

The Effect of China's Real Exchange Rate Appreciation in the Next Decade — An Investigation of a Recursive Dynamic CGE Analysis

Xin Li*

Institute of National Accounts, Beijing Normal University, Beijing, China,
xinli@bnu.edu.cn

Although recent empirical studies indicate that the renminbi is undervalued, few people discuss how to adjust it effectively. The essential objective behind this paper is to explore the effect of the alternative adjustment of China's real exchange rate. Different with the previous simulation designs, this paper considers the formation mechanism of the real exchange rate. By assuming the same change of factor's price during different time periods and using the recursive dynamic computable general equilibrium model, the two different scenarios are simulated against the baseline, one is to adjust the macro-structural imbalance by decreasing the gross national saving rate in China and the other is to adjust the micro-structural imbalance by increasing the real wage rate of Chinese labor. It can be seen that, first, the external imbalance will be improved by both the internal structural adjustments in the long-term; second, the effect of macro-adjustment is more significant than the micro-adjustment; third, a real appreciation would be sufficient for China to improve its terms of trade and change the export-oriented model of development into demand-oriented model of development in the next decade.

Key Words: Exchange rate, recursive dynamic CGE model, real wage, gross national saving rate