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Emerging Insight

The mysterious divergence between Taiwan's exports and TWD's performance

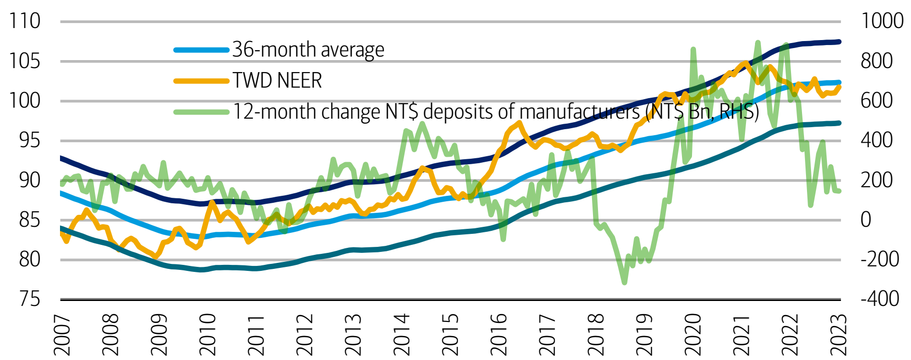
Key takeaways

- Despite impressive YTD equity inflow and a rising trade balance, TWD FX has had mediocre performance YTD.
- We analyze this relative weakness through the angle of the recent conversations we had in Taiwan with lifers and exporters.
- The main reasons behind TWD weakness is due to lifers reducing FX-hedging and exporters retaining their proceeds in US$.

By Chun Him Cheung

Exhibit 1: TWD NEER and growth rate of NT$ deposits of Taiwan's manufacturers

In late-2020, when manufactuers' holdings of NT$ deposit grew, this resulted in TWD NEER pushing against the top range of its band



Source: CEIC, Bloomberg

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Taiwan in Focus

Rising demand for Taiwan's exports of advance chips and computing devices and strong equity inflow have the FX market excited on the prospects of the TWD in 4Q23 and early 2024. However, the first two months of 2024 saw USDTWD rise despite these positive tailwinds, resulting in general disappointment. We think the disconnect between the performance of Taiwan's trade balance and the NT$ is caused by Taiwanese life insurance companies (lifers) unwinding their FX-hedging ratio and exporters retraining a higher percentage of their export proceeds in US$. In our recent conversations with Taiwanese exporters, they noted the higher US$ yield and structural demand to build-up offshore manufacturing capacity outside of mainland China is preventing them from remitting more of their exports proceeds back to Taiwan.

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Global

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NDF – non-deliverable forward

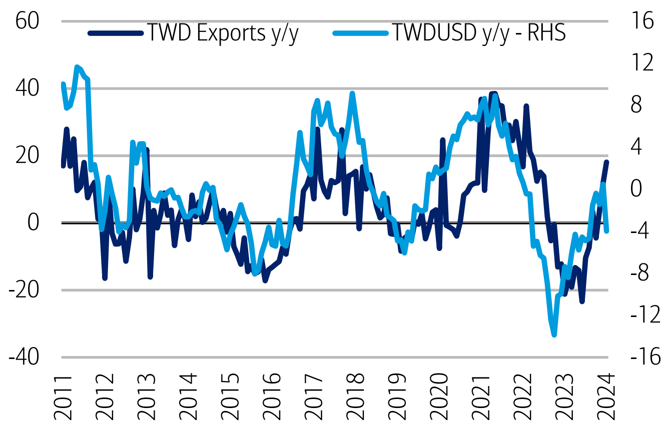
DF – deliverable forward

NT$ - New Taiwan Dollar

NEER – Nominal Effective Exchange Rate

Currently, there is a growing gap between Taiwan's exports and movement of TWDUSD. **Exhibit 2** shows throughout the past decade, the movement of TWDUSD is often explained by the performance of Taiwan's exports. Being a large current account surplus economy, this is not entirely surprising as a strong trade balance would result in a large excess holding of US$ which can be sold back to the local FX market resulting in local currency strength. However, in the latest months, this relationship has not been true: we see a dip in TWDUSD while exports remain strong. Thus, the relationship between the spot movement in TWD FX and trade balance is not a simple and direct 1-for-1 relationship.

