

Foreign Exchange Currency - CNY

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Abstract: *This requires traders to convert their currency into the required foreign currency, and then carry out economic activities. The foreign exchange market meets this need and allows international trading of different currencies through this market. In this paper, I will study CNY (renminbi or RMB) and analyze all kinds of economic information about it, and how the trading restrictions and policies affect it on the foreign exchange market.*

Keywords: *Foreign exchange; foreign currency; economic information; market*

1. Introduction

International trade, investment, tourism, and other economic exchanges often need the currencies of different countries to trade. This requires traders to convert their currency into the required foreign currency, and then carry out economic activities. The foreign exchange market meets this need and allows international trading of different currencies through this market. For any specific foreign currency, we can conduct basic research on it and understand different kinds of information about this currency, so that we can successfully use and trade this currency in the foreign exchange market. In this paper, I will study CNY (renminbi or RMB) and analyze all kinds of economic information about it, and how the trading restrictions and policies affect it on the foreign exchange market.

2. Turnover

Turnover is a key indicator to measure currency liquidity. The higher the turnover of a currency, the more active trading in this currency. In the past decade, CNY turnover has been calculated four times. According to BIS statistics, the turnover of CNY in 2010 was about 34 billions of US dollars, or 1%. In 2013, it was 120 billions of US dollars, 2%. In 2016, it was 202 billions of US dollars, 4%. In 2019, it was 285 billions of US dollars, which is also 4% (BIS, 2021). It's no hard to see that the turnover of CYN has increased rapidly over the last ten years. Turnover in 2019 ranks eighth of all currencies. Compared with the top three turnover currencies of USD, EUR, and JPY, the turnover rate of CNY is much lower. Despite this, it is an exciting growth for the CNY because it indicates that the CNY has traded more actively in the foreign exchange market in recent decades.

3. Onshore and Offshore Markets

For onshore and offshore markets, each currency has different rules for its use in its market. Unlike other currencies, there are two kinds of "RMB" used in China. One is for the onshore CNY, the other is offshore CNH. It's unique, but sometimes confusing. CNH and CNY are both called Renminbi, and they also have a 1:1 exchange rate. The only difference is that CNY is used exclusively for onshore and the CNH is for offshore. According to Jonathan Cusimano, the head of FX at Statrys, 2009 is the first year the offshore RMB (CNH) is used to trade freely on an international scale. CNY is controlled by the Chinese government, and the PBOC decides the value. CNH, on the other hand, can not be subject to trading restrictions imposed by the Chinese government. Instead, its value will change along with the fluctuations in the international exchange market (Jonathan Cusimano, 2020). That explains why CNH and CNY have different exchange rates when trading other currencies. Undoubtedly, this is a complicated currency system in China since two types of RMB existed, but in recent years China has gradually opened the use of RMB to trade in the international foreign exchange market.

4. Exchange rate

The exchange rate of a currency is changing all the time. Analyzing the historical changes of the exchange rate can help to forecast the future trend of a specific currency, therefore helps people to trade successfully in the foreign exchange market. The exchange rate of CNY must be paid attention to. Utilizing the data from TRADING ECONOMICS, the USDCNY is about 6.551 right now, and the fluctuation of this exchange rate is very little within a day. In a year, the US dollar against the Chinese yuan is in a downward trend. The exchange rate starts at 7.08 at the end of March 2020, reaches the highest point at 7.18 in May 2020, and then slowly and steadily declined for nine months until mid-February 2021, reached its lowest point at 6.40. Finally, there was a rebound and the exchange rate slowly rose to the current point.



