Flash Comment: China

PBoC cuts interest rates by 25bp, at least timing appears influenced by stock market plunge

- People’s Bank of China (PBoC) on Saturday cut both its one-year benchmark lending rate and its one-year benchmark deposit rate by 25bp to 4.85% and 2.0%, respectively. This was the fourth interest rate cut since November last year. In addition, the reserve requirement ratio (RRR) for commercial banks was cut by 50bp and for large banks the RRR is now 18%. In principle, it was a targeted RRR-cut in the sense that it will only cover banks that meet PBOC’s standards to support the agricultural sector and SMEs. However, most banks are expected to fulfil this requirement.

- While another interest rate cut by PBoC was widely expected, it was nonetheless a relatively aggressive easing move. First, it is unusual that PBoC cut both its leading interest rates and the RRR on the same day. Second, PBoC has also started to inject liquidity more aggressively into the money market again. PBoC injected substantial liquidity into the money market in connection with its reverse-repo operations on Thursday last week and the interest rate on the reverse-repo operations was cut markedly to 2.7% from 3.35% previously (see chart below).

- It is hard not to see at least the timing of the interest rate cuts as a response to the sharp decline in the Chinese stock market in the previous days. The main Shanghai stock market on Friday dropped more than 7% and is down close to 20% since its peak in mid-June, albeit still up close to 30% since the beginning of 2015. The bull market and the potential bubble in the Chinese stock market has been a major concern for PBoC. Hence, the interest rate cut should mainly be seen as an attempt to secure that a correction in the stock market does not get out of hand, rather than an attempt to underpin a continued bull market.

- We have not changed our macro-economic view on China in the wake of the recent sharp decline in the Chinese stock market. In our view, the impact on growth from the plunge in stock prices will be modest, as it was in connection with the Chinese stock market collapse in 2007/2008. What happens in the housing market will be much more important and so far there are tentative signs that the housing market has started to recover in the wake of PBoC’s easing. New home sales have recovered markedly in recent months and house prices also started to increase again in May. The manufacturing PMIs have also started to improve. Hence, data still support a moderate recovery in growth in H2.

- For that reason we do not expect to see aggressive easing from PBoC in the coming months. The RRR will probably be cut by at least another 50bp but we do not expect the leading interest rates to be cut further. That said, the impact of Greece on the global economy is a major uncertainty in the short run.

- We also continue to expect USD/CNY to trade broadly unchanged in the coming months as China does not want to rock the boat ahead of the IMF’s decision this autumn on possible inclusion of the CNY in the SDR.

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Fourth cut in leading interest rate since November last year

Reserve requirement cut 50bp

Sharp drop in interest rates on PBoC’s reverse-repo operations

USD/CNY is expected to remain stable in coming months

Source: Macrobond, Danske Bank Markets
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