

## CHAPTER 6 : PRICES

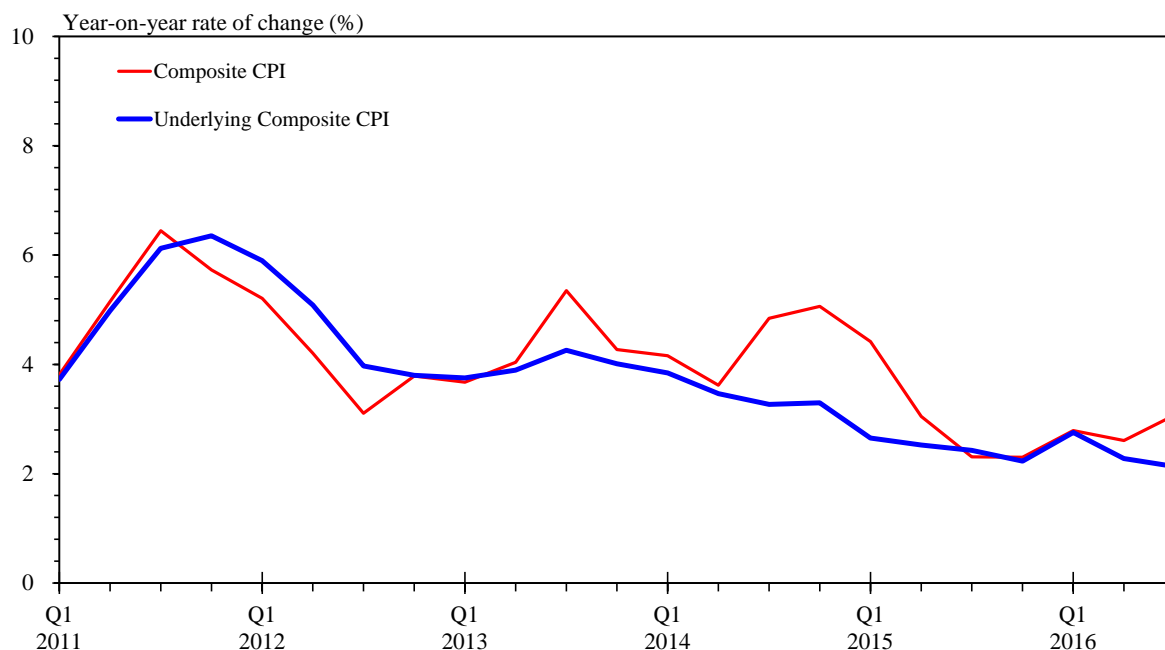
### *Summary*

- *Inflation continued its easing mode in the third quarter of 2016. 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 2.1% in the third quarter over a year earlier, abating further from the 2.3% increase in the preceding quarter. Over the same period, the headline Composite CPI inflation increased slightly from 2.6% to 3.1%, mainly due to a temporary low base of comparison resulted from the Government's one-off payment of public housing rentals in August last year.*
- *Domestic cost pressures remained mild. Increases in labour costs were steady in recent quarters amid the broadly stable labour market conditions. Rental inflation was largely kept at bay, as the earlier softening of fresh-letting residential rentals continued to feed through, while shop rentals fell further in face of protracted weakness in retail segment.*
- *External price pressures were muted, thanks to the tame inflation in our major import sources, a strong US dollar, and the relatively soft international energy and commodity prices.*
- *Looking ahead, inflation pressures should remain contained in the near term, given the moderate cost increases from both local and external sources. Yet, the situation has to be closely monitored as international food and energy prices could see some renewed upward pressures amid an unsteady global monetary environment.*

