

Global Macro Strategy

Rates Implications of PBoC Policy Easing

Strategy

Global

PBoC eases its policy stance further, removes bank deposit rate cap

The PBoC announced further policy easing after market close, today, in the form of a 50bp RRR cut, 25bp cuts in the 1yr bank lending and deposit rates, while fully removing the bank deposit rate ceiling. Although the RRR cut was primarily targeted at easing seasonal liquidity tightness, it confirms the authorities' policy reflation stance.

China (ND) IRS rates and bond yields have scope to decline further

With PBoC over-sterilising its FX interventions, this year, banking system and money market liquidity is ample. This should pave the way for further downside in CNY (ND) IRS rates and CNY bond yields notwithstanding significant outstanding levered bond positions funded through repos. We recommend entering a long position in China onshore government bonds on Monday 26 October at the market open. We set an initial yield target of 2.65% and place a stop-loss level at 3.10%.

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PBoC eases policy further, liberalises bank deposit rates

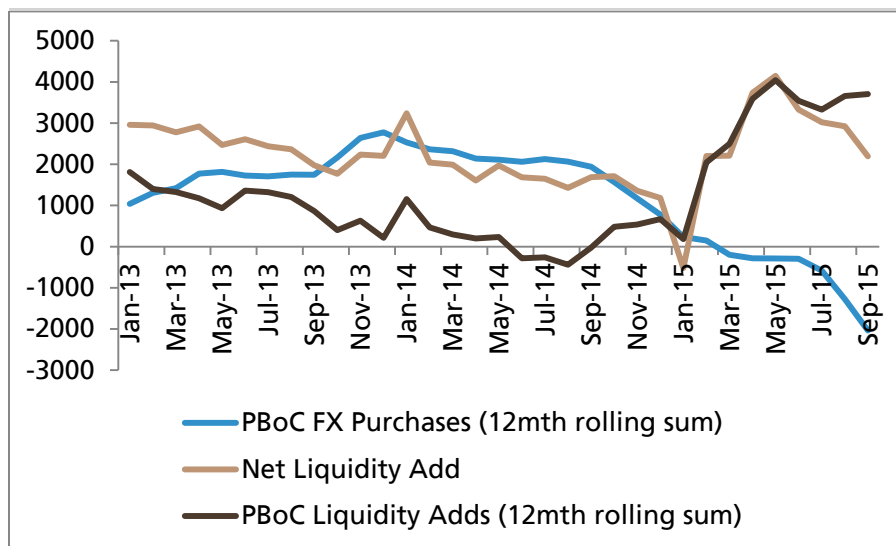
The PBoC announced further policy easing after market close, today, in the form of a 50bp RRR cut, 25bp cuts in the 1yr bank deposit and lending rates, while fully removing the bank deposit rate ceiling. For further details, please see: [China Economic Comment: China Cuts RRR and Interest Rates Again](#).

Liquidity Conditions Remain Very Accommodative

With the 50bp RRR cut, the PBoC will add approximately another RMB670bn of liquidity to the banking system and money market. According to the PBoC, the main motivation for the RRR cut is to ensure that money market liquidity will remain accommodative since liquidity typically tightens every October as a result of government tax collections (government deposits with PBoC increased by CNY722bn on average during October 2013 and 2014).

Nevertheless, coming so soon after a prior 50bp RRR cut effective October 1st, today's RRR cut also underscores PBoC's intention of keeping liquidity very ample, while over-sterilising its FX interventions. For instance, whereas the PBoC intervened for CNY2tr during 9M 2015, it added CNY2.5tr through RRR cuts and CNY804bn through PBoC loans (MLF, SLF, supplementary lending) over the same period for a net liquidity add of CNY1,443bn.

Figure 1: PBoC has over-sterilised its FX interventions – resulting in easier liquidity



Source: UBS, CEIC, BBG

Removal of bank deposit ceiling key reform measure

Of key note too is the removal of the bank deposit rate ceiling. This is the key interest rate liberalisation reform measure as it allows smaller banks in particular to compete more aggressively for deposit funding – a risk, which PBoC likely sees as more contained given the slowdown in loan demand over the past few months, which has led to easier bank liquidity.

