

Ma Tieying

Economist

**Please direct distribution queries to**Violet Lee +65 68785281 violetlee@db.com

- *Trump's decision of imposing tariffs on USD 300bn Chinese products, which are largely comprised of electronics, clouds Taiwan's export outlook in 2H19-2020.*
- *Adding to the trade war worries is the deterioration in cross-strait ties. China's suspension of an individual travel program for Taiwan could significantly hurt the latter's tourism sector.*
- *On the positive front, investment repatriation and trade diversion are proceeding faster than expected; "Made in Taiwan" is coming back to the fore.*
- **Implication for our forecasts:** *Taking these developments into account, we maintain Taiwan's GDP growth forecasts at 1.9% for 2019 and 1.8% for 2020.*
- **Implication for investors:** *Taiwan's central bank may not join their regional peers in cutting rates soon.*

Escalation of China-US trade war

The China-US trade war has re-escalated. US President Donald Trump said last Thursday that his government will impose 10% tariffs on the remaining USD 300bn Chinese goods entering the US, effective from September 1. In response, China suspended the purchases of US agricultural goods and allowed the yuan to depreciate past 7 against the dollar on Monday. The US Treasury immediately reacted by designating China as a currency manipulator, which opens the door for the US to impose more sanctions on China going forward.

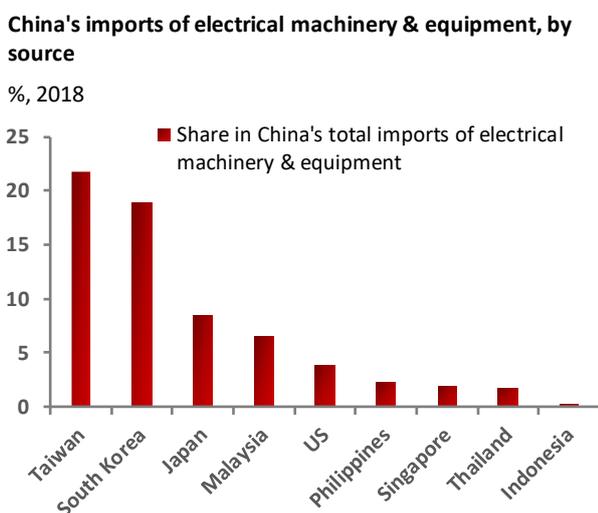
As far as the next round of US tariffs are concerned (10%, USD 300bn), the potential disruption to margins and profits of global electronics companies could be considerable. This tariff list includes essentially all products not covered by the previous rounds of tariffs against China (25%, USD 250bn). In particular, it includes a wide range of consumer electronics products, from cellphones, laptops, to computer monitors and flat panel TVs.

The China-based electronics firms may have some bargaining power with the US importers to raise prices and pass on the tariff costs. This is because the alternative substitutes of China-made electronics products are limited – China accounts for close to 40% of the US's imports of machinery and electrical equipment, or 30% of the world's total exports of machinery and electrical equipment (including shipments through Hong Kong).

Having said that, price elasticity of electronics products is relatively high compared to daily necessities like food and clothes. Demand may decline if their prices go up, especially against the current backdrop that the US's economic growth momentum is slowing.

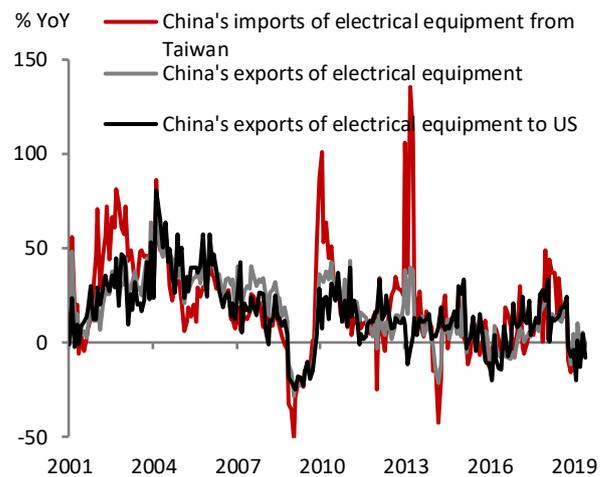
The ripple effect on Taiwan could be significant. Taiwan is highly involved in the electronics supply chain centred around China today. About 20% of China's imports of electrical equipment are sourced from Taiwan. Taiwan's exports of electrical equipment to China account for nearly 20% of the island's GDP. Meanwhile, there is a significant correlation between China's imports of electrical equipment from Taiwan and its related exports (0.7 in 2001-2018), and between China's imports of electrical equipment from Taiwan and its related exports to the US market (0.5).

To Taiwan, the trade disruption impact of 10% tariffs on USD 300bn Chinese exports is likely to be bigger than that of the 25% tariffs imposed on USD 250bn Chinese exports so far. We reckon that it would cut Taiwan's GDP growth by a circa 0.4ppt during the 2H19-2020 period.



