TAIWAN

ROBUST

The Taiwanese economy has been very resilient to the multiple external shocks of the past two years. The export sector has benefited greatly from the rise in global demand for high-tech goods. In addition, domestic demand has benefited from fiscal support and an accommodative monetary policy. In 2022, economic growth is constrained by many factors (the wave of Omicron in the spring, supply disruptions linked to the chaotic situation in China, rising inflation and monetary policy tightening, and a less favourable international environment). The economic growth slowdown may lead only to a limited deterioration in the quality of bank loans. Nevertheless, the real estate sector, after a sharp rise in prices since 2019, could see a correction.

The Taiwanese economy has once again proven its ability to withstand shocks over the past two years. Despite the Covid-19 pandemic, real GDP growth reached 3.4% in 2020, then jumped to 6.6% in 2021. External accounts, which were already very strong before the health crisis, have strengthened, and public finances have barely deteriorated.

In addition, medium-term growth prospects have improved compared to what they were at the end of the 2010s, thanks to government measures aimed at boosting the economy's competitiveness, an increase in the investment rate, and a solid potential for export expansion. However, in 2022, economic activity is likely to suffer from the consequences of the new waves of Covid-19 that have just hit the island and neighbouring countries, as well as from the deterioration of the international environment.

FORECASTS

	2019	2020	2021	2022e	2023e
Real GDP growth, %	3.1	3.4	6.6	3.5	3.0
Inflation, CPI, year average, %	0.6	-0.2	1.8	3.2	2.0
General government balance / GDP (%)	0.1	-1.0	-0.2	-1.0	-1.0
General government debt / GDP (%)	32.7	32.3	30.2	29.3	28.9
Current account balance / GDP, %	10.6	14.2	14.8	12.0	13.0
External debt / GDP, %	30.2	28.4	27.6	26.6	26.4
Forex reserves, USD bn	478	530	548	550	570
Forex reserves, in months of imports	17.4	20.8	16.2	13.9	13.5

TABLE 1
e: ESTIMATE & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

A STRONG RECOVERY IN 2021

In 2021, Taiwan's economic growth was driven by the sharp rise in industrial production and exports, accommodative monetary and fiscal policies, and the continued expansion of private investment. The latter was broad-based, with new investments favouring, in particular, industrial machinery and equipment, the expansion of the 5G network, and the transport and green energy sectors. Total investment rose 15.4% in real terms in 2021 and, by Q4 2021, was 19% above its pre-crisis level in Q4 2019.

The export sector has benefited greatly from the sharp rise in global demand for high-tech goods over the past two years. In particular, semiconductor companies (including Taiwan Semiconductor Manufacturing Co., the world's largest electronic chip manufacturer) have been able to increase production and sales amid a global shortage. In 2021, net foreign trade accounted for about a third of real GDP growth (chart 1). Total export receipts (in USD) grew by almost 30%, allowing Taiwan to continue to generate significant trade and current account surpluses (11.4% and 14.8% of GDP, respectively, in 2021).

The recovery in household demand has been much more subdued, despite government support measures. Private consumption fell by 2.5% in 2020 and did not increase in 2021 (-0.3%). It was kept back by the various waves of Covid-19 and the continuation of stringent mobility restrictions (the strictest lockdowns took place in the summer of 2021), which severely weakened household confidence. The absence of tourists has also had an impact on activity in the services sector for two years.

TAIWAN: ECONOMIC GROWTH SUPPORTED BY EXPORTS AND INVESTMENT

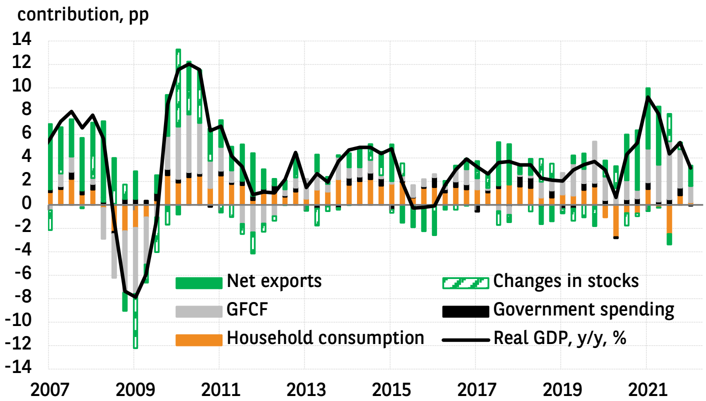

CHART 1
SOURCE: DGBAS, CEIC

MULTIPLE OBSTACLES IN 2022

The pandemic curve deteriorated again in spring 2022. The number of new Covid-19 cases skyrocketed in April and May, peaking at more than 80,000 cases per day in the last week of May (for a total population of 24 million). This wave, linked to the Omicron variant, partly resulted from the gradual abandonment of the zero-Covid strategy that had been followed by the authorities. This has been permitted by the improvement in the population's vaccine coverage (from 68% at the end of 2021 to 82% at the beginning of July, with 73% having also received a booster). Despite this change in strategy, mobility indicators fell in April-May, which weighed on activity, and retail sales in particular. Mobility indicators have improved gradually since the beginning of June, and private consumption should strengthen over the summer.

