

Structural Change and Counterfactual Inflation-Targeting in Hong Kong

Paul D. McNelis
Fordham University
Hong Kong Institute for Monetary Research

July 2009

Summary

This paper evaluates structural change and adjustment in Hong Kong with Bayesian estimation of a small open economy model with a fixed exchange rate, sticky prices and production of traded and non-traded goods. Empirical results show little or no change in the model's structural parameters or volatility estimates of the structural shocks before and after the Asian crisis and the experience of deflation. Terms of trade shocks remain the most important sources of volatility for inflation in both periods.

A counterfactual simulation shows that the dispersion of consumption and inflation volatility may have slightly decreased with an inflation-targeting regime with no uncertainty, but interest-rate volatility would have increased by factors of 50 to 100 percent.