Economic Analysis

The PBoC cut interest rate amid dubious signals of growth recovery

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The People's Bank of China (PBoC) cut the benchmark interest rates last Saturday, the second time since November 2014 and effective from March 1st. Although both the one-year benchmark lending and deposit rates were trimmed by 25 bps (to 5.35% and 2.5% respectively), the PBoC further expanded the permissible floating range of customer deposit rates to 30% (versus 20% previously) above the benchmark rates, which, as a result, only modestly reduces the one-year customer deposit rate to 3.25% from 3.3% previously. This move has constituted an additional step in interest rate liberalization and reaffirms the authorities' resolution to push for structural reforms. (Figure 1)

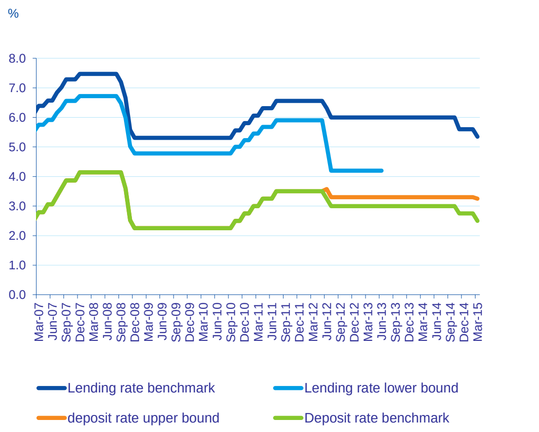
Interestingly, the interest rate cut came ahead of the February PMI releases. In particular, the February NBS PMI came out at 49.9 (Consensus: 49.7; Prior: 49.8), below the watershed level of 50. On the other hand, the HSBC Final PMI of February unexpectedly increased to a seven-month high of 50.7 from 49.7 of the last month (versus February HSBC Flash PMI: 50.1), primarily driven by improved output and new orders. (Figure 2) Encouraging as it may be, the February HSBC PMI doesn't seem compelling for two reasons: first, the seasonal effect of Chinese New Year always adds extra noises to PMI readings at the beginning of a year; second, the rosy HSBC PMI doesn't reconcile with not only the official PMI but also other economic indicators of late, such as decelerated M2 growth and continuously falling property prices.

Looking ahead, we anticipate more easing measures in the coming months. At least one additional interest rate cut of 25bps is expected to be enacted in the first half of the year. Moreover, an interest rate cut alongside the expansion of permissible floating range of the deposit rates could further squeeze banks' net interest margins (NIMs) and thereby make banks more reluctant to extend additional loans if no quantitative tools (for example, RRR cuts) are to be deployed in coordination. In this respect, we anticipate that the authorities need to boost banks' liquidity condition by lowering the RRR by (50-100 bps) between now and the end of the year. The PBoC can also resort to unconventional monetary policy tools to inject liquidity to the banking system, including selective RRR cuts, the PBoC's direct refinancing to banks, reverse repo, short or medium term lending facilities and other innovative measures.

Figure 1
PBoC cut the benchmark lending and deposit rate

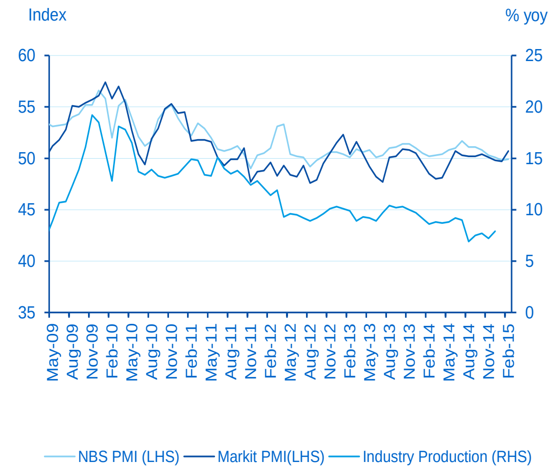
Figure 2
The second interest rate cut was mainly promoted

effective on March 1st



Source: CEIC and BBVA Research

by recent economic slow-down



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