China Policy

PBOC indicates moderate credit easing ahead

PBOC published its 4Q21 monetary policy report last Friday, indicating a moderate easing of credit policy ahead. The central bank vowed to maintain reasonable ample liquidity, lower corporate loan contract rates, stimulate credit demand and guide banks to expand credit supply especially to SMEs, agriculture, private enterprises, tech innovation & green development. It will not aggressively stimulate housing market, but will increase credit support to rental housing projects and reasonable housing demand to facilitate housing market stability. The PBOC would further increase renminbi exchange rate flexibility to absorb external shocks and maintain domestic policy autonomy. The combination of US policy tightening and China's economic slowdown has a negative impact on global markets. We may have to wait until 2Q22 to see a decline of US inflation with additional policy tightening and a stabilization of China economy with additional policy easing.

- **PBOC's views on economic condition.** 1) 4Q21 economy rebounded from the 2Y-CAGR perspective. This is mainly due to supply-side improvement as factory activities recovered from the energy crunch and chip shortage. 2) Economy faces demand weakening, supply shocks and confidence deterioration as resurgence of Covid-19 virus hurts consumption and property sector continues to slow down. 3) China should pay attention to spillover effects of US monetary policy tightening. 4) Inflation risk is low for China.
- **Stable liquidity policy with reasonable ample liquidity supply.** The PBOC said to improve monetary policy operations to maintain reasonable ample liquidity supply. Money market rates would fluctuate around the central bank's policy rates. It is possible to see additional RRR cut ahead of the National People's Congress (NPC) in March.
- **Corporate loan contract rates guided to decline to boost credit demand.** The PBOC said to enhance deposit market regulation to stabilize banks' funding costs. At the same time, the central bank will guide a decline of corporate loan contract rates to lower financing costs for enterprises and boost credit demand.
- **Banks urged to expand credit supply especially to SMEs, peripheral regions, science & tech innovation & green development projects.** The PBOC urged banks to expand credit supply especially to SMEs (key for employment), agriculture & peripheral regions (to narrow the rich-poor gap), science & tech innovation and green development projects (economic upgrading & transition). The central bank will use special low-cost refinancing loans to encourage banks to support carbon-reduction projects, coal energy saving and clean energy use.
- **More credit support to rental housing projects and reasonable housing demand to facilitate housing market stability.** The PBOC said China would not use real estate stimulus as a tool to boost growth. But China will increase credit support to rental housing projects and reasonable housing demand (first-home buyers and house upgrading demand) to facilitate housing market stability. In January, the PBOC cut 5Y LPR by 5bps, lower than 10bps for 1Y LPR. Along with the liquidity and credit supply easing from 4Q21, property developers' liquidity and credit risk tends to decline from 1Q22. But housing

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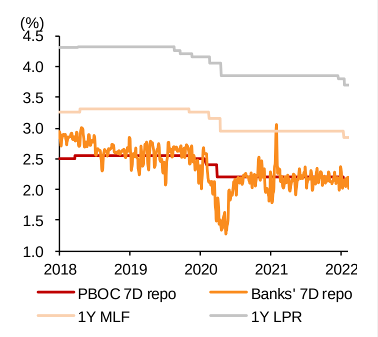
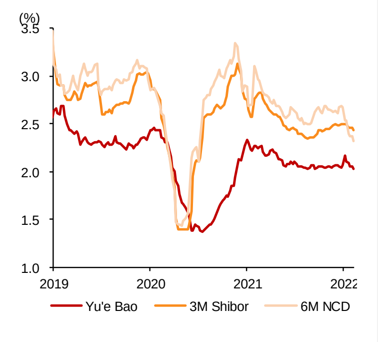




