NEWS ROUND UP

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Sri Lanka stocks close higher on John Keells Holdings

Sri Lanka's stocks closed 0.44 percent higher on Tuesday, with buying in index heavy John Keells Holdings (JKH) provisional data showed.

Colombo's All Share Price Index (ASPI) closed 25.84 points higher at 5,907.56.

The index underwent a continuous upward momentum throughout the day while reaching a day's high of 5,911.30 nearing the market close.

The S&P SL20 Index of more liquid stocks closed 1.19 percent or 34.44 points higher at 2,926.16.

The market turnover was 550 million rupees with 77 stocks gaining and 46 stocks declining.

Diversified holdings company JKH closed 2.60 rupees up at 156.00 rupees a share contributing most to the ASPI gain.

State-owned Sri Lanka Telecom closed 70 cents up at 29.60 rupees a share.

Sampath Bank closed 3.10 rupees higher at 170.00 rupees a share, also pushing the ASPI up.

The banking index closed 0.59 percent higher while diversified holdings index closed 0.92 percent higher. (EconomyNext)

Sri Lanka rupee ends firmer, bond yields edged up

Sri Lanka's rupee ended stronger at 179.75/85 against the US dollar on Tuesday, while bond yields rose, dealers said.

The rupee closed at 179.60/75 against the greenback on Monday.

Liquidity in the overnight money market fell to 9.06 billion rupees, down from Monday's 25.66 billion rupees as banks deposited less through the central bank window.

In the secondary bond market, gilt yields were marginally up in active trading, dealers said.

A bond maturing on 15.10.2021 closed at 8.75/85 percent on Tuesday, up from 8.70/80 percent at Monday's close.

A bond maturing on 15.03.2023 closed at 9.60/67 percent, gaining from 9.52/60 percent.

A bond maturing on 15.06.2024 closed at 9.90/95 percent, up from 9.78/82 percent.

A bond maturing on 01.08.2026 closed at 10.05/10.10 gaining from 9.90/10.00 percent.

A bond maturing on 15.01.2027 closed at 10.05/10.15 percent, up from 9.95/10.05 percent.

A bond maturing on 01.05.2028 closed at 10.05/20 percent, falling from 10.10/20 percent.

A 20-year bond maturing on 15.08.2039 closed unchanged at 10.10/30 percent. (EconomyNext)

Sri Lanka to award deal for offshore gas production before end-2019

Sri Lanka's Petroleum Resource Development Secretariat (PRDS) is currently evaluating bids for exploring and production of three offshore gas and oil blocks, and the tenders would be awarded before the end of the year, an official said.

Three bids have been received for the licensing round for the M2 block in the Mannar Basin off Sri Lanka's West coast, where gas deposits had been discovered in the past.

“Earlier this year, we went into the market to look for investors for the M2 block,” Director General Vajira Dassanayake said.

“It was supposed to close in May, but then the bombs went up and we had to extend it up to June and we got three proposals for the M2 block," he said.

“The project committee is in the process of evaluating them."

"We are hoping to submit our final report by the first week of September and hopefully before the end of this year, we will be able to award it to the successful party.”

Dassanayake said that the they expect the bidding companies to have a development plan by end-2019 which will then enable the winner to produce the country’s first hydrocarbons by 2023.

Meanwhile, only one bid was received for the second licensing round of 2019 for both the M1 block and the adjoining C1 block.

The tender deadline was in July.

“We went in the market for M1 and C1 blocks, because we had some investor interest,” Dassanayake said.

“After advertising, there was one proposal received for both blocks, which is also being evaluated.”

Dassnayake said that the single proposal for the two blocks came from a local company with both North and South American expertise.

India's Cairn had discovered natural gas in two of the four wells it had drilled in the M2 block spending 240 million US dollars in 2011 after winning a bidding round in 2007.

Cairn had abandoned the M2 block during the 2015 shale oil boom, when the firm decided to exit all international ventures to focus on its main oil fields in Rajastan.

