



Li and Qian: U.S. monetary policy uncertainty and RMB deviations from covered interest parity

Comments by Risto Herrala

The paper

- Empirical study of the RMB covered interest parity (CIP)
 - Does US mopo uncertainty (MPU) drive CIP deviations?
 - How is this link associated with capital controls; FX regime; FX reserves?
- Frames of reference:
 - CIP of major currencies linked to US monetary policy (Avdjiev et al 2019; etc)
 - The global financial cycle driven by US monetary policy (Rey et al, 2015)
- Linear regression, monthly data from 2000

$$Y_t = \alpha_0 + \alpha_i Y_{t-i} + \beta_1 MPU_t + \gamma Z_t + \varepsilon_t$$

Main results

- MPU negatively associated with CIP deviation
 - Increase in uncertainty->fall in USD/RMB interest rates or spot/forward rates
- Based on cross terms:
 - Stronger capital controls weaken MPU-CIP deviation link
 - RMB flexibility strengthens MPU-CIP deviation link
 - FX reserves weaken and even reverse MPU-CIP deviation link

Selected comments

- Specification may need more discussion:
 - Why MOPO uncertainty and not USD strength etc as in Avdjiev et al (2019)?
 - Lags or changes? Is CIP deviation stable under current specification?
- Interpretation of the results:
 - General or China specific? This needs discussion
 - The results may show specifically how China used capital controls. For example, when the US economy was hit maybe China used capital controls to keep the USD/RMB interest rate differential from falling too much?
- Subsample estimations might reveal interesting changes in Chinese policies
 - Xi vs Hu etc..
- Thank you!