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China Watch

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

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GEM Economics
Asia | China

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PBoC balance sheet expanded notably since mid-2023…

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.

…driven by various lending tools

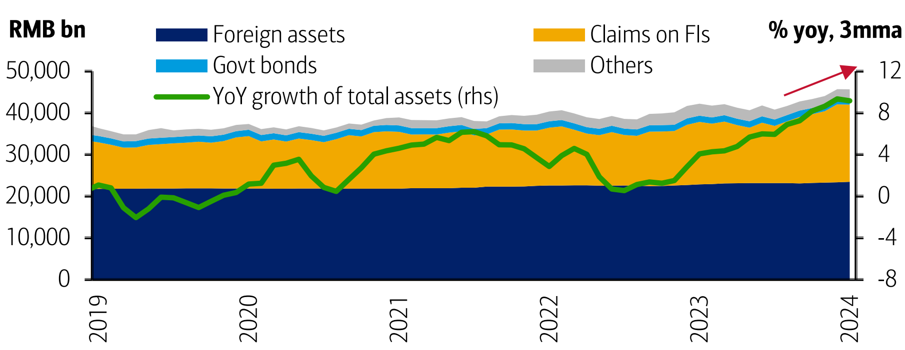
The recent increase in the PBoC's total assets was not due to large-scale bond buying but to a sharp increase in the central bank's "claims on depository financial institutions" (Exhibit 2), which record funds injected into the banking system via various monetary policy tools. Specially, three key factors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

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 (see Appendix for details). As a result, the outstanding amount of all relending tools reached RMB4.3tn as of December 2023, up RMB374bn from mid-2023 (Exhibit 3).

2) **Pledged Supplementary Lending (PSL) resumption:** The PBoC injected a total amount of RMB500bn via PSL in December 2023 and January 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) **Medium-term Lending Facility (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 1: PBoC's total assets: by breakdown
PBoC's balance sheet has expanded by nearly RMB5tn since mid-2023



Source: BofA Global Research, PBoC, CEIC

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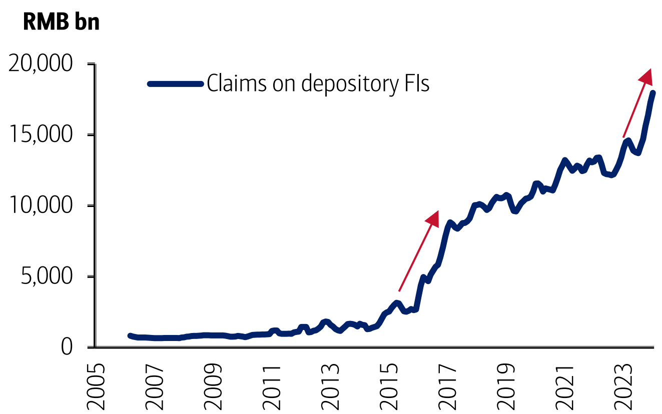
The various relending programs and PSL constitute PBoC's structural, or targeted, monetary policy toolbox. They now together account for more than 16% of the central bank's balance sheet. These targeted lending tools are also often thought of as "quasi-fiscal tools", as different from the universal monetary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

Exhibit 2: PBoC's claims on depository FIs (asset side on balance sheet)
The central bank's fund injection to the banking system has risen notably since mid-2023, similar to 2015-18



Source: PBoC, CEIC

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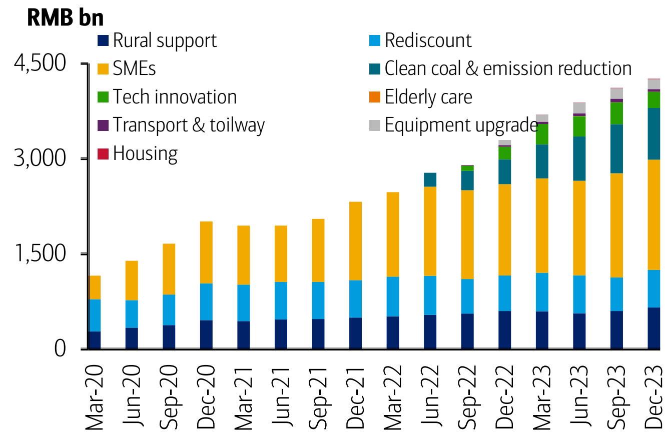
Exhibit 3: Relending & rediscount tools: breakdown by supporting area
The outstanding amount of relending & rediscount tools has continued to rise over time