The two wells are estimated to have two trillion cubic feet of natural gas and 10 million barrels of condensate, and twelve international firms had shown interest in bidding for the M2 block, PRDS has said in early 2019.

The M2 block tender round of 2019 is to both produce gas from the two wells and to explore the remainder of the block.

Gas production in the block from the discovered deposits would require nearly a billion US dollars in investments, according to PRDS estimates in the past.

PRDS has said that the 9 blocks in the Mannar Basin alone could have the potential of an additional 5 billion barrels of oil and 9 trillion cubic feet of natural gas which would be sufficient for Sri Lanka’s energy needs for the next 60 years.(EconomyNext)

President throws monkey wrench at Sri Lanka central bank reforms

Sri Lanka had stability until July 2019 with cash withdrawn by the central bank to keep a soft-peg with the US dollar until new injections began. The President meanshile has put a monkey wrench on laws to stop money printing in the future.

The question is, what is he smoking? This is relevant since President Maithripala Sirisena is against drugs and against cigarettes.

If he did not smoke anything, then the other question is, what are his advisor/advisors, who came up with this piece of advice smoking?

Printer-in-Chief

"The proposed MLA prevents the CBSL from purchasing any Government securities from the primary market. Given the global economic conditions, coupled with the impending large debt repayment, it could lead the country to default on its debt," he is reported to have said in a note to the cabinet.

"The lack of contingency support could have significant repercussions in a middle-income economy such as Sri Lanka that also does not have a mature domestic capital market for financing its budgetary operation adequately."

It is this 'contingency support' that led to the post-independent decline of Sri Lanka.

Buying Treasury bills with printed money has been the biggest source of instability this country has faced since 1950, when the central bank was created, ending a currency board which kept the country stable for almost three-quarters of a century, through two world wars.

But exchange controls and trade controls followed swiftly in the wake of T-bill purchases by the central bank and Sri Lanka became a lagging nation in Asia. The 1970s were the worst.

The President is seeking to undermine over decades of work by classical economists, politicians, journalists and citizens, who wanted to block money printing.

The President who has close relations with China should get his advisors who are giving dead ropes to check how the People's Bank of China successfully operated a peg from 1993 to 2005, laying the foundations for most of their economic performance.

The PBoC did not buy Treasury bills but mopped up inflows to build vast pile of foreign reserves, generating a current account surplus and a very strong exchange with regime that was tighter than a currency board.

China's relatively weaker economic performance now is partly due to monetary instability that is coming from the 'flexible exchange rate' from 2005. Its monetary operations have also been changed over the last 10 years.

The Presidents's advisors instead of going by the US Federal Reserve (which is a free-floating exchange rate whose reserves are all Treasury bills now) should check the PBoC law which was reformed around 1987 after BOP crises and inflation. Money printing was decisively blocked in 1995 with very minor exceptions which also required separate State Council approval.

The bankrupt advisors should particularly read Articles 20 and 30 of the PBoC law which says:

Article 29: The People's Bank of China may not make an overdraft for the government, and may not directly subscribe or underwrite State bonds or other government bonds.
Article 30: The People's Bank of China may not provide loans to the local governments or government departments at various levels, to non-banking institutions, other units or individuals, with the exception of the specific non-banking institutions as decided by the State Council.
The People's Bank of China may not provide guarantees for any unit or individual.
That means currency swaps are also illegal.

The President had also questioned the need to drop the Treasury Secretary from the Monetary Board. That the Treasury Secretary has been a source of instability and has stopped interest rates from going up is no secret.

When P B Jayasundera was Treasury Secretary, there were two policy rates, showing that the central bank was not allowed to raise rates.

When R Paskaralingam was Treasury Secretary, 20% inflation was routine. People were striking all over the place, asking for higher wages and factories were closed for weeks at a time.

CB Independence pre-supposes sound money

Having said that, people usually assume that a central bank is good for the freedom and prosperity of the people pre-supposing that people running the agency are liberal and will support sound money.

