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Maybank

FX Flash

RBI Delivers Unconventional 35bps Cut

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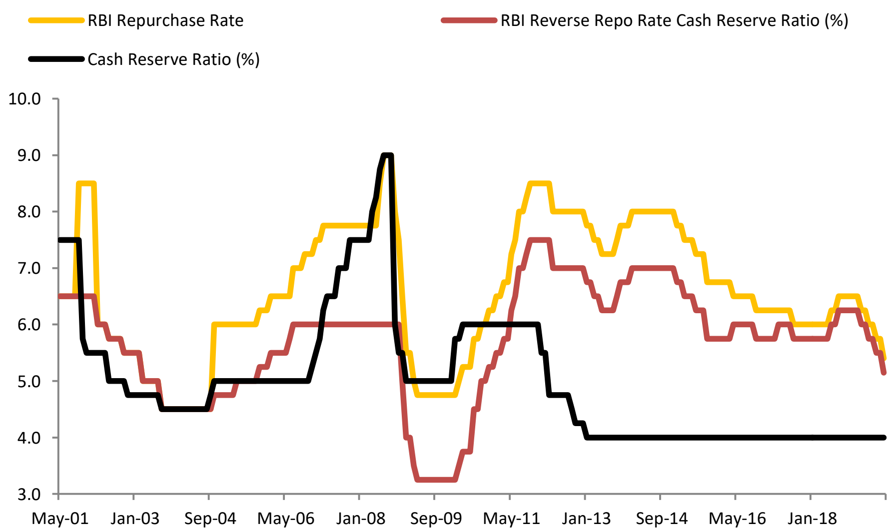
Providing a *Balanced* Cut

RBI lowered repurchase rate by 35bps to 5.40% from 5.75%. Reverse repo rate is also cut to 5.15%. Cash reserve ratio is left unchanged at 4.00%. Equity and bonds were lifted at first before coming under pressure. SENSEX was last seen in erasing gains to flat for the day, at last seen. 10y yield was pressed lower to around 6.272% before retracing higher to levels around 6.35% when it was revealed that the decision to cut rate was not a unanimous one with 4 members voted for 35bps cut and 2 who voted for a 25bps reduction.

USDINR remained stuck at levels just under the 71-figure as growth concerns are still at the fore, underpinning the decision to take the policy rates lower. Spot came off thereafter, last seen 71.83.

Governor Das emphasized on the central bank's focus to "fill output gaps" and that India is in a cyclical slowdown, not structural. He also explained that RBI had delivered an unconventional 35bps cut because "the standard 25bps cut may not be adequate" and "50bps cut" could be excessive given the fact that RBI already had 3 back to back cut this year that were "pre-emptive" already.

