

## A rates opportunity in China

We have a bold call for USD/CNY to fluctuate in the 6.85 to 7.25 range in 2026. If we're right, paying low Chinese rates while receiving higher US dollar rates in the coming year is almost akin to a free lunch. We see a similar appeal for longer tenors up to five years, or at the very least, we like the implied risk/reward profile



A few weeks ago, Lynn Song, our Chief Economist for Greater China, published an update on CNY [here](#). There are two key takeaways for players who might arbitrage between US and Chinese rates. First, the likely range for USD/CNY is shifted a tad lower to 6.85-7.25 for 2026, reflecting belated appreciation pressure into the end of 2025. Second, the People's Bank of China (PBoC) remains in the business of prioritising currency stability, though it has shifted focus toward curbing CNY appreciation.

The backstory here reflects a PBoC preference for broad FX stability to the US dollar. This is important when it comes to framing interest rate arbitrage between the US and China.

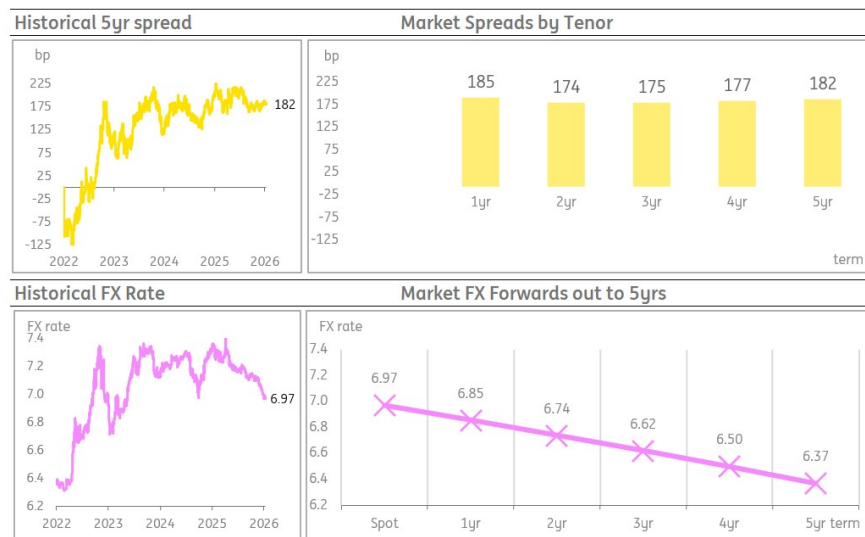
History shows that US rates traded below Chinese rates back in 2022, by some 125bp. Since 2023, that spread has flipped, as the Fed hiked rates and the PBoC cut them. The peak has been in the area of 200bp, and right now the spread from Chinese to US rates remains elevated, ranging from 175bp to 185bp. The Federal Reserve has been in rate-cutting mode for the last couple of years,

but not enough to wipe out spread differentials. Two or three further rate cuts from the Fed are already discounted in current levels.

This leaves us with significant interest rate differentials between the US and China (charts below).

## Spreads from CNY to SOFR

And the FX profile (lower charts)



Source: ING estimates, Macrobond

And that interest rate differential is balanced by an FX forward profile that maps out considerable CNY appreciation versus USD (charts above).

The FX forward profile can be viewed as a breakeven curve. Hit that, and the benefit of the positive carry play from paying CNY and receiving SOFR is wiped out. But if we don't hit the FX forward profile, then we've created an overall positive arbitrage. The 1yr forward FX rate is 6.85 – that's our breakeven rate. Lynn has identified a fluctuation band between 6.85-7.25. If we managed to edge away from 6.85 and end up closer to 7.25, we've then locked in not just the rate differential, but also an implied positive FX performance. That overall trade is a win-win, should it pan out like that.

For longer tenors, we need to ask more difficult questions. The most important centres around whether the PBoC would be okay should the USD/CNY rate hit its 5yr forward rate (at just under 6.4). That's a 9% appreciation in CNY over five years. It's always tough to look that far out, but our baseline view is that the PBoC would be happier to maintain something similar to a 7-handle or close to it for USD/CNY. If we are correct, then we have a scenario where the positive carry play generates some 185bp in positive carry, and it is not materially impacted by aggregate FX movements. It's akin to a free lunch.

That's it – we like the positive carry play. The rest of this piece explains the theory and dynamics of the cross-currency structure, broken into its key components.

### The pure interest rate difference and how to frame it

The positive carry play here is interesting. This is where SOFR rates are received and CNY

rates are paid, thus picking up the spread, e.g. to the tune of 180bp in the 5yr tenor.

For the asset manager, that is a play where a CNY-denominated bond is used to synthetically create a USD-denominated one (higher synthetic yield). For the liability manager, it's a play that results in a reduction in interest rate costs, i.e. instead of paying, e.g. 5yr SOFR at 3.5%, pay the CNY rate at 1.7%, and achieve 180bp in interest rate savings. This positive carry outcome is locked in.

But there is an FX angle to consider.

## The FX angle and how that interacts with the spread exposure

On a cross-currency swap, the FX rate is locked in (now 6.97) at initiation of the swap. On a 5yr swap, if the FX rate did not change, and in five years' time was the same as today, then we'd have a free lunch of 180bp in positive carry for five years.

But the FX rate is *not* expected to be unchanged. In fact, there is a very clear market discount for the CNY to appreciate. That *must* be the case, as the corollary of the interest rate differential is an appreciation in the currency of the lower interest rate economy, which is required to achieve interest rate parity.

And then there is the valuation of the entire trade.

## The combination of the two and framing a breakeven outcome

In consequence, while the aforementioned 180bp of positive carry is absolutely locked in, the performance of the entire trade deteriorates once the CNY appreciates. And if the CNY appreciates by as much as the forwards anticipate, then there is an overall balancing between the interest rate arbitrage differential and the FX implication.

As a final point, and to map out the longer tenor (5yr) breakeven profile, should USD/CNY hit the 5yr forward rate of 6.37 in five years, then the positive carry player finds themselves buying their dollars back at 6.97 (initiation rate), rather than the more advantageous rate of 6.37 (the 5yr forward that we hypothetically managed to hit).

In fact, hit that 5yr FX forward rate in five years' time, and the overall trade breaks even. A reasonable risk/reward profile.

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