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China Local Markets Weekly

Beyond the growth disappointment

Emerging Markets Strategy

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- China's July data reinforced signs of slowing growth, with weak investment activity highlighting that fiscal support has yet to meaningfully reach the real economy. CGB/LGB issuance still lags and policy bank net redemptions persist. **Financial market reaction to the latest data disappointment has been muted as China-linked assets had already unwound earlier optimism and entered the week with broadly neutral positioning.**
- The soft macro backdrop remains supportive for CNY rates, although seasonal liquidity headwinds may limit the scope for a near-term outright rally. **The 10s30s CGB spread continues to screen attractive, trading ~14bp or 1.5 s.d. wider than our model-implied fair value**. With the long end of the CGB curve remaining steep relative to macro fundamentals, soft growth dynamics coupled with seasonal liquidity pressures, and rich valuations on intermediate yields continue to favour further curve flattening.
- Chinese bonds have stood out against a backdrop of rising global yields, attracting renewed foreign investor interest as resilient returns and diversification benefits drive inflows despite limited pick-up in FX-hedged yields. **Buying through CIBM accounts, a channel more representative of long-term institutional investors, is running at its strongest pace since 2025**. At the same time, onshore demand for offshore bonds has strengthened following a series of regulatory easing measures under Southbound Bond Connect. Quota utilization has risen steadily, with 2026 YTD flows already exceeding last year's full-year total. This has provided strong demand support for the rapidly expanding dim sum bond market. With attractive RMB funding costs, issuance by non-Chinese borrowers has increased.
- USD selling from Chinese corporates softened in July. Given CNY's structural negative carry, **corporate USD conversion has become increasingly sensitive to CNY's total returns**. While the slowdown in July was disappointing, the recent downside break in USD/CNH and the return of positive CNY returns could potentially revive corporate USD selling going forward, creating a self-reinforcing source of CNY strength.
- While the PBoC's pace management of appreciation remains in place, **the weakening bias embedded in the fixing relative to our JPM estimate has moderated in recent weeks**, suggesting a gradual easing in its resistance to CNY strength and leaving scope for the fixing to move below 6.78. As markets look ahead to President Xi's upcoming US visit, risks remain skewed towards a more explicit strengthening bias in the fixing, while fading USD bullishness poses downside risks to our year-end USD/CNY forecast of 6.70.
- The recent US-Japan joint JPY intervention has rekindled the debate over FX policies, with scrutiny of CNY valuation intensifying. **While the decline in the CNY REER itself is an undeniable fact, the pronounced divergence between the CNY NEER and REER since 2022 complicates conventional assessments of RMB valuation and warrants a more nuanced interpretation**. With inflation differentials rather than nominal RMB weakness accounting for much of the decline in the CNY REER, interpreting the move solely as evidence of deliberate undervaluation by the PBoC risks conflating exchange-rate dynamics with broader macroeconomic developments and obscuring the path of necessary adjustment.

See page 10 for analyst certification and important disclosures.

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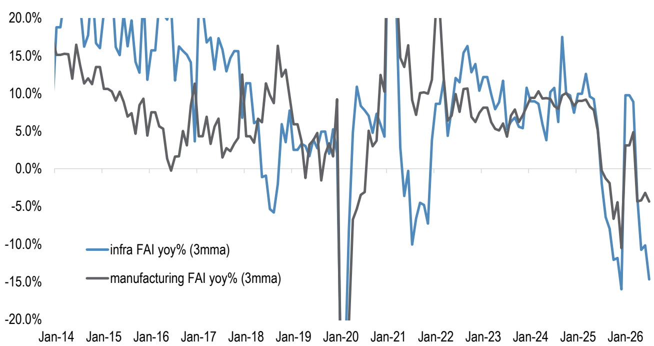
Beyond the growth disappointment

