China: PBoC studies shifting its policy rate to overnight

- **PBoC Governor Pan Gongsheng outlined a reform print of the PBoC's monetary policy framework, including studying a shift of the benchmark policy rate to overnight from a 7D tenor currently.**
- **Even though this is more about structural reforms instead of outright monetary easing, the expectation of the policy rate switch will help anchor short-term market rates around a lower level, in turn driving lower rates in bond market and bank loans. We expect the PBoC to increase the frequency of its ON reverse repo operation and consider announcing the operation rate, before the official switch likely in 2027.**
- **We expect the bull-run in cash bonds to continue and now prefer the 5-10Y section of the curve in Q4. We expect 10Y CGB yield to move into the 1.55-1.60% range towards year-end.**

PBoC announced interest rate reform and liquidity supports

At the opening of the annual Financial Street Forum on 19 October, PBoC Governor Pan Gongsheng outlined a reform print of the PBoC's monetary policy framework. Regarding the benchmark policy rates, Pan suggested that the PBoC will study shifting the PBoC's benchmark policy rate to overnight from a 7D tenor currently. Other reform measures are to promote bank loan pricing to include DR001 as a floating benchmark in addition to LPR and to phase out the bank loan and deposit benchmark rates.

To manage financial market risks and promote market opening, Pan suggested that the PBoC would soon roll out a few measures, with highlights including setting up liquidity backstop tools to cope with large NBFI redemptions to stabilise bond markets as well as expanding PBoC SLF facility to cover all onshore depository-taking FIs including foreign banks operating in China. Pan also reiterated the PBoC's stance on FX in response to intensified international debates on CNY valuation and its links to global imbalance, as well as providing roadmaps to facilitate RMB internationalism.

Helping anchor rates at lower and more stable levels

We think this is an encouraging signal to the markets that the PBoC is proactively working towards a significant milestone to upgrade its monetary policy framework. The planned interest rate reforms and liquidity management facilities would help strengthen the transmission of PBoC policy rates to short-term market rates and then bond yields and bank interest rates for the real economy, better anchor market rate expectation, lower market rate volatility and improve the effectiveness of the PBoC's monetary policymaking.

Even though this announcement is more about structural reforms instead of outright monetary policy easing, the expectation of the policy rate switch will nonetheless help anchor short-term market rates around a lower level, in turn driving lower rates in bond market and bank loans. Furthermore, the PBoC's policy intention to stabilise the rates market and prevent excessive market rate volatilities should be welcomed by markets.

Watch for near-term OMO signals; a switch likely in 2027

Pan's announcement of a planned switch of the benchmark rate to ON from 7D tenor has arrived within market expectation, though the exact timing is yet to be clear. Given Pan's intention "to study a shift… at an appropriate time", we think the PBoC may not be in a rush to roll it out soon, but more likely in 2027.

Before the official switch, the PBoC will likely increase the frequency of its ON reverse repo in its daily OMO and consider announcing the ON operation rate to



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the markets to guide a smooth switch to ON benchmark rate. We will pay attention to those signals to better assess the potential timing, while taking policy clues from the upcoming Q3 PBoC monetary policy report (in late October) and the annual Central Economic Work Conference (in early December).

Since the induction of ON reverse repos in its OMO in late June, the PBoC has been auctioning it with a fixed rate and quantity cap on an ad-hoc basis (typically a few days in mid-month and towards month-end), but the auction rate is not disclosed. Today, the PBoC announced it would conduct ON reverse repo operations between 21 October to 2 November, with a fixed rate and quantity-based tenders, capped at RMB1trn daily. We think the chance of a material change during this period is small.

Market rates have moved lower in anticipation of the change

In recent years, the PBoC often cut its policy rate cuts when it introduced a change to the benchmark rates. The shift of the benchmark policy rate to 7D rate in June 2024 was followed up by a 10bp cut in July, and the reform of LPRs in August 2019 arrived with a 10bp cut. We think it may not necessarily be the case this time, given China's wide interest rate gaps with other major economies and the ongoing reflation despite being largely imported. That said, we think there is still some modest room for further lowering of the PBoC policy rate (ie, 10bp) when imported inflation softens while other major central banks pivot to easing again. The durability of external demand strength deserves a close watch for potential step-up in monetary easing, given China's current measured structural approach in dealing with domestic demand weakness.

In anticipation of the PBoC's potential benchmark rate switch to the ON tenor, market rates have already moved lower since the return from the National Day holiday. The DR001 moved further lower to around 1.27% today (vs 7D reverse repo rate at 1.40%). The expectation of the policy rate transition would likely allow the DR001 anchoring at a level that is close to the ON reverse repo (reportedly at 1.25%). This would then influence other market rates to be priced at a lower level, as long as the PBoC retains its accommodative stance in managing market liquidity, in our view.

