

China Policy

Surprisingly modest LPR cut indicates Policymakers' dilemma

China trimmed its one-year loan prime rate (LPR) by 10 basis points from 3.55% to 3.45% while kept its five-year LPR on hold at 4.2% yesterday. The unchanged 5-year LPR was unexpected, particularly following a surprise cut on the medium term lending facility (MLF) rate last week. The mixed signals sent by the central bank shows the dilemma the policymakers currently facing: the market expected the government in policy support to address the worrying slump of property market, while the alarmingly narrowing interest margin of banking system and the mounting pressure on RMB exchange rate limited the interest rate policy space. Looking forward, we expect further decrease in deposit rates and RRR to create additional room for LPR cut when US dollar is not so strong. Meanwhile, more cities including tier-1 cities may further loosen property policy with continuous declines in down-payment ratios and mortgage rates for first-home and second-home buyers.

- LPR cut disappointed the market.** LPRs are basically linked with the MLF rates. As the PBOC lowered one-year MLF rate by 15bps last week, investors expected the LPRs to drop by the same magnitude yesterday. However, the central bank disappointed the market by lowering one-year LPR by only 10bps and keeping five-year LPR unchanged. By severing the linkage between LPR and MLF, the authority made the policy rate system more complex and the policy signal more ambiguous. In the long run, the central bank faces the problem of cultivating a clear and reliable policy rate.
- One obstacle for LPR cut is banks' NIM pressure.** The average NIM of commercial banks dropped from 2.2% in 4Q19 to 1.74% in 1H23. According to the prudential rule set by the Self-discipline Institution for Market Rate Pricing, banks should maintain their NIMs at above 1.8%. In 1H23, average NIMs of large banks, joint-stock banks, city banks and rural banks respectively reached 1.68%, 1.82%, 1.63% and 1.87%. To protect banks' NIM, the central bank is very cautious to lower LPRs and does not allow households to refinance their mortgage loans. However, the weak economy especially the worrying housing market needs additional policy support. To create additional room for LPR cut, the central bank may guide banks to further reduce deposit rates.
- Another factor is RMB exchange rate pressure.** The US-Sino interest rate spreads reached its highest for over a decade as renminbi depreciated sharply against US dollar. The weak Chinese economy amid fragile confidence compared to the still-hot US economy with bullish sentiment is like the Song of Ice and Fire. We expect the Fed will at least maintain its current policy rate until 1Q24, if not raising one last time in November possibly, depending on the 3Q23 inflation data. It would be an art of tightrope walking for the PBOC to balance its domestic policy support and foreign exchange rate pressure. To prioritize the target of supporting domestic economy, the central bank has to tolerate renminbi exchange rate fluctuations and may further tighten capital control.

