PBoC Watching

A framework in transition

The shift to a DR001-centric framework could improve policy transmission and funding stability,while limiting scope for significantly easier money market conditions.The PBoC remains accommodative,but is unlikely to cut rates/RRRs. Instead,it prefers targeted credit easing and liquidity tools.

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What is the key message from PBoC quarterly report?

The PBoC released its latest Quarterly Monetary Policy Report overnight(12 August).Rather than the monetary policy stance itself,we believe the key policy development is the formal transition from a DR007-centric framework to a DR001[1]-centric framework.This shift reflects the fact that overnight repos now account for more than 90%of money market repo trading volume,making overnight funding the primary liquidity management tool for financial institutions.We think the new framework could improve policy transmission and funding-market stability.

As highlighted in the report,the PBoC explicitly stated that:"Since 2025,the operational target has gradually shifted from DR007 to DR001,and since 2026 the PBoC has been sending a clearer signal that the target rate is the overnight rate(DR001)."This is the first systematic confirmation that DR001 has become the PBoC's effective operating target,bringing China's monetary policy framework closer to those of major central banks that focus on overnight funding rates.

The supporting measures,first announced by Governor Pan Gongsheng at the Lujiazui Forum in June,have now been formally incorporated into the policy framework:

- The interest-rate corridor has been narrowed from an asymmetric-20bp to+50bp range (previous:1.2-1.9%)around the policy rate to a symmetric±25bp corridor(current:1.15-1.65%).

- The PBoC has clarified the intervention trigger,with temporary repo operations activated when DR001 persistently moves outside the corridor(1.15-1.65%).

- The framework reform has begun to extend to loan pricing,with the PBoC report noting that some loans are already being priced using DR001 as a benchmark.

Overall,we view this as a meaningful step toward a more market-based and transparent operating framework,with DR001 increasingly serving as the key policy anchor for China's money markets.

What are the implications for the market?

We think the implications for the rates market are twofold.On the one hand,DR001 is now more clearly established as the PBoC's key policy anchor,while the narrower interest-rate corridor

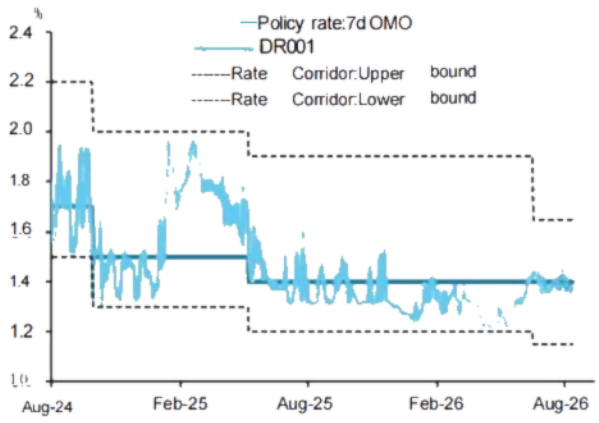
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[1]DR001 **is weighted-average overnight repo rate among** deposit-taking financial institutions in China's interbank market.

should help reduce volatility in money market rates.As a result,funding conditions are likely to become more stable and predictable.

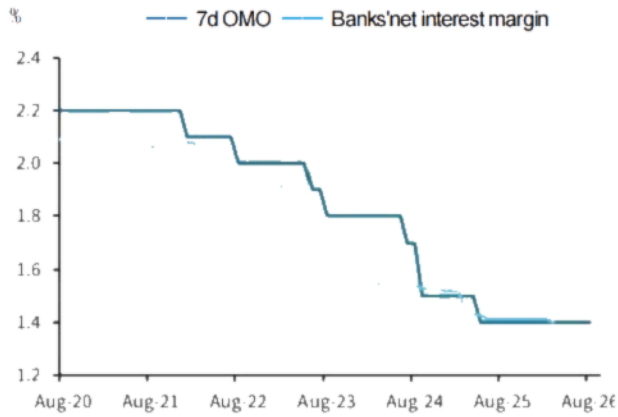
On the other hand,a more rules-based operating framework effectively places a firmer floor under overnight rates.We believe the likelihood of DR001 trading persistently and materially below the 7-day reverse repo rate(currently 1.40%)has diminished.In other words,while funding conditions should remain stable,the scope for significantly easier money-market conditions is now more limited.

