Economic Analysis

The PBoC's decision to inject RMB 1 trillion to boost the economy could aggravate debt overhang problems

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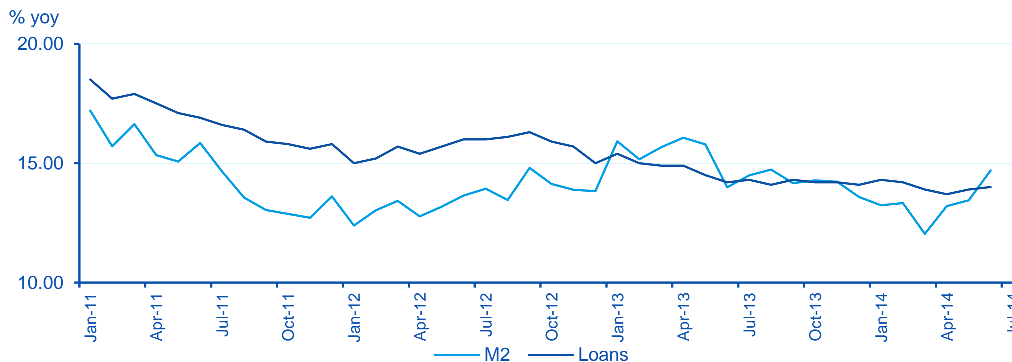
According to Chinese media reports, the People's Bank of China (PBoC) launched a new lending program in April, with the objective to support infrastructure investments (in particular for shantytown renovation projects). Under this program, the PBoC will lend up to RMB 1 trillion over the course of three years to China Development Bank (CDB), the largest "Policy Bank" of China. The CDB will in turn allocate funds to shantytown renovation projects in the form of normal commercial loans. It is reported that the PBoC will charge the CDB a favourable interest rate under the new program, believed to be much lower than the current benchmark lending rate of 6%. Most importantly, loans under the new lending program have a three-year maturity, which can provide long-term stable funding for the shantytown renovation projects.

This new lending program is among the PBoC's recent efforts to loosen monetary policy; including two targeted RRR cuts (in April and June), as well as the revision of the calculation method for loan-to-deposit ratio (making it easier for banks to meet ratio requirements). The amounts of funds that have already been tapped by the CDB to extend credit to shantytown renovation projects under the program remain undisclosed. However, we believe that this lending program has helped to precipitate credit growth in June, especially in the form of loans to shantytown renovation projects (Chart 1).

Looking forward, it is expected that the lending program, together with other easing measures, will underpin growth by boosting infrastructure investments. It seems increasingly likely that China will manage to avert an economic hard-landing this year and achieve its pre-defined growth target of 7.0% – 7.5% (BBVA projection: 7.2%). Nonetheless, this lending program also carries some costs: First, the program is so narrowly based (only eligible to the CDB) that investors might interpret it as a setback to structural reforms that aim to allow the market to play a "decisive" role in resource allocation. Second, too lax credit conditions could delay much-needed deleveraging of the overall economy and aggravate the debt overhang problem in local governments and the corporate sector.

Chart 1
Credit growth picks up in June



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