Bingnan YE, Ph.D

(852) 3761 8967

yebingnan@cmbi.com.hk

Frank Liu

(852) 3761 8957

frankliu@cmbi.com.hk

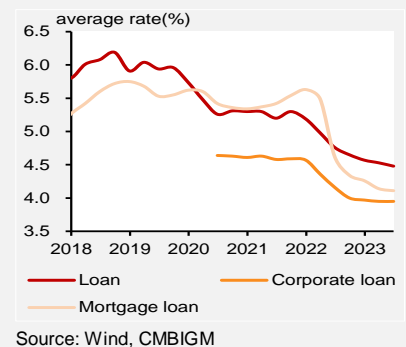
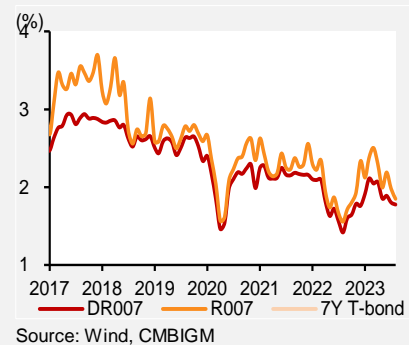
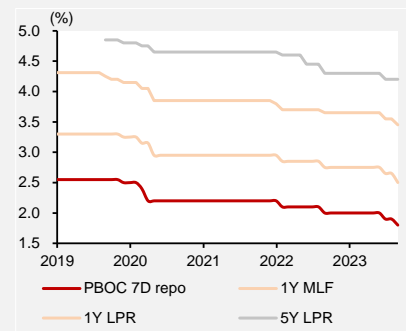
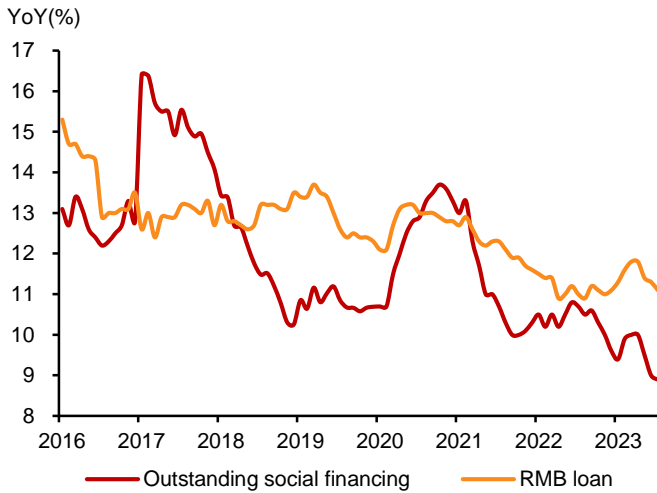
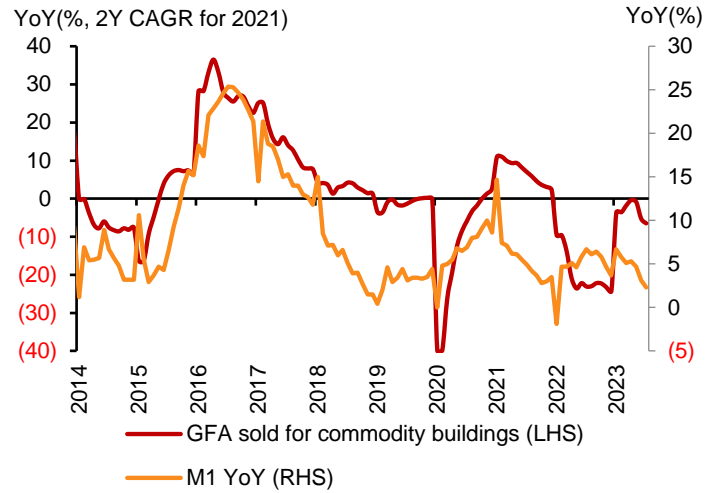


