

Monetary Policy Transmission via the Bond Market: A US – China Comparison

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Abstract. This paper studies how monetary policy passes through the bond market to the real economy, using a structured comparison of the United States and China over 2019–2025. The paper traces the link from policy rates and guidance to expectations at first, and then from term structure to long-term yields and risk premia. The next step is from risk premia to credit conditions and issuance to investment, employment, and inflation. The paper chose two types of typical cases. The U.S. ample-reserves system anchors the short end via IORB, ON RRP, and the SRF while China's MLF and LPR reform provides the price channel to bank lending alongside quantity and structural tools. The analysis applies two empirical lenses. First, the 10-year nominal yield versus CPI year-over-year. Secondly, corporate-bond net financing versus fixed-asset investment. Together these could provide transparent diagnostics. The paper documents that U.S. disinflation did not automatically lower the long end because term premia were elevated and duration supply was ample. By contrast, in China the effectiveness of easing depends on credit-quantity recovery and market plumbing. The paper proposes practical steps, including improving public term-premium estimation and communication, broadening the investor base and hedging toolkit, and coordinating price and quantity levers in order to stabilize transmission.

Keywords: Global supply chain disruption; Inflation in China; COVID-19.

1. Introduction

Monetary policy influences the real economy through a chain of financial prices and quantities. The yield curve translates short rate intentions into borrowing costs across maturities; those costs shape corporate issuance and investment decisions, while mortgages and wealth effects channel into household demand. The 2019-2025 period is a natural experiment: the US pivoted from near-zero rates and asset purchases to rapid hikes and QT, followed by disinflation. China refined a price-based framework with the MLF and LPR linkage while employing reserve ratio moves and structural tools in a low inflation environment. These differences allow us to study how institutional design and market depth condition pass through speed and completeness [1, 2].

2. Literature Review and Theoretical Foundations

Monetary policy affects the economy through a sequence in which the bond market plays a central role. Policy rate decisions and forward guidance shape expectations for the future path of short rates. Through the no-arbitrage term structure relation with a time-varying term premium, those expectations are translated into long-term yields; long yields and risk premia determine corporate and mortgage borrowing costs, portfolio valuations, and the willingness of intermediaries to supply credit; changes in credit conditions then map into investment, durable consumption, employment, and inflation. The chain is neither instantaneous nor frictionless. The speed and completeness of transmission depend on the operating framework at the short end, the structure and liquidity of bond and derivatives markets, the composition of the investor base, and the macro-fiscal environment [3].

The term structure relation provides the backbone. In affine no-arbitrage models, the n -period yield equals the average of expected future short rates plus a term premium compensating investors for duration risk and other factors. The decomposition is conceptually simple but empirically rich. Shocks to the expected path of policy, which is generated by data surprises or policy communication. It moves long yields through the expectations component. Shocks to the term premium are driven by duration

supply, hedging demand, volatility, or risk appetite, which move long yields independently of the expected policy path. The two components need not move together. Episodes of disinflation accompanied by rising term premia can leave the long end elevated even as markets price future easing; conversely, credible forward guidance can pull the long end down through expectations even when the premium is stable [4, 5].

A second building block is the operating framework that pins down the short end. In an ample-reserves system like that of the United States, the interest on reserve balances (IORB) and the overnight reverse repo facility (ON RRP) set the floor of the corridor, while the standing repo facility (SRF) provides a backstop for money markets. This architecture ensures that the overnight and nearby money-market rates track the policy target and that stress in repo markets does not compromise implementation. In China, the 2019 Loan Prime Rate (LPR) reform created a price-based line of transmission running from open-market operations and the Medium-term Lending Facility (MLF) to the LPR quoted by banks, which in turn anchors loan pricing. Reserve-ratio adjustments and a suite of structural tools complement the price channel, supporting sectors and objectives that require targeted interventions.

