THE WEEKLY **ASIA** ECONOMIC MONITOR

APRIL 8, 2019
FREYA BEAMISH, CHIEF ASIA ECONOMIST

Headline wage growth in Japan this year appears to have been depressed by sampling distortions.

Other data indicate there is life yet in key regular earnings growth, but the upside is limited.

The PBoC won't cut rates, but it will provide a targeted RRR cut to replace maturing MLF funds.

Recovering from the Shock of Japan's Wage Data... it's Not All Bad

Officially, Japanese wages have been *falling* year-over-year since January, marking a break from the gradual acceleration over the past 18 or so months. Data released on Friday showed that labour cash earnings fell by 0.8% in February, extending January's downwardly-revised 0.6% slide. For perspective, wages rose at an average of about 1.5% in Q4.

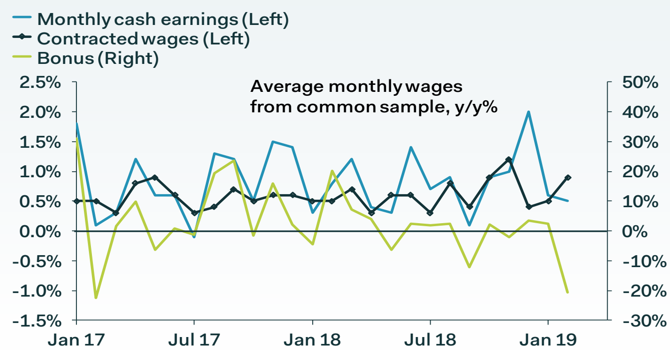
We are taking the latest numbers with a huge pinch of salt, and then some. The issue appears to be an abrupt change in this year's sample which, against last year's data, has distorted derived growth rates. Indeed, the near-complete reversal of January's provisional 1.2% *rise* in wages underscores the extent of the damage done. The Labour Ministry has been under pressure to clean up its act in recent months, after it was revealed that it hadn't been collecting data from about two-thirds of the firms in Tokyo, as required by law, for about 15 years.

For now, we're looking at the numbers for "common establishments", a less readily accessible set of data, but one that appears not to be affected by the scandal. Headline cash earnings growth here isn't a like-for-like match with the main series from one month to the next, though it does track the general direction of travel. The figures indicate that wage growth *has* softened this quarter, due in large part to downward volatility in bonuses, which contracted by 20.6% in February, after January's 2.3% rise. Bonuses are trivial in absolute size at this time of year, but such big swings can have a bearing on overall earnings growth.

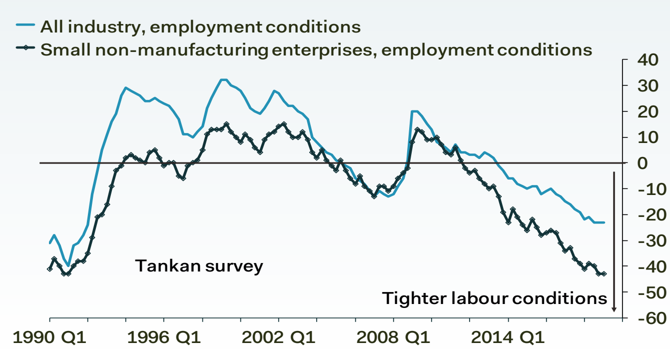
Accordingly, earnings growth at "common establishments" inched down to 0.5% in February, from 0.6% in January, as our first chart shows. The story isn't all bad, as the headline masks an *uptick* in contracted wage growth, to 0.9% from 0.5%, on the back of regular wages. The acceleration in contracted earnings would have been more pronounced if not for the continued decline in overtime pay.

Persistent regular wage growth is key, although not the only prerequisite, if the economy is to sustain price increases. Much *stronger* wage growth probably would be needed for inflation to *accelerate* and get

THERE'S LIFE YET IN JAPANESE REGULAR WAGE GROWTH



TANKAN POINTS TO TIGHT, BUT NOT TIGHTENING, MARKET



anywhere near the BoJ's elusive targets. The Q1 Tankan survey suggests that, for now, steady wage growth is all Japan can hope for, with the labour market remaining tight, but no longer tightening. Employment conditions for large firms in all industries held steady at -23 for a third straight quarter.

