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Macro Note

China: PBoC Makes Targeted Reserve Requirement Ratio Cut

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- PBoC makes its first RRR cut since Feb 2016, with an unusually large 100bps that will release around RMB1.3tn of liquidity.
- The move should not be seen as a shift away from PBoC's current "prudent and neutral" policy, as the newly released funds will be partially used to repay banks' MLF borrowings, and the remainder is to support small and micro enterprises. The central bank may also be taking a pre-emptive step in case of any escalation in the ongoing US-China trade tensions.
- As there is still plenty of room for PBoC to lower RRR further, if necessary, China's market sentiment, is expected to be boosted by this latest move.

First RRR Reduction Since 2016 And For New Governor

Despite a generally positive 1Q18 GDP report released earlier in the morning, China's central bank PBoC announced late Tue (17 Apr 2018) that it will reduce banks' reserve requirement ratio (RRR) by an unusually large 100bps, effective 25 Apr 2018. PBoC reiterated its "prudent and neutral" policy stance in the statement.

The move will lower RRR for large banks from 17% to 16%, and for small and medium banks, from 15% to 14%. This cut applies to deposits held at large commercial banks, joint-stock commercial banks, city commercial banks, non-county-level rural commercial banks and foreign banks.

According to the central bank, this targeted cut is partly aimed at the repayment of medium-term lending facility (MLF) loans from PBoC on that same day (25 Apr 2018).

The 1% point reduction in RRR could release about RMB1.3 trillion of additional liquidity, but about RMB900 billion of the released funds will be used to repay the MLF. This means a net injection of RMB400 billion liquidity, the bulk of which will go to smaller institutions.

This is first RRR cut since Feb 2016, when the main RRR for large banks was lowered by 50bps to 17%, and the first for newly appointed Governor Yi Gang.

Not A Shift In Monetary Policy Stance

Despite the more aggressive move of 100bps, it should not be seen as an outright shift away from the central bank's current "prudent and neutral" policy stance.

First, PBoC has made clear that the extra liquidity from this targeted RRR reduction is to be used to provide financing to small and micro enterprises, which are still facing funding and borrowing costs challenges. PBoC also added that lending to small and micro enterprises would be included as a requirement in its macro-prudential assessment (MPA) for banks.

Second, the fact that the RMB900bn under the MLF is to be repaid means that the banking system's overall balance sheet will be reduced by the same quantum, which is consistent with the authorities' deleverage and risk prevention approach. The difference in this case is that, instead of a corresponding RMB900bn reduction in loans and/or liquidation of assets, the repayment will be through reserves released from the RRR cut. This will help ensure sufficient liquidity and stability in the banking system and the broader economy.

Finally, despite a largely positive 1Q18 GDP report released just hours earlier (for more details please refer to "China: 1Q18 Growth In Line With Expectation", 17 Apr 2018), the move appears to be a pre-emptive step ahead of any potential deterioration in the US-China trade tensions, by keeping liquidity stable and the banking system well funded.

In the event of a "trade war" breaking out, there is still plenty of room for PBoC to lower RRR further, since at 16%, it is still well above the record low of 6%, last seen in 2003. Instead, China's market sentiment, especially for investors in equity and bond market, is expected to be boosted by this move.

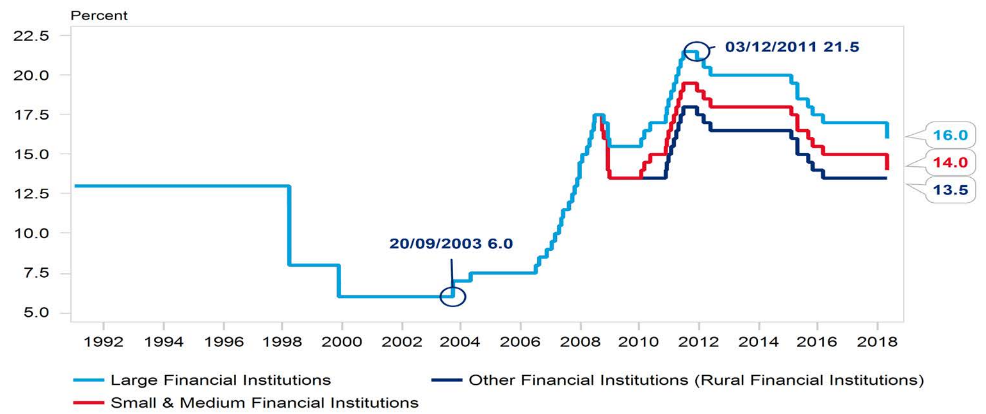
Other than the above, we expect that the net liquidity injection of RMB400 billion to dampen upward pressure on interest rates until the next interest rate move, if any. We reiterate our call that there is still likelihood for PBoC to raise its policy rates (1Y lending and 1Y deposit rates) by 25bps before end-2Q18 as the US Fed continues with its rate hike trajectory.

As for the RMB, we keep our existing USD/ CNY forecasts at 6.35 in 2Q18, 6.40 in 3Q18 and 6.45 in 4Q18. This is in line with our view for two more US Federal Reserve rate hikes for the rest of this year (For further details, please refer to "Is Current CNY Strength Justified?", 3 Apr 2018).

PBoC Announcement:
中国人民银行决定下调部分金融机构存款准备金率以置换中期借贷便利 17 April 2018 http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/3522107/index.html

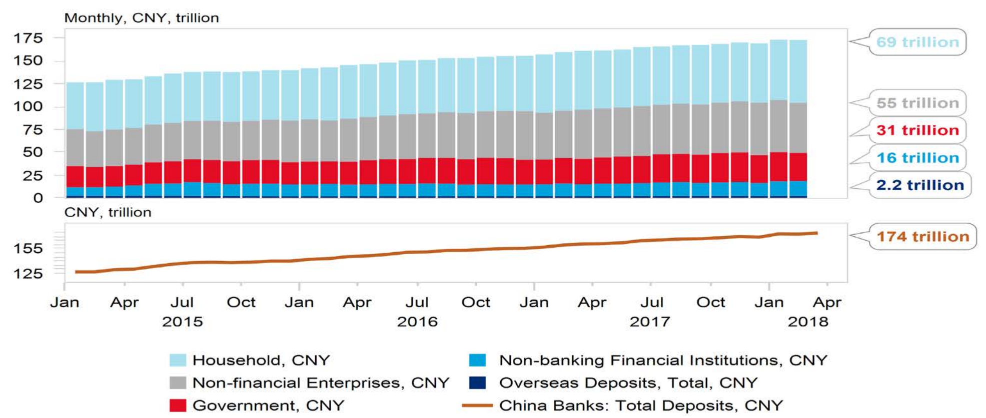
China: Banks' Reserve Requirement Ratio (RRR)

Source: Macrobond, UOB Global Economics & Markets Research



China: Banking System Deposits By Source

Source: Macrobond, UOB Global Economics & Markets Research



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