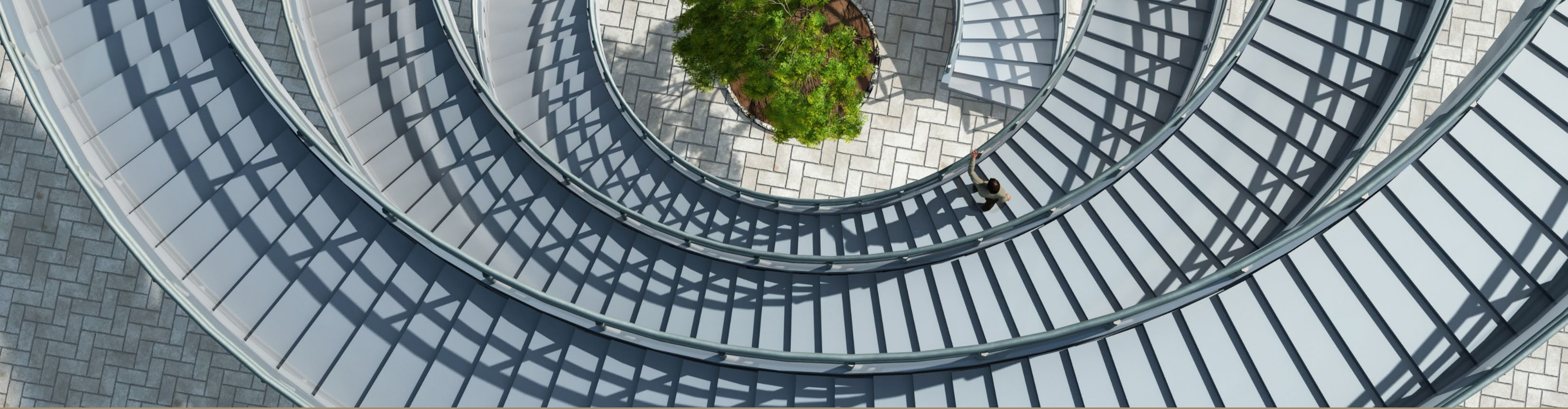


# 2024 Taiwan Credit Outlook

## Tech Demand To Determine Pace Of Recovery

**David Hsu, Associate Director**
Corporate Ratings

**Yuhan Lan, Director**
Financial Services Ratings

**Joe Lin, Director**
Structured Finance &
Fixed-income Fund Ratings

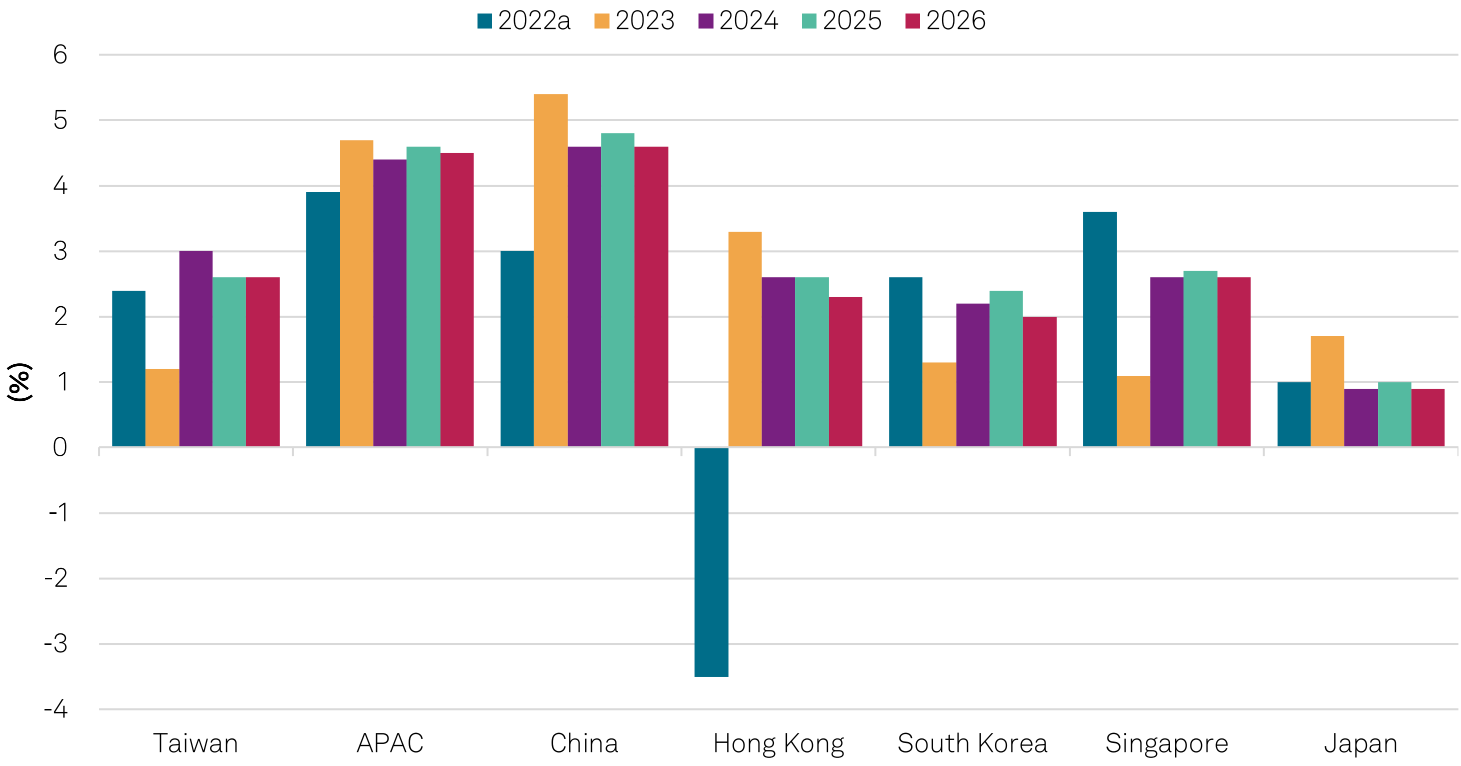
Dec. 14, 2023

S&P Global
Ratings

*This report does not constitute a rating action*

# Rising Tech Demand To Underpin A Rebound In Taiwan's GDP Growth In 2024

## GDP growth rates among key Asia-Pacific economies

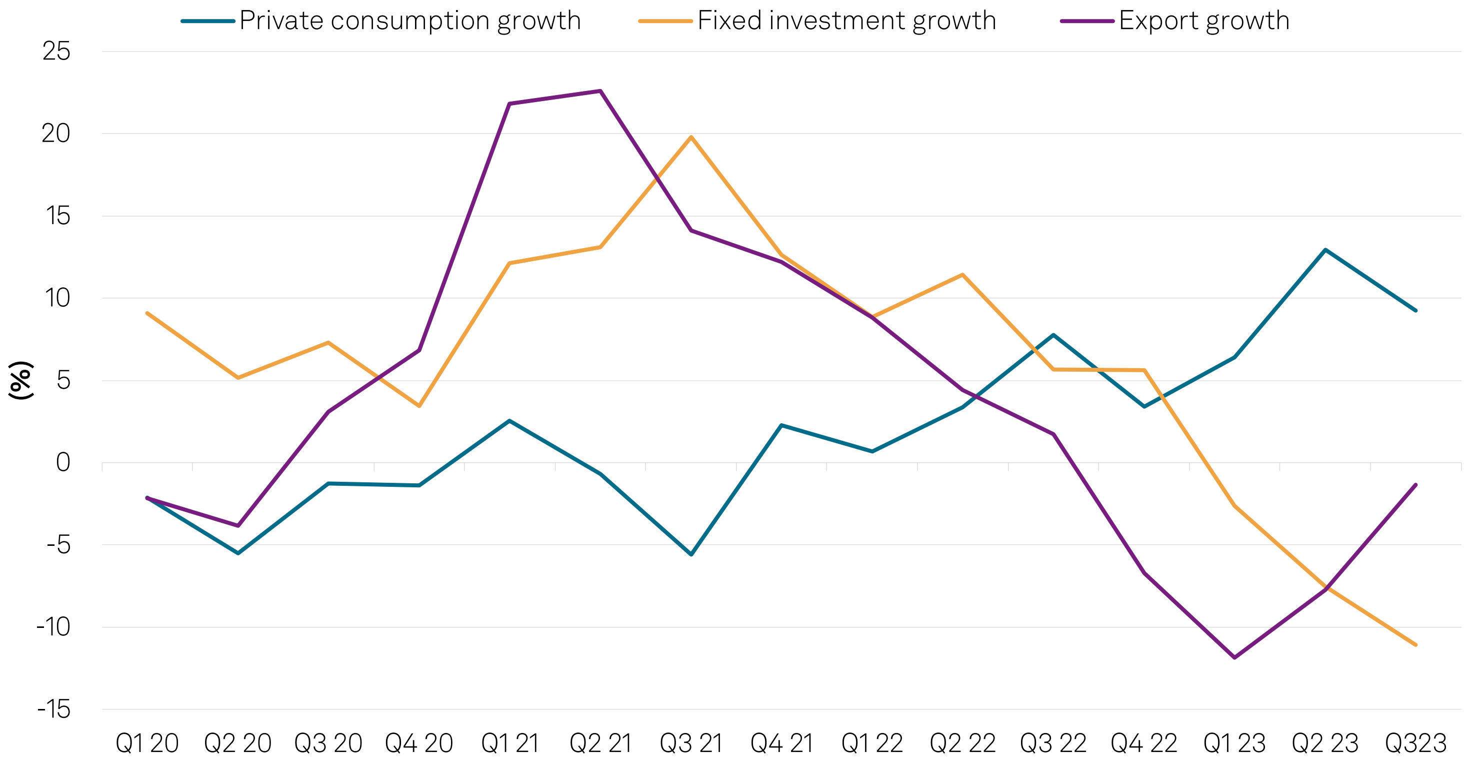



Source: S&P Global Ratings. a—Actual.