Exhibit 2: Taiwan's exports and movement in TWD FX
Currently there is a divergence between Taiwan's export performance and movement of Taiwan FX



Source: Bloomberg

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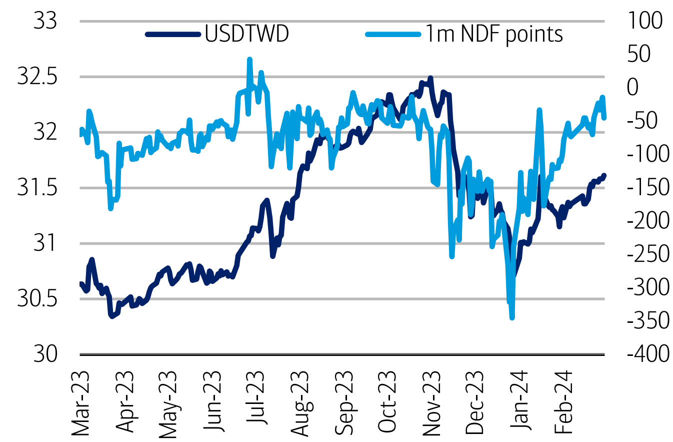
Exhibit 3: Spot USDTWD and 1-month NDF
1-month NDF points aggressively tightened, putting upward pressure on spot USDTWD



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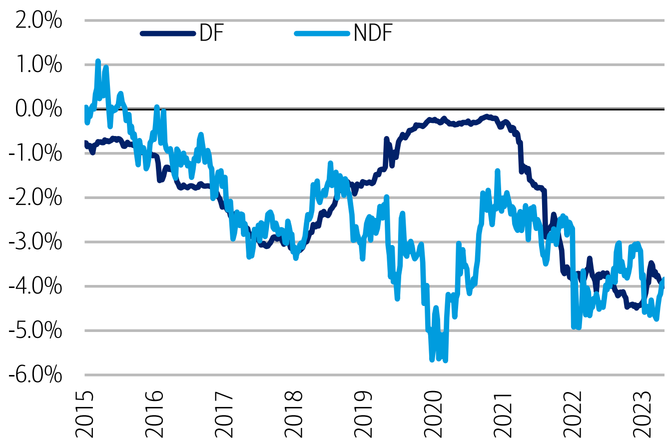
Our recent trip to Taiwan might provide some clues on this divergence. We do have not a single simple explanation for this divergence but the conversations we had with Taiwanese exports and lifers from our recent trip (early Feb-2024, see: [Asia FI & FX Strategy Watch: Taipei Trip Notes – February 2024]) might provide some qualitative details.

The lifers' FX-hedging ratio is likely declining. Firstly, we suspect lifers' FX-hedging ratios are likely coming off. **Exhibit 3** shows that currently spot USDTWD is moving tightly with 1-month NDF points. To us, this reflects that Taiwanese lifers are chasing higher the movement in spot by unwinding previous FX-hedging that they had likely conducted in 4Q23. **Exhibit 4** shows, currently FX-hedging cost across both the TWD DF and NDF curve remains high, at close to 4% annually. With the current US$ environment stabilizing, lifers are reducing FX-hedging cost and also recognizing realized FX gains if spot USDTWD further increases. The unwind of FX-hedging by lifers result in net buying of USDTWD outright which also pushes spot USDTWD higher.

Exhibit 4: Annual FX-hedging cost in selling USDTWD

Both DF and NDF cost of FX-hedging is close to 4%



Source: Bloomberg

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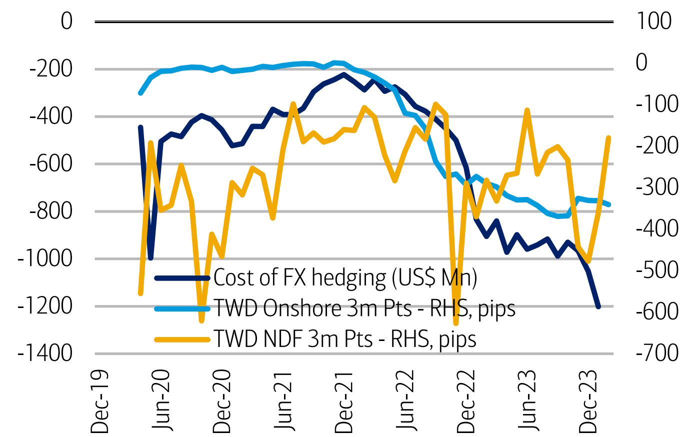
Exhibit 5: DF and NDF points and cost of FX-hedging

