

When RMB Optimism Meets a Wide Gap

Stronger renminbi demand has driven a sustained surge in FX settlement over the past 12 months, a pattern only last seen in 2013. Starting this year, these inflows have translated into additional liquidity onshore, which is equivalent to a 15bp RRR cut year-to-date, helping push CGB yields lower.

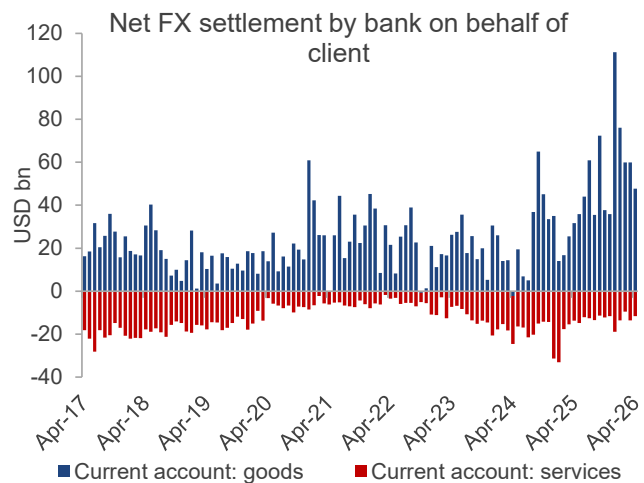
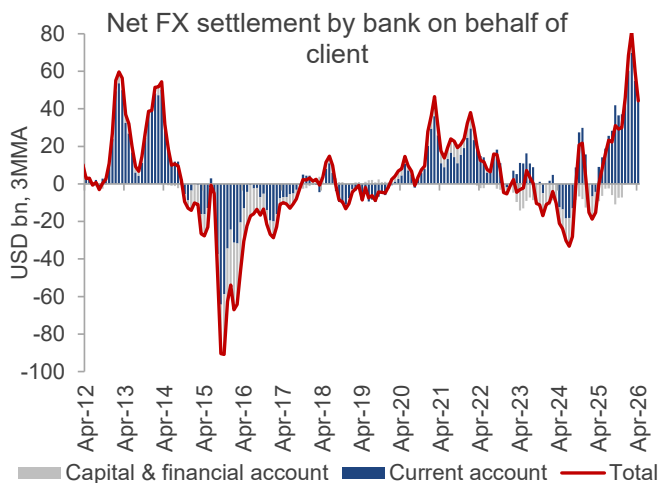
Looking ahead, US-China rate differentials are likely to remain wide, if not widen further in a NACHO scenario, as China's subdued domestic demand and contained imported inflation limit upside risks to CGB yields. At the same time, a persistent rate gap should help anchor RMB appreciation expectations, allowing the gap between yuan spot and fixing to gradually narrow. We expect the RMB to maintain a modest appreciation bias, with USD/CNH reaching 6.65 at the year-end.

RMB Demand Surges

China's banks have recorded twelve consecutive months of net foreign exchange settlement, the longest streak in four years. Over this period, corporates and households sold a cumulative USD437bn of foreign currency to banks in exchange for renminbi (Fig. 1). The main driver has been trade-related inflows, which peaked last December and averaged USD56bn per month over the past 12 months, more than double from the USD25bn in 2024 (Fig. 2).

