



CHINA ECONOMICS WEEKLY

Monetary easing back on the cards

Chinese government bonds have rallied over the past couple of months, with the 2-year yield falling over 20bps since mid-March. This reflects mounting expectations for monetary easing in response to what has widely been viewed as an underwhelming reopening recovery.

In its monetary policy report published this week, the People's Bank (PBOC) pushed back against this perception, noting that the recovery had exceeded expectations. It also downplayed concerns about China's low inflation rate. This is in line with [our view](#) that the recovery, while narrow in nature, isn't as weak as the most closely watched data suggest.

Nonetheless, the PBOC struck a dovish tone in its policy report. It argued that economic momentum still isn't strong enough and promised measures to expand demand. It also emphasised the need for a further decline in both deposit and lending rates.

While this suggests that the PBOC isn't done with easing just yet, we doubt the bank will roll out extensive stimulus. In its policy report, it argued that one lesson from the high inflation and banking strains faced by developed economies is the need to avoid large swings in monetary conditions. The PBOC also noted that it subscribes to the attenuation principle – the idea that central banks should react to greater uncertainty by making smaller changes to policy. Renewed weakness in the renminbi, which exceeded 7/\$ for the first time in five months earlier this week, will also encourage the PBOC to keep any easing modest.

Admittedly, its policy report did omit a pledge to “avoid flood-style stimulus” for the first time in more than a year. But this was replaced by new phrasing on maintaining a steady and appropriate pace of lending. And the PBOC reiterated its aim of keeping credit growing broadly in line with nominal GDP.

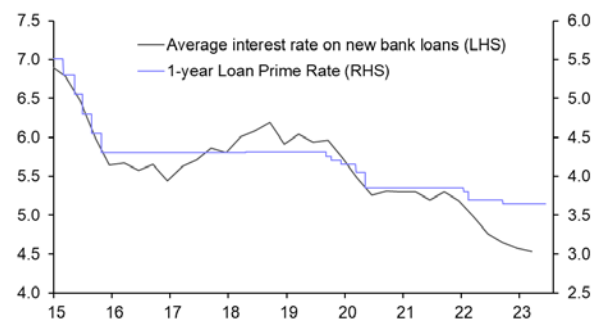
Although credit growth was [weaker-than-expected](#) in April, at 10% y/y it is, if anything, still on the strong side compared China's trend rate of nominal

GDP growth. As such, we think the PBOC's goal is primarily to ensure that it doesn't slow too much as the reopening boost to credit demand fades.

This can probably be achieved without policy rate cuts, which we think the PBOC will try to avoid. The downside to lowering the Loan Prime Rate (LPR) is that it reduces banks' return on their existing loan book, adding pressure to their net interest margins, which are at a record low. Instead, we think the PBOC will focus on lowering funding costs for the banks through RRR cuts, deposit rate window guidance and liquidity injections, thereby encouraging banks to lower the multiples at which they price new loans relative to the LPR.

This would not be a new strategy. The PBOC has already engineered a 70bp decline in the cost of new bank loans since the end of 2021, despite only reducing the 1Y LPR by 20bps. (See Chart 1.)

Chart 1: Bank Lending Rate and 1-Year LPR (%)



Sources: CEIC, Capital Economics

We now expect one more RRR cut this easing cycle, most likely before the end of this quarter. And we have revised down our end-2023 forecast for the 10-year government bond yield from 3.20% to 2.90%. But we still expect yields to rise from current levels due to our view that GDP growth will surprise to the upside this year and that monetary easing will be more modest than the market currently expects.

The week ahead

For the reasons discussed above, we expect the Loan Prime Rate to be left on hold on Monday.

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Data Previews

Loan Prime Rate (May)

Mon. 22nd May

Forecasts	Time (China)	Previous	Consensus	Capital Economics
Loan Prime Rate (1-year)	09.30	3.65%	3.65%	3.65%

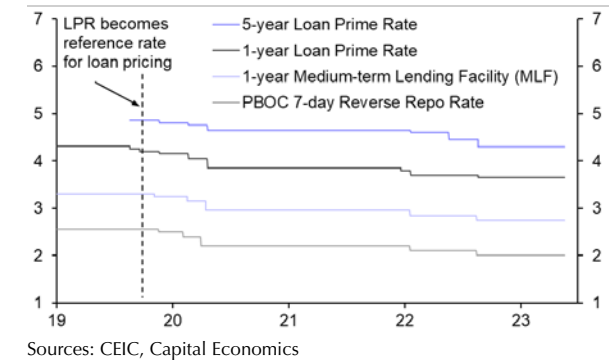
A hold still more likely than a cut

The PBOC refrained from cutting the rate on its medium-term lending facility (MLF) this month (see Chart 2), the usual precursor to any adjustments to the Loan Prime Rate (LPR). We therefore don't expect any imminent change.

