

China: More monetary easing ahead

China's central bank (PBoC) cut the required reserve ratio (RRR) by 1 percentage point on Friday. This is the start of a new wave of monetary easing coming in 2019



Source: Shutterstock

PBoC has started easing

The announced RRR cut of 1 percentage point will be exercised in two phases. The first phase of 0.5 percentage points will be on 15 January, and there will be another 0.5 percentage point cut on 25 January.

The amount released will be a total of CNY 1.5 trillion. But as some liquidity measures will not be rolled over, the net liquidity released will be CNY 800 billion.

This is not going to affect the USD/CNY materially as it is not a direct interest rate cut.

It is a bad signal for the economy

The RRR cut of 1 percentage point signals that the government is worried that the economy will weaken further if there is insufficient liquidity to push down interest rates.

Together with the negative tone from the Central Economic Work Conference, we believe that the

government is not particularly optimistic on the upcoming trade talks.

There will be more monetary easing

As the PBoC stated that it will not roll over the Medium-term Liquidity Funding (MLF) in 1Q19, the expectation that Targeted MLF will start in 1Q19 is high.

The targeted MLF (TMLF), a cheaper interest cost version of MLF, will channel liquidity into small or private companies. This matches the central government's policy objective to help private companies survive the trade war.

The uncertainty with Targeted MLF is the size. It seems that this is determined by banks, however, it is also possible that the central bank will advise on the size for each bank.

Three more RRR cuts expected in 2019

As we expect the trade war to continue to weigh on the economy, we expect three more RRR cuts for the rest of 2019, at the beginning of each quarter.

Together with TMLF, the net liquidity injection could be a total of CNY 3.8 trillion to CNY 6 trillion in 2019 depending on the size of TMLF and the size of RRR cuts, from 0.5 percentage points to 1 percentage point.