If they are Mercantilist (or Keynesian which amounts to the same thing) and are prone to generating monetary instability, there is no point giving independence to the central bank. But unless it is given independence the CB cannot implement stable policies even at a later stage when senior executive drop Mercantilism and start to follow basic (classical) economics.

Unlike high performing East Asia which had strong currencies and low inflation, Sri Lanka's central bank did not have a good record on monetary stability. That is not just due to the Treasury Secretary.

In East Asia, the King of Thailand, and his advisors such as James Baxter influenced by Western classical thinking - resisted creating a central bank for decades and later set up one hurriedly to avoid Japanese setting up a more dangerous one during World War II.

Both South Vietnam and South Korea, which came into US hands after World War II did not have very good central banks, though Korea's was better. (Not that the Soviet side was any better). The Philippines was the same.

Korea however got its act together and decisively reformed the central bank in the mid 1980s ending instability and is now almost a developed country.

Korea - that is partly why the term Korea had a certain meaning at one time and partly because the Japanese really messed that country up - had currency problems even during the Bretton Woods. But the government there managed to win the Korean War.

South Vietnam was not so lucky either in currency or in war. The Vietnam dong (Both South and North/Liberation Dong) was a joke until 1993 when a stable exchannge rate around 15,000/16000 dong for laid the foundation for FDIs and an export boom.

The central bank law was revamped in 1988 in Vietnam as part of Doi Moi reforms, but its law was not strict as that of China.

In Vietnam old shopkeepers and roadside vendors still keep two US dollar notes for luck in their purse.

The new rulers of Taiwan had learned a good lesson on how monetary instability helped Chairman Mao get recruits.

Japan, despite being under US control, had have learned good lessons. With interventionist Keynesian New Dealers taking over under US occupation, Japan exploded with inflation in the immediate post war years.

It was only the arrival of Joseph Dodge that saved the country. The issue of fukkin loans was stopped. The inflation was primarily coming from reconstruction subsidies given with fukkin bonds which were mostly bought by the Bank of Japan.

The 360 yen to the US exchange rate set by the Dodge stabilization remained until the break up of the Bretton Woods in 1971 making Japan an export powerhouse.

Malaysia and Singapore didn't get independence immediately after World War II from Britain and did not come under State Department pressure to set up dollar-soft pegs and break the Sterling area. Neither did Maldives or Mauritius for the same reasons.

As a result, they had monetary stability. Singapore, in any case, had extensive experience with Banana money (notes under Japanese occupation), which must have helped. The British honoured all pre-war currency board notes.

Monetary stability is a classical ideological conviction
If those who manage the central bank do not believe in monetary stability, regardless of whether they are from the Treasury or not, there will be instability and REER targeting and the like.

Goh Keng Swee, the economic architect of Lee Kwan Yew, explained later how the country had a stable exchange rate and kept a currency board despite having the finance minister as the head of the monetary authority.

"World Bank experts advised us against this since the Chairman should be an independent person with sufficient authority to resist a Finance Minister's request for money to finance a budget deficit," Swee said.

"It is the Finance Minister's prime duty to balance the budget and, if possible, accumulate a surplus for a rainy day.

"Successive Finance Ministers have been doing just this. They do not need an independent Central Bank Governor to persuade them not to run budget deficits. The World Bank's anxieties were misplaced."

Goh pointed out that deficit spending, financed by central bank credit to stimulate an economy, does not work in practice.

"This is admissible in theory, but in practice, since all modern states engage in foreign trade, a Keynesian stimulus will lead eventually to balance of payments deficits if the government does not exercise restraint in time.

"A part of the increased incomes people receive will be spent on imports, and when exports do not grow in proportion, a trade deficit will occur.

"Our economy was and is both small and open. Financing budget deficits through Central Bank credit creation appeared to us as an invitation to disaster.

"There was no effective way of exchange control in an open trading economy like ours to deal with the inevitable balance of payments troubles."

The 2018 balance of payments troubles did not come because money was printed for deficits, but because money was printed for rate cuts and to repay debt (buffer strategy) in April 2018 and to accommodate maturing swaps taken in 2013.

