Suan Teck Kin, CFA
Suan.TeckKin@uobgroup.com

Global Economics & Markets Research
Email: GlobalEcoMktResearch@uobgroup.com
URL: www.uob.com.sg/research

Wednesday, 25 January 2017

Flash Notes

China: MLF Rate Hike Signals PBoC Tightening Bias

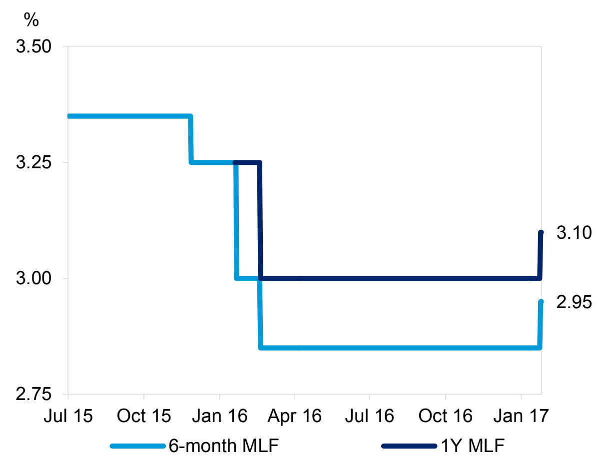
First MLF Rate Hike Since Feb 2016

PBoC on Tue (24 Jan) lifted lending rates for its 6-month and 1-yearMedium-term Lending Facility (MLF), the first such action since Feb 2016, effectively ending the period of easing between Nov 2015 and Feb 2016. The lending rate for 6-month MLF was increased to 2.95% from 2.85%, while the 1Y tenor was hiked to 3.1% from 3.0%. The operations on Tue added a total of RMB245.5bn funds to 22 financial institutions, including RMB138.5bn in 6 months and RMB107.0bn in 1Y tenor.

Elevated Market Interest Rates Ahead

While the increase appears to be insignificant at just +10bps, this is considered the first "interest rate hike" in 6 years, when PBoC raised its 1Y lending rate on 20 Oct 2010. It is a way for the central bank to signal to the market of its policy stance, considering the fact that MLF and other policy tools have been established as part of PBoC's monetary policy reform framework. The timing is important, in view of the record weekly open market operations (OMO) net injection just a week before, and the announcement over the weekend of the establishment of "Temporary Liquidity Facility" (TLF) and reported reserve requirement ratio (RRR) cut for the Big 5 banks.

China: MLF Interest Rates



Source: Bloomberg, UOB Global Economics & Markets Research Est

With the latest action, PBoC is reminding the market that the policy remains "prudent and neutral", though the bias appears to be tightening, as the focus in 2017 is to deleverage and prevent systemic risks and banking risks, which is a key message from the Central Economic Work Conference (CEWC) in Dec last year.

While PBoC is expected to continue to ensure sufficient liquidity especially in response to seasonal/festive demand, overall domestic interest rate trend is likely to remain elevated due to the deleveraging process to curb credit expansion, as well as a tightening US Fed policy, which would pressure China's domestic interest rates higher.

We still think that China's benchmark interest rates are likely to remain unchanged for now (at 4.35% for 1Y lending and 1.50% for 1Y depo), though PBoC is likely to lean further towards using market interest rates to guide market expectations and to influence the traditional "benchmark" interest rates that we have been familiar with. As such, we expect China's interest rate environment to continue to see upside pressure in the near term.