Figure 1: China credit growth



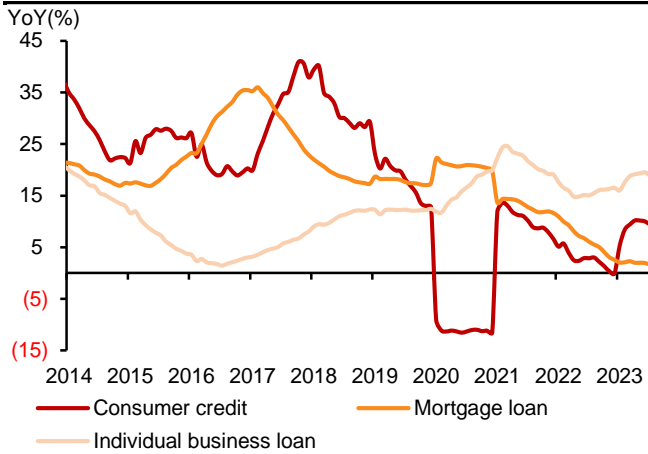
Source: Wind, CMBIGM

Figure 2: Property sales and M1 growth



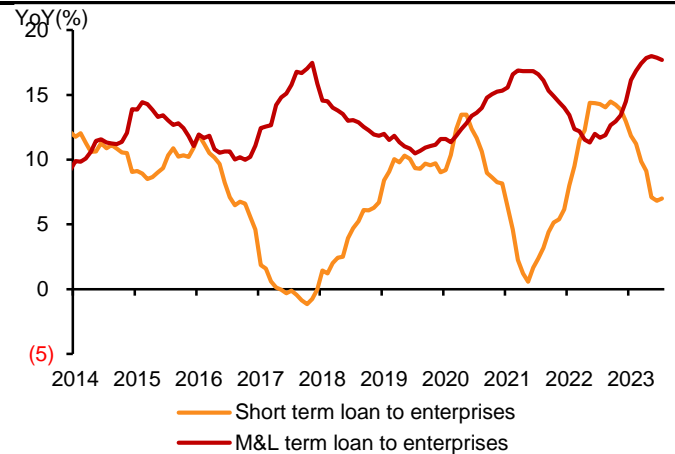
Source: Wind, CMBIGM

Figure 3: Growth of individual loans



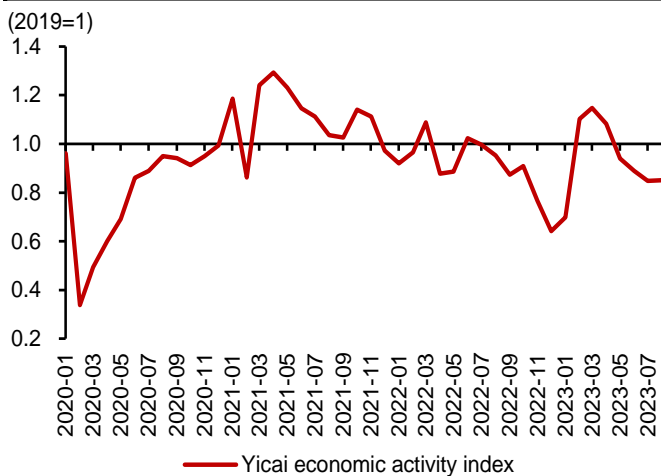
Source: MoF, CMBIGM

Figure 4: Growth of loans to enterprises



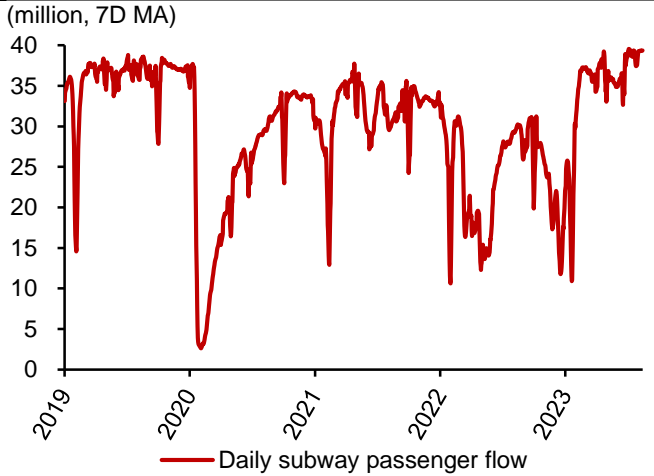
Source: MoF, CMBIGM

Figure 5: Yicai Economic Activity Index



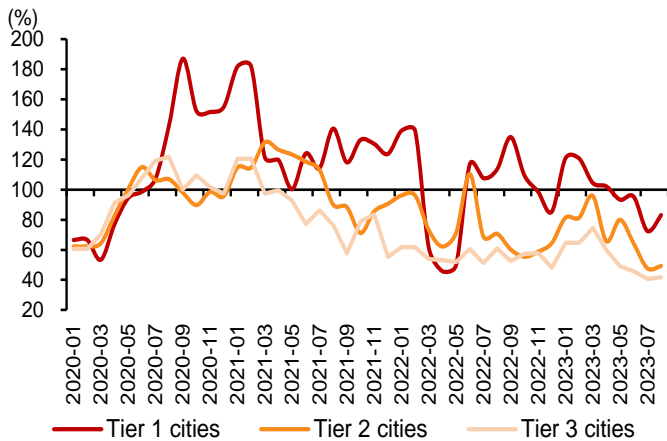
