



# BEYOND THE HEADLINES: CHINA UNLOCKED

*Navigating China's Shifting Investment Terrain*

*December 2025*



**NUS  
INVESTMENT  
SOCIETY**

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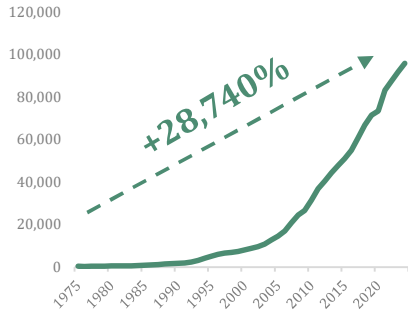
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# The Unique Chinese Economic System

Socialism with Chinese Characteristics and China's meteoric rise

**Figure 2: China's Meteoric GDP per Capita Growth (in RMB)**



Source: CEIC

**Figure 3: China-led Organisations**



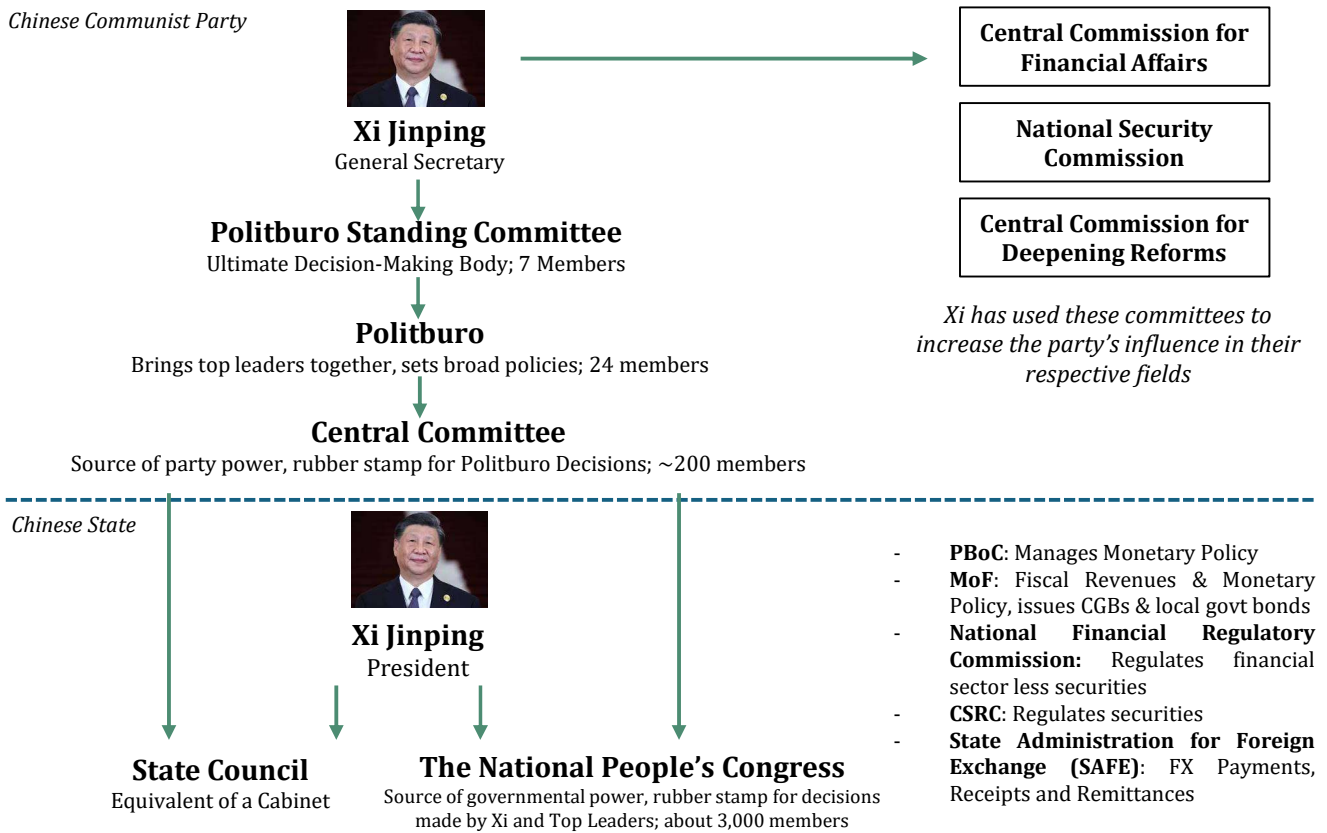
Source: Personal Analysis

## The Architecture of China's State-Led Economy

China's modern political and economy is built on a unique fusion of centralised one-party governance and state-directed market economics with the core ideology of "Socialism with Chinese Characteristics" (Figure 1). At its core stands the Chinese Communist Party (CCP) and its Chairman, Xi Jinping. Under his leadership, the Party consolidates control across all major power centres, the central government, the People's Liberation Army, the legislative and consultative bodies, the provincial and municipal administrations, and strategically significant sectors of the economy including finance, energy, telecommunications, and advanced technology.

This governance framework allows the CCP to **coordinate policy across vast administrative levels**, mobilise state resources quickly, and pursue long-horizon national goals such as technological self-reliance, poverty alleviation, and social stability. Economically, China operates a hybrid system where **market mechanisms drive growth**, but the state maintains decisive influence through instruments such as state-owned enterprises (SOEs), regulatory authorities, party committees embedded in China's Unique economic system has paved the way for exponential growth in the past century, growing from a rural farmland to a manufacturing and economic powerhouse competing for global hegemony (Figures 2,3).

**Figure 1: China's Unique Economic System**



Various Ministries

Source: Personal Analysis



# The Chinese Economy

World's Largest Exporter Facing Structural Issues

**Figure 4: Key Economic Data**

<b>Q3 GDP</b>	USD 4.96T (+4.8% YoY)
<b>M2 (Oct 2025)</b>	CNY 335.38T
<b>CPI (Nov 2025)</b>	+0.7% YoY
<b>PPI (Nov 2025)</b>	-2.2% YoY
<b>Consumer Sentiment (Sep 2025)</b>	89.6
<b>Policy Rate (Nov 2025)</b>	1.40%
<b>Currency</b>	Renminbi (CNY/CNH)

## Pivotal Engine for Global Economic Growth

China recorded a Gross Domestic Product (GDP) of RMB 134.91 trillion as of 2024, surpassing the RMB 130 trillion milestone for the first time (**Figure 4**). China has remained the second-largest economy for several consecutive years, contributing to approximately 30% of global economic growth. As of 2024, China's economy made up 17% of the global economy, with a growth rate of 5%.

Despite strong geopolitical tensions and tariffs by the United States, China's economy has held up. Through the first three quarters of 2025, China's economy has grown 5.2% YoY, firmly on track to meet its annual growth of 5%, supported by a strong start to the year. As a result, major financial institutions like the IMF has revised China's growth expectations to 5%, up by 0.2% in October.

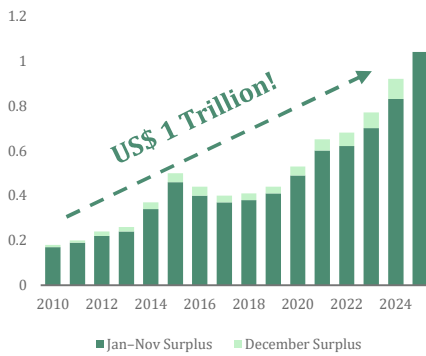
## Exports Take the Lead in Powering China's Economy

Despite punishing tariffs from the Trump administration, China's trade surplus hit a record US\$1 trillion in the first 11 months of the year (**Figure 5**). Its November 2025 exports grown to a whopping 5.9%, despite shipments to the U.S declining. This outcome has bolstered President Xi Jinping, confidence in taking a hardball approach with President Trump throughout the worsening trade tensions.

The key to China's export success is their strategy of Chinese exporters to diversify away from the U.S, reroute shipments and push aggressively into other markets demanding for cheaper goods (**Figure 6**). According to customs data, growth in exports to Europe, Southeast Asia, Africa are up 5%, 14.6% and 26% respectively, which more than offsets an 18.3% decline in exports to the U.S and 13% decline to the overall North American region in the same period. This effectively reduces China's reliance on a geopolitically sensitive market, reinforcing and sustaining China's export dominance in the future and potentially capturing underserved markets.

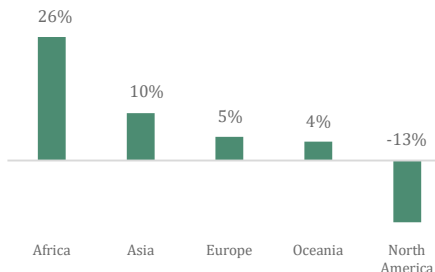
Separately, in specific Southeast Asian countries like Vietnam, in addition to seeing a surge in exports from China, exports to the U.S also increased significantly, likely reflecting trans-shipment of Chinese goods. This loophole, which the US has yet to address effectively in 2025, could pose a significant risk in 2026. This export surplus to other countries is supporting the strengthening of the RMB (covered later), appreciating by approximately 4.0% against the USD in 2025, making it the strongest currency in Asia after the AUD.

**Figure 5: China's Good Trade Surplus Tops US\$1 Trillion**



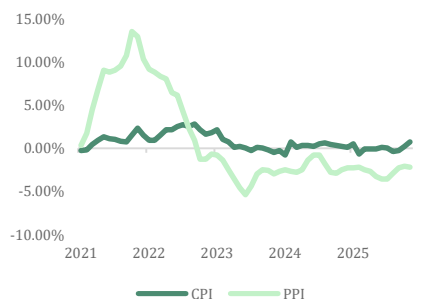
Source: China's Customs General Administration

**Figure 6: China's Exports by Region YoY (Jan - Oct)**



Source: China Customs General Administration, Bloomberg, UBP

**Figure 7: China's CPI & PPI YoY Growth Rates**



Source: CEIC

## CPI Turns Positive for Now, PPI still on the Decline

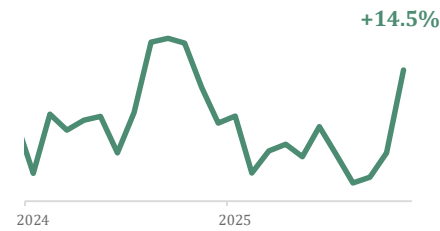
After months of low or declining CPI, Chinese CPI increased from 0.2% YoY to 0.7% YoY in line with expectations (**Figure 7**). This marks a 21-month high and tied for the highest level in the past 33 months. The biggest driver of this increase in CPI was a greater than expected increase in food prices, rising to 0.2% YoY, of which, the biggest contributor was a spike in vegetable prices, surging 14.5% YoY (**Figure 8**). This increase in food prices could persist in the coming months, as China's pork prices are expected to turn positive. Prolonged losses have pressured smaller producers to cut capacity, while restocking demand is gradually recovering, even as pork prices continue to weigh on food inflation following a sharp 15% YTD decline.