However, other obstacles are hampering economic growth, which is projected at 3.5% in 2022 as a whole. Real GDP growth slowed in Q1 2022 (+1.1% q/q compared to 2.4% q/q in Q4 2021) and could be negative in Q2 (q/q). It would only recover moderately in the second half of the year, against a backdrop of slowing global demand, rising inflation pressures and monetary tightening. Fiscal policy should, however, continue to support activity.

Taiwanese industry and exports were directly affected by the consequences of lockdowns in Shanghai and other Chinese industrial regions. Disruptions in goods transportation and value chains and the contraction in Chinese demand led to a slowdown in manufacturing production (+5.1% y/y in May 2022 compared to 9.2% in December 2021) and exports (+12.5% y/y in May compared to 23.3% in December). China accounts for around 30% of Taiwan's exports (and Hong Kong another 14%) and 22% of its imports.

Industry supply problems have started to ease with the (partial) lifting of mobility restrictions in China, but the Taiwanese export sector will remain held back in the short term by weakening global demand. The manufacturing PMI fell below 50 in June 2022 (to 49.8), for the first time since June 2020. In particular, it was affected by the drop (to 47.9) in the "new export orders" sub-component.

Indeed, given its high degree of trade openness and dependence on exports, the Taiwanese economy is exposed to the indirect repercussions of the war in Ukraine and its effects on global trade, value chains and commodity prices. The direct consequences of the conflict are very small, since the island's trade with Russia and Ukraine is extremely limited.

Finally, Taiwan has faced significant capital outflows since the beginning of the year: in addition to the withdrawal of portfolio investments felt by a majority of emerging markets, it has suffered from renewed concerns about tensions prevailing in the Taiwan Strait. The impact on financial variables has been significant (the Taiwanese dollar depreciated by more than 7% against the US dollar during H1 2022, and the main index of the Taipei stock exchange fell by almost 20%), but Taiwan's external liquidity position has remained intact and extremely robust.

MONETARY TIGHTENING IN PROGRESS

Consumer price inflation (CPI) has been rising for several months (+3.4% year-on-year in May 2022 compared to 2.6% in December 2021), mainly driven by the rise in food prices – which make up 24.8% of the CPI index and increased by 7.4% y/y in May (compared to 4.2% in December). Core inflation is barely accelerating (+1.7% y/y in May compared to 1.6% in December) and CPI inflation is not excessive. It is, however, at its highest level since 2008, and inflation expectations continue to deteriorate.

As a result, and like many other central banks, the Taiwanese monetary authorities have begun a tightening cycle. The main key rate, which had been kept at a historic low of 1.125% since the Covid-19 shock at the beginning of 2020, was raised to 1.375% in March and to 1.5% in June. Further hikes are expected from monetary policy committees over the next two quarters.

Lending rates have also increased as a result (chart 2), and growth in bank credit should slow in the short term. Growth in bank credit to the private sector has gradually strengthened since 2016, including over the last two years (growth in real terms reached 5.9% y/y in April-May 2022 compared to 3.9% in 2019). Bank credit to the private

TAIWAN: MONETARY POLICY TIGHTENING

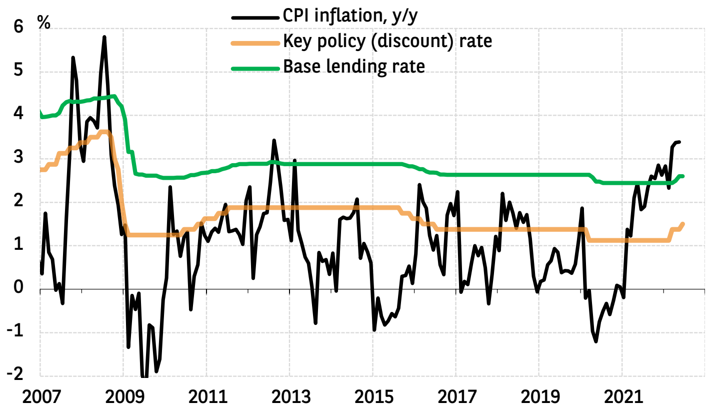

CHART 2 SOURCE: DGBAS, CBRC, CEIC

sector represented almost 160% of GDP in 2021, a relatively high level, and was distributed evenly between corporates and households. The tightening of lending conditions and the slowdown in activity could lead to a deterioration in the quality of the lending portfolio in the banking sector. In particular, the large exposure of banks to the real estate sector (around 40% of total loans) is a source of vulnerability, especially since prices, which rose sharply between Q4 2019 and Q1 2022 (+27%), could see a correction. Nevertheless, credit risks should remain largely under control. Firstly, the banking sector as a whole is robust, well capitalised and liquid. Secondly, the average quality of bank loans is very good, the result of prudent risk management policies (the average non-performing loan ratio is very low, at less than 0.2% since August 2021). Finally, the authorities have introduced macro-prudential measures since the end of 2020, which, in particular, have helped to limit speculative transactions on the property market and contain households' mortgage debt servicing burden.

Article completed on 5 July 2022

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