Wage-Price Dynamics, the Labor Market and Deflation in Hong Kong

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Abstract

The single-equation reduced-form traditional Phillips curve under the neoclassical assumptions estimated using OLS couldn't answer questions regarding the dynamic adjustments of prices in Hong Kong. A Phillips curve based on assumptions of sticky wages or prices, monopolistic competition and variable markup, might be a more appropriate vehicle. We estimate structural Phillips curves for Hong Kong, where price-wage dynamics are explained by fluctuations in labor market's variables such as unit labor cost, the real marginal cost and the markup of prices over costs. In addition to the traditional variables in the Phillips curve, these variables seem to explain why deflation is prolonged. We find evidence that permanent unexpected shocks to the markup of price over unit labor costs affect the rate of price change for subsequent periods after the shock.

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