It will take some years for the central bank to understand that there is little difference between term reverse repo injections and purchasing Treasury bills from auctions.

Unholy Treasury-CB co-ordination

Direct purchases inject cash to DST accounts in state banks with the borrower as the Treasury. Term reverse repo or outright purchase auctions inject cash to all banks, public and private, which is then loaned to many customers.

In August, more money was created by swapping Treasury dollars with the central bank generating the second run on the rupee, which then became a full-blown crisis due to the confidence erosion as a result of the political turmoil.

Creating money by buying dollars and not sterilizing them is fine if there was no ceiling policy rate. But with a ceiling policy rate at which money is printed, it is a disaster to make unsterilized interventions in the hope that excess liquidity will push down interest rates.

This column has also shown the dollar borrowing fiasco with the Ceylon Petroleum Corporation, which expanded the current account deficit. In this obviously, the Treasury also had to be complicit.

The rupee-dollar Soros-Style swaps was also a result of Treasury central bank complicity to artificially bring down rates.

The buffer strategy where state banks were overdrawn re-financed by printed money from the liquidity window to repay government bonds was also due to an unholy link between the Treasury and the central bank.

The key unholy link is having the central bank as the agency for selling Treasury bills in the first place, and placing on them a burden of getting the lowest rate.

Having a representative of the central bank governor in the Treasury bill tender committee to look after monetary policy interests is also an unholy link that should be done away with.

CB Independence misused

The current administration has suffered terribly from monetary instability, as the central bank cut rates and printed tens of billions rupees just as the credit system - read economy - recovered.

This administration came to power, promising a 'Social Market Economy'. But within months in 2015 money was printed.

Then came a deadly Real Effective Exchange Rate (REER) targeting exercise aimed at destroying the monetary foundations of the nation to subsidise hard goods exporters by slashing wages of workers and by extension generating political instability.

The Social Market Economy was a promise made to the people. It goes without saying that a Social Market Economy will not go out of the way to harm wage earners, low-income earners and small savers.

How did REER targeting come to operate?

Was there any discussion in cabinet that a Mercantilist monetary policy oriented to hard goods special interest will be adopted to sabotage the Social Market Economy?

To the knowledge of this columnist no such discussion was taken, or a cabinet paper seeking approval to target the REER and destroy the rupee, presented.

How is it that the central bank cannot even sell a $500 million bond but can take it upon itself to destroy the rupee without telling the politicians that it will lower living standards, destroy wages and capital?

The monetary instability of the 1980s, where the currency fell despite balance of payments surpluses, discrediting the entire framework of the 'open economy' with high inflation and high nominal interest was also based on implicit REER targeting.

Clearly, the central bank can do what it likes now, even without formal independence.

In the old days, central banks could not devalue the currency without parliamentary sanction, especially before central banks were nationalized.

When the Bank of England wanted to stop gold convertibility - float the pound - it had to go to parliament and get permission.

The British Parliament passed the Bank Restrictions Act to enable the pound to be floated and effectively devalued.

The critical difference was that at the time it was easier for classical economists, or ordinary citizens or the media to point out the flaws when a central bank is private, rather than when it is state-owned as now.

It is especially tricky when there is state worship in the country.

It is even more complicated when persons like Indrajit Coomaraswamy is heading the agency because people in general and critics in particular, know that he has no bad intentions towards the country and expects no personal profit.

This columnist has also been given to understand that Sri Lanka's Central Bank Governor is underpaid, which is also something that any future MLA should take care of. No one should become central bank governor out of altruism.

Weird Powers for Admin Measures

The President has called for broader consultation of the proposed Monetary Law Act.

There is speculation that the new law will give the central bank even more powers to place ad hoc credit controls such as LTV ratios during currency troubles.

To say the least, this is weird. For a central bank that is supposed to be moving towards inflation targeting - however flawed - it is indeed surprising that they want to place greater reliance on administrative controls rather than rates.

The central bank misled the government on taxing specific imports, gold, cars and placed loan-to-value ratios - on three-wheelers no less - to control imports instead of fixing its monetary policy errors.

