SOLID GROWTH IN A DIVISIVE CLIMATE

President Lai Ching-te took office on 20 May. He is expected to continue the domestic and foreign policy agenda of his predecessor, in a more tense climate. On the one hand, Beijing could increase its military manoeuvres around the island. On the other hand, Parliament is now dominated by opposition parties, which are expected to slow down or block many government projects. The new administration will at least be able to count on a favourable economic situation to start its mandate. Economic growth has been accelerating over the past year, driven by the rebound in the global electronics cycle. While Taiwan continues to maintain a very strong technological lead in the semiconductor industry, its manufacturing sector is experiencing changes related to the reorganisation of value chains in Asia.

NEW GOVERNMENT, NEW PARLIAMENT

On 20 May 2024, Taiwan's new President Lai Ching-te, of the Democratic Progressive Party (DPP), was appointed for a four-year mandate. His domestic and foreign policy agenda should be in keeping with that of his predecessor, Tsai Ing-wen, who came from the same party and remained in power for eight years. However, Lai Ching-te will have to deal with a much more tense climate. Firstly, while maintaining the official *status quo* in relations between Taipei and Beijing is the most likely scenario in the short term, pressure in the Taiwan Strait will remain intense. Beijing has increased the number of military exercises around the island in response to Lai Ching-te's offensive speech, and could gradually increase its intimidation tactics in the future. On the domestic front, the new government is expected to encounter significant difficulties in advancing its agenda, as the DPP lost the majority in Parliament[1] since the general election at the beginning of the year. The opposition parties could obstruct many projects, in a climate which may be, at times, chaotic, as recent incidents in Parliament suggest.

INDUSTRIAL ACTIVITY IS REBOUNDING

After a sharp slowdown in 2022 and early 2023, economic growth has recovered. It reached +1.3% in 2023 and +6.6% year-on-year (y/y) in Q1 2024, and is expected to be more than 4% on average this year (*chart 1*).

Taiwan enjoys a dominant position and a very significant technological advance in the semiconductor industry, which accounts for 39% of its total export goods and 34% of its industrial production. Economic activity is therefore highly dependent on the global electronic cycle. After reaching an all-time high at the beginning of 2022, export goods and industrial production contracted continuously from Q2 2022 to H1 2023 due, notably, to the turnaround in the electronic cycle. This momentum was then reversed again from summer 2023 onwards. Global semiconductor demand picked up, supporting the rebound in manufacturing production and exports. Taiwan's industrial production rebounded by +8.8% y/y over the first five months of 2024, after an average decline of -12.2% in 2023, and exports rose by +9.1% y/y in value over the same period (vs. -10% in 2023).

Growth in the industrial sector will remain strong in H2 2024, even though companies still have stocks to sell off. In fact, inventory levels in the manufacturing sector are still relatively high after more than a year of decline since the peak seen in Q1 2023. The global semiconductor demand forecasts for 2024 are favourable, especially in the AI and high-performance computer sector, which is particularly beneficial for Taiwan's factories.

FORECASTS

	2021	2022	2023	2024e	2025e
Real GDP growth, %	6.6	2.6	1.3	4.3	2.7
Inflation, CPI, year average, %	2.0	2.9	2.5	1.9	1.5
General government balance / GDP (%)	-0.2	0.2	-0.7	-0.6	-0.7
General government debt / GDP (%)	30.2	27.5	25.0	23.6	23.0
Current account balance / GDP, %	15.3	13.3	13.8	13.9	13.9
External debt / GDP, %	27.6	26.6	27.3	25.7	24.9
Forex reserves, USD bn	548.4	554.9	569.3	579.3	591.3
Forex reserves, in months of imports	18.5	16.5	19.4	18.7	18.3

e: ESTIMATES & FORECASTS

TABLE 1 SOURCE: BNP PARIBAS ECONOMIC RESEARCH

TAIWAN: ECONOMIC GROWTH RECOVERY

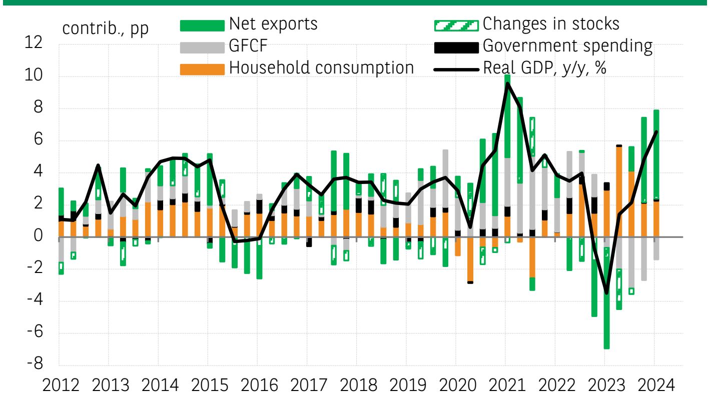

CHART 1 SOURCE: DGBAS, CEIC

REORGANISATION

Investment fell by 8.2% in real terms in 2023, driven by the drop in spending on machinery and equipment (-19.8%). This decline followed five years of sustained growth: the investment rate rose from 21.1% of GDP in 2017 to 28.1% in 2022, then to 25.5% in 2023. Investment suffered last year from the turnaround in the global electronics market, tighter financing conditions and concerns among entrepreneurs about the change of government in Taiwan and tensions with China.

1 The DPP now holds 51 seats in Parliament out of a total of 113 (previously 61), while the opposition party, Kuomintang, has 52 seats (previously 38) and the Taiwan People's Party has 8 seats. The remaining 2 seats are held by independents.

Investment continued to contract in Q1 2024 (-5.4% y/y), but is likely to recover soon, encouraged by the rebound in the electronic cycle.

