

**Box 6.2****An examination of the sources of recent food price hike  
and its impact on Hong Kong's inflation**

The movements of import prices in Table 6.3 indicate that much of the import price rise in 2006 came from raw materials and fuels, but the sources have switched to consumer goods and especially foodstuffs in recent months. In tandem, the edge-up in underlying consumer price inflation over the past six months was also increasingly associated with the rise in food prices. This article examines the sources of food price rise and analyses to what extent higher food prices in Hong Kong's major import sources have transmitted to retail food prices and hence CCPI inflation in Hong Kong. The key finding is that food-led inflation was not only seen in Hong Kong, but also in quite a number of countries which are Hong Kong's major sources of food supplies, including the Mainland, US, Japan, Australia, and Thailand. For Hong Kong, there was of course an additional cost-push from the weakness of the US dollar and renminbi appreciation, although the past experience is that higher import prices may not necessarily feed through to the local retail price levels to the full extent.

The pick-up in import prices of foodstuffs since mid-2006 was a result of two factors, viz. the depreciation of the Hong Kong dollar along with the US dollar and the appreciation of the renminbi (the exchange rate factor), and higher food inflation in Hong Kong's import sources. On the latter factor, the pick-up in food prices in the Mainland was often quoted as the key source of Hong Kong's food-led inflation, given that the Mainland is Hong Kong's largest source of food imports, especially for fresh food supplies like pork; live poultry; vegetables and fruits; and eggs. Indeed, import prices of these fresh food items have been generally rising over the past 12 months, and retail food prices in Hong Kong and hence consumer price inflation have risen in tandem.

Further examination of the trends of import prices of foodstuffs however indicates that the pick-up was in fact almost across-the-board for most sources. Amongst the major sources of food imports into Hong Kong, Thailand actually showed the largest increase in prices, at a rate which was much faster than that from the Mainland, presumably largely due to the appreciation of the Thai baht but to some extent also driven by rising food prices in Thailand. The increase in prices of imported foodstuffs from Australia was more modest, even though the Australian dollar has appreciated against the Hong Kong dollar by some 14% over the past year or so. In contrast, prices of foodstuffs imported from Japan showed softer increase than those from the Mainland, as a result of the weakness of the yen.

**Table 1 : Import prices of foodstuffs from Hong Kong's major sources\***  
(year-on-year rate of change (%))

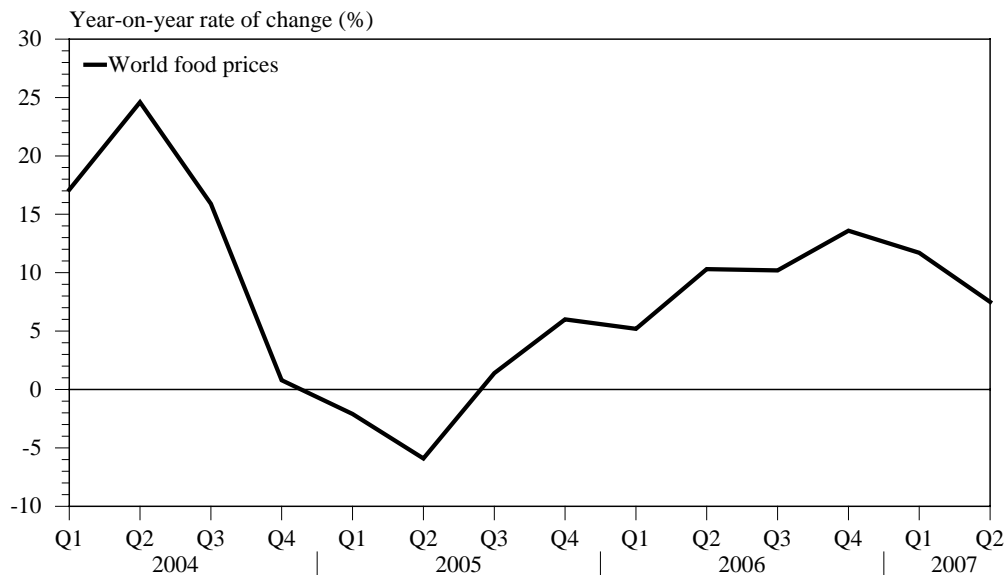
	<u>China</u> (26.2%)	<u>USA</u> (10.4%)	<u>Japan</u> (5.9%)	<u>Australia</u> (5.8%)	<u>Thailand</u> (5.7%)
2004	2.5	6.8	4.3	6.1	0.8
2005	0.5	0.8	3.6	6.0	-2.0
2006	0.6	2.1	4.4	1.0	8.7
2007 H1	3.1	4.3	2.2	3.6	8.3

( ) percentage share of respective source of Hong Kong's total imports of foodstuffs in 2006

**Box 6.2 (cont'd)**

In fact, we have seen a global trend of food inflation since late 2005 (Chart 1). According to International Monetary Fund (IMF)'s data source, world food prices reverted to increase after the second quarter of 2005 and then picked up progressively in 2006. In the first half of 2007, the cumulative increase in world food prices over a year was nearly 10%. IMF attributed the recent food price hike to a number of factors, including poor wheat crop in major producing countries; rising US demand for ethanol (which uses corn as an input); and prospects of higher biodiesel demand (which uses soybean oil and other edible oils). Higher prices of corn and soybean oil would in turn push up the price of partial substitutes, such as wheat and rice, and other edible oils. As corn and soymeal is the predominant source of feedstock, there would also be spillover to prices of meat, dairy, and poultry prices due to higher animal rearing costs.

