

## Taiwan Watch

## Post-election quick takes

**DPP won the presidential election with 40.1% of vote**

On January 13, the ruling Democratic Progressive Party (DPP)'s candidate, Lai Ching-te, won the presidential election with 40.1% of the vote. This was followed by the other two major candidates, Hou Yu-ih from the Kuomintang (KMT) and Ko Wen-je from the Taiwan People's Party (TPP), who secured 33.5% and 26.5%, respectively. This is the first time since 2000 a political party in Taiwan has won the presidency for the third time straight. The new president will assume office on May 20, with a four-year term.

**No majority party in the Legislative Yuan**

However, the DPP lost majority in the Legislative Yuan (Taiwan's parliament). Out of the total 113 seats in the Legislative Yuan, the DPP got 51 seats (-10 vs. 2020), the KMT 52 (+14), and the TPP 8 (+3). This is the first time since 2004 that no party won a majority in Legislative Yuan, which requires 57 seats. This set-up makes the TPP the deciding force if either of the larger parties wish to pass any legislation or enact their agendas.

**Potential gridlock in legislation**

The outcome of both the presidential and legislative elections came largely in line with pre-election polls and what the market had expected. That said, how much a divided government can affect Taiwan's policy agenda for the next four years is still not clear.

Over the past 16 years since 2008, the President and the majority in the Legislative Yuan had always been from the same party (Exhibit 1). The DPP's control of both the executive and legislative branches of the government over the past 8 years had made legislation relatively smooth. This time, the new set-up of the government could limit Mr. Lai's ability to pass bills and implement policy changes (e.g., budget spending). Such a gridlock could be avoided only if the DPP forms a coalition with the TPP, which the market does not perceive as a likely scenario.

**What to watch for next?**

After the elections, the next key events/developments to watch for include: (1) election of the president of the Legislative Yuan on 1 February 2024, the first day of next legislative session; (2) whether the DPP, KMT and TPP can negotiate effectively in the Legislative Yuan; and (3) Mr. Lai's inauguration speech when he assumes office on May 20.

**Economic impact likely limited in near term**

While the election outcome has stirred some concerns about geopolitical tensions, we believe the actual economic impact would be limited. In the near term, the market will be closely watching whether mainland China will remove more or even the whole early harvest programs under the Economic Cooperation Framework Agreement (ECFA) that gives preferential tariffs to Taiwanese products.

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Timestamp: 15 January 2024 07:45PM EST

Such preferential treatment for 12 petrochemical products from Taiwan had already ended in December 2023 (i.e., tariffs lifted from zero to 2-10%). China's Ministry of Commerce also announced earlier that similar actions on machines, textiles, car parts, farms and fish are planned. So far, the impact on Taiwan's overall trade is small, as those 12 products only comprise a small share of its total exports to mainland China (1.3%).

Assuming the most extreme scenario if the ECFA is fully suspended, about 5% of Taiwan's exports would be affected (not banned, but just with higher tariffs). Note that the main beneficiaries under ECFA are traditional sectors, including petrochemicals, machinery and textile. However, these products only account for about 20% of Taiwan's exports to mainland China, which in turn contributes to 25% of Taiwan's total exports. Electronic parts (mostly semiconductors), which account for over half of Taiwan's exports to mainland China (Exhibit 2), will not be directly affected by the status of ECFA.

### Exhibit 1: History of Taiwan elections

The 2024 elections marked the first time since 2004 that no party won a majority in Legislative Yuan

Election Year	Elected party	Election Vote share (in %)	Seats held in legislature
1996 (1998 for legislature)	KMT: Lee Teng-hui(李登輝)	54	123
2000 (2001 for legislature)	DPP: Chen Shui-bian(陳水扁)	39.3	87
2004	DPP: Chen Shui-bian(陳水扁)	50.11	89
2008	KMT: Ma Ying-jeou (馬英九)	58.44	81
2012	KMT: Ma Ying-jeou (馬英九)	51.6	64
2016	DPP: Tsai Ing-wen(蔡英文)	56.12	68
2020	DPP: Tsai Ing-wen(蔡英文)	57.13	61
2024	DPP: Lai Ching-te(賴清德)	40.05	51

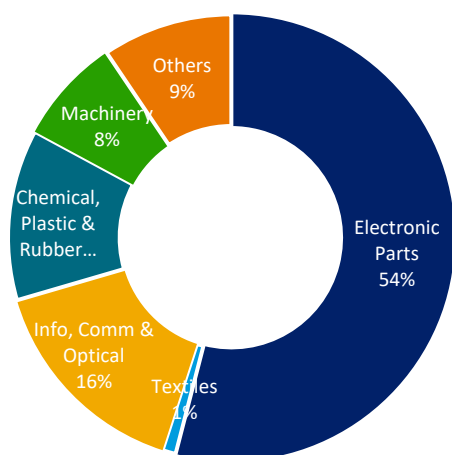
**Note:** Dotted line marks seats needed for majority. Total seats = 113 since 2008 and 225 during 1998-2004.

