

立法會 *Legislative Council*

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Panel on Financial Affairs Meeting on 10 June 2008

Background brief on inflation-related issues

Purpose

This paper summarizes the major views and concerns expressed by Members of this Council on rising inflation experienced by Hong Kong over the past year or so.

Background

2. The economy of Hong Kong has sustained strong growth since the trough in 2003, with economic growth at 6.4% in 2007 and distinctly above trend for 18 consecutive quarters. As stated in the Financial Secretary (FS)'s speech on the 2008-09 Budget¹, the continued expansion of the economy, strong consumer spending and the surge in import prices of foodstuffs has exerted upward pressure on inflation. In addition, the Hong Kong dollar has followed the depreciation of the US dollar against other major currencies, affecting import prices. According to the First Quarter Economic Report 2008, headline Composite Consumer Price Index (CCPI) inflation averaged at 4.6% in the first quarter of the year. After netting out the one-off effects of the rates concession and the public housing rental waiver, the underlying consumer price inflation reached 4.9%. The inflation outlook for the rest of 2008 is rather uncertain. High food and energy prices, rising wages and rentals, as well as the exchange rate factors are likely to continue to exert inflationary pressure, which is expected to be mitigated by the sustained increase in labour productivity².

¹ See paragraph 7 of the 2008-09 Budget speech.

² See Chapters 1 and 6 of the First Quarter Economic Report 2008.

Views and concerns raised by Members

Discussion at Council meetings

3. Inflation is a subject of prime concern to Members of this Council as it may give rise to other livelihood and economy-related issues affecting the community at large, in particular disadvantaged groups. At the Council meeting held on 16 January 2008, Members passed a motion on "coping with inflation" which urged the Government to adopt a series of measures to alleviate the pressure on people's livelihood. In its progress report submitted in response to Members' views, the Administration has highlighted the various initiatives announced by FS in the 2008-09 Budget³, as well as other ongoing initiatives. Questions on the impact of inflation on low-income families were raised at the Council meetings held on 7 and 14 May 2008.

4. During the resumption of the debate on the Second Reading of the Appropriation Bill 2008 at the Council meetings of 16 and 17 April 2008, Members took the opportunity to state their concerns about the soaring inflation in the past few months. They pointed out that rises in rent, prices of food, daily necessities and public utilities had an adverse impact on the livelihood of the grassroot population. Moreover, the appreciation of renminbi had aggravated the inflationary pressure faced by Hong Kong. The Administration was therefore urged to introduce more relief measures in addition to those announced by FS in the 2008-09 Budget.

5. The subject of inflation received centre-stage attention during the Chief Executive (CE)'s Question & Answer Session on 15 May 2008. In response to the many questions and concerns raised by Members about the recent rise in inflation, CE said that rising fuel prices had triggered a wave of fare-adjustment applications by operators of public transport and rising food prices had adversely affected lower-income families. While noting that inflation could not be eliminated in a free-market economy, CE reaffirmed the Government's commitment to assisting the community, notably the grassroot level of the population and small and medium enterprises, to cope with inflation. More concrete measures would be outlined in the coming Policy Address.

Deliberations at the FA Panel

6. The Panel on Financial Affairs (FA Panel) has been tasked to examine issues related to Hong Kong's macro-economic situation. For this purpose, it has been the Panel's standing practice to invite FS and the Chief Executive of the Hong Kong Monetary Authority (CE/HKMA) and their colleagues to brief the Panel periodically on the latest developments in the economic, financial and monetary environment. The subject of inflation has received serious attention during recent

³ Some of the major initiatives include the one-month rental waiver for public housing tenants, one-off reduction in Salaries Tax, one-off grant of \$3,000 to Old Age Allowance recipients, one additional month of payment to recipients of Comprehensive Social Security Assistance and Disability Allowance, the electricity charge subsidy etc.

meetings with FS and CE/HKMA in the current legislative session. In examining inflation, members were gravely concerned about the factors driving up inflation, the impact on people's livelihood and Hong Kong's competitiveness, as well as the measures adopted by the Administration to assist the public to cope with inflation.

The factors driving up inflation

7. Referring to the weak US dollar, the appreciating renminbi, the rapid rise in global food and oil prices, Panel members were worried about continued inflationary pressure and whether it was possible for Hong Kong to counter such pressure given the peg of the Hong Kong dollar to the US dollar under the Linked Exchange Rate (LER) system. Question was raised as to whether Hong Kong would be in a better position to deal with inflation if a more flexible exchange rate regime was adopted.

