

## RMB Watch

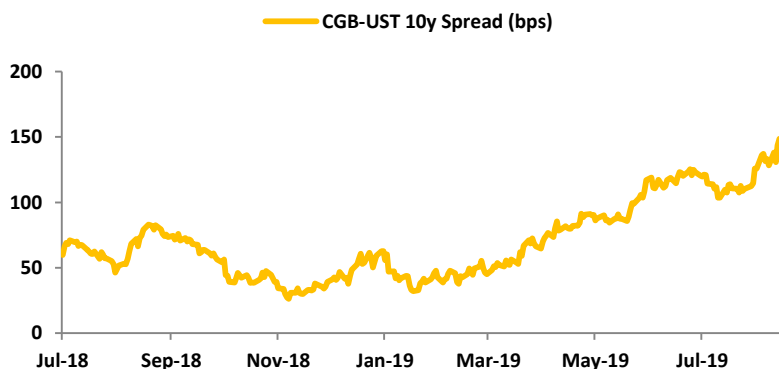
# Going Easier on Rates

### First LPR To Be Announced Tomorrow

Easing expectations of the Fed has brought the UST yields lower and the resultant widening of the CH-US 10y spread served as one support for the RMB. However, this spread may set to narrow from its 1.5year high after PBoC announced the new policy rate starting from tomorrow (20<sup>th</sup> Aug) and that seems to have generated some weakness for the CNY today. This weakness may be temporary and based on the perceived monetary convergence of the US and China monetary policy and rates. That said, if PBoC is able to improve the transmission mechanism (with the new policy rate), credit growth should be encouraged and that should be supportive of the economy.

**The Details:** PBoC said it will announce the new loan prime rate, aka the LPR, at 9.30am on the 20th of each month, starting this month (which means tomorrow), according to a statement released last Saturday. The central bank will require commercial lenders to set the price for new loans to businesses and households “mainly” with reference to the LPR, while the price for outstanding loans allowed to be retained for now. To compute the new LPR, commercial lenders will submit prices in terms of a spread on top of the interest rate of PBoC’s medium-term lending operations, currently at 3.3% (TMLF rate at 3.15%), a mechanism that seems similar to the current Libor. The current benchmark 1-year lending rate stands at 4.35%. This brings to mind Premier Li Keqiang’s words that borrowing rates would be reduced by 1ppt, earlier in Mar. By ensuring that commercial lenders price their future loans closer towards MLF or TMLF, this could fulfill Premier Li Keqiang’s promise of cutting borrowing cost by around 1ppt. Participants will now include city and rural commercial lenders, foreign lenders with operations in China and privately-owned lenders (18 lenders expanded from 10) which could mean a more effective/direct transmission mechanism. The LPR tenor will be extended from original one-year period to one-year and five year period. PBoC will also take into account the LPR and the pricing behavior of the banks into the Macroprudential Assessment.

### CGB-UST 10y Spread May Narrow From Here, Generating RMB Weakness



Source: Bloomberg, Maybank FX Research & Strategy

### Analysts

Saktiandi Supaat  
(65) 6320 1379  
saktiandi@maybank.com.sg

Fiona Lim  
(65) 6320 1374  
fionalim@maybank.com.sg

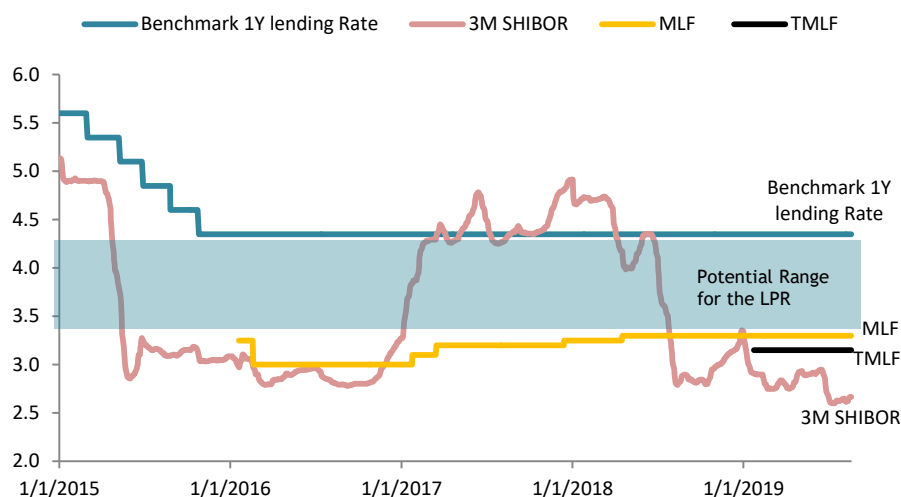
Tan Yanxi  
(65) 6320 1378  
tanyx@maybank.com.sg

