China cuts interest rates to support economic growth

The PBoC cut the 1Y and 5Y Loan Prime Rate today following its earlier cuts to the 7D reverse repo and 1Y Medium Lending Facility. All these actions are proactive to support economic growth. The question remains whether banks will respond by increasing lending

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

Rate cuts to support growth

This time the rate cut was not a balanced one. The 1Y Loan Prime Rate was cut 10 bp to 3.7% from 3.8%. While the 5Y Loan Prime Rate cut was only 5bp taking it to 4.65%. Three days ago, both the 7D reverse repo and the 1Y Medium Lending Facility were cut by 10bp, to 2.1% and 2.85%, respectively.

The smaller cut on the 5Y Loan Prime Rate indicates that deleveraging reform continues. Large corporates long-term borrowings are more expensive than SME's short-term borrowings.

We expect these rate cuts to provide a boost to GDP as at least SMEs borrowing costs are lowered.

Problems remain

After the central bank cuts interest rates, usually the logic is that borrowing will be cheaper. But we need to consider whether banks are also willing to increase lending. The current credit environment is not improving. The uncertainty of credit from real estate developers has led to a general atmosphere that credit quality is worse now than in 2020. Banks will be picky about who they lend to and may require more collateral.

One positive note is that state banks will be supportive of the economy, and will drive a rising lending trend. Another support is that SOEs might increase borrowing for infrastructure projects. Combined, these could increase lending volumes.

So, at least some parts of the economy will see rising bank loans.

This rate cut did not change our GDP forecast

We are keeping our GDP forecast at 5.4% for 2022. This set of rate cuts is not enough to change our forecast. As the PBoC spokesman said, these monetary actions are more proactive. That implies that Covid's spread could derail economic growth. These rate cuts should be interpreted as offsetting the negative impact from Covid.

More rate cuts are expected in March if the Covid spread continues in China - these will occur after the Two Sessions meetings due to be held on 4th and 5th March

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