8. In briefing the Panel, CE/HKMA reaffirmed the Government's policy to uphold the LER system as it had served Hong Kong well for some 25 years. The Panel was informed that rising inflation was a global phenomenon, in part due to higher crude oil and food prices. Compared with economies adopting more flexible exchange rate regimes, the current inflation rate in Hong Kong was not particularly high. HKMA advised that the exchange rate was not a key factor driving domestic inflation. It also shared with members its study that the depreciation of the US dollar and the appreciation of renminbi would only result in minimal rise in inflation. In the view of HKMA, domestic factors such as higher rent and the rise in unit labour cost had resulted in increased production cost which, together with strong local consumption, had the effect of driving up inflation.

Rising cost of living

9. One of members' main concerns was that the return of the inflation cycle would result in a general rise in the cost of living. For example, during FS's briefing in December 2007, members noted with concern that among the main components of the CCPI, the rise in the prices of foodstuffs by 11.9% in October 2007 had contributed most to the rise in inflation in the third quarter of 2007. The significant rise in food prices would cause particular hardship to low-income households. According to the Administration, the hike in food prices was a worldwide phenomenon. Different jurisdictions might adopt different measures to alleviate the impact of rising food prices to suit their own circumstances and there were no globally applicable measures.

10. The FA Panel also noted price rises in other items such as housing, clothing and footwear and durable goods etc. The increases in bus fares were also of concern to members as they would inevitably add to the financial burden of the general public, in particular low-income earners and other disadvantaged groups.

Measures to cope with inflation

11. The Administration assured members that it was keenly aware of the burden of inflation on the lower economic strata of the community. In its view, the most effective way to cope with inflation was to facilitate economic growth through increasing local productivity and creating employment opportunities. Initiatives in this direction included plans on mega infrastructure projects to create employment, upgrading the skills and productivity of the labour force through education and training and ensuring the provision of adequate land supply to meet the demand for long-term economic development.

12. While members did not doubt the need for initiatives to increase local productivity, they considered it equally important for the Administration to introduce appropriate relief measures so that the public could continue to maintain a reasonable standard of living and meet their livelihood needs. Given the substantial fiscal surplus⁴ recorded for 2007-08, members urged the Administration to actively consider introducing more measures to assist the needy to cope with inflation.

13. Members had also taken the opportunity to seek clarifications and give their views when examining relevant proposals in the 2008-09 Budget. For example, a subcommittee was formed to study the Rating (Exemption) Order 2008 to implement the rates waiver announced in the 2008-09 Budget. When being consulted on the proposed electricity charge subsidy and the proposal on government injection into the accounts of members of Mandatory Provident Fund Schemes and Occupational Retirement Schemes, the FA Panel supported their early implementation but some members suggested that the relevant eligibility criteria might be relaxed to benefit more grassroots population.

Latest position

14. Arising from the discussion of proposed tunnel toll and bus fare increases at the meeting of the Panel on Transport held on 25 April 2008, Hon Andrew CHENG, Panel Chairman, wrote to the Chairman of the House Committee proposing to invite the Chief Secretary for Administration and FS to attend a special House Committee meeting for discussion of the subject of inflation and related issues. At the meeting on 2 May 2008, the House Committee agreed that the subject of inflation would be discussed by the FA Panel and all non-Panel Members would be invited to join the discussion.

15. At the meeting of the FA Panel held on 5 May 2008, members agreed that inflation and related issues would be included under FS's briefing on the overall macro-economic situation scheduled to be held on 10 June 2008. Apart from FS and the Government Economist, the Panel would also invite the Secretary for

⁴ As announced by the Government on 30 April 2008, the provisional surplus for the 2007-08 financial year was \$123.6 billion, an improvement of \$8 billion over the \$115.6 billion forecast in the 2008-09 Budget.

Financial Services and the Treasury and CE/HKMA to attend the meeting. Meanwhile, to facilitate discussion of inflation-related issues, the Administration has been invited to provide its response to a number of issues as listed in **Appendix I**.

