A Study on the Impact of RMB Exchange Rate Fluctuations on China's Outward FDI

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Abstract. Amidst economic globalization, the RMB exchange rate's variability has significantly impacted China's foreign direct investment (FDI). As China's economy slowly merges into the international market, fluctuations in the RMB exchange rate influence not just the yield and expense of overseas investments, but also significantly shape the investment choices and strategic structure of Chinese companies. The dissertation delves into the context and traits of RMB exchange rate variances, integrating them with real-world data and scenarios to investigate how these fluctuations specifically affect China's external foreign direct investments and uncover the underlying mechanisms. Findings from the research indicate that variations in the RMB exchange rate significantly influence the magnitude, trajectory, and risk control of Foreign Direct Investment, particularly amid heightened unpredictability in the global market, leading to more adaptable and risk-averse investment patterns in companies.

Keywords: RMB exchange rate fluctuation; outward foreign direct investment; impact mechanism; Chinese economy

1 Introduction

China's rapid expansion in overseas investments is credited to its consistent partnerships with other countries, positioning it as a leader in the developing world. Post China joining the World Trade Organization (WTO) in the 2000s, China has seen a rise in its outward foreign direct investment (FDI), marked by increased scale and complexity. With the ongoing evolution of economic globalization, the intimacy of international direct investment collaboration is intensifying, and the tightness of investment networks is growing. In these novel conditions, nations are perpetually enhancing their stakes in investment networks, with the more pivotal the role, the more substantial their societal impact and the higher the risk. The fluctuation in exchange rates has consistently been a significant concern within the realm of international finance. Specifically, the U.S.'s adoption of a novel dollar exchange rate approach, along with the 'international spillover effect' resulting from U.S. monetary policy adjustments, impacts not just the monetary strategies of other nations but also alters the global monetary policy system. The SDR officially incorporated the 2015 "811 exchange rate reform" and the 2016 RMB. Following the official incorporation of the

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RMB into the SDR in 2016, there were bidirectional variations in the RMB exchange rate, which notably correlated with global direct investment. [1]According to the Ministry of Commerce in China (MOFCOM), the year 2023 saw China's aggregate foreign direct investment exceed US$160 billion, covering a range of countries and regions globally.2025 On January 26, 2025, China's MOFCOM released data showing that China's outward non-financial FDI was US$143.85 billion in 2024, a 10.5% increase compared to the previous year, and that outward investment had achieved a steady growth. Among them, Chinese enterprises in the "Belt and Road" co-built countries non-financial direct investment of 33.69 billion U.S. dollars, an increase of 5.4% over the previous year, the new contract amount of foreign contracted projects of 232.48 billion U.S. dollars, the completion of the turnover of 138.76 billion U.S. dollars, respectively, accounted for 87% of the total amount and 83.6%.[2]It can be seen that the fluctuation of RMB exchange rate is always an important consideration for enterprises' decision-making. The fluctuation of RMB exchange rate not only affects the investment cost and return of Chinese enterprises, but also is closely related to the external economic environment, global capital flow and domestic policies. Therefore, an in-depth analysis of the specific impact of RMB exchange rate fluctuations on FDI is of great theoretical and practical significance.

Based on real data and case studies, this thesis will explore how RMB exchange rate fluctuations affect Chinese enterprises' investment decisions, investment costs, investment returns, and risk management strategies, and propose corresponding policy recommendations.

2 Background and Characteristics of RMB Exchange Rate Fluctuations

2.1 Evolution of the Exchange Rate Regime

Following the 2005, overhaul of the RMB exchange rate system, China set up a stable, unified, and controlled floating exchange rate framework, anchored in market supply and demand. This system was modified according to a range of currencies, setting the RMB's exchange rate against the US dollar in accordance with market supply and demand, while the People's Bank of China (PBoC) continued to intervene when needed. Under this framework, fluctuations in the RMB exchange rate have increasingly demonstrated flexibility. In order to cope with external shocks such as the financial crisis and the Federal Reserve's monetary policy, and to reduce the risks to the economy arising from the increased fluctuations in the RMB exchange rate against the US dollar, the People's Bank of China (PBOC) suspended the process of market-oriented reform of the exchange rate system. This regime of exchange rates finalizes the dynamic regulation and control of the RMB exchange rate by monitoring fluctuations in the RMB multilateral exchange rate index, thereby ensuring the RMB's exchange rate remains fairly and consistently stable.[3]

In June 2008, the RMB exchange rate was re-fixed to the US dollar at only 6.82 to 6.82 per cent. The exchange rate fluctuated narrowly between 6.82 and 6.86 per cent.

