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THE WEEKLY **ASIA** ECONOMIC MONITOR

JUNE 11, 2018
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China's trade surplus has been trending down for the last two years.

We see further near-term downside risks, but the surplus should soon begin to trend up again.

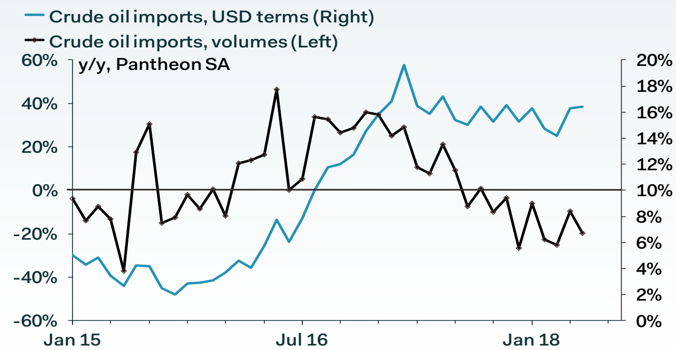
Japan's GDP revisions leave greater room for a rebound in second quarter.

China's Trade Surplus Should Start Trending up Again Later this Year

China's trade surplus has been trending down in the last two years. But slowing Chinese demand, amid late-cycle stimulus in the U.S., should see the overall surplus begin to trend up again, later this year. This means that Sino-U.S. negotiations, however successful they might be in the immediate future, are swimming against the tide.

The Chinese trade surplus trended *up* from 2014-to-2015, as the authorities allowed domestic demand to slow. This was the first time that Chinese policymakers' actions really matched the rhetoric on allowing the economy to run cooler. At the same time, the plunge in oil prices during that period helped to boost the surplus further.

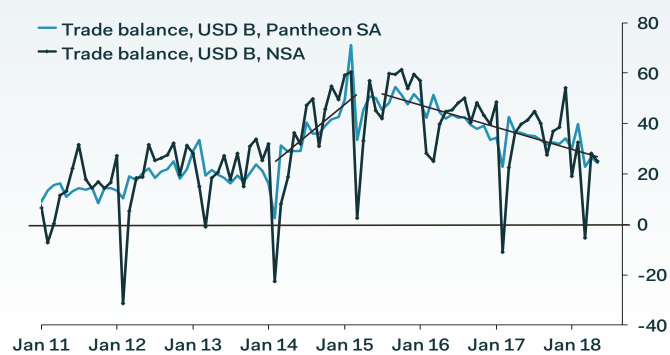
HIGHER OIL PRICES HAVE INFLATED CHINESE IMPORTS RECENTLY



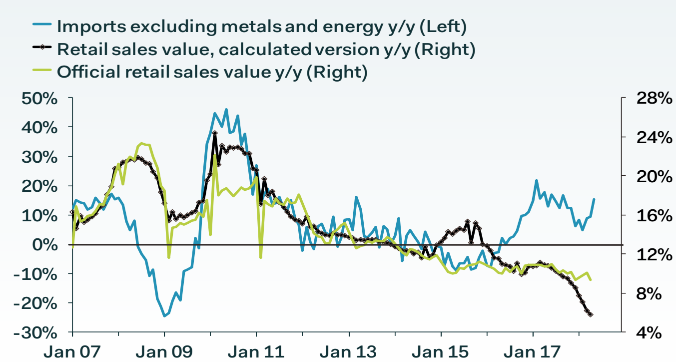
Oil prices have *risen* in spurts since 2016, however, creating a drag on China's surplus. Domestic demand developments also have worked to pull the surplus down, after the authorities got cold feet about their experiment in allowing slower GDP growth. Monetary policymakers, meanwhile, ended up easing conditions markedly as a by-product of their attempt to prop up the stock market in 2015. These factors led to a revival of domestic demand in 2016, when the mortgage market finally sprang into life too. Construction, though, remained sluggish.

The sustained rise in oil prices since midway through last year has prolonged the downtrend in the trade surplus. Oil accounted for 10.7% of the total

CHINA'S TRADE SURPLUS DOWNTREND SHOULD SOON REVERSE



CONSUMER DEMAND GROWTH HAS SLOWED IN RECENT YEARS



value of imports in May, up from 9.5% the previous year. But we aren't expecting a further substantial leg up in oil prices from here.

Domestic producer prices re-accelerated in April, and the PMI input price indices suggest that price rises picked up in May also. But PPI inflation should begin to slow in Q3. *And tight monetary conditions point to a substantial slowdown in Chinese domestic demand growth in the second half and into next year.*

In the immediate future, import price gains and softer exports will keep the trade surplus edging lower. The new export orders indices of the PMIs don't have great predictive power, but are pointing to softer demand. At the same time, U.S. imports have still to correct down further after the boost in the wake of the hurricanes last year. ***But the tide likely soon will turn, with the trade surplus beginning an uptrend in the second half.***

In any event, the decline in China's trade surplus can't be taken as evidence of a budding transition to consumer-led demand. Our third chart shows that retail sales growth likely has slowed substantially in the last two years. The official data have been spookily stable since 2015. But the authorities also publish *value* data for retail sales, and calculating year-over-year rates from this presents a very different picture, bizarrely, from the published year-over-year rates. The story from the calculated version probably is overly gloomy, given trends in consumer confidence and borrowing, though much of the proceeds of debt have been ploughed into speculative investment in housing. *Nevertheless, the rebound in growth of imports excluding metals and energy can't be explained by private consumption growth.*

Substituting toward U.S. agricultural and energy products could help limit the upswing in the surplus with the U.S. over the next 18 months. *Similarly, China's recent tariff cuts eventually will lift demand, but it will take time*. And though China will be *importing* more of its consumer goods, demand growth overall will be slowing.

