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Flash Notes

China: Deposit Insurance Scheme On Track

- PBoC announced last Sunday the draft regulations for a deposit insurance scheme, which is likely to be implemented in 2015 along with further interest rate cuts
- This announcement suggests that the government is on track to accelerate financial market reforms after it removed lending rate controls in July 2013
- The deposit insurance system should result in better reflection of the "true" financing costs and lowering of systemic risks in the financial sector over the mid-to-long term. We expect no material change to our growth and FX forecasts for the next one year

Draft Deposit Insurance Regulations Announced

China's central bank PBoC released on Sunday (30 Nov) draft regulations on deposit insurance, requesting for public feedback within 30 days, as the country takes its final steps towards implementing a scheme that has been in discussion since 1993. The latest announcement shows that the government's market reform plan remains on track and is taking yet another step towards the opening of its capital account as well as improving the transparency and stability of the financial system, as smaller financial institutions will have a better chance in competing for customers' deposits.

PBoC's surprise interest rate cuts announcement on 21 Nov already hinted at more reform measures ahead, as it also lifted deposit interest rate ceiling at that time to 1.2x of benchmark rate, from 1.1x previously. Once deposit insurance is in place, which is likely to be around the first half of 2015 given the 30-day feedback window. By then the ceiling on deposit interest rate will also go the way of the lending interest rate floor, which was abolished on 20 July 2013, or nearly one and half year ago.

After the surprise move on 21 Nov from PBoC, we expect another round of interest rate cuts along with the implementation of deposit insurance scheme in 2015, with cuts to both deposit and lending rates, as well as cuts in reserve requirement ratios (RRR) in the first half of next year.

Market Reform Pace Accelerating

As we mentioned back in April (please see our report "China: Pushing Ahead Financial Sector Reforms" dated 30 April 2014), The pace of financial market reform in China has taken on greater urgency under the administration of Xi Jinping/Li Keqiang. After allowing the establishment of privately owned banks with private capital to promote the opening of the sector after the 18th session of the Third Plenum, PBoC was already working on an accelerated schedule to set up a deposit insurance scheme.

A deposit insurance scheme is a key component in China's ongoing financial sector reform as it will form a bedrock of consumer confidence once the financial system is open to freer capital flows. Such a scheme should also improve transparency and strengthen the stability of the financial system, and making it less vulnerable to shocks. This is because smaller institutions will have a better chance in competing for deposits and also allow for the spreading out of the deposit base, which would otherwise bias towards the largest institutions that are perceived to be the "safest". Without a deposit insurance scheme, one potential risk is that smaller financial institutions are more exposed to deposit runs given that there is generally less confidence due to their size. But at the same time a high concentration of deposits in the largest institutions could also raise the risks of the entire system (i.e. "systemic risk") should these financial institutions fail for some reason. Thus a healthy development of smaller financial institutions will actually help to lower systemic risks and overall funding and credit costs, and to reach the small and medium enterprise (SME) and agricultural sectors, which are generally not as well served by larger institutions.

According to the Q&A accompanying PBoC's announcement, the proposed deposit insurance scheme will insure deposits of up to RMB500,000 (approx. US$81,400) for both individual and corporate depositors, an amount equivalent tot 12x China's per capita GDP in 2013, according to PBoC. This ratio is relatively high compared to the typical insured range of 2-5x of per capita GDP, e.g. the ratio of 5.3x for the US, 3x for the UK, 2x for South Korea, and 1.3x for India, with the rationale being that China is a high savings country, PBoC said. Based on its calculations, it is expected the insured amount of RMB500,000 would cover 100% of deposits for more than 99.5% of all depositors, including corporate depositors.

As a comparison, the table below shows various deposit insurance schemes in the Asia Pacific region, with India's being the oldest in Asia and the insured amount the smallest in absolute amount, consistent with the per capita measure as pointed out by PBoC in its Q&A.

