How China's new interest rate reforms will work

REUTERS/FILE

Pople walk past the headquarters of the People's Bank of China , the central bank, in Beijing.

REUTERS, *Shanghai/Beijing*

China's central bank pushed out long-awaited interest rate reforms on Saturday by establishing a reference rate for new loans issued by banks to help steer corporate borrowing costs lower and support a slowing economy.

The following explains how China's new Loan Prime Rate (LPR), a central part of the reforms, will work. The LPR, originally introduced by the People's Bank of China (PBOC) in October 2013, is an interest rate that commercial banks charge their best clients and was intended to better reflect market demand for funds than the benchmark the PBOC sets.

However, the LPR's moves since its launch have generally not reflected those market dynamics with lenders typically reluctant to cut into their profit margins with lower rates and was little-watched by the markets. The one-year rate, for example, is currently just below the benchmark one-year lending rate of 4.35 percent.

Under the reforms announced on Saturday, the new LPR will be linked to rates set during open market operations, namely the PBOC's medium-term lending facility (MLF), which is determined by broader financial system demand for central bank liquidity. Setting the LPR slightly higher than MLF rate will in theory give borrowers access to funds at rates that better reflect funding conditions in the banking system, providing a smoother policy transmission mechanism.

The new LPR will be announced at 9:30 a.m. on the 20th of every month, starting this month. The rate has up until now been set using quotations from 10 contributing banks. These banks will be joined by another eight, which include two foreign institutions.

Banks will submit their LPR quotations, based on what they have bid for PBOC liquidity in open market operations, to the national interbank funding center before 9am on the day.

If the reporting day falls on a weekend or a holiday, the rate will be published on the following working day.

In addition to the existing one-year LPR, the central bank will also use contributing bank quotations to publish similar reference rates for benchmarks of five-years and beyond. Banks will retain discretion as to how they price rates for loans maturities of less than 1-year and within 1-5 years.

The LPR will be a reference rate only for new loans issued by banks. Existing loans will still be based on the PBOC-set benchmark rate.

China has a long history of using two interest rate tracks to drive its lending sector - a market-based rate and a benchmark bank rate.

Although China has in recent years given commercial banks more leeway in setting lending rates, the benchmark lending rate remains a key reference for them to price loans, hampering the central bank's bid to lower corporate funding costs. The PBOC has pledged to "merge" the two tracks and reiterated this commitment several times this year. Beijing has vowed to lower average funding costs for small companies by 1 percentage point this year to spur growth in the economy, amid weak demand domestically and a year-long trade war with the United States.

The latest move is widely interpreted by the market as an official attempt to revive growth and effectively cut financing costs in the real economy.

But some analysts argue that the move could shift commercial banks to become more risk averse in their lending due to growing financial and economic risks. "We expect the PBOC to have more incentive to lower MLF rates and other quasi-policy rates, but we believe the PBOC's capability to reduce banks' lending rates is quite limited due to restraints on credit growth as well as banks' vulnerability," said Lu Ting, chief China economist at Nomura in Hong Kong.

"In our view, the PBOC will likely have to walk a tightrope between lowering borrowing costs and maintaining financial stability," Lu added.

Luo Yunfeng, an analyst at Merchants Securities in Beijing said the impact on corporate borrowing costs will be felt over the long-term and could be far more modest than benchmark rate cuts, which affect both new loans and the outstanding loans.

Investors now await Tuesday's LPR publication with many market participants expecting the new rate to be cut by 10 to 15 basis points from the current level.

Ming Ming, head of fixed income research at CITIC Securities in Beijing, expects the first new rate to be set lower to narrow the yield gap between LPR and interest rate on the MLF, which is now 3.3% for one-year loans. That gap is currently 101 bps.

Apple CEO warns Trump about China tariffs, Samsung competition

REUTERS

US President Donald Trump said on Sunday that he had spoken with Apple Inc's Chief Executive Tim Cook about the impact of U.S. tariffs on Chinese imports as well as competition from South Korean company Samsung Electronics Co Ltd.

Trump said Cook "made a good case" that tariffs could hurt Apple, given that Samsung's products would not be subject to those same tariffs.

Tariffs on an additional $300 billion worth of Chinese goods, including consumer electronics, are scheduled to go into effect in two stages on Sept. 1 and Dec. 15.

By contrast, the United States and South Korea struck a trade agreement last September.

"I thought he made a very compelling argument, so I'm thinking about it," Trump said of Cook, speaking with reporters at a New Jersey airport.

U.S. stock futures rose upon opening on Sunday after Trump's comments. In addition to his comments on Apple, Trump said on Twitter earlier in the day that his administration was "doing very well with China."

