

China: Central bank on hold during uneven economic recovery

The central bank left the loan prime rates unchanged. We expect a more targeted easing approach rather than a neutral monetary policy stance during the recovery from Covid-19



Leading members of the People's Bank of China, including Governor, Yi Gang (waving)

Policy interest rates on hold

The PBoC, China's central bank, has kept the policy interest rates on hold since April. The 1Y loan prime rate and 5Y loan prime rate remain unchanged at 3.85% and 4.65%, respectively.

The market widely expected no change in these interest rates as the central bank has kept the Medium Lending Facility (MLF) rate unchanged at 2.95% this month, and the MLF is a variable in the formula of the loan prime rates.

With uneven economic recovery measures, PBoC will adopt a targeted approach to help the economy

We have only seen the PBoC cut interest rates for a lending program for the SMEs and the agricultural sector, which we categorised as targeted measures, not broad-based easing.

It seems that this will be the way going forward as the economic recovery has been uneven. There seems to be a general recovery in exports and faster implementation of infrastructure projects. But some small manufacturers as well as catering businesses continue to be affected by the Covid-19 situation externally that affects China's export orders or internally from social distancing measures. The big flood since late June has not stopped yet, which has created economic loss for the economy. As such we believe that the uneven recovery will continue to result in a targeted easing approach from the PBoC.

A broad-based easing is not only unnecessary as the economy shows signs of recovery but it could also fuel asset price increases.

Forecasts on PBoC's future action

We expect that the PBoC will continue its targeted easing approach for smaller businesses. The size of the innovative lending program for SMEs, which is limited at a maximum of CNY1 trillion, could expand to CNY1.5 trillion, and interest rates on these loans could be cut by 25 basis points. There may be a need for reconstruction loans after the flooding is over. We expect this will be met by another lending program.

Apart from targeted easings, we do not expect any broad-based interest rate cuts or RRR cuts during the economic recovery.