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ECONOMY | CENTRAL BANKS

China's Monetary Policy Zigs Where U.S. Zags

After the Fed tightened monetary policy, the PBOC effectively loosened

The People's Bank of China made its largest single-day cash injection into the financial system since mid-January on Friday. PHOTO: THOMAS WHITE/REUTERS

By Shen Hong

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SHANGHAI—A day after the U.S. Federal Reserve tightened monetary policy, China's central bank effectively loosened, in a move that suggests Chinese authorities are now more concerned about financial turmoil inside the country than money flowing out of it.

The People's Bank of China on Friday injected a net 250 billion yuan ($36.73 billion) into the financial system—more than it has on any single day since mid-January, when demand for cash was high ahead of the Lunar New Year holiday.

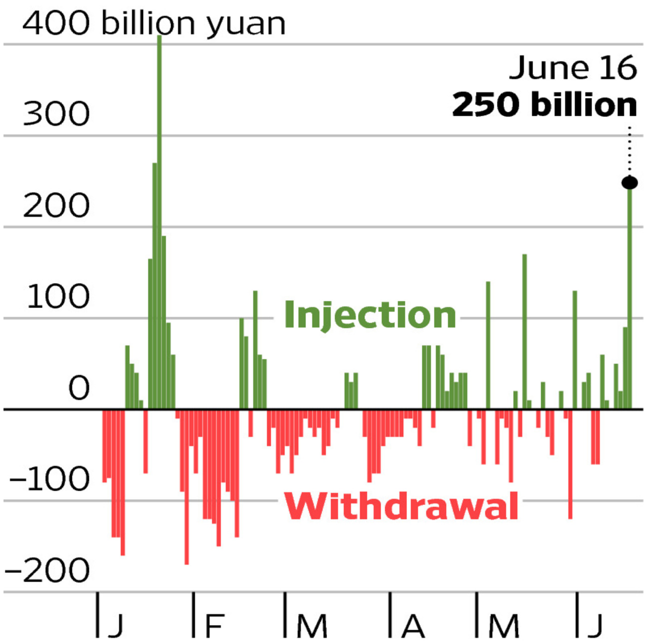
The massive pump priming comes as a monthslong regulatory crackdown on excessive leverage and financial misbehavior in China has left the markets jittery. Most recently, authorities detained Wu Xiaohui, the chairman of Anbang Insurance Group, one of China's biggest insurers, for what people familiar with the matter described as a probe into possible economic crimes.

Although market reaction has been muted, a number of Chinese banks had already distanced themselves from Anbang, whose life insurance unit in May was barred from selling new products for three months, in what was seen as an attempt to keep any troubles there from spreading to other parts of the financial system.

Regulators also tend to keep plenty of cash in the system in June, analysts say, due to a seasonal surge in demand due to corporate tax payments and regulatory requirements on banks' capital.

Flash Cash

China's central bank injected the largest amount of cash into the financial system on a single day since mid-January.



Note: 100 billion yuan = $14.7 billion
Source: Wind Info

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The PBOC's move contrasts with its actions following the Fed's previous rate increase in March, when it responded by pushing up its own rates within hours. Analysts attributed that reaction to the bank's desire to discourage a further surge in money leaving the country, a danger if interest rates in the U.S. look much more attractive than at home.

Since then, capital outflows have slowed, and analysts say Beijing's concerns have shifted to making sure its regulatory crackdowns don't endanger the economy and financial system.

"Apart from the seasonal factors, the central bank's move today also shows it is adopting a milder approach to its effort to reduce financial leverage because the latter has already started to have a negative impact on the real economy," said Tang Yue, analyst at Industrial Securities.

Beijing's campaign to tame highly leveraged investing began last summer and intensified in February and March when it twice raised a suite of key money-market interest rates. The move to clean up China's messy and risk-prone financial system has led to a sharp rise in borrowing costs in recent months: Yields on government bonds rose to a 29-month high last month and remain elevated, while a record number of companies have canceled or delayed new bond issuance.

Mr. Tang also pointed to weaker credit data released Wednesday as fresh signs of difficulty: China's broadest measure of money supply, M2, was up 9.6% at the end of May from a year earlier, lower than the 10.5% increase at the end of April and below economists' median 10.4% growth forecast. It is the first time the M2 growth figure has fallen below 10% since the central bank first published the data in 1986, according to Wind Information.

The return to liquidity tools such as short-term loans to commercial banks in money markets to adjust funding conditions, instead of following the Fed's footsteps, also betrays the central bank's concern about an already-tightening supply of cash triggering a liquidity crisis, said Liu Dongliang, senior analyst at China Merchants Bank .

June is typically a month when nervousness grips China's increasingly edgy interbank market as banks and financial institutions scramble for funds to meet needs ranging from corporate tax payment to mandatory deposits parked at the central bank. Loan defaults among a couple of medium-size banks led to an unprecedented cash crunch four years ago.

In addition, an improvement in China's foreign reserves, signs of easing pressures on capital outflows and a stable currency gave Beijing option to refrain from raising interest rates this week, Mr. Liu said.

Data released earlier this month showed that China's foreign-exchange reserves in May rose by the largest amount in more than three years, increasing by $24.03 billion from the previous month to $3.054 trillion—the fourth straight month of gains.

In a front-page commentary published on Friday, the state-run Securities Times attributed the PBOC's inaction to the better foreign-reserves data and reduced expectations of yuan depreciation.

"All these have reduced the necessity for the PBOC to follow the Fed with a passive rate hike," the newspaper wrote in the commentary.

Despite the PBOC's decision to stand pat this time, the gap between Chinese and U.S. market interest rates have widened sharply in recent months.

The yield on the 10-year Chinese government bond is at 3.56%, a 1.4 percentage-point premium above that on the corresponding Treasury, up from just 0.62 percentage point in early August, before Beijing started the campaign to cut financial risk.

“The interest-rate gap between China and the U.S. is wide enough, so there's no need for China to raise rates now,” said Mr. Tang.

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