China is in the middle of a push to “internationalize” the renminbi, signified by a successful push to add the currency to the special drawing rights (SDR) basket of the International Monetary Fund (IMF). The international use of China’s currency is rising, although it is still just the fifth most used currency worldwide and represents only around 2.5 percent of global payments, according to the Society for Worldwide Interbank Financial Telecommunication (SWIFT). China’s currency has been all over the news lately for other reasons, from charges of currency manipulation by US presidential candidates to concerns China will significantly devalue its currency in an attempt to boost exports. This series of blog posts begins by examining the overall picture of China’s currency, the renminbi (RMB), followed by posts focusing on whether it is overvalued, where China’s exchange rate policy may go, and offshore trading of the renminbi (CNH).

Background

From 1994 to 2005 the value of the renminbi was pegged to the US dollar. By the early 2000s, charges of manipulating its currency began to grow. In 2005, a soaring bilateral trade surplus with the United States and legislation in the US Congress threatening trade sanctions encouraged the People’s Bank of China (PBoC) to move toward a new foreign exchange policy. At that time, there was widespread agreement that the renminbi was seriously undervalued, leading to cheaper Chinese products in the United States (and elsewhere) and making US products more expensive in China.

The new policy allowed the renminbi to appreciate versus the dollar as the PBoC arbitrarily “fixed” the central parity exchange rate, the starting point for the daily trading of the renminbi to the dollar, and allowed the currency to trade within 0.3 percent of the parity rate (it can now trade within 2 percent of the fixing rate, see figure 1 below). This began a slow, nearly nine-year appreciation of 26 percent versus the dollar, from 8.27 RMB to 6.10 RMB. The currency used to trade more freely within the 2 percent range of the fixing rate; however, since the change in the foreign exchange rate policy in August 2015, the closing price has not deviated very far from the fixing rate.

Figure 1 Renminbi-US dollar exchange rate with trading band
CNY = The abbreviation of China’s currency, the renminbi

Source: Bloomberg.

Foreign Exchange Reserves

How did China’s central bank manage to keep the currency from appreciating too much? By purchasing and hoarding foreign currencies. After China’s entry into the WTO in 2001, the country received trillions of dollars of foreign investment, and all those investors wanted to exchange foreign currency into renminbi. In addition, China had a large annual current account surplus, meaning they were exporting a lot more than they were importing. These two factors put pressure on the renminbi to appreciate in value. The PBoC decided to “print” massive amounts of renminbi to purchase the foreign currencies coming into the country, known as intervening in the foreign currency markets. This is how China’s central bank ended up with $4 trillion worth of foreign exchange reserves.

In 2015, China began to face the opposite problem. Partly because of declining sentiment about the Chinese economy’s health, some investors began to pull money out of the country, converting renminbi into foreign currencies. Also, China’s current account surplus has shrunk since the highs of the mid-2000s. These two factors put pressure on the renminbi to depreciate. So the PBoC began to sell its reserves, to the tune of half a trillion dollars in 2015. It did this in order to keep the renminbi from depreciating too quickly, something welcomed by the US Treasury and others. But China cannot sell reserves
forever. If capital continues to flow out of China, the PBoC would have more limited powers to stop the currency from falling, possibly leading to a devaluation. Still, a devaluation appears unlikely at the moment. Compounding the problems, and adding downward pressure on the renminbi, some speculators try to borrow in renminbi and convert the money into a foreign currency, hoping for a depreciation. But the PBoC made this more difficult by shrinking the amount of renminbi offshore banks have to lend.

**Exchange Rate Policy Changes**

In August of 2015, in light of its campaign to have the renminbi join the SDR basket of the IMF, the PBoC changed its method for setting the daily fixing rate again (the renminbi will enter the SDR basket in October 2016). The policy change, while initially seen as a possible move to a further serious devaluation, only devalued the currency around 2 percent in one day. The policy change encompassed three new measures: The PBoC said it will begin taking into account the previous day’s closing exchange rate, the supply and demand conditions of the foreign exchange market, and the exchange rate movements of other major currencies. Because of the opacity surrounding the central bank’s setting of the “fixing” rate, however, it is difficult to tell whether they are actually abiding by all three rules.

In December 2015, the PBoC announced it will eventually move to manage the exchange rate against a basket of currencies, rather than just the US dollar. This basket will include the dollar, euro, yen, pound sterling, and a few other currencies. While this will further loosen the renminbi’s tie to the dollar, it doesn’t exactly make the renminbi’s exchange rate more market-based. This change has not yet happened, and the PBoC has not indicated when it is likely to make the switch to the basket.