Apple's MacBook laptops and iPhones would not face the additional tariffs until Dec. 15, but some of the company's other products, including its AirPods, Apple Watch and HomePod, would be subject to the levies on Sept. 1.

Apple was not immediately available for comment outside normal business hours.

REUTERS/FILE

Apple CEO Tim Cook talks with US President Donald Trump as they participate in an American Workforce Policy Advisory Board meeting in the White House State Dining Room in Washington.

Microsoft, Nvidia team up for more realistic visuals on Minecraft game

REUTERS

Microsoft Corp said on Monday it will use chipmaker Nvidia Corp's real-time ray tracing technology to provide the software company's Minecraft video game players more realistic graphics on personal computers.

Real-time ray tracing, or the ability for the chip to simulate how light rays will bounce around in a visual scene, helps video games and other computer graphics more closely resemble shadows and reflections in the real world.

Last week, Nvidia posted quarterly results ahead of Wall Street targets and said its profitability was getting a boost from new high-end graphics chips for video gamers.

"I think we've put all of the pieces in place to bring ray tracing into the future of games. The number of blockbuster games that have adopted RTX is really snowballing," Nvidia Chief Executive Officer Jen-Hsun Huang said on a post-earnings call.

Other games which would have the same graphic technology are Activision Blizzard's "Call of Duty: Modern Warfare", Ubisoft Toronto's "Watch Dogs: Legion" and Tencent NExT Studios' "Synced: Off Planet", Nvidia said on Monday.

Minecraft, a construction game in which players can build nearly anything imaginable, block by block, in a digital, Lego-like world, spread like wildfire since its full release in 2011 by developer Mojang, which was bought by Microsoft in 2014.

In May this year, Microsoft said 176 million versions of the game have been sold since its launch.

Oil up after drone attack on Saudi field, but Opec report caps gains

REUTERS, *London*

Crude oil prices rose on Monday following a weekend attack on a Saudi oil facility by Yemeni separatists and as traders looked for signs of progress in US-China trade negotiations.

Price gains were, however, capped to some degree by an unusually downbeat OPEC report that stoked concerns about growth in oil demand.

Brent crude, the international benchmark for oil prices, was up 36 cents, or about 0.6 percent, at $59.00 a barrel at 1225 GMT.

US West Texas Intermediate (WTI) crude futures were up 30 cents, or 0.5 percent, at $55.17 a barrel.

A drone attack by Yemen's Houthi group on an oilfield in eastern Saudi Arabia on Saturday caused a fire at a gas plant, adding to Middle East tensions, but state-run Saudi Aramco said oil production was not affected.

"The oil market seems to be pricing in again a geopolitical risk premium following the weekend drone attacks on Saudi Arabia, but the premium might not sustain if it does not result in any supply disruptions," said Giovanni Staunovo, oil analyst for UBS.

Iran-related tensions appeared to ease after Gibraltar released an Iranian tanker it seized in July, though Tehran warned the United States against any new attempt to seize the tanker in open seas.

Concerns about a recession also limited crude price gains.

Meanwhile, China's announcement of key interest rate reforms over the weekend has fuelled expectations of an imminent reduction in corporate borrowing costs in the struggling economy, boosting share prices on Monday.

US energy firms this week increased the number of oil rigs operating for the first time in seven weeks despite plans by most producers to cut spending on new drilling this year.

"WTI in recent weeks has performed relatively better than Brent... Pipeline start ups in the United States have been supportive for WTI, while the ongoing trade war has had more of an impact on Brent," said Warren Patterson, head of commodities strategy at Dutch bank ING.

The Organization of the Petroleum Exporting Countries (Opec) cut its forecast for global oil demand growth in 2019 by 40,000 barrels per day (bpd) to 1.10 million bpd and indicated the market would be in slight surplus in 2020.

It is rare for Opec to give a bearish forward view on the market outlook.

Eurozone inflation slows further

AFP, *Brussels*

Inflation in the eurozone slowed to 1.0 percent in July, official data showed Monday, sliding further away from the European Central Bank's target of just below 2.0 percent.

Revised figures from the Eurostat agency showed prices across the 19-nation single currency area showed inflation falling from 1.3 percent in June and from 2.2 percent a year earlier. ECB chief Mario Draghi last month signalled that new stimulus measures could be on the cards to try to shore up stubbornly low inflation, as the skies darken with growing fears over US protectionism, weakness in emerging markets -- and Brexit.

Observers are anticipating a "big bang" from the ECB in September with a possible rate cut as well as other measures. The ECB's governing council last month left the rate on the bank's main refinancing operations at zero, on its marginal lending facility at 0.25 percent and on its deposit facility at -0.4 percent.

But it hinted rates could fall still further -- saying they would be kept at "their present or lower levels at least through the first half of 2020" and said officials had been tasked to look at other options, including "new net asset purchases".

