Emerging Insight

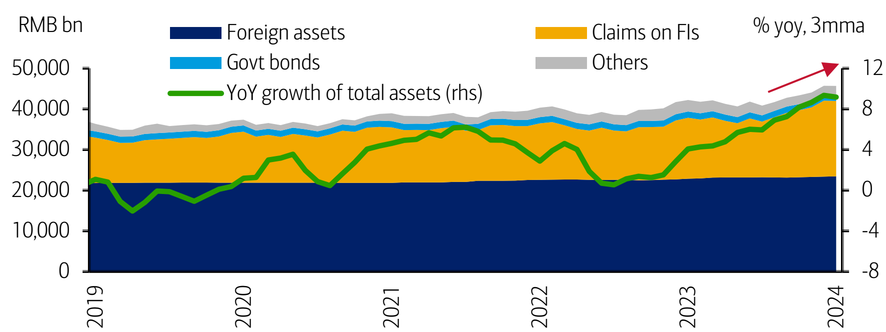
China: How much will the central bank balance sheet expansion boost growth?

Key takeaways

- The recent expansion in PBoC's balance sheet was driven by various lending tools (incl. relending, PSL, MLF) and not "QE".
- Effect on growth is limited so far, due to small size of targeted lending, lack of universal easing and weak risk appetites.
- We believe more broad-based monetary easing is still needed to revive credit demand and see more room for rate cuts in 2H24.

By Miao Ouyang & Helen Qiao

Exhibit 1: PBoC's total assets: by breakdown
PBoC's balance sheet expanded by nearly RMB5tn since mid-2023



Source: BofA Global Research, PBoC, CEIC

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China in focus

The People's Bank of China (PBoC) has expanded its balance sheet by nearly RMB5tn or 12% over the past 7 months, according to the latest data released by the central bank (Exhibit 1). This larger-than-usual expansion has led some to claim that China is now embarking on its own version of Quantitative Easing (QE) to stimulate the economy. This "QE" label stems from the fact that all QE programs undertaken by the developed economies (DMs) have resulted in a larger central bank balance sheet. Yet, not all balance sheet expansions can be called QE.

The recent increase in the PBoC's total assets wasn't due to large-scale bond buying, but driven entirely by a sharp increase in the central bank's "claims on depository financial institutions" (Exhibit 2), which record funds injected into the banking system via various monetary policy tools. Specially, three key factors have contributed to the rise.

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Abbreviations:

MLF: Medium-term Lending Facility

PSL: Pledged Supplementary Lending

RRR: Reserve requirement ratio

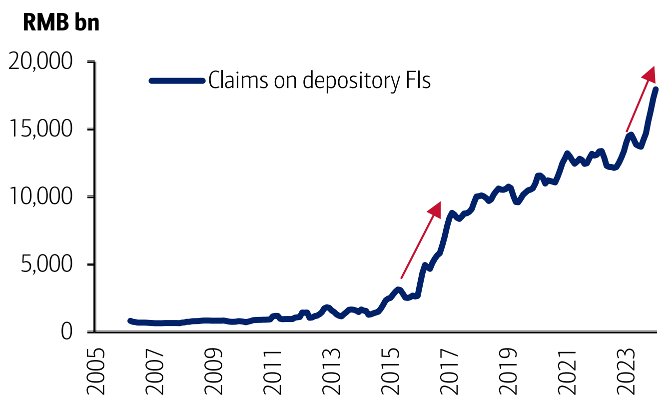
LPR: Loan prime rate

1) **Targeted relending tools**: Since 2H21, the PBoC has rolled out a series of new relending tools to provide funding support for targeted areas, such as clean energy and technology innovation. As a result, the outstanding amount of relending tools has reached RMB4.3tn as of Dec-2023, up RMB374bn vs. mid-2023 (Exhibit 3).

2) **PSL resumption:** The PBoC injected a total amount of RMB500bn via PSL in Dec 2023 and Jan 2024 (Exhibit 4), aiming to support the "three major projects" (namely social housing construction, urban village revamp and infrastructure for both normal and emergency use).

