China: PBOC introduces overnight reverse repo but keeps rate undisclosed

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Bottom line:

The PBOC conducted its first RMB 300bn overnight reverse repo on June 29th and followed it with another RMB600bn operation on June 30th, while keeping the operating rate undisclosed. The rate matters because the new tool could potentially help guide DR001 and signal the PBOC's stance on liquidity management. Media reported a rate of 1.25% for the June 29th operation, below market expectations of around 1.30%-1.35%, and market pricing appeared to reflect a dovish interpretation. In our view, the overnight reverse repo looks more like a liquidity provision tool at this stage, similar to outright repos and MLF loans. The PBOC's decision not to disclose the rate likely aims to preserve the 7-day reverse repo rate's role as the main policy rate and to avoid confusing the market before the new tool becomes operationally mature. Funding indicators suggest interbank liquidity has stayed ample. Lingering growth headwinds suggested by April-May activity data argue for easy funding conditions. Lower oil prices introduce downside inflation risks. Against this backdrop, we expect China cash yields and swap rates to move lower, especially at the front end.

Main points:

1. **What happened:** As announced on June 25th, the PBOC introduced overnight reverse repo operations on the morning of June 29th, with the first operation totaling RMB300bn, and conducted another RMB600bn operation on June 30th. Surprisingly, the PBOC did not disclose the operating rate, despite market expectations ahead of the first operation that the rate would be published and provide an important signal on the central bank's liquidity management stance. For the first overnight reverse repo operation, market expectations were clustered around 1.30%-1.35%, while various media outlets reported an operating rate of 1.25% on June 29th. Market pricing appeared to reflect some confidence in the reported rate and a dovish interpretation, as CGB yields and IRS rates edged down.

2. **Why it matters:** The operating rate matters because the new overnight reverse repo could become an important tool for guiding front-end rates (such as DR001, the overnight interbank repo rate for banks), even as the 7-day reverse repo rate remains the main policy rate for now. A rate near 1.4% would be consistent with the current setup of the interest rate corridor, while the overnight-to-7-day term spread in the interbank repo markets points to a lower level of around 1.30%-1.35%. Against that benchmark, the reported 1.25% rate looked dovish. It also raised several questions for the monetary policy framework: whether the new overnight tool will become a regular OMO instrument, used on a daily basis; whether the PBOC will disclose the operating rate in the future; and whether the tool could eventually

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complement the 7-day reverse repo and potentially replace it over time as the main front-end policy anchor.

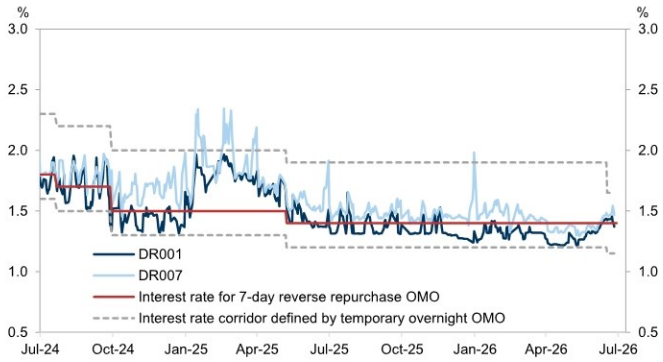
3. **Our view and market implications:** In our view, the overnight reverse repo looks more like a liquidity provision tool at this stage, similar to outright repos and MLF loans. The PBOC's decision not to disclose the rate likely aims to preserve the 7-day reverse repo rate's role as the main policy rate and to avoid confusing the market before the new tool becomes operationally mature. We summarize our views on interbank liquidity and the rates market below:

- **Liquidity conditions:** Funding indicators suggest interbank liquidity has stayed ample: DR001 has fallen back to around 1.35% after briefly rising above 1.40% (Exhibit 1); quarter-end seasonality also looks benign, with the FR007-OMO spread still much lower than in previous years (Exhibit 2). Our high-frequency tracker suggests that the PBOC net injected around RMB1.1tn of liquidity in June, including RMB600bn via the new tool, reversing from a RMB390bn withdrawal in May.[1] Taken together, these are consistent with our view that soft April-May activity data point to lingering growth headwinds and argue against sustained liquidity tightening.
- **Rates market implications:** Against this backdrop, we expect interbank liquidity to remain ample and China cash yields and swap rates to move lower, especially at the front-end rates, as lower oil prices introduce downside inflation risks and lingering growth headwinds should keep funding conditions easy. For 10y CGBs, yields could test or briefly break below 1.7%, as weak credit demand may nudge banks to shift more allocation from loan extension toward bond investment. The 10y CGB-7d OMO spread, currently around 30bp vs. a historical low close to 10bp in early 2025, suggests some remaining downside (Exhibit 3). That said, our expectation for faster fiscal policy implementation could limit the extent of further downside in longer tenors. Supply pressure from government bond issuance could keep the 10s30s curve relatively steep. Key things to watch are the frequency and size of operations, whether the rate will be disclosed in the future, and how DR001 trades relative to the 7-day OMO rate.

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[1] Our daily liquidity tracker covers OMOs, outright repos, MLF loans, and treasury cash auctions, while our monthly tracker also incorporates CGB purchases and relending programs.

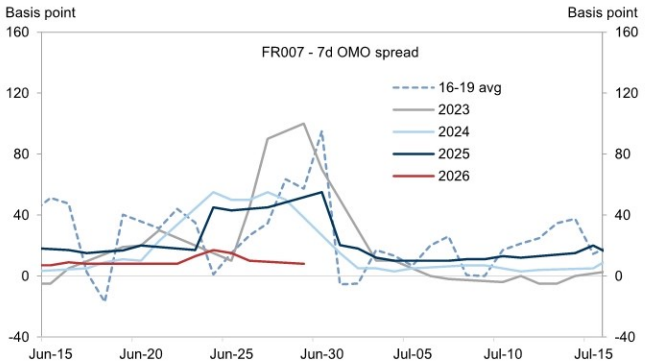
Exhibit 1: DR001 falls back below the 7-day OMO rate after a brief spike



The grey dashed lines represent the corridor defined by the temporary overnight OMOs.

Source: Wind, Goldman Sachs Global Investment Research

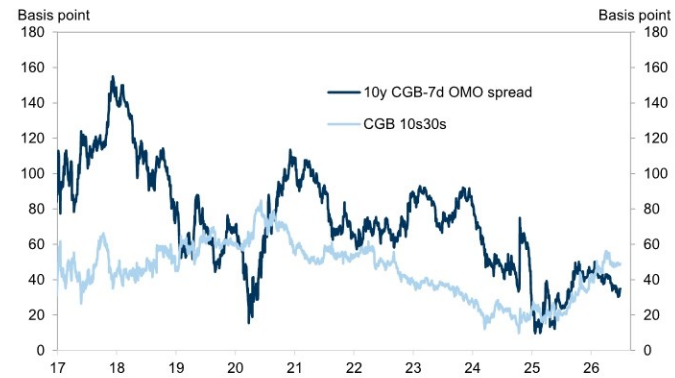
Exhibit 2: FR007-OMO spread remains much lower than levels seen in previous years



FR007: the fixing rate of 7-day interbank repo for all financial institutions

Source: Wind, Goldman Sachs Global Investment Research

Exhibit 3: The 10y CGB-7d OMO spread suggests some remaining downside for 10y CGB yields



Source: Wind, Goldman Sachs Global Investment Research

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