DBS Focus

Taiwan: AI cycle and 2H outlook

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- *AI remains the central theme shaping the 2H26 economic outlook, particularly for technology-oriented economies such as Taiwan.*
- *The AI outlook is balanced between strong structural optimism and rising cyclical caution.*
- *Our monitoring indicators suggest that the AI supercycle is approaching a peak*
- *Notably, the semiconductor industry's current robust growth is being driven primarily by higher chip prices rather than stronger shipment volumes.*
- *Taiwan is expected to maintain above-trend growth through 3Q26, before economic growth begins to normalize from 4Q26 onward.*
- *Inflation is likely to remain sticky, reflecting delayed cost pass-through and recovering domestic demand.*
- ***Forecast implications:** We maintain our 2026 GDP growth forecast at 9.4% and adjust our 2027 forecast to 4.5%.*
- *We also revise up our CPI inflation forecasts to 2.0% for 2026 and 2.1% for 2027.*

Global backdrop

The global economy recorded steady growth with only a moderate increase in inflation during the first half of 2026. Although tensions in the Middle East triggered an energy shock, its impact was largely offset by the AI supercycle, which continued to support global trade, business investment, and household wealth.

Looking ahead to the second half of 2026, global growth is expected to moderate while inflation remains elevated. The AI supercycle appears to be approaching its peak, while the lingering effects of the earlier energy shock are likely to continue constraining growth and keeping inflationary pressures elevated.

Evidence suggests that the AI supercycle is entering a more mature phase. Recent developments indicate that growth in the semiconductor industry is increasingly being driven by higher chip prices rather than expanding shipment volumes. At the same time, the AI boom is contributing to inflationary pressures through several channels. Rising chip prices have increased production costs for consumer electronics, while substantial bonus increases announced by major semiconductor firms have raised concerns that stronger wage demands could spread to other industries, lifting inflation expectations. Meanwhile, the continued rally in global technology equities has boosted household wealth and consumer spending, reinforcing demand-driven inflationary pressures.

The effects of tensions in the Middle East are also expected to persist. Although oil prices have eased following the US-Iran ceasefire agreement in June, uncertainty remains over its implementation, particularly amid renewed conflict in recent days. Even if peace is maintained, energy logistics and supply chains are likely to require several months to fully normalise. Moreover, earlier increases in upstream energy and raw material costs have yet to be fully passed through to downstream prices, suggesting that additional inflationary pressures could still emerge in the coming months.

Trade policy remains another key source of risk to the global growth and inflation outlook. The US is expected to introduce a new package of Section 301 tariffs after the temporary Section 122 measures expire on 24 July. The proposed package is expected to include a forced-labour-related Section 301 tariff of 10–12.5%, covering approximately 60 economies, alongside an overcapacity-related Section 301 action affecting 16 economies, with differentiated tariff rates still under discussion. While the forced-labour-related measures are expected to largely replace the expiring Section 122 surcharge, the overcapacity-related measures could have more significant sectoral implications, particularly for steel, batteries, solar products, semiconductors, and automobiles. These tariffs could further disrupt supply chains, dampen trade, and add to inflationary pressures.

AI cycle

AI remains the central theme shaping the 2H26 economic outlook, particularly for technology-oriented economies such as Taiwan.

Structural optimism remains intact. **Current AI technology is still likely to be in its early stages of development.** While the first wave of adoption has been driven primarily by generative AI models, the next phase could be powered by broader capability expansion through agentic AI and physical AI. These technologies have the potential to extend AI adoption beyond content generation into autonomous workflows, enterprise automation, industrial applications, and robotics.

AI investment is also being supported by strategic considerations. Governments, hyperscalers, and enterprises face strong incentives to build AI capabilities. Competitive dynamics and geopolitical rivalry could therefore sustain AI-related capital expenditure, even if near-term monetisation remains uncertain.

Cyclical caution, however, remains warranted. Monetisation is the biggest uncertainty facing the AI cycle. The key unanswered question is whether future demand will be sufficient to justify the current pace of investment. While leading AI developers such as OpenAI and Anthropic remain private, major technology companies including Microsoft and Alphabet (Google) do not separately disclose AI-related revenue. As a result, investors still lack visibility into a fundamental question: how many enterprises and consumers are willing to pay for AI services, and whether such demand can ultimately support current investment levels. If commercialisation progresses more slowly than expected, excess capacity and capital misallocation could become significant risks.

