China's Credit Easing Hits Limits

By Shen Hong

SHANGHAI—Ineffective monetary policy is hindering Beijing's efforts to pep up growth, with little of the extra cash it has pumped into the financial system filtering into the real economy.

China's government is taking other measures to stimulate economic expansion, including tax cuts and selective spending on infrastructure. Yet this stimulus is likely to be less effective than before.

While interest rates are typically the main tool used by central banks, China is unusual in frequently conducting policy by changing the sums banks must hold in reserve relative to deposits. The People's Bank of China, which isn't independent, does this partly because this reserve-requirement ratio is less politically sensitive than altering rates.

Since January 2018, it has undertaken five rounds of credit easing this way, theoretically freeing up hundreds of billions of dollars for banks to propel economic growth. Still, banks are reluctant to lend to struggling private companies, many of which need fresh loans to keep afloat. Instead, banks have been more willing to lend short term, often to financial borrowers.

"Money is staying in the financial system and not entering the real economy, as long as profit margins in sectors like manufacturing are thinning," said Landing Zhang, chief executive of Shanghai asset-management firm CYAM-LAN Investment.

Julian Evans-Pritchard, an economist at Capital Economics, said there were "lots and lots of companies willing to borrow" but the supply of credit was limited. Among the better-performing firms, he said, "Loan demand is weakening due to greater uncertainties about the economy."

On the surface, Beijing's efforts look impressive: Overall credit, including bank loans and funds raised in capital markets, expanded by a record 5.3 trillion yuan ($789.7 billion) in the first two months of the year. China's Lunar New Year holiday, which falls on different dates every year, can upset monthly comparisons, so analysts often look at combined January and February figures.

Meanwhile, the three-month Shanghai interbank offered rate, a popular gauge of short-term funding costs, has dropped to 2.81% from 4.73% in January 2018.

However, banks extended 1.913 trillion yuan of new long-term corporate loans in January and February, Wind data show, about 4% less than in the year-earlier period.

And while that sum comfortably exceeded the totals for new short-term corporate loans and bankers' acceptances—another shorter-dated lending instrument—volumes of these shorter-dated instruments leapt. That suggests a surge in borrowing to fund financial bets rather than business investment.

Unusually, Premier Li Keqiang this year criticized the rise of short-term funds for potentially fueling speculation and allowing risk to build up.

Other central banks have faced similar dilemmas. After the financial crisis, the European Central Bank failed to spark a lending boom despite pumping about €3 trillion ($3.4 trillion) into banks' books.

A core problem is that authorities are trying at once to protect growth and cut financial risk. The second goal prevents more aggressive easing, economists say, and has also rattled bankers.

The Chinese central bank didn't respond to a request to comment.

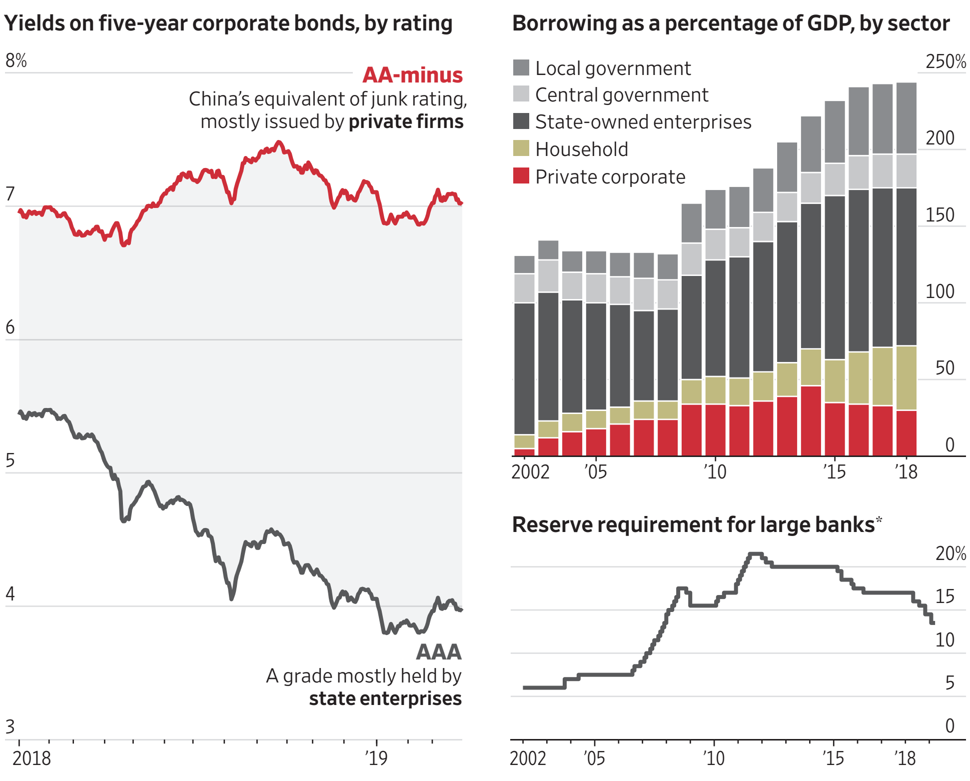
Chinese lenders, most of which are state-owned, have for decades favored their public-sector corporate peers. While private companies generate around nine out of every 10 new jobs in the country, according to the official Xinhua News Agency, loans for them are scarcer and more expensive than for state companies.

