

Original Paper

Research on the Impact of RMB Exchange Rate Fluctuations on China's Textile Exports

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Abstract

In recent years, following the exchange rate reform of July 2005, the renminbi's exposure to exchange rate risk against the US dollar has expanded significantly, profoundly affecting the Chinese economy. Existing work on exchange rate shocks has tended to operate at the aggregate level, leaving the more granular risks—those bearing on industrial structure and employment—underexplored. This gap motivates the present study, which narrows its focus to the textile export sector. By combining theoretical modeling with empirical analysis, the paper seeks to quantify how exchange rate risk differentially affects the operational performance of firms in this industry. The results indicate that exchange rate fluctuations have materially heightened uncertainty within the sector, with tangible implications for both day-to-day business decisions and longer-term strategic planning. In response, the paper argues for a coordinated approach spanning four dimensions: strengthening risk management at the firm level, improving macro-level industrial planning, deploying targeted government policy support, and leveraging the advisory and service functions of industry associations. The underlying premise is that only by aligning efforts across these dimensions can the textile industry build genuine resilience to exchange rate risks—and, by extension, sustain the stable growth of foreign trade.

Keywords

Exchange rate risk, Textiles, Exports

1. Introduction

1.1 Background and the Case for This Study

1.1.1 The July 2005 reform of the RMB exchange rate formation mechanism was a turning point for China's currency regime. The country moved away from a largely fixed exchange rate and adopted a managed floating system—one tied to market supply and demand, with adjustments pegged to a basket of currencies. The effect was to make the RMB more market-driven and to give policymakers greater

latitude in how they set exchange rate policy. These changes helped the currency adapt more readily to shifts in international financial markets, and over time they also enhanced the RMB's weight in the global monetary system. That said, greater flexibility has not been an unqualified benefit. The way the RMB fluctuates has shifted in ways that deserve scrutiny. Right after the reform, the RMB–US dollar rate was on a broadly appreciating course; the central parity climbed past 8.11 at one stage. The picture looks rather different now. Buffeted by a mix of domestic and overseas factors, the exchange rate has settled into a pattern of two-way movement, and the swings have become noticeably wider. Consider the figure for 29 December 2023: the central parity of the RMB against the US dollar came in at 7.0827, pulling back from earlier highs—a clear sign that volatility has taken on a phased, back-and-forth character rather than a single direction. The broader takeaway is that as exchange rate marketisation continues to deepen, the RMB has become far more reactive to shifts in the domestic and external economic climate. Short-term swings may well grow sharper, and we should not rule out phased trends that run counter to the longer-term direction—something that only adds to the difficulty of planning for firms and investors. The bottom line is that exchange rate risk for economic actors has climbed appreciably, and there is little reason to expect a reversal anytime soon. For enterprises, financial institutions and macroeconomic management authorities, how to effectively identify, monitor and manage exchange rate risks has become a matter of high priority. In a complex and volatile international financial environment, establishing sound exchange rate risk management mechanisms and enhancing the ability of market entities to cope with exchange rate fluctuations are of great significance for maintaining economic and financial stability and promoting the healthy development of the foreign-related economy.

1.1.2 Significance: The impact of exchange rate fluctuations on the textile industry is significant and multifaceted. On the one hand, a depreciation of the renminbi may enhance the price competitiveness of export products, thereby helping to expand the scale of textile exports and foreign exchange earnings, presenting a window of opportunity arising from exchange rate fluctuations. On the other hand, however, depreciation may also drive up the costs of imported raw materials and production equipment, undermining corporate profitability and creating cost-driven exchange rate risks. At the same time, two-way exchange rate fluctuations introduce uncertainty into enterprises' import and export settlements, foreign currency financing and balance sheet valuation, creating multiple impacts in the form of transaction risk, translation risk and economic risk. Consequently, the impact exerted by exchange rate fluctuations upon the textile industry is inherently dual-faceted. Such fluctuations may, under certain conditions, present short-term opportunities; yet they simultaneously deepen the operational uncertainty that firms within the sector are compelled to navigate. In terms of risk management, the textile industry can draw upon a diverse repertoire of strategies. Enterprises may, for instance, flexibly recalibrate their production arrangements and strengthen the localisation of supply chains, which would work to dampen their price sensitivity to imported raw materials. An alternative or complementary path lies in enhancing non-price competitiveness—specifically, by upgrading technological capabilities and increasing the value-added content embedded in their product offerings. Beyond this, firms might actively seek to

