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Faculty of Finance and Accounting

Finance and Accounting

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Exchange Rate Policy in China

Author: Miao Zhang

Supervisor: doc. Ing. Karel Brůna, Ph.D.

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Declaration

I hereby declare that I compiled this thesis independently, using only the listed resources and literature, and the thesis has not been used to obtain a different or the same degree.

Prague, date Signature

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Abstract

China's exchange rate regime began to reform in 1978, during these 40 years, the Chinese economy has developed rapidly from many aspects, and the exchange rate system has been reformed many times. First, this thesis will analyse the exchange rate policies of various stages in China after 1978, and the changes in exchange rates under the exchange rate system in different periods and the impact on trade and currency reserves.

Second, in 2015 the Renminbi inclusion in the SDR basket is an important step in the internationalisation of the RMB. Although the Renminbi is included in SDR and the Renminbi has been convertible on the current account since 1996, there are still many barriers to financial accounts. Analyse the openness of RMB convertibility and financial accounts, and how foreign investors invest in China. In the end, with Haier Group as a case, introduce the foreign exchange management in Chinese companies and how Chinese multinationals manage foreign exchange fund and choose the best fund management model.

Keywords: Exchange rate policy; RMB convertibility; Financial account; Fund management.

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Abbreviations

PBC	People's Bank of China
WTO	World Trade Organization
NFA	Net Foreign Assets
MCI	Monetary Conditions Index
ISR	Internal Settlement Rate
FEC	Foreign Exchange Certificates
RQFII	Renminbi Qualified Foreign Institutional Investor
QDII	Qualified Domestic Institutional Investor
QFII	Qualified Foreign Institutional Investor
FTZs	Free Trade Zones
ETFs	Exchange-traded Funds
SDR	Special Drawing Rights
IIP	International Investment Position
FDI	Foreign Direct Investment
SAFE	State Administration of Foreign Exchange

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1. Introduction

China began foreign exchange reform in 1978, and 2018 was the 40th anniversary of the reform and opening up in China. The Chinese economy continues to overgrow and has achieved a series of achievements. The reform of the foreign exchange management system has changed many times in the past years. In the financial sector, one of the most important reforms is the exchange rate reform. The reform of exchange rates not only relates to RMB'S appreciation or depreciation, but it also relates to the establishment of the market mechanism of the exchange rate, also increasing convertibility of RMB.

China’s exchange rate system is currently changing from government-led to market-led. China’s foreign exchange situation is currently relatively stable, and government regulation is strict. With the internationalisation of the RMB, exchange rate fluctuations have become more complex (Li, Y, 2008). The China exchange rate no longer presents a single trend of appreciation or depreciation. The increasing volatility impacts differently to the government, corporate, family.

Furthermore, the exchange rate system had open to the foreign company, like the Shanghai-London link, and the reduce the admittance restrictions for the foreign investment, the Renminbi to join the SDR basket. The most recent exchange rate system has changed greatly is On August 11, 2015, the central bank adjusted the formation mechanism of the intermediate price and asked the market maker to refer to the closing exchange rate of the inter-bank foreign exchange market before the opening of the previous day. The bank's foreign exchange market, taking into account the supply and demand of foreign exchange and the exchange rate changes of major international currencies, then provide intermediate quotations to the China Foreign Exchange Trading Center.

After China's joined the WTO, it proposed a plan for the linkage between the exchange rate system and the monetary policy system. The current exchange rate regime is a managed floating exchange rate linked to a basket of currencies, which provides sufficient flexibility for monetary policy to generate real-world shocks at home and abroad. At the same time, the inflation target system of monetary policy is implemented to increase the credibility of the independent monetary policy and reduce the source of monetary shock (Xie, P, & Luo, X, 2003).

With the development of economy, China has gradually and steadily promoted the convertibility of financial account. At present, the RMB has realised partial convertibility of financial account. The opening process of China's financial accounts consists of two levels: first, domestic investors can invest in overseas financial products; Second, overseas investors can invest in Chinese financial products. According to the 40 transactions under the financial account stipulated in IMF Remittance Arrangement and Exchange Restriction 2011, according to the standards of non-convertibility, partial convertibility, basic convertibility and full convertibility, there are currently 14 basic convertible accounts in China, accounting for 35%. They are mainly focused on credit instrument transactions, direct investment, direct investment in liquidation, etc. There are 22 partial convertible accounts, accounting for 55%, are mainly concentrated in bond and stock transaction, real estate transactions and personal capital transactions (Y, Sun, 2018).

Moreover, have 4 non-convertibles, accounting for 10%, mainly for non-residents who participate in the domestic currency market, trust fund market and trading derivatives. Overall, 90% of China's capital accounts are currently in a basic convertible or a partially convertible state, but the capital control is still strict, the free convertibility of financial accounts still needs some time.

Exchange rate management is an important part of the management of foreign investment companies. With the development of international trade and international ownership of assets and the steady progress of RMB internationalisation, the foreign-related companies and foreign currency assets are increasing year by year. Also, exposure to foreign exchange risk is increasing. Foreign exchange management not only has an important impact on the production and operation of companies but also affects the value of companies. Therefore, domestic companies should pay more attention to strengthening foreign exchange management.

The exchange rate is an important method for a country macro-control, reflecting the external value and economic strength, directly affect a country's foreign trade, capital flow and balance of payments. The exchange rate regime chosen by each country is different. The formulation and selection of the exchange rate system need to be based on the national conditions of the country, meeting the needs of economic development. Therefore, the optimal choice of the exchange rate system, the reasonable determination of the exchange rate level and the exchange rate adjustment both have a great impact on the national finance and economy.

This thesis will analyse the development of China's exchange rate system and China's exchange rate policy, exchange rate management system and convertibility of RMB, to discuss China's exchange rate policy and foreign exchange management.

In the second part, it will discuss the literature review from the perspective of the reform of the exchange rate and exchange rate and foreign exchange rate management — the convertibility measure of the exchange, and the effect of the exchange rate system in China.

In the third part will discuss the history of China’s exchange rate changed. China’s foreign exchange management reform began in 1978. In the past 40 years, China's exchange rate system reform has experienced four essential stages. It will in detail discuss the exchange system, which includes the exchange rate system and the exchange rate.

The fourth chapter will discuss the RMB convertibility and financial account opening. At present, China has completed the free convertibility of the current account. The convertibility of the financial account is closely related to the RMB exchange rate.

Through the assessment of the openness of financial markets, to understand the current status of the opening of RMB financial accounts.

The last part takes the Haier Group as a case to analyse foreign exchange management in Chinese companies. Nowadays, more and more Chinese companies are investing abroad and involved in the multi-currency settlement. Exchange rate fluctuations can have a significant impact on the company. Through the research on foreign exchange fund management policies and the development of actual foreign exchange funds management by Haier Group, find the best foreign exchange fund management model.

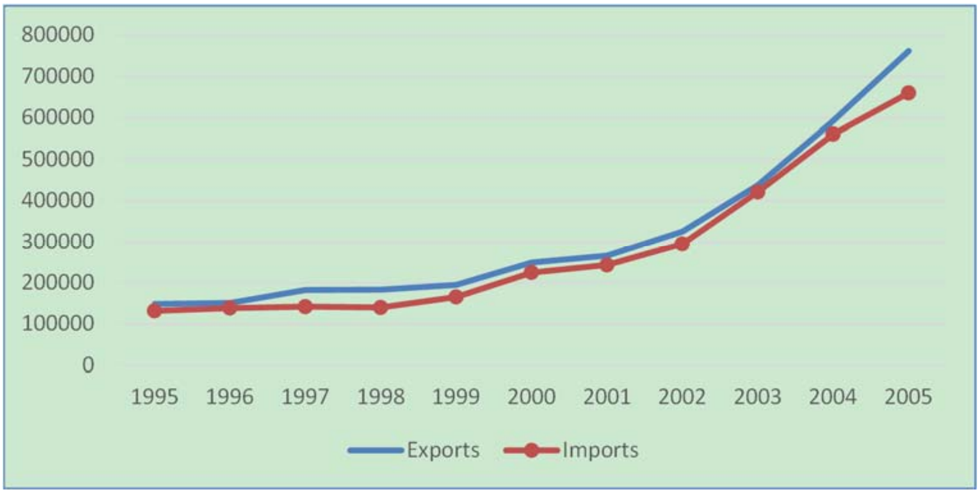
2. Literature Review

2.1 Overview

According to Lafrance’s (2008) paper:

Since China joined the WTO in 2001, China’s trade volume has grown substantially and has maintained a trade surplus (Figure 1). The trade surplus over the years has enabled China to accumulate a large number of international reserves. China's exchange rate system is nominally flexible, but it is closely related to the dollar, and the Chinese authorities do not want the yuan to appreciate too quickly.

Exhibit 1：China’s Trade Balance, USD (1995-2005)



Source: IMF International Financial Statistics.

Lafrance, R (2008) [1]pointed out that China's exchange rate system developed over the past few decades. After a period of substantial cumulative inflation, the official RMB exchange rate against the US dollar fell sharply in 1994, while the official and parallel market exchange rates were also unified. During the Asian financial crisis, the Chinese government resisted strong depreciation pressures. From 1997 to July 21, 2005, the Chinese authorities controlled the Renminbi and the US dollar within a narrow range. On July 21, 2005, the PBC announced that it would implement a regulated and managed floating exchange rate system based on market supply and demand, as well as a basket of currencies. Singapore has inspired China's new exchange rate system, but China's regime may reduce flexibility, and the Chinese government's control over the exchange rate system is more stringent.

Lafrance, R (2008) noted that Singapore has a basket with a crawling exchange rate system, the goal is to keep the price stable. Some economists pointed out that its system is not a fixed exchange rate. The Monetary Authority of Singapore does not rely on the

[1] Lafrance, R. (2008). *China's exchange rate policy: A survey of the literature*.

https://www.bankofcanada.ca/wp-content/uploads/2010/01/dp08-5.pdf.

autonomous target value of the exchange rate, but only on the value that is believed to contribute to the goal of mas inflation. In contrast with Singapore, Chinese authorities are more concerned about foreign demand for Chinese goods in order to maintain employment growth.

In the process of exchange rate reform, the PBC introduced a number of measures to strengthen the operation of China's foreign exchange market, including the introduction of the over-the-counter market (Lafrance, R, 2008), the pilot introduction of RMB and foreign exchange swaps and RMB interest rate swaps, the central bank gradually withdraw from the foreign exchange market

In the study of China's exchange rate regime reform by international organisations, data from the International Monetary Fund (IMF) show that China's increased exchange rate flexibility can increase the independence of monetary policy, promote banking reform, and reduce the vulnerability of China's depreciating foreign exchange reserves (IMF, 2006). The European Central Bank (2007) analysed that China's trade surplus is the result of internal structural weaknesses, which will increase bank savings. Exchange rate flexibility in exchange rate reform will increase investment decisions and increase consumer purchasing power (Lafrance, R., 2008).

In terms of fluctuations in the exchange rate of the RMB, Lafrance, R (2008) believed that the Renminbi appreciation would reduce China's trade surplus and promote the balanced development of the domestic economy. Through its inhibition, the RMB appreciation will prevent the economy from entering a state of overheating due to increased consumption. This will also lead to an increase in the price of traded goods relative to the price of non-traded goods, thereby contributing to the growth of non-traded goods sectors such as services. However, the range of appreciation cannot be accurately estimated in advance.

In terms of resisting the appreciation of the Renminbi, FDI has been the driving force of China's export-oriented growth from the beginning. Eichengreen (2005) said that the pegged exchange rate system is conducive to multinational companies and promotes the diversification of production facilities and procurement from China. From 1993 to 2003, 65% of China's exports came from subsidiaries and joint ventures of foreign multinational companies. The total export value of private domestically owned firms in China was less than 10 per cent (Lafrance, R, 2008).

McKinnon (2006) believed that China should not have the pressure to appreciate the currency. He said the expectation of currency appreciation would undermine the natural trend of wage growth (and the price of non-trading sectors due to the Balassa-Samuelson effect) to match productivity growth. Since the beginning of 1980, the unstable appreciation of the Japanese Yen has weakened the international competitiveness of Japan with the United States. The resulting deflationary pressure severely affected the Japanese economy in the 1990s.

McKinnon (2007) argued that for an international creditor, the impact on the income and expenditure of a significant appreciation of the world's major currencies is so strong that the impact of currency appreciation on its trade surplus is ambiguous. First, a decline in exports will curb income. Foreign direct investment and investment in net inflows will also decline, and large capital losses in foreign exchange reserves may inhibit growth. McKinnon (2007) believed that in order to protect the agricultural sector affected by appreciation, China should use the exchange rate as its nominal anchor, allowing the currency to fluctuate against the inflation target rate due to the difference between the US inflation rate and the domestic interest rate (Lafrance, R, 2008).[2]

[2] Lafrance, R. (2008). *China's exchange rate policy: A survey of the literature*.

https://www.bankofcanada.ca/wp-content/uploads/2010/01/dp08-5.pdf..

2.2 China's perspective

In 1994, the RMB exchange rate system reformed, the dual exchange rate system was changed to a single exchange rate system. The official RMB exchange rate and the swap centre rates were unified. China has begun to implement a single, managed floating exchange rate system based on market supply and demand. The new ‘managed floating exchange rate’ allows the Renminbi to float within the smaller range prescribed by the government. Although some well-known foreign economists such as McKinnon opposed the reform of the RMB exchange rate system, China's domestic research reached a consensus that China should withdraw from the fixed exchange rate system with the US dollar and establish a more flexible exchange rate system. Lu Jinzhong (2006) argue that a truly managed floating exchange rate system will become the dominant trend in the adjustment of the RMB exchange rate regime. The choice of the RMB exchange rate system will ultimately be guided and weighed by the national policy-making department “independent monetary policy, free capital flow, and exchange rate stability”. However, China's economic and financial development decision-makers prefer to choose the independent monetary policy and free capital flow to sacrifice the stability of the RMB exchange rate, the result is an appreciation of the RMB exchange rate. This process needs to be achieved by increasing the RMB’s exchange rate volatility.