RBI Has Been Lowering Policy Rates At Every Meeting This Year

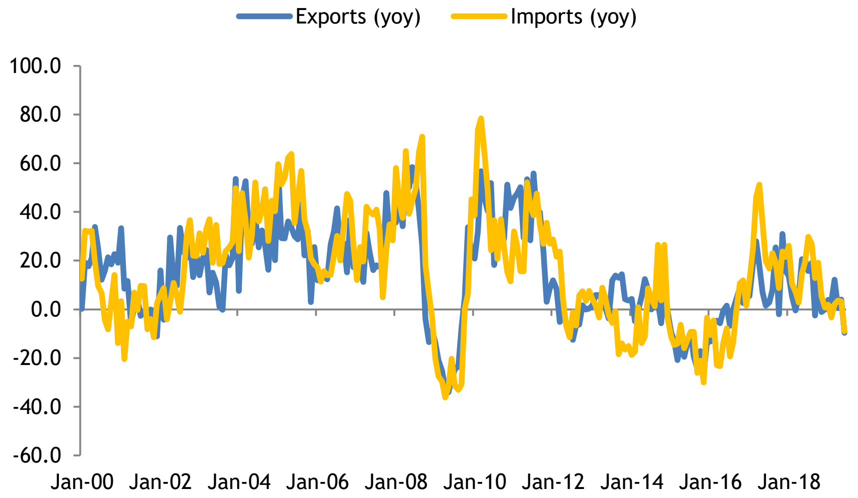


Source: *Bloomberg, Maybank FX Research & Strategy*

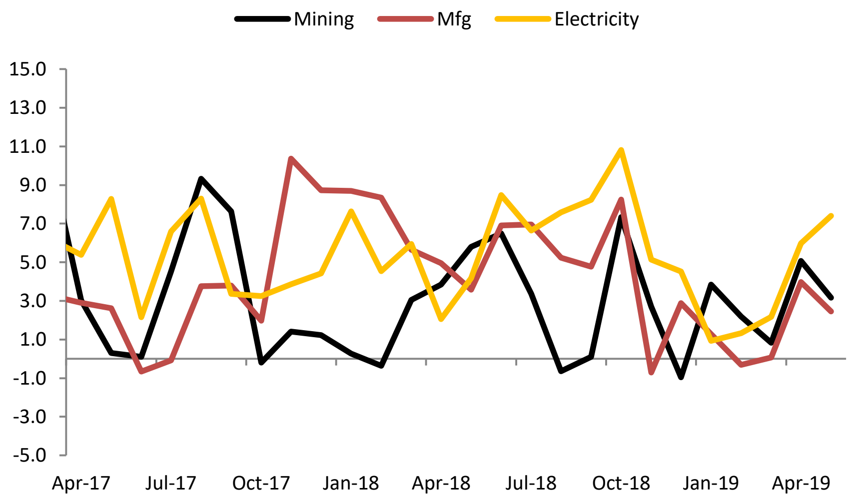
Future Cuts to be Calibrated

Real GDP Growth forecast is revised lower to 6.9% for 2019-20 from 7.0% seen in the Jun resolution with growth expected to pick up pace from 5.8-6.6% for 1H of 2019-20 to 7.3-7.5% for 2H, with risks somewhat tilted to the downside as domestic economic activity especially investment activity, is still "sluggish". Exports growth had not been reassuring either, with a contraction recorded recently in Jun, keeping the trade deficit above $15bn. This was probably exacerbated by the US decision to remove India from the Generalized System of Preference that could have added pressure on India's external demand.

Trade Has Been On the Decline



Manufacturing is not glowing and output has moderated in May, PMI-mfg has improved for Jul but has trended lower since the start of the year.



CPI is projected at 3.1% for 2Q of 2019-20 and 3.5-3.7% for 2H:2019-20 with risks evenly balanced. The negative reaction in the bond space suggests some disappointment that further easing may not come as easy as the ones that have been done this year. Governor Das said future cuts to be calibrated and data dependent. With regards to the transmission, the first 75bps cut in the past three central bank meetings this year saw the weighted average lending rate fall 29bps. With inflation rather benign and crude oil soft, RBI may continue in its easing cycle. With repurchase rate still above the GFC low of 4.75% and above 2004 low of 4.5%, there is ample room for this central bank to ease further. That said, RBI may want to pace the cuts out a bit more and the next cut may come only in Dec, not in Oct.

Along with the rate decision, RBI announced measures to improve credit transmission to non-bank finance company by raising the banks' counter party exposure limit to a single NBFC to 20% of its Tier-1 capital from 15%. These are targeted at lending to agriculture, small businesses and housing classified as priority sector lending. That could improve credit conditions for small business and boost investment activity.

Where would the Rupee Head to Next?

The rally of the 1M USDINR NDF to a high of 71.78 was underpinned by the Fed's guidance that turned out to be less dovish than expected, the breach of the US-China trade truce when Trump declared more tariffs for China on 1st Sep as well as concerns on the India-Pakistan conflict after India revoked Kashmir's autonomous status and to make Kashmir a "union territory" aka a territory of India. Pakistan has strongly protested against India's action and has formed a 7-person committee to propose legal, political and diplomatic response. While it would be premature to say that the geopolitical conflict is unlikely to escalate, the move by Pakistan to appeal to the United Nations and the formation of the 7-member committee suggest that Pakistan is approaching this with some sort of calm for now. There could be some bilateral negotiations and that could give rupee room (and time) to retrace.

On the daily chart, stochastics flag overbought condition. We see potential for further move lower for this pair to head towards a target at 70.12 to close up the gap-up. Price is last seen at 71.13. Stoploss at 71.55. Risk reward at 1:2.4. That said, bullish momentum is intact. Eyes are on the US-China trade war development. More volatility emanating from the RMB could also mean risk-off reaction that could weaken the INR.

SGDINR still has bullish momentum but 200-dma could cap topside at around 51.60. Another interim resistance is seen at 51.50, historical high seen in Apr, May and Jun. We see potential for retracement against the SGD towards 50.86 and then at 50.72. With SGD still a tad more vulnerable to trade-war escalation between the US-China and some expectation for MAS to ease in Oct, this cross may have more propensity to trade to the downside from here.

MYRINR has been trading with an upside bias but has net resistance at around 16.91 in the past two sessions. Momentum is stretched for this cross as well and MYRINR may start to retrace lower. Support around 16.83 before the next at 16.65 and then at 16.40. Resistance at 17.00. n the longer term, failure to break above the 17-figure may leave this pair within the 16.50-17.00 range.

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