Fig 1 Surging demand in exchange for renminbi

Fig 2 Inflows related to goods trade are the main driver

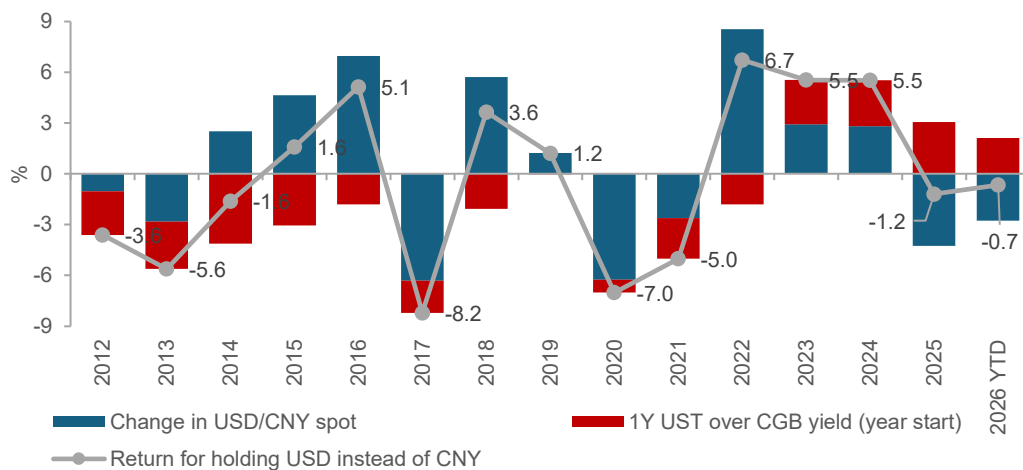


Source: CEIC, Mizuho

These inflows happened as a result of the market's growing expectation for renminbi appreciation, instead of just widening trade surplus. Despite the still-wide US-China interest rate differential, the relative return from holding renminbi rather than US dollars has become more attractive since late last year (Fig. 3), as the CNY appreciated 4.3% against the dollar in 2025 and has gained a further 2.7% year-to-date.

If this trend continues, renminbi appreciation could gain further momentum into year-end. Against this backdrop, **it remains necessary for the PBoC to lean against one-way appreciation expectations.** Otherwise, expectations for a stronger renminbi could become self-reinforcing, if the market starts to price in more than 4% CNY appreciation over the next 12 months. We expect the RMB to maintain a modest appreciation bias, with USD/CNH reaching 6.65 by the end of 2026.

Fig 3 The relative return from holding renminbi rather than US dollars became more attractive in 2025

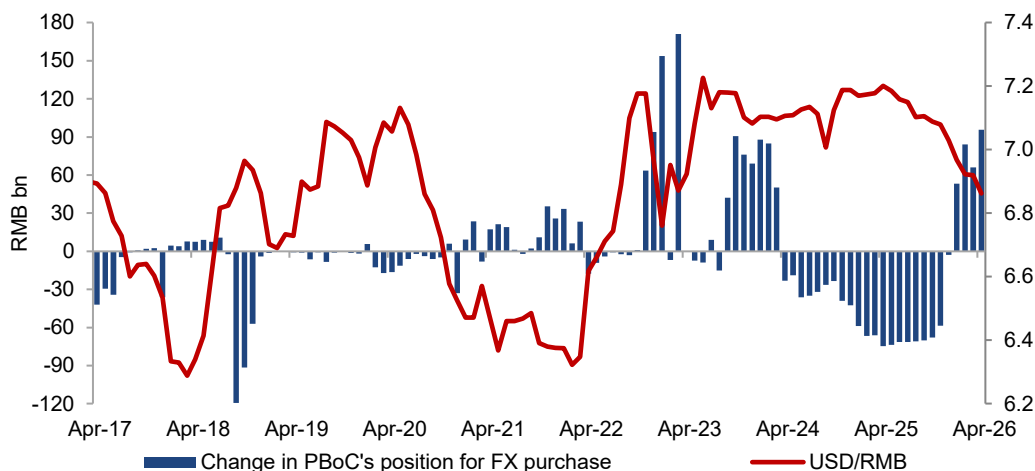


Source: Bloomberg, Mizuho

Inflows Push CGB Yields Lower

That said, sustained FX settlement inflows should not be interpreted mechanically as liquidity injections into the real economy. The PBoC’s position for FX purchases did not turn positive until this January. Before that, the position had been declining for almost two years, withdrawing a cumulative RMB806bn of liquidity during 2024-25, equivalent to around a 40bp RRR hike. Since the start of this year, however, the increase in this position has injected around RMB299bn of liquidity, equivalent to roughly a 15bp RRR cut (Fig. 4).

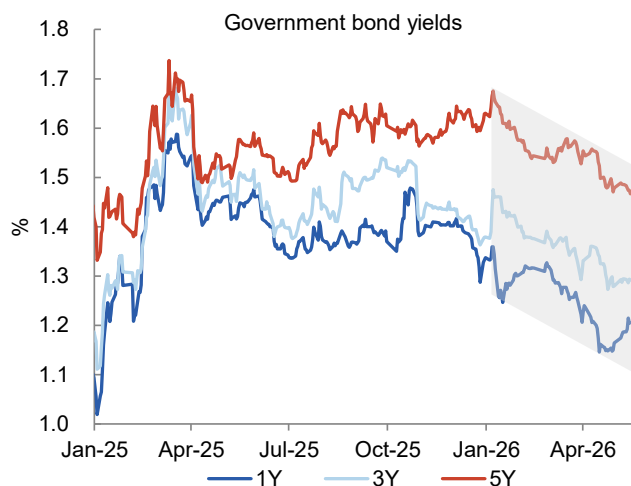
Fig 4 YTD inflows into the economy are equivalent to a 15bp RRR cut



