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# China Macro

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## RMB:Imbalance≠Valuation≠Adjustment


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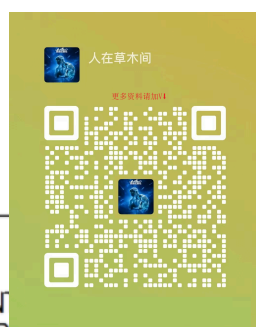
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- Λ **21%current-account gap is not the same thing as a 21%undervalued currency**.That is the central distinction missing from much of the current RMB debate.The IMF's latest External Sector Report estimates China's REER gap at -21.3%,but that number answers a narrow counterfactual: how much the real exchange rate would need to appreciate if the exchange rate alone were required to close the current-account surplus. It is not a direct estimate that the RMB is 21%below fair value.

- **The debate is therefore over-compressed.China's surplus is large,but it has several sources.** Weak domestic demand and excess saving have clearly suppressed imports and inflation.Corporate FX hoarding also delayed the normal translation from trade surplus to RMB appreciation. But part of the surplus also reflects China's productivity gains: technology upgrading,scale,supply-chain density and faster cost declines have made Chinese manufactured goods cheaper in real terms, even as the RMB has appreciated in nominal effective terms.

- **That makes a one-off RMB revaluation the wrong cure**.China needs a stronger REER,but that is more likely to come from domestic reflation, stronger absorption and gradual RMB appreciation than from a disruptive step move.

- **The rest of the world also needs to adjust.**If China's larger export share partly reflects genuine productivity outperformance,global rebalancing requires not just China importing more,but other economies catching up in productivity and competitiveness.





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INCOMPLETE DISCLOSURE INFORMATION MAYHAVE BEEN DISPLAYED,PLEASE SEE APPENDIX1FOR FURTHER DETAILS.



**IMF's latest estimate on RMB valuation is fueling an ongoing debate**.In the latest 2026 External Sector Report published on July 31,IMF staff assessed China's real effective exchange rate (REER)gap to have widened to -21.3%in 2025.This is a much larger gap than in previous years;the estimate was -8.5%in the previous year,and even smaller before that

This latest estimate will likely be featured prominently in the ongoing international debate about China's currency.The US Treasury's July 2026 Report on FX Policies cited an earlier IMF estimate that the RMB is 16%undervalued. Various European leaders also think RMB is undervalued,with their assessments ranging from 15%to 25%.Council on Foreign Relations'Brad Setser argues for an ever larger 30-35%undervaluation once China's trade surplus is adjusted for a few factors.

However,three IMF insiders-Gopinath,Gourinchas and Rey(GGR)-are cautioning the outside world against reading too much into this latest IMF point estimate.In arecent article,they argued that demands for RMB revaluation to fix global imbalances "get both the diagnosis and the cure wrong".

**We agree with GGR's assessment.The debate often bundles together three distinct issues:** China's trade imbalance,the RMB's valuation,and the exchange-rate adjustment required to reduce the surplus.These should be separated. China's external surplus is genuinely large,but the evidence for an equally large currency mispricing is much weaker.Bringing the surplus back toward normal levels will likely take several years.Over that period,the RMB should continue to strengthen,but domestic adjustment will matter more than a one-off FX revaluation.

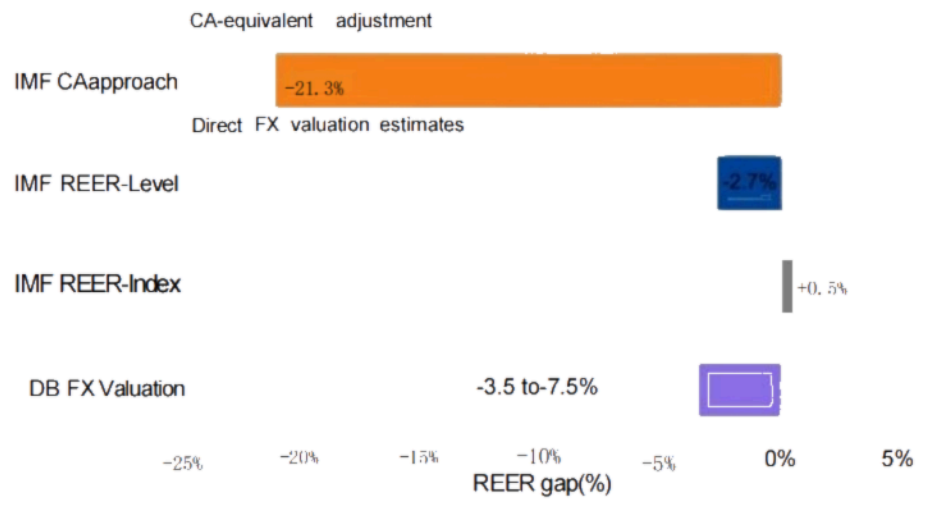
## The 21%measures the current-account gap,not the currency

**The IMF's estimate starts with China's 2025 current account surplus of 3.8%of GDP.**After adjusting for cyclical and temporary factors,it estimates an underlying surplus of 3.6%.It then compares this with a current-account"norm"of 0.6%-the balance its model associates with China's fundamentals and desirable medium-term policies.The difference is a 3.0 ppt current account gap.

