

EM Alpha

Enter CNY NDIRS 1s5s steepener

Politburo triggered risk rally and bond leverage unwinding

Holding very low expectations heading into the Politburo meeting, investors were surprised by policymakers' supportive tone on the property market and local government debts (see more details in [China Watch -Politburo meeting slightly beat expectation](#)). Though details on policy measures are yet to be disclosed, the sentiment boost along with bearish positioning led to a sharp rally in China equities and RMB the following day. The 10y CGB yield rebounded by 7bp as market participants rapidly unwound leveraged long positions.

Upcoming policy support should steepen the NDIRS curve

We recommend CNY NDIRS 1s5s steepener at 44bp (target: 62bp, stop loss: 34bp) as it offers attractive risk-reward in the current policy backdrop.

Despite the major knee-jerk move, the curve remains relatively flat compared with the level at the beginning of the year. Similar to the curve dynamics between Nov 2022 and Jan 2023, back-end swap rates will likely face more upward pressure when policy support measures are being rolled out and growth sentiment bottoms out. Also, even though there wasn't any mentioning in the Politburo statement, we think the risk of more government bond issuances has risen as more fiscal room is probably needed to resolve local debt risks and boost consumption. Back-end bonds and swap rates will be more susceptible to incremental fiscal expansion. On the other hand, front-end rates should be better anchored by the PBoC. With CPI inflation declining to 0%, we believe both RRR and policy rate cuts are on the cards to keep interbank liquidity ample and guide lending rates lower.

Risks to our trade recommendation are: 1) tighter funding condition as a result of insufficient liquidity injection by the PBoC, and 2) upcoming support measures falling short of expectation and growth confidence weakening again.

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NDIRS – non-deliverable interest rate swap

CGB – China government bond

PBoC – People's Bank of China

For the complete list of open and closed trades in the last 12 months, please see [Global Emerging Markets Weekly - Dr. Taylor prescribes rate cuts](#).

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