AN EXAMINATION OF THE RELATIONSHIP BETWEEN EXCHANGE RATE AND EXPORT DEMAND IN CHINA

RESEARCH MANAGEMENT INSTITUTE (RMI)
UNIVERSITI TEKNOLOGI MARA
40450 SHAH ALAM, SELANGOR
MALAYSIA

BY;

NOORAZLINA AHMAD
FADLI FIZARI ABU HASSAN ASARI
SAKINAH MAT ZIN

DECEMBER 2012

3. Acknowledgements

The authors would like to thank all colleagues who contributed to this study. We thank Research Management Institute (RMI) Universiti Teknologi MARA, Shah Alam and Universiti Teknologi MARA Terengganu for the opportunity in nurturing us to be good writers. We are also grateful to Dr. Norazamina Mohamed, RMU Coordinator who has been deligent in coordinating our needs and requirements throughout most of our research term. We wish to thank our spouses for their tremendous contributions and support morally towards the completion of this paper. We also show our gratitude to our students and all who contributed in one way or the other in the course of the article.

5. Report

5.1 Executive Summary

The effect of export performance on exchange rate reflects the increasing degree of financial market integration. They are important for both theoretical and empirical considerations. This study empirically investigates the relationship between export and exchange rate with respect to China. Objectives of this research are to identify whether exchange rate has a significant and direct impact on export volume and also to determine whether there is a long-run equilibrium relationship between the variables in the export demand functions. Specifically, this paper attempts to analyze the impact of exchange rate volatility on export performance. In order to achieve this objective, the Vector Error Correction Model (VECM) is employed to determine whether stock prices affect the exchange rate. Based on 48 years (1962 – 2010) annual data for China, the findings reveal that exchange rate volatility is not effective in the short run.

5.2 Introduction

An exchange rate is known as the value of the national currency in relation to a foreign currency. Practically, it is vital to those engaged in foreign transactions such as those who are involved in trade, investment speculation or travelling to another country and so on. It is positioned at the centre of a country's monetary policy, where it may serve as a target, an instrument or simply an indicator – depending upon the chosen framework of the said policy. There are several factors which can influence the exchange rate, namely - interest rates, inflation, and the political and economic state of each country.

There are two basic types of exchange rate systems namely the fixed and flexible exchange rate system. Government determines the exchange rate in the fixed exchange rate system, while in the flexible exchange rate system the demand and supply force determine the exchange rate. Exchange rate regimes are arranged into three categories according to their degree of flexibility:-

i) Fixed-rate regimes - currency unions, dollarized regimes, currency boards and conventional fixed pegs;
ii) Intermediate regimes - conventional fixed pegs, crawling pegs and crawling bands; and
iii) Flexible regimes - managed and independent floats.

In an exchange rate regime where the currency's value is matched to the value of another single currency or to a basket of other currencies, or to another measure of value, such as gold, it is known as the fixed exchange rate or pegged exchange rate. While, the flexible exchange rate system is where the exchange rate is determined by demand and supply force in the foreign exchange market. It is a system in which the values of participating currencies are free to change in relation to one another according to the market demand and supply for each currency.

Depreciation in dollar will have distinctive consequences on economies with currencies pegged to the dollar and floating exchange rates. Nearly all DMCs uphold floating exchange rates, under which authorities usually do not interfere in the foreign exchange market and the currency is left to respond to market signals. Currencies with floating exchange rates will rise in response to dollar depreciation. A few DMCs peg their currencies to the US dollar. Hong Kong, China officially pegs the Hong Kong

Contents

1. Letter of Report Submission iii

2. Letter of Offer (Research Grant) iv

3. Acknowledgements v

4. Research Title and Objectives vi

5. Report 1

   5.1 Executive Summary 1

   5.2 Introduction 2

   5.3 Problem Statement 7

   5.4 Significance of the Study 10

   5.5 Organization of the Study 11

   5.6 Literature Review 12

   5.7 Methodology 18

   5.8 Results and Discussion 24

   5.9 Conclusion and Recommendation 29

   5.10 References/Bibliography 30

6. Research Outcomes 35