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Imbalance Without Bretton Woods

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Trade imbalances are not new; they have occurred periodically throughout post-war history. But what makes today's imbalances unique is the apparent absence of a corresponding financial system to offset the one-sided trade flows. The Bretton Woods II system, which helped recycle USD trade receipts from surplus countries back into the US financial system, is no longer functioning as it did in the past.

This is our third note on global trade imbalances, following strong interest in the first two during our recent discussions. In our first note, RMB: Imbalance ≠ Valuation ≠ Adjustment, we argued that China's large current-account surplus would likely persist and could not be corrected by a simple one-off RMB appreciation. Our second note, Trade Imbalance and Rates Divergence, linked the trade imbalance to the RMB's unusual performance—namely, the rare combination of currency appreciation and falling yields against a backdrop of rising global yields.

In this third note, we go one step further: **why did previous trade imbalances, such as those in the 2000s, not cause a divergence in rates? What has changed today?**

The answer lies not in the imbalance itself, but in the accompanying financial mechanism. In the 2000s, China's surplus passed through the PBOC's reserve portfolio into dollar bonds. Official reserves stopped rising a decade ago, yet recycling continued through corporations and banks.

This financing—the so-called Bretton Woods II system that recycled Asia's surpluses into USD safe assets—has diminished significantly. A decade after China's official reserves stopped rising, we observe that China's private sector has also stopped accumulating USD safe assets. Similarly, the surpluses of Korea and Taiwan are largely being translated into holdings of US equities rather than bonds. As the recycling of surpluses becomes less dependable, more of the adjustment falls on market prices. We see this as a force behind a stronger renminbi and the divergence between low Chinese interest rates and higher US yields.

How did Bretton Woods II work?

Imbalances and Bretton Woods are closely related concepts in economic history. The original Bretton Woods system, established in 1944, not only pegged global currencies to the USD and the USD to gold, but also gave countries a framework for managing external imbalances and easing the pressure for abrupt adjustment. After the breakdown of the original system in 1971, the world experienced high inflation, high interest rates, and volatile exchange rates throughout the 1970s.

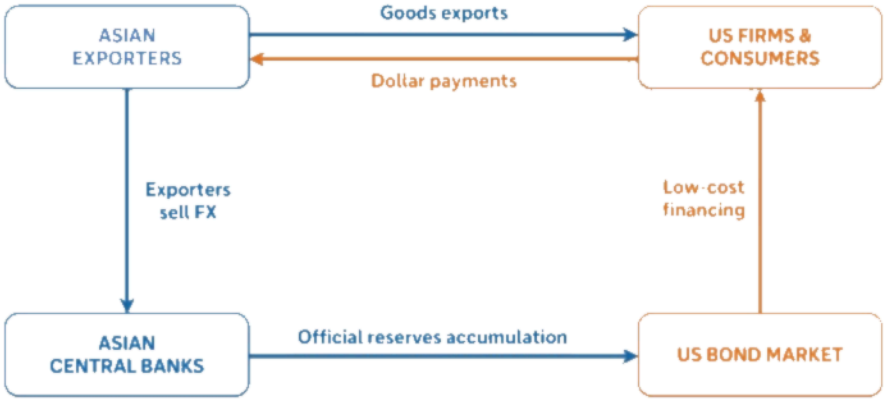
IMPORTANT RESEARCH DISCLOSURES AND ANALYST CERTIFICATIONS LOCATED IN APPENDIX 1. UNTIL 19th MARCH 2021 INCOMPLETE DISCLOSURE INFORMATION MAY HAVE BEEN DISPLAYED, PLEASE SEE APPENDIX 1 FOR FURTHER DETAILS.

Then came the Bretton Woods II system, a term developed by Michael Dooley, David Folkerts-Landau, and Peter Garber to describe the emergence in the 1990s of a new international monetary system. It replaced the previous Bretton Woods system and injected stability into global currency markets. The system comprised two groups of countries:

- **"The center"—the US, Europe, and Japan**: these economies had the world's largest consumer markets, issued reserve currencies, and hosted large, developed financial markets denominated in those currencies.
- **"The periphery"—emerging Asian economies**: these economies pursued export-led growth by selling their products to the center economies and accumulating FX over time. The periphery countries, in turn, invested their FX holdings in the center economies' financial markets, purchasing safe assets such as US Treasuries.

