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# Currency Peg and Monetary Autonomy in China

## 固定汇率制度与中国货币政策独立性

*Articles in our Policy Forum series are commentaries on current political issues. They reflect the opinion of the authors and – although researched to our best knowledge – are not scientific papers. If there are CFDS papers on related issues, they will be referred to in the text.*

China's external policy features exchange rate targets, capital controls and sterilized interventions. Although constrained by a strictly managed exchange rate, China's monetary policy can maintain considerable independence owing to capital control and sterilization measures.

According to the official announcement in 1994, China established a managed floating exchange rate system based on market supply and demand. But the CNY exchange rate system was never a managed float in its true sense. The authority maintained tight control over the exchange rate and effectively pegged its currency to the U.S. dollar in the following decade. A new round of reform started in 2005, when China moved away from the fixed exchange rate regime and the CNY was allowed to crawl higher. However, this appreciation process stopped after

中国对外政策的主要特点是汇率目标、资本管制和冲销干预。虽然受到严格的汇率管制，中国货币政策仍可以保持相当的独立性，主要原因是资本管制和冲销措施。

根据 1994 年发布的官方公告，中国建立了以市场供求为基础的有管理的浮动汇率制度。但人民币汇率并非真正意义上的管理浮动，在接下来的十年里，人民币实际上是与美元挂钩。2005 年开始了新一轮改革，人民币相对于美元缓慢升值。然而，这一升值过程在 2007 年金融危机后停止，人民币重新盯住美元。自 2010 年下半



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the financial crisis in 2007, and the Chinese Yuan was re-pegged to the U.S. dollar. Again, since the second half of 2010, the CNY has become more flexible, with a gradually expanded fluctuation range centering around 1: 6.5.

The Mundell-Fleming model predicts the trilemma that it is impossible to have fixed exchange rates, an independent monetary policy, and free capital mobility at the same time. Under perfect capital mobility, the UIP (uncovered interest rate parity) condition holds. This means that when the exchange rate is fixed, domestic interest rates move one-to-one with foreign interest rates, so that the central bank loses its monetary autonomy. This prediction is not consistent with the Chinese economy. China's monetary policy maintains considerable independence under a currency peg: the benchmark interest rates in China are adjusted mainly in response to the domestic economic situation.

Capital control is the main reason for China's monetary autonomy under a strictly managed exchange rate. The Chinese government strictly regulates short-term capital flows in and out of the country, although it takes all measures to attract long-term FDI (foreign direct investment). Capital control drives a wedge between domestic and foreign interest rates. The UIP no longer holds, so that the domestic interest rate can be set at a different level from foreign interest rates even when the exchange rate is fixed. In extreme cases such as financial autarky, domestic monetary policy can be conducted independently from the rest of the world (in the sense of targeting inflation only). Therefore, capital control alleviates Mundell's trilemma.

However, capital control is not enough for China's monetary autonomy under the exchange rate misalignment. There are leakages in China's short-term capital account, because a complete ban on private holdings of foreign assets is unrealistic. Moreover, the external economy can still influence the domestic economy through other channels, including the current account, FDI,

年以来，人民币汇率再次变得更加灵活，波动幅度以 1:6.5 为中心逐渐扩大。

基于蒙代尔-弗莱明模型的三元悖论表明：不可能同时有固定汇率、独立的货币政策和自由的资本流动。在完全资本流动的情况下，UIP（无抛补利率平价）条件成立。这意味着，当汇率固定时，国内利率与国外利率一对一地变动，从而使央行失去货币自主权。这一预测与中国经济并不相符。在盯住汇率制度下，中国的货币政策保持了相当大的独立性：中国的基准利率主要是根据国内经济形势进行调整。

资本管制是中国货币政策保持独立的主要原因。尽管中国政府不遗余力的吸引长期外国直接投资（FDI），对于短期资本流动则采取了严格管制措施。资本管制在国内和国外利率之间形成了一个楔子。