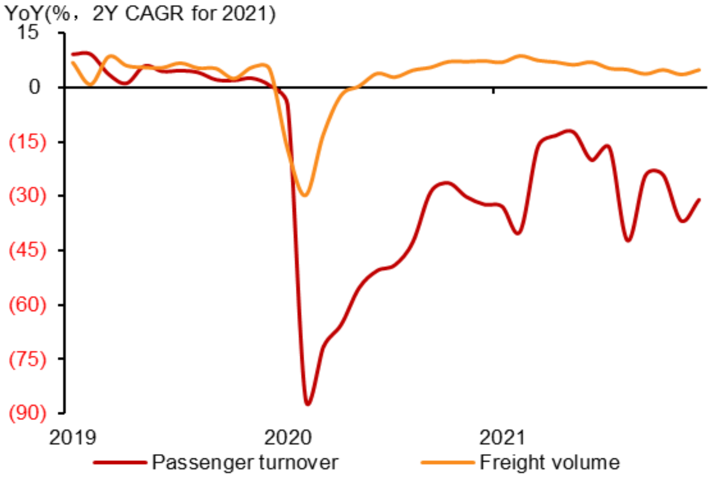
demand and development investment may remain weak for a few months before a stabilization in late 2Q22. 2H22 may see a gradual improvement of housing sales and development investment. But this round of deleveraging definitely accelerates the close of the growth era for China's real estate sector. Except for tier-one cities and some core tier-two cities, most small and medium sized cities may enter a long-term downward period in future.

- **More flexible renminbi exchange rates to absorb external shocks and maintain domestic policy autonomy.** Flexible exchange rates are key for China to maintain domestic policy autonomy in face of US Fed's policy tightening cycle. The PBOC has basically given up direct forex interventions as its forex position has remained stable since 2017. When the market moves in one direction too long to cause a disorder risk, the central bank my use verbal intervention, central parity guidance, window guidance or swap with large banks to influence market expectations. US$/RMB exchange rates basically move along with the US-Sino interest rate spreads, reflecting the dynamics of the two countries' relative economic strength. Renminbi seemed much stronger than the interest rate spreads implied. One possible reason is the forex inflow due to China's huge trade surplus and bond market opening. We believe renminbi may turn weak with some mild depreciation as the Sino-US interest rate spreads should continue to decline.

- **Financial systematic risk prevention and accountability.** 1) Systemically important banks should establish total loss absorption capacity. 2) Small and medium sized banks are encouraged to dispose risk and replenish capital by issuing perpetual bonds. 3) China will enhance regulation over financial holding group companies. 4) Local government leaders are the main person responsible for risk disposal. China will take serious accountability for major financial risks. The above policies should have a mixed impact on China's credit growth. They tend to improve China's financial system stability. But the last two policies may restrain China's credit growth in the short term.

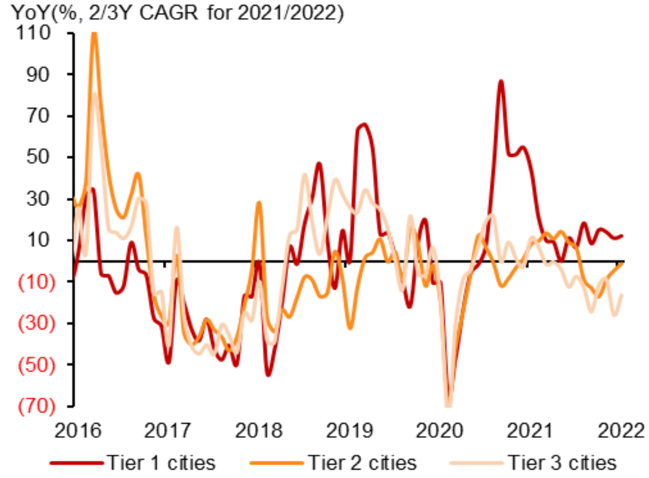
- **Investors wait to see when US inflation declines and China economy stabilizes.** The combination of US policy tightening and China's economic slowdown has a negative impact on global markets. The US policy tightening is rapid while China's policy easing is slow. Investor confidence may remain weak in near term. We may need to wait until 2Q22 to see a decline of US inflation with additional policy tightening and a stabilization of China economy with additional policy easing.

