Economics

DBS Flash

Taiwan vs Hong Kong: outperformer vs underperformer

Economics/Taiwan/Hong Kong/Growth

Group Research

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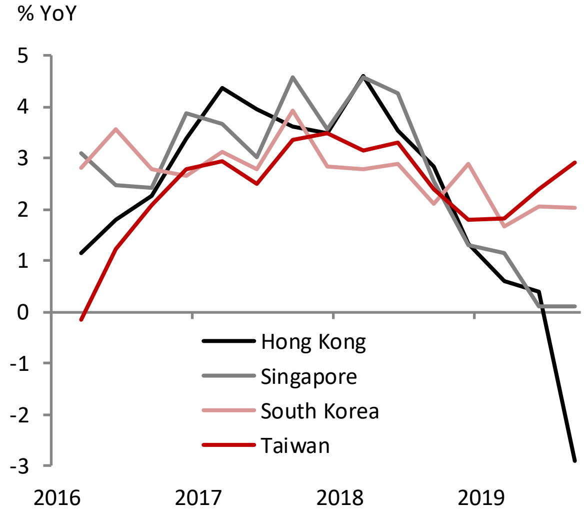
Asian NIEs: GDP growth



Sources: CEIC, DBS

- ***Taiwan**'s third quarter GDP beat consensus and our forecasts, recording a decent 2.9% YoY growth*

- *The island has started to benefit from the trade diversion and investment repatriation effects of the China-US trade war; the electronics sector is also showing signs of bottoming-out*

- *In contrast, **Hong Kong** entered a technical recession in 3Q with GDP contracting sharply by -2.9% YoY*

- *The city's growth performance is dragged by both consumption and exports, amid political uncertainties and lingering China-US trade tensions*

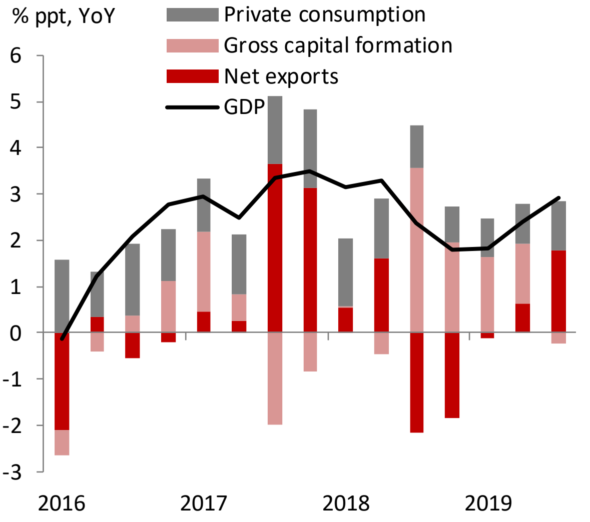
- ***Implication for our forecasts**: We are revising up Taiwan's GDP growth forecasts for 2019-20, to 2.3% (vs 1.9%) and 2.0% (vs 1.8%), respectively*

  Hong Kong's GDP estimate for 2019 is downgraded further to -1.7% from 0%. The 2020 forecast is revised up to 1.5% from 0.5%, to reflect the low base effect

Taiwan

GDP growth rose 2.9% YoY in 3Q, faster than the 2.4% in 2Q and beating the consensus / our forecast of about 2.5%. With growth averaging 2.4% in 1Q-3Q, Taiwan clearly outperformed its regional peers including South Korea (1.9%), Singapore (0.4%), and Hong Kong (-0.6%) so far this year. In contrast, Taiwan's growth was the slowest among the Asian NIEs through the past four years from 2015 to 2018.