Figure 1 offers a simple illustration of how Bretton Woods II recycled USD trade payments back into the US financial system. Emerging Asia had become a major net supplier of capital, and much of its savings were directed towards safe dollar assets. The resulting demand helped finance the US current-account deficit and lower global long-term real interest rates. Asia's trade surplus, official reserves, and demand for US assets formed a single loop.

Figure 1: The Mechanics of Bretton Woods II: Trade Surpluses and Capital Recycling



Source: Deutsche Bank Research

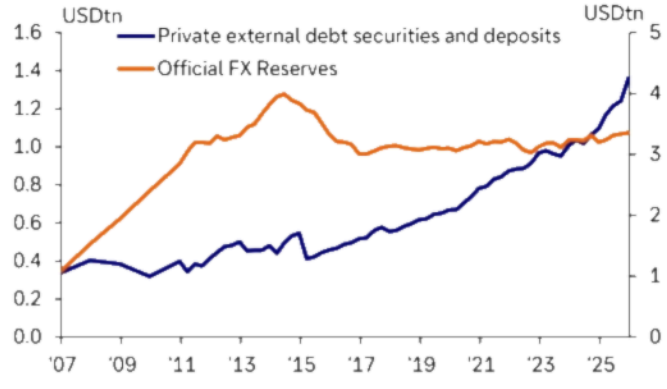
China in the 2000s illustrated the mechanism. American consumers bought Chinese goods, and Chinese exporters sold their dollar receipts to domestic banks. To limit RMB appreciation, the PBOC absorbed much of the surplus foreign exchange and invested it in reserve assets, predominantly safe and highly liquid dollar securities. The capital returned to US financial markets, helping finance the spending that generated China's surplus. As a result, China's official FX reserves rose from USD166bn at the end of 2000 to USD4trn at their peak in 2014.

China's official reserves stopped rising in 2014, but USD recycling continued until 2025

China's FX reserves peaked at USD4trn in 2014… By the end of 2016, they had fallen to USD3.01trn, a decline of almost USD1trn. Capital was leaving China, and the PBOC was no longer the automatic buyer of each new export dollar. This appeared to mark the end of Bretton Woods II.

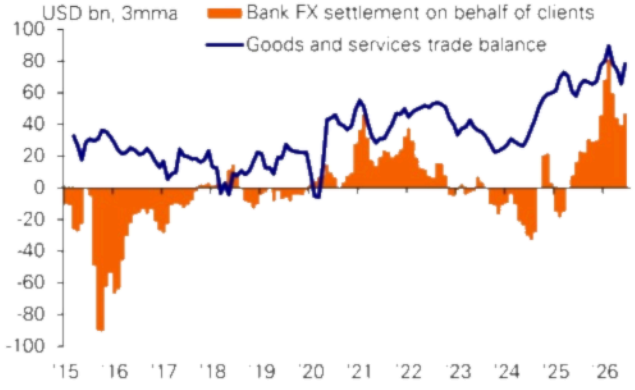
Yet Chinese savings continued to flow abroad into the USD market. Non-reserve external assets held by Chinese onshore banks and other sectors continued to increase after 2015. According to China's IIP statistics, total external deposits and debt held by Chinese onshore entities increased by USD1trn between 2015 and 2025. This figure likely understates total holdings, as it fails to account for assets held by offshore Chinese entities which are also likely sizable. A useful proxy is the persistent gap between China's trade balance and its banks' FX settlement balance, which points to roughly USD5trn of cumulative outflows between 2015 and 2025. **Thus, the USD recycling mechanism continued; only the holders of foreign assets changed, from the PBOC to Chinese banks and corporations.**

Figure 2: After China's official FX reserves peaked in 2014, Private FX holdings continued to increase



Source: Deutsche Bank Research

Figure 3: Bank FX settlement was significantly lower than trade balance in 2015-20 and 2022-24, suggesting private FX outflows



Source: Deutsche Bank Research

Chinese companies accumulated dollars from 2022 to H1 2025

The period from 2022 to H1 2025 is a classic example of how Bretton Woods II continued to operate despite little increase in the PBOC's official FX reserves:

- On the one hand, post-pandemic demand favored Chinese manufactured goods, the property downturn weakened domestic demand, and China's trade surpluses grew alongside US deficits. China maintained an annual goods-and-services trade surplus of approximately USD500bn in 2022–24, which expanded further to USD800bn in 2025.
- On the other hand, the RMB remained weak during these years, primarily because Chinese enterprises continued to convert their export revenues into overseas assets. Throughout this period, bank foreign-exchange



settlement and sales on behalf of clients recorded a persistent deficit, while corporate USD deposits overseas steadily increased.

