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Rosefinch Weekly

Logic Behind the Small RRR Cut

Following last Wednesday's State Council meeting, PBOC cut RRR on Friday after market closed. But unlike the traditional 50 bps or 100 bps reductions, this time only a less-than expected 25 bps cut was announced. There was a subcategory of regional banks that had 50 bps reduction in RRR, with the end result being the average RRR is reduced from Dec 2021's 8.4% to the current 8.1%, or a release of 530 billion RMB from reserve funds. PBOC cited the "reasonably ample level of liquidity" as the reason why only 25 bps was cut this time. Because the liquidity has been relatively stable and loose, further marginal benefit of RRR to liquidity is relatively low. **The key messages from the RRR cut are therefore to send market the signal for steady growth, to improve confidence for real economy, to reduce bank cost of funding, to guide financial institutions to support pandemic hit sectors, and to increase policy support for regional banks that are more active in agriculture and SME sectors.**

PBOC has been looking at structural policy tools such as refinancing to improve credit lending instead of the broad-impact OMO/MLF rates. In addition, PBOC has encouraged banks to defer loan repayment schedule for pandemic-impacted consumer and business loans. By providing banks with additional funding via RRR cut, PBOC gives additional flexibility for banks to support the pandemic efforts. The RRR cuts the overall funding costs for banks, thus supporting the PBOC policy of "reducing aggregate social funding cost", and may lead to LPR reductions in future which will again impact business loans more directly.

As for the stock market, the Ukraine conflict still have much uncertainty, but the direct shocks are receding. FED hike and balance sheet reduction have largely been priced in by the US Treasury market, which is also reflected in diverse return profiles of various sectors in the equity market. **The main factors affecting asset allocation are short term pandemic control and medium to long term inflation expectations.**

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The pandemic's widening effect and the subsequent "dynamic zero" policy are affecting the economy, especially in logistics and in-person businesses. The overall impact is not just purely in demand repression or production interruption, but also in domestic supply chain: there's a massive drop in domestic trucking volume, with delays in logistics raising short term costs, and some even causing the entire supply chain to freeze. **Government has announced policy to prioritize smooth logistics, and how it may resume normal logistics remains to be seen.**

From inflation angle, as consumers stockpile basic goods and logistic restrictions reduce supply and demand, the pandemic has increased inflationary pressure for consumer staples and key industrials. On the other hand, the income reduction and tight movement control have repressed demand for consumer discretionary goods. **Government may also announce more consumer or investment supportive policies to offset economy drag.**

To bridge the gap between weak current economy and strong future target, there's high expectation of more steady growth policy responses. **Monetary is the fastest policy tool, and has indeed been deployed several times across different areas since the start of year. Future focus should be on other government announcements on key areas such as fiscal, infrastructure, and real estate areas.**

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