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USD/CNY – PBOC Hints at -100bp of Official Policy Rate Cuts

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Key Points:

- **PBOC drops a broad hint it may cut its official policy rate target by 100bp**
- **We think the first cut may happen by next week**
- **Since the policy rate is pretty much window dressing, we don't expect cuts to unjam domestic monetary policy transmission**
- **But the symbolism of a cut may be major in global markets, including for equities**
- **Perhaps most interesting, PBOC may be signalling greater official tolerance for CNY depreciation in the longer run**
- **We'll see if this shows up in day-to-day currency management**

PBOC Drops a Broad Hint

PBOC hints in the *China Daily* it may cut its official policy lending rate by 100bps

For us, it was unusual to see an important policy article in the *China Daily* (it may be the first time ever in our memory), but a front-page article today heavily hinted that PBOC will be cutting the 1-year lending rate, still the official policy target.

Chinese commercial banks, however, are still using the one-year lending rate of 4.35 percent — the rate commercial banks charge businesses — set by the central bank in 2015. It is higher than interbank market rates or the interest rates banks have been paying to the central bank of 3.05 to 3.30 percent. ***The central bank will eliminate that interest rate margin, sooner or later,*** *and guide commercial banks to lower lending rates closer to a market-determined level, Sun said. "Theoretically, there is room for rate cuts of 1 percentage point," said Zhang Tao, an analyst in the financial market department of China Construction Bank.* [Our emphasis.]

Timing

We think the first cut may happen by next week

With this broad hint, we're thinking **a policy move is imminent, perhaps as early as next week.** We don't think they'll go the whole -100bp at once, maybe electing to cut by -25bo as they did in 2015 (*Asia Cross Current: CNY - PBOC Really Concerned about Refinancing,* 2 March 2015). This means the 1-year rate will first fall to 4.10% (adjustments to our forecasts will be made in the next monthly) but, as hinted in this article, **PBOC will not be done.**

No Domestic Surprise, But Also Limited Policy Effectiveness

PBOC said it didn't want to surprise domestic markets

One immediate reason we can think of why PBOC would drop such a broad hint is it didn't want to surprise onshore markets.

"We hope (policy fine-tuning) will not surprise the market when it is introduced," Sun said.

The policy rate is mainly window dressing

As we wrote in 2015, the 1-year lending rate is mainly window dressing since *"financial institutions' 'actual' lending rate for companies"* bears no relationship to the policy rate. It may be helpful for some SOEs if there are any old loans still written in such language; this was the motivation we deduced in 2015.

And **unlikely** to unjam lending

It's much more difficult for us to believe a cut would somehow unjam the monetary policy transmission mechanism, which is part of the motivation for almost any monetary policy action these days.

Foreign Fireworks

This is also clearly communication meant for foreign markets

Second, this is after all the *China Daily,* China's megaphone to the rest of the world. The official excuse for easing given in this article is because of all those other central banks around the world easing, when in truth we think PBOC has been easing since about May 2018.

And the symbolism of PBOC, a major central bank, cutting rates won't be lost

But we don't want to underestimate the symbolism of a cut in global markets. Imagine the headline: **PBOC becomes the first major central bank in the world to cut interest rates.** All the talk of Fed cuts, ECB cuts, etc. will crank up to 11 in market chatter (we agree with some of those calls but not with others). Equity markets, in particular, may be pleased, as we have never seen a Chinese stimulus package they didn't like.

Communication with other countries is also needed before launching new policies or introducing creative monetary policy tools, and "the PBOC has good communication mechanisms with other central banks including the US Federal Reserve and the European Central Bank", Sun said.

Consider foreign central banks already informed

So official communications will ensue before the first actual cut, but that's not too difficult since this article was just published.

More Tolerance for Long-Run Depreciation

Perhaps most important, PBOC must know this suggests more CNY depreciation ahead

Third, and perhaps more interesting, PBOC must know how that headline above will appear to FX traders: **It will increase depreciation pressure for the renminbi.** In fact, over the past six months we have occasionally heard comments from the central bank that this (fear of depreciation) was the reason it was not eager to cut the official policy rate (so also the reason we were surprised by today's foreshadowing). It now possibly speaks of a greater tolerance for currency weakness over the rest of the year.

And possibly greater policy tolerance for that

Of course the proof will be in the pudding in terms of how day-to-day currency management changes or not, but if this is a correct interpretation we may need to review far-horizon forecasts.

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