

Country analysis

Taiwan

Taiwan Banks

Loan growth zooms ahead

Banks

In our October sector initiation we made the seemingly bold call that declining lending and LDR would turn around, helping to lift Taiwan financials to an OVERWEIGHT. Now we have egg on our faces—for being too conservative!

Loan growth powers ahead in 2H03. Since our last sector update, Taiwanese lending has picked up markedly, to finish out 2003 with a total gain of 5.1% versus our previous forecast of a 3.6% increase. With year-on-year growth almost doubling in the last four months of the year and macro indicators looking better than expected, our 2004-05 forecasts of 5.7% and 5.8% growth, respectively, are looking conservative.

Loans-to-deposits also rise. Even more important than the volume growth is that the critical LDR began to rise decisively in 4Q03; we believe that this presages improved margins in 2004 as supply and demand for money come back into balance.

Deposits are peaking. Although the rising LDR is currently driven by loan growth, looking further out towards year-end, we believe that an attractive domestic market for risk assets including property and equities will begin to shrink the deposit base and thus produce a dual LDR-boosting effect.

Card growth still steady. Card spending and revolving balances have largely recovered from the SARS period and should slightly exceed our predicted 15% growth for 2003 when final figures are in. At this rate of increase, we see no risk to overall credit quality—particularly given strong employment data.

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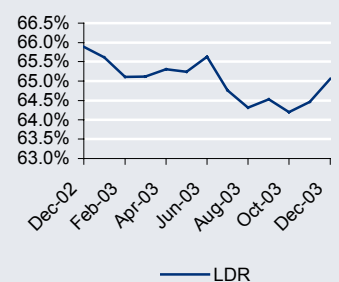
9 February 2004

Loan growth (%ch YoY)



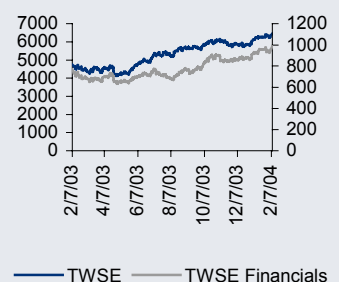
Source: CBC

LDR



Source: CBC

Share performance



Source: Datastream

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Fig 1 Total loans (NT\$m)

	1995	1996	1997	1998	1999	2000	2001	2002	2003
Commercial and SOEs	3,390,690	3,270,534	3,778,670	4,407,831	4,944,061	5,180,323	5,050,335	4,964,234	5,050,335
Agricultural, forestry, fishing and animal husbandry	23,154	22,400	22,938	30,582	25,141	27,069	13,384	14,475	18,401
Mining and quarrying	8,831	9,935	12,204	12,249	14,174	15,097	6,685	5,733	5,312
Manufacturing	1,435,636	1,399,614	1,610,308	1,793,809	2,097,744	2,345,005	2,305,171	2,256,434	2,255,761
Electricity, gas and water supply	186,263	180,195	182,987	193,098	180,390	197,744	206,011	207,283	204,166
Construction	471,119	408,057	445,070	532,617	501,586	440,982	342,961	312,249	305,435
Trade	599,693	562,406	658,022	707,014	761,079	759,672	673,999	653,757	717,275
Accommodation and eating-drinking places	21,471	21,891	18,490	28,543	27,711	33,125	56,717	50,685	53,206
Transport, storage and communication	132,295	133,657	165,142	165,931	206,847	281,946	278,741	366,583	401,948
Finance and insurance	74,928	114,066	141,778	246,262	316,156	233,081	428,283	448,299	459,025
Real Estate, rental and leasing	233,605	228,411	270,841	335,591	397,766	435,634	483,275	415,570	394,206
Services	203,695	189,902	250,890	362,135	415,467	410,968	255,108	233,166	235,600
Government agencies	928,150	1,132,394	1,357,950	1,507,623	1,693,764	2,007,421	2,055,935	1,839,738	1,839,384
Social Security insurance, pension fund and non-profit institutions	42,073	50,326	36,654	42,945	48,850	55,264	71,917	107,481	117,989
Individuals	3,023,037	3,408,407	4,115,930	4,444,450	4,599,916	4,754,566	4,650,040	4,670,589	5,163,531
Total loans	7,383,950	7,861,661	9,289,204	10,402,849	11,286,591	11,997,574	11,828,227	11,582,042	12,171,239

Source: CBC

Fig 2 Loans by category (% of total)