Source: Wind, CMBIGM

Figure 6: Subway passenger flow in tier-1 cities



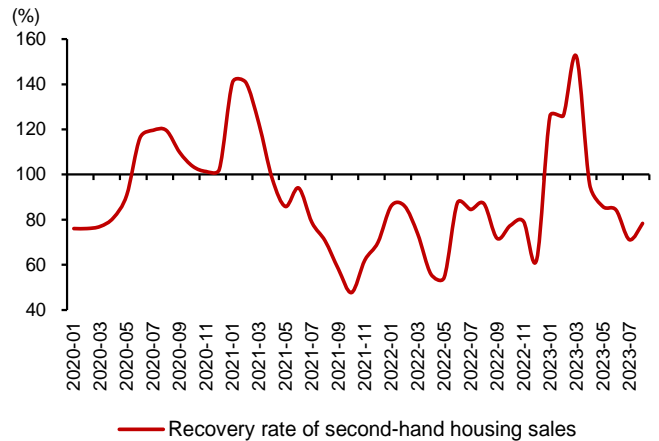
Source: Wind, CMBIGM

Figure 7: Housing Sales Recovery Rates to 2019 in 30 Cities



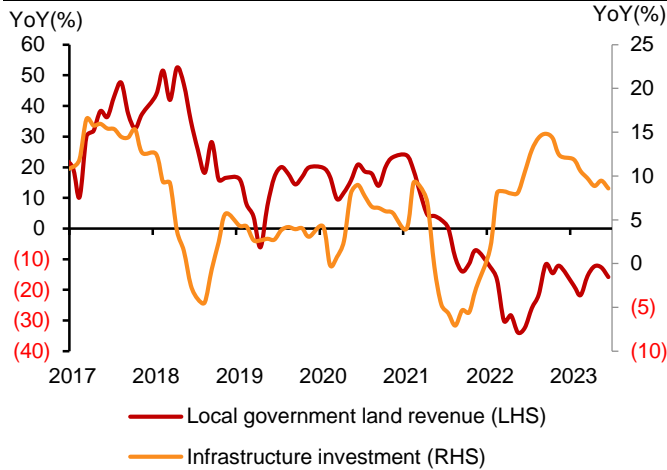
Source: Wind, CMBIGM

Figure 8: Recovery rate of 2nd hand housing sales compared to 2019 in 11 selective cities



11 cities include Beijing, Shenzhen, Hangzhou, Nanjing, Chengdu, Qingdao, Suzhou, Xiamen, Wuxi, Dongguan and Foshan
Source: Wind, CMBIGM