### **Consumer prices**

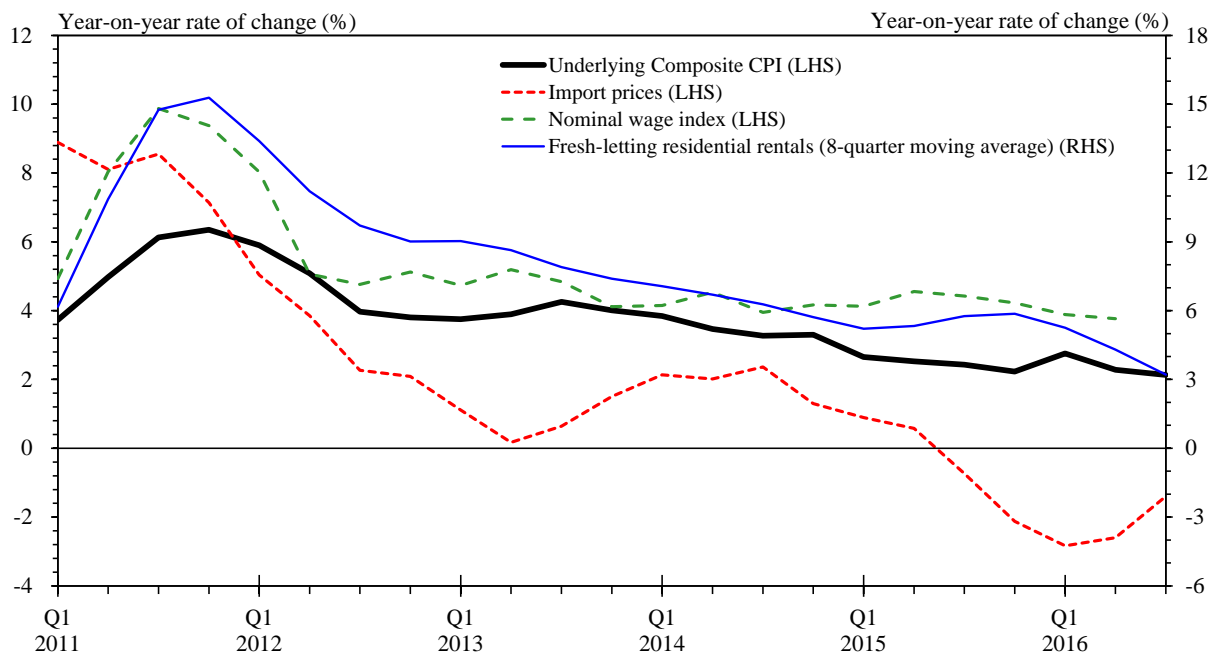
6.1 Underlying inflation continued its easing trend in the third quarter of 2016. Domestically, wage growth, on the back of a broadly stable labour market, remained steady in recent quarters. Furthermore, rental inflation was kept largely at bay as the earlier softening of fresh-letting residential rentals fed through. The slowdown in retail business, in tandem with a rather unsteady performance in inbound tourism, led to successive declines in shop rentals, while also curtailing the pricing power of the retail segment. External price pressures were likewise virtually absent, given the tame inflation in many of Hong Kong's major import sources<sup>(2)</sup>, a strong US dollar, and international energy and commodity prices being still generally lower than year-ago levels.

**Diagram 6.1 : Underlying inflation remained moderate in the third quarter 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 and domestic cost pressures stayed modest**



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, moderated further to 2.1% in the third quarter of 2016, from 2.3% in the second quarter. Headline consumer price inflation, as measured by the year-on-year rate of change in the Composite CPI, was 3.1% in the third quarter of 2016, up slightly from 2.6% in the preceding quarter. The increase in the headline figure was mainly due to the temporary influence of a low base of comparison stemming from the Government's payment of public housing rentals in August last year. In the first three quarters of 2016, the underlying and headline consumer price inflation rates averaged 2.4% and 2.8% respectively, both slightly lower than those of 2.5% and 3.0% for 2015 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</u> <sup>(a)</sup>	<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
	Q3	2.1	3.1	4.5	2.6	2.2
<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
	Q3	0.4	0.4	0.5	0.4	0.3

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.