China's core CPI, which excludes food and energy prices and is primarily driven by non-food consumer goods and services, stabilised at 1.2% YoY in November

# The Chinese Economy

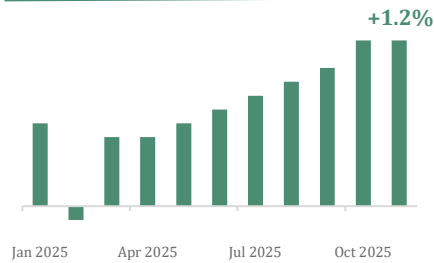
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**Figure 8: Chinese Fresh Vegetable Prices**



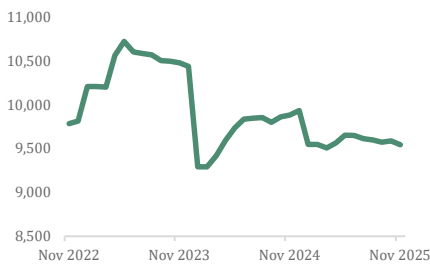
Source: CEIC

**Figure 9: China's Core CPI YoY**



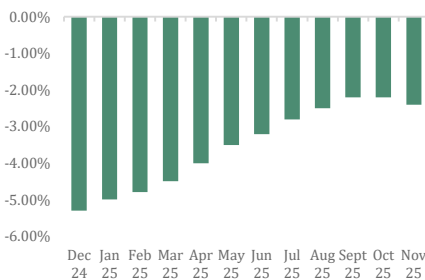
Source: Trading Economics

**Figure 10: China's Average Home Prices (RMB/sq m)**



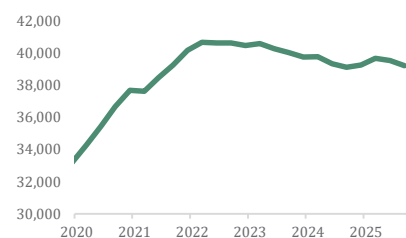
Source: CEIC

**Figure 11: China's Newly Built Home Prices YoY Change**



Source: National Bureau of Statistics China

**Figure 12: China Housing Mortgage (RMB Bn)**



Source: CEIC

after rising for six consecutive months (**Figure 9**). This suggests that underlying inflation pressures remain contained despite the recent rebound in headline CPI. Within core inflation, non-food prices moderated to 0.8% YoY, down from 0.9% in October, reflecting renewed price softness across discretionary categories. The deceleration was mainly driven by a sharper decline in transport and communication prices, which fell to -2.3% YoY, underscoring ongoing competitive pressures, excess capacity, and weak consumer demand in these segments.

PPI however, remained in negative territory at -2.2% YoY (**Figure 7**), coming from -2.1% YoY in October. Despite the decreasing YoY numbers, PPI was positive on a month-on-month (MoM) basis for the second month in a row, at 0.1% MoM. These show signs of easing deflationary pressures, possibly due to easing price wars on products like EVs after the government put a stronger focus anti-involution. Overcapacity however, is still prevalent, as consumer demand remains insufficient as the underlying problems have not been solved.

## China's Property Sector Remains Weak

Following the introduction of the "three red lines" policy in 2020, designed to curb excessive leverage among property developers. China's property market entered a prolonged downturn, culminating in a full-blown crisis around 2021. A sector that once accounted for nearly 25% of China's economy has since remained under sustained pressure. Home prices have continued to decline across the vast majority of cities nationwide, reflecting cyclical weakness and deep-seated structural imbalances within the property market (**Figure 10**).

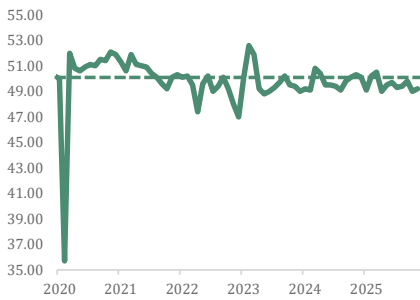
This downturn has been further compounded by persistent declines in new home prices. China's new home prices across 70 cities dropped 2.4% year-on-year in November 2025, deepening from a 2.2% decline in the previous two months. The latest reading marked the 29th consecutive month of price declines and the steepest pace since August, underscoring Beijing's ongoing struggle to counter the prolonged weakness in the property sector. Prices fell at a quicker pace in Beijing (-2.1% vs. -2.0% in October), Guangzhou (-4.3% vs. -4.2%), Shenzhen (-3.7% vs. -2.6%), Chongqing (-2.9% vs. -2.6%), and Tianjin (-2.2% vs. -1.5%). Meanwhile, costs in Shanghai eased (5.1% vs 5.7%) (**Figure 11**). On a monthly basis, prices were 0.4% lower, after a 0.5% fall in October. This underscores weak underlying demand from Chinese households and reinforcing the sector's drag on broader economic activity. As housing represents a core store of household wealth at around 70% and even up to 80% in larger cities, falling prices have amplified negative wealth effects, dampened consumption and weighing on overall growth.

The stress in the property sector is also evident beyond prices. China has seen a flattening in its mortgage curve alongside a marked slowdown in mortgage borrowing (**Figure 12**), as prospective buyers take on fewer loans and remain increasingly reluctant to enter the housing market amid expectations of further price declines. This reflects deeply subdued property sentiment, weaker housing transactions, and cautious household balance-sheet behaviour. However, there are early signs of tentative stabilisation: while mortgage demand remains depressed, the pace of decline has moderated, suggesting that conditions may be bottoming out. This nascent stabilisation hints that household confidence is no longer deteriorating sharply, though a sustained recovery in property demand is likely to require clearer price stabilisation and stronger income growth before buyers meaningfully re-engage.

# The Chinese Economy

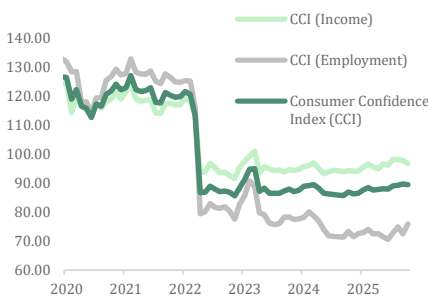
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**Figure 13: China Manufacturing PMI**



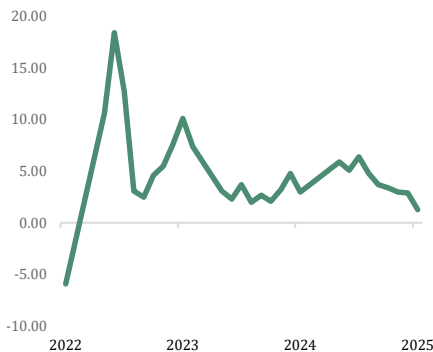
Source: CEIC

**Figure 14: China Consumer Confidence Index**



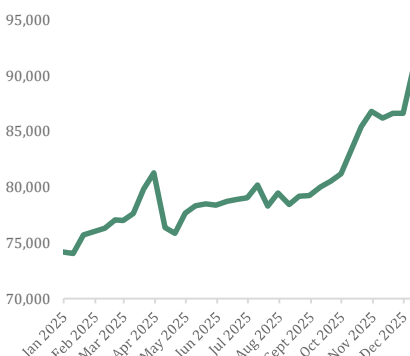
Source: CEIC

**Figure 15: Chinese Retail Sales Growth**



Source: CEIC

**Figure 16: China Copper Prices (RMB/ton)**



Source: CEIC

## China's Factory Activity: Still in Contraction Territory

China's factory sector remained under sustained pressure in November, with manufacturing activity contracting for an eighth consecutive month as the manufacturing PMI stayed below the 50-expansion threshold coming in at 49.2 (**Figure 13**), New orders fell for the fifth consecutive month (49.2 vs 48.8 in October), while foreign sales, purchasing activity, and employment all remained weak. At the same time, output stagnated after October's first decrease in six months (50.0 vs 49.7), and delivery times were broadly steady (50.1 vs 50.0). On inflation, input costs rose for the fifth consecutive month, with a faster pace of increase (53.6 vs. 52.5). Selling prices continued to fall, albeit at a slower rate (48.2 vs. 47.5). This highlights how manufacturers face persistently weak demand, intensified price competition at home, and cautious export sentiment amid global uncertainty continue to weigh on industrial momentum.

## China's Consumer: Recovery Remains Elusive

Following the sharp collapse in China's consumer confidence index after the property market downturn (**Figure 14**) a significant portion of household wealth was eroded, undermining balance-sheet security. Thus, recovery has been slow and uneven rather than decisive, reflecting persistent caution among households. Although confidence has stabilised off its trough, it remains deeply depressed by historical standards, edging down to 89.4 in October from 89.6 in September and still far below pre-crisis levels. The index's fall to a record low of 85.5 in November 2022 underscores the severity of the shock, and the muted rebound since then suggests that structural headwinds, such as falling home prices, weak income expectations, job insecurity and precautionary savings behaviour continue to constrain consumer willingness to spend, limiting the strength of China's broader demand recovery despite ongoing policy support.

## Retail Sales Shows Cracks in China's Economic Recovery

China retail sales for November underscores the continued weakness of domestic consumption, emphasising that household demand remains a key spot in China's economic recovery. Retail growth slowed sharply to 1.3% YoY, undershooting market expectations of 2.9% and marking one of the slowest readings since late 2022 (**Figure 15**). This deceleration from October highlights a sustained loss of momentum, suggesting that recent policy support have yet to translate into a durable pickup in spending. This softness reflects persistently weak consumer confidence, as households remain cautious amid job-market uncertainty, subdued income growth, and negative wealth effects from the prolonged property downturn. The weak retail print underscores the challenge Beijing faces in rebalancing growth toward domestic demand, implying that consumption is unlikely to provide a meaningful offset to slowing investment in the near term. It also strengthens the case for continued policy accommodation, as restoring confidence and spending power, rather than short-term stimulus alone, remains critical for achieving a more self-sustaining recovery.

## A Silver Lining: Copper Prices Continues its Uptrend

Rising copper prices in China, up roughly 22% YTD, highlight pockets of resilience in industrial activity (**Figure 16**). As a core input for power grids, electric vehicles, renewable energy and advanced manufacturing, stronger copper prices point to firmer demand in policy-prioritised sectors. This underscores how targeted investment in electrification, energy transition and industrial upgrading is helping to stabilise parts of the economy despite broader weakness.

# The People's Bank of China (PBoC)

Calibrated Easing, Disciplined

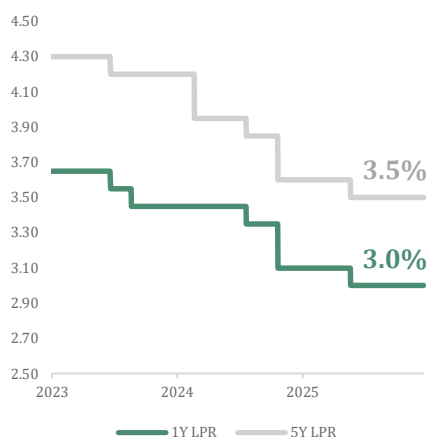
Figure 17: PBoC and its Governor



**Governor  
Pan Gongsheng**

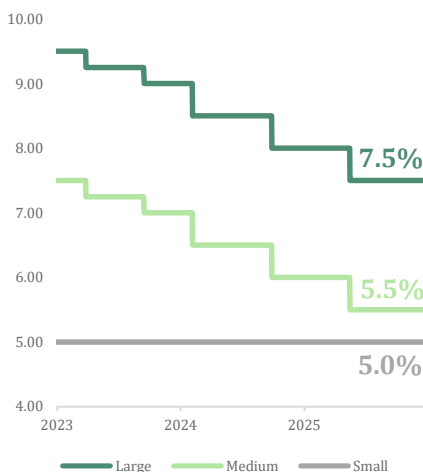
Source: PBoC

Figure 18: China's 1 & 5-year Loan Prime Rates



Source: CEIC

Figure 19: China's Respective Reserve Requirement Ratios



Source: CEIC

## The PBoC: Centre of China's Monetary Policy

The PBoC, helmed by PBoC governor Pan Gongsheng (Figure 17), plays a central role in guiding China's macroeconomic and financial stability, with a mandate to maintain price stability, supporting economic growth, fostering employment and managing the country's balance of payments. Policy direction is shaped through the Monetary Policy Committee (MPC) which meets at the end of each quarter to assess conditions across interest rates, credit growth, inflation dynamics and exchange rates, providing guidance and policy direction on the appropriate stance.

