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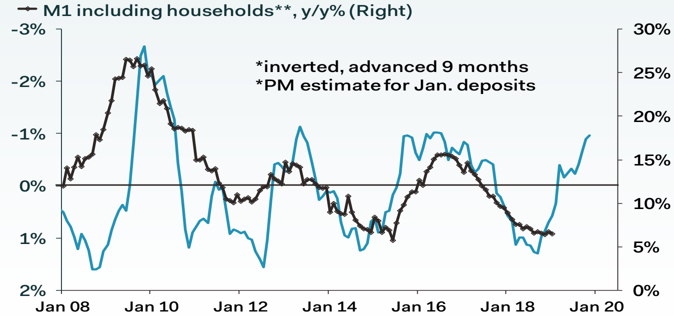
Ignore the Chinese New Year noise in January's money data; the pick-up in new loans is credible.

The break appears to have pulled up services inflation, but the real upside will come from food in Q2.

China barely escaped PPI deflation last month, though it won't be so fortunate for most of 2019.

YIELDS POINT TO IMMINENT MONETARY LOOSENING



Chinese New Year Effects Evident in January's Money and Price Data

Take China's data dump last Friday with a pinch of salt, as Chinese New Year—CNY—effects look to have distorted January's money and price data. As we noted about last month's trade numbers—see here—it's prime time for CNY noise, even though the distortions shouldn't be as pronounced as usual, given that the break fell entirely in February this year and last.

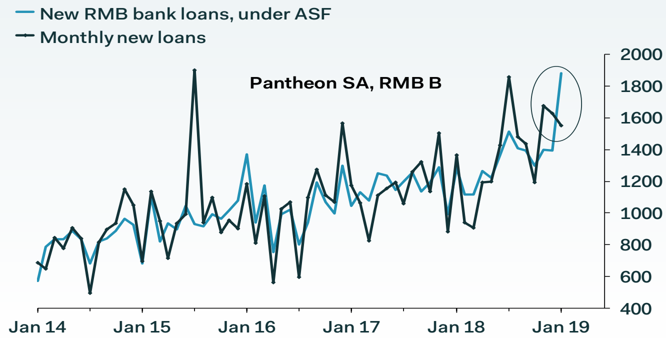
Nevertheless, the slightly *earlier* start of the holiday this month appears to have been enough to affect behaviour noticeably in the last few days and weeks of January, distorting full-month figures. M2 growth ticked-up surprisingly to a six-month high of 8.4% year-over-year, from 8.1% in December. We aren't convinced by the durability of the acceleration, just yet, as our seasonal adjustment model shows a *slowdown* last month. The uptick in M2 growth on a quarter-on-quarter annualised basis was trivial, too, extending the sideways trend established in Q4.

The main action was in the narrower measures of money, which tend to be more sensitive to CNY effects. M1 growth plunged to a near standstill of 0.4%, from 1.5% in December. M1 growth is one of the best leading indicators for GDP growth, but we see two reasons not to panic. First, the steep drop-off likely reflects the mass withdrawal of deposits ahead of the holiday, which traditionally sees an explosion in cash gifts. Consistent with this, M0 growth spiked to 17.2%, from 3.6%. Second, M1 *finally* improved month-on-month, rising by 0.6%, on our adjustment, after consecutive declines in Q4. We suspect that the increase was driven by a combination of factors, including the resumption of local bond issuances and looser credit conditions. Going forward, the slide in sovereign yields points to an impending acceleration in year-over-year M1 growth.

Don't shrug off the strong pick-up in aggregate social financing—ASF—to RMB 4,640B in January from RMB 1,590B in December, despite the very favourable seasonals. The jump more than survives seasonal adjustment, rising to RMB 1,844B—a six-month high—from RMB 1,475B. Crucially, the rise was driven by conventional loans, which rose to RMB 1,880B from RMB 1,394B, and *not* shadow banking, which remains on a tight leash, despite the slowing economy.

The loans story is far from clear, but overall, the jump in lending can't be fully explained away by holiday distortions. A separate loans gauge moves closely with the aforementioned ASF loans number. This measure of new loans *dropped* in January, on our adjustment, for a second straight month, but this jars with the ASF result. And the breakdowns show a pick-up in credit to both corporates and households. Household borrowing maintained a punchy pace of

BREAKDOWNS INDICATE A CREDIBLE PICK-UP IN NEW LOANS

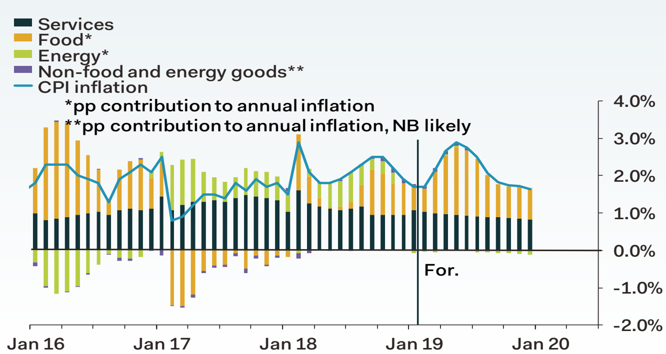


increase, rising by 1.5% month-on-month, following December's 1.3% increase. Corporate borrowing surprised to the upside also, jumping by 1.5%, after the more modest 0.8% rise in December. The data-set on borrowing by non-banking financial firms is too short for our seasonal-adjustment programme, though its drop last month looks like a CNY issue.

