

# Taiwan election: Decoupling from China remains top of mind

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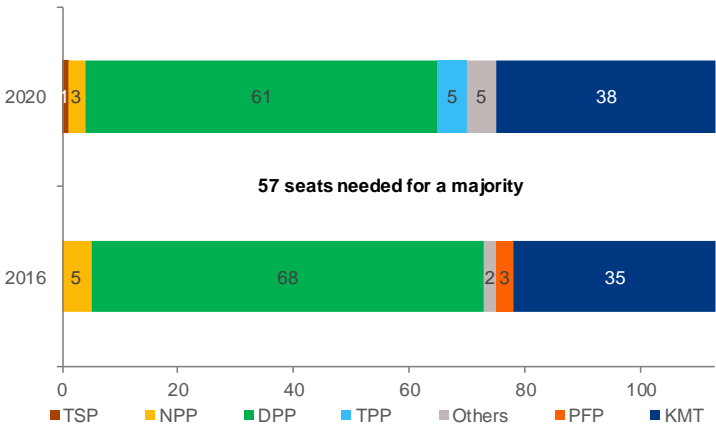
- **Tsai Ing-wen was reelected as president of Taiwan on Saturday 11 January in a landslide victory against runner-up Han Kuo-yu.** Tsai's party, the Democratic Progressive Party (DPP), also managed to keep its majority in the Legislative Yuan (albeit with a smaller margin).
- **These results should ensure policy continuity from Tsai's first term.** The biggest difference between Tsai and Han is in external policies. The reelection of Tsai means that Taiwan will keep affirming its willingness to decouple from China. We expect policy continuity, with prudent spending in energy, infrastructure and childcare, as well as more reshoring of Taiwanese businesses from abroad.
- **The relationship between Taiwan and China is likely to remain choppy, with tourism being the main victim. However, a significant disruption in the relationship is unlikely in the short to medium term, in our view,** given the economic dependencies. Notably, China depends on Taiwan for more than 20% of its imports in the electronic sector and 10% in the chemicals sector. From Taiwan's perspective, sectors vulnerable to an intensification of tensions could be metals, food, vehicles and energy.
- **Given that policy continuity is expected, we keep our economic outlook of a moderate rebound into 2021 unchanged.** We expect Taiwan's GDP to grow by +1.5% in 2020 and +1.9% in 2021, after +2.2% in 2019. A more benign external environment will be supportive, but the lack of a clear turnaround in the semiconductor cycle and the lack of policy easing will weigh on growth.
- **What does this mean for companies?** Companies in sectors such as tourism and retail might be exposed to additional downside risks. Conversely, a continuation of Tsai's policies of reshoring and denuclearisation could benefit companies in the technology and green energy sectors. Overall, we are forecasting a slight increase of +2% in insolvencies in Taiwan for 2020, after two consecutive years of a declining trend.

After what has been considered one of the most dramatic campaigning periods leading to the general election on 11 January 2020, Taiwan has re-elected Tsai Ing-wen of the Democratic Progressive Party (DPP) as President for a second term. With 8.2 million votes (57.1%), Tsai received the highest vote count since Taiwan began holding direct presidential elections in 1996. The runner-up, Han Kuo-yu of the Kuomintang party (KMT), gathered 5.5 million votes (38.6%).

DPP also managed to once again secure its majority in the Legislative Yuan, albeit with a smaller margin, winning 61 out of 113 seats (compared with 67 seats in 2016). The election results were not too surprising, given that the latest polls before the election had predicted a relatively comfortable win for Tsai and an approximative lead of 10% for the DPP.

Indeed, the incumbent President and governing party have been supported by a relatively resilient economy, buoyant financial markets, and democratic protests in Hong Kong. The resurgence of support for Tsai could be seen as Taiwanese voters reaffirming their willingness to decouple from mainland China.

Figure 1 – Legislative Yuan election results in 2016 and 2020



- TSP: Taiwan Statebuilding Party
- NPP: New Power Party
- DPP: Democratic Progressive Party
- TPP: Taiwan People’s Party
- PFP: People First Party
- KMT: Kuomintang

Sources: Official Taiwan statistics, Euler Hermes, Allianz Research

**Policy continuity: Increase autonomy from China, reshore Taiwanese companies from abroad and prudent public spending**

External policies on cross-strait relations and foreign trade was the biggest difference between the two main candidates in this election. Tsai’s foreign policy stance continues to insist on Taiwan’s autonomy from mainland China, by rejecting the “one country, two systems” proposition, while Han and the KMT focus more on reducing confrontation and reopening talks with China.

