中信証券國際
CITIC Securities International

Banking Thematic – Liquidity (II)

Gradual ease of liquidity pressure and slow decline in funds rate

CSI Research Department

Event:

The People's Bank of China (PBOC) undertook massive reverse repos to ease the funding pressure on China's banking system. This research aims to explore the historic pattern of changes in liquidity following the Chinese New Year (CNY) holiday period and, on the basis of our findings, to forecast the post-CNY funding conditions in 2012E.

Comment:

❖ **Tighter-than-expected liquidity prior to the CNY due to capital outflow and a delay in the supply of liquidity by the PBOC**

On the approach to the 2012E CNY holiday season, liquidity became increasingly tight. The interest rate on 7-day repos averaged 6.0% in the week prior to the start of CNY (versus the forecast 4.8%), with the high exceeding 7.7%. We believe it was the result of three factors. First, liquidity grew tight due to a combination of: (i) higher reserves to meet the demand for cash withdrawals during the holidays; (ii) the massive, natural year-end deposit decline in Dec 2011; and (iii) the levy of budgetary tax in January. We estimate that the total amount of cash withdrawn from commercial banks before and during the CNY holiday period could be up to Rmb1.8trn. Secondly, the normal money supply by the PBOC before the holidays was less than expected. Considering that the amount of central bills to term was relatively low (totaling Rmb125bn in the three weeks prior to the CNY) and there was an estimated Rmb100bn in total reserve payments by small and medium banks in a 15 day period, the PBOC should have injected cash on the order of Rmb500bn. Although total money supply reached its target, it was only accomplished just prior to the onset of the holiday period, resulting in a tight capital market for a period of time. Thirdly, the interest rate on the PBOC's first repo of the year was 5.47%. Total repos came to a disappointing Rmb169bn. On the one hand, it failed to meet the capital demand from the banking system (some banks borrowed from the inter-bank lending market on the same day they made reverse repos). On the other hand, it adversely affected market sentiment (the function of reverse repos in establishing the "bottom" was moderated, as banks became less willing to lend and more willing to borrow). This caused interest rates to rise rather than fall, until the implementation of non-public reverse repos and the second public reverse repo.

❖ **Following the injection of cash, liquidity is expected to gradually loosen up after the holidays, with the median rate of 7-day repos declining steadily to between 3-3.5% and the overnight rate hovering near 3%**

We see a high probability that liquidity will gradually ease following the CNY. The median rate of 7-day repos in the post-holiday month may fall to 3-3.5% (versus 3.42% in the same period last year) and the overnight rate is likely to hover near 3%. The anticipated easing of liquidity should result mainly by: (i) cash inflow following the holidays (M0 may decline by Rmb1trn) and a turnaround in the picture of supply-demand due to decreasing settlement demand; (ii) RRR adjustment: current monetary conditions do not support loan growth given the regulations regarding loan/deposit ratios. Taking into account the downward trend of outstanding funds for foreign exchange, we forecast that the RRR will be reduced four times (a total of 2ppts) going forward; and (iii) according to overseas media reports, 1Q12E lending quotas granted by the PBOC to major banks are not more than 5% above their actual lending in 2011, while the quotas for some joint-stock banks are basically flat YoY. As such, we forecast that 2012E credit and loan growth will be concentrated in the 1Q12E (possibly hitting Rmb2.2-2.4trn in the quarter). In view of past experience, the increase in lending will lead to an increase in deposits, thus improving money supply and liquidity.

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	Hold	Relative performance over MSCI-China Index -10% ~ 5%
	Sell	Relative performance over MSCI-China Index > -10%
	NR	Not rated
Sector rating	Outperform	Relative performance over MSCI-China Index >10%
	Neutral	Relative performance over MSCI-China Index -10% ~10%
	Underperform	Relative performance over MSCI-China Index > -10%

地址:	香港中环 添美道 1 号 中信大厦 26 楼	Address:	26/F CITIC Tower 1 Tim Mei Avenue Central, Hong Kong
电话：	(852) 2237 9250	Tel:	(852) 2237 9250
传真：	(852) 2104 6580	Fax:	(852) 2104 6580
电邮:	hkresearch@citics.com.hk	Email	hkresearch@citics.com.hk
网址：	http://www.citics.com.hk	Website:	http://www.citics.com.hk