

Current Situation, Problems and Countermeasures Analysis of China's Foreign Exchange Market

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Abstract. China, as the second-largest economy in the world, plays a vital role in the development of FX market. In recent years, China's FX market has been expanding continuously, liquidity has been enhanced, and the exchange rate mechanism has been perfected. However, there are still some problems in the market, such as preventing and controlling the market risk, the irrational structure of participants, and so on. To solve these problems, it is necessary to deepen the opening-up of the financial market, perfect the mechanism of the formation of the exchange rate, enhance the risk prevention and control, optimize the structure of the market participants, and enhance the infrastructure of the foreign exchange market. Therefore, the study of this thesis is of great importance, and it can offer some help to the problems which should be resolved in FX market. This article will analyse the current situation of Chinese FX market, the four existing problems and the corresponding countermeasures. This article discusses some problems in the foreign exchange market: China's FX market has been severely influenced by the increase of interest rate, while China has been in a disadvantageous position in the field of FX operations, the size of assets and the establishment of institutions. The types of FX derivatives in China are less, and the participants in the FX market are unitary, and the investors' acceptance is low.

Keywords: Foreign exchange market; China; Problems and Countermeasures.

1. Introduction

The FX market is one of the most important markets in one country. The FX market provides a platform for the trading and trading of FX and facilitates the cross-border movement of capital. Along with the opening-up and internationalization of Chinese economy, more and more foreign capital has come into China's market. Meanwhile, the existence of the FX market has also provided more investment opportunities and options for China's investors, and it has promoted the healthy development of the international capital market. Moreover, the FX market can also improve and develop the financial market. The foreign exchange market plays an important role in the financial market. Its development has a direct impact on the operation of the entire financial market. The research on FX market will help us to know the operation mechanism, risk features and trading strategies, which will help to perfect and develop the financial market.

But China's FX market is special, as shown below. The first is government intervention. The FX market in China is regulated by the country, which is involved in foreign exchange market by means of monetary policy and so on. The purpose of this intervention is to stabilize the exchange rate and keep the macro economy stable. The second is the volume of trade. The scale of Chinese FX market is very big, and it has obvious superiority over the international FX market. The volume of Chinese FX market has been growing rapidly in recent years. Third, the kinds of trade and the way of trading. The variety of Chinese FX market is relatively simple. It mainly focuses on the exchange of RMB versus USD, RMB versus EUR, etc. Also, the trading method is more traditional, and there is still some difference with the FX market. Fourthly, the structure of the market. The FX market in China is divided into the interbank exchange market and the retail one. Interbank FX is the main trading platform, and the retail FX market is relatively small.

For this reason, this article focuses on the Chinese FX market, reviews the current situation of the market, and makes a deep analysis of the difficulties in the market, and puts forward some countermeasures.

2. Current situation of China's foreign exchange market

The history of Chinese FX market starts from 1949 and has been divided into three periods [1]. The first historical period was from 1949 to 1978. In this period, the main activities in China were to establish the legal position of RMB, and to explore the mechanism of foreign exchange balance. The exchange rate of the RMB remained stable during 1963-1965. In the meantime, with the recovery of foreign trade, the bank's lending has been growing steadily, reaching RMB 2.7 billion in 1963, RMB 3.9 billion in 1964, and RMB 5.3 billion in 1965. The second period, from 1978 to 2013, represents the formation and development of the FX market in China. In this historic moment, China started to explore and build a new socialist market economy system. In this process, the establishment and development of FX market is an essential component of the open economy. The FX market has gone through a process of growth from zero to big. The market has formed the basic frame and has begun to develop the market. The third historical period is 2013 to the present. Based on the initial development, China's FX market has started to develop its own innovation and seek high quality development. The most notable achievement of Chinese FX market in this period is the expansion of the market scale and the growth of the trading activity. Under the impetus of policy support and market demand, the Chinese FX market is expanding continuously. Meanwhile, the trading activity in FX market has also increased, the amount of FX derivatives has increased, and the structure of market participants has become more diverse. According to the figures below, the Chinese State Administration for Foreign Exchange data shows that the average daily trading volume in China has increased from \$48.66bn in 2015 to about \$90.294 billion in 2023. It will peak in 2021 at \$101.007 billion per day. China has emerged as a major player in the world currency market [2] (See Fig. 1).