expand into emerging markets, a move that would reduce dependence on settlement in any single currency. The judicious use of financial derivatives for exchange rate hedging also constitutes a viable instrument in this regard, helping to buffer revenue streams against adverse currency movements. A complicating factor, however, deserves emphasis. China's textile industry has long been encumbered by structural challenges—rising labour costs and a deficit in technological competitiveness being among the most salient. These pre-existing vulnerabilities mean that the industry is disproportionately exposed when external exchange rate risks intensify. Given this state of affairs, the effective identification and management of exchange rate risks has become less of an optional enhancement and more of a prerequisite for the industry to maintain steady development. It is within this context that systematic theoretical and empirical research into the relationship between RMB exchange rate fluctuations and textile exports acquires its significance. A thorough analysis of the transmission channels and impact mechanisms through which exchange rate risks operate can furnish the industry with the analytical foundations needed to formulate robust risk management strategies and bolster its overall resilience. The insights thus generated may also serve as a point of reference for relevant policy design and for corporate decision-making at both the strategic and operational levels.

2.1 Review of the Literature

Zhang Zefang argues that a rising exchange rate tends to weigh on textile exports in a lasting way, though this drag can be partly cushioned—for a time at least—by countervailing forces such as economic expansion and policy support. The net result is a movement toward equilibrium, but one reached only through fits and starts. Seen in this light, the effect of RMB exchange rate movements on China's textile exports is anything but smooth; it is, by nature, volatile. The implication, in Zhang's view, is twofold: the industry must build up its own capacity to absorb risk, and market-oriented exchange rate reform needs to keep moving forward. Only if both conditions are met can export trade settle onto a path of steady growth.^[1]Qu Desheng finds that exchange rate risk is a broadly shared hazard for businesses, but the nature of the challenge varies considerably depending on firm size. Larger companies carry substantial exposure simply by virtue of their transaction volumes; smaller ones, by contrast, tend to be hamstrung by a lack of know-how and the right tools to manage the risk at all. On that basis, the study calls for a tiered approach to risk management—one tailored to the circumstances of different types of firms—coupled with targeted policy backing to help businesses build genuine resilience.^[2]Cao Qian makes the case that when firms importing intermediate goods are confronted with heightened exchange rate risk, their tax avoidance behaviour increases markedly. The logic, as Cao lays it out, is straightforward enough: exchange rate swings inject uncertainty into cash flow projections, and firms respond by stashing away precautionary savings—tax avoidance serving as one convenient vehicle for doing so. The effect, however, is not felt evenly. It turns out to be especially pronounced among firms that are already in a weaker position: those with thin cash flows, heavy debt loads, or low productivity, as well as state-owned enterprises.^[3]Tong Yinan's position is that the real key to sound risk management lies in sticking to a risk-neutral stance and steering clear of currency speculation altogether. Firms, in Tong's view, should set