The PBoC implements this stance through a range of instruments which will be covered later, such as that of the Medium-Term Lending Facility (MLF) and Loan Prime Rates (LPRs) announced on the 15<sup>th</sup> and 20<sup>th</sup> of each month, while liquidity tools including the 7-day reverse repo rate and reserve requirement ratio (RRR) are adjusted in line with macro and financial data typically released in January, April, July and October. Together, this framework allows the PBoC the adjust liquidity conditions and credit transmission, enabling targeted support for growth while maintaining financial stability and currency balance a complex environment.

## Monetary Policy Through Targeted Tools

**Loan Prime Rates (LPR):** This is the PBoC's key benchmark for guiding lending rates across China's banking system and serves as the primary transmission channel for monetary policy into the real economy (Figure 18). The **1-Year LPR, currently at 3.0%** is charged to banks' best-quality clients and acts as the benchmark for loans with tenors of up to 5 years, making it influential for corporate borrowing and short-to-mid-term credit conditions. The **5-Year LPR, currently at 3.5%**, serves as the benchmark for long-term lending like mortgages, is mostly tied to the property market and financing costs. By adjusting these rates, the PBoC can selectively influence borrowing demand across different segments of the economy. With current LPRs near historic lows, it indicates that the PBoC is maintaining a easing stance, while remaining cautious as hastened easing could increase capital outflow risks and put a strain on the RMB.

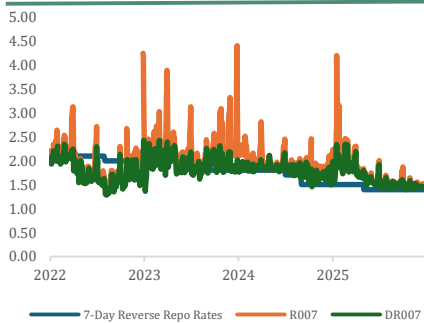
**Reserve Requirement Ratios (RRR):** RRRs are used to manage China system-wide liquidity and influence credit growth by determining the proportion of customer deposits that banks must hold as reserves with the central bank. By raising or lowering the RRR, the PBoC can directly tighten or loosen the amount of funds available for lending, making it an effective measure to control money supply without changing interest rates.

The RRR framework is differentiated across bank sizes with larger national banks face lower requirements to support higher reserve ratios, while smaller and rural banks face lower requirements to support lending to SMEs and local economies. This multi-tiered approach allows the PBoC to inject liquidity in a target manner, while maintain overall financial stability and avoiding excessive credit expansion in the broader banking system. More recently, the PBoC cut rates in both large and medium banks' RRRs, while maintaining the RRR for small banks. The RRRs now stand at: **Large - 7.5%, Medium - 5.5%, Small - 5.0%** (Figure 19). These rates signals an accommodative stance taken by the PBoC and shows that they are responding to weaker growth/credit conditions by releasing long-term liquidity in the system.

# The People's Bank of China (PBoC)

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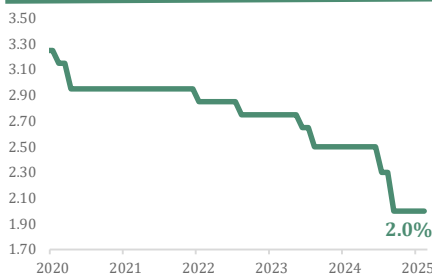
**Figure 20: China's Reverse Repo Rates**



Source: CEIC

**Reverse Repos & Medium Lending Facilities (MLFs):** These are other tools used by the PBoC to inject, maintain, or reduce liquidity within China's money market. Firstly, the 7-day reverse repo rate is the PBoC's primary short-term liquidity tools, used to inject funds into the banking system by purchasing securities from financial institutions with an agreement to sell them back after 7 days. These rates guide short-term money market conditions and signals its near-term policy stance, with the reverse repo rates effectively anchoring interbank funding costs. Such operations directly influence benchmark interbank rates such as the 7-day pledged repo rate among depository institutions (DR007) which is closely monitored as the cleanest gauge of underlying liquidity conditions. R007, which covers a broader set of financial institutions, usually trades at a smaller premium due to higher perceived risk. They currently stand at: **7-day reverse repo rates: 1.40%, R007: 1.51%, DR007: 1.44%** (Figure 20). China's 7-day reverse repo rate has moved onto a clear easing path, remaining anchored at 1.40% following the policy cut in May 2025. In tandem, interbank funding indicators such as R007 and DR007 have also trended lower through 2025, reflecting improved liquidity conditions and the PBoC's continued accommodative policy stance.

**Figure 21: China's 1Y MLF**



Source: CEIC

Complementing these short-term tools, the 1-year MLF provides a longer-tenor funding to large commercial banks, helping the PBoC manage medium-term liquidity and stabilize funding expectations (Figure 21). The MLF rate serves as a key reference for banks' funding costs and plays an important role in shaping the Loan Prime Rates (LPRs), linking policy intentions to real-economy borrowing costs. The current 1Y MLF rate stands at: **2.0%**. The decline in the 1Y MLF rate signals that the PBoC is easing monetary conditions and aiming to reduce banks' funding costs over the medium term, allowing long-term interest rates to guide down further.

**Figure 22: PBoC Balance Sheet Total Assets (USD 100 Mns)**

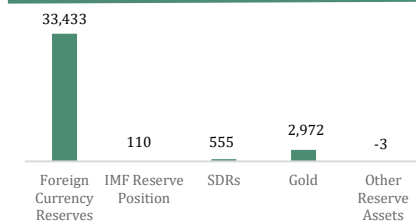


Source: CEIC

## The PBoC's Balance Sheet: FX Heavy, Gold Rising, Declining USD Holdings

Over the past five years, the PBoC's reserve assets have expanded steadily (Figure 22), underpinned by sustained current-account surpluses, resilient export competitiveness and continued accumulation of external assets. Despite periods of global volatility and capital outflows, the PBoC has preserved and gradually grown its reserve stock, reflecting disciplined balance-of-payments management and active FX intervention.

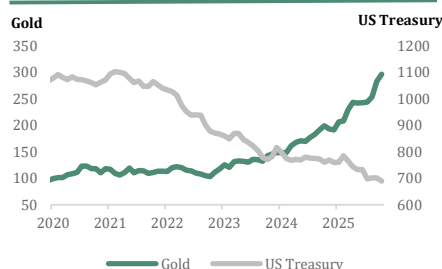
**Figure 23: PBoC's Balance Sheet (USD 100 Mns)**



Source: PBoC

The PBoC's reserve dynamics reflect a deliberate strategic shift of external buffers rather than a response to near-term cyclical macro stress. Foreign currency reserves have remained broadly stable, at around US\$3.3 Trillion (Figure 23), underpinned by persistent trade surpluses exceeding US\$1 Trillion in 2025's first 11 months, as mentioned earlier. These provide policymakers with substantial firepower to smooth RMB volatility and manage balance-of-payment pressures. In parallel, the composition of reserves has shifted meaningfully. The PBoC has continued a steady and persistent accumulation of gold, increasing their gold holdings from below 2,000 tonnes in 2022 to over 2,300 tonnes, while decreasing their US Treasury holdings by almost 50% from 2020 to 2025 (Figure 24). In valuation terms, gold now accounts for 8-9% of the PBoC's total reserves, up from around 6% in 2022. This trend showcases a structural diversification away from US dollar-denominated assets aimed at reducing exposure to geopolitical risks and financial sanctions. Importantly, this shift has occurred without shrinking FX reserves, reinforcing that gold accumulation is being funded by external surpluses rather than reserve drawdowns.

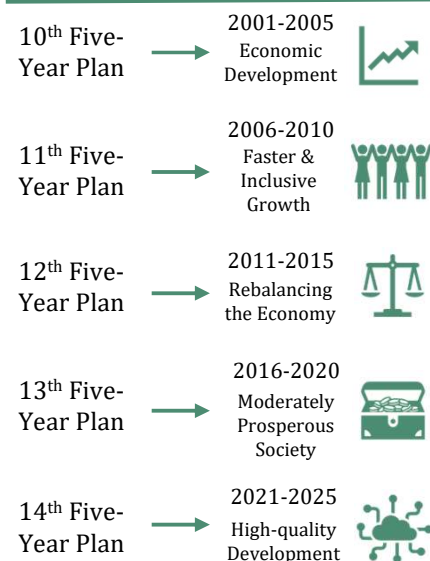
**Figure 24: China UST vs Gold (USD Bns)**



# China's Policy Landscape

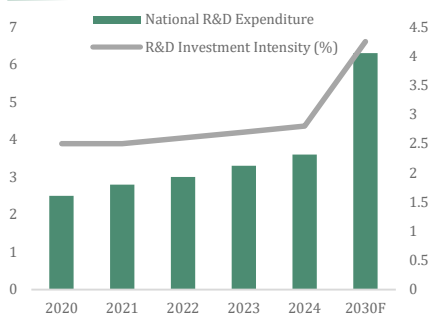
Forward-thinking, Targeted Easing, Measured Fiscal Support

**Figure 25: China's last 5 FYP's Main Objectives**



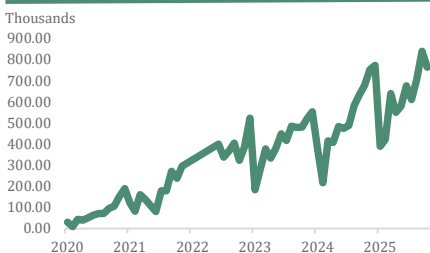
Source: Personal Analysis

**Figure 26: China's Expected R&D Expenditure (RMB Trillions)**



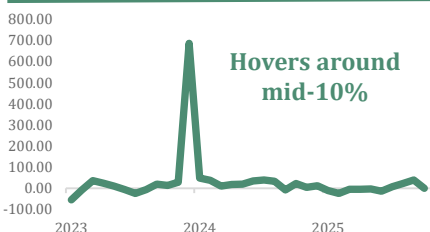
Source: NBS, UBP

**Figure 27: Automobile Sales for New Electric Passenger Vehicles**



Source: CEIC

**Figure 28: YoY Growth of Solar PV Exports**



Source: CEIC

## 15<sup>th</sup> Five-Year Plan: High-Quality Development in a Fragmented World

The 20th Central Committee of the CCP held its Fourth Plenum in Beijing from 20-23 October. For context, China's plenums are annual Party meetings where political consensus is translated into economic strategy, providing high-level policy direction for the country's medium-term development. In particular, these meetings help shape the framework of China's Five-Year Plans (**Figure 25**). Against this backdrop, the forthcoming 15th Five-Year Plan (FYP) is scheduled for release in March 2026 at the National People's Congress (NPC).