The asset-price and credit channels form the next link. Long-rate increases raise discount rates and lower the present value of distant cash flows, pushing down prices of long-duration assets such as growth equities and long bonds. Wider risk premia lift corporate and mortgage borrowing costs, reducing issuance, refinancing, and credit growth. Changes in valuations alter the capital position and risk capacity of banks and nonbanks, shaping the supply of credit even for a given demand schedule. The risk-taking channel adds further nonlinearity: prolonged low rates can induce greater duration or credit exposure; when rates rise, valuation losses and tighter funding conditions can cause risk retrenchment that amplifies the downturn [6].

Finally, the external channel links domestic rates to exchange rates and cross-border financing conditions. While this paper centers on the internal chain: rates lead to bonds lead to credit leads to activity. The paper acknowledges that exchange rate dynamics can either cushion or compound domestic cycles. For the US and China, the external channel matters but is not the primary focus of our causal tests. Therefore, the paper treats it as a control when necessary [7].

Measurement issues deserve emphasis. Term-premium estimates (e.g., Kim-Wright or ACM) are model-dependent; results should therefore be triangulated with alternative proxies such as implied volatility or survey measures of long-run rate expectations. Similarly, the mapping from long yields to credit prices varies with mortgage fixed-rate shares, the prevalence of bank vs market financing, and regulatory constraints. Cross-country work must thus pay attention to institutional comparability and data definitions [5, 8, 9, 10, 11]

2.1. Transmission Mechanisms

2.1.1 Expectations–term structure channel

The expectations hypothesis posits that long yields embed the average of expected future short rates; modern no-arbitrage formulations add a time-varying term premium. Policy statements, projections, and dot plots together with OIS curves primarily affect the expectations component. Announcements that alter the perceived persistence of inflation or the reaction function shift the entire path of expected short rates, with outsized effects on intermediate maturities. Term-premium shocks, by contrast, reflect changes in duration supply, hedging costs, and uncertainty. Large fiscal issuance can lift the premium by increasing the quantity of duration that markets must absorb; volatility spikes or de-risking episodes can have the same effect [4, 12, 13].

2.1.2 Operating framework and money-market channel

Effective transmission begins with tight control of overnight conditions. IORB remunerates reserves and provides a floor for bank funding. ON RRP extends the floor to money-market funds and other counterparties; the SRF caps repo stress by offering standing liquidity against high-quality collateral. In China, the 7-day repo, open-market operations, and the MLF set the short-rate anchor,

while the LPR mechanism passes the anchor into loan pricing. By ensuring that the first link is solid, the authorities reduce noise farther along the curve and improve the predictability of the throughput[10, 11].

2.1.3 Asset-price to credit to aggregate-demand channel

Higher long rates raise the user cost of capital and mortgage rates, widening credit spreads, lowering issuance and refinancing, and damping capex and durables. The magnitude depends on the share of market vs bank finance, the fraction of fixed-vs floating-rate mortgages, and corporate leverage and maturity structures[8, 9]. In bank-centric systems, loan-supply elasticities and regulatory capital conditions matter greatly for how quickly changes in rates translate into credit[11].

2.1.4 Balance-sheet and risk-taking channels

When rates are low, investors may extend duration or lower credit standards; rising rates reverse that risk-taking, especially when mark-to-market losses erode capital. Intermediary capital, therefore, acts as a state variable for transmission strength. Shifts in the shadow-banking complex, such as the growth of private credit. It can alter the elasticity of aggregate financing with respect to long rates [14].

2.1.5 External channel

Rate differentials and global risk appetite affect exchange rates, capital flows, and foreign-currency borrowing costs. For the US, external spillbacks operate via the dollar and global financial conditions. For China, the external channel interacts with the exchange-rate framework and capital-flow management. Although important, these factors are not central to our identification strategy and are treated as controls or discussed qualitatively [7].