As such, Chinese companies continuously exported products abroad and reinvested the USD foreign exchange proceeds back into US financial markets. This sustained the strength of the US dollar, while the weak RMB further stimulated Chinese exports. The Bretton Woods II system operated just as smoothly as it did in the 2000s.

Companies began to sell FX in H2 2025

Corporate behaviour changed as the renminbi started to strengthen in mid-2025. By Q4, expectations had shifted more clearly towards appreciation. Higher dollar yields now had to be weighed against potential currency losses. Exporters started to report exchange losses, not only on their unhedged receipts but also from existing FX assets. This made FX hedging and conversion more attractive. At the very least, exporters now have little appetite for accumulating more FX assets.

The bank FX market shows the sharp reversal among corporations. Client FX settlement exceeded FX sales by USD222bn in H2 2025, following a USD25bn net deficit in H1. The surplus increased further to USD338bn in January–August 2026. This reversal is consistent with companies becoming more willing to convert foreign currency.

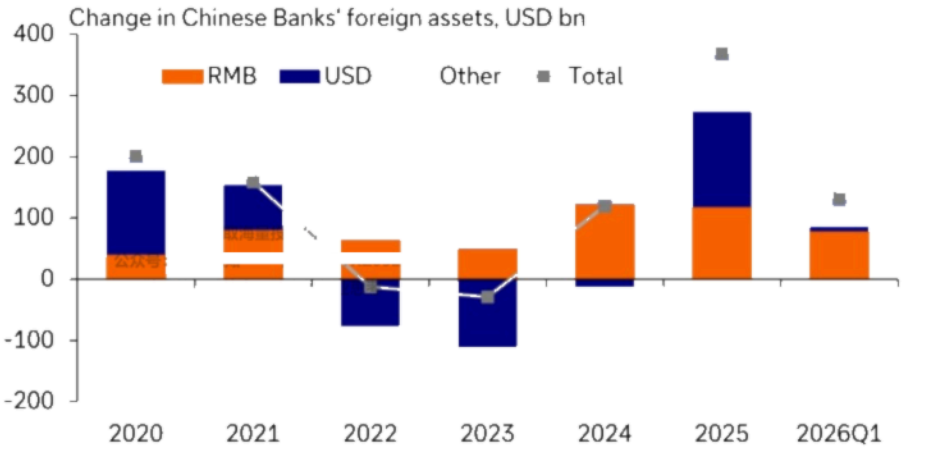
Banks increased dollar holdings in 2025, then almost stopped in Q1 2026

The dollars companies were less willing to hold still found a buyer in 2025: Chinese banks. Chinese bank external assets rose from USD1.61tr at the end of 2024 to USD1.98tr at the end of 2025, an increase of USD368bn. We read much of this as replenishment: their external USD assets had fallen from USD1.0tr at the end of 2021 to USD815bn at the end of 2024. In 2025 they rose by USD155bn to USD970bn, restoring the bulk of that earlier decline. More active corporate FX conversion could therefore coexist with limited PBOC FX purchases, with the RMB turning only moderately stronger.

By Q1 2026, however, dollar accumulation by banks also stalled. Banks' total external assets increased by another USD131bn in Q1 2026. But USD-denominated assets rose by only **USD7bn**. Instead, RMB-denominated assets accounted for USD78bn of the increase and other currencies for USD46bn. About 95% of the increase was in non-dollar assets.

Banks had several reasons to become less willing to add dollars. They had rebuilt much of the stock lost during 2022–24, while RMB appreciation raised the risk of losses on unhedged exposure. RMB internationalisation also created more opportunities to lend to non-residents in China's own currency.

Figure 4: Chinese Banks helped recycle USD in 2025, and then stopped in 2026



Source: Deutsche Bank Research, SAFE

2026: Imbalance without Bretton Woods recycling flows

The sequence is now clear: Chinese entities have gradually moved away from purchasing US Treasuries. The PBOC stopped accumulating reserves after 2014. Companies became less willing to add dollars in H2 2025. By Q1 2026, banks were adding very little as well. China's surplus remained large, while demand to absorb it into dollar assets weakened significantly. This is the change that makes today's imbalance harder to accommodate on the old terms.

