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China: PBoC formalizes the shift to overnight OMO

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Following Governor Pan's advance notice at the Financial Street Forum about two weeks ago, on 30 October, the PBoC issued a statement to officially replace the 7d OMO rate with an overnight OMO rate as its key policy rate, with the interest rate set at 1.25%. The shift and the level of interest rate were largely expected, especially after the overnight OMO was *introduced* in late June and its operations have become more frequent and larger in recent weeks, although the pace might be a bit *sooner than expected*. The tenor shift does not necessarily trigger a broad cut to interest rates, as suggested by the *transition* from 1y MLF to 7d OMO, despite the lingering growth headwinds and recent stock market rout. We maintain our forecast of no policy rate cuts for the rest of this year, especially as other major central banks remain under pressure to raise rates. That said, as the de facto lower bound for DR001 is lowered by 15bp, the PBoC's tolerance for the extent of liquidity abundance has further increased.

The 7d OMO rate gives way to an overnight policy anchor

On 30 October, the PBoC announced that, from 2 November, it will conduct overnight reverse repo operations on every working day via fixed-rate, quantity tenders, with the operation interest rate settled at 1.25%. This is the first time the central bank has officially disclosed the overnight rate since the tool debuted on *29 June*, although the same level has already been widely reported (see Reuters). Meanwhile, 7d reverse repos will move to fixed-quantity, interest-rate tenders with multiple-price allotment, and will be conducted mainly around tax payment periods and month-ends. In our view, this formally phases out the 7d rate as the key policy rate, a role it has played since mid-2024; the rate itself has been unchanged at 1.40% since May 2025. Although the announcement does not explicitly designate a new policy rate, we believe the changes effectively establish the overnight reverse repo rate as the PBoC's main policy anchor of its evolving monetary policy framework.

The announcement does not specify any changes to Standing Lending Facility (SLF) rates, which provide the official upper bound of the PBoC's formal rate corridor. However, at the Financial Street Forum held in Beijing on 19 October, Governor Pan Gongsheng announced that SLF access would be extended to domestically incorporated foreign banks, with national banks under the same arrangements, giving it full coverage of domestic deposit-taking institutions. In our view, this would make the SLF perhaps a more credible backstop under the new overnight framework.

The operational rate corridor shifts down by 15bp

The announcement also re-anchors to the overnight rate all other tools previously priced at a spread to the 7d rate, keeping the spreads unchanged. The most important are the temporary overnight repo and reverse repo operations, which form a narrower operational corridor and are triggered when DR001 stays persistently below or above their respective rates. As these operations have been priced at 25bp below and above the policy rate since June, the corridor will shift from 1.15-1.65% to 1.00-1.50% (Figure 1), with both bounds lowered by 15bp and its 50bp width unchanged. In our view, the lower floor suggests that the PBoC is now prepared to let overnight rates fall further before draining liquidity, implying a higher tolerance for ample liquidity, while the lower upper bound should provide a cheaper liquidity backstop when funding conditions tighten.

A cheaper FIMA RMB repo should support offshore liquidity

For the FIMA RMB repo, the re-anchoring means that funding at the same 7-day, 1-month and 3-month tenors will be 15bp cheaper from 2 November, as an unchanged spread is applied to a lower base rate. In our view, the impact extends beyond foreign central banks and sovereign funds, as foreign-owned RMB clearing banks were added to the tool's counterparties on 20 October. These banks will be able to obtain RMB liquidity from the

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PBoC at a lower cost to support their offshore RMB business. This may help contain spikes in offshore RMB funding costs during periods of stress and strengthen the transmission of the onshore policy rate to offshore RMB rates. A lower repo cost also raises the liquidity value of CGBs for foreign official holders, which could marginally support their allocation to RMB assets. We think the aggregate impact will depend on take-up and the extent to which eligible institutions pass the cheaper funding through to offshore markets, with the facility potentially more valuable during episodes of funding stress.

Governor Pan flagged the switch only 11 days earlier

The switch had been clearly flagged by the PBoC in advance. At the Financial Street Forum on 19 October, Governor Pan Gongsheng said the PBoC would study switching the tenor of its main OMO instrument from 7 days to overnight "when appropriate", with the overnight repo rate becoming the main policy rate accordingly. Mr Pan argued that the interbank overnight repo rate (DR001) had in effect become the target rate for the PBoC's operations, while the main OMO instrument and the policy rate remained at the 7d tenor. Aligning the two, in his view, would improve the precision of interest rate control. Governor Pan also outlined two related reforms: diversifying loan pricing benchmarks away from predominant reliance on the LPR, and phasing out the legacy PBoC benchmark deposit and lending rates. With overnight operations already in use since June, we believe the rapid follow-through suggests that much of the operational groundwork was already in place when Pan delivered the speech.

More frequent and larger operations of overnight OMO

On 25 June, the PBoC announced it would conduct overnight reverse repos on 29-30 June. Since then, a total of 30 operations have been conducted (Figure 2), with two in June, three in July, eight in August, eight in September, and nine in October. With more frequent overnight OMO, the size of operation has also picked up. Initially, it was RMB300bn on 29 June and RMB600bn on 30 June, and then it has enlarged over time, to RMB1,000bn for each day of 27-30 October. With more frequent and large operations of overnight OMO, the operations of 7d OMO were reduced or even skipped at times.

The shift does not necessarily lead to a rate cut to LPR

Although the policy rate is shifted to the overnight OMO rate of 1.25% from the 7d OMO rate of 1.40%, and the loan prime rate (LPR) was linked to the 7d OMO rate, this shift does not automatically trigger a cut to LPR.

