China rates: Maintain pay 3y NDIRS position

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Tighter liquidity and higher bond supply are key drivers.

- We stay paid 3y NDIRS, targeting a move to 1.60% by end-July.
- Liquidity has finally tightened, with the 7d repo fixing back above 1.4%. The PBoC's net liquidity drain via medium- to long-term monetary policy tools since March is finally starting to filter through.
- Government bond supply will likely pick up in Q3 after CGB and LGB issuance only reached 35% of the annual target at end-May (compared to 39% in 2025). Also, there are signs that funds have started to take profit on long bond positions.

The long-awaited liquidity normalization has finally happened

In the last week of May, China rates rallied by 4-6bp across tenors, owing to flush liquidity (the PBoC net injected RMB100bn via 1y MLF and conducted a relatively large amount of OMOs), the 5bp decline in the 1y MLF rate to 1.45% (source: *Bloomberg*) and media reports that local governments guided rural banks to invest more in bonds than NCDs (source: *Wind* ; our preliminary data has not yet shown such a pattern).

Then, in June MTD, China rates rebounded by ~4-5bp from the low. In our view, **liquidity continues to be the key driver of China rates**, as has been the case since April. Considering the slow pace of government bond issuance (especially LGBs) in the first five months of the year, **bond supply** should start to garner more attention in coming months, as large/concentrated bond issuance could mean tighter liquidity and some improvement in the economic growth outlook (with fiscal expenditure speeding up). On the **demand** side, after accumulating a large amount of (ultra) long-end CGBs/PFBs in April and May, onshore funds reduced their bond holdings in June. It remains to be seen whether such outflows can sustain, or if there will be buy-on-dip flows once 10y and 30y CGB yields reach key levels of 1.75% and 2.25%, respectively.

In this report, we present our view on liquidity and bond supply/demand outlook and provide an update on our China Rates Trading Model (CHaRT).

Liquidity

1. **OMOs:**

The PBoC skipped OMOs on 3 and 4 June but resumed operations on 5 June. Looking at the moves in money market rates, both DR007 and 1y NCD yields started to rebound on 5 June. Thus, we interpret the PBoC's OMO pattern as an effort **to net inject short-term liquidity via 7d OMOs when there is real demand in the market** (i.e., on the dates when money market rates are likely to move higher), and skip OMOs as needed to avoid injecting too much liquidity and bringing already-cheap funding costs even lower.

Note that prior to 3 June, the last time the PBoC skipped an OMO was on 7 August 2024. At that time, the DR007 dropped to ~1.69% on 2-6 August, below the 7d OMO rate of 1.70%. While we do not think there is any material difference between the OMO gross injections of RMB0.5bn (which happened on a few days in April and May), RMB0.2bn (2 June) and RMB0bn (3 and 4 June), the PBoC might still send a signal to the market that **it could skip OMOs if there is no demand and it does not want money market rates to decline further.**

Figure 1 shows the outstanding OMO amount. **In previous years, the PBoC usually became more proactive in liquidity injection via OMOs in the last 1-2 weeks of June**, to smooth the funding tightness amid higher government bond supply, tax payment and

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quarter-end funding needs. **In this year, however, the short-term OMO liquidity injection started earlier.**

2. **Medium- to long-term monetary policy tools (ORR, MLF, net CGB purchases):**

As we have *flagged* in previous reports, large net liquidity injections by the PBoC in January-February were one of the main drivers of super flush liquidity in recent months. The total net liquidity injection of RMB2.05trn in January-February 2026 was clearly well above the average levels over the past few years (Figure 2). From March to May, the PBoC net withdrew RMB200bn, RMB560bn and RMB850bn of liquidity, respectively (mainly via ORRs, Figure 3). In June so far, the PBoC further net drained RMB300bn via 3m ORRs on 5 June. Accordingly, **the cumulative medium- to long-term net liquidity injections from the PBoC since start of the year** (via ORRs, MLFs, the PBoC's net CGB purchases and RRR cuts; excluding OMOs) **dropped significantly to RMB140bn latest, well below 2020-25 average of ~RMB1.1trn.** This is consistent with our view in the mid-May *update*, and money market rates did eventually react to the low absolute level of liquidity in the market in May, albeit at a gradual pace.