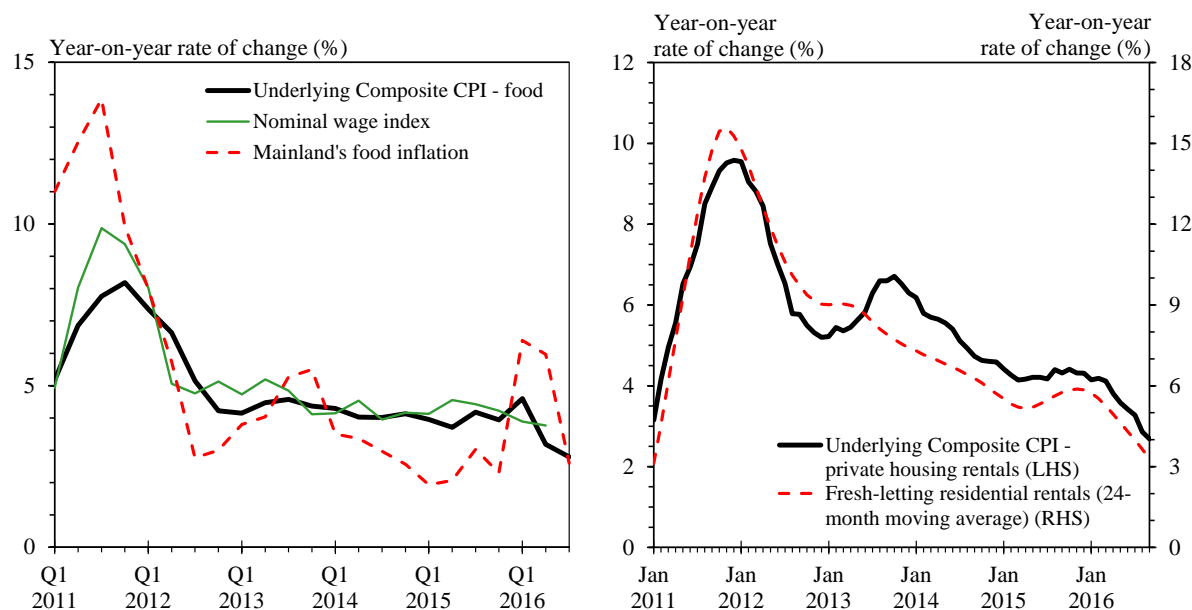
(b) The year-on-year rates of change of the CPIs from the fourth quarter of 2015 onwards are computed from the new 2014/15-based series, and those before are from the old 2009/10-based series. Splicing has been applied to the indices in order to obtain better estimates of the rates of change for the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

6.3 Many major components of the underlying Composite CPI saw abatement in price pressures. On the two largest components by weight, local food inflation eased to 2.8% in the third quarter alongside the still-soft global food prices and moderating food inflation in the Mainland, while the rental increase for private housing also tapered to 3.0%. Even though property market activities turned more active which provided some support to fresh-letting rentals in more recent months, this had yet to be fully reflected in the private rental component of the CPI. In face of the weak state of the local consumption market, prices of clothing and footwear registered a widened decline. The prices of durable goods likewise stayed on their secular downtrend. Over the same period, the prices in the electricity, gas and water component rebounded notably year-on-year, mainly attributable to the special fuel rebate in electricity in mid-August and September last year, which had created a low base of comparison.

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

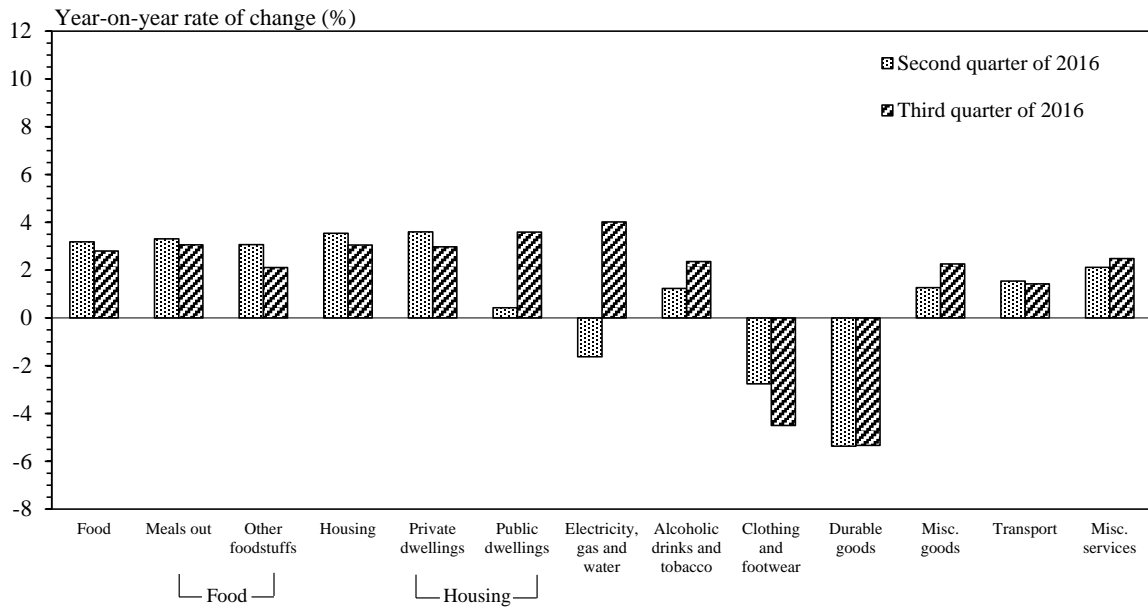
**(a) Food inflation eased in the third quarter**

