



The first phase of that transition was a crawling peg regime from 2005 to 2013 and with it the progressive widening of the trading band around the central parity rate. The August 11 announcement made the central parity more market determined. The introduction of a reference basket provides some guidance for how the PBOC views the value of the currency – and perhaps an indication of future interventions.

It may be stretching things too far at this early stage, but one might conclude from Figure 3 and both the August 11 changes and the recent interventions that the policy framework is to try to keep the trade weighted value of the currency within a roughly 100 to 105 range on the CFETS index. Time will tell.

It looks like PBOC has a view on where the trade-weighted RMB should be valued.

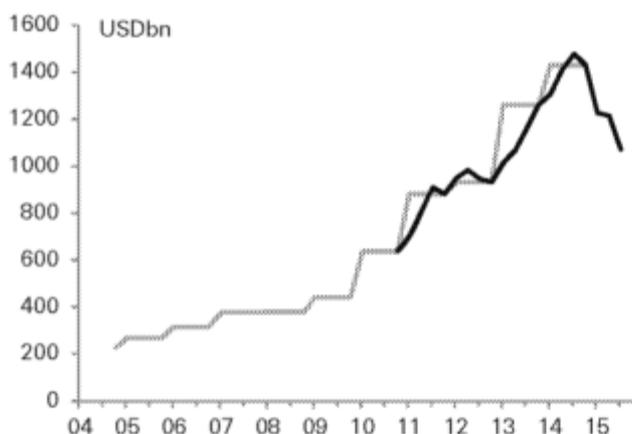
How much capital outflows?

At our conference this week, many investors expressed fears that the weakness in the RMB is being driven by capital flight and that even China's USD3.3tn of foreign exchange reserves aren't enough. It is remarkable, on reflection, to hear such talk when not 18 months ago most people we met thought China's reserves were excessively high. While we don't have Q4 balance of payments data, the data through Q3 suggest that capital outflows have been largely due to repayment of external liabilities/unwinding carry trades.

In Figure 5, we show the stock of external debt as reported in China's international investment position excluding foreign ownership of domestic bonds, which are expected to continue to rise as China opens up the bond market to foreign investors including sovereign wealth funds. External loans and bond plus currency and deposits held by non-residents plus trade credit and "other" debts rose quickly from USD440bn at the end of 2009 to a peak of USD1.47tn in September 2014 as Chinese firms and investors took advantage of record low interest rates abroad. But by September 2015 these liabilities had fallen by USD400bn. Over those four quarters, China's foreign exchange reserves fell a currency adjusted USD258bn despite a current account surplus of USD276bn. So total capital outflows of USD534bn, including the errors and omissions in the balance of payments were dominated by debt-reducing outflows.

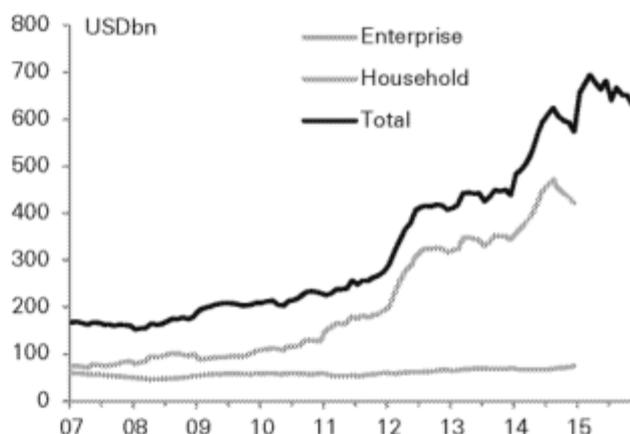
We estimate that of the \$534bn of capital outflows over the year to September, \$400bn went to repaying external liabilities.

Figure 5: External debt liabilities



Sources: CEIC and Deutsche Bank

Figure 6: Domestic foreign currency deposits



Sources: CEIC and Deutsche Bank

How much more external debt needs to be repaid? We think it is plausible that borrowers will want to take liabilities down to end-2009 levels (some borrowers, of course, will hedge rather than repay external debts). That implies a further USD600bn or so of outflows. Some of that will have left in the fourth quarter of last year already. With a rising trade surplus – another

Perhaps another \$600bn needs to be repaid.