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Discussion on the Dynamic Trend of RMB Exchange Rate after the Full Lifting of Epidemic Control

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Abstract: In recent years, the internationalization of the RMB has been steadily advancing, becoming increasingly significant in international trade, investment, payment, and settlement. As one of the world's major payment currencies, the RMB's exchange rate fluctuations have garnered considerable attention since the full lifting of epidemic control at the end of 2022. This paper systematically reviews the changes in the RMB exchange rate post-epidemic control and its potential influencing factors, while also providing an outlook on future research directions.

Keywords: Post-pandemic era, International finance, RMB exchange rate, Exchange rate fluctuations.

1. Introduction

Since the outbreak of the COVID-19 pandemic at the end of 2019, China swiftly implemented a series of epidemic prevention and control measures, including the cancellation of public events, school closures, and workplace shutdowns. The sudden onset of the pandemic and the demand for epidemic prevention supplies undoubtedly impacted both supply and demand in China. In the first quarter of 2020, the agriculture, industry, and service sectors on the supply side, as well as the demand side's consumption, investment, and import and export, were severely affected by the pandemic. Although the epidemic prevention and control measures effectively curbed the pandemic, small-scale infections continued to occur after the resumption of work and production, hindering "revenge consumption" [1]. From 2020 to 2022, the year-end exchange rate changes of the RMB against the US dollar were an appreciation of 6.5%, an appreciation of 2.3%, and a depreciation of 9.2%, respectively. The changes in the RMB exchange rate index against the CFETS were an appreciation of 3.8%, an appreciation of 8.0%, and a depreciation of 3.7%, respectively. After the lifting of epidemic control in 2023, the central parity rate of the RMB against the US dollar experienced appreciation in the first month, followed by a depreciation trend until the end of the year. It is evident that since the lifting of epidemic control in 2023, China has faced the dual pressures of economic recovery and adjustment. The fluctuation of the RMB exchange rate is a crucial indicator guiding the adjustment of China's economic policies. By studying the dynamic changes in the RMB exchange rate, insights can be gained into the direction and adjustment of China's economic policies, providing reference for relevant decision-making, which holds significant theoretical and practical implications. Therefore, this paper will analyze this issue.

2. Domestic Economic Situation after the Lifting of Epidemic Control

In the first quarter of 2023, the impact of the epidemic gradually dissipated, market expectations improved, and the secondary and tertiary industries recovered quickly. However, throughout the year, despite the government's continuous efforts to stimulate the market through tax cuts, fee reductions, and interest rate cuts, the market remained unstable. With the increase in external instability factors, not only did geopolitical risks intensify, but overseas demand also contracted. In the manufacturing sector, due to supply chain disruptions and labor shortages during the epidemic, overall production capacity had not yet returned to pre-epidemic levels, and the external instability also exerted pressure on manufacturing imports and exports.

The author believes that the factors causing the weakness in the import and export industries after the lifting of epidemic control in 2023 may include the following: First, continuous interest rate hikes by major central banks led to a global economic downturn, while the US dollar strengthened, and the RMB depreciated relatively. At the same time, global consumption suppression and tight monetary policy will continue to reduce market willingness to import Chinese goods, leading to weak Chinese exports. Second, after three years of the pandemic, domestic consumers' consumption and investment strategies have become more conservative, tending to hold more savings. Despite the government's continuous efforts to stimulate consumption, consumer confidence relies on profitability and still needs time to recover slowly. Third, the short-term dividends caused by the regional asymmetric shocks of the COVID-19 pandemic have faded. China's outbreak occurred earlier than other countries, and the resumption of work and production also occurred earlier, which increased China's market share of import and export goods. Now that the pandemic has subsided, this dividend no longer has a driving force, and China's market share of export goods will return to pre-pandemic levels.