their hedging sights on 'preserving value'—not on 'generating value'. What works in practice is a mechanism that can be adjusted on the fly, combining natural hedging with financial instruments in whatever mix happens to be optimal at a given moment. The management model laid out in the study is offered as something that comparable firms might find useful as a point of reference.^[4]Bing Shiwen contends that exchange rate fluctuations can erode the efficiency with which a company manages its cash flows. The answer, in Bing's view, is to put in place a systematic risk management framework—one that tackles the problem from several directions at once: improving the way cash flows are structured, making use of hedging instruments, and branching out into a broader set of markets. Taken together, these measures should go some way toward shoring up the overall effectiveness of cash management.^[5]Deng Chuang takes the view that, on balance, exchange rate risk has worked against China's position in the global value chain—and that this drag has intensified since 2016. That said, the picture looks rather different depending on which sector one examines. Services turn out to be the most exposed, whereas manufacturing, perhaps counterintuitively, may actually hold up better—or even gain—in high-risk environments. For Deng, the way forward is clear enough: climbing further up the value chain and embedding oneself more deeply in global production networks can go a long way toward cushioning the blow of exchange rate swings.^[6]Yao Jin's argument runs along similar lines. With two-way swings in the RMB exchange rate now very much the norm, firms that are expanding overseas have little choice but to adopt—and stick to—the principle of 'exchange rate risk neutrality' if they want to keep their operations on an even keel. What this means in practice is weaving exchange rate risk management into the fabric of everyday decision-making, rather than treating it as an afterthought. Through disciplined, science-based hedging and the like, companies can dampen the knock-on effects of currency swings on their core business, earnings and cash flow, which in turn makes their performance more predictable and, not incidentally, more attractive to the market.^[7]Ni Fangliang believes that, in the process of system localisation, CB Bank's foreign exchange risk management suffers from systemic shortcomings; an effective risk control framework can only be established through coordinated improvements across four key areas: awareness, mechanisms, technology and talent.^[8]Zhu Ying believes that Company Y's foreign exchange risk management suffers from systemic issues such as a loose structure, inadequate systems and a lack of diversity in methodologies. The root causes lie in the absence of a risk-neutral philosophy, unscientific decision-making mechanisms and a shortage of specialist talent. Systemic optimisation must be achieved by establishing a risk-neutral philosophy, restructuring management mechanisms and adopting portfolio hedging strategies.^[9]Hao Yajuan believes that, in the face of the new normal characterised by a strong rebound and two-way fluctuations in the renminbi exchange rate, enterprises must strengthen their awareness of 'risk neutrality' and proactively utilise tools such as hedging to manage exchange rate risks, thereby ensuring operational stability.^[10]Qing He documents a strong positive link between policy uncertainty and firms' exchange rate exposure—a finding that holds up even after macroeconomic conditions are controlled for and endogeneity concerns are addressed. What stands out, though, is that the effect is far from uniform: it

hits considerably harder for firms with deep international involvement and for those whose governance structures leave something to be desired.^[11] Wancheng Ling's contention is that looking into how SMEs can sharpen their foreign exchange risk management in the new landscape of cross-border e-commerce is more than an exercise in operational fine-tuning. It matters, first and foremost, because it helps these smaller firms stabilise their day-to-day operations and protect their margins. But the stakes are broader than that: getting this right also goes some way toward consolidating the foundations of China's cross-border e-commerce sector and bolstering the international competitiveness of the SMEs at its core—all of which, Ling suggests, ought to inform the way relevant policies are drawn up.^[12]

2. Methodological Approach

This study draws on both theory and empirical work to probe how exchange rate risk—rooted in fluctuations of the RMB—feeds through into China's textile exports. On the theoretical side, the paper walks through how exchange rate risk forms and transmits, paying particular attention to the operational structure and trade patterns that characterise the textile industry. From there it teases out the specific threats exchange rate swings may pose: price risks, cost pressures, and the more diffuse operational uncertainties that textile exporters have to live with. The empirical side leans on a VAR model, supplemented by a Granger causality test and related techniques, to get at the actual effects of RMB–USD fluctuations on the scale, competitiveness and profitability of China's textile exports. At the same time, it quantifies the transmission pathways and the relative weight of the various risk factors at play. A comparison of what the theory predicts and what the data actually show then helps pin down how exchange rate risk manifests in this particular industry, and what its distinguishing features are—something that should prove useful both for policymakers drawing up risk management frameworks and for firms looking to sharpen their own responses.

3. Conceptual Framework

The three classical theories—interest rate parity, balance of payments theory, and purchasing power parity—each shine a light on a different facet of exchange rate risk, and taken together they amount to something more than the sum of their parts: a framework that is both multidimensional and dynamic, useful for pinning down where exchange rate risk comes from, making sense of it, and figuring out what to do about it. These theories work at different time horizons and through different channels, which means each one picks up on drivers of exchange rate movement that the others may miss. The upshot is that, between them, they lay down an analytical foundation that neither firms nor policymakers can really do without when it comes to understanding—and ultimately managing—exchange rate risk.

