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Review Article

Chinese Yuan Per SDR During Covid-19

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Abstract

In this paper, author seeks to explore the dominant determinants that would influence the behaviour of Yuan per SDR especially during the period of Covid-19 from 2020m_1 to 2021m_7 since Yuan enters into the SDR basket from October 2016.Author selected three dimensions such as dominant macro variables, exchange rates and important capital market indicators. The paper found that Yuan/US$ had great influence on Yuan per SDR rate, export, import and foreign exchange reserves which affected Yuan per SDR rate and market capitalization, number of listed companies, Shanghai Composite Index and interbank lending trading volume have significant impact on the Yuan per SDR during the specified period. The paper focus on the policies of capital account convertibility, exchange rate stability, more participation in interbank lending, balance the onshore and offshore RMB market, and strengthening capital market of China.

Keywords: *Yuan Per SDR; Internationalization of Yuan; Multiple Regression; CUSUM of Squares; Correlation Matrix; Seasonal Variation*

JEL Classification Codes:C13, C22, F31, G15

Introduction

Chinese Yuan had been taken in currency basket of SDR by IMF since 1/10/2016 which was recognized as the greatest achievement of Chinese economy in the international monetary system and international capital market too where Yuan can be treated now as international currency in case of international payment mechanism. Presently, SDR currency basket consists of five currencies, US$, Euro, Yuan, Yen and Pound Sterling in which the weights of the currencies are 41.73,30.93,10.92,8.33 and 8.03 respectively and their respective fixed unit of currencies are 0.5825,0.3867,1.0174,11.900, and 0.0859 where exchange rate with respect to US $ as on 1st September,2021 are 1.0,1.182,6.46070,110.295, and 1.37610 respectively showing 1SDR=1.423240 US$. The value of SDR is set daily based on a basket of 5 major international currencies like US$(42%), Euro (31%), Yuan (11%), Yen (8%) and Pound Sterling (8%) respectively. After inclusion of Chinese Yuan into the SDR basket, IMF advised China to strengthen its Yuan in international respect to improve exchange rate stability, price stability, capital market improvement and international trade shares and market capitalization etc. Since the inclusion period and as of now, Chinese international GDP share stood 17.31%-the second largest, the share of international liquidity excluding gold is 25.64%-the largest share, the international export share is 13.23%-the second largest share in 2019.The indicators of capital market such as equity finances, turnover of trading, market capitalization, number of listed companies and Shanghai Composite index had been

improving during $2020m_1$ to $2021m_7$ i.e., the period of covid-19 although the interbank lending trading volume has been decreased too which is not quite healthy situation. But the macroeconomic indicators had been increased too with a marginal fall in the beginning of covid-19. In case of FDI inflows and outflows of China in 2019, it is the third largest recipient and supplier of FDI in the world. The World FDI inflows fell down by 7% in 2020 with respect to 2019 whereas Chinese FDI inflows increased by 6% during that period. Peoples Bank of China (2021)released that RMB ,as of 2021June,had appeared as the fifth most active currency for home and international payments by value showing a share of 2.5%.As on $2021Q_1$,RMB assets share of official foreign reserves held by central banks increased to 2.45%.The average yield of China's 10 year government bonds stood 3.27% as against 1.36% of USA and -0.31% of Germany up to $2020Q_4$.Foreign central banks hold Chinese bonds 263.7 billion US$ in last five years which is 51% of all foreign institution's holdings.

So, there is ample scope to discuss the impact of such indicators on the Yuan SDR exchange rate to hike the weight of the Yuan in IMF.

Review of Literature:

Bhowmik (2016a) measured the weights of basket currencies in SDR through alternative indicator like share of international trade as percent of world trade (i.e., export plus import as percent of world trade) or the share of international trade as percent of world GDP (i.e., export plus import as percent of world GDP) and found that the weight of Euro became 44.96% followed by Yuan 21.16%, US$ 19.89%, Yen 8.87% and Pound Sterling 6.09% respectively. Author also believed that SDR payment mechanism would be more equitable if other dominant currencies were included in the basket. Also, Bhowmik (2016b) expressed that the future of Yuan as an international currency is brighter than US$ and Euro. It is expected that the multipolar international monetary system can produce more stability than the unipolar system and reduces currency war. If the reform measures on Chinese Yuan were done through capital account convertibility, capital market reform, introduction of freely floating exchange rate, good management of offshore and onshore bond market, proper utilization of foreign direct investment, equity flows, interbank lending, then the Yuan may be a dominant player under a three polars of international monetary system.