**(b) Rental inflation trended down further**

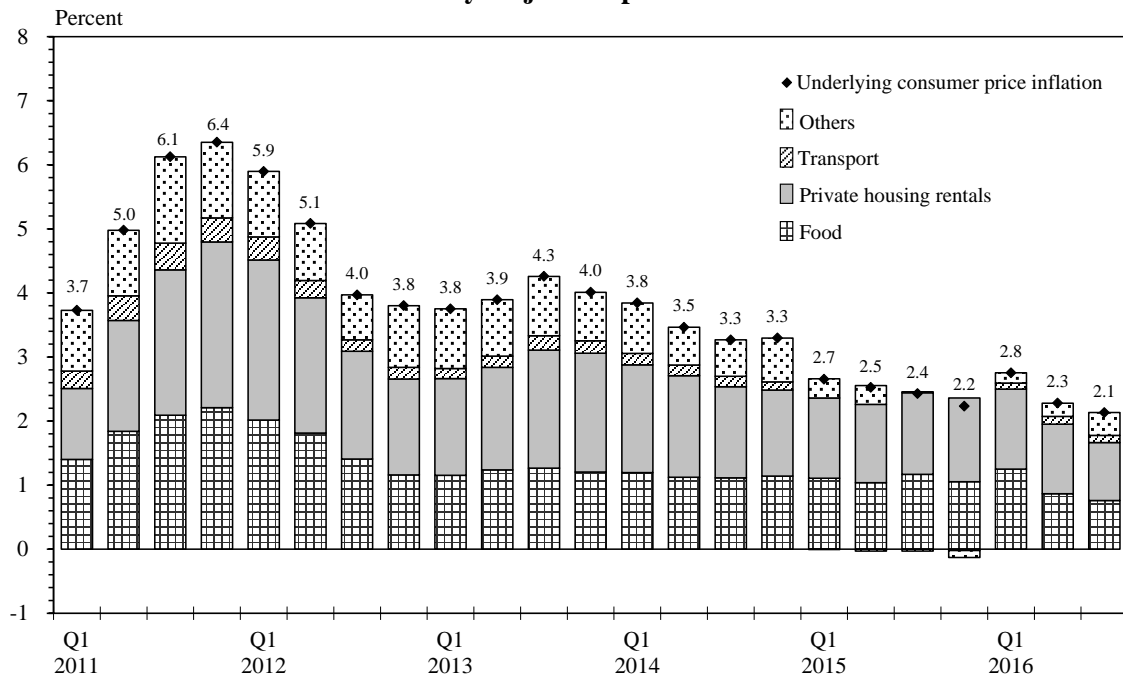


Note : The year-on-year rates of change of the CPIs from October 2015 onwards are computed from the new 2014/15-based series, and those before are from the old 2009/10-based series.

