CHINA Insights

OCBC Bank

An innovative "carrot" to support reform agenda

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Highlights:

- **Different from previous targeted RRR cut in the past few years, we see three unique features this time, which may bring PBoC's monetary policy tool to a new height to balance growth and structural reform.**
- **It is the first time for PBoC to announce forward RRR cut, which will only be rolled out in 2018. In addition, by redefining inclusive finance, it will standardize the qualification criteria to make targeted RRR cut more transparent to support China's reform agenda.**
- **Given majority of banks are qualified for the targeted RRR cut, this targeted RRR cut is as good as universal RRR cut. However, as the new targeted RRR cut is expected to overwrite all previous targeted RRR cuts, the actual net injection is likely to be smaller. As such, we think the net injection in 2018 could be around CNY300-400 billion.**
- **The targeted RRR cut is kind of structural easing for smaller financial institutions. However, we consider this targeted RRR cut is more about reform than easing.**

PBoC unveiled the details about targeted reserve requirement ratio (RRR) cut on 30 Sep, three days after the State Council mentioned that in its regular meeting on 27 Sep. Since 2014, PBoC has used targeted RRR cut to incentivise financial intuitions to support funding needs of small and micro companies as well as agriculture sectors.

Targeted RRR cut announced since 2014	
22 Apr 2014	200bps RRR cut for county level rural commercial banks and 50bps RRR cut for county level rural cooperative bank.
9 Jun 2014	50bps RRR cut for qualified FIs supporting agriculture and small business financing.
4 Feb 2015	50bps RRR cut for qualified city commercial bank and non-county level rural commercial bank supporting agriculture and small business financing.
19 Apr 2015	50bps RRR cut for qualified national bank and join stock commercial bank supporting agriculture and small business financing.
23 Oct 2015	50bps RRR cut for qualified financial institutions supporting agriculture and small business financing.

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Two-tier targeted RRR cut

Qualification criteria for targeted RRR cut have been expanded this time to include broader definition of inclusive finance, which include the funding supports for mass innovation and entrepreneurship as well as other than agriculture and small business financing.

In addition, there will be two-tier assessment for targeted RRR cut. Financial institutions, which total outstanding or flows of inclusive finance as percentage of total loan for the past one year exceeds 1.5%, will be qualified for tier one 50bps RRR cut. Should those ratios go up to 10% and above, additional tier two 100bps cut will apply.

What's new?

Different from previous targeted RRR cut in the past few years, we see three unique features this time, which may bring PBoC's monetary policy tool to a new height to balance growth and structural reform.

First, it is the first time for PBoC to announce forward RRR cut. The targeted RRR cut will only be rolled out in 2018, three months from the announcement. We see two possible rationales behind that. First, the three-month period window may give some financial institutions, which are not qualified for the targeted RRR, time to realign their lending policies with China's direction to support inclusive finance. Second, it also may give PBoC some time to withdraw previous liquidity support via open market operation and medium term lending facility to maintain its prudent monetary policy tone.

Second, by redefining inclusive finance, it will standardize the qualification criteria to make targeted RRR cut more transparent and more targeted to support China's reform agenda.

Third, the new targeted RRR rule will overwrite previous targeted measures. For those big financial institutions, which have already benefitted from previous targeted RRR cut, may not receive additional benefit from this round of targeted RRR cut unless they increase their lending support to inclusive finance to more than 10% of their total lending to be qualified for the tier two RRR cut.

How much liquidity will this targeted RRR cut inject?

According to PBoC estimation, almost all big banks, 90% city commercial banks and 95% rural commercial banks are qualified for tier one targeted RRR cut. As such, this targeted RRR cut is as good as universal RRR cut, which may inject about CNY600-700 billion. However, as the new targeted RRR cut is expected to overwrite all previous targeted RRR cut, the actual net injection is likely to be smaller. As such, we think the net injection in 2018 could be around CNY400 billion.

Implications

There are two possible implications of this targeted RRR cut. First, we think it will lead to structural easing for smaller financial institutions. As most of financial institutions are unable to get the liquidity directly from PBoC's active liquidity management. A RRR cut, however, will directly inject liquidity to those smaller intuitions. Second, we don't consider this as change of monetary policy. Instead, we think this targeted RRR cut will serve as carrot for banks to increase their support to inclusive finance to support China's reform agenda.

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