Harrison and Xiao (2018) prescribe that China should use SDR widely in the transactions of government, firms, and individuals that can benefit to reduce dollar related imbalances and even China can incorporate SDR into capital account opening for state, local government, firms, institutions and individuals and thereby can set up clearing window for SDR. Moreover, Harrison and Xiao (2019) recommended that China can take unilateral initiative to promote SDR and proposed to introduce cryptocurrency version of SDR which may provide risk mitigating control and transparency. Even, China can open capital account convertibility for wider use of SDR along with its digital currency. Authors had encouraged the initiative of Peoples Bank of China which had rightly recommended swap agreements with other 36 central banks and that policy could enhance the bilateral trade of China with them. They congratulated Hongkong Monetary Authority which attempted to start RMB's real time gross settlement system and Shenzhen Financial Settlement System which would promote RMB internationalization. Zhao (2019) thought that RMB inclusion in SDR basket can accelerate RMB internationalization, reduce cost of overseas financing and help to build a new order of international monetary system. Even, it can stabilize RMB value, get involvement in global financial crises and so on. Since, the rise of interest rate of SDR happened due to improvement of global economic situation so that policies of interest rate variation of peoples Bank of China are the crucial tasks towards monetary stability in home and abroad.

Chen (2021) showed that during pandemic from $2020m_4$ to $2021m_6$, Chinese 10-year bonds revived to 3.1% from a low of 2.4% through the policy of safe haven approach by Peoples Bank of China. Author observed that

the annualized returns of China's government bonds recorded as 3.6% and annualized standard deviation was 3.2% and risk adjusted return was 1.11% during $2010m_1$-$2021m_2$ as against US treasury bonds of 3.3%,4.5% and 0.72% for those indicators. The low correlation of weekly local bond market return of China with India, USA, Germany, Japan and UK were found as 0.12,0.22,0.20,0.14 and 0.21 respectively during $2010m_1$-$2021m_2$.Author prescribed that China's onshore bond market finds opportunities for global investors to add diversification and return potential to their portfolios but market is not without risk so that China should consider carefully to avoid a policy cliff and ensure market stability.

Amstad and He (2019) verified that 54% of the corporate bond outstanding in China enjoys an AAA rating as against 6% in the U.S. corporate bond market by the end of 2018 where 23% bond is AA+, another 19% bond is AA rated and only 2% bond are rated as AA- and below. Of the Chinese corporate issuers, 14% hold an AAA rating, 19% an AA+ rating and 41% an AA. On the contrary, presently, Chinese bond credit rating given by S&P is A+ and A1 and A+ are given by Moody's and Fetch agencies.

It was found that the yield returns of bond for one month of Shanghai Composite Index was 4.41% in comparison to 5.76% for 6 month and 21.94% for 2-year bonds. Moreover, its index stood high at 3474.92 in 2020, December 31 which increased to the high of 3731.69 on 2021, February 18 in comparison to its low of 2646.80 on 2020March 19 which rose to 3312.72 on 2021, July 28(Money Control, 2021).

Cheng (2020) described that more than 1100 new mutual funds have launched in China whose total values amount to 373.1 billion US$ which was possible as a result of lower interest rate, changes in Chinese investor preferences and other new regulations. From 2017, Chinese mutual funds have been accelerating because of easing monetary policy, free capital movement, unregulated shadow banking during the pandemic.

In the recent position of foreign direct investment of China, World Investment Report (2021) released that total FDI inflows of China stood 149.342 billion US$ in 2020 with respect to 6% increase from the previous year where FDI stock reached to 1918 billion US$ in 2020 which is the second largest recipient. But the total outflow of FDI of China was mentioned as 132.940 billion US$ in 2020 where China is now considered as the donor of FDI. The FDI inflows accelerated especially in technology related industry. It is to note that the index of transfer transparency is 10.0 for China as against 7.4 of USA, but the index of share holders' power of China is 5.0 as against 9.0 of USA.

Objective of the paper

The paper endeavors to find out the specific roles of Chinese capital market especially, equity financing, turnover of trading, market capitalization, stock market, interbank lending and yuan exchange rate, and other macro variables like GDP, inflation, export and import of China etc. on the exchange rate of Yuan per SDR during the pandemic from $2020m_1$ to $2021m_7$.How much Chinese economy was affected by the entry of Yuan into SDR basket is the focus of the paper as an impact of Covid-19. What are the respective policies that may led to leading role of RMB in the international monetary system is the other theme of the paper.

Research Methodology:

Monthly data of Chinese Yuan per SDR, Yuan per US$, Foreign exchange reserves excluding gold (in billion US$),interbank lending in total trading volume(unit 100 million Yuan),Equity financing (unit 100million Yuan),China's turnover of trading(unit 100 million Yuan),Total market capitalization at the end of the period(unit 100 million Yuan),Total listed companies at the end of the period, Shanghai Stock Exchange Index, etc. have been collected from the Peoples Bank of China. Chinese monthly export and imports data in billion US$ have been collected from Business Data Platform (No, 1).The data on monthly Real Effective Exchange Rate with 2010=100 ,monthly Consumer Price Index (% change with previous year),monthly GDP normalized index were collected from the Federal Reserve Bank of St. Louis. The data on monthly Nominal Effective Exchange

rate have been collected from the Bank of International Settlements.