Source: CEIC, DBS

China's electronics imports from Taiwan & exports to US

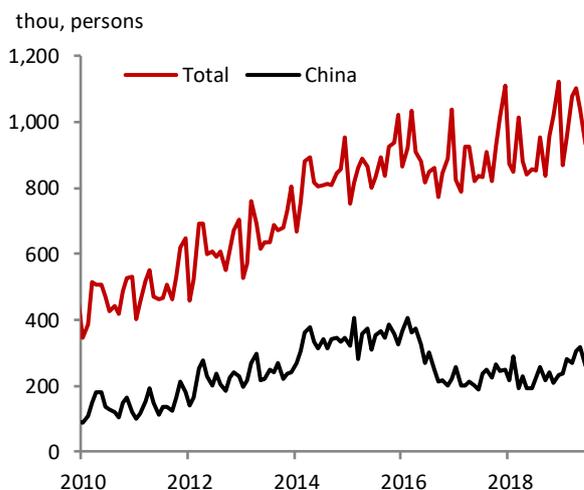


Source: CEIC, DBS

China's tourism ban on Taiwan

Adding to the trade war worries is the ongoing deterioration in cross-strait relations in the run-up to Taiwan's January 2020 presidential elections. Beijing suddenly announced last week to suspend a program that allows Chinese individual tourists from 47 mainland cities to travel to Taiwan, effective from August 1.

Taiwan: Visitor arrivals



Source: CEIC, DBS

Individual travel accounts for as much as 40% of the total number of Chinese tourists visiting Taiwan. And Chinese tourists contribute about 25% to Taiwan's total visitor arrivals. Hence,

China's tourism ban can cause a significant loss in Taiwan's tourism revenues. We estimate it to be 0.4% of GDP during the 2H19-2020 period.

The rise of MIT

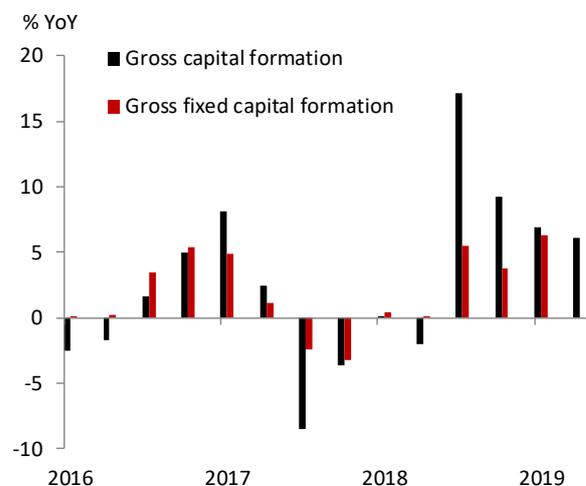
On the positive front, investment repatriation and trade diversion are proceeding faster than expected. After more than a decade of investment exodus and industrial hollowing out, "Made in Taiwan" (MIT) is coming back to the fore. On the one hand, the China-US trade war has boosted the need for the China-based Taiwanese firms to diversify their supply chains. On the other hand, the Taiwanese government has launched an "Invest Taiwan" campaign against the backdrop of trade war, proactively offering tax, rental, and financial incentives to lure companies to return to Taiwan to invest.

According to the Invest Taiwan Office, there have been investment applications from 102 Taiwanese firms with overseas operations so far this year (as of August 2), with the amount totalling TWD 504.7bn (2.8% of GDP). Assuming half of these figures are fresh investment and 70% will be realised over a three-year horizon, investment repatriation is expected to boost GDP growth by about 1ppt during the 2019-2021 period. Indeed, the actual investment indicators have started to pick up. Gross capital formation under the GDP account registered a strong 6.5% YoY growth in 1H19, well above the 10-year average of 2.2%. Gross fixed capital formation also grew a robust 6.3% YoY in 1Q19.

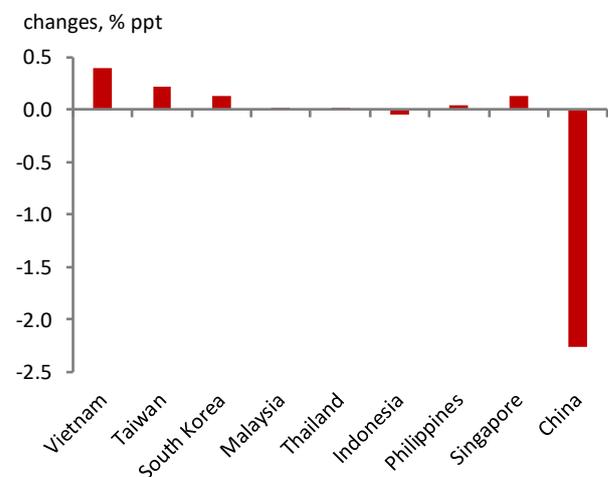
Reflected in trade figures, Taiwan's exports to the US have picked up notably, from an average of 8.2% YoY in 1H18 to 12.2% in 2H18-1H19. In the US's import market, Taiwan's share has risen from 1.8% in Jun18 to 2.1% as of Jun19. A 1ppt rise in exports to the US market is

estimated to boost Taiwan's total export growth by 0.1ppt, and GDP growth by 0.07ppt.