China's July data dump reinforced the signal from the earlier weak PMI release that growth momentum remains subdued, with little sign of a meaningful rebound following an already soft 2Q. While weak consumption and a sluggish property market remain well-established headwinds, the persistent weakness in investment activity is increasingly concerning. Infrastructure investment fell sharply again in July after a brief stabilization in June, while manufacturing FAI showed little sign of improvement (Figure 1).This suggests that the much-anticipated fiscal support has yet to meaningfully reach the real economy, despite policymakers' increasingly supportive rhetoric. Both CGB and LGB issuance remain lagging last year's pace (Figure 2), while policy bank bond issuance has also remained lackluster, with year-to-date net redemptions persisting. This points to limited expansion in quasi-fiscal support and has been a key disappointment. As we have argued previously, while the sizeable remaining government bond quota leaves room for a stronger fiscal push in the months ahead, upcoming local government leadership reshuffles could result in under-delivery of stimulus. Against this backdrop, JPM economists have revised down their 2026 GDP growth forecast to 4.5%, placing growth at the lower end of the official target range. **Interestingly, though, the growth disappointment has not triggered a significant deterioration in local market sentiment.** Reaction from China-linked assets has so far been rather muted this week. This reflects the fact that China-linked assets entered the data release having already unwound much of the optimism priced in earlier. Our market-implied China risk premium started the week around neutral levels, suggesting positioning and sentiment had already pulled back in prior weeks (Figure 3, Figure 4).

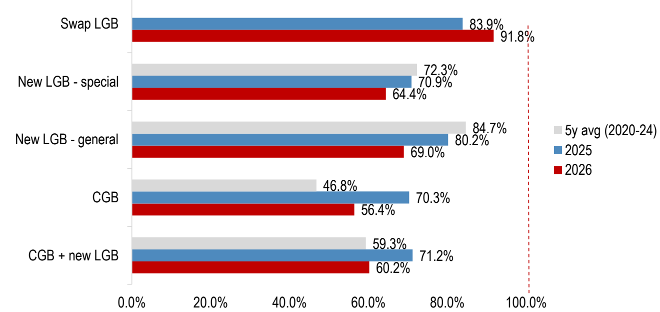
Figure 1: Deteriorating investment growth in China is particularly concerning



Source: Wind, J.P. Morgan

Figure 2: Government bond issuance has remained lagging last year's pace

as of August, ytd net issuance % annual quota



Source: Wind, J.P. Morgan

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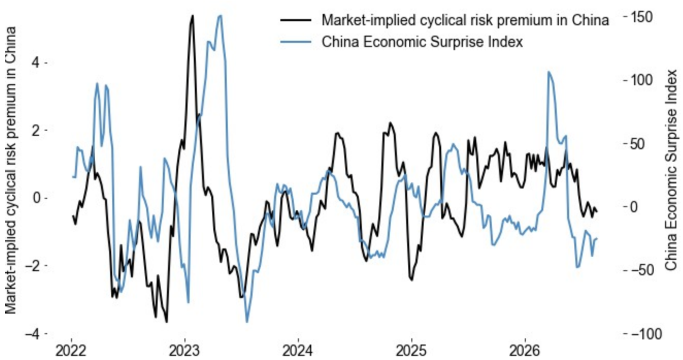
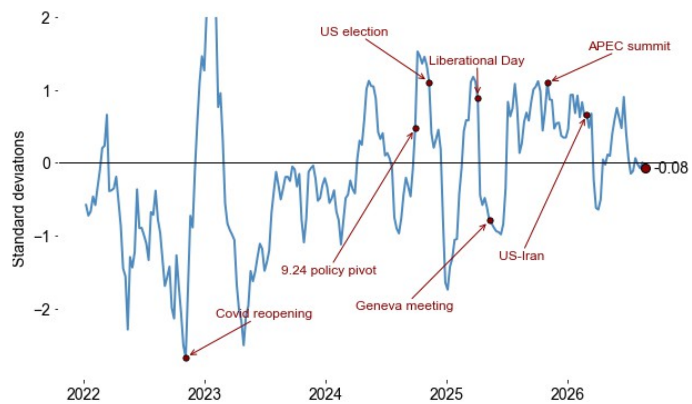
Figure 3: China-linked assets have largely unwound the earlier optimism ...