**Renminbi’s Value**

There has been a lot of focus on the renminbi’s bilateral exchange rate with the dollar, which has a huge effect on China’s bilateral trade relationship with the United States. However, the renminbi’s exchange rate versus its main trading partners is actually of greater importance. The Financial Times’ front-page announcement that China’s “currency nears 5-year low” was somewhat misleading.[1] Yes, in January 2016 the renminbi had not been that weak versus the dollar in five years, but it had only depreciated around 7 percent from the dollar since its all-time strongest point in early 2014. The value of the renminbi looks much different when viewed against the currencies of its trading partners, a measure known as the nominal effective exchange rate (NEER). In the past five years, China’s currency in NEER (or trade-weighted) terms has actually appreciated around 25 percent and is currently near its strongest level ever.

**Figure 2 Renminbi exchange rate to US dollar and trade-weighted**
CNY = The abbreviation of China’s currency, the renminbi

Note: NEER is the nominal effective exchange rate, or its trade-weighted exchange rate

Source: Wind Information.


Renminbi Series Part 2: Is China’s Currency Fairly Valued? by William R. Cline | March 23rd, 2016 | 07:00 am

In the US presidential campaigns, both Donald Trump and Bernie Sanders have accused China of currency manipulation and called for penalties in the form of countervailing duties or fees. However, their accusations are out of date. By my calculations, the renminbi has not been undervalued since late 2014, and its undervaluation has not exceeded 5 percent since late 2011. The International Monetary Fund estimates that it has not been undervalued since early 2015. Hillary Clinton is closer to the mark when she uses the past
tense to describe Chinese currency manipulation as something that should not be tolerated.

In its World Economic Outlook of October 2015, the International Monetary Fund projected China’s medium-term external current account balance (on trade and income) at a surplus of less than 1 percent of GDP. On this basis, I once again estimated in my most recent calculations of Fundamental Equilibrium Exchange Rates (here) that China’s currency, the renminbi (RMB), is neither undervalued nor overvalued. (I consider a currency to be undervalued if the country has a current account surplus of more than 3 percent of GDP, and overvalued if it has a deficit of more than 3 percent of GDP). From October to February China’s trade-weighted real effective exchange rate (REER), which measures the strength of the RMB against currencies of all other countries, rose by 3.9 percent, even though its bilateral rate against the US dollar fell by 3 percent. So China’s currency is still neither under- nor over-valued.

My calculations also indicated, however, that the US dollar has become substantially overvalued, and that the medium-term US current account is headed to a deficit of almost 5 percent of GDP. Accordingly, there was a need for the dollar to fall by about 10 percent. Instead, the real effective exchange rate of the dollar has risen by another 8 percent from October to February. As of the October estimates, if (but only if) all currencies appreciated against the dollar by the then-needed 10 percent, the right level for the Chinese currency would have been 5.74 RMB per dollar (compared to 6.35 in October). New estimates would show an even larger needed decline in the dollar against all currencies including the renminbi.

In 2006-07 when China was running a current account surplus of 10 percent of GDP, and was intervening in the exchange market to prevent a more rapid rise in the currency and hence adding to already huge foreign exchange reserves, the “currency manipulation” diagnosis would have been appropriate. However, as shown in figure 1, in recent years China’s current account surplus has been far smaller (and it is projected by the IMF to remain relatively small through 2020, as shown). A major reason is that since 2006, China’s real effective exchange rate has risen by about 50 percent (figure 1), curbing the competitiveness of Chinese goods from levels they otherwise would have reached.
Moreover, as most currency analysts are acutely aware, for the past year there has been a large decline in China’s reserves, from a peak of about $4 trillion to about $3.2 trillion (figure 2). China has been intervening in the foreign exchange market but in the opposite direction from that before: selling dollars in an attempt to keep the renminbi from falling further, rather than buying dollars to keep the it from rising. The need to prop up rather than hold down the renminbi reflects a shift toward large capital outflows (figure 2). These appear to be mainly driven by the changed outlook for the renminbi, from what was previously a one-way bet on appreciation to what has been a risk of depreciation against the dollar. Chinese firms are finding it less attractive to borrow dollars and more attractive to borrow renminbi, given the new risk that repayment in dollars will be more expensive rather than less.