Relevant papers

16. A list of relevant papers is at **Appendix II**.

Council Business Division 1
Legislative Council Secretariat
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**List of inflation-related issues
to which the Administration's response is sought**

- (a) The background and factors leading to the current level of inflation in Hong Kong, the latest development of the inflationary trend and the forecast growth, if any, of inflation in Hong Kong;
- (b) to what extent is the current inflation attributable to the Linked Exchange Rate system; and whether the inflationary pressure on Hong Kong can be alleviated if a more flexible exchange rate policy is adopted;
- (c) the consequences of inflation, notably the general rise in prices, the soaring cost of living, and the impact on people's livelihood and on Hong Kong's overall economic development;
- (d) the policy stance adopted by the Government to deal with inflation, the strategies and action plans, if any, to alleviate the hardship resulting from inflationary pressure on the public; as well as the effectiveness or otherwise of such measures; and
- (e) how inflation in Hong Kong compares with that in other jurisdictions, the approaches taken by other governments to curb inflation and ease inflationary pressure on people's livelihood, and how far overseas experience can serve as reference for Hong Kong

List of relevant papers

Committee	Paper	LC Paper No.
Meeting of Panel on Financial Affairs (FA Panel) on 3 December 2007	<p>✧ Briefing by the Financial Secretary on Hong Kong's latest overall economic situation</p> <p>"Third Quarter Economic Report 2007" and the press release provided by the Administration</p> <p>http://www.legco.gov.hk/yr07-08/english/panels/fa/papers/facb1-268-e.pdf</p> <p>Administration's paper on "Recent situation and near-term outlook for the Hong Kong economy"</p> <p>http://www.legco.gov.hk/yr07-08/english/panels/fa/papers/fa1203cb1-331-3-e.pdf</p> <p>✧ Minutes of meeting (paragraphs 7 to 39)</p> <p>http://www.legco.gov.hk/yr07-08/english/panels/fa/minutes/fa071203.pdf</p>	<p>CB(1)268/07-08</p> <p>CB(1)331/07-08(03)</p> <p>CB(1)663/07-08</p>
Council Meeting on 16 January 2008	<p>✧ Motion on coping with inflation</p> <p>Hansard of Council Meeting on 16 January 2008</p> <p>http://www.legco.gov.hk/yr07-08/chinese/counmtg/floor/cm0116-confirm-ec.pdf (Page 81 to 149)</p> <p>✧ Progress report on coping with inflation</p> <p>http://www.legco.gov.hk/yr07-08/english/counmtg/motion/cm0116-m1-prpt-e.pdf</p>	--
Council Meeting on 27 February 2008	<p>✧ 2008-09 Budget Speech</p> <p>http://www.budget.gov.hk/2008/eng/speech.html</p>	--

Committee	Paper	LC Paper No.
Meeting of Subcommittee on Rating (Exemption) Order 2008 on 19 March 2008	✧ Report of the Subcommittee http://www.legco.gov.hk/yr07-08/english/hc/papers/hc0411cb1-1201-e.pdf	CB(1)1201/07-08
Council Meetings on 16 and 17 April 2008	✧ Resumption of the debate on the Second Reading of the Appropriation Bill 2008 Hansard of Council Meetings on 16 and 17 April 2008	--
Special meeting of FA Panel on 28 April 2008	✧ Hong Kong Monetary Authority's paper on briefing on its work http://www.legco.gov.hk/yr07-08/english/panels/fa/papers/fa0428cb1-1332-1-e.pdf	CB(1)1332/07-08(01)
--	✧ Press release on "Provisional financial results for the year ended March 31, 2008" http://www.info.gov.hk/gia/general/200804/30/P200804300161.htm	--
Meeting of House Committee on 2 May 2008	✧ Minutes of meeting (paragraphs 78 to 91) http://www.legco.gov.hk/yr07-08/english/hc/minutes/hc080502.pdf	CB(2)1831/07-08
Meeting of FA Panel on 5 May 2008	✧ Administration's paper on "Proposal on government injection into accounts of members of the Mandatory Provident Fund Schemes and Occupational Retirement Schemes" http://www.legco.gov.hk/yr07-08/english/panels/fa/papers/fa0505cb1-1379-6-e.pdf ✧ Administration's paper on "Electricity charge subsidy" http://www.legco.gov.hk/yr07-08/english/panels/fa/papers/fa0505cb1-1379-7-e.pdf	CB(1)1379/07-08(06) CB(1)1379/07-08(07)

Committee	Paper	LC Paper No.
Council Meeting on 7 May 2008	✧ Hansard of Hon CHAN Yuen-han's question on "Measures to assist low-income people"	--
Council Meeting on 14 May 2008	✧ Hansard of Hon Frederick FUNG's question on "Measures to alleviate poverty"	--
--	✧ Chapters 1 and 6 of the First Quarter Economic Report 2008 http://www.legco.gov.hk/yr07-08/english/panels/fa/papers/facb1-1569-e.pdf	CB(1)1569/07-08