

# PBoC's Monetary Policy Tools

## A Quick Guide

China's monetary policy is targeted at multiple objectives such as economic growth, inflation, financial stability, exchange rate and credit growth amongst others. Changing economic situations mean that its priorities change as well. As such, the People's Bank of China (PBoC) uses multiple tools to achieve its monetary policy objectives.

The central bank has been responding to increasing downside growth risks amidst China's dynamic zero-COVID policy, slowing external demand, higher global inflation and the prolonged downturn in the domestic property market. We continue to see scope for further monetary policy easing given the mild inflation backdrop in China to-date but aggressive rate cuts are unlikely as the central bank has repeatedly ruled out "flood-like" stimulus while lower rates are failing to spur credit demand due to the weaker outlook.

In China's case, the presence of large state-owned banks also allows PBoC to achieve its intended monetary policy by guiding these financial institutions to increase/decrease the issuances of credit to meet the financing requirements of the real economy as well as enhancing financial support for key areas and weak links in the economy.

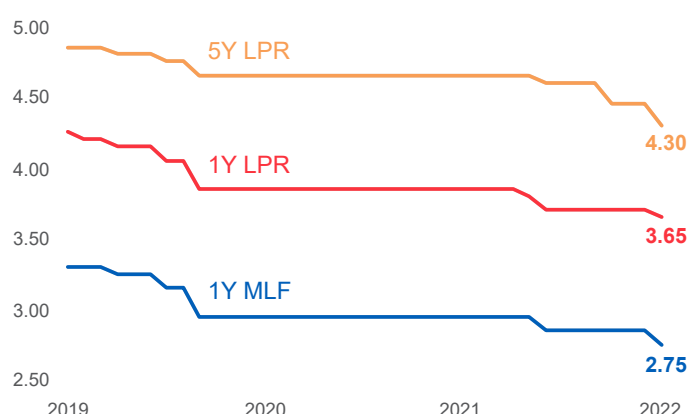
Below are some of the key instruments used by the central bank to manage the money supply and interest rates in the Chinese economy.



### Loan Prime Rate (LPR)

- first announced in 2013 and revamped in 2019 as the market-based benchmark for loans
- set monthly based on quotes from 18 panel banks
- 5Y LPR - reference rate for longer term lending to companies and homebuyers
- we expect the 1Y LPR to fall by another 10bps to 3.55% by end-4Q22 and 5Y LPR is still poised to fall further as PBoC extends support to the property market
- 1Y LPR cuts ytd - 15bps
- 5Y LPR cuts ytd - 35bps

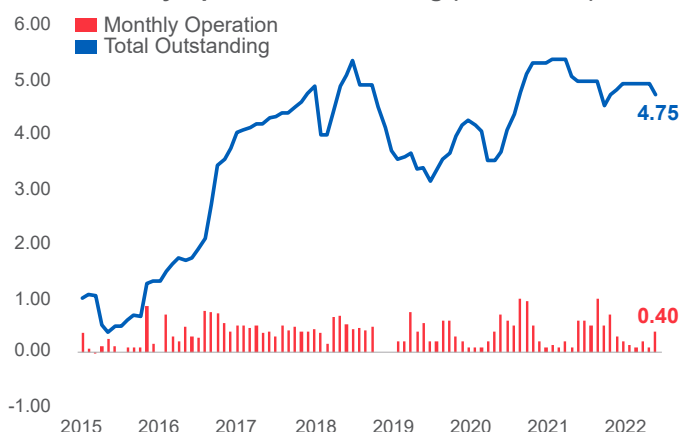
LPR / MLF (%)



### Medium-Term Lending Facility (MLF)

- introduced in 2014
- the main rate at which PBoC lends to big commercial banks with securities as collateral
- the 1Y MLF acts as a guide for the 1Y LPR and is thus the main medium-term policy benchmark
- PBoC has cut the 1Y MLF twice this year, by 10 bps each in Jan and Aug, we expect another 10bps cut in 4Q22
- 1Y MLF cuts ytd - 20bps

MLF - Monthly Operation/Outstanding (CNY trillion)