Figure 9: Growth of infrastructure investment



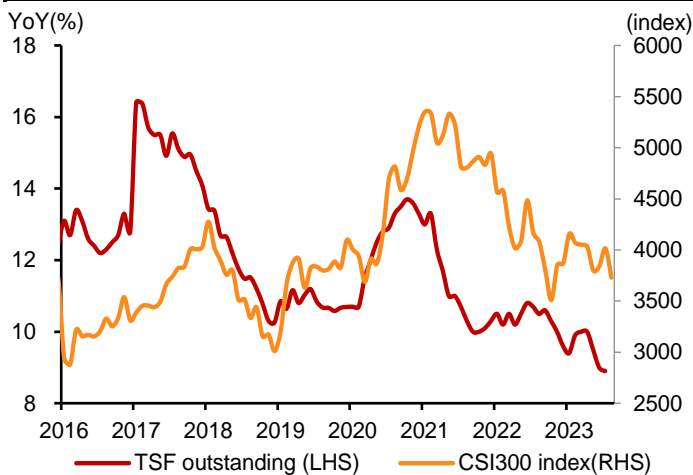
Source: Wind, CMBIGM

Figure 10: Core CPI growth & 2Y T-bond rates



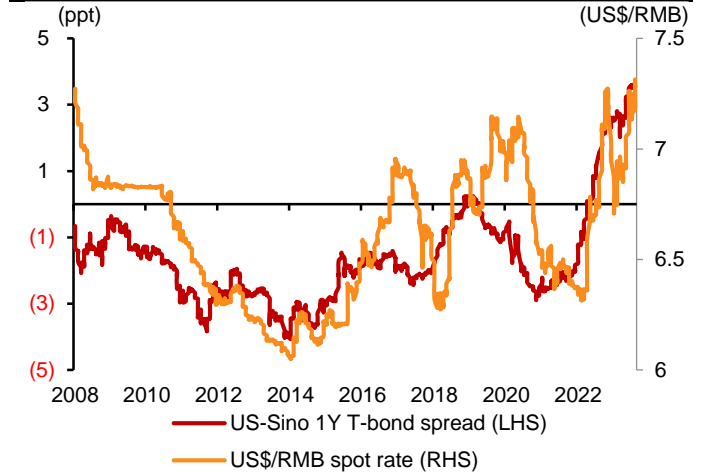
Source: Wind, CMBIGM

Figure 11: Credit growth & CSI300 index



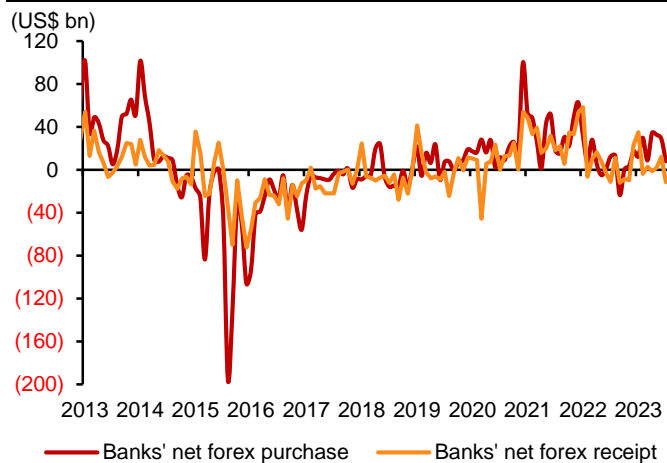
Source: Wind, CMBIGM

Figure 12: US/RMB interest spreads & exchange rates



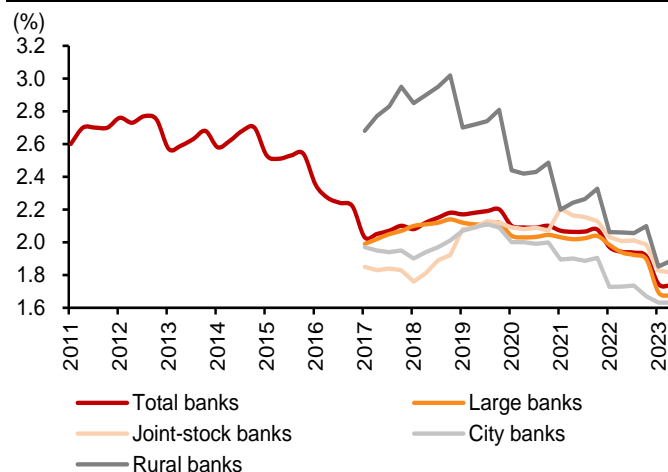
Source: Wind, CMBIGM

Figure 13: Net forex inflow



Source: Wind, CMBIGM

Figure 14: Net interest margins of banks



Source: Wind, CMBIGM

Disclosures & Disclaimers

Analyst Certification

The research analyst who is primary responsible for the content of this research report, in whole or in part, certifies that with respect to the securities or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about the subject securities or issuer; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific views expressed by that analyst in this report.

Besides, the analyst confirms that neither the analyst nor his/her associates (as defined in the code of conduct issued by The Hong Kong Securities and Futures Commission) (1) have dealt in or traded in the stock(s) covered in this research report within 30 calendar days prior to the date of issue of this report; (2) will deal in or trade in the stock(s) covered in this research report 3 business days after the date of issue of this report; (3) serve as an officer of any of the Hong Kong listed companies covered in this report; and (4) have any financial interests in the Hong Kong listed companies covered in this report.

CMBIGM Ratings

BUY : Stock with potential return of over 15% over next 12 months
HOLD : Stock with potential return of +15% to -10% over next 12 months
SELL : Stock with potential loss of over 10% over next 12 months
NOT RATED : Stock is not rated by CMBIGM

OUTPERFORM : Industry expected to outperform the relevant broad market benchmark over next 12 months
MARKET-PERFORM : Industry expected to perform in-line with the relevant broad market benchmark over next 12 months
UNDERPERFORM : Industry expected to underperform the relevant broad market benchmark over next 12 months

CMB International Global Markets Limited

Address: 45/F, Champion Tower, 3 Garden Road, Hong Kong, Tel: (852) 3900 0888 Fax: (852) 3900 0800

CMB International Global Markets Limited ("CMBIGM") is a wholly owned subsidiary of CMB International Capital Corporation Limited (a wholly owned subsidiary of China Merchants Bank)

Important Disclosures

There are risks involved in transacting in any securities. The information contained in this report may not be suitable for the purposes of all investors. CMBIGM does not provide individually tailored investment advice. This report has been prepared without regard to the individual investment objectives, financial position or special requirements. Past performance has no indication of future performance, and actual events may differ materially from that which is contained in the report. The value of, and returns from, any investments are uncertain and are not guaranteed and may fluctuate as a result of their dependence on the performance of underlying assets or other variable market factors. CMBIGM recommends that investors should independently evaluate particular investments and strategies, and encourages investors to consult with a professional financial advisor in order to make their own investment decisions.

