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Global Markets Strategy
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China Local Markets Weekly

Re-engage with CNH longs; lean into curve flattening

Emerging Markets Strategy

Tiffany Wang [AC]
(852) 2800-1726
tiffany.r.wang@jpmorgan.com
J.P. Morgan Securities (Asia Pacific) Limited/ J.P. Morgan Broking (Hong Kong) Limited

Arindam Sandilya
(65) 6882-7759
arindam.x.sandilya@jpmorgan.com
JPMorgan Chase Bank, N.A., Singapore Branch

- **China is nearing the end of 3Q with only a fragile stabilization in domestic conditions**. Low bill financing rates continue to signal soft credit demand despite policy easing efforts. Persistently weak activity has weighed on risk sentiment, with Chinese equities, particularly tech, underperforming global peers. While structural AI and tech themes remain supported, the ongoing thematic rotation into financials, commodities and healthcare is suggesting a more defensive investor stance amid fading risk appetite.
- China's weak domestic backdrop argues for stronger fiscal support, but implementation remains uncertain. While government and policy bank bond issuance has picked up, it still trails last year's pace, leaving scope for further supply into year-end. However, additional issuance is likely to tighten liquidity before generating meaningful growth support, especially amid local leadership reshuffles that could delay spending. In fact, slow fiscal spending this year has led to larger-than-usual fiscal-related liquidity drains. **With seasonal liquidity pressures building and the long-end of the curve still steep versus fundamentals, we continue to favor curve flattening as we initiated long 30Y CGBs vs. paying 5Y NDIRS**.
- **Recent capital injections into major banks and insurers should provide support for long-end CGB demand on the margin**. Banks and insurers now hold nearly 70% of outstanding CGBs, up from ~65% prior to last year's recapitalization to major banks. Improved capital positions could translate into greater government bond demand. With loan demand still subdued, banks may allocate additional balance sheet capacity to sovereign bonds, while insurers should remain a key source of structural demand for ultra-long maturities. While regulators have encouraged insurers to increase equity allocations over recent years, resulting in a rapid expansion in equity holdings, growth in bond holdings has generally continued to outpace overall AUM growth. This suggests that the increase in equity allocations has not come entirely at the expense of insurers' bond demand.
- **Re-engage with CNH longs**. USD/CNH has fallen more than 1% in 3Q, restoring positive carry-adjusted returns which could potentially encourage a renewed pickup in corporate USD selling ahead of the typical year-end seasonality. While the PBoC continues to manage the pace of appreciation, the moderation in fixing bias and lower fix levels signal a greater tolerance for CNY strength on the margin. With CNY still lagging broader Asian FX and the CNY TWI now off this year's highs, the room for further appreciation has expanded. This, in our view, leaves scope for the PBoC to further ease FX management, particularly ahead of President Xi's expected visit to the US in late September. **We therefore re-engage with long CNH positions versus USD and EUR and move OW CNY FX in GBI-EM**

Current trade recommendations

Current outright trades	Entry Date	Entry	Current	P&L	Relevant Note
Long CNH vs EUR and USD	Sep 09, 2026	100.0	100.2	+0.2%	Note
Long 30y CGB vs pay 5y NDIRS	Sep 09, 2026	66	66	0bp	Note
GBI-EM Model Portfolio	**Positions**	**Weight**			
CNY FX	OW				
CNY bonds	MW				

Source: J.P. Morgan.

See page 8 for analyst certification and important disclosures.

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A stronger yuan and a flatter curve