3. **NCD:**

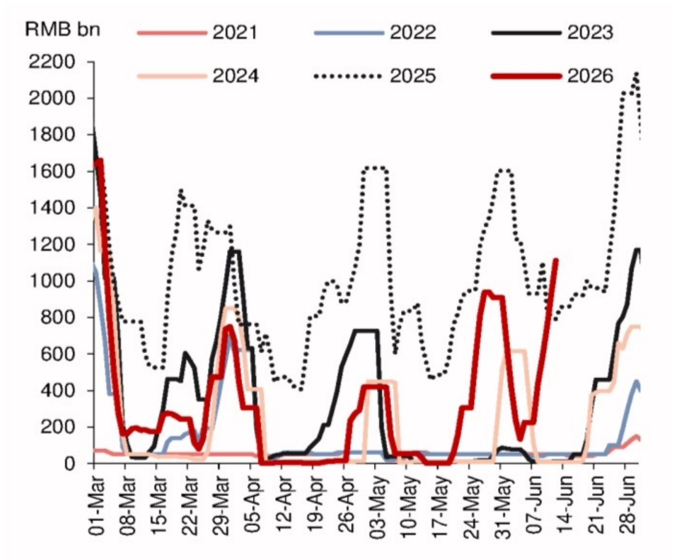
Monthly net NCD issuance has been in negative territory most of the time since June 2025 (except October 2025), as the PBoC was proactive in injecting medium- to long-term liquidity to the market over that period (including the 50bp RRR cut in May 2025). Banks were equipped with enough funding and it was not necessary to expand their liabilities through the NCD market. However, **in May, net NCD supply turned positive for the first time since October last year**. If we look at weekly data (Figure 4), net supply was positive during the weeks of 18 May and 1 June, and this is why NCDs have garnered more attention lately; when net supply turns positive, large NCD maturities matter more (RMB940-960bn this week and next week; RMB730bn in the week of 22 June) and NCD yields should face more upside pressure as well.

4. **Our view on liquidity in coming weeks:**

We continue to expect the PBoC to be more flexible with 7d OMOs to inject short-term liquidity amid higher government bond supply, as well as tax payment and month-end funding needs. As for medium- to long-term liquidity (ORRs, MLFs and net CGB purchase combined), the PBoC might continue to drain in June, but we expect the pace to slow from April and May, as the current YTD cumulative injection is already below that of previous years (except 2021).

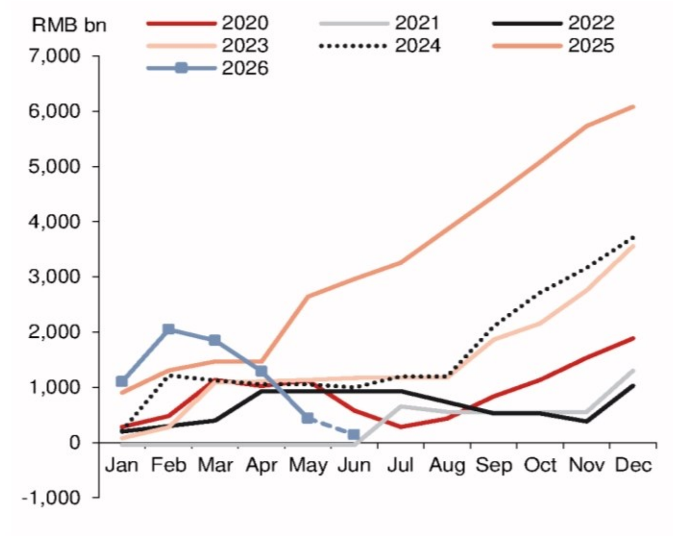
Figure 5 shows that, while **DR001 already started to grind higher around mid-May, DR007 and 1y NCD yields only began to rebound more significantly since 5 June.** This is worth noting, as if only the overnight rate climbs higher but 7d and 1y money market rates remain stable, it would be difficult to conclude there was an increase in broader funding costs. In the past week, **with DR007 and 1y NCD yields rising, market expectation for tighter liquidity have been growing as well.** Considering large NCD maturities in the next two weeks, tax payment effects (due on 15 June) and a potential pickup in LGB supply in the last week of June, we see further upside in money market rates. **We expect the 7d repo fixing to continue moving higher towards 1.50% (or slightly above that) through the rest of June.** The monthly average spread may widen to 5-10bp in June from -3bp in May, which is also consistent with seasonality (Figure 6).

