.0	3.7	4.2	3.9	4.6	3.2
<i>Meals bought away from home</i>	17.74	4.2 <sup>(b)</sup>	4.4	4.3	4.3	4.0	3.7	3.3
<i>Other foodstuffs</i>	9.55	3.4 <sup>(b)</sup>	3.3	2.8	4.0	3.7	6.3	3.1
Housing <sup>(a)</sup>	34.29	4.5 <sup>(b)</sup> (5.1) <sup>(b)</sup>	4.7 (8.2)	4.7 (4.2)	4.5 (4.1)	4.1 (4.1)	4.0 (4.0)	3.5 (4.6)
<i>Private dwellings</i>	29.92	4.3 <sup>(b)</sup> (4.7) <sup>(b)</sup>	4.3 (6.8)	4.2 (3.8)	4.3 (3.9)	4.4 (4.4)	4.2 (4.2)	3.6 (4.8)
<i>Public dwellings</i>	1.94	6.2 <sup>(b)</sup> (10.9) <sup>(b)</sup>	9.8 (29.0)	9.4 (10.0)	6.1 (6.4)	* (* )	* (* )	0.4 (0.5)
Electricity, gas and water	2.67	-2.6 <sup>(b)</sup> (8.4) <sup>(b)</sup>	-1.4 (21.5)	-0.7 (22.8)	-6.1 (-4.6)	-2.2 (-1.1)	-1.1 (* )	-1.6 (-1.1)
Alcoholic drinks and tobacco	0.54	1.3 <sup>(b)</sup>	4.3	-0.1	0.3	1.0	0.3	1.2
Clothing and footwear	3.21	-1.8 <sup>(b)</sup>	-0.8	-2.7	-1.9	-1.6	-3.3	-2.8
Durable goods	4.65	-5.6 <sup>(b)</sup>	-5.5	-5.7	-5.6	-5.8	-5.7	-5.4
Miscellaneous goods	3.56	0.9 <sup>(b)</sup>	1.2	1.3	0.6	0.5	0.5	1.3
Transport	7.98	-0.3 <sup>(b)</sup>	-0.1	-0.4	-0.4	-0.3	1.2	1.5
Miscellaneous services	15.81	1.1 <sup>(b)</sup> (1.1) <sup>(b)</sup>	0.8 (0.8)	1.4 (1.4)	1.1 (1.1)	1.2 (1.2)	2.7 (2.7)	2.1 (2.1)
All items	100.00	2.5 <sup>(b)</sup> (3.0) <sup>(b)</sup>	2.7 (4.4)	2.5 (3.0)	2.4 (2.3)	2.2 (2.3)	2.8 (2.8)	2.3 (2.6)

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.

(b) The year-on-year rates of change of the CPIs from the fourth quarter of 2015 onwards are computed from the new 2014/15-based series, and those before are from the old 2009/10-based series. Splicing has been applied to the indices in order to obtain better estimates of the rates of change for the year 2015.

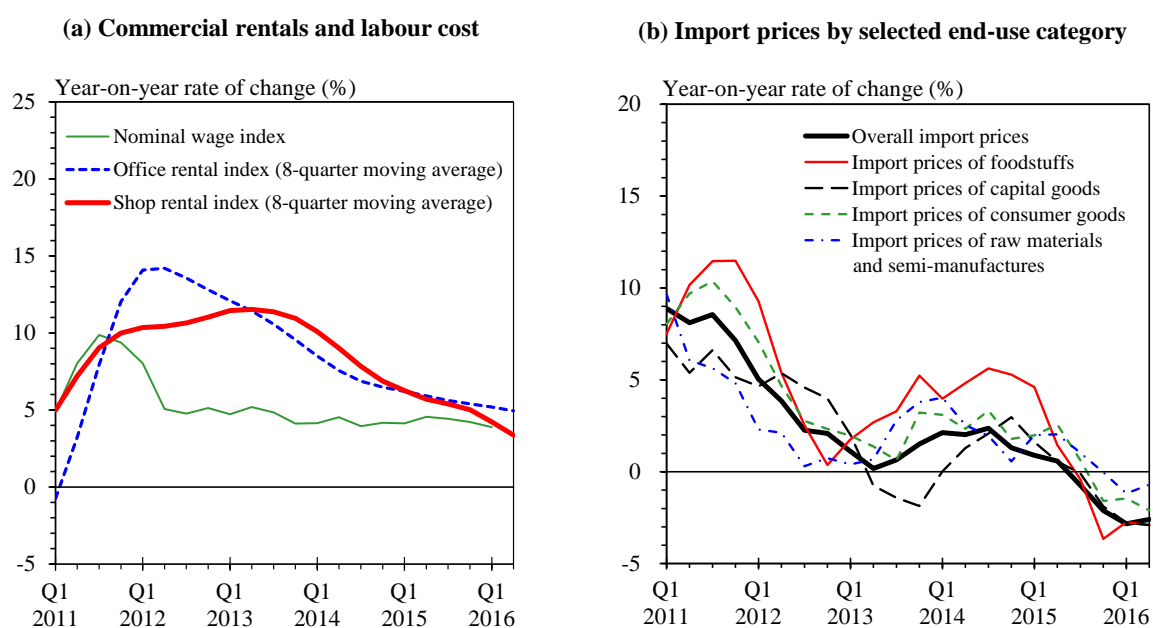
( ) Figures in brackets represent the headline rates of change before netting out the effect of Government's one-off relief measures.

