

Abstract

This paper shows empirically that China's trade balance is sensitive to fluctuations in the renminbi real effective exchange rate. However, the current size of the trade surplus is such that exchange rate policy, alone, will probably not be able to address the imbalance. The reduction in the trade surplus is limited mainly because Chinese imports do not react as expected to exchange rate appreciation. In fact, they tend to fall rather than increase. By estimating bilateral import equations for China and its major trading partners, we find that such reaction of imports to exchange rate appreciation is generally confirmed for South-East Asian countries but not for others. This might be a direct consequence of Asia's vertical integration as a large share of Chinese imports from Southeast Asia is directed to re-exporting. We also find that the total exports from a number of Asian countries react negatively to a renminbi appreciation, which points to a dependence of Asian countries' exports on those of China.

Keywords: China, trade, exports, real exchange rate

JEL classification: F1, F14