As an important part of the reform, China's implementation of a managed floating exchange rate system is a choice based on China's economic and financial development (X, Hu, 2010). It includes three aspects: First, the RMB exchange rate is formed by market supply and demand, and the market's discovery effect on prices is exerted. Second, the exchange rate volatility is adjusted according to the current account balance, which is mainly based on the trade balance, and the “management” advantage is exerted. The third is to refer to a basket of currencies. That is, not paying attention to the bilateral exchange rate of the Renminbi but based on China's economic and financial development goals. Clear weights and choose the main country currency to form a currency basket

Cao Honghui (2005), deputy dean of the China Development Bank Research Institute, made a detailed comparison and study of pinning a basket of currencies concerning a basket of currencies. His viewed that the choice of a basket of currencies is based on the close trade with China, selecting the major foreign trade targets such as the US dollar, the Euro, the Japanese Yen, the Korean Won and the East Asian currency in the relevant economies of the European Union, the United States, Japan, South Korea and ASEAN. According to a certain method, the weight of each currency in the basket is set, and the fluctuation of the local currency is determined according to the exchange rate fluctuation of the currency in the basket, to maintain the stability of the weighted average exchange rate of the local currency. If the fluctuation of the local currency closely follows a basket of currency fluctuations, this is to peg a basket of the monetary system. If only a basket of currencies is used as a reference, the range of fluctuations of the local currency is determined by comprehensively measuring the multilateral exchange rate index of the local currency, which is the reference to a basket of the monetary system.

Due to China's development, China's financial market strategy is to ensure the full development of financial markets, phasing out capital controls and increasing exchange rate flexibility (X, Zhou, 2006). China has also begun to adopt a multi-pronged medium-term process to reduce trade and current account surpluses. These include measures to stimulate domestic demand and increase imports, open international capital trading measures, and achieve greater flexibility to reduce domestic savings and exchange rates (X, Zhou, 2006).

2.3 Types of Regimes

1) Conventional fixed ped

The pegged exchange rate system refers to the exchange rate system in which a country maintains a fixed exchange rate between its currency and the foreign currency or a basket of currencies. In the pegged exchange rate system, a country's currency maintains a relatively stable price ratio with one or a certain basket of currencies, that is, the selected currency. The national currency fluctuates with the fluctuation of the selected currency, but the price ratio between them is relatively fixed or only fluctuates within a small range, and the general range does not exceed 1%. The pegs are generally the currency of major industrial countries or the SDR of the IMF.

According to the pegged currency, the pegged exchange rate system can be divided into a single currency and a basket of currencies. Under the linked exchange rate, the government intervenes in the market to ensure the stability of the currency exchange rate. For example, until 1971, multinational governments linked the exchange rate to the price of gold at a certain level to stabilise its currency. Therefore, when the price of gold fell, it was bought, and when the price rose. Countries that use the pegged exchange rate system often buy or sell their currency, just to offset exchange rate fluctuations.

2) Crawling peg

Crawling peg is an exchange rate adjustment system that allows currencies with a fixed exchange rate to fluctuate within a range of interest rates. The face value and interest rate range of the currency may also be adjusted frequently, especially when exchange rate fluctuations are large. When there is a threat of currency devaluation due to factors such as inflation or economic instability, crawling peg is often used to control currency movements (Kenton, W., 2019).

The disadvantages of crawling peg are because the process of pegging currencies can result in artificial exchange levels, there is a threat that speculators, currency traders or markets may overwhelm the established mechanisms designed to stabilise currencies.

3) Crawling band

Crawling band is a special form of the target area in which the frequency band and intermediate frequency and frequency band follow some pre-announced rate of change. Williamson (1987) defined the crawling band is " broadband that moves slowly in order to keep the exchange rate consistent with the basics."

In 1994, a clear nominal exchange rate crawling band in Colombia responded to the implementation of a stable model based on monetary base control to reduce inflation. One of the arguments in support of exchange rate fluctuations in Colombia is to allow nominal exchange rates to fluctuate within a single band, providing central banks with monetary flexibility while consolidating market expectations. The crawling band allowed a compromise between monetary flexibility (for the current independent central bank to fulfil its new constitutional obligations) and a certain degree of certainty between the private sector and the government (Brooks, C., & Revéiz, A. H., 2002).

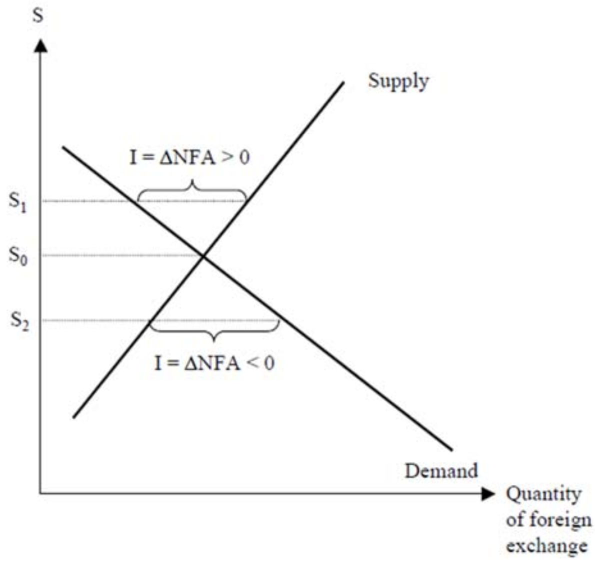
4) Managed float[3]

A managed floating exchange rate is a system that allows the central bank to regularly intervene in the foreign exchange market in order to change the direction of currency fluctuations and support its balance of payments during periods of excessive volatility.

A country can maintain a perfect uncovered interest parity through the foreign exchange market intervention. The foreign exchange market intervention can be described with a simple diagram (Exhibit 2).

Exhibit 2 The flow channel of foreign exchange market interventions

[3] Managed floating exchange rate. (n.d.). Retrieved from https://www.kantox.com/en/glossary/managed-floating-exchange-rate/.

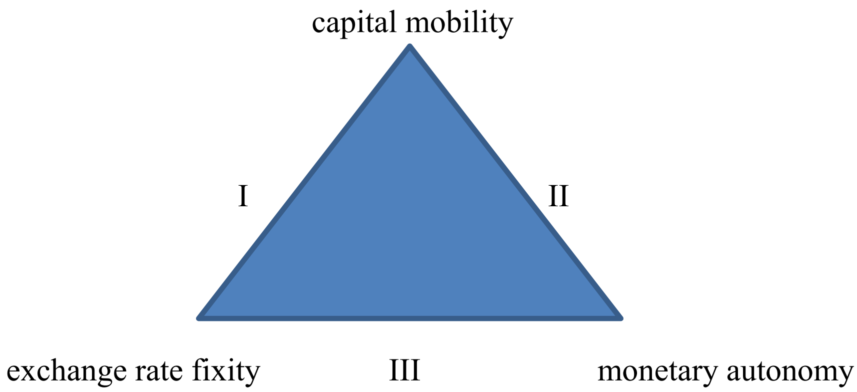


Source: Bofinger, P. & Wollmershauser, T. (2003). Managed Floating: Theory, Practice and ERM II.

Y-axis is the foreign exchange price in domestic. Therefore, there is an upward-sloping supply curve and a downward-sloping foreign exchange demand curve. The equilibrium exchange rate is S0. Foreign exchange market intervention means that the central bank's target is the exchange rate above or below the market clearing rate. If the central bank's goal is to raise the interest rate S1 above the equilibrium interest rate, then it must purchase excess foreign exchange in exchange for domestic reserves. As a result, its net foreign assets (NFA) will grow. In the case where the target interest rate S2 is lower than the market liquidation rate, the central bank must satisfy foreign exchange demand by selling foreign assets from foreign exchange reserves (NFA<0). The reserves of commercial banks have fallen. Concerning the effectiveness of interventions, the central bank can target exchange rates different from the equilibrium exchange rate as long as the central bank can fill the gap between the quantity demanded and the unbalanced supply.

Also, a country can adopt an intermediary system in an inconsistent triangle (Exhibit 3). Inconsistent triangles assume that a country can only obtain one side of a triangle (i.e., a pair of attributes): capital control, fixed exchange rate, or pure float.

Exhibit 3: consistency triangle



I: fixed exchange rates **II**: pure floating **III**: capital controls

Source: Bofinger, P. & Wollmershauser, T. (2003). Managed Floating: Theory, Practice and ERM II.

In 1999, Frankel proposed that nothing in the existing theory could prevent a country from pursuing a managed float. Half of the money demand fluctuations were met through intervention, and half were allowed to be reflected in the exchange rate.

Bofinger and Wolmershauser’s (2003) shown that the solution of inconsistent triangles is not a halfway house between half-stability and half-independence. Instead, an integrated approach is needed to determine the best interest rate level and the best exchange rate path. Therefore, a managed float allows the inconsistent triangle to be converted into a consistent triangle with three corners: capital liquidity, autonomously determined currency condition index, and an exchange rate path following the interest rate difference, for as long as the reserve can be controlled above the critical level. Most importantly, managed floats provide a comprehensive solution to the problem of capital inflows.

One disadvantage of managed floats is that there are no privately expected anchors. In the past, monetary targets and exchange rate targets were seen as ideal targets for establishing transparent and credible monetary frameworks in different monetary fields. However, without the help of the central bank's announcement of public inflation targets, it is impossible to achieve the goals of the private sector. Besides, the central bank may not be able to control the macroeconomic situation. The central bank's direct intervention in the foreign exchange market requires the use of foreign exchange reserves, but foreign exchange reserves are limited, and the monetary authorities will lose control of the exchange rate. In order to maintain a given Monetary Condition (MCI)[4], monetary authorities must raise interest rates to limit the domestic economy. The sharp devaluation caused by lack of confidence has caused the currency crisis to fall into a financial crisis.

3.1 Changes in China's Exchange Rate Regime

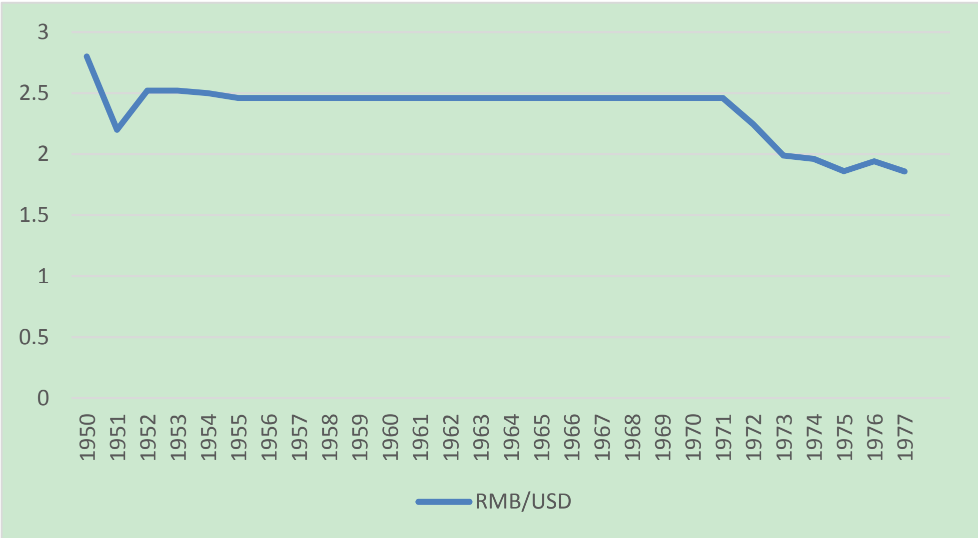
3.1.1 1949 – 1977：RMB exchange rate overvalued

At the beginning of the founding of New China, China's exchange rate adjustment was relatively frequent, 1 dollar to RMB from 2.1 to 2.8 constantly changing. According to the theory of exchange rate determination, the exchange rate depends on factors such as the balance of payments, economic growth, prices and interest rates. Since 1953, China has implemented a socialist planned economic system, import and export companies operate by national plans, and the government monopolises foreign trade. This has led to the RMB exchange rate not regulating the import and export. At the same time internationally, the currencies of various countries have remained stable under the Bretton Woods system. They have implemented a fixed exchange rate system and are linked to the US dollar, while the US dollar is linked to gold. During the period from 1953 to 1972, the RMB exchange rate was stable. Until the collapse of the Bretton

[4] MCI: Monetary Conditions Index . It is a weighted average of interest rates and exchange rates as an indicator of the tightness of the monetary conditions.

Woods system in 1971, the fixed exchange rate system gradually withdrew from the historical arena. Later, Western countries generally adopted a floating exchange rate system, and exchange rate adjustments between countries continued. In order to promote the role of the Renminbi in external pricing, China has adopted the form of pegged synthetic currency floating since 1973, not only pegged to the dollar. The annual average exchange rate of the Renminbi against the US dollar has been adjusted from 2.2401 to 1.5771 since 1972 (Exhibit 4).

Exhibit 4: RMB and US Dollar exchange rates from 1949 to 1977



Source: The World Bank

3.1.2 1978—1993：Dual exchange rate regime[5]

Following Guijun, L., & Schramm, R. M. (2003, P. 4) study:

In 1978, China began to implement the reform and opening up. At this stage, foreign trade reform involves three interrelated aspects: breaking the monopoly and encouraging competition among trading companies, abandoning central planning to

[5] Guijun, L., & Schramm, R. M. (2003). China's foreign exchange policies since 1979: A review of developments and an assessment. http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.194.8075&rep=rep1&type=pdf

allow market forces to play an important role in allocating resources, foreign trade companies are financially independent. Therefore, the fundamental task of exchange reform is to transform the foreign exchange distribution mechanism from the mechanism stipulated by government planning to a mechanism based on market principles and establish a market-oriented regulatory framework.

Reforms were carried out in 1979, dispersing some foreign trade management powers and allowing more foreign trade companies to be established. One of the important decisions was the establishment of special economic zones in Shenzhen, Zhuhai, Shantou and Xiamen. At the end of 1981, about 400 new foreign trade companies were established. By the mid-1990s, this number had exceeded 10,000. In 1981, 10 traditional foreign trade companies accounted for 76.6% of exports and 81.3% of imports. By 1992, their stocks had fallen to 10% and 16.9% respectively (see Table 1).

Table 1: China's 10 Foreign Trade Corporations' Share of Annual Imports and Exports 1981-1992 (%)

Year	Exports	Imports
1981	81.3	76.6
1982	78.5	71.5
1983	77.9	60.6
1984	74.0	51.0
1985	76.7	42.3
1986	65.7	37.6
1987	64.3	30.3
1988	21.8	19.1
1989	20.2	17.8
1990	19.3	14.7
1991	21.6	9.8
1992	16.9	10.0

Source: Ministry of Foreign Trade and Economic Cooperation.

