Economics and Macro Strategy

DBS Flash

China: More PBOC cash injection ahead

Economics/Strategy

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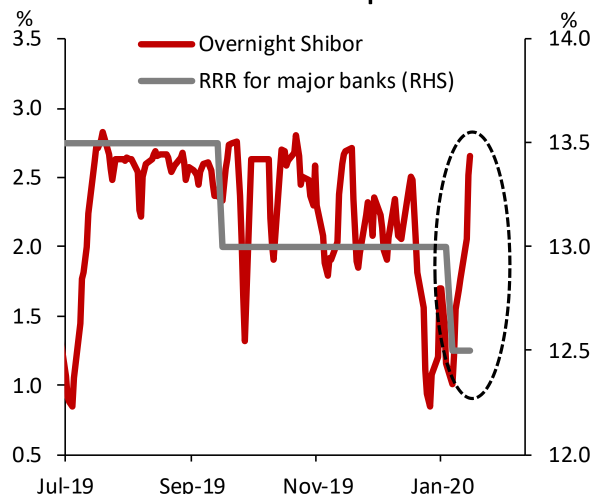
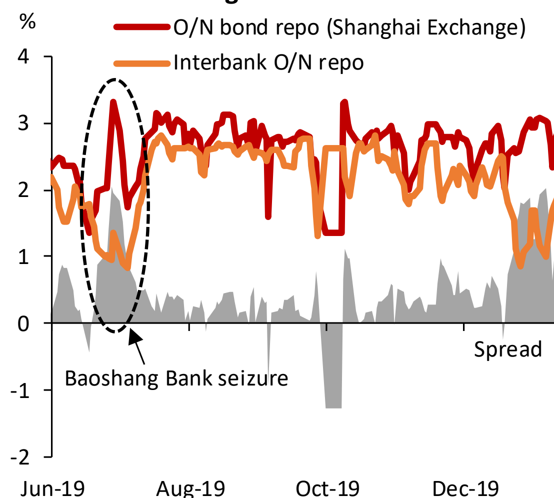
- *The PBoC extended fresh short- and medium-term loans this week through its 1-yr lending window*
- *More cash injection is warranted to sooth liquidity strains on top of yesterday's operations*
- ***Implication for our forecast** – We expect a 5bps cut of the Loan Prime Rate on January 20*
- ***Implication for investors** – Bond yield will stay low even as trade war goes on hold*

The People's Bank of China conducted RMB300bn of one-year medium-term lending facility at 3.25% on Wednesday. It also injected RMB100bn with 14-day reverse repo at 2.65%. The latest moves are in line with our expectation. Despite PBoC has just released RMB800bn by a 50bps reduction in banks' require reserve ratio last week, the resultant fall in interest rates proved short lived. After dipping 16bps and settling at 1.00% on January 6, overnight SHIBOR soared to 2.52% on January 14.



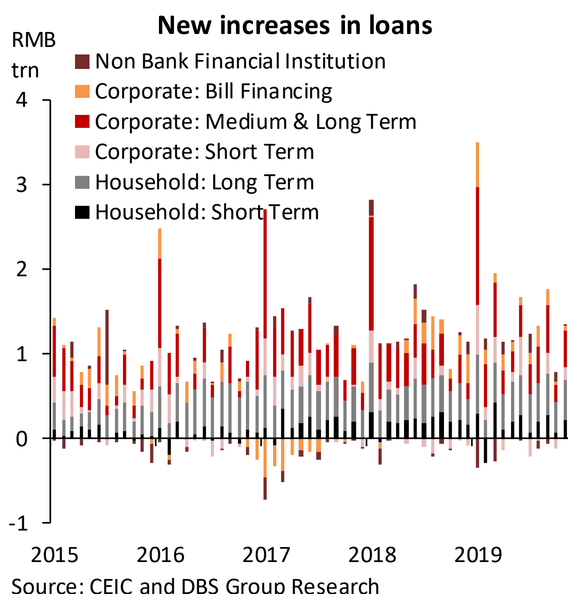
Source: Bloomberg, DBS

Moreover, the overnight bond repo rate on the Shanghai Exchange – an indicator of funding costs for non-bank financial institutions – rose above its average over the past three months. Its spread with the interbank repo rate is particularly worrisome. The rate gap has recently expanded to levels unseen since the Baoshang Bank seizure, in part reflecting banks' reluctance to extend credit to smaller banks or other financial institutions.



Source: Bloomberg, DBS

Seasonal overwhelming cash demand was largely attributed to the surge in funding costs and will further weigh on liquidity, in our view. First, Chinese banks tend to front-load loans at the beginning of the year to retain higher-quality customers and gain market share. In January of 2016-19, banks extended new credit line totaling RMB2.5tn-3.2tn. Second, historical data show quarterly tax payments would drain about RMB600bn from the banking system. Third, cash demand ahead of the Lunar New Year holiday could be around RMB1.5tn. Fourth, a RMB257.5bn drain from expiring one-year medium lending facility on January 23 is also pending to be offset. Fifth, local government is estimated to issue special bonds worth some RMB3bn to fund infrastructure projects. Hence, more liquidity injection is warranted to sooth liquidity strains on top of yesterday's operations. We also expect a 5bps lowering of the one-year Loan Prime Rate on January 20.



Source: CEIC and DBS Group Research

On the bond market end, China sovereign yields rose on January 13-14 ahead of the signing of the phase-one trade deal. The benchmark 10-year government yield jumped to 3.104% from 3.080% last Friday. While the phase-one deal is positive for market sentiment, export growth will likely remain sluggish amid the prolonged impact of the US tariffs and tech sanctions. Domestically, private sectors are still suffering from high entry barriers and financing difficulties. Steadying inflation will provide PBoC more room to maneuver.

As such, we believe Beijing's tolerance for leverage will be higher in 2020 to fulfil policy and growth targets. Bond yields may well trend sideways in the near term thanks to China-US trade truce. Yet any selloff should prove short-live and we expect 10Y sovereign yields to edge lower to 3.0% amid PBoC's accommodative policy stance.

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Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations).

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