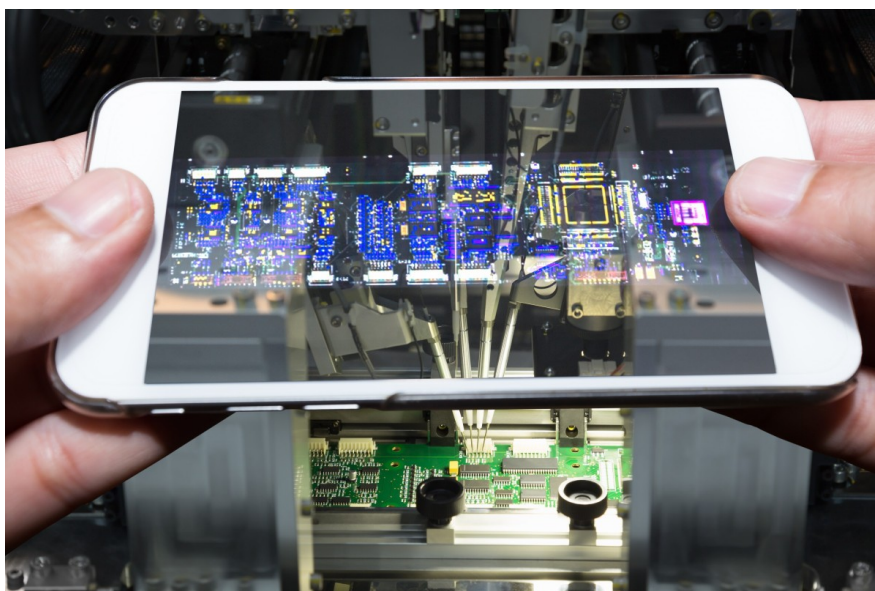


Taiwan: Super strong GDP growth in 1Q but chip shortage risk is imminent

GDP in 1Q21 was strong, but that's history. Water shortages have slowed semiconductor production in Taiwan just as global chip shortages are rising. Given that this is such a vital industry for Taiwan, we look at what this means for the economy in the coming quarters



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Strong growth in 1Q21 but that's in the past

8.16% year-on-year GDP growth for the first quarter of 2021 is very encouraging.

This was thanks to strong net export growth, which contributed 4.53 percentage points to GDP growth. Exports alone increased 24.58% YoY, of which electronic parts grew 28.37% YoY.

Consumption only contributed 1.02 percentage points to GDP growth. This shows that consumption demand was mild, partly because employment in the service sector was still affected by Covid, which has limited tourism activities in Taiwan.

Capital formation, including both government and private investment, contributed 2.03 percentage points to economic growth, mostly through investment in 5G infrastructure and

equipment.

Overall, the economy still depends very much on exports and mainly on electronic exports. This poses an imminent risk to the economy.

Significant consequences of Taiwan's water shortage

Taiwan's economic growth depends on exports and exports have mainly come from the semiconductor sector. We think that Taiwan's strong economic growth may not last. Water shortages, which are a climate issue that the government can't control, have affected Taiwan's semiconductor chip production. For now, the temporary solution is to dig underground for water used in factories, and at the same time limit water usage by households around those factories.

The possible consequences are:

1. slower production activity growth from the first quarter;
2. slow down in export growth from the first quarter as the output of chips can't increase any more, the best scenario is that output levels stay the same from the first quarter, which is also very difficult to achieve;
3. some production could be moved away from Taiwan to factories owned by Taiwanese companies in the rest of Asia, and Mainland China should benefit from this;
4. without an increase in chip production, global chip shortages will continue, which will push up chip prices and therefore goods that use a lot of chips, e.g. automobiles, smartphones, home appliances, and even lighting (LED uses chips as well).

All of these are negative for GDP growth in the coming quarters for Taiwan.

Forecasts

We have revised our Taiwan GDP forecast for 2021 to 4.9% from 4.3% solely due to the unexpectedly strong growth in the first quarter. We will monitor the chip production and export problem, and the possibility of a downgrade to our forecast is higher than the possibility of an upgrade, which is climate dependent.