- Exports are an important driver of Taiwan's economy. We expect Taiwan's economic growth to rebound to 3% in 2024, from 1.2% in 2023, which reflects stronger activity in the tech sector.
- However, sluggish global trade and subdued growth in China could constrain Taiwan's upside growth potential, particularly for the commodity sectors.
- S&P Global Ratings expects a soft landing and slight GDP growth of 1.5% in the U.S., 0.8% in the eurozone and 4.6% in China in 2024.
- We expect policy rates in Taiwan to fall by around 25 bps in the second half of 2024 though global interest rates are likely to remain higher for longer.

# Macro Uncertainties Remain Despite Likely Monetary Policy Easing

## Key drivers behind Taiwan's GDP growth
(Year-on-year growth)




Source: Directorate General of Budget, Accounting and Statistics, Executive Yuan, R.O.C.

- **Economic growth is back on track.** A rebound in consumer demand for electronics and rising demand for electric vehicles, renewable energy and artificial intelligence could support Taiwan's export growth in 2024.
- **Slowing consumption and investment.** Domestic consumption is likely to be modest in 2024, given the high base growth in 2023 once the impact of the COVID-19 pandemic subsided. In addition, cautionary consumer behavior will slow discretionary spending amid still-high prices. Corporate investment will remain slow amid the gloomy global economic outlook.
- **Global macroeconomic obstacles.** Uncertainties include restructuring of the global supply chain, the high interest rate environment, and geopolitical tension, and could weigh on corporate capital expenditure plans over the next few quarters.

# Top Risks Facing Taiwanese Entities

| Top Risks | Risk Level | Risk Trend |
|---|---|---|
| **Global economic downturn:** U.S. and Europe risk a hard landing, further depressing aggregate demand and exports | High | Unchanged |
| **China's economy:** Deepening property sector woes, weak confidence, and high debt levels to weaken China's growth momentum | High | Unchanged |
| **Higher prices:** Inability to fully pass-through high prices could risk increasing cost pressure faced by borrowers | High | Improving |
| **Financing:** High rates for longer to exacerbate interest burdens and worsen prospects of weaker credit issuers | Elevated | Unchanged |

| Structural Risks | | |
|---|---|---|
| **Geopolitics:** Intensification of geopolitical tensions could hit business confidence, worsening trade and investment conditions | High | Unchanged |
| **Climate change:** Extreme weather and energy transition could threaten supply and costs | Elevated | Worsening |
| **Technology:** Accelerating technological advancement and mounting cyber-attacks could disrupt business operations | Elevated | Unchanged |

Note: Risk levels may be classified as moderate, elevated, high, or very high. They are evaluated by considering both the likelihood and systemic impact of such an event occurring over the next one to two years. Typically, these risks are not factored into our base-case rating assumptions unless the risk level is very high. Risk trend reflects our current view about whether the risk level could increase or decrease over the next 12 months.
Source: Credit Conditions Asia-Pacific Q1 2024: China Slows, India Grows, published Nov. 28, 2023, by S&P Global Ratings.

# Key Economic Metrics For Taiwan

| | 2022 | 2023e | 2024e | 2025e | 2026e |
|---|---|---|---|---|---|
| Real GDP % | 2.4 | 1.2 | 3.0 | 2.6 | 2.6 |
| Inflation % | 2.9 | 2.5 | 1.5 | 1.0 | 1.0 |
| Unemployment % | 3.7 | 3.5 | 3.4 | 3.5 | 3.5 |
| Policy rate % (year end) | 1.75 | 1.88 | 1.63 | 1.38 | 1.13 |
| Exchange rate (per U.S. dollar) | 30.7 | 32.4 | 32.1 | 31.9 | 31.7 |

Note: Inflation and unemployment rate shown are the period average. e--Estimate. Source: Economic Outlook Asia-Pacific Q1 2024: Emerging Markets Lead The Way, published November 2023 by S&P Global Ratings.

# Top Risks Facing Taiwan-Based Entities

## U.S. and Europe risk a hard landing, further depressing aggregate demand and exports

The lagged effects of rapid rate hikes by the Fed and the European Central Bank have slowed global economic growth. More conservative household consumption and corporate investment activity could exacerbate the demand slowdown from Western economies. For Taiwan, tepid global trade will hit exports and manufacturing activities. At the same time, slower growth in China and a widening Middle East conflict could sour business and household propensity to consume.

## Deepening property sector woes, weak confidence and high debt levels to weaken China's growth momentum

Persistent weakness in the Chinese real estate sector, tepid household and business confidence, high debt, and subdued exports are curbing China's economic growth momentum. Contagion risk from weaker confidence could spill over into real estate-related sectors (such as building materials and engineering and construction) and consumption-related sectors. Fiscal constraints in local governments due to weak land sales revenue, limit their ability to contain spillover risks, which could arise from defaults from some state-owned enterprises or highly indebted local government financial vehicles. For Taiwan, the spillover effect could be more significant due to its close economic ties with China.

Source: Credit Conditions Asia-Pacific Q1 2024: India, Southeast Asia Advance As China Slows, published Dec. 5, 2023, by S&P Global Ratings.

# Top Risks Facing Taiwan-Based Entities (cont)

## Inability to pass through persistently high prices will drag on already thin profit margins

While inflation risks have eased, rising food and fuel prices could lead to higher core inflation. Taiwan's net energy-importing status underlines its susceptibility to high fuel prices. Should the Middle East conflict intensify and widen, an energy supply shock could spur inflation and weigh on economic activity. Although businesses have been gradually passing through higher input costs to customers, slowing consumption could limit further efforts by businesses to raise prices. Specifically, Taiwan exporters to China, Europe, and the U.S. could find it hard to raise prices due to slowing demand. Meanwhile, weakness in the new Taiwan dollar (NT$) could lead to higher imported inflation.

## High rates for longer to exacerbate interest burdens and worsen prospects for weaker credit issuers

While financing access appears stabilized, lower-rated issuers remain susceptible to higher borrowing costs and liquidity squeezes. Slowing global economies and high input prices could further the weakened credit quality of borrowers. Higher interest rates could weaken the cash flow of Taiwan corporates. However, the degree is much milder than for regional peers with lower domestic interest rates and low dependence on U.S. dollar funding. Tightened USD liquidity and the high interest differential between the USD and NT$ could continue to have a negative impact on Taiwan life insurers.

Source: Credit Conditions Asia-Pacific Q1 2024: India, Southeast Asia Advance As China Slows, published Dec. 5, 2023, by S&P Global Ratings.

# Top Risks Facing Taiwan-Based Entities (cont)

## Intensification of geopolitical tensions could hit business confidence, worsening trade and investment conditions

A deepening or widening of political tensions and conflicts, particularly U.S.-China geopolitical friction, could spill over into regional trade and investment flows. A further reduction in supply chain reliance on China by Western and other importers could push up near-to-medium costs, adding to inflation pressures. A widening of investment and export restrictions by the U.S. on China in respect of high-end semiconductors, quantum technology and artificial intelligence, and the Chinese response of curbing raw mineral exports would affect supply chains. An escalation of international disputes would damage economic activity.

## Extreme weather and energy transition to threaten supply and costs

While countries are trying to cope with more extreme weather and adjusting to the costs of climate-change policies, the physical and financial effect of these developments could worsen. This threat is more acute for the less financially strong emerging markets and so-called brown industries. A rapid phase-out of fossil fuels could be disruptive for many industries, and strain credit quality. Equally, "brown" companies that delay transition could be left with stranded assets and higher financing costs. Economies that depend on hydrocarbon export revenues or that center on energy intensive industries could also suffer. Meanwhile, disruptions in agriculture and energy supply could fan inflation and social unrest. Insurance-model assumptions for catastrophe exposures could become outdated--understating claims and loss provisions. In the case of flood-prone areas, markets may need to recalibrate property values.