Monthly FX-hedging cost rose to a record high of US$ 1.2bn in Dec-2023



Source: Bloomberg

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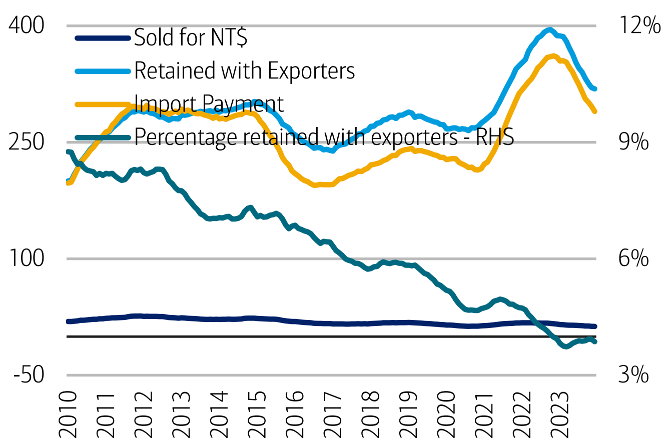
Export proceeds sold for NT$ remains at a decade low. Secondly, during our recent trip to Taiwan, Taiwan's exporters with whom we met told us that they are not meaningfully selling their FX earnings back to the local FX market. **Exhibit 6** shows the share that the exporters are converting their export proceeds back to NT$ remains at a decade low. Although this is not a new trend, when the exporters reduced their selling of US$ back to the local FX market, this means other flows (i.e. lifers unwinding FX-hedging, net equity flow etc) can have a bigger impact in the movement in spot USDTWD.

Annual ODI by Taiwanese corporates rose to US$ 24bn in 2023. Moreover, Exhibit 7 shows the outbound direct investment (ODI) needs of Taiwanese corporates significantly accelerated in 2023 to over US$ 24bn. This strong need to invest in overseas manufacturing capacity is driven by clients' demand (particularly EU and US clients) to reduce Chinese content from Taiwanese production. The increased need to invest overseas by Taiwanese corporates is also prompting them to retain a larger share of their export proceeds in foreign accounts and reduced their US$ selling for NT$.

Exhibit 6: Taiwan's export proceeds and sold for NT$ (US$ bn, 12-month sum)

The share of export proceeds sold for US$ remains at a decade low



Source: CEIC

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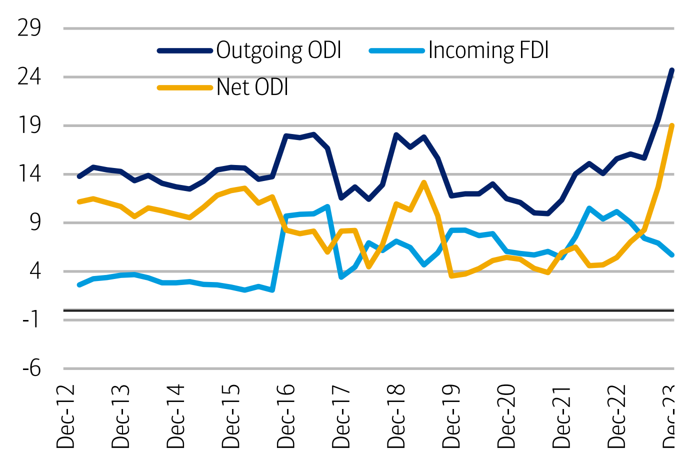
Exhibit 7: Patterns of foreign direct investment to and from Taiwan (US$ Bn, 4q-sum)

Outbound direct investment from Taiwanese corporations significantly accelerated in 2023.