In August, as part of its effort to have the RMB included in the IMF’s Special Drawing Rights basket of major currencies, China moved toward greater market orientation in its daily fixing practices. After an initial decline of the RMB by about 2-3 percent against the US dollar, international fears of a new phase of competitive devaluation by China temporarily triggered turmoil in financial markets. As it has turned out, however, China has not launched a beggar-thy-neighbor currency war. Indeed, from July 2015 to February China’s real effective exchange rate rose by 2.9 percent, even though the RMB fell by 5.2 percent against the surging US dollar.

---

**Figure 1 Real effective exchange rate (REER) of the renminbi and China’s current account surplus**

<table>
<thead>
<tr>
<th>Year</th>
<th>REER</th>
<th>Current Account (right-hand side)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>140</td>
<td>120</td>
</tr>
<tr>
<td>2001</td>
<td>120</td>
<td>110</td>
</tr>
<tr>
<td>2002</td>
<td>110</td>
<td>100</td>
</tr>
<tr>
<td>2003</td>
<td>100</td>
<td>90</td>
</tr>
<tr>
<td>2004</td>
<td>90</td>
<td>80</td>
</tr>
<tr>
<td>2005</td>
<td>80</td>
<td>70</td>
</tr>
<tr>
<td>2006</td>
<td>70</td>
<td>60</td>
</tr>
<tr>
<td>2007</td>
<td>60</td>
<td>50</td>
</tr>
<tr>
<td>2008</td>
<td>50</td>
<td>40</td>
</tr>
<tr>
<td>2009</td>
<td>40</td>
<td>30</td>
</tr>
<tr>
<td>2010</td>
<td>30</td>
<td>20</td>
</tr>
<tr>
<td>2011</td>
<td>20</td>
<td>10</td>
</tr>
<tr>
<td>2012</td>
<td>10</td>
<td>0</td>
</tr>
</tbody>
</table>

Note: REER is the real effective exchange rate, or its trade-weighted exchange rate adjusted for inflation.

Source: IMF World Economic Outlook Database, January 2016.
The US dollar is overvalued mainly because of the new phase of a return to more normal monetary policy and higher interest rates in the United States even as Europe and Japan are moving toward additional monetary easing. The dollar has also risen against commodity-dependent currencies as prices for oil and other commodities have fallen sharply. In short, it would be a serious mistake to blame the strong dollar on currency manipulation by China.

Renminbi Series Part 3: A New Development in Offshore Renminbi
by Joseph E. Gagnon | March 30th, 2016 | 10:31 am

China is continuing to take steps to integrate its financial markets with those in the rest of the world. Already the data suggest changes in the behavior of the offshore renminbi market. It is too soon to know how deep and lasting the changes will be.

Two years ago, Kent Troutman and I wrote a paper showing that the growth of offshore renminbi deposits responded strongly to differences in the foreign exchange value of onshore and offshore renminbi, also known as CNY and CNH, respectively. We believe this response arises from the behavior of Chinese importers and exporters. When CNH is more valuable than CNY, Chinese importers send money to pay for imports in Hong Kong, growing the stock of CNH deposits. When CNY is more valuable than CNH, Chinese exporters take payment in Hong Kong and then repatriate their earnings to the mainland, shrinking the stock of CNH deposits.

Figure 2 China’s net capital flows and foreign exchange reserves

Source: China’s State Administrations of Foreign Exchange (SAFE).

www.piie.com
We observed this relationship over the period from mid-2010 through early 2014 and it held up well for a year and a half after we published our results in May 2014. Since November 2015, however, it seems to have broken down. A possible explanation for this breakdown is intervention by the People’s Bank of China (PBoC) aimed at narrowing the CNH-CNY spread. In February 2016, the PBoC removed all limits on foreign institutional purchases of CNY bonds, which may go a long way toward unifying the onshore and offshore markets.[1] Only time will tell.

The Old Model: A Recap

Capital controls between mainland China and the rest of the world prevent arbitrage that would equalize the CNH and CNY exchange rates.[2] Foreign residents are free to buy CNH but face restrictions in buying CNY. When foreigners are bullish on the future value of CNY, they buy CNH and drive its value to a premium over CNY. Conversely, when foreigners are bearish about CNY, they sell CNH and drive it to a discount below CNY. On average from mid-2010 through early 2014, CNH traded at a small premium of 0.1 percent over CNY (figure 1).