The AI investment cycle is also becoming increasingly dependent on external financing. Companies are relying increasingly on debt markets and structured financing to fund large-scale infrastructure expansion, while equity valuations have become more stretched. Tighter liquidity conditions and more restrictive financial conditions could create a negative feedback loop by slowing investment and increasing financial stress among highly leveraged participants. The IMF has highlighted neocloud providers as particularly vulnerable due to elevated leverage and weaker balance-sheet resilience (here).

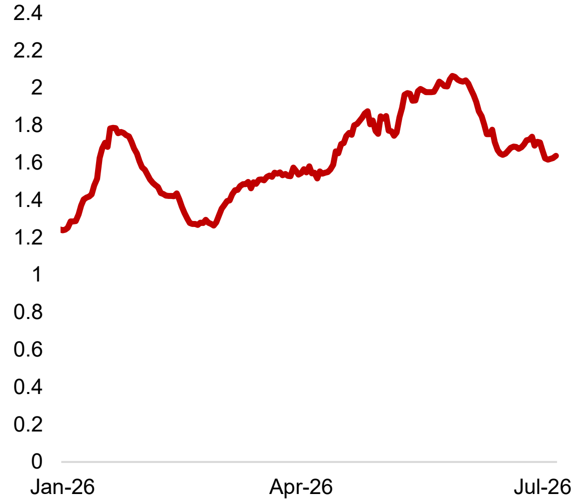
Physical constraints may also become increasingly binding. The AI expansion cycle faces real-world bottlenecks, including electricity availability, land supply, and infrastructure capacity. Rapid growth in data-centre electricity demand is placing increasing pressure on power systems, while concerns over grid stability, environmental impacts, and AI-related labour displacement are gradually moving from public debate into policy discussions. This could increase regulatory uncertainty surrounding future data-centre expansion and potentially constrain the pace of AI infrastructure investment.

We monitor the AI cycle across three layers: AI token usage, hyperscaler capital expenditure, and semiconductor demand and supply. These indicators suggest that the momentum of the AI super-cycle is approaching a peak.

AI token usage: The Silicon Data LLM Token Expenditure Index has declined by 20% from its peak at the end of May. One interpretation is that enterprises are becoming more cautious, reducing AI budgets and delaying deployment, which would imply slower demand growth ahead. A more constructive interpretation is that companies are improving AI efficiency. The shift toward lower-cost models, open-source alternatives, and declining cost per token could allow overall AI utilisation to continue expanding even as measured token expenditure declines.

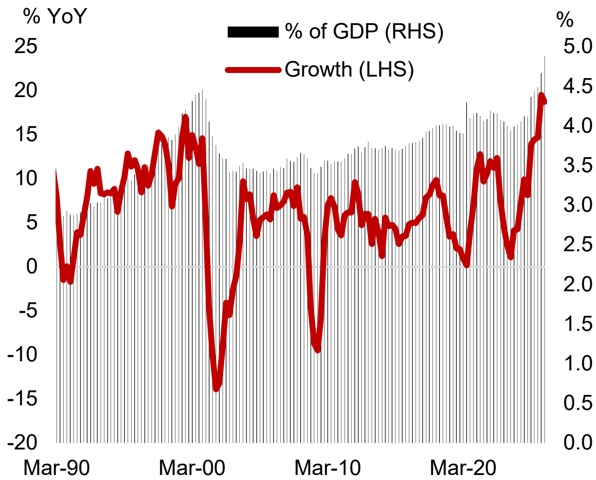
Hyperscaler capital expenditure: US private investment in information-processing equipment and software remains on a strong expansion path, with growth approaching 20% yoy in 1Q26. As a share of US GDP, investment has risen to around 5%, surpassing the peak levels reached during the late-1990s technology boom.

