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# THE REVALUED RENMINBI 

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# ON THE CHINESE RENMINBI 

USDA Agricultural Outlook Forum
February 17, 2006

China scores an unfair trade advantage against the United States by pegging the renminbi at an artificially attractive level relative to the U.S. dollar.

## Today:

- Exchange-rate mechanism


## Today:

- Exchange-rate mechanism * Real exchange rate


## Today:

- Exchange-rate mechanism * Real exchange rate
* Sterilization


## Today:

- Exchange-rate mechanism * Real exchange rate * Sterilization
- Command economy


## Today:

- Exchange-rate mechanism * Real exchange rate * Sterilization
- Command economy
- Greater flexibility

The views expressed here today are my own and not necessarily those of the Federal Reserve Bank of Cleveland or the Board of Governors of the Federal Reserve System.

## RENMINBI DOLLAR EXCHANGE RATE



3 things matters for trade and investment

## 3 things matters for trade and investment

USA prices in dollars

## 3 things matters for trade and investment

Chinese prices in renminbi

USA prices in dollars

## 3 things matters for trade and investment

Chinese prices in
renminbi

Dollars per
renminbi

USA prices in dollars

## 3 things matters for trade and investment

Chinese prices in
renminbi

| Dollars per |
| :--- |
| renminbi |

$<\quad \begin{gathered}\text { USA prices in } \\ \text { dollars }\end{gathered}$

Buy from China.

## 3 things matters for trade and investment

Chinese prices in renminbi

| Dollars per |
| :--- |
| renminbi | USA prices in

dollars

Buy from USA.

## Real exchange rate



## RENMINBI DOLLAR EXCHANGE RATE



## RENMINBI DOLLAR EXCHANGE RATE



## INFLATION RATES



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## RENMINBI DOLLAR EXCHANGE RATE


"...it is difficult to arrive at any firm and robust conclusions about the equilibrium level of the renminbi-dollar exchange rate using existing techniques."
[IMF 2004]

## If China undervalued its exchange rate....



## CHINA'S OFFICIAL RESERVES



## If China undervalued its exchange rate....



## INFLATION RATES



## If China undervalued its exchange rate....



## Sterilized the reserve accumulation

## STERILIZATION OF RESERVE FLOW



## STERILIZATION OF RESERVE FLOW



## STERILIZATION OF RESERVE FLOW



# Why rapid trade, surplus, and reserve accumulation? 

A command economy

## Greater flexibility.....

- Independent monetary policy
- Protection from shocks


## Greater flexibility.....

- Independent monetary policy
- Protection from shocks
=> Flexible exchange rates
=> Forward \& derivative markets



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