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The PBC Spokesman Answered Press Questions on Improving Quotation of the RMB Central Parity

1. Why choosing the current time to improve quotation of the central parity of RMB against US dollar?

Currently, the international economic and financial conditions are very complex. The U.S. economy is recovering and markets are expecting at least one interest rate hike by the FOMC this year. As such, the U.S. dollar is strengthening, while the Euro and Japanese Yen are weakening. Emerging market and commodities currencies are facing downward pressure, and we are seeing increasing volatilities in international capital flow. This complex situation is posing new challenges. As China is maintaining a relatively large trade surplus, RMB's real effective exchange rate is relatively strong, which is not entirely consistent with market expectation. Therefore, it is a good time to improve quotation of the RMB central parity to make it more consistent with the needs of market development.

Since the reform of the foreign exchange rate formation mechanism in 2005, the RMB central parity, which serves as the benchmark of China's exchange rate, has played an important role in market expectation and stabilizing RMB exchange rate. Recently, however, the central parity of RMB has deviated from the market rate to a large extent and with a larger duration, which, to some extent, has undermined the market benchmark status and the authority of the central parity. Currently, the

foreign exchange market is developing in a sound manner, and market participants are increasingly strengthening their pricing and risk management capacities. The market expectation of RMB exchange rate is diverging, and the preconditions for improving quotation of the RMB central parity are becoming mature. Improving the market makers' quotation will help enhance the market-orientation of RMB central parity, enlarging the operation room of market rate and enabling the exchange rate to play a key role in adjusting foreign exchange demand and supply.

2. Why did the central parity of RMB against US dollar of 11 August change by nearly 2% compared to that of 10 August?

We noticed that the central parity of RMB against US dollar of 11 August changed (in the depreciation direction) by nearly 2% compared to that of 10 August. The following two factors may be relevant. First, after the improvement of the quotation of the RMB central parity, the market makers may quote by reference to the closing rate of the previous day and, therefore, the accumulated gap between the central parity and the market rate received a one-time correction. Second, a series of macro economic and financial data released recently made the market expectation diverge. Market makers paid more attention to the changes of market demand and supply. Compared with the closing rate of 6.2097 Yuan per dollar in the previous day, today's central parity depreciated by about 200 bps. The market still needs some time to adapt. The PBC will monitor the market condition closely, stabilizing the market expectation and ensuring the improvement of the formation mechanism of the RMB central parity in an orderly manner.

3. RMB exchange rate reform: what's next?

Next, the reform of RMB exchange rate formation mechanism will continue to be pushed forward with a market orientation. Market will play a bigger role in exchange rate determination to facilitate the balancing of international payments. Foreign exchange market development will be accelerated and foreign exchange products will be enriched. In addition, the PBC will push forward the opening-up of the foreign exchange market, extending FX trading hours, introducing qualified foreign institutions and promoting the formation of a single exchange rate in both on-shore and off-shore markets. Based on the developing condition of foreign exchange market and the macroeconomic and financial environment, the PBC will enhance the flexibility of RMB exchange rate in both directions and keep the exchange rate basically stable at an adaptive and equilibrium level, enabling the market rate to play its role, and improving the managed floating exchange rate regime based on market demand and supply.

Currently, under the complex international economic and financial condition, we are seeing increasingly large and volatile cross-border capital flow. As such, the PBC and SAFE will strengthen the examination of banks' FX transactions according to relevant laws and regulations, adopt effective measures to fight money laundering, terrorist financing and tax evasion activities, and improve the monitoring of suspicious cross-border capital flow. The PBC and SAFE will severely punish illegal FX transactions, including underground banks, and maintain a compliant and orderly capital flow.

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