PRC surprises with early increase in bank reserve ratio

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China yesterday raised the proportion of deposits that banks must hold in reserve in the clearest sign yet that it has started to tighten monetary policy with its economy roaring back to the brink of overheating.

The 0.5 percentage point increase in the reserve requirement ratio (RRR) will take effect on Monday and will apply to all banks apart from rural credit cooperatives, the People’s Bank of China said on its Web site.

It was the first time that the central bank adjusted the ratio since it lowered the ratio in December 2008 as part of its loosening cycle at the time.

Many in the market had thought that China might increase the RRR before it lifted interest rates, but the move came far earlier than expected amid concerns that a renewed surge in bank lending was flooding the economy with too much cash.

“This is exactly what happens with Chinese policy. They say fine tuning. It never happens that way. It’s always nothing or boom,” said Ken Peng (□□), an analyst with Citigroup in Beijing.

“When they reach a consensus, it happens very quickly,” he said.

Shi Lei, an analyst at Bank of China in Beijing, said there could two or three more RRR increases before June.

“The reserve ratio hike is a strong signal the central bank is stepping up efforts to absorb excessive liquidity,” Shi said. “The hike may drain about 200-300 billion yuan [US$29 billion to US$44 billion] from the market but it really needs to drain about 700-800 billion yuan.”

The RRR increase also followed two other tightening steps taken by the central bank yesterday.

The central bank raised the yield on 20 billion yuan in one-year bills by about 8 basis points (bps) to 1.8434 percent after holding it steady in the previous 20 auctions, compared with a median forecast among traders that it would go up by just 4bps.

It also drained a record 200 billion yuan via 28-day bond repurchase agreements, ensuring it will draw net funds from the market this week.

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