Beijing's easing has brought down lending rates by about 0.5 percentage point for corporate loans in general in the past year, but interest rates on one-year loans for private firms remain elevated at 6% to 8%, according to bank officials. State-run enterprises pay rates much closer to the benchmark one-year lending rate of 4.35%.

"We already have lots of bad loans in hand and we haven't lent to [small and medium-size enterprises] for two to three years. Our loan officers will find all kinds of excuses not to do so now as well," said a manager at Citic Bank in Inner Mongolia.

Beijing has pressed its largest banks to lend more to the private sector. Industrial & Commercial Bank of China Ltd.'s outstanding loans to smaller businesses rose by 18% in 2018, for example. Still, the country's largest bank by market value accounts for less than 1% of all such loans.

Faced with higher bond-financing costs than those of their state-owned peers, China's private companies have missed out on the country's credit boom, despite stimulus measures such as the easing of banks' reserve requirements.



*The amount banks must hold in reserve relative to deposits
Sources: Wind (yields); Macquarie Capital (borrowing); Refinitiv (reserve ratio)

Beijing Closes Fentanyl Loophole

By Eva Dou

BEIJING—China is clamping down on more substances related to the deadly opioid fentanyl, moving to meet a promise made to President Trump amid U.S. and Chinese negotiations to resolve the countries' trade dispute.

Chinese regulators announced Monday a wider range of fentanyl derivatives would be declared controlled substances on May 1 and laid out steps for further enforcement. The new regulations adopt a broad definition of "fentanyl-related substances," banning whole classes of chemicals in line with U.S. practice. The change should make much of China's fentanyl production illegal, closing a loophole in Chinese regulations that U.S. officials say has fueled an epidemic.

China previously classified only 25 fentanyl variants and two ingredients used to make the drug, which U.S. officials argued was far from enough. Manufacturers could easily sidestep the blacklist by tweaking the chemicals, with myriad possible variations.

China's harder line on fentanyl marks progress on a priority issue for the Trump administration and is likely to brighten the atmosphere for trade talks that continue this week with a high-level round of negotiations in Washington.

—Chunying Zhang contributed to this article.

Factory Activity Stabilizes

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ing expansion.

"We've still got some juice behind us," said Tim Fiore, who oversees the U.S. survey. "I don't think things are getting weak based on what I'm seeing here."

An official purchasing managers index in China rebounded strongly, too, with a pickup in a measure of forward-looking orders. China's index rose to a six-month high of 50.5 in March from 49.2 in February, well above the forecasts of many economists. Power consumption, steel output and sales of bulldozers all rose.

Though manufacturing activity accounts for a fraction of gross domestic product in the U.S., it is highly cyclical and is seen as a bellwether for the broader economy. The purchasing manager surveys are also timelier than official data, which have been delayed even more than usual this year by the partial government shutdown in December and January.

The Dow Jones Industrial Average closed 329.74 points higher, or 1.3%, to 26258.42, while the yield on 10-year Treasury notes rose 0.08 percentage point to 2.496%. Bond yields rise when prices fall. (See related articles on page B11.)

