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Economics Research
13 September 2026 | 1:20PM HKT

ASIA IN FOCUS

China: Gauging the Impact of Government Bond Supply on Bond Yields

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- After softer growth momentum and slower-than-expected fiscal spending in H1 2026, government bond issuance—including both central and local government bonds —is picking up, echoing the July Politburo meeting's call to accelerate fiscal spending. We expect total bond net issuance (both central and local) to rise meaningfully in the coming months, with monthly net issuance reaching 1% of GDP per month during September–October, up from a monthly average of around 0.6% of GDP in H1. In this note, we examine whether heavier bond supply could put upward pressure on bond yields and swap rates in China.
- Historical episodes suggest that higher government bond issuance has had mixed effects on 10y CGB yields, with the yield response depending on a host of factors including PBOC liquidity management, the speed of fiscal-proceeds spending, as well as shifts in growth, inflation and policy rate expectations.
- Controlling for changes in growth and inflation expectations, and changes in the interbank funding tightness relative to PBOC's policy target, we estimate a larger sensitivity of yields at the front end of the CGB curve to net CGB issuance. By our estimates, a 0.2% of GDP acceleration in net CGB issuance is associated with a 4.8bp increase in the 1-year CGB yield, compared with 2.0bp in the 5-year CGB yield and 1.5bp in the 10-year CGB yield. These estimates suggest that higher government bond supply in China transmits mainly through front-end funding conditions rather than a larger long-end risk premium, leading to curve flattening.
- 1-year CDB yields and 1-year IRS rates are similarly sensitive to net CGB issuance. By contrast, the relationship between LGB issuance and CGB yields is less clear across maturities, potentially because incremental LGB supply is absorbed partly through wider LGB-CGB spreads and because the timing of CGB and LGB issuance may be coordinated to contain liquidity pressure.
- Looking ahead, faster government bond issuance—especially CGB supply—could push front-end yields higher temporarily. But with repo rates well anchored around the OMO target, domestic demand and credit conditions weak, and inflation expectations still low despite the current global energy-supply shock, a sustained CGB sell-off appears unlikely. In the longer term, we expect Chinese rates to remain on a structural downward trend, reflecting excess savings, subdued private-sector credit demand, high debt levels, and demographic

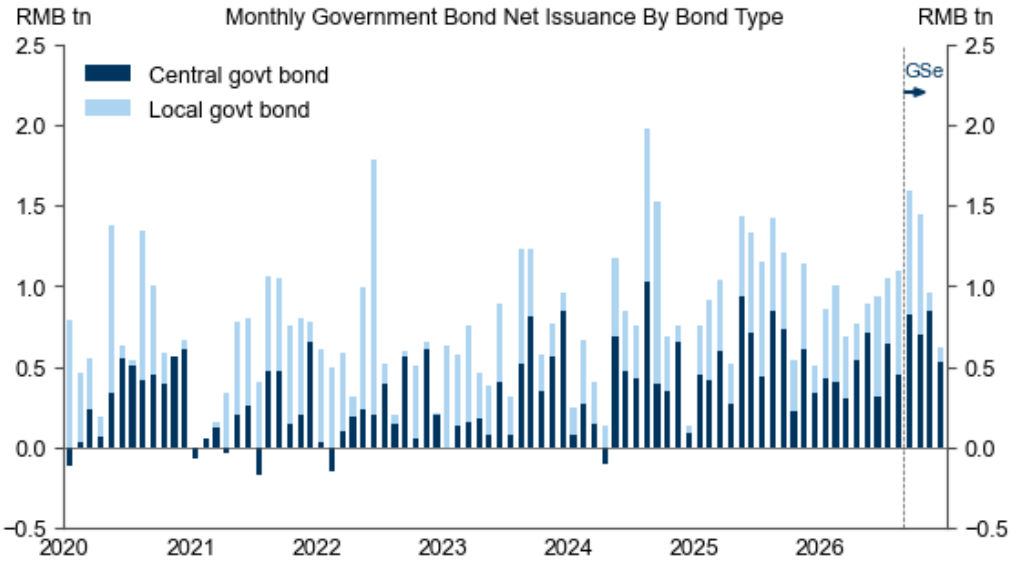
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headwinds.

Gauging the Impact of Government Bond Supply on Bond Yields

China's growth momentum has softened notably in recent months, and the pace of fiscal spending was sluggish in the first seven months of the year. Against this backdrop, the July Politburo meeting called for "accelerating the progress of fiscal expenditures and the spending of bond proceeds". Government bond issuance – including both central and local government bonds – has started to accelerate. In addition, the RMB800bn New Policy-Based Financing Instrument (NPBFI), announced earlier this year, has started to be allocated. We expect total bond net issuance (both central and local) to rise meaningfully in the coming months, with the monthly net issuance reaching 1% of GDP per month during September–October[1], up from a monthly average of around 0.6% of GDP in H1; Exhibit 1).

