Report No. 17 Taiwan: Strong underlying macros and metrics to support equities 28/3/2022

The story for investors

Ending 2021 as one of the strongest Asian equity markets means nothing in the case of Taiwan unless there is reason to expect strong performance going forward. Taiwan continues on the track of solid GDP growth, signs of industrial output recovery, solid business expectations, possibly a peaking inflation and a forex rate likely to be supported by a strong C/A surplus and the first hike in interest rates since 2011.The war in the Ukraine has affected Taiwan with fears of disruptions in the supply chain of electronics exports, but possibly, positively, in its relations with the PRC.A politically sensitive issue is that the failure of Russia so far to subdue Ukraine may cause the PRC to reconsider its overall approach of Taiwan's reunification, a bullish development for the longer term outlook for Taiwan.

The basic macros

Taiwan's GDP did not shrink, as most countries' GDP did, during 2021, a near unique example of resilience, while the deceleration during 2021 may be bottoming. (See Fig. 1) The PMI index, with the exception of the mid 2020 dip, has stayed above the 50 level, and even going above 60, reflecting the strong underlying forward looking expectations. Inflation accelerated since the middle of 2020, and although in absolute terms is quite low even for Asian standards (around he 2.00 yoy mark), did cause the central bank in March to hike rates by 25 bps an unusually high amount, and the first hike since 2011.The strong current account surplus reflecting the market position of Taiwan as key electronics exporters, plus the hike in the interest rates will support the TWD. The USDTWD had appreciated almost continuously since the middle of 2019, giving further lie to the belief that all Asian economies follow weak rates polices versus the USD. The currency bottomed at the start of 2022.The Covid policies followed had Taiwan with a high 76.0% complete vaccination ratio, plus the usual supportive fiscal polices and the low and flat interest rates till recently. As indicated the strong rhetoric by the PRC in the last two years over reunification had little impact on confidence. China continues being the biggest export market for Taiwan taking about 30.0% of its total exports,

Fig 1:Taiwan GDP (red), C/A (blu), CPI (gr), PMI (br), 2015-2022

Source: Bloomberg

Investment conclusions

In addressing the impact on Taiwan's markets of the degree of pressure by the PRC's on reunification, is worth pointing out that historically the impact was never critical or even important. For example throughout 2021 the intensification of pressure did not deter a strong equities performance. Symmetrically, the likelihood that the pressure may diminish because of the "example" of Ukraine may not be important but equally cannot be negative. More importantly, two sectors of Taiwan's economy will continue to benefit from current trends, the market for microchips and container shipping, both sectors benefiting from undiminished demand driven both by global recovery and lingering supply chain constraints.

Sectoral developments, politics and equities

The shortage of micro chips caused initially by the drop in orders at the outbreak of Covid, especially from car producers, reversed itself in 2020 into an acute shortage as demand for IT equipment surged by the work-form-home development and with the lockdowns leading to a shift to home entertainment. These shortages are now being complicated by China's efforts to boost its domestic production and loosen its still strong dependence on microchip imports from the US, S.Korea and, in particular, Taiwan. A recent development involved the blocking by US of exports to the PRC of Extreme Ultraviolet Lithography equipment used to produce extremely small microchips. The equipment is almost exclusive produced by a Dutch firm and its main users are US companies and Taiwan's TMSC. At the same time the shortage of containers has no abated significantly with freight rates remaining high. These two developments impact directly the TWSE where semiconductors have a 39.1% weight and shipping a 4.2 % with Taiwanese's shippers being an important part of the global shipping industry. The TWSE in terms of P/E remains one of the cheapest indices in Asia and it definitely not oversold in terms of RSI. (See Fig. 2)

Fig 2: Taiwan, TWSE (rd.), P/E (blu) RSI (black) 2015-2022

Source: Bloomberg

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