"We're really just seeing growth moderate, consistent with the economy reverting back towards its trend after what was a pretty strong year thanks to fiscal stimulus," said Sarah House, a senior economist at Wells Fargo.

At the same time, data showed Europe's manufacturing sector lagging far behind in March. The IHS Markit Purchasing Managers' Index for the eurozone fell to 47.5 in March from 49.3 in February, the biggest fall in output in nearly six years.

Global growth has appeared to slow in recent months after a synchronized upturn early last year. Trade tensions hit not only U.S. and China but also businesses in markets that supplied them, including many in Europe.

Policy makers responded by trying to stimulate activity, with authorities in China cutting taxes and lifting spending and the Federal Reserve halting an interest-rate-raising campaign. The European Central Bank also modestly eased monetary policy.

Economists are now watching to see whether those steps clear the way for sustained growth or whether a deeper global downturn is building.

For now, Europe appears to be having the most trouble regaining its footing.

Germany, which relies more heavily on exports to drive growth than many other large economies, saw its PMI fall in March to the lowest level in nearly seven years. Germany's Mechanical Engineering Industry Association on Monday halved its production forecast for this year to a 1% increase, citing the trade dispute between the U.S. and China.

"It's going to be a bloodbath for manufacturers in Europe this year, and the first improvement probably won't come until the second half of 2020," said Marco Bonometti, chairman of Italian auto supplier OMR Automotive and lobby group Confindustria Lombardia.

In the U.S., the ISM numbers, along with simultaneous reports showing better-than-expected construction spending in February, reassured some economists. JPMorgan revised its running estimate for U.S. gross-domestic-product growth in the first quarter to 2% from 1.5% after Monday's data.

The U.S. data weren't uniformly strong. Consumer spending has been mixed early in 2019. Retail sales, a measure of purchases at stores, restaurants and online, declined a seasonally adjusted 0.2% in February from a month earlier, the Commerce Department said Monday.

"I don't think the tenor is quite as bullish as it was a year ago for consumer sentiment as we see it. Not terrible, but not quite as good as it was," Liberty Media Corp. CEO Greg Maffei said at a March conference.

And while the yield curve on U.S. Treasurys is no longer inverted, some economists said the narrowing spread between long- and short-term yields suggests the nearly 10-year expansion could be approaching an end.

—Austen Hufford, Liyan Qi and Eric Sylvers contributed to this article.

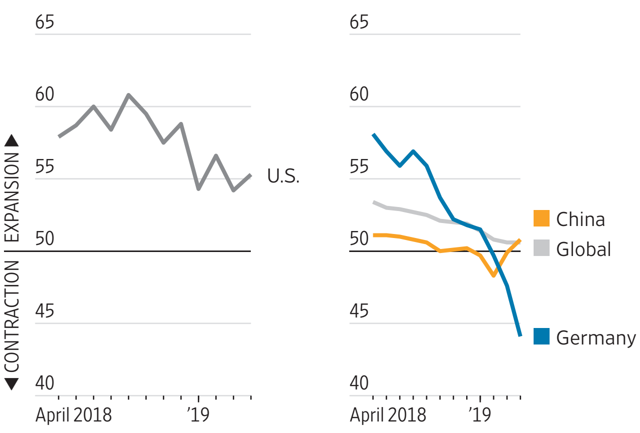
An index in China showed gains in a measure of forward-looking orders. Above, employees making fashion accessories in Jiangsu province.

REUTERS

Two Speeds

March factory activity expanded in the U.S. and China but contracted in Germany.

Manufacturing purchasing managers' indexes



Sources: Institute for Supply Management (U.S.); IHS Markit (others)

Vale Fails Security Reviews

Continued from Page One

surrounding regions.

Vale said it had removed more than 900 people from their homes near high-risk dams as of March 21.

German certifications group **TÜV SÜD**, which certified the dam that collapsed in January four months before the incident, is now facing possible penalties under Brazil's anticorruption law, officials told The Wall Street Journal last week.