Figure 1: Passenger Turnover & Freight Volume



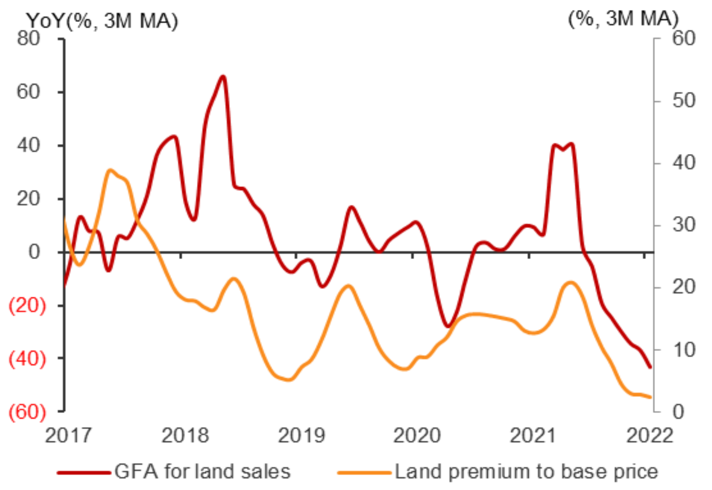
Source: Wind, CMBIS

Figure 2: House Sales Volume



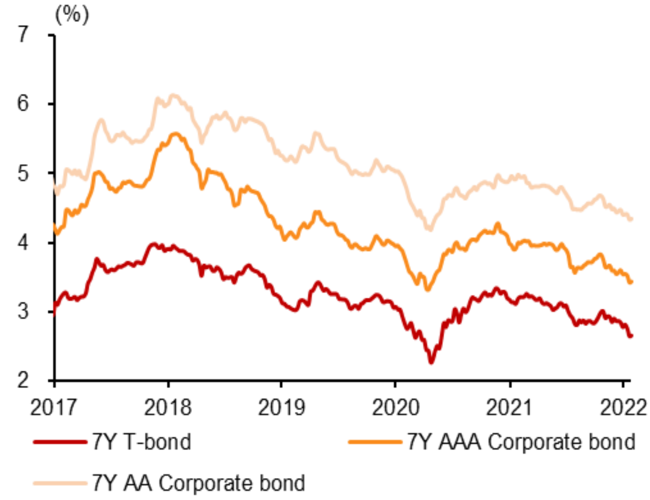
Source: Wind, CMBIS

Figure 3: Land Sales Volume & Premium



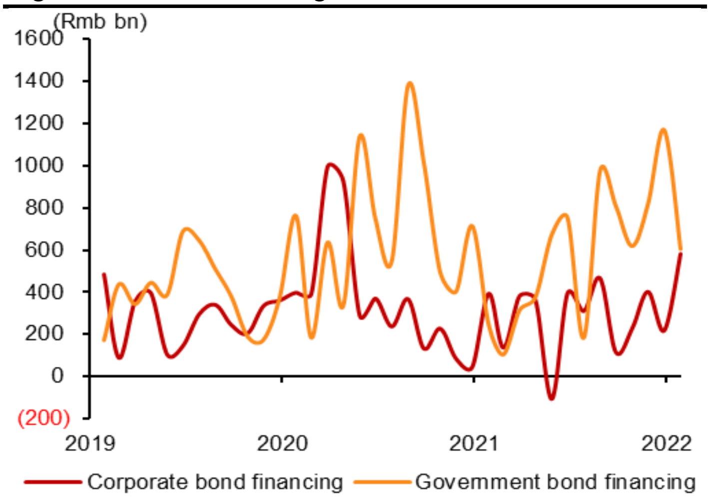
Source: Wind, CMBIS

Figure 4: Bond Market Rates



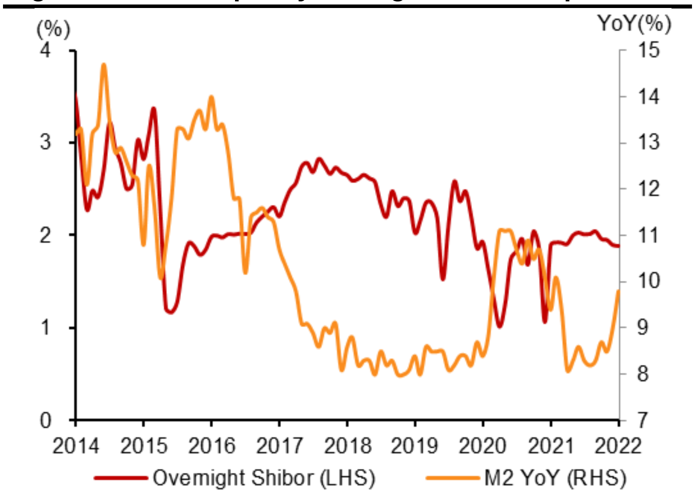