Regarding external economic policy, Tsai’s “homecoming program”, which had already started in her first term, seeks to bring back more Taiwanese companies and investments from abroad. This is achieved with provisions of industrial land, cheaper financing on loans and tax benefits. Han, on the other hand, proposes to set up free trade zones and promote more trade with China.

Domestically, Tsai maintains the target for the Taiwanese economy to become nuclear-free by 2025. This implies green energy investments, outlined in her Forward-looking Infrastructure Development Program.

Overall, looking ahead at Tsai’s second term, we expect policy continuity with prudent spending in energy, infrastructure and childcare, as well as more reshoring of Taiwanese businesses.

Figure 2 – Main candidates’ programs on specific topics: fiscal policy, relationship with China, long-term policies, etc.

| External Policies                                | DPP (Tsai)   | KMT (Han)  |
|--|--|--|
| <b>Foreign policy and cross-strait relations</b> | <ul style="list-style-type: none"> <li>Insist on the autonomy of Taiwan vs. mainland China</li> <li>Increase national defense budget</li> <li>Develop indigenous defense systems, including building more submarines</li> </ul>  | <ul style="list-style-type: none"> <li>Neutral stance towards mainland China</li> <li>National defense focuses on discouraging cross-strait confrontation</li> </ul>   |
| <b>Foreign trade and economic policy</b>         | <ul style="list-style-type: none"> <li>Make Taiwan a restructured global manufacturing and technology hub</li> <li>Join CPTPP</li> <li>Reshore Taiwanese companies to increase domestic investment*</li> </ul>   | <ul style="list-style-type: none"> <li>Establish free trade zones</li> <li>Strengthen ECFA and continue to boost exports to Mainland China</li> </ul>  |
| Domestic Policies                                | DPP (Tsai)   | KMT (Han)  |
| <b>Energy Policy</b>                             | <ul style="list-style-type: none"> <li>Maintain the target for Taiwan to become nuclear-free by 2025</li> <li>Green energy investments in Forward-looking Infrastructure Development Program**: budget of NTD11.4bn in 2019-2020</li> <li>Wind power promotion: target wind power capacity 6.7 GW by 2025</li> </ul> | <ul style="list-style-type: none"> <li>Gradual phase-out of nuclear power before alternative energy sources mature</li> </ul>  |
| <b>Education and social policy</b>               | <ul style="list-style-type: none"> <li>Increase monthly child subsidy to NTD5,000, extended from birth to 6 years old (instead of 4 years old)</li> <li>Increase childcare program budget to NTD100bn</li> </ul>   | <ul style="list-style-type: none"> <li>Establish co-living plan among the old and young to combat the risks of an aging society</li> <li>More educational autonomy to schools</li> <li>1-year government subsidy for students enrolled in universities abroad</li> </ul> |
| <b>Other policy</b>                              | <ul style="list-style-type: none"> <li>Forward-looking Infrastructure Development Program**: special budget of NTD420bn over four years (from September 2017), out of which NT\$222.9bn for 2019-2020</li> </ul>   | <ul style="list-style-type: none"> <li>Set up a sovereign wealth fund, valued at NTD10tn</li> </ul>  |

\* According to the Ministry of Economy, the reshoring of Taiwanese businesses has increased domestic investment by over NTD700 billion to date. More than 150 companies that relocated back to Taiwan are considered large- and medium-sized corporations, including Pegatron, Quanta Computer, Giant and AcBel Polytech. This could be due to the “homecoming policy” implemented by the government in January 2019, with provisions of industrial land, cheaper financing on loans and tax benefits. The impact of the U.S.-China trade war might also have played a role.

\*\* Forward-looking Infrastructure Development Program: Funding included for the development of green energy, railway projects, water treatment, digital infrastructure, child-care, food safety, talent employment and urban-rural development. The program is funded by a special budget of NT\$420 billion (US\$13.9 billion) over four years, divided into two terms. The first term spanned from September 2017 through December 2018, with a budget of NT\$107.1 billion (US\$3.5 billion), and the second will run from 2019 to 2020 with a budget of NT\$222.9 billion (US\$7.2 billion).

Sources: Media, Euler Hermes, Allianz Research

### Relationship with China: Bending but not breaking

Given the outcome of the election, Taiwan’s relationship with mainland China should remain tense. That said, a breakdown of economic ties between China and Taiwan or any military intervention remain highly unlikely in the short to medium horizon in our opinion. Indeed, the stakes are prohibitively high for both economies.

