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Flash Notes

China: PBoC Enhances Its Monetary Policy Toolbox

Expanding Assets Eligible For Re-lending

In a low-key release over the weekend, on 10 Oct, PBoC announced that it is expanding its pilot program for banks' assets eligible for re-lending further to include 9 additional provinces/cities, including Shanghai, Tianjin, Liaoning, Jiangsu, Beijing, Chongqing, among others, building on the pilot locations of Shandong and Guangdong that began in 2014. These collaterals will be subjected to rating assessments by PBoC (both for the banks and the pledged assets), which would then take the qualified loan assets as collaterals, and with discounts, and release funding to the banks for re-lending, similar to a factoring operation.

This is an expansion of the central bank's liquidity management toolbox from higher quality collaterals previously, such as government bonds, local government bonds, among others, to corporate loans on banks' books. In its statement, PBoC noted that this is an enhancement of the asset pool qualified for collaterals to improve the effectiveness and flexibility of policy operation, solve the problem of banks' not having sufficient qualified assets for re-lending, (and more importantly) guide lending towards agricultural and small-medium enterprises (SME) sectors.

A Chinese QE?

Many will be quick to jump at the latest announcement as another sign that China is expanding its QE (quantitative easing) program, similar to those by central banks in the US, Europe, and Japan had done or are doing. While it looks the part, the details do not show that it is a case of "China style QE".

As explained in our article in June this year (please see links below), PBoC's latest announcement is closer to that of ECB's Long Term Refinancing Operations (LTRO) to a certain extent, than to QE, which generally requires a prescribed size of large scale asset purchase (LSAP) program over a set calendar period to expand the central bank's balance sheet. There are two reasons that this is not a China-style QE: 1) China's monetary policy is already quantitative in nature as it sets a growth target for M2 money supply (12% target for 2015); and 2) PBoC is more than capable of executing a QE-like program through reserve requirement ratio (RRR) policy, to provide broad-based liquidity into the system. Even the LTRO comparison is not entirely correct as China's banking system is not facing liquidity crisis, which was the backdrop when ECB launched its LTRO program.

Clearly it is not the case for QE in China's refinancing or re-lending programs including this latest one and earlier ones such as PSL (pledged supplementary lending; 抵押补充贷款) program, MLF (Medium-term Lending Facility, 中期借贷便利), SLO (Short-term Liquidity Operations, 公开市场短期流动性调节工具), SLF (Standing Lending Facility, 常备借贷便利).

This alphabet soup of programs are aimed at providing "targeted" liquidity to the banking system, which is not at this moment facing a liquidity crunch, and also at directing bank lending to sectors that PBoC deemed important, and at the same time influencing the lending rates. Instead of unleashing a torrent of liquidity to the system via RRR, PBoC uses these facilities for selective objectives. It is more of the case of what Premier Li Keqiang had repeatedly called for, i.e. making better use of existing resources instead of continuously pumping in new resources or stimulus ("用好增量 盘活存量").

For instance, the RMB1tn PSL for China Development Bank in July 2014 was targeted at rebuilding of slum areas, and the lending rate would then be the benchmark rate. For this past weekend's announcement, the targeted sectors are agricultural and SME sectors, which left to their own, are largely shunned by most commercial banks.

Negligible Impact On RMB

For those who believe that this is yet a further sign of China-style QE, there is obviously negative impact on the currency, just like what QE did to the EUR and JPY earlier. The logical conclusion would be that there is further depreciation pressure on RMB ahead.

As we argued above, the latest announcement is merely a further refinement of PBoC's toolbox of liquidity management and not a China-style QE in the making, which could simply be achieved through its money supply target and/or through RRR. As such, we do not see any significant impact on the RMB based on PBoC's latest announcement, and will also reduce the risks of an immediate RRR cut.

As such we still see a fairly low probability for a large scale or prolonged depreciation of the RMB, at least not in the next few months. However, as the RMB becomes more market-determined and flexible, we should expect more two-way fluctuations of the RMB as it responds to market developments and news, and therefore the increased importance to manage FX and market risks.

With the IMF/World Bank annual meetings just concluded over the weekend, the Special Drawing Rights (SDR) decision will be in focus into Nov 2015, and we should anticipate further market/capital account opening and liberalization measures, such as RMB band widening, among other measures, to surface in the weeks ahead.

An SDR decision in favour of China should be positive for the RMB, and we are still pegging such probability at 60%. We maintain our end-2015 RMB forecast at 6.50/USD, and at 6.56/USD for end-2016, as the uncertainty over US Fed rate "liftoff" could keep the USD supported.

Links
人民银行推广信贷资产质押再贷款试点 10 Oct 2015
http://bit.ly/pbc-20151010-refi

China: Market Liberalization Measures Update, 4 Jun 2015
http://www.uobgroup.com/assets/pdfs/research/Flash_150604A.pdf

中国 : 市场自由化的最新举措, 5 Jun 2015
http://www.uobgroup.com/assets/pdfs/research/Flash_150605.pdf

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