



# Economic Analysis

July, 2011

A Publication of the BEA Economic Research Department

## Rising cost of living in Hong Kong

The Census and Statistics Department of the HKSAR Government recently completed its quinquennial adjustment of the weightings of expenditure items within the Consumer Price Index (CPI), and released the report “2009/10 Household Expenditure Survey and the Rebasing of the Consumer Price Indices” to present the updated pattern of household consumption<sup>1</sup>.

In a sharp reversal of a long-term trend, the combined share of expenditure on food and housing jumped to 59.1% of overall household expenditure in 2009/10, from 56.1% in 2004/05. The overall level of prices increased by 13.3% compared with 2004/05, as measured by the composite CPI after netting out the effect of the Government’s one-off relief measures<sup>2</sup>. Food and housing alone grew by around 21%; excluding food and housing, prices rose by only 3.6%. The impact of price movements on spending behaviour varied across consumer items and households. However, it is clear that those with lower incomes and tenants of private housing have been particularly hard hit by the increase in the cost of living.

### Overview

Households on average spent \$21,945 per month (netting out government relief measures) in 2009/10, 16.2% more than in 2004/05. Adjusted for the increase in prices, household expenditure rose by 2.6% in real terms.

**Table 1: Changes in consumer expenditure implied by composite CPI (2009/10 vs 2004/05)**

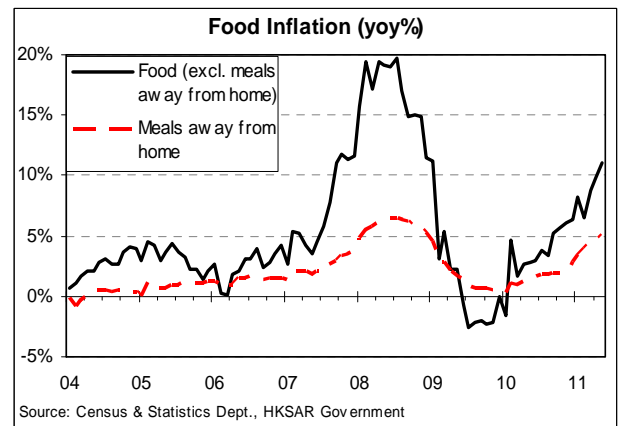
Section	Change in expenditure		Price change
	Nominal	Real	
Food	18.4%	-1.8%	20.5%
- Meals away from home	17.7%	3.9%	13.2%
- Food, excl. meals away from home	19.7%	-9.9%	32.8%
Housing	26.1%	4.0%	21.2%
Electricity, gas & water	0.3%	-4.8%	5.4%
Alcoholic drinks and tobacco	-21.2%	-32.6%	16.9%
Clothing and footwear	2.5%	-7.0%	10.3%
Durable goods	11.3%	35.7%	-17.9%
Miscellaneous goods	1.4%	-10.9%	13.8%
Transport	7.9%	3.9%	3.8%
Miscellaneous services	14.2%	8.7%	5.0%
<b>All items</b>	<b>16.2%</b>	<b>2.6%</b>	<b>13.3%</b>

Source: BEA estimates, Census &amp; Statistics Dept., HKSAR Government

<sup>1</sup> The survey period is October 2009-September 2010.<sup>2</sup> To facilitate the analysis on the consumption basket of composite CPI, changes in prices were calculated after netting out the government one-off relief measures. This is consistent with the calculation of expenditure weights in the CPI basket. The same method was used to derive the price changes in table 1.

The cost of food rose by 20.5% during the five-year period, while that of housing rose by 21.2%. Clothing and footwear, alcoholic drinks and tobacco, and miscellaneous goods also recorded double-digit price increases. However, rising costs in the latter categories led consumers to cut back their consumption of these items in real terms. In particular, real expenditure on alcoholic drinks and tobacco fell by 32.6% as prices rose by 16.9%.

