CCXI & CCXAP – Research & Commentary

Overall Monetary Easing is Less Likely, Interest Rate May Experience Slight Correction

Hong Kong, 20 October 2020 -- China Chengxin International Credit Rating Co., Ltd. ("CCXI") has released a report titled *"Liquidity Tightened with Normalized Monetary Policy, and the Yield might be Slightly Adjusted after Reaching the Top——Review and Outlook of Monetary Policy and Interest Rate bonds in Q1-Q3 of 2020"*. According to the report, due to the steady recovery of economic fundamentals and gradual alleviation of liquidity disturbance, the overall monetary easing is less likely in the subsequent period while the policies may become normalized. However, given the distribution of maturing funds of the open market and special attention given to liquidity by the Central Bank at the end of this year and the beginning of next year, it is expected that there will still be one (targeted) RRR cut around the New Year or the Spring Festival. **In the opinion of CCXI Research Institute, with respect to yields, the overall disturbing factors are not many, and the movement is expected to focus more on the fundamentals and marginal policy changes. However, shored up by the substantial continued inflows of overseas capital, the yields may decrease slightly, fluctuating between 2.9% and 3.3% in Q4 this year and Q1 next year.**

According to the report, monetary policy and interest rate bond mark operation of the past three quarters demonstrated three major characteristics. Firstly, the monetary policy steadily returned to the normal state, and the liquidity gradually weakened marginally while maintaining reasonable adequacy. With the sustained pickup of domestic economy in Q3, the monetary policy has returned to normal condition step by step after being relaxed in emergency situations, maintained a robust trend, and boasts of more flexibility and accurate orientation. In the first three quarters, the money market interest rates declined on the whole from the same period last year, which rebounded amid fluctuations with a V-shaped movement after a periodic bottom in April, and then recovered to the level of the same period last year at the end of September. The LPR was flat for six months consecutively. **Secondly, the "three arrows" of proactive fiscal policies were introduced in all aspects, resulting in a significant rise in issuance of interest rate bond driven by intensive issuing of RMB 1 trillion of special treasury bonds for COVID-19 control and local government bonds.** The interest rate bond issuing scale in the first three quarters increased 45.66% from the same period last year to reach RMB14.84 trillion, with the net financing rising by 70.11% to RMB8.74 trillion. Specifically, the treasury bonds (including special treasury bonds of RMB1 trillion) reached RMB4.80 trillion with an increase of 60.75% from last year, the local government bonds increased by 36.80% to RMB5.68 trillion driven by substantial expansion of new special bonds, and the policy bank bonds increased to RMB4.36 trillion, up 44.39%. **Thirdly, the yield curve of the 10-year treasury bonds presented a V-shaped movement, rallying remarkably after reaching the bottom of the period in April.** Due to economic recovery, the restart of risky assets, the normalization of monetary policies and marginal tightening of liquidity become the major drivers of interest rate rally. The yield in the first three quarters registered an overall pickup from the same period last year, with the rally stronger in the short term than the long

term.

Looking ahead, CCXI Research Institute believes that the monetary policy will continue to focus on prudence and flexibility and attach more importance to accurate orientation. With the sustained recovery of domestic economy, the monetary policy will be more "domestic-oriented", and be adjusted marginally along with the movements of domestic fundamentals. Given the obvious rise of macro leverage ratio in the first half, the overall easing of monetary policy is less likely, but it will not be tightened beyond expectation either. More attention will be paid to structured accurate orientation subsequently. The regular meeting of the Central Bank in Q3 called for deepening market-oriented interest rate reform, and guiding further decline of lending rates. In light of the distribution of maturing funds of the open market and protection of liquidity by the Central Bank at the end of this year and the beginning of next year, it's expected that there will still be one (targeted)RRR cut around the New Year or the Spring Festival, and the LPR may also be further cut within the year, since there is still room for further decline of lending rates.

With respect to the trend of the yield, CCXI Research Institute maintains its previous opinion in the interim report on interest rate bond that the overall fluctuation of yield in the second half is between 2.9% and 3.3%. It also believes that, given the sustained pickup of economic fundamentals, reverting to normalized state of monetary policies and continued inflow of overseas capital, there is room for minor correction for the yield of treasury bonds, which is expected to fluctuate in the 2.9%-3.0% band in the upcoming six months. Firstly, the economic fundamentals will continue to be improved, and the improvement may be within expectation. In addition, the inflation is controllable on the whole, which will not seriously impede the monetary policy, and will not be too negative for the bonds market. **Secondly**, the monetary policy has reverted to the normal condition, and later on structured operation will become the focus. Combined with the fact that the New Year and the Spring Festival will fall in the coming six months, the Central Bank will still be careful about protection of monetary supply. **Thirdly**, the repeated outbreaks of the pandemic in overseas countries, the mounting uncertainties of the US election and the decline of global risk appetite will still be favorable for safe haven assets. In addition, due to the rising interest rate spread between China and the US combined with the inclusion of China's treasury bonds into the FTSE Russell index and the favorable policy to further promote opening-up, overseas capital inflows may witness overall increase, to shore up the yield of China's bonds market. **Besides,** in light of the historical rising cycle of the yield of treasury bonds, the yield of this round of treasury bonds has been rising faster and more robustly than the previous several rounds, and the movement pattern indicates that there will still be time and space for temporary adjustment on the whole. According to analysis based on multiple factors, the fluctuating band of the yield may be corrected from the current level but the change will not be much. Meanwhile, considering the intensive issuing of local government bonds in advance in Q1 next year, the bond market may get disturbed at certain time points, and the yield may rise slightly. Overall, the yield of treasury bonds in the coming six months may fluctuate in the 2.9%-3.3% band, but there is still a need to watch the sharp rise of risk appetite which may be triggered by the unexpected rally of economy in the subsequent period**.**

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