In the run-up to the elections, China had stepped up its mixed strategy towards Taiwan. On the positive side, “26 measures” were proposed to Taiwan last November, including, among other things, preferential policies on trade, investment and market access for Taiwanese companies. They were, however, rejected by the Taiwanese leadership.

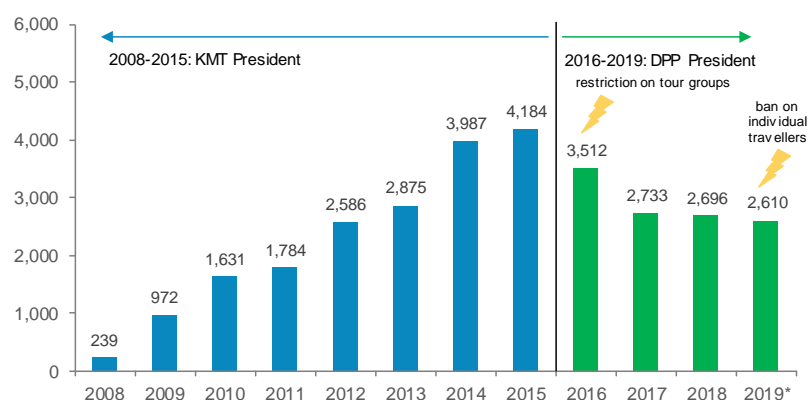
Figure 3 – Presentation of mainland China’s “26 measures” for Taiwan

|                   |   |
|-------------------|---|
| <b>Technology</b> | <ul style="list-style-type: none"> <li>• Allow Taiwanese companies to participate in construction, R&amp;D, pilot programs in key industries, such as technical equipment, 5G development, and civil aviation</li> <li>• Permit qualified youths to utilize technology and business incubators and university science parks</li> </ul>  |
| <b>Tourism</b>    | <ul style="list-style-type: none"> <li>• Allow qualified Taiwanese investment in theme parks and tourist operators</li> <li>• Allow Taiwanese to access consular services in China’s embassies and consulates abroad</li> </ul>   |
| <b>Trade</b>      | <ul style="list-style-type: none"> <li>• Preferential policies for Taiwanese exports</li> <li>• Access to export credit insurance for Taiwanese companies</li> <li>• Faster custom clearance and quality inspection for Taiwanese imports</li> </ul>  |
| <b>Investment</b> | <ul style="list-style-type: none"> <li>• Funding support for Taiwanese corporations from local governments</li> <li>• Support Taiwanese banks to set up micro-lending, financial leasing and financial guarantee organizations</li> <li>• Allow Taiwanese companies to raise funds through equity stocks and corporate bonds</li> </ul> |
| <b>Education</b>  | <ul style="list-style-type: none"> <li>• Offer qualified Taiwanese subsidies and study support to enroll in Chinese universities</li> <li>• Increase the recruitment effort of Taiwanese students to Chinese universities</li> </ul>  |

Sources: [http://www.gwyttb.gov.cn/wyly/201911/t20191104\\_12214955.htm](http://www.gwyttb.gov.cn/wyly/201911/t20191104_12214955.htm), Euler Hermes, Allianz Research

However, the tourism ban on mainland Chinese entering Taiwan was strengthened last August. This is likely to be enforced with much vigor going forward. As a response, the Taiwanese government had announced an additional NTD3.6bn (0.02% of GDP) in Q4 2019 government spending to boost domestic tourism. They estimated lost tourism revenue could be as high as NTD28bn (0.16% of GDP) over the six months following the ban.

Figure 4 – Mainland Chinese tourist arrivals to Taiwan (thousands)