With the reform of foreign trade, the authorities took measures to reform the foreign exchange system. In March 1979, the State Administration of Foreign Exchange was established, the SAFE assume the foreign exchange control function. In the same year, the authorities implemented a foreign exchange reservation system. Under this reservation system, domestic exporters can retain some of the foreign exchange earnings. The retained foreign exchange income can be used to import goods that exceed the import plan.

As more foreign trade companies have been established, there has been an unprofitable for export companies. Before the reform, the overestimated official exchange rate made the country's import sector generally profitable. However, through a centralised accounting scheme, the government can use the import surplus to subsidise unprofitable exports. After the reform, the import and export of many commodities were transferred to foreign trade companies in the local government and industrial sectors. Given the overvaluation of the official exchange rate and the government do not want to provide more subsidies, many foreign trade companies find it difficult to export. For example, in 1979, the average cost of one dollar of foreign exchange earnings was 2.40 yuan per dollar, while the official exchange rate remained at around 1.50 yuan per dollar. This means that the cost of many exportable goods cannot be calculated at the official exchange rate.

In 1979, due to the development, the State Council decided to introduce the RMB Internal Settlement Rate (ISR). According to the nationwide average cost per unit of income, the ISR is fixed at 2.80 yuan. At the same time, the authorities also retained a more favourable official exchange rate, mainly including overseas Chinese remittances, tourism, foreign diplomatic and business representative offices in China, and Chinese foreign embassies and consulates, such as non-trade foreign exchange transactions, foreign investment, foreign trade transportation and insurance fee. The system also includes the introduction of Foreign Exchange Certificates (FECs), which are separate currencies issued to foreigners at official exchange rates. For example, certain stores (friendship stores) and hotel transactions need to use FEC instead of RMB.

ISR was used from 1981 to 1984. During this period, domestic prices rose steadily. At the same time, government subsidies have also become an important factor in supporting export growth. In 1984, China’s economy was overheated. All of these changes have led to the beginning of the depreciation of the official exchange rate close to the ISR. Besides, after the adoption of the ISR, China has been under international pressure to abandon this practice. For example, the US government accuses China of using ISR to subsidise its exports. The International Monetary Fund has repeatedly tried to persuade the Chinese authorities to abandon the ISR. In December 1984, the PBC and other seven government departments announced that they decided to cancel the ISR before January 1, 1985, and the official exchange rate depreciated to 2.80 yuan per dollar.[6]

In 1985, with the cancellation of the internal settlement price and the increase in the proportion of foreign exchange earning retention, the foreign exchange swap centre was established. The earning retention scheme refers to the quota for foreign exchange purchases by export companies based on centralised management and unified balance of foreign exchange, allowing companies to transfer excess foreign exchange through the swap market (Guijun, L., & Schramm, R. M.,2003).

The first sign of China's foreign exchange market appeared in October 1980, when the retained foreign exchange bonds were transferable. The first is to start the exchange service through the People's Bank of China, then the provincial swap centre, and finally a

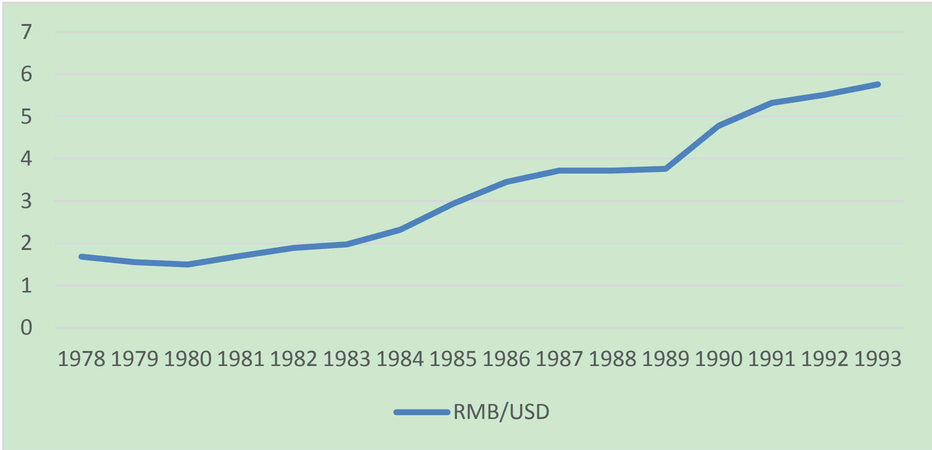
[6] Guijun, L., & Schramm, R. M. (2003). China's foreign exchange policies since 1979: A review of developments and an assessment. http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.194.8075&rep=rep1&type=pdf

comprehensive national swap market. In the late 1980s, foreign exchange swap activities expanded, the number of market participants increased, and exchange rates became more flexible. As of the end of 1993, there were 108 local exchange centres, and 18 markets joined the system. This established a mechanism for forming a market exchange rate, coexisting with the official linked exchange rate. The exchange rate of the swap market provides an initial market price reference for the official exchange rate adjustment. The official exchange rate of the Renminbi is close to the exchange rate of the swap market by gradual depreciation.

In the years after 1990, the official exchange rate of the RMB still devaluation slightly. By December 31, 1993, the exchange rate of the RMB against the US dollar was about 5.80. In the total depreciation trend of the RMB, the highest swap price was 1USD to 5.5 yuan, and the lowest was 1USD to 10 yuan. By December 1993, the foreign exchange swap price was 1 USD to 8.7 yuan.

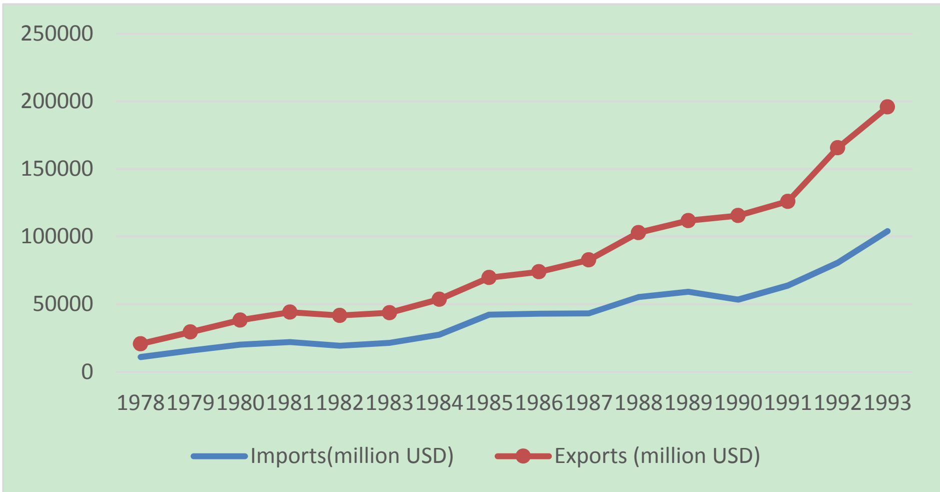
Exhibit 5 and 6 show the trend of the official exchange rate, total imports and total exports of the RMB against the US dollar from 1978 to 1993. It can be seen from Exhibit 5 that since the reform from 1978, the RMB has been in a depreciation channel, and the exchange rate of the RMB against the US dollar has risen from 1.98 in 1983 to 5.76 in 1993, with the depreciation of about 65.6%. The decentralisation of foreign trade management rights due to the reform of the foreign exchange system has led to a sharp rise in total exports. At the same time, China’s total import volume also rose sharply. Even in 1993, imports were greater than exports. This is because in the initial stage of reform and opening up, domestic technology, equipment and production capacity are relatively backward, and it is necessary to introduce a large number of high-tech products and domestic shortages of materials.

Exhibit 5: The exchange rate of RMB against the US dollar from 1978 to 1993



Source: The World Bank

Exhibit 6: China's imports and exports from 1978 to 1993



Source: National Bureau of Statistics of China

On the whole, during this period, the complex exchange rate system implemented by China is adapted to the needs of economic development. First, the complex exchange rate system can avoid exchange rate fluctuations caused by the impact of financial account under the balance of payments account, so that international speculators can take advantage of the inorganic. At the same time, the efficiency of resource allocation under the complex exchange rate system is superior. Because the tax formed by the complex exchange rate system is evenly distributed to all capital transactions, it helps to improve the level of social welfare. Second, officials can observe changes in the market by the difference between official price and swap price and use foreign exchange reserves in time to adjust the difference between these two prices to keep them within a reasonable range. Avoid large-scale illegal transactions and arbitrage behaviours. Finally, the complex exchange rate system provides a good transition for China to change from a fixed exchange rate system to a floating exchange rate system. Because of China's large economic aggregate and a wide range of specific national conditions, it is a more reasonable choice to gradually transition to a floating exchange rate system through a complex exchange rate system.

3.1.3 1994-2005: Pegged exchange rate regime

Since the reform and opening up, China's economic development has made remarkable achievements. The economic growth rate and the total volume of foreign trade have greatly increased, providing the most basic prerequisite for the exchange rate. At the same time, China's vigorously developed labour-intensive industries that use cheap labour and quickly occupy the international market. The accumulated trade surplus of the current account has laid a certain foundation for the exchange rate. The reform and opening up promotes an export-oriented economy. The government encourages and supports export policies. It has successively established special economic zones, coastal open cities and development zones and other special economic zones so that China's foreign exchange reserves accumulate and provide economic support exchange rate rebound. At the same time, the central bank has accumulated a certain amount of foreign exchange reserves to intervene in the foreign exchange market, stabilise the exchange rate, and prevent speculative foreign investment from entering the foreign exchange market and the fluctuation of the RMB exchange rate.

At the end of 1993, China carried out a comprehensive reform of the foreign exchange system. From January 1, 1994, the official exchange rate was merged with the market exchange rate, and a “single management floating exchange rate system based on market supply and demand” was implemented. Under this new system, the RMB exchange rate has the following characteristics:

First, the RMB exchange rate is determined and adjusted by the designated foreign exchange bank and is no longer directly decided and announced by the government.

Second, the exchange rate determined by the designated foreign exchange bank is based on market supply and demand. This is because the new system implements the foreign exchange income settlement system and cancels foreign exchange reservations and payments. Generally, companies must not hold foreign exchange accounts when they are in foreign trade. The foreign exchange supply under all trade transactions enters the foreign exchange market, implements the bank sales system, cancels the recurring plan for foreign exchange payments under the trading account, and cancels the mandatory foreign exchange income and expenditure plan. This means that most of the foreign exchange demand under the current account must be met through the foreign exchange market.

Third, the exchange rate based on market supply and demand is unified. After the implementation of the new exchange system, the official exchange rate will naturally cease to exist (Shi, J, 2006). At the same time, under the foreign exchange settlement and sales system, the supply and demand of foreign exchange are the intermediary agencies of designated foreign exchange banks. It is forbidden to buy or sell foreign exchange directly between companies.

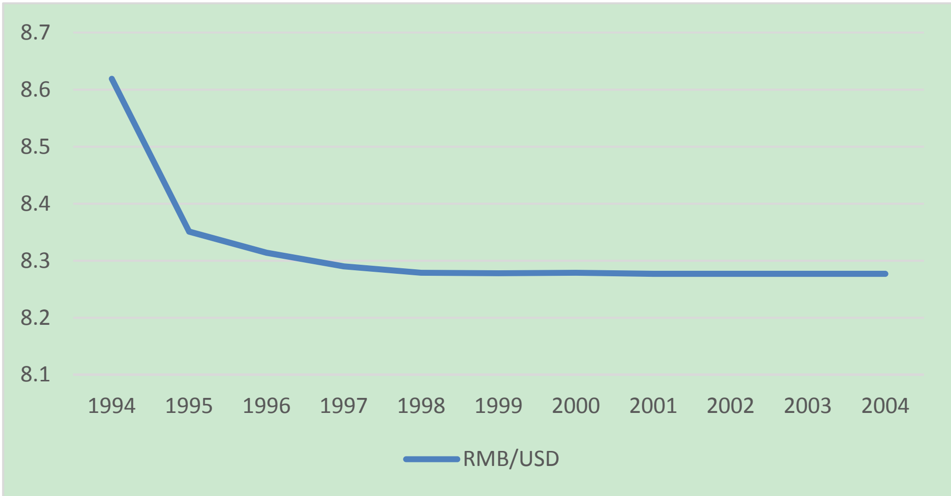
The foreign exchange swap market has completed its historic mission, and the foreign exchange swap price is also close to the market exchange rate. This is the "exchange rate unify." Since the exchange rate is not formally designated, it is determined by each foreign exchange bank. However, the distribution of foreign exchange supply and demand within the scope of banking operations is different. The unification of the RMB exchange rate must be achieved by establishing a foreign exchange market between inter banks.

It can be seen that the exchange rate merger has caused profound changes to China's foreign exchange management system, and to some extent, opened the exchange rate and activated the foreign exchange market. On the one hand, the opening of the foreign exchange market can integrate the country into the world economic system and promote economic growth. On the other hand, it also makes international turmoil more likely to affect the domestic economy, which is not conducive to the country's economic and social stability, especially in the early days of the opening of the foreign exchange market. The possibility and harm of impact are higher. The 1997 Asian financial crisis proved this.

Due to a large amount of debt, excessive open financial markets, extensive economic development, poor supervision, and excessive exchange rate, the currencies of Thailand, the Philippines, Malaysia, Indonesia and other countries have all suffered from the impact of international financial speculators' capital, and the crisis spread to South Korea. In Japan, Singapore and other economies, not only has the currency depreciated sharply, but the real economy has also been hit hard, which has had a huge negative impact on the economic development and social stability of the Asian region. Foreign trade plays an important role in the Chinese economy. Asian countries and regions are China's important partners. The financial crisis has significantly increased China's imports. At the same time, China's main investment comes from Asia, and the financial crisis is rampant. The spread has led to a significant reduction in direct investment in China. In the two years after the crisis, China’s actual use of foreign investment fell from US$64.48 billion to $52.59 billion. The actual use of foreign investment in other countries has shrunk significantly from $7.13 billion to $21.28 billion.

The most direct impact of the financial crisis is the impact on the RMB exchange rate. Because Southeast Asian countries are under pressure to depreciate their national currencies, and in order to prevent the crisis from spreading, the Chinese government is under big pressure from all parties to declare that the renminbi will not depreciate. After 1997, the Renminbi stabilised the dollar and remained at around 8.27. Exhibit 7 and 8 show the trend of the official exchange rate, total imports and total exports of the RMB against the US dollar from 1994 to 2004. As can be seen from Exhibit 4, the RMB exchange rate against the US dollar has fallen from 8.70 to 8.35 and has remained at 8.27.

