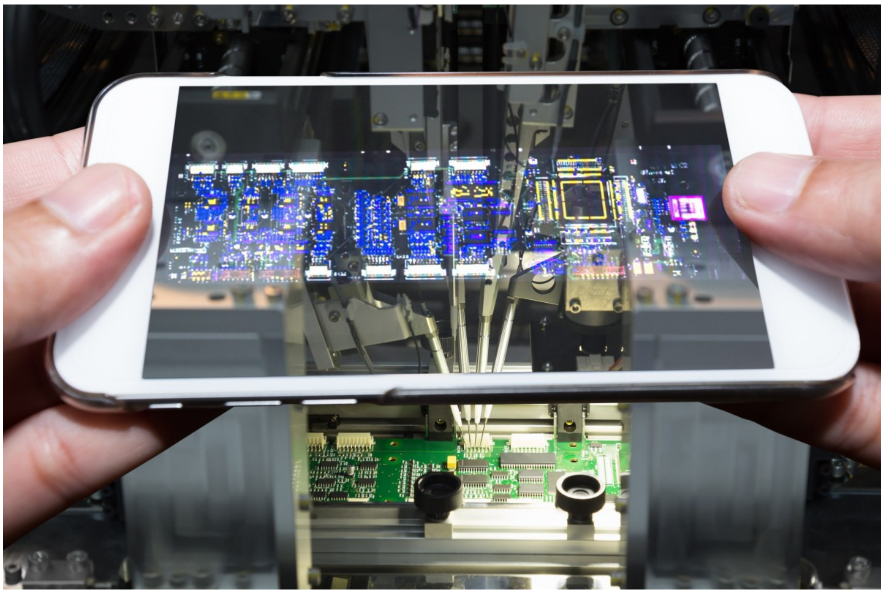
Taiwan: Export growth positive but too soon to celebrate

June data shows that Taiwan's import and export growth has turned positive again. We believe that structural issues tied to the smart phone product cycle and weak demand for these products will continue to impact Taiwan's manufacturing and export sector. Can 5G help the economy?



Source: Shutterstock

Exports and imports grew again but too early to celebrate

Imports rose 6.6% year-on-year while exports finally ended a seven-month stretch of negative growth, with a 0.5% rise. As imports grew faster than exports, the trade balance fell to $3.87 billion in June from $4.49 billion in May.

Still, it is too early to celebrate. First, the positive growth of exports is mainly due to a technical low base effect. Second, we doubt that the moving of factories from Mainland China to Taiwan will change the landscape for trade.

Taiwan puts too many eggs in one basket

Taiwan's export-related manufacturing - from chips to screen panels to cameras - is closely linked to the smart device product cycle.

Taiwan has put all of its eggs into this manufacturing basket. When the industry falls into a structural downturn, as it is now, manufacturing is severely affected. Smart devices are relying on adding more camera functions to win over customers, but that alone has its limit.

Exports of smart phones in August and September will be an important indicator of how well the economy can ride out this low demand cycle. If sales over this period don't exceed last year's exports, 2019 as a whole could see exports shrinking, which will directly hit the economy.

Does moving factories from Mainland to Taiwan change the landscape?

The Taiwan government has encouraged manufacturers to move their Mainland China production lines back to Taiwan. There are hopes for a material increase in manufacturing activities after heavy investment in moving factories.

But this would really only be possible if the US continued to impose further tariffs on Mainland China, especially on electronic devices. If the US-China truce continues, the moving of production lines, which is very costly, may be for naught.

Imports of capital goods and equipment grew 41.6% YoY in June, which is a bit exaggerated by the low base effect, and could slow again if export orders do not exhibit growth in August and September.

Moving production lines back to Taiwan does not solve the key issue that the country faces, which is a lack of diversification.

Even worse, this will increase tensions between Mainland China and Taiwan.

A structural issue has created a cyclical problem

The cyclical economic downturn is a by-product of the structural issues in Taiwan whereby the whole economy is dependent on exports of electronic products.

5G could be the future engine of Taiwan manufacturing

Still, we are not too pessimistic about Taiwan's economy so long as there are other economies refusing to use Mainland China-made 5G products. Taiwan can tap this opportunity.

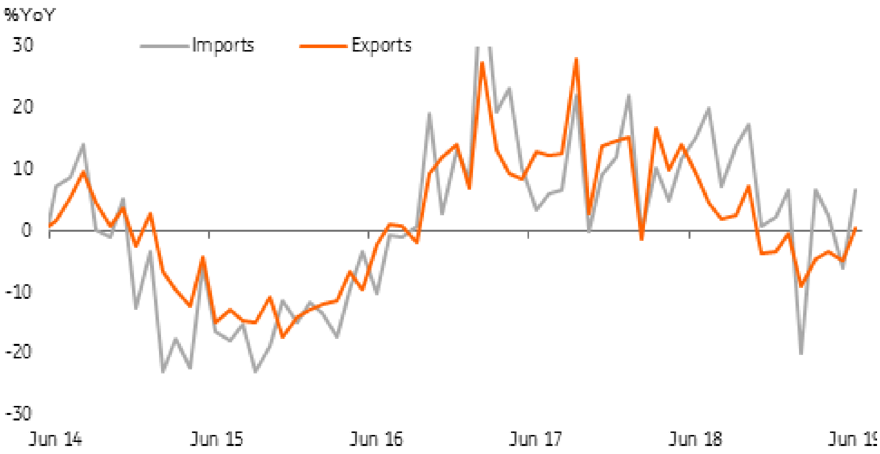
The manufacturing of equipment to produce 5G chips and infrastructure-related products should begin in 2020. We realise that this may be a bit late for the economy, but at least Taiwan should grow faster next year.

Before then, however, exports will continue to get worse.

The currency can't help exports very much. We expect the USD/TWD to rise to between 31.5-31.7 for the rest of 2019, which could only help exporters' margins by around 1.60% from the current spot exchange rate of 31.198.

As such, we continue to expect GDP growth to slow from 2.63% in 2018 to 1.8% in 2019, after which we think 5G will begin to help the manufacturing sector and lead the economy to 2.0% GDP growth in 2020.

Taiwan trade has yet to be confirmed a rising trend



Source: ING, Bloomberg

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