Source: Credit Conditions Asia-Pacific Q1 2024: India, Southeast Asia Advance As China Slows, published Dec. 5, 2023, by S&P Global Ratings.

# Top Risks Facing Taiwan-Based Entities (cont)

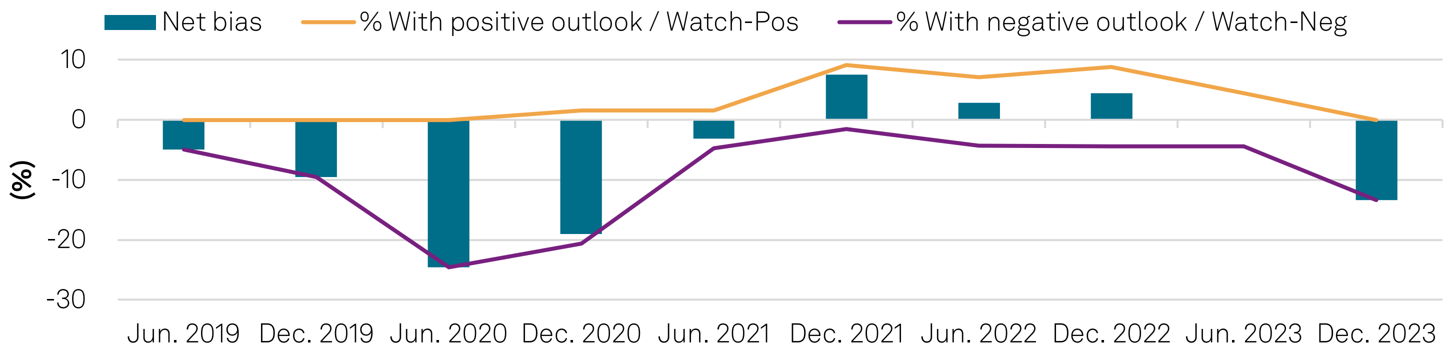
## Accelerating technological advancement and mounting cyber-attacks to disrupt business operations

Technological advances, such as in artificial intelligence, could alter business landscapes, rendering technology laggards obsolete. While technology developments (beyond just information technology) could enhance productivity, operational efficiencies, and competitive positioning, such advances also create complexity in management, maintenance costs, and added regulation. Businesses may need to incur additional ongoing and rising costs to continually adopt and adapt to new technologies. Additionally, increasing interconnectedness of economic activity means expanding exposure of critical infrastructure and issuer operations to cyber-attacks. This could evolve into a systemic threat and significant single-entity risk.

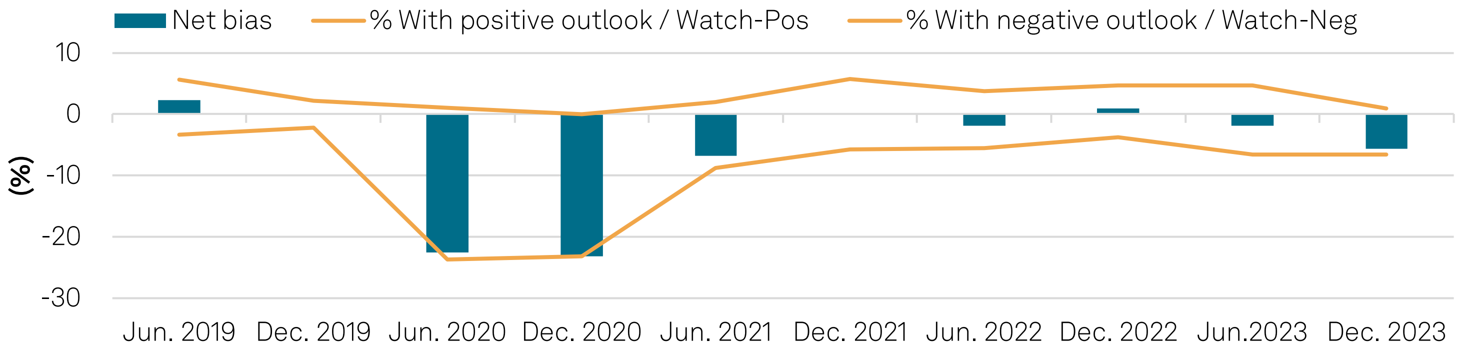
Source: Credit Conditions Asia-Pacific Q1 2024: India, Southeast Asia Advance As China Slows, published Dec. 5, 2023, by S&P Global Ratings.

# Slower Economic Growth Could Still Weigh On Net Rating Bias

## Rating bias of Taiwan ratings' corporate ratings




## Rating bias of Taiwan ratings' financial services ratings




Source: Taiwan Ratings Corp.

- Over 85% of corporate sector companies retain a stable outlook, but rating outlook bias in the corporate rating sector turned negative in Q4 2023. Persistently weak demand darkens the credit outlook for the commodity sector amid heightened downside risk for the pace of recovery. The gloomy economic outlook could constrain recovery for Taiwan's non-tech sector in 2024.
- Rating outlook bias in the financial services sector remains somewhat negative in Q4 2023, while we continue to see a negative credit trend for the life insurance sector and their related group entities. Over 90% of companies in the financial services sector retain a stable outlook.

# Corporates

S&P Global
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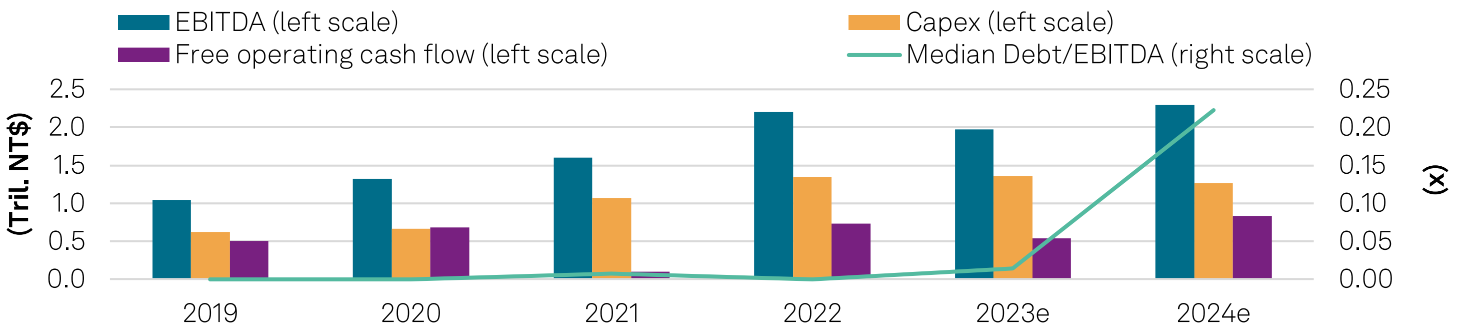
# Tech/Non-Tech Overview

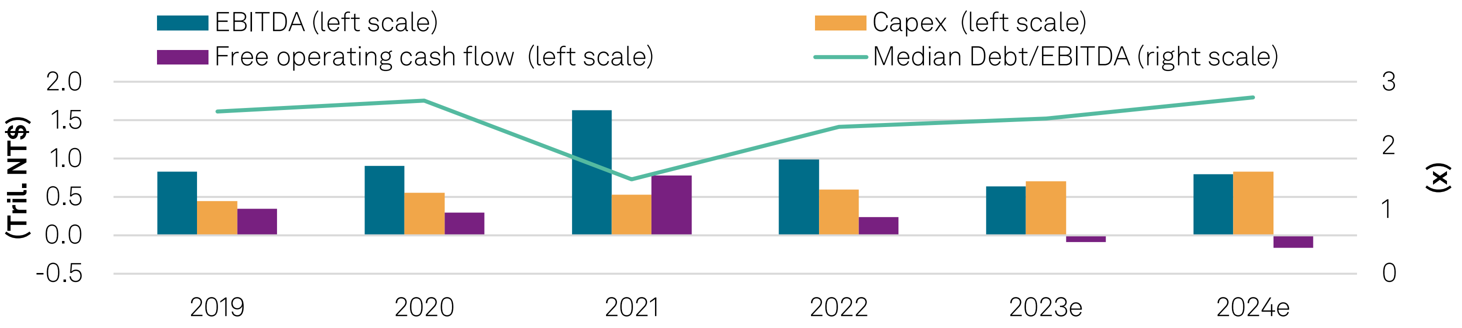
## Gloomy economic outlook to constrain recovery for the non-tech in 2024

- Likely rebound for end-consumer electronics and demand growth for electric vehicles, renewable energy and artificial intelligence could support strengthen EBITDA and cash flow for the tech sector in 2024.
- However, average leverage in the tech sector could rise slightly in 2024 due to weaker cashflow generation in 2023 and relatively high capital spending since 2021.
- A slower economic recovery in China coupled with the gloomy global economic outlook could constrain the pace of recovery for non-tech players in 2024.
- Credit metrics in the non-tech sector could worsen moderately in 2024 due to limited profitability recovery and higher capital spending.