Source: Bloomberg Finance L.P., J.P. Morgan

Figure 4: …with more neutral positioning heading into this week's data release

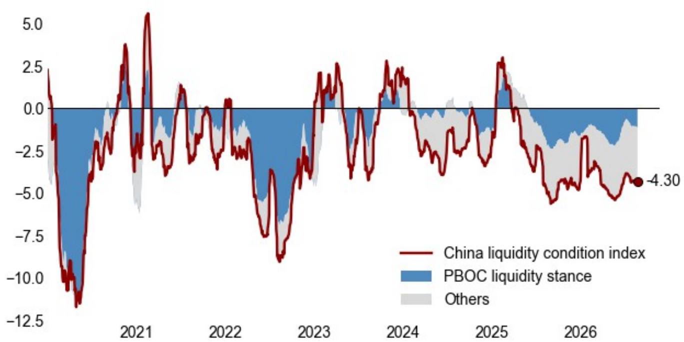
s.d., misalignment between the market-impplied risk premium in China and the economic surprises, +ve indicates bullish market pricing



Source: Bloomberg Finance L.P., J.P. Morgan

Seasonal liquidity headwinds may limit the scope for a near-term outright duration rally, but the soft macro backdrop remains supportive for rates, with further curve flattening likely. While liquidity conditions remained broadly accommodative in recent weeks, they have tightened modestly since June (Figure 5), reflecting the PBOC's more calibrated liquidity management in 2Q. However, with economic momentum still subdued, PBoC liquidity injections have picked up since July (Figure 7) and are likely to remain necessary to offset upcoming funding pressures in the weeks ahead (Figure 6). The PBOC has increased the frequency of overnight reverse repo operations, including supplementary injections around tax payment dates, alongside month-end operations. This should help smooth funding volatility and stabilize funding conditions, while gradually paving the way for a shift in the PBOC's official operational target from the current 7-day tenor toward overnight rates.

Expectations for further monetary easing have risen on the margin post a series of data disappointments, but limited perceived room for substantial policy rate cuts may constrain performance of the very front-end rates, which are already running with negative carry. By contrast, the CGB curve remains relatively steep beyond the 10y sector, leaving room for the ultra long end to outperform and the curve to continue flattening. 10y CGB yields are already trading below our model-implied fair value at ~1.84% (China Local Markets Weekly: Summer softness keeps duration in season), which could limit the scope for a significant outright rally from here, but **the 10s30s segment still appears steep relative to fundamentals (Figure 8): the 10s30s spread is roughly 14bp or 1.5 s.d. too wide relative to our model estimate**, suggesting further room for flattening given a mixed backdrop of soft growth, seasonal liquidity headwinds, and somewhat rich valuations in intermediate maturities.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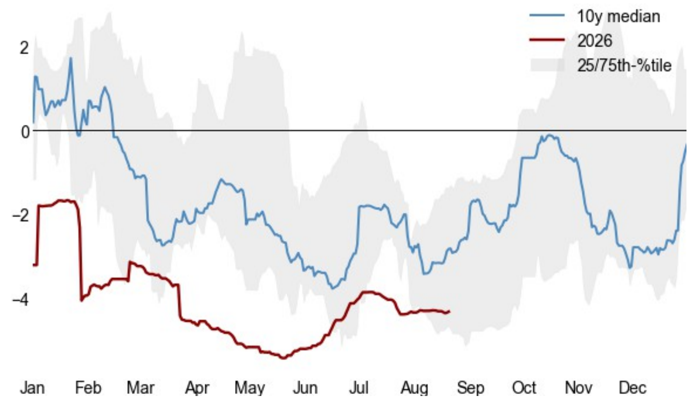
2026
-4.30
China liquidity condition index
PBOC liquidity stance
Others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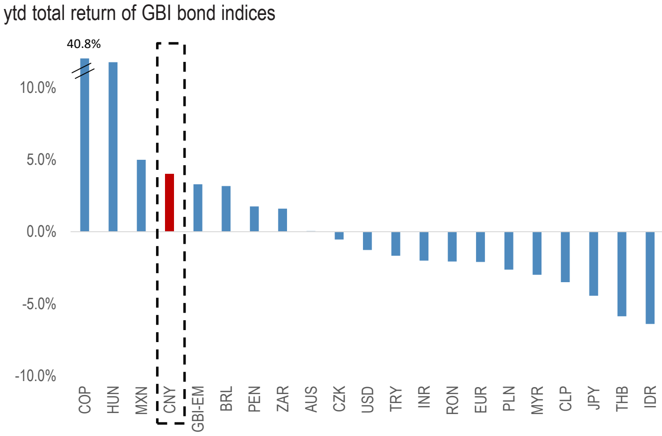
Meanwhile, onshore demand for offshore bonds has strengthened, supported by a series of regulatory easing measures. After expanding Southbound Bond Connect access to non-bank financial institutions last year, Chinese regulators announced further liberalization measures last month, including an official increase in the Southbound quota from CNY500bn to CNY800bn. Quota utilization has risen steadily since last year's policy relaxation, with cumulative southbound flows in 2026 already exceeding last year's full-year total (Figure 11).This has provided demand support for dim sum bonds, at a time when issuance is also accelerating (Figure 12). China's prolonged low-inflation environment and accommodative monetary policy stance have created a persistent interest rate differential relative to the rest of the world, making RMB funding increasingly attractive. Dim sum bond issuance by non-Chinese borrowers has continued to rise, with ex-China issuers accounting for 24% of 2026 YTD supply, up from 19% in 2016 (CNH Credit Markets: A dim sum menu).

