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China joins nervous global easing

Gabriel Wildau in Shanghai and Chris Giles in London


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China's central bank cut benchmark interest rates for the sixth time in 12 months in a bid to support an economy which is forecast to grow at its slowest annual rate in 25 years.

The move comes a day after the European Central Bank indicated it would extend its quantitative easing programme and cut its deposit rate in a bid to boost the eurozone's sluggish recovery.

The People's Bank of China's actions, combined with Thursday's ECB announcement and market doubts over the US Federal Reserve's commitment to raise interest rates this year, highlight a wider nervousness in official circles over the health of the global economy.

Expectations for global growth have already been revised down to 3.1 per cent in 2015, the lowest International Monetary Fund forecast since 2009, and analysts are concerned that prospects for next year are also dimming.

The PBoC said on its website that it was lowering the one-year benchmark bank lending rate by 25 basis points to 4.35 per cent and the one-year benchmark deposit rate to 1.5 per cent — its lowest on record — from 1.75 per cent.

The central bank also cut the share of customer deposits banks must hold in reserve, injecting Rmb560bn ($90bn) of cash into the banking system to counteract the cash drain from capital outflows in recent months. The required reserve ratio was lowered by 0.5 percentage points to 17.5 per cent.

“The PBoC’s two-pronged monetary policy action signals an intensification of policy measures intended to combat the economic slowdown in China,” said Eswar Prasad, Cornell University professor and former China head of the International Monetary Fund.

“It heightens concerns that the economy may be losing growth momentum somewhat faster than suggested by the headline official GDP growth rate.”

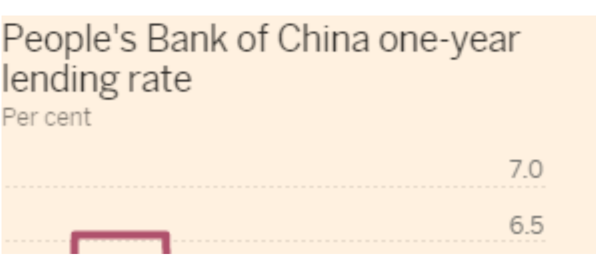
The PBoC’s actions are the latest in a string of domestic interest rate reductions and injections of credit into the Chinese economy, designed to raise lending and spending by reducing financing costs for home mortgages and loans to big companies.

Official figures released earlier this week showed China’s economy expanded at its slowest pace since 2009 in the third quarter. The data showed the challenges facing China’s leaders in achieving their growth target of around 7 per cent for the year.

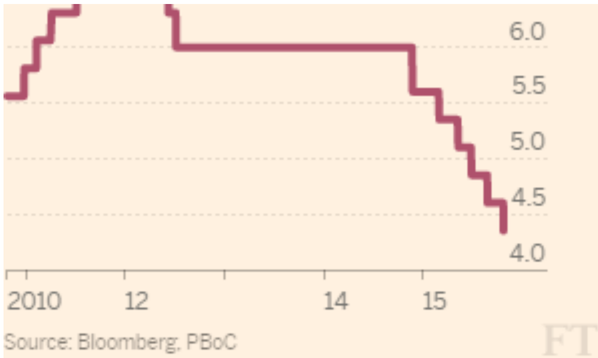
China has long been an engine of growth for the global economy, and its slowdown has had far-reaching consequences, depressing commodity prices, triggering big swings in emerging market currencies and provoking doubts about the wisdom of raising interest rates in the US.

Fears about China were further stoked by a plunge in the country’s stock market during the summer and a surprise devaluation of the renminbi.

Analysts say the latest rate cut is aimed at industrial borrowers, who are struggling to service debt that is fixed in nominal terms, even as falling prices decrease their revenue.



Yet economists caution that benchmark rate cuts will not benefit all borrowers equally. Since 2013, Chinese banks have been free to set lending rates as they choose. The benchmark lending rate is only a guideline. In practice,



home mortgages and loans to big state-owned companies are correlated most closely with PBoC benchmarks.

The central bank has drawn down its foreign exchange reserves in recent months to prop up the renminbi exchange rate following the surprise move on August 11 to let the currency depreciate.

This intervention, which involves selling dollars and buying renminbi, sucks money out of China's banking system because the renminbi that the PBoC buys is taken out of circulation. The cut in banks' required reserve ratio on Friday aims to offset the tightening impact of the PBoC's currency moves by pumping funds back into the system.

"We see rising [downward] pressures on [renminbi] and [offshore renminbi] exchange rates as PBoC will find it difficult to strike a balance between monetary policy easing and a stable exchange rate," Zhou Hao, China economist at Commerzbank, wrote on Friday.

In addition to the easing moves, the PBoC also took its final step towards deregulating China's domestic interest rates by removing the ceiling on all bank deposit rates. Alongside its previous rate cut in August, the PBoC removed the ceiling for deposits above one year. Friday's move eliminates the cap for deposits for all maturities.

Analysts say liberalising interest rates is a key prerequisite for China to win the IMF's endorsement of the renminbi as a global reserve currency. The fund is expected to decide late this year whether to include the renminbi in its Special Drawing Rights.

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