Exhibit 7: The exchange rate of RMB against the US dollar from 1994 to 2004



Source: The World Bank

Exhibit 8: China's imports and exports from 1994 to 2004

Source: National Bureau of Statistics of China

During this period, China's international balance of payments showed a double surplus. The main reasons for this phenomenon are: First, due to the comparative advantage of labour, the global manufacturing industry has shifted to China, and China has formed a complete range of supporting facilities. The processing trade system has increased exports. Second, the government encourages exports and adopts various subsidies for weaker export products. Third, global economic development is in good condition, which provides a high-quality external environment for stimulating domestic product exports. Fourth, the undervaluation of the Renminbi also has a certain role in promoting trade growth. Fifth, China's economy is developing rapidly, national income levels are rising, domestic demand is strong, and demand for imports is expanding.

3.1.4 2005-2015: Managed floating exchange rate regime

After joining the World Trade Organization (WTO) in 2001, large numbers of foreign businesspeople were attracted to China to participate in the investment, especially in factories and companies with large foreign investment and investment in coastal cities and economic development zones. The net increase in foreign direct investment generated increased substantially. At the same time, the trade surplus has also produced huge current accounts, financial account surpluses and foreign exchange reserves. According to statistics, in 2005 China's current account surplus plus financial account surplus reached 220 billion US dollars, foreign exchange reserves are as high as 811.8 billion US dollars (IMF, 2005). Developed countries led by the United States and Japan in the international community ask many times for the appreciation of the renminbi.

On July 21, 2005, the central bank issued the "Announcement on Improving the Reform of the RMB Exchange Rate Formation Mechanism", officially start a new chapter in exchange rate reform. The main contents of this reform are as follows:

First, the RMB exchange rate is no longer pegged to the US dollar alone, but a floating exchange rate system based on market supply and demand and regulated concerning a basket of currencies. Although the official classification of China’s exchange rate regime is a managed float against a basket of currencies, the IMF's de facto classifications state otherwise. In 2005, the IMF classified the de facto exchange rate to be other conventional pegged against a basket of currencies (IMF, 2005). This classification changed to a crawling peg in 2008, a stabilised arrangement in 2009 and a crawl-like arrangement in 2011 (Ng, P. K. V., Mak, S. W. A., Chau, N. Y. G., Tong, C. Y. E., & Bao, L., 2013).

China's current exchange rate system is"based on market supply and demand, concerning a basket of currencies, There is a managed floating exchange rate system. The basis of "regulation" and "management" can be expressed by the BBC, namely the three dimensions of the basket, the band and the crawling.

"A basket of currencies" means that the Renminbi is no longer pegged to the dollar alone, but rather determines the exchange rate based on a basket of currencies. "A basket of currencies" involves two key issues: currency selection and weight setting. On August 10, 2005, Zhou Xiaochuan, the governor of the People's Bank of China, elaborated on four principles for the selection of a basket of currencies and the determination of their weights: focus on the weight of goods and services trade as the basis for basket currency selection and weight determination; due consideration should be given to the currency structure of foreign debt sources; due consideration should be given to the factors of foreign direct investment; due consideration should be given to the income and expenditure of some unpaid transfer projects in the current account. For the first time, he disclosed the currency baskets referenced by China, indicating that the US dollar, the Euro, the Japanese yen and the Korean won are the main basket currencies. "The basis for basket currency selection and weight determination is to focus on the weight of trade in goods and services. The United States, the Eurozone, Japan, South Korea, etc. are currently China's most important trading partners, and accordingly, the US dollar, the Euro, the Japanese yen, the Korean won will become the main basket currency. Also, Singapore, Malaysia, Russia, Australia, Canada, Thailand

and other countries have a large proportion of trade with China. The currency of these countries is also very important for China's RMB exchange rate."[7]

X, Zhou (2011) stated that there are about 20 currencies in the RMB exchange rate reference. In addition to the currencies of about 10 developed countries, half of these currencies are the currencies of emerging market countries. Based on the above information, and consider trade, foreign debt, foreign direct investment factors[8], the currency basket may include US dollars (USD), Japanese yen (JPY), Euro (EUR), British pound (GBP), Australian dollar (AUD), Canadian dollar (CAD), Korean won (KRW), Malaysian forest (MYR), Russian rupee (RUB), Singapore dollar (SGD) and Thai baht (THB), etc.

The “band” refers to the range of the exchange rate movement. In the fluctuation range, the exchange rate is determined by market supply and demand. Once this interval is exceeded, the monetary authorities will immediately intervene to stabilise the exchange rate. Generally, the wider the fluctuation range, the smaller the degree of intervention by the monetary authorities, the more flexible the exchange rate, and the closer the formation mechanism is to the floating exchange rate system. Expanding the range of fluctuations helps to increase exchange rate flexibility to absorb asymmetric shocks, and even gives the monetary policy a certain degree of autonomy. In operation, the monetary authority sets the base price of the benchmark exchange rate before the daily trading and sets the fluctuation range as the centre. The fluctuation range of the RMB against the US dollar exchange rate expanded from ±0.3% to ±0.5% on May 21, 2007, and expanded to ±1% on April 16, 2012, and further expanded to ±2% on March 17, 2014.

“Crawling” refers to the official adjustment of the exchange rate of the RMB against

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[7] On August 10, 2005, the governor of the People's Bank of China, Zhou Xiaochuan, delivered a speech at the opening ceremony of the Shanghai headquarters of the central bank.

[8] According to the website of China's Ministry of Commerce - "China's Foreign Trade Situation Report" and the State Administration of Foreign Exchange - the distribution of regions and currencies in the "China Balance of Payments Report" over the years.

a basket of currencies according to different economic conditions. This will eliminate the exchange rate deviation caused by the inflation difference between the RMB and the basket currency.

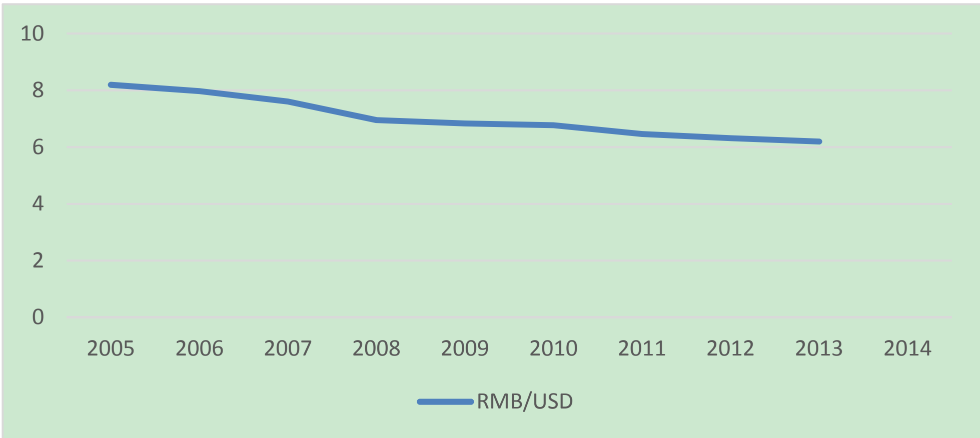
Second, on the day of the announcement of the reference to a basket of currencies, the exchange rate of RMB against the US dollar rose from 8.27 to 8.11 yuan as the median price of the interbank market on the next day.

Third, since January 2006, the central bank introduced market makers in the market and incorporated the method of inquiry trading into the foreign exchange rate pricing. The basic process is the central bank's reference to market makers' quotes, and the major trades in China are determined after the market closes every day. The closing price of the target currency and the RMB exchange rate is the intermediate price of the exchange rate on the next business day, and the fluctuation of the intermediate price of the exchange rate on the next day is 3‰.

After the exchange rate system was reformed three years, the US dollar against the RMB rose by 19% from 8.11 yuan to 6.82 yuan in 2008. At the same time, with the continuous deepening of the market economy, China's economic development has also achieved remarkable achievements. From 2005 to 2008, China's GDP grew by an annual average of 14.5% from 187.318 billion yuan to 32,150.50 billion yuan, and foreign exchange reserves were 182.872 billion dollars per year at an average of 24%. The growth rate has risen to 19,460.43 billion U.S. dollars. The total import and export volume had risen from an annual average of 11% to 1,792.147 billion yuan from 1,1,921.18 billion yuan until the arrival of the US subprime mortgage crisis in 2008 (Yu and Wang, 2018). This situation changed until the arrival of the US subprime mortgage crisis in 2008.

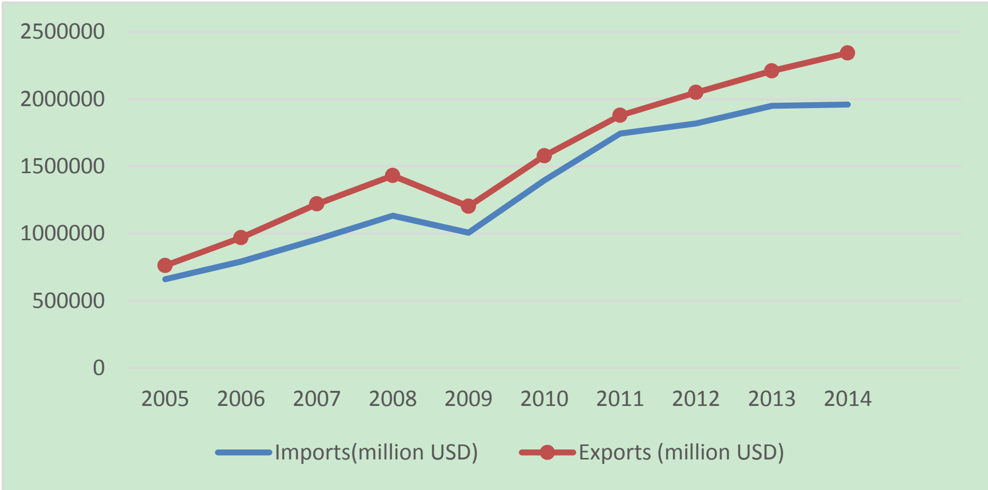
Because the United States is an important trading partner with China, China’s import and export trade is seriously affected by the economic crisis. In 2009, the impact of the current account had been huge, and the decline in the current account reached 42%. In response to the all-round impact of the crisis, the central bank actively narrowed the range of exchange rate fluctuations. In 2008-2010, the exchange rate of the US dollar against the RMB had remained stable at around 6.82. After 2010, the RMB continued to appreciate slightly (see Exhibit 9). Exhibit 10 shows the changes in China's total import and export volume from 2005 to 2014. It can be seen from Exhibit 10 that China's imports and exports have continued to grow, just in 2009, the total import and export volume was affected by the US subprime mortgage crisis, and there was a short-term decline.

Exhibit 9: The exchange rate of RMB against the US dollar from 2005 to 2014



Source: The World Bank

Exhibit 10: China's imports and exports from 2005 to 2014



Source: National Bureau of Statistics of China

The exchange reform in 2005 opened a new chapter in China's conversion, the exchange rate regime from a pegged exchange rate system to a floating exchange rate system. Although China narrowed the range of exchange rate fluctuations during the 2008 financial crisis, the increase in the flexibility of the RMB exchange rate and the acceleration of marketisation is inseparable from the direction of China's future economic development and the need to adapt to the international environment. Since the beginning of the 21st century, China has accumulated a large number of foreign exchange reserves, which also exposes China to the risk of depreciation of the foreign currency and shrinking foreign exchange reserves. At the same time, the rapid development of the economy is accompanied by inflation. If the exchange rate system of pegged US dollar continues to be implemented. The pressure of inflation will be nowhere to be released and increasing the flexibility of the RMB exchange rate system is also beneficial for better implementation of monetary policy.

The reform of the system will not be completed overnight. Although China has taken the first step of exchange rate reform, it still needs to be further promoted. For example, although the new exchange rate system allows the RMB exchange rate to float within a certain range, the range of fluctuations is small. This is because the US dollar still occupies a large weight in the currency basket. Also, due to careful consideration, the Chinese government and the central bank also have considerable regulatory power, which limits the marketisation process to a certain extent. In short, from all aspects, the floating exchange rate system implemented by the “721 Exchange Reform” still needs to be continuously improved.

3.2 2015 - Present

In 2015, the PBC announced on improving the quotation of the RMB to the USD and changed the RMB/USD mid-price quotation mechanism. Under the new mechanism, banks are required to submit quotations that combine the closing rate of the previous day with market demand and changes in the supply and exchange rates of major currencies.[9] A depreciation of the yuan accompanied the announcement against the US dollar by 1.9%.

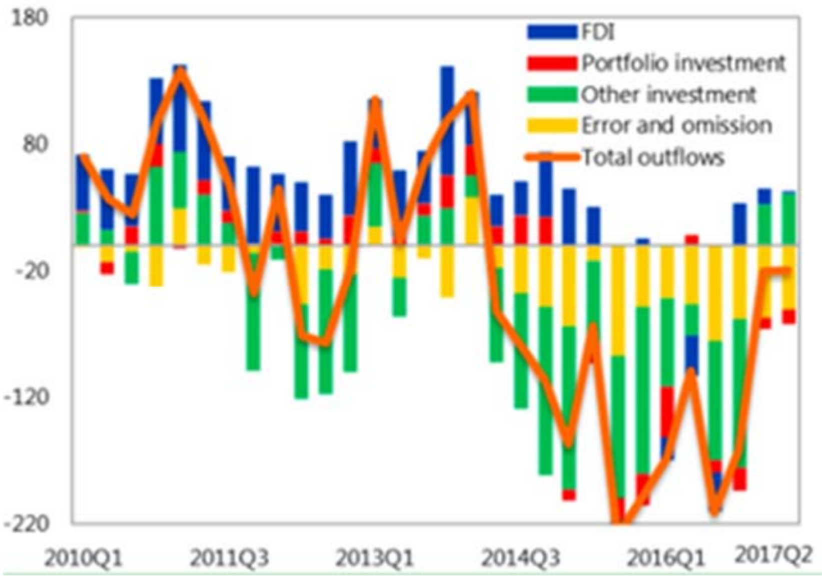
Das, S.(2019) pointed that changes in this mechanism have triggered volatility in global financial markets, capital outflows have accelerated, and many market participants have interpreted this change as the beginning of a sharp depreciation of the renminbi. The exchange rate of the RMB against the US dollar depreciated again by 1% on August 12, and then stabilised and traded in a very narrow range from mid-August to the end of September.