To institutionalize such powers is nuts.

When controls are placed on specific goods, and the central bank continues to inject money to keep rates low, the money will go somewhere, since liquidity is fungible. What happened in the 2018 instability was that most of the 'saved credit' went to buy bonds from fleeing foreign investors.

Can't someone understand this, please?

Naughty Boys Pledge
This columnist can imagine that some people in the central bank do not understand soft-pegs or how to operate them since it is evident that outside of some East Asian nations with strong currencies and some Gulf nations such knowledge does not exist.

But surely we must know by now that admin controls have no effect if cash is injected?

Even the IMF, which seems to have lost part of its knowledge about pegs, knows this one.

Trade and exchange controls were one of the reasons that the IMF programme was suspended in 2018, and the naughty boys had to go to confession later and promise not to repeat the sin.

"In October 2018, we also required a minimum cash margin for the importation of certain non-essential consumer goods under Documents Against Acceptance terms," the central bank and Treasury told the IMF to get the program restarted.
"This temporary measure for motor vehicles was also introduced to ensure that banks do not take excessive risk in providing loans for car imports, given a surge in demand. In addition, in October 2018, we advised authorized dealers not to release FX for the conversion of Sri Lankan Rupees for making advance payments for the importation of certain non-essential consumer goods."
These measures, which resulted in nonobservances of the continuous PC on non-introduction/intensification of exchange restrictions under the arrangement and were inconsistent with our Article VIII obligations, were eliminated in March 2019. No further measures inconsistent with Article VIII obligations were introduced.
"For the remainder of the program, we will not impose or intensify restrictions on the making of payments and transfers for current international transactions; introduce or modify multiple currency practices; conclude bilateral payments agreements that are inconsistent with Article VIII, or impose or intensify import restrictions for balance of payments reasons."
Any requests from the central bank to legitimize or strengthen these admin controls in the new monetary law should be resisted by the authorities.

If inflation targeting is to work - flexible or otherwise - the central bank has to be weaned away from administrative controls to actual monetary policy. Though admin controls were largely dropped by A S Jayewardene, they have come back since the Rajapaksa regime and had worsened under the current government.

Administrative controls - whether import controls, credit ceilings, LTV ratios, or overnight dollar position of banks -- simply give the central bank more room to commit policy errors and delay actual policy adjustment which is to stop printing money (raise rates or float if the credibility of the peg has been lost).

Having a total credit limit - inclusive of bond purchases - has an effect unlike individual controls on specific imports. But gentle rate rises are the best.

Shorn of all esoterics, inflation targeting with a floating rate works when a central bank with proper inflation index - like New Zealand - ended up generating a policy rate that was closest to the market, which prevented mal-investment and bubbles.

In the absence of pegging, there can be no BOP crises (forex shortages) in a floating exchange rate regime.

If rates are below market, and the index is manipulated downwards through core-inflation, through hedonics, high inflation boom (food crisis, energy crisis) mal-investment (housing bubble) and economic collapses (Great recession, Depression) is the final outcome in a floating exchange rate as happened in the United States.

While bubbles happen in floating rates, BOP crises and currency depreciations come earlier in soft-pegs like Sri Lanka even before a bubble fully develops.

Monetary Instability ends - on a recovery path
(This column is adapted from one originally published in the August 2019 issue of Echelon Magazine and written in July 2019 before the current monetary instability began)
Monetary instability in Sri Lanka ended in the first quarter of 2019. The central bank was no longer printing money through its liquidity windows to de-stabilize the peg leaving the private citizens to engage in growth generating activities upt July 2019.

However, growth could fall sharply in the second quarter, given past experience (see Chart 1) after the currency falls.

In the March quarter, there was hardly any inflation, as the currency collapse had just finished and there were still liquidity shortages. As a result, the GDP deflator was near zero.

But the steep fall in tax revenues, the current account surplus shows the actual conditions of the economy.

This column had warned that too wide an inflation target (the IMF deal tolerated inflation up to 8 percent) while operating a peg will delay corrections and lead to monetary instability and stagflation.

