

ABSTRACT

In this paper monthly data from 1990 through October 2004 are used to establish real effective exchange rate indices of RMB for export, import and bilateral trading respectively. These real effective exchange rate indices are established taking the particular political and economic conditions in China into consideration, based on the increasingly liberation of importation and exportation after joining WTO, and using China's import and export volume as well as its CPI. The theory used is doubtlessly correct and there is no much dispute on the data referred herein.

To adhere with what the China government proclaimed: "a flexible exchange rate meeting the market economics", currencies of its top 12 trade partners are selected for a basket of currencies instead of pegging to US dollar, in forming the real effective exchange rate indices. These indices can effectively reflect RMB's true value, and measure China's foreign trade competition.

According to the result of verification, in comparing with the base period (2000), the indices for 1990 – 1993 were mostly less than 100, representing that RMB was overvalued. In 1994 the exchange rates were unified, resulting in a structural change on foreign exchange rate, RMB was undervalued. Then, these indices fell gradually, and the exchange rate tended to become balanced in 1997. From 1997, while the Asian financial crisis happened, till 2002, there was no much deviation from the balanced exchange rate, i.e., even there was any out of balance, it was adjusted properly within a relatively short time. From the second half of 2002 till the end of 2004, the tendency of undervaluation was ascertained, by the deviation was only about 5%, the range was not so much.

Proclaiming that it is going to "peacefully rise", China should assume more international liabilities, and the appreciation of RMB is a non-reversible trend. To avoid interference to its economic development, China has no choice but to adopt an aggressively control on its floating exchange rate regime, pegging to a basket of currencies and setting up a relatively narrow range of tunnel for "snaking". In addition of its own political economy, international political situation must be taken into consideration for timing of its exchange rate adjustment. From some China government officials' statements, it can be seen that appreciation of RMB would be done without any warning in advance and unexpectedly.