3. RMB Exchange Rate Fluctuations and Influencing Factors after the Lifting of Epidemic Control

In terms of the RMB exchange rate, after the lifting of epidemic control, the RMB exchange rate experienced significant fluctuations. In 2022, the RMB exchange rate against the US dollar showed a trend of staged stability, rapid decline and depreciation, followed by slow recovery, with the spot exchange rate of the US dollar against the RMB depreciating by 8.2% for the whole year. Especially in

November 2022, the spot exchange rate of the RMB once fell below 7.3, a new low in recent years [2]. As we entered 2023, with the increase in global economic uncertainty, the RMB exchange rate continued to exhibit two-way fluctuations. Although China's economy gradually recovered after the pandemic, the uncertainty of the external environment and the interest rate hike policies of major economies put pressure on the RMB exchange rate. However, with the continuous improvement of China's economy and the inflow of foreign capital, the RMB exchange rate gradually stabilized in two-way fluctuations. Looking back at 2023, the RMB exchange rate against the US dollar showed a wide range of fluctuations overall, while the exchange rate against a basket of currencies remained basically stable. The annual trend can be summarized as rapid appreciation against the US dollar and a steady rise against a basket of currencies from the beginning of the year to early February; range fluctuations against the US dollar and relative stability against a basket of currencies from mid-February to early May; large fluctuations against the US dollar and a steady rise against a basket of currencies from mid-May to the end of October; and a strong trend against the US dollar and stable operation against a basket of currencies from early November to the end of the year [3].

The depreciation of the RMB exchange rate in 2023 may have its unique reasons. Some scholars believe that since March 2022, the Federal Reserve has started the seventh round of interest rate hikes, but the US economy showed strong resilience in 2023, driving the US stock market to grow strongly and hit new highs at the end of the year. In contrast, the performance of the Chinese stock market in 2023 was not as good. the disparity in risk asset returns between the two countries may also lead to short-term securities investment flowing from China to the United States, exacerbating the depreciation pressure of the RMB against the US dollar [4]. The author believes that the significant fluctuations in the RMB exchange rate in 2023 are also linked to widespread liquidity risks in the banking sectors of Europe and the United States. In March 2023, the collapse of Silicon Valley Bank in the United States triggered a bank run, pushing the US dollar index to retreat. Along with the US government debt ceiling issue at the same time, this led to fluctuations in the RMB exchange rate against the US dollar.

From a geopolitical perspective, 2023 was not peaceful. The Russia-Ukraine war brought significant risk aversion sentiment to the global economy and financial markets. The conflict led to rising energy prices, especially fluctuations in natural gas and oil prices, increasing global inflation pressure, which in turn affected the monetary policies of various countries. The Federal Reserve continued to raise interest rates in 2023 to address inflation pressure, strengthening the US dollar and relatively depreciating the RMB. From the supply side, the Russia-Ukraine war also led to global supply chain tensions, especially Europe's dependence on Russian energy, increasing the demand for safe-haven currencies in the Asia-Europe market. At this time, the appreciation of the US dollar reflected its status as a traditional safe-haven currency, while the RMB appreciated against the US dollar from February to March, indicating that the RMB may also begin to exhibit safe-haven currency characteristics, although the specific reasons are still unknown in academia. In fact, the initial safe-haven characteristics of the RMB increased market demand for the RMB as a safe-haven currency during this period, leading to exchange rate fluctuations.

In addition, the Israel-Palestine conflict and its spillover effects on the Red Sea route further exacerbated global supply chain tensions. The Red Sea, as one of the world's most important shipping routes, accounts for about 12% of international trade. The conflict led to increased shipping costs and logistics delays, resulting in rising international trade and commodity prices. In this context, the US dollar, as a traditional safe-haven currency, strengthened, and the RMB faced relative depreciation pressure. Moreover, the supply chain crisis along the Red Sea route directly affected China's import and export trade. Due to increased shipping costs and logistics delays, the competitiveness of China's export goods in the international market was affected, impacting foreign exchange income and the RMB exchange rate. The rising prices of imported goods also increased domestic inflation pressure, further affecting the stability of the RMB.

4. Outlook for Future Economic and RMB Exchange Rate Trends

Looking ahead to 2024 and beyond, the RMB exchange rate trend will continue to be influenced by the global economic environment, China's economic fundamentals, monetary policies, and geopolitical factors.