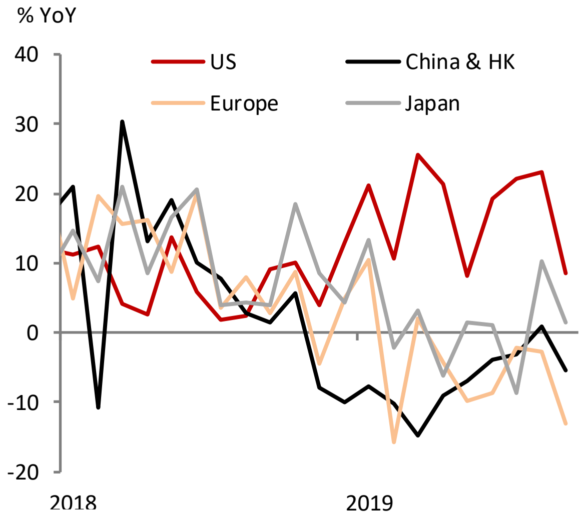
Taiwan: GDP growth & contributions



Sources: CEIC, DBS

The economy may have started to benefit from the trade diversion and investment repatriation effects of the China-US trade war. Exports of goods and services grew 4.2% YoY in 3Q, the second consecutive quarter of solid gains. And the rise was mainly driven by exports to the US market (18.0%, in nominal terms). Gross capital formation slipped 1.0% in 3Q, but this came after two quarters of very strong expansion (7.4% in 1Q, 5.9% in 2Q). According to the Invest Taiwan Office, the mainland-based Taiwanese manufacturers have continued to expand the onshore investment activities, in a bid to diversify the supply chains and avoid the US tariffs imposed on China-made products. The total amount of investment repatriation has risen further to TWD620bn as of late-October.

Taiwan: Exports by market

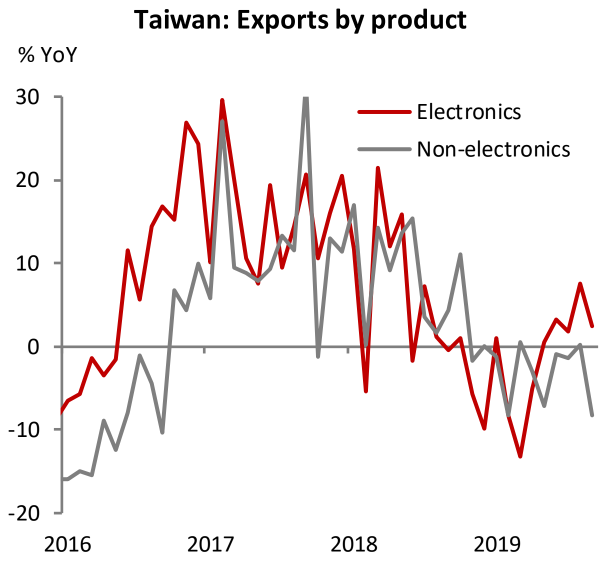


Sources: CEIC, DBS

Cyclically, the electronics sector has showed some signs of bottoming out. The rise in goods exports in 3Q was largely driven by electronic components (3.9% YoY, in nominal terms). It was reported that orders from the Apple supply chain have started to pick up, as the new iPhone 11 products received better-than-expected demand worldwide, thanks to the more competitive pricing strategy. Meanwhile, the 5G related demand appears to have kicked in. TSMC recently announced to increase its capex plan to USD14bn-15bn for 2019 (vs the previous estimate of USD11bn), citing stronger-than-expected growth in the 5G smartphone market.

Looking ahead, investment repatriation and trade diversion are likely to be sustained next year. Regardless of a so-called Phase 1 trade deal between China and the US in the near term, the two countries' conflicts on thorny issues like industry subsidies and cybersecurity will likely remain in place for years. The lingering uncertainties in China-US relations would continue to prompt Taiwanese manufacturers to diversify their supply chains.

Whether the electronics sector can sustain a recovery is a bigger question mark. The overall global demand outlook remains weak, given the risk of US/China slowdown in 2020 and the unresolved trade tensions between the world's largest economies. Note that smartphones have been spared from the US tariffs so far, as Washington has postponed a planned 15% tariff on the China-made electronics products from September to December. Whether these tariffs will be further postponed/cancelled still depends on details of the Phase 1 trade deal.



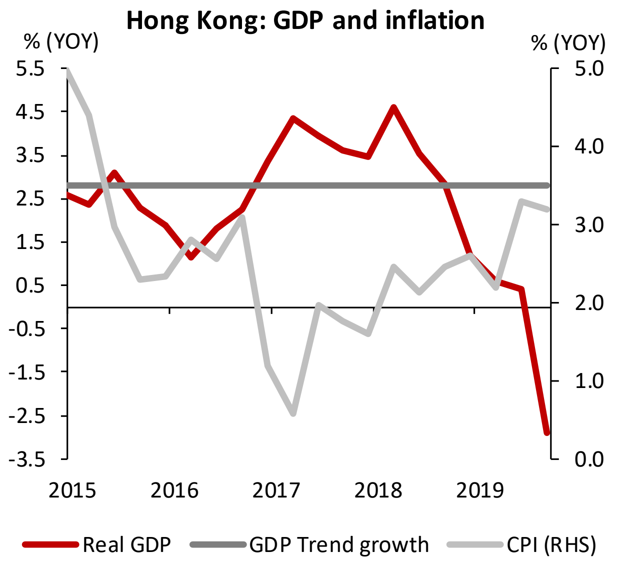
Sources: CEIC, DBS

Considering all, **we are revising up Taiwan's 2019-20 GDP growth forecasts modestly, to 2.3% (vs 1.9%) and 2.0% (vs 1.8%),** respectively.