Capital outflows accelerated, including the closing of arbitrage trades and capital flight. Out-of-capital flows doubled from an average of approximately $100 billion in the third and fourth quarters of 2014 to a quarterly average of $200 billion in the second half of 2015 (Exhibit 11). The deterioration in the financial account, a US$ 900 billion swing in annual financial account flows between 2013 and 2015, were mainly attributable to three factors: (i) arbitrage closings, and (ii) residents (through official channels) acquiring foreign assets, And (iii) some “capital flight” (unrecorded outflows) (Das, S,

[9] www.imf.org.

2019).

Exhibit 11: Capital Flows



Source: Sonali Das(2019), China's Evolving Exchange Rate Regime, IMF.

In the form of repayment of the debt, the reversal of the net acquisition of foreign debt of residents accounted for 500 billion US dollars, so the possibility of lifting the arbitrage transaction is more than half. Specifically, the decline in China's external liabilities mainly reflects the lifting of non-resident loans and the repatriation of non-resident deposits, which is due to the falling interest rates from looser Chinese monetary policy together with the changes in exchange rate expectations. The rest of the financial account includes the acceleration, recording and unrecording of residents' acquisition of foreign assets.

The People's Bank of China has adopted foreign exchange interventions to stabilise the exchange rate with CMFs to prevent capital outflows. In the second half of 2015, international reserves have decreased by $321 billion.

In December 2015 and early 2016, the RMB exchange rate against the US dollar began to depreciate again (Table 2), causing a new round of volatility in China and the global market. A large amount of foreign exchange intervention was then carried out in January and February 2016 to stabilise the currency. The Real Effective Exchange Rate depreciated 5.7% from 2015 to 2016. The implementation of existing CFM has tightened, including overseas direct investment and offshore renminbi loans, as well as other measures, such as reserve requirements for bank foreign exchange forward transactions.

Table 2: The exchange rate of RMB against the US dollar from 2015 to 2017

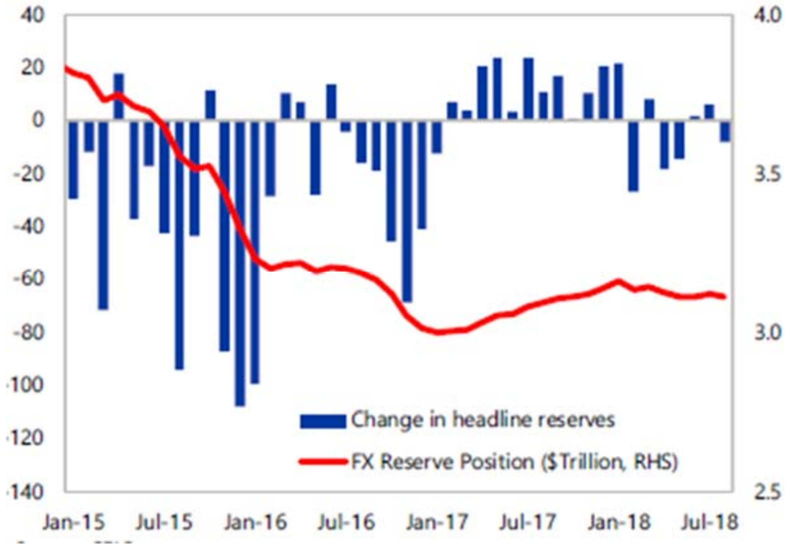
15Jan	6.25
15Jun	6.2
16Jan	6.576
16Jun	6.648
17Jan	6.881
17Jun	6.5

Source: *The World Bank.*

The pressure on the Renminbi subsided at the beginning of 2017. Capital outflows decreased in early 2017, in part because CFMs returned outbound direct investment to pre-surge levels and external borrowing increased, in part because of global economic recovery, China's growth prospects and weaker US dollar. Foreign exchange interventions gradually declined at the beginning of 2017, and foreign exchange reserves began to increase in February 2017 (partly because of the valuation effect of a weaker dollar)[10] (Exhibit 12).

Exhibit 12: Foreign Exchange Reserves (in billions of US dollars)

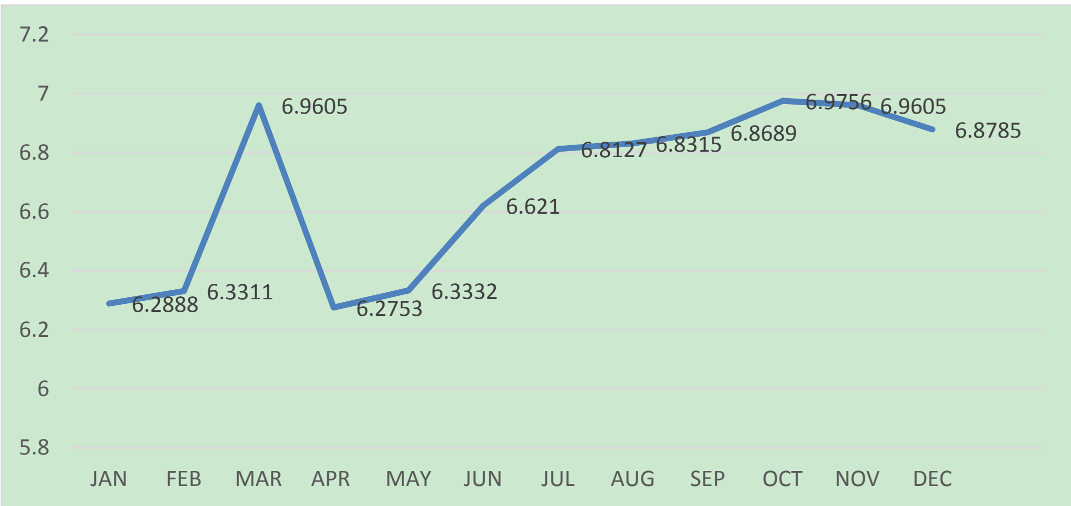
[10] www.imf.org.



Source: IMF via CEIC.

With the help of foreign exchange intervention and CFMs, the RMB has remained stable with the CFETS basket from mid of 2016 to the end of 2017, and PBC's guidance on the median price mechanism has become clearer. The RMB against the dollar exchange rate remained stable until the end of 2017.

Exhibit 13 Exchange rate of RMB against the US dollar in 2018



China continued to achieve a floating exchange rate in the first half of 2018. In the case of a stronger dollar, the pressure on the renminbi and other emerging market currencies resumed in April 2018. As a result of increased trade, the renminbi depreciation pressure in the renminbi intensified the initial signs of tension and economic slowdown in mid-June. The RMB exchange rate against the US dollar depreciated from 6.27 to 6.62 from April to June and then depreciated at 6.8 in August. In early July, the People’s Bank of China provided guidelines indicating that the RMB is stable. However, Das, S (2019) thought that there is no sign of a major intervention using foreign exchange reserves. The pace of change of the RMB – via both the U.S. dollar and the CFETS basket – was quicker than during any previous period. The episode was also unlike previous episodes of relatively sharp depreciation, in that significant capital outflows did not materialise in summer of 2018.

Internationalisation of the RMB. In 2015, the Renminbi was included in the International Monetary Fund's Special Drawing Rights (SDR) basket. The SDR is an international reserve asset, created by the IMF in 1969 to supplement its member countries’ official reserves (IMF,2019). The Board decided at that time that the weights of each currency would be 41.73 per cent for the U.S. dollar, 30.93 per cent for the Euro, 10.92 per cent for the Chinese yuan, 8.33 per cent for the Japanese yen, and 8.09 per cent for the Pound sterling (IMF, 2016). This is an important step in the internationalisation of the RMB, and the pace of internationalisation of the RMB has been further accelerated.

4. RMB Convertibility and Financial Account Opening

4.1 Concepts[11]

Convertibility

[11] The IMF includes detailed information on Concept of Convertibility, Current account, Financial account and Capital account (http://www.imf.org).

According to the International Monetary Fund, currency convertibility is to eliminate foreign exchange restrictions, and there are no restrictions on international payments and capital transfers. Also, according to the degree of freely convertible currency, the International Monetary Fund divides the currency exchange into completely non-convertible and can be freely exchanged under the current account of the balance of payments and fully convertible. Convertibility may depend on the entity (resident or non-resident), and residents and non-resident holders are free to exchange fully convertible currencies without the permission of a government agency (BPM6, 2011).

Current account

The current account is an important grouping of accounts in the balance of payments. The current account shows the goods, services, primary income and secondary income flows between residents and non-residents (BPM, 6th edition, 2011).

Capital account[12]

The capital account shows credit and debit entries for non-produced non-financial assets and capital transfers between residents and non-residents. It records the acquisition and disposal of non-produced non-financial assets, such as the sale of land and leases and permits sold to embassies, and capital transfers, i.e. the use of funds for which one party does not have any economic value. Provided to the party as a direct return (BPM 6, 2011).

Financial account

The financial account records transaction that involves financial assets and liabilities and that take place between residents and nonresidents. Table 3 shows some

[12] BPM5 brought about a number of changes in definitions, terminology, and the structure of the accounts, including removing capital transfers and non-produced assets from the current account to a newly designated capital account, the renaming of the capital account as the financial account.

main headings in the financial account. The left-hand column of Table 3 shows the net acquisition of financial assets and the right-hand column shows the net incurrence of liabilities (BPM6, 2011).

Table 3 Overview of the Financial Account

	Net acquisition of financial assets	Net incurrence of liabilities
Direct investment		
Portfolio investment		
Financial derivatives (other than reserves)		
moreover, employee stock options		
Other investment		
Reserve assets		
Total		
Of which:		
Equity and investment fund shares		
Debt instruments		
Other financial assets and liabilities		
Net lending/net borrowing (from the financial account)		

Source: Balance of Payments and International Investment Position Manual Sixth Edition, 2010.

1）Direct investment

Direct investment is a type of cross-border investment, characterised by the fact that residents of one economy have administrative control or significant influence on resident companies in another economy. Direct investment companies are always companies. As a statistical term, in addition to corporate entities, the company also includes branches, nominal resident units, trust institutions, other quasi-corporations and investment funds. Since another entity owns a direct investment enterprise, the household or government can be a direct investor, but it cannot be a direct investment enterprise. In some cases, public companies may also be direct investment companies (BPM6, 2011).

2）Portfolio investment

Portfolio investment refers to cross-border transactions and positions related to debt or equity securities that are not included in direct investment or reserve assets. Equity not in the form of securities (e.g., in unincorporated companies) is not included in portfolio investment; it is included in direct or other investment. Portfolio investment can be listed by instrument, original or remaining maturity, or institutional unit (BPM6, 2011).

3）Financial derivatives

A financial derivative contract is a financial instrument that is linked to another specific financial instrument, indicator, or commodity through which financial risk can be applied to a particular financial risk (e.g., interest rate risk, foreign exchange risk, equity). Trade with commodity price risk, credit risk, etc.) (BPM6, 2011).

4) Other investment

It includes one-off guarantees and other debt assumption; Insurance technical reserves, pension fund entitlements, and provisions for calls under standardised guarantees; Special drawing rights; Securities repurchase agreements and other reverse transactions; Currency (BPM6, 2011).

5）Reserve assets

Reserve assets are those external assets that are readily available to and controlled by monetary authorities for meeting balance of payments financing needs, for intervention in exchange markets to affect the currency exchange rate, and for other related purposes (such as maintaining confidence in the currency and the economy and serving as a basis for foreign borrowing) (BPM6, 2011).

4.2 RMB Convertibility

After the Second World War, the US dollar replaced the pounds as the dominant currency. Economists Chinn and Frankel (2005); Elwell (2007); Galati and Wooldridge

(2009) argue that the dollar may lose its core position in the coming decades. Since the release of the euro in 1999, the Euro is affecting the international status of the dollar. The share of the Euro in the total reserves allocated to the IMF increased from 18% in 1999 to 26% in 2010. At the same time, the share of the dollars fell from more than 70% in 1999 to about 60%. Also, in addition to the euro in 2010, there is another currency to become the new potential challenger US dollar, which is the Chinese yuan (Gui, L., 2012).

In the 2008 global financial crisis, governor of the People's Bank of China, X, Zhou (2009) proposed reforming the existing international monetary system. In the past several decades, China has experienced rapid economic growth. Today, China as the second largest economy and the world's main promoter, China strives to achieve the internationalisation of its currency. After the global financial crisis broke out in 2008, the Chinese monetary authorities accelerated the internationalisation of the RMB. Through a series of policies and cooperation agreements with other countries, the current international use of the renminbi is far more than a few years ago (Gui, L., 2012). However, if the Chinese monetary authorities intend to promote the Renminbi as a real international currency, there are still many obstacles.

The main obstacle is the restriction on the convertibility of the financial account (IMF, 2009)[13]. In December 1996, China accepted Article 8 of the International Monetary Fund and promised to lift all foreign exchange restrictions on the current account. The Asian financial crisis of 1997-1998 slowed the pace of China's financial account liberalisation. Until China joined the World Trade Organization in 2001, China began to gradually open its financial account to promote the internationalisation of the RMB. At present, about half of the 43 financial accounts classified by the IMF are not

[13] In economic literature, “capital account” is often used to refer to what is called the financial account in this *Manual* and in the *SNA*. This thesis will use the term financial account.

released.

From capital control to financial account convertibility, it is an important part of China's foreign exchange management system reform. Before the mid-1990s, due to the shortage of foreign exchange, China has been implementing strict capital controls. Under these controls, domestic citizens are restricted from investing abroad, and foreign investors are also restricted from entering China's financial markets.

Gui, L (2012.) thought that the liberalisation of financial accounts can increase the efficiency of domestic financial markets and it is better to allocate savings and investment. On the other hand, liberalisation increases the vulnerability of the economy, as international capital flows are often highly sensitive to macroeconomic policies, the soundness of the banking system, and economic and political development, also causes that monetary policy cannot be autonomous (Fischer, 1998). China’s major restriction on financial accounts is using the Renminbi in the international. Financial account convertibility is a prerequisite for international currency. The high convertibility of the renminbi will increase the incentives for individuals and institutions to use and hold the renminbi. However, the Chinese monetary authorities have set limits on the convertibility of the renminbi according to China's situation and for the health of the domestic economy and the security of the financial market. However, based on the experience of other international currencies, the potential of the renminbi as an international currency is achievable.