**The 21.3%number is then produced by dividing this gap(3.0%)by China's estimated CA sensitivity to the REER(0.14).** It asks how much the REER would need to appreciate if the exchange rate alone reduced China's current account surplus from 3.6%of GDP to the IMF's 0.6%norm.The calculation is internally consistent,but it is not an independent estimate that the market price of the RMB is 21%below fair value.

**In fact,the same IMF report contains two direct estimates of RMB valuation, both of which are much more muted.** Its REER-Level model,which compares relative price levels across countries,finds the RMB undervalued by only 2.7%.Its REER-Index model,which explains RMB movements using China's economic fundamentals,concludes that the RMB is fairly valued at 0.5%above its historical benchmark.DB's FX Research Team reached a similar conclusion using three separate approaches:the RMB is undervalued by only 3-8%against a trade-weighted basket of currencies(seeFX Valuation Snapshot,June 2026).

Figure 1:The IMF's 21%gap measures China current-account gap,not the RMB effective exchange rate




*Source:Deutsche Bank Research FXValuation Snapshot June 2026,IMF 2026 ESR Report*

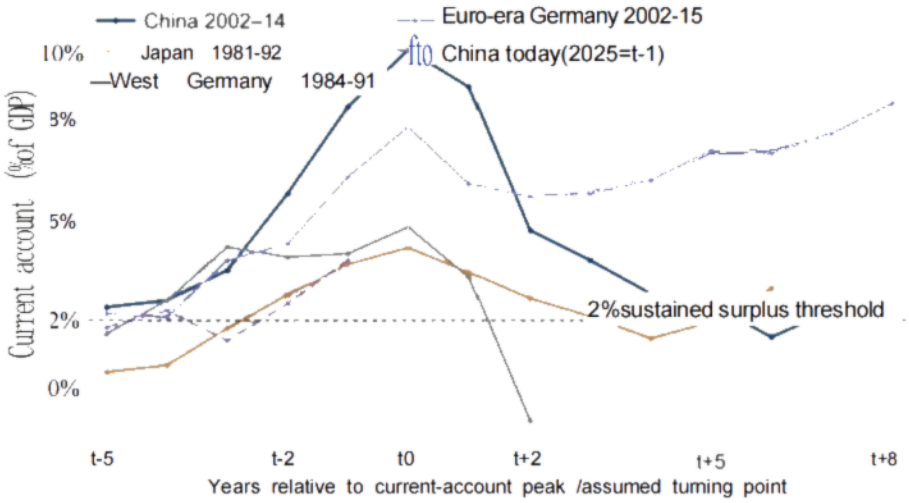
**We therefore read the IMF results as evidence that"China's surplus is more clearly excessive than the RMB is deeply undervalued".** The direct valuation models point to a currency close to fair value.The CA approach points to a domestic savings-investment imbalance that stillneeds to be resolved.

## Surplus reversals historically combine FX appreciation and domestic adjustment

**The current account is,by identity,the difference between saving and investment**.A surplus can narrow because households,companies or the government save less;because domestic investment rises;because a stronger real exchange rate increases imports and reduces net exports;or because foreign demand and the terms of trade change.Currency appreciation is therefore only one channel of adjustment,not the whole process.

**Historical experience suggests that domestic adjustment is at least as important as currency appreciation.** An 2010 IMF study identified 28 policy-induced current-account surplus reversals between 1960 and 2008.During those reversals,private savings fell by 3.3%of GDP and investment rose by 3.0%of GDP, while exchange-rate appreciation was moderate:both NEER and REER rose by about 10%on average.The adjustment also came mainly through imports rather than exports.Imports rose by an average of 4.2 percentage points of GDP,while exports as a share of GDP were virtually unchanged.In short,surplus adjustment was achieved primarily by stronger domestic demand in surplus economies,which lifted imports with little damage to exports despite FX appreciation.

