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China Economics Update: A 25bp RRR cut to support economic recovery
中国经济评论: 央行降准 25 基点稳增长

Kevin Xie
(852) 3911 8241
kevinxie@ccbintl.com

Li Cui
(852) 3911 8274
cuili@ccbintl.com

The PBoC delivered a 25bp cut to the Required Reserve Ratio (RRR) following a similar cut in November 2022. Maintaining sufficient liquidity remains the PBoC's top priority. Long-term and interest-free liquidity released by the RRR cut will increase banks' lending facility and will lower borrowing costs to meet business demand and aid the economic recovery.

Additional broad-based RRR cuts are likely. The Chinese economy remains in the early days of a recovery. January-February data confirms a gradual recovery is underway. A full recovery may take some time, however. Monetary support is needed to support credit expansion and boost confidence.

继 2022 年 11 月下调存款准备金率以来后，央行再次将存款准备金率下调 25 个基点。降准释放的长期流动性有助降低银行借贷成本，满足企业信贷需求并支持经济复苏。

进一步降低存款准备金率仍有可能。中国经济仍处于复苏初期。1-2 月数据证实经济正温和复苏，但完全恢复仍需时日。保持充足的流动性，以支持信贷扩张和提振信心，预计仍然是中国人民银行短期的首要任务。

PBoC cuts the RRR by 25bp

On 17 March 2023, the PBoC announced it would cut the RRR by 25bp, effective 27 March 2023. According to the accompanying statement, the 25bp RRR cut will be broad-based, insofar as it will apply to all financial institutions except those that currently have a 5% RRR. The weighted average of RRR among deposit-taking financial institutions will fall to 7.6%.

According to the PBoC, the RRR cut will help keep credit growth steady, maintain ample interbank liquidity provisions, and support the real economy. Liquidity released by the RRR cut provides long-term and interest-free funding to financial institutions, compared with a liquidity injection through the one-year Medium-term Lending Facility (MLF). Based on the experience of RRR cuts, we estimate this 25bp RRR cut is likely to save financial institutions interest rate costs of about RMB5.5b every year.

Our view

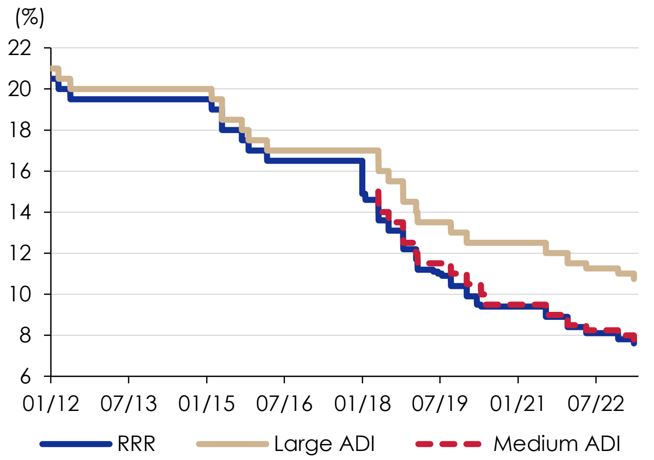
The 25bp RRR cut on Friday follows a similar cut in November 2022. Maintaining sufficient liquidity remains the PBoC's top priority. The PBoC has injected a total net liquidity of RMB548.5 billion into the banking system via the MLF in 1Q23. We estimate the latest 25bp RRR cut will release long-term liquidity in the amount of RMB500 billion. The total net long-term liquidity injection from the MLF, the PSL and RRR cuts, but excluding short-term liquidity changes, amounts to RMB1.05 trillion in 1Q23, similar to the pace in 4Q22.

In our view, rising funding costs may have been a factor in the PBoC's decision to deliver the RRR cut. The seven-day collateralized repo rate has picked up since January following China's Covid exit (Fig 2). Long-term funding released from the RRR cut should help to increase banks' lending capacity and lower borrowing costs to businesses.