The semi-log linear model and semi-log non-linear model have been used to find the linear trend to show the growth rate per year, and non-linear trend was shown to clarify its different phases. The seasonal variation is verified by finding autocorrelation and partial autocorrelation functions. The estimate of Multiple regression technique has been applied to find the relationships among the variables. The residual test for stability is done using CUSUM and CUSUM of squares findings. The residual test for justifying serial correlation is achieved by taking Breusch-Godfrey LM test technique. The correlation matrix is used to explain cross correlation among the said variables.

Observations of the models

The growth rate of Yuan per SDR has been observed from the linear trend line during $2020m_1$ -$2021m_7$ that is shown below.

$$\text{Log}(y)=2.28402-0.003379t+u_i$$
$$(389.90)^* \quad (-6.57)^*$$

R^2=0.717, F=43.25, DW=0.58, *=significant at 5% level, y=Yuan per SDR, n=19

It states that the Yuan per SDR had been falling at the rate of 0.3379% per year during the study period which implies that in terms of SDR, the Yuan is appreciating compared to 0.6234% appreciation of Yuan in terms of US$.

Actually, the trend line of Yuan per SDR from $2020m_1$ to $2021m_7$ is cubic in nature where its first phase is increasing followed by declining trend and then it turns into upswing in which all its coefficients are significant for t statistic with high R^2 and DW and significant F in the estimated equation.

$$\text{Log}(y)=2.2401+0.01645t-0.00212t^2$$
$$(282.47)^* \quad (4.91)^* \quad (-5.53)$$
$$+6.40e^{-05}t^3+ui$$
$$(5.06)^*$$

R^2=0.918, F=56.72*, DW=1.56, u_i= random error, n=19, *=significant at 5% level.

In Figure 1, the fitted trend line of Yuan per SDR has been depicted along with the actual and residual series from $2020m_1$ to $2021m_7$ and it looks like a horizontal inverse S curve.

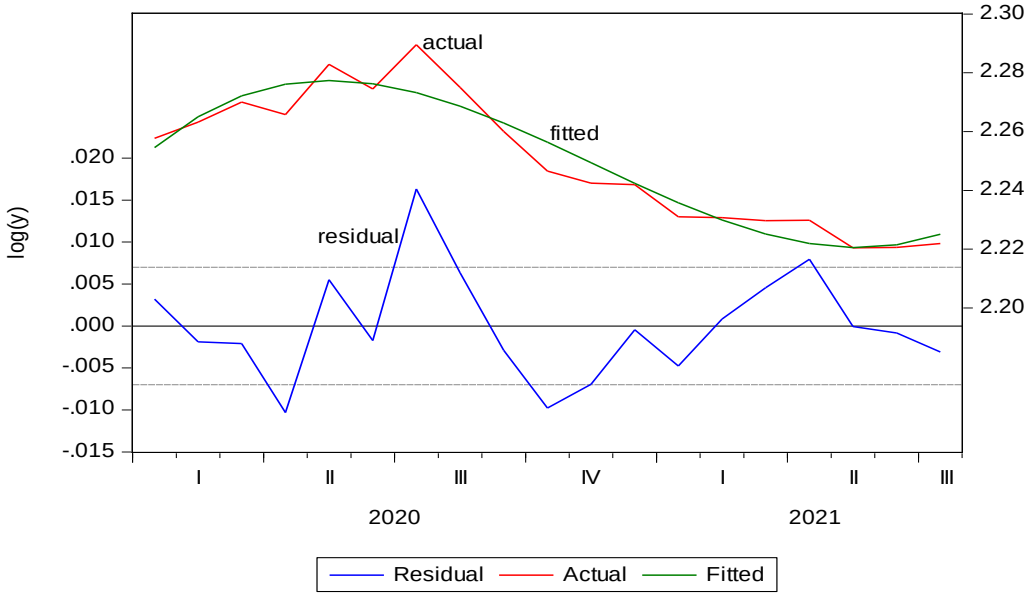


Figure 1: The Trend Line of Yuan Per SDR
Source: Plotted by author

This nonlinear trend line of Chinese Yuan per SDR exchange rate is seen as a stable model because the line of CUSUM of squares of the residuals goes between the ±5% significant level which is observed in Figure 2 below.

