

## China Watch

# Larger-than-expected 5yr LPR cut signals policy support to property sector

## 5y LPR fell more than expected, 1y unchanged

China's benchmark 1-year Loan Prime Rate (LPR) remained unchanged at 3.45% in February, against market expectations of a small 5bp cut. However, the 5y LPR was lowered by 25bps to 3.95%, beating consensus forecast of a 10bp cut. The magnitude of the 5y LPR cut was larger than the previous few reductions (10bps in June '23, 15bps in May and August '22) and also marked the biggest move on record (see Exhibit 1 and Exhibit 2).

This reduction in the 5y LPR came on the back of prior rounds of deposit rate cuts and the 50bp RRR cut that took effect on February 5. Note that the PBoC did not cut the MLF rate two days ago, amid renewed currency depreciation pressure as the market expected timeline for Fed cuts was delayed further.

## A clear signal to bolster property and long-term lending

It is not entirely a surprise to us to see an asymmetric change in the 5y vs. 1y LPR. Keep in mind that the 5y and 1y LPR can move by different magnitudes, depending on policymakers' priorities. Given that the 5y LPR is the benchmark to price mortgages and medium-to-long-term (MLT) corporate loans, today's deliberate choice to deliver a large 5y LPR cut (instead of a modest cut in both the 1y and 5y LPRs) sends a strong signal that policymakers intend to support the housing market as well as other longer-term business projects.

At a time when new mortgage rates have already dropped to a record low level (3.97%, Exhibit 3), this further 5y LPR reduction will help lower households' burden of mortgage payments. Lower lending rates for corporates can also stimulate demand for capex spending and support infrastructure investment.

## Expect further monetary easing in coming quarters

In our view, the PBoC will likely step up on monetary easing this year, as external constraints gradually ease. In the near term, the pace of further interest rate cuts could be limited, given the PBoC's continued focus on FX stability and pressure on the net interest margins of commercial banks. However, we see room for more rate cuts for the rest of the year, facilitated by likely further deposit rate reductions and the Fed's pivot to rate cuts (our US Economics team expects the first cut in June). We still expect the 1y LPR to decline by a cumulative 45bps in 2024, mostly during the 2H. But even before the Fed pivot mid-year, we think the PBoC may still guide down the 5y LPR further without changing the 1y tenor.

Meanwhile, we think the PBoC is likely to provide more funding support to several targeted areas (technology, green economy, SMEs, senior care and digital economy) and continue to drive a reasonable pace of credit growth (see report: [PBoC reiterates focus on effective credit expansion](#)). Policymakers may also continue to utilize quasi-fiscal tools (such as PSL) to prop up investment growth.

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### Abbreviations:

MLF: Medium-term Lending Facility

PBoC: People's Bank of China

RRR: Required Reserve Ratio

PSL: Pledged Supplementary Lending

SME: small and medium enterprise

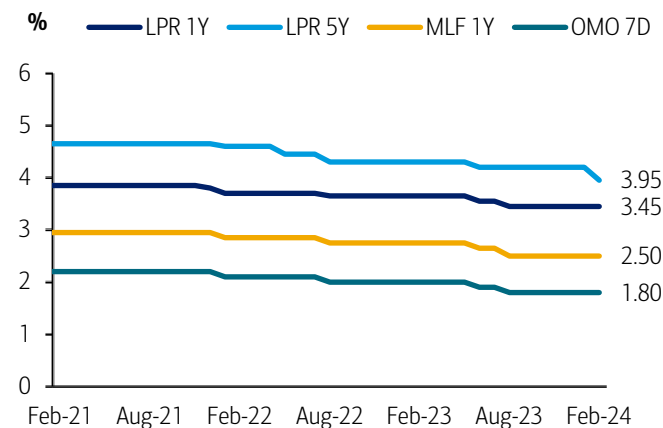
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Timestamp: 20 February 2024 12:51AM EST

**Exhibit 1: Key policy rates movement**

The 5y LPR was lowered by 25bps to 3.95%, beating the consensus forecast of a 10bp cut

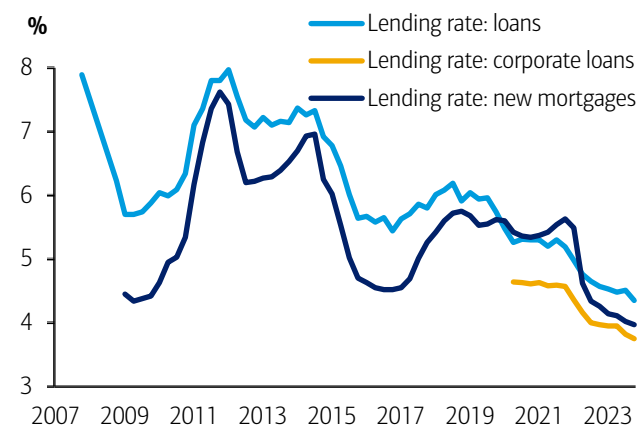


Source: Wind

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**Exhibit 3: Weighted average lending rates published by the PBoC**

New mortgage rate fell to 3.97% as of end-4Q 2023



Source: CEIC, PBoC

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**Exhibit 2: Monthly key policy rates movement (bp)**

The magnitude of the 5y LPR cut was larger than the previous few reductions and marked the biggest move on record

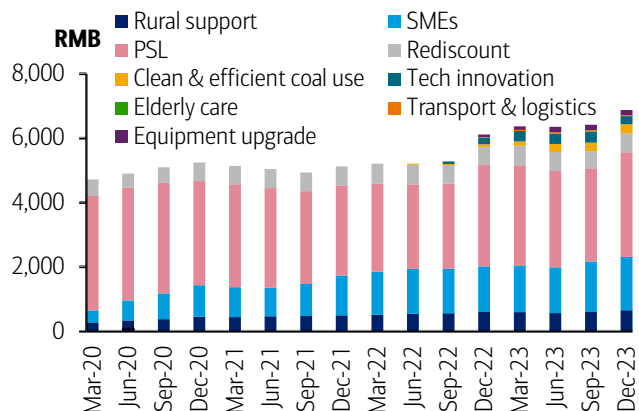
	OMO 7D	MLF 1Y	LPR 1Y	LPR 5Y	
Sep-19	0	0	-5	-5	0
Nov-19	-5	-5	-5	-5	-5
Feb-20	-10	-10	-10	-10	-5
Mar-20	-20	0	0	0	0
Apr-20	0	-20	-20	-10	-10
Dec-21	0	0	-5	-5	0
Jan-22	-10	-10	-10	-10	-5
May-22	0	0	0	0	-15
Aug-22	-10	-10	-5	-15	-15
Jun-23	-10	-10	-10	-10	-10
Aug-23	-10	-15	-10	0	0
Feb-24	0	0	0	-25	-25

Source: Wind, BofA Global Research

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**Exhibit 4: PBoC's targeted lending tools**

The total outstanding balance of targeted lending tools rose notably in 4Q23



Source: PBoC, CEIC

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