**Source:** News

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### Exhibit 2: Taiwan's exports to mainland China (2023)

Electronic parts (mostly semiconductors) account for 54% of Taiwan's exports to mainland China



**Source:** CEIC

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# FX implications

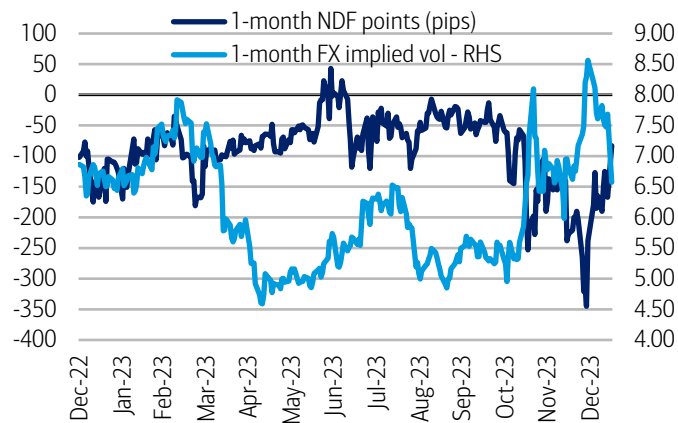
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**Spot FX and FX volatility reacted largely within our expectations following this weekend's election.** As noted in [Emerging Insight: A heavy downside skew to USDTWD ahead of the election 08 January 2024](#), our base-line expectations for FX performance following the election was a relatively muted reaction in the spot FX (for both the USDTWD and the TWD NEER) and a larger reaction in implied FX volatility and in risk reversals. We note that, in Taiwan's past six elections, the 3-month implied FX vol on USDTWD declined by around 0.2 to 0.3, while the 25-delta 3-month risk reversals increased by around 0.2, 10 trading days following the general election.

**Implied FX volatility declined while USDTWD risk reversals become less negative after the election.** In the 2024 election, during the first trading day following the election, the Taiwanese Dollar depreciated by around 0.5% versus the USD, weaker than our base-case expectations, but within expectations. In-line with our base case is the decline in implied FX volatility. The increase in spot USDTWD and unwind of downside hedges have front-end NDF points (using the 1-month as representative) rising. The increase in NDF points reduced the value of USDTWD puts and decreased the overall value of long gamma positions, resulting in a decline in 1-month implied FX volatility (**Exhibit 3**). The decline in the value of puts versus call makes USDTWD risk reversals less negative (**Exhibit 4**).

**Exhibit 3: 1-month NDF points and 1-month implied FX volatility**

The rise in NDF points reduced the value of implied FX volatility...

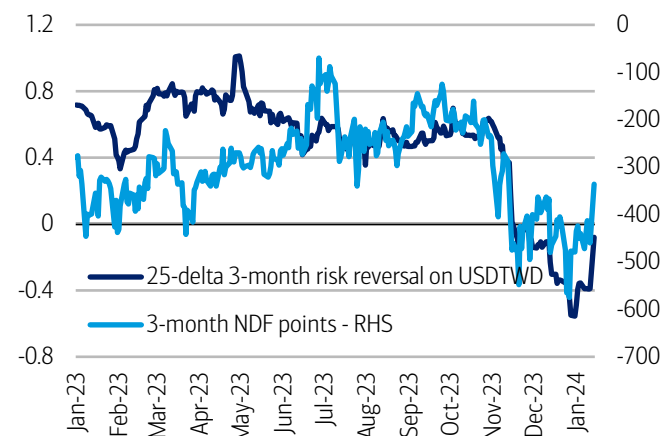


Source: Bloomberg

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**Exhibit 4: USDTWD risk reversals and NDF points**

... the removal of downside USDTWD risks is making risk reversals less negative



Source: Bloomberg

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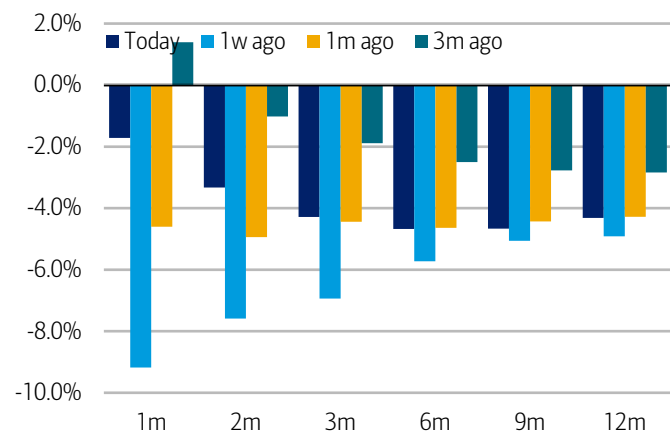
## Expect USDTWD to decline in 1H24 but FX carry on NDF curve remains deep

With the election risk over and the market positioning for a dovish Fed pivot, we think spot USDTWD can decline for the first six months of 2024. Moreover, with AI exports strong and non-tech exports recovering, we think the backdrop is favorable for Taiwanese Dollar appreciation. However, despite this backdrop, the NDF curve remains deep and negative at 4-5% (annualized) around the 3-6 month tenors (**Exhibit 5**). With the US rates market already pricing close to seven cuts for the coming 12 months, we think the marginal benefit of additional rally to US rates resulting in tech equity inflows into Taiwan would be limited. Our core position on USDTWD remains to receive forward-forward position for lower NDF points over time (see: [Asia FI & FX Strategy Viewpoint](#):

[Asia Year Ahead 2024 – A break out year 21 November 2023](#)) as lifers increase their FX-hedging ratio. Risk to this view is a stronger USD and higher spot USDTWD.

#### Exhibit 5: Annualized FX carry on sell USDTWD position

Despite narrowing versus 1-week ago, annualized carry on selling USDTWD remains high



Source: Bloomberg

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