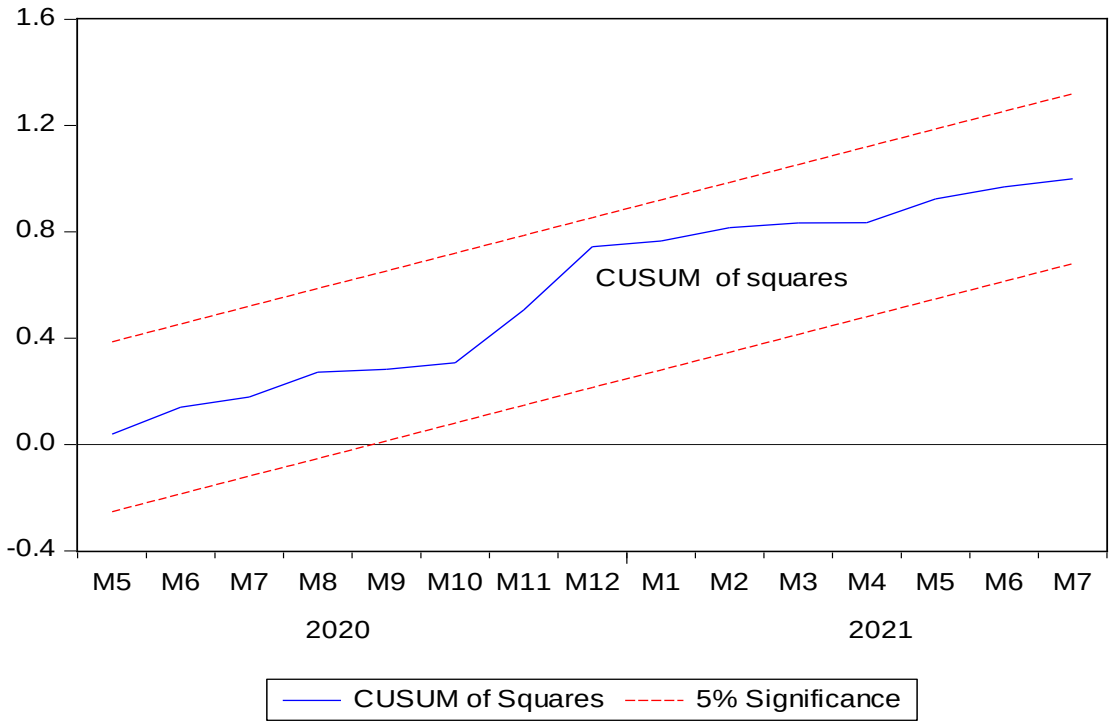
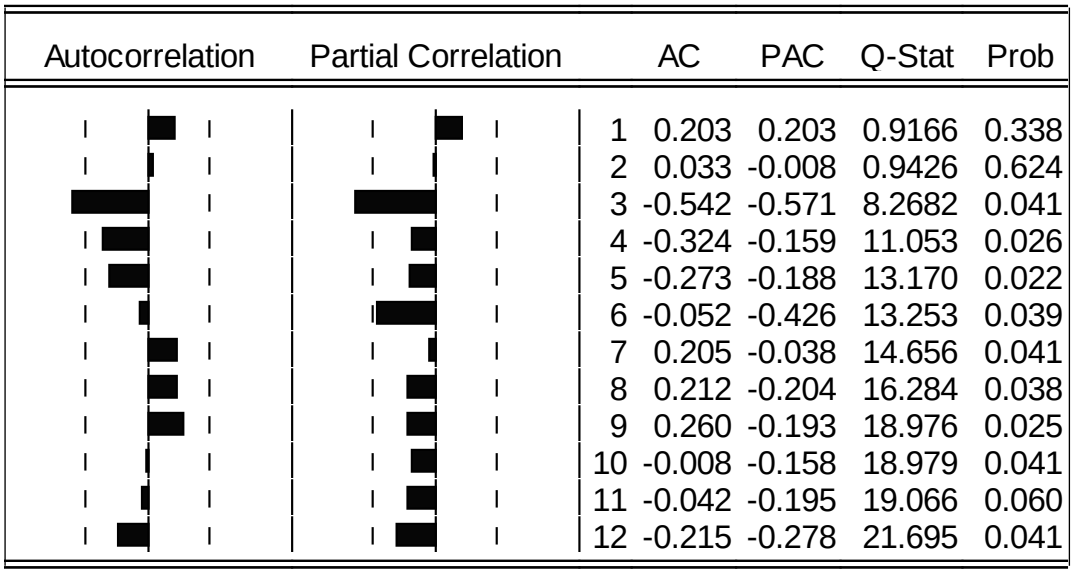


Figure 2: Stability of the Model
Source: Plotted by author

The nonlinearity of the trend line is consistent with the seasonal variation property which is verified by the patterns of autocorrelation and partial autocorrelation functions which are showing both positive and negative values and most of the Q stat are significant at 5% level. All these have been observed in the Figure 3.



