China rate cut: The right move at the right time

China's 28 February interest rate cut – the second in just three months – came as little surprise to the market, as it continues a program of monetary and fiscal support measures designed to maintain an appropriate balance between ongoing structural reform to reorient China's economy toward domestic consumption and the need to maintain sufficient economic growth to provide jobs for its population. Kai Kong Chay, Senior Portfolio Manager for Greater China Equities with Manulife Asset Management believes that the rate cut represents the right action taken at the right time and expects it to be supportive of the A-share market.

On 28 February 2015, the Peoples' Bank of China (PBoC) announced a 25 basis point (bp) cut to its benchmark interest rate, lowering the one-year deposit rate to 2.50% and the one-year lending rate to 5.35% as of 1 March. The announcement was accompanied by an increase of the deposit rate ceiling to 1.3x the benchmark rate from the previous 1.2x.

The announcement came as little surprise to the market, as it continues momentum on economic support measures that have included about US$126 billion in direct liquidity injections in the second half of 2015, an asymmetrical interest rate cut on 21 November 2015 (benchmark deposit rates fell 25bp and lending rate 40bp) and a bank reserve requirement ratio (RRR) cut on 6 February 2015. The government also implemented more targeted economic support measures during 2014, including fiscal spending on rail construction, slum renovation and social housing, RRR cuts for specific provinces and loosening loan provision for certain industries.

These stimulus measures come against the backdrop of continued slowing in China's economy, with 2014 GDP growth having ended the year at 7.4%, its lowest level since 1990[1], and the official Manufacturing Purchasing Managers' Index (PMI), a key indicator of the health of China's manufacturing sector, having fallen to 49.8 in February after having ended January at 49.9 to fall below 50 for the first time in two and the half years[2]. The property market also remains relatively weak by historical standards.

More easing likely to come

Kai Kong Chay, Senior Portfolio Manager for Greater China Equities with Manulife Asset Management, explained: "This interest rate cut does not come as a great surprise and, in our view, is not a cause for concern. The government has guided for lower-than-historical GDP growth around the 7% level as it is well aware that structural reforms being implemented to support stable longer-term economic growth are slowing some sectors in the shorter term – in fact, 2014 GDP growth came in above market expectations.

"We believe that this cut is the right action at the right time, as recent disinflation has taken the edge off inflation, China's real interest rate remains high by global standards and this type of monetary action should have a more direct stimulus effect on the economy than more targeted measures implemented in early 2014. We expect to see further support measures in 2015 as China generally remains behind the curve on monetary easing – this could include further interest rate or RRR action."

All data sourced from Bloomberg unless otherwise stated.

[1] IMF World Economic Outlook Database, April 2014.
[2] National Bureau of Statistics of China, 2 March 2015.

Against this backdrop, Chay is constructive on A-shares, particularly those that will benefit directly from government support. This includes players in the healthcare, environmental protection, e-commerce and property development sectors. Similarly, lower rates are feeding the current trend of renminbi (RMB) depreciation, which is likely to support manufacturers and exporters.

Meanwhile, the A-share market should continue to benefit from progressive opening of China's capital account, with the Shanghai-Hong Kong Stock Connect scheme launched in late 2014 giving foreign investors unprecedented access to locally listed firms and a complementary Shenzhen-Hong Kong Stock Connect program scheduled for launch in late 2015.