China’s central bank cuts RRR to support economy

The People's Bank of China cut the required reserve ratio by 0.25 percentage points to support economic growth, as the economy continues to be dragged down by the rising number of Covid cases and real estate crisis

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

China's central bank to cut RRR by 0.25 percentage points from 5 December

China's central bank, the PBoC, is going to cut its required reserve ratio (RRR) by 0.25 percentage points from 5 December, for all banks except those already charging a 5% RRR. This should release CNY500 billion of liquidity for banks to lend out. The last time the PBoC cut the RRR was in April.

How can the PBoC get the most out of this RRR cut?

Our view is that if the RRR cut is the only monetary policy tool that the PBoC is going to implement, it may not lead to a significant increase in bank lending. This is especially the case when it comes to lending to SMEs. This is because credit quality of smaller companies deteriorates faster than it does for big corporates when the economic environment worsens. Companies are currently facing weaker retail sales from a higher number of Covid cases and falling home prices from unfinished home projects.

What I expect is that the PBoC will exercise some form of unconventional monetary policy to increase the effectiveness of this RRR cut. This unconventional monetary policy could include raising the quota of re-lending programmes for SMEs, increasing matching loans for the construction of unfinished residential projects, and it could also be possible that there will be some guidance to commercial banks to increase loan growth.

If there are accompanying policies to increase bank lending other than just cutting the RRR, job losses in December could be stable. Otherwise, we might see another increase in job losses, and retail spending will fall further.

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