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Targeted but not full-scale

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Highlights:

- **The new monetary policy tool TMLF shows that PBoC will continue to leverage on its balance sheet size to support the economic growth.**
- **PBoC down plays the impact of US rate hike on its domestic monetary policy. It could be bad for RMB in the near term.**
- **The impact is limited. The 15bps saving is unlikely to be the game changer as the key factor held banks from lending is not the price but credit risk.**
- **Although interest rate cut is always in China's tool box, the creation of new tool TMLF implies that China may prefer targeted measure to balance growth and financial risk.**
- **We think the probability of interest rate cut is still low at the current stage.**

PBoC unveiled a new monetary policy tool targeted medium term lending facility (TMLF) on 19 Dec just ahead of the December FOMC meeting. The new TMLF is created to support the funding needs from the small and private owned companies.

The new TMLF has two important features including lower interest rate and longer term tenor. First, funding cost for TMLF will be 15bps below the prevailing MLF rate, which is at 3.3% currently. Second, the tenor for TMLF will be one-year but allowed to be rolled over twice. As such, the maximum tenor for TMLF will be 3-year, much longer than MLF's 1-year maximum tenor.

However, the TMLF will only be accessed by the qualified big commercial banks, joint stock banks and big city commercial banks. For smaller banks with no access to TMLF, PBoC will expand the quota for rediscount and relending by CNY100 billion to encourage smaller lenders to support private owned companies.

The launch of this targeted measure together of the expansion of rediscount and relending quota will help lower Chinese banks' liability cost to serve the private owned companies better. This is in line with China's direction to support non-state owned economies. Meanwhile, the new initiative shows that PBoC will continue to leverage on its balance sheet size to support the economic growth.

Below are our three key takeaways from the TMLF.

First, timing shows PBoC downplays the impact of US rate hike.

The launch of the TMLF was just ahead of FOMC rate hike decision. PBoC Governor Yi Gang said in early December that PBoC will take both internal and external factors into account when setting the monetary policy. Nevertheless, the adjustment will mainly depend on the changes in the domestic economic situation. This shows that PBoC will down play the impact of US rate hike on its domestic monetary policy. Given China is not in urgency to maintain its interest rate differential, it could be bad for RMB outlook in the near term.

Second, the support could be still limited

We expect Chinese banks may increase their lending support to private owned companies thanks to slightly lower funding costs. However, from risk-reward perspective, the 15bps saving is unlikely to be the game changer as the key factor held banks from lending is not the price but credit risk. Meanwhile, the possible requirement for collateral for TMLF also shows that the ammunition from TMLF is not unlimited. As such, we see limited impact from here.

Third, the TMLF does not imply an imminent rate cut

Expectation on interest rate cut heightened after PBoC lowers the interest rate for TMLF. Although interest rate is always in China's tool box, the creation of new tool TMLF implies that China may prefer targeted measure to balance growth and financial risk rather than full-scale rate cut. The complexity of current monetary policy tool box shows that China will consider reserve requirement ratio cut, the reduction of reverse repo rate and the reduction of MLF rate before eventually moving towards interest rate cut. As such, we think the probability of rate cut is still low at the current stage.

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