Meanwhile, the Chinese economy is still at an early stage of re-opening. January-February data confirms a gradual recovery underway (read here for details). However, sequential growth in retail sales and industrial output remains below pre-pandemic trends. The labor market remains soft, and a sustained improvement in household income and employment will take time. External demand also faces more uncertainty due to the financial turbulence of recent weeks. The RRR cut was consistent with our expectation of an accommodative monetary policy stance, and the current supportive monetary policy is likely to continue.

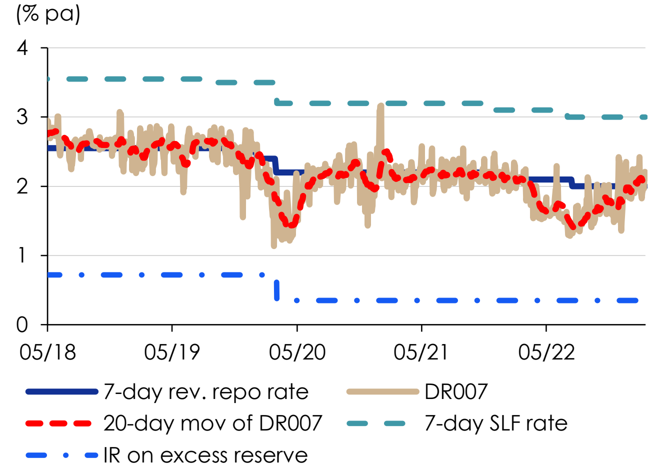
Additional broad-based RRR cuts are possible in coming quarters. We continue to hold the view that the PBoC will maintain steady credit expansion to support the economic recovery while refraining from cutting the policy interest rates amid the improving growth outlook. At a press conference on 3 March, re-appointed PBoC Governor, Yi Gang, said current interest rates were appropriate, adding that RRR cuts could be an effective tool to support the real economy and achieve the objective of anchoring credit growth to nominal GDP growth, in keeping with statements in the *2023 Government Work Report*.

Fig 1: RRR trended lower



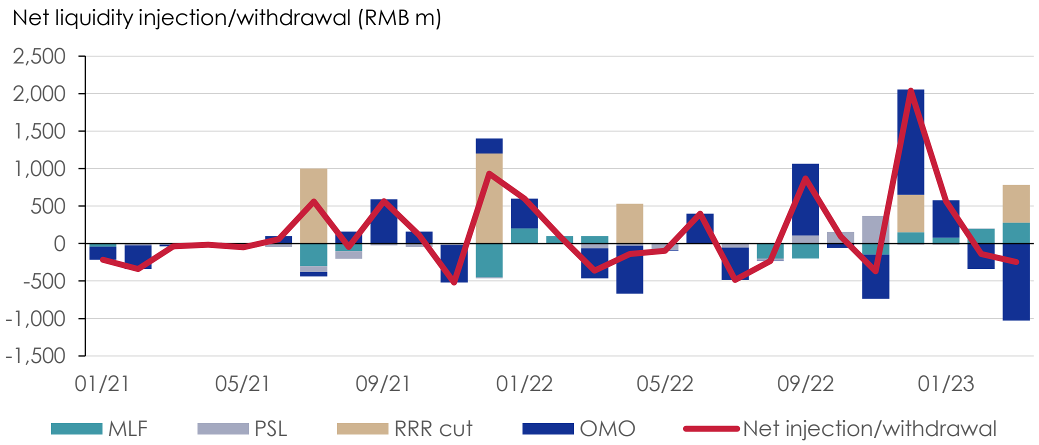
Source: NBS, CCBIS

Fig 2: Interbank rates picked up recently since January



Source: NBS, CCBIS

Fig 3: PBoC liquidity management



Source: NBS, CCBIS

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CCB International Securities Limited
12/F, CCB Tower, 3 Connaught Road, Central, Hong Kong
Tel: (852) 3911 8000 / Fax: (852) 2537 0097s