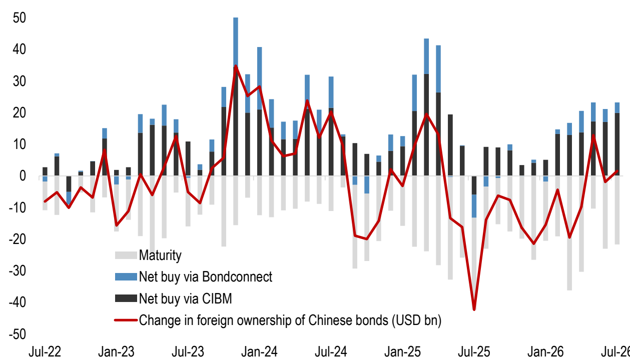
Figure 9: Chinese bonds stand out against a backdrop of rising global yields, having delivered ~4% total return ytd

ytd total return of GBI bond indices



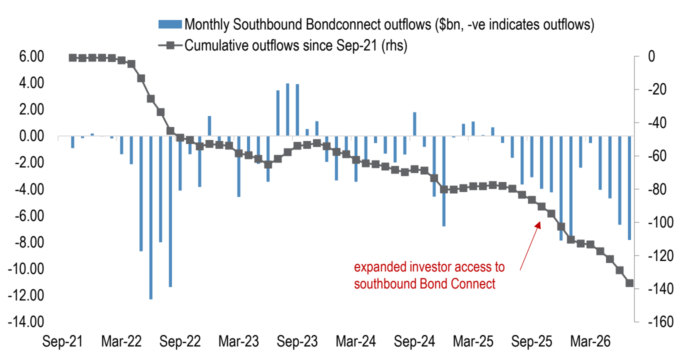
Source: Bloomberg Finance L.P., J.P. Morgan.

Figure 10: Foreign buying interest in Chinese bonds through CIBM accounts has remained robust in recent months



Source: CFETS, J.P. Morgan.

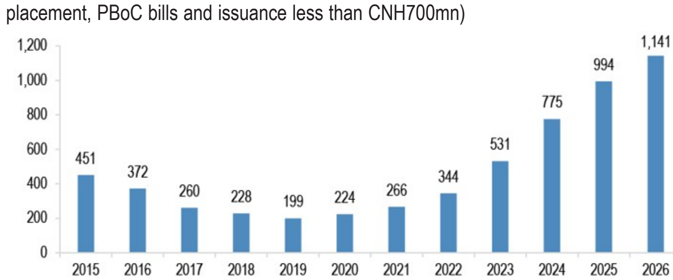
Figure 11: Southbound bond connect flows have picked up steadily since last year amid policy relaxation



Source: SHCH, J.P. Morgan.