3) **MLF operation**: The outstanding amount of MLF has jumped by RMB2.1tn since June-2023 (Exhibit 5), as the PBoC injected more liquidity into commercial banks.

Exhibit 2: PBoC's claims on depository FIs (asset side on balance sheet)
PBoC's fund injection to banks surged since mid-2023, similar to 2015–18



Source: PBoC, CEIC

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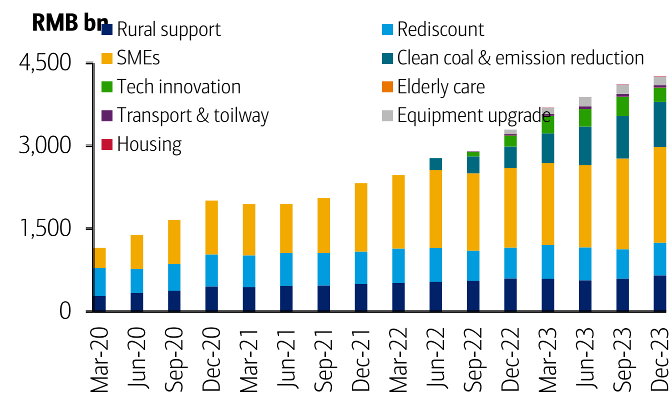
Exhibit 3: Relending & rediscount tools: breakdown by supporting area
The outstanding amount of relending & rediscount tools continued to rise



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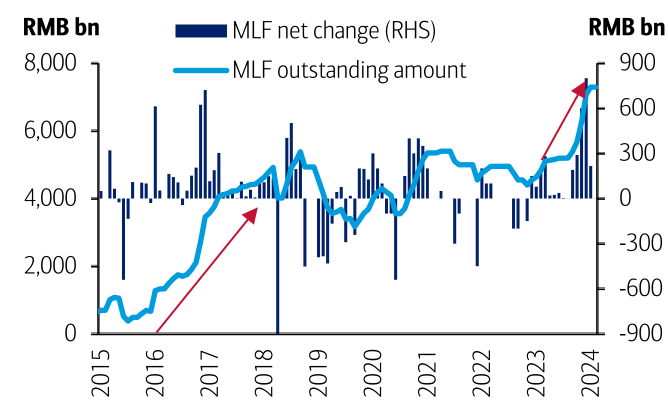
The various relending programs and PSL constitute PBoC's structural, or targeted, monetary policy toolbox. They now altogether account for more than 16% of the central bank's balance sheet. These targeted lending tools are also often thought of as "quasi-fiscal tools", as different from the universal monetary measures, they aim to funnel funds to narrowly defined sectors with favorable interest rates.

Exhibit 4: MLF net injection and outstanding amount
Net MLF injection rose notably since mid-2023



Source: PBoC, CEIC

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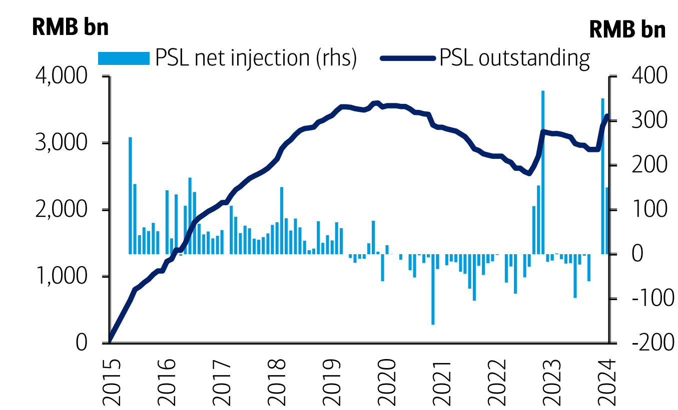
Exhibit 5: PSL monthly net injection and outstanding amount
The PBoC injected RMB500bn liquidity via PSL in Dec 2023 & Jan 2024



Source: PBoC, Wind

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Limited effect on growth so far

The resemblance to the 2015–18 period, as shown in Exhibit 2 and Exhibit 4, raises the question why such injection of funds hasn't translated into a meaningful pick-up in overall growth momentum so far.