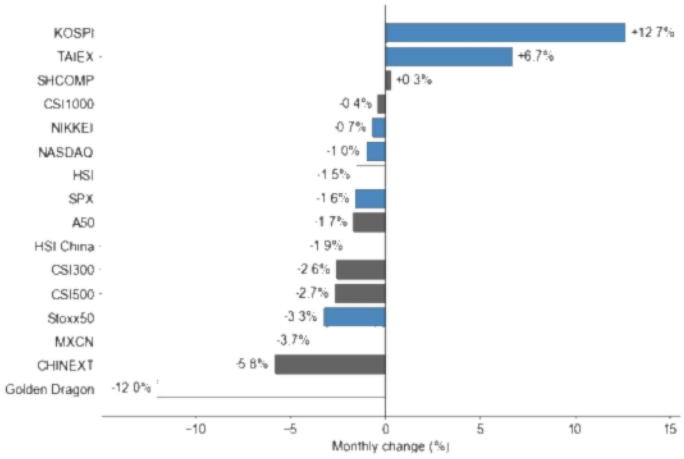
China is approaching the end of 3Q with only a fragile stabilization in domestic cyclical conditions. Recent activity data, including the latest PMI readings, point to some firming in production, but the recovery remains narrowly based as weak domestic demand continues to be the key binding constraint. Credit growth also remains sluggish. Bill financing rates have yet to show any rebound following their sharp decline since April, suggesting that underlying credit demand remains soft despite the PBoC's repeated calls for banks to step up lending and support the real economy in recent months (Figure 1). The persistence of cyclical weakness has increasingly weighed on broader risk sentiment. Chinese equities, particularly the technology-heavy indices, have visibly lagged global peers in recent weeks, highlighting how subdued domestic conditions and continued earnings headwinds are beginning to translate into higher risk premia in asset markets (Figure 2). While our equity strategists remain constructive on selected China AI and technology names on the back of structural growth opportunities, recent market leadership has shifted towards financials, commodities and healthcare, a rotation suggesting that investors are becoming more defensive amid waning risk appetite (China Equity Strategy: Thematic rotation into financials, commodities and healthcare).

Figure 1: Bill financing rates have remained low, signaling still tepid credit demand overall



Source: Wind, J.P. Morgan

Figure 2: Chinese equities have remained broadly weak



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

China's weak domestic backdrop continues to argue for a stronger fiscal push, although the pace and effectiveness of implementation remain uncertain. Government and policy bank bond issuance has accelerated in recent months following a sluggish 2Q (Figure 3), but the overall issuance pace still trails last year's trajectory. With roughly 40% of the annual government bond quota yet to be supplied, there remains considerable room for issuance to accelerate into year-end (Figure 4). However, any near-term increase in supply is likely to affect liquidity conditions more immediately than growth outcomes. The transmission from bond issuance to actual fiscal spending and project execution typically occurs with a lag, and there is a risk that deployment will remain particularly slow in the current cycle. Upcoming local leadership reshuffles could dampen local governments' willingness to initiate large-scale projects, prolonging the gap between financing and expenditure. Indeed, fiscal policy has acted as a greater drag on liquidity conditions this year than in previous years. While issuance has generally fallen short of expectations, fiscal expenditure has been even weaker, resulting in a larger net liquidity

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drain tied to fiscal factors (Figure 5). An acceleration in bond supply therefore raises the risk that the seasonal liquidity tightening typically seen in 4Q plays out again this year, even as the growth impulse from fiscal easing remains delayed.This combination of tighter liquidity conditions and only gradual improvement in underlying activity should remain supportive of further curve flattening. As we have highlighted previously, the long end of the curve remains steep relative to underlying macro fundamentals (Figure 6). **We therefore add a curve flattener through long 30Y CGBs overlaid with a 5Y NDIRS payer (entry: 66bp, target: 50bp, review: 75bp), positioning for further curve flattening in the coming months.**

Figure 3: Government and policy bank bond issuance has picked up after a slow 2Q, but the pace still trails last year's trajectory, ...

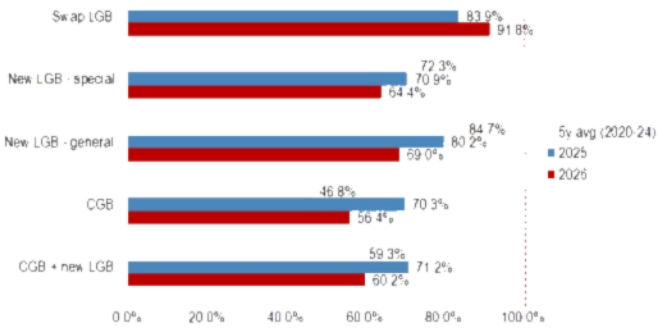
net issuance of CGBs, LGBs and policy bank bonds, CNYbn, 4w sum



Source: Wind, J.P. Morgan

Figure 4: , ... with around 40% of this year's government bond quota yet to be supplied for the rest of the year

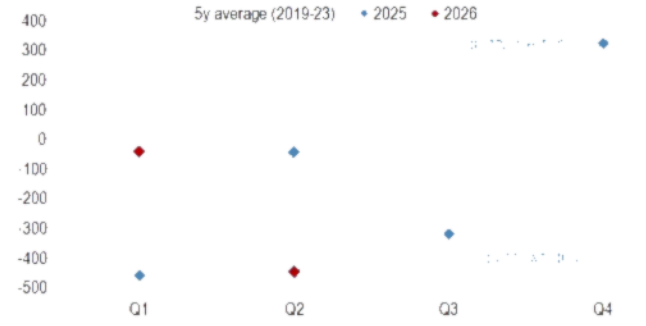
ytd net issuance % annual quota, as of August