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



**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>	<u>Q3</u>
Food	27.29	4.0 <sup>(b)</sup>	4.0	3.7	4.2	3.9	4.6	3.2	2.8
<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	3.1
<i>Other foodstuffs</i>	9.55	3.4 <sup>(b)</sup>	3.3	2.8	4.0	3.7	6.3	3.1	2.1
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)	3.1 (6.0)
<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)	3.0 (4.1)
<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)	3.6 (51.3)
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)	4.0 (4.1)
Alcoholic drinks and tobacco	0.54	1.3 <sup>(b)</sup>	4.3	-0.1	0.3	1.0	0.3	1.2	2.4
Clothing and footwear	3.21	-1.8 <sup>(b)</sup>	-0.8	-2.7	-1.9	-1.6	-3.3	-2.8	-4.5
Durable goods	4.65	-5.6 <sup>(b)</sup>	-5.5	-5.7	-5.6	-5.8	-5.7	-5.4	-5.3
Miscellaneous goods	3.56	0.9 <sup>(b)</sup>	1.2	1.3	0.6	0.5	0.5	1.3	2.3
Transport	7.98	-0.3 <sup>(b)</sup>	-0.1	-0.4	-0.4	-0.3	1.2	1.5	1.4
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)	2.5 (2.5)
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)	2.1 (3.1)

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.

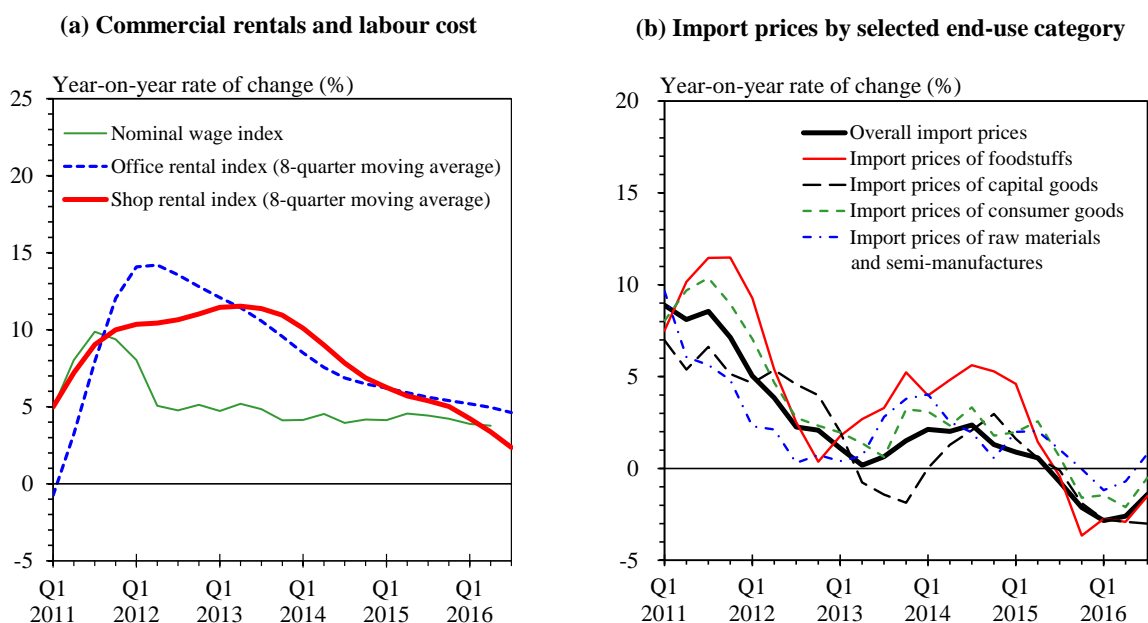
( ) Figures in brackets represent the headline rates of change before netting out the effect of Government's one-off relief measures.

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

## Costs of factor inputs and import prices

6.4 The increases in domestic costs were generally moderate in the third quarter. On labour costs, wage growth held steady in the past few quarters, thanks to the largely stable labour market conditions. The year-on-year increases in office and shop rentals, when analysed on an eight-quarter-moving-average basis, continued to show a moderating trend in line with the below-trend economic growth.

**Diagram 6.5 : Local cost pressures remained in check, while external price pressures stayed low**





6.5 Imported inflation stayed muted in the third quarter, thanks to the tame inflation in major import sources, a strong US dollar, and the relatively soft international energy and commodity prices. Overall import prices extended their decline in the third quarter, down by 1.4% from a year ago. Analysed by end-use category, the import prices of foodstuffs and consumer goods fell further by 1.5% and 0.5% respectively in the third quarter. The decline in import prices of capital goods widened slightly to 3.0%. Import prices of fuels still fell visibly by 15.5%, albeit narrowed from the previous quarters. On the other hand, import prices of raw materials and semi-manufactures rebounded by 0.8%, after declining in the first half of the year.

