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Macro Picture:

**China's Currency Dilemma: Growth,
Consumption, and Global Imbalances**

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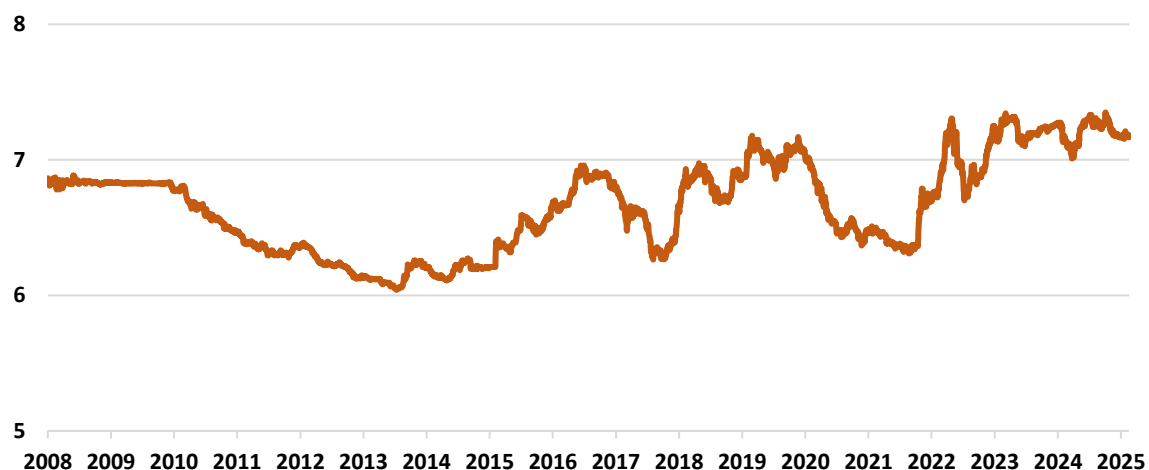
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Executive Summary

- ✧ Global imbalances reflect the U.S.'s persistent deficits and China's surpluses rooted in repressed consumption and investment-heavy growth. Adjustment requires China to raise household demand, with currency appreciation seen as a key—though politically and economically difficult—mechanism.
- ✧ China faces a currency trilemma—appreciate, depreciate, or hold steady—each carrying risks, while Europe's own surpluses, especially Germany's, highlight that imbalances are a broader systemic issue, not just a China–U.S. problem.
- ✧ China's economy grew 5.2% in Q2 2025, above target but with slowing momentum, as policy support cushioned tariffs while structural weaknesses persisted—marked by a deep property slump, weak consumer sentiment, muted investment, and rising deflationary pressures.
- ✧ Trade rebounded in H1, driven by exports (+7.2%) and diversification toward ASEAN and Belt and Road partners, but falling imports and tariff-related distortions highlight fragile domestic demand and the risk that recent gains may not be sustainable.
- ✧ China's investment-led growth, fueled by high savings and repressed consumption, has built global surpluses and rising debt risks, leaving household demand structurally weak.
- ✧ The renminbi sits at the core of this imbalance: a weak currency sustains exports but limits purchasing power, while appreciation could aid rebalancing but hurt competitiveness.
- ✧ Stronger RMB carries short-term costs—lost exports, job losses, industrial stress, and higher debt risks—amid deflationary pressures and political resistance from exporters.
- ✧ Depreciation offers only temporary relief, worsening imbalances; real solutions lie in boosting household incomes, social safety nets, and shifting toward consumption-driven growth.
- ✧ Beijing has intervened heavily—via state banks absorbing inflows and record offshore bill sales—to prevent RMB appreciation, sustaining weak household demand and export dependence while reinforcing global imbalances.
- ✧ Many commentators argue for gradual RMB appreciation backed by reforms, which would boost household purchasing power and advance China's goal of internationalizing the renminbi, though at the cost of export competitiveness.
- ✧ Devaluation is not a solution: in a surplus economy with an undervalued currency, it depresses consumption and risks retaliation. China's real problem lies in structural imbalances—household income suppression and overreliance on external demand—rather than the exchange rate itself.