FIGURE 1.**The PBoC has narrowed interest rate corridor**



Source:Wind,Barclays Research

FIGURE 2.**Record low banks'NIM limits the room for policy rate cuts**



Source:Wind,Barclays Research

What is the PBoC's overall stance?

The PBoC Monetary Policy Report shows that central bank willremain accommodative,with the report re-emphasised that the PBoC will "continue to implement an appropriately accommodative monetary poilcy,"and pledges to "comprehensively deploy and timely adjust monetary policy tools"(综合运用并适时调整货币政策工具), to maintain "ample liquidity"and to "intensify countercyclical supports."

Will the PBoC cut policy rates and RRR in 2026?

Despite the accommodative stance,we believe the Q2 PBoC Monetary Policy Report suggests that the central bank remains in no rush to cut policy rates or the RRR.**Therefore,we continue to expect policy rates to remain unchanged throughout 2026.**Notably,the latest quarterly report again made no reference to policy rate or RRR cuts,marking the second consecutive report this year without such guidance.By contrast,the PBoC expicitly signaled these high-profile easing measures in both theQ1and Q425 reports,and the RRR cut and policy rate cut delivered in May 2025.

While the recent strength of the RMB has eased some of the constraints on monetary easing,we believe the record-low level of banks'net interest margins(NIMs)limits the room for further rate cuts.Historically,banks'NIMs tend to move in tandem with policy rates,as lending rates,which are linked to the LPR,typically reprice lower soon after policy rate cuts.Deposit rates,however, tend to decline more slowly and by a smaller magnitude due to intense com deposits,resulting in NIM compression.

In our view,the authorities'focus on protecting banks'NIMs reflects two key First,maintaining reasonable bank profitability ensures that banks retain a buffer,which serves as the first line of defense against potential NPLlosses

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profitability helps sustain banks'willingness and capacity to lend,thereby supporting the smooth transmission of monetary policy to the real economy.

What are the prefered tools for the PBoC to support economy?

The latest PBoC Monetary Policy Report suggests that the central bank's preferred easing tools are no longer broad-based rate cuts.Instead,**the PBoC is relying primarily on a combination of structural policy tools and liquidity management operations to support growth.**

- **Structural tools(most preferred):**the PBoC is leaning heavily on structural and targeted facilities rather than across-the-board easing.Such tools are designed to support priority sectors directly and preserve banks'profitability.We highlight some recent examples, including CNY1trn relending facility for private firms,green financing facilities,technology and equipment-upgrading relending.Under these programs,the PBoC provides low-cost funding to banks,which in turn extend credit at preferential rates to sectors that policymakers want to support selectively.When deploying structural tools,the PBoC generally focuses on the"Five Major Areas of Finance(**金融“五篇大文章”**)" covering tech, green transition,private enterprises,aging services,and digital transformation.

- **Liquidity management tools:** The PBoC is also placing increasing emphasis on liquidity management operations to keep funding conditions accommodative.The latest quartely report repeatedly stresses the importance of maintaining ample liquidity and keeping DR001 stable around the policy rate.Compared with RRR cuts,liquidity management tools allow the PBoC to adjust market conditions more frequently and flexibly.These tools can be calibrated according to changing liquidity needs and help smooth short-term fluctuations in money markets.The recent actions includes:**overnight reverse repo(**1d OMO),and 7d,3**m and 6m** reverse repos,**MLF**,and government bond purchases.

Overall,we think the PBoC's current policy approach is best described as targeted credit easing plus active liquidity management,rather than broad-based monetary stimulus.