Source: PBoC, CEIC

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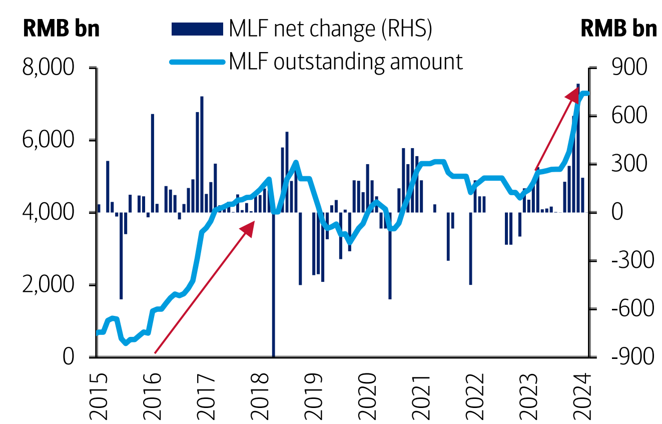
Exhibit 4: MLF net injection and outstanding amount
Net MLF injection rose notably since mid-2023



Source: PBoC, CEIC

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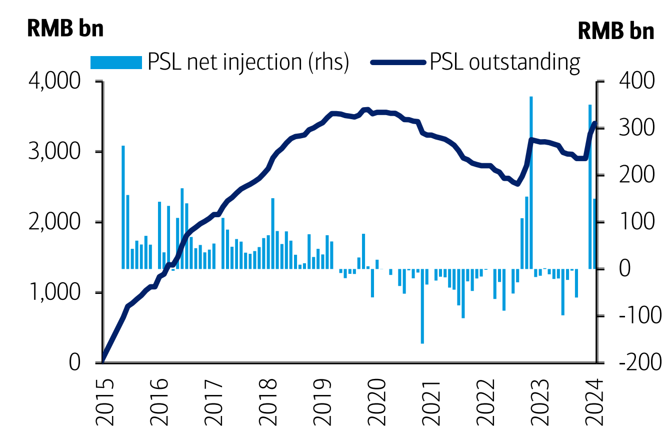
Exhibit 5: PSL monthly net injection and outstanding amount
The PBoC injected RMB500bn liquidity via PSL in Dec 2023 & Jan 2024



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 has not 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.

We caution this time around about 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 that face dire fiscal strains probably will not have very strong incentive 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 the following:

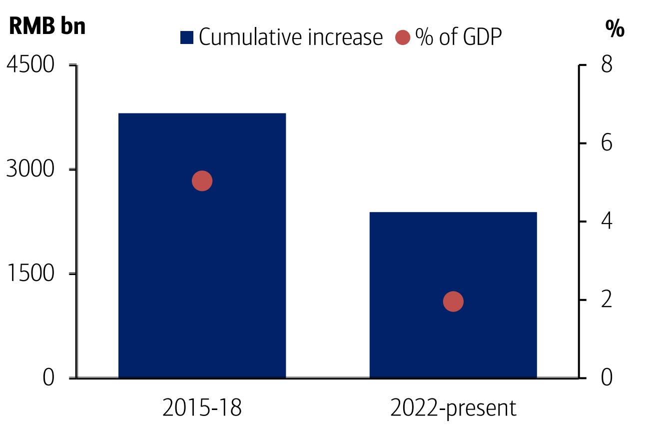
1) The targeted lending support so far is still small in size, especially compared with the size of the economy. The increase in targeted lending since the beginning of 2022 is only equivalent to 2% of GDP, versus. 5% during 2015-18 (Exhibit 6).

