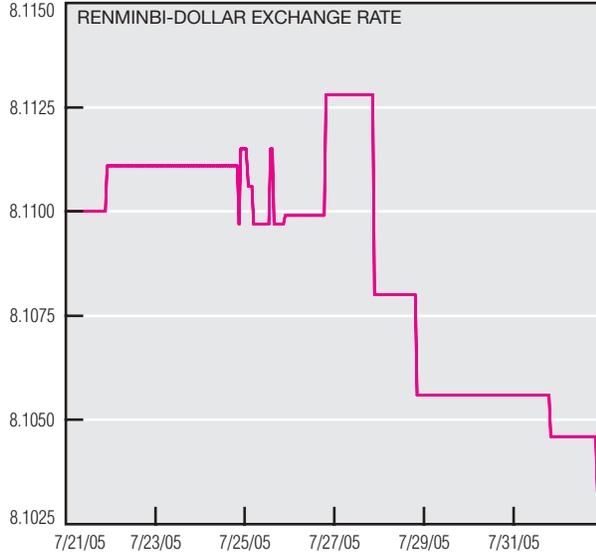
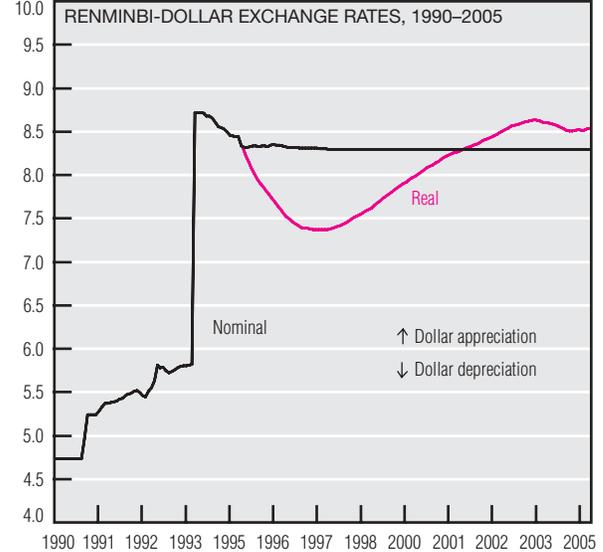


The Renminbi Revaluation

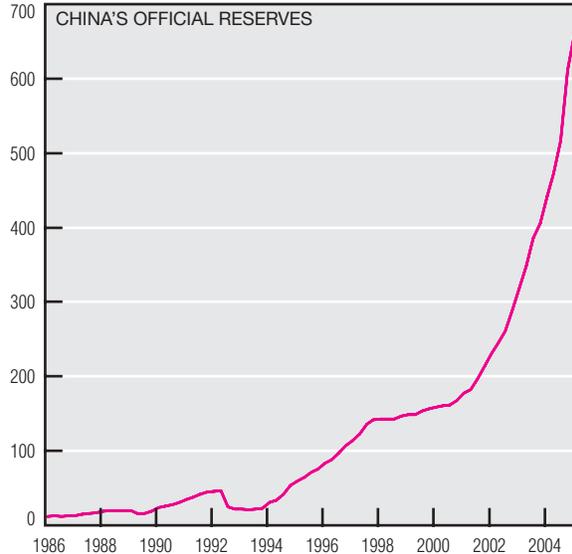
Renminbi per U.S. dollar



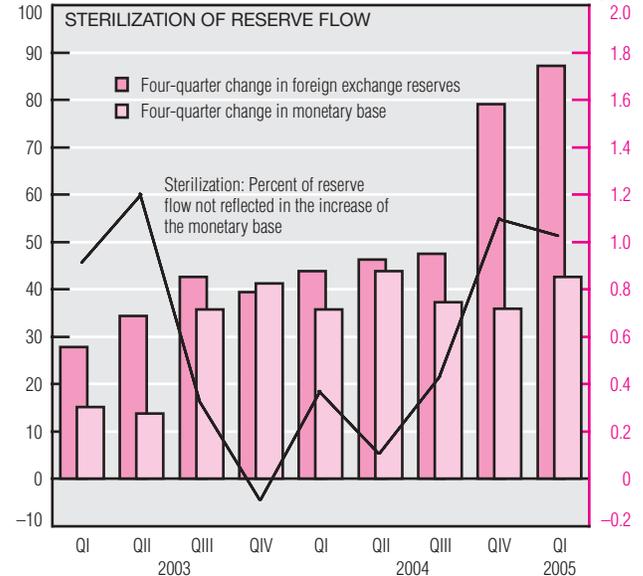
Renminbi per U.S. dollar



Billions of dollars, end of quarter



Percent



NOTE: See Patrick Higgins and Owen Humpage, "The Chinese Renminbi: What's Real, What's Not," Federal Reserve Bank of Cleveland, *Economic Commentary*, forthcoming 2005.

SOURCES: International Monetary Fund, "International Financial Statistics"; Central Bank of the People's Republic of China; and Bloomberg Financial Information Services.

On July 21, China devalued the renminbi 2.1% to 8.11 per U.S. dollar and revised its exchange rate policy. Since then, the renminbi has not changed much relative to the dollar, suggesting that this revaluation may not be the first in a near-term series.

The focus on the renminbi is unfortunate because it diverts attention from the real problem: China's command economy. Revaluing the renminbi or introducing more exchange rate flexibility will, at best, affect China's trade competitiveness only temporarily. The nominal exchange

rate—the one China revalued—tells us little about China's competitiveness because it ignores price patterns. The real exchange rate accounts for price patterns and provides a clearer picture. The renminbi revaluation brings the real exchange rate roughly back in line with where it was in mid-1995.

To keep the nominal exchange rate stable, China must buy foreign exchange and supply renminbi to the market. This would generate inflation, produce a real appreciation, and dull China's competitive edge if China's central bank did not simultaneously

neutralize the monetary effects of its exchange rate policies through off-setting operations. But if maintaining the peg requires the People's Bank of China to buy dollars with renminbi, the peg cannot endure long should the Bank then reabsorb these renminbi through other operations. Instead, the Chinese government must try to guarantee a persistent demand for these renminbi at the existing exchange rate. It can accomplish this through artificial restraints on imports and financial outflows.