The opening of the financial account and the exchange rate system and the internationalisation of the renminbi are conditions and mutually reinforcing. On the one hand, the opening of the financial account and the flexibility of the exchange rate system are necessary conditions for the internationalisation of the RMB. The degree of internationalisation of the RMB depends not only on the degree of openness of the financial account but also on the degree of flexibility of the exchange rate system. On the other hand, the process of RMB internationalisation will promote the opening of the financial account and the flexibility of the exchange rate system.

4.3 Financial Account Liberalization[14]

The Chinese government has developed several programs that allow controlled and calibrated openness of incoming and outgoing financial accounts. These plans will create more free capital flows. Prasad, E. S. (2016) described each scheme of the inflow and outflow:

Inflows

Qualified Foreign Institutional Investor (QFII) scheme

The QFII program was launched in December 2002, to allow qualified foreign institutional investors to convert foreign currency into RMB and invest in stocks listed on the Shanghai and Shenzhen stock exchanges, and other RMB-denominated financial products approved by the China Securities Regulatory Commission. The program aims to attract high-quality and stable (medium and long-term) foreign investment portfolio while preventing speculative inflows of short-term foreign investment. One of the main objectives of the program is to promote the development of the Chinese securities market (Prasad, E.S., 2016).

The China Securities Regulatory Commission and the State Administration of Foreign Exchange (SAFE) will jointly oversee the QFII program. The China Securities Regulatory Commission is responsible for approving the application for permission, and the State Administration of Foreign Exchange sets the investment quota.

The China Securities Regulatory Commission and the State Administration of Foreign Exchange have established eligibility criteria for QFII applicants to prevent

[14] Prasad, E. S. (2016). *China's efforts to expand the international use of the Renminbi*. https://www.brookings.edu/wp-content/uploads/2016/07/RMBReportFinal.pdf

short-term speculative capital from flowing into foreign capital. Long-term investors such as pensions, insurance, mutual aid and charitable funds are invited to invest in long-term investment horizons (Prasad, 2016).

FIIs applying for QFII status must meet the minimum eligibility criteria associated with multi-year operations, manage the dollar value of total assets, sound financial status and corporate governance. They also need to operate in countries with sound legal and regulatory systems, and their securities market regulators have signed a Memorandum of Understanding (MOU) to maintain regulatory cooperation with the China Securities Regulatory Commission.

QFII is usually a foreign fund management institution, insurance company, securities company and other asset management institutions. It has obtained the license of the China Securities Regulatory Commission and the investment quota of the State Administration of Foreign Exchange to invest in China's financial market. The most important thing is in the stock market. The QFII eligibility criteria related to operations in recent years and the minimum total asset management scale in the most recent fiscal year have gradually opened up, allowing more and more foreign institutional investors to invest in securities in China.

Over time, the State Administration of Foreign Exchange opened the foreign securities investment flow through the QFII channel, increased the total amount of QFII quota available, and relaxed the maximum quota for individual QFII. As of October 2015, the total investment of the program was approximately $78.9 billion, involving 277 institutions. The China Securities Regulatory Commission also announced that the total QFII would increase from $80 billion to $150 billion.

The State Administration of Foreign Exchange has also gradually increased the maximum amount of each QFII in the quota. From January 2003 to September 2009, each QFII received up to $800 million in all quota allocations. As of the end of 2009, this maximum value increased to $1 billion. With only a few sovereign wealth funds, central banks and monetary authorities can invest more than $1 billion. In March 2015, the quota limit for overseas fund management companies investing $1 billion was abolished as part of efforts to further open the national capital market and carry out structural reforms.

The dominant position of QFIIs are from developed countries and regions, and only 10 (i.e. less than 5%) of the 251 QFIIs are developing regions. The largest number of QFIIs (45% or 18%) settled in Hong Kong, followed by the United States (38% or 15%) and the United Kingdom (27% or 11%). It is estimated that QFII accounts for an average of two-thirds of the total assets of a stock (Prasad, E.S., 2016). However, QFII's investment in the A-share market only small compared to the overall size of the market. QFII holds less than 2% of the A-share market. Therefore, any impact of the QFII program on the development of the securities market is primarily a catalyst rather than a direct importance.

In the early stages of the QFII, each QFII must hold no less than 50% of its total assets or stock-related instruments and no more than 20% of its assets. These restrictions attempt to avoid the expectation that QFII may place most of its assets in fixed-income securities or even cash, primarily to speculate on the appreciation of the Renminbi.

Since 2012, the China Securities Regulatory Commission has lifted restrictions on at least 50% of the QFII portfolio that must hold stock or equity-related instruments. However, QFII still cannot hold more than 20% of its cash portfolio. Also, QFII's investment in any company listed in China may not exceed 10% of its total shares, and the cumulative shares of all QFIIs in any company may not exceed 20% of its total shares (Prasad, 2016).

Renminbi Qualified Foreign Institutional Investor (RQFII) scheme

RQFII launched by the China Securities Regulatory Commission, the State Administration of Foreign Exchange and the People's Bank of China (PBC) at the end of 2011. The main difference between the QFII and RQFII programs is that RQFII can directly invest in the mainland market using offshore RMB. In contrast, QFII must first convert its foreign currency funds into RMB and then buy stocks and securities in the domestic market. The QFII scheme requires financial institutions to apply for the license of the China Securities Regulatory Commission and the investment quota of the State Administration of Foreign Exchange, and submit all relevant materials to the People's Bank of China. Approved institutions need to open special accounts for RMB for investment in the foreign exchange market, inter-bank bond market and stock index futures — domestic custodian bank. Besides, the institution's funds and client funds accounts must be separated.

The flow of funds under the RQFII program has been subject to some restrictions. The funds that can be remitted to the country include the foreign exchange investment principal, the amount required to pay the relevant taxes, and other RMB funds allowed by the People's Bank of China and the State Administration of Foreign Exchange. The funds that can be exchanged for foreign exchange include domestic securities sales income, cash dividends and interest, and other RMB funds that the People's Bank of China and the State Administration of Foreign Exchange allow the foreign exchange.

At first, only Hong Kong subsidiaries of Chinese financial institutions were eligible for RQFII licenses. Since 2014, the RQFII scheme has been extended to other Hong Kong banks and asset management companies, and subsequently to financial institutions in the UK, Singapore, Korea, France, Germany, Australia and Switzerland. As of July 2015, according to the RQFII scheme, 135 financial institutions, including foreign institutions and foreign affiliates of Chinese financial institutions, received a total of US$68.4 billion. However, the financial institutions from Hong Kong, many of which are Hong Kong branches of mainland financial institutions, mainland are still major players in mainland financial institutions.

Outflow

Qualified Domestic Institutional Investor (QDII) scheme

The QDII scheme allows Chinese domestic financial institutions (mainly state-owned institutions) to invest in offshore financial products such as securities and bonds. The origin of the scheme was that the Chinese government decided in September 2004 to allow insurance companies such as Ping An (Group) to invest overseas. The scheme was officially launched in 2006, allowing selected commercial banks, securities companies and fund management companies and insurance companies to invest in the foreign market, but have certain restrictions.

The condition of this scheme is that financial institutions must first apply for QDII licenses to relevant regulatory agencies (China Banking Regulatory Commission, China Banking Regulatory Commission and China Insurance Regulatory Commission), depending on their main business. The general qualification requirements for QDII include :

(i) A stable financial position and a good reputation;

(ii) Qualified personnel with the necessary expertise in asset management and risk assessment;

(iii) sound governance structures and internal control systems;

(iv) There is no record of any significant fines imposed by the relevant regulatory body.

The specific requirements depend on the type of organisation involved. For example, eligible fund management companies need to have at least 200 million yuan in net assets and actively participate in fund management business for at least two years, and more than 20 billion yuan worth of equivalent assets or in the latest quarter.

QDII approved investment destinations include Hong Kong, UK, USA, Singapore, Japan, Korea, Luxembourg, Germany, Canada, Australia and Malaysia. These countries are mainly developed economies and have well-established financial markets and sound financial sector regulatory frameworks.

As of November 2015, 132 institutions have received a total of $90 billion in QDII licenses. The breakdown of quotas by institution type is as follows: securities companies ($38 billion), insurance companies ($31 billion), banks ($14 billion) and trust companies ($8 billion).

Qualified Domestic Individual Investor (QDII2) scheme

The Qualified Domestic Individual Investor scheme, commonly referred to as QDII2, will extend the QDII scheme from institutional investors to individual retail investors. PBC first proposed the scheme in January 2013. In June 2015, the official website of the Shanghai Municipal Government stated that Shanghai would launch a trial of the program in its free trade zone before the end of the year The scheme was also discussed in the RMB internationalisation report issued by the People's Bank of China in June 2015.

The QDII2 program will eventually be launched in at least six Chinese cities: Shanghai, Tianjin, Chongqing, Wuhan, Shenzhen and Wenzhou. News reports indicate that the new pilot program will allow individuals with at least 1 million RMB ($160,000) in assets to invest directly in overseas securities, stocks and real estate. Currently, the maximum amount of RMB that an individual can exchange for foreign currency is capped at US$50,000 per year; this limit does not apply to investors under QDII2.

4.4 Financial Account Opening

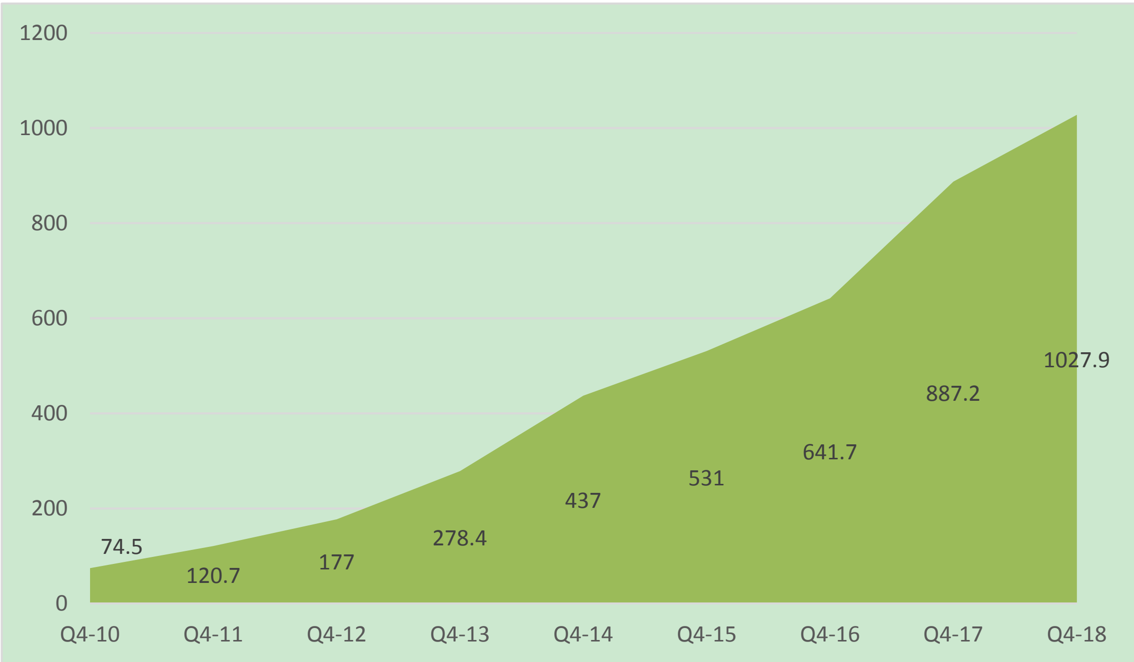
One way to assess the openness of economic and financial development is to analyse measures that are integrated into global financial markets. Opening RMB financial accounts are one of the important components of China's economic and financial marketisation reform. Since the announcement of the RMB current account convertibility in 1996, the financial account opening process has been gradually promoted.

Bond item is progressing faster and is now basically convertible. In the bond market, investors have opened up to the outside world. Since February 2016, the Chinese inter-bank bond market has been fully open to foreign institutional investors. Non-residents purchase domestic bond instruments are convertible, residents' purchase of overseas bond instruments are still mainly completed through QDII. In the bond market issuer's opening to the outside world, the resident's overseas issuance can be completed through registration, non-residents have stricter entry conditions in the domestic issue, and the restrictions on the issuer are gradually liberalised from the end of 2014.

Since 2005, the first batch of foreign institutional investors has entered the Chinese inter-bank bond market. Until 2014, the pace of opening up to the inter-bank bond market has been relatively stable, and the pace of opening up in 2015 has accelerated significantly. According to the “2015 Financial Market Operation” issued by the central bank, as of the end of 2015, 308 overseas central banks, sovereign wealth funds, QFII and other overseas institutions have entered the inter-bank market, and the number of overseas institutional investors has increased by about 70% from the end of 2015. On February 24, 2016, the central bank issued the “further liberalization of overseas institutional investors to invest in the inter-bank bond market”, canceling the audit and quota restrictions of foreign institutional investors investing in the inter-bank bond market, and expanding the scope of qualified market participants to many financial institutions including commercial banks, insurance companies, securities companies, fund management companies and other asset management institutions. So far, the inter-bank bond market has been fully liberalised to foreign investors.

Since the developed countries adopted the loose monetary policy after the global financial crisis in 2008, the cost of overseas financing was lower than the domestic market. Therefore, domestic companies have chosen to issue bonds in Hong Kong and the United Kingdom. According to the statistics of the Bank for International Settlements, the scale of overseas issuance of international bonds by Chinese companies has increased rapidly since 2010. As of the fourth quarter of 2018, the balance of international bonds issued by Chinese issuers has reached 1027.9 billions of US dollars. Among them, the offshore renminbi market in Hong Kong is the first choice for domestic companies to choose to issue renminbi bonds.

