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THE WEEKLY **ASIA** ECONOMIC MONITOR

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Japan's workers received large end-year bonuses in 2018, as expected, lifting total wage growth.

Regular cash earnings growth slowed in December, but growth at the margins has picked up...

...This likely won't be enough to open the door for urgently-needed BoJ policy tweaks.

Winter Bonuses will Help Q4 GDP, but they Mask Underlying Softness

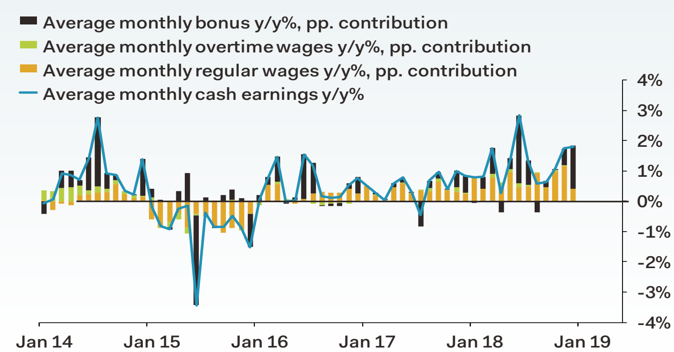
Wage growth in Japan accelerated to a six-month high in December, inching up to 1.8% year-over-year, from November's 1.7%. Strong end-year bonuses were the main story, as we have been predicting for a while, in view of 2018's bumper mid-year packets. The two generally track each other, as our second chart shows. The most recent exception was in 2017, when mid-year bonuses dropped year-over-year, while the Christmas payout rose further. We thought this less favourable base effect would limit the extent of this winter's bonus pop. But the actual bonus was stronger than we expected, contributing a hefty 1.4 percentage points to headline wage growth.

The generous end-year bonuses bode well for our above-consensus forecast on the scale of the Q4 GDP recovery, given the outsized impact of bonuses on spending behaviour during an expansionary phase. We expect *growth* of 0.6% quarter-on-quarter, following the similar *contraction* in Q3, when the economy was derailed by natural disasters. Private consumption, underpinned by strong bonus growth in *real* terms—given the coinciding plunge in inflation—will play a big part in the rebound. Admittedly, the bar for growth is low, after consumption *slipped* by 0.2% in Q3. Nevertheless, we think households will more than recoup this hit, with consumption likely to rise by 0.7%.

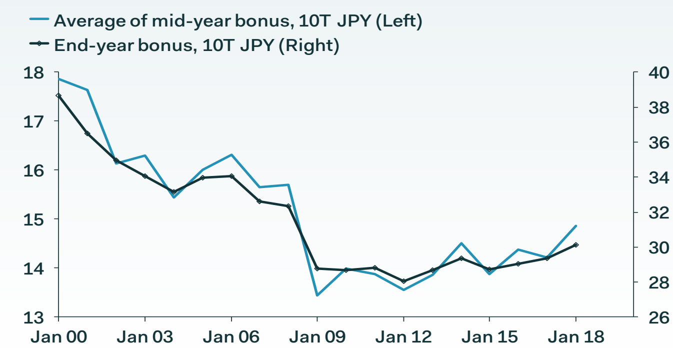
The details of December's cash earnings weren't all rosy. *Indeed, they also showed further evidence of how regular wage growth is struggling increasingly to shift up another gear, as the tight labour market no longer is* tightening. Regular wage growth slowed to 0.9% year-over-year in December, from 1.3% in November, marking a three-month low. Base effects admittedly were less favourable in December, and they flattered November's strong print.

The once-stable correlation between bonuses and retail sales volumes has started to weaken in recent months, too, as our next chart, on page two, shows. This likely reflects rising cautiousness on the part of households, as the two-year-long steady

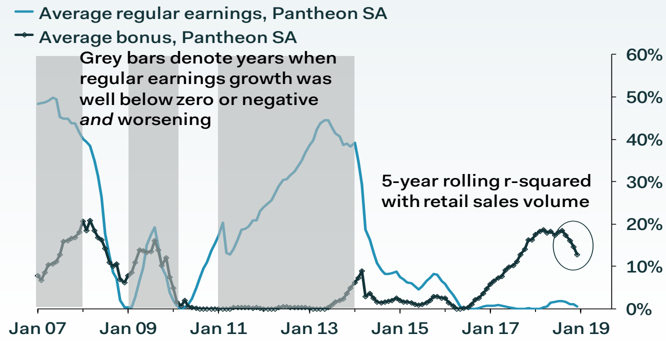
WAGE GROWTH IN DECEMBER POPPED, THANKS TO BONUSES...



