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The PBoC has pushed interbank rates below their previous floor; "stable" RMB talk is a hurdle.

Japan's trade surplus unexpectedly deteriorated in January, due to a significant fall in exports.

The deficit won't narrow anytime soon, as the drag on imports from oil prices has largely played out.

The PBoC has Effectively Cut Rates; An Overt Cut Hangs in the Balance

China's interbank rates in February so far, on average, have been a little more than 20bp *below* the floor of the PBoC's corridor, the 2.55% seven-day reverse repo rate. From a functionality standpoint, we think the Bank would like to make the *effective* rate cut *overt.* Trade talks, for now, are making that difficult.

From the perspective of monetary and credit conditions, we reckon that the need to cut rates further is dubious. January data released last week showed some green shoots, suggesting that conditions are loosening. Holiday effects were rife, and in our report—see here—we said that M1 growth slumped to 0.4% year-over-year, from 1.5% in December, in part because of this.

Subsequent questions suggest what we said was slightly misleading, and further clarification is necessary. Official M1 contains M0—hard cash—and corporate demand deposits, but not household demand deposits. *M1 growth tends to slump ahead of the holiday, because money appears to leave corporate deposits and wind up in household deposits.* We don't yet have the household deposit data for January, but this was the pattern in 2017, and 2011, when the timing of the Lunar New Year generated a similar pattern to this year. In any case, official M1 growth *rose* month-on-month in January, after three consecutive months of decline.

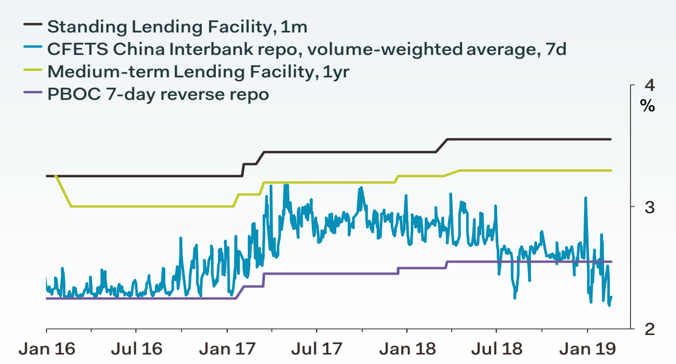
At the same time, the authorities have been out in force knocking back ideas of any kind of QE, after the announcement of the new Central Bank Swap mechanism last month. Our view of the new mechanism still is somewhat different from the official line; see here. But we stop short of saying it's QE.

The PBoC seems pretty comfortable with rates at or modestly below its previous floor; it hasn't soaked up liquidity, in February, though it has refrained from rolling over maturing loans. Ideally, the Bank probably would like to maintain its corridor, which was only recently set up in the last few years, and has been seen as a step forward in the monetary policy framework. From this standpoint, the PBoC likely wants officially to cut the reverse repo rate, and other key rates in its corridor.

The argument against an overt cut, however, has just been strengthened, with U.S. officials resuming fretting about the RMB. Bloomberg reports suggest that U.S. negotiators are pressing Chinese counterparts to pledge to keep the RMB stable as part of a trade deal. Overall, reports emerging in recent weeks have *strengthened* our conviction that a trade deal will be struck by spring. The re-emergence, however, of the fixation with the RMB is a *hurdle.*

Granted, a trade deal should relieve depreciation pressure in the immediate future. But if any threat of tariffs reappeared, then the RMB would come under

SO MUCH FOR THE PBOC'S INTEREST RATE CORRIDOR



renewed pressure. *On the face of it, to keep its pledge, the PBoC would have to burn through its FX reserves, or sharply tighten domestic policy, two things it wouldn't want to do.* More broadly, China would be tying its monetary policy hands, effectively accepting interest rate policy from the Fed, or engaging in unsustainable FX interventions. *At this stage, though, it's not clear what is meant by "stable" and overall, the signs are still good, while the demands for RMB stability could easily be a bargaining position.*

The problem going forward is that real economy indicators are likely to deteriorate further in the first half. ***Even though monetary conditions will loosen more, signalling an economic rebound in the second half, the PBoC could be tempted to ease further in the meantime.***

A Japanese trade surplus is a distant prospect

The new year didn't come with good news for Japanese trade, as both exports and imports tanked in January. Outbound shipments fell harder, though, resulting in an unexpectedly wider trade deficit. Not surprisingly, the unadjusted shortfall ballooned, to -¥1,415B from only -¥57B in December, with the seasonals for exports predictably very unfavourable this time of year. But even the *adjusted* balance deteriorated, to -¥311B from -¥231B in our model, underscoring the extent of the export slump.

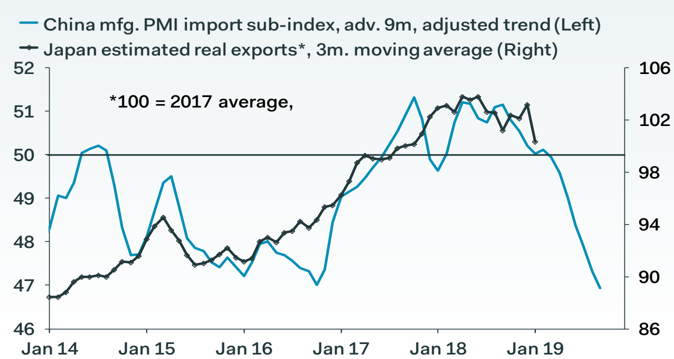
On our adjustment, exports fell by 6.6% month-on-month in January, marking the largest fall since March 2011. That was mostly on weaker volumes, as export prices dropped by a comparatively small 1.7% last month, following December's 0.3% dip. A nasty print was due, with only shipments of raw materials and mineral fuels preventing much steeper drops in previous months. In January, this partial offset gave way. The picture on the demand side also went from bad to worse, as shipments to the EU dropped last month, joining the ongoing weakness in exports to the U.S. and Asia.

A turnaround in exports is highly unlikely in the short run, now that all main product groups and export markets are displaying weakness. Leading indicators from China, which is Japan's largest export market, also show that Chinese import demand will get a lot worse before it starts to turn around towards the end of 2019. The hit from China was substantial last month, with exports to that country plunging by 10.2%, extending the 2.8% decrease in December.

Japan's trade balance, which had been stabilising, won't return to the black anytime soon. Imports dropped sharply in January, by 5.2%, after December's equally grim 4.6% fall. The import bill probably is past the worst of the declines, though, as the Q4 collapse in global oil prices essentially has fed fully through to mineral fuel imports. As prices have recovered since the start of the year, such imports should see something of a recovery this month and next. Meanwhile, the country's other imports are due a bounce, too. They now are well below trend, having undergone a mini-slump in the months after the post-natural disaster, catch-up surge in October, leaving room for a rebound.

Overall, last month's abysmal trade numbers give additional evidence that the Q4 rebound in GDP growth quickly lost steam. BoJ Governor Kuroda said on Tuesday that the Bank may consider fresh stimulus in view of the yen's strength, which he said may have a bearing on growth and inflation. *We reckon that the scope for additional easing is very narrow, though, and it would take much more than just a poor Q1 to invoke a looser monetary policy response.*

JAPAN'S EXPORTS TO CHINA LOOK SET TO FALL FURTHER



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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 widened to **-¥1,415B** in January, from -¥57B in December, below the consensus, -¥1,029B. The adjusted balance deteriorated despite another sharp m/m fall in imports, as exports saw an even steeper plunge.

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

	q/q			y/y	
GDP	Official	PM est.		Official	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		PPI, y/y
	Headline	Core	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.