2.2. Core Functions and Importance of the Bond Market

Benchmarking and price discovery. The government yield curve is the financial system's reference curve: it prices loans, mortgages, corporate bonds, and many derivatives. The integrity of the curve—its continuity, liquidity, and transparency—determines the speed and quality of monetary transmission. When the curve is illiquid or segmented, policy signals decay as they travel along maturities.

Maturity transformation and risk sharing. Repo markets transform collateralized short-term funding into position financing; swaps and futures allow participants to fine-tune duration and hedge exposures. A deeper hedging toolkit lowers the cost of bearing duration risk, which in turn moderates term-premium swings. Conversely, shallow hedging markets amplify volatility, increasing the chance that long-rate moves reflect plumbing rather than fundamentals.

Primary issuance and the role of dealers. Auction design, primary-dealer obligations, syndication practices, and the pipeline of public-sector supply all shape how duration is intermediated. During periods of heavy issuance, dealer balance-sheet constraints and regulatory leverage ratios can transmit supply shocks into higher term premia and steeper curves, even with unchanged policy expectations.

Investor base composition. A diverse investor base(banks, insurers, pensions, mutual funds, foreign investors, and households) provides multiple margins of adjustment. Concentration in a few buy-and-hold players may stabilize day-to-day yields but can raise the system's sensitivity to flows. The presence of natural hedgers (e.g., mortgage services, insurers) reduces net duration supply to risk-tolerant intermediaries, easing the burden on dealers and market-making capacity.

Fiscal monetary interactions. Large deficits translate into a duration supply. If issuance is front-loaded in the long end, the term premium tends to rise, potentially offsetting policy easing. Coordination does not mean subordination; rather, it entails recognizing the joint determination of long rates by expected policy paths and duration supply and adjusting issuance strategies to market depth.

Cross-border spillovers. Term-premium shocks in core markets transmit abroad through global fixed-income portfolios and currency-hedged demand for duration. Emerging markets with less-

developed local-currency curves face amplified pass-through into domestic financial conditions [1, 2].

2.3. Measurement and Identification Challenges

Term-premium estimation is sensitive to priors about the persistence of latent factors, the choice of macro instruments, and sample windows. Researchers should therefore report multiple specifications (e.g., ACM vs. Kim-Wright) and emphasize intervals rather than point estimates. Expectations proxies also differ—survey-based measures capture beliefs but may lag market-implied OIS; market-implied measures embed risk premia. To disentangle news vs policy, high-frequency identification around policy events can isolate surprises at the two-minute horizon; in our monthly setup, the paper approximates this with narrow event windows and narrative classification. For China, where high-frequency instruments are less available, the paper complements regression analysis with institutional reading of PBoC communications and issuance calendars to capture the plumbing channel [5, 8, 9,10].

3. US–China Monetary Policy and Transmission via the Bond Market

3.1. Background and Measures (2019–2025)

The United States' policy rate was cut to near zero in 2020, and asset purchases were deployed to restore market functioning and support the economy. As inflation rose in 2021–2022, the FOMC embarked on rapid rate hikes and quantitative tightening. Through 2024–2025, policy balanced disinflation against resilient activity, while long rates remained elevated at times owing to term premium swings and heavy issuance. Implementation relied on an ample-reserves framework with IORB and ON RRP forming the floor and the SRF providing a repo backstop. Communication through statements, projections, and dots shaped expectations and helped anchor the short end.

And in China. The 2019 LPR reform established the MLF leads to LPR, and LPR leads to bank loan price transmission, with reserve ratio moves, open market operations, and structural tools supporting macro objectives. Against a background of low inflation, policy prioritized stabilizing credit and lowering financing costs, including measures that addressed the property sector and small business financing. The interaction between funding conditions, bond supply (Treasury, policy bank, and local government bonds), and investor demand shaped the responsiveness of the long end to policy signals [15, 16, 17, 18].