Key Picture: Chinese Yuan Renminbi to One U.S. Dollar, Not Seasonally Adjusted



Source: FRED

The Currency Debate

The debate over global imbalances centers on how persistent surpluses and deficits distort the world economy. The United States has sustained structural current account deficits, while China has relied on large surpluses built on repressed household consumption, high savings, and investment-heavy growth. These imbalances are not just accounting curiosities; they represent transfers of demand across borders that fuel instability and generate political tension.

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The core adjustment must come from the two largest economies: China and the United States. For global imbalances to narrow, China must raise the household share of GDP and shift away from dependence on external demand. Currency appreciation is one potential mechanism: a stronger renminbi would improve household purchasing power, reduce the implicit transfer from consumers to producers, and encourage a rebalancing toward domestic demand. Without such adjustment, China's surpluses will continue to weigh on the global system, leaving other economies exposed to the consequences.

China is navigating a currency policy trilemma: whether to allow the renminbi to appreciate, depreciate, or remain broadly stable. Each path presents near-term challenges. Appreciation could weigh on export competitiveness, depreciation might raise concerns over capital outflows and debt servicing, while stability requires sustained intervention and constrains monetary flexibility.

However, this is easier said than done. For example, Europe, [while voicing dissatisfaction with China's unfair trade practices](#), has itself been at the center of persistent global imbalances. Germany in particular has long resisted scrutiny of its current account surpluses, preferring to deflect attention rather than confront the distributional tensions they create within the euro area and globally.

Domestic Economic Context

China's GDP grew 1.1% quarter-on-quarter in Q2 2025, slightly below the 1.2% pace in Q1 but above market expectations of 0.9%. Year-on-year growth came in at 5.2%, easing from 5.4% in Q1, bringing H1 growth to an average of 5.3%—well above the government's 5% target. The resilience reflects earlier reopening momentum and Beijing's policy support, including rate cuts and liquidity injections, which helped cushion the tariff-hit economy. Still, the moderation points to underlying fragilities despite meeting short-term goals.

Industrial activity was mixed in Q2: factory output rose 6.8% YoY in June, but retail sales slowed to 4.8% as consumer sentiment weakened. Fixed investment grew just 2.8% in H1, with real estate investment plunging 11.2% and home prices down 3.2% YoY, extending the property slump. Inflation remained muted—CPI rose only 0.1% and PPI fell 3.6% in June—highlighting weak demand and a deepening deflationary cycle that continues to weigh on growth.

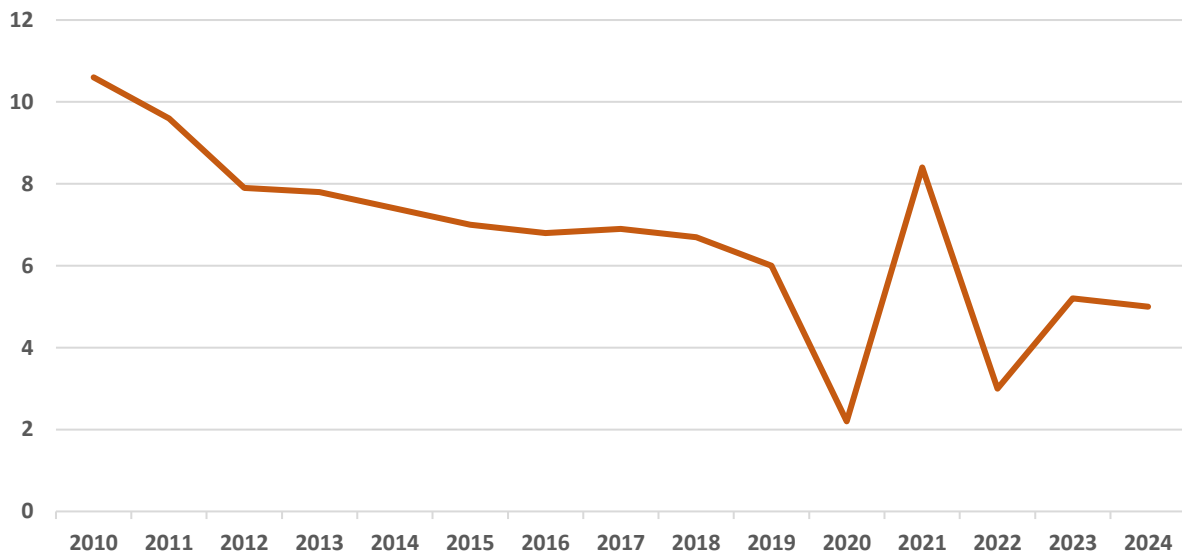
In Q2, policymakers deployed targeted monetary and fiscal support. The PBoC cut rates and added liquidity, while Beijing boosted infrastructure spending and expanded consumer subsidies such as appliance trade-ins, giving a temporary lift to demand. Yet large-scale stimulus was avoided amid high local debt risks. Investors now look to the July Politburo meeting for further measures, as deflationary pressures, a property slump, and weak confidence suggest stimulus alone may not offset structural drags. GDP grew 5.2% in Q2, keeping H1 on track but with softer momentum.

