



record in Q4 – these outflows could potentially imply less pressure on the RMB in the months to come.

While China has enough foreign exchange reserves to pay off all external debt twice over, as is often noted its reserves level relative to the domestic deposit base is less impressive at 16%. But households in China don't seem to view currency risk with particular alarm. While only 2014 data are available on the breakdown of foreign currency deposits, in that year as the RMB depreciated slightly household foreign exchange deposits rose only USD5bn and represented less than 1% of household deposits.

The possibility that investors might redenominate domestic deposits is certainly an important risk for policymakers to consider. In that event – a run on the currency – foreign exchange reserves will not be enough to defend the currency and extremely tight capital controls – tighter than China has had for some years and possibly interest rate increases would be needed. But we don't see that as a reasonable baseline scenario for China.

Does China need a weaker currency?

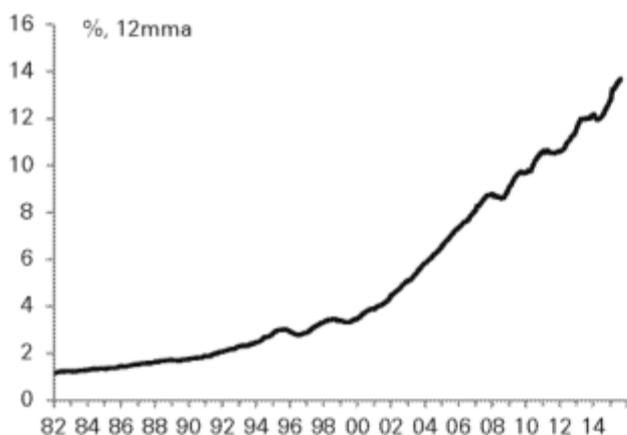
One reason we don't see domestic capital flight as a major concern at this point in time is that we think investors well understand that the currency's value is ultimately protected by the current account surplus. That surplus isn't as large as it once was, but at a trailing USD276bn over the past four quarters and likely to remain well above 2% of GDP in the year or two ahead the surplus remains a formidable support for the currency once external debts have been brought down to more sustainable levels.

*External debts are finite and China has more than enough reserves to cover them.*

*But they don't have enough to allow a significant redenomination of deposits.*

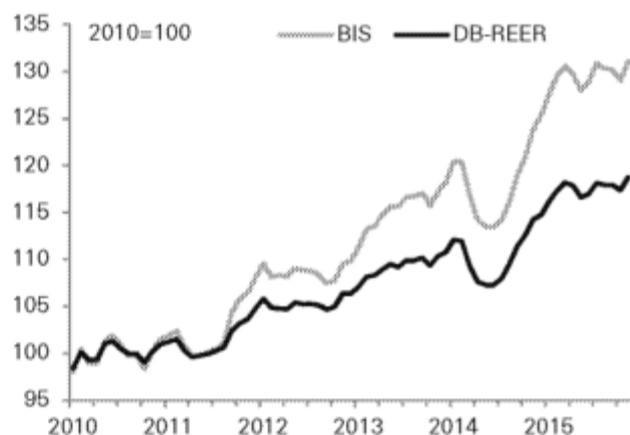
*With a current account surplus still well above 2% of GDP ...*

Figure 7: China's share of world exports



Sources: Hever and Deutsche Bank

Figure 8: DB's alternative real exchange rate for China



Sources: BIS, Ministry of Customs, UN COMTRADE and Deutsche Bank

Figure 7 shows something quite astonishing to many investors: China's share of world exports continues to rise at the same rate – 0.6% a year – as it did during the pre-crisis years. It has risen much faster than that in 2015 (through August) despite the much faster appreciation of the RMB in trade-weighted terms.

*...and a rising share of world exports, China doesn't seem uncompetitive.*