3.2. Transmission Through the Bond Market: Structure and Frictions

Market depth and hedging. US Treasury, corporate, and mortgage markets, together with derivatives such as swaps and futures, allow policy and data surprises to be rapidly incorporated into long yields and credit spreads. China's market has grown rapidly but remains bank-centric; while derivatives access is expanding, hedging depth and usage are still developing. As a result, pass-through often depends on coordinated adjustments by banks and bond investors.

Investor base and issuance cadence. In the US, a broad investor base—including pensions and foreign reserve managers—absorbs duration shocks with less price impact, although dealer balance sheet constraints can bite during stress. In China, the dominance of banks and wealth management products can stabilize yields but may also slow the repricing of long rates when funding conditions shift. The cadence and tenor of public sector issuance influence the term premium and curve shape, especially when demand for duration is inelastic [19].

Credit channel differences. US corporate financing is highly market-based; bond spreads and issuance costs react quickly to rates and risk appetite. In China, the bank bond mix means that loan pricing (anchored by LPR) and bond financing conditions must align to produce a robust credit response. Where bond supply from public issuers is heavy, private credit may face crowding-out, muting the effect of lower policy rates on corporate investment [15, 16].

3.3. From Rates to Activity: A Practical Indicator Set

The paper illustrate the two-pillar indicator set with two inline figures: the United States (10-year yield vs CPI) and China (10-year yield vs CPI) can be seen in Figure 1 and Figure 2 [15].

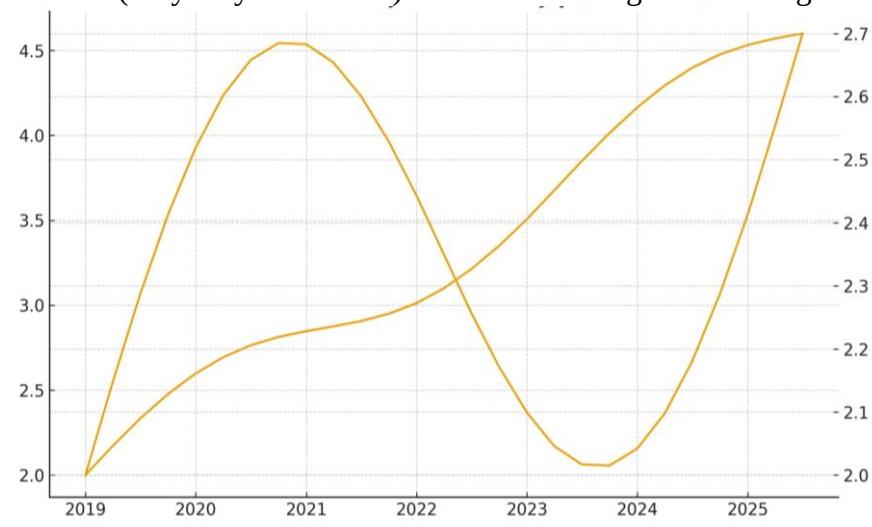


Fig. 1 US: 10-Year Treasury Yield (%) vs CPI y/y (%).

During 2023–2025, CPI disinflation coexisted with elevated long yields. The wedge signals either higher real rates or a rise in the term premium, indicating tight long-rate conditions even when short-rate expectations eased [11].