	AC	PAC	Q-Stat	Prob
1	0.203	0.203	0.9166	0.338
2	0.033	-0.008	0.9426	0.624
3	-0.542	-0.571	8.2682	0.041
4	-0.324	-0.159	11.053	0.026
5	-0.273	-0.188	13.170	0.022
6	-0.052	-0.426	13.253	0.039
7	0.205	-0.038	14.656	0.041
8	0.212	-0.204	16.284	0.038
9	0.260	-0.193	18.976	0.025
10	-0.008	-0.158	18.979	0.041
11	-0.042	-0.195	19.066	0.060
12	-0.215	-0.278	21.695	0.041

Figure 3: Seasonal Variation Verified by AC and PAC
Source: Plotted by author

From the macroeconomic point of view, the dominant determinants of the Chinese Yuan per SDR from $2020m_1$ to $2021m_7$ during the pandemic are assumed as the export (x_1 in

billion US $), import ($x_2$ in billion US$), inflation rate ($x_3$ in % change of CPI), GDP (x_4 in normalised for China index) and the total foreign exchange reserves excluding gold (x_5 in billion US$). The traditional method of multiple regression analysis showed that the Chinese export is positively related with Yuan per SDR and import and foreign exchange reserve are negatively related with Yuan per SDR significantly. But the positive relation between inflation rate and Yuan per SDR is insignificant and the negative relation between GDP index and Yuan per SDR is also insignificant. On the other hand, the export, import and foreign exchange reserves helped to hike the values of the exchange rate whereas inflation rate showed in significant with favourable impact on the exchange rate.

Similarly, GDP index had enough favourable impact on the Yuan SDR exchange rate although it is found as insignificant.

The estimated regression equation is given below.

$y=18.263+0.0038x_1-0.0045x_2+0.0157x_3$

(5.36)* (2.380)* (-2.46)* (0.60)

$-0.02806x_4-0.0019x_5$

(-1.62) (-1.94)*

$R^2=0.77$, F=8.72*, DW=0.87, SC=-0.84,

AIC=-1.14, *=significant at 7% level.

n=19.x_1=export, x_2=import, x_3= inflation rate, x_4=GDP index, x_5=forex reserves

This estimated model is stable since the line of CUSUM of residuals runs through the ±5% significant level which is depicted in Figure 4.

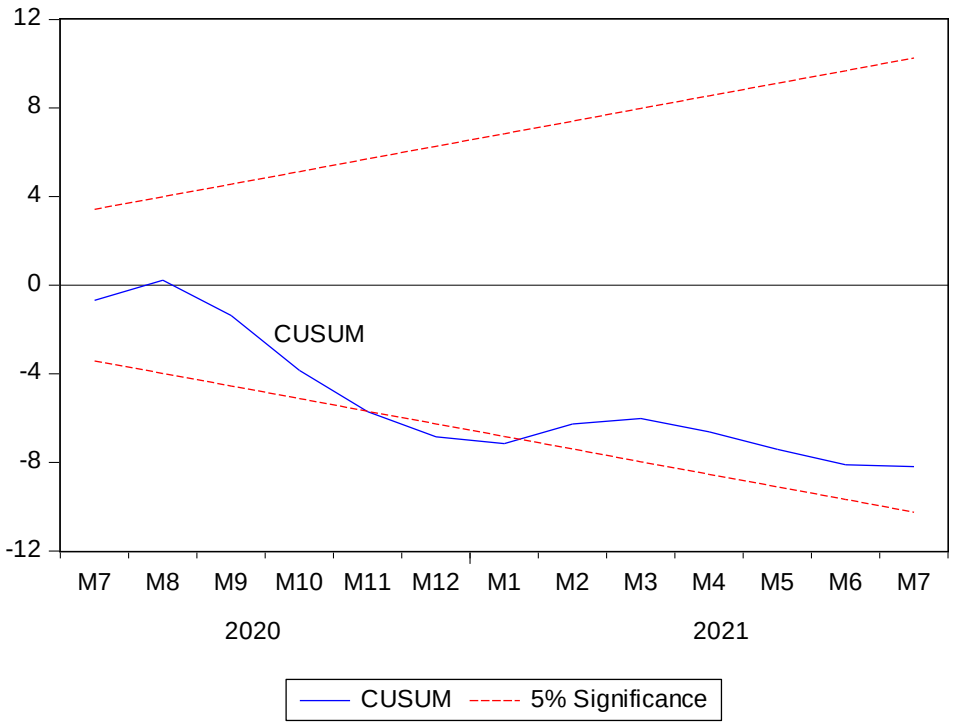


Figure 4: *Stability of the Estimated Relation*

Source: Plotted by author.

The residual test for serial correlation measured by Breusch-Godfrey LM test showed that the residuals have serial correlation since the test found that $nR^2=5.363010$ whose probability of Chi-square (1)=0.0206 at H0 where F=4.719231 whose probability of F(1,12) =0.0506, so that H0 is rejected for no serial correlation.

The cross correlations among the macro determinants and Yuan per SDR are all negative except with inflation rate and all are very high. The values are given below in Table1.

