

ABSTRACT

Previous literatures have focused on quantitative models in explaining exchange rate movements. Since the RMB exchange rate is under managed floating, qualitative factors like government intervention, will also affect its movement. In view of this alternative, this study tries to compare the explanatory power between these two approaches in the RMB/USD exchange rate movement.

Firstly, quantitative analysis is undertaken by running three exchange rate models namely, the purchasing power parity (PPP) test, monetary and ARIMA models. Results from the PPP test imply both absolute and relative PPP are questionable. However, the long-run PPP relationship cannot be rejected through the cointegration test.

The most appropriate monetary model for the nominal RMB/USD exchange rate implies that only relative income and interest rate differentials are significant. However, it appears that the ARIMA model is empirically better than the monetary model in terms of explanatory and predictive powers.

Both models have explained over 55% of the RMB exchange rate movements, the remaining percentage left unexplained can be further explained by qualitative factors. In case if there is any change in the course of government policy, qualitative approach is preferable to its counterpart in suggesting the direction of RMB exchange rate movement.

Under the current managed floating system, quantitative approach is non-exclusive in explaining the RMB exchange rate movement. Qualitative forces sometimes offset/reinforce the quantitative factors in affecting the RMB exchange rate. Therefore, both quantitative and qualitative approaches should be attended in explaining the RMB exchange rate movements.