However, other more structural causes explain the recent weakness of investment growth. In the period 2018-2022, the electronics industry in Taiwan strengthened its production capacities and position as a global leader in the highly sophisticated semiconductor industry. Its expansion was driven by the sharp increase in demand for electronic goods during the pandemic. In addition, trade tensions between the US and China have prompted some Taiwanese producers based in mainland China to relocate some of their business. They have invested in factories in other countries in the region, to benefit from lower production costs, but also in Taiwan - especially since financial and logistics support programmes have been put in place by the government. Since 2022, the geopolitical context has become more complex and the tech war between the US and China has intensified. Governments and multinationals have adopted de-risking policies, which aim to secure their production chains (including by immunising themselves against the potential repercussions of conflicts and Western sanctions against China) and their supply of strategic goods (including semiconductors and electronic equipment). This reorganisation of global production chains directly affects the manufacturing sector in Taiwan, given its specialisation and tensions in the Taiwan Strait. It could slow growth in domestic investment in the short and medium term. At the same time, there is little doubt that Taiwanese industry will be able to maintain its technological lead in microprocessors.

Changes in direct investment (DI) flows and the composition of exports reflect current adjustments. First, Taiwanese DI overseas rose sharply in 2023 (to USD 24.8 billion from USD 15.6 billion in 2022) and foreign DI in Taiwan fell slightly; as a result, net DI outflows (residents and non-residents) reached an all-time high of -USD 19 billion or -2.5% of GDP, compared to -0.7% on average in 2019-2022 (net DI flows are structurally negative and Taiwan is, overall, a net foreign creditor). Second, the composition of Taiwanese DI has changed: investment in China has been declining for several years, and the decline accelerated in 2023 (it represented 11% of total DI flows in 2023, compared to 33% on average in 2020-2022 and 50% in 2015). Conversely, Taiwanese DI in ASEAN countries and the US have increased at a steady pace.

Lastly, Taiwan's trade structure has also evolved as a result of the reorganisation of production chains, China-US tensions (which have led US importers to replace certain goods from China with goods purchased directly from Taiwanese producers), and the need for Taiwan to reduce its economic dependence on China. Over the first five months of 2024, exports from Taiwan to the US jumped +58% y/y and those to ASEAN-6 countries increased by 22%, while exports to mainland China and Hong Kong fell by 4%. The share of China and Hong Kong in Taiwan's total exports decreased from 43.9% in 2020 to 33.5% over the twelve-month period ending in May 2024; the share of ASEAN-6 countries increased from 15% to 18.3% (including 7.2% for Singapore) and that of the US from 14.6% to 20.6% (*chart 2*).

STRONG PRIVATE CONSUMPTION

Private consumption recovered from summer 2022 onwards, after a long period of health restrictions. Its growth reached a solid rate of +8.2% in 2023 (after +3.8% in 2022) and +4.4% y/y in Q1 2024.

TAIWAN: MAIN TRADE PARTNERS

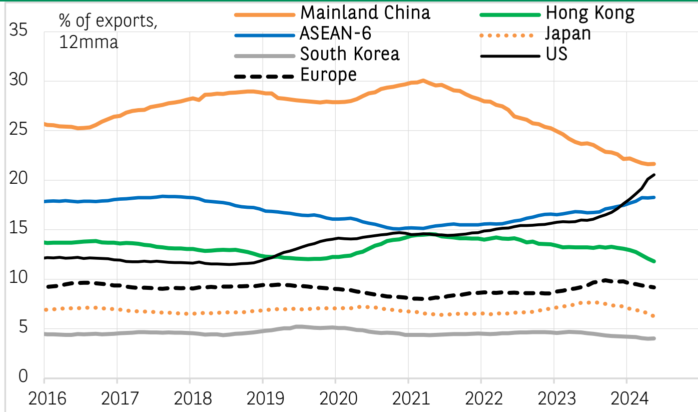

CHART 2 SOURCE: MINISTRY OF FINANCE, BNP PARIBAS

It was stimulated by government support measures, the recovery of the labour market in the wake of the rebound in manufacturing activity (the unemployment rate fell from 3.6% at the end of 2022 to 3.35% in May 2024), and positive wealth effects linked to rising prices of property and stock market assets. The property price index in Taipei was up +13.6% y/y in May 2024 and the TAIEX index rose 63% between December 2022 and June 2024, driven by high tech companies and breaking record highs for several weeks.

The recovery in tourism on the island from the end of 2022 onwards has also bolstered consumption. The number of visitors increased to 2 million in Q1 2024, but this figure remains 30% below pre-Covid levels in Q1 2019. This can be explained, in particular, by the slight uptick in the number of tourists from mainland China, who accounted for 38% of total visitors in 2018, but only 20% in Q1 2024.

Growth in private consumption will slow in the short term. There are still some supporting factors, in particular the good conditions on the labour market. However, tensions in the Taiwan Strait should prevent a more significant recovery in tourism. Regarding economic policy, fiscal measures should continue to support activity, but credit conditions should become more restrictive.

The central bank raised its main policy rate from 1.125% in early 2022 to 1.875% in March 2023 in response to the (moderate) acceleration in inflation. Consumer price inflation slowed in H2 2022 and H1 2023, but then rose again (to +2.6% y/y in December 2023). In addition, the property market is overheating once again, with growth in property loans to individuals accelerating again from +3.9% y/y in June 2023 to +8.6% in May 2024. The central bank therefore raised its policy rate again in March 2024 (to 2%). It also increased the reserve requirement ratio (to 5.75%) and further tightened the prudential rules governing mortgages. Inflation moderated in H1 2024 and is expected to slow further. In the short term, the central bank should leave its policy rate unchanged, but could introduce other measures to contain the rise in house prices.

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