Christopher Wong  
(65) 6320 1347  
wongkl@maybank.com.sg

## Where will the new policy rate, Loan Prime Rate, be set tomorrow?

Eyes will be on the LPR set tomorrow which could be around 3.35%, which could be somewhere between the old benchmark 1Y lending rate (at 4.35%) and 1Y medium term lending rate (3.15%). However, since the contribution from the commercial banks should be a spread from these recently used medium term rates, the new LPR could be around 3.35% which would be 1ppt lower from the old benchmark 1Y lending rate at 4.35%, effectively fulfilling the promise made by Premier Li.

### LPR Should Be Set Between 3.30%-4.35%



Source: Maybank FX Research & Strategy, Bloomberg

### Intent of the Rate Reform

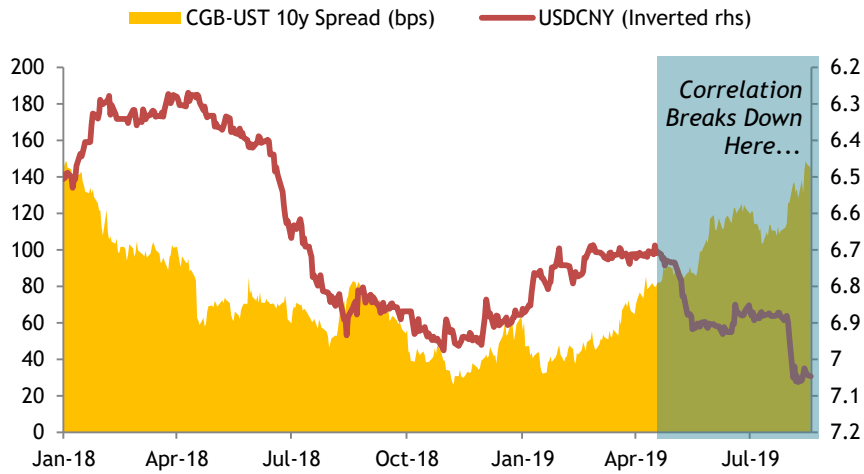
According to PBoC statement, there are a few intents including ensuring a 1) “more market-based rate”, to 2) “lower real lending rates” and to 3) “improve the efficiency of interest rate transmission”. By taking the contributions from commercial banks to compute the LPR, it is more reflective of the market-based rate. Also, the inclusion of more lenders such as foreign banks and city and rural commercial lenders, the transmission mechanism of future policy actions would be wider and could directly impact the prices of the loans that are issued by these lenders.

In addition, there is a sense of urgency as the credit numbers for Jul was dismal, accompanied by weaker activity numbers.

### What Has Happened to RMB Since the Announcement?

USDCNH has crept up this morning, even after the USDCNY fix which was stronger than our estimates. While easier monetary policy and lower rates should theoretically mean a weaker RMB vs. the USD from the perspective of CH-US rate differential convergence, a revamp of the monetary policy that can improve the transmission mechanism of the monetary policy could encourage more credit lending after a rather dismal tranche of credit numbers released for Jul.

