



THE WEEKLY **ASIA** ECONOMIC MONITOR

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*Marginally stronger Chinese manufacturing activity will support Q2 headline GDP growth.*

*But new export orders are weakening, before the trade war even takes effect.*

*Japan's employment trends are robust, but the unemployment rate will tick back up, temporarily.*

**China's PMI Points to Q2 Strength, but Watch Slump in Export Orders**

China's official manufacturing PMI slipped in June, but the overall picture for Q2 is sound despite the uncertainty posed by rising trade tensions with the U.S. The headline rose to an average of 51.6 in Q2, from 51.0 in Q1, supported in large part by stronger output and new orders. Factories were turned back on after the winter anti-pollution drive, giving activity a boost. *Tightening monetary conditions point to a sharp slowdown in the second half, however.*

The latest figures should keep Chinese policymakers on their toes, in any case. In particular, the outright month-on-month contraction implied by the new export orders subindex in June cannot be shrugged off as a monthly blip. Granted, the print was only trivially below 50, but it is significant nonetheless as it affirms a broad softening in export momentum

since the latter part of 2017. The subindex doesn't reliably lead the hard data. But the recent weakening in Korean export data also paints a worrying picture about global trade.

*It is far too soon to pin the dip in June on China's spat with the US, but the new barriers will serve only to exacerbate exporters' existing woes.* The June weakness is worrying as, if anything, exporters would have been front-loading trade them ahead of the imposition of the U.S. tariffs on July 6.

To be sure, our base case is unchanged: We expect trade skirmishes only trivially to damage Chinese headline GDP growth this year. *Taking the spread between the new orders and new export orders subindices as a rough proxy for domestic demand, the latest data indicate that local players appear healthy enough to keep manufacturers afloat, for now.*

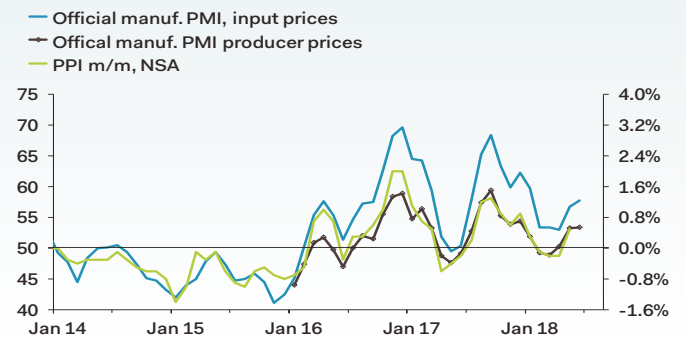
**A further boost to bottom lines in China**

On that note, the price sub-indices continue to augur well for the bottom lines of China's old-guard industries, at least in the short term. The input price index rose yet again in June, to 57.7, from 56.7 in May, marking a five-month high. The producer price index, however, was up only trivially to 53.3, though it remains at a six-month high. The numbers suggest that year-on-year PPI will rise further, flirting with

