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EUROSYSTEM

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Comments on Fluctuation and Intervention: The Tale of Two RMB Markets

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Main findings (i)

- **First empirical work on CNH-CNY pricing differential that included the most recent period**
  - Prior work include Funke and others (2015) and Craig and others (2013)
- **Stylized facts on CNH-CNY pricing differentials**
  - In the short run, CNH Granger caused CNY but not vice versa. In the long run, CNH and CNY Granger caused each other
  - Four volatility peaks identified: CNH initialization, Sept/Oct 2011, Aug/Sept 2015, Jan 2016
  - Sharp decline in half-life of volatility shock post Aug 2015
  - Significant leverage effects especially post August 2015
  - A depreciation shock of CNH induced more fluctuation in CNH-CNY pricing differential post Aug 2015

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Main findings (ii)

- **Global and policy effects**
  - Global conditions (US 10-year yield and VIX) affects price differential
  - Volatility of pricing differential increases for all types of reforms: widening of trading bands, capital account liberalization measures and currency reform steps
- **"August 11" exchange rate reform**
  - Temporary and permanent effect on pricing differential: permanently larger pricing differential
  - CNY central parity pricing changed: smaller weight of USD and depending more on previous day price

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What do the results imply?

- **August 11 exchange rate reform has led to permanently larger pricing differential**
  - Policy communication problem?
  - Differences in market expectation?
  - Expectation of continued intervention in CNH market?
- **USD has become less important in the anchor**
  - Important information for markets/investors
  - The authorities have communicated this policy line more recently
- **We should expect more volatility going forward as reform measures continue to be rolled out**

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Policy effects: Measurement challenges (i)

- **Announcement vs. implementation date**
  - The introduction of CIPS was already expected earlier before the launch date of October 2015
  - Shanghai Free Trade Zone was already approved by the State Council in August 2013 before launching in September 2013.
  - The latest exchange rate reforms (August 11 and CFETS RMB index introduction) may be least affected as there were no prior announcements
- **How to capture measures implemented with no announcement?**
  - Tighter capital controls since August 11
- **What about monetary policy measures which affected CNY liquidity?**

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Policy effects: Measurement challenges (ii)

- Not clear why the results on policy effects are different from those of Funke and others (2015)
  - on the effect of capital account liberalization on pricing differential
  - on the effect of global liquidity
  - Policy implications are quite different
- Looking at the effects of related data releases (such as foreign reserve level) or policy communication (PBoC Governor's interview) could be useful

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Implications for fx movement in the future

- **Widened pricing differential post August 2015 to continue?**
  - Different market expectations/responses to policy changes
  - CNH liquidity is key
    - Growing liquidity prior to 2015 with appreciation bet
    - Shrinking liquidity since then plus periodic squeezes
    - CNY may start to lead CNH even in the short run?
- **Further market integration to create more or less volatility?**
  - Market expectation on the authorities' actions/priorities: short-term stability vs. long-term liberalization
  - Prior international experience: more volatility post financial market integration

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