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Trade talks between the U.S. and China are likely to continue, despite the resumption of tit-for-tat tariffs.

China's Q1 current account data further highlight how it miscalculated, overplaying its hand.

The March drop in wages in Japan isn't as grim as the headlines show, but the good news ends there.

Latest U.S. Tariff Rise against China isn't the Death Knell for Trade Talks

The U.S. pulled the trigger on Friday, following through on President Donald Trump's tweeted threat to raise the tariffs on $200B-worth of Chinese goods, under the so-called "List 3", to 25% from 10%. This increase was originally scheduled to take effect on January 1, but was delayed when Mr. Trump and his Chinese counterpart, Xi Jinping, struck a "trade truce" in Argentina in December. The revised enforcement date of March 1 was then postponed indefinitely, due to the supposed progress being made in the talks.

How have tensions re-escalated so quickly? The negotiators from China probably—and incorrectly—interpreted Mr. Trump's calls on the Fed to ease policy as a sign that he believes the U.S. economy to be weakening. Meanwhile, the Chinese economy ostensibly performed better than expected in the first quarter, giving Vice Premier Liu He and his team an arguably false sense of confidence in negotiating from a position of strength. So they overplayed their hand, by reportedly "reneging" on earlier commitments made to cement IP protection reforms in domestic legislation, and this duly backfired.

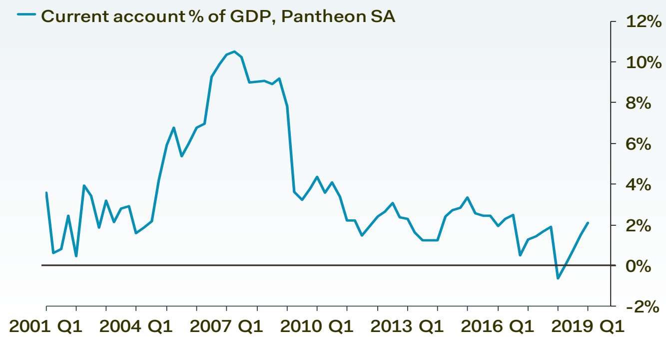
The latest increase, while economically painful for both sides, is unlikely to sound the death knell for negotiations; if anything, it could speed things up. Tellingly, Beijing has been vague about how it plans to retaliate, which we see as a willingness to leave the door open for negotiations to continue. Note that Liu He still travelled to the U.S. for talks late last week, days *after* Mr. Trump's tweetstorm. Admittedly, the ambiguity over China's bottom line position is also forced by the nature of the bilateral trade balance; China simply is running out of U.S. goods to raise or impose new tariffs on without causing grievous hurt to its economy. The authorities have been aware of this constraint since mid-2018, when they first started talking vaguely about "quantitative and qualitative measures" against the U.S.

Nevertheless, the strength of China's likely recovery in the second half of this year is fragile, as April's money data showed last week; see here. *Accordingly, it remains in Beijing's interest to remain engaged in talks and show restraint in any retaliatory actions.* We wrote last week that China may decide to stomach the latest tariff increase in order to avoid looking weak domestically if it caved with the proverbial gun to its head. ***But our base case remains that a deal will be struck soon, if not sooner, now that an economic hit will be realised.*** Mr. Xi appears to be borrowing from the relatively successful playbook of Japanese Prime Minister Shinzo Abe, playing to Mr. Trump's ego late last week by penning him a "beautiful letter". For Washington's part, it now has more room both to give Beijing the partial roll-back in tariffs it seeks and still claim a "win" merely by returning to pre-May 10 rates.

China's current account grew in the first quarter

Broadly speaking, the ongoing rise in China's current account surplus makes sense in the context of the economy's weaker health in *reality* and its under-performance relative to the global economy. The preliminary data released on Friday showed that the unadjusted surplus grew to $58.6B in Q1, from $54.6B in Q4, on the back of the volatile primary

THE WIDER Q1 SURPLUS MAKES SENSE GIVEN SOFTENING GROWTH



income balance, which flipped to a $25.4B surplus, from a $22.8B deficit. This more than offset a $44.6B deterioration in the trade surplus, which was signposted by the monthly numbers.

The increase in the current account surplus was much more pronounced on our adjustment, spiking to $73.2B from $50.8B. In GDP terms, it rose to 2.1%, from 1.5%, marking the largest surplus in about two years. The swing in the primary income balance was half as big as reported after adjusting for seasonality. ***More importantly, the adjusted trade surplus grew, underscoring the economy's actual softness in the first quarter.*** Indeed, the increase was driven by both a slip in exports and a further decline in imports to a seven-quarter low.

The deterioration in the trade balance in April from March and the likely hit from the imposition of higher U.S. tariffs point early to a drop in the quarterly balance in Q2. Looking further ahead, a softening in demand from the U.S., alongside China's likely—but gentle—recovery in the second half, should push the trade balance further south.