Exhibit 1: Government Bond Net Issuance Is Set to Accelerate in the Coming Weeks



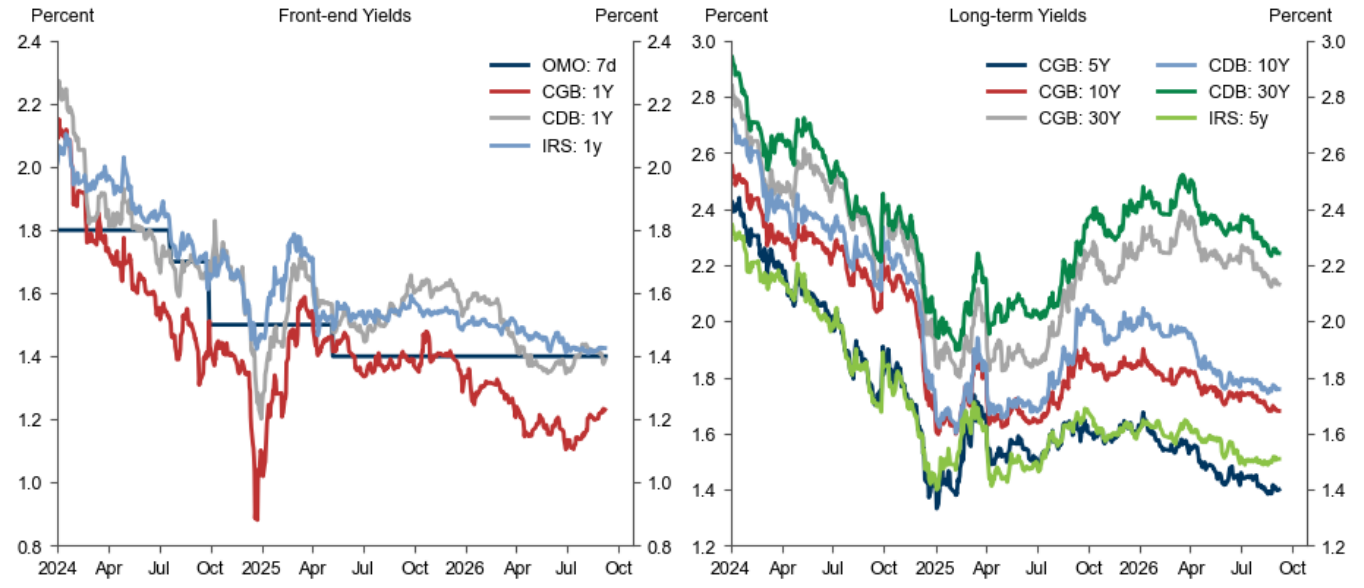
Local government refinancing bond issuance for debt resolution is not included.

Source: Wind, CEIC, Goldman Sachs Global Investment Research

The recent rise in 1-year CGB yields, alongside still-subdued long-end yields, raises the question of how a heavier issuance calendar may affect the level and shape of the CGB curve (Exhibit 2). In principle, additional long-term government bond supply should point to a bear steepener, but the transmission in China is less straightforward. PBOC liquidity accommodation, the pace at which fiscal proceeds are disbursed, and the extent to which markets have already priced in additional fiscal easing all matter. In this Asia in Focus, we examine past episodes of higher government bond issuance, assess the implications of the expected acceleration in bond supply, and discuss our rates views.

[1] We expect monthly central government bond (CGB) net issuance to pick up from a monthly average pace of 0.3% of GDP in H1 2026 to 0.6% of GDP during September–October, and local government bond (LGB) net issuance to accelerate from a monthly average of 0.3% of GDP to 0.5% of GDP over the same period.

Exhibit 2: One-Year CGB Yields Have Risen Recently, While Long-Term Rates Remained Low in August



CGB: Central government bonds, CDB bond: bonds issued by China Development Bank, IRS: Interest rate swap rate.