Fig. 1: Outstanding OMOs



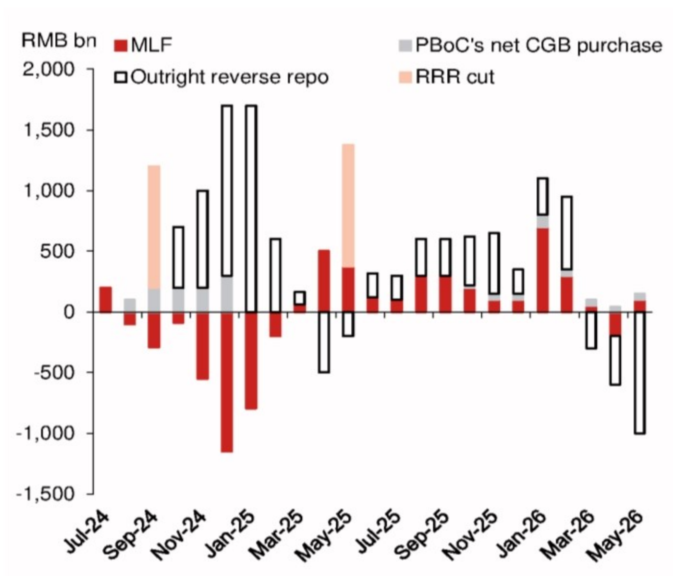
Source: Wind, Nomura

Fig. 2: The PBoC's medium- to long-term net liquidity injections (cumulative from the start of the year)



