Flash Note
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China is stepping up its monetary easing. Q&As. Outlook

The facts

- On Sunday, the People's Bank of China announced that from October 15 it will cut the reserve requirement ratio (RRR) for banks by 100bp (after the cuts in April and June).
- Big state owned banks will have a RRR of 14.5% (from 15.5%), and smaller banks will face a RRR of 12.5%.

The intensity

- The measure will inject a gross amount of RMB 1.2 trn into the financial system (RMB 750bn in net terms, since a portion of this liquidity injection will be used to repay the lending facility due n October 15)
- This injection is larger than the two previous injections, meaning that Beijing's authorities are stepping up the pace of its monetary stimulus, probably because they already feel the pressure of Donald Trump's trade measures. Every day I have more clear that Beijing underestimated the threats.

The aim

- This measure is aimed at reducing bank funding costs and corporate borrowing costs (by improving bank liquidity).

The timing: Why now?

- Foreign reserves are no longer growing (and swelling the PBOC's balance sheet with which to feed new injections to the system). As a result the PBOC has only one way to improve liquidity: Cut RRR periodically to maintain excess liquidity in the system and prevent a rise in the interbank rates.

The unintended consequences

- The flip-side of cutting RRR (at a time when the Fed is tightening rates) is that the PBOC will tolerate greater volatility in the exchange rate (this is why we cut our CNYUSD target in our last Investment Committee to 7.00, from 6.50)

The intended consequences

- The RRR cut does not have big directional consequences but one of the objectives is to support banks, and thus, the Chinese equity market.
- From the point of view of bank profitability, RRR cuts are much more preferable than liquidity injections via PBOC lending facilities.

Much gunpowder still in the hands of the PBOC

- The scale of Beijing's monetary easing is being more modest than in the last easing cycle (2014-2015), when the PBOC cut benchmark lending rates by 125bps in just 12 months.

Outlook: China will suffer more from the effects of the external hostile environment, but we do not foresee a crisis.

- If trade war escalates, Beijing will come up with more supportive policies.
- The combination of RRR cuts, lower interbank rates, higher bank lending, accelerated local government bond issuance, and potential cuts in benchmark rates, will help to keep credit growth stable at around 10%-12% yoy, helping to keep infrastructure spending and households consumption.

Best regards