According to the International Monetary Fund (IMF), the global economic growth rate in 2024 is expected to be 3.2%, the same as in 2023. However, the growth momentum of developed economies and emerging markets will differ. The growth rate of developed economies is expected to increase, while the growth of emerging markets and developing economies may slow down slightly. Global economic uncertainty remains, particularly due to geopolitical risks and trade tensions, which may negatively impact global economic recovery. Meanwhile, China's economy is expected to continue stable growth in 2024. According to a report by the United Nations, China's economic growth rate is projected to be 4.8%, higher than the global average. The Chinese government will continue to implement proactive fiscal policies and prudent monetary policies to support economic growth and stabilize employment. Additionally, China's consumption market and investment demand are expected to continue recovering, especially with policy support and the release of pent-up demand.

From the perspective of global monetary policies, the Federal Reserve continued raising interest rates in 2023 to combat inflation, but it is expected to pause rate hikes or even begin cutting rates in 2024. This will likely exert depreciation pressure on the US dollar, thereby alleviating external pressure on the RMB. Meanwhile, the People's Bank of China will continue to adopt flexible monetary policies to respond to changes in the domestic and international economic environment. The RMB exchange rate is expected to remain basically stable at a reasonable and balanced level and may even appreciate in 2024.

Geopolitical risks remain a significant factor influencing the global economy and the RMB exchange rate. The Russia-Ukraine war has not ended, and the Israel-Palestine conflict continues. These geopolitical upheavals may lead to sustained volatility in global energy prices, thereby impacting the global economy and financial markets. These uncertainties increase market risk aversion, potentially strengthening the US dollar and exerting depreciation pressure on the RMB.

From a domestic market perspective, China is actively addressing risks in small and medium-sized financial institutions and continuously optimizing real estate policies, which will help revive domestic demand. In terms of exports, high-value-added products, led by electric vehicles, are expected to continue bolstering China's export momentum, providing strong support for China's trade surplus. However, the author believes that China's export growth will continue to face challenges in the coming years. High global interest rates are reducing global demand, and post-pandemic adjustments in global industrial and supply chains are beginning to impact China's exports to developed countries. On the other hand, the impact of RMB exchange rate fluctuations on China's import and export trade will be limited. Even if the RMB appreciates, the appreciation will be modest, and the demand elasticity of China's imports and exports is significantly higher than the price elasticity, meaning that changes in internal and external demand have a more substantial impact than exchange rate fluctuations.

5. Conclusion

This paper systematically reviewed the dynamic changes in the RMB exchange rate following the full lifting of epidemic control at the end of 2022, providing an in-depth analysis of the influencing factors and an outlook on future research directions. The study first examined the domestic economic situation post-epidemic control, highlighting the dual pressures of economic recovery and adjustment faced by China. The study found that the significant fluctuations in the RMB exchange rate were influenced by various factors, including the global economic environment, geopolitical events, and domestic economic policies. Key findings include continuous interest rate hikes by major central banks, the strengthening of the US dollar leading to RMB depreciation, and the impact of geopolitical events such as the Russia-Ukraine war and the Israel-Palestine conflict on global supply chains and the RMB exchange rate. Additionally, the study identified domestic factors such as conservative consumption and investment strategies by Chinese consumers and the fading short-term dividends from regional asymmetric shocks caused by the COVID-19 pandemic. These findings are significant for understanding the dynamic changes in the RMB exchange rate and their implications for China's economic policies, providing valuable references for policymakers and researchers. However, this study has certain limitations, including potential biases in data sources and the inability of research methods to fully capture the complexity of factors influencing the RMB exchange rate. Future research could benefit from more comprehensive data collection and the application of advanced econometric models to better understand the underlying mechanisms influencing the RMB exchange rate. In conclusion, this paper provides a comprehensive analysis of the dynamic changes in the RMB exchange rate post-epidemic control, offering valuable insights for policymakers and researchers. Future research should focus on exploring the long-term effects of global economic and geopolitical changes on the RMB exchange rate and developing more robust models to predict exchange rate movements. Additionally, further studies could investigate the potential impact of emerging technologies and digital currencies on the internationalization of the RMB and its exchange rate stability.

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