It fluctuated narrowly between 6.82 and 6.86. It was not until June 2010 that the PBOC decided to restore the floating RMB exchange rate, which provided an institutional basis for capital flows. The economy of China recovered well in the following period. The Central Bank raised interest rates to prevent overheating, while the Federal Reserve maintained its zero interest rate policy. The widening of the interest rate differential between China and the United States attracted a large amount of capital inflow into China, and the RMB exchange rate entered into a prolonged appreciation path.[4]The year 2015 saw an expansion in the fluctuation of the RMB exchange rate in relation to the US dollar, signifying an additional progression in the market dynamics of the exchange rate.

Consider the years 2020 and 2021 as examples, during which global epidemics and economic fluctuations significantly altered the RMB's exchange rate, especially at the onset of the epidemic in early 2020. The RMB's exchange rate to the U.S. dollar fell to 7.2, a recent low. Yet, in 2021, as the Chinese economy rebounded and the US dollar depreciated, the RMB's exchange rate began to rise, reaching approximately 6.4 against the US dollar, highlighting a notable trend of exchange rate instability.

2.2 Causes of Fluctuations in the Exchange Rate of the RMB

The volatility of the RMB exchange rate is affected by multiple factors, the most important of which include: Worldwide economic climate: The RMB exchange rate may vary due to global economic instability and shifts in international commerce, particularly under tense trade ties between the United States and China. As an illustration, following the commencement of the U.S.-China trade conflict, the RMB's value fell below 7.1, a situation worsened by anticipated interest rate increases in the U.S. and a deceleration in China's economic expansion.

2. Foreign exchange marketplace intervention: the PBOC will stabilize the RMB exchange rate through foreign exchange market intervention when necessary to avoid excessive volatility from negatively affecting the market. In 2018 and 2019, the central bank intervened to keep the RMB exchange rate within a certain range by increasing foreign exchange reserves.

3. Capital flows and international investment: With the gradual liberalization of China's capital marketplace, foreign capital inflows and outflows have an increasing impact on the RMB exchange rate. In particular, changes in foreign investment and financing needs in the Chinese market will have a direct infulence on the short-term volatility of the RMB exchange rate.

3 Impact of RMB Exchange Rate Fluctuations on China's OFDI

3.1 Changes in Investment Costs

Fluctuations in the exchange rate of the RMB have a direct impact on the cost of cross-border investment for firms. the RMB depreciated by 1.4% in 2015 .[5] When

the exchange rate of the RMB depreciates, exports to the EU will rise and imports will fall, which will help optimise the structure of China's foreign trade.[6] The instability of the RMB exchange rate may in turn lead to speculative activities of international capital, exacerbating the large-scale flow of international capital in China in the short term and adversely affecting the stability of our domestic economy.[7]

Alibaba, a company from China, and Paytm, India's leading mobile payment and commerce platform, jointly declared on September 29, 2015, that Alibaba Group and Ant Financial, its financial branch, would infuse capital into Paytm. Ali referred to it as a "strategic" investment. By February 2015, Ant Financial had secured a quarter share in One97 Communications, Paytm's parent company, as reported by individuals knowledgeable about the situation. Additionally, the transaction's value exceeded$500 million at that time, according to those acquainted with the situation. A fall in the yuan's value has reduced the expenses for Chinese firms to invest abroad, thus facilitating their pursuit of international partners and the integration of sophisticated technology and managerial skills. Concurrently, the devaluation of the yuan has compelled firms to intensify their research, development, and innovation to enhance the quality and technological aspects of their products. vation efforts to improve product quality and technology content.

3.2 Fluctuations in Investment Returns

Exchange rate fluctuations also have a significant impact on the return on investment of enterprises. When the RMB appreciates, companies can exchange less foreign currency for more RMB, and the return on overseas earnings is more substantial; while when the RMB depreciates, the return on overseas earnings flowing back to China will fall due to exchange rate differences.

