UOB Economic-Treasury Research
Company Reg No. 193500026Z

Suan Teck Kin Suan.TeckKin@uobgroup.com

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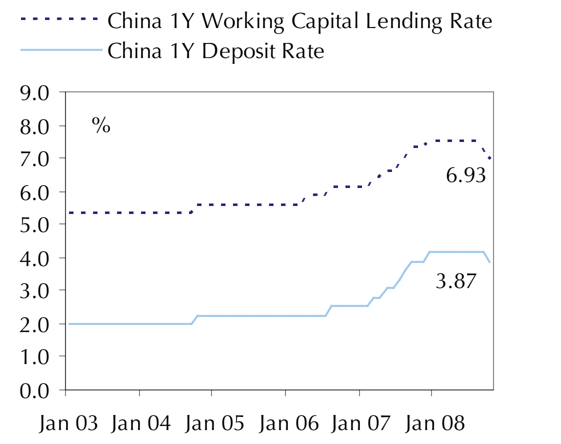
Flash Notes

China: PBoC's Rate Cut on 8 Oct

Following the joint global rate cuts led by the US Fed yesterday (8 Oct), the PBoC announced immediately its second round of interest rate cuts in the current easing cycle which started just about three weeks ago. This time round, PBoC's approach is more comprehensive, cutting both 1Y lending and 1Y deposit rates by 27bps each, to 6.93% (from 7.20%) and 3.87% (from 4.14%), respectively. The reserve requirement ratio (RRR) was cut by 50bps. Xinhua also reported tht China has temporarily shelved the 5% tax on interest income from individual savings account, which looks like an apparent step to make the cut on interest rate palatable for savers and reduce the risk of excessive spending.

One curious element of the latest policy announcement is that there are no official statements or discussions accompanying the rate decision. In addition, the US Fed's statement on the coordinated interest rate cuts also did not mention PBoC's move. These suggest that PBoC's decision could be a last minute one and was not part of the joint global efforts, and may also be conscious efforts on the PBoC's part to appear to be independent and to avoid the perception of panic. That aside, the speedy manner in China's interest rate decision suggests that its hands are being forced by the significant deterioration of global credit environment since Lehman Brother's bankruptcy a month earlier. On the domestic data front, there are indeed indications of softening. In particular, industrial production data which has been decelerating through the year. **As such, we expect at least another five interest rate reductions of 27bps each before middle of 2009, bringing the key 1Y lending rate to 5.58% by end-1H09.**

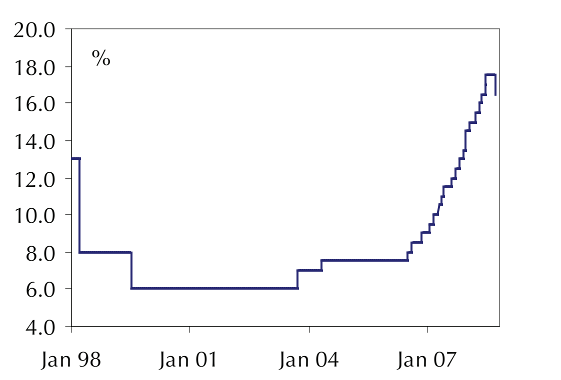
China: 1Y Lending and Deposit Rates



Source: Bloomberg, UOB

On the currency front, the impact on the RMB should be minimal as the PBoC maintains controls on both the FX and interest rate tools. This is important as the RMB movements will again serve as a guide for other Asian currencies during this volatile period, as it did during the Asian financial crisis in 1997/98 when Chian resisted calls for an RMB devaluation. This time round, we expect the RMB to maintain its stability amidst the heavy selling on Asian currencies as a result of flight to safety. It should be noted that the reversal of PBoC tight policy does not mean the RMB would depreciate, as what the current non-deliverable forward (NDF) prices are suggesting. It could simply mean a slower pace of appreciation, compared to the 6.9% rise in 2007. Indeed, the RMB has stayed relatively stable in 3Q09, after having risen 6.5% against the USD. Since October, the PBoC has maintained a steady pace of the RMB

China: Bank's Reserve Requirement Ratio



Source: Bloomberg, UOB

fixings despite sharp moves in the FX market. **We are maintaining our end-2008 RMB forecast at 6.70/USD (which we had already lowered from earlier forecast of 6.80). For 2009, we are still looking for moderate upside of 3% for the RMB, with end-2009 projection at 6.50/USD (from our earlier call of 6.37).**

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