CNY-related distortions were more subtle in the price data. CPI inflation fell further last month, to 1.7%, from 1.9% in December, due to weaker food and energy inflation. The drop would have been much sharper if not for the pick-up in services inflation, which rose to 2.4%, from the stable 2.1% prints in the previous four months. ***We aren't reading too much into this uptick, though, as the price of services likely jumped in anticipation of the break.*** Indeed, services inflation tends to be the most volatile in Q1.

Nonetheless, headline inflation will soon pick up, even if services inflation resumes its downtrend and energy deflation persists. The upward force will come

THE SLOWDOWN IN CPI INFLATION IS COMING TO AN END



from food prices, which will be pushed up by strong base effects from March.

China's PPI will deflate for most of this year

PPI inflation shrivelled in January, to just 0.1%, from 0.9% in December; the price components of the PMIs had suggested outright deflation. We still reckon that will come, so we are downgrading our PPI outlook. ***At this stage, it seems as though RMB depreciation last year is providing less of a counterbalance to the drop in commodities prices than we initially had supposed.***

We continue to think that China will be protected from the full onslaught of the commodities decline in USD terms, but we now see this becoming a larger and more sustained drag in China's PPI. Deflation will emerge next month, and inflation won't resume until late this year. The CRB commodities index leads our estimate of Chinese PPI commodity price inflation by around one month. In turn, PPI commodity prices lead prices of manufacturing goods—excluding processing—by around two months. Manufacturing inflation likely was stable at 0.7% in January, but is stronger than would be expected, given the downturn in commodities. Some of the breakdowns have been subject to wild revisions over the last year, so we take these data with a pinch of salt. *But it seems likely that manufacturing prices will follow commodities into a mild deflation in coming months.*

Combined with the base effects, this suggests a double dip, with deflation appearing to diminish in the next few months, but the real trough not arriving until Q3. Nevertheless, the trough shouldn't be deeper than -1%, substantially shallower than the deflation bout that started in 2012, at around minus 2-to-3%. But deflation, however mild, is likely to alarm the authorities, and these data strengthen our conviction in a 10-basis point PBoC rate cut this quarter.

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THIS WEEK IN BRIEF

Data and events covered in the Asian Data Wrap.

Monday, February 18

- **No major data released.**

Tuesday, February 19

- **No major data released.**

Wednesday, February 20

- **Japan: Trade Balance (1) 08:50 JST**

The unadjusted trade deficit probably widened to **-¥1,092B** in January, from -¥56.7B in December, as unfavourable seasonals hit exports markedly. The adjusted deficit should have continued to narrow. **Consensus: -¥1,030B.**

Thursday, February 21

- **Japan: Nikkei PMI Manufacturing (2) 09:30 JST**

The PMI likely rebounded to **51.6** in February, after collapsing to 50.3 in January, undershooting significantly its downtrend. Forward-looking sub-indices will be looking past the distortions from Chinese New Year. **Consensus: N/A.**

- **Japan: All-Industry Activity Index (12) 13:30 JST**

The weak tertiary print should have dragged the all-industry index down a further **-0.2%** m/m in December, after November's 0.3% drop. Industrial production had a quiet month, and we expect only a modest rise in construction, following the 1.9% jump in November. **Consensus: -0.2%.**

- **Korea: 20-Day Exports (2)**

The y/y contraction in 20-day exports probably moderated in February, to **-3.5%**, from -14.6% in January. The 12% m/m drop in shipments last month, on our adjustment, was sharp and is due a small correction. **Consensus: N/A.**

Friday, February 22

- **Korea: PPI (1) 06:00 KST**

The continued slide in import price growth in December, which leads by a month, points to a further drop in PPI inflation, to **0.7%** in January, from 1.0% in December. **Consensus: N/A.**

- **Japan: National CPI (1) 08:30 JST**

CPI inflation likely inched down to **0.2%** in January, from 0.3% in December. Energy inflation should have continued to slow last month, while the deflation in food prices likely deepened, creating a marginally stronger drag. **Consensus: 0.2%.**

- **China: Property Prices (1) 09:30 CST**

New home prices probably rose by **0.5%** m/m in January, softer than December's 0.8% increase. The more subdued second-hand market indicates scope for the primary market to cool further, with sales weakening. The nascent recovery in equities likely also is drawing in liquidity. **Consensus: N/A.**

CHINA ECONOMIC FORECASTS

GDP	q/q Official	q/q PM est.		y/y Official	y/y PM est.
Q4 2017	1.6%	1.6%	*2015*	*6.8%*	*5.4%*
Q1 2018	1.5%	1.6%	*2016*	*6.8%*	*7.9%*
Q2 2018	1.7%	2.1%	*2017*	6.8%	7.4%
Q3 2018	1.6%	0.8%	*2018*	6.4%	5.6%
Q4 2018	1.5%	1.1%	2019	6.1%	4.1%
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%	-0.6%
Jun-18	2.7%	1.6%	-0.7%
Sep-19	1.7%	1.5%	1.2%

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*	0.0%	0.2%
Q4 2018	0.3%	*Jun-18*	0.1%	0.2%
Q1 2019	0.2%	*Sep-19*	0.0%	0.3%

*Excluding 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*	1.1%	1.5%
Q4 2018	1.0%	*Jun-19*	1.0%	1.5%
Q1 2019	0.5%	*Sep-19*	0.9%	1.5%

ASIAN YIELDS

		Dec	Mar	Jun	Sep
10-year, %	China	3.31	3.30	3.36	3.40
	Japan	0.03	0.10	0.20	0.20
	Korea	1.94	2.04	2.14	2.24

ASIAN MONETARY POLICY FORECASTS

China Two more RRR cuts this year, and 10bp cut to the 7-day reverse repo rate, and corridor in Q1.

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.