Start with interest rate parity. This theory homes in on arbitrage and the way capital sloshes around short-term financial markets. The core idea is simple enough: where capital can move freely, an interest rate gap between two countries will set off cross-border arbitrage flows, and those flows in turn push spot and forward exchange rates around until the arbitrage opportunity is arbitrated away. In practice, though,

things rarely work so neatly. In economies where the capital account has yet to be fully opened up—and where foreign exchange controls or direct monetary policy interventions are still part of the picture—markets tend to linger in a state of 'imbalance' rather than settling into the equilibrium the theory predicts. China is a case in point. The market segmentation and restrictions on arbitrage that stem from policy choices are, in a real sense, a form of policy risk in their own right. If enterprises base their short-term financing or investment decisions on the theoretical interest rate parity, they may face unexpected exchange rate losses due to sudden restrictions on capital flows or non-market-driven adjustments to interest rates. Consequently, the interest rate parity theory not only reveals the risk of short-term exchange rate fluctuations driven by interest rate differentials, but also highlights how unexpected policy changes, under institutional frictions, exacerbate the uncertainty of short-term exchange rate risks.

Secondly, the balance of payments theory reveals the root causes of trend-related exchange rate risks from the medium- to long-term perspective of macroeconomic fundamentals. According to this theory, persistent imbalances in a country's current account (which reflects trade and income flows) and capital and financial accounts (which reflect cross-border capital flows) inevitably require exchange rate adjustments to restore balance of payments equilibrium. For example, a prolonged current account surplus creates upward pressure on the domestic currency, whilst sustained capital outflows may trigger depreciation pressure. It is particularly worth noting that, under the influence of the global financial cycle, capital flows exhibit strong pro-cyclicality: during economic upturns, large-scale capital inflows push up the domestic currency exchange rate, whereas during economic downturns, sharp capital outflows exacerbate depreciation pressure. This risk of 'sudden stagnation or even reversal of capital flows' is one of the primary exchange rate risks facing emerging market economies. The theory of the balance of payments therefore suggests that exchange rate risk management must not merely focus on spot market fluctuations, but must also monitor and analyse trends in the structure of the balance of payments to anticipate the medium- to long-term adjustment pressures accumulating within it.

Purchasing power parity, for its part, offers a benchmark for thinking about where exchange rates ought to settle in the long run—and, by extension, the risks that come with a currency being out of line. The gist of the theory is that the exchange rate between two currencies should track changes in their relative purchasing power. In the short term, of course, rates can stray a long way from what PPP would predict, knocked about by capital flows and swings in market sentiment; over the longer haul, though, there is a tendency for them to drift back toward parity. When the real exchange rate sits well away from the level implied by PPP for an extended period, it usually signals that the currency is overvalued or undervalued—and that a sizable correction may be building up. The causes of such misalignments vary: productivity gaps between countries (the Balassa–Samuelson effect), asset price bubbles, or persistent shocks to the terms of trade can all be at work. For businesses, spotting the risk of a long-term misalignment matters a great deal. A persistently overvalued domestic currency eats away at the competitiveness of exporters; a persistently undervalued one piles cost pressure onto importers and on firms carrying foreign-currency liabilities. In that sense, PPP gives firms and policymakers a qualitative anchor—a way of judging which

direction the long-term risk is pulling.

The risk mechanisms that these three theories lay bare do not, of course, operate in isolation; they tangle with one another and reinforce each other in ways that matter. To take one example, short-term capital flows—the sort the interest rate parity mechanism highlights—can worsen a balance of payments imbalance, and a balance of payments that stays out of kilter for long enough will in turn colour market expectations about where the long-run equilibrium exchange rate should be, which then pulls in yet more capital flows. What this means is that exchange rate risk is never purely one thing: it carries a financial dimension, a macroeconomic dimension and a valuation dimension all at once. A single sharp move in the exchange rate may well be the upshot of several forces converging—an arbitrage-driven capital shock, deteriorating fundamentals, and a valuation correction all hitting at the same time.

The takeaway is that effective exchange rate risk management cannot rest on a single theoretical lens or a single analytical tool. Managers need a more rounded, systematic way of reading the situation: they have to be alive to the volatility that short-term arbitrage stirs up in financial markets, able to spot the trend risks that build when macroeconomic imbalances go uncorrected over the medium to long term, and capable of judging how far the exchange rate has drifted from its long-run equilibrium value. Only by getting to grips with these tangled causes and sizing up risk exposure across different time horizons—short, medium and long—and across different drivers—financial arbitrage, fundamental adjustments, valuation reversion—can firms put together risk management strategies that are genuinely resilient and forward-looking. Anything less leaves them vulnerable in a global financial environment that is only getting more complicated.