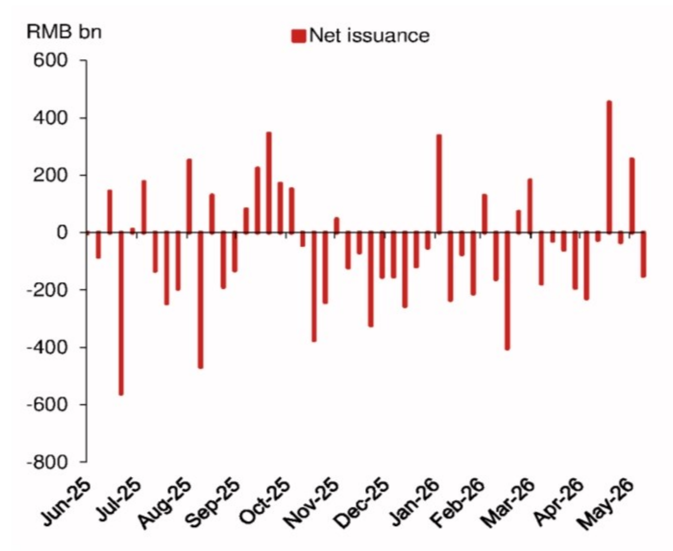
Source: Wind, the PBoC, Nomura

Fig. 3: The PBoC's medium- to long-term net liquidity injections



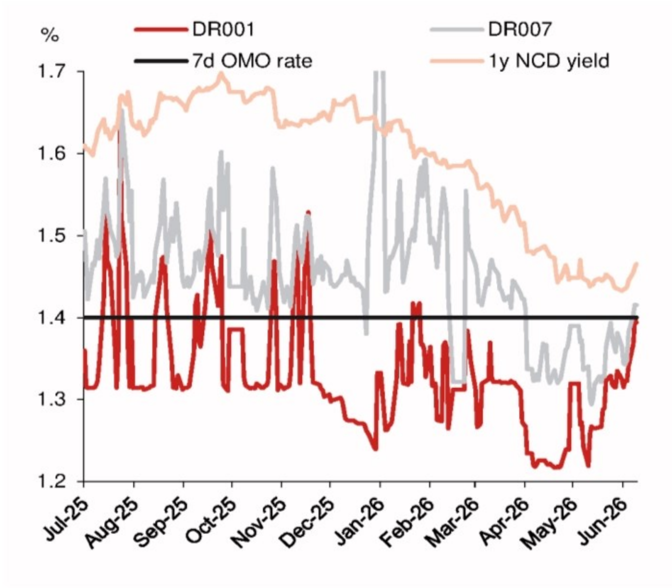
Source: Wind, the PBoC, Nomura

Fig. 4: Weekly net NCD issuance



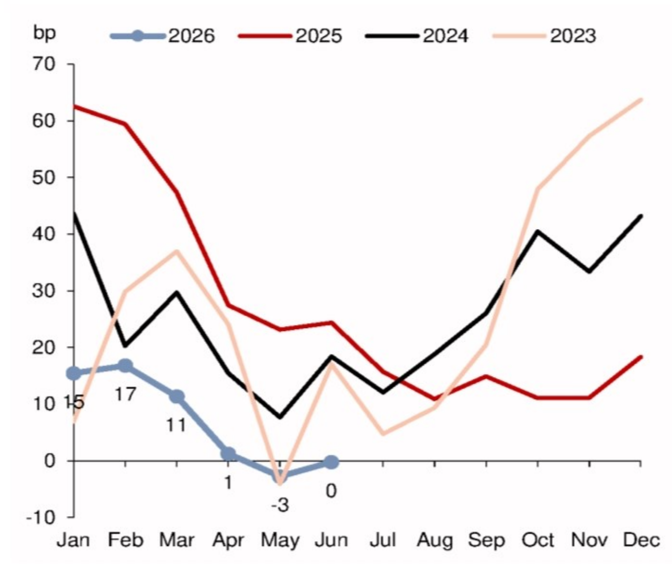
Source: Wind, Nomura

Fig. 5: DR001, DR007 and 1y NCD yield



Source: Bloomberg, Nomura

Fig. 6: Monthly average spread between 7d repo fixing and 7d OMO rate



Source: Wind, Bloomberg, Nomura

Bond supply

As of end-May, 35% of annual net bond financing quota has been completed for both CGBs and LGBs. The CGB issuance pace was slower than in 2025 but still faster than in 2021-2024 (Figure 7). For LGBs, however, issuance over the first five months on 2026 looks slower than in previous years (2021-25 average: 38%; Figure 8). In May 2026, net government bond supply was particularly low (due mainly to LGBs). On one hand, this (together with the super flush liquidity) might explain the large bond buying flows from onshore funds in May, as there was a lack of high-quality assets in the market. On the other hand, it also means bond issuance pressure in coming months can be higher. **We expect monthly net CGB and LGB supply to rise to ~RMB1.0trn in June** (May: RMB890bn) **and further to RMB1.3trn in Q3, before declining to an average of RMB900bn in Q4** (Figure 9).