Source: CEIC

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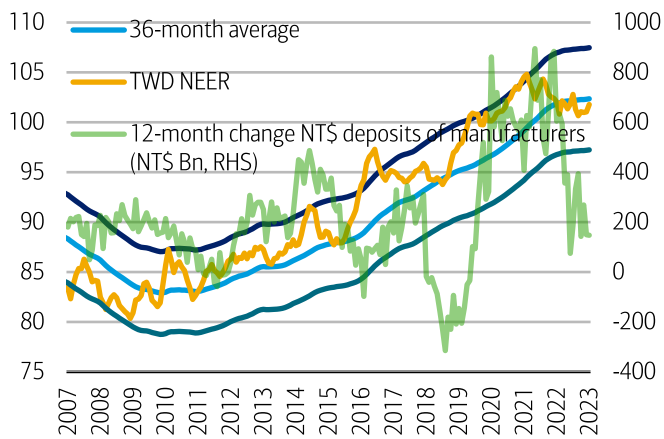
The growth of local NT$ deposits by manufacturers remain weak. Lastly, another angle to understand the disconnect between the current account activities and FX performance is to look at the growth rate of local NT$ deposits of Taiwan's manufacturers. Manufacturers represent the majority of Taiwan's export proceeds and the growth in NT$ deposit should mirror the US$ selling from export proceeds. In late-2020, when the manufacturers were actively converting exports proceeds to become NT$ deposits, this resulted in the TWD NEER to pushes against the upper limit of its 5% band. The latest data in Dec-2023 shows, the NT$ deposit growth of Taiwan's manufacturers remain on a general trend of decline, helping partially explain the recent underperformance of NT$.

Watch for whether NT$ deposits of Taiwanese manufacturers grow. However, should the trend of Taiwan's manufacturers retaining their export proceeds change, then we can once again expect a stronger correlation between Taiwan's trade performance and its FX performance.

Exhibit 8: TWD NEER and growth rate of NT$ deposits of Taiwan's manufacturers

In late-2020, when manufacturers' holdings of NT$ deposit grew, this resulted in TWD NEER pushing against the top range of its band



Source: CEIC, Bloomberg

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News and Views

Brazil: Central Government Primary Balance reached R$79.3bn surplus in January

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The Central Government reported a primary surplus of R$79.3bn in January, from R$116.1bn deficit in December. The result was close to market expectations of R$79.7bn. On the revenues side, net revenues increased 6.8% yoy in real terms. Expenses increased 3.8% yoy in real terms, reaching R$158.3bn – highlight to the spending on mandatory expenses with flow control (which includes social programs). In 12-month accumulated terms, the central government primary deficit went to R$230.1 bn or -2.3% of GDP in January (from -R$230.5bn or -2.1% of GDP).

- **To follow:** Revenues-boost measure should impact positively the primary result this year. All in, we continue with our out-of-consensus call of -0.5% of GDP for the central government primary balance in '24.

Brazil: Unemployment went up for the first time since Mar23

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According to the Nationwide Job Market Survey (PNAD), unemployment rate went up to 7.6% in January (vs 7.4% in December), below market expectations of 7.8%. The upward move came in line with the seasonal behavior. In seasonally adjusted terms, the unemployment rate went down to 7.8%, from 7.9% in Dec23. On the other hand, real income continued to grow in January, registering an increase of 4.0% yoy (vs 2.6% yoy in December) - mainly driven by the industrial sector (5.3%yoy).

- **To follow:** Looking ahead, we expect employment measures to deteriorate in 2024, especially due to activity deceleration compared to last year.

Brazil: GDP grew 2.9% in 2023

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GDP growth was qoqsa stable in 4Q23 for the second consecutive time (vs 0.0% qoqsa in 3Q23, revised from +0.1%). Compared to the same quarter in 2022, activity growth was stalled at 2.0% yoy (from 2.0% yoy previously). As a result, real GDP ended 2023 with 2.9% growth, roughly in line with our above consensus forecast of 3.0%. Looking at supply side, most of the categories posted positive results. Industry grew 1.3% qoqsa (vs 0.6% in 3Q23) and services 0.3% qoqsa (vs 0.3% in 3Q23), while agriculture contracted by -5.3% qoqsa (vs -5.6% in 3Q23), as record crops that boosted growth in 1H24 continues to paybacks on GDP readings. On the demand side, household consumption was disappointing at -0.2% qoqsa, though domestic demand (0.9% qoqsa) and government consumption (0.9% qoqsa) rose in the quarter. For the first time of the year, net exports contributed negatively, as imports increase (0.9% qoqsa) offset the shy exports hike of 0.1%qoqsa. Some inventories depletion was also recorded for the second consecutive quarter, which is positive for production in coming quarters.