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

## Costs of factor inputs and import prices

6.4 The upward pressures on domestic costs weakened somewhat in the first half of 2016. Labour costs continued to increase moderately, but decelerated more recently given that labour demand in some economic sectors showed signs of easing. Alongside the below-trend economic expansion and the weakness in retail sales, the increases in office and shop rentals remained on a moderating trend when analysed on an eight-quarter-moving-average basis.

**Diagram 6.5 : Both domestic and external cost pressures were trending down**





6.5 External price pressures remained largely in check, conceivably helped by the tame inflation in major import sources, the still relatively low international energy and commodity prices, as well as the relative strength of the Hong Kong dollar against many other currencies. Overall import prices fell for the fourth consecutive quarter, by 2.6% from a year earlier in the second quarter, giving an average decrease of 2.7% for the first half of 2016 as a whole. Import price pressures were muted across all end-use categories in the second quarter. The import prices of fuels continued to plunge year-on-year. The import prices of capital goods, and raw materials and semi-manufactures dropped by 2.9% and 0.7% respectively, in the midst of the sluggish global demand. Meanwhile, the import prices of consumer goods and foodstuffs fell by 2.1% and 2.9% respectively.

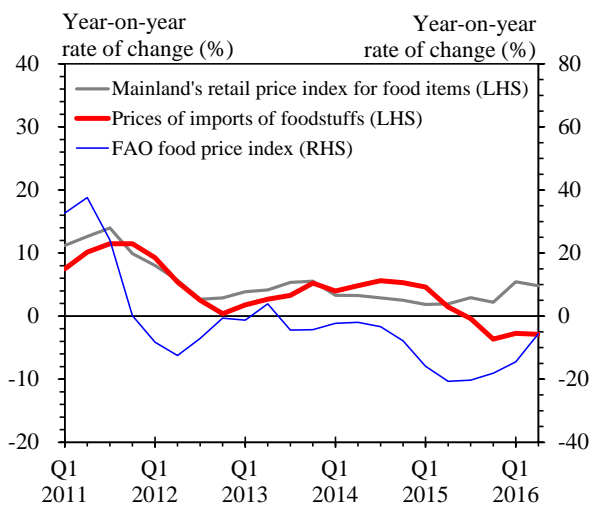
**Table 6.3 : Prices of imports by end-use category  
(year-on-year rate of change (%))**

		<u>Foodstuffs</u>	<u>Consumer goods</u>	<u>Raw materials and semi-manufactures</u>	<u>Fuels</u>	<u>Capital goods</u>	<u>All</u>
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
2016	H1	-2.9	-1.8	-0.9	-33.7	-2.8	-2.7
	Q1	-2.7	-1.4	-1.2	-39.2	-2.8	-2.8
	Q2	-2.9	-2.1	-0.7	-28.5	-2.9	-2.6