Source: Wind, CMBIS

Figure 5: Bond Financing



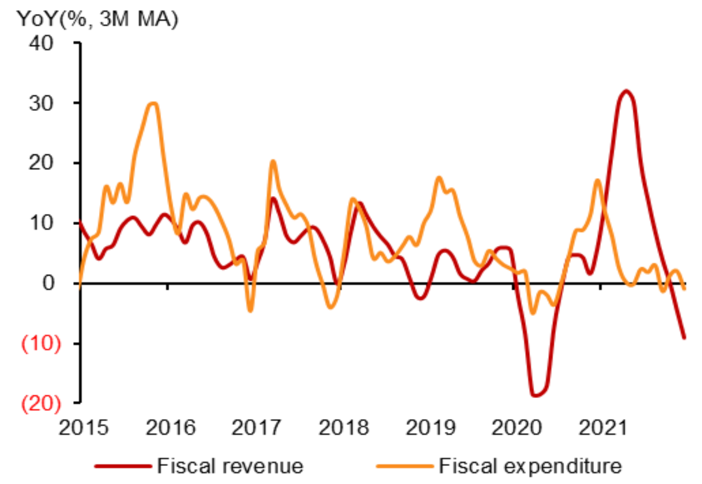
Source: Wind, CMBIS

Figure 6: From Liquidity Easing to Credit Expansion



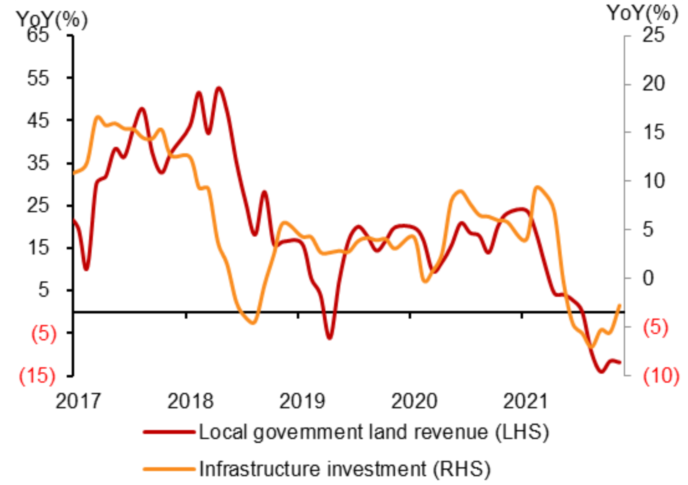
Source: Wind, CMBIS

Figure 7: Fiscal Expansion Slower Than Expectations



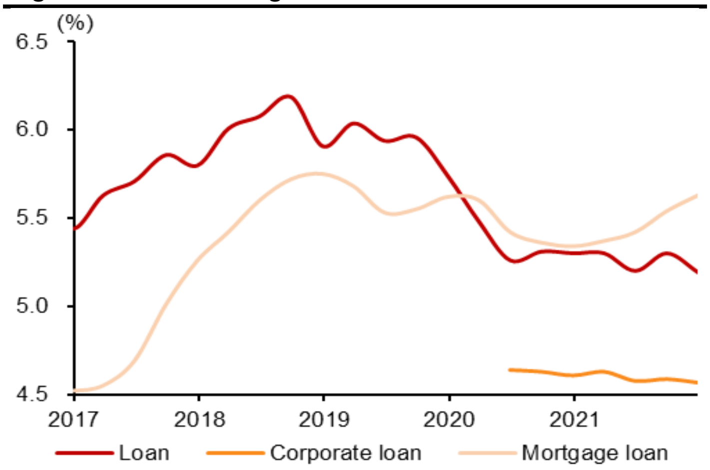
Source: Wind, CMBIS

Figure 8: Land Revenue & Infrastructure Investment