Source: Wind, J.P. Morgan

Figure 5: Slow fiscal spending this year has led to larger-than-usual fiscal-related liquidity drains

change in fiscal deposits, CNYbn



Source: Haver, J.P. Morgan

Figure 6: Back-end of the CGB yield curve remains relatively steep

z-scores of the spread between longer-end vs shorter-end yields; +ve indicates a steep curve

	DR001	DR007	1y	2y	3y	5y	7y	10y	30y	50y
DR001		-1.6	-0.7	-1.1	-1.2	-1.2	-1.3	-1.2	-0.7	-0.6
DR007			-0.1	-0.6	-0.8	-0.8	-0.9	-0.7	-0.2	-0.1
1y				-1.2	-1.5	-1.2	-1.3	-0.7	-0.0	0.0
2y					-1.2	-0.6	-0.8	0.0	0.5	0.5
3y						0.1	-0.4	0.5	0.8	0.7
5y							-0.7	0.7	0.9	0.8
7y								1.4	1.2	1.0
10y									0.7	0.7
30y										0.3
50y										

Source: Wind, J.P. Morgan

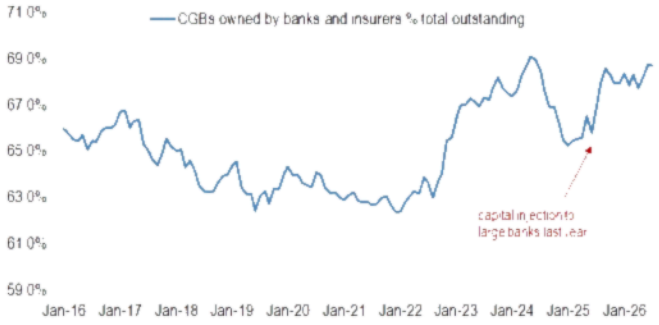
In addition, the recent capital replenishment measures for large Chinese banks and major insurance companies could provide incremental demand support for long-end CGBs. Chinese regulators recently announced a CNY360bn recapitalization plan for eight financial institutions, of which the MoF will contribute CNY300bn directly. This follows last year's CNY500bn capital injection into four large state-owned banks, but notably expands coverage this time to include policy banks and major insurers. While the primary objective is to strengthen capital adequacy ratios and expand balance

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sheet capacity for these state-owned financial institutions to better support the real economy, the measures should also be marginally supportive for the CNY rates market, given that domestic financial institutions remain the dominant holders of government bonds. State-owned banks and insurance companies now account for nearly 70% of total CGB holdings, up from around 65% prior to last year's recapitalization (Figure 7). For banks, with loan demand still subdued and the supply of high-quality credit assets remaining limited, part of the newly created balance sheet capacity could naturally be deployed into government bonds. The inclusion of insurance companies is particularly supportive for the ultra-long end of the curve, where insurers remain a key source of structural demand. While regulators have encouraged insurers to increase equity allocations over the past year, resulting in a rapid expansion in equity holdings, growth in bond holdings has generally continued to outpace overall AUM growth (Figure 8). This suggests that the increase in equity allocations has not come entirely at the expense of bond demand. Improved capital positions for large insurers should therefore continue to support incremental demand for long-duration CGBs, a tailwind for a flatter curve.

Figure 7: State banks and insurance companies hold close to 70% of total CGB outstanding, up from 65% prior to last year's capital injection



Source: Wind, J.P. Morgan

Figure 8: Asset allocation of major Chinese insurers

CNYmn

	1H26	H/H growth%	% of AUM
China Life			
Bond	4,534,013	6%	57.1%
Stock	1,522,220	21%	19.2%
Total AuM	7,946,101	7%	
Ping An			
Bond	3,743,531	3%	56.6%
Stock	1,281,865	3%	19.4%
Total AuM	6,610,950	2%	
CPIC			
Bond	1,949,642	5%	61.4%
Stock	453,409	8%	14.3%
Total AuM	3,172,982	4%	
New China Life			
Bond	975,101	7%	51.3%
Stock	485,800	25%	25.5%
Total AuM	1,901,854	3%	
PICC Group			
Bond	981,861	7%	49.1%
Stock	308,712	22%	15.5%
Total AuM	1,997,723	5%	