Silicon Data LLM token expenditure index



Sources: Bloomberg, DBS

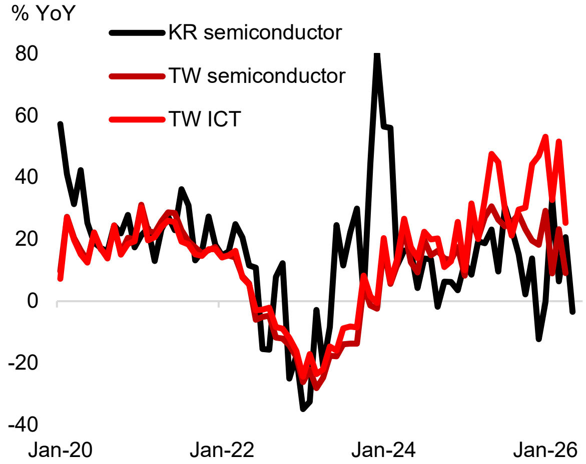
US: Private fixed investment - Information processing eqpt & software



Sources: CEIC, DBS

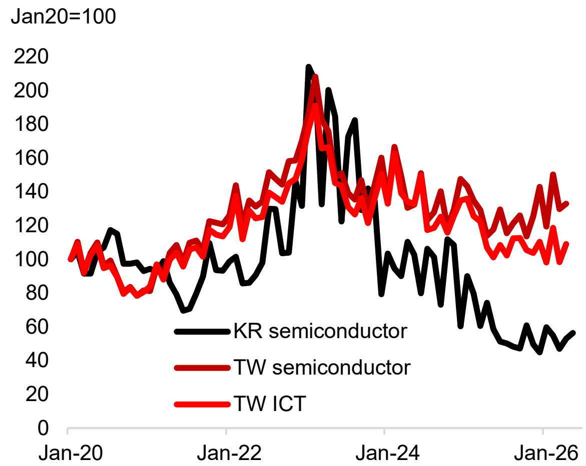
Semiconductors: Global semiconductor sales have continued to accelerate, reaching approximately 100% yoy growth in April and exceeding the peak growth rates observed during the 1990s semiconductor cycle. However, after adjusting for price effects, semiconductor shipments from South Korea and Taiwan have shown early signs of moderation, suggesting that underlying volume growth may be slowing. Inventory conditions remain relatively healthy. Taiwan's ICT inventory-to-sales ratio remains close to historical averages, while semiconductor inventory ratio in South Korea continues to decline. These trends suggest that the industry has not yet entered a broad-based inventory correction.

South Korea & Taiwan: Semiconductor/ICT shipments



Sources: CEIC, DBS

South Korea & Taiwan: Semiconductor/ICT inventory to shipment ratio

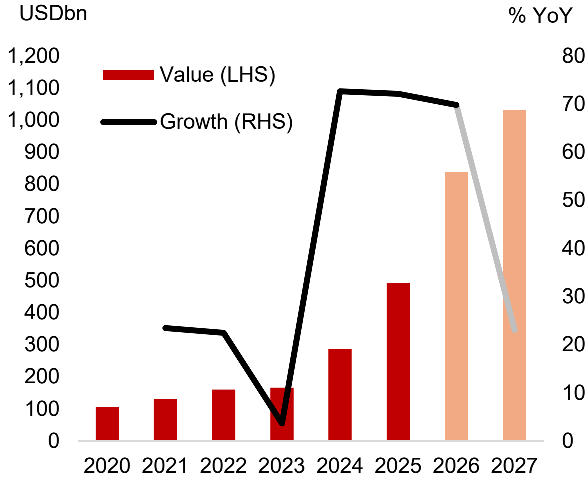


Sources: CEIC, DBS

Outlook: Global hyperscaler capital expenditure is expected to remain exceptionally strong in 2026 before gradually normalising in 2027. According to Bloomberg and TrendForce estimates, aggregate spending could reach approximately USD830 bn in 2026, representing a third consecutive year of around 70% yoy growth. Spending is expected to exceed USD1 tn in 2027, while growth momentum is projected to moderate to around 23%.