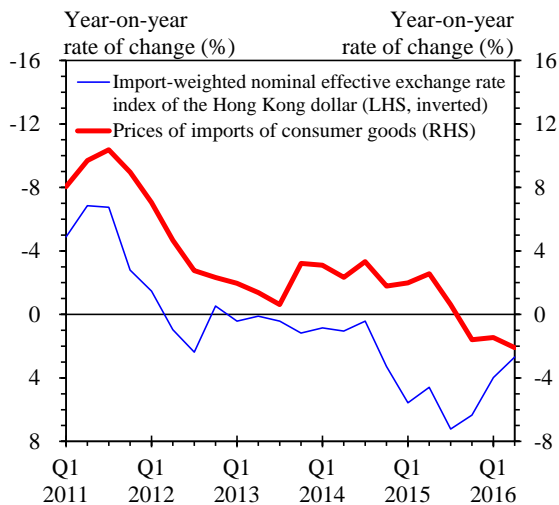
Note : (\*) Change within  $\pm 0.05\%$ .

**Diagram 6.6 : Import prices by end-use category**

**(a) Import prices of food fell**

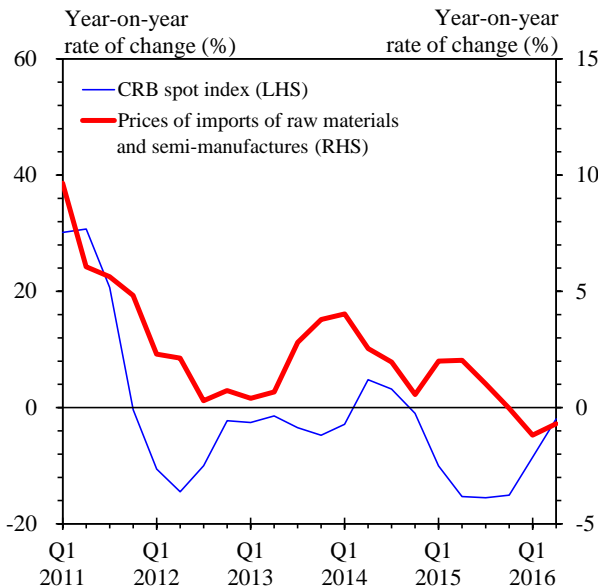


**(b) Import prices of consumer goods stayed soft**

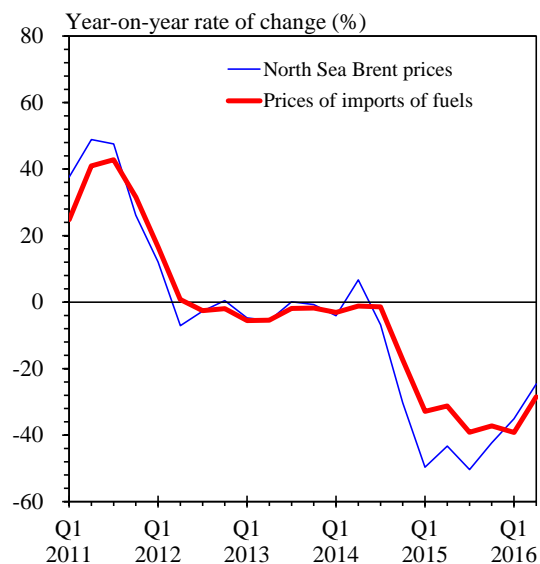


Note : An increase in the nominal EERI indicates strengthening of the Hong Kong dollar. The y-axis of nominal EERI in this graph is inverted for easier comprehension.

**(c) Import prices of raw materials and semi-manufactures continued to decline**



**(d) Import prices of fuels were still notably lower than a year ago**



## Output prices

6.6 The movement of output prices, as measured by the *Producer Price Indices*<sup>(3)</sup>, remained generally on a downtrend across sectors in the first quarter of 2016. Output prices for the manufacturing sector registered a further year-on-year decline, albeit narrowed somewhat from the preceding quarter. As for the selected service sectors, output prices for accommodation services extended its year-on-year decrease, alongside a double-digit decline in visitor arrivals over the same period. Mirroring the unsteady external environment and the still-subdued regional trade flows, output prices for water transport and air transport plummeted, while increase in output prices for courier services decelerated. Meanwhile, the increase in output prices for land transport held broadly stable, and output prices for telecommunications services stayed on its secular downtrend.