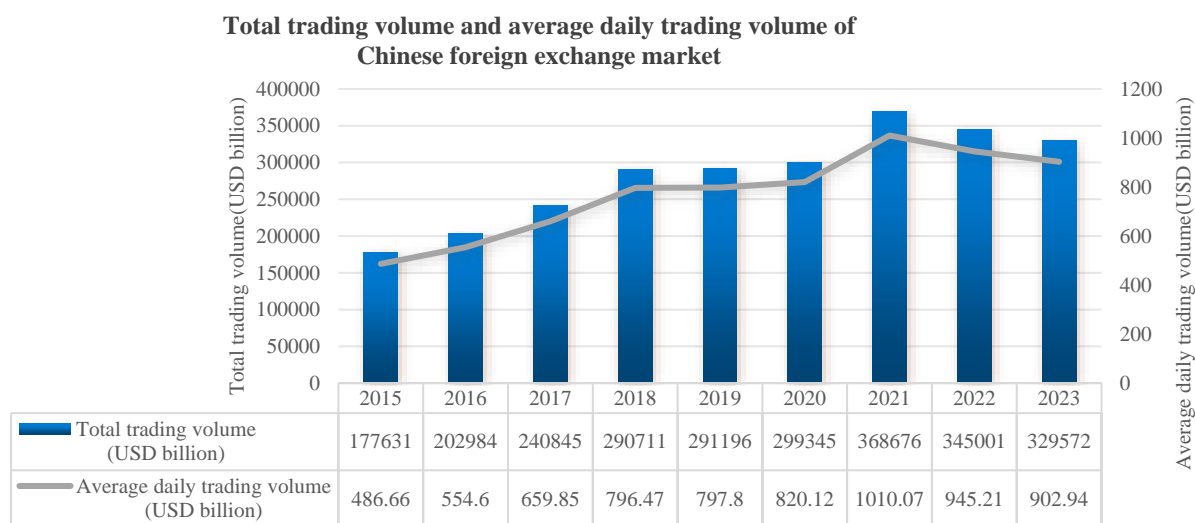


Fig. 1 Total trading volume and average daily trading volume of Chinese foreign exchange market
 (Data source: China State Administration of Foreign Exchange portal; Average daily trading volume taken to two decimal places)

3. Problems in China's foreign exchange market

3.1. Seriously Affected by the Interest Rate Hike

The rise in the dollar has had a profound impact on the global economy, especially in emerging market countries. First, a higher dollar rate leads to capital outflows as investors move money to countries with higher interest rates. As a result, emerging market countries face capital outflow pressure, which leads to the depreciation of their currencies and increased financial market volatility.

Second, one of the most obvious effects of a higher dollar rate on China is that it increases the debt burden of emerging market countries. Many emerging market countries, including China, are

denominated in dollars when borrowing in international markets. If the dollar continues to raise interest rates, it will lead to further increases in the debt interest burden of these countries, which will limit their investment and consumer spending to a greater extent, thus affecting economic growth.

In addition, the rise in the dollar will also have a negative impact on the exports of emerging market countries. As a result of the rising dollar exchange rate, the relative price of emerging market countries' exports will rise, putting more pressure on exporters, and the competitiveness of these countries' exports will also decrease, resulting in a decrease in exports. Lower exports mean less domestic production, which affects overall economic growth.

On the other hand, the US dollar rate hike has also brought some pressure on the Chinese economy. China is the world's largest holder of foreign exchange reserves, and a rise in the dollar could lead to a decline in foreign exchange reserves, which could affect China's monetary policy and financial stability. In addition, China's export market is also vulnerable to the impact of the US dollar interest rate rise, and export enterprises are facing pressure.

3.2. Disadvantages in Operation, Asset Scale and System Construction

In the context of global economic integration, China still has certain disadvantages compared with the international advanced level in foreign exchange management, asset scale, system construction and other aspects. This is mainly reflected in the following aspects:

First of all, in terms of foreign exchange operation, China's foreign exchange market is relatively small, and the trading activity is not high enough, which has a certain gap compared with developed countries. Although the openness of China's foreign exchange market has been increasing in recent years, the participation of foreign investors still needs to be improved. In addition, there are relatively few derivatives trading and risk management tools in China's foreign exchange market, which is difficult to meet the diversified needs of market participants.

Secondly, in terms of asset scale, there is a big gap between the asset scale of Chinese financial institutions and that of large international financial institutions. This is mainly due to the relatively short development history of China's financial market, insufficient innovation in financial products and businesses, and insufficient financial regulation. Therefore, the competitiveness and influence of Chinese financial institutions in the global financial market still need to be improved.

Finally, in terms of system construction, although China's financial regulatory authorities have taken a series of measures to strengthen financial market supervision, there is still a certain gap compared with developed countries in terms of system design, regulatory means and law enforcement. As a result, China's financial market still faces certain challenges in preventing financial risks and maintaining market stability.