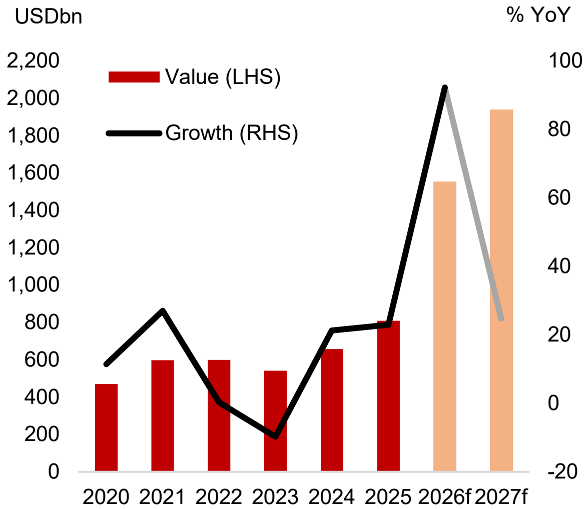
The global semiconductor market is expected to follow a similar cyclical pattern. WSTS forecasts global semiconductor sales to reach approximately USD1.5 tn in 2026, representing around 90% yoy growth, before increasing toward USD1.9 tn in 2027 as growth moderates to approximately 27%. Gartner's projections broadly support a similar trajectory, pointing to continued expansion but a transition toward a more mature phase of the cycle.

Global hyperscaler capex



Sources: Bloomberg, DBS

Global semiconductor market



Sources: Gartner, DBS

Taiwan 2H Outlook

Taiwan entered 2026 with exceptionally strong economic momentum. Growth in 1H26 remained robust as the AI super-cycle continued to support exports, investment, and corporate activity. Inflation rose only modestly, with energy-related pressures largely contained by government subsidies.

Looking ahead to 2H26, we expect Taiwan to maintain above-trend growth through 3Q26 before activity begins to normalize from 4Q26 onward. Inflation is likely to remain sticky, reflecting delayed cost pass-through and improving domestic demand.

We maintain our 2026 GDP growth forecast at 9.4% and adjust our 2027 forecast to 4.5% from 3.5%. On a quarterly basis, GDP growth is expected to remain around 10% yoy in 3Q26 before moderating to a more sustainable pace of around 4% yoy from 4Q26 onward.

Exports have approached a cyclical peak. Real export growth moderated in 2Q26, although nominal exports remained exceptionally strong due to elevated semiconductor prices. US-bound exports, which are closely linked to AI demand, have shown clear signs of cooling, while stronger shipments to ASEAN economies have provided a partial offset. ICT exports are also beginning to normalize, whereas traditional manufacturing exports have improved modestly.

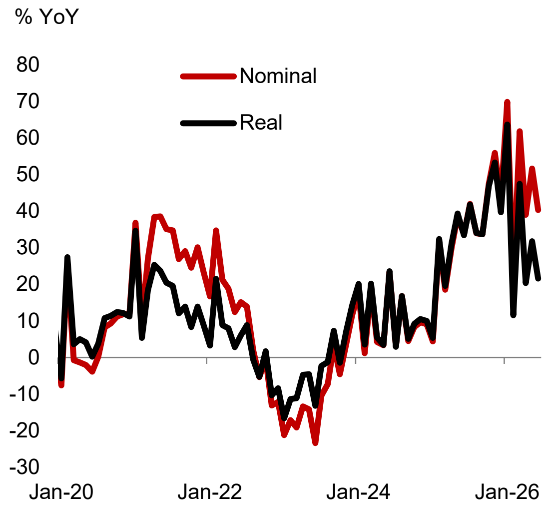
Investment has also approached a cyclical peak. Machinery investment, as measured by capital goods import growth, moderated in 2Q26, suggesting that firms expanded advanced foundry and advanced packaging capacity at a more measured pace. Meanwhile, construction-related investment indicators—including building permits and construction lending—remain weak and are unlikely to recover meaningfully in the near term, as the residential property market continues to consolidate under the central bank's credit controls.

Consumption has room to recover. Household spending on goods and services improved in 2Q26, as reflected in retail sales and food and beverage sales. A steady labour market, a stabilizing housing market, and accumulated equity-price gains should continue to support household spending through income and wealth effects.