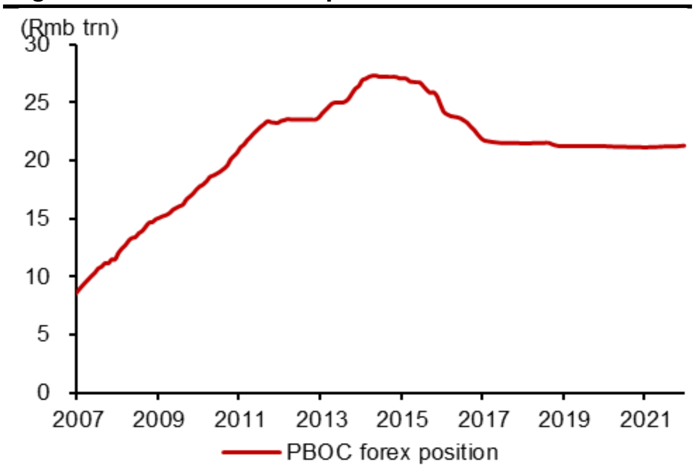
Source: Wind, CMBIS

Figure 9: Outstanding Loan Contract Rates



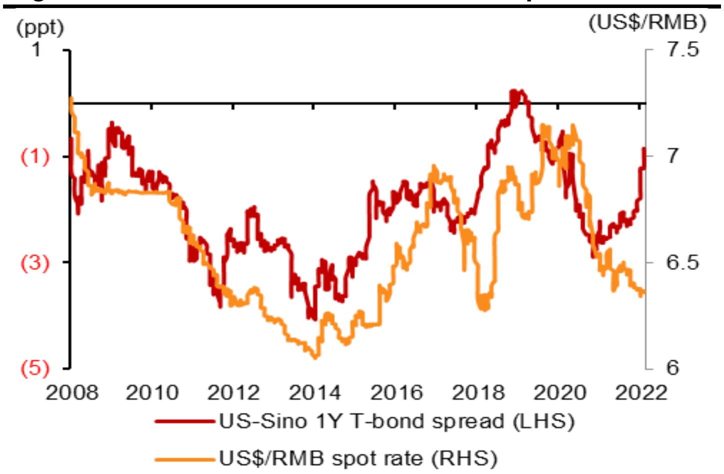
Source: Wind, CMBIS

Figure 10: PBOC Gives Up Direct Forex Interventions



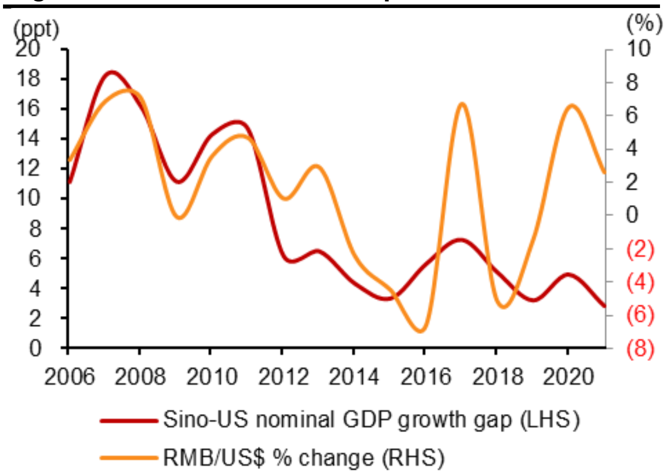
Source: Wind, CMBIS

Figure 11: US$/RMB Rates and Interest Spreads



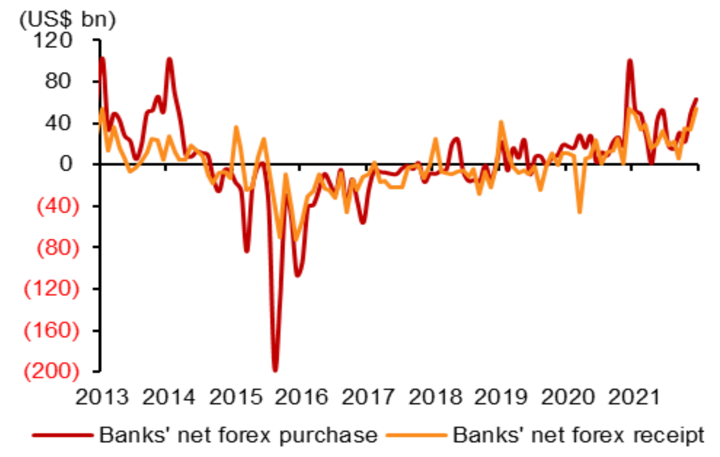
Source: Wind, CMBIS