Japan's GDP revisions point to a rebound in Q2

Revisions to Japan's Q4 and Q1 GDP growth leave more room for a rebound in Q2. The overall picture in Q1 was unchanged, with GDP contracting 0.2% quarter-on-quarter; revisions cancelled each other out. And growth in Q4 was revised up to 0.3% from 0.1% previously.

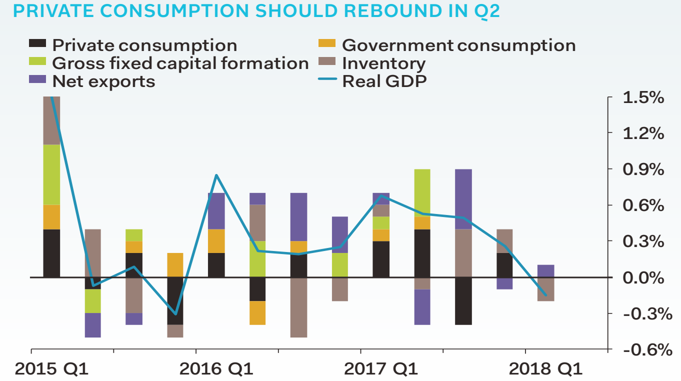
The story on both residential and non-residential capex remained weaker in Q1 than in Q4, consistent with the slowdown in borrowing. But the weakening was less serious than in the preliminary reading.

In contrast, private consumption growth was weaker in the final estimate than in the preliminary reading. ***But we are less worried about this, as non-core inflation leapt higher around the end of the year, but has now subsided, while nominal regular wage growth has continue to trend up.***

Q4 private consumption growth was revised up, so the trend remains intact, despite the downward revision to Q1 growth. With real income growth now on a firmer footing, these data strengthen our conviction that a rebound is underway.

Finally, inventories shaved 0.2 percentage points off GDP growth in the latest reading, compared with a 0.1pp hit in the preliminary read. At the same time, the contribution in Q4 was revised *up* by 0.1pp. This again improves the odds of a rebound in Q2.

PRIVATE CONSUMPTION SHOULD REBOUND IN Q2



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THIS WEEK IN BRIEF

Data and events covered in the Asian Data Wrap.

June 10-to-15

• China: M2 (5)

M2 growth should rebound to **8.7%** y/y in May, from 8.3% in April, but growth will trend down again later in the year. **Consensus: 8.5% y/y.**

Monday, June 11

• Japan: Monetary Stock M2 (5) 08:50 JST

Money growth likely was unchanged at **3.3%** y/y in May. The BoJ stealth taper seems to have dampened M2 growth, but the drag should now diminish. **Consensus: 3.3%.**

Tuesday, June 12

• Japan: Tertiary Index (7) 08:50 JST

The index likely *rose* by **0.5%** m/m in April, after falling 0.3% in March, bringing it back to trend. **Consensus: 0.6%.**

Wednesday, June 13

• China: PBoC

The PBoC likely will shift the key rates in its policy corridor higher by 5bp, after the probable Fed hike. The authorities also are likely to cut the RRR, in the imminent future.

Thursday, June 14

• China: Retail sales (5) 10:00 CST

Retail sales growth likely was unchanged at **9.4%** y/y in May. The headline is spookily stable, however, and probably doesn't reflect reality. **Consensus: 9.6%.**

• China: Industrial Production (5) 10:00 CST

The rise in industrial production likely slowed m/m, dragging the y/y growth rate down to **6.5%** in May, after the jump to 7.0% in April. **Consensus: 7.0%.**

• China: FAI ex Rural (5) 10:00 CST

FAI growth should slow to **6.5%** YTD y/y in May, from 7.0% in April, as the headline continues to converge back to the underlying trend. **Consensus: 7.0%.**

Friday, June 15

• Korea: Unemployment Rate (5) 08:00 KST

The jobless rate should be unchanged at **3.8%** in May, but should soon edge down to 3.7%. This should assuage any fears that the minimum wage hike has seriously damaged hiring. But the unemployment rate is due to head higher later in the year, as a result of sluggish growth. **Consensus: N/A.**

• Japan: BoJ decision

The policy balance rate likely will be unchanged at **-0.1%**, with the 10-year yield target also unchanged at **0.0%.** But we are getting closer to an "adjustment", especially if a fourth dot emerges in Fed predictions in September. **Consensus: N/A.**

CHINA ECONOMIC FORECASTS

	q/q			y/y	
GDP	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	2.90	2.90

ASIAN MONETARY POLICY FORECASTS

China	Mini-hikes to interest rate corridor around Fed hikes, combined with RRR cuts
Japan	Policy balance rate to 0.0% before Q4, from -0.1%; 10-year target to 0.2% from 0.0%
Korea	7-day repo rate to 1.75% in July from 1.50%.