When the Chinese government used PSL to inject funds via policy banks for the "shanty town renovation" program in 2015, many also dubbed the new tool "Chinese-style" or stealth QE, because of its money creation nature and the expansion in the central bank's balance sheet. In retrospect, PSL played an indispensable role in stimulating home sales and revitalizing China's housing market at that time. Local governments subsequently were able to pay off the interest and loans from policy banks, as the housing market recovery brought more land sales revenue.

One should take caution this time around when drawing comparison with the historical episode, as the effectiveness of quasi-fiscal policy could vary depending on the local governments' fiscal situation. Today, some local governments who face dire fiscal strains probably won't have very strong incentives to tap into such funds, even as top decision makers urge more borrowing for the construction of "three major projects".

In our view, the muted effect of credit injection this time around can also be explained by several reasons:

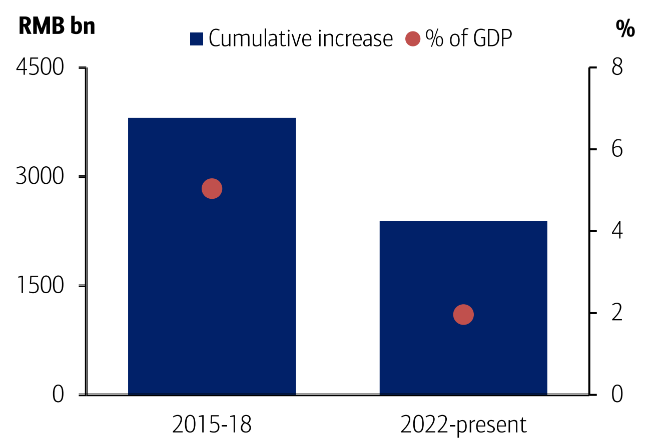
1. The targeted lending support so far is still small in size, especially compared with the size of the economy. The increase in targeting lending since the beginning of 2022 is only equivalent to 2% of GDP, vs. 5% during 2015–18 (Exhibit 6).

2. The expansion in the PBoC's balance sheet in 2015–18 was accompanied by more substantial monetary policy easing, especially universal interest rate cuts and RRR cuts (Exhibit 7). In contrast, during this cycle, the 1yr LPR has declined by only 25bp since 2022.

3. Despite credit extension guided by the central bank, some funds are sitting idly in the banking system, due to weak credit demand and low risk appetite in the private sector.

The former two factors are clearly reflected in our proprietary BofA China Financial Condition Indicator (FCI, see methodology report), which eased much more during the 2015 cycle than this time (Exhibit 8 and Exhibit 9).

Exhibit 6: Cumulative injection of targeted lending
The size of targeted lending support was more substantial in 2015–18



Source: BofA Global Research, PBoC, CEIC, Wind

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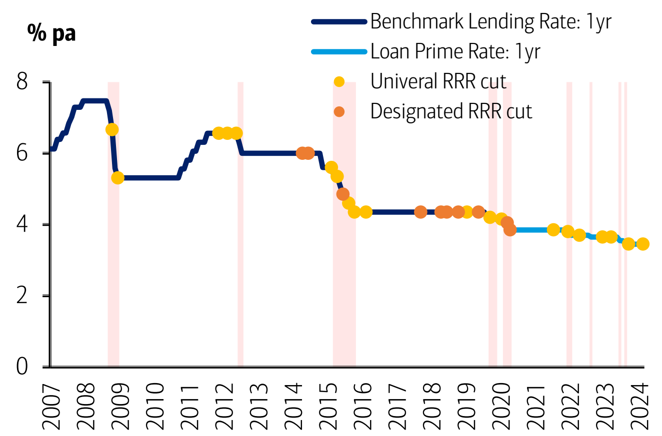
Exhibit 7: Historical interest rate and RRR moves by the PBoC
Substantial interest rate and RRR cuts during 2015–16