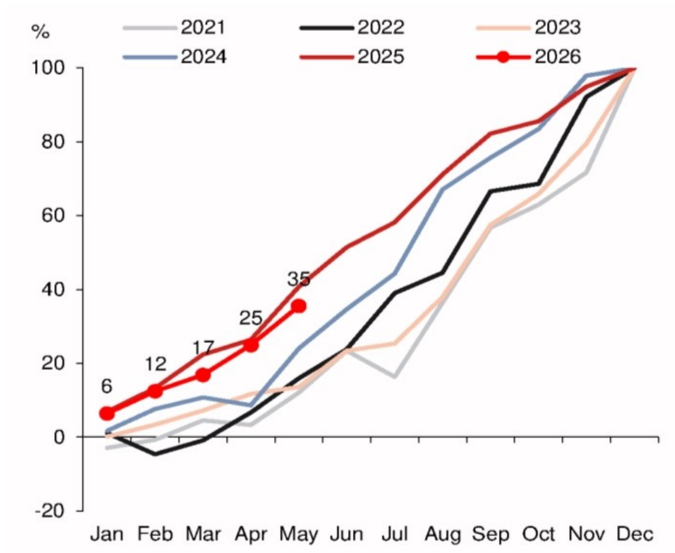
Bond demand

As shown in Figure 10, **after accumulating massive (ultra) long-end CGBs/policy bank bonds in April and May, onshore funds reduced bond holdings in June**. In the first week of June, funds were still adding 10y and above tenors while net selling the front-end and belly parts of the curve. Then this week, the selling extended to the back end as well, and funds sold large amount of 10y policy bank bonds.

On 30y CGBs, while we saw outflows from funds and securities firms starting from 9 June, the size was small relative to inflows seen in previous weeks. While liquidity tightness (or expectations on that) may trigger larger selling flows in 30y CGBs, the currently wide 10s30s spread at ~49bp provides a buffer and would generally support **30y CGB outperformance**, in our view. Also, insurance firms' demand for 30y CGBs has clearly picked up this week. This is consistent with their historical buy/sell patterns, as insurance firms tend to add 30y bonds amid selloffs and reduce holdings during rallies. Such flows can gain further momentum if 30y CGB yields climb to 2.25%, which means the upside in yields is also somewhat capped.

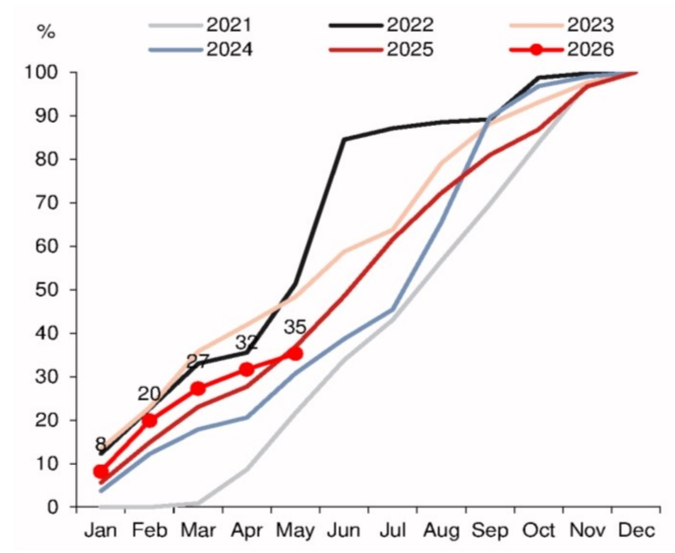
We do not expect a significant steepening in the CGB space until we see a meaningful improvement in economic data (especially credit demand and retail sales etc.), or unless liquidity tightens at a much faster pace/by a much larger amount (for example, DR001 to ~1.50%, DR007 to ~1.60%). Thus, we continue to prefer to pay 3y NDIRS over 5y tenors. Also, we believe positioning favors payers, since NDIRS are trading ~3bp below the onshore IRS level, which is slightly wider than the 12-month average.