	1995	1996	1997	1998	1999	2000	2001	2002	2003
Commercial and SOEs	45.9	41.6	40.7	42.4	43.8	43.2	42.7	42.9	41.5
Agricultural, forestry, fishing and animal husbandry	0.3	0.3	0.2	0.3	0.2	0.2	0.1	0.1	0.2
Mining and quarrying	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0
Manufacturing	19.4	17.8	17.3	17.2	18.6	19.5	19.5	19.5	18.5
Electricity, gas and water supply	2.5	2.3	2.0	1.9	1.6	1.6	1.7	1.8	1.7
Construction	6.4	5.2	4.8	5.1	4.4	3.7	2.9	2.7	2.5
Trade	8.1	7.2	7.1	6.8	6.7	6.3	5.7	5.6	5.9
Accommodation and eating-drinking places	0.3	0.3	0.2	0.3	0.2	0.3	0.5	0.4	0.4
Transport, storage and communication	1.8	1.7	1.8	1.6	1.8	2.4	2.4	3.2	3.3
Finance and insurance	1.0	1.5	1.5	2.4	2.8	1.9	3.6	3.9	3.8
Real estate, rental and leasing	3.2	2.9	2.9	3.2	3.5	3.6	4.1	3.6	3.2
Services	2.8	2.4	2.7	3.5	3.7	3.4	2.2	2.0	1.9
Government agencies	12.6	14.4	14.6	14.5	15.0	16.7	17.4	15.9	15.1
Social Security insurance, pension fund and non-profit institutions	0.6	0.6	0.4	0.4	0.4	0.5	0.6	0.9	1.0
Individuals	40.9	43.4	44.3	42.7	40.8	39.6	39.3	40.3	42.4
Total loans	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: CBC

Loan growth takes a turn for the better

After two straight calendar years of declining loan balances, Taiwanese financials picked up the pace dramatically in 2H03 to finish the year strongly in the black. At the end of July, aggregate lending was rising at a meagre 2.3% annual rate; however, a strong finish to the year made the final tally a very respectable 5.1% increase—well above our estimate of 3.6% growth for the full year and the strongest year since 2000.

Although the growth is still patchy, with numerous areas of weakness, strength in the critical retail mortgage (+8.0%) and personal lending (+15.5%) areas, which collectively account for some 42% of total loans, is carrying the market. Trade finance also did creditably, up 9.7% on the year.

A big surprise was the slowdown in manufacturing lending, which had been up 0.7% at mid-year. Some seasonality may be at work here, but recent years' data are ambiguous on the subject. Government loans also shrank; not a concern for us as they are marginally profitable anyway.

Fig 3 Loans by category (% growth YoY)

	1996	1997	1998	1999	2000	2001	2002	2003
Commercial and SOEs	(3.5)	15.5	16.7	12.2	4.8	(2.5)	(1.7)	1.7
Agricultural, forestry, fishing and animal husbandry	(3.3)	2.4	33.3	(17.8)	7.7	(50.6)	8.2	27.1
Mining and quarrying	12.5	22.8	0.4	15.7	6.5	(55.7)	(14.2)	(7.3)
Manufacturing	(2.5)	15.1	11.4	16.9	11.8	(1.7)	(2.1)	(0.0)
Electricity, gas and water supply	(3.3)	1.5	5.5	(6.6)	9.6	4.2	0.6	(1.5)
Construction	(13.4)	9.1	19.7	(5.8)	(12.1)	(22.2)	(9.0)	(2.2)
Trade	(6.2)	17.0	7.4	7.6	(0.2)	(11.3)	(3.0)	9.7
Accommodation and eating-drinking places	2.0	(15.5)	54.4	(2.9)	19.5	71.2	(10.6)	5.0
Transport, storage and communication	1.0	23.6	0.5	24.7	36.3	(1.1)	31.5	9.6
Finance and insurance	52.2	24.3	73.7	28.4	(26.3)	83.7	4.7	2.4
Real Estate, rental and leasing	(2.2)	18.6	23.9	18.5	9.5	10.9	(14.0)	(5.1)
Services	(6.8)	32.1	44.3	14.7	(1.1)	(37.9)	(8.6)	1.0
Government agencies	22.0	19.9	11.0	12.3	18.5	2.4	(10.5)	(0.0)
Social Security insurance, pension fund and non-profit institutions	19.6	(27.2)	17.2	13.8	13.1	30.1	49.5	9.8
Individuals	12.7	20.8	8.0	3.5	3.4	(2.2)	0.4	10.6
Total loans	6.5	18.2	12.0	8.5	6.3	(1.4)	(2.1)	5.1