The upcoming 15th Five-Year Plan is expected to articulate China's ambition to secure global leadership in strategic sectors, particularly technology, as it shifts from a follower to a front-runner in innovation. It will also signal a structural rebalancing away from traditional growth engines such as exports and real estate, toward high value-added manufacturing and stronger domestic consumption. Key policy priorities are likely to include reducing regional and geographic inequalities, alongside a heightened emphasis on environmental goals. These objectives align with the "new development paradigm" and President Xi's vision of building an "ecological civilisation," a core pillar of the broader China Dream.

## Innovations Remains the Central to Long-term Growth

In 2024, the bulk of China's R&D expenditure is concentrated in experimental development, particularly across high-tech industries, which accounts for roughly 81% of total R&D spending, or about CNY 2.9 trillion out of CNY 3.61 trillion. This focus is expected to deepen under the 15th Five-Year Plan, with priority areas likely to include semiconductors, artificial intelligence and quantum computing. These investments underscore China's strategic push to accelerate indigenous innovation, move up the technology value chain, and reduce reliance on foreign technology inputs (**Figure 26**). Innovation is also aimed at growing the digital economy, helping to offset structural challenges in the real estate sector, which accounts for 17% of China's GDP.

## Energy Transition and Sustainable Development Persists

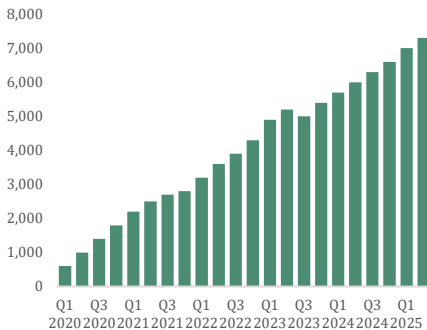
From 2020 to 2024, China made notable progress in lowering its energy intensity, with energy consumption per unit of GDP falling by roughly 11%, a reduction equivalent to about half of the European Union's annual emissions. While this improvement fell short of the original 13.5% target set in 2020, it underscores China's continued commitment to advancing its green energy and decarbonisation agenda.

At the same time, China has made extreme improvements in the development of New Electric Vehicles (NEV) (**Figure 27**). The national NEV fleet grew from 4.92 million in 2020 to 31.4 million in 2024. As a result, China overtook Japan as the World's largest exporters automobiles, majority of which were NEVs. Turning to solar power, China installed a remarkable 93 GW of solar capacity in May alone, equivalent to roughly 230 million solar panels. This means that in a single month, China added more solar capacity than any other country managed to install over the entirety of 2024. This pace underscores China's unparalleled manufacturing scale and policy-driven execution in renewables and accelerates decarbonisation while strengthening its global leadership in clean-energy supply chains (**Figure 28**). From the success of this push, it is expected for the 15<sup>th</sup> FYP to continue prioritizing export of Chinese clean technologies.

# China's Policy Landscape

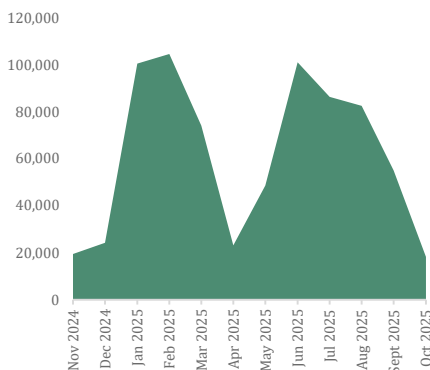
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**Figure 29: China's Rising Excess Household Savings (RMB Bns)**



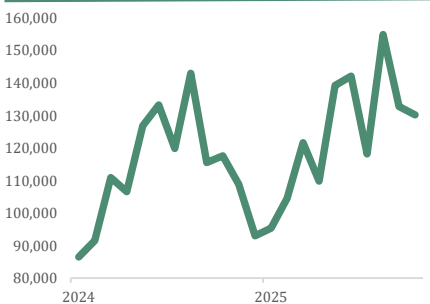
Source: PBoC, UBP, Bloomberg

**Figure 30: Local Government Bond Issuance (RMB Mns)**



Source: CEIC

**Figure 31: Local Government Bonds Interest Payments**



Source: CEIC

**Figure 32: China's Stock Exchanges & Tech-Oriented Boards**



Source: Personal Analysis

## China's Trade-In Programme: Unlocking Pent-Up Household Demand

China's high household savings in recent years reflect years of precautionary behaviour driven by pandemic uncertainty, property market weakness, and softer income expectations, resulting in excess liquidity (**Figure 29**). The government's trade-in programme, which offers subsidies for consumers to exchange old items (cars, appliances, electronics) for newer, energy-efficient models, stimulating spending, supporting local economies and promote a circular economy through spending. Beneficiary categories have included autos, household appliances, consumer electronics, and furniture, and these categories saw major outperformance in their respective policy windows. However, the trade-in policy front loads consumption and has limited lasting power as consumers will halt on their consumption for a while before they repurchase a new equipment.

## Stabilisation of Local Government Finances (Hopefully)

In November last year, China approved a 10 trillion RMB debt-resolution package to ease mounting local government financial stress. The programme includes 2 trillion RMB per year from 2024 to 2026 to swap existing hidden local government debt, alongside 800 billion RMB annually from 2024 to 2028 in newly issued special local government bonds specifically earmarked for debt reduction. By the end of 2024, local governments accounted for 63% of total government debt, underscoring the structural nature of the problem and the need for intervention. Bond issuance has accelerated sharply as a result. In the first 10 months of this year, local governments issued a record 9.1 trillion RMB in bonds (**Figure 30**), up 23% year-on-year, with roughly 60% directed toward repaying existing debt rather than funding new projects, primarily through refinancing bonds. By converting opaque, high-interest liabilities into longer-tenor, lower-cost explicit debt, the programme helps reduce borrowing costs and alleviate near-term repayment pressures. Despite rising local government bond interest payments (**Figure 31**), Fitch estimate that these debt swaps could generate cumulative interest savings of around 1.08 trillion RMB between 2024 and 2028, improving short-term fiscal sustainability while buying time for deeper reforms.

## Building Deeper, More Credible Capital Markets

China's securities regulator, the China Securities Regulatory Commission, has pledged to deepen reforms and further open China's capital markets (**Figure 32**) to strengthen investor confidence and support high-quality growth, with a particular focus on boosting listings by technology and innovation-driven firms. This push comes as tech-oriented exchanges such as the STAR Market and ChiNext already account for the majority of new IPO proceeds in recent years, underscoring their growing role in financing strategic sectors. The reform agenda emphasises attracting stable, long-term domestic and foreign capital, rather than short-term speculative flows, and smoothing the full capital cycle from fundraising to exit to better support venture capital and private equity. Key priorities include lowering listing thresholds for innovative firms, improving market infrastructure and corporate governance, and strengthening investor protection, while balancing tighter supervision with greater openness. Overall, the reforms signal Beijing's intent to modernise its capital markets into a more resilient, innovation-focused financing channel, capable of supporting technology upgrading while anchoring stability amid ongoing market volatility.

# China's Policy Landscape

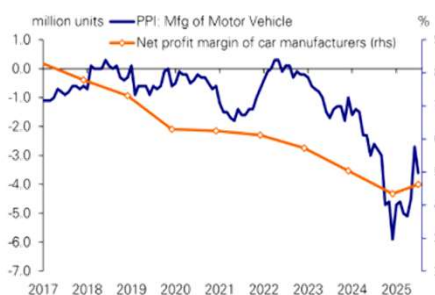
Contd.

**Figure 35: Car Sales vs Net Profit of Car Manufacturers (%)**



Source: Deutsche Bank Research, Haver Analytics

**Figure 36: Manufacturing of Motor Vehicles vs Net Profit Margins of Car Manufacturers**



Source: Deutsche Bank Research, Haver Analytics

**Figure 37: Largest Chinese EV Companies**



Source: Personal Analysis

**Figure 38: China Monthly Housing Prices YoY (%)**



Source: CEIC

## Addressing 'Anti-Involution'

"Anti-involution", or *fan nei juan* represents Beijing's ambitious attempt to break free from self-destructive economic cycles that have plagued several key industries, particularly that of the New Electric Vehicle sector. This signals a significant reorientation of China's economic policy focus, with profound impact for growth, inflation and trade. This could reshare the competitive landscape in industries from electric vehicles to renewable energy technology.

As mentioned earlier, China's NEV market has expanded rapidly since 2020, driven by strong consumer adoption of EVs offering advanced features, competitive pricing, and increasingly widespread charging infrastructure. Over the past five years, NEV production and sales have grown by nearly tenfold, and by 2025, NEV sales had overtaken internal combustion engine vehicles in the domestic market. However, this explosive growth has come at the expense of profitability, with industry margins falling from around 8% in 2017 to just 4.3% in 2024 (Figure 35).

Competition in China's EV market has become increasingly involutionary, as prolonged price wars persist without meaningful consolidation, allowing many loss-making players to survive despite sustained operational losses (Figure 36, 37). Market exit has been limited in part due to strong local government incentives to support automakers, given the sector's importance to local GDP, employment, and fiscal revenues, as well as direct support through land grants, tax incentives, or equity stakes. Weak enforcement of bankruptcy and creditor rights has further delayed consolidation. The economic costs of this dynamic are now evident, with negative spillovers across the value chain: suppliers face payment delays, dealers suffer inventory losses and cash-flow strain, and consumers are hit by falling resale values. More broadly, steep declines in car prices are undermining China's reflation efforts, given the sector's significant weight in both CPI and PPI.

In response, policymakers have stepped in: in May 2025, the China Association of Automobile Manufacturers issued an initiative opposing below-cost competition, followed by a July State Council directive to strengthen price monitoring, enforce payment discipline, and encourage automakers to compete through innovation and quality improvements rather than price wars.

## China's Pledges to Stabilise and Revamp the Housing Market

During a housing policy conference on Dec 23, China's top housing authority reaffirmed its commitment to stabilising the property market through city-specific measures to manage new housing supply, reduce excess inventory, and optimise overall supply amid still declining property prices (Figure 38). Housing Minister Ni Hong highlighted plans to combine these policies with urban renewal and urban-village renovation, while encouraging the purchase of existing commercial housing for use as affordable housing, resettlement homes, and talent apartments. Looking ahead, policymakers aim to expand and target affordable housing, upgrading housing quality, and supporting developers' reasonable financing needs through the "whitelist" system. Local governments will be given greater autonomy to adjust property policies to support genuine housing demand and ensure market stability. Authorities also plan to accelerate the transition to a new real estate development model, including promoting the sale of completed homes to reduce delivery risks, while tightening supervision of pre-sale funds where pre-sales remain in use. In some cities, they are piloting the move towards a 'spot sales system', where developers sell completed homes instead of relying heavily on pre-sales, aiming to improve transparency and reduce systemic risk. Collectively, these measures signal a shift from short-term stimulus toward a more sustainable, quality-driven housing framework.

# China's Policy Landscape

Contd.