Ma Tieying

Hong Kong

We have further downgraded Hong Kong's GDP growth forecasts to -1.7% from 0% for 2019. Due to the low base comparison this year, we revised up our forecast for 2020 from 0.5% to 1.5%. Advance estimate on the 3Q19 real GDP growth was -2.9%, the first YoY decline since the Global Financial Crisis in 2008-2009. On a sequential basis, it contracted by 3.2% after recording a 0.5% drop in 2Q. **Hong Kong has entered technical recession.**

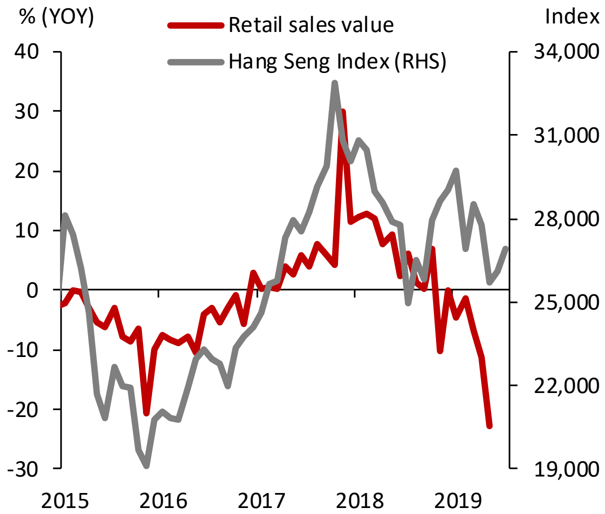


Source: CEIC, DBS

Third quarter performance was dragged by the subdued local consumption sentiment. Private consumption expenditure, which accounts for over 60% of the city's economic activities, plunged by 3.5% amid political uncertainties. Shops have not been able to operate over the weekend. This was again the first negative reading since the Global Financial Crisis. Consumer confidence was further affected by the negative wealth effect from volatile stock market.

A pro-longed domestic unrest will eventually feed through to the labour market. The unemployment rate of consumption and tourism related sectors (16.5% of labour force) already leapfrogged from 3.9% in 2Q19 to 4.9% in 3Q19, lifting the headline jobless rate from its 20-year low of 2.8% to 2.9%. Yet, we do not expect the unemployment rate to rocket due to shortage of labour amid aging population. Also, retail premise owners may offer temporary rental adjustments for tenants. The risks of large-scale closure of businesses and laid-off are limited.

Hong Kong: Retail Sales and Hang Seng Index



Source: CEIC, DBS

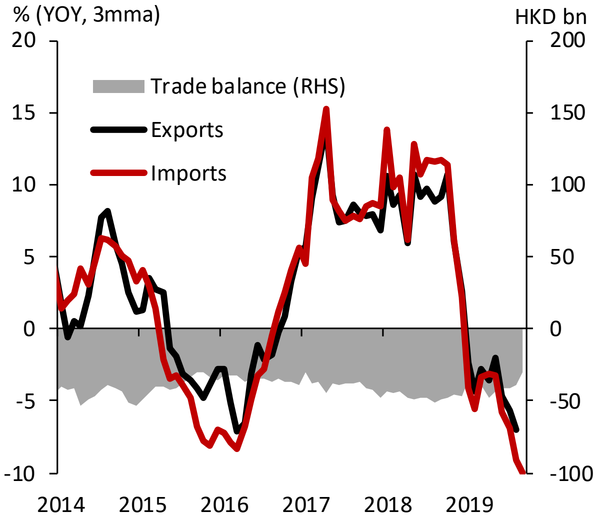
Hong Kong's economic condition remains clouded by the lingering trade tensions between China and the US, Hong Kong's top two export destinations. Merchandise exports have contracted 11 straight months since November 2018. By country, outward shipment to the US and China fell 24.3% and 4.6% in September respectively. Outward cargoes to other advanced economies (EU: -16.6%; Japan: -4.1%) and emerging markets (ASEAN: -2.0%; India: -10.8%) were also sluggish alongside easing global demand.

