

# **The Renminbi Central Parity: An Empirical Investigation**

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## **Summary**

On August 11 2015, China revamped its procedure of setting the official central parity of the renminbi (RMB) against the US dollar. In essence the new formation mechanism is meant to afford market forces a bigger role in setting the daily official rate.

Our empirical investigation shows that the intertemporal dynamics of China's central parity are not the same before and after the policy change; they are more variable but easier to explain after the policy change. Our results show that the deviation of the RMB offshore rate CNH and the US dollar index are the two factors that help explain changes in the central parity both before and after the policy change. The VIX index has explanatory power before August 2015, but not after.

Since the policy change in August 2015, the RMB onshore rate CNY and the difference between the one-month CNH and CNY forward points have become two additional determinants. If the official fixing is indicative of policy intentions, adjustments to CNH deviations from the fixing, and even to differences between the one-month CNH and CNY forward points and the VIX index, can be interpreted as responses to market forces overseas. We do not find evidence of a role for the RMB exchange rate index (against a basket of currencies) revealed by China in December 2015 in the fixing process. Apparently, the RMB's value tends to follow the general valuation of the US dollar, and the stability of the RMB exchange rate against the US dollar is still the market focus after the 2015 policy change.