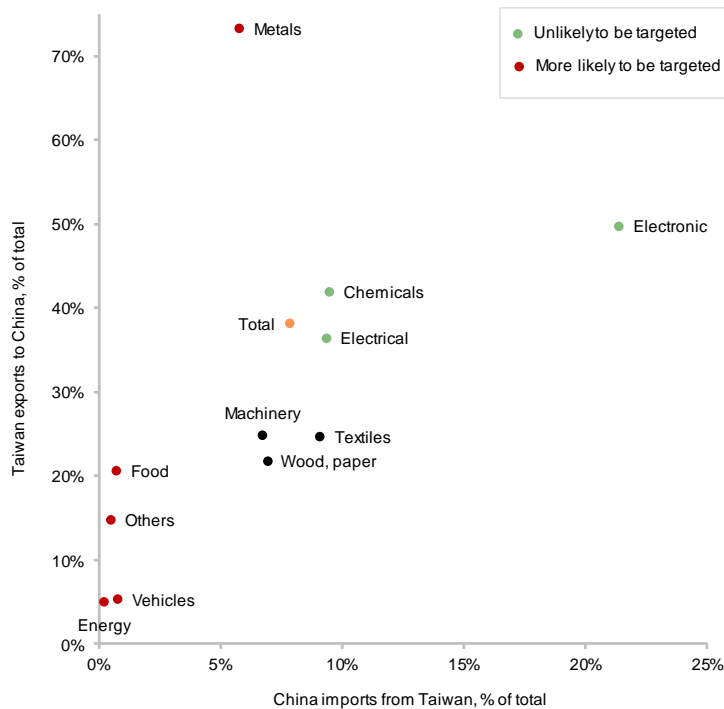
\*2019 number is for January to November

Sources: Taiwan Tourism Bureau, Euler Hermes, Allianz Research

On other economic topics, we expect limited reaction from China in the short term. The context of continued downside pressures on the Chinese economy, both domestically and externally, means that authorities cannot afford policies that might take a hit on trade and investment.

Should tensions exacerbate much further, China could limit trade in sectors where the Chinese market is comparatively large for Taiwanese exporters, but not important enough for Chinese importers. Those include the metals, food, vehicles and energy sectors.

Figure 5 – Trade between Taiwan and China, by sector (% of respective totals)



Sources: Chelem, Euler Hermes, Allianz Research

More importantly, Taiwan will continue to be a point of disagreement and tension between the U.S. and China. The U.S. Secretary of State as well as several Senators welcomed the Taiwanese election results, vowing to further strengthen collaboration and the relationship with Tsai’s administration under the Taiwan Relations Act. This may include further arms sales – the U.S. had already sold to Taiwan an arms package worth USD2bn last July and a further USD8bn of fighter jets and equipment in August.

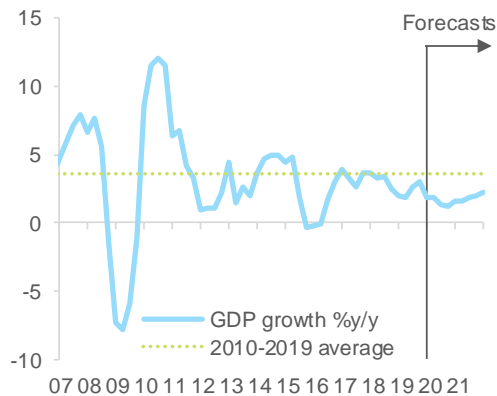
**We keep our economic outlook of a moderate rebound into 2021 unchanged**

As the election results were largely in line with expectations and given that we expect policy continuity, we keep our economic outlook for Taiwan unchanged. We expect Taiwan’s GDP to grow by +1.5% in 2020 and 1.9% in 2021, after +2.2% in 2019. Despite a lower annual average, the growth profile should be better in 2020 than in 2019, reflecting a moderate rebound supported by more benign external conditions.

Challenges this year come from the lack of a clear turnaround in the semiconductor cycle<sup>1</sup>, a high base of investment growth in 2019 and no aggressive policy easing domestically. Indeed, on the fiscal side, prudence is prevailing (despite a low level of public debt). On the monetary side, no change in the policy rate is expected in the coming months. Bank loans are still growing solidly, and Taiwan wants to avoid being labelled a currency manipulator by the U.S.

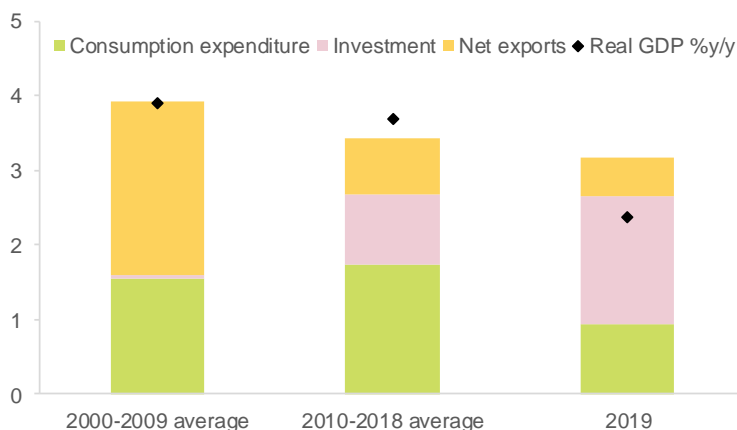
<sup>1</sup> For more details, see: [A 2020 semiconductor slump will send shockwaves across the global electronics industry](#)