Taiwan: GDP - investment growth



Shares in the US's imports (Jun19 vs Jun18)



Source: CEIC, DBS

Forecast implications

Thanks to strong investment and better-than-expected export performance, the Taiwanese economy grew 2.1% YoY in 1H19, surprisingly outperforming South Korea (1.9%), Singapore (0.6%) and Hong Kong (0.6%). Notwithstanding the new headwinds from the escalation of trade war and deterioration in cross-strait ties, the tailwinds from investment repatriation and trade diversion appear strong enough to offset in the near term. We therefore maintain our GDP growth forecasts for 2019 and 2020, at

1.9% and 1.8%, respectively. Accordingly, we also expect Taiwan's central bank to keep the benchmark discount rate unchanged at 1.375% in 2H19-2020, refraining from joining the regional peers in easing monetary policy.

Recent publications

[Taiwan chartbook: Trade war's costs and silver lining](#)

[Impact of escalating trade war on Taiwan](#)

[Taiwan more vulnerable to tech war than South Korea](#)

[Taiwan: No recession, but tepid growth ahead](#)

[South Korea and Taiwan: Tentative signs of a bottom](#)

Group Research

Economics & Strategy Team

Taimur Baig, Ph.D.

Chief Economist - G3 & Asia

+65 6878-9548 taimurbaig@db.com**Chang Wei Liang**

Strategist

+65 6878-2072 weiliangchang@db.com**Nathan Chow**

Strategist - China & Hong Kong

+852 3668-5693 nathanchow@db.com**Masyita Crystallin, Ph.D.**

Economist - Indonesia & Philippines

+ 62 21 2988-4003 masyita@db.com**Joanne Goh**

Equity strategist

+65 6878-5233 joannegohsc@db.com**Eugene Leow**

Rates Strategist - G3 & Asia

+65 6878-2842 eugeneleow@db.com**Chris Leung**

Economist - China & Hong Kong

+852 3668-5694 chrisleung@db.com**Ma Tieying, CFA**

Economist - Japan, South Korea & Taiwan

+65 6878-2408 matieying@db.com**Radhika Rao**

Economist - Eurozone & India

+65 6878-5282 radhikarao@db.com**Irvin Seah**

Economist - Singapore, Malaysia, & Vietnam

+65 6878-6727 irvinseah@db.com**Duncan Tan**

Strategist - ASEAN

+65 6878-2140 duncantan@db.com**Samuel Tse**

Economist - China & Hong Kong

+852 3668-5695 samueltse@db.com**Philip Wee**

FX Strategist - G3 & Asia

+65 6878-4033 philipwee@db.com

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

Disclaimer:

The information herein is published by DBS Bank Ltd and PT Bank DBS Indonesia (collectively, the "DBS Group"). It is based on information obtained from sources believed to be reliable, but the Group does not make any representation or warranty, express or implied, as to its accuracy, completeness, timeliness or correctness for any particular purpose. Opinions expressed are subject to change without notice. Any recommendation contained herein does not have regard to the specific investment objectives, financial situation & the particular needs of any specific addressee. The information herein is published for the information of addressees only & is not to be taken in substitution for the exercise of judgement by addressees, who should obtain separate legal or financial advice. The Group, or any of its related companies or any individuals connected with the group accepts no liability for any direct, special, indirect, consequential, incidental damages or any other loss or damages of any kind arising from any use of the information herein (including any error, omission or misstatement herein, negligent or otherwise) or further communication thereof, even if the Group or any other person has been advised of the possibility thereof. The information herein is not to be construed as an offer or a solicitation of an offer to buy or sell any securities, futures, options or other financial instruments or to provide any investment advice or services. The Group & its associates, their directors, officers and/or employees may have positions or other interests in, & may effect transactions in securities mentioned herein & may also perform or seek to perform broking, investment banking & other banking or financial services for these companies. The information herein is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation. Sources for all charts & tables are CEIC & Bloomberg unless otherwise specified.

DBS Bank Ltd., 12 Marina Blvd, Marina Bay Financial Center Tower 3, Singapore 018982. Tel: 65-6878-8888. Company Registration No. 196800306E.
PT Bank DBS Indonesia, DBS Bank Tower, 33rd floor, Ciputra World 1, Jalan Prof. Dr. Satrio Kav 3-5, Jakarta, 12940, Indonesia. Tel: 62-21-2988-4000.
Company Registration No. 09.03.1.64.96422.