China: Not that loose monetary policy after all

Credit data shows that China's monetary policy is not that loose after all. And, the central bank governor warned that the scale of required reserve ratio cuts will be trimmed. When he mentioned the central bank aims to lower real interest rates, he did not refer to cutting the policy rate. The "prudent" monetary policy stance has returned

Source: istock

Credit was tight in February after a very loose January

Total social financing fell steeply to CNY703 billion after a big jump of CNY4.64 trillion in January. The consensus was CNY1.3 trillion. New yuan loans increased only by CNY885.8 billion, down from CNY3.32 trillion in the previous month ago, and lower than consensus of CNY950 billion.

This is partly a result of fewer working days due to the Chinese New Year holiday as well as a big drop in shadow banking. Undiscounted bankers' acceptance experienced a decrease of CNY310.3 billion, contrasting from an increase of CNY378.6 billion in the previous month. Weak shadow banking is consistent with the guidance from Premier Li who commented that credit growth, including shadow banking, in January was too fast.

CNY703billion

Total social financing growth

Feb 2019

Lower than expected

Central bank governor stated that there will be easing, but to a lesser extent

Central bank (PBoC) governor, Yi Gang, commented that there will be fewer required reserve ratio (RRR) cuts in 2019 compared to 2018.

We see two possibilities from his comments. One is that each RRR cut will be 0.5 percentage points, not 1 percentage point, in which case we can still have 3 more RRR cuts this year. Another is that there will be fewer RRR cuts in 2019, but each still within a range from 0.5 percentage points to 1 percentage points.

We believe that as long as the trade negotiation does not turn into a deal that lasts for a long time, then China still needs three more 0.5 percentage point RRR cuts at the beginning of each quarter. This could spread out the easing, and will not put massive downward pressure on the interbank interest rate compared to a 1 percentage point RRR cut.

Lowering interest rates without cutting the policy interest rate

Yi Gang used a lot of air time to explain how the central bank can lower real interest rates. What he did not mention is the use of the policy interest rate. That implies cutting the 7D policy rate should be out of the cards for now.

We find that the central bank is referring to multiple tools to lower real interest rates.

Historically, when the central bank cuts the RRR, interbank rates fall.

Targeted medium term lending facility (TMLF) is a liquidity injection tool that yields a lower interest rate (3.15% for 1Y) than the medium term lending facility (MLF) (3.3% for 1Y), and liquidity goes directly to small private firms.

Monetary policy in 2019

We keep our forecast of 3 more RRR cuts in 2019. The timing of each RRR should be around the start of each quarter so that liquidity can be smoothed out from the tight liquidity created in the previous quarter-end. The central bank will lower the RRR by a different extent for big banks relative to small banks. We will continue to see smaller banks enjoying a lower RRR.

We have removed the policy rate interest rate cut. This is because the central government wants to avoid a too low-interest rate, even if they want some parts of the economy to enjoy lower interest rates, eg, the private sector.

In sum, this year's monetary policy will be highly targeted to inject liquidity to small private firms, and therefore will not be as loose as in 2018 for the whole economy.

Author

Iris Pang
Chief Economist, Greater China
iris.pang@asia.ing.com