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Flash Notes

China: PBoC Reaffirms Monetary Policy Stance

Monetary Policy To Stay Prudent And Netural

The main message from PBoC's 4Q16 monetary policy report (released on Fri 17 Feb) remains that monetary policy stance ahead is likely to continue the trend established late 2016, to deleverage and prevent systemic risks. While the stated policy is "prudent and neutral", a tilt towards tightening has been made clear in the report and interest rate hikes in open market operations in early 2017.

To strike a balance of economic growth, economic reform and restructuring, and preventing systemic risks and excessive financial speculation, further money market rate tightening is very likely, though the magnitude would remain gradual.

With the PBoC keeping its policy of a reasonably stable RMB at equilibrium level, increasing the market's role in determining FX value, referencing of currency baskets, and managing of capital flows, risks of large RMB depreciation remain low, though two-way fluctuations for the currency are likely to be the case.

Monetary Policy Implementation Ahead

Not surprisingly, signals of further tightening of PBoC policy stance ahead are scattered throughout the 4Q16 report. In the area of credit growth (i.e. bank loans and total social financing), PBoC notes that the figures could be understated once local government debt swap, the rise in banks' nonperforming loans and disposals, and increased direct financing (via bond and equity) are taken into account.

PBoC also says that credit customers' interest rates have generally held steady or even lower in 2016. For instance, weighted average loan interest rate was steady at 5.27% at end-2016 while mortgage interest rates fell by 0.18bps from a year ago to 4.52% in Dec 2016. In addition, the proportion of customers getting discounts off the benchmark rates have increased by 6.77% points to 28.22%, while those having to pay a premium on top of the benchmark rates have fallen by 7.23% points to 52.73% at end of 2016. This generally benign picture of the credit market environment suggests that PBoC would be comfortable to raise money market rates further in the months ahead, as it continues to refine its interest rate corridor and price (i.e. interest rate) transmission channels and mechanism. **Therefore, our view remains that PBoC benchmark interest rates would stay unchanged for now (at 4.35% for 1Y lending and 1.50% for 1Y depo rates)**, with money market rates staying elevated and discounts off benchmark rates could be reduced.

On the FX front, PBoC appears to be unperturbed by the full year decline of 6.05% in the CFETS RMB index in 2016 and the 6.5% decline of the RMB exchange rate to 6.9467/USD. PBoC says that the Feb 2016 shift to the "closing price plus currency basket changes" methodology of the USD/CNY central parity has further enhanced the consistency, transparency, and market driven nature of the RMB fixing. We think that these improvements and the reference to currency basket should help reduce risks of large devaluation of the RMB. Since the July 2005 FX reform, the RMB has accumulated gains of 19.31% against the USD. **We are keeping our USD/CNY forecasts of 7.02 for mid-2017 and 7.16 for end-2017, while keeping a close watch on what actions, if any, the US government would take on its currency and trade policy against Asian countries.**

Following the outcome of the Central Economic Work Conference late 2016, it is no surprise that managing and preventing systemic risks and asset price bubbles, including property prices, are high on PBoC's agenda. One article deals with the concerns of banks' off-balance sheet activities and the other on asset price bubbles. In all, the word "bubble" appears 16 times in the 4Q16 report, compared to just 6 times in the 3Q16 report.

Below are key highlights from the two box items (please click the link for full details).

Inclusion Of Banks' Off-Balance Sheet Items In Macroprudential Assessment (MPA)

The concerns over China's banking system's increased use of wholesale funding as well as wealth management products (WMPs) has certainly caught the authorities' attention. According to PBoC's calculations, banks' off-balance sheet wealth management business has grown by more than 30%y/y to RMB26tn at end-2016, well ahead of bank loans' growth rate of 13.5% and RMB deposits growth of 11% in the same period. The concerns involved the possibility that risks are also building up quickly due to such rapid increases in off-balance sheet activities and the likelihood that these “off” balance sheet activities would turn to become “on” balance sheet in a crisis due to lack of clarity in terms of law or even within the industry. This move to enhance the existing MPA framework, starting from 1Q17, is a positive one and would help to ascertain and quantify the exposures of the banking system’s off balance sheet activities.

Asset Price Risks

Particularly for the property market, mentions of “property price bubble” appear twice in 4Q16 report while the term was not even used in the 3Q16 version. In addition, PBoC devotes an entire “box item” to analyze the monetary policy and the impact on property market. In the argument over “mop up after” the bubble vs. “lean against the wind” in preventing a bubble from forming, PBoC’s tone seems to lean towards (no pun) the latter, as it notes that MPA would be necessary –but not sufficient – towards managing property price cycles. This suggests that the central bank will be watching the property market closely and employing its suites of policy tools, just as it and the central government devise comprehensive policy measures that encompass finance, land, taxation, investment and legislation, to promote a healthy long term development of the market.

Reference:

PBoC 4Q16 Monetary Policy Report (Chinese)
http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/3254786/2017021719463365852.pdf