Fig. 7: Net CGB issuance as percentage of annual quota



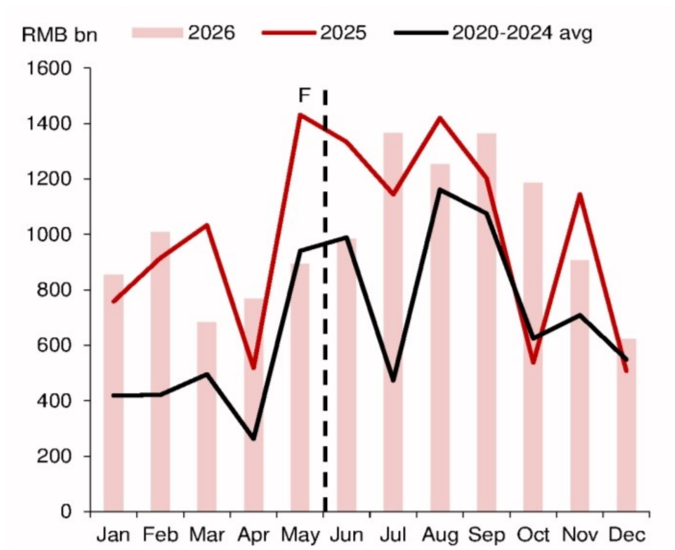
Source: Wind, Nomura

Fig. 8: Net LGB issuance as percentage of annual quota



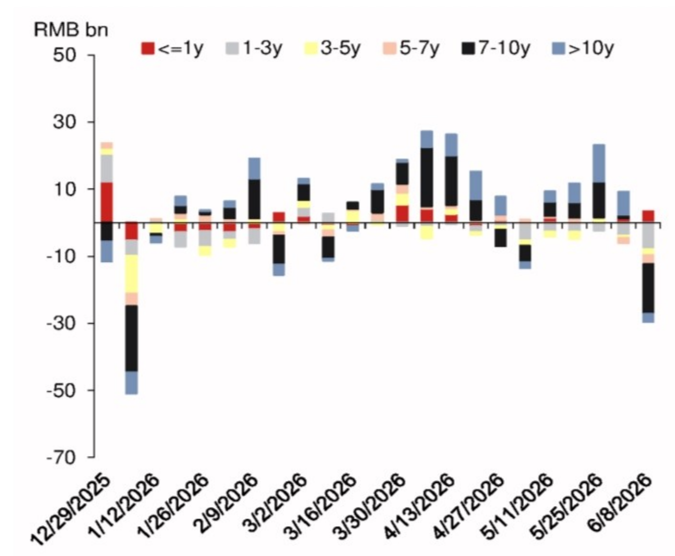
Source: Wind, Nomura

Fig. 9: Monthly net CGB and LGB supply



Source: Wind, Nomura

Fig. 10: Onshore funds' net CGB/PFB buying



Source: iData, Nomura

Rates strategy: We maintain pay 3y NDIRS, targeting a move to 1.60%

China rates moves on Wednesday (10 June) were quite interesting. In the morning session, rates first dropped by 1.0-1.5bp post after the weaker-than-expected May CPI inflation data release. Then, rates reversed back higher, thanks to liquidity tightness concerns. The intraday move shows that, at this juncture, **liquidity remains the key driver of China rates**.

This is in line with our China Rates Trading Model (CHaRT, Figures 11 and 12). Liquidity and market technicals have been the dominant themes since end-May. Also, after generating receive signals for three consecutive weeks, **CHaRT** finally rose above 0.5 on 9 June and **equalled 0.60 latest (small pay signal)**. Thus, we maintain a pay 3y NDIRS position and roll to Sep-IMM. Monitor for a 6m ORR operation (announcement should be out tonight 5pm; RMB600bn maturing), as well as May activity data (next Tuesday).