- **To follow:** After 2023 GDP matched our end-year forecast, we continue to expect GDP growth at 2.2% this year. Growth should be gradually revised to the upside by the market, as interest rates reduction and better credit market conditions should bring positive results, amid a still resilient labor market.

Mexico: Banxico expects lower growth for 2024 in its 4Q report

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Banxico published its quarterly report for 4Q 2023. Banxico revised to the downside its growth forecasts for 2024 to 2.8% yoy (BofA 1.8%) from 3.0%, but left unchanged its forecast for 2025 at 1.5% (BofA 1.0%). Banxico left unchanged its inflation forecasts. Banxico expects headline inflation to end-2024 at 3.5% (BofA 4.9%), while its estimate for end-2025 is 3.1% (BofA 4.4%). Banxico expects core inflation for end-2024 at 3.5% (BofA 4.4%) while its forecast for end-2025 is 3.1% (BofA 4.2%). On inflation and monetary policy, Governor Rodriguez said that the disinflation process continues but that it still faces challenges, and deputy governor Mejía mentioned that advances in inflation outlook may deem to study a rate adjustment. Deputy governor Espinosa commented that inflation risks remain and that wages and demand in the services sector are still putting pressure on services' inflation. Finally, deputy governor Heath said it would be a mistake to lower the rate if Banxico is not sure that it will beat inflation.

- **To follow**: The cut to growth is slightly dovish. We maintain our view Banxico will likely cut in March. Regarding the various comments from the board members, we believe 3 out of 5 members are in line with starting a cutting cycle in March (the Governor included). In our view, deputy governor Espinosa is still the most hawkish member, followed by Heath who stressed the importance of not lowering the rate prematurely. Nonetheless, the latter mentioned that a 25bp adjustment could be useful. Hence, one possible scenario is that Banxico cuts by 25bp in March with a hawkish statement in line with Heath's view, which could put the votes 4 to 1 (Espinosa voting against).

Mexico: Unemployment rate at 2.76% sa in January

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Unemployment rate in January was slightly above expectations at 2.85% (E. 2.80%, BofA 2.75%), up from 2.61% in December. Once adjusted for seasonality, however, unemployment was 2.76% sa, down from 2.79% in December, still below 3.00% (has been since November 2022). The participation rate increased to 60.31% sa, from 60.21% (revised to the upside from 60.16%), while the informality rate increased to 54.48% sa, from 53.94%. Underemployment fell as well, to 7.30% from 7.87% in December.

- **To follow:** Despite the fall in unemployment once adjusted for seasonally, we believe Banxico is ready to cut in March (although, as the labor market clearly indicates, it should not, which will prevent inflation from converging to 3%).

Mexico: Consumer credit grew 11.3% yoy in real terms in January

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Total financing in Mexico as of January (both performing and non-performing loans) increased 3.0% yoy in real terms (vs 2.9% year ago, 2.9% month ago). Credit (performing) to the private sector rose 5.3% yoy in real terms (vs 4.9% year ago, 5.6% month ago) mainly due to consumer credit at 11.3% yoy (vs 9.0% year ago, 12.3% month ago). Housing credit grew 3.7% yoy in real terms (vs 3.6% year ago, 4.1% month ago), while corporate credit gew 2.7% yoy (vs 3.4% year ago, 3.0% month ago). The monetary base rose 5.9% yoy in real terms (vs 1.4% year ago, 4.8% month ago), while M1 rose 4.2% yoy (vs -1.8% year ago, 2.7% month ago).

- **To follow**: Credit growth is decelerating, but remains high in the case of consumer credit, which has remained in the double-digit range since March 2023. This is an upward pressure to inflation.

Mexico: Remittances slightly below expectations in January at US$4.6bn

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Remittances in January were slightly below expectations at US$4.6bn (E. US$4.7bn, BofA US$4.6bn). In annual terms, remittances increased 3.1% yoy (vs 2.2% yoy in December; 12.7% yoy last year). The number of remittances fell slightly by -0.7% yoy (vs 2.2% yoy in December; 11.2% yoy last year), while the average remittance increased 4.0% yoy (vs 0.0% yoy in December; 1.4% yoy last year) to US$389. In MXN, remittances fell -7.2% yoy (vs 4.4% yoy last year). Year to date, remittances totaled US$4.6bn (3.1% ytd).

- **To follow:** Remittances have decelerated but are still growing, still supporting consumption in Mexico.

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