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Flash Notes

China: First RRR Cut In 2016

No Surprise To The 50bps Cut In RRR

China's central bank PBoC announced on the evening of Mon (29 Feb) a broad-based 50bps cut in banks' reserve requirement ratio (RRR), effective from 1 Mar, to ensure sufficient liquidity in the system and to provide a conducive environment for credit growth and economic reforms.

The cut will bring RRR for major banks to 17%, from 17.5% previously, and will free up reserves of about RMB700bn into the financial system. This is the fifth RRR cut during the current cycle, which began in Feb 2015. PBoC last reduced RRR on 23 Oct 2015, the fourth such move in 2015.

China: Changes in Reserve Requirement Ratios for Major Banks

Announcement	Pre-announcement (%)	Post-Announcement (%)	Difference (bps)
29 Feb 2016	17.5	17.0	-50
23 Oct 2015	18.0	17.5	-50
25 Aug 2015	18.5	18.0	-50
19 Apr 2015	19.5	18.5	-100
4 Feb 2015	20.0	19.5	-50

Source: PBoC, UOB Global Economics & Markets Research

The announcement did not come as a surprise to us. PBoC had already signaled, just prior to the G20 Finance Ministers and Central Bank Governors meeting in Shanghai on Fri, a subtle shift in monetary policy stance, towards one that is "prudent but with slight easing bias" (For more details on the change, please refer to our report "China: Shift In Monetary Policy Stance?", 26 Feb 2016). In addition, the RMB exchange rates for both onshore and offshore had stayed relatively calm after the Lunar New Year holidays, with spread narrowing to just about 50pips or even lower, a far cry from the 1400pips difference seen in early Jan. The PBoC had earlier noted that it did not undertake RRR cut due to considerations of possible negative impact on the RMB exchange rate.

With the relatively calm RMB exchange rate and staying consistent with its message of "slight easing bias", PBoC took on an easing step just after the G20 finance ministers meeting and before the commencement of the annual National Peoples' Congress scheduled to start from 5 Mar.

More Easing Ahead Expected

As we highlighted in earlier report, PBoC had been active in managing financial market liquidity in recent months through open market operations (OMO), using repos/reverse repos, and other liquidity management tools. Based on available data, the amount of PBoC's net injection peaked at RMB1.15tn at end-Jan 2016, which is equivalent to about 2 times RRR reductions. However, this situation is expected to reverse by early March based on current trajectory, to result in net withdrawals of RMB1.2tn. The RRR reduction announced on Monday would be just in time to plug part of the maturity of the injections, as well liquidity withdrawals due the declines in FX reserves and capital outflows.

With the easing bias from PBoC and availability of policy tools, the risks of "hard landing" in China remain relatively low and so is likelihood of large-scale depreciation/devaluation of the RMB, at least for the next 6-9 months. The fact that PBoC undertakes such policy bias as well as its decision to open up the interbank bond market (announced on 24 Feb 2016) to foreign financial institutions such as banks and insurers, suggests that it is not overly concerned of capital outflows and the impact of declines in FX reserves. It should be noted that any attempts by China to devalue its currency would ultimately be futile in boosting exports or economic growth, and would also jeopardize the healthy development of its onshore financial markets and RMB internationalization.

As such, we think there is room for further monetary policy easing in 2016, although the burden is likely to fall on RRR, as it works to fine tune the interest rate corridor. PBoC last changed policy on 23 Oct 2015, the sixth interest-rate cut in a year (depo rate 1.50%; lending 4.35%). **Coupled with Monday's announcement, we still see further room for interest rate and RRR reductions ahead, with a slim chance of interest rate cuts by end-1Q16. The next reduction in RRR is likely to be in 2Q16**, as shown in the table.

China: Interest Rate and RRR Forecasts							
%	2Q15	3Q15	4Q15	1Q16F	2Q16F	3Q16F	4Q16F
1-year Benchmark Lending Rate	4.85	4.60	4.35	4.10	3.85	3.85	3.85
1-year Benchmark Deposit Rate	2.00	1.75	1.50	1.25	1.00	1.00	1.00
Reserve Requirement Ratio	18.50	18.00	17.50	17.00	16.00	15.00	15.00
Source: UOB Global Economics & Markets Research Estimates							

As for the RMB, we had cautioned back in January, when depreciation pressures were at its peak, that such pessimism and negative sentiment on the currency (and China economic outlook in general) was excessive and unwarranted. It was an over- exaggeration of China's economic slowdown and also the fall in China's foreign exchange reserves. We are still keeping our forecasts intact, with our call at 6.55 for end-1Q16, 6.60 at 2Q16, and then towards 6.45 by end-2016. The recent stability of the onshore and offshore prices suggests that speculative activities are now kept at bay. However, depreciation pressure on the currency remains significant as there is still room for a USD rebound against EM currencies, including RMB. **More important though is that with the RMB referencing a basket of currencies, the USD/RMB exchange rate is likely to see greater volatility and more flexibility going forward, even if the basket as a whole stays relatively stable.**

With monetary policy remaining supportive we expect China's real GDP growth to be able to maintain about 6.8% pace for the full year in 2016, vs. 6.9% in 2015. This is based on our rather conservative assumptions that tertiary activities to slow to below 8% for the year, from 8.3% growth in 2015. For the secondary sector (primarily industrial production), we expect activities to stabilize at around 6% growth for 2016, similar to the 6.1% pace in 2015.

Technical Insights (USD/CNH)

For the most recent RRR cuts, namely 23-Oct-2015 and 25-Aug-2015, we noticed that both USD/CNH (see chart below) and USD/CNY has the tendency to reverse the primary trend preceding the RRR cut (see red circles in chart). If the pattern holds true again, we can expect USD/CNH to drift lower in the next few sessions. At the lower 6.50's, we see better value to lock in bullish USD/CNH call spreads.

Source: Bloomberg, UOB Global Economics & Markets Research

FX OUTLOOK	01-Mar-16	End 1Q16F	End 2Q16F	End 3Q16F	End 4Q16F
USD/JPY	112.4	118	119	120	122
EUR/USD	1.088	1.10	1.11	1.11	1.12
GBP/USD	1.394	1.42	1.41	1.39	1.41
AUD/USD	0.712	0.74	0.74	0.75	0.76
NZD/USD	0.661	0.65	0.65	0.66	0.67
USD/SGD	1.406	1.42	1.44	1.43	1.41
USD/MYR	4.192	4.15	4.25	4.20	4.10
USD/IDR	13,375	13,500	13,400	13,300	13,200
USD/THB	35.6	36.2	36.5	36.8	37.0
USD/PHP	47.5	47.5	48.0	47.0	46.0
USD/INR	68.4	67.9	69.0	70.0	71.1
USD/TWD	33.5	33.9	34.1	33.9	33.6
USD/KRW	1,237	1,220	1,250	1,200	1,180
USD/HKD	7.77	7.80	7.80	7.80	7.80
USD/CNY	6.554	6.55	6.60	6.47	6.45

Source: Bloomberg, UOB Global Economics & Markets Research

Link
PBoC's Reduction of Banks' Reserve Requirement Ratio (29 Feb 2016)
http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/3023454/index.html