Mirroring the conflicts over tech products between China and the US, re-exports of machinery and transport equipment contracted by 5.4% in September. This was the 8th consecutive decline. Trade finance continued to shrink (-2.1%) despite a low-base comparison (September 2018: -0.6%), pointing to weak business confidence in the external sector.

Against this backdrop, exports of services recorded double-digit decrease of -13.7%. The Hong Kong stock market was volatile in the quarter. Cross-border financial activities decelerated, thereby affecting the transport, financial and other business services sectors.

Exports of travel services and visitor spending were also dampened by a weaker Chinese yuan and domestic instability. Retail sales dropped by 23% in August, with tourist spending accounting for 40% of the sector's performance. In fact, visitor arrivals slumped by 39.1% and 34.2% in August and September respectively. Tourists' hot picks such as clothing, jewellery, as well as cosmetics/medicines fell by over 30%.

Hong Kong: Merchandise trade statistics

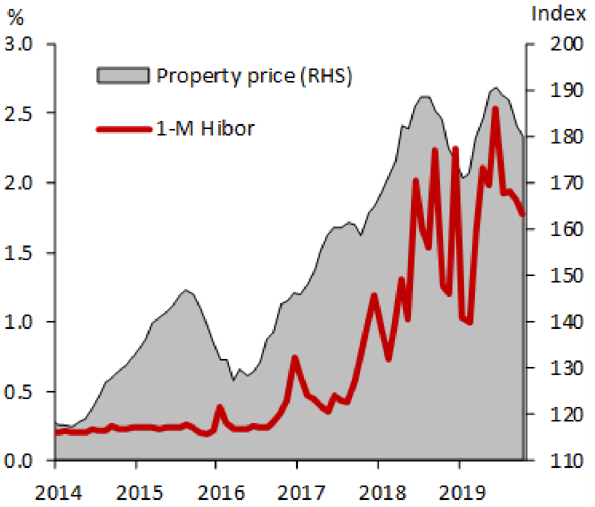


Source: CEIC, DBS

Gross domestic fixed capital formation decelerated further to a new decade low of -16.3% in 3Q19 from -10.8% in 2Q19. The pessimistic investment sentiment indicated a weak business expectation. The PMI only improved slightly to 41.5 in September after falling to the historical low of 40.8 in August. The residential property market consolidation also dragged the investment performance. In fact, Centaline Property Centa-City Leading Index fell by 5.1% after hitting the new record high in June.

Yet, there will be a rebound in property price despite economic recession. The global monetary easing condition, the latest Prime Rate cut, and HKMA's Countercyclical Capital Buffer cut will render some support to the asset prices. More importantly, transaction rebounded (that of Centaline 10 major properties up 29.4% m-o-m in October) shortly after the announcement of Chief Executive Carrie Lam's Policy Address. With the raised cap on the value of properties under the Mortgage Insurance Programme, potential home owners could access the property market with higher leverage and weaker stress test requirements. Also, the land supply policies such as Use of Lands Resumption Ordinance and Lantau Tomorrow (artificial island for 1.1mn population) remains as medium-long term solutions. Residential price is set to rise.

Hong Kong: Property price and HIBOR



Source: CEIC, DBS

On the monetary front, capital outflows remained manageable. Although M2 growth has slowed to 1.9% in end of 3Q from 3.5% in June, HKD deposits reversed the m-o-m drop of 1.6% in August to advancement of 0.6% in September. 1M HIBOR also hovered at 1.5%-1.9% in October. Both USD/HKD spot and its 12M forward outright were still well within the 7.75-7.85 convertibility band. Also, **Hong Kong is well-positioned to safeguard its HKD peg.** The Exchange Fund is substantial at USD530bn or more-than-double of the monetary base**.**

CPI inflation edged down from 3.5% in August to 3.2% YoY in September. Yet, this remained as a relatively high level. Food price continued to record double-digit growth of 13.1% from increased pork (swine fever), beef, chicken and lamb (through substitution effect) prices in China. Against a weaker growth outlook alongside insufficient stimulus package (HKD21bn, or 0.7% of GDP), **stagflation risk is emerging**.

Samuel Tse

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