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

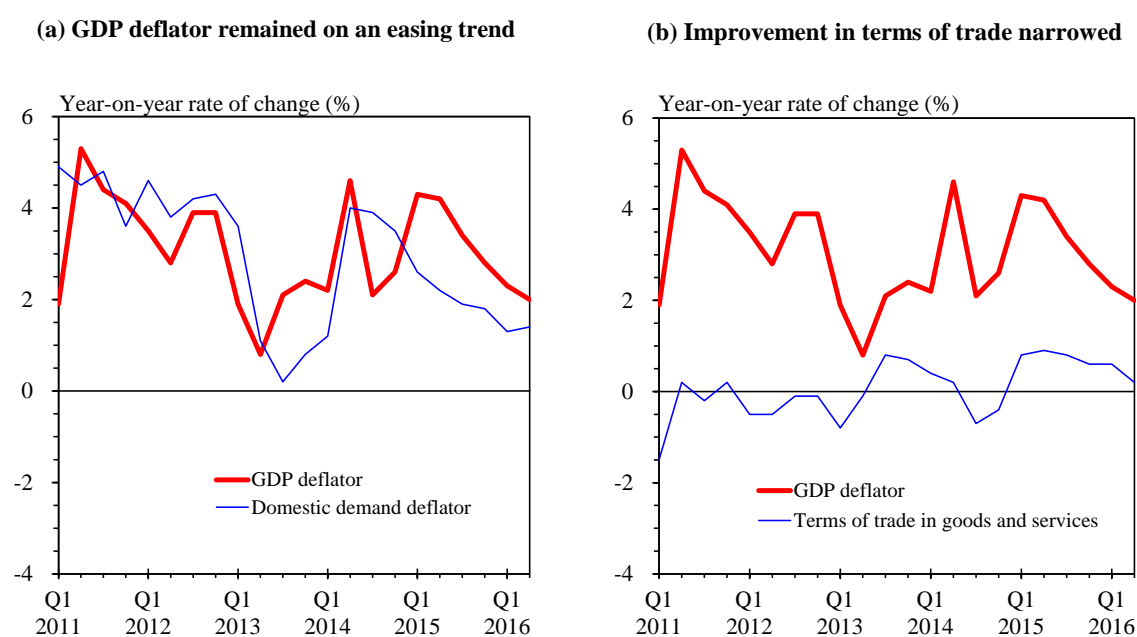
<u>Industry group</u>	<u>Annual</u>	<u>2015</u>				<u>2016</u>
		<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>	<u>Q1</u>
Manufacturing	-2.7	-0.6	-2.8	-4.4	-3.2	-2.8
Selected service sectors <sup>(a)</sup>						
Accommodation services	-3.6	-1.6	-5.4	-4.8	-2.6	-4.7
Land transport	2.3	2.9	2.3	2.1	2.0	2.6
Water transport	-7.0	-0.2	-3.5	-10.4	-13.5	-15.8
Air transport	-7.8	-3.4	-7.9	-9.2	-10.8	-12.1
Telecommunications	-4.3	-3.9	-4.4	-4.7	-4.2	-3.6
Courier services	4.5	4.2	4.8	4.7	4.3	1.8

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*<sup>(4)</sup> rose at a slower year-on-year rate of 2.0% in the second quarter of 2016, following a 2.3% increase in the first quarter. Within the GDP deflator, the improvement in *terms of trade*<sup>(5)</sup> tapered in the second quarter. Taking out the external trade components, the year-on-year increase in domestic demand deflator was 1.4% in the second quarter, somewhat faster than the 1.3% in the first quarter.