**Figure 39: Cross-border Policies and Channels**

Schemes	Launch Date	Quota (RMB)
Shanghai-HK Stock Connect	Nov 2014	Southbound Net Buy (42bn Daily) Northbound Net Buy (52bn Daily)
Mutual Recognition of Funds	Jan 2015	Southbound Aggregate 300bn Northbound Aggregate 300bn
Shenzhen-HK Stock Connect	Dec 2016	Southbound Net Buy (42bn Daily) Northbound Net Buy (52bn Daily)
Bond Connect	Jul 2017 (Northbound) Sep 2021 (Southbound)	Southbound Aggregate 500bn (annual) & Aggregate 20 Bn (Daily) Northbound No Limit
GBA Wealth Management Connect	Sep 2021	Southbound & Northbound Aggregate 150bn
Swap Connect	May 2023 (Northbound)	Trading 20bn (Daily) Clearing 4bn (Daily)

## Strengthening Cross-Border Financial Connectivity

China has progressively expanded a range of cross-border financial channels with Hong Kong to facilitate capital flows, deepen market access, and support the internationalisation of the renminbi. Through programmes such as the Shanghai–and Shenzhen–Hong Kong Stock Connect, Bond Connect, Wealth Management Connect and Swap Connect, investors on both sides are able to access equities, bonds, wealth products and derivatives under well-defined quota and risk-management frameworks (**Figure 39**). Additionally, more recently, Hong Kong Monetary Authority (HKMA) has implemented a trade financing liquidity facility that offers longer-tenor 1-month, 3-month and 6-month RMB funds with interest rates referencing onshore interest rates plus a spread, expanding the previous short-term offerings, including overnight, 1-day, 1-week and intraday. This new facility will introduce currency swaps, where banks can swap their HKD funds for RMB funds with the HKMA, which can obtain RMB funds from the PBoC through a RMB 800bn currency swap agreement. Together, the Connect schemes and the enhanced RMB liquidity facility show a coordinated push to deepen financial integration, promote RMB internationalisation, and reinforce Hong Kong's role as China's offshore financial gateway, while keeping capital flows orderly and risk-controlled.

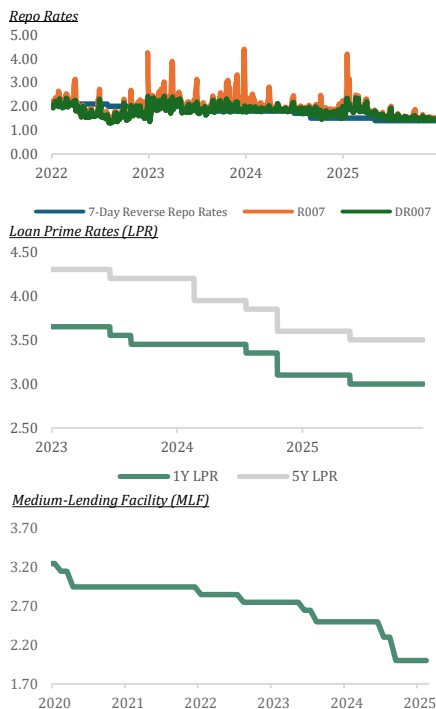
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BOND CONNECT



# China's Policy Landscape

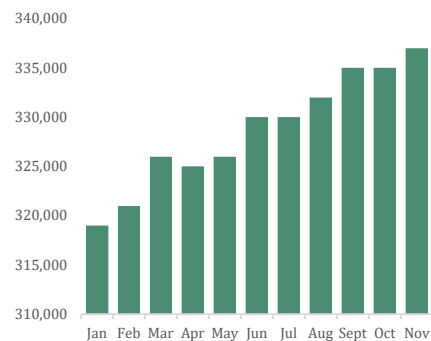
Is the PBOC done with easing?

**Figure 40: China's Policy Rates**



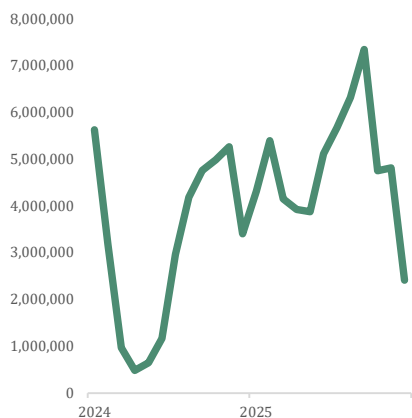
Source: CEIC

**Figure 41: China's M2 Money Supply (RMB Bns)**



Source: PBOC, Trading Economics

**Figure 42: Funds Injected into Circulation through OMOs (RMB Mns)**



Source: CEIC

## Dovish Bias with Limited Rate Cuts

The PBoC adopted a notably cautious stance in 2025, delivering only one major easing move in May through cuts to policy rates (**Figure 40**) and the reserve requirement ratio (**Figure 19**). This restraint reflects three key considerations:

First, economic growth proved more resilient than expected, with the official 5% growth target remaining broadly on track despite recent signs of deceleration, reducing the urgency for further near-term easing. Moreover, with nominal interest rates already low, the PBoC appears reluctant to push policy rates toward a zero-interest-rate environment, mindful of Japan's prolonged experience with ultra-low rates. Second, Chinese banks' net interest margins continued to narrow, placing pressure on profitability and limiting the scope for aggressive rate cuts that could further strain the banking system. Third, domestic equity markets rallied through much of 2025, prompting concerns among some policymakers and investors that excessive easing could fuel asset-price imbalances. That said, monetary conditions remain accommodative, with policy rates already at historically low levels and money supply continuing to expand through year-end, as reflected in an increase in money supply with M2 in China rising 8% year-on-year to CNY 336,915 billion in November 2025, reaching an all time high (**Figure 41**).

Looking ahead, the PBoC is likely to retain an easing bias into next year for two closely linked reasons. First, the economic slowdown has proven persistent, with both structural and cyclical headwinds continuing to weigh on growth. Stress in the property sector remains a key drag on household wealth, local government finances, and overall confidence, while elevated youth unemployment is constraining income growth and reinforcing precautionary saving, thereby limiting a durable recovery in domestic consumption. Second, these domestic weaknesses are compounded by rising external risks, as weaker global demand amid geopolitical tensions and renewed trade frictions threatens exports and industrial activity. Together, these factors are expected to keep demand subdued and deflationary pressures entrenched. As a result, even if inflation returns to positive territory, it is likely to remain well below historical norms, reinforcing the case for the PBoC to maintain a more dovish, supportive policy stance.

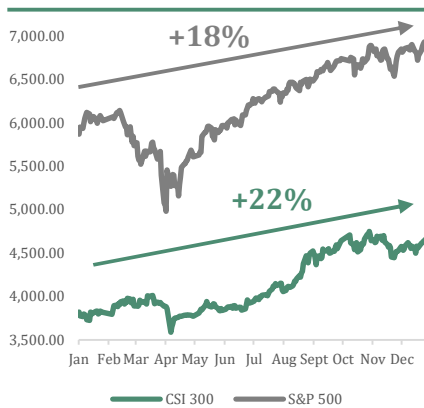
## Managing Liquidity Through Open Market Operations

The PBoC has announced that it will resume buying and selling CGBs on the open market after a 10-month suspension that began early in 2025. The pause earlier this year was implemented because of supply-demand imbalance and heightened market risks, including concerns that previous bond purchases had driven yield too low and destabilized bond prices, resulting in suspending OMOs as part of the PBoC's liquidity management strategy. This resumption will allow for the PBoC to deploy government bond purchases and sales as part of its broader monetary policy toolkit to manage liquidity. Since resumption, the PBoC has conducted a record CNY 487 billion in seven-day reverse repos through OMOs on Sep 18 at 1.4%. This, coupled with CNY 292 billion in seven-day repos maturing on the same day, resulting in a net injection of CNY 195 billion. More recently on Dec 11, the PBoC conducted a similar exercise, and with more seven-day reverse repo expiring, it resulted in a net withdrawal of CNY 62.2 billion. Overall, these operations show that the PBoC is managing liquidity in a **calibrated, two-way manner**, injecting funds when conditions tighten and withdrawing them when liquidity is ample, with the aim of stabilising money-market rates and providing calibrated easing through increased liquidity (**Figure 42**).

# Chinese Equities

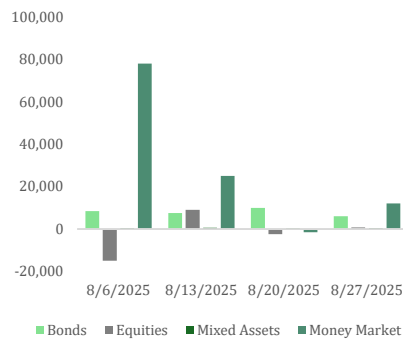
Outperformance amid Low Valuations

**Figure 43: China's CSI 300 vs S&P 500 YTD Performance**



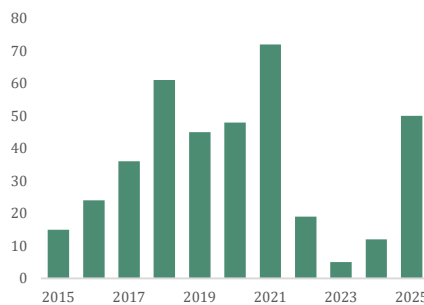
Source: Investing.com

**Figure 44: Fund Flows: U.S Domiciled Asset Classes (July 2025)**



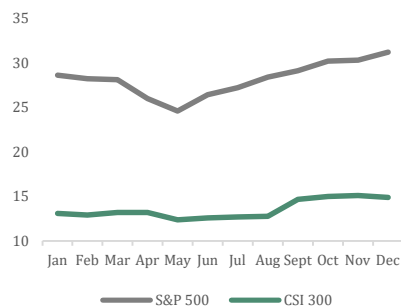
Source: Reuters

**Figure 45: China Equity Flow (monthly USD Bns)**



Source: Institute of International Finance

**Figure 46: CSI 300 vs S&P 500 P/E Ratio YTD**



Source: CEIC

## Surging Chinese Stock Indices

China's equity market made a strong comeback in 2025 after years of uncertainty, with the CSI 300 making an outstanding gain of approximately 22%, outperforming the S&P 500's gain of 18% YTD (Figure 43). Catalysts for this bull run mainly come in these three forms:

**Technological/AI structural upgrade themes:** China's AI capital spending is set to reach up to US\$98 billion, underscoring the strategic importance of artificial intelligence amid intensifying rivalry with the US. Of this total, government-led investment is expected to account for around US\$56 billion, reflecting strong state support through subsidies, policy-bank financing, and funding for national computing hubs and data centres. Meanwhile, Chinese big tech firms are projected to contribute roughly US\$24 billion, driven by accelerated spending on cloud infrastructure, large language models, AI chips, and proprietary data platforms.

**Favourable Policy:** The rollout of the trade-in program, alongside the strategic emphasis on technological advancement and the anti-involution agenda, signals a clear policy direction aimed at addressing overcapacity and deflationary pressures in key sectors such as electric vehicles, while promoting more sustainable, quality-driven growth.

**Favourable Global Macro Backdrop:** Policy uncertainty in the US has encouraged global investors to diversify away from concentrated exposure (Figure 44), driving increased capital flows into other markets, including China. Elevated fiscal and trade policy risks, alongside expectations of US rate cuts, have raised volatility in US assets, while China's relatively low valuations and clearer policy support have improved its appeal. This has been reflected in renewed foreign inflows into Chinese equities and bonds (Figure 45), with foreign funds investing US\$4.6 billion into Chinese equities in September, the highest monthly inflow since November 2024, supported by a softer US dollar and narrowing yield differentials.