UIP 条件不再有效：因此即使汇率固定，国内利率也可以设定在不同于国外利率的水平。在极端情况下，当国内金融市场与国外完全隔离，国内货币政策可以完全独立于世界其他地区（即货币政策只需要对目标通胀进行反应）。因此，资本管制缓解了蒙代尔三元悖论的困境。

然而，仅仅资本管制对于中国的货币自主性是不够的。中国的短期资本账户存在漏洞，因为完全禁止私人持有外国资产是不现实的。此外，外部经济仍然可以通过其他渠道影响国内经济，包括经常项目、外国直接投资等。例如，当人民币被低估时，出口的增加导致经常项目持续盈余。根

etc. For example, when the CNY is undervalued, the increase of exports leads to persistent current account surpluses. According to the compulsory foreign exchange settlement system, domestic firms cannot hold foreign currency revenues. The PBoC (People's Bank of China) should buy them from exporters at prevailing exchange rates to grow its holdings of foreign reserves. Since the purchases are financed by money creation, foreign exchange becomes an essential channel of currency issuance and the overissuance of currency generates inflationary pressure.

This is why sterilized intervention is needed for China's monetary autonomy. Sterilized intervention can be seen as foreign asset purchases financed by domestic bond issuance. The central bank intervenes in foreign asset markets to influence a nation's exchange rate. Meanwhile, it issues short-term central bank bills to absorb the increase of bank reserves caused by its interventions, to the effect of insulating domestic money supplies from the foreign exchange transactions.

The PBoC engages in extensive sterilization activity to maintain the country's closed capital account in the face of persistent current account surpluses. Since the early 2000s, the PBoC has been intervening actively in the foreign exchange markets to prevent sharp appreciation of the CNY. Meanwhile, it resorts to open market operations (OMOs), issuing central bank bills, and raising reserve requirements of banks to manage the country's liquidity situation. The PBoC also relies on unorthodox tools, such as direct control over bank lending and adjustment of retail interest rates. These measures allow the central bank additional flexibility in conducting domestic monetary policy.

Sterilization interventions can resist the overheating pressures triggered by persistent current account surpluses and large-scale capital inflows (mainly FDI). Capital controls enhance the effects of currency interventions. In a complete market model or a world without financial frictions or capital controls (therefore the UIP holds), FX

据强制结汇制度，国内企业不能持有外汇收益，中国人民银行（PBoC）应该以现行汇率从出口商手中购买外汇。这使得国家的外汇储备快速增加；同时，外汇成为货币发行的重要渠道，而货币的过度发行产生了通货膨胀压力。

冲销干预是保持货币政策独立的另一个原因。冲销干预可以看作是通过发行国内债券融资来购买外国资产。中央银行在外汇市场干预，以影响一国的汇率。同时，它发行短期央行票据，以吸收由外汇购买导致的银行准备金增加，从而将国内货币供应与外汇交易隔离开来。

面对持续的经常账户盈余，中国人民银行开展了广泛的冲销活动，以维持中国封闭的资本账户。自本世纪初以来，中国人民银行一直在积极干预外汇市场，以防止人民币大幅升值。同时，它采取公开市场操作（OMOs）、发行央行票据、提高银行存款准备金率等手段来管理国家的流动性状况。中国人民银行还依赖于非正统的工具，如直接控制银行贷款和调整零售利率。这些措施使央行在执行国内货币政策时有了更多的灵活性。

冲销干预可以抵御持续的经常账户盈余和大规模资本流入（主要是FDI）引发的过热压力。资本管制增强了冲销干预的效果。在一个完全市场的经济中，或者在一个没有金融摩擦或资本管制（因此 UIP 成立）的世界中，外汇干预对汇率是没有效果的。所以资本管制与外汇冲销干预缺一不

interventions have no effect on the exchange rate. So both are needed. Capital controls combined with sterilized interventions allow the Chinese central bank to maintain an independent monetary policy.

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可，二者相结合，使中国央行得以维持独立的货币政策。

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