Taiwan: GDP growth

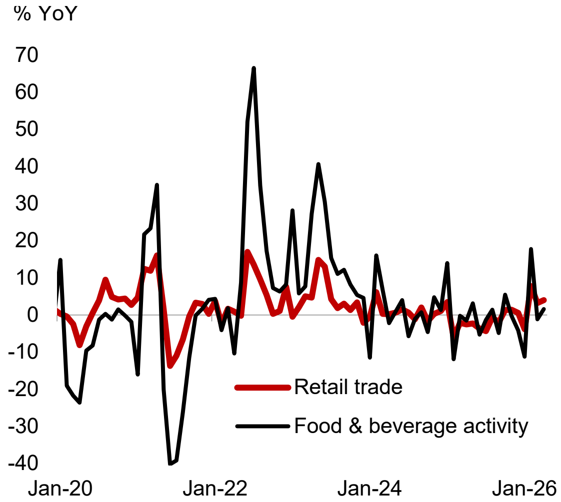
Sources: CEIC, DBS

Taiwan: Export growth



Sources: CEIC, DBS

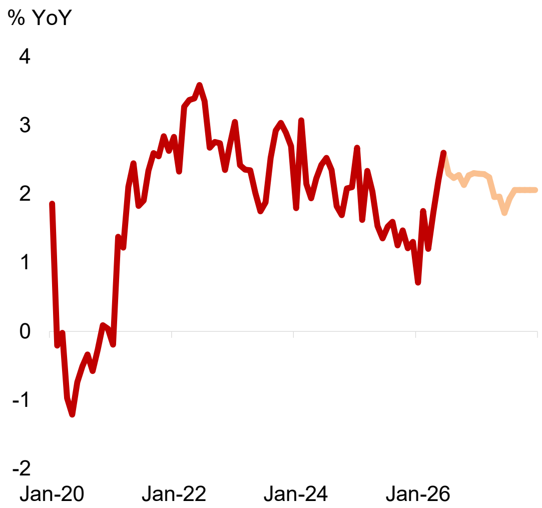
Taiwan: Consumption indicators



Sources: CEIC, DBS

We revise up our 2026–2027 CPI inflation forecasts to 2.0% and 2.1%, respectively, from 1.9% and 1.8%. Inflation is expected to remain close to 2% through 2H26 and into 2027. Energy-related inflation stemming from Middle East tensions should persist, with delayed cost pass-through keeping consumer prices elevated in the coming months. Extreme weather conditions associated with El Niño are expected to contribute to heightened food price volatility in 2H26. Over the medium term, tight labour-market conditions, asset-price gains, and a recovery in domestic demand should gradually lift inflation expectations and contribute to firmer inflation in 2027.

Taiwan: CPI inflation



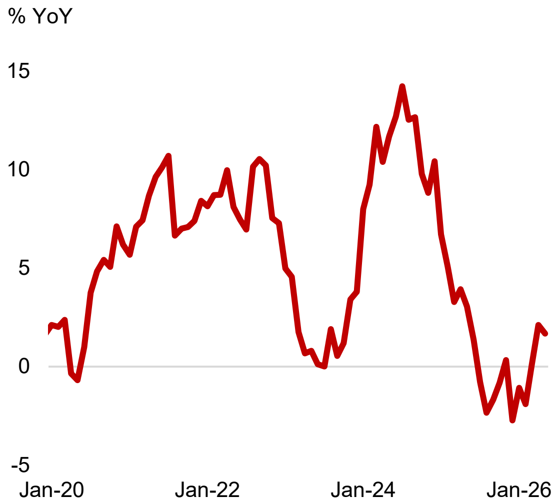
Sources: CEIC, DBS

The labour market should remain steady. The unemployment rate remained around 3.3% in 2Q26, while regular wage growth held at 2.5%–3.0% yoy. Strong economic growth should continue to support employment and wages, but the overall impact is likely to remain moderate given that ICT manufacturing accounts for less than 10% of total employment. Unlike South Korea, where semiconductor companies distribute sizeable employee bonuses, Taiwanese firms retain a larger share of earnings to finance future investment.

The property market is expected to continue consolidating through 2H26. Housing transactions and prices improved modestly in 2Q26. The government's new subsidy programme for first-time homebuyers, scheduled to begin in August, should provide some support to housing demand. Nevertheless, the central bank is expected to maintain existing loan-to-value restrictions—including a 60% cap for second homes and a 30% cap for third homes and high-value properties—amid lingering concerns over housing affordability and the concentration of real estate lending.

