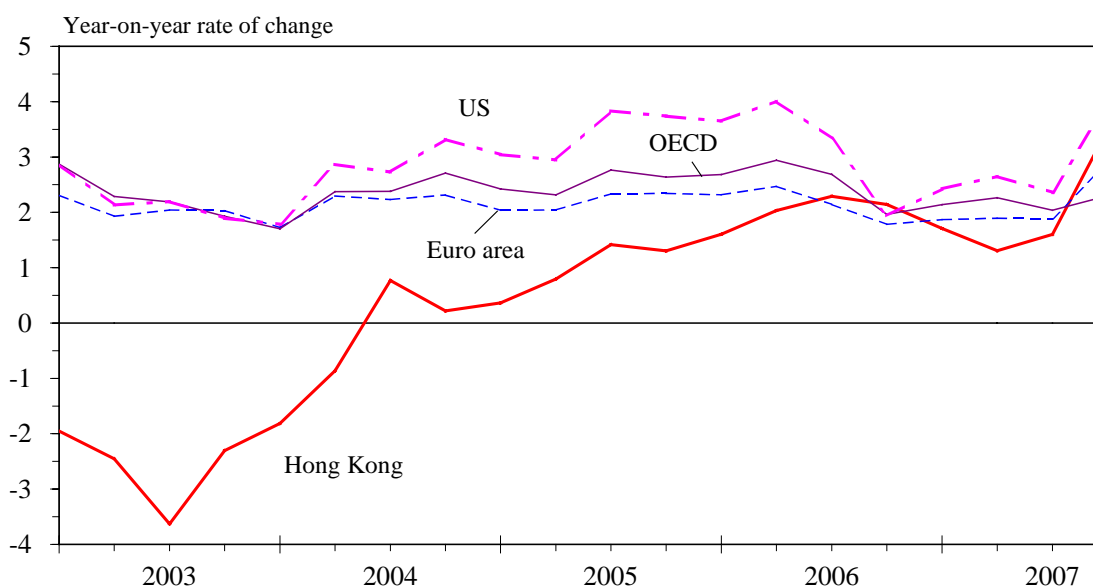


Box 2.1**Hong Kong's inflation in global context**

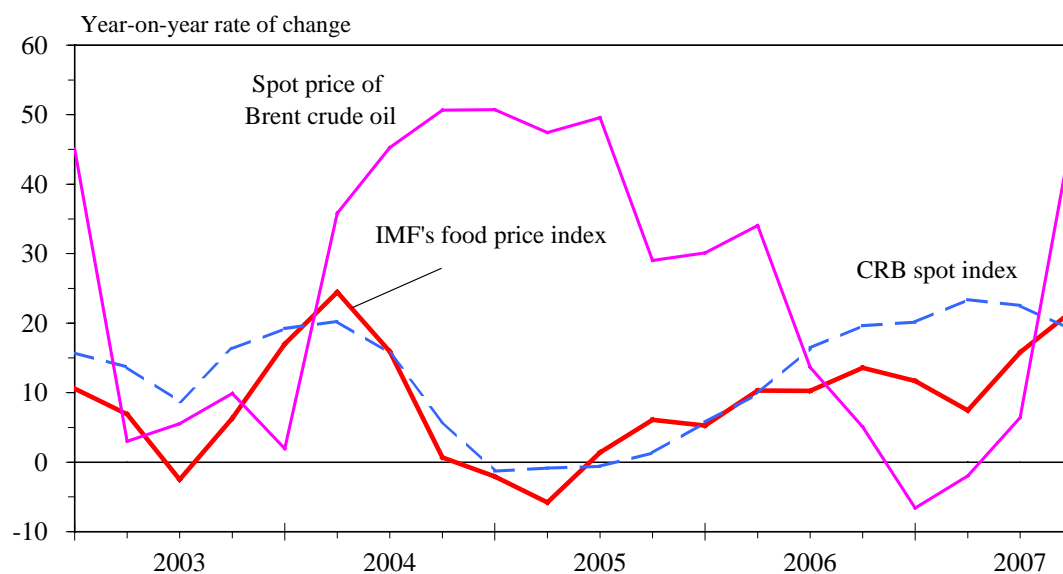
Average inflation in the advanced economies has been low since the early 1990s, largely on account of the efforts by these economies in adopting more independent monetary policy and prudent fiscal stances. The advanced economies learned the hard lessons from the experience in the 1970s, when inflation shot up to double-digit levels. Productivity growth, especially through the IT revolution, as well as competition brought about by globalisation and the rise of the low-cost emerging market economies have also been contributory to the recent low inflation era. Although the declines in inflation in the major emerging market economies have lagged behind those in advanced economies, world inflation on the whole has been rather moderate over the past decade or so. According to the IMF, world inflation averaged at 4.0% over the past decade. In the US and euro area, the corresponding figures were 2.6% and 2.0%.

