

# China Unbalanced

6-18-2013

# How to see if a currency is undervalued/overvalued?

$$\left( \frac{\text{Price Big Mac in RMB}}{\text{Price Big Mac in US} * e} - 1 \right) * 100$$

Where  $e = \text{RMB}/\text{\$}$



# How to generalize this?

*Price of Basket of goods in RMB vs.*  
*Price of Basket of goods in US \* e*

- Where  $e = \text{RMB}/\text{\$}$

# What about ULCs?

- What about differences in costs?
- $W_{us}/MPL_{US}$  vs.  $W_{chi}/(e * MPL_{chi})$

# China Unbalanced

Diego Comin

HBS

# China unbalanced

- A case with many different angles
  - An old growth strategy
  - The New Growth strategy
  - More pieces to construct the framework
  - China-US relationship

# The Old Growth Strategy

- Gain access to international markets through
  - WTO
  - Surplus labor in rural areas (low urban wages)
  - Low exchange rate
- To maximize employment
- Foster accumulation and technology transfer through FDI

# A turning point?

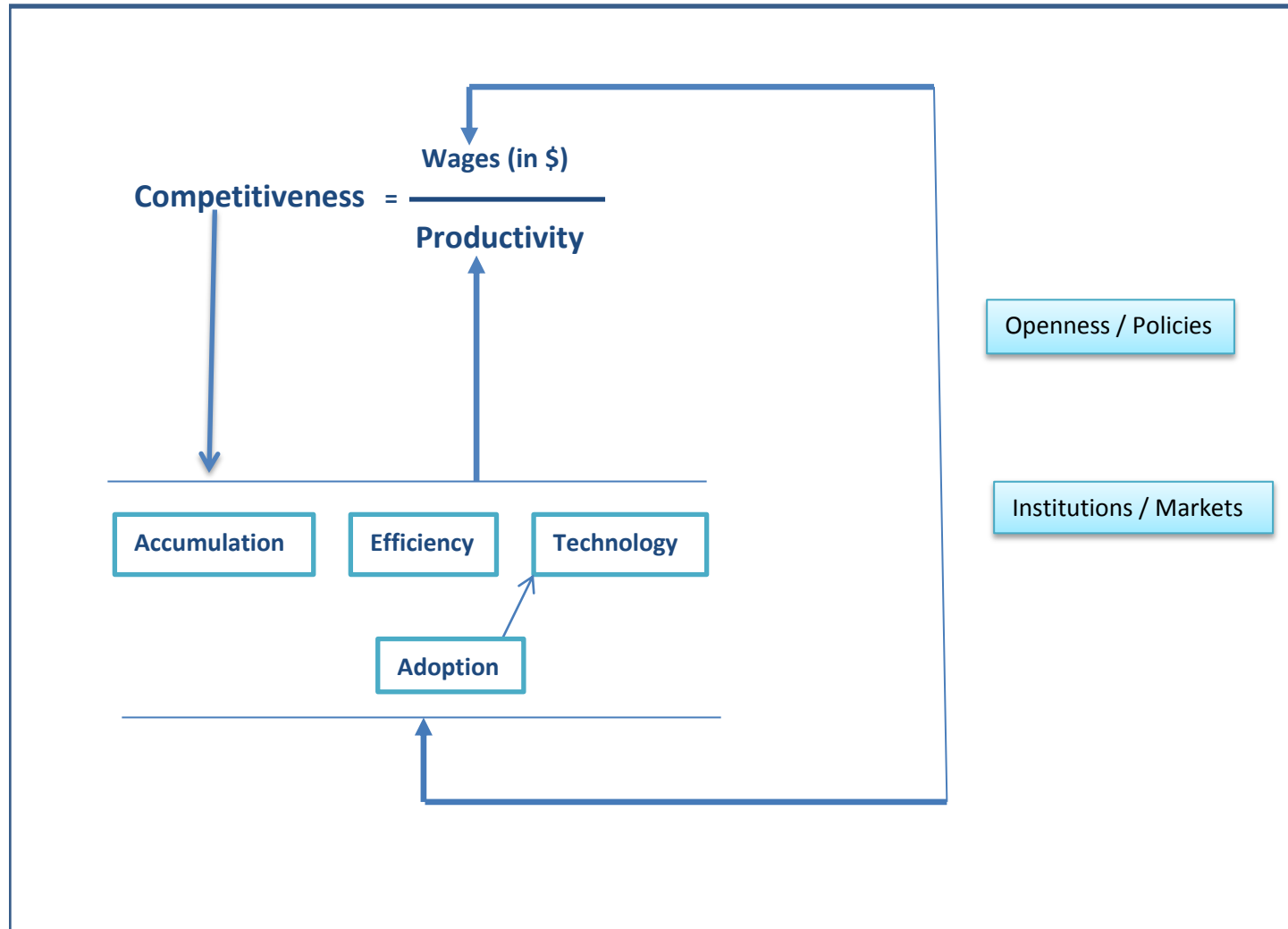
- With recession China saw
  - Decline in exports
  - Growth deceleration
  - Increased unemployment
  - Signs of unrest



# New Growth Strategy

- Wen Jibao new growth model to alleviate tensions in the system based on:
  - Growth of domestic demand to rely less on Net Exports
  - Reduce regional inequality (G directly mostly to rural areas)
  - An increasing military power to secure commodities needed to satisfy domestic demand
  - More efficient, more technology-intensive
  - Still controlled by the CCP
- But exports keep growing (a lot)
- Will the exchange rate policy adjust to the new strategy?
- Will the PBOC liberalize the banking sector?

# The framework



# China-US relationship

- Lost of manufacturing jobs...
- ... some going to China
- Large trade deficit...
- ... while China has a growing surplus
- China accumulates US bonds...
- ... while the US runs a large deficit
- And senator Schumer (D-NY) complains about the exchange rate

# This reminds me of

Darling, you got to let me know  
Should I stay or should I go?

...

If I go there will be trouble  
And if I stay it will be double  
So you gotta let me know