

Box 2.1**Inflation outlook of Hong Kong's major import sources for 2020**

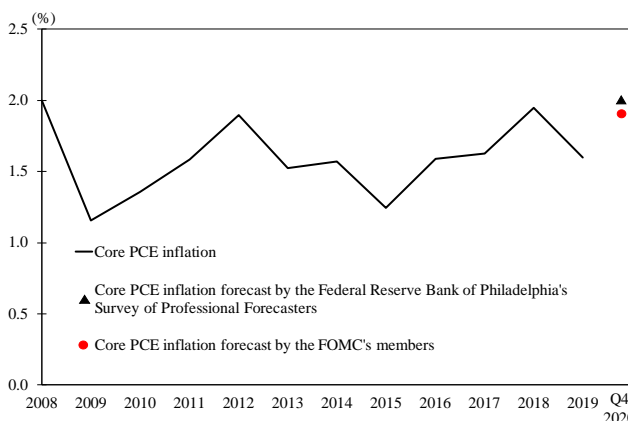
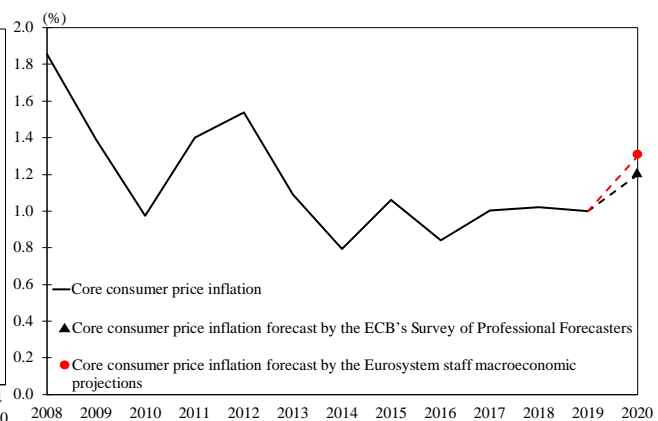
As a small and open economy, Hong Kong is highly reliant on imports, especially for foodstuffs and consumer goods. As such, inflation in Hong Kong's major import sources⁽¹⁾ could have significant impacts on the price pressures faced by Hong Kong. This box article discusses their near-term inflation outlook and the possible implications for Hong Kong's inflation in 2020.

Inflation outlook of the US

In the US, inflation eased somewhat in 2019, though remained close to the Federal Reserve's (Fed) 2% target. Core personal consumption expenditure (PCE) inflation, the Fed's preferred measure of inflation after excluding the food and energy components, went down to 1.6% in 2019 from 2.0% in 2018. Looking ahead into 2020, various projections conducted by the Fed generally suggested that inflation would edge up over the course of the year amid tight labour market conditions⁽²⁾, but should remain moderate and in the vicinity of its inflation target. For instance, the median projection by the Federal Open Market Committee's (FOMC) members in December 2019 suggested that core PCE inflation would increase slightly to 1.9% in the fourth quarter of 2020. Meanwhile, according to the Fourth Quarter 2019 Survey of Professional Forecasters conducted by the Federal Reserve Bank of Philadelphia, core PCE inflation was projected to reach 2.0% in the fourth quarter of 2020 (*Chart 1*).

Inflation outlook of the euro area

In the euro area, core consumer price inflation stayed modest at 1.0% in 2019. According to the Eurosystem staff macroeconomic projections in December 2019, it is forecast to increase to 1.3% in 2020. Likewise, based on the European Central Bank's (ECB) Survey of Professional Forecasters for the first quarter of 2020, respondents, on average, expected that core CPI inflation would edge up to 1.2% in 2020 (*Chart 2*). These forecasts indicated that inflation in the euro area should remain modest in 2020 despite some pick-up, alongside the still-sluggish growth momentum expected for the region⁽³⁾.

Chart 1: Inflation forecast in the US**Chart 2: Inflation forecast in the euro area**

Source: The Federal Reserves, the Federal Reserve Bank of Philadelphia, the European Central Bank.

- (1) For end-use categories of foodstuffs and consumer goods, the Mainland, the euro area, the US, ASEAN and Japan were Hong Kong's main import sources in 2019.
- (2) The unemployment rate in the US, at 3.6% in January 2020, continued to hover around the 50-year low, and is expected by the Fed to stay low over the course of 2020.
- (3) In January 2020, the IMF forecast that the economic growth in the euro area would stay modest at 1.3% in 2020.