Far less flexibility was shown in respect of the daily necessities food. Overall expenditure on food fell by only 1.8% in real terms, despite the sizable price increase. Food is, of course, a necessary expenditure, and there is little room to cut consumption in response to price increases. Fortunately, the growth in nominal income has helped alleviate the impact of food inflation. Nevertheless, food consumption behaviour has changed, largely due to the significant narrowing of the gap between the cost of preparing meals at home and the cost of dining out. While the cost of food prepared at home rose by 32.8% over the five-year period, that of dining out rose by only 13.2%. In response, consumers have cut real expenditure on food consumed at home by 9.9% while they increased real expenditure on dining out by 3.9%.



While the 21.2% increase in the cost of housing over the five-year period hit tenant households, expenditure on housing increased by 4% in real terms, implying that Hong Kong households in general have seen their living conditions improve. This improvement is partially driven by property owners trading up to better properties, as allowed by economic growth and low interest rate environment. In fact, the housing affordability ratio has been hovering around the affordable range of 30%-40% throughout the 2005-2009 period and residential property

market has been active in recent years<sup>3</sup>. According to the Land Registry, there were 540,067 residential property transactions in the period 2005/06 to 2009/10, 30% more than in the previous five years when the Hong Kong economy was suffering through the impacts of the Asian financial crisis and SARS.

Meanwhile, prices of durable goods fell by 17.9%, led by video and sound equipment, computers and telecommunication equipment. The price drop is believed to be the result of technological advances and innovation. With lower prices, sales of durable goods rose by 35.7% in real terms.

## Different impacts across household groups

Overall speaking, Hong Kong people have maintained their level of real consumption during the past five years, as implied by the 2.6% real growth in household expenditure. However, the changes in real expenditure were uneven among different types of households.

With government relief measures included, households living in public and subsidized housing on average spent \$14,002 per month in 2009/10, representing a 5.5% rise in nominal terms but an estimated 4.2% drop in real terms from 2004/05. In contrast, households living in private housing on average spent \$28,715 per month in the same period, with a nominal growth of 20% and an estimated real growth of 5.1%<sup>4</sup>.

**Table 2: Estimated real change in consumer expenditure by household types (2009/10 vs 2004/05)**

Section	Households in public and subsidized housing	Households in private sector housing
Food	-4.1%	2.3%
- Meals away from home	3.8%	8.2%
- Food, excl. meals away from home	-13.1%	-6.0%
Housing	2.6%	4.7%
Electricity, gas & water	-2.9%	0.5%
Alcoholic drinks and tobacco	-33.8%	-14.4%
Clothing and footwear	-8.5%	-1.0%
Durable goods	8.6%	36.9%
Miscellaneous goods	-16.5%	-12.1%
Transport	-12.2%	1.3%
Miscellaneous services	1.3%	17.0%
<b>All items</b>	<b>-4.2%</b>	<b>5.1%</b>

Source: BEA estimates, Census & Statistics Dept., HKSAR Government

Food inflation hit the lower-income group the most. Households living in public and subsidized housing have cut food expenditure by 4.1% in real terms while households living in private housing have increased food expenditure by 2.3%.

This may be attributed to two factors. First, low-income households usually spend relatively more of their total expenditure on food, compared with high-income households. For example, in 2004/05, expenditure on food was 33.4% of total expenditure for a household living in public or subsidized housing, whereas the corresponding ratio for a household living in private housing was 22%. Moreover, low-income households were more vulnerable to the sharp increase in the cost of food consumed at home. In 2004/05, a public or subsidized housing family spent 13.4% of their total expenditure on food consumed at home, compared with only 7.5% for a private housing family.

Second, low-income households have experienced only a modest rise in income. Between 2005Q3 and 2010Q3, the levels of median income for households living in public housing and subsidized housing increased by 4.8% and 13.5% respectively, slower than the 19.2% increase in the median income for households living in private housing. The faster income growth of private housing families allowed them to increase their real expenditure on food. However, with slower income growth, public and subsidized housing families have cut their real spending on food.

Private housing costs rose by 23% between 2004/05 and 2009/10. Private housing tenants were hardest hit. As at 2011Q1, there were roughly 370,000 private housing tenants, representing 30% of total private housing households. Meanwhile, the rise in housing costs (which is based on rental costs) had little impact on those who lived in self-owned properties as they need not pay market rents while occupying their own properties. Instead, improving economic conditions allowed them to trade up to better accommodation. This led to higher overall real expenditure on housing by private housing households.