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 reserve requirement ratio (RRR) cuts (Exhibit 7). In contrast, during this cycle, the 1-year loan prime rate (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 our 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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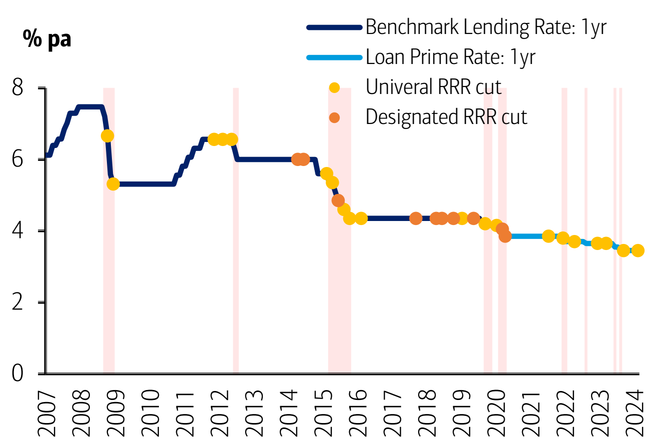
Exhibit 7: Historical interest rate and RRR moves by the PBoC
Substantial interest rate and RRR cuts during 2015-16



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

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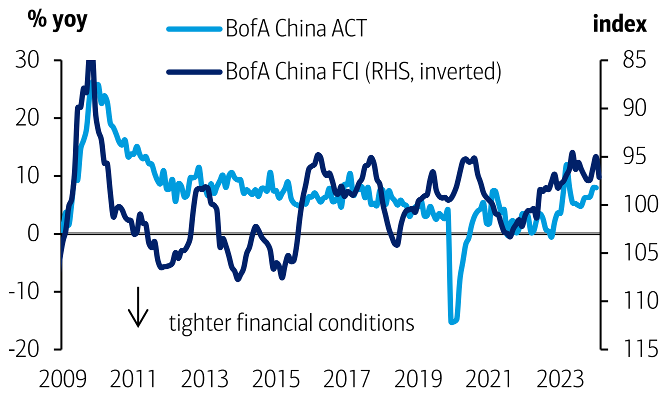
Further rate cuts needed to spur credit demand

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 than in 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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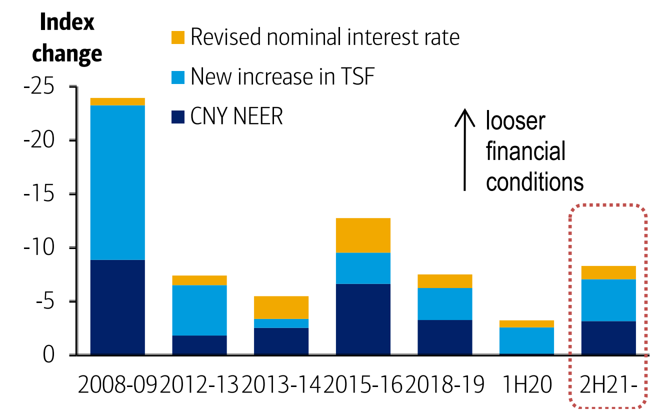
Exhibit 9: BofA China FCI: breakdown by contribution

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



Source: BofA Global Research, CEIC, WIND

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Appendix:

Exhibit 10: PBoC's current structural/targeting monetary policy tools

More and more targeted tools have been rolled out in the past two years

	Structural monetary instruments/ Support areas	Status	2023-end Interest rate (1yr)	2023-end quota (RMB bn)	Outstanding amount (RMB bn) 1Q 23	2Q 23	3Q 23	4Q 23
Long-term facilities	Relending for rural development	Active	2%	810	596	566	599	656
	Relending for SMEs	Active	2%	1,800	1,433	1,423	1,566	1,655
	Rediscount loans	Active	2% (6 month)	740	606	595	529	592
Temporary facilities	SME support loans	Active	1% (incentive to lender)	80	28	40	50	53
	PSL (pledged supplementary lending) facility	Active	2.25%	-	3,129	2,990	2,902	3,252
	CERF (carbon emission reduction facility)	Active	1.75%	800	399	453	510	541
	Special relending for coal exploitation	Inactive	1.75%	300	137	246	262	275
	Relending for tech innovation	Inactive	1.75%	400	320	320	346	256
	Special relending for elderly care	Active	1.75%	40	1	1	2	2
	Special relending for transport and logistics	Inactive	1.75%	100	35	43	45	32
	Special relending for equipment upgrade	Inactive	1.75%	200	111	169	167	157
	Facilities supporting interest rate cuts on SME loans	Inactive	1% (incentive to lender)	-	27	27	27	27
	Facilities supporting tollway loans	Inactive	0.5% (incentive to lender)	-	0	0	8	8
	Private enterprise bond financing facility (Phase II)	Active	1.75%	50	0	0	0	0
	Loan program to ensure delivery of housing projects	Active	0%	200	1	1	6	6
	Special relending for troubled property developers	Inactive	1.75%	80	0	0	0	0
	Loan support scheme for rental housing	Active	1.75%	100	0	0	0	0

Source: PBoC website

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Exhibit 11: PBoC's monetary toolbox

PBoC has a wide range of monetary policy tools

Name	Full Name	Last Observed Rates	Purpose	Counterparty	Collateral
LPR	loan prime rate	1y 3.45%, 5y 3.95%	Replace benchmark lending rates as the main reference rate that banks price their loans on	Banks submit their quotes based on MLF rate	
RRR	Required Reserve Ratio	RRR (Feb 2024): 7.0% 10.0% for large banks; 7.0% for medium sized; 5.0% for small depository institutions Rate on reserves (Nov 2008): 1.62%; Rate on excess reserves (Apr 2020) 0.35%	Portion of deposits that banks hold at the PBoC; higher reserve ratio reduces liquidity; interest on excess reserves serves seen as floor for repo rate	Banks	None
Repo and Reverse Repo	Repo and Reverse Repo	Reverse Repo: 7d 1.80%, 14d 1.95%, 28d 2.85% Repo: 14d 3.2%, 28d 4.0% (Repo is not in use for years)	Reverse Repo: inject liquidity Repo: withdraw liquidity	Policy and national commercial banks	CGB and policy bank bonds
MLF	Medium-term Lending Facility	1y 2.50%	Guide medium term rate; support low-cost funding to targeted sectors	Policy and commercial banks	CGB, PBoC bills, policy, financial bonds, IG bonds, local government bonds, quality loans
Relending	Relending	For rural and SMEs: 1y 1.75%, 6m 1.65%, 3m 1.45%. For environment protection, innovation, elderly, logistics: 1.75%	Encourage loans to targeted areas	Targeted financial institutions	Loan assets
SLO	Short-term Liquidity Operation	(Jan 2016) 3d 2.10%, 6d 2.25%	Manage short-term liquidity	12 medium-large sized banks	CGB, PBoC bills, policy, financial bonds and IG bonds
SLF	Standing Lending Facility	(Aug 2023) 1d 2.65%, 7d 2.80%	Supply short-term liquidity; set ceiling for repo rate	Small local banks	CGB, PBoC bills, policy, financial bonds, IG bonds, local government bonds, quality loans
		(Aug 2023) 1m 3.15%	Supply large liquidity demand for 1-3 months	Policy and national commercial banks	CGB, PBoC bills, policy, financial bonds, IG bonds, local government bonds
TLF	Temporary Liquidity Facility	(Jan 2017) similar to OMO, unannounced	Manage short-term liquidity without need for liquid assets as collaterals. Last used for LNY liquidity demand.	Large banks with a relatively large share of cash injections (i.e., 5 large banks)	None
TMLF	Targeted Medium-term Lending Facility	(Apr 2020) 1y 2.95%	Guide medium-term rate; support low-cost funding to private businesses, SMEs	Policy and commercial banks	CGB, PBoC bills, policy, financial bonds, IG bonds, local government bonds, quality loans
CRA	Contingent Reserve Arrangement	Announced end-2017	To support liquidity and stabilize interbank market during LNY; up to 2% of deposit reserves for up to 30 days	National commercial banks with a relatively large share of cash injections	N/A

Source: BofA Global Research, PBoC **Note**: As of Feb 2024

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