## Standing Lending Facility (SLF)

- introduced in 2013
- central bank's emergency-funding facility to commercial banks
- banks can obtain funds with shorter maturity typically from overnight to 1 month
- for this framework, banks need to offer assets with high credit ratings as collateral as compared to the MLF
- the rate is considered the upper bound of China's interest rate corridor
- latest policy action - Jan 2022
- SLF cuts ytd - 10bps



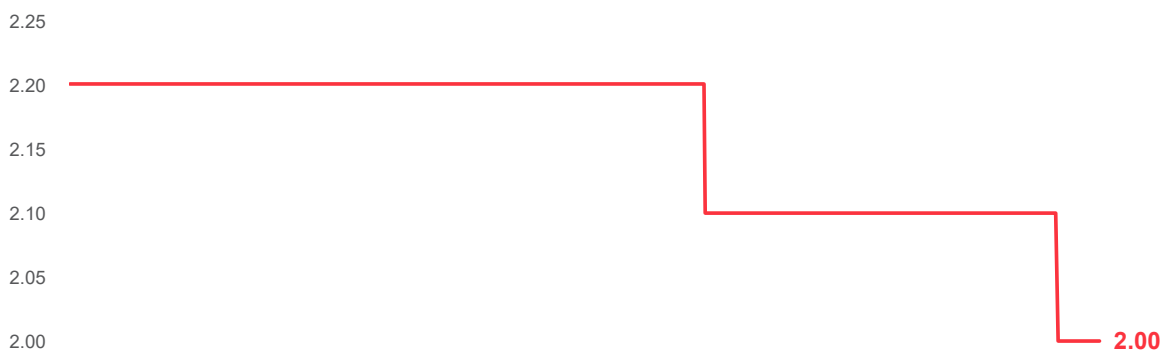
## Open Market Operations (OMO)

- allows the central bank to control money supply and interest rates on a short-term basis
- PBoC removes liquidity through the sale of repurchase agreements and injects liquidity via reverse repurchase
- assets offered on time frames ranging from 7 to 28 days
- the 7D reverse repo rate was cut by 10bps each time in Jan and Aug to 2.00% currently
- 7D reverse repo rate cuts ytd - 20bps

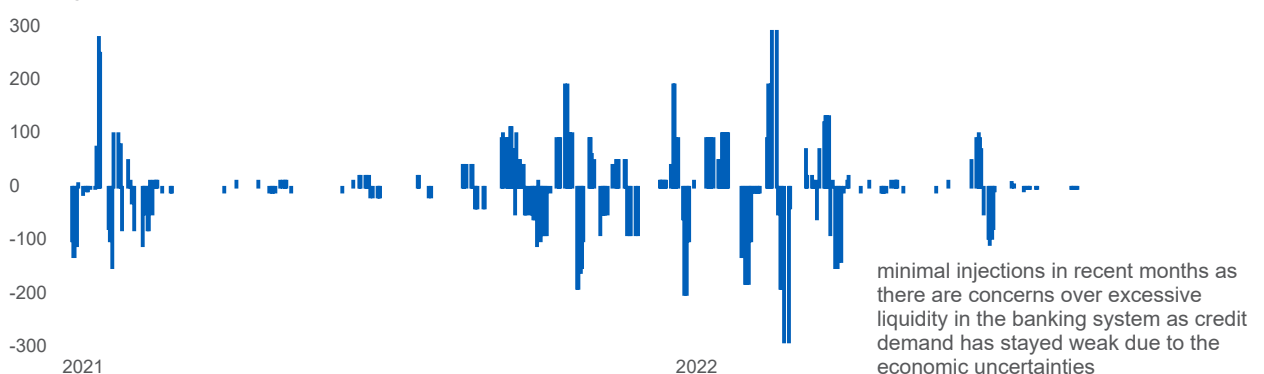
7D China Interbank Repo Rate (%)



7D Reverse Repo Rate (%)



Net Injections (CNY billion)

