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Weekly Economic Snapshot

Wenjie Ding, PhD
(852) 3900 0856
dingwenjie@cmbi.com.hk

RRR Cut to Boost Domestic Growth, Rmb Will Remain Stable

On 29 Feb 2016, the PBoC announced a cut in Reserve Requirement Ratio (RRR) by 50bps. This marks the first RRR cut since Oct 2015. Effective from 1 Mar 2016, RRR would be 17% for large financial institutions.

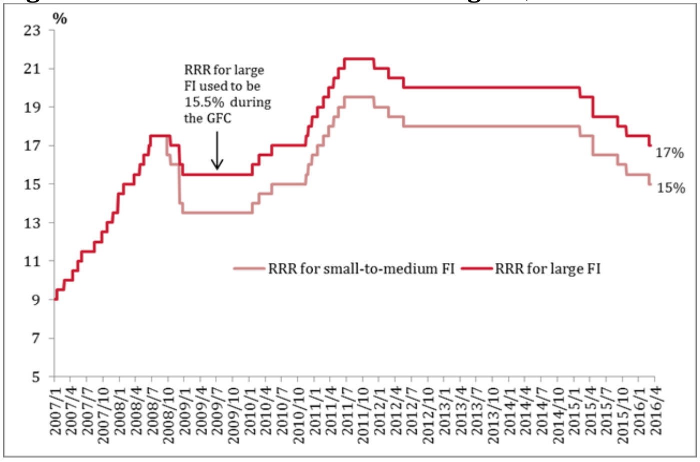
Delayed RRR cut. Monetary easing is necessary to stabilize economic growth and facilitate structural reform. As we pointed out in our 19 Jan 2016 report, the PBoC has delayed double cuts but instead used a set of tools, MLF and reverse repos in particular, to provide liquidity to the financial system since the end of 2015. Although the market expected broad cuts in RRR and benchmark interest rate, the fear that they may lead to further depreciation of Rmb and speed up capital outflow overweighed.

Why 'Now'? First of all, depreciation pressure of Rmb against dollar had subdued since Jan-16. Capital control measures have been gradually introduced and are now effectively in place to prevent arbitrage outflows. Second, the PBoC has clarified its stance on currency and monetary policies during the G20 meeting of finance ministers and central bank governors last week, thereby beating uncertainties regarding Rmb and the Chinese economy. Therefore, **we think the Rmb value will remain stable after the RRR cut.** Third, RRR cut is necessary to ease liquidity conditions because Rmb1.16tn from previous reverse-repo operations is coming due this week.

Where will the money go? We estimate that this time's RRR cut will add about Rmb500bn to the market. Where and how these money will be spent is crucial, in order to boost economic growth and at the same time without blowing up bubbles in certain asset classes, such as housing. Reflecting on recent policies to encourage home purchases, we do expect an increasing amount of mortgage originations this year. Putting in a longer time frame, however, we think guidelines and incentives should be provided to channel credit to sectors that represent economic transition and serve long-term growth purposes, for example, technology, infrastructure, sustainable energy, agriculture and etc.

