

The amendment of RRR calculation to smooth offshore RMB liquidity

Monday, June 06, 2016

Highlights:

- China will change the assessment of denominator part of RRR calculation from end of period to daily average with effective from 15 July.
- The assessment of numerator part of RRR calculation has been changed to daily average since September 2015, which gives banks more flexibility to manage the liquidity.
- The new rule has more impact on offshore RMB liquidity rather than onshore RMB liquidity in our view.
- This is likely to help smooth offshore RMB liquidity and prevent from the repeat of similar distortion as we saw on 31 March when CNH interbank deposit rate collapsed to negative.

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PBoC announced on 3 June to amend its calculation to assess the reserve requirement ratio for the second time since September 2015.

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With effective from 15 July, the reserve requirement ratio will be calculated based on the average total deposit level during the assessment period rather than that at the end of period.

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We think the new rule has more impact on offshore RMB liquidity rather than onshore RMB liquidity. The impact on onshore liquidity is likely to be insignificant though the net effect may be towards tighter liquidity.

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To start, China's mandatory reserve requirement ratio is calculated as follows:

$$\text{RRR} = \frac{\text{banks' deposit reserves with central bank (numerator)}}{\text{total deposits (denominator)}}$$

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In the past, the RRR has been assessed by the end of period data. This tended to lead to higher fluctuation of liquidity approaching end of assessment period to meet regulatory requirement.

In September 2015, PBoC announced to change the assessment of numerator of RRR to daily average rather than end of period. This gives banks more flexibility to manage the liquidity. However, the assessment of denominator remained unchanged.

The change of assessment of denominator to daily average from end of period is unlikely to have significant impact on onshore liquidity. However, it may help smooth quarter end liquidity in the offshore RMB market.

To recall, the offshore CNH interbank deposit rate and implied yield from swap fell to negative on 31 March, which is distorted by banks' behaviour to lower their quarter end deposit base to minimize their obligation for RRR following the announcement of impose of RRR on offshore RMB deposit in January this year.

However, this distortion is unlikely to happen again at quarter-end as banks have less incentive to reduce quarter-end deposit base after the change of assessment to daily average. As such, we expect a more stable offshore RMB liquidity.

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