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China's central bank surprises with magnitude of stimulus measures

In a major package of stimulus measures, China's central bank on Tuesday announced a 20 bps cut to the seven-day reverse repo rate from 1.7% to 1.5%. Other moves included:

- Making a 50 bps cut to the reserve requirement ratio (RRR) – the amount of cash that banks must hold as reserves – providing an estimated RMB 1 trillion of liquidity to the banking system, with a possible further 25-50 bps cut before the end of the year depending on market conditions.
- Lowering the existing mortgage rate by about 50 bps.
- Reducing the minimum downpayment for second-home buyers from 25% to 15%.
- Providing new monetary policy tools to support stock market development (eg, allowing securities firms, funds and insurers to borrow liquidity from the central bank via asset pledges).
- Launching a special-purpose relending tool to help banks fund listed companies' share buybacks

What are the implications?
China bond yields initially reacted positively and declined by 2 bps before retracing 6 bps higher as onshore equities rallied. The RRR cut and lower mortgage rate on existing mortgages were expected ahead of the People's Bank of China's (PBoC) press conference. But the timing and magnitude of the 20 bps policy rate cut were not – especially given that the last rate cut of this size occurred during the Covid-19 pandemic in March 2020.

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PBoC Governor Pan Gongsheng implied that the macroeconomic easing baton will now pass to the Ministry of Finance for further fiscal stimulus.

Regarding the bank's recent intervention in the Chinese government bond (CGB) market, Governor Pan said that the central bank had acted to calm the bond market, and the market has "calmed somewhat". He added that the level of bond yields was market-driven and the PBoC respects the role of market forces.

This may imply less intervention from the PBoC on the CGB yield level and curve going forward.

What does this mean for investment positioning?

Having been overweight CGB duration for most of this year, we took profits and shifted to a neutral duration position as most monetary easing expectations have now materialised. Other than further cuts to the RRR, which have been guided, any more easing in the policy rate for the rest of this year seems unlikely.

The next wave of policy easing will likely come from fiscal and housing policy, which may shift growth expectations and market sentiment, depending on the magnitude and efficacy of any announcements.

For the rest of the year, we see better risk-reward in yield curve flatteners than outright duration trades.

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