Box 2.1 (Cont'd)

Inflation outlook of the Mainland

In the Mainland, consumer price inflation went up from 2.2% in the first half of 2019 to 2.9% and 4.3% in the third and fourth quarter⁽⁴⁾ respectively, mainly due to the surge in pork prices⁽⁵⁾ amid the impact of the African swine fever on the supply of live pigs. Excluding food, the inflation rate in the fourth quarter was only 1.1%. Overall inflation averaged 2.9% for 2019 as a whole, up from 2.1% in 2018. As for inflation outlook, the International Monetary Fund (IMF) in October 2019 projected that consumer price inflation in the Mainland would moderate to 2.4% for 2020 as a whole. On the other hand, the Chinese Academy of Social Sciences in December 2019 forecast that consumer price inflation would be about 3.4% for 2020 as a whole, which was somewhat higher than the annual inflation in 2019 yet lower than that in the fourth quarter of 2019 (*Chart 3*). On balance, overall price pressures in the Mainland are expected to moderate through 2020, though the pace of easing would largely hinge on the supply situation of live pigs⁽⁶⁾ and the extent of the impact of the recent novel coronavirus infection on production activity.

Inflation outlook of Japan

In Japan, consumer price inflation (excluding fresh food) remained modest at 0.7% in 2019. Looking ahead, the Bank of Japan (BoJ) in January 2020 forecast that consumer price inflation (excluding fresh food) would pick up to 1.0% for the fiscal year 2020 (*Chart 4*). In fact, the expected pick-up in inflation was largely due to the increase in consumption tax rate from 8% to 10% since October 2019⁽⁷⁾. Overall inflationary pressures should remain modest, mirroring the expected meagre economic growth in the year⁽⁸⁾. Meanwhile, according to the Tankan survey conducted by the BoJ in December 2019, which excludes the effects of the consumption tax rate hike, enterprises generally forecast the price pressures to remain mild in the near term, projecting a modest annual increase of 0.8% in general prices in 2020.

Chart 3: Inflation forecast in the Mainland

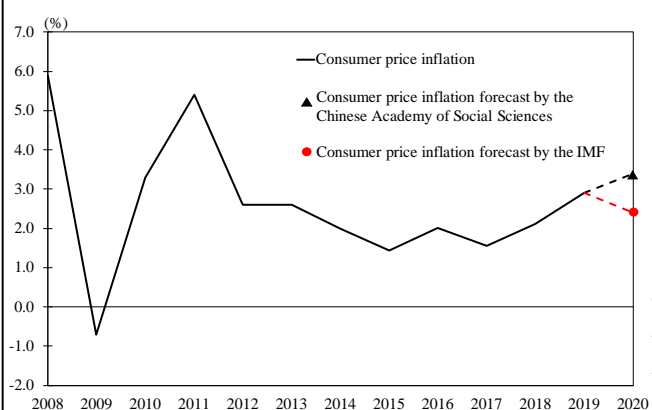
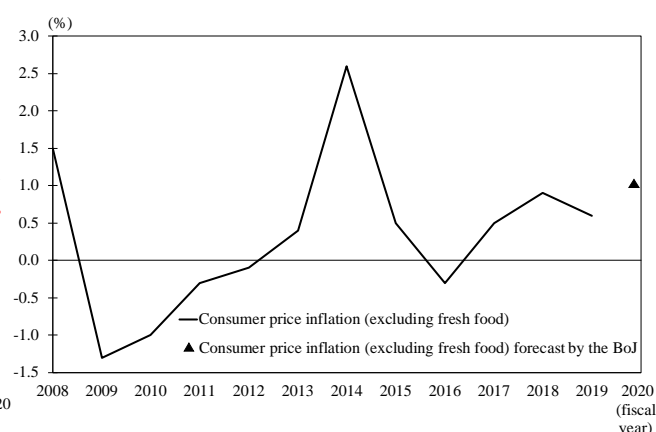