Table 1: Cross Correlation Among Yuan Per SDR and Other Macro Determinants

	x_1	x_2	x_3	x_4	x_5	y
x_1	1	0.79645	-0.70840	0.90491	0.70526	-0.52873
x_2	0.79645	1	-0.64030	0.73073	0.77424	-0.76538
x_3	-0.70840	-0.64030	1	-0.67940	-0.73523	0.61848
x_4	0.90491	0.73073	-0.6794	1	0.63940	-0.5835
x_5	0.70526	0.77424	-0.73523	0.63940	1	-0.77444
y	-0.52873	-0.76538	0.61848	-0.58350	-0.7744	1

Source-Calculated by author.

Das (2019) clarified that the central parity of RMB/US$ during trading day and over- night with the adjustment of changes in currency basket has impact on the cross rates in basket currencies. RMB's appreciation and depreciation have counter cyclical adjustment factor that influences the rates in SDR basket. Thus, in this paper, the behaviour of exchange rate of Chinese Yuan is rather mixed in which Yuan per SDR is significant positive relation with Yuan per US$ in comparison to negative insignificant relation with NEER and REER of Yuan during the study period from 2020m_1 to 2021m_7.It implies that Yuan depreciation and appreciation is aligned with US$ but it has the same relation with NEER and REER where both appreciated during covid-19.However,the regression is found with high R^2 and DW with significant F value. The estimated regression equation is given below.

$y=11.11075+0.4656y_1-0.0157y_2-0.0234y_3+u_i$

(4.41)* (3.51)* (-1.42) (-1.66)

$R^2=0.938$, $F=76.217$*, $DW=2.13$, *=significant at 5% level, n=19, y_1=Yuan per US$, y_2=REER, y_3=NEER, u_i=random error This model of relationship is a stable one because line of CUSUM of squares of the residuals passes through the lines of significant level of ±5% which is seen in the Figure 5.

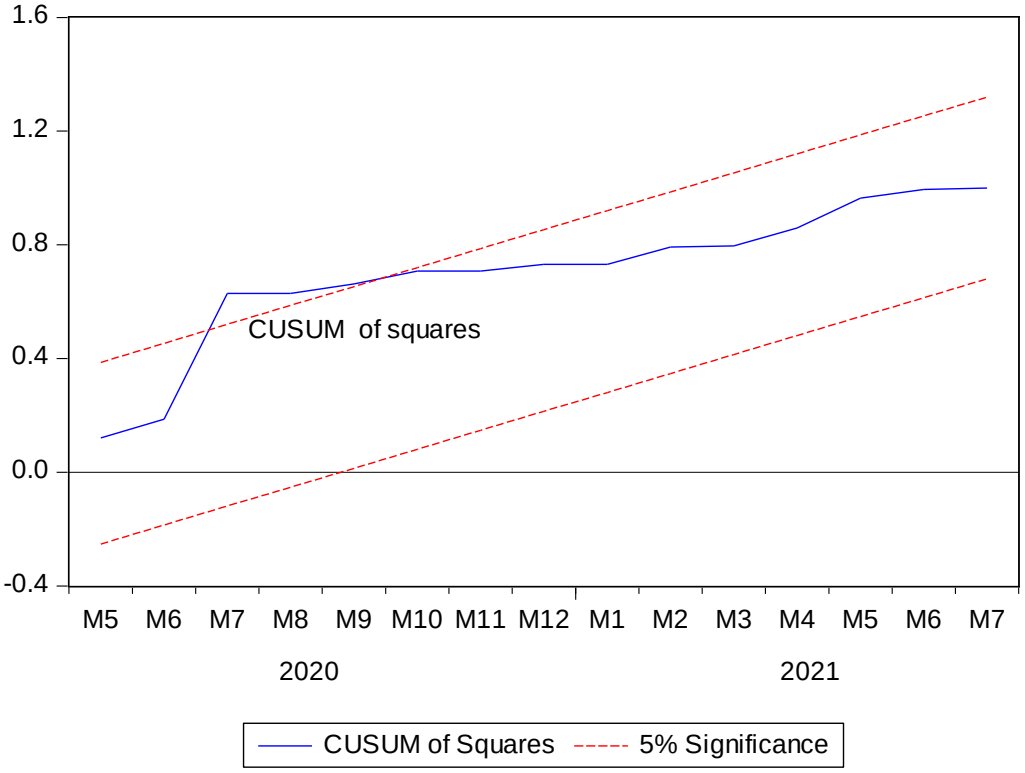


Figure 5: Stability Test

Source: Plotted by author

The Breusch-Godfrey serial LM test confirmed that the residuals had no serial correlation among all exchange rates since $nR^2=0.60517$ whose probability of Chi-square (1) =0.436 and F=0.4605 whose probability F (1,14)

=0.5084 which are accepted for H0=no serial correlation.

The correlation between Yuan per SDR and Yuan per US$ is positive and high but negative and high with NEER and REER respectively and all other cross correlations are also high which are given in Table 2.