Figure 1 CNH Premium Relative to CNY
August 2010 to January 2016

Until recently, we believe the main arbitrage channel for preventing large and sustained CNH premiums or discounts to CNY was exporter and importer settlement in Hong Kong. When CNH trades at a premium to CNY, a Chinese importer is able to obtain more foreign currency by paying in CNH. The importer transfers a claim on a mainland bank to a Hong Kong bank, which can use it to back a CNH deposit, thereby growing the CNH deposit market. Conversely, when CNH trades at a discount to CNY, a Chinese exporter will be able to get more CNH for a given amount of foreign currency, and thus he will prefer to be paid in Hong Kong. When the exporter repatriates the proceeds to the mainland (which he is entitled to do at par), the Hong Kong bank transfers the funds to a mainland bank and the CNH market shrinks.
The first column in table 1 shows the estimated statistical relationship between the CNH premium and the change in CNH deposits as of two years ago. The constant term and the lag coefficient imply that CNH deposits grow around 2 percent per month even when the CNH premium is zero. A CNH premium of 1 percent further increases the CNH deposit growth rate by more than 13 percentage points, with additional lagged effects in subsequent months. The $R^2$ term shows that the model fits quite well. Figure 2 displays the growth rate of CNH deposits and the fitted values from the model in column 1.

Table 1 Growth of CNH deposits (percent change, monthly rate)

<table>
<thead>
<tr>
<th>Effects of</th>
<th>August 2010 to March 2014</th>
<th>August 2010 to October 2015</th>
<th>August 2010 to January 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>CNH-CNY premium</td>
<td>13.39*** (1.70)</td>
<td>12.17*** (1.38)</td>
<td>9.93*** (1.35)</td>
</tr>
<tr>
<td>Lagged CNH growth</td>
<td>0.46*** (.07)</td>
<td>0.48*** (.06)</td>
<td>0.50*** (.07)</td>
</tr>
<tr>
<td>Constant</td>
<td>1.11* (.62)</td>
<td>1.22** (.45)</td>
<td>1.50*** (.48)</td>
</tr>
<tr>
<td>$R^2$</td>
<td>.83</td>
<td>.82</td>
<td>.78</td>
</tr>
<tr>
<td>Observations</td>
<td>44</td>
<td>63</td>
<td>66</td>
</tr>
</tbody>
</table>

***, **, and * denote statistical significance at the 1, 5, and 10 percent levels, respectively. (parentheses) are standard error. Sources: Bloomberg, Hong Kong Monetary Authority, and author’s calculations.

The second column shows that the model did not change much over the next year and a half. Figure 2 confirms that the model fit well for many months beyond the sample in which it was estimated. The vertical line denotes the end of the original sample period.

However, figure 2 shows that a pronounced gap opened up between the data and the model starting in November 2015. The third column of table 1 confirms that the model coefficients change noticeably when the latest available months (November 2015 through January 2016) are added to the sample period. The coefficient on the CNH-CNY premium drops and the constant rises.
New Developments

In 2015, the PBoC made a highly publicized push to have the renminbi included in the International Monetary Fund’s (IMF) special drawing rights (SDR) basket. The SDR is the unit of account for IMF transactions. Traditionally it is based on the world’s most important and widely traded currencies. Many people in China view inclusion of the renminbi in the SDR as a mark of China’s importance in global trade and finance. The IMF announced in late November 2015 that the renminbi would be included in the SDR basket effective in late 2016.

A key concern expressed by IMF staff in their report on the SDR basket was the CNH-CNY spread. Other currencies in the SDR basket do not have any appreciable spread in offshore versus onshore trading. The IMF report noted that concerns about this spread had been mitigated by the opening of the CNY market to official institutions and foreign exchange reserve managers as of July 2015. In addition, the IMF report noted that “ongoing reforms that promote greater integration between the onshore and offshore markets should reduce the risk of spikes in the spread over time.”

A possible explanation for the breakdown in our model around and after the SDR decision is that the PBoC appears to have intervened in the CNH market to reduce the CNH discount that opened up late last year (figure 1).[4] If the PBoC bought CNH and held on to CNH deposits in Hong Kong banks, this could explain why CNH deposits did not shrink as our model predicted.