Fig. 11: China Rates Dashboard

China Rates Dashboard

Daily data		11-Jun	10-Jun	9-Jun	8-Jun	5-Jun	4-Jun	3-Jun	1y avg	1m avg	w-o-w change	Indicate higher or lower rates
									Green if current > avg; Red if current < avg			
Liquidity												
7d repo fixing	%	1.44	1.42	1.41	1.41	1.39	1.38	1.38	1.52 🔴	1.38 🟢	↑	
7d repo fix (1m avg) - OMO rate	bp	-1.7	-2.1	-2.3	-2.6	-2.8	-2.8	-2.7	13 🔴	-2 🟢	↑	↑
1y AAA NCD yield	%	1.48	1.47	1.46	1.46	1.45	1.44	1.44	1.60 🔴	1.45 🟢	↑	
1y AAA NCD yield - 7d OMO rate	bp	8.3	6.5	6.2	5.5	4.5	3.8	3.5	20 🔴	5 🟢	↑	↑
Overnight repo % total	%	86.8	87.0	87.2	87.5	87.7	88.0	88.2	87.5 🔴	87.9 🔴	↓	↓
Market technical												
5y AA corp - 5y CGB	bp	56	57.1	58.6	58.6	60.0	61.5	61.1	72 🔴	63 🔴	↓	↓
SHCOMP vs. SPX	% w-o-w	0.76	1.57	1.34	0.13	1.59	-1.27	-0.68	-0.08 🟢	-1.14 🟢	↑	↑
Macro data												
Iron ore price (1m z-score)	Z-score	-1.5	-1.7	-1.8	-1.7	-1.6	-1.4	-1.2	0.1 🔴	-0.4 🔴		↓
Secondary home transactions (7dMA volume)	% y-o-y	1.6	6.0	6.7	31.3	40.9	44.6	40.4			↓	↓

Weekly data		8-Jun	1-Jun	25-May	18-May	11-May	4-May	1y avg	1m avg	w-o-w change	Indicate higher or lower rates
								Green if current > avg; Red if current < avg			
Liquidity											
NCD maturity	RMB bn	944	413	951	533	925	550	677 🟢	710 🟢	↑	↑
Market technical											
Net CGB and LGB supply	RMB bn	352	57	279	584	193	186	253 🟢	318 🟢	↑	↑
Onshore funds' net CGB+PFB purchase (daily avg)											
- CGBs and PFBs <=3y	RMB bn	-4.6	-2.4	-1.7	-2.8	-1.2	-5.2	0.9 🔴	-2.9 🔴	↓	↑ short-end
- CGBs and PFBs >=10y	RMB bn	-17.1	7.9	21.5	10.1	7.2	-6.6	1.5 🔴	5.6 🔴	↓	↑ long-end
Macro data											
Container throughput (3m z-score)	Z-score	0.4	1.4	-0.3	0.2	0.4	0.9	0.2 🟢	0.4 🔴		→

Source: Nomura

Fig. 12: China Rates Trading Model (CHaRT)

China Rates Trading Model (CHaRT)

	Index *(ranges from 0 to 1)*	**Signal** *(higher rates if >0.5, lower rates if <0.5, no signal if =0.5)*
1y NDIRS	0.60	China front-end rates are likely to go HIGHER over the next week.
5y NDIRS /10y CGB yield	0.60	China long-end rates are likely to go HIGHER over the next week.

Dominant themes and signals in previous weeks

What is the key driver of China rates - liquidity, market technical, or macro data?

		Theme	Index	Signal
The latest signal		Liquidity Market technical	0.60	Higher rates
The week of	8-Jun-26	Liquidity	0.45	Lower rates
The week of	1-Jun-26	Liquidity Market technical	0.30	Lower rates
The week of	25-May-26	Market technical	0.33	Lower rates
The week of	18-May-26	Macro data	0.60	Higher rates

**Note: Dominant themes and signals here are identified with regard to long-end rates (5y swap and 10y bond yield) movements.*

Source: Nomura

Please see Strategy portfolio update (7 May 2026) for our full portfolio.

Appendix A-1

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