Figure 2:Current account adjustment takes multiple years




Source:Deutsche Bank Research,IMF

**A comparison of recent adjustment in major economies highlights different paths-and the different roles their currencies played**.On one extreme,Japan's post-Plaza adjustment saw the yen nearly double against the dollar between 1985 and 1987 and rise roughly 30%in real effective terms,but the surplus rebounded once the appreciation stopped.On the other extreme,West Germany moved from surplus into deficit within two years with barely any currency movement at all-the swing was generated by an exceptional reunification investment and fiscal shock.Euro-era Germany is the less successful case:its real effective rate rose 4.5%during the 2002-07 surplus build-up and then fell 11% between 2007 and 2015,while the surplus stayed above 6%of GDP throughout-an adjustment that never happened in a currency area with no exchange rate of its own.

**China's own current-account reversal in 2007-13 was also largely driven by domestic stimulus.** China's surplus fell from about 10%of GDP in 2007 to below 2%in 2013.The reversal was accompanied by a 27%nominal and 31%real effective appreciation over five years,but the adjustment was possible because China relied heavily on a large domestic investment stimulus,while weaker global demand also helped.Importantly,the larger rise in the REER than in the NEER suggests that China's domestic demand and inflation were stronger than those of its trading partners.

## China's relative price gains is the main driver of its trade imbalance

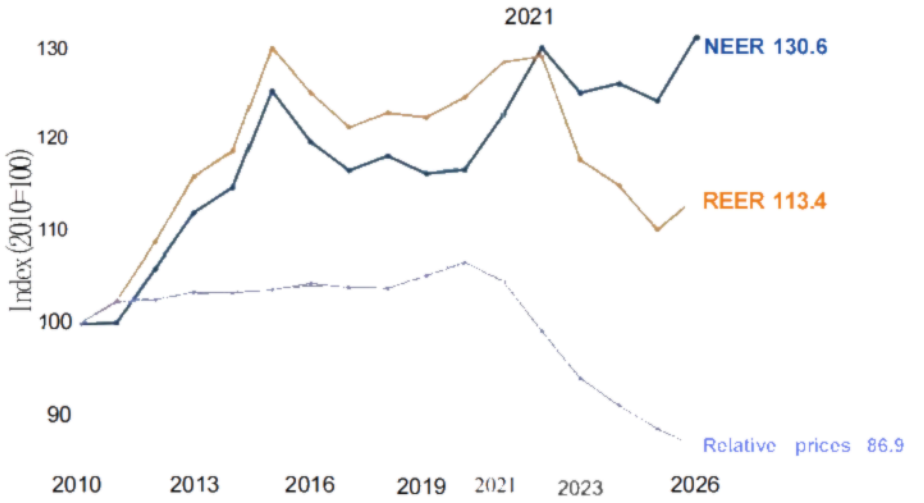
**The gap between nominal and real effective exchange rates is key to China's widening surpluses.** This is a point we have made repeatedly in previous reports, but it is worth emphasizing again because it reconciles two facts that otherwise look contradictory:the RMB has appreciated in nominal effective terms,while Chinese goods have become cheaper in real terms.

**The RMB itself is stronger than ever against China's trading partners.** Between 2021 and 2025,China's broad NEER compiled by the BIS rose by approximately

1.2%.It further appreciated by 5.5%in the first half of 2026,reaching its highest level in history.

**Yet the real prices of Chinese goods dropped sharply.** RMB REER fell by 15.1% between 2021 and 2025 and only rebounded by 3%in the first half of 2026.This is because China's domestic prices declined by 16.3%relative to its trading partners;China's consumer prices barely moved while producer prices dropped during this period while the world experienced a post-pandemic inflation surge. This real depreciation contributed to China's competitiveness gains despite RMB's nominal appreciation,resulting in a widening trade surplus.

Figure 3:China's real depreciation since 2021 came from prices,not the nominal RMB




Source:Deutsche Bank Research

**How did this real depreciation happen?**

**First and foremost,Chinese manufacturers have improved their price competitiveness** through technological upgrading,scale,and increasingly complete supply chains.Take EVs for an example:Tesla's Model Y base version, manufactured in its Shanghai Factory,saw its MSRP dropping by 40%on the Chinese market between 2020 and 2026.In comparison,prices dropped only by 20%on the US market.Foreign carmakers have been shocked by the quality improvements and price cuts in EVs made in China,but this should not come as a surprise;Shan Weijian gave a simple explanation by comparing productivity of Tesla factories in and outside of China.China is the world's largest EV market with a 60%share and has the greatest number of EV makers.The laws of learning curve and economy of scale in the manufacturing sector is the primary driver for China's real depreciation in EVs,as well as many other products.

**At the same time,China's economic downcycle also contributed to price weaknesses.** The property downturn has reduced investment,damaged household confidence and increased precautionary saving.Local-government balance-sheet repair has restrained fiscal demand.Competition among producers has compressed margins and prices,while household consumption has

not filled the space left by property and infrastructure.These forces have yet to reach a convincing turning point.