Chart 4: Inflation forecast in Japan



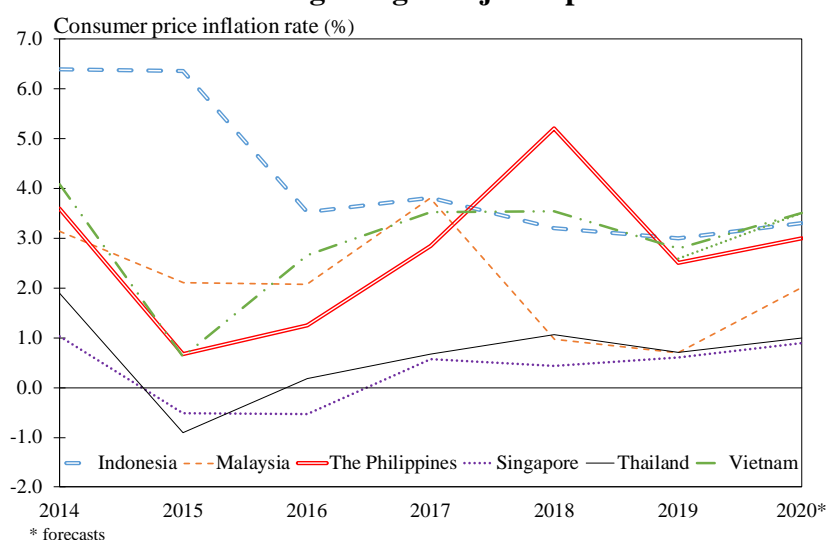
Source: The Chinese Academy of Social Sciences, the IMF, the Bank of Japan.

- (4) The consumer price inflation in the third and fourth quarter is the simple average of that in each month in the quarter.
- (5) The pork component rose by about 18% year-on-year in the second quarter of 2019, and surged by around 48% and 103% in the third and fourth quarter respectively.
- (6) According to the Ministry of Agriculture and Rural Affairs, the stock of sows that are pregnable resumed month-to-month increases for three months in a row from October to December 2019, after falling for nineteen consecutive months.
- (7) The BoJ estimated that the effects of the consumption tax rate hike on the year-on-year rate of change in CPI (excluding fresh food) was 0.5 percentage point for the fiscal year 2020, predicating on the assumption that the rise in the consumption tax would be fully passed on to prices of taxable items.
- (8) In January 2020, the BoJ forecast that the economic growth in Japan would be modest at 0.9% for the fiscal year 2020.

Box 2.1 (Cont'd)**Inflation outlook of ASEAN economies**

Indonesia, Malaysia, the Philippines, Singapore, Thailand and Vietnam are Hong Kong's major import sources within ASEAN economies. In 2019, consumer price inflation in those economies generally eased along with softening global economic growth. Looking ahead into 2020, the Asian Development Bank (ADB) in December 2019 projected that consumer price inflation would pick up by varying degrees in these economies, ranging from 0.3 percentage point in Indonesia, Singapore and Thailand to 1.3 percentage points in Malaysia⁽⁹⁾, alongside their slightly faster economic growth in general⁽¹⁰⁾. In specific, the rates of consumer price inflation in Indonesia, the Philippines and Vietnam were expected to climb somewhat to 3.3%, 3.0% and 3.5% respectively in 2020, while those in Malaysia, Singapore and Thailand were forecast to remain modest or moderate at 2.0%, 0.9% and 1.0% respectively in 2020 (**Chart 5**). In sum, overall price pressures in these ASEAN economies, while expected to go up alongside the slightly brighter growth outlook, should remain generally contained in 2020⁽¹¹⁾.

Chart 5: Inflation forecast in selected ASEAN economies which are Hong Kong's major import sources



Source: Asian Development Bank.

Conclusion

While consumer price inflation in many of Hong Kong's major import sources are expected to pick up somewhat in 2020, the inflation rates in advanced economies (i.e. the US, the euro area and Japan) should remain modest, while those in the Mainland and some ASEAN economies should stay largely contained. Hence, barring a prolonged disruptions to regional supply chains caused by the novel coronavirus infection or a renewed upsurge of international commodity and food prices that would drive up the inflation pressures in the major economies, external price pressures in Hong Kong should still be kept in check in 2020. The Government will continue to closely monitor inflation of our major import sources and their possible impacts on inflation in Hong Kong.

(9) The expected pick-up of consumer price inflation in Malaysia in 2020 was partly due to the low inflation rate in the first five months in 2019 amid the replacement of sales tax scheme that covers fewer goods since June 2018.

(10) The ADB forecast the economic growth of these ASEAN economies would generally pick up somewhat in 2020. On the other hand, The Viet economy is expected to see further solid growth of 6.8% in 2020, broadly on par with the 7.0% growth in 2019.

(11) The consumer price inflation forecasts for these ASEAN economies in 2020 by the IMF were largely similar to those by the ADB.