Source: JPM China Insurance Team

Re-engage with CNH longs. USDCNH has fallen more than 1% in 3Q26, moving closer to 6.70 amid the recent decline in USDJPY and a softer broad dollar backdrop, lifting CNH total returns back into positive territory (Figure 9). As we have highlighted previously (China Local Markets Weekly: Beyond the growth disap could encourage Chinese corporates to resume more active USD sel moderation in July, as corporate FX conversion behavior has becom sensitive to CNH carry-adjusted returns. Such repatriation flows als seasonally into year-end as exporters increase FX conversion, provi source of support for the yuan heading into 4Q.The still-elevated sp that a degree of pace management by the PBoC remains in place, bu

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has become increasingly one of moderation in resistance. Since August, the PBoC's fixing stance has turned incrementally less defensive, with the weakening bias embedded in the daily fixings narrowing relative to our model-based estimate incorporating the countercyclical factor (Figure 10). Together with the break below 6.78 in the fix itself, this has helped facilitate the recent decline in USDCNH. That said, the pace of CNY appreciation continues to lag much of the region, particularly currencies such as JPY, KRW and AUD (Figure 11). This has contributed to the recent softness in the CFETS basket, a pattern that is not unusual during periods of broader DXY weakness. With the CNY TWI now off this year's highs, the room for further appreciation has expanded. This, in our view, leaves scope for the PBoC to further ease FX management at the margin, particularly ahead of President Xi's expected visit to the US in late September, should policymakers seek to support market sentiment around key geopolitical events and the upcoming National Day holiday. While expectations for major breakthroughs in US-China negotiations remain modest, history suggests that high-level US-China presidential engagements have generally acted as a positive catalyst for the yuan, with USD/CNH tending to fall around key events (Figure 12). **Against this backdrop, we believe the balance of risks continues to favor further CNY strength. We therefore re-engage with long CNH positions versus USD and EUR (entry: 100, target: 102, review: 99) and move OW CNY FX in GBI-EM**. Our year-end forecast for USD/CNY remains unchanged for now at 6.70 but we see downside risks to our forecast profile if the lower USD/JPY trend and soft USD momentum have legs.

Figure 9: The recent dip in USD/CNH has lifted CNH total returns back into positive territory



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

Figure 10: The weakening bias in CNY fixings has moderated in recent weeks



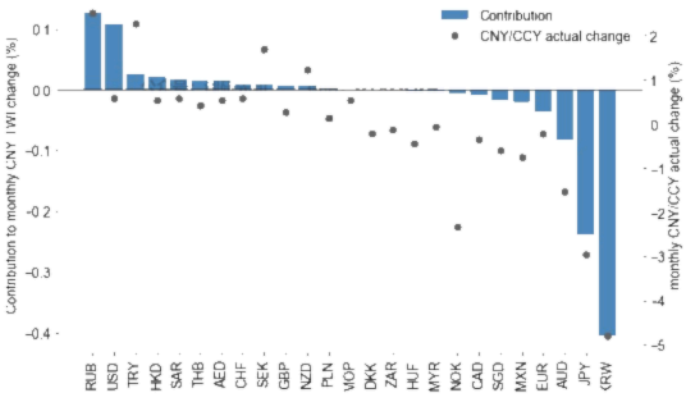
Source: Bloomberg Finance L.P., J.P. Morgan

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Figure 11: CNY's underperformance vs Asian FX has been a major source of CNY TWI weakness of late

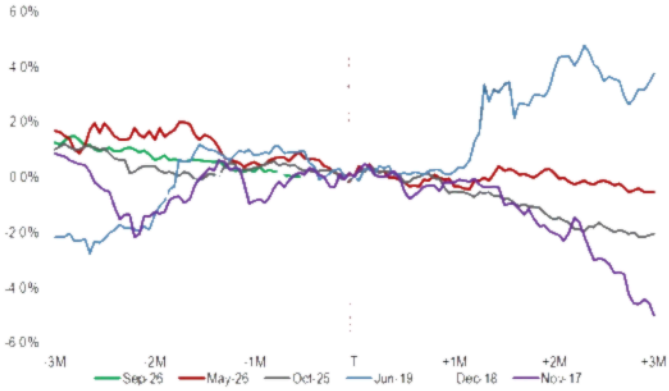
contribution to monthly CFETS TWI change



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

Figure 12: Presidential summits tend to be a bullish impulse for CNY FX

USD/CNH around presidential summits, cumulative change in USD/CNH, T=day of presidential summits