4. Empirical Investigation

4.1 Variables and Their Justification

To carry out the empirical work, the study draws on annual time-series data spanning 2001 to 2023 and settles on five core variables. The dependent variable is China's total textile exports, calculated by aggregating major categories such as yarn and woven fabrics, and used to measure the scale of exports. The explanatory variables include: the real effective exchange rate of the Renminbi, used to measure the actual exchange rate level after adjusting for inflation; the domestic Consumer Price Index (CPI) and Producer Price Index (PPI), used to measure general domestic price levels and production costs respectively; and government investment in the textile industry, used to gauge the extent of government support for the sector.

4.2 Test for Stationarity of Variables

Prior to conducting VAR model analysis, it is necessary to perform ADF stationarity tests on each variable to avoid spurious regression caused by multicollinearity. Before building the VAR model, we first need to check whether the variables are stationary—skip this step and you run the risk of spurious regression. To that end, ADF unit root tests were carried out on each of the five core variables. The results are straightforward enough: in levels, every one of them (EX, REER, CPI, PPI, TEX) fails to reject the null

of a unit root at the 10% significance level. In other words, the raw series are non-stationary. That changes once we take first differences. For all five differenced series (DEX, DREER, DCPI, DPPI, DTEX), the ADF statistics fall below the 1% critical value, so the unit root null is rejected at the 1% level. The first-differenced series are stationary, and it is on these that the remainder of the analysis will be based. Furthermore, the results of the autocorrelation tests conducted on the selected variables show that the P-values are greater than 0.05; the null hypothesis that ‘there is no autocorrelation’ is accepted, thereby satisfying a further requirement for model construction.

4.3 Development of a VAR model

Building on the results of the stationarity tests, this section proceeds to construct a vector autoregressive (VAR) model. Firstly, the optimal lag order of the model is determined based on the results of various information criteria output by Stata. In tests covering lag orders (Lag) ranging from 0 to 3, the likelihood ratio test, residual error, Akaike Information Criterion (AIC), Hannan-Quinn Information Criterion (HQIC) and Schwarz Information Criterion (SIC) all consistently indicate that the optimal lag order is 2. Consequently, the lag order of the VAR model in this study is set to 2. On this basis, a VAR model has been established with the first-difference series of China’s total textile exports as the dependent variable; the specific form of the regression equation is as follows:

DEX_t

$$= 473.168DREER_{t-1} + 502.490DREER_{t-2} + 1457.335DCPI_{t-1} + 2480.609DCPI_{t-2} + 0.594DTEX_{t-1} - 0.230DTEX_{t-2} - 2848.314DPPI_{t-1} - 1221.563DPPI_{t-2} + 9459.947 + \varepsilon_t$$

The stability of the VAR model is a prerequisite for ensuring the validity of the impulse response and variance decomposition analyses. In this paper, the stability of the model is assessed using the unit circle test; the reciprocals of all eigenvalues lie within the unit circle (see Figure 1). This result indicates that the VAR model constructed in this paper satisfies the stability conditions, and that the model specification is robust, making it suitable for subsequent econometric analysis.

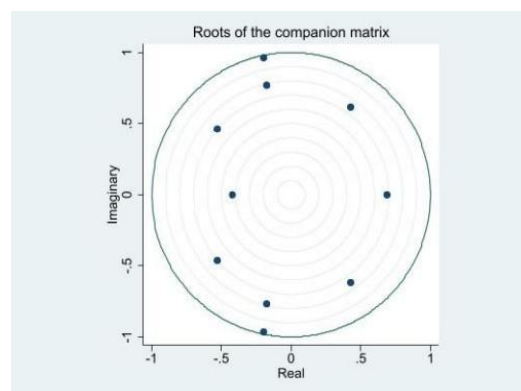


Figure 1.