An investigation in February by the Journal found that employees of TÜV SÜD, as well as Vale, knew for months of dangerous conditions at the dam on the outskirts of the town of Brumadinho. Yet TÜV SÜD employees certified the dam as safe, expressing worry about losing contracts with Vale, a major client, the investigation found. Those employees may face murder charges over the disaster, legal experts said.

Vale had initially hired the Brazilian unit of Tractebel, a subsidiary of French energy giant **Engie** SA, to certify the stability of the Brumadinho dam in September. But after Tractebel inspectors refused to approve the dam because of their concerns over its stability, Vale hired TÜV SÜD instead, according to court documents.

Prosecutors said they suspect this type of pressure by miners on their auditors to be widespread in Brazil, raising fears about the stability of other dams belonging to Vale and its competitors. They are probing more than 100 high-risk mining dams across the country, causing panic among local communities that depend on those mines for their livelihoods, but now fear for their lives.

"The large majority of dams have stability certificates, but everyone is now wondering if these certificates are reliable," José Adércio Leite Sampaio, the federal prosecutor coordinating the investigation, said in an interview.

Vale said Monday's announcement didn't affect the company's latest production guidance. Last week, Vale estimated the tragedy could cut its sales volume by as much as 75 million metric tons this year.

Marcelo Kokke, a federal prosecutor at the Office of the Federal Attorney General, said companies in Brazil's mining industry have come under pressure—both from society and from government authorities—to be more cautious in the aftermath of the Brumadinho disaster.

The Rio de Janeiro-based miner said early Monday that it had failed to secure approval for 17 of its structures, later raising the number to 18. It said it is working to ensure the safety of its dams, and cooperating with the authorities over the investigation into the Jan. 25 disaster. TÜV SÜD said it is also carrying out its own investigation into the dam's collapse.

The Brumadinho dam collapse comes three years after another dam jointly owned by Vale collapsed less than 100 miles away, killing 19 people. Both dams were so-called upstream dams—the most widespread and cheapest method to store tailings, or mine waste, and the most prone to failure, according to experts.

Mining companies around the world have scrambled to review their own upstream dams after Brazil's latest tragedy, raising concerns that the structures themselves are fundamentally flawed.

"All mining companies are racing against time to take action," said Pedro Galdi, an investment analyst at Mirae Asset brokerage in São Paulo. He also blamed lax legislation in Brazil for not forcing companies to take more precautions at their dams in the Latin America country.

DOUGLAS MAGNO/AGENCE FRANCE-PRESSE/GETTY IMAGES

The mud-filled Paraopeba River in Brumadinho, Brazil, last month following a January dam collapse.

https://www.wsj.com/articles/factory-slowdown-adds-to-gloom-over-global-economy-11554123173

ECONOMY

Global Growth Faces Fresh Threat as Industrial Downturn Spreads

Downturn has gripped factories in the eurozone as well as major Asian exporters such as Japan and South Korea

Employees at the BMW factory in Leipzig, Germany. PHOTO: KRISZTIAN BOCSI/BLOOMBERG NEWS

By Paul Hannon

Updated April 1, 2019 9:28 a.m. ET

Factory activity in much of the world shrank last month, stirring fears that a rebound in manufacturing in China won't be enough to stave off a sharp slowdown in global economic growth this year.

Fresh figures Monday showed that an industrial downturn has gripped factories in the eurozone's biggest countries, including Germany, the region's economic powerhouse, as well as major Asian exporters such as Japan and South Korea. The new data added to expectations that central banks will continue to loosen monetary policy to combat the slowdown.

March surveys of purchasing managers at factories around the world showed a pickup in activity in China and other regional economies with which it has close links, including Indonesia, the Philippines and Thailand.

But even within Asia, major manufacturing economies continued to register declines in activity, including South Korea and Taiwan, while a separate survey of Japanese businesses pointing to weaker confidence.

And Europe's factories continued to suffer weak demand for their exports, partly driven by trade disputes between the U.S. and countries that supply most of its imports, including China and the European Union.

Germany has been hit particularly hard, since it relies more heavily on exports to drive growth than many other large economies, including the U.S. Over recent decades, it has supplied high-end tools and equipment to China and other developing economies as they have beefed up their own manufacturing capacity.

