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Economics Group

Jay H. Bryson, Global Economist
jay.bryson@wellsfargo.com • (704) 410-3274
Michael Pugliese, Economist
michael.d.pugliese@wellsfargo.com • (212) 214-5058

Taiwanese GDP Growth Tops Expectations in Q2

Real GDP growth in Taiwan was 3.3 percent year over year in Q2, led by private and government consumption. Taiwan's direct exposure to the United States via exports to China poses a downside risk given trade tensions.

Consumption Growth Steady, but Investment Spending Still Soft

Data released this morning showed economic growth in Taiwan picking up slightly in Q2-2018, reaching 3.3 percent year over year (top chart). Every component of GDP growth actually slowed on a year-over-year basis, however, dampening some of the enthusiasm around the beat.

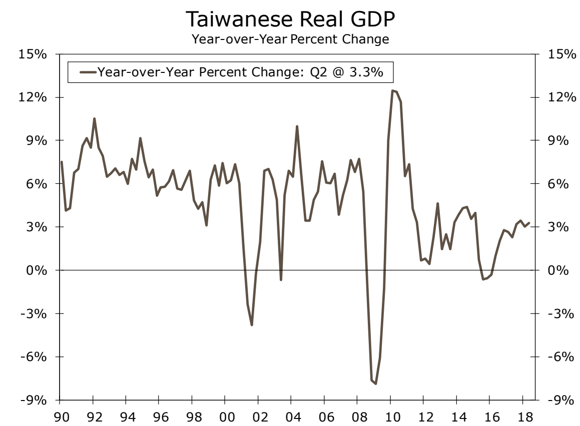
Private consumption remained a key driver of growth, slowing only slightly from 2.73 percent in Q1 to 2.65 percent in Q2. The boost to GDP growth from government consumption also eased a bit in Q2, but stimulus from the public sector remains above levels seen over the past couple years. Export and import growth both softened in Q2, though neither to an extent that appears particularly worrisome. The weak trend in gross fixed capital formation is an area with a bit more cause for concern; fixed investment growth has been negative on a year-over-year basis for four consecutive quarters.

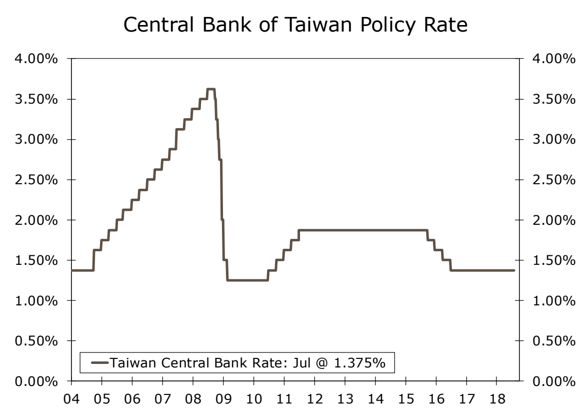
At its last policy meeting in June, the Taiwanese central bank once again elected to remain on hold (middle chart). The central bank upwardly revised its growth forecast for the year, citing a stronger outlook for exports and private investment growth. The central bank does not seem particularly concerned about the recent weakness in fixed investment growth, citing unfavorable base effects and an anticipated rise in capital expenditures by domestic manufacturers in the second half of the year.

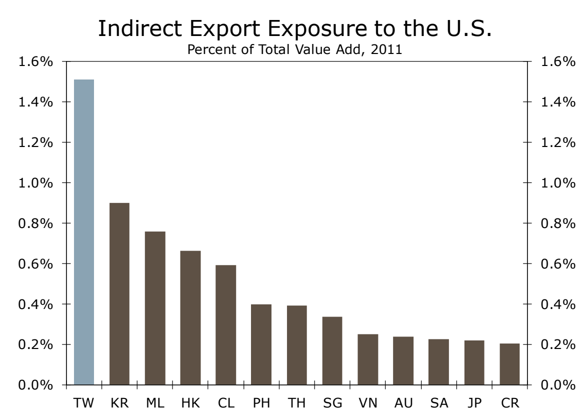
Although the economic growth environment in Taiwan and abroad remains solid, policymakers revised down their core CPI forecast. With inflation in check and nominal and real interest rates remaining in-line with where the central bank would like them relative to a host of other countries, there are few reasons to tighten policy at this time. As trade uncertainty is pervasive (more on that below), the Taiwanese central bank may stay on hold for the foreseeable future unless its hand is forced by a major change to key macroeconomic variables.

Trade Troubles a Big Deal for Taiwan

Taiwan's small, open economy is heavily reliant on trade, as foreign spending on Taiwanese goods and services accounts for about 40 percent of the value added that is generated in Taiwan. In a recent special report we published (available upon request), our analysis shows that Taiwan would be the economy with the most to lose collaterally from a trade war between China and the United States (bottom chart). This finding makes intuitive sense due to the significant amount of exports from Taiwan to the mainland, which in 2017 totaled almost $90 billion (nearly 30 percent of total Taiwanese exports). Thus far, the United States has implemented tariffs on $34 billion of Chinese-specific goods, plus more sweeping tariffs on imports such as steel and aluminum. President Trump has threatened another $200 billion in tariffs on Chinese goods. With this threat lingering in the background, there are clear downside risks to the outlook in Taiwan over the next year.







Source: IHS Markit, Bloomberg LP, OECD and Wells Fargo Securities

Wells Fargo Securities Economics Group

Diane Schumaker-Krieg	Global Head of Research, Economics & Strategy	(704) 410-1801 (212) 214-5070	diane.schumaker@wellsfargo.com
John E. Silvia, Ph.D.	Chief Economist	(704) 410-3275	john.silvia@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Jay H. Bryson, Ph.D.	Global Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	Currency Strategist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Azhar Iqbal	Econometrician	(704) 410-3270	azhar.iqbal@wellsfargo.com
Tim Quinlan	Senior Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Eric Viloria, CFA	Currency Strategist	(212) 214-5637	eric.viloria@wellsfargo.com
Sarah House	Senior Economist	(704) 410-3282	sarah.house@wellsfargo.com
Charlie Dougherty	Economist	(704) 410-6542	charles.dougherty@wellsfargo.com
Erik Nelson	Currency Strategist	(212) 214-5652	erik.f.nelson@wellsfargo.com
Michael Pugliese	Economist	(212) 214-5058	michael.d.pugliese@wellsfargo.com
Ariana Vaisey	Economic Analyst	(704) 410-1309	ariana.b.vaisey@wellsfargo.com
Abigail Kinnaman	Economic Analyst	(704) 410-1570	abigail.kinnaman@wellsfargo.com
Shannon Seery	Economic Analyst	(704) 410-1681	shannon.seery@wellsfargo.com
Matthew Honnold	Economic Analyst	(704) 410-3059	matthew.honnold@wellsfargo.com
Donna LaFleur	Executive Assistant	(704) 410-3279	donna.lafleur@wellsfargo.com
Dawne Howes	Administrative Assistant	(704) 410-3272	dawne.howes@wellsfargo.com

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