## Compelling Value at Depressed P/E Levels

Despite the expansion in China's equity valuations in 2025, P/E multiples remain relatively compressed at around 15, well below the S&P 500's roughly 31 (Figure 46). This persistent valuation gap highlights the extent to which macro uncertainty, policy risk, and weaker investor sentiment continue to be priced into Chinese equities. As such, this could result in upside opportunities for the Chinese equity market.

## Global Rate Cuts Could Boost Chinese Equity Markets

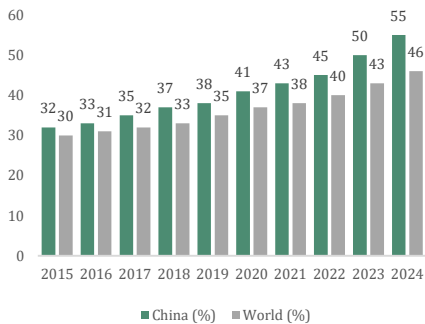
As the global monetary environment is expected to shift toward a rate-cutting cycle in the coming year, historical patterns suggest this often encourages capital rotation away from U.S.-centric markets toward more attractively valued emerging economies such as China. In this context, Chinese equities, supported by their large market scale, improving liquidity conditions, and gradually strengthening corporate fundamentals, and depressed P/E ratios, are well positioned to benefit from renewed investor interest.

As global portfolios rebalance in response to lower yields and valuation dispersion across regions, this rotation could provide meaningful medium- to long-term support for Chinese markets, alongside calls to investors increasingly seek diversification beyond developed economies amidst uncertainty

# Chinese Equities

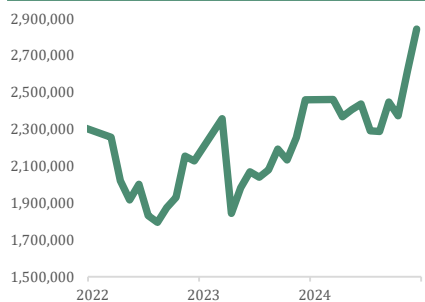
Certain Sectors are Poised for Greater Growth

**Figure 47: Share of Renewable in Total Electricity**



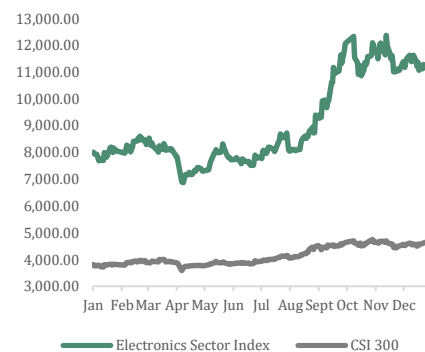
Source: IRENA, Allianz Research

**Figure 48: Industrial Production of Lithium-Ion Batteries**



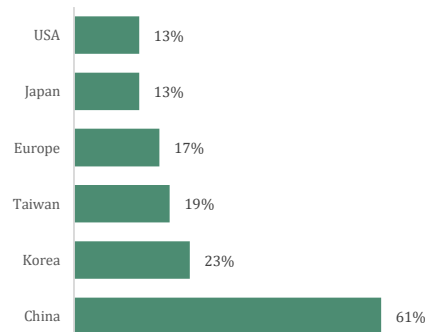
Source: CEIC

**Figure 49: Electronic Sector Index vs CSI 300 YTD**



Source: Investing.com

**Figure 50: Average CapEx Ratio of Semiconductor Firms (2021-2025)**



Source: Allianz Research

## China's Energy Transition Creates Equity Opportunities

**China's lead position in global renewable energy (Figure 47):** Today, China accounts for over 60% of global manufacturing capacity across key clean-energy technologies, including solar, wind, and batteries, underscoring its central role in the global energy transition. This dominance is most pronounced in solar, where China controls around 80% of global manufacturing capacity, spanning the entire value chain from polysilicon and wafers to cells and modules (mentioned earlier). In batteries, Chinese firms also lead globally in both capacity and technology (Figure 48), particularly in lithium-iron-phosphate (LFP) chemistry, due to its comprehensive control over the supply chain, from mineral processing (refining 80+% of key materials like lithium, graphite) to cell manufacturing (over 85% of global capacity). This manufacturing leadership has been reinforced by years of policy support, deep supply-chain integration, and continuous cost reductions, positioning China not only as the world's largest producer but also as a key price-setter and exporter in global renewable energy markets.

**Enabler of Developing Economies:** China's large-scale clean energy deployment and manufacturing have driven substantial cost reductions across key climate technologies, making renewables increasingly affordable for developing economies and enabling them to leapfrog traditional, carbon-intensive growth paths. As emerging markets accelerate renewable adoption to meet rising energy demand and climate goals, China's cost-competitive and integrated supply chains position it as a central supplier to the global energy transition. This dynamic not only reinforces China's leadership in clean energy manufacturing but also supports continued expansion of its global market share in green technologies.

**Valuation Potential:** Many renewable-energy equities in China currently trade at mid-teens P/E multiples, representing a substantial discount to global clean-energy peers that often command 25–35x P/E. This offers scope for **multiple re-rating**, providing an attractive risk-reward profile relative to more richly valued global peers.

## China Electronics: Scale, Speed, Outperformance

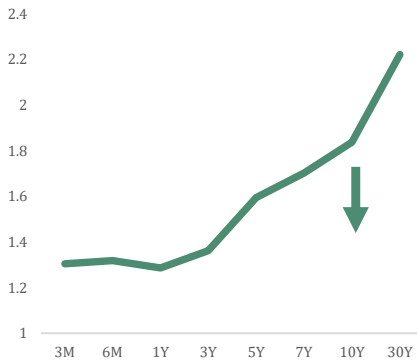
**China's electronics sector** has outperformed the CSI 300 YTD, with gains of ~37% compared to the indexes gains of ~22% (Figure 49), reflecting growing investor confidence in the sector. They continue to show significant upside potential, underpinned by both strong performance momentum and powerful structural tailwinds.

Firstly, the sector is supported by intensifying policy and capital commitments to semiconductors. In 2024, it launched a 3<sup>rd</sup> cycle of investment through its National Integration Circuit Fund, amounting nearly RMB350b specially focused on semiconductor and equipment, this lead to a direct investment into the electronics sector, boosting earnings. Secondly, firms themselves are also increasing capex with rapid growth in AI and cloud demand is driving a surge in spending by Chinese tech giants, Alibaba and Tencent have increased capex by approximately 200% and 119% respectively, boosting demand for memory chips, electronic components, and related hardware (Figure 50). Thirdly, the sector is supported by supply-chain localisation, as China accelerates efforts to reduce reliance on foreign technology. This shift toward domestic sourcing of chips, components, and equipment expands demand for local electronics manufacturers, providing more stable orders and reinforcing long-term growth. Together, these factors suggest that despite recent outperformance, China's electronics sector still has meaningful room for further growth in 2026.

# Chinese Fixed Income

CGBs and Panda Bonds

**Figure 51: Chinese Government Bond Yield (CGB) Curve**



Source: PBoC

## Chinese Government Bonds (CGBs): Anchored by Easing Expectations

As of 26 Dec 2025, CGB Yields stood at: **3M: 1.3053%, 6M: 1.3185%, 1Y: 1.2872, 3Y: 1.3627%, 5Y: 1.5948%, 7Y: 1.7033%, 10Y: 1.8376%, 30Y: 2.2233% (Figure 51)**. CGB Yields remain low across the curve amid a yield curve shifting down due to a combination of structural and policy-driven factors:

First, subdued inflation and deflationary pressures continue to anchor nominal yields. Weak domestic demand, excess capacity in parts of the economy, and ongoing price competition, particularly in property, autos, and manufacturing, have kept CPI and PPI inflation low despite the anti-Involution campaign. This reduces inflation risk premia and long-term expectations, limiting upward pressure on yields especially at the long end.

Next, the PBoC's dovish policy stance has resulted in a downward shift of the yield curve. With structural headwinds facing the Chinese economy, the PBoC has relied on liquidity injections through reverse repo agreements by open market operations, lowering of policy rates cautiously in May 2025 this year.

**Figure 52: 10Y CGB Yields (%)**



Source: Investing.com

## What's Next for CGB's?

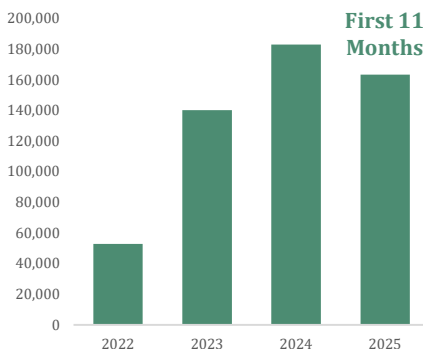
Given the economy's uneven recovery, with growth being supported by exports while domestic consumption remains low, it may put a downward pressure on yields. China's ongoing structural challenges (Figures 13-15), such as weakness in the property sector and the need to sustain growth, are hence likely to prompt policy easing through interest rate cuts by the PBoC's monetary policy tools.

China's uneven recovery, driven by exports amid weak domestic consumption, continues to place downward pressure on bond yields, with structural challenges such as property-sector stress increasing the likelihood of further PBoC policy easing. If this occurs, the 10Y CGB yield (Figure 52) could fall below its earlier-2025 low of around 1.60%, presenting investment opportunities in the 10Y.

**Figure 53: Clearing and Settlement Platforms for Panda Bonds**



**Figure 54: Panda Bond Issuance - Shanghai Clearing House (RMB Mns)**



Source: CEIC, Personal Analysis

Across the yield curve, continued liquidity expansion (Figures 41 and 42) is likely to exert greater downward pressure on the short end, as money-market conditions remain accommodative. While yields at the long end are also expected to decline, the pace of the fall may be more gradual, as measured fiscal stimulus and controlled long-term bond issuance help limit upward pressure on longer-dated supply. This may present opportunities in the form of a bullish steepener, whereby the short-end yields fall more than long-end yields.