This report or any information contained herein, have been prepared by the CMBIGM, solely for the purpose of supplying information to the clients of CMBIGM or its affiliate(s) to whom it is distributed. This report is not and should not be construed as an offer or solicitation to buy or sell any security or any interest in securities or enter into any transaction. Neither CMBIGM nor any of its affiliates, shareholders, agents, consultants, directors, officers or employees shall be liable for any loss, damage or expense whatsoever, whether direct or consequential, incurred in relying on the information contained in this report. Anyone making use of the information contained in this report does so entirely at their own risk.

The information and contents contained in this report are based on the analyses and interpretations of information believed to be publicly available and reliable. CMBIGM has exerted every effort in its capacity to ensure, but not to guarantee, their accuracy, completeness, timeliness or correctness. CMBIGM provides the information, advices and forecasts on an "AS IS" basis. The information and contents are subject to change without notice. CMBIGM may issue other publications having information and/or conclusions different from this report. These publications reflect different assumption, point-of-view and analytical methods when compiling. CMBIGM may make investment decisions or take proprietary positions that are inconsistent with the recommendations or views in this report.

CMBIGM may have a position, make markets or act as principal or engage in transactions in securities of companies referred to in this report for itself and/or on behalf of its clients from time to time. Investors should assume that CMBIGM does or seeks to have investment banking or other business relationships with the companies in this report. As a result, recipients should be aware that CMBIGM may have a conflict of interest that could affect the objectivity of this report and CMBIGM will not assume any responsibility in respect thereof. This report is for the use of intended recipients only and this publication, may not be reproduced, reprinted, sold, redistributed or published in whole or in part for any purpose without prior written consent of CMBIGM.

Additional information on recommended securities is available upon request.

For recipients of this document in the United Kingdom

This report has been provided only to persons (I) falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (as amended from time to time) ("The Order") or (II) are persons falling within Article 49(2) (a) to (d) ("High Net Worth Companies, Unincorporated Associations, etc.") of the Order, and may not be provided to any other person without the prior written consent of CMBIGM.

For recipients of this document in the United States

CMBIGM is not a registered broker-dealer in the United States. As a result, CMBIGM is not subject to U.S. rules regarding the preparation of research reports and the independence of research analysts. The research analyst who is primary responsible for the content of this research report is not registered or qualified as a research analyst with the Financial Industry Regulatory Authority ("FINRA"). The analyst is not subject to applicable restrictions under FINRA Rules intended to ensure that the analyst is not affected by potential conflicts of interest that could bear upon the reliability of the research report. This report is intended for distribution in the United States solely to "major US institutional investors", as defined in Rule 15a-6 under the US, Securities Exchange Act of 1934, as amended, and may not be furnished to any other person in the United States. Each major US institutional investor that receives a copy of this report by its acceptance hereof represents and agrees that it shall not distribute or provide this report to any other person. Any U.S. recipient of this report wishing to effect any transaction to buy or sell securities based on the information provided in this report should do so only through a U.S.-registered broker-dealer.

For recipients of this document in Singapore

This report is distributed in Singapore by CMBI (Singapore) Pte. Limited (CMBISG) (Company Regn. No. 201731928D), an Exempt Financial Adviser as defined in the Financial Advisers Act (Cap. 110) of Singapore and regulated by the Monetary Authority of Singapore. CMBISG may distribute reports produced by its respective foreign entities, affiliates or other foreign research houses pursuant to an arrangement under Regulation 32C of the Financial Advisers Regulations. Where the report is distributed in Singapore to a person who is not an Accredited Investor, Expert Investor or an Institutional Investor, as defined in the Securities and Futures Act (Cap. 289) of Singapore, CMBISG accepts legal responsibility for the contents of the report to such persons only to the extent required by law. Singapore recipients should contact CMBISG at +65 6350 4400 for matters arising from, or in connection with the report.