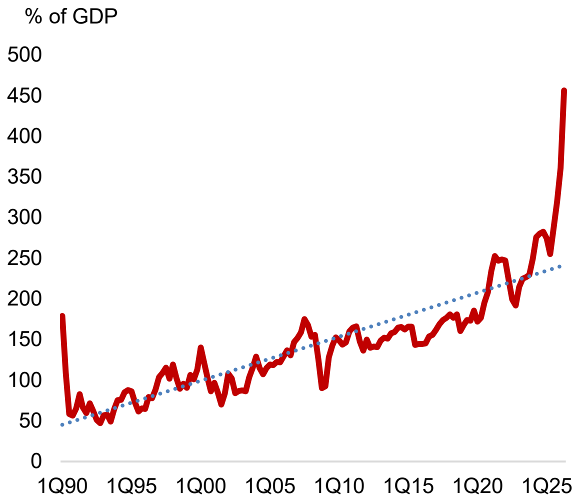
The equity market is increasingly exposed to overheating risks. Taiwan's stock market capitalization exceeded USD5tn in late May, making it the world's fifth-largest equity market. Market capitalization now exceeds 450% of nominal GDP, while average price-to-earnings ratios have risen to around 30x. Retail investor participation and leverage have also increased significantly. Monthly new trading account openings exceeded 100,000 during the first half of 2026, while margin financing balance surpassed TWD700 bn in May, roughly 60% above December 2025 levels. These conditions increase the market's sensitivity to shifts in investor sentiment and liquidity conditions.

Taipei: Sinyi residential property prices



Sources: CEIC, DBS

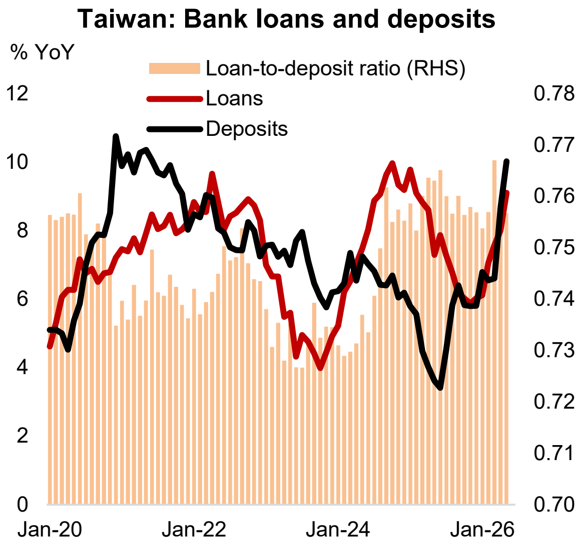
TWSE market cap



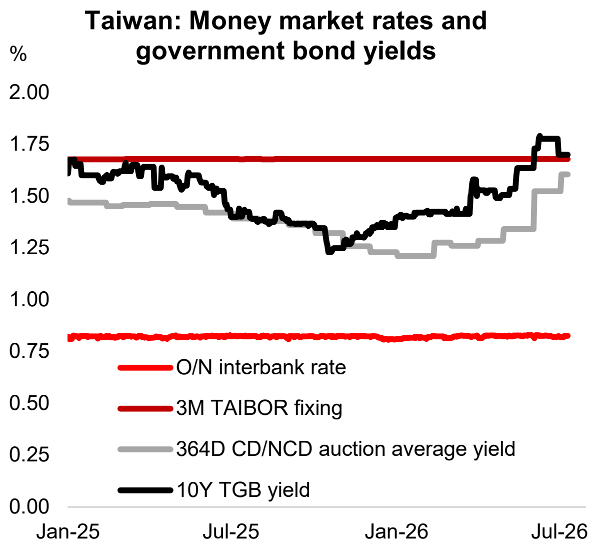
Sources: CEIC, DBS

The credit cycle still has room to strengthen. Historically, loan growth tends to lag GDP growth by two to three quarters. Bank lending accelerated to around 9% yoy in May. Corporate lending remains robust, driven by ICT firms financing AI-related investment and securities firms expanding margin financing amid buoyant equity-market activity. Consumer lending is expected to remain relatively stable, as housing mortgage growth continues to be constrained by macroprudential measures.

Monetary policy is expected to shift toward modest tightening. Financial conditions have already tightened through market channels, with robust loan growth and buoyant equity markets contributing to higher money market rates and government bond yields. Policymakers are likely to monitor inflation and inflation expectations closely when assessing the appropriate monetary policy stance. In addition to maintaining existing macroprudential measures on housing lending, policymakers could introduce measures aimed at containing leverage in equity markets.



Sources: CEIC, DBS



Sources: Bloomberg, DBS

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