Exhibit 14: The balance of international bonds issued by Chinese issuers in 2018 **(**billions of US dollars**)**



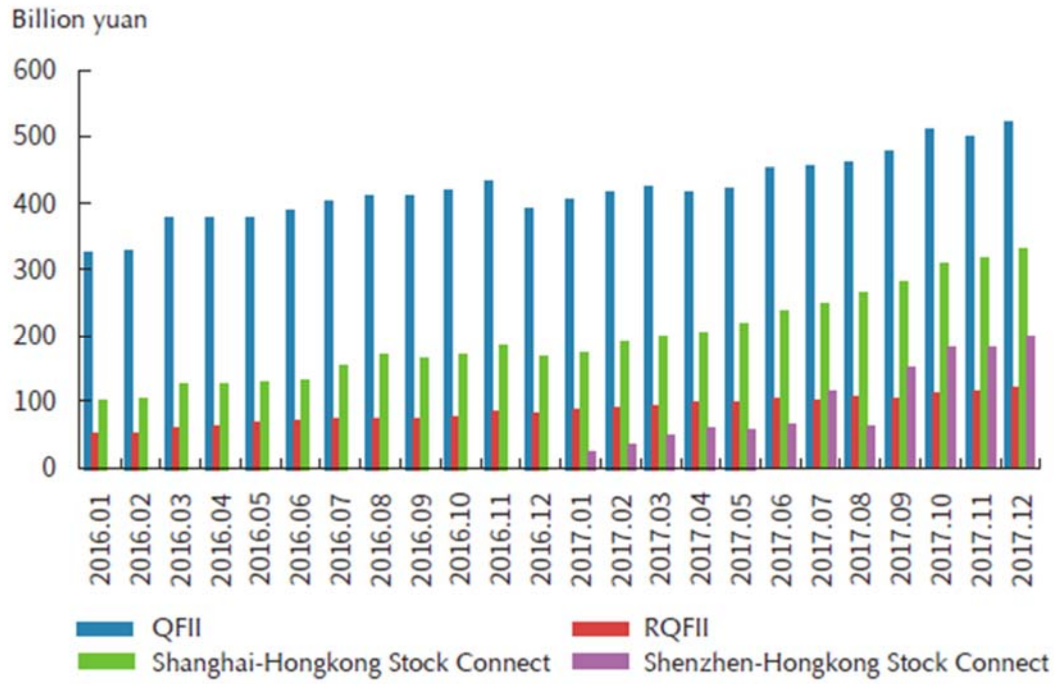
Source: Debt securities issues and amounts outstanding, by residence and nationality of the issuer, BIS.

Part of the stock item is convertible, and qualified institutional investors can complete domestic and foreign investment. Through the arrangement of "Shanghai-Hong Kong Stock Connect", the scope of participants in the two-way investment between Shanghai and Hong Kong is extended to ordinary institutional investors and qualified individual investors. By the listing of domestic companies on overseas stock markets is unrestricted, and non-residents are still required to break through the issuance of RMB stocks in China.

In 2017, the cross-border payment of securities investment RMB was converted from net outflow to net inflow in 2016. The cross-border RMB cross-border payment amount under securities investment totalled 1.9 trillion yuan, a substantial increase of 219% year-on-year, of which income was 1.04 trillion yuan. The expenditure was 855.6 billion yuan, and the net inflow was 185.07 billion yuan. In 2016, the net outflow was 261.37 billion yuan.

The increase in the cross-border settlement of securities investment in the renminbi was due to the continuous expansion of the two-way opening of the domestic financial market. From the perspective of the overseas stock investment in the domestic stock market channel, the qualified foreign institutional investors (QFII) channel holds the largest stock market value, and the Shanghai and Shenzhen stock exchange channels contribute the most to the increment. As of the end of 2017, the overseas stocks held by QFII, RQFII, Shanghai Stock Connect and Shenzhen Stock Connect were 502.03 billion yuan, 123.232 billion yuan, 332.225 billion yuan and 198.383 billion yuan respectively. 32%, 46%, 94% and 635%.Among the overseas stocks of 5,545.85 billion yuan, the market value of foreign investors increased by 38%, 31%, 24% and 7% respectively through the channels of Shenzhen Stock Connect, Shanghai Stock Connect, QFII and RQFII.

Exhibit 15: RMB Stock Value Held by Overseas Entities Under Different Investment Channel



Source: 2018 RMB Internationalization Report, PBC.

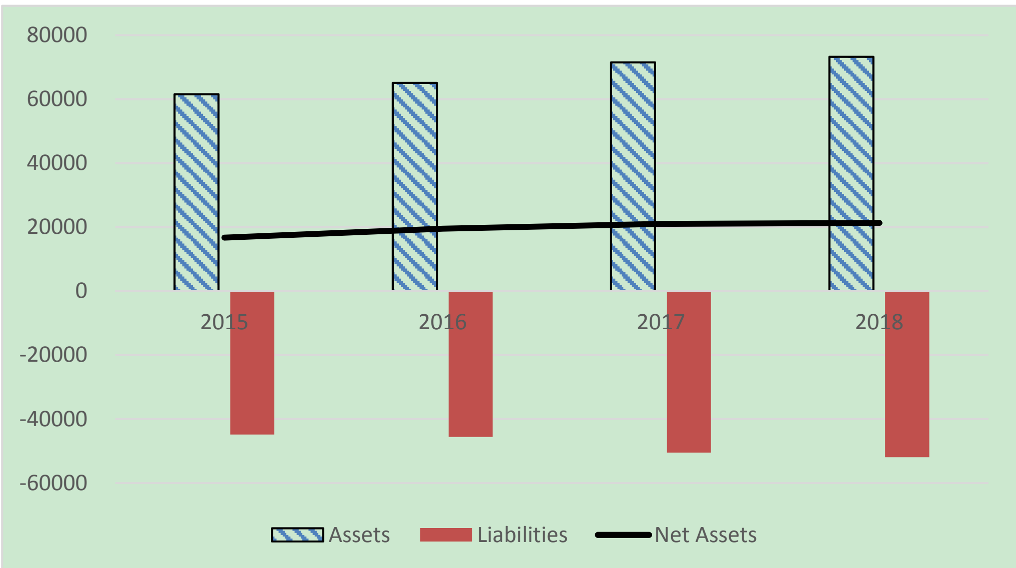
China has been constantly promoting and accelerating the pace of opening up the Chinese bond market. Foreign institutions have issued bonds to the Chinese bond market, called “Panda Bond”. In terms of the issuance of panda bonds, the main body of Panda bond issuance is constantly enriched. Now there are international development agencies, such as the World Bank, like the Asian Development Bank, etc., there are foreign government agencies, overseas financial institutions, and some large companies outside the country. By the end of 2018, the total issuance of panda bonds will be nearly 200 billion yuan.

In order to facilitate overseas investors to issue panda bonds to China's bond market, last year the People's Bank of China and the Ministry of Finance jointly issued a document, "Interim Measures for the Administration of Issuance of Foreign Institutional Bonds in the National Inter-bank Bond Market", further clarifying the overseas The framework for the issuer's policy of issuing panda bonds in the interbank market in China. This includes the management of the issuance of simplified bonds. In addition to the approval of the PBC by financial institutions. Other institutions, international development agencies, offshore non-financial institutions, and overseas governments issue Panda bonds, as long as they are registered and issued by the China Association of Dealers.

Moreover, beginning in 2015, China began reporting its international investment position (IIP) by the International Monetary Fund's latest Balance of Payments and International Investment Position Manual (BPM6). According to the State Administration of Foreign Exchange, a major change is the use of market valuation methods rather than historical traffic accumulation methods to report key international investment position items. Data as of 2014 is still based on the BPM5 report. Data after 2015 and data before 2014 cannot be compared. This thesis will use data from 2015-2018.

Exhibit 16 shows the total external (foreign) assets and liabilities and net assets of China for the years 2014 to 2018. As of the end of 2018, China currently has \$734.2 billion in foreign assets and \$519.41 billion in external liabilities. Assets and liabilities continue to grow. The study of Eswar Prasad (2016) analysed that data from 2004 to 2014, both assets and liabilities have risen sharply over these ten years.

Exhibit 16: China's External Assets and Liabilities (in billions of U.S. dollars)



Source: State Administration of Foreign Exchange

The review of China's international investment position also reveals some characteristics. From table 4 can be seen that foreign direct investment has the largest proportion of China's external liabilities, while portfolio equity liabilities account for a relatively small proportion. Portfolio debt and other investments (usually bank loans) account about one-third of external liabilities. It can be seen that the foreign debt's share of China's external debt is relatively low, and the foreign exchange reserves are sufficient to cover the external debt, which indicates that China will not face the vulnerability caused by high-risk external debt.

Table 4: China's International Investment Position (in billions of U.S. dollars)

	2015	2016	2017	2018
Net position	1673	1950	2101	2130
Assets	6156	6507	7149	7324
FDI	1096	1357	1809	18990
Portfolio	261	367	493	498
Equity	162	215	298	270
Debt	99	152	195	228
Other investments	1389	1680	16056	1753
Reserve Assets	3406	3098	3236	3168
FX Reserves	3330	3011	3140	3073
Liabilities	4483	4557	5048	5194
FDI	2696	2755	2726	2762
Portfolio	817	811	1099	1096
Equity	597	580	762	684
Debt	220	232	337	412
Other investments	964	984	1220	1329

Source: State Administration of Foreign Exchange

Many of the restrictions on cross-border capital flows have been loosened over time, consistent with the policy objective of promoting the RMB's role as an international currency. In most cases, constraints on capital inflows and outflows have been loosened but not eliminated. The country’s financial account is becoming increasingly open, although by this measure China is financially less open than many reserve currency economies.[15]

4.5 Impact of Capital Flows

Although China still has extensive control in the financial account, it selectively and carefully removes these controls. Partly because of this dismantling, China’s financial account is increasingly open. This trend affects the quantity and composition of capital inflows and outflows.

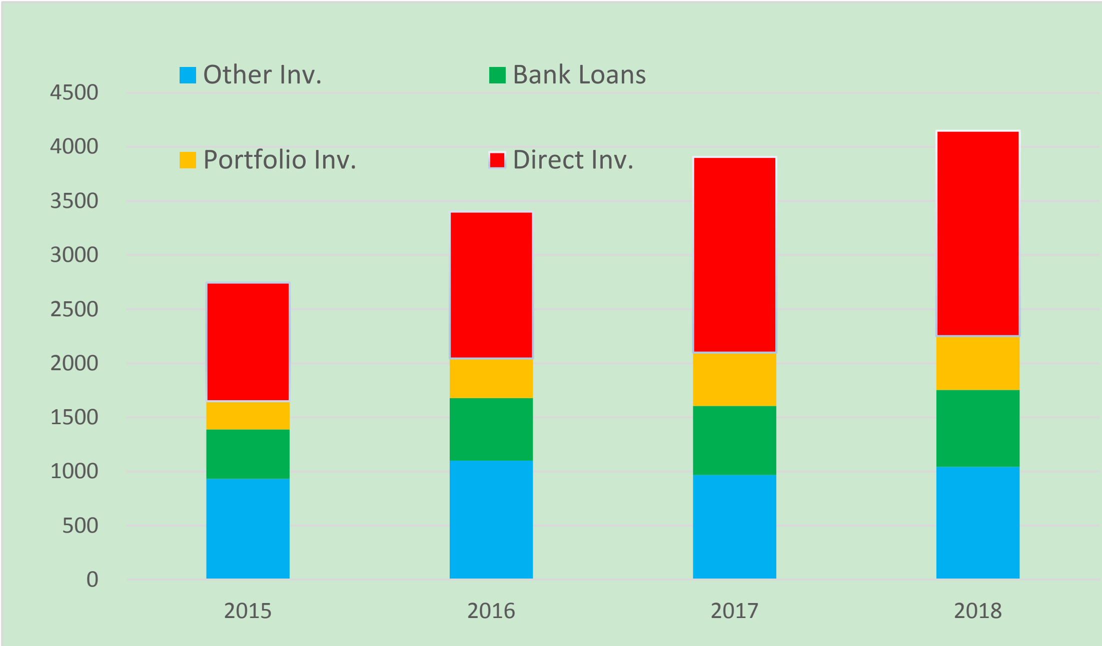
Exhibit 17 shows that the composition of gross inflows has shifted significantly from 2015 to 2018[16].

During this time, FDI has continued to rise, because the government has reduced some barriers to FDI inflows. Due to the quota and liberalisation of the QFII program and the introduction of the RQFII program, the portfolio investment has also gradually increased. Portfolio inflows remain moderate relative to overall capital inflows.

Exhibit 17: Gross Capital Inflows and Inflows (in billions of U.S. dollars)

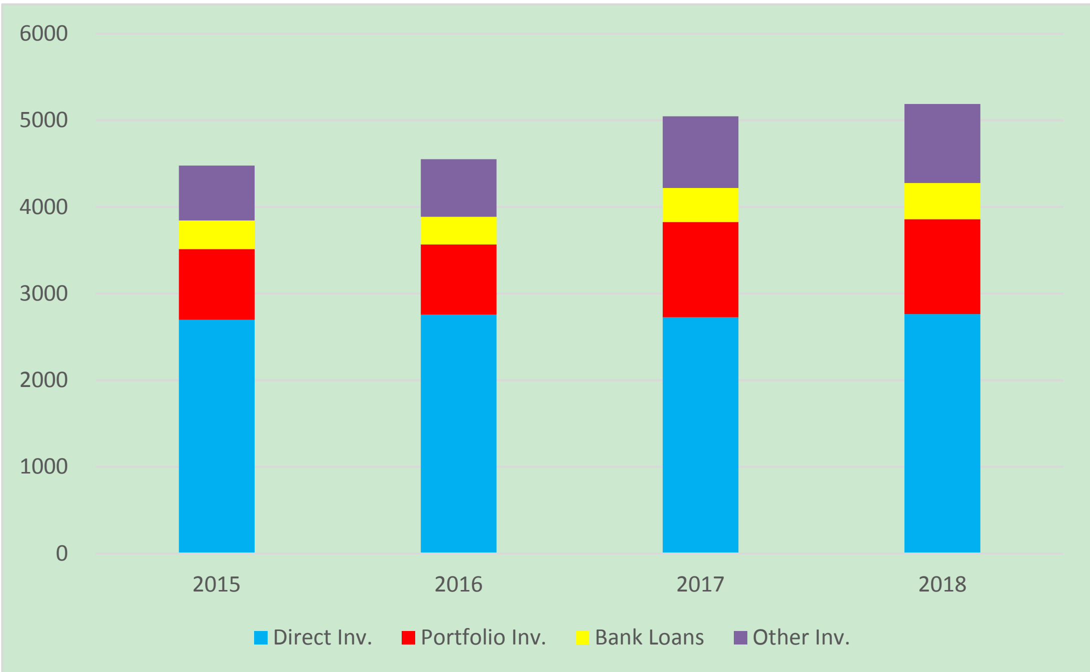
[15] Prasad, E. S. (2016). *China's efforts to expand the international use of the Renminbi*. https://www.brookings.edu/wp-content/uploads/2016/07/RMBReportFinal.pdf

[16] Because since the first quarter of 2015, China international investment position table has been compiled and presented in accordance with the International Monetary Fund's Balance of Payments and International Investment Position Manual (Sixth Edition) standards.



