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PBoC turns more flexible

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Highlights:

- **PBoC did not follow the Fed to hike its reverse repo rate.**
- **PBoC may be more flexible against the backdrop of rising default risk.**
- **RRR cut is still expected**
- **Currency stability is not the key concern for now**

PBoC did not follow the Fed to hike its reverse repo rate as widely expected this morning after the PBoC has hiked its money market rate for four times since 2017.

Back in March after the last money market rate hike, the PBoC has mentioned clearly that there is no guarantee that it will follow the Fed every time.

The pause of rate hike against the backdrop of rising default risk signals two things to us. First, the PBoC is likely to return to neutral stance to safeguard the bottom line of no financial risk after the recent data show that structural de-leverage has taken effect. In addition, the deceleration of Chinese key economic data this morning also warranted China to take a cautious tone. The pause may fuel the expectation on reserve requirement ratio cut again, which may be supportive of market sentiment.

Second, there is no urgency for China to maintain its favorable yield differential against the US as capital outflow and currency stability is no longer the key concern for China at the moment. With US-China trade war looming, a slightly weaker Yuan may be in China's favor. We think China will continue to allow market to play a bigger role in foreign exchange market.

We expect PBoC to use both MLF and RRR cut to strike the balance between financial stability and structural de-leverage.

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