

ABSTRACT

Since the founding of New China, through several stages of development, the RMB exchange rate system which utilized a fixed exchange rate system has gradually moved towards a managed floating exchange rate system. During the period of fixed exchange rate regime, the RMB fluctuations were more in accordance to the current economic policies, where various factors on the impact of the RMB exchange rate are concealed. As China's exchange rate regime continues to undergo reformation, the RMB exchange rate eventually comes to the market. Thus, researching of the determinants of RMB exchange rate has become more important.

This study aimed to determine the factors that affect the RMB exchange rate during the year 2000 to 2012 by using simple Linear Regression model with ordinary least square method (OLS). In this paper, the dependent variable is RMB exchange rate; whereas the independent variables are money supply, GDP differential, trade balance, interest rate differential, exchange rate reserve, inflation rate differential, government spending and dummy variable exchange rate reform. The study utilized quarterly data from the first quarter of year 2000 to the last quarter of year 2012 totally consisting of 52 observations.

This paper found out that foreign exchange reserve, interest rate differential, inflation rate differential and exchange rate reform dummy have impact on the RMB exchange rate. The foreign exchange reserve, interest rate differential and exchange rate reform have negative relationship with RMB exchange rate. On the other hand, the inflation rate differential is positively related to RMB exchange rate.

This study provides recommendation to Chinese government upon maintaining the RMB exchange rate stability. Furthermore, financial institutions and multinational companies can also use those results to make the appropriate measure responses to RMB exchange rate change to reduce the losses caused by changes in

exchange rate. The results of this paper may also benefit foreign investors in making the right investment in foreign exchange market. In terms of academic contribution, the results of this paper may contribute to the additional empirical evidence of existing economic literature in China.