Figure 12: The Dim Sum bond market continues to see rapid expansion

CNHbn, outstanding of dim sum bonds (excl. CDs, commercial papers, private placement, PBoC bills and issuance less than CNH700mn)



Source: Bloomberg Finance L.P., J.P. Morgan.

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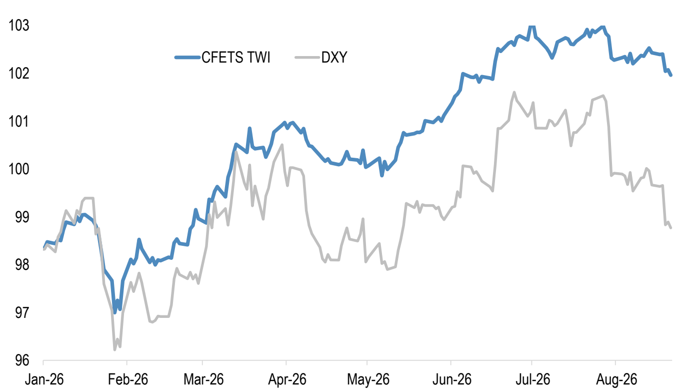
Despite recent disappointments in China's economic data, USD/CNH has broken into a lower range amid the broader USD pullback, with spot reaching the 6.72 handle this week. CNY, however, has generally lagged the weaker dollar move, with the CNY TWI falling to its lowest level since June (Figure 13). The latest SAFE data showed that Chinese corporates' USD selling activity moderated in July, with both gross and net FX settlement ratios declining to multi-year lows after several months of above-seasonal conversion activity (Figure 14). This slowdown came against a backdrop of negative CNY total returns in June, driven in part by a slower pace of appreciation in the daily fixing. **Given CNY's structural negative carry,corporate USD conversion decisions have understandably become increasingly sensitive to CNY's total returns over the past year** (Figure 15). While the slowdown in July conversion activity was disappointing, the recent downside break in USD/CNH and the return of positive CNY total returns in recent weeks could encourage a renewed pickup in corporate USD selling going forward. Such flows tend to act as a self-reinforcing source of CNY strength, as stronger returns incentivize further conversion, which in turn supports additional appreciation.

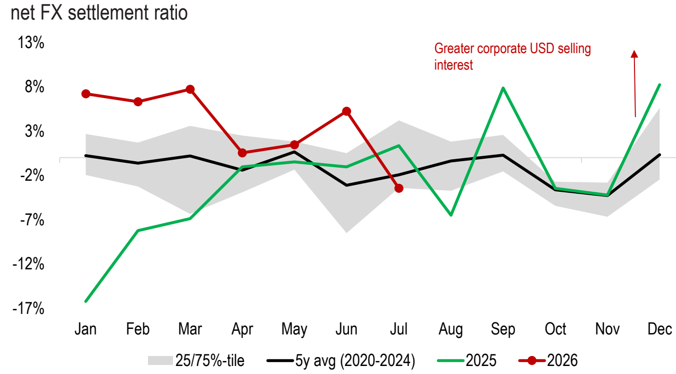
While the widening spot-fix gap indicates that the PBoC's pace management of CNY appreciation remains in place, the weakening bias embedded in the fixing relative to our JPMe including the CCF, has moderated in recent weeks (Figure 16). This points to a marginal easing in the PBoC's grip on the fixing and leaves a move below 6.78 in the fixing within reach. This is consistent with our long-held view that the recent stabilization in the CNY fix represents a temporary pause rather than a hard cap on further CNY strength from the PBoC (China Local Markets Weekly: PBoC taps the brakes, not the wall). As markets move closer to President Xi's upcoming state visit to the US, the balance of risks still favors a resumption of a more explicit strengthening bias from the PBoC, in our view. Our Global FX team has recently shifted to a neutral view on the DXY, following the yen intervention and steepening of the US rate curve (Key Currency Views: Pausing the bullish USD narrative (temporarily)). **A less bullish backdrop for the broad dollar poses downside risks to our year-end USD/CNY forecast of 6.70.**

Figure 13: CNY TWI has been tracking the DXY lower in recent weeks



Source: Bloomberg Finance L.P., J.P. Morgan.

