

## China: Third Interest Rate Cut in 7 weeks

China cut interest rates late yesterday (Wed 29 Oct) for the third time in less than two months (the previous 2 moves were on 8 Oct and 15 Sep), lowering the benchmark 1Y lending rate by the usual 27bps, to 6.66% and the 1Y deposit rate by 27bps to 3.60% from 3.87%. The latest cut by PBoC was timed just hours ahead of the US Fed FOMC decision, which incidentally lowered its Fed funds target rate by an expected 50bps to 1.00%, as well as BoJ's MPC decision on Fri.

The PBoC's third interest rate reduction this year was in response to slowing domestic growth ahead (which we expect to slow to 8.3% from about 9.5% in 2008) and another step in easing credit conditions to boost domestic demand. While external demand is expected to slow given the pullback in consumer demand in G3 economies, further weighing on the export sector is that the current global credit crisis has hampered trade activities as the deleveraging process is hitting corporate sector as well.

With growth risks weighing heavily toward the downside, there is a risk that the PBoC may make another interest rate reduction before end-2008. The PBoC is likely to move based on mainly domestic considerations from now on rather than according to the FOMC schedule, as the US Fed is increasingly "running out of bullets" in terms of interest rate policy, with its Fed funds target rate already at 1.00%. We are keeping to our view of 4 more 27bps reductions are forthcoming before mid-2009, bringing the 1Y lending rate to 5.58% and 1Y deposit rate to 3.60% by end-2Q09. While the PBoC did not reduce the banks' reserve requirement ratio (RRR) this time, there is plenty of room in this space given that most of tightening process in the past 2 years has been through the RRR. We should see more frequent RRR cuts in the months ahead although outright removal of credit quota may be another tool PBoC would use. For now, we continue to see at least another 50bps cut to the RRR before end-2008, bringing the ratio to 15.5%, and 4 additional cuts in the first half of 2009 to bring the ratio to 13.5%.

