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Flash Notes

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China: Launching Of Deposit Insurance System

Deposit Insurance To Start On 1 May

China announced on Tuesday (31 March 2015) the launch of the bank deposit-insurance system, to be in place on 1 May 2015, as the government prepares the ground to fully liberalize interest rates on bank deposits that PBoC Governor Zhou Xiaochuan said could happen as soon as this year.

Up to RMB500,000 (approx. US$80,550) in both RMB and foreign currency deposits made by businesses and individuals per bank will be protected. China's State Council said this will cover as much as 99.63% of the RMB122 trillion (US$19.65 trillion) in China's bank deposits, among the world's largest totals. The insured amount– subject to regular review – is based on 12x of China's per capita GDP in 2013, compared to maximum of 2-5x per capita GDP in other countries' systems, according to Chinese government. China will join the rank of more than 110 countries that have already established some form of

Comparison of Deposit Insurance Systems in Asia Pacific

Country	Established/Operationalized	Type of system	Insured amount
Australia	1998	Government legislated and administered	AUD $250,000 (~USD190,735)
Brunei	2011	Government legislated and privately administered	B$50k per depositor per institution (~USD36,451)
Chinese Taipei	1985	Government legislated and administered	NTD3 million (~USD95,975)
HK	2006	Government legislated and privately administered	HK$500,000 per depositor (individual or business entity) per bank (~USD64,484)
India	1962	Government legislated and privately administered	INR100,000.00 per depositor in same capacity and same right. (~USD1,602)
Indonesia	2004	Government legislated and privately administered	IDR 2 billion (~USD153,082)
Japan	1971	Other Government legislated	Single Accounts=JPY 10 million (~USD83,354)
Korea	1996	Government legislated and administered	KRW 50,000,000 per depositor, per institution (~USD45,086)
Malaysia	2005	Government legislated and administered	RM250,000 per depositor per institution (~USD67,512)
Philippines	1963	Government legislated and administered	PHP 500,000 per depositor per institution (~USD 11,188)
Singapore	2006	Government legislated and privately administered	SGD50,000 (per depositor per institution) (~USD36,441)
Thailand	2008	Government legislated and administered	THB 50,000,000 per depositor per institution* (~USD1,535,981)
Vietnam	1999	Government legislated and administered	VND50 million (~USD2,320)

* The 50 million baht coverage will be implemented until 10 Aug 2015 before lowering to 25 million baht from 11 Aug 2015 to 10 Aug 2016. The 1 million baht coverage as stipulated by the Act, will be implemented from 11 Aug 2016 onwards.

Source: International Association of Deposit Insurers (http://www.iadi.org/di.aspx?id=173); various central banks; newswires; UOB Global Economics & Markets Research est.

deposit insurance system. The insurance will be provided by a fund run by the PBoC, though no details on the amount of premiums that will be paid by banks.

For comparison, the table on the first page shows that China's insured deposit amount of US$80,500 equivalent is among the largest in Asia Pacific. Interestingly, New Zealand does not have a deposit insurance system. RBNZ said in 2013 the lack of such arrangement is mainly due to the problem of "moral hazard", and it has other toolkit to deal with bank failures despite the absence of deposit insurance. "Moral hazard" is one key issue that the Chinese policymakers may need to monitor closely and offset with other policy measures just as it puts the deposit insurance system to work.

Interest Rate Liberalization And More

Nevertheless, China's bank deposit insurance system will go in some way to remove the ambiguous and uncertain concept of "implicit guarantee" of the banking system, towards one that is clearer and more explicit, and driven by market forces. As such, the insurance system will help to prevent and resolve financial risks in a timely and more transparent manner. The removal of implicit guarantee will also further reduce the delusion of any government bailout and "too big to fail", and that means that sporadic failures of banks could be the "new normal".

The deposit insurance system also will help to incentivize spreading of deposits among banks, thus diluting the dominance of large state owned banks, and allowing more space for smaller institutions to thrive, which is a healthy development. The reduction in "concentration risk" and increase in competition among banks will level the playing field and improve the resilience of the banking system.

One key reason for establishing a deposit insurance system is China's aim of opening of its capital account, full convertibility of the RMB and inclusion into IMF's Special Drawing Rights (SDR) basket as soon as late 2015 (during IMF's twice-in-a-decade review). With these developments and aims, it is necessarily to establish a resilient financial system (including banking sector, equity, debt, and other markets) that could withstand the movements of financial capital flows, which will see deposit insurance playing a critical role just like in other countries.

It should be noted that about 85% of China's capital account is already convertible, though still subject to restrictions e.g. RQDII and RQFII quotas, equity market that is only via the Shanghai-HK connect route, and less or little restrictions on FDI and ODI. Currently the 15% that is not convertible includes capital market and money market instruments, derivatives, and individuals' conduct of investments. Those last bit of restrictions (15%) are the most crucial for capital flows, and China will need to overcome the bulk of the remainder, even with some limits imposed, to even have a normal type of open capital account regime, and the insurance system will help in some way to cushion the volatility of capital flows when more restrictions are lifted.

Forecasts Remain Intact

Taking everything into account, the implementation of China's deposit insurance system is well within our expectation in terms of timing, as we had mentioned before (see for example UOB 2Q15 Quarterly Global Outlook issued on 20 March 2015).

This should pave the way for PBoC to lift the ceiling on deposit interest rates, which is currently limited to maximum of 1.3x of the benchmark interest rate. This is an important policy decision as it will mean that the "true" interest rate pricing will be largely driven by market forces and reflecting market reality, from one that was generally dictated by the central bank.

As we mentioned in previously, interest rate liberalization is indeed getting near. Barring any unforeseen circumstances, we continue to expect China to lift the cap on deposit interest rates in PBoC's next 1-2 interest rate cuts. We are still of the view that PBoC will reduce interest rates sometime in 2Q15 (see table below), and lift the deposit ceiling to 1.4x, and subsequently follow with the total lifting of the deposit rate cap.

China: Interest Rate and RRR Forecasts					
%	1Q15F	2Q15F	3Q15F	4Q15F	1Q16F
1-year Best Lending Rate	5.35	5.10	5.10	5.10	5.10
1-year Deposit Rate	2.50	2.25	2.25	2.25	2.25
Reserve Requirement Ratio	19.50	19.00	19.00	19.00	19.00
Source: UOB Global Economics & Markets Research Estimates					

Other than for the banking system, we do not expect any material impact on the broader economy from the deposit insurance system. In fact, such a system should have the positive effect of boosting confidence and improving transparency, thus strengthening the economic recovery process.

For 2015, we had earlier lowered our forecast for 2015 growth projection to 6.8%, from previous forecast of 7.2%. In addition, we had also reduced our forecast for China's 1Q15 GDP reading, which is scheduled for release on 15 April, along with industrial production, retail sales, and investment. In view of the recent poor run of data, we had also lowered our forecast for China's 1Q15 GDP growth expectation to 6.8%, from our initial call of 7.1%.

With China's growth outlook likely to remain downbeat, we still expect a somewhat weak tone for the RMB ahead, which is in line with our call that the US Federal Reserve would commence its interest rate liftoff from June. Despite the USD/CNY pair's declines in recent weeks, we are keeping to our USD/CNY forecasts of 6.33/USD by end-2Q15, and 6.29 by end-2015, keeping in mind larger volatility for the currency, which could include a possible widening of trading bands sometime this year.

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