There is likely to be stagflation in the near term as inflation overtakes growth. To the extent that the currency is allowed to bounce back, off the adverse effects will be lessened.

It took about 18 months for the credit system to fully recover from the 2015 soft-peg collapse and barely less than a quarter for the central bank to trigger another soft-peg crisis.

In 2019 the government should be able to deficit spend a little, without much harm, because private credit is negative.

Since Mangala Samaraweera is not given to wholesale spending, the budget may not de-stabilize the credit system a lot.

But the fall in imports and the current account surplus in the first quarter has reduced revenues. Therefore the central bank was right to keep a watch on rates and keep rates higher than the market. It was doubly so after the April blasts.

The central bank was not printing money to cut rates up to July, unlike in 2015 and 2018.

Up to July as had been pointed out by others, the central bank is keeping rates slightly above market with its floor 7.50 window and 7.70-7.80 percent repurchase auctions.

This columnist would say cut the rate further. As long as the ceiling rate is not reduced, there is no danger to the economy as rates can bounce back.

However, if the ceiling rate is also cut, given the past experience of the Monetary Board's unwilling to allow short term rates to go up, there are risks for monetary stability if revenues are inadequate. If the ceiling rate is kept high, (about 250 basis points) the floor rate can be cut.

Rates will automatically move up if there is a credit spike due to state borrowings without any need for the Monetary Board to make decisions. This column has pointed out earlier that the sharp rate fall in late 2017 (effectively a rate cut) helped narrow the time of the recovery as the floor rate was low.

In 2019 the central bank has been mopping up dollars and selling down its Treasury bill stock, strengthening the peg. When inflows are mopped-up steadily, the peg becomes stronger than a currency board.

Dollar backing of the rupee rose to broadly around 91 percent by July, up from a low of 71 percent in February 2019, due to a combination of mopping up (Net Foreign Assets growth) and cutting of the statutory reserve ratio, which led to a shrinking of the monetary base.

The high SRR, in addition to causing monetary instability, is one reason for excessive nominal and real interest rates in Sri Lanka. But the principal reason for the high nominal interest is the monetary instability from the soft-peg.

China is also suffering from the same problem now. It is not just Xi Jingping's illiberalism and statism that are undermining the Chinese economy.

Meanwhile, in another controversial move, the central bank is cutting deposit rates, giving subsidies to banks.

The reason that it takes about a year or two for an economy to fully recover from a soft-peg collapse is that consumers need time to recover from lost incomes.

Businesses will expand and borrow when there is demand. In any case, it takes a few months to draw up an expansion plan. The destroyed capital never recovers. That is why even East Asian countries with depreciating currencies, have poor infrastructure, in addition to lower salaries and export of labour to the Middle East.

If deposit rates are cut faster than market and lending rates do not fall, depositors themselves will seek other avenues of investment and speculation, before businesses have time to formulate new plans for real investments.

It is one thing to remove the floor overnight policy rate, but it is quite another to force deposit rates down faster than the market further along the yield curve. Even in a depressed situation, it can lead to mal-investments.

The planned flexible inflation targeting regime is unlikely to be much different from the past two years since the same type of flexible exchange rate and de facto inflation targeting as well as a mish-mash of administrative controls and Nixon shocks.

However, according to recent statements made by the Governor of Sri Lanka's central bank, there is a broad understanding that printing money by purchasing government securities at weekly auctions is terrible.

This is a significant victory for the poor.

The 2018 crises and bust was created with term reverse repo injections, not outright purchases of bills from banks. Reverse repo injections involving buying bills not from the Treasury but from banks, with the same results.

A 'buffer strategy' also generated a shock by overdrawing a state bank to repay maturing bonds with printed money - not by the purchase of new bills. In the 2015/2016 crisis liquidity was generated by term repo releases and an 'operation twist' to manipulate the yield curve.
Like direct interventions in bill auctions and provisional advances, all such deadly monetary nukes need to be outlawed as well. From all accounts, a peg is going to be maintained for the foreseeable future.