China's trade sector regained momentum in Q2 2025 despite global headwinds. Total goods trade rose 4.5% YoY, lifting H1 trade to \$3.04 trillion (+2.9% YoY). The rebound was export-driven, with shipments up 7.2% while imports fell 2.7% on weak domestic demand, widening the trade surplus. Exports surged in June (+5.8% YoY), fueled by front-loading ahead of US tariff hikes. Shipments to the US jumped over 30% month-on-month, while sales to ASEAN rose 16.8%, highlighting both tariff-related distortions and growing regional diversification. Imports showed their first increase of the year in June (+1.1% YoY), hinting at tentative domestic stabilization.

Trade with Belt and Road partners expanded 4.7% in H1, now accounting for over half of China's trade, offsetting weakness with developed markets. Still, US tariffs and softer global demand are expected to weigh on exports in H2, with analysts warning that recent gains may prove temporary. Overall, China's trade has been resilient and adaptive, but sustaining momentum will be a key challenge going forward.

Deflation has re-emerged as a key challenge for China in 2025, in contrast to inflation elsewhere. Flat prices, weak demand, and industrial overcapacity have raised fears of a deflationary spiral, forcing Beijing to balance efforts to restore confidence and price stability against the risk of fueling new financial vulnerabilities.

Figure 1: Full Year GDP Growth



Source: FRED

China's Currency Trap

An Investment-Heavy Growth Model

China's rise to the world's second-largest economy is closely tied to its investment-led growth model, fuelled by high domestic savings shaped by government policies. These savings have funded subsidized lending into infrastructure, manufacturing, and real estate, enabling China to expand investment far faster than peers at a similar stage of development. However, vast investment needs have been boosted by domestic savings through policies that repressed consumption. This repression works [through mechanisms](#) such as low wage growth relative to productivity, limited social safety nets that encourage precautionary saving, and financial repression—where households earn low returns on deposits while cheap credit is directed to state firms and local governments.

The Imbalance Problem

This imbalance creates two problems. First, it ties China's growth to external demand just as the rest of the world struggles to absorb rising Chinese surpluses. Second, it forces Beijing into an investment treadmill: high growth requires ever-higher investment, even in increasingly unproductive projects, raising debt risks.

Weak household consumption has become central to China's policy debate, with Xi Jinping and other leaders stressing the need to boost demand as economic headwinds mount. Ahead of the 15th Five-Year Plan, officials are weighing how strong the Chinese consumer really is and what policies could spur spending. The renminbi sits at the heart of this dilemma. Allowing the renminbi to appreciate would shift income toward households and help reorient and rebalance the economy.

The Renminbi at the Heart of the Dilemma

Keeping it weak supports exporters but suppresses household purchasing power, reinforcing low consumption. A stronger currency, by contrast, could encourage rebalancing toward consumption but would erode manufacturers' competitiveness just as Beijing leans on them to offset the property downturn and weaker local government spending. Importantly, China's export strength and weak domestic demand are two sides of the same coin: policies that boost one inevitably constrain the other.

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The Costs of Appreciation

The transition costs of a stronger renminbi would also be significant. In the short run, exports would likely fall faster than domestic demand could rise, since factories would need time to retool and redirect production toward the domestic market. This adjustment could trigger job losses, weaker industrial profits, and financial stress in debt-heavy manufacturing provinces.

Policymakers remain cautious about appreciation given current conditions of falling producer prices, near-zero consumer inflation, and fierce competition. A stronger renminbi could entrench deflation, suppress demand further, and blunt monetary easing, while also increasing pressure on fiscal policy in an already debt-laden system. Political economy constraints add to the challenge: powerful export-oriented industries resist appreciation, and PBoC efforts to support the currency through reserve sales would tighten liquidity, raise interest rates, and worsen debt-servicing costs in an economy where total debt already exceeds 300% of GDP.