Table 2: Correlation Matrix of Exchange Rates

	y	**y_1**	**y_2**	**y_3**
y	1	0.9517	-0.8240	-0.9343
y_1	0.9517	1	-0.7679	-0.9162
y_2	-0.8240	-0.7679	1	0.8051
y_3	-0.9343	-0.9162	0.8051	1

Source: Calculated by author

After entry of Yuan into the SDR basket, China needs some important policies regarding internationalization of Yuan as proposed by IMF which is to be strengthened where the Chinese bond, equities, shares and market capitalization, trading turn over, interbank lending are very much crucial determinants for a healthier Yuan in improving its weight in the offing. Therefore, the simple relation between Chinese Yuan per SDR(y) with equity financing(z_1), turnover of trading(z_2), market capitalization(z_3), number of listed companies(z_4), Shanghai Composite Index(z_5) and interbank lending volume(z_6) respectively during the period of pandemic from 2020m_1 to 2021m_7 has been build up through the traditional regression method. The estimated multiple regression equation is given below. $y=16.712 +1.99e^{-05}z_1+2.70e^{-07}z_2+5.41e^{-06}z_3$

(9.60)* (0.19) (0.53) (2.27)*

$-0.00183z_4-0.0012z_5+1.34e^{-06}z_6+u_i$

(-3.44)* (-2.30)* (1.86)*

R^2=0.918, F=22.43, DW=1.63, n=19, *=significant at 9% level. AIC=-2.07, SC=-1.72

The equity financing and turn-over of trading have insignificant positive impact on Yuan per SDR but number of listed companies and Shanghai Composite index have significant negative relation with Yuan per SDR and again the market capitalization and interbank lending volume have significant positive relation with Yuan per SDR respectively. It can be explained that the listed companies and Shanghai Composite Index had favourable impact on the appreciation of Yuan SDR value, on the other hand equity financing, turnover trading, market capitalization and interbank lending volume had favourable impact on the devaluation of Yuan SDR exchange rate during the study period which had boosted Chinese export.

This relationship in the regression equation is a stable one since the line of residuals of CUSUM of squares passes through the region of 5% significant level which is depicted in Figure 6.

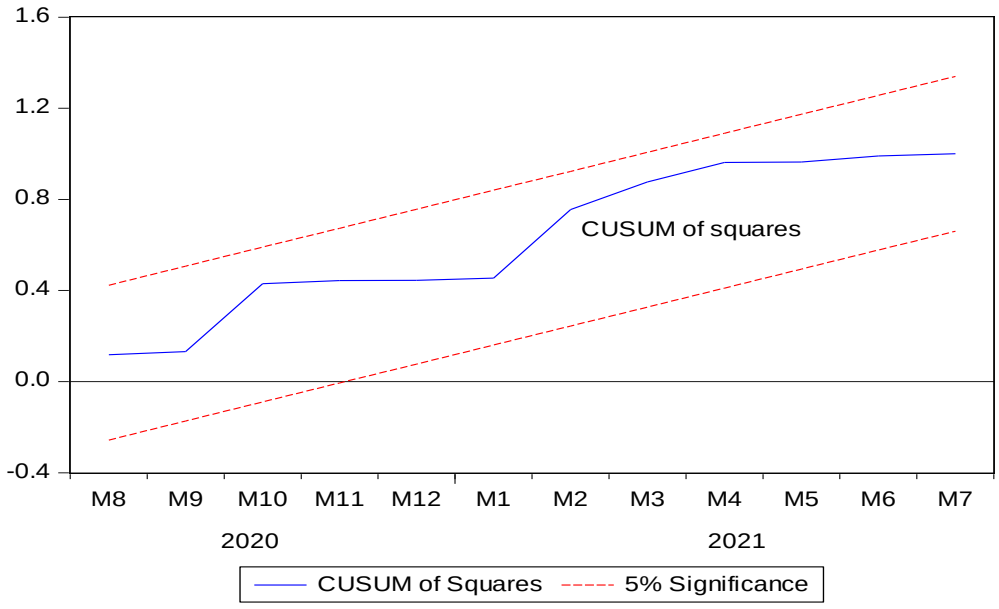


Figure 6: Stability Test

Source: Plotted by author

The residual test for serial correlation in this multiple regression model showed that there is no serial correlation problem among the variables since nR^2=0.693 whose probability of

Chi-square=0.4049 (n=19) and F=0.4167 whose probability F (1,11) =0.5318 at the H0=no serial correlation which is accepted significantly.

The correlation between y and z_1 and z_2 are very low but the correlations between y and z_3,z_4,z_5 and z_6 are quite high. The cross correlations between z_1 and z_6, z_2 and z_3, z_5, z_6, z_6 and z_2, z_3 respectively are low and the rest were very high which have been arranged in the correlation matrix in Table 3 below.

