Economics

DBS Flash

South Korea & Taiwan: Tentative signs of a bottom

Group Research

April 9, 2019

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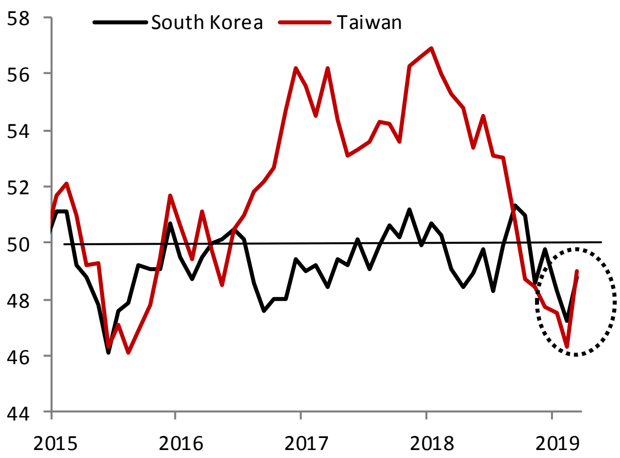
- *The PMI/trade data in March may be tentative signs of growth bottoming in South Korea and Taiwan.*
- *Other supportive factors include China's policy stimulus, a bottoming in the tech cycle, and easing of financial conditions.*
- *March data would not be enough to prevent growth in 1Q19 from disappointing and weighing on the full-year's outlook.*
- *Implication for our forecasts: We will probably need to lower our 2019 growth forecasts, current at 2.6% for Korea and 1.9% for Taiwan*
- *Implication for investors: Expectations for rate cuts have found their way into the bond market but central banks will likely prefer to keep the powder dry.*

A bottom may be in sight in 1Q19

March PMI and trade data have become tentative signs for the South Korean and Taiwanese economies to bottom in 1Q19. **Manufacturing PMIs have risen from the three-and-a-half year lows.** Taiwan's headline PMI bounced to 49.0 in March from the trough of 46.3 in February. This was not only the highest reading in over six months but also the softest decline for the current contraction phase. South Korea's PMI improved to a three-month high of 48.8 in March from 47.2 in February. On a positive note, the surveyed enterprises in these two markets both expressed cautious optimism towards the production outlook in the next 12 months.

South Korea & Taiwan: Manufacturing PMI

Index, 50=neutral



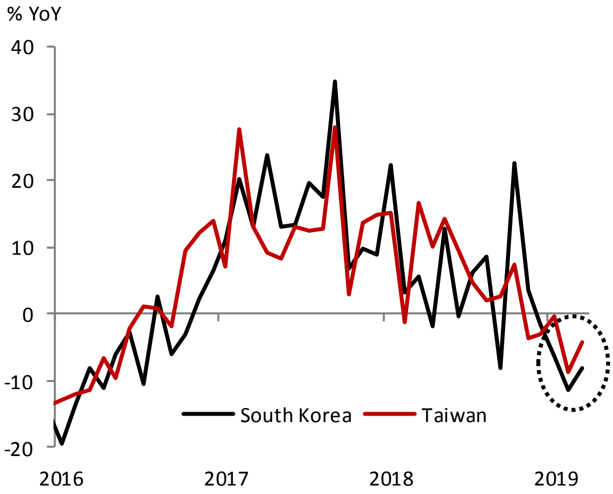
Key indicators have remained weak in March but stabilised from January-February. For example, the contraction in exports slowed to -4.4% YoY from -4.5% for Taiwan, and to -8.2% from -8.8% for South Korea. The decline in semiconductor exports in South Korea narrowed to -16.6% from -24.1%. We were particularly encouraged by a strong rebound in Taiwan's capital goods imports to 34.9% from 4.5%; the sector is a leading indicator for machinery investment.

Tech cycle, China stimulus, and financial conditions

Growth may bottom out in the months ahead on three factors. First, **the tech sector may have troughed in the short-term.** Apple has, in a bid to regain market share, been pushing for iPhone price cuts in the Chinese market through its authorised retail partners in recent months. The Chinese e-commerce providers including JD.com, Tmall, and Suning have started to offer up to 20% price cuts for iPhone 8/8 Plus/XR sold in the country since

January. Lower prices may help to boost iPhone sales to some extent, and in turn, benefit the South Korean and Taiwanese tech companies in the Apple supply chain.

South Korea & Taiwan: Exports



There is anecdotal evidence that the orders for chips, cameras and other electronic components from Chinese tech companies may have picked up. Huawei has reportedly asked its foreign suppliers to increase shipments, not only for its new smartphone models, but also for pre-emptive inventory stockpiling to circumvent potential supply disruptions from the tech war.

Second, **China's economic slowdown worries appear to have subsided** from signs that the moderate stimulus package adopted since late 2018 has started to work. The measures ranged from reserve requirement ratio cuts, infrastructure spending, tax cuts, import tariff cuts and export rebates (here). Manufacturing PMIs in China (both official and Caixin) have returned to the expansionary territory in March. Fixed asset investment has also rebounded modestly. A broader improvement in China's domestic demand should lead to inventory restocking and a rise in Chinese imports, albeit with a time lag. The consumption-focused stimulus measures, such as subsidies on the purchases of cars, green and smart home appliances should help to lift China's imports from South Korea and Taiwan.

Thirdly, **financial conditions have been easing in South Korea and Taiwan.** The KOSPI and the TAIEX have gained 8% and 11% year-to-date, respectively, amidst optimism over China's stimulus, progress in China-US trade negotiations and Brexit delay hopes. The 10-year KRW and TWD government bond yields have fallen by about 10bps over the past one month, thanks to the Fed's dovish tilt at the March FOMC meeting. Meanwhile, the KRW and the TWD have depreciated on an effective exchange rate basis, largely from the appreciation in the CNY, GBP and other high-yielding Asian/G7 currencies. The positive wealth effects, cheaper borrowing costs, and more competitive exchange rates should help to bolster consumer and business confidence and lift domestic demand.

Growth outlook remains weak

Having said that, these two markets will still need to digest some negative data in the near term. The weaker-than-expected manufacturing/trade performances in January-February will be **net negative for 1Q19 GDP.** The preliminary estimates for 1Q19 GDP later this month will likely see growth in South Korea and Taiwan weaken close to 2% YoY and 1% respectively.

Indeed, **if growth disappoints in 1Q19** without an imminent rebound in the subsequent quarters, **this year's forecasts will probably need to be downgraded.** At last count, South Korea's growth forecast is considered optimistic at 2.5% (Bloomberg consensus) and 2.6% (Bank of Korea, DBS). Our forecast for Taiwan is lower at 1.9% compared to the 2.1% projected by the central bank and Bloomberg consensus.

The rate cut expectations that have emerged in these bond markets could increase first before subsiding. Overall, we believe that the central banks will prefer to keep the powder dry and refrain from lowering the benchmark rates this year (here).

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