### Tech sector will resume growth in 2024




### Non-tech sector EBITDA is unlikely to recover rapidly




Capex--Capital expenditure. Note: Capex, free operating cash and EBITDA are the sum for tech and non-tech companies rated by Taiwan Ratings. Sources: Company data and Taiwan Ratings Corp. estimates (e).

# Technology Sector:

## Recovery in end demand could aid recovery in credit profiles in 2024

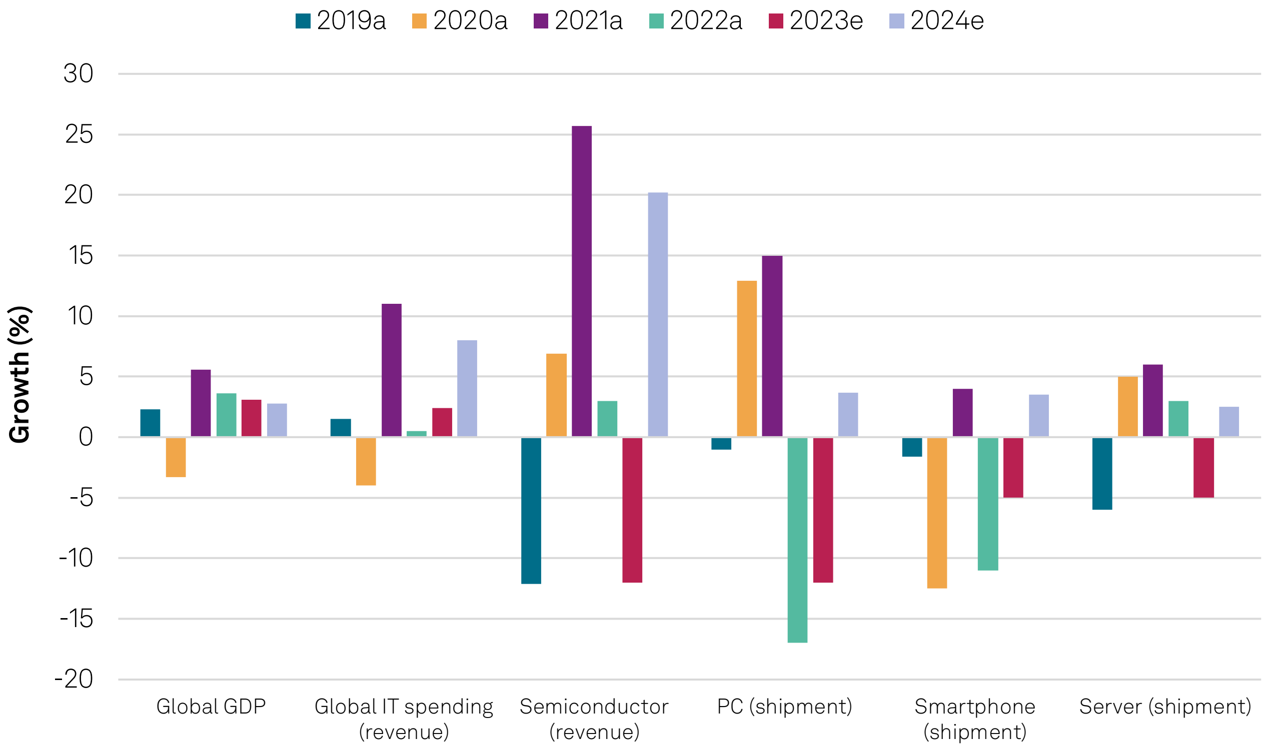
**What do we expect over the next 12 months?**

- A likely recovery in operating cash flows could help improve credit profiles for tech players in 2024. However, capex and working capital needs could also increase to support business and geographic expansion.
- Decline in the shipment of end products (such as smartphones and PCs) could bottom out in late 2023 as vendors finalize inventory corrections and demand gradually resumes. AI will be a key growth driver in the still-sluggish data center market.
- A low base in 2023, rising demand for AI servers and recovering demand for end devices could support a rebound for the semiconductor sector in 2024 following a 12% decline in 2023.

**What are the key risks for our base case?**

- The generally sluggish global economy and geopolitical tensions could limit the scope of recovery for the tech sector.
- Increasing oversupply risk for mature node foundries, given that record investments will come online from 2023 to 2025.

### Semiconductor sector could see a strong rebound in 2024




a--Actual. Sources: Industry data and Taiwan Ratings Corp. estimates (e).

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# Chemical Sector:

## Sluggish demand continues to pressure the outlook for the chemical sector

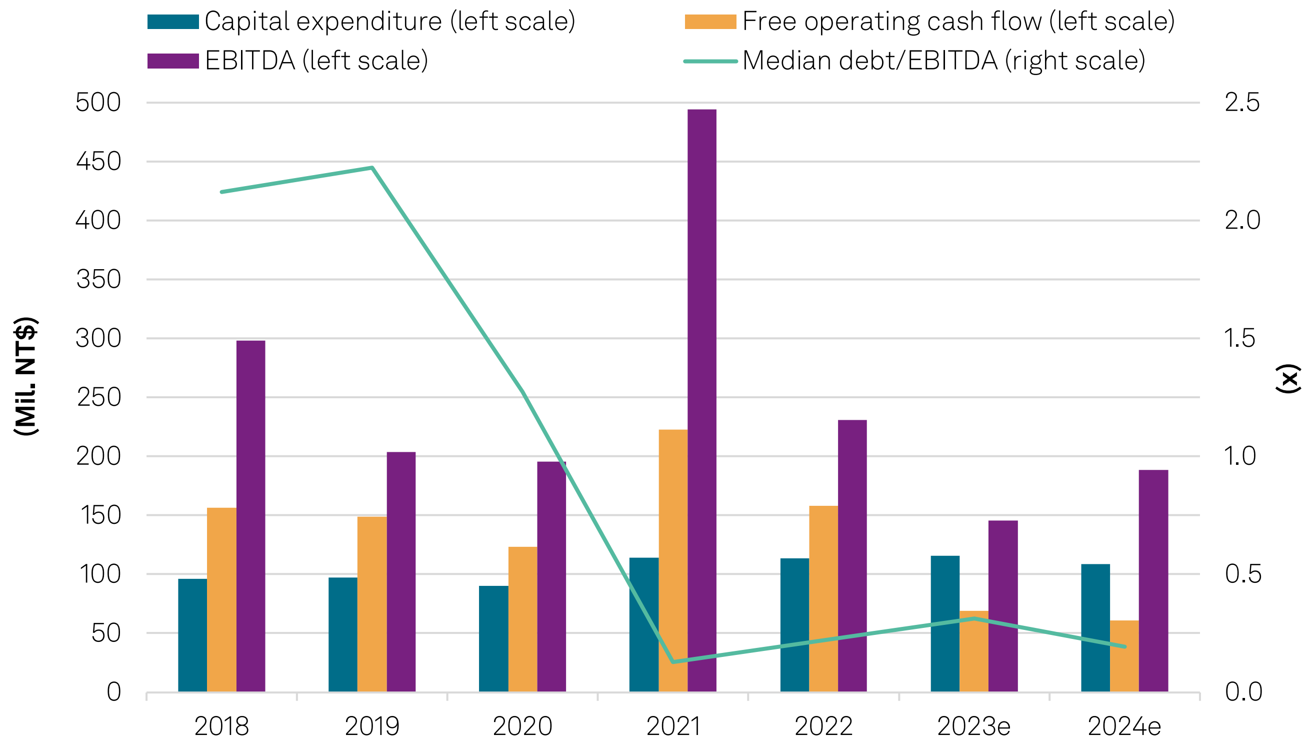
**What do we expect over the next 12 months?**

- Persistently weak demand darkens the sector's credit outlook with heightened downside risk for the pace of recovery.
- A persistent slump in China's property market and exports could prevent a meaningful rebound in chemical demand.
- Aggressive capacity additions in China combined with weak demand could keep utilization low, exacerbating pricing and cost pressure for Asia's chemical companies.

**What are the key risks for our base case?**

- Some issuers are running low on financial buffers could face increasing downside pressure for the ratings over the next 12 months. However, most rated entities' leverage will remain within their ratings triggers, despite thinner rating buffers.

### EBITDA will improve slightly in 2024 after continued decline in 2023




Note: Capital expenditure, free operating cash, and EBITDA are the sum for rated chemical companies rated by Taiwan Ratings. Sources: Company data and Taiwan Ratings Corp. estimates (e).

