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Has the Chinese currency been undervalued?

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Abstract

China's trade surplus reached a record \$102 billion in 2005 while the US trade deficit of \$717 billion accounted for 5.8% of US Gross Domestic Product in the same year. US policy makers claim China's currency is undervalued about 25 to 35% against the US dollar and they blame China for holding the value of the RMB weak to keep Chinese products competitive on prices in international markets. Given the unique situation in China, where the capital account is only partially convertible and the economy has been growing at an annual average rate of 10% over the last two decades, this paper empirically examines the magnitude of the exchange rate misalignment of China's RMB against the US dollar by using the Behavioral Equilibrium Exchange Rate (BEER) and Permanent Equilibrium Exchange Rate (PEER) models. Our results show that the RMB was undervalued by approximately 15% from 2002:Q2 to 2003:Q4; however, it is interesting to note that while the RMB was overvalued during 1997:Q4–2002:Q2, China experienced a huge trade surplus during that period.

Keywords:

behavioral equilibrium exchange rate misalignment exchange rate regime

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