

China: Rate cut on hold even as Covid-19 cases have increased

China's central bank, PBoC, has kept interest rates on hold. The decision came in the middle of an increase of Covid-19 cases. Central bank easing may be saved for later



Source: istock

PBoC stayed put

The central bank has decided to pause and kept the Loan Prime Rate (LPR) for 1Y and 5Y at 3.85% and 4.65%, respectively.

This comes a few days after the central government said that there could be a cut in the reserve requirement ratio (RRR) to help stimulate the economy.

So this rate pause was widely expected.

Looking for limited easing from the PBoC

We are looking for a targeted RRR cut this week, by 0.5 percentage points for some banks on the specific requirement to use the liquidity for SMEs.

On a slightly longer time horizon, we expect an upgrade of the innovative re-lending programme with a lower interest rate or in combination with either government guarantees or loan insurance schemes so that SMEs are more willing to borrow and banks are more willing to lend.

In short, a rate cut is still possible but may not be in the form of Loan Prime Rates but through the special re-lending programme for SMEs.

CNY showed immediate strength but it won't last long

Just after the announcement of the rate pause, CNY showed strength against the US dollar.

But we do not think this will last for long as the external risks that China's economy is facing have not changed. One is the technology war with some economies, mostly the US. Another is that Covid-19 cases and social distancing measures have kept global demand at a very low level, which will continue to damage export orders for China. These two factors should continue to put weakening pressure on the CNY.

We keep our USDCNY forecast at 7.05 by the end of 2020.