# Cement Sector:

## Persistent overcapacity limits improvement in credit profiles

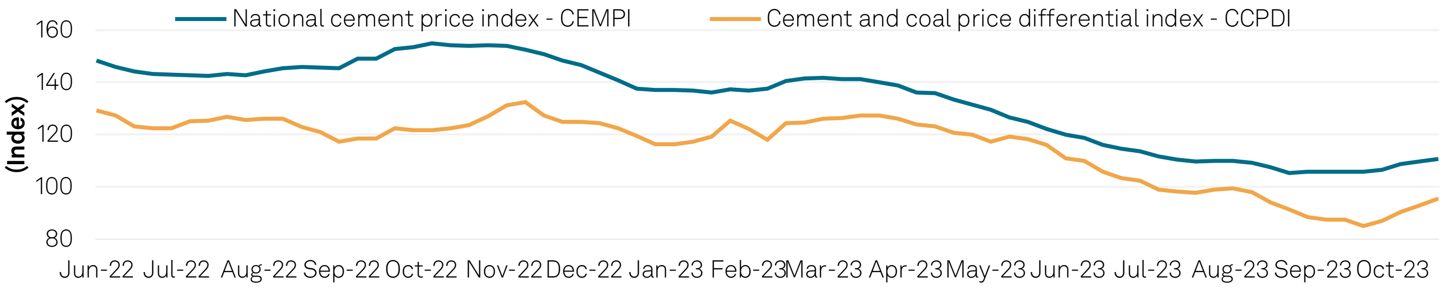
**What do we expect over the next 12 months?**

- An extended deep recession in the property market will sustain a weak spread between cement and coal prices, delaying recovery in cement companies' EBITDA until 2024.
- Enhanced staggered production cannot fully offset the impact of weak demand, thereby suppressing margins despite falling coal prices.

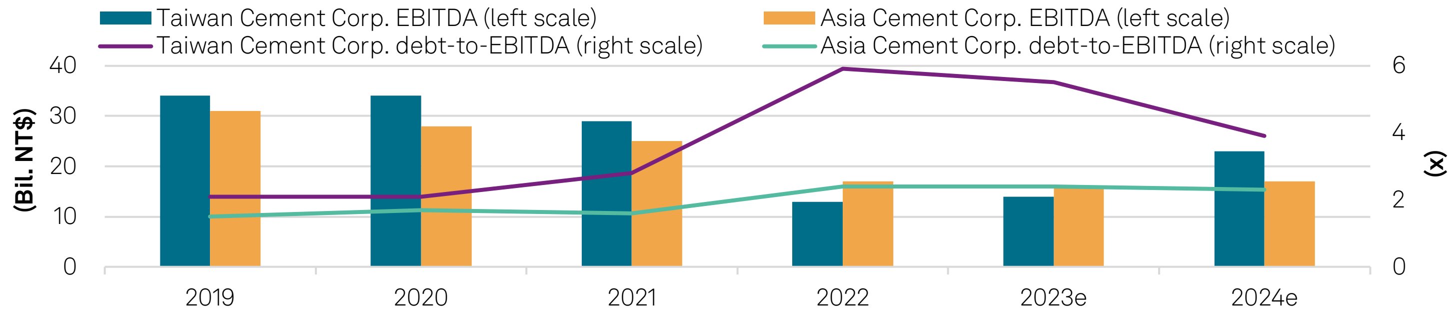
**What are the key risks for our base case?**

- The China government's shifting focus for its economic engine and slowing infrastructure investments could lower cement demand in China, leading to chronic overcapacity and persistent margin pressure if cement producers implement substantial capacity reductions.

### Cement index prices fell faster than coal prices in China in H2 2023




### Sluggish demand could keep cement companies' credit metrics weak in 2024




Sources: Company data and Taiwan Ratings Corp. estimates (e).

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# Steel Sector:

## Mild recovery in profit margins but less visibility in 2024

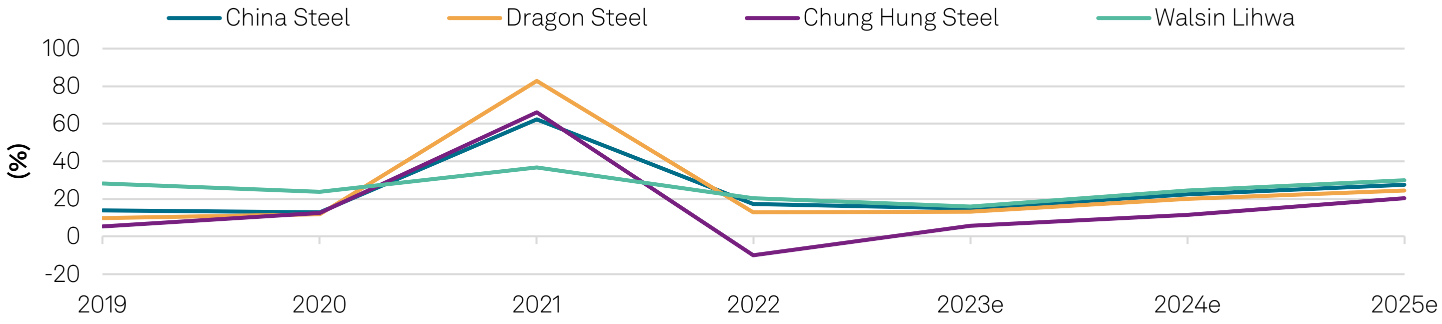
**What do we expect over the next 12 months?**

- Steel demand remains soft, reflecting weak growth of base metals consumption in the U.S. and Europe, and still-subdued property construction in China.
- Profitability could recover mildly amid a slight increase in sales volume, given the low base in 2023. Still-high material prices could sustain steel prices at the 2023 level.

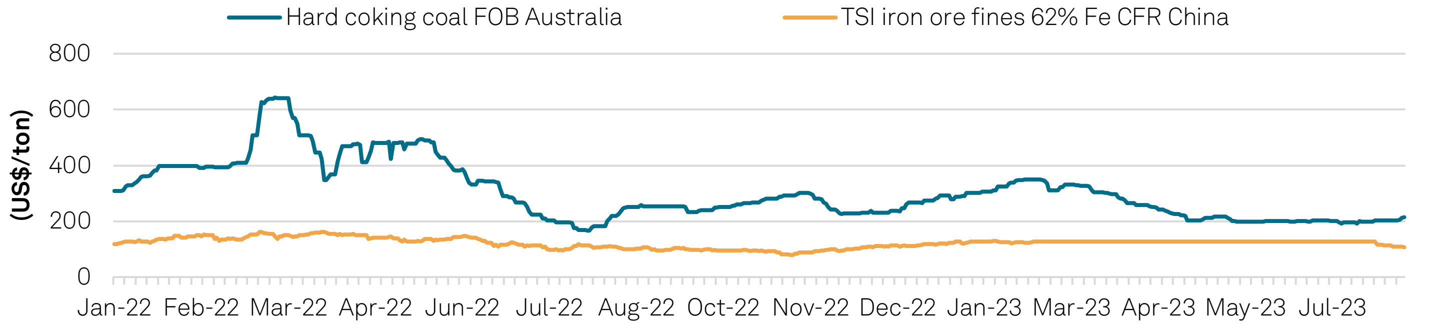
**What are the key risks around our base case?**

- Performance visibility remains low amid high volatility in prices for raw materials and steel products due to economic uncertainty and geopolitical risks.

### Softer improvement in FFO-to-debt ratio than under our previous expectation, albeit with no impact on credit strength




### Declining coking coal prices to support some recovery in profitability




Sources: Company data, Taiwan Ratings Corp. and S&P Global Commodity Insights.

# Container Shipping Sector:

## Chronic Supply-demand imbalance could pressure carriers' profitability

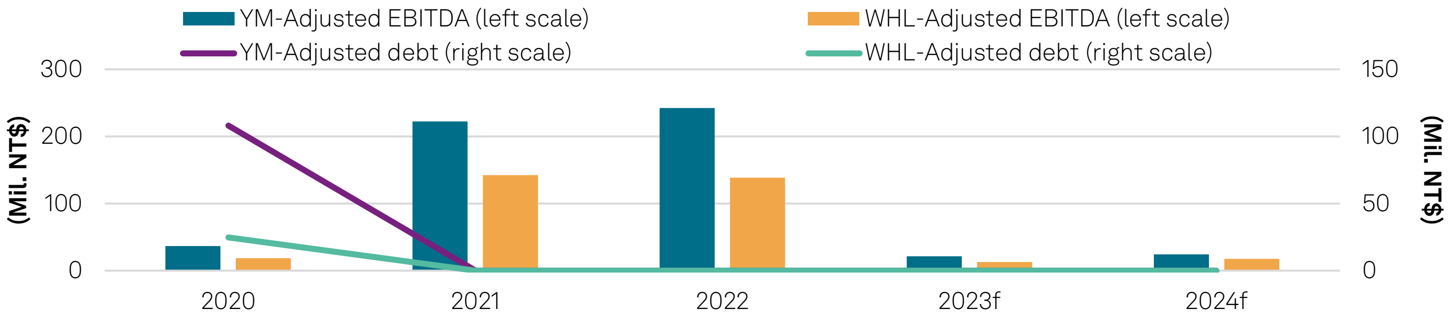
**What do we expect over the next 12 months?**

- Seaborne freight rates across main-lane service lines are unlikely to see a sharp rebound.
- Major container liners will continue to resort to carrying out blank/slow sailings to manage capacity increase and support freight rates.
- Substantially lowered operating cash flow and heightened capital expenditure for vessel replacements are unlikely to materially increase debt leverage, amid high net cash positions.