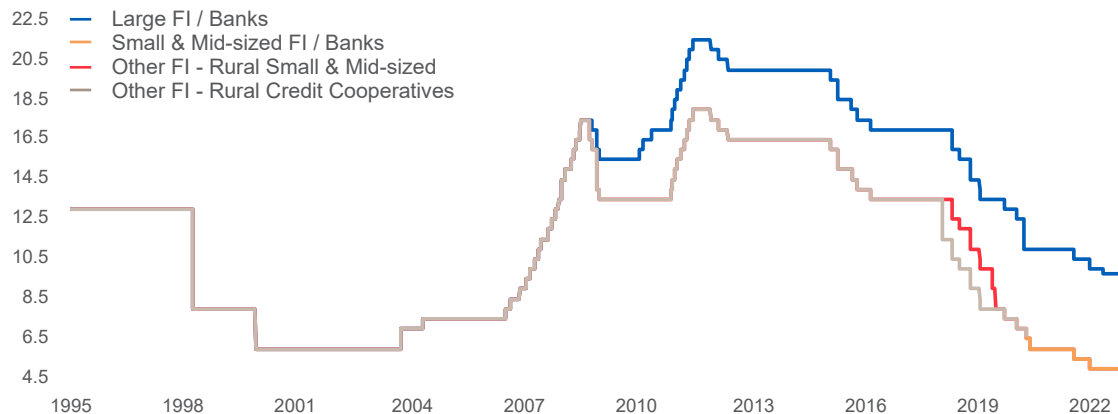




## Banks' Reserve Requirement Ratio (RRR)

- refers to the amount of reserves a bank is mandated to keep as a proportion of its total deposits
  - a major component of the monetary policy toolbox since mid-2000s
  - quantitative instrument to control liquidity in the financial system e.g. an RRR cut releases more liquidity for bank lending
  - the lowering of banks' RRR is aimed at the following objectives:
    1. optimize the funding structure of the financial institutions as it increases the long-term funding source and enhance financial institutions' capital allocation capabilities;
    2. guide financial institutions to use the funds from the RRR cut to increase support to small, medium and micro enterprises
    3. promote reduction of comprehensive social financing costs
- latest policy action - Apr 2022
- RRR cuts ytd - 25bps

### RRR (%)



## Foreign Currency Reserve Requirement Ratio (FC RRR)

- refers to the amount of foreign currencies that a bank needs to keep as reserves as a proportion of its foreign currency deposits.
  - helps to regulate foreign currency liquidity and thus stabilizes the foreign exchange market's expectations e.g. PBoC cuts FC RRR to release more foreign currency liquidity into the onshore market to ease pressure on the CNY depreciation
  - important signaling tool used by the PBoC during extreme moves in the CNY
- latest policy action - Sep 2022
- FC RRR cuts ytd - 300bps

### FC RRR & USD/CNY





## Rediscount and Re-lending Facility

- re-lending refers to lower cost loans issued by the PBoC to financial institutions that are targeted for specific uses such as loans provided to farmers, small businesses and projects that help alleviate poverty, or pandemic relief as well as for green development and the innovative sectors
- re-lending for 3-month, 6-month, and 1 year
- through the rediscount window, the central bank accepts loans and other bank obligations as collateral

### Rediscount & Re-lending Loans Outstanding (CNY trillion)



### Comparison of PBoC Monetary Policy Framework

	<u>PBoC</u>	<u>Advanced Economy Central Banks</u>
<b>High Level Objective(s)</b> (mandate)	<b>Multiple objectives:</b> price stability, economic growth, employment and broadly maintaining balance of payments; financial reform & opening up, and financial market development	<b>Single, dual or triple mandate</b>
<b>Intermediate Target(s)</b> (nominal anchor)	1) Inflation 2) M2 3) Total social financing (TSF) 4) Credit to MSEs 5) Exchange rate	1) Inflation
<b>Operational Target(s)</b>	1) Monetary base 2) 7D interbank repo rate 3) Loan prime rate (LPR)	1) Overnight cash rate target 2) Reserves / asset purchases
<b>Primary Instrument(s)</b>	1) PBoC 7D repo rate in corridor system 2) Open market operation 3) Benchmark lending/deposit rates 4) Lending facility rates, notably MLF rate 5) Required reserve ratio (broad & targeted)	1) Open market operations: corridor system 2) Administered rates: floor system



Source: IMF Working Paper - Monetary Policy Transmission and Policy Coordination in China

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