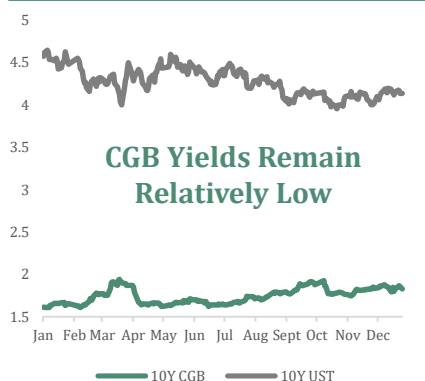
## Panda Bonds Gain Momentum from Regulatory Clarity

Panda Bonds are bond dominated in RMB and issued within China's domestic bond market by entities domiciled outside of mainland China (Figure 53). They can include Chinese-owned companies incorporated in offshore financial centers but with primary operations in mainland China and foreign corporations, financial institutions and sovereign entities. Issuers use panda bonds to secure lower-cost RMB funding, diversify financing sources, and access China's onshore investor base, with added flexibility from policy reforms allowing offshore use of proceeds. In recent years, the Chinese panda bond market is experiencing a historic boom. In 2024, foreign issuers raised a record 194.8 billion yuan through panda bond issuance according to S&P Global Ratings China. Momentum has stayed strong into 2025, with about 160 billion yuan raised in the first 11 months of the year (Figure 54). Some key drivers behind the surge include a major regulatory shift in 2022, clarifying that foreign issuers can use panda bond

# Chinese Fixed Income

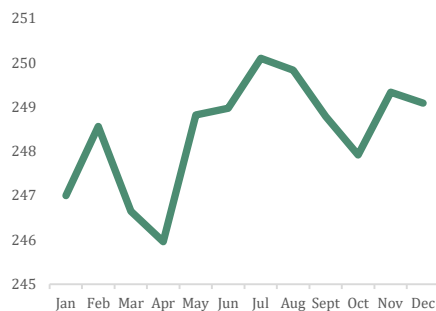
CGBs and Panda Bonds

**Figure 55: 10Y CGB vs 10Y US Treasury (%)**



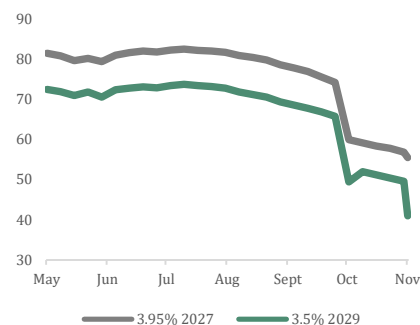
Source: Investing.com

**Figure 56: ChinaBond New Composite Index**



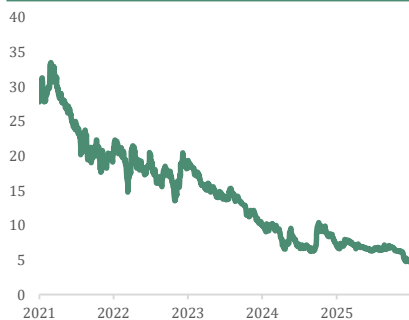
Source: ChinaBond

**Figure 57: Vanke's Dollar Bonds Dropped by 10 Points in Nov**



Source: BondBloX

**Figure 58: Vanke's Depressed Stock Prices**



Source: Investing.com

proceeds offshore as well as domestically has expanded the market's appeal by reducing restrictions that previously the attractiveness of panda issuance. Another driver includes that of China bond yields trading below comparable U.S. Treasuries (**Figure 55**), creating a favourable arbitrage opportunity for foreign borrowers and this overall lower cost of yuan funding hence continues to attract issuers.

Looking ahead, if further capital market opening, ongoing efforts to promote RMB internationalisation, and the resumption of more active PBoC bond market operations persists, they are likely to support liquidity and confidence in the panda bond market. Furthermore, as global monetary policy shifts toward easing and investors seek diversification beyond traditional funding markets, panda bonds are well positioned to see broader issuer participation and sustained issuance growth, cementing their role as a key bridge between China's bond market and global capital. If these supportive conditions persist, panda bonds are likely to extend their strong momentum into 2026 (**Figure 56**).

## Panda Bonds: Not Without Friction

Despite the growth potential of the panda bond market, several risks remain. Panda bonds are still less liquid than China Government Bonds (CGBs) or policy bank bonds, with secondary-market trading often thin, particularly for smaller or first-time issuers. While low CGB yields currently support issuance, this environment reflects overlapping factors including persistent pessimism toward China driving portfolio shifts into bonds, entrenched deflationary expectations compressing inflation premia, and weak borrowing demand alongside ample bank liquidity following RRR cuts. A shift in sentiment, inflation expectations, or liquidity conditions could therefore push yields higher, eroding the RMB funding cost advantage and slowing panda bond issuance. Additionally, market narratives around CGBs tend to remain skewed negative regardless of yield direction, oscillating between "Japanisation" concerns when yields fall and "bond market rout" fears when yields rise, reinforcing volatility in expectations.

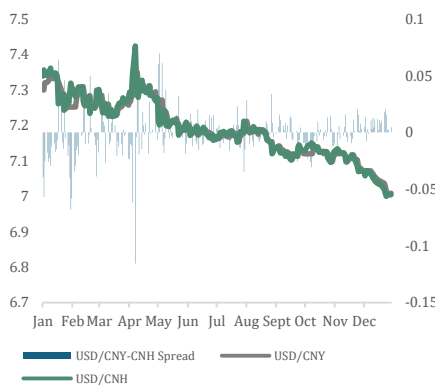
## Fixed Income Headliner: China Vanke Under Pressure

Vanke's USD bonds fell sharply in November (**Figure 57**) as investors rapidly repriced the company's default risk amid mounting liquidity stress. Concerns intensified after Vanke sought to delay onshore bond repayments, raising fears of broader restructuring risks that could extend to offshore creditors. Credit rating downgrades, including a move to selective default, further undermined confidence and triggered forced selling, while fading expectations of a strong policy backstop and persistent weakness across China's property sector reinforced negative sentiment. To add on to Vanke's woes, on 23 Dec, S&P Global Ratings has downgraded China Vanke Co. Ltd. to SD (Selective Default) following its recent handling of onshore bond payments, specifically viewing the extension of a grace period on a 2 billion yuan RMB bond due Dec 15 as a distressed debt restructuring rather than a normal repayment. This downgrade means Vanke is considered to have selectively defaulted on that obligation, and the rating carries no outlook because the company's situation is now in default territory. It also reflects Vanke's deepening liquidity strain amid China's broader property sector crisis, with its ability to meet obligations under pressure and multiple bonds maturing in the near term. It follows earlier actions in which S&P had already downgraded Vanke's long-term credit rating into highly speculative levels prior to this (e.g., CCC to SD), underscoring Vanke's severely weakened credit profile. These debt issues Vanke faces is also reflected in its poor performing stock prices since the onset of China's property crisis (**Figure 58**).

# Chinese FX

Gradual Appreciation, Policy-Anchored

**Figure 59: USD/CNY vs USD/CNH, USD/CNY-CHY Spread**



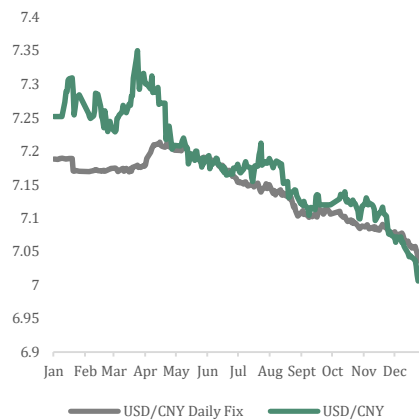
Source: Investing.com, Personal Analysis

**Figure 60: CNY Central Parity Rates (as of 29 Dec 2025)**

Currency Pair	Central Parity	Change (bps)	Direction (from 28 Dec)
USD/CNY	7.0331	27	Down
EUR/CNY	8.263	117	Down
100JPY/CNY	4.4833	165	Down
HKD/CNY	0.90494	0.8	Up
GBP/CNY	9.4661	106	Down
AUD/CNY	4.7061	4	Up
NZD/CNY	4.0819	119	Down
SGD/CNY	5.4633	22	Down
CHF/CNY	8.8904	131	Down
CAD/CNY	5.1305	13	Up

Source: CFETS

**Figure 61: USD/CNY vs USD/CNY Daily Fix by PBoC**



Source: CFETS, Investing.com, Personal Analysis

## Introduction: On and Off-shore Currencies

China utilises two currencies, the onshore yuan (CNY), and the offshore yuan (CNH) (Figure 59).

**CNY:** Traded within Mainland China and subject to strict capital controls and close monetary policy supervision by the authorities. Its exchange rate is managed under a managed-float regime, guided by a daily central parity fixing against the USD set by the PBoC, with onshore trading allowed only within a prescribed fluctuation band around this fixing (discussed later).

**CNH:** Launched in 2010, CNH is traded outside of Mainland China and is largely determined by market forces, with fewer capital controls and greater participation by global investors. While CNH is freely tradable, the PBoC retains effective influence over the offshore market through a range of indirect tools, most notably by selling USD from its substantial foreign exchange reserves, directing state-owned banks to manage liquidity, or tightening offshore RMB funding conditions. These actions raise CNH funding costs, often reflected in spikes in offshore RMB interest rates, thereby discouraging speculative positioning and limiting the ability of investors to sustain short-CNH carry trades for extended periods.

**CNY-CNH Spread:** A **negative spread** would mean that the offshore market expects CNY appreciation, reflecting capital inflows, investor optimism or anticipation of policy tightening. A **positive spread** however, would mean that the offshore market expected CNY depreciation, indicating capital outflow pressure, bearish sentiment or expectations of PBoC easing.

## Introduction: On and Off-shore Currencies

Unlike most countries that allow their currencies to free-float in the FX market, China operates a managed exchange-rate regime, whereby the onshore renminbi (CNY) is closely guided by the PBoC. Each trading day at 9:15am, the PBoC sets a central parity (fixing) rate against a basket of currencies, most importantly the USD (Figure 60), which serves as the reference point for onshore FX trading. Banks are then permitted to trade USD/CNY only within a  $\pm 2\%$  intraday band around this fixing, effectively limiting excessive volatility and allowing the PBoC to influence exchange-rate expectations. As such, movements in the daily fixing provide a clear signal of the PBoC's policy stance, indicating whether authorities support appreciation or tolerate depreciation of the yuan.

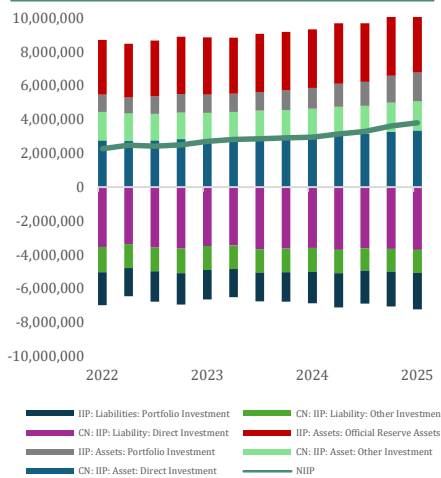
## Fixings Signal a Stronger Yuan Bias

China's central bank, the People's Bank of China (PBoC), on 29 Dec, set the yuan's daily central parity (fixing) rate at 7.0331 per US dollar, marking the strongest midpoint in roughly 15 months (Figure 61). By setting stronger-than-expected daily fixings, the PBoC signals policy control and reduces one-way depreciation expectations, which in turn deters speculative short-RMB positioning and capital outflows. This is especially important given China's still-wide interest-rate differential versus the US, which would otherwise incentivise carry trades against the yuan. This timing of strengthening also reflects favourable external conditions, particularly a softer US dollar driven by expectations of future Fed rate cuts. The PBoC is effectively opportunistic, reinforcing RMB strength when global FX conditions allow, rather than fighting the market. This allows authorities to guide appreciation through fixings and liquidity management instead of costly direct FX intervention.

