China Cuts Rates, Is ‘Getting Desperate’

By Valentin Schmid, Epoch Times | October 23, 2015 | Last Updated: November 3, 2015 10:58 am

According to China’s latest GDP report, everything seemed to be just fine with the Chinese economy. After all, GDP is still growing at 6.9 percent, much faster than in Europe or the United States.

So why did the People Bank of China (PBOC) cut rates on Friday for the sixth time in a year? Maybe because things aren’t that great after all. In fact, the latest cuts of 0.25 percent in the benchmark bank lending rate (down to 4.35 percent, a record low) and deposit rate (down to 1.5 percent) confirm a monetary easing campaign not seen since the last financial crisis. Just a few more cuts and China will join Japan, Europe, and the United States in the zero interest rate club.

China is “getting more and more desperate” and “things are really bad there” said Vikas Gupta, executive vice president at Mumbai-based Arthveda Fund Management.

For good measure, China also lowered its required reserve ratio (the money banks need to stash at the central bank and cannot loan out) by 0.5 percent to 17.5 percent.

So why is this really bad? It’s a confirmation that growth is slowing down to less than the 6.9 percent advertised and that the much talked about transition to a consumer economy is not happening.

It is also bad because previous rate cuts didn’t have the intended effect. Last but not least, it proves that more capital is flowing out of the country and China needs to print money to offset the drain. Chinese and international investors could have pulled out as much as $850 billion until the end of September 2015.

So far, China has stabilized its exchange rate—under pressure from the capital outflows—by selling Treasurys. This actually has a deflationary, anti-growth effect on the economy.

"When they sell a Treasury, they sell a U.S. dollar, get renminbi back and it pulls that renminbi out of the economy," said Evan Lorenz of Grant's Interest Rate Observer. This is because the renminbi comes from the private market onto the PBOC's balance sheet where it vanishes into monetary oblivion.

MORE:

- **Japan Might Overtake China as World's No. 2 Economy—Gordon Chang**
- **Jack Ma Says Don't Worry About China, but Maybe You Should**

So to make up for that deflationary effect, the PBOC has to ease conditions domestically, which it just did again. The problem: Lowering rates and printing money puts more pressure on the currency and makes capital flight even worse. "If they lowered interest rates dramatically, it would actually increase the pressure to depreciate, which means they would have to sell Treasurys," said Lorenz. "It would be self-defeating." And that's exactly what it looks like at this moment.

The country is suffering from the so-called monetary trilemma, which states you cannot have a stable currency, independent domestic monetary policy, and free capital movement.

But China wants to have its cake and eat it too:

- Stable currency: Previously this helped to promote exports, now it needs a stable currency to keep more capital from flowing out.
- Independent monetary policy: Needed to stimulate the slowing economy.
- Open capital account: Still somewhat closed at the moment. China needs to open up if the renminbi wants to compete with the dollar for reserve currency status. On the other hand, it wants to prevent people from moving money out too fast.

"Ultimately they can decide if things get dire enough to abandon the peg [stable currency] and ease dramatically in the domestic economy. But it's going to cause some capital outflows," said Lorenz.

Catch 22.

Article printed from The Epoch Times: **http://www.theepochtimes.com**

URL to article: **http://www.theepochtimes.com/n3/1883412-china-cuts-rates-is-getting-desperate/**

Click here to print.

Copyright © 2015 The Epoch Times. All rights reserved.