China: PBoC's relief measures for Covid are mostly window guidance

China's central bank (PBoC), released some measures to help people and companies affected by Covid. Most of the measures are window guidance to banks. The outcome depends on the banks' reaction to the central bank's suggestions. The measures also suggest that the monetary policy response will remain modest compared to fiscal stimulus

China is still under a zero-Covid policy and consumption has been weak

PBoC's relief measure is to urge banks to be flexible on lending

The PBoC released a statement (in Chinese) to help people and companies affected by Covid. Most of the measures mentioned are window guidance for banks to be flexible in lending to individuals and companies that are affected temporarily by lockdowns and credit issues, but which are willing to repay debts when the lockdowns are released.

Actions from the central bank include rolling over SME loans of CNY 400 billion and providing a 1% increase in loan quotas for banks that lend to SMEs. The central bank also urged banks to lend to the agricultural industry.

So the PBoC's action is quite small compared to what it expects the banks to do to help those affected by the lockdowns.

What is the advantage of window guidance compared to interest rate cuts?

Window guidance will have some pressure on banks, but unless the PBoC puts quota loans to SMEs and the agricultural sector, the pressure from window guidance will not be considered a "must-do" for all banks. It is more likely that big banks will take on more responsibilities as they are in a better position to take on more risk.

The advantage of window guidance is that banks have some room to decide where to grow loans even under the window guidance. Banks take the credit risks, it is their responsibility to calculate the cost-benefit of who to lend to. As such, credit quality should not deteriorate in the banking sector.

Further easing from the PBoC?

Our view is that the PBoC thinks liquidity is enough in the market to overcome difficulties during this lockdown. It could just be that banks are reluctant to lend. In this case, further extensive PBoC pressure will be required for banks to tap the standing lending facility (SLF) if banks do not get enough liquidity through open market operations. The standing lending facility is expensive, for example, the 7D rate is 3.1%, compared to 1Y Medium Lending Facility (MLF) at 2.85%.

We believe that the next step for the PBoC is still cutting the required reserve ratio (RRR) and 1Y MLF. These two policy tools may take turns each month, and each move will probably be a small step.

As monetary policy is unlikely to be the main relief measure, we expect that there will be more fiscal support for the economy. This includes faster issuance of local government special bonds to fund infrastructure investments, which should provide some job opportunities for the construction industry as well as GDP growth support.

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