August 20, 2019

# FX Flash

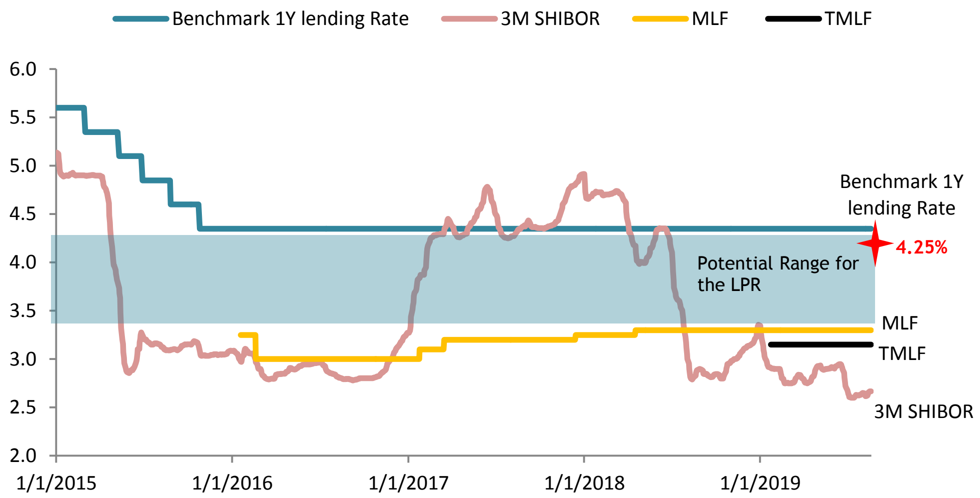
# RMB - PBoC Makes A Cautious Start with Rate Reform

## PBoC is Cautious

The new Loan Prime Rate (LPR) for 1Y was announced to be at 4.25% vs. previous LPR at 4.31%, 1Y lending rate at 4.35%. The 5Y LPR was set at 4.85%. That was well above the expected rate including our own and underscores PBoC's intent of ensuring that the LPR is reflective of the market-based rates. A less aggressive easing stance may mean that yield differential between the CGB-UST is unlikely to narrow in a hurry, lessening the pressure on the CNY and CNH. We think this suggest that 1) PBoC may prefer to execute the rate reform cautiously. Setting a rate that is too low may increase the risk that this new Loan Prime Rate may not be seen as reflective of current market commercial lending rates and would doom the new Loan Prime Rate from the start. Nonetheless, 2) the lower rates (albeit not much lower) fulfill the promise to some extent that PBoC aims to lower lending rate, as well as an easing stance, one of the three intents that we highlighted in our piece yesterday. 3) The magnitude of the "cut" also goes in line with our view that PBoC is unlikely to engage in aggressive easing although that this magnitude is certainly much smaller than what we had expected.

That does mean that once the LPR is seen to be more reflective of the market lending rates, the efficacy of a rate cut in the future would be enhanced. This could come via a reduction in the MLF rates, currently at 3.30% for 1Y or TMLF at 3.15%. Our expectation was for LPR to be at around 3.35% and we anticipate this LPR to head gradually lower from 4.25% and 4.85% gradually. This LPR is announced at 9.30am on the 20th of every month and the next is simply 20th Sep. To some extent, the gradual easing signal should be supportive of the local bonds and positive for the CNY via bond inflows.

**PBoC Declares the First 1Y LPR to be at 4.25%, just a tad below the previous 1Y Lending Rate, At the top of Estimates**