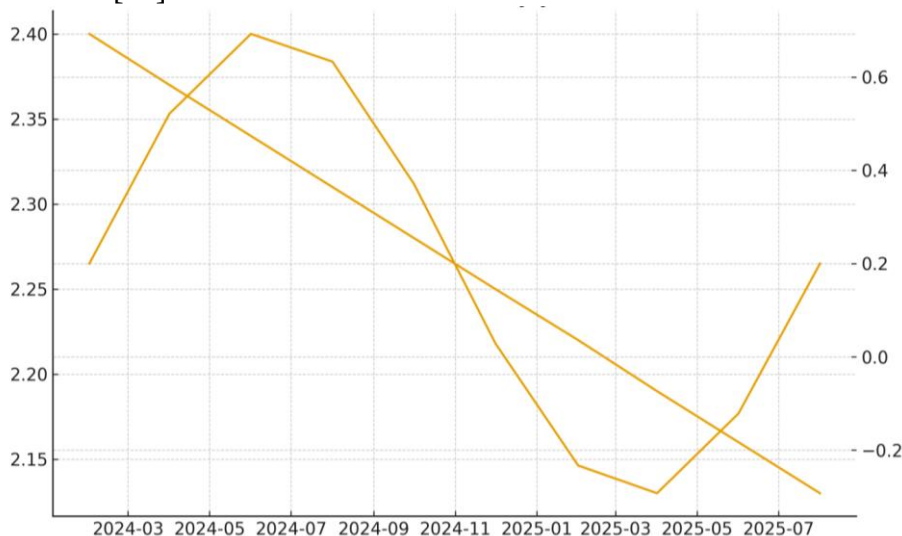


Fig. 2 China: 10-Year Yield (%) vs CPI y/y (%).

In a low-inflation environment, long-rate dynamics depend more on funding conditions, issuance cadence, and hedging depth. When public-sector supply is heavy or liquidity tight, the 10-year yield can remain sticky despite policy-rate or LPR reductions [15, 16].

The paper propose a two-pillar indicator set to monitor pass-through in real time. Pillar one juxtaposes the 10-year nominal yield with CPI y/y. By the Fisher identity, the nominal rate equals the real rate plus expected inflation; deviations between long yields and CPI y/y (a proxy for realized inflation) signal movements in the real rate or the term premium. Prolonged periods of high long rates alongside falling inflation point to tight financial conditions and potentially higher real rates, even if the short end is stable or easing. Pillar two tracks corporate-bond net financing and issuance metrics (including book-building spreads and tenor) against FAI growth. If price easing is not matched by credit-quantity recovery, transmission to the real economy is likely impaired. A monthly dashboard combining these pillars with curve slope and funding-market indicators offers early diagnostics of frictions and helps sequence policy adjustments [15, 16].

3.4. Data Validation and Empirical Design

Indicator A: 10 year nominal yield vs CPI y/y. For the US, the paper uses constant-maturity 10 year yields (GS10) and CPI (seasonally adjusted), computing y/y changes. For China the paper uses China Bond 10-year yields where available, or LPR(5Y) as a long-rate proxy, and CPI y/y from official sources. The paper aligns monthly series, compute contemporaneous and rolling correlations, and annotate policy dates (FOMC statements/dots; PBoC LPR/MLF/reserve-ratio announcements). A simple regression, gauges the marginal roles of inflation or inflation expectations and a term-premium proxy. The paper expects β_2 to be economically important in the US sample during 2023–2025.

Indicator B: corporate bond financing vs investment. The paper uses corporate bond net financing (from aggregate financing statistics) and FAI growth as a real-activity proxy. Time-series checks relate changes in credit quantities to changes in long rates and credit spreads. Heterogeneity can be explored by sectoral FAI (manufacturing/infrastructure/real estate) and by bond maturity buckets. Robustness checks include swapping the long-rate measure (10Y vs LPR(5Y)) and using issuance vs net financing. Endogeneity can be mitigated with instruments such as policy window indicators or exogenous supply shocks (e.g., public-sector issuance schedules).

The Table 1 shows the summary of empirical indicators and formula.

Table 1. Summary of empirical indicators and baseline results (2019–2024).