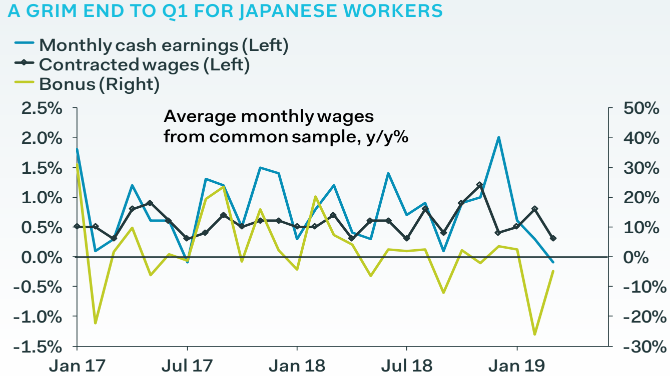
Wage growth in Japan is deteriorating quickly

Labour cash earnings in Japan tanked by 1.9% year-over-year in March, extending the 0.7% fall in February. The latest numbers were a huge disappointment, with the consensus forecast predicting a more modest 0.5% drop. We thought wages would be much weaker, on the assumption that the sampling issues which have plagued the series since the start of the year haven't been resolved; so the impact of the unfavourable base effects from March 2018 would be doubly painful. These base effects will reverse quickly for April, though, so the likely further decline in earnings growth last month shouldn't be as sharp.

For now, we continue to look at the sample of "common establishments", which hasn't been affected by the scandal over the Labour Ministry's past survey practices. The news here is better, but not great, as this dataset indicates that earnings growth continued to slow in March, to -0.1%, from only 0.3% in February. The source of the weakness is even more alarming, as it wasn't down primarily to the volatile bonuses component, which continued to fall in March, albeit at a much more moderate rate. Instead, regular earnings growth slipped to 0.5% from 0.9% in February, pulling contracted wage growth down for the first time in three months, to 0.3%, from 0.8%.

To be sure, the share of part-time and temporary workers rose modestly in March also, helping to depress wage growth. ***Nevertheless, the big picture is grim, with earnings growth decisively slowing since the start of the year.*** This weakening is sharp even in the context of the softening labour market, but is not unexpected, in view of the reliance on bonus rises rather than regular wages adjustments last year; firms do this when they are worried about the outlook.

A GRIM END TO Q1 FOR JAPANESE WORKERS



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THIS WEEK IN BRIEF

Data and events covered in the Asian Data Wrap.

Monday, May 13

- **No major data released.**

Tuesday, May 14

- **Japan: Current Account Balance (3) 08:50 JST**

The unadjusted surplus likely rose to **¥3,144B** in March, from ¥2,677B in February, largely on the back of a continued rise in the trade and primary income surplus. **Consensus: ¥3,007B.**

Wednesday, May 15

- **Korea: Unemployment Rate (4) 08:00 KST**

Unemployment probably held steady, at **3.8%** in April, after inching up to that rate in March. Manufacturing surveys were broadly upbeat on April jobs. We continue to expect unemployment to rise gradually this year. **Consensus: 3.8%.**

- **Japan: Monetary Stock M2 (4) 08:50 JST**

M2 growth likely slipped to **2.3%** y/y in April, from 2.4% in March, partly due to an unfavourable base. Trends at the margin remain subdued, due to a host of factors, including BoJ tapering and softening economic activity. **Consensus: 2.3%.**

- **China: Retail Sales (4) 10:00 CST**

Sales growth likely ticked up, to **8.9%** y/y in April, from 8.7% in March. Volume growth likely was steady, with the rise driven by price gains. The weak labour market is limiting the scope for a stronger recovery in consumption. **Consensus: 8.6%.**

- **China: Industrial Production (4) 10:00 CST**

Industrial production growth probably corrected in April, to **6.2%** y/y, following the absurd spike to 8.5% in March. April PMIs pointed to a moderation in output gains from the Lunar New Year-inspired surge in March. **Consensus: 6.5%.**

- **China: FAI ex Rural (4) 10:00 CST**

The underlying levels data remain highly distorted. We reckon that the authorities will print an unchanged rate of **6.3%** in April for year-to-date FAI growth. **Consensus: 6.4%.**

Thursday, May 16

- **Japan: PPI (4) 08:50 JST**

Inflation should slip to **1.1%** in April, from 1.3% in March. This will be led by previous weakness in oil and base effects on electrical machinery and equipment. **Consensus: 1.1%.**

- **China: Property Prices (4) 09:30 CST**

New home prices probably rose by **0.7%** m/m in April, slightly stronger than 0.6% in March. The market finally is turning the corner, thanks to previous monetary policy easing and the relaxation of curbs in lower-tier cities. **Consensus: N/A.**

Friday, May 17

- **Japan: Tertiary Index (3) 13:30 JST**

The tertiary index likely increased modestly, by **0.1%** m/m in March, after falling by 0.6% in February back down to trend. The PMI services dipped in March, but held on to most of its February rise, pointing to a small bounce. **Consensus: 0.1%.**

CHINA ECONOMIC FORECASTS

	q/q			full year/full year	
GDP	Official	PM est.		Official	PM est.
Q4 2017	1.6%	1.5%	2016	6.7%	6.6%
Q1 2018	1.5%	2.1%	2017	6.8%	7.9%
Q2 2018	1.7%	1.9%	2018	6.6%	6.4%
Q3 2018	1.6%	0.4%	*2019*	*6.2%*	*4.0%*
Q4 2018	1.5%	0.6%	*2020*	*6.3%*	*7.3%*
Q1 2019	*1.4%*	*1.1%*			

	CPI, y/y		PPI, y/y
	Headline	Core	Headline
Dec-18	1.9%	1.8%	0.9%
Mar-18	2.3%	1.8%	0.4%
Jun-18	3.1%	1.6%	0.6%
Sep-19	2.2%	1.5%	1.3%

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*	0.5%	0.2%
Q4 2018	0.5%	*Jun-18*	0.4%	0.2%
Q1 2019	-0.3%	*Sep-19*	0.1%	0.3%

*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 May targeted RRR cut to be extended to all banks, and interbank rates maintained at or below the corridor floor in H1. Further RRR cut in H2.

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.