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In this bundle



China | Philippines...

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By Robert Carnell



Taiwan

Covid hasn't hurt Taiwan's trade but climate change will

Taiwan's export and import data were very good for May and that's creating a puzzle as to the impact of Covid-19 on the economy. We keep our GDP...

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Why no concern?

As US Treasury bond yields drop again overnight, we have to make a decision. Maybe bond markets are absolutely right. The inflation we are seeing now, and are likely to see more of later today in China, and overnight from the US really is just transitory. This is a case of "nothing to see here, move on".

Or, and this is looking more likely, even if this is transitory - in the sense that it does not give rise to a spiral of wage and price increases that drags on for a while - it might still drag on for a while and in the meantime, remain higher than anticipated, or wished. Firms really do seem to be using the unprecedented opportunity of the disruption of the pandemic to undertake adjustments to prices - helped in the knowledge that everyone else is doing so too. And workers, flush with cash from handouts and realizing that life at home isn't so bad anyway (and what's the point of working if you can't blow it all on a nice overseas holiday) decide to hold out for higher wages, or at the very least, for a nice fat signing on bonus.

So there are a couple of points to make about this. The first is that the consensus seems to be a bit low for the May US CPI figure. The 0.4% MoM consensus call is quite a lot weaker than the recent run rate for the inflation prints (3m annualised rate is more than 6%). Furthermore, in time we

may find out that the number released overnight from the US turns out not to be the inflation peak after all. We won't know that until next month. And that will require next month's figure to deliver a 0.5%MoM or higher print to keep the annual inflation rate either stable or edging higher. But even though 0.5%MoM is quite a high hurdle, it is well within recent ranges, and definitely achievable.

China's inflation poses fewer concerns

We're a bit less concerned about today's Chinese inflation. For the most part, the increase in inflation we expect (we forecast 1.5%YoY in May from 0.9% in April, just a little below the 1.6% YoY consensus) is almost entirely a base-effect driven increase. In that sense, this month's figure will be very like last month. A notable rise in the headline rate, but little of substance underlying the change.

That said, we could see China's May PPI inflation push higher than the 8.5%YoY consensus forecast, raising the prospect of a possible double-digit PPI increase (up from 6.8%YoY), driven by rising commodity prices and higher semiconductor prices. This might well spur thoughts of further direct dampening measures from the authorities on firms' commodity purchases. There isn't much that anyone can do about higher semiconductor prices, and we don't think there will be any meaningful response from the PBoC.

Asia today

The China inflation data is definitely the main highlight for Asia today.

We have already had some revised 1Q21 GDP data for South Korea - that was a little higher at 1.7%QoQ (initially reported as 1.6%). We have some "banked" forecast increases we are holding back for Korea currently, while we wait to see if it manages to avoid going the way of many of its neighbours with a new wave of Covid and imposition of movement restrictions. If it does, we can add this held back reserve to our forecasts in a month or two. If not, then we can reduce the magnitude of any back-flip we have to perform.

Philippine trade data for April is today's other release. Eye-watering year on year growth figures (146%YoY growth forecast for imports) lose all meaning against the backdrop of huge falls last year, and the main focus should be on the trade balance, which is expected to remain roughly unchanged at -\$2400m.

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The military have been disinfecting public areas, such as subways, after a rise in Taiwan's Covid cases in May

Big trade growth and trade balance

Covid-19 virtually disappeared from Taiwan but there's been a rise in cases since the middle of May this year. Despite that, it hasn't affected trade performance at all. Exports grew 40.9% Year-on-Year in May and at the highest single month value on record. Imports grew 51.1%YoY. The trade balance was high at \$6.16 bn.

Looking at specific sectors, we're seeing more trade activities in minerals, rubber and plastic. And there was a steady growth of electronic goods of near 30% YoY.

The high trade balance will add to GDP growth in the second quarter of this year; it's expected to come in at 6.1%YoY in 2Q after an upward revision of GDP growth of 8.92%YoY in the first quarter by Taiwan's government.

But we are still downgrading Taiwan's 2021 GDP forecast

Even with such an unexpectedly good performance on trade in May, we are still downgrading Taiwan's GDP for 2021 from 4.9% to 4.1%.