**A further contributing factor was the accumulation of FX assets by Chinese private firms.** Chinese corporates increased FX purchases and reduced FX settlement in recent years so they could hold more FX assets outside China and avoid holding a weak,low-yielding currency (see China Macro:The excess FX holdings of Chinese corporates).The total gap amounted to almost USD800bn between 2022 andH12025.This behavior muted the normal link between China's rising trade surplus and RMB appreciation.The RMB began to strengthen from H2 2025 onward,coinciding with the end of these FX-hoarding flows by Chinese corporates.

**Do not blame China's surplus on FX intervention**.The PBOC's core principle has been to smooth currency movements.As a result,its intervention over this period has more often leaned against depreciation than against appreciation.The daily USD/CNY fixing,for example,frequently stayed on the stronger side of the spot rate between 2022 and 2025.Had PBOC not intervened,The RMB would have been much weaker.

## Restoring balance requires multi-year adjustment,not a 20% one-off revaluation

**China's rebalancing needs a stronger REER,which in turn needs stronger domestic demand and stronger inflation.** Property sector stabilization would reduce precautionary saving and revive household confidence.Fiscal policy directed towards household income,healthcare,pensions and public services would support consumption more directly than another round of manufacturing investment.A new round of infrastructure investment into the so-called"six networks"will also boost domestic demand,in fact it has already led to higher imports growth this year.Importantly,a demand-driven recovery would not only allow the REER to appreciate,but also raise domestic interest rates and contribute to RMB nominal exchange rates.

**This does not mean that RMB appreciation would be ineffective,but that sequencing matters.** Appreciation is more likely to facilitate rebalancing when it accompanies stronger domestic demand and higher inflation,rather than when it substitutes for them.Without domestic adjustment,a nominal appreciation intended to close the relative-price gap could deepen the domestic forces-weak demand,deflation and low profit margins-that created the CA surplus in the first place.It would worsen domestic absorption and push Chinese manufacturers further to the exports market,eroding any initial gains from currency appreciation and failing to rebalance China's economy.

**The world also needs to accept the reality that China's productivity gains will eventually lead to its larger market share..**.This is an economic inevitability that cannot be prevented by either currency appreciation or domestic adjustment.A stronger RMB would be the result of China's real productivity gains;it would not run ahead of economic fundamentals and reverse China's increase in export share.As is highlighted in the previous section,past rebalancing cases were primarily driven by increase in imports rather than decrease in exports.China's upcoming adjustment willlikely follow the same playbook.

**….and to rebalance,adjustment must happen not only in China but also outside China.** New technologies such as AI,robotics,renewable energy and new materials are reshaping the manufacturing sector.Chinese manufacturers are reaping the benefits from early adoption and gaining a competitive edge.The rest of the world must catch up and gain productivity at a faster pace than their Chinese competitors.Only through narrowing productivity gap can the global imbalance be finally addressed.

**We expect RMB adjustment to be steady and gradual over the next few years.** The trade and CA surpluses are already creating underlying appreciation pressure,as exporters started to convert more of their FX receipts since late-2025.Meanwhile,China's low inflation created a persistent interest rate gap between RMB and other currencies,burdening RMB holders with a negative carry and slowed RMB's appreciation.This points to progressive appreciation rather than a sharp revaluation.Chinese policymakers would not accept a sharp appreciation either,which would completely go against their goal of reflating the domestic economy.

**In sum,external pressure for a one-off RMB revaluation is unlikely to solve China's surplus problem,while a domestic demand recovery would do more to raise imports,lift inflation and allow gradual RMB appreciation.The debate should therefore focus less on whether/by how much the RMBis mispriced,and more on how China can engineer a multi-year absorption-led adjustment.**

**Two prominent counterarguments deserve direct answers:**

- Brad Setser's 30-35%estimate is built by reconstructing China's current account from customs data,stripping gold imports and normalizing the investment income deficit,until the surplus reaches 6-7%of GDP.The procedure is biased upward by construction.More fundamentally,even a genuinely larger surplus would not imply a larger currency mispricing: converting a CA gap into "undervaluation"assumes the exchange rate does the adjusting,which is precisely what the historical evidence contradicts.
- Michael Pettis makes the subtler case that appreciation rebalances through household purchasing power.That channel exists,but it is likely second order.Household savings are primarily determined by the economic cycle,confidence and income expectations.Chinese households would not necessarily reduce saving materially simply because imported goods became cheaper.They might buy more imports, but they could also reduce domestic purchases at the same time, aggravating China's deflation problem.In other words,an externally induced NEER appreciation would be unlikely to generate enough REER appreciation to solve China's excess-saving problem.