Figure 12: Sino-US Growth Gap & RMB Fluctuations



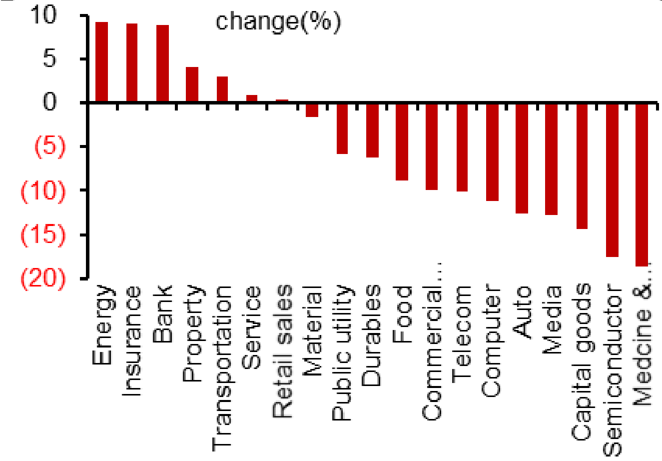
Source: Wind, CMBIS

Figure 13: China's Forex Inflow



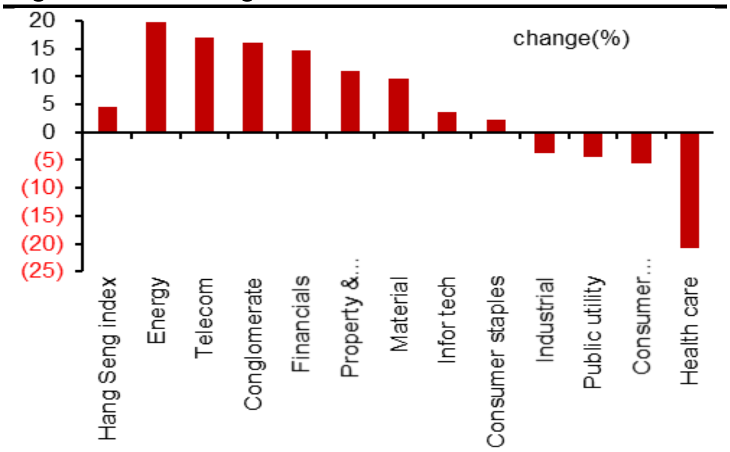
Source: Wind, CMBIS

Figure 14: % Change of A Shares in 2022 YTD



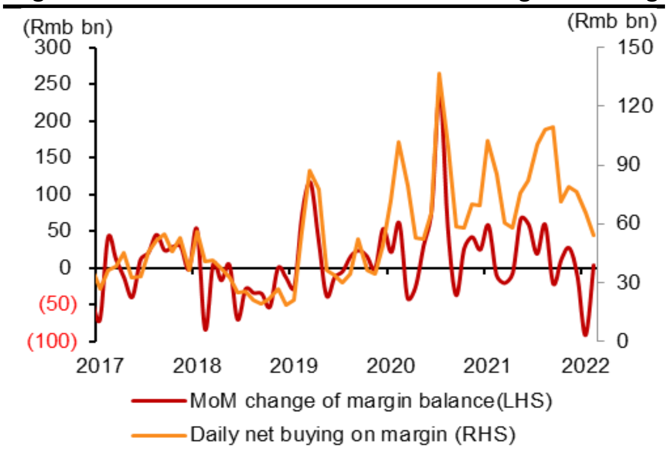
Source: Bloomberg, CMBIS

Figure 15: % Change of HK Stocks in 2022 YTD



