

Reply to 2nd Referee's Comments

General Comments:

We are not sure if the referee fully understands the key contribution of our paper. Since we have made improvement in terms of the modelling method and the data coverage, our RMB misalignment estimates should be more accurate than those provided by the previous modellers. The estimates show a clear time path of how the real value of RMB has evolved from being undervalued in the early 2000s to being overvalued since 2008. Such estimates could serve as useful reference for the policy makers.

Specific Issues:

1. Unfortunately, the referee has mixed up the concepts of the *nominal* exchange rate and the *real* exchange rate. *Equilibrium rates* are defined by the *real rates*, which result from a combined effects of prices and the nominal rates. A fixed exchange rate policy regime operates only on the nominal rate. That is why there exist numerous empirical studies on estimating the exchange rate misalignments of many countries whose exchange rates are not freely floating.
2. We have followed the mainstream here. The justification of our choice of the fundamentals is already given in our cited references.
3. Both international capital transfer and the bank lending rates have been under close control in China under our sample period. Hence, the key condition of the interest rate parity, ie a free international capital market, is absent.
4. The 'fair value' in the referee's discussion seems to assume the equilibrium rate being one constant value. That is too simplistic for any practical purposes. What we have estimated is (quarterly) dynamic paths of the equilibrium rate and the associate disequilibrium paths for the RMB. The previous studies have not done that. Moreover, our finding that the RMB has become overvalued since 2008 rejects, with a very high probability, the popular assertion that the Chinese currency is still substantively undervalued.