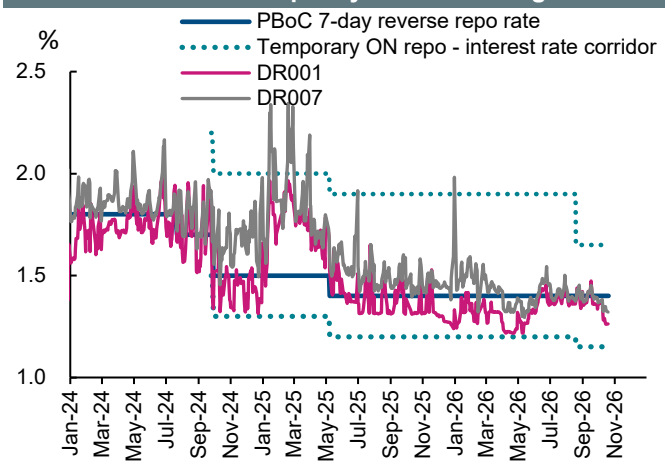
Lower interbank funding support continued rates bull-run

The PBoC's announcement has fuelled market interest in receiving repo IRS and bull-run in cash bonds, as investors have formed firmer expectations of declining interbank funding costs with likely more frequent ON reverse repo operations by the PBoC. Meanwhile, the 1Y NCD yields, benchmark market rates for banks' medium-term interbank borrowing rates, dropped 3bp today to around 1.40%, indicating expectation around easing bank funding costs during the transition process of benchmark policy rates.

We expect the bull-run in cash bonds to continue, and now prefer the 5-10Y section of the curve in Q4 after calling for compression of 30Y-10Y spread tightening in Q3. The declining interbank borrowing costs for banks would open room for the carry trade again, which has been weighing on market demand in the belly of the CGB curve given negative carry status. Meanwhile, some smaller banks might also prefer to reconsider the 5-10Y tenor given reported window guidance of duration exposure from regulators into year-end. We now expect 10Y CGB yield to move into the 1.55-1.60% range towards year-end.

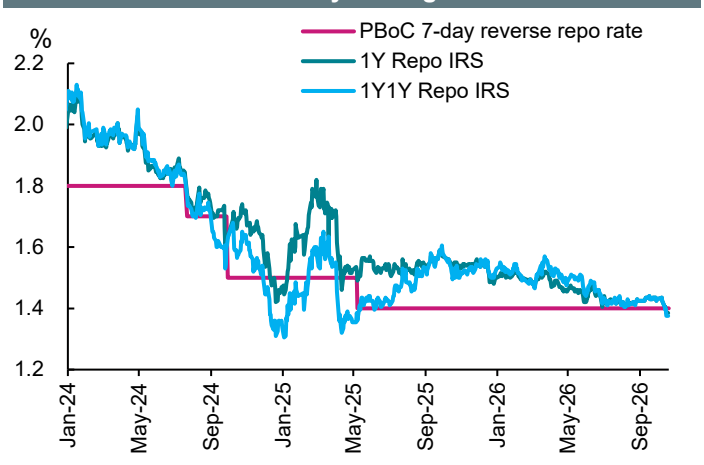
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The PBoC will shift its policy rate to overnight tenor



Source: Bloomberg, Crédit Agricole CIB

IRS curve has been already trading below 1.40%



Source: Bloomberg, Crédit Agricole CIB

The PBoC's monetary policy reform measures and liquidity tools

PBoC Governor Pan Gongsheng delivered a speech at the opening of the 2026 Financial Street Forum on 19 October, outlining measures and reforms to China's monetary policy framework.

Transformation of monetary policy framework

Pan shared three reform initiatives to strengthen the role of interest rate guidance:

- **Study shifting the benchmark policy rate to the ON rate:** the PBoC will examine shifting predominant OMO from 7-day to ON operations when appropriate. The overnight repo rate will then serve as the primary policy rate.
- **Reform loan benchmark rates:** the PBoC will guide financial institutions in transitioning toward more diversified pricing benchmarks, moving away from the relatively singular reliance on the Loan Prime Rate (LPR). DR001 could be considered as a benchmark for floating-rate loans for selected corporates with sound financial health.
- **Phase out benchmark deposit and lending rates:** the PBoC proposes phasing out the current benchmark deposit & lending rates and replacing them with market-based interest rates.

New liquidity tools and opening up measures in the pipeline

The PBoC will introduce new tools and measures to strengthen macroprudential management and market opening-up facilities:

- **Liquidity backstop for large redemptions by NBFIs:** this tool is designed as a stabilisation mechanism to prevent a negative feedback loop between redemptions and sell-offs in the bond market.
- **Expansion of SLF eligibility:** the facility will cover all deposit-taking financial institutions onshore, including foreign banks incorporated in mainland China.
- **Connectivity between interbank and exchange-traded bond markets:** the infrastructure is ready and will be launched upon completion of testing.
- **Facilitating overseas entities in the domestic FX market:** eight offshore RMB clearing banks will be permitted to conduct proprietary trading in the interbank FX market.
- **Inclusion of foreign offshore RMB clearing banks as eligible entities for PBoC's FIMA tool.**

FX and RMB internationalisation

Pan also commented on the CNY exchange rate and the promotion of RMB internationalisation. Pan reiterated that China has never engaged in competitive devaluation to enhance trade competitiveness.

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- The PBoC will expand the RMB clearing bank network to facilitate cross-border trade and investment.
- The PBoC will broaden the supply of high-quality RMB-denominated assets and enhance offshore product liquidity.
- The PBoC will maintain stable, multi-layered RMB liquidity supply by expanding the instruments available to foreign clearing.

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