CFDS At Henan University

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A guide to monetary policy in the PRC

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Monetary Policy Supports Rural Development

In our MP Reports, we aim to provide a concise and timely analysis of Chinese monetary policy that makes it accessible for an international audience.

The current economic background

In the first quarter of 2019, it seems as if China and the U.S were making considerable progress in their negotiations for a trade deal, particularly regarding an enforcement mechanism to alleviate American concerns that the Chinese side would not follow up on promises. However, the unresolved international trade dispute made the global economy fragile and unstable. To offset the negative influence of a challenging global economic climate, the Chinese government has announced several economic stimulus measures, most notably including a VAT tax cut, and a reserve requirement ratio (RRR) reduction. Regardless of the relatively low GDP growth forecast, the Chinese stock market performed well in the first quarter of 2019. The GDP rose to 21.34 trillion in the first quarter, which corresponds to a year over year growth rate of 6.4%, exceeding expectations.

Monetary policy in the first quarter 2019: Overview

Policy Dashboard

The PBoC focused on stabilizing the financial system and responding to the trade conflict with the US. On April 12th, the PBoC released a brief statement of its 2019 first quarter monetary policy committee (MPC) meeting. Table 1 summarizes the major actions of the PBoC during the recent months.

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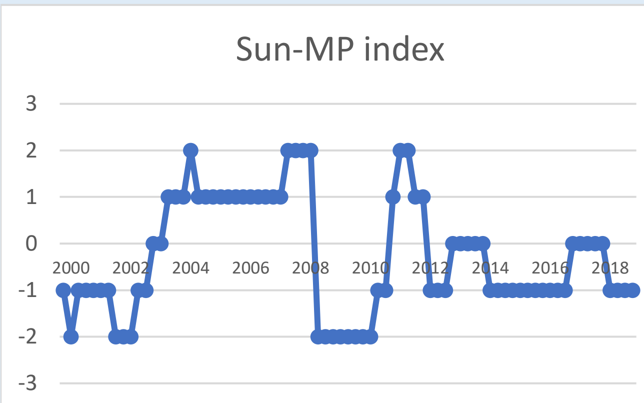
Table 1: Policy Dashboard

Jan 4th	The required reserve ratio (RRR) was cut to support voluntary and mandatory debt-equity swaps and finance small and micro firms
Jan 23th	Introduction of a new monetary policy tool, the Targeted Medium-term Lending Facility (TMLF).
Jan 25th	Launches Central Bank Bills Swap to Support Liquidity of Banks' Perpetual Capital Securities
Feb 11th	Guidelines for financing serving rural vitalization

Current monetary policy stance

Given that China's most recent actions were mostly compensating the ongoing macroprudential measures, China's policy is still only mildly expansionary and mostly neutral. This is in line with both the PBoC's official communication and the comprehensive Sun-MP index, summarizing monetary policy in China, that has been fluctuating between 0 (neutral) and -1 (mildly expansionary) since 2012 (see Figure 1).

Figure 1: SUN-MP-Index



Note: The index is normalized to mimic the direction of interest rate changes as traditional summary indicator for monetary policy, i.e. high values are contractionary: 2 highly contractionary, 0 neutral, 2 highly expansionary

China's politburo and state council have replaced the term "deleveraging" with "structural deleveraging" in their official statement, which could potentially suggest a less harsh regulation on credit. In order to facilitate lending to private enterprises the PBoC has cut the required reserve ratio (RRR) five times in 2018 and 2019 in order to lower financing costs.

In general, the PBoC is aiming to alleviate credit constraints in sectors and regions that lag behind the general economic development through both new financial regulation (in particular to promote rural areas) and expansionary policy that targets only small and medium sized banks (rather than the "big four") which are particularly important for small enterprises and rural areas.