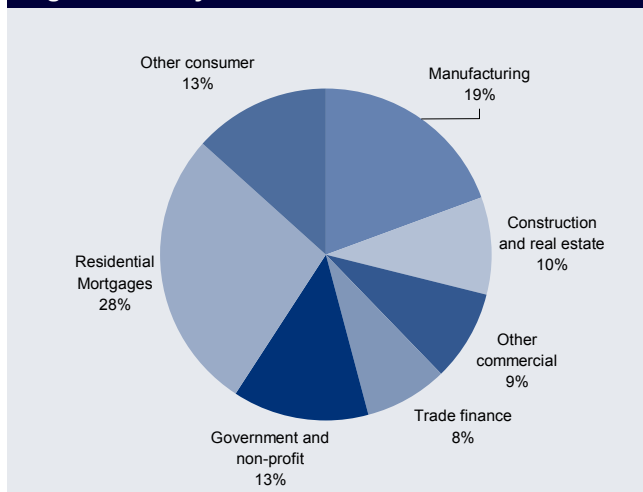
Source: CBC

Remember that loan growth has been fighting an offsetting tide of write-downs of bad loans: since YE1998, domestic banks together have written-off over NT\$1tr in bad debt, or fully 8% of the current loan base.

Stable loan mix

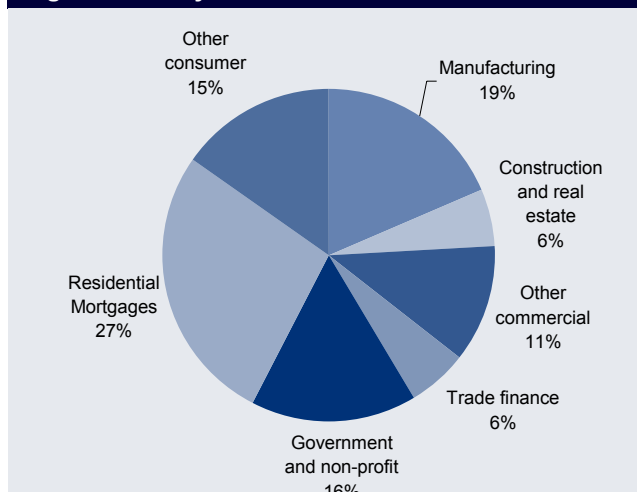
Taiwanese industry loan mix has remained fairly constant over the past decade, with the major changes being the relative contraction in importance of the construction sector and trade finance, and the increase in non-mortgage consumer lending and loans to service-sector businesses.

Fig 4 Industry loan mix: 1995



Source: CBC

Fig 5 Industry loan mix: 2003



Source: CBC

Targets now look conservative

Our original estimate of 3.6% having been handily exceeded, our 2004-06 forecasts of 5.7%, 5.8% and 5.0% growth are now starting to look a little conservative. In particular, we expect added growth next year to come as manufacturing lending picks up to 7% from its current flat status, while consumer lending should continue to be strong.

We see 2005 as the peak year for loan growth, with many projects and facilities arranged in the 2004 post-election period only being fully-disbursed in that year, and improved cross-strait relations potentially leading to the recapture of Taiwanese corporates on the mainland.

As before, we forecast a 7% increase in manufacturing loans in 2004 (versus 0% in 2003) and an 8.5% increase in 2005. These are big numbers for growth, but by no means a return to the heyday of 1997-2000, when manufacturing loans grew at an average annual rate of 13.8%.

We project that lending to individuals will strengthen to 9% by 2005, before falling back to 8% in 2006. With stronger economic growth and pressure off property prices, even this high rate of borrowing will not significantly increase the debt/income or debt/asset positions of Taiwanese households, in our view.

Bear in mind that consumption generally follows unemployment; with a consistent fall in this measure over the past four months and fifteen months past the peak level, the effects should be kicking in right about...now.

Fig 6 Total loans (NT\$m)

	2002	2003	2004F	2005F	2006F
Commercial and SOEs	4,964,234	5,050,335	5,218,730	5,491,858	5,782,946
Agricultural, forestry, fishing and animal husbandry	14,475	18,401	19,597	20,773	22,019
Mining and quarrying	5,733	5,312	5,046	5,147	5,353
Manufacturing	2,256,434	2,255,761	2,413,664	2,618,826	2,802,144
Electricity, gas and water supply	207,283	204,166	212,537	225,289	236,553
Construction	312,249	305,435	299,326	305,313	312,946
Trade	653,757	717,275	763,898	813,551	854,229
Accommodation and eating-drinking places	50,685	53,206	52,674	53,727	55,877
Transport, storage and communication	366,583	401,948	418,026	438,927	458,679
Finance and insurance	448,299	459,025	422,303	401,188	413,223
Real estate, rental and leasing	415,570	394,206	372,525	360,418	364,022
Services	233,166	235,600	239,134	248,699	257,901
Government agencies	1,839,738	1,839,384	1,912,959	1,874,700	1,771,592
Social Security insurance, pension fund and non-profit institutions	107,481	117,989	129,788	136,277	143,091
Individuals	4,670,589	5,163,531	5,602,431	6,106,650	6,595,182
Total loans	11,582,042	12,171,239	12,863,909	13,609,486	14,292,811