Source: *Bloomberg, Maybank FX Research & Strategy*

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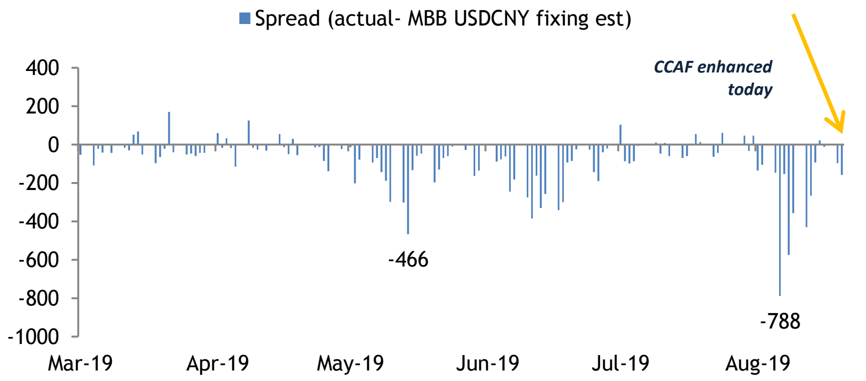
## Mindful of Impact on CNY

The less aggressive stance of the PBoC also suggests that the central bank is mindful of its impact on the CNY. This comes after we saw significant weakness in the CNY and CNH yesterday. The USDCNY reference rate was fixed at 6.0454, 89pips higher from the USDCNY fixed yesterday at 7.0365. According to our model, a full reflection of the USD move would have meant that the USDCNY should be fixed between 7.05-7.06. We have penciled in our forecast for the USDCNY reference rate to be fixed at 7.0470 taking into account the deviation from the previous fix as well as the USDCNY close at 11.30pm yesterday at 7.0507. Our estimation turns out to be close to the actual which suggests that PBoC indeed enhanced the countercyclical adjustment factor to ensure that the USDCNY does not open much higher from where it closed.

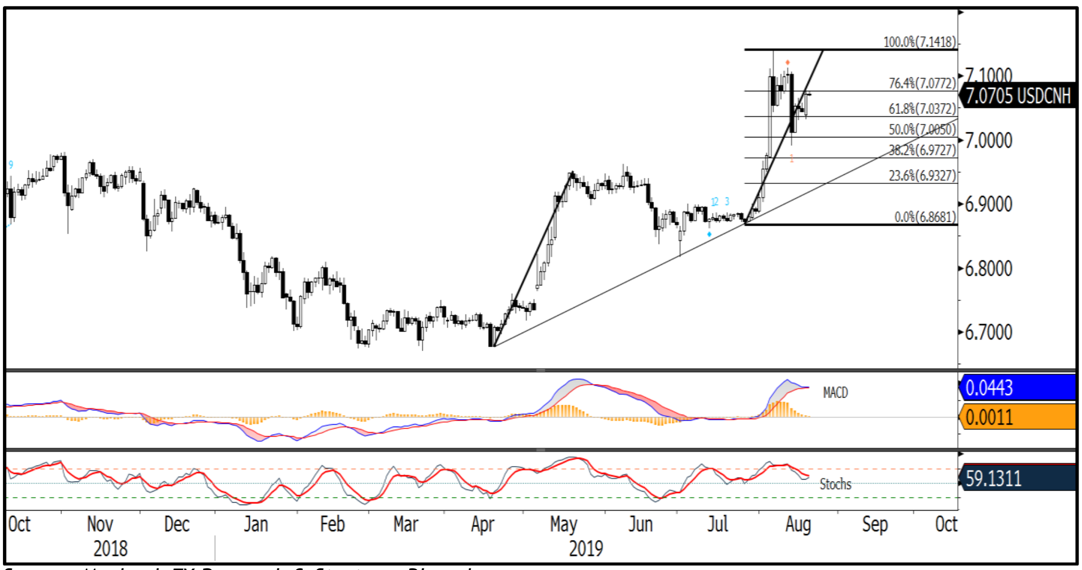
## USDCNY Reference Rate is fixed with an aim To Cap USDCNY at Open




*Source: Maybank FX Research & Strategy Estimates, Bloomberg*

## FX Technical Outlook: USDCNH [Daily] - Consolidative, 1-2 Week View

Support is seen around the 7.0700-level and momentum indicators suggest that this pair could consolidate within the 7.00-7.10 range for now. Resistance is seen around 7.0770 before 7.10. Resistance beyond the recent high of 7.1418 is seen around 7.2064. Support at 7.0370 before 7.0050. Weekly momentum is still positive, so some bias to the upside for now.




*Source: Maybank FX Research & Strategy, Bloomberg*

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