Note: Shaded areas refer to those periods with rate cuts
Source: BofA Global Research, PBoC, CEIC, Wind

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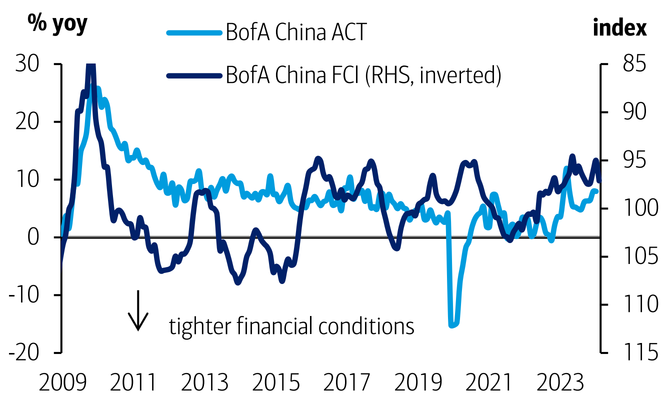
Further rate cuts needed to spur credit demand

In our view, more broad-based monetary policy easing is still needed to revive credit demand. At a time when CPI/PPI inflation is at very weak levels, financing costs in the real economy likely stay elevated, measured in real interest rate terms. The PBoC needs to both expand the size of its lending programs and cut interest rates more aggressively if it hopes to support investment growth more effectively.

We see more room for interest rate cuts in 2H24, if the Fed pivots to rate cuts by mid-year (as our US Economics team expects), even though the PBoC is likely to remain reluctant to cut rates in the near term due to FX depreciation concerns. Ultimately, interest rate reductions would be more effective in spurring credit growth, if accompanied by stronger fiscal support and better policy coordination.

Exhibit 8: BofA China FCI and ACT

Financial conditions eased less this time around than the 2015 cycle



Note: BofA China ACT shown in compound annual growth rate (CAGR) vs. 2019 level from 2021 and onward to remove the distortion by year-ago base. **Disclaimer:** The indicators identified as BofA China ACT and BofA China FCI above are intended to be indicative metrics only and may not be used for reference purposes or as a measure of performance for any financial instrument or contract, or otherwise relied upon by third parties for any other purpose, without the prior written consent of BofA Global Research. These indicators were not created to act as benchmarks.
Source: BofA Global Research, CEIC, WIND

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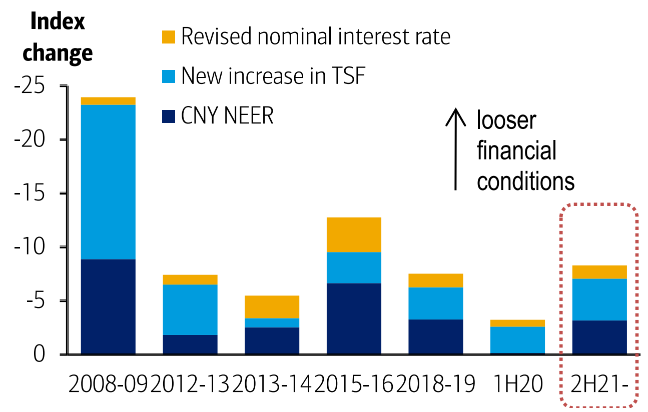
Exhibit 9: BofA China FCI: breakdown by contribution

Nominal interest rate played a smaller role in loosening financial condition this time



Source: BofA Global Research, CEIC, WIND

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News and Views

Brazil: IPCA forecasts revised slightly up for 2024

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According to the Brazilian Central Bank's (BCB) weekly survey (Focus), market analysts now see slightly higher inflation for 2024, though forecasts remained unchanged for the rest of the horizon (2025–2027). Analysts now see IPCA at 3.77% (from 3.76%) for YE24, while YE25 remained at 3.51%, and YE26 and YE27 at 3.50%. For GDP, forecasts went up to 1.78% (from 1.77%) for 2024 and remained at 2.00% for the rest of the years. Selic rate median expectation stood still at 9.00% for 2024, and 8.50% for 2025, 2026 and 2027. Regarding FX, exchange rate expectations stood still at R$4.93/US$1 for YE24, R$5.00/US$1 for YE25, R$5.04/US$1 for YE26 and R$5.10/US$1 for YE27.