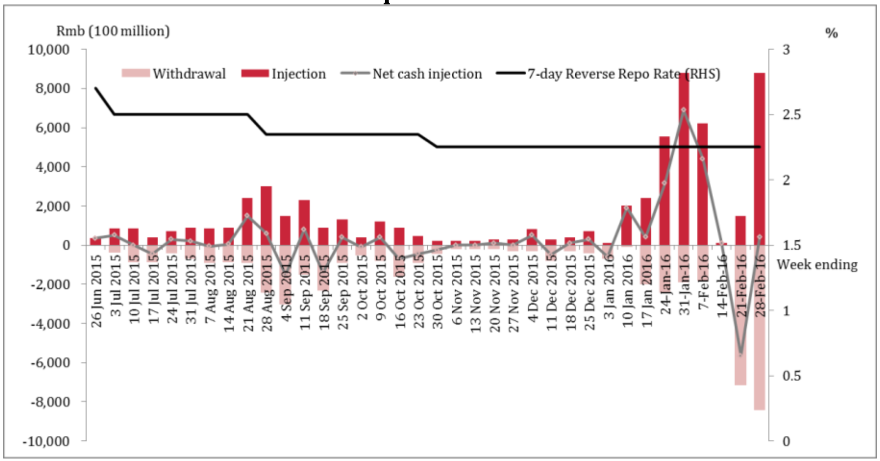
Will there be further cuts in RRR and benchmark interest rates? YES. We think carefully-channeled monetary easing is necessary to stabilize China's economic growth and facilitate structural reforms. After the cut, RRR for large FIs is 17%, still 1.5ppt higher than its level during the global financial crisis. **Over the remaining of 2016, we forecast three more cuts in RRR and one cut in benchmark interest rate.** We expect fewer cuts in benchmark interest rate because market interest rate is now guided more often by the PBoC's open market operations. The relevance of benchmark interest rate will become weaker over time. The PBoC has already lowered the interest rate of Medium Loan Facilities (MLF) several times since the end of 2015 – interest rate of 6-month MLF was lowered from 3.35% in Oct-15 to 2.85% in Feb-16.

Figure 1: RRR Lowered to 17% for Large FI, Effective on 1 Mar 2016



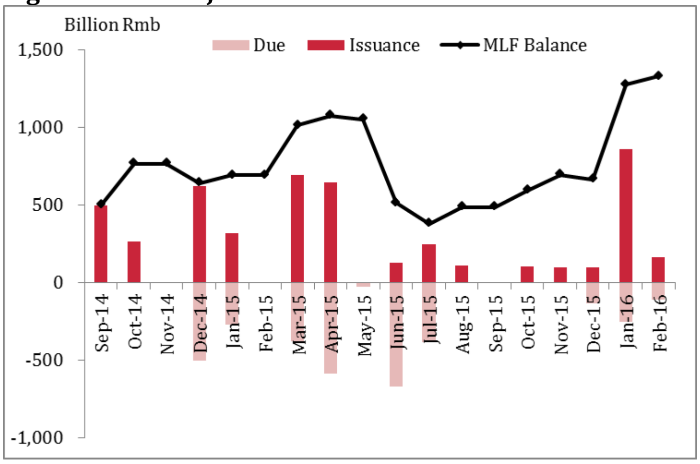
Source: The PBoC. CMBIS.

Figure 2: The PBoC Immensely Expanded Reverse-Repos During the Chinese New Year and Rmb1.16 tn Is Expected to be Withdrawn This Week



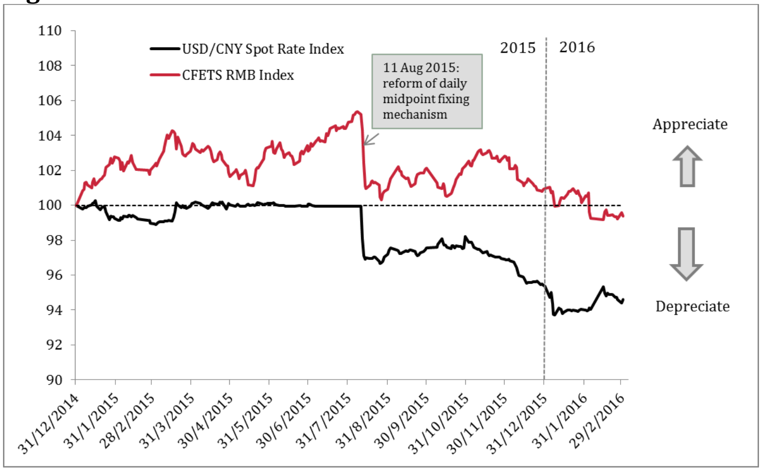
Source: The PBoC. CMBIS.

Figure 3: Cash Injection via MLF



Source: The PBoC. CMBIS.

Figure 4: We Think the CFETS RMB Index Will Float around 100 in 2016.



Source: The PBoC. CMBIS.

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