It is not just mainland China; Korea and Taiwan have also generated little additional demand for Treasuries, as the bulk of their surpluses has been reinvested in the US stock market. According to official TIC data, Korean residents bought a net USD109bn of US equities between January 2025 and June 2026, while selling USD6bn of Treasuries. Taiwanese residents bought USD17bn of US equities, USD18bn of agency bonds, and USD14bn of corporate bonds, compared with only USD3bn of Treasuries. Unlike mainland China, their savings still reached US financial markets, yet only a small portion went into US government bonds.

Without the recycling of East Asia's surpluses, it is not surprising that US Treasury yields have risen alongside yields in other major markets.

Conclusion

Since the late 1990s, the Bretton Woods II system has functioned for nearly thirty years, outlasting even the original Bretton Woods system (1944–1971). As Bernanke's global saving glut analysis demonstrated, this spontaneously formed system continuously channelled East Asia's excess savings into USD financial markets. It maintained the stability of the international monetary system through many crises and also helped keep global interest rates low for a prolonged period.

Yet no system can last forever, no matter how stable it has been. The rise of AI has further concentrated trade surpluses in a handful of East Asian economies. Our analysis above suggests that East Asian central banks and corporations are no longer content simply to accumulate more USD Treasuries. While excess



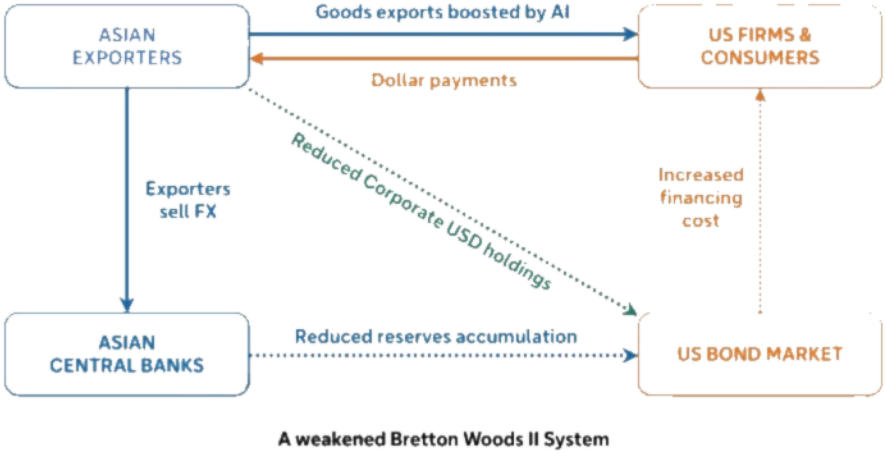
savings in East Asia—particularly in China—persist, they are no longer funding the core USD markets to the same extent. Instead, some of these excess savings have flowed into equity markets, while a larger portion has remained within domestic financial systems. Another portion has been converted into gold purchases: China's gold imports more than doubled YoY in USD terms in H1 2026, accounting for 10% of its total imports; likewise, gold imports by Korea and Taiwan also increased.

The weakening of the Bretton Woods II flows is highly consistent with the series of phenomena we currently observe, including a systemic rise in global interest rates, an anomalous decline in Chinese interest rates, strong stock market performance, and the depreciation of major currencies against gold.

Has the Bretton Woods II system come to an end, or is it merely facing temporary disruption? We have some preliminary thoughts on this question but have yet to reach a definitive conclusion. We will leave a detailed discussion to our next report.

What is relatively certain for now is that global trade imbalances will likely persist for some time, whereas the stable financing conditions once provided by BW2 have weakened significantly and are unlikely to recover soon. **Consequently, elevated global interest rates and high exchange-rate volatility are likely to persist**. Combined with oil-supply disruptions and surging gold prices, the global macroeconomic and financial environment shares many similarities with the 1970s—the transition period after the collapse of the original Bretton Woods system and before the establishment of BW2. The international monetary system may have entered a new era of volatility.

Figure 5: A Less Stable System: Rising Imbalances, Reduced USD Recycling



Source: Deutsche Bank Research