Source: CEIC, Mizuho

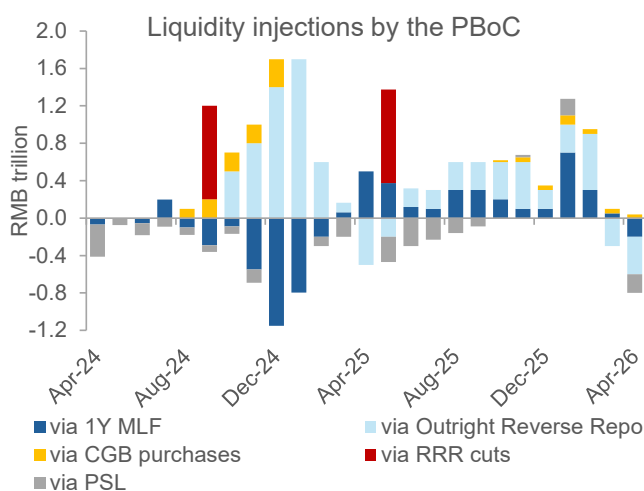
This additional liquidity has helped drive China government bond (CGB) yields lower, even in the absence of liquidity easing measures from the PBoC (Fig. 5). Indeed, the central bank conducted net liquidity withdrawals of RMB200bn in March and RMB760bn in April (Fig. 6). Additionally, net FX inflows into securities investment have turned positive and continued to improve in recent months, albeit on a much smaller scale than trade flows, amounting to USD35.5b YTD, more than ten times the inflows recorded during the same period last year.

Fig 5 CGB yields have been on a downward trend since January



Source: CEIC, Mizuho

Fig 6 Liquidity injections by the PBoC have been subdued YTD



Rate Gap to Persist, If Not Widen

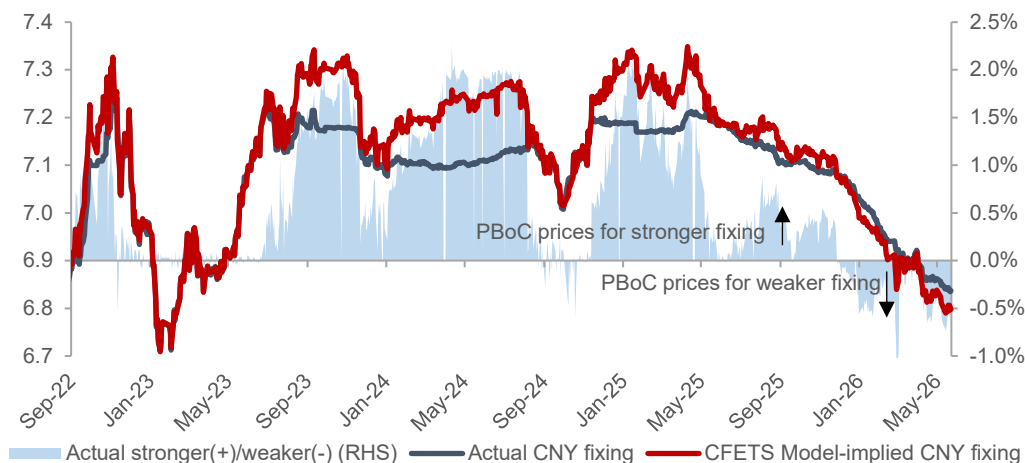
Looking ahead, **the US-China rate spreads are likely to remain or widen further, as markets increasingly price in a NACHO scenario.** Even with the reopening of the Strait of Hormuz, damaged local oil facilities, higher shipping and insurance costs, and the possibility of additional toll fees all suggest that oil prices may remain materially above pre-conflict levels for some time.

Although both the US and China face imported inflation pressures, the macro implications are likely to differ. In the US, relatively resilient domestic demand raises the risk that higher import costs feed into a broader inflation spiral. In China, by contrast, still weak domestic demand limits pass-through from higher input costs to end users. The decline in China’s April discretionary consumption, as the boost from government’s trade-in subsidies faded, underscores the fragility of consumer sentiment, leaving Chinese manufacturers exposed to further margin compression.

Additionally, **several factors should also help contain or offset China’s imported inflation risk,** including limited energy exposure to Middle Eastern oil, domestic pork prices near a 15-year low, a stronger renminbi, and ample fiscal room to subsidize oil consumption if needed. Together, these suggest limited upside pressure on CGB yields.

In FX markets, a persistently wide US-China rate differential should help dampen one-way RMB appreciation expectations. This, in turn, may allow the current gap between the yuan’s spot rates and the official fixing to gradually narrow (Fig. 7).

Fig 7 The current gap between the yuan’s spot rates and the official fixing may narrow gradually



Source: Bloomberg, Mizuho

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