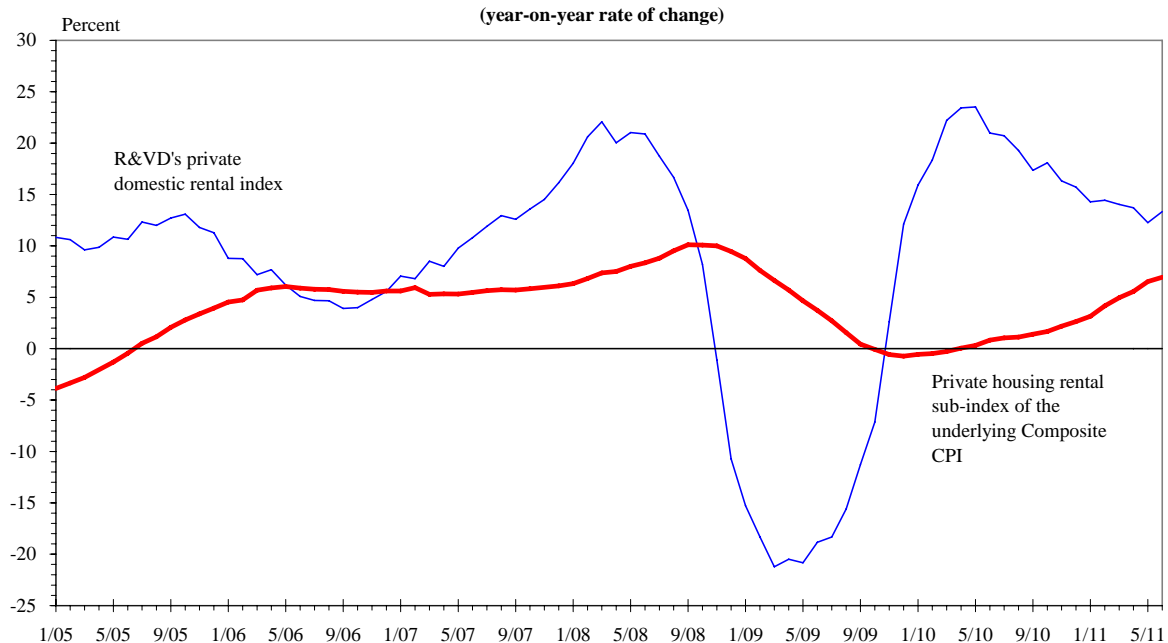


Box 6.1

Relationship between the CPI's private housing rental sub-index and R&VD's private domestic rental index

The rental index for private domestic premises, as compiled by the Rating and Valuation Department (R&VD), covers the movements in rent for fresh lettings, exclusive of rates and other charges but inclusive of Government rent. On the other hand, the private housing rental sub-index of the Composite CPI tracks the fluctuations in average rent, including rates and government rent, paid by all private residential households. Among all kinds of residential leases it covers, existing rentals constitute a much larger share of the total tenancies of private dwellings, relative to the new and renewed lettings. Given the broader coverage of the Composite CPI's private housing rental sub-index, the leases thus comprise mostly tenancy agreements made some time ago with the terms and conditions expected to hold throughout the contractual period. As such, the private housing rental sub-index of the Composite CPI tends to be less directly susceptible to the latest changes in lease market conditions, or to be responsive only with a certain time lag, as compared to R&VD's private domestic rental index. Yet, past increases in market rentals will eventually be reflected in the new tenancies when the existing ones expire, thereby translating into increases in the private housing rental sub-index of the underlying Composite CPI.

Movements in the private housing rental sub-index of the underlying Composite CPI and in R&VD's private domestic rental index



Inflationary pressures arising from the movements in private housing rentals have turned increasingly visible since late 2010. The private housing rental sub-index of the underlying Composite CPI rose by 6.4% year-on-year in the second quarter of this year, up visibly from 4.1% in the preceding quarter and 2.2% in the fourth quarter of last year. The rise in private housing costs in the Composite CPI over the past few quarters mirrored the progressive feed-through of the strong rise-back in market rentals since the second quarter of 2009 (*Chart*). On current trends, this feed-through process will likely further push up the rate of increase in private housing costs in the Composite CPI in the coming months.