Figure 14: USD selling from Chinese corporates moderated in July



Source: SAFE, J.P. Morgan.

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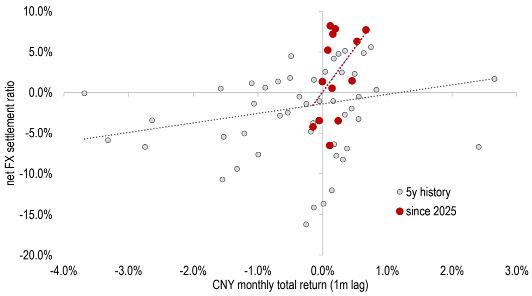
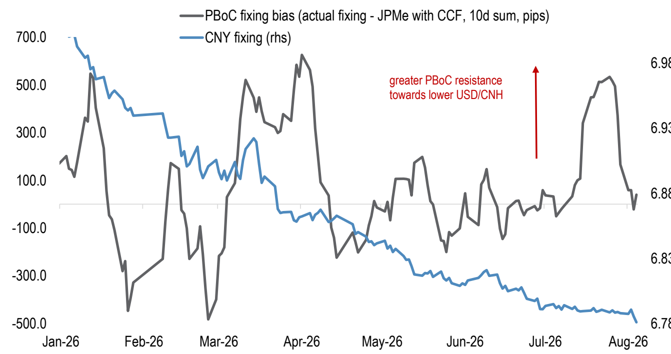
Figure 15: Corporate USD conversion decisions have become increasingly sensitive to CNY's total returns



Source: Bloomberg Finance L.P., J.P. Morgan.

Figure 16: PBoC's fixing signal to resist lower USD/CNH moves has moderated in recent weeks



Source: J.P. Morgan.

The recent US-Japan joint intervention on the yen has rekindled the debate over FX policies in international politics, placing the RMB back in the spotlight as scrutiny of CNY valuation has intensified in recent months (see here and here). While much of the debate has centered around the sharp decline in China's real effective exchange rate (REER) in recent years, the interpretation of this move is less straightforward than commonly portrayed. CPI-adjusted and PPI-adjusted CNY REER have fallen roughly 15-20% from their 2022 peaks, which has fueled arguments that the yuan is materially undervalued. **While the decline in the CNY REER itself is an undeniable fact, viewing it solely through a currency valuation lens overlooks a key structural shift since 2022, namely the sharp divergence between the CNY's NEER and REER (Figure 17)**. Alongside the sharp decline in CNY REER, the CNY NEER has in fact appreciated by more than 5% since 2022, implying broad-based nominal RMB strength rather than weakness. This divergence suggests that the decline in the REER primarily reflects China's unusually weak inflation dynamics relative to the rest of the world, a structural feature that has persisted throughout the post-Covid period.

As such, interpreting the entire REER decline as evidence of a deliberately undervalued currency risks conflating exchange-rate dynamics with broader macroeconomic developments. This distinction is particularly important in Asia, where the RMB has generally appreciated against regional peers in nominal effective terms and, in some cases, even in real terms despite sizeable inflation differentials (Figure 18). Such trends sit uneasily with the prevailing narrative that China has relied on a weaker currency to enhance its trade competitiveness at the expense of its neighbors. In our view, the valuation debate is better framed within a broader general-equilibrium context that reflects the divergence in growth, inflation, and macroeconomic cycles between China and the rest of the world, rather than a partial-equilibrium trade or current-account analysis. The key question is therefore less whether the RMB REER has undershot, and more how that gap will ultimately close. While we continue to believe the PBoC remains open to a gradual, managed nominal appreciation of the RMB over time, such a policy bias is driven by longer-term strategic objectives, including RMB internationalization, motivating corporate USD conversion, and further development of offshore RMB markets, rather than an explicit effort to correct perceived REER undervaluation.

