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- Manufacturing PMIs In South Korea and Taiwan have fallen below 50 in 4Q18.
- While correlated in both economies, weak manufacturing PMIs have historically hurt GDP growth rates more in Taiwan compared to South Korea.
- Unlike South Korea, Taiwan is heavily dependent on manufacturing and less reliant on its non-manufacturing sectors.
- We expect Taiwan's GDP growth to slow to 2.2% in 2019, while South Korea's to moderate to 2.6%. The risk of downward revision is higher for the former.

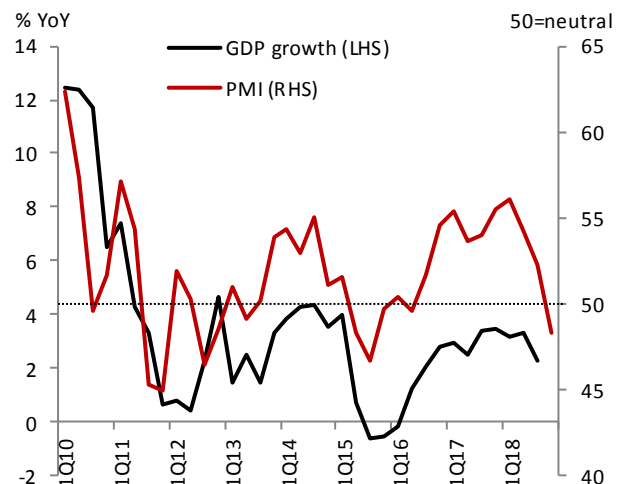
Manufacturing PMIs In South Korea and Taiwan have fallen below 50 recently. Taiwan's PMI dropped to 48.7 in Oct18, the first subpar reading since May16. It fell further to 48.4 in Nov18 and 47.7 in Dec18, its lowest since Sep15. South Korea's PMI also contracted respectively to 48.6 and 49.8 in Nov18 and Dec18. The deterioration was broad-based across new orders, export sales and production. It also did not help that growth in

customs exports in South Korea and Taiwan have turned negative in Nov/Dec18.

Contraction in PMIs often points to weaker growth, albeit not recession

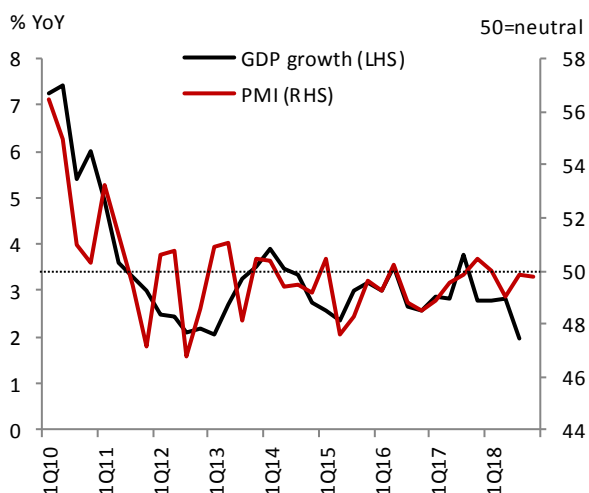
While correlated in both economies, weak manufacturing PMIs have hurt GDP growth rates more in Taiwan compared to South Korea. In Taiwan, GDP growth weakened sharply in years that PMIs fell below 50 for at least half a year. For example, growth dropped below 1% YoY for 1-2 quarters when PMIs contracted 7 and 6 months in 2011 and 2012 respectively. Growth went negative for two quarters in 2015 on 8 months of sub-50 PMI readings (**Chart below**).

Taiwan: GDP growth vs manufacturing PMI



South Korea's GDP growth has held up better around 2-3% YoY when manufacturing PMI weakened to 47-49 (**Chart next page**). In contrast to Taiwan, where manufacturing has been the primary contributor to growth in recent years, South Korea's resilience has been attributed to relatively strong support from its non-manufacturing sectors, including services and construction.

South Korea: GDP growth vs manufacturing PMI



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Downside growth surprises are higher for Taiwan

Clearly, there is less room for complacency in the Taiwan economy. The first warning sign will come from the contraction in its manufacturing PMI in 4Q18 persisting into 2019. Concerns are warranted given the deterioration in global economic conditions, the negative impact of the US-China trade war surfacing in 1H19, and the weakness in the electronics sector in the next couple of quarters.

On a positive note, Taiwan posted its strongest wage growth (Jan-Oct18: 2.6% YoY) since 2000 while banks expanded credit at the fastest pace (Jan-Nov18: 4.9%) in seven years. Residential property prices have also stopped falling since 2017 and gained modestly in 2018 (Sinyi: 1.5% in Jan-Sep18). These have underpinned the cyclical recovery in the services and construction sectors, which should, to some extent, help to offset the weakness in manufacturing in the near term.

We currently expect Taiwan's GDP growth to slow to 2.2% in 2019, while South Korea's to moderate to 2.6% (both economies are estimated to have expanded by 2.7% in 2018). The risk of a downward forecast revision is higher for Taiwan than South Korea.

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Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations).

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