In February 2016, the PBoC announced the removal of all restrictions on purchases of CNY bonds by private foreign institutions. This step has the potential to dramatically reduce the CNH-CNY spread. At a minimum, it will make the relationship between the CNH-CNY spread and CNH deposit growth more complicated, as bond investors can now...
arbitrage between the two markets based not only on the CNH-CNY spread but also on the spreads of interest rates across the two markets. China financial watchers have a lot to look forward to in coming months!

Notes

[1] Some observers claim that foreign investors have not been given assurances of complete freedom to exit the market in the future. Such uncertainty would hinder market integration.

[2] As discussed below, this story may be changing, but it correctly describes the situation as of a few months ago.


[4] Another motivation for PBoC intervention besides the SDR-related concern may be that a discount on the currency outside China could be viewed as a sign of an overvalued currency, which could encourage capital outflows.

Renminbi Series Part 4: The Outlook for the Renminbi
by Nicholas R. Lardy | April 2nd, 2016 | 12:06 pm

Some market participants anticipate that the Chinese authorities soon will devalue the renminbi by a large amount or that market forces eventually will force a similarly large depreciation. This narrative is based on several factors. First, China’s growth is slowing, perhaps by more than is revealed in the official headline numbers. Second, export growth turned negative in 2015 and continued to shrink on a year-over-year basis in the first two months of 2016. A large decline in the value of the renminbi, the argument goes, would give exports a shot in the arm and help offset domestic economic weakness. Third, China’s currency has appreciated by 55 percent in real terms against a weighted average of its trading partners’ currencies since mid-2005, when China first introduced flexibility in its exchange rate. The China bears argue that China’s currency is now overvalued and a correction is overdue. Fourth, China’s official foreign exchange reserves are both vastly overstated and falling rapidly because of capital flight that the authorities seem unable to stem. Thus, even if the authorities do not want to devalue, the market will force a capitulation.

This narrative has several fundamental flaws. Start with the exchange rate. Yes, the renminbi has appreciated significantly over the last decade, but that does not support the view that the currency is now overvalued and thus due for a sharp correction. China’s currency was massively undervalued in the mid-2000s and the cumulative real appreciation since then led the International Monetary Fund (IMF) to judge in 2015 that the exchange rate is at a level “that is no longer undervalued.” My colleague William Cline, in an earlier post in this series, reaches the same conclusion.
Moreover, there is not much evidence that renminbi appreciation has undermined China’s global competitive position. Yes, China has lost market share in recent years in some of the most labor-intensive commodities, such as footwear and garments, but it has successfully moved up the value chain into higher value-added products and, as a result, according to the World Trade Organization (WTO), its share of global exports measured in constant prices continued to expand through early 2015. In value terms in 2015 China’s share of global exports was 15 percent, up from 6 percent in 2004 (before the currency began to appreciate), and up from 4 percent in 2001, when it joined the WTO. Yet another indicator pointing in the same direction is that China’s current account surplus in 2015 was almost $300 billion, the largest of any nation (though not the largest as a share of GDP).

Another flaw in the “depreciation is inevitable” is that China is running out of foreign exchange reserves. According to Kyle Bass, a prominent hedge fund manager, China’s official reserves at the end of January this year were only $2.2 trillion to $2.3 trillion, not the advertised $3.2 trillion. Most of Bass’s downward adjustment to the value of China’s reported foreign exchange holdings is based on the assumption that a large part of these reserves has been allocated to China’s sovereign wealth fund, the China Investment Corporation (CIC), and to the recapitalization of the government’s three policy banks. This assumption is simply incorrect. Detailed analysis by UBS, conducted a half year before Bass’s claim, showed that the government’s use of foreign exchange reserves to fund CIC, to recapitalize policy banks, and other official initiatives was reflected in a reduction in headline foreign exchange reserves.

Even if the official reserve numbers are not overstated, aren’t the amounts falling rapidly and doesn’t this reflect “panicked mainlanders desperately seeking ways to get money out of the country”? The first thing to note is that a chunk of the decline in official foreign exchange reserves reflects valuation changes. China’s official foreign currency reserves include financial assets in a variety of currencies, but their value is reported in US dollars. Since the US dollar began to appreciate against these currencies (think euro, yen, sterling, etc.) starting in late 2011 and continuing until very recently, the value of these nondollar assets measured in dollars has been going down. In 2015 the headline decline in official foreign exchange reserves was $513 billion. But UBS estimates that $130 billion of this decline, or fully one-quarter, reflects this valuation effect rather than an actual outflow of reserves.

