

China: A Bold RRR Reduction

A Larger-Than-Usual 100bps Move

PBoC announced late on Sunday (19 Apr) a one percentage point cut, or 100 basis points, in the reserve requirement ratio (RRR) for large banks to 18.5% from 19.5%, effective Monday. PBoC last lowered the RRR in Feb 2015, the first across the board reduction since May 2012, and by the usual 50 basis points or half a percentage point. This time round, the 100bps reduction is the largest since late 2008.

The latest move is estimated to free up an additional RMB1.2tn funds that banks can now lend, with total bank deposits at RMB124.89tn as at end-March 2015. PBoC also announced additional reserve reductions, which included an extra 100 bps cut in the RRR to commercial banks for agricultural services, and an additional reduction of 200bps to the Agricultural Development Bank of China. Further, the central bank also lowered RRR by another 50bps for eligible banks that lend a certain amount of money to agricultural borrowers or to small and micro businesses, which should release an additional RMB300bn in funds.

Implications

While we had anticipated a supportive move from the central bank since the release of a largely disappointing 1Q15 GDP report last Wed, the larger magnitude of the 100bps reduction (instead of the usual 50bps) in headline RRR on Sunday suggests heightened concerns over the underlying data, which are at its weakest during the 2008/09 period, and to ensure that the growth rate this year to stay around the 7% target.

To recap, China's 1Q15 real GDP growth slowed to 7.0%/y from 7.3% in 4Q14, marking the worst result in six years. More alarming is the sharp deceleration in industrial output and retail sales in March, while the figure for fixed asset investment also weakened in 1Q15.

In addition to the slowing economic activities, capital flows leaving China also added complications to the PBoC, and it is the other key reason for such a major move on the RRR to offset such outflows. One gauge of capital flows, yuan positions on the central bank's balance sheet, declined by a record RMB252.1bn in 1Q15 and extending the trend since late last year, which further tightened domestic liquidity conditions.

No sooner than the ink dried (or trending slowed) on PBoC Governor Zhou Xiaochuan's comments that China has scope to ease its monetary policies though won't necessarily take advantage of it (during the IMF/WB Spring Meetings session in Washington DC over the weekend), a larger-than-usual 100bps cut in RRR happened. **As such, we now see there are risks of another 50bps reduction in RRR in the months ahead**, conditional on data showing further downtrend and capital outflows continuing. We do see broader economy to stabilize especially in the second half of 2015 as well as the RMB holding steady, pressures for capital outflows are also likely to ease off in the coming months. However, concerns about costs of funding would be addressed through interest rates and **we still see scope for another round of cuts in interest rates, possibly before the end of 2Q15, as the deposit insurance system begins on 1 May 2015.**

With an eye on the IMF review of Special Drawing Rights (SDR) to be completed by end-2015, risks are tilted towards the upside on the RMB exchange rate, although this is offset by unfavourable domestic economic conditions and a strong USD on the external front. **We continue to expect USD/RMB exchange rate at 6.22 for end-2Q15, and at 6.2040 for end-2015 (Friday 17 Apr close: 6.1978), though one should be mindful of large swings in the currency** as it increasingly becomes driven further by market factors. We also maintain our view that a band widening could still take place this year.

China: Interest Rate and RRR Forecasts						
%	1Q15	2Q15F	3Q15F	4Q15F	1Q16F	2Q16F
1-year Best Lending Rate	5.35	5.10	5.10	5.10	5.10	5.10
1-year Deposit Rate	2.50	2.25	2.25	2.25	2.25	2.25
Reserve Requirement Ratio	19.50	18.50	18.00	18.00	18.00	18.00

Source: UOB Global Economics & Markets Research Estimates

Link:

PBoC's Reserve Requirement Ratio Reduction Announcement (19 April 2015)

中国人民银行决定 继续普降存款类金融机构存款准备金率 并有针对性地实施定向降准措施

<http://www.pbc.gov.cn/publish/goutongjiaoliu/524/2015/20150419165818249314312/20150419165818249314312.html>

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