- **To follow:** Consensus for IPCA is still above our forecasts of 3.7% for 2024 and 3.5% for 2025. Regarding interest rates, consensus see a lower Selic for 2024 and 2025, as we expect the selic rate at 9.5% by the end of both years. GDP consensus is below our 2.2% growth expectation for 2024, and 2.5% in 2025. Regarding FX, market participants foresee a weaker currency than us by end of 2024 (R$4.75/US$1), but similar in 2025 (R$5.00/US$1).

Brazil: February IPCA with imminent benign sign

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Inflation in the month was 0.83% mom, from 0.42% mom in January. The result was in line with our expectation, but above market consensus of 0.79%. In 12 months, inflation was stable at 4.5% yoy, at the upper bound of inflation target (3.0% + 1.5%). Average core measures continued to decelerate in annual terms, now at 4.0% (from 4.2%). Also, seasonal adjusted inflation core returned to decelerate in the margin. However, momentum is not fully benign yet, as 3mma of core inflation was up to 4.1% annualized rate (from 3.9% in January) and core services went up to 5.8% (from 5.6%). While the main upward pressure came from the seasonality on Education, with 4.98% mom, given the annual school tuition readjustment; Clothing group represented the main downward pressure (-0.44% mom). Besides that, the diffusion index (percentage of items that recorded inflation in the month) declined to 57.0% (vs 65.1%), in addition to the drop of the ex-food index - now at 57.9% (vs 65.1%).

- **To follow:** After core services inflation (BCB's largest concern) surprising to the upside in the last two prints, February IPCA showed a more benign composition. All in, we continue to see inflation decelerating until reach 3.7% in 24YE and 3.5% in 25YE.

Mexico: Industrial production starts 2024 with gains, 0.4% mom sa in January

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Industrial production in January in line with expectations at 0.4% mom sa (E. 0.4%, BofA 0.2%) up from -0.7% mom sa in December, in real terms. This is the first monthly increase since October 2023. By components construction was the main upward contributor at 2.2% mom sa (vs -0.5% in December), while manufacture increased 0.2% mom sa (vs -1.3% in December). On the other hand, utilities decreased at -0.8% mom sa (vs -1.4% in December), and mining fell as well at -0.4% mom sa (vs 1.4% in December). In annual terms IP was 2.9% yoy nsa (E. 2.2%, BofA 1.3%), up from 0.0% in December. The main upward contributor was construction, at 17.9% yoy nsa, while the rest of the components either grew marginally (utilities at 0.6%, manufacture at 0.1%) or decreased (mining at -1.6%)

- **To follow**: This print is in line with our view of a more dynamic first half of the year, with construction being at its centre. Nonetheless, we still expect a weakening after the election and Banxico cutting in March despite the uptick in activity.

Mexico: Nominal wage growth accelerated at 8.63% yoy in February

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Nominal wages increased 8.6% yoy in February, up from 8.0% in January (revised to the downside from 9.5%). 2024's print is above the increase observed in February 2023 of 8.4% yoy. By sector, public employees' wages increased 5.6% yoy (vs. 4.1% in January) and private employees' wages increased 8.7% yoy (vs. 10.0% in January). In real terms, overall wages grew 4.0% yoy, with public employees' wages increasing for the first time since November at 1.1% yoy, while private employees' wages grew 4.1% yoy, thus decelerating for the third month in a row.

- **To follow:** Wages keep growing at high rates, which will continue to put upside pressure on prices. Regardless, we believe this will not stop Banxico from cutting in March, given the downward trend so far in core inflation.

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