China: Targeted rate cut, finally

We have waited nearly a month for the PBoC to ease again. Finally, targeted rate cuts have arrived for small firms and the agricultural sector. The impact on domestic interest rates and USDCNY should be limited

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

PBoC cut rate only for small firms and agricultural sector

The People's Bank of China cut the re-lending rate for micro-SMEs as well as the agricultural sector by 25bp on 1 July 2020. After the rate cut is effective, these rates will now be 1.95%, 2.15% and 2.25% for 3M, 6M, and 1Y, respectively.

Separately, the central bank also cut the rediscount rate by 25bp to 2%.

Targeted

The purpose of these rate cuts is to increase the incentives for banks to lend to small firms and the agricultural sector, which have higher credit risks. The central bank hopes that this will increase the willingness of banks to lend to these targets and therefore can stabilise employment because SMEs are a big source of jobs for migrant workers. If migrant workers return to their home towns they can borrow from banks if they develop their own business in the agricultural sector.

However, if small factory owners cannot see a return of export orders, they may not be willing to borrow. They may just wait for a month or two and then decide if they should close their business. On this front, fiscal stimulus is expected to play a role.

PBoC is expected to send a clear signal to the market

The market had been waiting for a rate cut after the government made a statement around two weeks ago that RRR cuts can support economic recovery. The message and its timing confused market expectations for monetary policy.

Better communication with the market is important to amplify the effectiveness of monetary policy.

USDCNY should not be responsive to the targeted rate cut

Since targeted rate cuts will only bring around CNY 1.5 trillion loans for this year, which is small compared to outstanding loans of CNY 232.3 trillion, the impact of the targeted rate cuts should not have much impact on interest rates in China.

We also believe that USDCNY will not be responsive to these targeted rate cuts. Our forecast of USDCNY for the end of 2020 is still at 7.05.

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