As an illustration, amidst the 2015 devaluation of the RMB, numerous Chinese firms reported their earnings in foreign currencies abroad, yet returned them to their homeland, facing markedly reduced RMB returns owing to fluctuations in exchange rates. The earnings of certain export-focused firms suffered greatly, particularly those heavily invested in the European Union and United States.

3.3 Risk Management and Alignment of Investment Decisions

The volatility of the RMB exchange rate increases the exchange rate risk of cross-border investments. Enterprises usually adopt exchange rate hedging tools to reduce this risk. Risk management strategies using foreign exchange derivatives such as futures and options as tools enable enterprises to effectively predict and manage future exchange rate fluctuations.

For example, many Chinese companies use foreign exchange hedging contracts when making overseas investments to lock in future exchange rate costs and avoid investment losses due to exchange rate fluctuations. Especially during the RMB depreciation cycle, companies tend to stabilize their profit expectations by means of foreign exchange hedging.

3.4 Selection of Investment Areas

RMB exchange rate fluctuations also have an important impact on firms' regional investment choices. When the RMB appreciates, firms tend to choose markets with less volatile currencies, such as the European Union and the United States, where currency exchange rates are more stable. When the RMB depreciates, firms are more likely to invest in emerging markets, especially those with large currency depreciation, as the return on investment in these regions may rise due to currency depreciation.

At the time of the depreciation of the RMB, many Chinese enterprises increased their investments in the markets of South-East Asia, Latin America and Africa. Due to the depreciation of the local currency in these regions, the expectation of a more substantial return on RMB investment attracted large inflows of Chinese capital.

4 Case Study: The Specific Impact of RMB Exchange Rate Fluctuations on FDI

4.1 Depreciation of the RMB During the Trade War Between the United States and China

The commencement of the trade conflict between the United States and China led to the devaluation of the RMB, prompting firms to make more adaptable investment choices in this timeframe. As an illustration, numerous Chinese firms scaled back their U.S. market investments, opting instead to diversify into different markets, predominantly in Southeast Asia and Europe. Data from China's Ministry of Commerce reveals that in 2018, China's external foreign direct investment reached $143.04 billion, marking a 9.6% decrease from the previous year[8].

4.2 Cross-Border Mergers and Acquisitions in a Period of RMB Appreciation

Against the backdrop of RMB appreciation, many Chinese companies have increased their M&A investments in the European and American markets. In terms of innovation of multinational enterprises, the appreciation of the RMB exchange rate plays more of a facilitating role. At this juncture, the rise in the RMB exchange rate is conducive to the creative growth of global corporations[9]. The magnitude of China's external foreign direct investments markedly enhances both the cross-border trading and reserve capacities of the RMB, and similarly, the cross-border trading and reserve capacities positively influence the internationalization of the RMB[10].

For instance, in June 2016, there was a noticeable trend of appreciation in the RMB exchange rate in relation to the US dollar. Data from the China Foreign Exchange Trading Center reveals that on June 1, 2016, the average exchange rate between the RMB and the US dollar stood at RMB 6.5889. By June 2, this rate had risen to RMB 6.5688, marking an increase of 201 points. Furthermore, the RMB's median rate on June 21 reached RMB 6.5656, marking a 52 basis point rise from the prior trading

day. In summary, the RMB saw an increase in value compared to the USD during June.And Tencent made an announcement in June 2016 to acquire an 84.3% stake in Finnish mobile gaming company Supercell for $8.6 billion. , a period in which the appreciation of the RMB made these M&A deals less costly to fund while boosting investment returns.

5 Conclusions and Policy Recommendations

The impact of RMB exchange rate fluctuations on China's outward FDI is far-reaching and complex. When making cross-border investments, enterprises must comprehensively consider the impact of exchange rate changes on investment costs, returns and risk management. The government should provide more supportive measures to help enterprises cope with the challenges posed by exchange rate volatility. Specifically, the government can reduce the exchange rate risk of enterprises by strengthening foreign exchange market supervision, providing exchange rate hedging tools and optimizing the mechanism of foreign capital inflow.

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