Table 2: Recent changes of the required reserve ratio

Date	Large-scale Financial Institutions			Small-medium-scale Financial Institutions		
	Before	After	Adjustment	Before	After	Adjustment
2015.02.05	20.00%	19.50%	-0.50%	18.00%	17.50%	-0.50%
2015.04.20	19.50%	18.50%	-1.00%	17.50%	16.50%	-1.00%
2015.06.28	Part of banks RRR cut by 0.50%					
2015.09.06	18.50%	18.00%	-0.50%	16.50%	16.00%	-0.50%
2015.10.24	18.00%	17.50%	-0.50%	16.00%	15.50%	-0.50%
2016.03.01	17.50%	17.00%	-0.50%	15.50%	15.00%	-0.50%
2018.01.25	Part of banks RRR cut by 0.50-1.50%					
2018.04.25	17.00%	16.00%	-1.00%	15.00%	14.00%	-1.00%
2018.06.24	16.00%	15.50%	-0.50%	14.00%	13.50%	-0.50%
2018.10.07	15.50%	14.50%	-1.00%	13.50%	12.50%	-1.00%
2019.01.07	14.50%	13.5%	-1.00%	12.50%	11.50%	-1.00%

Recent policy decisions in detail

Monetary policy to maintain aggregate liquidity

As expected, on January 7th the PBoC announced a reduction of the required reserve ratio (RRR) by one percentage point. This is the fifth adjustment in merely 12 months. Like some of the previous changes, the reduction of the RRR is to compensate for expiring medium term lending facilities.

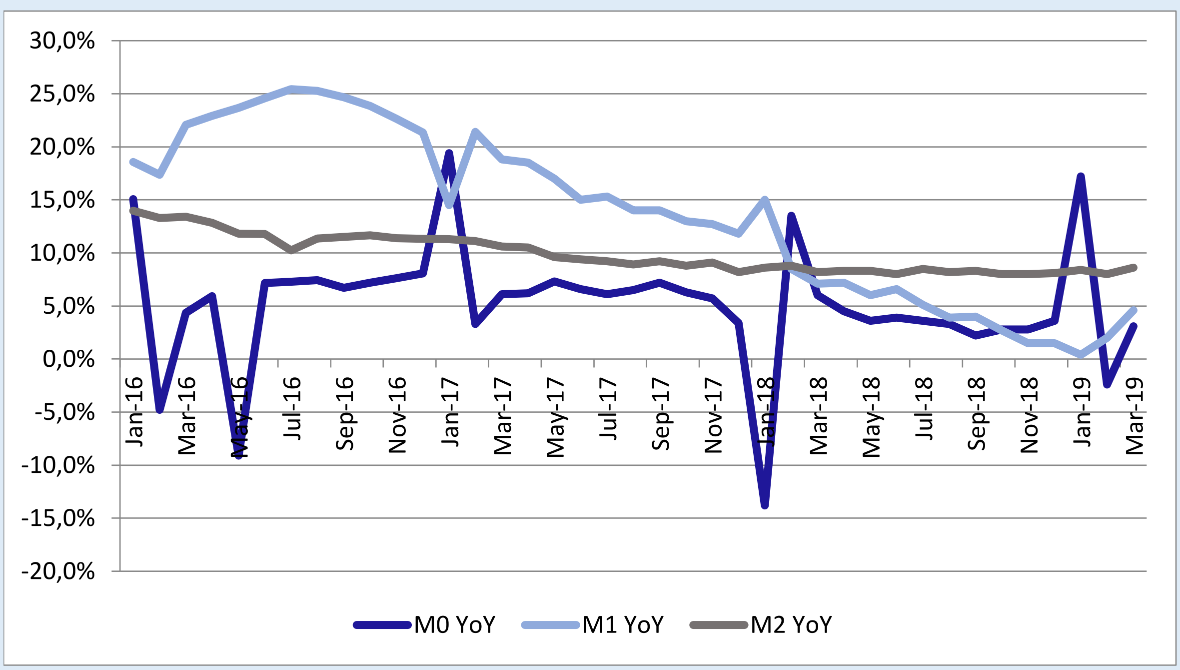
Specifically, the most recent change offsets the expiration of 700 billion medium-term lending facilities, but also releases 800 billion additional liquidity. In total the cumulative effect of the RRR reductions in past four times is 4.75 trillion RMB. The goal is to inject liquidity and stabilize the interbank market. The change of deposit reserve ratio emerges as the major monetary policy tool for now. Although the bulk of the cash will be used to repay loans from the central bank and support the lending to small businesses and rural areas, it still starts a period of mild monetary easing.