- First, in March 2025, when the policy rate was shifted to the 7d OMO rate of 1.5% from the 1y MLF rate of 2.0%, there was no imminent adjustment to LPR. In other words, the tenor shift does not necessarily lead to a broad interest rate cut.
- Second, although there has been neither policy rate cut nor LPR cut since May 2025, falling market rates already led to lower banks' lending rates. Since early 2025, DR001 has become the new operation target rate of PBoC, and PBoC has attempted to guide DR001 to move around its policy rate, which was the 7d OMO rate. On a quarterly basis, DR001 fell by an average of 23bp to 1.30% in Q2 2026 from a year ago, while over the same period, banks' average lending rates fell by 24bp to 3.05% in Q2 2026 from a year ago, according to PBoC's quarterly report.
- Third, the current level of DR001 rate is at around 1.28%, which is not substantially different from the overnight OMO rate of 1.25%. As the current level of DR001 is not lower than the overnight OMO rate, PBoC has little pressure from markets to deliver a rate cut to overnight OMO rate in the near term. In other words, the next LPR adjustment might come along with an adjustment to overnight OMO rate.

Overall, we maintain our view of no policy rate cuts for this year, especially as other major central banks are still under pressure to raise rates. That said, along with the shift to overnight OMO rate, the lower bound for DR001 is lowered by 15bp, which suggests that PBoC's tolerance for the extent of ample liquidity has increased.

The timing of the shift coincides with a credit risk event related to a local SOE

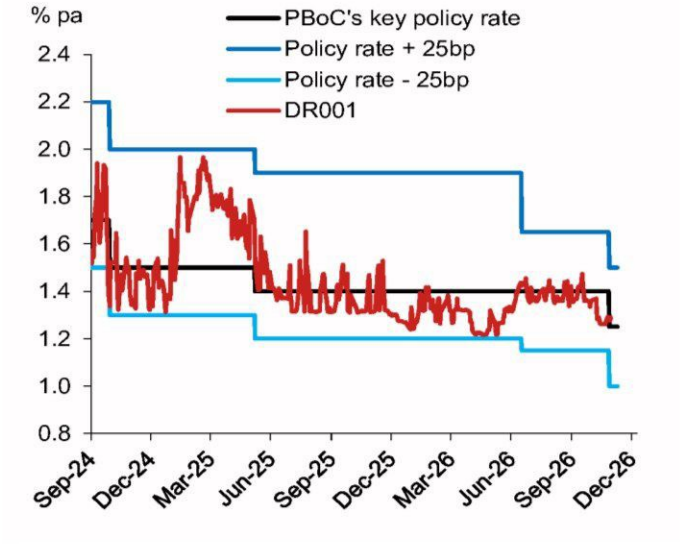
Zhuhai Huafa Group, a major local state-owned conglomerate that is heavily exposed to the property sector, reportedly missed payments on two recently due trust products and requested loan extensions from major banks, according to Bloomberg. This triggered a selloff in its offshore bonds initially and then even sparked some market volatility in onshore bond markets on Friday, as investors expressed concerns that this credit risk event could force fixed-income funds to meet unexpected investor redemption demand

and cause liquidity pressure in bond markets. As the announcement of the shift in the PBoC's key policy rate also took place on Friday, markets appeared to question whether the selloff in onshore bond markets had triggered this policy announcement.

We believe this might be a coincidence, rather than a policy reaction. First, the shift to overnight OMO rate is just part of the PBoC's ongoing efforts to improve interest rate transmission and modernize its monetary policy framework. The shift does not necessarily imply a more easing bias of the PBoC. Second, the Bond Market NBFI Swap Facility (BNSF) was just launched on 26 October. The PBoC could enlist this new policy instrument when there is a surge in liquidity risk and bond markets face systemic pressure.

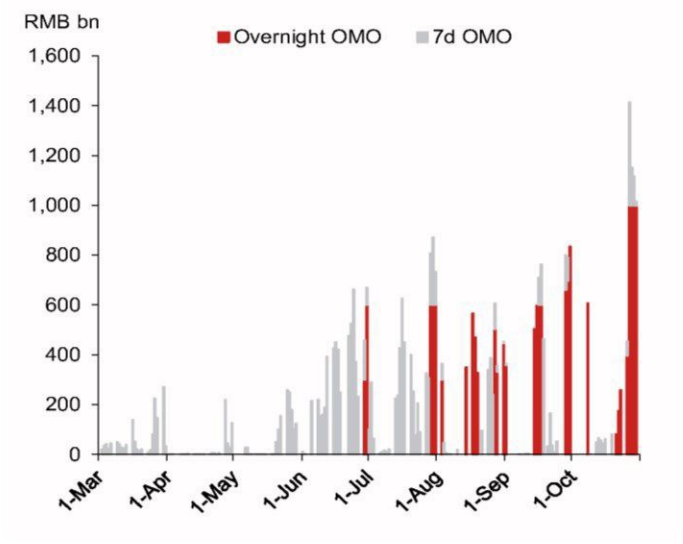
On a separate note, we view this type of credit risk event as likely inevitable, as the property bust persists. Although we see no signs of a systemic credit crisis, the colossal inter-firm arrears might continue to impair the credit system, dent credit demand, and depress domestic investment and consumption. In our view, the current economic weakness calls for *non-performing debt* to be addressed and more skillful planning, while we see some structural reforms of public finance and the social security system as necessary.

Fig. 1: Interest rate corridor



Note: PBoC's key policy rate was 7d OMO rate, before shifting to overnight OMO rate in November 2026.
Source: PBoC, Wind, Nomura Global Economics.

Fig. 2: The PBoC's OMO short-term operations



Source: PBoC, Wind, Nomura Global Economics.



Appendix A-1

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