Source: State Administration of Foreign Exchange

Exhibit 18: Composition of Gross Capital Outflows (in billions of U.S. dollars)



Source: State Administration of Foreign Exchange

Exhibit 18 shows the composition of capital outflows. Direct investment dominates total outflows. The outflow of portfolio investment in 2017 has risen, which may reflect the increasing channels for Chinese investors to obtain funds and the decline in China's stock market.

Ren Zhigang (2011), former head of the Hong Kong Monetary Authority, believes that China's long-term goal should be full financial account convertibility. He defined it as expand capital controls but maintaining "soft" control. The form of registration and reporting requirements for regulatory purposes. He made a careful distinction between this and the completely unfettered capital flow system, called the free financial account convertibility. This definition provides a way to open up financial accounts without having to fully control market forces.

5. Foreign Exchange Management in Chinese Companies: The Case of Haier Group

In recent years, the SAFE has actively promoted the decentralisation of foreign exchange management and the opening of financial accounts and continued to promote the liberalisation and facilitation of cross-border trade and investment and financing, and continuously explored and reformed the centralised operation and management of funds of Chinese multinational companies.

5.1 Haier Group Background

Haier Group is a world-renowned manufacturer of household appliance brands and the first local multinational enterprise group in China to create a global, national enterprise brand. The Haier Group was established in 1984 and has grown to 2018. The global turnover has reached US$39.5 billion. Following Haier's comprehensive acquisition of Sanyo White's brand and New Zealand's national treasured household appliance brand, Fisher & Paykel, in 2012, it again invested US$5.58 billion in 2016 to acquire the US century-old GE appliance. Haier’s overseas revenue accounted for 42% in 2018, and its compound annual growth rate has reached 22% in the past decade. Haier Group's current household appliance brands include Haier, Commander, Casa Di, AQUA, Fisher & Paykel, GE, etc., covering Asia, Europe, America, Africa and Australia and New Zealand. According to a survey by the world's authoritative market research agency Euromonitor, the Haier brand has 10.3% of the global retail sales of large household appliances. At present, Haier has established an effective Trinity system in the United States, Europe, Asia-Pacific, Australia and New Zealand, and has realised the globalisation of design, globalisation of manufacturing, globalisation of marketing, and globalisation of procurement centred on internet technology.

5.2 Why Haier Group to implement foreign exchange fund management

The total overseas investment of Haier Group has reached nearly 8 billion US dollars. The assets of overseas companies have exceeded 20 billion US dollars. The total annual cash flow of overseas funds has exceeded 10 billion US dollars, and the global Haier industrial system has been constructed. With the global strategic layout of Haier Group's industry and the continuous growth of overseas business volume, the Group's cash flow continues to increase, and the geographical distribution of the industry makes the Group's overseas assets face many risks.

First of all, Haier Group has established overseas branches through different ways of investing in new projects, mergers and acquisitions, and joint ventures with local institutions. The capital of Haier has different proportions in global branches, and it is difficult to realise the Group's unified management strategy in management authority. Moreover, even 100% of the controlling member companies may be restricted by information systems and other reasons and cannot obtain business information such as bank accounts and cash flow management of the company beforehand.

Secondly, the operation mode of Haier Group's overseas 70 corporate companies has enabled Haier Group's global funds to be distributed throughout the world as a corporate entity. The business conditions and development conditions of different business segments and legal entities vary, and the remaining funds are not the same. The legal person company is limited by the scope of its main business and the foreign exchange management policies, and tax policies of each country and region cannot achieve centralised management of funds.

Thirdly, because the capital surplus of each country cannot be adjusted, the deposits and loans coexist at the same time, and the assets and liabilities exist in different currencies. For Haier, a company that uses RMB as the local bookkeeping currency faces both multi-currency assets and liabilities. The multi-interest rate risk under the structure also faces the impact of large exchange gains and losses in the group's consolidated statements.

At present, the Group's industry involves more than a dozen settlement currencies, and each company operates independently. Exchange rate fluctuations such as the Russian ruble's exchange rate changes of nearly ±25% a year have a direct and significant impact on the assets, costs and profit margins of the industry (Pesanti, D., & Pesanti, D., 2017). Due to the lack of unified management ideas and the lack of professional risk management personnel, the overseas member companies around the world have been concentrating on the management of exchange rate risks.

At the same time, the contradiction between the Haier Group's domestic and foreign financial resources distribution is increasingly uneven. Due to the establishment of the group finance company, domestic RMB funds and domestic and foreign currency funds have achieved centralised operation management. Their funds have replaced a large number of bank loans, and bank credits have been widely used in bank acceptance bills in an industrial settlement. In 2009, the People's Bank of China officially promoted electronic bank acceptance bills in China. As the first batch of pilot companies, Haier Group Finance Company realised that the market share of electronic acceptance bills accepted by Haier Finance Company was close to 100% in less than two years. The usage rate of domestic bank credit is less than 10%. Contrary to this, overseas industries are subject to many factors such as the initial investment scale of the company, the initial stage of development, lack of fixed assets support, and other financial factors. In the domestic foreign exchange management policy, the background of the direct guarantee provided by the enterprise group has not been released. Under the circumstance, the contradiction between large-scale and diversified financial service needs and scarce financial service resources is particularly prominent.

5.3 The Development of Haier Group's Foreign Exchange Fund Management

In October 2004, Haier Group was approved by Haier finance company as the main body and carrier to carry out the pilot project of collective management of foreign exchange funds of the Group's current account, becoming the first enterprise group company to conduct pilot projects in China.

In October 2006, Haier Group was approved to carry out the centralized management project of the Group's global foreign exchange funds, and it was approved to open a special account for the centralized management of domestic foreign exchange funds, to carry out the collection of funds for domestic cross-regional current account and financial account, to grant the opening of foreign exchange. Funds for centralised management, implementation of fund collection for overseas member companies, granting cross-border lending accounts, and granting cross-border lending support to overseas member companies within the quota. In 2008, Haier finance company was approved by Qingdao Foreign Exchange Administration as the main body and carrier of the project and officially launched its business.

In April 2010, Haier finance company was approved by the China Foreign Exchange Trading Center and became a member. It can enter the China Foreign Exchange Trading Center market as a member of the market for spot inquiry transactions.

In April 2011, Haier Finance Co., Ltd., approved by Qingdao Foreign Exchange Administration, granted its short-term foreign debt index of US$5 million for the first time to carry out overseas financing business within the indicator.

In December 2011, Haier Group was approved by Qingdao Foreign Exchange Administration for the first time and granted a foreign guarantee of US$500 million. Haier officially began to realise the cross-border sharing of rich credit resources accumulated in China.

In June 2013, Haier Finance Co., Ltd. was approved by the State Administration of Foreign Exchange based on the qualifications of derivative business products issued by the China Banking Regulatory Commission and was approved by the State Administration of Foreign Exchange to obtain the qualifications for derivative products trading such as forward settlement and sale.

In February 2015, initiated by Haier Finance Company, authorized by Haier Group, approved by the People's Bank of China Qingdao Central Branch, Haier Finance Company as a host company to carry out Haier Group's cross-border RMB two-way fund pool business, clearly opened through the cross-border RMB two-way fund pool account realizes the cross-border sharing of the Group's RMB funds.

In August 2015, Haier finance company took the lead in sponsoring the Qingdao Foreign Exchange Administration to apply for the policy upgrade of the centralised operation management of foreign exchange funds of multinational corporations. It can open main domestic accounts and main international accounts to implement domestic and cross-border foreign exchange funds. Conduct centralised operation management and carry out centralised collection and payment of foreign exchange funds according to the needs of the enterprise.

Based on the actual needs of its industrial development, Haier Group has combined the various policies and business qualifications of the foreign exchange business approved by the Group and Haier finance company to clarify the main ideas for the centralised operation and management of foreign exchange funds. That is to say, Haier Finance Co., Ltd., as the main body and carrier of the centralized operation and management of foreign exchange funds of Haier Group, implements the collection and management of foreign exchange funds through the establishment of a “global one account” fund collection model; through the “global resource sharing” model, it will be collected. The financial resources will be implemented in the Group's global scope, and the expansion of industrial chain finance will be implemented to achieve a win-win value-added of the entire industry chain; the financial risks such as interest rates and exchange rates will be faced in the process of industrial development through the “one global centre” model. Through internal transactions, it is concentrated in Haier finance company, and Haier finance company establishes a special management team to implement specialised centralised operation management.

In summary, the centralised operation and management of foreign exchange funds is an inevitable demand brought about by the globalisation of Haier Group's industry. On the other hand, Haier Finance's rich experience in centralised operation and management of RMB funds approved policy resources, and the establishment of the Group's shared centre system has laid a solid foundation for the Group to carry out centralised management of foreign exchange funds.

6. Conclusion

First of all, though do research 40 years of reform and opening up, it summarises several characteristics of the changes and development of China's exchange rate system:

The flexibility of the RMB exchange rate is growing. The exchange rate system of a country or economy is often closely related to the comprehensive national strength. When the national strength is weak, in order to prevent economic instability caused by large-scale fluctuations in the exchange rate, a fixed exchange rate system is usually adopted, and when the national strength is continuously enhanced, and the exchange rate is regulated. The ability to adopt a floating exchange rate system. Before the beginning of the new China and before the reform and opening up, China was still in a planned economy, with slower development and less foreign exchange reserves. Due to careful consideration, China adopted a stable exchange rate system. After the reform and opening up, China gradually liberalised the exchange rate and implemented a parallel exchange rate system in which the official exchange rate and the internal settlement price of trade were parallel, and the official exchange rate and foreign exchange adjustment price were parallel. With the deepening of reform and opening up, the exchange rate was implemented in 1994, the "721 Exchange Reform" in 2005 and the "811 Exchange Reform" in 2015 are proof of the increasing exchange rate flexibility. The volatility of the RMB day on May 21, 2007, was raised from 0.3% to 0.5%, and was further raised from 0.5% to 1% on April 14, 2012, and announced on March 17, 2014. The fluctuation range has expanded to 2%, and the RMB exchange rate fluctuations have better adapted to the immediate changes in the economy.

The mechanism for generating exchange rates is becoming more and more market-oriented. The government formulated most of the previous exchange rates according to the economic development of a specific period, the international social and economic environment, and the development needs and goals of the next stage. At the same time, the central bank has stricter controls. From 1994 to 2012, China has been implementing a mandatory foreign exchange purchase and sale system. Although this system has allowed foreign exchange reserves to grow, it has also brought pressure on the appreciation of the renminbi and inflation. The implementation of the central bank's monetary policy has also been affected. On January 4, 2006, the central bank announced the introduction of a market maker system. The daily exchange rate intermediate price refers to the quote of the market maker on the previous day. This major measure means that the central bank officially delegates power to the market and is more responsible for the macro. The role of regulation has further developed the foreign exchange market, improved the RMB exchange rate generation mechanism, and improved the liquidity of foreign exchange market transactions.

The internationalisation of the RMB exchange rate is getting higher and higher. With the continuous enhancement of China's strength, the expansion of foreign trade targets and trade scope, the internationalisation of the RMB is an inevitable trend. At present, the US dollar still dominates the international currency. More than two-thirds of China's foreign exchange reserves are in US dollars, so it is at risk of depreciation of the US dollar and a sharp decline in foreign exchange. On the one hand, the internationalisation of the renminbi can reduce the threat to foreign exchange security and reduce China's dependence on the US dollar.

On the other hand, it also promotes the free exchange of the Renminbi internationally and acts as a currency for pricing and settlement in international trade. The renminbi is gradually decoupled from the dollar, realising the exchange rate of a basket of currencies. This phenomenon shows that in the future, the renminbi will no longer follow the changing trend of the US dollar, and the road to the internationalisation of the renminbi will accelerate.

Then, the analysis of RMB convertibility and financial account opening has been carried out. The Chinese financial account has a high degree of convertibility. The next step of capital account opening will focus on promoting the opening of a few non-convertible items. Before the mid-1990s, due to the shortage of foreign exchange, China has been implementing strict capital controls. In November 1996, after the People's Bank of China announced the acceptance of the eighth clause of IMF, that is, the realisation of current account convertibility, the focus of China's foreign exchange management system reform began to shift to the convertibility of capital account gradually. In the past 20 years, the degree of convertibility of China's capital account has been significantly improved, and many successful experiences have been accumulated in the process of advancing.

In the field of direct investment, since 2002, it has simplified the examination and approval procedures for foreign direct investment projects, simplified the management of foreign exchange settlement under foreign investment, and eliminated the restrictions on foreign mergers and acquisitions of domestic companies in some open industries. Moreover, allowing foreign capital to make strategic investments in domestic listed companies. On the other hand, under the guidance of the "going out" strategy, the authorities also have relaxed restrictions on foreign exchange purchases of foreign direct investment by domestic companies below the quota, simplifying various procedures.

In the field of securities investment, in the first few years, on the one hand, qualified foreign institutional investors (QFII) were introduced into the domestic securities market; on the other hand, through the arrangement of qualified domestic institutional investors (QDII), the insurance and funds were loose to some extent. Banks and other financial institutions, such as overseas securities investment and wealth management. By launching RQFII and RQDII, and implementing many innovative arrangements such as "Shanghai-Hong Kong Stock Connect", "Shenzhen-Hong Kong Stock Connect" and "Panda Bond", the two-way openness of securities investment has also been greatly improved. On the whole, after 20 years of market-oriented reforms, the degree of convertibility of capital accounts has been significantly improved.

The 2015 Belt and Road Development Strategy has once again brought the Chinese economy into close integration with the global economy. The foreign-related operations and global layout of the corporate group are growing at an unprecedented rate.

Taking Haier Group's centralised operation management project of foreign exchange funds as an example, the external policy environment, internal motivation and development status of Haier Group's centralised operation management model of foreign exchange funds were analysed. The following conclusions were drawn:

In the process of implementing globalisation, enterprise groups realise centralised management of capital and financial resources, which has important practical significance for companies to achieve financial cost management and improve management efficiency. In particular, in the implementation of the strategy of “going out” and “going up”, how do Chinese-funded multinational corporations achieve centralized management of cross-border and cross-regional funds of enterprise groups, improve the efficiency of capital use, maximize the value-added of funds, and enhance their Important measures for competitiveness in overseas markets.

Any single centralised management model of funds is difficult to achieve global fund management across the group. For Chinese-funded enterprise groups, the combination of domestic financial companies and overseas treasury centres should be the best model for implementing multinational enterprise groups to implement centralised management of global funds.

7. References

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