German economy could continue to shrink

REUTERS, *Frankfurt*

The German economy could have continued to shrink over the summer as industrial production drops amid a dearth of orders, the Bundesbank said on Monday, suggesting that the euro zone's biggest economy is now in a recession.

German growth contracted in the second quarter on slumping exports as a global trade war, China's own slowdown and Brexit uncertainty sapped confidence, dealing a blow to an export-focused economy.

"Overall economic performance could again decline slightly," the Bundesbank said in a monthly report.

"The main reason for this is the continuing downturn in industry," the central bank said, pointing to a significant decline in orders and a big drop in sentiment indicators for manufacturing firms.

While domestic consumption continues to isolate the economy, the jobs market is already showing signs of weakness and confidence in the services sector is also dropping, the Bundesbank added.

Still, the construction boom is likely to continue, providing some support.

While Germany has so far rejected the idea of boosting public spending to offset the slowdown, Finance Minister Olaf Scholz said that Berlin has the fiscal strength to counter any future economic crisis "with full force".

Speaking on Sunday, Scholz said the global financial crisis in 2008/2009 had cost Germany roughly 50 billion euros and the government could again muster such a sum, if necessary.

Obsessed with running a balanced budget, Germany has produced surpluses for years, ignoring calls for more spending to boost growth.

Japan's exports slip for eighth month, sales to China drop as recession fears grow

REUTERS, *Tokyo*

Japan's exports slipped for an eighth month in July, while manufacturers' confidence turned negative for the first time in over six years as China-bound sales slumped again in a fresh sign the Sino-US trade war could tip the economy into recession.

The gloomy data underscored the challenge for Japanese policymakers worried that prolonged weakness in external demand will drive a sharp economic downturn at home.

Exports in July fell 1.6 percent from a year earlier, Ministry of Finance data showed on Monday, dragged down by China-bound shipments of car parts and semiconductor production equipment. That compared with a 2.2 percent decrease expected by economists.

It marked the longest run of declines in exports since a 14-month stretch from October 2015 to November 2016. Yet there was some glimmer of hope for shippers, as export volume rose 1.5 percent in July year-on-year - the first positive reading in nine months.

Separately, the Reuters Tankan survey showed Japanese manufacturers' business confidence turned negative for the first time since April 2013 in August.

"My impression is that the year-on-year rise in the export volume was slightly stronger than expected. That's a positive as falling exports is the biggest issue faced by the Japanese economy," said Taro Saito, executive research fellow at NLI Research Institute.

"But it'll be hard for exports to recover going forward, since there's no solution in sight for the US-China trade war, and the global economy and manufacturing remain weak."

REUTERS/FILE

A man in a bicycle drives past containers at an industrial port in Tokyo, Japan.

Indeed, the negative reading underlined the darkening outlook for the Japanese economy even as the most recent quarter showed a welcome improvement. Gross domestic product grew faster than expected in April-June to mark the third straight quarter of expansion, as robust domestic consumption and business investment offset the negative contribution from external demand.

Though service-sector activity remains firm in Japan, simmering international trade tensions have caused manufacturers' sentiment to worsen.

Analysts at Capital Economics said they expect imports will continue to outpace exports as consumers are seen bringing forward demand ahead of a planned sales tax hike in October.

"The upshot is that net trade may remain a drag on growth in the third quarter," the analysts wrote in a note to clients.

Anxiety about a global slump rose to fever pitch recently after an inversion in the US Treasury yield curve implied a growing risk of a recession there, and data showed Germany's economy was in contraction and China's was worsening.

Exports to China, Japan's biggest trading partner, shrank 9.3 percent year-on-year in July, down for a fifth month. The contraction was led by sizable declines of 31.5 percent in semiconductor production equipment, 35 percent in car parts and 19 percent in electronics parts, the data showed.

Manufacturers' exports to China of semiconductors and electronics parts slumped as a rush of demand ahead of a US ban on federal purchases of telecommunication equipment from Huawei Technologies Co Ltd wound down, analysts said.

Shipments to Asia, which account for more than half of Japan's overall exports, declined 8.3 percent in the year to July.

Export-reliant economies such as Japan have been hit hard by the Sino-US tariff row, which has already upended supply chains and undermined global trade, investment and corporate earnings.

Japan has also been embroiled in an intensifying trade row with South Korea, further threatening to hurt the outlook for its manufacturers.

Japan's exports to the United States rose 8.4 percent in the year to July, driven by a jump in semiconductor production equipment, construction and mining machinery and airplanes.

It marked the tenth straight month of exports growth to the United States, following a 4.9 percent increase in June, which could raise the ire of US President Donald Trump who has criticized Japan and other trading partners for running what he sees as unfair trade imbalances with his country.