RMB Exchange Rate and Local Currency Price Stability: The Case of China and ASEAN+3

This paper uses Chinese and ASEAN+3 industry panel data to measure variations in mark-up adjustment behaviour that is associated with the exchange rate changes across export destination markets. Exports that are substitutes for local products exhibit a high degree of mark-up adjustment, which has the effect of stabilising prices in export destination countries. There is evidence of this behaviour in certain export products to China where the Chinese Government provides subsidies. When mark-up adjustment behaviour exists, the short-term dynamic mark-up adjustments are consistent with the long-term pricing behaviour in source countries.

Introduction

RMB appreciation has been a focus in international economic policy discussion since 2001. In December 2001, China formally joined the World Trade Organisation (WTO) and needs to fulfil the commitments it undertook with the WTO. In February 2002 the Minister of Finance, Japan raised the RMB appreciation issue in the OECD annual ministerial conference with a view to easing the pressure on international imbalances; in June 2003, Federal Reserve Chairman Alan Greenspan stated in public that China should increase its foreign exchange flexibility to resolve the huge US–China trade deficit. Academic views, however, differ on whether the RMB should be appreciated or not depending on the perspective taken: for example economic growth, employment, wages, foreign reserve management, trade relationships with the United States and Japan, economic diplomacy and politics. This paper addresses the issue of RMB appreciation from a different angle: the importance in regional economic cooperation and integration by examining the currency and trade interaction among the member countries in the region. In particular, it investigates the impact of changes in the RMB exchange rate on the pricing behaviour of exporters within ASEAN+3 countries. The main question this paper attempts to answer is how exports in ASEAN+3 adjust their mark-ups when observing the changes of RMB exchange rate during the sample period.

This paper adds to the empirical literature on pricing behaviour when exchange rates change by examining export mark-up adjustments in both China’s export to ASEAN+2 and ASEAN+2’s exports to China using data directly collected from Chinese statistical sources.