Figure 6 – Taiwan quarterly GDP growth (%y/y)



Sources: National statistics, Euler Hermes, Allianz Research

Figure 7 – Taiwan GDP growth (%y/y), with contribution breakdown



Sources: National statistics, Euler Hermes, Allianz Research

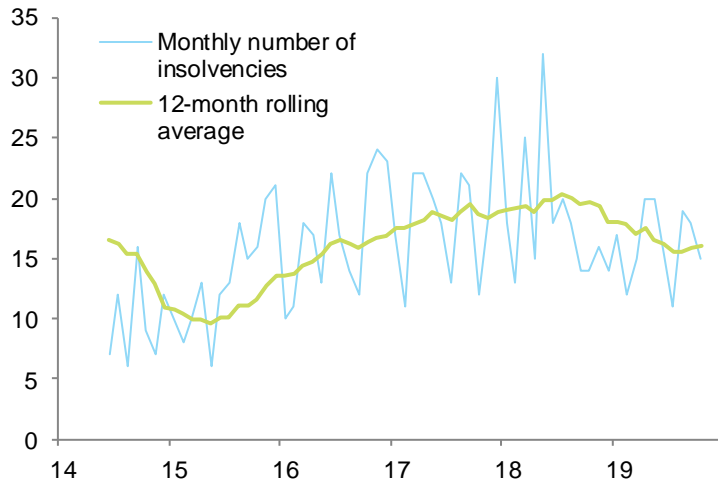
### What does this mean for companies and markets?

We are forecasting a slight increase of +2% in insolvencies in 2020. After two years of moderate declines in 2018-2019, the latest monthly data suggest an inflection to an increasing trend again from Q3 2019. The economic outlook and reelection of Tsai mean that companies in sectors such as tourism and retail might be exposed to additional downside risks.

The election results may also support continued positive investor sentiment toward Taiwan, extending gains in the Taiwanese currency (the NTD is already at its highest since mid-2018 against the USD). Such appreciation will reinforce pressure on the tourism sector.

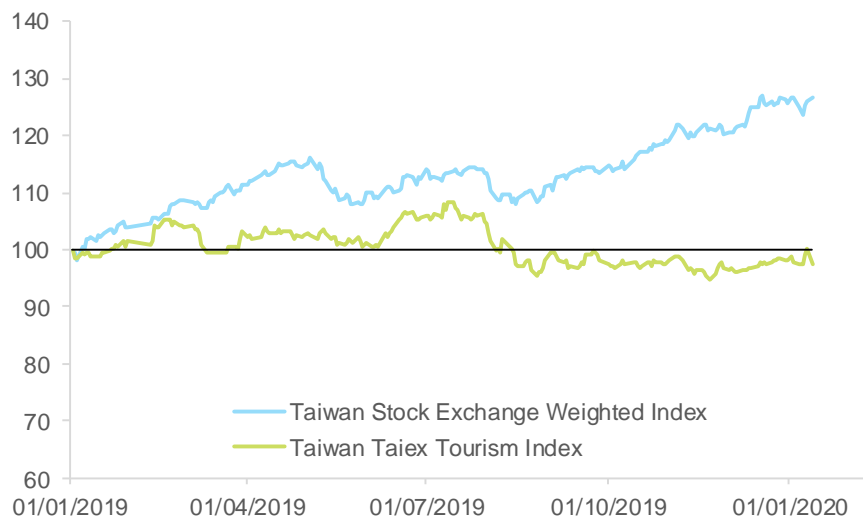
Conversely, the reelection of Tsai implies a continuation of her policies of reshoring and denuclearisation, which should benefit companies in the technology and green energy sectors. The reaction in equity markets is so far coherent with this view.

Figure 8 – Monthly number of insolvencies in Taiwan



Sources: Euler Hermes, Allianz Research

Figure 9 – Taiwan stock exchange indices (02/01/2019 = 100)



Sources: Bloomberg, Euler Hermes, Allianz Research

#### **FORWARD-LOOKING STATEMENTS**

The statements contained herein may include prospects, statements of future expectations and other forward-looking statements that are based on management's current views and assumptions and involve known and unknown risks and uncertainties. Actual results, performance or events may differ materially from those expressed or implied in such forward-looking statements.

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