Admittedly, the PBOC has cut the LPR without first lowering the MLF rate on a couple of occasions. But in both cases, the economy was in the midst of a downturn, not recovering as it is now. And as discussed above, although the PBOC has hinted that some further easing is still forthcoming, it will probably favour other tools instead of policy rate

cuts, which would add unnecessary pressure to banks' net interest margins.

Chart 2: Policy Rates (%)





Economic Diary & Forecasts

Upcoming Events and Data Releases

Date	Country	Release/Indicator/Event	Time (China)	Previous*	Median*	CE Forecasts*
May						
Mon 22 nd		Chn 1-Year Loan Prime Rate (May.)	(09.15)	3.65%	3.65%	3.65%
		HK Consumer Prices (Apr.)	(16.30)	(+1.7%)	-	(+1.8%)
Fri 26 th		HK The Birthday of the Buddha (National Holiday)	-	-	-	-
Also expected during this period:						
TBC		Chn Government Revenue and Expenditure (Apr.)	-	-	-	-
TBC		Chn CBRC Data on Assets and Liabilities of Financial Institutions (Apr.)	-	-	-	-
Selected future data releases and events:						
May						
Sat 27 th		Chn Profits of Large Industrial Firms (Apr., ytd y/y)				
Mon 29 th		HK Trade Data (Apr.)				
Wed 31 st		Chn "Official" PMIs (May.)				
June						
Thu 1 st		Chn Caixin Manufacturing PMI (May.)				
		HK Retail Sales (Apr.)				

Main Economic & Market Forecasts

%q/q annualised (%y/y), unless stated	Latest	Q2 2023	Q3 2023	Q4 2023	Q1 2024	2022	2023f	2024f	2025f
Official GDP	+2.2(+4.5)*	(8.7)	(5.9)	(6.6)	(5.2)	(3.0)	(6.5)	(4.7)	(4.2)
GDP (CE CAP-derived estimates)	+7.0(+4.2)*	(10)	(9)	(11)	(4.5)	(-2.0)	(8.5)	(4.5)	(4.0)
Consumer Prices	(+0.1)**	(0.7)	(1.1)	(1.5)	(2.1)	(2.0)	(1.0)	(2.0)	(1.5)
Producer Prices	(-3.6)**	(-2.8)	(-0.6)	(0.5)	(1.3)	(4.2)	(-1.0)	(1.1)	(0.3)
Broad Credit (AFRE)	(+10.0)**	(10.1)	(10.1)	(10.7)	(9.2)	(9.6)	(10.7)	(8)	(7.7)
Exports (US\$)	(+8.5)**	(-15.5)	(-19.0)	(-8.0)	(-12.5)	(7.0)	(-11.0)	(-2.5)	(2.5)
Imports (US\$)	(-7.9)**	(-4.0)	(-8.0)	(0.5)	(1.5)	(1)	(-4.5)	(3.5)	(1)
RMB/\$ [†]	7.06	6.95	6.90	6.90	6.80	6.95	6.90	6.50	6.40
7-day PBOC reverse repo [†] %	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00
1-year Loan Prime Rate [†] (LPR) %	3.65	3.65	3.65	3.65	3.65	3.65	3.65	3.65	3.65
1-year MLF Rate [†] %	2.75	2.75	2.75	2.75	2.75	2.75	2.75	2.75	2.75
10-year Government Bond Yield [†] %	2.72	2.80	2.90	2.90	2.85	2.85	2.90	2.70	2.60
RRR (major banks) [†] %	10.75	10.50	10.50	10.50	10.50	11.00	10.50	10.50	10.50
CSI 300 Index [†]	3,955	3,955	3,950	3,950	4,085	3,872	3,950	4,500	5,100
Hong Kong GDP	(+2.7)*	(4.0)	(9.0)	(11.0)	(7.5)	(-3.5)	(6.5)	(7.5)	(6.5)
Hang Seng Index [†]	19,535	19,750	20,000	20,250	21,185	19,781	20,250	24,000	27,500

Sources: Bloomberg, Refinitiv, CEIC, Capital Economics *Q1; **Apr.; [†] End of period



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