The uneven income growth also led to different spending changes between public and subsidized housing families on the one hand and private housing families on the other, with respect to other consumer items such as durable goods and miscellaneous services. The falling prices of durable goods encouraged households of all types to increase consumption in this category, with households in private housing spending significantly more. The private housing families also spent much more in real terms on miscellaneous services such as package tours. The smaller increase in spending on these consumer items by the lower-income group implies that, with slower income growth, they had little spare money for discretionary spending after devoting much of their income to basic necessities.

## Relief measures and policy implications

The government has rolled out a number of measures in the past few years to mitigate inflationary pressure, including public housing rental subsidies, rate

<sup>3</sup> The affordability ratio is the ratio of monthly mortgage payment for a 45-square-metre flat to median income of households living in private housing, with assumptions of a 20-year mortgage and 30% down payment.

<sup>4</sup> The price index used to estimate the real growth of spending by households living in public and subsidized housing was compiled based on CPI(A) as approximately 70% of these households are covered by CPI(A). On the other hand, the corresponding price index for households living in private housing is compiled based on composite CPI (with private housing index being the housing index) as the range of expenditure of these households is larger. Accordingly, the real change in expenditure of each section in table 2 is estimated based on price index of the corresponding section of CPI(A) and composite CPI.

concessions and electricity subsidies<sup>5</sup>. For a public housing tenant, it is estimated that the three months of rental subsidies offered in fiscal year 2010/11 helped cut around 24% in housing costs and around 3.7% in total living costs for the year. Such rental and electricity subsidies were timely assistance to public housing families in coping with food inflation. Yet, even with the relief measures, lower-income households in public and subsidized housing still had to cut their real food and overall expenditure as their income growth lagged behind food inflation.

Underlying the surge in food prices is a structural problem caused by increasing global food demand, especially from emerging countries. As such, food prices are likely to remain high as emerging countries continue to grow. Added to that, the appreciation of the Renminbi raises the price Hong Kong has to pay for food imports from the Mainland. Therefore, the pressure of food inflation is likely to persist for the long term.

To assist low-income households, the government may have to continue to subsidise expenditure on basic necessities. Meanwhile, the government has taken steps to increase income for the lowest paid. The introduction of a minimum wage has had a knock-on effect on wages above the minimum wage. However, in the long run more efforts will be needed to raise skills and productivity.

For families living in private housing, the rate concessions are estimated to have lowered the housing component of the corresponding CPI by roughly 3.1% and overall CPI by 1.1%. However, not all private housing families are better off. Those who are renting private properties face pressure from rising rents. Further, most private housing tenants did not benefit from the rate concessions as, under their leases, only around 8% are required to pay rates<sup>6</sup>. Instead, landlords benefited from the rate concession.

With market rental yields at the lowest level in decades, residential rent is expected to trend upward in the medium term, placing private housing tenants in an even more unfavourable position. Home purchase would be a sensible choice for current tenants, to remove the looming threat of higher rents. However, high property prices make it more and more difficult for them to purchase. As at 2011Q1, the price of a 45-square-metre unit is equivalent to 10.8 times the median income of households living in private housing, up from 9.3 times a year earlier.

Therefore, assisting private housing tenants has become a major social issue. In this respect, the "My Home Purchase Plan" proposed last year should help eligible households by providing rental subsidies and thus assisting them in saving money for buying their own homes. Meanwhile, the government is also under considerable pressure to re-launch the "Home Ownership Scheme". As private housing tenants have suffered the brunt of the inflationary shock in the past five years, their demand for assistance to make up lost ground will not go away.

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<sup>5</sup> For example, in the fiscal year April 2010-March 2011, the government has paid the rental for public housing tenants in July-August 2010 and the Housing Authority has waived public housing rental in September 2010. The government has also offered rate concession of \$1,500 per quarter for each rateable tenement for the whole year, estimated to cost \$8.6 billion.

<sup>6</sup> See the reply from the Secretary for Financial Services and the Treasury on 9 January 2008 to a question on rate concession in the Legislative Council.