3.3. Fewer Types of Foreign Exchange Derivatives

Foreign exchange derivatives are a kind of financial contract for the purpose of making profits in various ways, and it is a foreign exchange trading instrument derived from the evolution of original assets [3]. In the global financial market, there are many varieties and large scale of derivatives transactions, among which foreign exchange derivatives, as an important financial derivative, have also been developed to a certain extent in China. However, compared with other financial markets, the variety of foreign exchange derivatives in China is relatively small, which is closely related to the development of China's financial market, regulatory policies and the needs of market participants.

First, from the perspective of the development of China's financial market, compared with traditional financial markets such as stocks and bonds, the foreign exchange market started relatively late [4]. Although China's foreign exchange market has achieved remarkable development in recent years, there is still a big gap in the scale and maturity of China's foreign exchange market compared with developed countries. Therefore, in the foreign exchange market, there are relatively few types of derivatives, which is also a microcosm of the development of China's financial market.

Secondly, regulatory policy is an important factor affecting foreign exchange derivatives. In order to prevent financial risks, Chinese regulators have strong supervision over the foreign exchange

market. In the field of derivatives, the regulatory authorities have taken a series of measures, such as strengthening the supervision of OTC derivatives and promoting the healthy development of OTC derivatives trading. This has led to some restrictions on the types of foreign exchange derivatives available in China to ensure a robust market.

In addition, the demand of market participants is also an important factor affecting the foreign exchange derivatives class. In China, there is a growing demand from enterprises and individuals for the foreign exchange market, but there are currently limited foreign exchange derivatives available to investors in the market. In order to meet market demand, financial institutions and regulatory authorities need to work together to develop more derivatives that meet market demand to improve investors' risk management ability.

In short, there are three main reasons for the small number of foreign exchange derivatives in China: the degree of financial market development, regulatory policies and the needs of market participants. In the future, with the continuous maturity of China's financial market and the improvement of regulatory policies, the types of foreign exchange derivatives are expected to gradually enrich, in order to better serve the development of the real economy and the steady operation of the financial market. At the same time, market participants should continuously improve their risk management capabilities, make full use of existing foreign exchange derivatives instruments, and provide more diversified investment options for enterprises and individuals.

3.4. Single Participants

The participants in China's foreign exchange market are relatively simple, which is closely related to the development degree of China's financial market and the structural characteristics of the financial system. Compared with other financial markets, the acceptance degree of investors in the foreign exchange market is relatively low. There are many reasons behind this phenomenon.

First, China's foreign exchange market is relatively open. For a long time in the past, China's foreign exchange market was strictly regulated, making it difficult for ordinary investors to participate in foreign exchange trading. Although China has made significant progress in opening up its foreign exchange market in recent years, it still needs to be more open compared to other financial markets. As a result, many investors are still relatively new to the forex market, and participation is naturally relatively low.

Secondly, the investment risk in the foreign exchange market is relatively high. Compared with financial products such as stocks and bonds, the foreign exchange market is more volatile, and the investment risk is higher. It is often difficult for ordinary investors to bear such a high investment risk, so the level of participation in the foreign exchange market is relatively low.

In addition, the investment products and services in China's foreign exchange market are relatively undiversified. At present, China's foreign exchange market mainly focuses on foreign exchange trading, and investment products and services are relatively simple, which is difficult to meet the diversified investment needs of investors. This has also weakened the interest of some investors in the foreign exchange market and affected the degree of participation.

However, with the continuous development and opening of China's financial market and the deepening of financial reform, the development prospect of China's foreign exchange market is very broad. In the future, China's foreign exchange market should gradually introduce more investment products and services, lower the investment threshold, and improve the acceptance of investors.

4. Countermeasure analysis

According to the problems discussed above, this part tries to give solutions respectively.

4.1. Optimize Monetary Policy

The rise in the US dollar has had a certain negative impact on the economic growth of emerging market countries and China. In dealing with this problem, governments and businesses should work

together. The government can maintain stable domestic economic growth by optimizing monetary policy and other means. In addition, it is also necessary to carefully consider the deterioration of expectations in addition to the fundamentals, and to be vigilant about possible market manipulation problems, make plans in advance, and take some heavy actions to curb the deterioration of market expectations when necessary [5].

At the same time, enterprises should increase transformation and upgrading efforts, improve the added value and competitiveness of products, reduce the impact of external risks, and reduce dependence on export markets. At the same time, the global economic governance system should also be adjusted to better cope with external shocks such as the rise in the US dollar.