**What are the key risks around our base case?**

- Lukewarm global trade and accelerating containership supply growth
- Volatile bunker cost and increasing operating costs amid inflation could further test carriers' profitability.

### EBITDA to contract materially while maintaining net cash position in 2023-2024




YM--Yang Ming Marine Transport Corp. WHL--Wan Hai Lines Ltd. Sources: Company data and Taiwan Ratings adjustments and forecasts (f).

### Container shipping supply growth to continue to outpace demand growth in 2024

| Growth rate | | 2022 | 2023f | 2024f |
|---|---|---|---|---|
| Alphaliner | Supply | 4.1% | 8.4% | 9.1% |
| | Demand | 0.1% | 1.4% | 2.2% |
| Clarksons | Supply | 4% | 7.7% | 6.8% |
| | Demand | -5.1% | 1.2% | 3.8% |

f--Forecast. Sources: Alphaliner Monthly Monitor, Oct. 2023 and Clarksons Container Intelligence Monthly, Oct. 2023.

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# Aviation Sector:

## Airlines could maintain relatively strong credit metrics despite rising capex

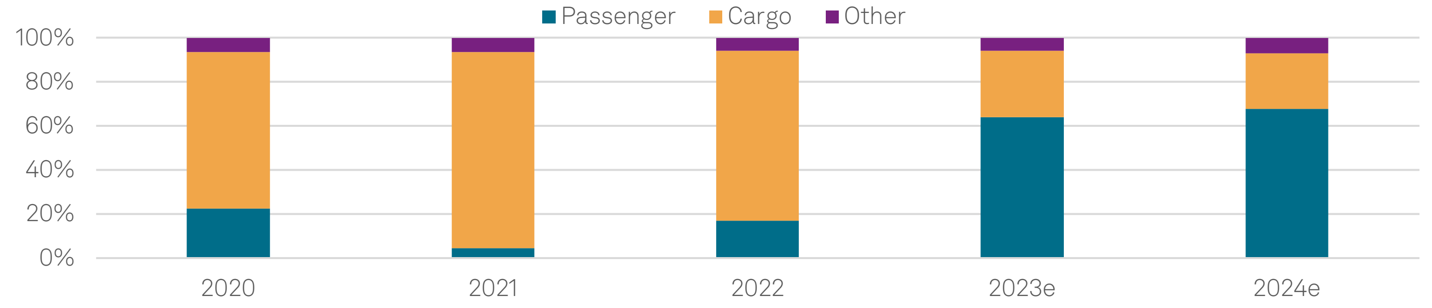
**What do we expect over the next 12 months?**

- The stable rating outlook for the sector reflects our view of a sufficient financial buffer for a downward revision in profitability due to relatively high fuel cost with increasing costs for passenger services.
- Passenger volume continues to grow albeit more slowly. Passenger yield normalizes but remain higher than before the pandemic.
- Muted air cargo growth amid a gloomy global economy and growth in competing supply.

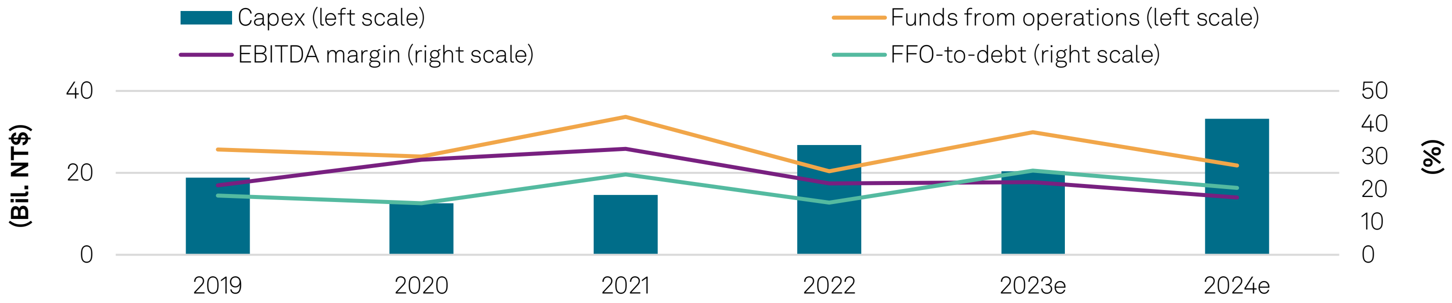
**What are the key risks for our base case?**

- Volatility in fuel prices, high spending on fleet replacement, and increasingly stringent carbon emission standards are all key risks for the sector.

### China Airlines' strong recovery in passenger business could largely offset the revenue effect of declining cargo demand in 2024




### China Airlines' margin to normalize to the pre-pandemic level




Sources: Company data and Taiwan Ratings Corp. estimates (e).

# Auto and Auto Suppliers Sector:

## Moderate financial buffer to support stable outlook

**What do we expect over the next 12 months?**

- Global auto sales growth to decelerate to just 1%-2% in 2024. However, Taiwan's auto sales could remain high in 2024 following strong growth in 2023 amid relatively stable domestic demand.
- Taiwan companies to retain prudent capital spending and dividend payout strategies. These could underpin moderate credit strength despite weak profitability.

**What are the risks for our base case?**

- Auto suppliers could face squeezed margins as they refocus on portfolio repositioning in the race for the electric vehicles market amid a chronically weak macroeconomy.

**Visibility on Chinese market recovery to remain low over next 12-18 months**

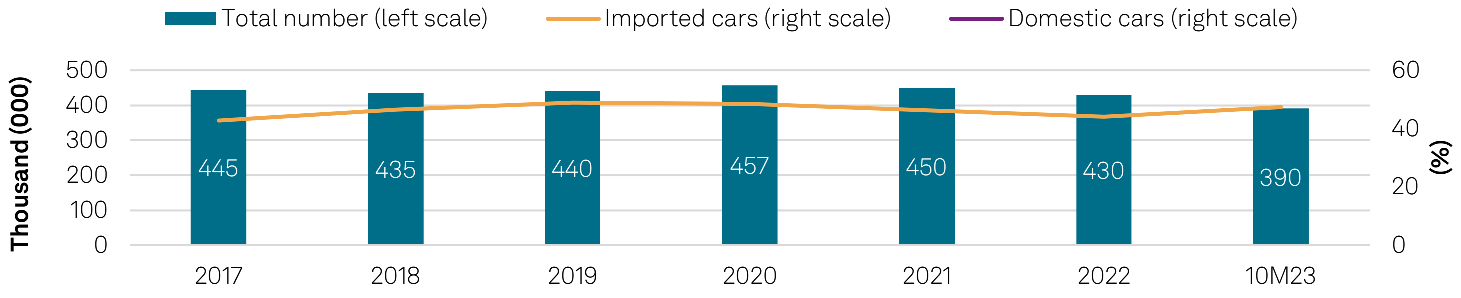
| | Mil. units | % year-on-year change | | |
|---|---|---|---|---|
| | 2022a | 2022a | 2023f | 2024f |
| U.S. | 13.9 | (7.9) | 9-11 | 0-1 |
| China | 24.1 | (0.9) | 0-2 | 0-2 |
| Europe | 15.0 | (11.2) | 9-11 | 0-2 |
| Rest of the world | 20.1 | (9.0) | 6-8 | 5-7 |

**Electrification scenario: Share of BEVs and PHEVs as a percentage (%) of total sales**

| | (%) | | | |
|---|---|---|---|---|
| | 2020 | 2021 | 2022 | 2025f |
| U.S. | 2 | 4 | 7 | 16-20 |
| China | 5.5 | 14 | 27 | 35-40 |
| Europe | 10 | 14 | 22 | >30 |
| Global | 4.2 | 8.3 | 13 | 18-23 |

BEV--Battery electric vehicles. PHEV--Plug-in hybrid vehicles. Source: Taiwan Transportation Vehicle Manufactures Association.