Source: CEIC, Goldman Sachs Global Investment Research

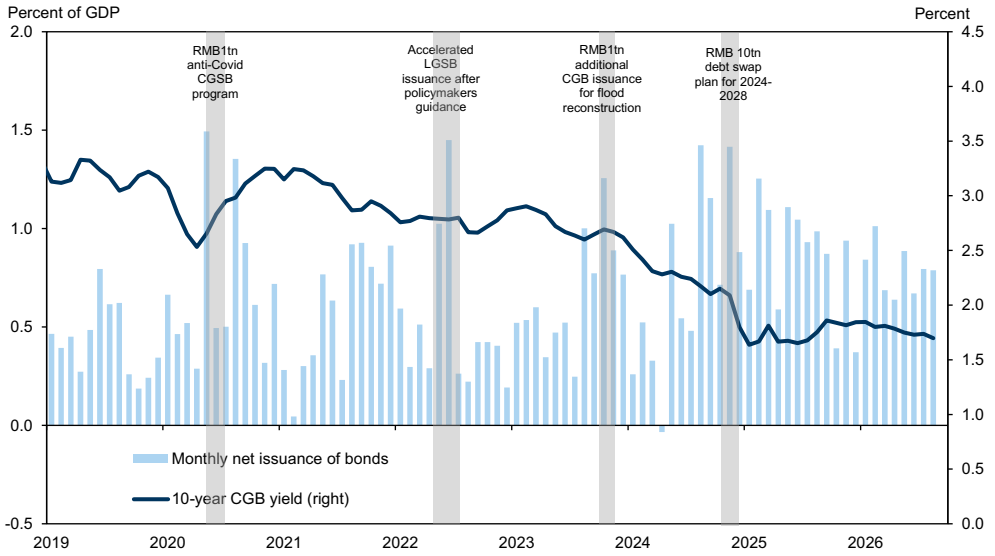
Historical episodes suggest that higher government bond issuance has had mixed effects on 10y CGB yields, underscoring the importance of the accompanying liquidity conditions and macro backdrop (Exhibit 3). We examine four episodes of accelerated issuance to illustrate these interactions.

- **Mid-2020:** The RMB1 trillion anti-Covid special CGB program increased government bond supply. 10y CGB yields rose alongside repo rates normalizing from pandemic lows towards the PBOC's OMO target. Tighter funding conditions, rather than incremental supply alone, were likely an important driver of the bond sell-off.
- **May-June 2022**: Policymakers accelerated LGSB issuance, providing advance guidance to largely complete the annual quota by end-June amid renewed Covid disruptions and property-sector weakness. However, 10y CGB yields were broadly stable initially and declined subsequently. The heavy issuance was accompanied by fiscal support, including large-scale VAT credit refunds, while weak growth reinforced expectations that monetary policy would remain accommodative.
- **October-November 2023:** Special refinancing LGBs and the additional issuance of RMB 1tn central government bonds increased bond supply. Yet funding pressure appeared to emerge ahead of the bulk of issuance, potentially because banks pre-managed liquidity needs in anticipation of heavier issuance. 10y CGB yields rose only modestly, while the sell-off was more pronounced at the front end of the curve. This episode illustrates how supply pressure can be amplified through tight funding conditions.
- **November-December 2024**: Authorities approved a RMB10 trillion debt-swap plan for 2024–28 to reduce outstanding "hidden debt", including RMB6tn of additional debt quota for local refinancing bonds during 2024–26 and RMB4tn out of the annual LGSB quota over 2024–28. However, 10y CGB yields declined despite repo rates remaining above the OMO target, likely for two reasons. First, the change in

monetary policy stance from "prudent" to "moderately loose" at the December Politburo meeting, a term last used during the GFC, led to market speculation of substantial policy rate cuts. Second, markets were disappointed by the fiscal package. Ahead of the announcement, investors had expected RMB1–2tn of ultra-long-term central government special bond issuance. Instead, the announced package relied more heavily on LGSB issuance for debt refinancing and substitution. While the program boosted headline LGB issuance, it was mainly a refinancing exercise rather than a conventional increase in fiscal borrowing for new spending.

Overall, these episodes suggest that the yield response depends on the persistence of funding pressure after PBOC liquidity operations and fiscal proceeds spending, as well as shifts in growth and policy-rate expectations.

Exhibit 3: Higher Government Bond Supply Issuance Has Not Consistently Led to Higher 10-Year CGB Yields



Source: CEIC, Goldman Sachs Global Investment Research

To examine the conditional relationship more systematically, Exhibit 4 shows monthly regressions of the change in CGB bond yields on net government bond issuance, controlling for changes in growth and inflation expectations, and changes in the interbank funding tightness relative to PBOC's policy target (i.e., DR007-OMO spread).

