China. PBOC Cuts Rates. Economy Slows. Constructive For Equity Markets and Risk Assets.

The Chinese economy is clearly slowing down and the PBOC is reacting by providing stimulus to maintain a sustainable rate of growth. It needs to do this in a balanced way without undoing some of the credit market reforms that have been enacted in the last year. On Sunday, the PBOC announced a 0.25% cut to its benchmark 1 year lending rate (to 5.1%) and its benchmark 1year deposit rate (to 2.25%) while raising the deposit rate ceiling from 130% to 150%.

The PBOC is seeking to reduce borrowing costs and boost output while keeping asset bubbles from inflating, particularly in its real estate market, stock market and shadow banking system. The PBOC has a host of monetary policy tools at its disposal including the Standing Lend Facility, Medium-term Lending Facility and Pledged Supplementary Lending, analogous to the ECB's MRO and LTRO open market operations. The PBOC said recently that there was no need for QE at this point and would rely on its open market operations.

The economy is slowing down but conditions are in place for stabilization and recovery.

That said, the PBOC will likely continue to operate expansionary policy while the economy rebalances towards more consumption and less exports and investment.

Conditions are supportive of equity and risk assets, however, the current volatility may persist a bit longer as the PBOC seeks to avoid a hyperbolic equity market bubble.

Credit market reforms have been enacted that will see greater market discipline. Expect increased defaults among smaller and non-systemic issuers, even among SOEs.