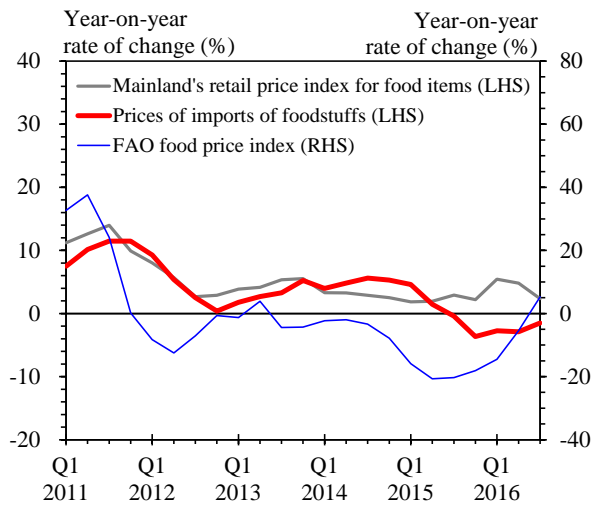
**Table 6.3 : Prices of imports by end-use category  
(year-on-year rate of change (%))**

		<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
	Q3	-1.5	-0.5	0.8	-15.5	-3.0	-1.4

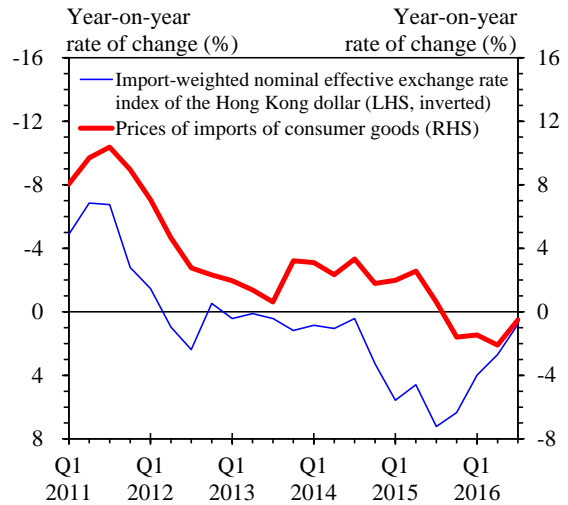
Note : (\*) Change within  $\pm 0.05\%$ .