There are two major reasons:

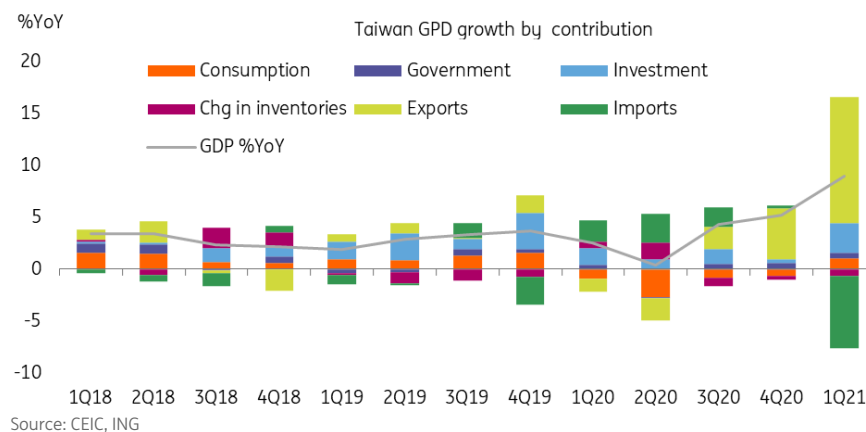
Covid-19: It doesn't seem that Taiwan's government will implement a lockdown, with cases still around 300 per day. There aren't enough vaccines for the entire population which, given the experience of other economies, could delay virus' suppression. Several of the infected groups are factory workers and that could affect both industrial production and exports.

Rainfall: Despite the fact that there's been more rain in the past two weeks, it still looks as though the summer will be exceptionally dry and this is a critical issue for semiconductor factories. Combined with a number of electricity blackouts, one option for electronic goods' producers to avoid raising prices is to reduce the number of chips in any product given the global shortage. We think that's quite likely.

If these two problems persist, we believe industrial production will slow in the second half of the year.

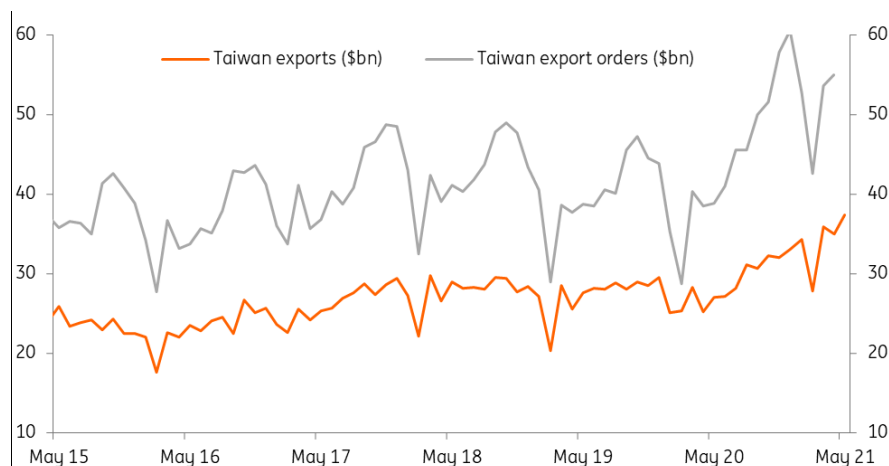
This could be mitigated by fiscal stimulus from the Taiwan government. But so far, the stimulus announced is around 1.75% of the forecast 2021 GDP, which is small compared to the 12% of GDP we saw in 2020.

Taiwan GDP recovery



Taiwan's export orders v exports

The gap between export orders and exports widens reflecting faster export growth from overseas factories owned by Taiwan companies compared to exports from Taiwan



Source: CEIC, ING

Climate change could be part of the business equation

And, let's be frank. If drought and blackouts are climate issue, they're unlikely to disappear. This is also a headache for business plans because of the uncertain nature of climate change. Do factories need to move out of Taiwan to avoid drought and blackouts if the climate issue persists? We think that this is already in the mind of producers as the gap of export orders and exports is widening. That tells us that the growth of exports from overseas factories owned by Taiwan companies outpaced exports from factories in the country itself.

Climate change could be part of a business decision.

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