However, inflationary pressures have been building up in many parts of the world more recently. This is particularly evident in the major emerging market economies, including the mainland of China, India and Russia. Inflation in the advanced economies, though still contained, has also picked up to levels outside their comfort zones.

Inflation in advanced economies

Box 2.1 (Cont'd)

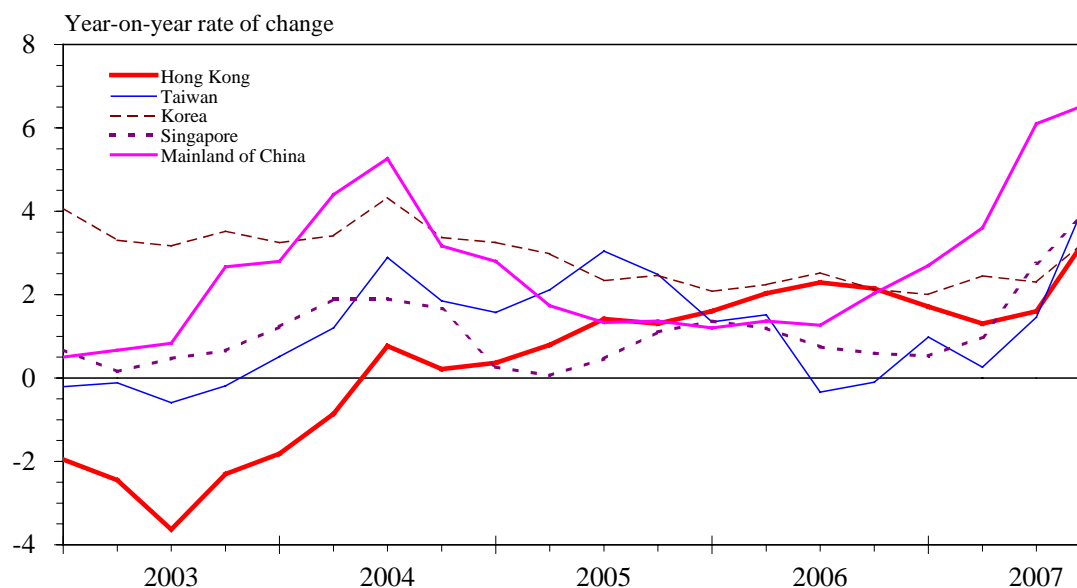
Several major developments have tended to push up world inflation. Firstly, global economic expansion over the past several years has been the strongest in decades. A number of advanced economies began to run against their capacity constraints in 2007, as evidenced by the continuous falls in their unemployment. Secondly, there has been strong demand for food, oil and other commodities, as a result of the robust global economic conditions. The fast-growing emerging market economies, while contributing to the softness of prices of manufacturing products over the past decade, are often cited as a major source of new demand leading to the surges in food and other commodity prices. Also, the increased use of food crops for production of biofuels has contributed in a significant way to global food inflation. Thirdly, the near-term economic outlook for the advanced economies and indeed the global economy is dimmed by the credit market turmoil triggered by the US subprime problems as well as the downturn of the US economy. As a result, the advanced economies have to adopt a looser monetary policy stance to forestall economic downturn, thus allowing some inflationary pressures to build up.

Food, oil and other commodity prices

In Hong Kong, inflation has become a concern. Yet the CPI inflation rate in Hong Kong in the fourth quarter of 2007, at 3.5%, was actually comparable to the situation in the relatively advanced economies. Specifically, our inflation rate was similar to or lower than the corresponding rates in the US (4.0%) and other Asian economies at a similar stage of economic development, like Singapore (4.1%), Taiwan (4.5%) and Korea (3.4%). Thus it is worth noting that the inflationary pressures facing Hong Kong are by and large part of a more worldwide phenomenon.

Box 2.1 (Cont'd)

Inflation in Asia



The return of the unpleasantly high inflation rates on a global scale as experienced in the 1970s is highly unlikely, as fighting inflation is still the chief objective of the governments of the major economies over the medium term. Indeed, inflation expectations in the advanced economies at this juncture are still well-anchored. Having said this, elevated inflationary pressures may still persist in the coming years. It is also worth noting that price adjustments in Hong Kong in response to changes in the global economic environment are part and parcel of Hong Kong's flexible market mechanism, which helps to balance the demand and supply of various goods and services. Although Hong Kong's inflation rate is not high when compared with many other places in the world, the Government is still very concerned about the impact of inflation on the lower-income families and the elderly and will continue to assist these people to weather the hardship.