**Taiwan's auto market sales look set to reach a 10-year high in 2023**




Sources: Company data and Taiwan Ratings Corp. forecasts (f).

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# Telecom Sector:

## Telecom operators' improving profitability underpins stable rating outlooks

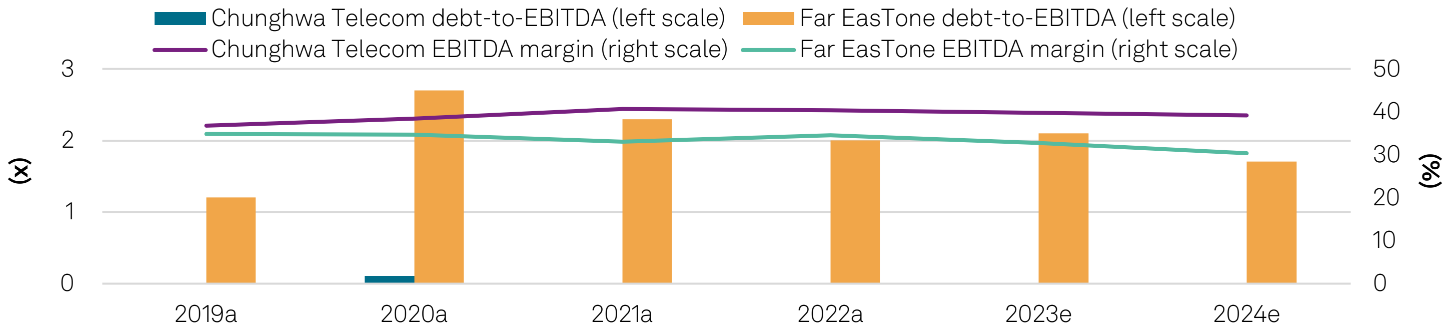
**What do we expect over the next 12 months?**

- Three oligopoly players will focus on enhancing competitiveness through service upgrades. The increasing adoption of 5G data plans under benign price competition should support modest growth in average revenue per user.
- Improved capital structures and cash flow could facilitate private 5G network construction and enhance the service for enterprise customers without a material negative effect on operators' financial positions.
- Relatively strong operating cash flows and prudent capital spending will sustain stable outlooks with a significant rating buffer.

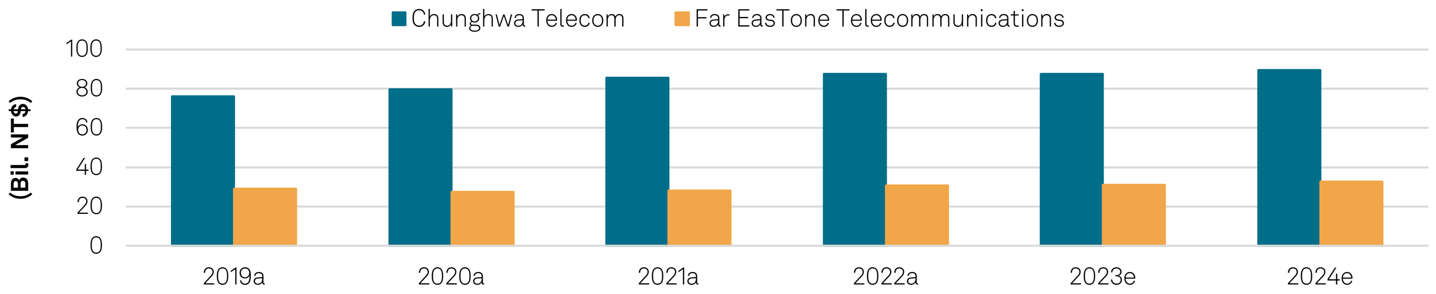
**What are the risks for our base case?**

- A pricing war develops for 5G services, albeit with low probability; intensifying competition for enterprise ICT business that erodes margins.

### Improved profitability should help to reduce carrier's leverage




### Sustainable and stable EBITDA generation for rated telecom operators




a--Actual. Sources: Company data and Taiwan Ratings Corp. estimates (e).

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# Financial Services

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# Banking Sector

## Stable credit trends and solid capitalization provide a rating buffer

### About 6.5% loan growth (year on year)

- Banks could see slightly higher loan growth in 2024 vs. 2023 amid better domestic GDP growth prospects over the next year.
- Fee income will recover slightly on warming wealth management business and a gradual recovery of bancassurance due to the lower base in 2023.

### About 0.6% pretax return on average assets

- We expect flat profitability for the sector in 2024.
- Net interest margins to maintain in 2024 as higher-for-longer interest rates will persist for a while; however, foreign exchange swap gains are likely to be lower compared with 2023.
- Credit costs to remain flat amid stable economic conditions domestically and a prudent overseas growth pattern.

### About 12.5% Tier 1 capital ratio

- Banks' adequate-to-strong capitalization provides a sufficient buffer for business growth and unexpected volatility.
- High retail deposit base supports the bank sector's funding resilience.



Source: Taiwan Ratings Corp. estimates.

# Securities Sector

## Strong capitalization can support potential business growth and an increase in investment portfolios over the next few quarters

| 2023 forecast | Key ratios | Key takeaways |
|---|---|---|
| | **2.0%-2.5%**<br>Return on assets (ROA) | • Annualized ROA is 2.2% in 2023, a recovery from 1.7% in 2022, supported by increased brokerage commission income and trading gains.<br>• We expect a flat ROA of 2.0%-2.5% in 2024, supported by the continued improving economic outlook in Taiwan. |
| | **3.5-4.5x**<br>Asset to equity ratio<br>**13%-15%**<br>Risk-adjusted capital ratio remains strong | • The sector could see leverage at 3.5-4.5x in 2024. Leverage grew to 4.1x at the end of September 2023 from 3.3x at the end of 2022 and was higher than the 5-year average of 3.5x, which suggests an increased risk appetite on the back of a more bullish market view.<br>• That said, we estimate the sector's RAC will remain strong at 13%-15% in 2024. We believe that most of the increased investments will be for hedging purposes and on fixed-income securities. We see Taiwan brokers remaining prudent with largely unchanged risk management and risk appetite for directional equity trading. |

Source: Taiwan Ratings Corp. estimates.

# Finance & Leasing Sector

## More stringent underwriting to halt deteriorating asset quality in H1 2024

| 2024 forecast | Key ratios | Key takeaways |
|---|---|---|
| | **Deteriorating asset quality**<br>Higher delinquency ratio over the next few quarters | • Deterioration of asset quality will likely reach a peak in H1 2024 following more stringent underwriting controls since 2023.<br>• We believe that the additional credit cost is absorbable, given the sector's product pricing which reflects the inherent higher risks of its clientele portfolio. |
| | **Return on assets (ROA): 1.5%-2.5%**<br>Funding cost and credit provision constrain profitability | • Higher funding cost and additional credit provision cost will continue to pressure profitability over the next few quarters.<br>• We expect the industry wide ROA to remain flat at 1.5%-2.5% in 2024, down from 2.0%-3.0% during 2020-2022. |
| | **Adequate-to-strong capitalization**<br>Proactive management will underpin financial profiles | • Proactive capital management will help underpin capital strength over the short term.<br>• Funding diversification is likely to continue lowering the sector's overall funding risk. |

Source: Taiwan Ratings Corp. estimates.

# Life Insurance Sector

## Key indicators are gradually stabilizing

| Year | Premium growth | ROAA |
|---|---|---|
| 2022 | (20.3)% | 0.4% |
| 2023e | (5)%-(8)% | 0.5% |
| 2024f | 0%-5% | 0.5% |

ROAA--Return on average assets. Source: Taiwan Ratings Corp. estimates (e) and forecasts (f).

## Negative credit trend given insurers' thin capital buffer

The declining trend for premiums has eased in 2023. Larger lifers saw a rebound in monthly renewal premiums from Q3 2023. Premiums could increase moderately in 2024 with less volatility, amid insurers' efforts to sell protection-type policies with a longer premium tenor.

Return on average assets could return to the historical norm in 2023 with improved recurring yields. Profitability to remain relatively unchanged in 2024.

Foreign exchange (forex) risk to remain higher than for regional peers. An overly profit-oriented mindset for forex risk could lead to earnings shocks and capital erosion under the relaxation of hedging ratios across the sector.

Profitability still faces headwind from heightened hedging costs and less flexibility to make optimal investment disposals amid market volatility. Capitalization has somewhat stabilized following the valuation rebound of insurers' investment portfolios but still has only a thin buffer for unexpected external shocks.

# Non-Life Insurance Sector

## Key indicators look set to remain stable in 2024

| Year | Premium growth | COR | ROE |
| --- | --- | --- | --- |
| 2022 | 7% | 221% | -153% |
| 2023e | 10% | 99% | 12% |
| 2024f | 8% | 95% | 10% |

COR--Combined ratio. ROE--Return on equity. Source: Taiwan Ratings Corp. estimates (e) and forecasts (f).