On January 23rd, the PBoC introduced a new targeted MLF to spur lending to small and private firms. The size of first TMLF operation was set at RMB 257.5 billion, with an interest rate of 3.15%, 15 basis points below the rate of regular MLF. The TMLF will mature in one year and can be rolled over twice in accordance with the demands of financial institutions, making the actual maturity as long as three years.

On January 25th, the PBoC decided to launch a Central Bank Bills Swap (CBS) to encourage banks to raise more capital through perpetual bond issuance. And bank's perpetual bonds with ratings at no lower "AA" will be considered as qualified collateral for the medium-term lending facility.

On February 11th, the People's Bank of China (PBoC), the China Banking and Insurance Regulatory Committee (CBIRC), the China Securities Regulatory Commission (CSRC), the Ministry of Finance (MOF) and the Ministry of Agriculture and Rural Affairs (MOA) jointly released the "Guidelines on Financing Rural

Figure 2: Growth of Money Supply



Note: YoY denotes monthly growth rates calculated annually

Vitalization”. The guidelines encourage state-owned banks to lend more to small and midsize companies, especially, agricultural enterprises. Furthermore, the guidelines will establish the systems of financial market, organization and products to support rural vitalization.

Summary of Financial Indicators

Growth of monetary aggregates slightly accelerate

The growth of monetary aggregates in the first quarter of 2019 was mostly stable. According to the PBoC, the year on year growth rate of M2 has increased to 8.6% with an absolute level of RMB 188.94 trillion (8% in the last quarter); the year on year growth rate of M1 rose to 4.6% with an absolute level of RMB 54.76 trillion, indicating a slight acceleration in M1 growth. The monetary base M0 increased by 3.1% (year-over-year) to roughly RMB 7.49 trillion. It is noteworthy that the Chinese Spring Festival – where traditionally cash gifts are made - being in early February rather than mid-February (as 2018) caused a shift in M0 demand to January, causing the massive increase in January 2019 with the corresponding decline in February.

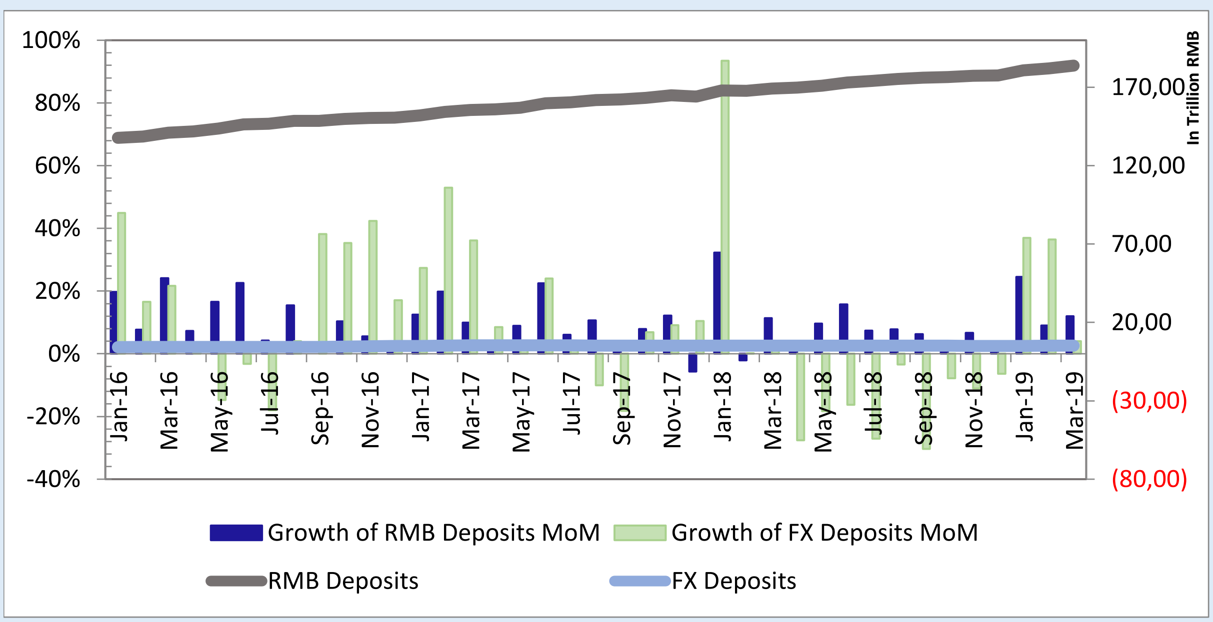
RMB and foreign currency deposits in financial institutions growth rate decelerate

By the end of March, the outstanding RMB and FX deposits totaled RMB 189 trillion, an increase of 8.3% year on year. This is entirely driven by the growth of RMB deposits. FX deposits have been dramatically increasing early this year, after a considerable drop in the growth of foreign assets in 2018. However, the total amount of FX deposits is still far too low to be a main driver of total deposit growth.

