16 March 2017

Flash Comment China

Money market policy rates increased – official rates left unchanged (for now)

China raised a range of money market borrowing rates by 10bp this morning (7, 14 and 28-day repos, medium lending facility) – not long after the Fed hiked 25bp. The move by the People's Bank of China (PBoC) follows a 10bp hike in February. The official deposit and lending rates were kept unchanged, though.

China uses the money market facilities to try to reign in too much leverage in the financial system. Official lending and deposit rates are changed when deemed necessary to steer the real economy and inflation. Currently inflation is well below the 3% target but we expect it to move above target during spring and the PBoC to raise official rates by 2x 25bp over next six months.

The 3m money market rate is now very close to the upper level in the rate corridor of official rates as the 1-year lending rate is 4.35% and the 3m money market rate now at 4.33%. However, a larger part of the money market funding has moved to short maturities using 7-day and 14-day funding as the rates are much lower here. Hence **in order to increase the real cost of money market funding, the PBoC needs to push up the cost of shorter-dated repo rates.** The moves of 10bp at a time are very moderate, but it has been enough to push up the cost of borrowing through the bond market. The rise in bond yields is starting to weigh on highly indebted companies, which is why the PBoC is probably careful in not taking too big steps.

The Chinese money market system has evolved gradually over the past couple of years with many different facilities and rates, making it harder to interpret moves by the PBoC. However, the recent moves are most likely targeted at dampening leverage in the financial system, which has gone up over the past year in order to get a higher return in an environment where it has become harder to deliver the promised returns in for example Wealth Management Products. This is because yields have in general declined to low levels. Lower yields drive more leverage creating more financial fragility. It is this leverage that the PBoC is trying to dampen by making it more expensive.

CNY strengthened against USD yesterday from 6.89 to 6.85 following the Fed hike as the USD weakened. This morning CNH is a bit weaker again, moving up to around 6.87 against the USD. The CNH rate is again a bit stronger than CNY (6.874 vs 6.897). **Hence companies with export income in CNY can take advantage of this and convert CNY to CNH at a 1-1 rate gaining the spread between the CNH and CNY.**

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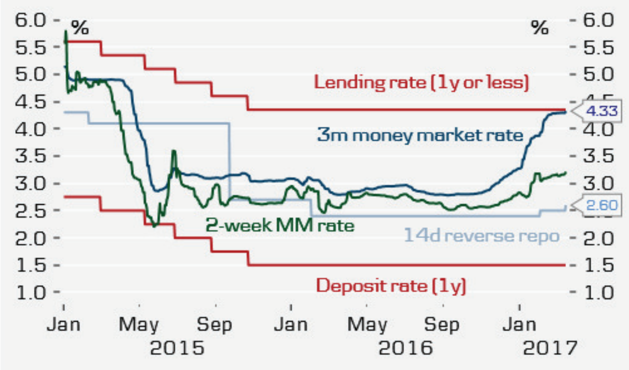
PBoC raised short-term repo rates another 10bp



Source: Macrobond Financial, Bloomberg

Higher money market rates have pushed up financing costs

Source: Macrobond Financial, Bloomberg

CNH stronger again than CNY

Source: Macrobond Financial, Bloomberg

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None.

Date of first publication

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