We estimate a larger sensitivity of yields at the front end of the CGB curve to net CGB issuance. An increase in monthly net CGB issuance equivalent to 0.2% of GDP, approximately one standard deviation in the sample, is associated with a 4.8bp increase in the 1-year CGB yield, compared with 2.0bp in the 5-year CGB yield and 1.5bp in the 10-year CGB yield. The 30-year estimate is small and statistically insignificant. This pattern points to a bear-flattening response, suggesting that higher government bond supply in China transmits mainly through front-end funding conditions rather than a larger long-end risk premium.

With commercial banks being the major government-bond investors, th
liquidity ahead of large issuance, temporarily draining interbank liquidit
greater pressure on short-term funding rates and therefore front-end C
consistent with the larger coefficient on DR007-OMO at shorter maturi

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In contrast, the impact on longer-term yields appears more muted. Weak loan demand can leave banks with more capacity for bond investment, while insurers and other investors matching long-dated liabilities may help absorb supply at the very long end (e.g., 30-year). The declining explanatory power of the regression toward longer maturities also suggests that long-end yields may be affected more by factors outside our specification, potentially including structural asset allocation demand.

Exhibit 4: Higher CGB Supply Is Associated with a Bear-Flattening Yield Response

	1-year CGB yield change (bp)	5-year CGB yield change (bp)	10-year CGB yield change (bp)	30-year CGB yield change (bp)
Impact from a one standard deviation in:				
Monthly net CGB issuance (0.2% of GDP)	4.76 *** (3.77)	2.03 ** (2.02)	1.53 * (1.71)	0.73 (1.32)
1-year inflation expectation (10bp)	2.19 * (1.93)	1.35 (1.49)	0.87 (1.07)	1.00 (1.26)
1-year growth expectation (20bp)	4.43 *** (4.30)	3.93 *** (4.77)	2.31 *** (3.15)	1.58** (1.93)
DR007–OMO gap (10bp)	6.00 *** (4.87)	3.77 *** (3.82)	1.83 ** (2.08)	1.35 (1.76)
Adjusted R-squared	0.51	0.39	0.21	0.10

Sample: Monthly, Jun 2016–Jun 2026; monthly dummies included.
***, **, * indicate significance at 1%, 5%, and 10%, respectively.

Source: Goldman Sachs Global Investment Research, Consensus Economics

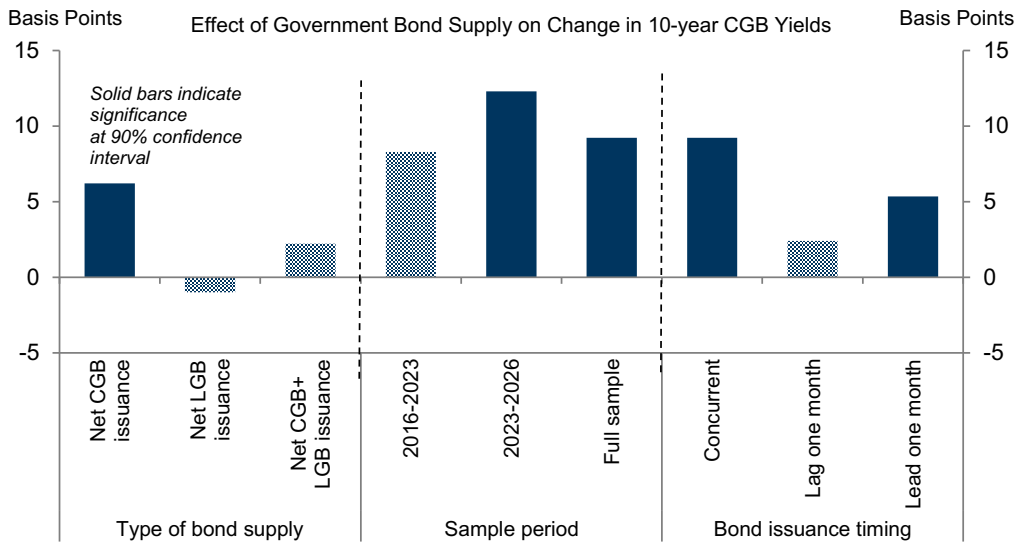
Exhibit 5 shows that the relationship between government bond supply and CGB yields varies by type of bond supply, sample period, and timing. Net CGB issuance has a positive coefficient, while the estimates for LGB issuance and combined government issuance are less conclusive. The relationship appears stronger in the post-2023 sample and is most pronounced for contemporaneous issuance.

LGB net issuance shows no clear relationship with changes in CGB yields across maturities, whether measured by net new issuance alone or by net issuance including refinancing bonds[2]. This likely reflects three factors. First, incremental LGB supply may be absorbed mainly through a wider LGB-CGB spread, rather than higher CGB yields. Second, LGB and CGB issuance appear relatively coordinated, helping to contain liquidity pressure. Third, LGBs are held largely by commercial banks and insurers, which tend to hold to maturity, limiting the spillovers in the secondary market.