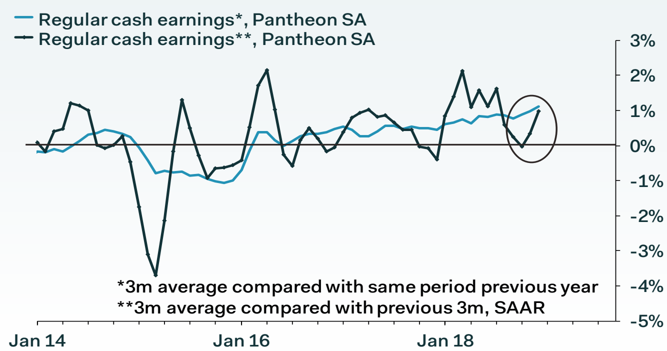
...STRONG MID-YEAR PACKETS PRESAGED A LAVISH CHRISTMAS



BONUS IMPACT IS FALLING AS CURRENT CYCLE NEARS AN END...



...BUT TRENDS AT THE MARGIN POINT TO ONE FINAL PUSH



acceleration in regular wage growth is starting to teeter. ***To be sure, a sharp deceleration is unlikely, at this stage, as growth at the margins is showing signs of life.*** Regular earnings grew at a seasonally-adjusted annualised rate of 1.0% in the three months to December, compared with the previous three months, up markedly from the 0.0% trough in the three months to October. On balance, headline wage growth will slow this quarter as the lift from bonuses disappears, but expect to see some offset from a small pick-up in regular wage growth.

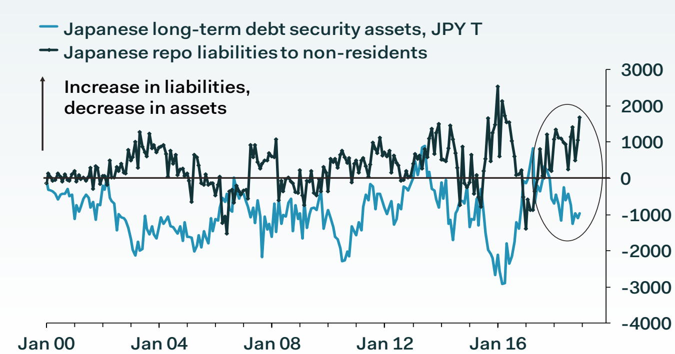
Key policymakers within the BoJ, such as Deputy Governor Amamiya, have recognised the risk of a potential soft patch in total wage growth. Assuming no upside surprises, this will further complicate the efforts by Amamiya and others to tweak the Bank's ultra-loose policy settings. The need to curb the financial distortions created by Japan's low-rate environment remains urgent, though, as December's balance of payments data continued to demonstrate.

The unadjusted current account surplus continued to narrow, to ¥453B from ¥757B in November, due primarily to a further seasonal fall in the primary income surplus. The adjusted surplus has bottomed-out, however, and should start to rebuild as the weakness in global oil prices pushes imports down and the trade surplus higher. The goods balance returned to the black in December, albeit only modestly on our adjustment, after spending four straight months in the red.

A larger current account surplus will translate into increased capital outflows. That's where the main action is, as far as the BoJ is concerned. The latest figures point to continued substantial capital outflows in December, coupled with a build-up in exposure to short-term dollar loans, linked to hedging activity. As our chart below shows, short-term funds supplied by non-residents in reverse transactions rose to a near three-year high of ¥1,674B in December, on our adjustment, from ¥1,066B in November.

Overall, these data support our assumption that the BoJ probably would still consider policy tweaks, even if the timing is becoming increasingly cloudy. The pick-up in regular cash earnings growth at the margin is encouraging, though unlikely to be sufficient to re-open a window in Q2 for BoJ action.

RISING FOREIGN LIABILITIES WILL KEEP THE BOJ UP AT NIGHT



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THIS WEEK IN BRIEF

Data and events covered in the Asian Data Wrap.