Source: CBC

Fig 7 Loans by category (% growth YoY)

	2002	2003	2004F	2005F	2006F
Commercial and SOEs	(1.7)	1.7	3.3	5.2	5.3
Agricultural, forestry, fishing and animal husbandry	8.2	27.1	6.5	6.0	6.0
Mining and quarrying	(14.2)	(7.3)	(5.0)	2.0	4.0
Manufacturing	(2.1)	(0.0)	7.0	8.5	7.0
Electricity, gas and water supply	0.6	(1.5)	4.1	6.0	5.0
Construction	(9.0)	(2.2)	(2.0)	2.0	2.5
Trade	(3.0)	9.7	6.5	6.5	5.0
Accommodation and eating-drinking places	(10.6)	5.0	(1.0)	2.0	4.0
Transport, storage and communication	31.5	9.6	4.0	5.0	4.5
Finance and insurance	4.7	2.4	(8.0)	(5.0)	3.0
Real estate, rental and leasing	(14.0)	(5.1)	(5.5)	(3.3)	1.0
Services	(8.6)	1.0	1.5	4.0	3.7
Government agencies	(10.5)	(0.0)	4.0	(2.0)	(5.5)
Social Security insurance, pension fund and non-profit institutions	49.5	9.8	10.0	5.0	5.0
Individuals	0.4	10.6	8.5	9.0	8.0
Total loans	(2.1)	5.1	5.7	5.8	5.0

Source: CBC

Credit cards

Card transaction values are back into positive YoY territory—remember that the SARS epidemic earlier in 2003 took a huge chunk out of card spending, particularly overseas spending as most flights were cut. Local spending is nevertheless showing an 11.7% annualised gain for the year through November, not far below the 2002 level and pretty resilient on the whole.

Cash advances are increasing faster than regular charge volume—a potential danger sign, but not one which is so far worrisome; we suspect that it is more a reaction to low teaser-rate programmes than anything else.

Fig 8 Credit card transactions and receivables: 1995-2003

NT\$m	1995	1996	1997	1998	1999	2000	2001	2002	2003/11
Total transaction value:									
Local	N/A	227,386	322,480	441,505	545,830	660,934	716,162	813,489	908,936
Overseas	N/A	45,001	51,945	49,592	51,956	58,836	55,700	60,107	56,371
Total	190,653	272,387	374,425	491,097	597,786	719,770	771,862	873,596	884,864
% increase		42.9	37.5	31.2	21.7	20.4	7.2	13.2	1.3
% increase, local			41.8	36.9	23.6	21.1	8.4	13.6	11.7
% increase, overseas			15.4	-4.5	4.8	13.2	-5.3	7.9	-6.2
Cash advances									
Local	N/A	13,453	24,456	38,172	49,682	77,820	101,601	130,376	174,733
Overseas	N/A	1,249	1,286	1,466	1,706	1,948	2,178	2,110	2,153
Total	N/A	14,702	25,742	39,638	51,388	79,768	103,779	132,486	156,878
% increase			75.1	54.0	29.6	55.2	30.1	27.7	18.4
% increase, local			81.8	56.1	30.2	56.6	30.6	28.3	34.0
% increase, overseas			3.0	14.0	16.4	14.2	11.8	-3.1	2.1
Total receivables outstanding	N/A	N/A	88,420	124,908	152,768	205,656	259,875	316,328	368,381
% increase, YoY				41.3	22.3	34.6	26.4	21.7	16.5

Note: 2003 figures are annualised.

Source: CBC

On the balance side, total receivables are increasing at a 16.5% annual rate; good news for Chinatrust, Taishin and Fubon, among others. We continue to believe that card balances in Taiwan can grow at a 15%+ CAGR over the next five years, especially on the back of improved macroeconomic performance and real income growth for consumers.

Loan to deposit ratio now rising

All year long we have been pounding the table on the critical LDR as a leading indicator for profitability, and in October we went on record as saying that Taiwan's long LDR slide (from a peak of 83.3% to a low of 64.3%) had turned around. The data now show that Taiwan did indeed lift off the bottom, with gross loans growing from June 2003 onwards and LDR rising from September onwards.

Our estimates call for an acceleration in the rise in LDR from 2H04 onwards as still-rising deposits begin to run off in favour of investments in property, equities and other risk assets—such makes a reflationary market.

Fig 9 Taiwan LDR: 1961-2003



Source: CBC

Fig 10 Taiwan LDR: 2000-2003



Source: CBC

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Recommendations

In Asia ex-Japan our recommendations are defined as follows:

Buy: At least 10% share price upside is expected over our 12-month view.

Hold: Share price movement of between -10% and +10% is expected on a 12-month view.

Sell: At least 10% share price downside is expected over our 12-month view.

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