THE DECLINE IN JUNE EXPORT ORDERS IS NOT AN ANOMALY



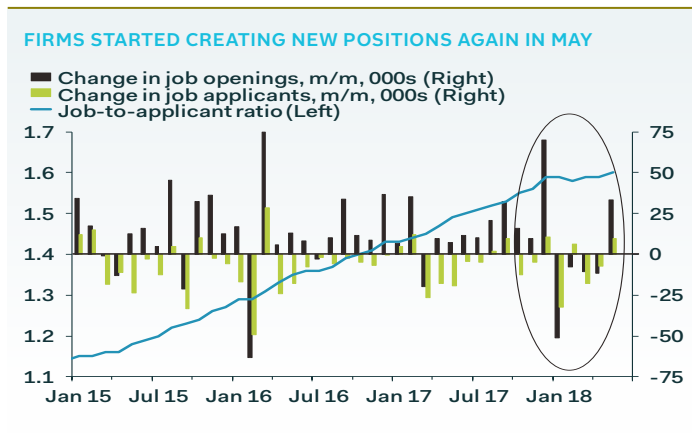
MONTH-ON-MONTH PPI PRESSURES CONTINUE TO BUILD



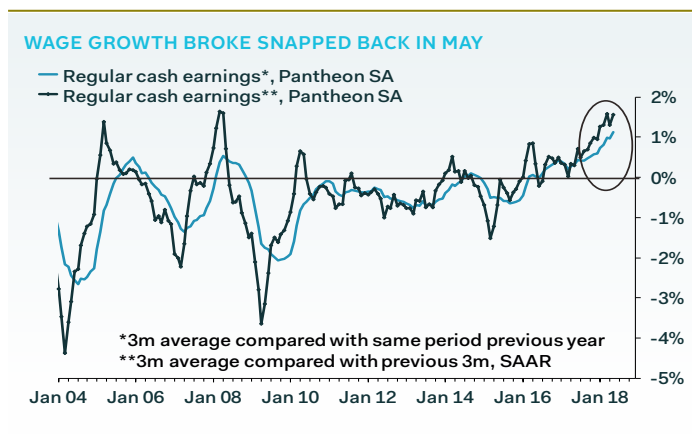
the 5% mark in June. Thanks to base effects and big month-on-month price rises, PPI and, by extension, profit growth, is expected to remain fairly brisk. But PPI inflation will begin slowing again in the quarter.

**How low will Japan's unemployment rate go?**

Japan's unemployment rate fell to its lowest level in more than 25 years in May, dipping to 2.2%, from 2.5% in April. Underscoring how tight the labour market is, the jobs-to-applicants ratio also set a new multi-decade high, rising to 1.60 from 1.59 in April. At the same time, companies are responding to these conditions by increasing wages either to attract or retain employees. Indeed, the quits rate—the number of voluntarily unemployed in the labour force—fell to a fresh low of just 0.9% in May.



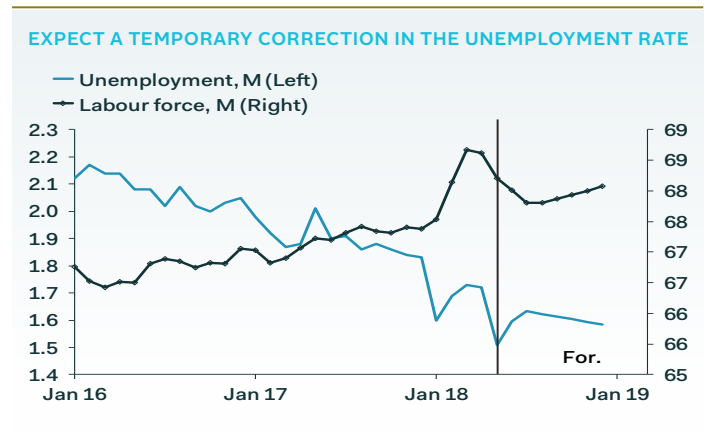
The scarcity of labour is pushing up wage growth. According to data released at the close of last week, the growth in average monthly cash earnings surged to 2.1% year-over-year in May, from 0.6% in April to



2.1% in May, surprising market expectations well to the upside and the strongest print since mid-2003. At 1.3% in real terms, earnings grew at their fastest pace in close to two years.

Critically, regular wage growth picked up at the margin, to an annualised rate of 1.6% in the three months to May compared with the previous three months, after April's dip to 1.3%. The question going forward is how much tighter the labour market can get. **GDP growth likely will remain at or above trend this year, so pressure will intensify.**

In coming months, however, the unemployment rate should tick up, for two reasons. First, the size of the labour force appears to be correcting after an unusual surge in the beginning of the year. Second, the number of unemployed workers dropped by a hefty 12% month-on-month in May. A similar drop was seen in January, and we now expect unemployment to rise in a similar fashion to the reversal in the wake of the January plummet.



Any correction, however, is likely to remain just that; a correction. The backlog of work is still rising at a brisk pace, according to the latest PMIs, suggesting that fundamental demand for workers will remain strong for the foreseeable future. The employment conditions index of the quarterly Tankan survey barely improved in the April-to-June period, reflecting the severe labour shortages firms continue to face.

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## THIS WEEK IN BRIEF

Data and events covered in the Asian Data Wrap.