Table 3: Correlation Matrix Among the Variables of y, z_1, z_2, z_3, z_4, z_5, z_6

	y	**z_1**	**z_2**	**z_3**	**z_4**	**z_5**	**z_6**
y	1	-0.1475	0.0705	-0.7616	-0.8788	-0.7487	0.5329
z_1	-0.1475	1	0.6411	0.6672	0.4460	0.6845	-0.1652
z_2	0.0705	0.6411	1	0.3581	0.1869	0.3678	-0.0081
z_3	-0.7616	0.6672	0.3581	1	0.9469	0.9896	-0.4629
z_4	-0.8788	0.4460	0.1869	0.9469	1	0.9138	-0.4265
z_5	-0.7487	0.6845	0.3678	0.9896	0.9138	1	-0.4800
z_6	0.5329	-0.1652	-0.0081	-0.4629	-0.4265	-0.4800	1

Source: Calculated by author.

Discussion

The equity financing and turn-over of trading of China had not increased steadily rather they behaved volatile so that negative relationships with Yuan SDR exchange rate were not established. Therefore, capital market structure in improving equity market and turn over should be strengthened where short term and long-term issues should be encouraged. The stock exchange index of Shanghai Composite index behaviour is volatile which should be enriched with improving confidence and returns because it is unfavourable to Yuan SDR exchange rate. Even, the Yuan US$ stability should be the prime goal in which Yuan depreciation and appreciation should be discouraged by implementing floating exchange rate with convertibility of Yuan for which export and import policy reforms are necessary to adjust with US$. The volatility of NEER and REER should be controlled by adjusting capital account and current account balance enhancing export and capital transfer especially FDI and equities. The inflation differentials are to be well maintained by control measures on inflation. Lastly, covid-19 did not reshuffle the Chinese economy abruptly because recovery of GDP, export, import was happened very quickly although rebreak in 2021m_2 and 2021 m_3 and capital market structure was volatile which is to be recovered urgently. However, Chinese economy had recovered much more than the other economies. The important policy concern is to balance the relationship between on-shore and offshore RMB markets. It is high time to improve liquidity management and holding and open up more on-shore RMB foreign exchange markets. Das (2019) emphasised that China needs implementation of freely floating exchange rate for internationalisation of RMB because liquidity and depth of China's on shore foreign exchange market remain low compared to other countries. So, China should increase efficiency and depth of market to participate interbank foreign exchange market. Even, two-way flexibility can improve Chinese foreign exchange market speedily. The significance of expanding the onshore RMB FX market and boosting the offshore RMB FX markets. To help the RMB become more international, to make it easier for foreign institutions to enter domestic FX markets stimulate trading is needed (Peoples Bank of China, 2021).

Many experts believe that the Yuan will become a prominent international currency as China grows into a dominant economy with a high trade/GDP ratio. In recent years, the Chinese government have taken major steps in internationalising the Yuan, including the establishment of Yuan settlement payment channels, Yuan swap lines, and restricted convertibility with Hong Kong. Though the Yuan's participation in global exchange rate agreements has been modest, it might grow with increased flexibility in the Yuan-Dollar rate (Balasubramaniam, Patnaik & Shah, 2011).

Limitations and future scope

Irrespective of the observations with the consulting variables, there are other variables which can explain the behaviour of Yuan per SDR of China in which foreign direct investment, bond yield (whether it is derived by one year or more) are important but they are excluded due to nonavailability of monthly data during the specified period. Even, the data of the profit of foreign banks of China are also excluded due to the same reason. Since, our period of data from $2020m_1$ to $2021m_7$ are considered for explanation of covid-19 period and thus, the number of observations is short for calculating the time series data analysis using cointegration and vector error correction methodologies which were excluded from this paper that was needed more observations of the variables in the model. In future, there will be ample scope to include such type explanations so that long run and short run causalities could be established with cointegrating equations.

Conclusion

The paper concludes that the trend line of Yuan per SDR during $2020m_1$ to $2021m_7$ is basically non-linear having three phases with cyclical fashion showing seasonality. Yuan per SDR is strongly influenced by the Yuan/US$ and insignificantly related with NEER and REER of Yuan. The Yuan per SDR is significantly related with Chinese export, import and foreign exchange reserves but its relation with inflation and GDP index were insignificant. Market capitalisation and interbank lending trading volume are positively related with Yuan per SDR significantly, but number of listed companies and Shanghai Composite Index have negative significant relations with Yuan per SDR. Moreover, the equity financing and turnover of trading of China have positive insignificant relations with Yuan per SDR during the pandemic. The paper emphasised the policies for improving and balancing on-shore and offshore bond market, ensures stability of share market, stability of capital and current account balance and encourages to adopt capital account convertibility and two-way flexibility. Above all, stable exchange rate, enhancing participation of interbank lending, strengthening capital markets are the central goals of China to hike international demand for RMB as international payments so that weight of Yuan in SDR basket might be improved.

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Conflict of Interest:

There is no conflict of interest in the process of the paper publication.

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