**Diagram 6.7 : GDP deflator**



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

	<u>2014</u>		<u>2015</u>				<u>2016</u>	
	<u>Annual</u>	<u>Annual</u>	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>	<u>Q1<sup>#</sup></u>	<u>Q2<sup>+</sup></u>
Private consumption expenditure	2.9	1.0	1.7	1.1	0.4	1.0	1.2	1.6
Government consumption expenditure	4.7	4.5	4.8	4.6	4.6	4.2	4.0	4.0
Gross domestic fixed capital formation	3.1	4.5	4.8	4.8	5.5	3.2	0.5	0.1
Total exports of goods	0.8	-0.7	0.8	0.4	-1.2	-2.4	-2.8	-2.4
Imports of goods	0.9	-1.4	0.1	-0.7	-2.1	-2.8	-3.6	-2.8
Exports of services	0.8	-2.0	-0.6	-1.6	-3.1	-2.7	-3.7	-2.7
Imports of services	1.2	-4.3	-3.7	-3.0	-5.3	-4.8	-3.4	-1.5
<b>Gross Domestic Product</b>	<b>2.9</b>	<b>3.6</b>	<b>4.3</b>	<b>4.2</b>	<b>3.4</b>	<b>2.8</b>	<b>2.3</b>	<b>2.0</b>
			< <b>1.2</b> >	< <b>1.0</b> >	< <b>0.1</b> >	< <b>0.4</b> >	< <b>0.7</b> >	< <b>0.7</b> >
Total final demand	1.5	*	1.2	0.7	-0.5	-1.1	-1.5	-1.1
Domestic demand	3.1	2.1	2.6	2.2	1.9	1.8	1.3	1.4
Terms of trade in goods and services	-0.1	0.7	0.8	0.9	0.8	0.6	0.6	0.2

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 2014/15-based CPIs are shown below:

	Approximate proportion of <u>households covered</u> (%)	Average monthly expenditure range <u>during Oct 2014 to Sep 2015</u> (\$)
CPI(A)	50	5,500 to 24,499
CPI(B)	30	24,500 to 44,499
CPI(C)	10	44,500 to 89,999

The weightings of the various components in the 2014/15-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	27.29	34.37	26.26	20.85
<i>Meals bought away from home</i>	17.74	20.99	17.88	13.98
<i>Other foodstuffs</i>	9.55	13.38	8.38	6.87
Housing	34.29	33.77	35.24	33.60
<i>Private dwellings</i>	29.92	26.51	32.15	30.72
<i>Public dwellings</i>	1.94	5.44	0.49	--
<i>Maintenance costs and other housing charges</i>	2.43	1.82	2.60	2.88
Electricity, gas and water	2.67	3.85	2.38	1.76
Alcoholic drinks and tobacco	0.54	0.75	0.57	0.26
Clothing and footwear	3.21	2.57	3.26	3.88
Durable goods	4.65	3.41	5.03	5.53
Miscellaneous goods	3.56	3.28	3.64	3.77
Transport	7.98	6.75	7.60	9.84
Miscellaneous services	15.81	11.25	16.02	20.51
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>2016</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>
Selected developed economies								
US	1.6	0.1	-0.1	*	0.1	0.5	1.1	1.1
Canada	2.0	1.1	1.1	0.9	1.2	1.3	1.5	1.6
EU	0.5	*	-0.3	0.1	*	0.1	*	-0.1
Japan	2.7	0.8	2.3	0.5	0.2	0.3	0.1	-0.4
Major emerging economies								
Mainland China	2.0	1.4	1.2	1.4	1.7	1.5	2.1	2.1
Russia	7.8	15.5	16.2	15.8	15.7	14.5	8.3	7.4
India	6.6	4.9	5.3	5.1	3.9	5.3	5.3	5.7
Brazil	6.3	9.0	7.7	8.5	9.5	10.4	10.1	9.1
Selected Asian economies								
Hong Kong	4.4	3.0	4.4	3.0	2.3	2.3 <sup>^</sup>	2.8 <sup>^</sup>	2.6 <sup>^</sup>
Singapore	1.0	-0.5	-0.3	-0.4	-0.6	-0.7	-0.8	-0.9
Taiwan	1.2	-0.3	-0.6	-0.7	-0.3	0.3	1.7	1.3
Korea	1.3	0.7	0.6	0.5	0.7	1.1	1.0	0.9
Malaysia	3.1	2.1	0.7	2.2	3.0	2.6	3.4	1.9
Thailand	1.9	-0.9	-0.5	-1.1	-1.1	-0.9	-0.5	0.3
Indonesia	6.4	6.4	6.5	7.1	7.1	4.8	4.3	3.5
Philippines	4.1	1.4	2.4	1.7	0.6	1.0	1.1	1.5
Vietnam	4.1	0.6	0.7	1.0	0.5	0.3	1.3	2.2
Macao	6.0	4.6	5.1	4.8	4.5	3.9	3.7	2.6

Notes : (\*) Change within  $\pm 0.05\%$ .  
 (^) By reference to the new 2014/15-based CPI series.

- (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.