Second, a large part of the reduction of reserves reflects Chinese corporates repaying foreign currency debts and foreigners reversing carry trades—both primarily as a result of a change in exchange rate and interest rate expectations. Because interest rates were lower offshore, because of monetary policies of central banks in advanced economies, and because the renminbi had appreciated steadily against the US dollar from 2005 through 2013, a growing number of Chinese corporates borrowed money offshore and then converted the funds to renminbi needed in their onshore businesses. They saved on interest expenses and figured on additional gains when they converted renminbi to dollars at a more favorable rate in the future when the loans came due. As a result, the Bank for International Settlements reports that cross-border claims by foreign banks on Chinese counterparties resident in China reached a peak of $1.1 trillion at the end of the third quarter of 2014, roughly double the amount at the end of 2012. But once the expectation of these corporates that the renminbi would continue to appreciate eroded, and the possibility that the end of quantitative easing by the US Federal Reserve would be followed by rising interest rates offshore, Chinese corporates began to repay this debt. By the end of the third quarter of 2015 (the most recent data available), cross-border claims...
had fallen by $235 billion to $875 billion. This reduction is recorded as a capital outflow, but it should not be regarded as capital flight. Most importantly, repayment of this foreign debt leaves China’s net international financial position completely unchanged. The foreign currency assets of the central bank, which supplies the foreign exchange to the corporates in exchange for domestic currency, fall. But the foreign currency liabilities of the corporate sector are reduced by an identical amount. Attention in most press treatment of this topic is exclusively on the fall in the foreign exchange assets of the official sector; a completely offsetting decline in the foreign currency liabilities of Chinese corporates is not mentioned.

The same analysis applies to the so-called carry trades of foreign investors. They brought foreign currency into China and converted it to renminbi, in the process swelling China’s official foreign exchange reserves. They deposit the renminbi in bank accounts in China or buy renminbi-denominated bonds, which pay higher interest than bank deposits or bonds available offshore, and hope to benefit from the renminbi appreciation as well. As the expectations of these foreign investors began to change, with respect to both the continued appreciation of the renminbi and the favorable interest rate differential, they began to repatriate these funds. Again while this is recorded as a capital outflow, it should not be regarded as capital flight and has no effect on China’s net international investment position. The foreign currency assets of the central bank are reduced, as it supplies foreign currency to the investors in exchange for their renminbi, but the foreign liabilities of domestic banks are reduced by an identical amount.

How large a contribution to the reduction of China’s official reserves have these two types of transactions made? According to an estimate of Oxford Economics, repayment of foreign currency loans by Chinese corporates and the repatriation of foreign inflows in the third quarter of 2015 accounted for 53 percent of China’s net financial outflows, which were $228 billion after adjusting for valuation change.3 These flows are likely to diminish going forward because a growing portion of cross-border claims by foreign banks on Chinese counterparties has already been repaid and the stock of foreign financial capital in China available to repatriate is relatively small.

Another large chunk of outflows, about 31 percent of net financial outflows in 2015Q3, reflected higher foreign currency loans to foreign entities. These loans are extended primarily by China Development Bank, China’s main policy bank, or other state-owned banks, which acquire the foreign currency in the foreign exchange market with the funds coming from the central bank. These transactions too have no effect on China’s net international investment position. The central bank’s foreign exchange assets fall, but the foreign currency assets of domestic banks rise by a similar amount. A substantial share of these loans appears to be extended to advance China’s foreign policy objectives. The authorities can easily dial back the volume of these foreign currency loans should it be necessary.

The remaining source of outflows is primarily the increase in foreign deposits and foreign currency acquired by Chinese citizens and corporates and the overinvoicing of exports, which is usually reflected in errors and omissions in the balance of payments. These are more difficult to control, but if necessary the Chinese authorities could reduce or even suspend the right of every citizen to acquire $50,000 worth of foreign currency annually in exchange for renminbi.
In short, capital outflows are not as large as the headline numbers suggest, and a large share of these outflows reflects changes in exchange rate and interest rate expectations of Chinese corporates or foreign investors or the foreign policy objectives of the Chinese government, rather than a rush for the exits for fear of a hard landing. Reserves are large and highly liquid and continually replenished by large current account surpluses. And the authorities have ample tools to limit the sources of outflows that are not already largely self-limiting. Thus the likelihood that the Chinese authorities will devalue the renminbi or that market forces will force a large depreciation seems small.