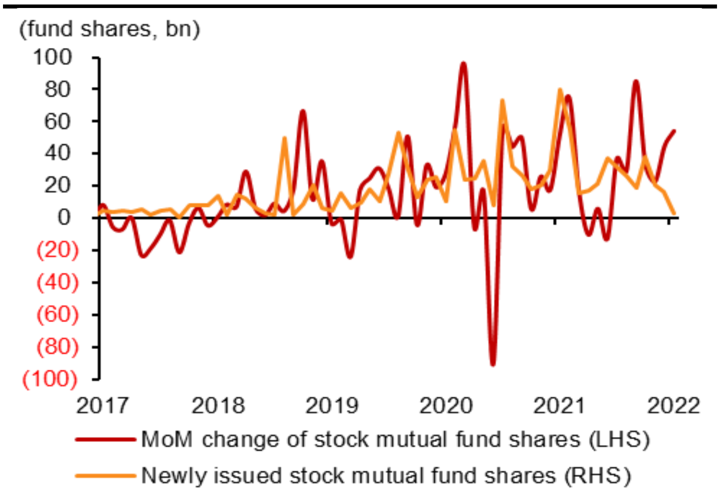
Source: Bloomberg, CMBIS

Figure 16: China Market Confidence: Margin Trading



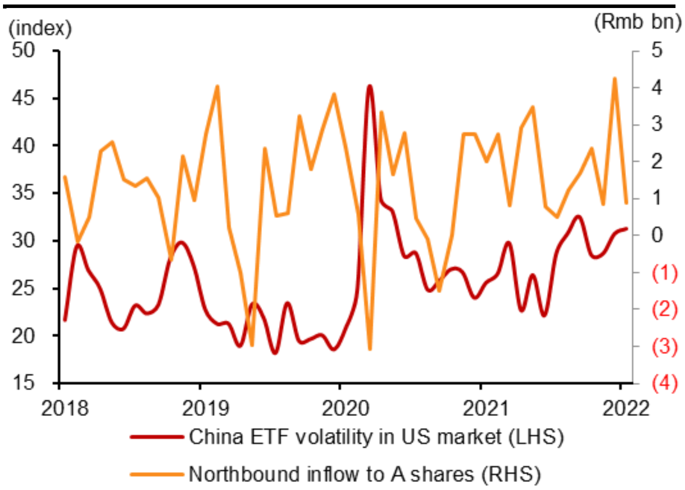
Source: Wind, CMBIS

Figure 17: China Market Confidence: Mutual Fund Shares



Source: Wind, CMBIS

Figure 18: Global Risk Appetite for China & Northbound Inflow



Source: Wind, CMBIS

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