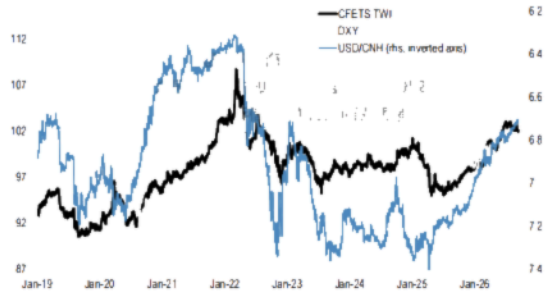


Source: Bloomberg Finance L.P., J.P. Morgan

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China local markets charts

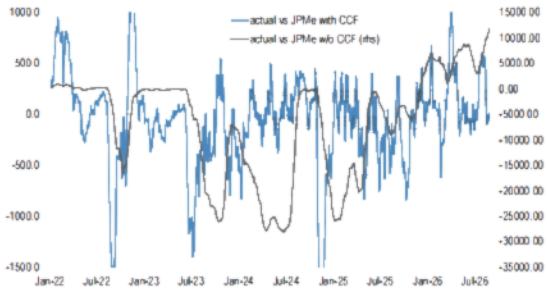
Figure 13: USD/CNY and CFETS TWI



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

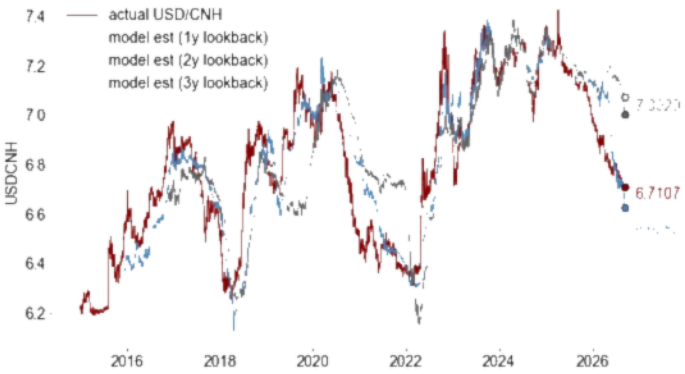
Figure 14: CNY fixing bias

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

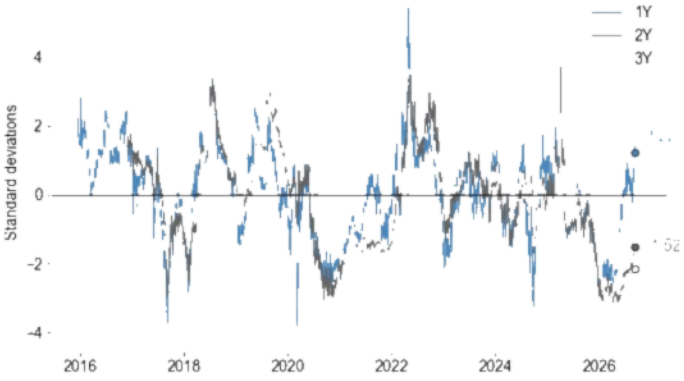
Figure 15: USD/CNH and yield-spread-based fair value



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

Figure 16: Misalignment in USD/CNH vs. rate fundamentals

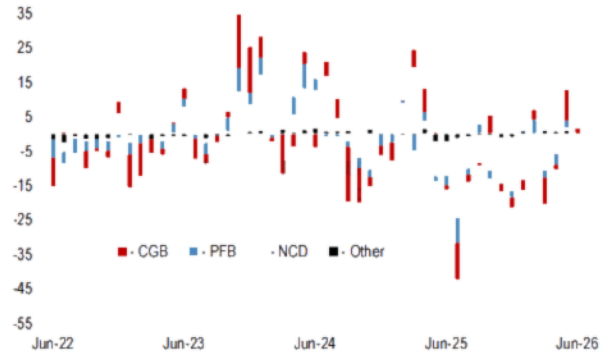
ln s.d.



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

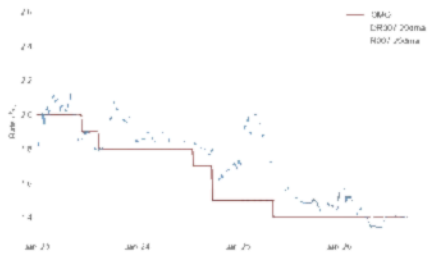
Figure 17: Foreign bond inflows

$bn, change in foreign ownership



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

Figure 18: Money market rates



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