

**Comparative Studies on the Currency Board Regime
and its Impact on Hong Kong's Economy**

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Abstract

My thesis attempts to search evidence on the performance of the currency board regime and its impact on Hong Kong's economy. Three sets of related questions have been set up and carefully investigated in my empirical models.

Chapter 2 investigates output growth and inflation rate in order to compare the historical performance of free-floating and currency board regimes for Hong Kong. I apply some advanced econometrics tools to identify my structural VAR models and offer appropriate analysis. My first empirical model suggests that output returns to a steady state much faster in a flexible exchange rate regime than in a fixed exchange rate regime after an aggregate demand shock. My evidence offers an essential answer to the question on why the recovering process of Hong Kong from the Asian financial crisis lasted longer compared with the other Asian countries with a flexible exchange rate regime. Furthermore, my counter-factual analysis suggests that a free-floating regime may generate much smaller output variance in Hong Kong and deliver higher output and price levels to Hong Kong.

Chapter 3 investigates the currency board regime from 1984 to 2007, by considering some important variables which have significant impacts on Hong Kong's economy. For instance my empirical models attempt to examine the economic relationships with the US economy under the currency board regime and the close economic relationships with China under a Closer Economic Partnership Agreement with Mainland China. My models emphasises the importance of entrepot trade for Hong Kong's economy. Evidence shows that those exogenous variables have significant impacts on Hong Kong's economy, and they are one of the important factors when considering the choice of exchange rate regimes. My empirical evidence indicates some new findings which contradict existing studies which conclude that the Chinese economy is much less significant than the US economy in explaining Hong Kong's output variance.

Chapter 4 examines the real effective exchange rate misalignment of the two economies, Hong Kong and Singapore, and offers new policy implications on the choice of exchange rate regimes. Entrepot trades are essential to both economies. While the literature has paid little attention to such an important character and shown evidence of larger scale REER misalignment in Hong Kong compared with Singapore, my model reveals that including such an important variable has remarkably improved the model and offered strikingly different conclusions. I have applied Vector Error Correction Modelling and the Johansson Method in identifying the empirical models. Evidence suggests that Hong Kong performs well in terms of small real exchange rate misalignment even under its currency board regime.

My thesis indicates that although there are limitations in the currency board regime in terms of relatively slow recovery from external demand shocks and relatively larger output variance, the regime is still a preferable choice for Hong Kong, especially when we consider the close economic link with Mainland China and the United States. Moreover, there is no evidence in my models to suggest that the real exchange rate misalignment was significantly larger in the case of Hong Kong's currency board regime.

Declaration

NAME: PROGRAM:

This work contains no material which has been accepted for the award of any other degree or diploma in any university or other tertiary institution and, to the best of my knowledge and belief, contains no material previously published or written by another person, except where due reference has been made in the text.

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