# Chinese FX

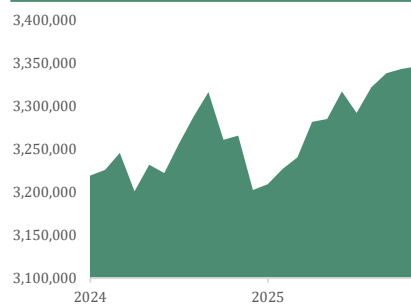
Gradual Appreciation, Policy-Anchored

**Figure 62: China's Net IIP Position Favourable for RMB Performance (USD Mns)**



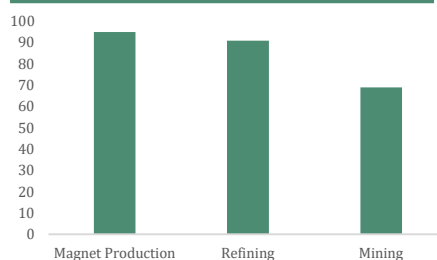
Source: CEIC

**Figure 63: China's FX Reserves (USD Mns)**



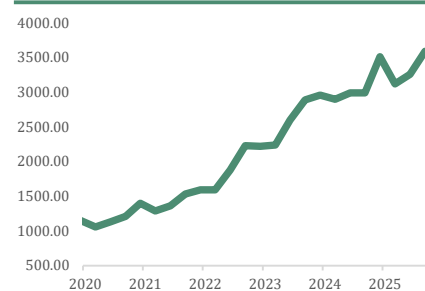
Source: CEIC

**Figure 64: China's Share in the Rare Earth's Market (%)**



Source: IEA, Goldman Sachs GIR, Woodmac

**Figure 65: Cross-border RMB Settlement (RMB Bns)**



Source: CEIC

## Favourable Balance of Payments Underpins Yuan Strength

Other than the PBoC's daily fixing rates, China's favourable balance of payments has also been a key driver supporting the appreciation of the yuan. China's Net International Investment Position (NIIP) has consistently generated net external inflows, underpinned by a persistent trade surplus and an external asset position that exceeds liabilities (Figure 62). This structural surplus creates steady and recurring demand for the RMB through exporter FX conversion and foreign income receipts, reducing China's reliance on more volatile portfolio or short-term capital inflows.

Additionally, China's foreign exchange reserves have remained large and have continued to grow, reflecting both the country's record-high trade surplus and ongoing external inflows (Figure 5). Part of this reserve accumulation can also be attributed to PBoC intervention, whereby authorities absorb foreign currency inflows by purchasing FX, allowing the yuan to appreciate in a more gradual and controlled manner. By recycling surplus FX into reserves rather than allowing all flows to be absorbed directly by the market, the PBoC smooths currency movements, anchors expectations, and reinforces the yuan's underlying strength without triggering excessive short-term volatility.

## Increased Usage of the RMB in Global Trade

RMB-Denominated trade settlement have reached unprecedented levels in 2025, driven by shifts in commodity markets and high-tech supply chains that play to China's manufacturing comparative advantage. In commodity trade, China has leveraged its position as the world's importer of raw materials to gradually price strategic goods in the RMB. This leverage is further reinforced by China's dominance in rare earths, where it controls a significant share of global mining and refining. Given the essential role of rare earths in electric vehicles, renewable energy, semiconductors, and defence technologies, China is able to exert pricing and settlement influence across critical upstream supply chains, encouraging counterparties to accept RMB settlement. This is reflected in cross-border RMB settlement reaching record highs in 2025 (Figure 65), as an increasing share of Chinese exporters and trading partners opt to invoice and settle transactions in RMB rather than USD, reducing FX conversion needs, lowering dollar exposure, and embedding RMB usage more deeply into real trade flows. China's scale in commodities and its chokehold over strategically vital inputs strengthen the case for RMB usage in trade, embedding the currency more deeply into real economic flows and supporting its broader internationalisation.

The expanding use of the RMB in global trade presents several important strategic advantages for China. First, settling trade in RMB reduces foreign-exchange risk for Chinese exporters and importers by limiting exposure to USD volatility and lowering hedging costs, thereby improving pricing certainty and margins. Second, wider RMB usage allows China to bypass the USD-dominant financial system, reducing vulnerability to sanctions risk, and more importantly, geopolitical frictions, particularly in trade with emerging markets and strategic partners. Finally, as more commodities and manufactured goods are priced and settled in RMB, the currency's role in global trade deepens, strengthening the RMB's status as a medium of exchange and store of value. Over time, this reinforces confidence in the currency, supports RMB internationalisation, and lays the groundwork for its gradual evolution into a more prominent global reserve currency.

# Trade Idea: Short USD/CNH

All roads lead to this

## Trade Setup (as of 30 Dec 2025)

CavanLim28 created with TradingView.com, Dec 30, 2025 08:07 UTC

US Dollar/Chinese Yuan - 1D - FXCM. O6.99426 H7.00246 L6.98392 C6.98401 -0.01025 (-0.15%)  
Vol. 54.52K



TradingView

Source: TradingView

<b>Conviction</b>	<b>8/10</b>
<b>Current Price</b>	<b>6.835</b>
<b>Entry</b>	<b>6.995</b>
<b>Take Profit</b>	<b>6.95000</b>
<b>Risk-Reward Ratio</b>	<b>3x</b>
<b>Time Horizon</b>	<b>6 Months</b>
<b>6 Months Carry</b>	<b>(1.80% (CNH HIBOR) - 3.61%) x (6/12) = -0.905%</b>
<b>Breakeven Level after 6 Months</b>	<b>(1+0.905%) x 6.995 = 7.058</b>

### Rationale 1: PBoC's support for the RMB

Covered earlier, the recent fall in the CNY fixing indicates that the PBoC is adopting a more defensive stance to support the yuan, with the daily fixing set at 7.0331 on 29 Dec, its strongest level in 15 months. This stronger-than-expected fixing signals official intent to anchor FX expectations and reinforce confidence in the currency amid external and domestic uncertainties. At the same time, the increase in China's FX reserves alongside a widening trade surplus suggests that the PBoC may be actively absorbing foreign currency inflows, either directly or via state banks, to smooth appreciation pressures. By recycling surplus FX into reserves rather than allowing all inflows to pass through the spot market, authorities can guide the yuan higher in a gradual and controlled manner, balancing currency stability with broader macro-objectives such as export competitiveness and financial stability.

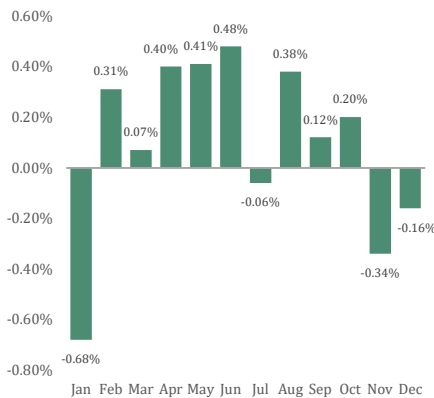
### Rationale 2: Favourable Policies

As 2026 marks the first year of China's 15th Five-Year Plan, I expect policy support and reform momentum aligned with the country's long-term development agenda to improve investor sentiment and drive a continued revaluation of Chinese assets. In addition, I expect China to further institutionalise the RMB, expanding its role in global trade and financial transactions, which should generate structurally higher demand for the currency over time. In terms of monetary policy, while the PBoC remains dovish, I expect it to continue exercising a high degree of caution, as evidenced by only a single rate cut in 2025. This measured approach should help support growth while reducing the risk of sharp RMB depreciation, by limiting interest-rate divergence and anchoring currency expectations.

# Trade Idea: Short USD/CNH

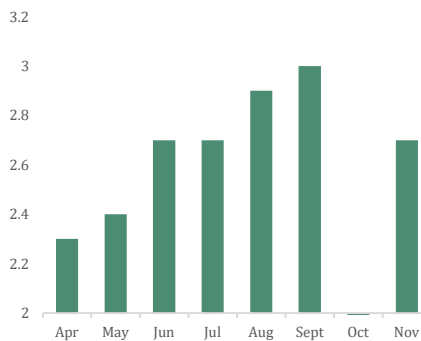
All roads lead to this

**Figure 66: USD/CNH Average Monthly Return (last 15 years)**



Source: BarChart

**Figure 67: US CPI YoY (%)**



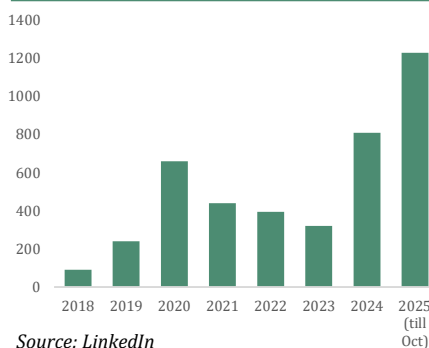
Source: TradingEconomics

**Figure 68: Chart of USD/CNH**



Source: Investing.com

**Figure 69: Annual Net Outflows through Southbound Connect (HKD Bns)**



Source: LinkedIn

## Rationale 3: Favourable Seasonality

The CNH exhibits strong year-end seasonality (**Figure 66**), which is often supportive for the currency. Toward the end of the year, Chinese corporates and financial institutions typically repatriate and convert offshore USD balances, driven by window dressing, dividend settlements, and funding needs ahead of year-end reporting. This increases demand for CNH liquidity in offshore markets such as Hong Kong. At the same time, offshore RMB funding conditions tend to tighten seasonally, as banks reduce balance-sheet usage and the PBoC, via state-owned banks, becomes less tolerant of speculative short-CNH positioning. These dynamics often lead to higher CNH funding rates and a compression of short-CNH carry, discouraging depreciation trades. As a result, year-end seasonality in the offshore market frequently reinforces CNH strength and aligns with policy efforts to stabilise or support the RMB during periods of heightened market sensitivity.

## Risk 1: Widening US-China Rate Differentials

If elevated US inflation and a resilient labour market occurs next year, the Fed may keep interest rates higher for longer. If China simultaneously maintains a cautious and accommodative monetary stance, with policy rates held steady, the resulting widening US-China interest-rate differential is likely to sustain negative carry on CNH positions. In this environment, holding CNH exposure becomes increasingly costly, as investors earn relatively low yields on CNH assets while facing higher USD funding costs. While policy-driven tightness in offshore CNH liquidity can temporarily deter speculative positioning by raising funding rates, any subsequent normalisation of CNH liquidity would reduce funding costs and make it more attractive for investors to re-establish short-CNH carry trades. This could reintroduce depreciation in the CNH market, particularly if spot appreciation momentum fades or global risk sentiment weakens.

## Risk 2: Geopolitical Shocks

Geopolitical or policy shocks, such as an escalation in trade tensions, rising sanctions risk, or unexpected regulatory announcements, including “Liberation Day”-like policy actions, can quickly erode investor confidence and trigger capital outflows. The CNH is particularly vulnerable to these developments due to its greater exposure to global sentiment and reliance on market-driven liquidity. During these shocks, risk premia tend to widen, hedging demand rises, and speculative positioning can amplify currency moves, leading to heightened volatility and depreciation pressure in the CNH market (**Figure 68**), even if onshore fundamentals or policy settings remain broadly unchanged.

## Risk 3: Southbound Connect Flows

Increased Southbound Stock Connect flows, which are Chinese retail investments into offshore equities, have accelerated sharply in 2025 (**Figure 69**), reaching US\$159 billion in the first ten months alone, already surpassing the US\$104 billion recorded in the whole of 2024. This surge reflects a combination of improving risk appetite, relative valuation attractiveness of offshore Chinese equities, and growing confidence in policy support following stabilisation measures in China’s domestic economy. Although stronger southbound flows underscore renewed confidence in offshore investments into Hong Kong equities, but they also represent a channel of capital outflow pressure. This persistence or sudden outflow may lead to depreciation of the RMB, though this is only likely to happen in a longer time horizon.

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