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

**(a) Import prices of food remained soft**

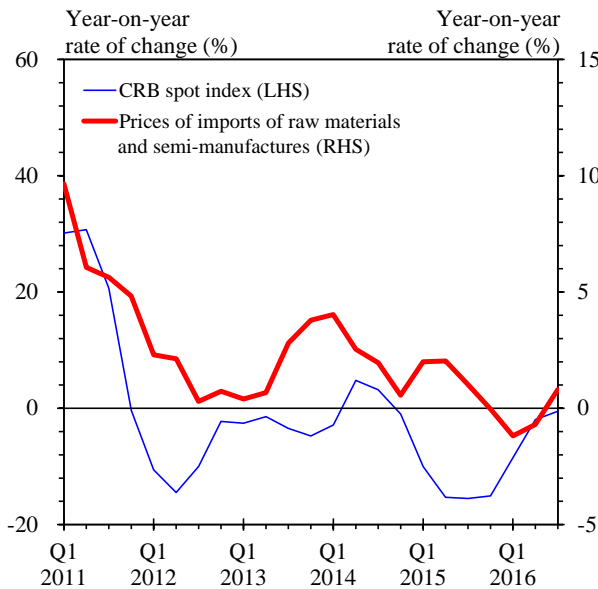


**(b) Import prices of consumer goods fell slightly further**

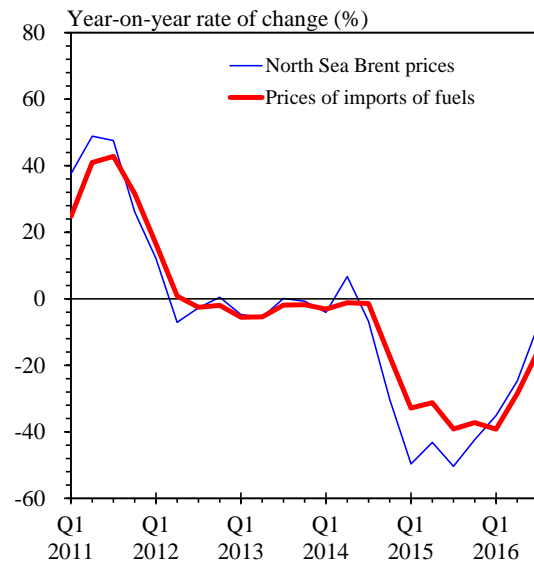


Note : An increase in the nominal EERI indicates strengthening of the Hong Kong dollar. The y-axis of nominal EERI in this graph is inverted for easier comprehension.

**(c) Import prices of raw materials and semi-manufactures resumed some increases**



**(d) Import prices of fuels still registered visible year-on-year decline**



## Output prices

6.6 Output prices, as measured by the *Producer Price Indices*<sup>(3)</sup>, were generally soft in the second quarter of 2016. For the manufacturing sector, the output prices reverted to a mild year-on-year increase, after having declined for six consecutive quarters. As for the selected service sectors, the year-on-year decline in output prices for accommodation services narrowed, conceivably helped by the smaller decline in visitor arrivals over the same period. However, the output prices for water and air transport recorded further double-digit year-on-year declines in the midst of an unsteady external environment. The increases in output prices for land transport and courier services likewise remained modest. Meanwhile, the output prices for telecommunications services continued to stay on their 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>	<u>Q2</u>
Manufacturing	-2.7	-0.6	-2.8	-4.4	-3.2	-2.8	0.4
Selected service sectors <sup>(a)</sup>							
Accommodation services	-3.6	-1.6	-5.4	-4.8	-2.6	-4.7	-1.9
Land transport	2.3	2.9	2.3	2.1	2.0	2.6	2.1
Water transport	-7.0	-0.2	-3.5	-10.4	-13.5	-15.8	-14.8
Air transport	-7.8	-3.4	-7.9	-9.2	-10.8	-12.1	-10.9
Telecommunications	-4.3	-3.9	-4.4	-4.7	-4.2	-3.6	-3.1
Courier services	4.5	4.2	4.8	4.7	4.3	1.8	2.3

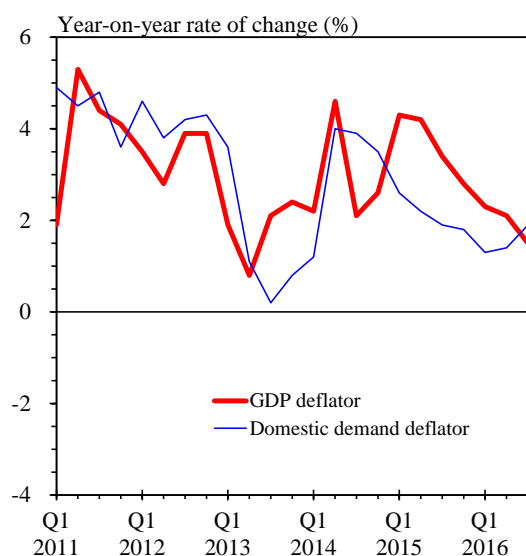
Note : (a) Producer Price Indices for other service sectors are not available, due to the difficulties involved in defining and delineating the various types of services and hence in measuring their respective price changes. This is particularly so for such sectors as banking and insurance, where the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