The response to CGB issuance appears larger in the post-2023 sample, potentially reflecting more frequent upside surprises to issuance quotas, including the October 2023 additional CGB issuance quota, the RMB10tn debt-swap plan announced in 2024, and the additional LGB quota approved in Q4 2025. Across timing specifications, contemporaneous issuance has the largest coefficient, while previous-month issuance is smaller and insignificant. The positive and significant coefficient on next month's issuance is consistent with some advanced pricing of expected supply.

[2] We also find no statistically significant effect of other bond net issuance, such as policy bank bonds, on CGB yields. This likely reflects two factors 1) government bond issuance has a more direct liquidity impact because fiscal deposit inflows drain interbank liquidity 2) China's bond market remains segmented, limiting substitutability across instruments. As a result, non-CGB issuance may not meaningfully crowd out demand for CGBs.

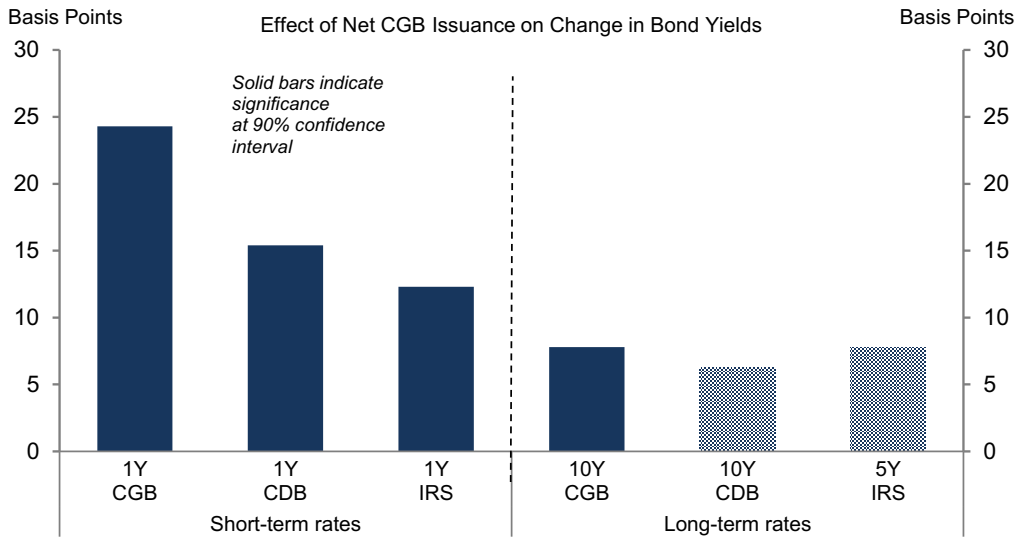
Exhibit 5: 10-year CGB Yields Show a Clearer Positive Association With CGB Supply Than with LGB Supply



Source: Goldman Sachs Global Investment Research

Across type of bond yields, the evidence for an association with CGB issuance is clearest at shorter maturities (Exhibit 6). The reported coefficients are positive and significant for 1-year CGB yields, 1-year CDB yields and 1-year IRS rates, consistent with funding pressures transmitting across markets. At longer maturities, however, the coefficients for 10y CDB yields and 5y IRS rates are positive but statistically insignificant. For IRS, since swap rates reflect the expected path of repo fixings, a temporary increase in funding costs may have a smaller impact on the five-year rate if investors expect funding conditions to normalize as PBOC provides liquidity. For policy bank bonds, they have greater secondary-market liquidity and a larger share of fund investors, who trade more frequently than banks. Changes in fund flows and CDB issuance that are unrelated to CGB supply could introduce variation in CDB yields.

Exhibit 6: Net CGB Issuance Has a Larger Effect for Short-term Rates



Source: Goldman Sachs Global Investment Research

Looking ahead, faster government bond issuance—especially CGB supply—could temporarily tighten liquidity and lift front-end yields, particularly around quarter-end when interbank liquidity is seasonally tight. However, for this to turn into a sustained CGB sell-off, repo rates would likely need to remain materially above the OMO policy rate, implying limited PBOC liquidity accommodation. This appears unlikely given repo rates remain broadly anchored, domestic and credit demand is still weak, and inflation expectations are still low despite the current global energy-supply shock.

Over the longer term, we expect Chinese rates to retain a structural downward trend, reflecting excess savings relative to investment demand, subdued private-sector credit demand, large debt accumulation, and demographic headwinds.

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