**Chart 1: There is a global trend of food inflation since late 2005**



Source: International Monetary Fund

To the extent that the current supply shortage was triggered by the cut back in production in response to the earlier price fall, stronger demand for and the price hike of foodstuffs should now work in the other way to stimulate production, although this will take some time to work through. All in all, while the global-wide food inflation is likely to remain for some time, it should hopefully wane once the supply response works through to restore a better demand/supply balance.

**Box 6.2 (cont'd)**

To what extent has global-wide food price hike transmitted to higher inflation in Hong Kong? It is worthwhile to note that while global food prices have been rising at a rate of over 10% in recent periods, import prices of foodstuffs rose by a lesser extent of 5.4% in the past two quarters. Likewise, only part of the Mainland's food price hike and renminbi appreciation has fed through to raise prices of foodstuffs imported from the Mainland. 2004 was a case in point. In that year, food prices in the Mainland soared by around 10%, yet prices of food imports from the Mainland rose by only 2.5%. Similarly, in the first half of 2007, food prices in the Mainland (gauged in terms of the Mainland's CPI) rose by 7.6%, and when coupled with the 5% cumulative appreciation in the renminbi against the Hong Kong dollar, this should have translated into an around 13% rise in import cost of foodstuffs from the Mainland assuming full feed-through. Yet prices of Hong Kong's food imports from the Mainland actually rose by 3.1% over the period.

**Chart 2: Food inflation in the Mainland does not necessarily fully pass through to the retail food price level**

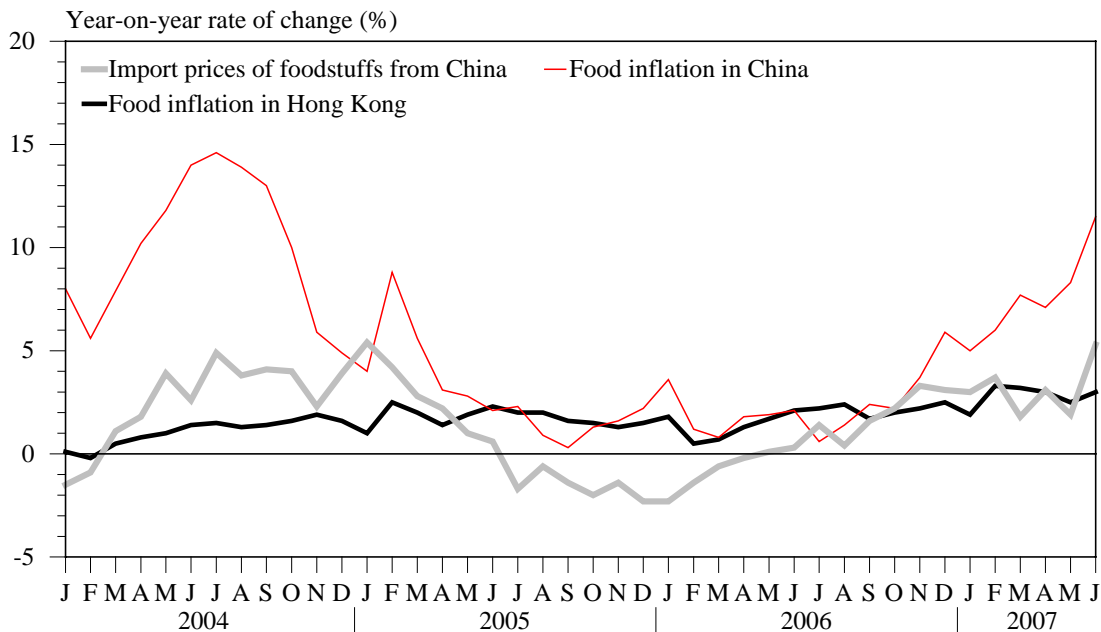


Table 2 below provides some broadbrush estimates of the impact of rising food prices on CCPI inflation, with reference to the weighting of basic foodstuffs in the CCPI. The estimates suggest that of the pick-up in CCPI inflation from 1.8% in the first half of 2006 to that of 2.4% (after adjusted for the effect of one-off measures) in the first half of 2007, around 0.3% point was due to food price hikes. The impact would be slightly higher, at around 0.4% point, if the induced indirect lifting effect from the ensuing increase in prices of meals out is also taken into account. Clearly, the global-wide rise in food prices would continue to pose an upside risk to Hong Kong's inflation in the near term, although there would be cushions from the on-going process of productivity upgrading and from the various one-off measures by the government in the year. Yet, the impact on CPI(A) should be relatively higher compared with other CPIs, given its larger weighting on foodstuffs.

## Box 6.2 (cont'd)

**Table 2 : Food price hike and its impact on Hong Kong's inflation**  
(Year-on-year rate of increase (%))

		World food prices*	Import prices of foodstuffs	of which : from China	Underlying CCPI after netting out one-off measures	of which : due to rising prices of basic foodstuffs	
2006	Q1	5.2	-0.3	-1.5	1.6	0.10	(0.25)
	Q2	10.3	0.6	0.1	2.0	0.23	(0.46)
	Q3	10.2	1.5	1.1	2.3	0.32	(0.56)
	Q4	13.6	3.0	2.8	2.1	0.35	(0.60)
	H1	7.8	0.2	-0.7	1.8	0.17	(0.35)
	H2	11.9	2.3	2.0	2.2	0.33	(0.58)
Annual		9.8	1.2	0.6	2.0	0.25	(0.47)
2007	Q1	11.7	4.9	2.8	2.5	0.44	(0.77)
	Q2	7.5	6.0	3.4	2.4	0.41	(0.75)
	H1	9.6	5.4	3.1	2.4	0.43	(0.76)

(\*) International Monetary Fund data

( ) Respective figures if prices of meals out are also taken into account. It has to be noted, however, that part of the rise in prices of meals out is also driven by rising domestic costs such as rentals and improved profitability.