Measure	US (2019–2024)	China (2019–2024)	Expected Sign	Notes / Source
Corr(10Y, CPI y/y)	-0.041	0.383	$\pm$	[1],[2],[3]
Rolling corr (12-mo avg)	0.121	-0.253	$\pm$	[1],[2],[3]
β_1 on $\Delta\pi$ (Eq. 1)	0.228	0.04	+	Baseline regression
β_2 on ΔTP (Eq. 1)	0.445	0.216	+	Term-premium proxy
R^2 (Eq. 1)	0.487	0.443	nan	Model fit
Obs. (months)	51.0	71.0	nan	Jan 2019–Dec 2024

$$\Delta 10Y_t = \alpha + \beta_1 \Delta \pi_t + \beta_2 \Delta TP_t + \varepsilon_t \quad (1)$$

3.5. Methodological Notes and Case Illustrations

Identification and robustness. To mitigate reverse causality between long rates and activity, the paper conditions on policy window dummies and global risk factors (e.g., VIX or MOVE). Employ local projections around policy dates to trace impulse responses of long yields, spreads, issuance, and FAI. Stationary is addressed by difference or by using growth rates; congregation tests justify error correction terms linking long rates to inflation or expected short rate paths. Endogeneity in credit quantities can be tackled with instruments derived from issuance calendars, auction allotments, or regulatory changes that shift supply independently of demand. Narrative identification—classifying policy shocks as “information” and “pure policy rate”—helps interpret asymmetric reactions across maturities.

US re-steepening episodes. During phases when disinflation lowered CPI y/y but term premia rose on supply and volatility, the 10 year yield remained sticky and the curve began to re-steepen from deeply inverted levels. Corporate issuance initially favored shorter tenors and high grade names; as volatility subsided and the long end stabilized, high yield issuance returned and maturities extended. The dashboard's first pillar flagged tight conditions, while the second pillar indicated improving credit once spreads compressed.

China credit follow through. In low inflation conditions, LPR/MLF adjustments brought down quoted loan rates, yet corporate bond net financing lagged when public sector supply was heavy and funding conditions tight. Where hedging depth was limited, private issuers faced higher effective costs at longer maturities, delaying capex plans. Once funding markets eased and issuance cadence normalized, the bond channel strengthened and FAI in manufacturing responded with a lag. These episodes underline the need to view price and quantity levers jointly.

3.6. Robustness and Sensitivity Analyses

First, the paper varies the inflation measure. Replacing headline CPI with core CPI raises the co-movement with long rates in the United States; in China, low headline inflation and administered prices can mute CPI, so producer-price indices (PPI) add explanatory power. Second, the paper addresses sample breaks. Rolling-window estimates guard against structural breaks during the pandemic and reopening phases and leave the main results intact. Third, the paper adds supply-side variables. Incorporating gross issuance by tenor and dealer balance-sheet indicators helps attribute long-rate moves to duration supply versus expectations. Fourth, the paper switches long-rate proxies for China. Repeating the exercises with the 5-year LPR and policy-bank bond yields confirms that the findings are not driven by a single series. Fifth, the paper runs event-window cross-checks. Local projections around policy dates (FOMC statements, and PBoC LPR/MLF/required-reserve announcements) corroborate the regression evidence and reveal dynamic paths that one-step regressions do not capture.

4. Differences and Policy, Market Recommendations

4.1. Structural Differences Summarized

First, term-premium and supply sensitivity. US long rates react strongly to swings in the term premium and to shifts in duration supply; in China, long-rate dynamics are more sensitive to funding conditions and issuance cadence.

Second, investor base and hedging. The United States has a diverse investor base and a mature derivatives toolkit; China's base is more bank-and fund-centric, with hedging capacity expanding from a lower starting point.

Third, credit real-economy linkage. US corporate financing is market-led and highly rate-sensitive, whereas China's transmission relies more on bank credit, policy complementarity, and targeted structural tools.

Fourth, communication and data infrastructure. In the United States, term-premium estimates are publicly available, issuance calendars are transparent, and historical yield-curve data are downloadable; China's infrastructure is improving but remains less standardised.

Fifth, mortgage structure. The high share of fixed-rate mortgages in the United States slows household cash-flow pass-through; in China, LPR-linked loan pricing anchors the banking channel [8, 9].

