

The Balassa-Samuelson Effect in China and its Implications for China's Equilibrium Real Exchange Rate

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ABSTRACT

With a rapid accumulation of current account surpluses and foreign exchange reserves in China in the past decades, China's exchange rate policy has caused many international controversies. One of the most popular approaches to estimate the misalignment of the renminbi real exchange rate is the Balassa-Samuelson hypothesis. This paper examines whether the renminbi real exchange rate is misaligned or not based on the Balassa-Samuelson hypothesis, and explores possible reasons for the violation of the Balassa-Samuelson hypothesis in China. Based on the empirical evidence in Singapore and Taiwan, this paper also predicts that with the rapid industrialization and the end of a dual economy in China in the future, China's real exchange rate will appreciate rapidly.