4.2. Advance Financial Reform

In recent years, the scale of China's foreign exchange market has been expanding with increasingly rich trading varieties, providing more choices for domestic and foreign investors. On the other hand, Chinese financial institutions have made breakthroughs in asset size and are not only competitive in the domestic market, but also have an important position on a global scale. However, compared with the international advanced level, China still has a certain gap in foreign exchange operations, asset scale, system construction and other aspects. In order to reduce China's disadvantages in foreign exchange operation, asset scale and system construction, the government and regulatory authorities should take the following measures:

First, improve the financial regulatory system. By deepening financial reform and improving the operational efficiency of financial institutions, China's foreign exchange market and asset scale will grow. Second, strengthen risk prevention to ensure the steady operation of the foreign exchange market. It is necessary to strengthen monitoring of cross-border capital flows, improve our ability to respond to external shocks, and safeguard national financial security.

In addition, it is necessary to strengthen the inspection of foreign exchange related illegal activities. Relevant departments' attention to foreign exchange market crimes such as arbitrage and evasion may help regulate the foreign exchange market, maintain the healthy order of the foreign exchange market, alleviate the outflow pressure of foreign exchange from illegal channels, and make market supervision more effective [6].

In short, although China has made some achievements in foreign exchange operations, asset scale, system construction and other aspects, there is still a gap to be overcome with the international advanced level. Therefore, it is necessary to continue to intensify reform efforts, improve the financial system, strengthen international financial cooperation, train high-quality financial talents, and reform in a direction that is more in line with China's economic situation and reality [7]. Only in this way can China gradually narrow this gap and realize the comprehensive revitalization financial market.

4.3. Increase the Richness of Financial Products

To solve the problem of incomplete foreign exchange derivatives in China, many aspects needed to be started:

Facilitate the opening of financial markets. The government should intensify the opening of the financial market and attract more foreign and domestic investors to join the FX derivatives market. Thus, it can increase the volume and liquidity of the market and promote the healthy development of the market.

Diversification of FX derivatives. Based on the existing FX derivatives, new FX derivatives are introduced continuously to satisfy the needs of different investors. For instance, it would be possible to introduce products like futures and options on multiple currency pairs, or to introduce foreign-exchange derivatives linked to commodities.

Strengthen supervision and control. We should strengthen the supervision of FX derivatives market to make sure that it is fair, transparent and controllable. At the same time, we also need to strengthen the control and supervision of the current system, strictly monitor the examination of market entry conditions and professional standards and provide a sound credit rating system and a

sound regulatory system in time, so that operators can truly benefit from derivatives [8]. Furthermore, the basic construction of Chinese legislation has been strengthened. Considering the concrete conditions of cross-border capital flows, we have made a comprehensive and comprehensive regulation on FX management in order to make the related legislation more reliable [9].

Promotion of international cooperation and communication. Under the background of globalization, international cooperation and communication has become the main engine for the development of each country's economy. In particular, the development and perfection of FX derivatives market depends on the close cooperation among countries. The Chinese side has always adhered to the principle of mutual benefit and mutual benefit. It has actively strengthened its cooperation and communication with other countries and regions and made joint efforts to develop and perfect the FX derivatives market. Only by cooperating closely can China continuously improve the global FX derivatives market and contribute more to the prosperity of the world economy.

4.4. Strengthen the Protection of the Legitimate Rights and Interests of Investors

Firstly, we need to know the causes of the single-target and the low acceptance among the investors. This has something to do with the Chinese financial market development level. Compared with the developed countries, China's financial market is not mature enough, which leads to low awareness and participation in FX market.

In this regard, investors' legitimate rights and interests can be effectively protected by continuously strengthening the protection of investors, persisting in the concept throughout all aspects of the capital market supervision chain, coordinating the use of administrative reconciliation, advance compensation, ordered repurchase and other institutional measures, and enriching the practice of shareholding exercise supporting litigation model judgments [10].

The phenomenon that the participants of China's foreign exchange market are single, and the investors' acceptance is low is the result of many factors. Measures such as deepening financial reform, expanding market opening, enriching investment products and services, improving market infrastructure and strengthening market supervision are expected to increase investors' participation in the foreign exchange market and promote the high-quality development of China's foreign exchange market.

5. Conclusion

The FX market is one of the most important markets in a country. The FX market provides a platform for the trading and trading of FX and facilitates the cross-border movement of capital. However, the FX market in China is unique. For instance, the FX market in China is relatively big in the world, and it has significant advantages.

In the future, China's FX market will continue to deepen its reform, perfect its market system, and improve its market function. China will also enhance the establishment of foreign exchange market infrastructure, enhance the transparency of the market, and improve the resilience of the market. Moreover, China will take an active part in the international financial cooperation, push forward the reform of the global economic governance system, and contribute to the construction of an open world economy.

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