No PBoC rate cut, but a targeted RRR cut, for now

Expectations of PBoC easing are waning, partly thanks to recent upside surprises in the PMI survey data. While we remain unconvinced that the recovery has started in earnest, we agree that an overt PBoC rate cut is looking less likely. Toward the end of last year, we reckoned that the Bank would cut rates, and we feel justified in calling victory on that; interbank rates have averaged 5bp *below* the previous floor of 2.55% in the year so far, with a low of 2.19%.

The Bank seems unlikely, however, to go all the way and cut rates officially. Granted, Fed dovishness has given the PBoC some further breathing space, but monetary conditions are showing signs of loosening, though they remain very tight. And the slippage in foreign trade seems unlikely to get any worse; the export and import subindices of the PMIs stabilised in March, though are still deep in contraction territory.

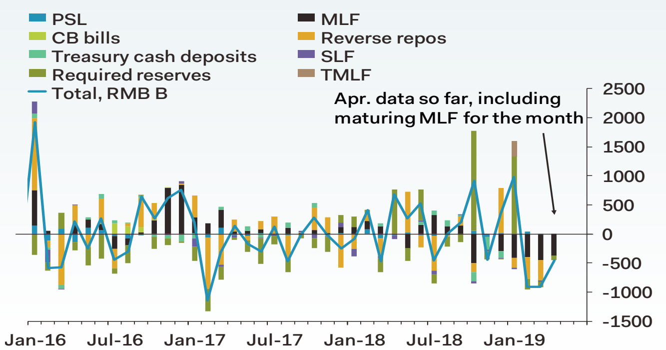
At the same time, the PBoC still has some regard for longer-term efforts to deleverage, and it faces the immediate problem of avoiding bubble-blowing. ***Finally, fiscal policy will do a lot of the legwork this year, so all the PBoC need do is make sure it doesn't get in the way by keeping monetary conditions too tight.***

The case for the RRR is somewhat different, and we anticipate another cut. *The primary aim here will be to replace maturing funds at the PBoC lending facilities.* Overall, the Bank withdrew a substantial amount of funds from the interbank market in the first two months of the year. Interbank rates remained low, however, as the market was still benefiting from previous large PBoC injections and lengthening of maturities. Another month of net withdrawals, however, seems too much.

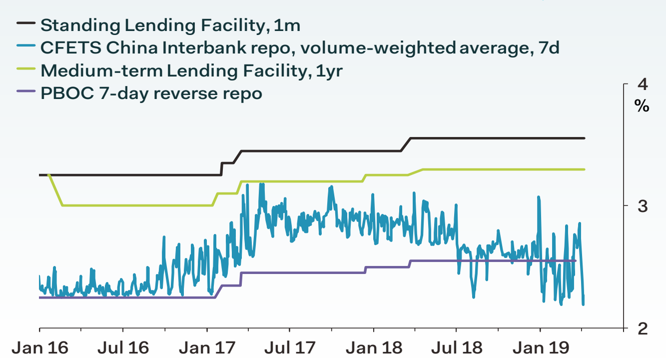
The authorities have promised targeted cuts, but have been more coy about an outright reduction, and, for now, a full-blown 50bp cut seems too much. Maturing MLF funds amount to RMB 368B this month, but a 50bp cut for all banks would release around RMB 800B. ***So the approach is likely to be targeted, with released funds amounting to slightly more than the MLF maturations.*** Real economy data will continue to disappoint in Q2, though, leaving scope for the cut to be extended to the wider banking sector, as in previous rounds.

The recovery should be confirmed by the second half, but that doesn't rule out a further RRR cut. The RMB will come under mild depreciation pressure as the Fed retraces its dovish steps. *The PBoC will tend to lean against that depreciation, by selling FX reserves, but it will counterbalance the implied liquidity destruction by cutting the RRR.*

THE PBOC WILL INJECT FUNDS AS MLF LOANS MATURE



THE PBOC WILL AIM TO KEEP RATES WHERE THEY ARE, FOR NOW



Freya Beamish, Chief Asia Economist **+44 191 249 9209**
freya@pantheonmacro.com
Miguel Chanco, Senior Asia Economist **+44 191 249 9274**
miguel@pantheonmacro.com

THIS WEEK IN BRIEF

Data and events covered in the Asian Data Wrap.