Lending by financial institutions grew rapidly

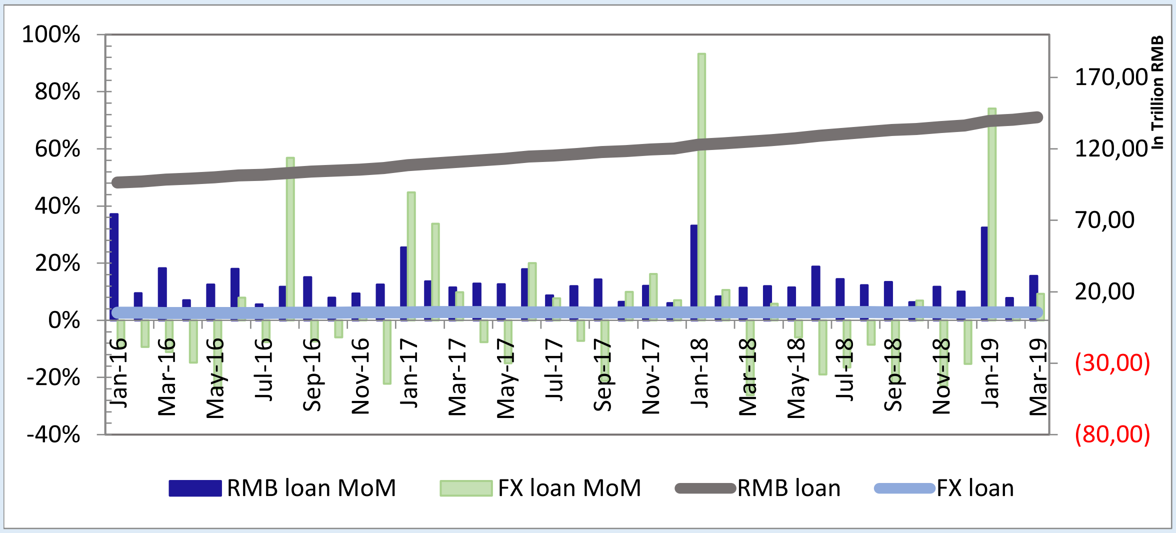
Outstanding loans in domestic and foreign currencies of all financial institutions totaled RMB 147.77 trillion at the end of March, increasing by 13.3% year on year. As with deposits, the growth is almost entirely determined by the domestic part. Outstanding RMB loans grew by 13.7 percent year on year to RMB 142.11 trillion, which is the highest during the past two years. This is partly driven by Beijing strongly encouraging improved access to credit for small and micro private enterprises. Furthermore, the outstanding foreign currency loans arrived at USD 841 billion, down by 3.4% year-on-year.

Figure 3: Growth of RMB and FX Deposits and total amount of RMB and FX Deposits (in trillion RMB)



Note: Growth of RMB Deposits MoM is Month-on-Month

Figure 4: Growth of Loans and total amount of RMB and FX loans (in trillion RMB)



Note: Growth of RMB Loans MoM is Month-on-Month

Inter-bank market more active

In March, the total volume of transaction in the interbank market was 280.89 trillion, implying a 30% year on year growth. At the same time, the weighted average interest rate of interbank lending was 2.42%; and the monthly weighted average repo rate was 2.47%. Both rates reflect that the price of interbank market is stable.

Foreign reserves fell and RMB depreciates

The RMB slightly appreciate since early 2019. At the end of March, the exchange rate was RMB 6.7335 per USD, and China's foreign reserves fell back to USD 3.1 trillion.

International trade start more active

In the first quarter, RMB settlement of cross-broader trade in goods, cross-border trade in services and other current account items, ODI and FDI amounted to RMB 957.47 billion, 334.24 billion, 143.35 billion and 447.27 billion, respectively.

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