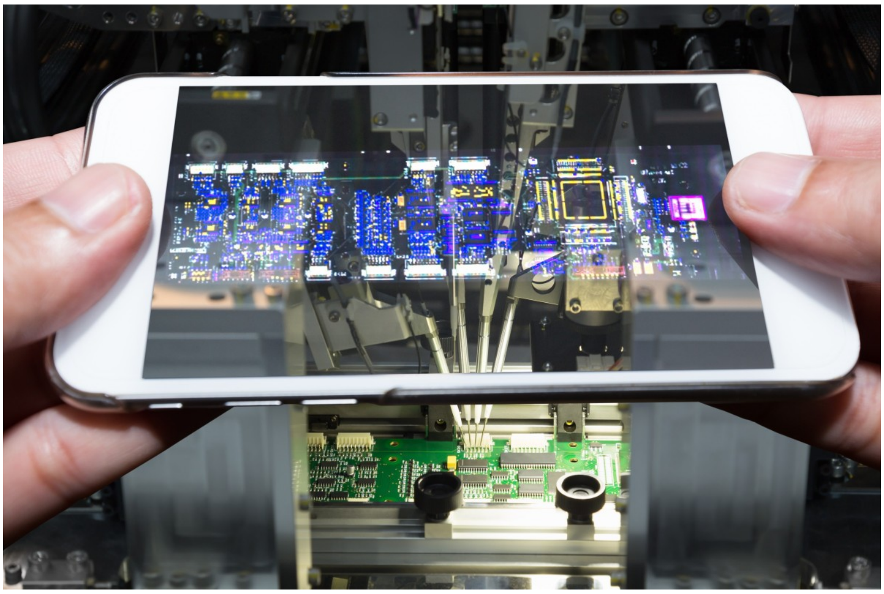
Will Taiwan's surprisingly good GDP numbers last?

Even though factories in Taiwan performed better than our expectations in 1Q20, consumption was still hit hard by Covid-19. 1Q20 will probably be the best quarter this year and growth will inevitably contract in 2Q20 and FY20. The currency is likely to weaken too



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Manufacturing to the rescue?

Taiwan's GDP grew at 1.54% year on year in 1Q20, a significant slowdown from the 3.31% growth we saw in 4Q19 and a contraction of 5.91% QoQ.

In comparison to other economies in Greater China, Taiwan's growth numbers don't look that disappointing. GDP in Mainland China contracted by 6.8% year on year and we expect Hong Kong's GDP to contract by around 10% YoY in 1Q20. Taiwan's growth numbers are probably better because it imposed Covid-19 preventive measures quite early and thus avoided a total lockdown and very strict social distancing measures. Peoples' lives and work were not affected as much as they were in Mainland China and Hong Kong.

The details show consumption shrank by 0.97% YoY which was reflected in the contraction of retail sales by -0.56%YoY. Investment, which includes government investments, grew 3.13%YoY and government spending increased by 3.67%YoY. Exports and imports of goods and services contracted by 2.89%YoY and 4.87%YoY while exports of electronic parts grew by more than a notable 20%YoY!

Fiscal stimulus expanded

Earlier in the month, Taiwan's Executive Council increased the fiscal stimulus package to TWD 1.05 trillion (equivalent to $34.64 billion), of which TWD81.6 billion are subsidies for employers to prevent a spike in unemployment.

The unemployment rate in March was just 3.76%, up from 3.70% in February due to weakness in the consumption sector in 1Q20. But it is set to go up in other sectors aside from retail and catering, which doesn't seem to included in the calculation of the current stimulus package.

But the positive growth story is unlikely to last

Taiwan's economy relies heavily on the exports and manufacturing sectors and in particular, electronic manufacturing. This niche is likely to become a challenge for Taiwan in the coming quarters as global demand for electronic goods will probably fall in 2020 compared to 2019 as these are not necessities.

With global demand expected to be weak even after this health pandemic subsides, unemployment is likely to shoot up and wages will have gone down, which means weaker spending power from domestic consumption.

Our GDP forecast is less optimistic than the official forecast

The increased stimulus doesn't seem to be accounting for more unemployment in the manufacturing and export sectors, which is partly why we're not upgrading our GDP forecasts even after the stimulus expansion.

We forecast a GDP contraction of 0.5% YoY in 2Q20 and a contraction of 0.4% in FY20. This is relatively dismal compared to the positive growth forecast of 1.93% by the central bank in March when it cut rates for the first time since 2016 to 1.125%.

We expect at least one more rate cut in 2020 by 12.5bp, most likely to take place in 2Q20.

TWD forecast

The spot rate is 29.77 down from 30.238 at the beginning of April as capital flows into Taiwan's stock market, which rose over 10% this month.

High volatility in the market, including weak global demand that is likely to reflect in 2Q20's earnings reports of electronic companies and a possible return of the trade war ahead of the US presidential elections in November, should result in a weak TWD against the dollar in the latter part of the year.

We forecast USD/TWD at 29.70 by the end of 2020.

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