Economic Analysis

# The PBoC deployed a large cut in the RRR to arrest flagging growth momentum

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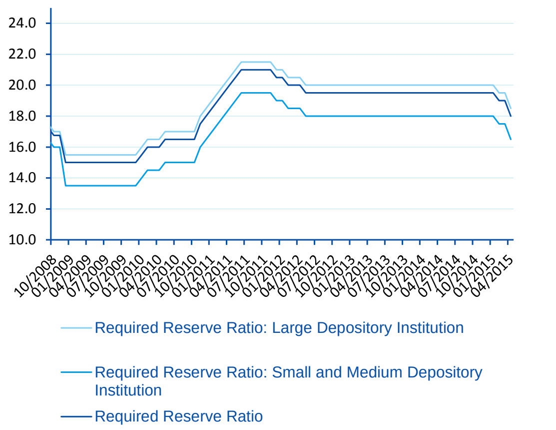
Yesterday, the People's Bank of China (PBoC) cut the required reserve ratio (RRR) by 100 bps to 18.5%, effective from April 20th. It is the second time of a universal RRR cut since last November when monetary policy shifted to be accommodative, along with two 25-bps interest rate cuts during the same period. (Figure 1) In order to "facilitate the structural adjustment ability of financial institutions", the PBoC, on top of the universal cut, gave additional RRR cuts of 100 bps to rural financial institutions and 50 bps to active SMEs lenders respectively. Moreover, the Agricultural Development Bank of China, the sole policy lender for the agriculture sector, was given an additional RRR reduction of 2 percentage points. All together, the move is expected to release RMB 1.35 trillion in the financial sector, enabling banks to extend more credit in support of the real economy.

Although the RRR cut, along with other easing measures, has been widely anticipated by the market, its magnitude (100 bps instead of the general 50 bps) was beyond the market consensus and was never being seen since November 2008, reflecting the authorities' deep concerns for the significant slowdown in growth momentum. To a certain extent, the move has also sent a clear signal to the market that the authorities are very committed to achieve their 7.0% growth target just announced in March's National People's Congress (NPC). We anticipate more conventional monetary easing measures to be implemented in the coming months, mainly the interest rate cuts (cumulatively 75 bps). In the meantime, the authorities could use other selective policy tools to ensure the liquidity adequacy in the interbank market and therefore lower the funding costs for the corporate sector.

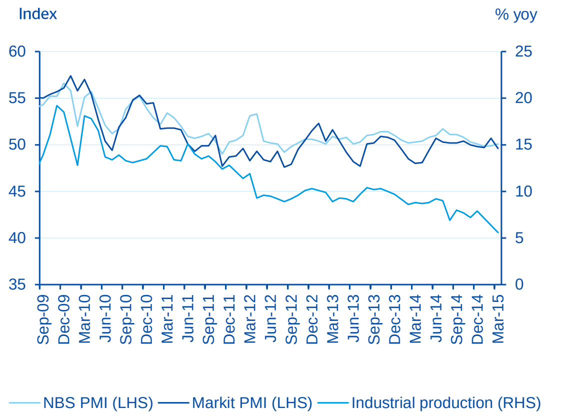
- **The RRR cut was in response to the lackluster economic performance in the first quarter.** On the heels of a decade-low growth outturn 7.4% in 2014, China's economy continued to decelerate as the Q1 growth dipped to 7.0%. Other activity indicators also showed that the ongoing slowdown in the world's second-largest economy is sharper than anticipated (see our China Flash, April 15, 2015), prompting the PBoC to cut the RRR to spur domestic demand. (Figure 2)
- **The resultant liquidity injection is tremendous.** We estimate that the universal cut of 100 bps in the RRR will inject liquidity of RMB 1.25 trillion to the banking sector while the accompanied selective cuts are to add liquidity of RMB 100 million. This move will enable banks to extend more and cheaper lending to their corporate clients and boost domestic demand.
- **…nevertheless some caveats are noteworthy:** The RRR cut might add financial risks if lax credit aggravates asset bubbles instead of lending real support to the real economy. The recently announced RRR cut could add fuel to the run-up of China's onshore stock market. (Figure 3) The second risk is to dampen the RMB exchange rate and trigger more capital outflows. The capital outflow has already become significant in recent months, reflected upon a capital account deficit of 96 bn USD in 2014, compared with a surplus of USD 326.2 bn in 2013 (Figure 4).

Figure 1
### The PBoC cut RRR twice to stimulate growth in 2015




Source: CEIC and BBVA Research

Figure 2
### The RRR cut was prompted by the lackluster Q1 economic outturns

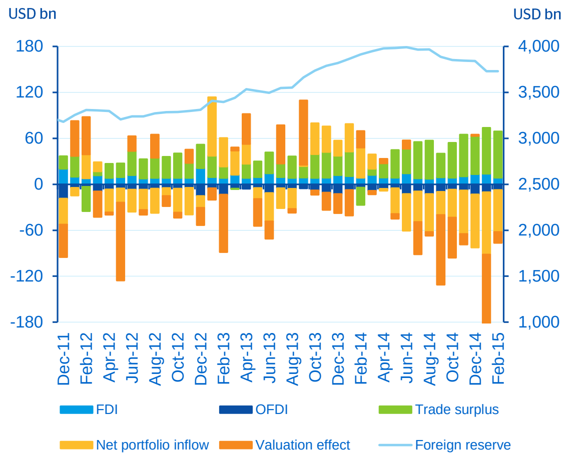



Source: CEIC and BBVA Research

Figure 3
### The RRR cut might add fuel to the run-up of stock market instead of going to real sector


Source: CEIC and BBVA Research

Figure 4
### Capital outflow issue has become significant in recent months




Source: CEIC and BBVA Research

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