4.4 Granger Causality Test

To examine whether there is a causal relationship between fluctuations in the RMB exchange rate and textile exports, this paper conducts a Granger causality test on the VAR model; the results are shown in Table 1:

Table 1. Granger Causality Test for the VAR Model

Dependent variable: DEX			
Excluded	Chi-sq	df	Prob.
DREER	7.9911	2	0.022
DCPI	4.8347	2	0.009
DTEX	12.013	2	0.002
DPPI	21.512	2	0.000
ALL	34.483	8	0.000

As shown in Table 1, at a 5% significance level, we can reject the null hypothesis that the RMB exchange rate is not a Granger cause of textile exports (P-value = 0.022). Therefore, fluctuations in the RMB exchange rate are a Granger cause of textile exports; in other words, changes in the RMB exchange rate in the previous period have a substantial impact on textile exports in the current period. Similarly, the Consumer Price Index is a Granger cause of textile exports at the 10% significance level. Government investment and the Producer Price Index are also Granger causes of textile exports.

5. Result

This chapter's empirical analysis selects China's total textile exports, the real effective exchange rate of the Renminbi, the Consumer Price Index, the Producer Price Index, and government investment in the textile industry as core variables; all data are sourced from authoritative institutions such as the National Bureau of Statistics, the General Administration of Customs, and the World Bank. The analysis reveals that the first-difference series of all variables are stationary. The VAR(2) model constructed on this basis passes the stationarity test, and the Granger causality test further confirms that fluctuations in the RMB exchange rate are a significant Granger cause of textile exports. The final quantitative results indicate that: a depreciation of the RMB significantly boosts textile exports in the short term; an increase in the domestic Consumer Price Index also exerts a positive driving effect; the stimulative effect of government investment on exports exhibits diminishing returns; whilst a rise in the Producer Price Index exerts a sustained inhibitory effect on exports by driving up production costs.

6. Conclusion

Plenty of studies have looked at exchange rate fluctuations and their bearing on imports and exports of

goods—work on the renminbi in particular has been voluminous. What has received far less attention is how RMB movements play out differently across sectors. This paper set out to fill part of that gap, combining theoretical and empirical approaches to probe the impact of RMB exchange rate fluctuations on China's textile exports. The analysis unfolded in three stages. First, taking stock of China's current circumstances, the paper traced the recent trajectory of both the exchange rate and textile exports. Second, drawing on a close reading of the relevant literature, it laid out a theoretical account of how exchange rate swings feed through into textile export performance. Third, and most substantially, it turned to the data—annual figures from 2001 to 2023—and brought vector autoregression (VAR) techniques to bear on the question.

What the data show is that fluctuations in the RMB exchange rate are the main driver behind swings in textile exports. The relationship is significant, and it comes with a lag. Since 2014 the RMB has been on a gradual depreciating trend, and the pattern that emerges is telling: a fall in the RMB exchange rate may initially push textile export volumes down, but before long they begin to climb back. Depreciation, in other words, tends to support sustained long-term growth in total textile exports. That is the upside. The downside is that while the currency is sliding, short-term exchange rate volatility can hit the textile industry hard—hard enough, potentially, to pose real challenges for broader economic development. It is with this tension in mind that the paper goes on to combine an analysis of the domestic situation with the theoretical insights developed earlier, putting forward policy recommendations aimed at managing the challenge.

Looking ahead, RMB exchange rate movements will remain a weighty factor shaping China's textile exports. As global economic uncertainty mounts, exchange rate fluctuations are liable to become both more frequent and more violent. That will put textile exporters on the back foot, requiring greater flexibility in how they respond. A further depreciation of the RMB could give textile exports a competitive edge, but it would also bring unwelcome side effects—rising raw material costs and heightened exchange rate risk among them. Firms will need to tighten their cost management and make more deliberate use of hedging instruments, while at the same time pushing up the value-added content and quality of what they sell. An appreciating RMB, on the other hand, would push up textile export prices and eat into market share. In that scenario, the imperative shifts towards technological innovation and product upgrading—exporting higher-value goods so as to stay competitive when price competition turns unfavourable. Across the board, then, the message is much the same: exchange rate swings are not going away, and firms that want to hold their ground will need stronger risk management, sharper market adaptability, and a willingness to diversify their channels if they are to keep growing sustainably.

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