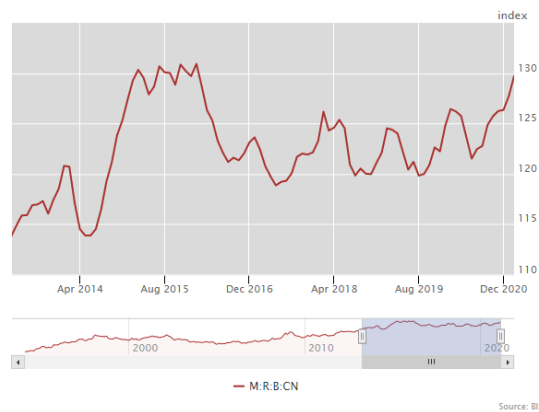
Source: TRADING ECONOMICS

Figure 1

According to the statistics, the average exchange rate of the US dollar to the Chinese yuan in one year is about 6.79 (TRADING ECONOMICS, 2021). The USDCNY is close to this average exchange rate in October 2020. Before that, the exchange rate was once higher than the average exchange rate and has been declining since then. In my perspective, the value of CNY is related to international politics to a certain extent. The depreciation in the second half of 2020 was probably the result of China's response to Trump's economic strategies against China. On the other hand, the recent appreciation of CNY may be caused by the quick economy recovering from the Covid-19 pandemic.

5. Real Valuation

Whether CNY is undervalued or overvalued in recent years has always been a debatable question. Compared with other currencies, the CNY is more likely to be affected by the management of the national government, which means that its value will be less influenced by the behavior of the free market. That is part of the reason why many people have different opinions on the controversy of its real valuation. A weighted real exchange rate index can provide information that help to analyze and determine the real valuation of a certain currency. The BIS real CNY index is shown below.



Source: BIS

Figure 2

As shown in the chart, the real value of CNY has been in a steady range for the past eight years since 2014. In the past two months, its real valuation has continued to grow and nearly reached the top of this range. This trend indicates that the real valuation of CNY should be biased to weaken going forward.

6. Forecasting

The exchange rate of a currency is influenced by many factors. By observing the rate changes in the past, combined with international events that can affect the national economy in specific aspects, we can forecast the value of a currency in the future. I still prefer to use USDCNY to forecast the CNY exchange rate. Looking at the year's chart, despite some inevitable rebound (declined), the USDCNY has shown a slow upward trend beginning at this month. The exchange rate seems to reach its bottom in February, and it might rise slightly in the next few months. The USDCNY may reach 6.60 in the next one-year period. At the same time, the international trading relationship between the United States and China, especially the policy about tariffs targeting imports from China, will depreciate the CNY. If these tariff policies are removed in 2021, the international trading relationship between China and the United States may be improved, thus the CNY value will appreciate. Besides, the technology war between China and the US companies also contributed to the depreciation of CNY from a short-term perspective. I would consider that CNY has a better 5-year outlook compared with USD, EUR, and JPY since China has become the second-large and fastest-growing economy in the world. However, this only indicates that CNY might have a relatively faster growth value compared with the other three currencies. The use of CNY in the international free market is still at an immature stage.

7. Central Bank Policies

For decades, the PBOC has been strictly controlling the CNY exchange rate policy. The main goals of exchange rate policy can be summarized as exchange rate floating based on market supply and demand, maintaining currency stability, promoting economic growth, and balancing international payments (PBOC, 2010). The new currency exchange rate policy takes the market exchange rate as the only standard value of CNY against the currencies of other countries, which makes the supply and demand in the foreign exchange market the main basis for determining the CNY exchange rate.

8. Hedging

It would be a less risky trading strategy to hedge long exposure in CNY for a dollar-based investor. Hedging investment uses the profit or loss in the futures market to offset the profit or loss in the spot market. For export enterprises, orders are mostly made in US dollars, and the appreciation of CNY damage the profits of enterprises. For import enterprises, the depreciation of CNY increases the import costs. Also, the depreciation of CNY directly causes exchange losses for Chinese enterprises investing abroad. The changes in the exchange rate of CNY, whether appreciation or depreciation, will always bring losses to these investors who trade in US dollars. Hedging locks the exchange rate of CNY to a certain extent and effectively minimizes the losses caused by the huge exchange rate fluctuations.

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