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- U.S. Factory Activity Decelerates Sharply Amid Global Slowdown (Jan. 3, 2019)

German industrial robot maker Kuka AG saw 2018 orders fall 8.5% from the year before due to a falloff in economic growth and a decline in investment by clients. The company will cut 350 jobs this year.

Germany's Mechanical Engineering Industry Association Monday halved its production forecast for this year to just a 1% increase, citing the trade dispute between the U.S. and China.

German auto makers have been grappling with slower demand for cars in China while also facing difficulties at home in upgrading their models to comply with new European emissions standards. These difficulties are now percolating down the supply chain, affecting a broad range of smaller suppliers and services companies that depend on the industry.

The Purchasing Manufacturing Index for Germany's manufacturing sector fell to 44.1 in March from 44.7 in February, the lowest level in nearly seven years. A reading below 50.0 indicates a decline.

> **" It's going to be a bloodbath for manufacturers in Europe this year and the first improvement probably won't come until the second half of 2020. "**
>
> —Marco Bonometti, chairman of Italian auto supplier OMR Automotive

Earlier in March, the independent Ifo economics institute in Munich cut its 2019 economic growth forecast for Germany to 0.6% from 1.1%, as manufacturing "will largely fail to act as an economic engine in 2019," said Timo Wollmershäuser, an economist at Ifo.

Germany's woes have had a ripple effect across Europe, with the overall eurozone index declining for the eighth month.

"It's going to be a bloodbath for manufacturers in Europe this year and the first improvement probably won't come until the second half of 2020," said Marco Bonometti, chairman of Italian auto supplier OMR Automotive and lobby group Confindustria Lombardia.

A similar survey to be released later Monday is expected to show that while still growing at a relatively robust pace, manufacturing activity in the U.S. is also showing signs of cooling.

An official gauge of activity in China's crucial manufacturing sector rebounded strongly in March. Known as the Caixan PMI after its sponsors, the measure rose to 50.8 from 49.9 in February, pointing to an increase in factory activity for the first time since November.

Many economists attributed the gains to the waves of support measures Beijing has rolled out over the past half-year or so—from hectoring banks to lend to the private sector to tax cuts and more infrastructure spending.

They caution that the change is tenuous. Demand for exports, new cars and new homes—critical sectors all—remains anemic.

At a building materials supply center in the south of Beijing, customers were scarce on a recent weekday. He Shengmiao, a sales manager, played with his phone inside his shop, which sells doors, made from aluminum, cedar and other materials for $100 to $300 per piece. He had no clients.

"For us, it's just getting harder and harder each year. It's not just the property downturn. It's everything," Mr. He said, citing a clampdown on polluting factories, rising costs and "just not enough demand."

Some are skeptical about the higher PMI reading for March, seeing it as part of the normal seasonal recovery that happens after the long Lunar New Year holiday, whose dates shift from year to year between January and February.

This year, said Leon Gong, a business manager at a sports gear manufacturer in the southern city of Guangzhou, his company isn't seeing that usual pickup in orders.

Even if China's manufacturing sector rebounds further, it may take some time for that revival to spread beyond its borders.

Indeed, Japan's central bank recorded a further worsening of sentiment in the three months through March. Chief among their concerns are trade tensions.

"Even if trade negotiations between the U.S. and China come to a settlement, it is highly possible that Japan becomes the U.S.'s next target," said Tsuyoshi Ueno, an economist at NLI Research Institute.

Economists worry that the longer manufacturing is in the dumps, the greater the risk its weakness spreads to other parts of the global economy that have so far remained robust, such as the services sector.

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In some services with close ties to manufacturing, the damage is already apparent.

Airfreight carriers in Asia-Pacific, which account for more than a third of global airfreight, saw an 11.9% drop in demand during February compared with the year-ago period, according to the International Air Transport Association, which expects weakness in air cargo markets to continue.

Citi's economists on Monday cut their global growth forecast for this year to 2.8% from 2.9%, compared with 3.2% in 2018, and warned the expansion could be even weaker if fragile confidence lessens the impact of stimulus measures in China and Europe.

—Liyan Qi and Lin Zhu in Beijing, Nina Adam in Frankfurt, Megumi Fujikawa in Tokyo, Eric Sylvers in Milan and Robert Wall in London contributed to this article

Write to Paul Hannon at paul.hannon@wsj.com