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Flash Notes

China: PBoC Provides Temporary Liquidity Support

A Temporary Relief To Seasonal Demand

PBoC issued a statement on its official Weibo account late Fri (20 Jan) that it has established a new liquidity tool to provide temporary liquidity support to "several large commercial banks" in response to seasonal demand for cash and to improve funding in financial system. The "Temporary Liquidity Facility" (TLF) has a 28-day tenor with funding cost similar to the regular open market operations (OMO) of similar tenor, which is about 2.55%.

Earlier on the same day, various media outlets also reported that PBoC has cut reserve requirement ratio (RRR) by 1% point to 16% for China's top 5 commercial banks, for a period of 28 days.

PBoC's statement and media reports on the RRR cut capped an unusual week in terms of liquidity injection that already exceeded RMB1tn by Thur (19 Jan), and hitting a total of RMB1.13tn by Fri, the biggest weekly net increase on record, through its various OMO.

No further details on the TLF are available, but together with the targeted RRR reduction reported by media, if true, are certainly temporary measures in response to seasonal demand due to the upcoming Lunar New Year holidays. The surges in cash demand, tax payments, and large shifts in fund flows accompany the world's "largest annual human migration" that are estimated to see 3 billion trips made during the Spring Festival travel period.

The reported RRR cut is aimed at China's 5 largest commercial banks (ICBC, ABC, BOC, CCB, and BOCOM), which account for about 45% share of China's total deposits (RMB150.59tn at end-2016). This means that a 1% point cut in these large banks' reserve requirement ratio would free up about RMB675bn of liquidity.

As such, the combined net additions from OMO and this temporary RRR cut would see a total fund injection exceeding RMB1.8tn. Given that a typical broad based RRR cut is in steps of 50bps (releasing about RMB750bn each time), the amount of fund injection last week would be equivalent to about 2.4 rounds of broad based RRR cuts.

The last time PBoC cut RRR was on 29 Feb 2016, which lowered major banks' RRR to 17% from 17.5% and released approximately RMB700bn then in liquidity through the system-wide cut.

Not A Shift In PBoC's Policy Stance

Although the amount of net increases in liquidity looks sizeable, especially if scaled along the number of RRR cuts, these additional funds are largely in response to seasonal demand due to the upcoming Lunar New Year holidays.

Unlike broad based RRR cuts in the past that involve the entire banking system and with injections that remain in effect indefinitely, the latest reported RRR reduction is targeted both in terms of quantity (only for large commercial banks) and duration (for 28 days), thus reducing the risks of excessive credit creation and therefore keeping the message of deleveraging intact. Furthermore, any negative impact on the RMB exchange rate would also be limited.

The targeted nature of the reported RRR cut and the temporary nature of the TLF suggests that PBoC intends to keep to its message of prudent and neutral policy stance. Therefore, we do not see these moves as a signal of a fundamental shift in PBoC's policy bias. On the contrary, the deleveraging process could very well get underway after the Spring Festival once liquidity condition returns to normal, thus keeping domestic interest rates relatively elevated and liquidity conditions tight as China moves to address the risks posed by debt and leverage.

For now, we expect PBoC to maintain its current benchmark interest rates unchanged at 4.35% (1Y lending) and 1.50% (1Y depo), as well as the broad RRR intact at 17.0%. As for the RMB, our forecast is for a gradual depreciation towards 7.02/USD by mid-2017 and to 7.16/USD by end-2017, largely due to the strength of USD.