Comparison of Deposit Insurance System Across Asia Pacific

Jurisdiction	Established / Operationalized	Type of system	Insured amount (local currency)	USD equivalent (current exchange rate)
Australia	1998	Government legislated and administered	AUD $250,000	231,850
Brunei	2011	Government legislated and privately administered	B$50k per depositor per institution	39,825
Chinese Taipei	1985	Government legislated and administered	NTD3 million	99,438
HK	2006	Government legislated and privately administered	HK$500,000 per depositor (individual or business entity) per bank	64,488
India	1962	Government legislated and privately administered	INR100,000 per depositor in same capacity and same right.	1,655
Indonesia	2004	Government legislated and privately administered	IDR 2 billion	174,000
Japan	1971	Other Government legislated.	Single Accounts=JPY 10 million	97,440
Korea	1996	Government legislated and administered	KRW 50,000,000 per depositor, per institution	48,500
Malaysia	2005	Government legislated and administered	RM250,000 per depositor per institution	76,717
Philippines	1963	Government legislated and administered	PHP 500,000 per depositor per institution	11,245
Singapore	2006	Government legislated and privately administered	S$50,000 (per depositor per institution)	39,824
Thailand	2008	Government legislated and administered	Baht 50,000,000 per depositor per institution*	1,550,550
Vietnam	1999	Government legislated and administered	50 million VND	2,350

* The 50 million baht coverage will be implemented until 10 Aug 2015 before lowering to 25 million baht during 11 Aug 2015 to 10 Aug 2016. The 1 million baht coverage as stipulated by the Act, will be implemented from 11 Aug 2016 onwards.
Source: International Association of Deposit Insurers (http://www.iadi.org/di.aspx?id=168), UOB Global Economics & Markets Research Estimates

Implications

After percolating for more than 20 years, the imminent implementation of a deposit insurance scheme is a right direction for China's financial sector in the mid to long term towards a healthier and more resilient system, and the draft regulation suggests that PBoC remains on track. As we expect the ceiling for deposit interest rate to be removed about the same time of the implementation of the deposit insurance, banks' margins will be compressed further as interest rates are fully liberalized and subject to fiercer competition. This should help to reflect the "true" funding costs for the system, thus allowing for a more proper allocation of credit.

In the near term however, such a scheme is not expected to have any significant effect on the broader economy. We continue to maintain our projections of 7.4% for 2014 (with 7.4% expansion already achieved in the first three quarters of 2014) and 7.5% for 2015. While we believe that the somewhat more accommodative monetary policy would keep China's economic growth on track, downside risks to our growth projections for 2015 remain significant.

As mentioned earlier, we also anticipate interest rate and RRR cuts to be announced along with the expected implementation of deposit insurance in the first half of 2015. Below is our table of forecasts for interest rates and RRR to 2015.

China: Interest Rate and RRR Forecasts

Indicator	4Q14	1Q15	2Q15	3Q15	4Q15
1-year Best Lending Rate	5.60%	5.35%	5.10%	5.10%	5.10%
1-year Deposit Rate	2.75%	2.50%	2.25%	2.25%	2.25%
Reserve Requirement Ratio	20.00%	19.50%	19.00%	19.00%	19.00%

Source: UOB Global Economics & Markets Research

Our expectations remain that there is little room for appreciation for the RMB going into 2015, and instead more two-way volatility should be expected for the currency with the US Federal Reserve poised to "normalize" interest rates. We maintain our end-2014 USD/CNY forecast at 6.10, and at 6.03 for end-2015, keeping in mind the possibility of bouts of depreciation for the currency as PBoC accelerates financial market reform and RMB internationalization.

For further details:

Deposit Insurance Regulation (Draft)
存款保险条例（征求意见稿）
http://www.pbc.gov.cn/publish/main/527/2014/20141130165955327719569/20141130165955327719569_.html

Rationale For Deposit Insurance (Draft)
中国人民银行关于《存款保险条例（征求意见稿）》的说明
http://www.pbc.gov.cn/publish/main/527/2014/20141130170627847426506/20141130170627847426506_.html

PBoC's Q&A on Deposit Insurance Scheme
存款保险知识专家问答
http://www.pbc.gov.cn/publish/main/527/2014/20141130171434519357762/20141130171434519357762_.html

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