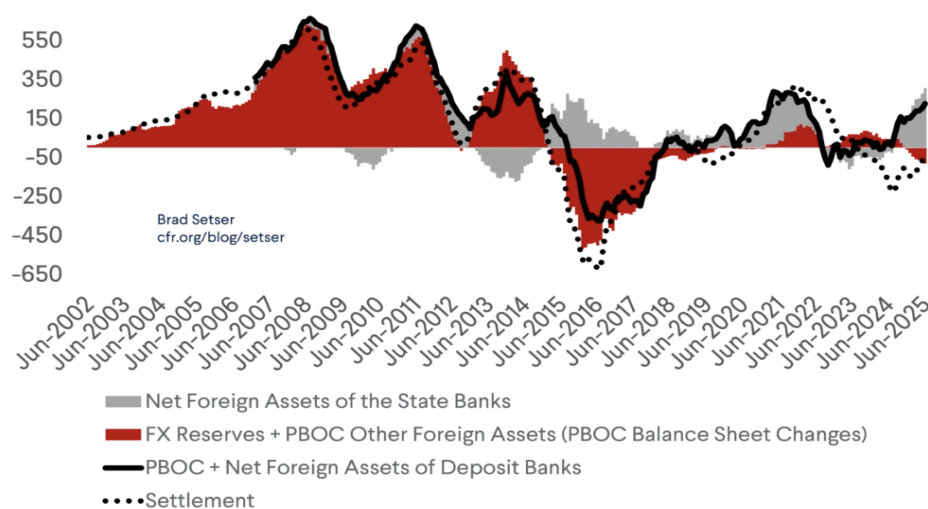
Why Depreciation Isn't the Answer Either

Even if depreciation offers exporters temporary relief, it deepens structural imbalances—high savings, weak household consumption, and reliance on external demand. The real solution lies not in currency management but in reforms to strengthen household income and consumption, expand social safety nets, and shift growth away from investment and exports toward a more sustainable domestic base.

Beijing's Intervention to Prevent RMB Appreciation

So far, evidence suggests that Beijing has been resisting pressures for the renminbi to strengthen. [As Brad Setser notes](#), state banks have absorbed massive foreign inflows to prevent appreciation. This intervention sustains China's weak household demand and export-led growth, reinforcing precisely the kind of global imbalances that Wade and Pettis argue destabilize the world economy.

Figure 2: Foreign Asset Accumulation: FX Settlement is Now At Odds with Other Indicators



Source: [CFR](#). Note: Trailing 12-months sums, USD billion

[The PBoC issued 60 billion yuan of bills in Hong Kong in January](#), its largest-ever single offshore yuan bill sale in the city and the first such issuance in January. The auction was oversubscribed 2.16 times. It was meant to support the renminbi as it faces renewed pressure from economic weakness and Trump's tariff threats. The move drained offshore liquidity, making it costlier for traders to short the currency, though markets still expected gradual depreciation.

Conclusion

Many international commentators argue that Beijing could instead guide the renminbi toward gradual appreciation, supported by domestic reforms that demonstrate credibility and stability. Such a move would not only bolster household purchasing power but also advance China's strategic objective of elevating the renminbi's global role and contributing to a more multipolar international currency system.

A stronger currency would boost household purchasing power and support long-promised rebalancing toward consumption, but it would also erode the competitiveness of China's manufacturing sector at a time when exports are doing much of the heavy lifting. At the same time, further devaluation is not a viable escape route. [As Michael Pettis, drawing on Ragnan Nurkse](#), has argued, devaluation is expansionary only when correcting an overvalued currency. In a surplus country with an already undervalued exchange rate, it is contractionary: it taxes consumers, deepens underconsumption, and risks retaliation abroad.

Taken together, this highlights the structural trap at the heart of China's growth model. The renminbi cannot easily rise without undercutting industry, nor fall without worsening imbalances at home and abroad. What appears to be a currency dilemma is in fact a symptom of deeper distortions: household income held down to sustain investment and exports, leaving China dependent on external demand. Until this imbalance is addressed, exchange-rate management—whether resisting appreciation or flirting with devaluation—will only paper over the problem rather than resolve it.