## GDP deflator

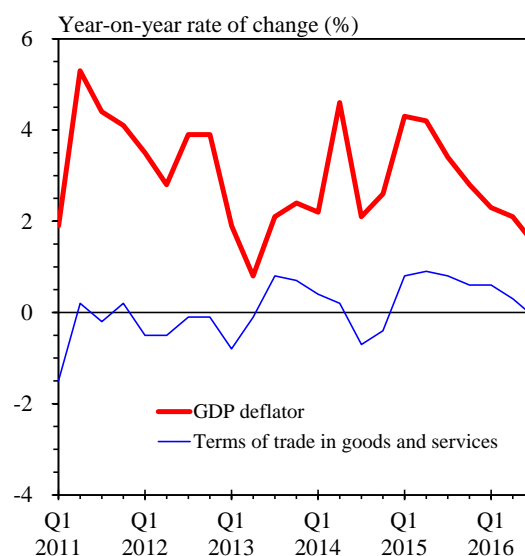
6.7 As a broad measure of the overall change in prices in the economy, the *GDP deflator*<sup>(4)</sup> rose by 1.5% in the third quarter of 2016 over a year earlier, slower than the average of 2.2% in the first half of the year. Within the GDP deflator, the *terms of trade*<sup>(5)</sup> worsened slightly over the same period as export prices dropped slightly faster than import prices. Taking out the external trade components, the domestic demand deflator rose by 1.9% year-on-year in the third quarter.

Diagram 6.7 : GDP deflator

(a) GDP deflator continued to ease, despite the slight pick-up in domestic demand deflator



(b) Terms of trade deteriorated but only slightly



**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</u>	<u>Q2<sup>#</sup></u>	<u>Q3<sup>+</sup></u>
Private consumption expenditure	2.9	1.0	1.7	1.1	0.4	1.0	1.2	1.6	2.1
Government consumption expenditure	4.7	4.5	4.8	4.6	4.6	4.2	4.0	3.9	3.9
Gross domestic fixed capital formation	3.1	4.5	4.8	4.8	5.5	3.2	0.5	-0.2	*
Total exports of goods	0.8	-0.7	0.8	0.4	-1.2	-2.4	-2.8	-2.4	-1.2
Imports of goods	0.9	-1.4	0.1	-0.7	-2.1	-2.8	-3.6	-2.8	-1.3
Exports of services	0.8	-2.0	-0.6	-1.6	-3.1	-2.7	-3.7	-2.7	-1.6
Imports of services	1.2	-4.3	-3.7	-3.0	-5.3	-4.8	-3.4	-1.7	0.2
<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>2.1</b>	<b>1.5</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> >	< <b>0.2</b> >
Total final demand	1.5	*	1.2	0.7	-0.5	-1.1	-1.5	-1.1	-0.3
Domestic demand	3.1	2.1	2.6	2.2	1.9	1.8	1.3	1.4	1.9
Terms of trade in goods and services	-0.1	0.7	0.8	0.9	0.8	0.6	0.6	0.3	-0.1

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 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>	<u>Q3</u>
Selected developed economies									
US	1.6	0.1	-0.1	*	0.1	0.5	1.1	1.0	1.1
Canada	2.0	1.1	1.1	0.9	1.2	1.3	1.5	1.6	1.2
EU	0.5	*	-0.3	0.1	*	0.1	*	-0.1	0.3
Japan	2.7	0.8	2.3	0.5	0.2	0.3	0.1	-0.4	-0.5
Major emerging economies									
Mainland China	2.0	1.4	1.2	1.4	1.7	1.5	2.1	2.1	1.7
Russia	7.8	15.5	16.2	15.8	15.7	14.5	8.3	7.4	6.8
India	6.6	4.9	5.3	5.1	3.9	5.3	5.3	5.7	5.1
Brazil	6.3	9.0	7.7	8.5	9.5	10.4	10.1	9.1	8.7
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>	3.1 <sup>^</sup>
Singapore	1.0	-0.5	-0.3	-0.4	-0.6	-0.7	-0.8	-0.9	-0.4
Taiwan	1.2	-0.3	-0.6	-0.7	-0.3	0.3	1.7	1.3	0.7
Korea	1.3	0.7	0.6	0.5	0.7	1.1	1.0	0.9	0.8
Malaysia	3.1	2.1	0.7	2.2	3.0	2.6	3.4	1.9	1.3
Thailand	1.9	-0.9	-0.5	-1.1	-1.1	-0.9	-0.5	0.3	0.3
Indonesia	6.4	6.4	6.5	7.1	7.1	4.8	4.3	3.5	3.0
Philippines	4.1	1.4	2.4	1.7	0.6	1.0	1.1	1.5	2.0
Vietnam	4.1	0.6	0.7	1.0	0.5	0.3	1.3	2.2	2.8
Macao	6.0	4.6	5.1	4.8	4.5	3.9	3.7	2.6	1.8

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.