Monday, February 11

• **China: Foreign Reserves (1)**
Reserves likely rose to **$3,086B** in January, from $3,073B in December. Currency valuation effects should have lifted GBP- and CAD-based holdings. **Consensus: $3,082B.**

Tuesday, February 12

• **Japan: Monetary Stock M2 (1) 08:50 JST**
M2 growth likely held steady, at **2.4%** y/y in January, after inching up to that rate in December. **Consensus: 2.4%.**

• **Japan: Tertiary Index (12) 13:30 JST**
The tertiary index probably fell a further **-0.5%** m/m in December, after November's -0.3% drop. The services PMI plunged at the end of last year. **Consensus: -0.1%.**

Wednesday, February 13

• **Japan: PPI (1) 08:50 JST**
PPI inflation likely dropped further in January, to **1.0%**, from 1.5% in December. Oil prices remain a drag on the headline rate, but this force is starting to moderate. **Consensus: 1.0%.**

• **Korea: Unemployment Rate (1) 09:00 KST**
The jobless rate probably inched up to **3.9%** in January, from 3.8% in December. The 11% minimum wage hike last month will make hiring even tougher this year. **Consensus: N/A.**

Thursday, February 14

• **Japan: GDP (Q4) 08:50 JST**
GDP likely *rebounded* by **0.6%** q/q in Q4, after *contracting* by -0.6% in the disaster-hit Q3. Domestic demand has recovered well, but net trade likely was a big drag. **Consensus: 0.4%.**

• **China: Trade Balance (1)**
The unadjusted trade surplus likely fell to **$41.2B** in January, from $57.1B in December, though it probably rose on an adjusted basis, with imports falling. **Consensus: $32.0B.**

Friday, February 15

• **China: Current Account Balance (Q4)**
The current account surplus likely rebounded to **$57.3B** in Q4, from $23.3B in Q3. The adjusted surplus likely remained low as a percentage of GDP, but should begin to rebuild. **Consensus: N/A.**

• **Korea: Current Account Balance (12) 08:00 KST**
Strong seasonal factors likely cut the surplus to **$3.6B** in December, from November's $5.1B. But the adjusted surplus should have risen, thanks to lower imports. **Consensus: N/A.**

• **China: CPI (1) 09:30 CST**
Inflation probably slipped further, to **1.8%** in January, from December's 1.9%. It should continue to fall this month before rising from March on low food base effects. **Consensus: N/A.**

• **China: PPI (1) 09:30 CST**
PPI inflation likely fell below zero in January, to **-0.3%**, after the 0.9% rise in December. The price metrics of the official PMI pointed to another month of big m/m falls. **Consensus: N/A.**

CHINA ECONOMIC FORECASTS

	q/q			y/y	
GDP	Official	PM est.		Official	PM est.
Q3 2017	1.8%	1.9%	*2015*	*6.8%*	*5.4%*
Q4 2017	1.6%	1.6%	*2016*	*6.8%*	*7.9%*
Q1 2018	1.4%	1.6%	*2017*	6.8%	7.4%
Q2 2018	1.8%	2.0%	*2018*	6.4%	5.6%
Q3 2018	1.6%	0.9%	2019	6.1%	4.1%
Q4 2018	1.4%	0.9%			

	CPI, y/y		PPI, y/y
	Headline	Core	Headline
Dec-18	1.9%	1.8%	0.9%
Mar-18	2.1%	1.5%	0.8%
Jun-18	2.7%	1.5%	0.9%
Sep-19	1.7%	1.4%	0.7%

JAPAN ECONOMIC FORECASTS

GDP	q/q	CPI	Headline	Core*
Q1 2018	-0.3%	*Dec-18*	0.3%	0.1%
Q2 2018	0.8%	*Mar-18*	0.0%	0.2%
Q3 2018	-0.6%	*Jun-18*	0.1%	0.2%
Q4 2018	0.6%	*Sep-19*	0.0%	0.3%

*Excluding food and energy

KOREA ECONOMIC FORECASTS

GDP	q/q	CPI	Headline	Core
Q1 2018	1.0%	*Sep-18*	2.1%	1.4%
Q2 2018	0.6%	*Dec-18*	1.3%	1.3%
Q3 2018	0.6%	*Mar-18*	1.5%	1.4%
Q4 2018	1.0%	*Jun-19*	1.4%	1.4%

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.