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A PBC Official Answers Questions on Adjustment of Reserve Requirement Ratio

Q1: What is the main content of the adjustment of the reserve requirement ratio?

A: With approval of the State Council, the PBC decided to raise the reserve requirement ratio of deposit-taking financial institutions by 0.5 percentage points from July 5, 2006. The reserve requirement ratio for state-owned commercial banks and joint-stock commercial banks will be increased from 7.5 percent to 8 percent, and the reserve requirement ratios for urban credit cooperatives and financial institutions with differentiated reserve requirement ratios will be raised by 0.5 percentage points from their current levels respectively. But rural credit cooperatives (including rural cooperative banks) will continue to implement the current ratio without adjustment.

Q2: What are the main considerations for the adjustment of the reserve requirement ratio?

A: A main purpose of the adjustment is to prevent the excessively fast growth of monetary and credit aggregates and provide a stable financing environment for the sustained and healthy development of national economy.

In recent years, national economy of China has witnessed strong dynamic, fast growth and stable price level through strengthening and improving macro adjustment to enhance sound and coordinated economic performance. However, problems such as excessively fast

growth of fixed assets investments, relatively fast growth of money and credits and widening foreign trade surplus are still there. Currently, liquidity in banking system tends to increase, commercial banks have strong incentive to enhance profitability through credit extension and project investment enthusiasm is quite high in localities. In May 2006, the growth rate of M2 was above 19 percent and the RMB loans of financial institutions increased by 1.78 trillion yuan from January to May, accelerating by 793.9 billion yuan compared with the same period of 2005. If money and credits continued to increase rapidly, despite the low CPI level at the current situation, the national economy may become over-heated and come under increased inflationary risks. Therefore, it is necessary to properly strengthen macro management through monetary policy measures while maintaining the sound policy stance at the same time.

Q3: How will the adjustment affect commercial banks and financial market?

A: The new reserve requirement ratio will become effective on July 5, 2006. At present, liquidity in the banking system is abundant. The outstanding balance of both required reserves and excess reserves of commercial banks in the PBC totals 2.3 trillion yuan, and at the same time commercial banks hold above 7 trillion yuan of high liquidity assets including treasury bonds, financial bonds and central bank bills. Since the increase of 0.5 percentage points of the reserve requirement ratio will freeze 150 billion yuan of liquidity at once, commercial banks will have enough time to adjust their liquidities to adapt to the new reserve requirements. The central bank will adjust the strength of its open-market operations after the rise of the reserve requirement ratio in order to facilitate financial institutions to adjust their assets and liability structures. Commercial banks will still have plenty of usable funds to maintain their normal payment and settlement level and be able to increase loans steadily.

Q4: Why the reserve requirement ratio of rural credit cooperatives will not be adjusted?

A: Currently, the pilot reform of the rural credit cooperatives is at a critical juncture. It is necessary to further consolidate the outcome of the reform. In addition, since the reform of rural financial system is at its infant stage, rural credit cooperatives (including rural cooperative banks) still shoulder most of financial service functions for rural areas. As a result, in order to strengthen credit extending to agricultural economy and improve rural financial service, the PBC has decided not to raise the reserve requirement ratios of rural credit cooperatives (including rural cooperative banks).

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