Rates Implications

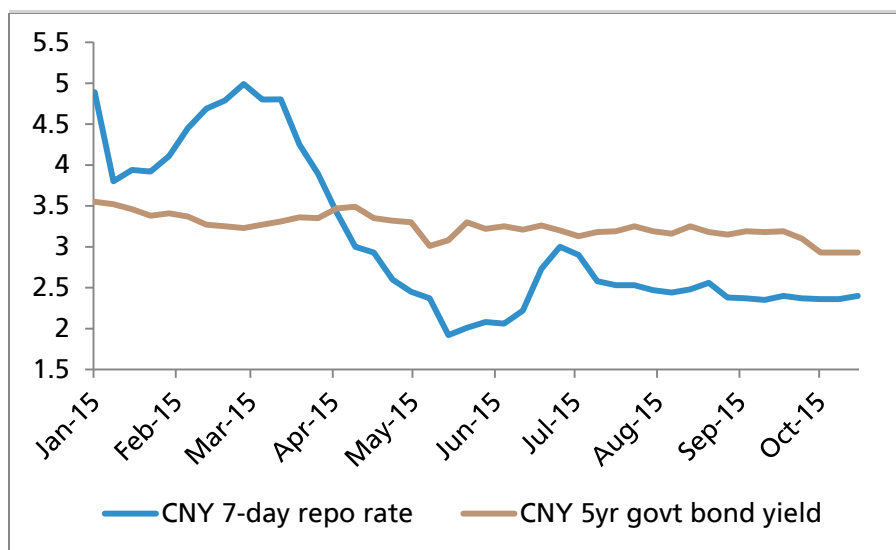
CNY Rates

Although the liquidity injections will over time add to downward pressure on money market rates, the 7-day repo rate has thus far not reacted much to prior RRR cuts as the CNY repo market has been used heavily by banks and non-banks to fund levered corporate and government bond positions. Nevertheless, despite risks of a liquidation

of these levered bond positions – due to corporate credit defaults or as a result of regulatory forbearance, the RRR cuts should provide more scope for Chinese banks to invest excess liquidity in government or policy bank bonds. We also see stability in the 7-day repo rate continuing given the size of PBoC liquidity injections and given ample bank liquidity.

As a result, we see scope for a further decline in the 5yr CNY-denominated government bond yield to 2.75% versus 2.4% for the 7-day repo rate. Medium-term, further declines in the CNY NDIRS rates and bond yields cannot be ruled out either as our China economist, Tao Wang, notes that China policy rates remain too high in real terms, while the implied interest burden on China's debt remains higher than the rate of nominal GDP growth ([China: Reality of Growth and Financial Stability, 2 October 2015](#)). As such, we recommend entering a long position in China onshore government bonds on Monday 26 October at the market open. We set an initial yield target of 2.65% and place a stop-loss level at 3.10%.

Figure 2: The 5yr CNY government bond yield has scope to decline further



Source: BBG

Trade Monitor (1/2)

EM Tactical Trade Monitor

EM FX Trades

		P&L Units	Notional	Date of entry	Entry level	Date of closing	Current level	P&L
Short Taiwan Dollar vs 50-50 EUR/USD basket								
	Long USDTWD	%	5	22-Sep-15	32.80			
	Long EURTWD	%	5	22-Sep-15	36.90			
Long Indian Rupee vs South African Rand								
	Short ZARINR	%	10	1-Dec-14	5.59		4.84	12.9%
Long US Dollar vs Israeli Shekel								
	Long USDILS	%	10	24-Feb-15	3.9300	13-May-15	3.8350	-2.4%
Short Australian Dollar vs Chinese Renminbi								
	Short AUDCNH	%	10	26-Jan-15	4.954	28-Apr-15	4.954	0.4%
Long US Dollar vs Singapore Dollar								
	Long USDSGD	%	10	13-Oct-14	1.271	23-Mar-15	1.370	7.8%

EM Rates and Credit Trades

		P&L Units	Notional	Date of entry	Entry level	Date of closing	Current level	P&L
Long 5y China Onshore Govt bond								
		bp	10	*	2.93			
Sell CDX EM vs Itraxx Xover								
	Sell CDX EM (Buy Protection)	bps	10	23-Sep-15	370	8-Oct-15	345	-25
	Buy Itraxx Xover (Sell Protection)	bps	8.5	23-Sep-15	335	8-Oct-15	345	-10
Pay Hungary 3y IRS								
	Pay HUF 3y	bp	10	17-Jul-15	1.78	11-Sep-15	1.61	-17
Receive Mexico 9m TIIE								
	Rec 9m MXN TIIE	bp	10	30-Apr-15	3.58		3.31	10
Pay Hungary 3y IRS vs Poland 3y IRS								
	Pay HUF 3y	bp	9.90	5-Jun-15	1.83	17-Jul-15	1.78	-5
	Rec PLN 3y	bp	10	5-Jun-15	2.20	17-Jul-15	1.92	28

Source: UBS, Bloomberg, Datastream

Market Pricing as of 1000 GMT on 23-Oct-15

Past performance is not an indication of future results



Year to date, the EMBI-GD benchmark has returned +2.5%. The GBI-EMGD benchmark returned -11.4% during that period.

