

Taiwan Business Forecast Report Q2 2014

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Abstracts

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Core Views

Taiwan's economy accelerated strongly in Q413, leading the island to record a full-year 2013 real GDP growth of 2.2%, marginally eclipsing our forecast of 2.1%. While we remain constructive on economic momentum in the coming quarter, we remain less upbeat on Taiwan's growth trajectory through 2014. We expect the economy to face key downside risks from a slowing Chinese economy, as well as a possible correction within the local property market. We are happy to remain below consensus with our real GDP growth forecast for 2014 coming in at 3.0%, versus 3.5%.

While the Taiwanese dollar has lost 3.4% of its value since the selloff which began in October 2013 and 1.5% since the start of 2014, it appears to have found some measure of stability in recent trading sessions. We expect the unit to trade between the range with resistance at the TWD30.20/US\$ level and support at the TWD30.70/US\$ level. We are forecasting the currency to average TWD30.50/US\$ in 2014 before ending the year at TWD30.70/US\$. Taiwan's biggest long-term political challenge is managing its deepening economic ties with mainland China, so that it retains its de facto political independence. Beijing appears to be pursuing the absorption of Taiwan by stealth, but this could yet lead to a backlash from Taiwanese voters.

Taiwan's property market appears to be moving in the opposite direction to the broader economy. Despite relatively sluggish economic performance over the past year, Taiwanese real estate continues to boom. We have highlighted before that property boom has not been backed by solid economic fundamentals and the continuing rise in prices merely makes our conviction stronger. With property demand expected to be hit by a weakening economy, while housing supply continues to increase, we believe that a

correction in the sector is only a matter of time.

Key Risks To Outlook

Downside Risks To Growth Forecast: Should we see a re-emergence of a crisis in the eurozone, or a downward spiral in China's economy, we can expect Taiwan to head into a sharp recession.

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Key Risks To Outlook

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Cross-Strait Relations: Deepening Political Ties The Next Major Step

Taiwan 's biggest long-term political challenge is managing its deepening economic ties with mainland China, so that it retains its de facto political independence. Beijing appears to be pursuing the absorption of Taiwan by stealth, but this could yet lead to a backlash from Taiwanese voters.

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Legal Status Quo To Prevail

Taiwan's long-term political prospects are inseparable from its relations with China, and while cross-Strait relations have thawed in recent years, we believe the status quo will largely prevail. While further economic integration is likely between the two Chinas, we exclude meaningful political convergence. Meanwhile, Taiwan extremely unlikely to regain internationally recognised independence. As a result, we believe Taiwan will remain in a political no-man's land – with this being the least worst path for political stability.

CHAPTER 2: ECONOMIC OUTLOOK

SWOT Analysis

BMI Economic Risk Ratings

Economic Activity

Near-Term Optimism To Reverse As 2014 Progresses

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Taiwan's growth trajectory through 2014. We expect the economy to face key downside risks from a slowing Chinese economy, as well as a possible correction within the local property market. We are happy to remain below consensus with our real GDP growth

forecast for 2014 coming in at 3.0%, versus 3.5%.

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Share Sales No Panacea Taipei's spending habits have been called into question yet again. In order to fund the 2014 budget deficit, the government will be selling some of the stakes it holds in a number of blue-chip companies and state-owned enterprises. The government has had to turn to such an avenue as public debt inches dangerously close to the statutory 40.6% of GDP level. This further reflects the fact that the government continues to struggle in its efforts to implement wide-ranging fiscal reforms that are sorely needed to prevent a further deterioration in public finances.

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Taiwan's property market appears to be moving in the opposite direction to the broader economy. Despite relatively sluggish economic performance over the past year, Taiwanese real estate continues to boom. We have highlighted before that property boom has not been backed by solid economic fundamentals and the continuing rise in prices merely makes our conviction stronger. With property demand expected to be hit by a weakening economy, while housing supply continues to increase, we believe that a correction in the sector is only a matter of time.

Currency Forecast

TWD: Weakness In Store, But Downside Capped

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A strong recovery from the global financial crisis by no means suggests that Taiwan's economy will maintain a robust growth trajectory going forward. We believe the lingering presence of the government within the banking sector, an increasingly uncompetitive tech sector, an overly tech-focused economy and the reluctance to speed up Chinese investment, will impede Taiwan's structural growth prospects. Moreover, a rigid labour

market, coupled with fast deteriorating demographics will serve to erode the attractive of Taiwan's business environment. Lastly, we expect the structural shift in China's economy to carry wide-ranging ramifications for Taiwan. We expect real GDP growth to average 3.9% between 2014 and 2023.

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