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Figure 17: The pronounced divergence between the CNY NEER and REER since 2022 complicates conventional assessments of RMB valuation and warrants a more nuanced interpretation of REER-based metrics

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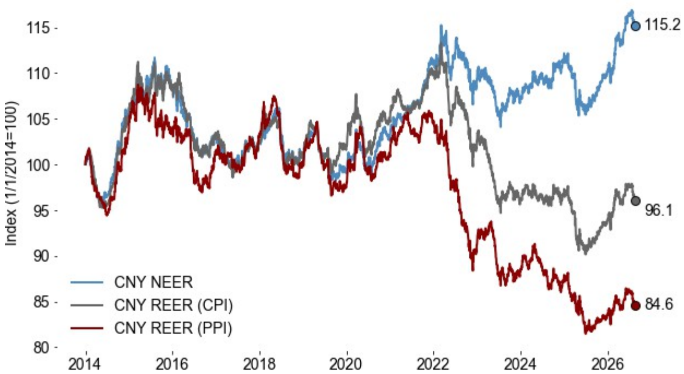
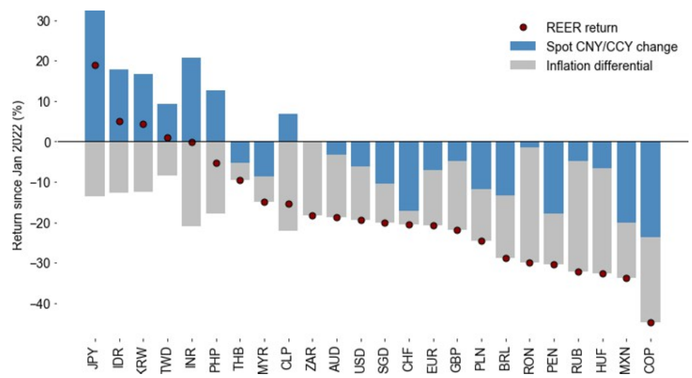


Source: Bloomberg Finance L.P., J.P. Morgan

Figure 18: Much of the CNY REER weakness is driven by inflation differentials rather than currency mis-match

decomposition of the bilateral REER of CNY/ccy, deflated using CPI



Source: Bloomberg Finance L.P., J.P. Morgan

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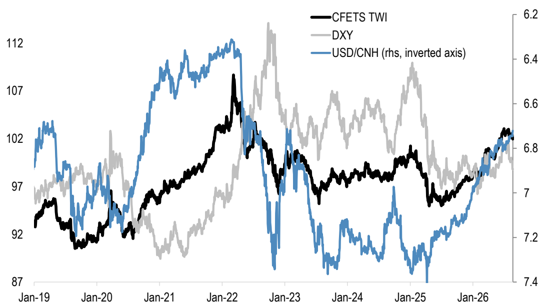
China local markets charts

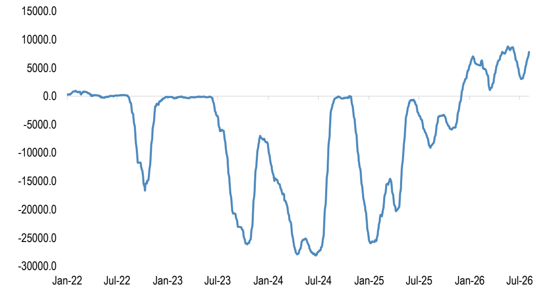
Figure 19: USD/CNY and CFETS TWI



Source: Bloomberg Finance L.P., J.P. Morgan.