* Entry at Market Open on Monday (26-Oct-2015)

Final PnL (in bp) includes carry/roll

Trade Monitor (2/2)

EM Structural Trade Monitor

		P&L Units	Notional	Date of entry	Entry level	Date of closing	Current level	P&L
Receive Korea 5y5y vs the US								
	Rec 5y5y KRW IRS	bp	10	11-Nov-14	2.82		2.11	75
	Pay 5y5y USD IRS	bp	9.6	11-Nov-14	3.31		2.58	-75
Long India fixed income vs Turkey (FX-unhedged)								
	Long Jul-24 IGB's	%	9.87	12-Sep-14	8.50	23-Oct-15	7.76	13.9%
	Short Jul-24 TurkGB's	%	10.00	12-Sep-14	9.09	23-Oct-15	9.59	-7.0%
	Long INRTRY	%		12-Sep-14	0.0364		0.0442	21.4%
Long Jan'19s in Brazil vs Ibov equity index								
	Receive Jan'19s	bps		7-Jul-15	12.80		15.93	-292
	Receive Jan'17s	bps		11-Nov-14	12.71	7-Jul-15	13.72	-85
	Short Ibov equity index	%		11-Nov-14	52,474		47,772	9.0%
	Long USDBRL	%		11-Nov-14	2.56		3.91	52.8%
Overweight Taiwan Equities vs Indonesia (Long TWDIDR)								
	Long Taiwan Equities	%		11-Nov-14	9,034		8,674	-4.0%
	Short Indonesia Equities	%		11-Nov-14	5,032		4,653	7.5%
	Long USDIDR	%		22-Sep-15	14,500		13,621	-6.1%
	Long TWDIDR	%		11-Nov-14	399.64	22-Sep-15	444.97	11.3%
Long Mexico Equities vs S. Africa (Long MXNZAR)								
	Long Mexico Equities	%		11-Nov-14	44,301		44,628	0.7%
	Short South Africa Equities	%		11-Nov-14	50,355		53,742	-6.7%
	Long MXNZAR	%		11-Nov-14	0.824		0.814	-1.2%
Long US Dollar vs Thai Baht and Sing Dollar								
	Long USDTHB	%	5	11-Nov-14	32.86		35.40	6.0%
	Long USDSGD	%	5	11-Nov-14	1.2910		1.3887	7.6%
Long US Dollar vs Hungarian Forint								
	Long USDHUF	%	10	11-Nov-14	246.58		278.33	11.8% 
Short New Zealand Dollar vs Malaysian Ringgit								
	Short NZDMYR	%	10	11-Nov-14	2.586	7-Jul-15	2.523	1.6% 
Short Australian Dollar vs Chinese Renminbi								
	Shot AUDCNH	%	10	7-Jul-15	4.637		4.647	-0.5%
Long 10y Mbonos vs Italian BTPs (FX-unhedged)								
	Long Mbonos 2024	%	7.87	11-Nov-14	5.98	7-Jul-15	5.98	3.7%
	Short BTPs	%	10.00	11-Nov-14	2.33	7-Jul-15	2.24	-2.1%
	Short EURMXN	%		11-Nov-14	16.973	7-Jul-15	17.217	-1.4%
Long Turkey 5y CDS vs Indonesia CDS								
	Short Indonesia 5y CDS	bp	10	11-Nov-14	144	3-Mar-15	124	33
	Long Turkey 5y CDS	bp	10	11-Nov-14	175	3-Mar-15	186	10

Source: UBS, Bloomberg, Datastream

Market Pricing as of 1000 GMT on 23-Oct-15

Past performance is not an indication of future results

Since 11-Nov-14, the EMBI-GD benchmark (hard currency debt) has returned +0.7%. The local currency debt GBI-EM benchmark has returned -16.2% (In USD terms)

Final PnL (in bp) includes carry/roll

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Buy	FSR is > 6% above the MRA.	49%	33%
Neutral	FSR is between -6% and 6% of the MRA.	40%	26%
Sell	FSR is > 6% below the MRA.	12%	18%
Short-Term Rating	Definition	Coverage ³	IB Services ⁴
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%

Source: UBS. Rating allocations are as of 30 September 2015.

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Credit Rating	AAA, AA, A, BBB, BB, B, CCC, CC, C (+/-)	Up to 12 months	UBS' assessment of a company's creditworthiness
Outlook	Positive; Stable; Negative	Up to 6 months	UBS' expected trend in a company's creditworthiness
Security Recommendations			
Bond Recommendation	Outperform; Marketperform; Underperform	Up to 3 months	A corporate bond's expected relative performance versus a defined reference
CDS Recommendation	Buy Protection; Sell Protection	Up to 3 months	Recommendation to hedge a company's creditworthiness

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Source: UBS

Company Disclosures

Issuer Name	Credit Rating	Outlook
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Commonwealth of Australia ^{2, 4, 5}	-	-
Federal Republic of Germany ^{2, 4}	-	-

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