### Monday, July 9

- **Japan: Current Account Balance (5) 08:50 JST**

The current account surplus likely fell to **¥1,569B** in May from ¥1,845B in April. The trade balance fell into the red, though the primary surplus should hold up. **Consensus: ¥1,266B.**

- **China: Foreign Reserves (6)**

The RMB's plunge in June suggest a further fall in reserves, to **\$3,100B**, from \$3,111B in May. **Consensus: \$3,102B.**

### Tuesday, July 10

- **Japan: Monetary Stock M2 (6) 08:50 JST**

M2 growth likely held steady at **3.2%** y/y in June for the third straight month. **Consensus: 3.2%.**

- **China: CPI (6) 09:30 CST**

CPI inflation likely rose in June, to **1.9%** y/y, from 1.8% in May. Food inflation likely will pick up, after recent sluggishness, while energy inflation also is heading up. **Consensus: 1.9%.**

- **China: PPI (6) 09:30 CST**

Base effects combined with the signal from the PMIs suggest that PPI inflation likely rose, to **4.9%** y/y in June, from 4.1% in May. **Consensus: 4.5%.**

- **China: M2 (6)**

M2 growth likely edged yet lower to **8.2%** y/y in June, from 8.3% in May. **Consensus: 8.4%.**

### Wednesday, July 11

- **Korea: Unemployment Rate (6) 08:00 KST**

Unemployment was likely steady in June, at **4.0%**, after ticking up again in May, from 3.8% in April. **Consensus: N/A.**

- **Japan: PPI (6) 08:50 JST**

PPI inflation should rise to **3.1%** y/y in June, from 2.7% in May, on the back of petrol prices. **Consensus: 2.8%.**

### Thursday, July 12

- **Korea: BoK Decision 10:00 KST**

We expect the BoK to hold its benchmark rate **unchanged**, at 1.50%. Export growth is slowing and the unemployment rate bounced higher again in May, suggesting the minimum wage hike has damaged hiring. **Consensus: 1.50%.**

- **Japan: Tertiary Index (5) 13:30 JST**

The tertiary index likely fell by 0.3% m/m in May after a strong 1.0% rise in April. **Consensus: -0.3%.**

### Friday, July 13

- **China: Trade Balance (6) 11:00 CST**

The trade balance probably was little changed, at **\$25.2B** in June. Imports, which have been growing above trend over the past few months, likely rose further, partly thanks to price effects, but also moving ahead of the recent imposition of tariffs against the US. **Consensus: \$27.2B.**

## CHINA ECONOMIC FORECASTS

GDP	q/q			y/y	
	Official	PM est.		Official	PM est.
Q1 2017	1.5%	1.8%	2015	6.8%	5.0%
Q2 2017	1.8%	1.2%	2016	6.8%	5.8%
Q3 2017	1.8%	1.5%	2017	6.8%	6.8%
Q4 2017	1.6%	1.4%	2018	6.4%	4.5%
Q1 2018	1.4%	1.5%			

	CPI, y/y		PPI, y/y
	Headline	Non-food	Headline
Mar-18	2.1%	1.8%	3.1%
Jun-18	2.0%	1.6%	4.2%
Sep-18	1.0%	1.5%	1.9%
Dec-18	0.8%	1.3%	2.0%

## JAPAN ECONOMIC FORECASTS

GDP	q/q	CPI	Headline	Core*
Q3 2017	0.5%	Mar-17	1.1%	0.3%
Q4 2017	0.3%	Jun-18	0.9%	0.5%
Q1 2018	-0.2%	Sep-18	1.1%	0.6%
Q2 2018	0.5%	Dec-18	0.5%	0.7%

\*Excluding food and energy

## KOREA ECONOMIC FORECASTS

GDP	q/q	CPI	Headline	Core
Q3 2017	1.5%	Mar-17	1.3%	1.5%
Q4 2017	-0.2%	Jun-18	1.9%	1.5%
Q1 2018	1.1%	Sep-18	1.6%	1.5%
Q2 2018	0.8%	Dec-18	1.7%	1.5%

## ASIAN YIELDS

		Mar	Jun	Sep	Dec
10-year, %	China	3.75	3.75	3.80	3.80
	Japan	0.05	0.00	0.20	0.20
	Korea	2.65	2.75	2.80	2.80

## ASIAN MONETARY POLICY FORECASTS

China	Interest rate corridor on hold for this year; 50bp RRR cut for all banks Sep/Oct and around Dec/Jan
Japan	Policy balance rate on hold at -0.1%; 10-year yield target to 0.2% from 0.0% before year end
Korea	7-day repo rate on hold.