The IMF will not allow a fully floating exchange rate until its loans are repaid, hence the flexible this and flexible that.

In that case, for the protection of Sri Lanka's poor and monetary stability, it is better to follow policy consistent with the peg. Such stability will also come by retaining the ability to issue Central Bank Securities.

Persisting with lost generation economics will only spell doom. (EconomyNext)

Markets sag as hope fades for trade war détente

Investors' souring hopes for detente in the US-China trade war dragged stocks lower on Tuesday, putting a dent in the relief rally that started the week.

An inverted yield curve and worrisome economic data out of Germany also helped wipe away Wall Street's early gains, while results in Europe and Asia were mixed.

US President Donald Trump's repeated assertions that Beijing wants to make a deal to end the two countries' year-long trade war had cheered markets on Monday. But the optimism was short-lived, since Chinese officials did not confirm any new talks.

In Frankfurt and Paris, shares advanced solidly but London dipped as Brexit-weary British investors played catch-up after a three-day holiday weekend.

US Treasurys continued to fall, deepening the inversion of the curve between yields on the 2-year and the 10-year notes, a widely accepted sign a recession is likely.

China's beleaguered yuan nosedived to 7.1722 yuan to the dollar -- a level not seen since 2008.

The currency had plunged Monday on last week's news that Washington would hike tariffs on more than half-a-trillion dollars of Chinese imports, after Beijing unveiled levies on tens of billions of dollars of US goods.

- GRIM NEWS FROM GERMANY -

Chris Low of FTN Financial said investors were absorbing the reality that, despite Trump's rosy forecasts on Monday about the chances for a trade deal, the two sides were in fact no closer to an agreement.

"We've been barraged by comments from the Chinese side that nothing has changed," he told AFP.

He also pointed to unhappy economic news out of Germany, which recorded negative growth in the second quarter.

The news prompted fresh talk of a recession, with many saying growth could easily be negative again in the third quarter.

"Given that other data points for Germany in Q3 have been weak, there's every chance that we see another contraction and satisfy the definition of a technical recession," said David Cheetham at XTB.

Charles Schwab analysts said "early gains that came amid cooled trade tensions between the US and China fell victim to worries surrounding the persistent decline in bond rates, with the inversion between the 2-year and 10-year Treasury notes widening to heighten recession concerns."

In commodities, oil prices rose after Trump said he was prepared to meet Iran's Hassan Rouhani in the next few weeks, following talks over Tehran's nuclear program at the G7 summit.

"Expectations are... rising that tensions in the Gulf can be de-escalated following President Macron's overtures to broker a meeting between Donald Trump and his Iranian counterpart," noted AxiTrader analyst James Hughes.

- KEY FIGURES AROUND 2100 GMT -

New York - Dow: DOWN 0.5 percent at 25,777.90 (close)

New York - S&P 500: DOWN 0.3 percent at 2,869.16 (close)

New York - Nasdaq: DOWN 0.3 percent at 7,826.95(close)

London - FTSE 100: DOWN 0.1 percent at 7,089.58 points (close)

Frankfurt - DAX 30: UP 0.6 percent at 11,730.02 (close)

Paris - CAC 40: UP 0.7 percent at 5,387.09 (close)

EURO STOXX 50: UP 0.7 percent at 3,370.47 (close)

Tokyo - Nikkei 225: UP 1.0 percent at 20,456.08 (close)

Hong Kong - Hang Seng: DOWN 0.1 percent at 25,664.07 (close)

Shanghai - Composite: UP 1.4 percent at 2,902.19 (close)

Euro/dollar: DOWN at $1.1083 from $1.1102

Dollar/yen: DOWN at 105.77 yen from 106.12 yen

Pound/dollar: UP at $1.2288 from $1.2217

Euro/pound: DOWN at 90.25 pence from 90.87 pence

Brent North Sea crude: UP 81 cents at $59.51 per barrel

West Texas Intermediate: UP $1.29 at $54.93 (AFP)