**CNY Weakens Even as CGB-UST Premium Rises**



Source: *Maybank FX Research & Strategy, Bloomberg*

The correlation between US-CH rate differential and USDCNY has broken down since Trump escalated the trade war earlier this year and we do not expect the narrower rate differential to weigh that much on the local currency in the medium term. In addition, easing is unlikely to be aggressive as there could still be concern on over-leveraging and so PBoC’s action would not erode the CGB-UST premium significantly.

In fact, this should be positive for the growth and eventually CNY. The reform in the policy rate, if successful and effective in bringing down borrowing rates with better transmission mechanism, should be expansionary for the economy and positive for the CNY in the medium term. Bond inflows could be also encouraged by the easing action and could translate to CNY gains.

**USDCNH [Daily] - Little Bias At this Point**



USDCNH was last seen around 7.0550 and price has lost most of its bullish momentum. This pair may consolidate within 7.0050-7.0770 for now, in the absence of strong market cues and fluidity of the US-China trade talk situation.

**SGDCNY [Weekly] - Bullish Bias**



SGDCNY still trades with an upside bias and was last seen around 5.0903. Next resistance is still seen at 5.11. This cross may continue to head higher towards the next resistance at 5.11 since momentum on daily, weekly, monthly chart is still bullish. Support at 5.055.

**MYRCNY [Daily] - Bullish Bias**

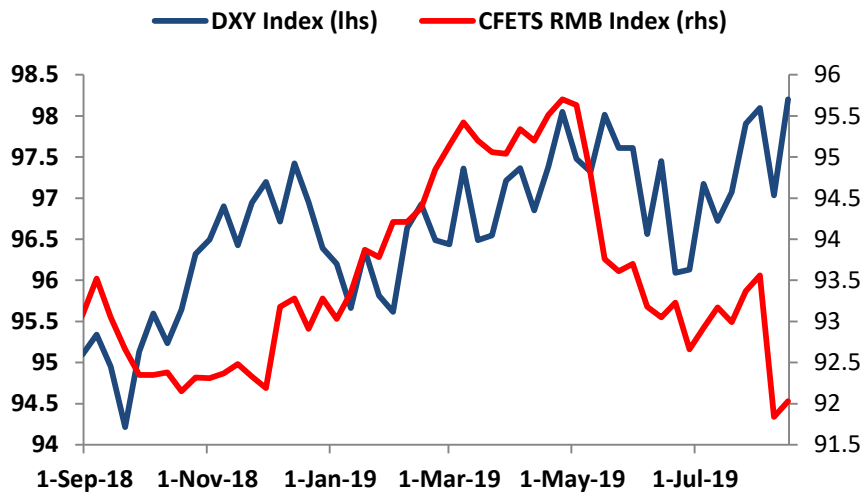


MYRCNY touched a high of 1.6920 today and momentum is also bullish for this cross on the weekly chart. Last seen around 1.6870 and we look for a potential breach of the 1.69-figure with a daily close or further bullish extension. Or else, this cross risks a double top and a bearish pullback. Last seen at 1.6830. The 1.69 level happens to be the 50% Fibonacci retracement of the 2014-2015 decline and the next resistance is seen at 1.7530. Support at 1.65.

**Upcoming Events to Watch in The Next Two Weeks**

- 22-24<sup>th</sup> Aug - Jackson Hole Symposium (Powell speaks on 23<sup>rd</sup> Aug)
- 27 Aug - Industrial Profits
- 29 Aug - SWIFT Global Payments (CNY)
- 31 Aug - PMI Mfg (NBS)
- 2 Sep - Caixin Mfg PMI

**CNY TWI Moves in Tandem with DXY More Recently**



Source: Bloomberg, Maybank FX Research & Strategy

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Published by:



Malayan Banking Berhad  
(Incorporated in Malaysia)

Saktiandi Supaat  
Head, FX Research  
saktiandi@maybank.com.sg  
(+65) 63201379

Christopher Wong  
Senior FX Strategist  
wongkl@maybank.com.sg  
(+65) 63201347

Fiona Lim  
Senior FX Strategist  
Fionalim@maybank.com.sg  
(+65) 63201374

Yanxi Tan  
FX Strategist  
tanyx@maybank.com.sg  
(+65) 63201378