Monday, April 8

- **Japan: Current Account Balance (2) 08:50 JST**

The unadjusted current account surplus probably jumped to **¥2,857B** in February, from ¥600B in January. The trade balance will move from deficit to surplus, as the unfavourable seasonals from January reverse. A seasonal increase in the primary income surplus will help, too. **Consensus: ¥2,634B.**

Tuesday, April 9

- **No major data released.**

Wednesday, April 10

- **Korea: Unemployment Rate (3) 08:00 KST**

The jobless rate probably rose back up to **4.1%** in March, after dropping to 3.7% in February. The jobs data have been extremely volatile since the start of the year, due to the 11% minimum wage hike in January. Slowing growth will result in higher average unemployment this year. **Consensus: 4.0%.**

- **Japan: PPI (3) 08:50 JST**

PPI inflation likely ticked up further, to **1.0%** in March, from 0.8% in February, with the help of favourable base effects. The drag from Q4's oil price plunge will continue to fade, while metals should provide some minor upside. **Consensus: 1.0%.**

- **China: M2 (3)**

M2 growth probably returned to **8.4%** y/y in March, after slowing to 8.0% in February, due primarily to high base effects. Growth should accelerate gradually from here, on the back of previous policy loosening. **Consensus: 8.2%.**

Thursday, April 11

- **Japan: Monetary Stock M2 (3) 08:50 JST**

M2 growth likely was stable at **2.4%** y/y in March. Growth has ebbed between 2.3%-to-2.4% since November. The BoJ's persistent tapering and slowing economic activity mean that M2 growth is likely to remain subdued. **Consensus: 2.4%.**

- **China: CPI (3) 09:30 CST**

CPI inflation probably increased to **1.7%** in March, from 1.5% in February, despite a likely further softening in services inflation and a quiet month for energy prices. The huge drop in the base for food prices last spring will push food inflation up significantly until the middle of 2019. **Consensus: 2.3%.**

- **China: PPI (3) 09:30 CST**

The price sub-indices of the March PMI suggest a rebound in PPI inflation, to **0.5%** in March, from 0.1% in February. The risk of outright deflation in H1 has fallen. **Consensus: 0.4%.**

Friday, April 12

- **China: Trade Balance (3)**

The balance likely will be around **zero** in March, after plunging to $4.1B in February. The seasonals are even more unfavourable than in February, but the adjusted surplus should have started to rebuild. **Consensus: $8.1B.**

CHINA ECONOMIC FORECASTS

GDP	q/q Official	q/q PM est.		y/y Official	y/y PM est.
Q4 2017	1.6%	1.6%	2016	6.8%	8.0%
Q1 2018	1.5%	1.6%	2017	6.7%	7.3%
Q2 2018	1.7%	2.1%	2018	6.4%	6.1%
Q3 2018	1.6%	0.8%	*2019*	*6.2%*	*5.0%*
Q4 2018	1.5%	1.1%	*2020*	*6.2%*	*5.5%*
Q1 2019	*1.5%*	*1.5%*			

	CPI, y/y Headline	CPI, y/y Core	PPI, y/y Headline
Dec-18	1.9%	1.8%	0.9%
Mar-18	2.1%	1.7%	0.0%
Jun-18	2.8%	1.6%	-0.2%
Sep-19	1.8%	1.5%	0.9%

JAPAN ECONOMIC FORECASTS

GDP	q/q	CPI	Headline*	Core**
Q2 2018	0.8%	*Dec-18*	0.3%	0.1%
Q3 2018	-0.7%	*Mar-18*	0.3%	0.5%
Q4 2018	0.5%	*Jun-18*	0.4%	0.4%
Q1 2019	-0.5%	*Sep-19*	0.3%	0.6%

*Ex. tax, education and mobile charge effects; **Ex. food and energy

KOREA ECONOMIC FORECASTS

GDP	q/q	CPI	Headline	Core
Q2 2018	0.6%	*Dec-18*	1.3%	1.3%
Q3 2018	0.6%	*Mar-19*	0.4%	0.9%
Q4 2018	1.0%	*Jun-19*	0.6%	1.1%
Q1 2019	0.3%	*Sep-19*	0.5%	1.1%

ASIAN YIELDS

		Dec	Mar	Jun	Sep
10-year, %	China	3.31	3.10	3.10	3.20
	Japan	0.03	-0.08	0.00	0.10
	Korea	1.94	1.90	2.10	2.20

ASIAN MONETARY POLICY FORECASTS

China Two more RRR cuts this year, and interbank rates maintained at or below the corridor floor.

Japan Further dilution of the 2% inflation target; policy unchanged, though threat of further adjustments can't be ruled out in the second half, if the Fed is forced into a U-turn

Korea 7-day repo rate on hold at 1.75% through 2019.