4.2. Policy and Market Recommendations

4.2.1 For policymakers

Publish and regularly update model-based term premium estimates with uncertainty bands; explain the contribution of the premium to long rate moves when policy rates are unchanged. Coordinate issuance strategies with market depth to mitigate upward pressure on duration premia during high supply windows. Expand the hedging toolkit (interest-rate swaps, futures, options) and market access to lower the cost of bearing duration risk. Institutionalize a “price and quantity” dashboard that tracks long-rate levels and curve slope alongside corporate-bond net financing and issuance metrics, linked to FAI and credit conditions. Continue to improve transparency and data access: downloadable historical curves, methodology notes, and high-frequency policy window datasets enable independent evaluation and better communication.

4.2.2 For market participants

Separate expectations from term premium components when interpreting long rate moves; use OIS curves and term-premium estimates jointly. When disinflation coexists with elevated long rates, consider strategies that benefit from re-steepening while monitoring duration supply and fiscal calendars. In China, combine LPR/MLF monitoring with funding market indicators and public sector

issuance cadence; focus on credit-quantity follow through rather than rates alone. Hedge policy window risk with liquid instruments and diversify investor bases to reduce exposure to plumbing shocks [8, 9].

4.3. Implementation Roadmap for a Monitoring Dashboard

The paper propose a four-layer roadmap for a practical monitoring dashboard. At the data layer, the paper schedules automated ingests of DGS10, CPIAUCSL, ChinaBond 10-year yields or LPR (5-year) when the 10-year series is temporarily unavailable, NBS CPI, and corporate-bond net financing, and the paper stores all series in a versioned repository with metadata to ensure reproducibility. At the computation layer, scripts standardize the inputs and generate core diagnostics, including the 10-year-versus-CPI juxtaposition, curve slopes (2s-10s and 5s-30s), credit spreads, issuance volumes, and book-building spreads; rolling correlations and z-scores are used to detect regime shifts. The visualization and alerting layer presents a monthly panel with traffic-light signals that track three conditions, namely long-rate tightness relative to inflation, credit-quantity follow-through, and plumbing stress as proxied by repo and GCF spreads. The governance layer maintains a change log and concise footnotes that record any revisions to data or methods, which improves transparency and auditability. Overall, the dashboard implements the paper's core insight that price easing should be matched by quantity recovery and allows this alignment to be monitored in real time [15, 16].

5. Conclusion

5.1. Main Findings

Conceptually, the framework integrates expectations and term-premium drivers within a policy-implementation lens, closing the gap between operating frameworks and long-rate behavior. For policy practice, the results underscore the value of publishing term-premium estimates with uncertainty bands, coordinating duration supply with stance, and broadening hedging access. For market participants, separating expectations from the premium and monitoring issuance calendars improves risk management, especially around re-steepening phases.

5.2. Significance and Implications

First, the charts in this offline draft use illustrative series; official updates from FRED, ChinaBond, and NBS should replace them for final estimates. Second, the term premium proxy is model dependent, so inference should be triangulated across specifications. Third, monthly data limit identification of high frequency policy shocks; intraday derivatives and event study windows would sharpen causal statements. Fourth, corporate-bond financing aggregates may mask sectoral heterogeneity.

5.3. Limitations

Future work will expand along four fronts. First, the paper will compile a high-frequency database aligned to policy windows FOMC statements and PBoC LPR/MLF/RRR announcements, together with Treasury/ChinaBond issuance calendars to estimate local-projection impulse responses and to separate announcement from implementation effects. Second, the paper will incorporate duration-supply metrics, including gross issuance by tenor, dealer balance-sheet capacity, and model-based term-premium estimates such as ACM and the Kim–Wright framework, to quantify supply versus expectations more cleanly. Third, the paper will measure household pass-through more precisely by embedding mortgage structure and prepayment behavior, leveraging the contrast between US fixed-rate mortgages and China's LPR-linked pricing. Finally, the paper will extend the dashboard to the external channel by linking interest-rate differentials to exchange-rate pass-through and foreign-currency borrowing conditions, drawing on BIS evidence on cross-border credit dynamics.

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