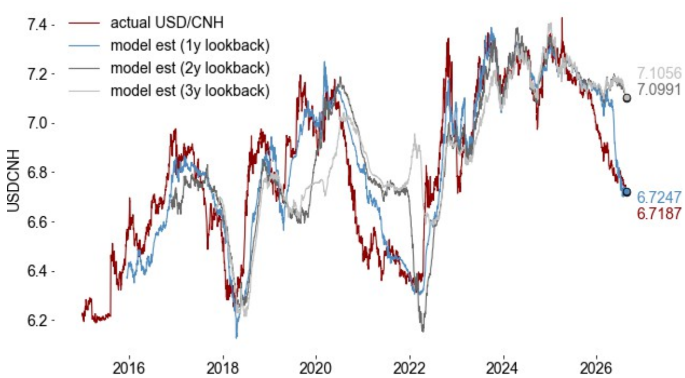
Figure 20: CNY fixing bias

pips, 20d rolling sum



Source: Bloomberg Finance L.P., J.P. Morgan. Strengthening bias is measured as the difference between actual fixings and J.P. Morgan model estimates derived from overnight basket currency performance only.

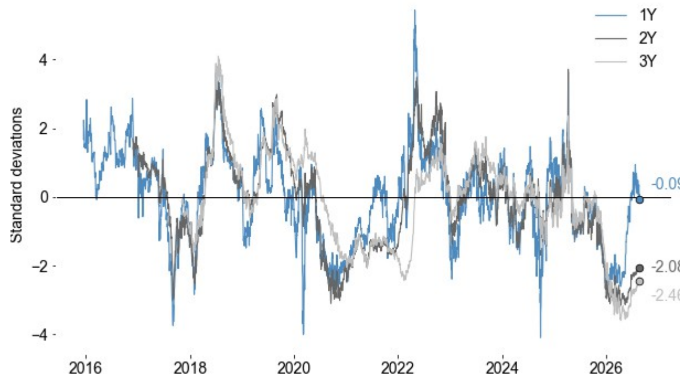
Figure 21: USD/CNH and yield-spread-based fair value



Source: Bloomberg Finance L.P., J.P. Morgan.

Figure 22: Misalignment in USD/CNH vs. rate fundamentals

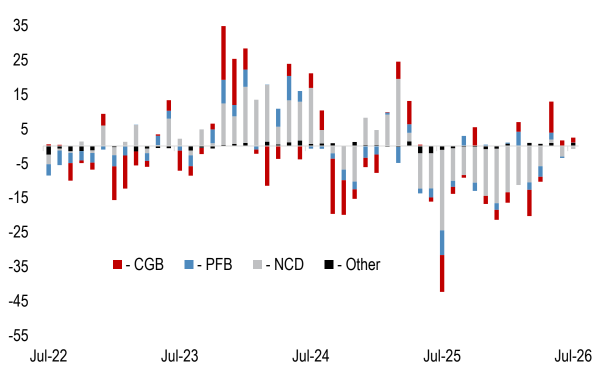
In s.d., based off models of 1y/2y/3y lookback windows



Source: Bloomberg Finance L.P., J.P. Morgan.

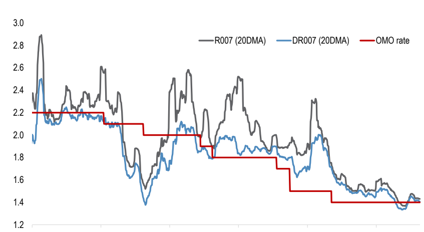
Figure 23: Foreign bond inflows

$bn, change in foreign ownership



Source: Chinabond, Shanghai Clearing House, J.P. Morgan.

Figure 24: Money market rates



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J.P. Morgan Emerging Markets Sovereign Research Ratings Distribution, as of July 4, 2026

	Overweight (buy)	**Marketweight** (hold)	**Underweight** (sell)
Emerging Markets Sovereign Research Universe*	9%	84%	7%
IB clients**	100%	84%	100%

***Please note that the percentages may not add to 100% because of rounding.**
****Percentage of subject issuers within each of the "Overweight, "Marketweight" and "Underweight" categories for which J.P. Morgan has provided investment banking services within the previous 12 months.**
For purposes of FINRA ratings distribution rules only, our Overweight rating falls into a buy rating category; our Marketweight rating falls into a hold rating category; and our Underweight rating falls into a sell rating category. The Emerging Markets Sovereign Research Rating Distribution is at the issuer level. Issuers with an NR or an NC designation are not included in the table above. This information is current as of the end of the most recent calendar quarter.

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