## Stable credit trend with priority for risk-pricing

Inflation, reinsurance cost, and risk-pricing that drove the sector's direct premium growth in 2023 are likely to continue throughout 2024, albeit to a lesser extent. Stable new car sales, insurance demand amid Taiwan's gradual GDP growth, and the return of travel insurance also support the sector's overall growth in 2024.

Underwriting profits as measured by the combined ratio should return to the historical norm in 2024 following the sector's hefty pandemic losses in 2022 and partial losses in 2023. Increasing risk awareness and risk-pricing are persistent throughout the industry.

Profitability as measured by the return on equity remains in the double digits, given insurers' small capital base. Remaining reinsurance recoverable for earlier pandemic losses remain an uncertainty as insurers build on their provision levels based on expected credit losses.

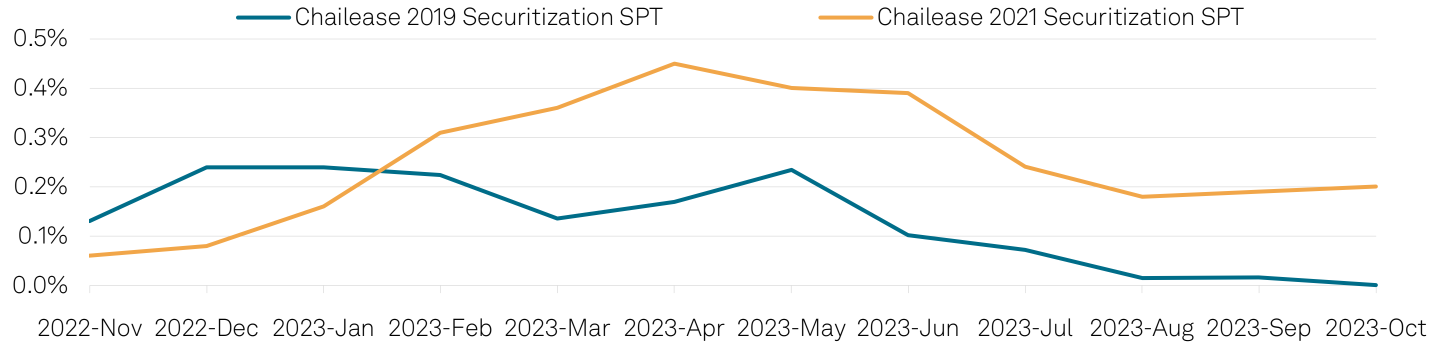
The sector's capital strength to remain strong relative to its risks. Catastrophe risk remains well-covered by adequate reinsurance treaties.

# Structured Finance

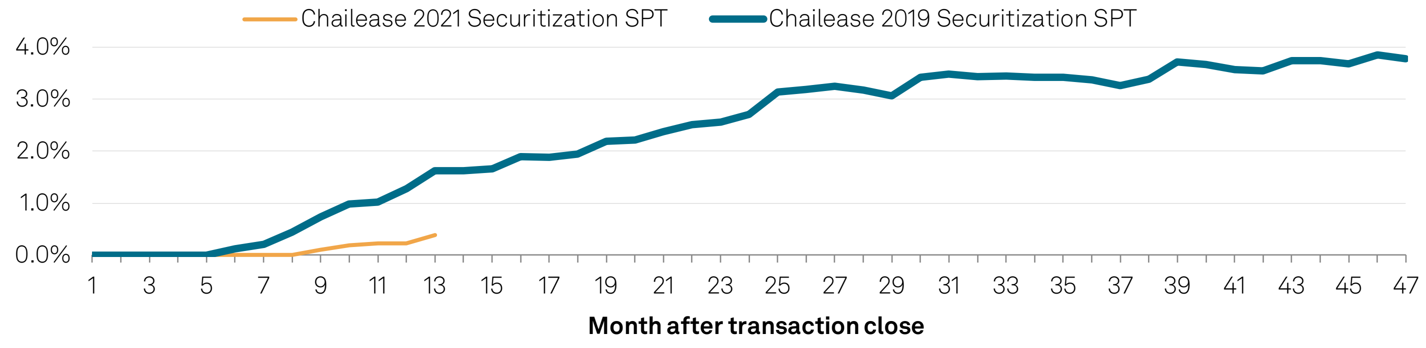
S&P Global
Ratings

# We Expect Stable Notes Rating Performance Over The Next  Few Quarters

## Asset delinquency rate of Taiwan ABS transaction (overdue 1-30 days; % of outstanding pool balance) 3 months moving average




## Cumulative net loss of Taiwan ABS transactions (% of initial pool balance)




ABS—Asset backed securitization. Data as of October 31, 2023. Source: Taiwan Ratings Corp.

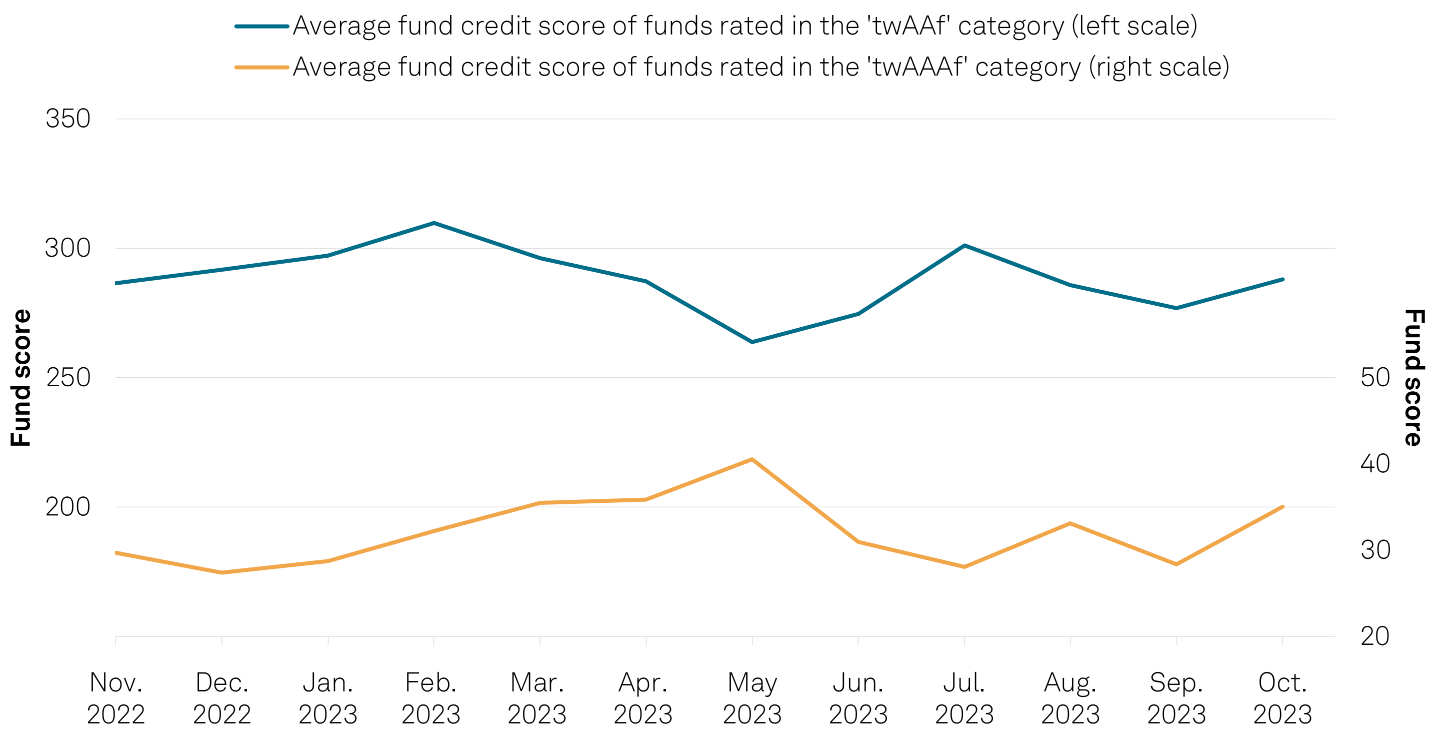
- Gradual recovery in Taiwan's economy underpins the transactions' likely stable underlying performance over the coming few quarters. This follows some asset performance volatility in H1 2023, though such performance remains within our expectation.
- Average recovery rate of the defaulted assets continues to enhance as the deals season, providing additional support to the rated notes considering that the actual recovery rate is higher than we initially assumed upon deal closing.
- Creditworthiness of the rated notes should perform well, supported by the originator's sophisticated underwriting policy and risk management, and the better economic outlook over the next few quarters.

# Fixed-Income Funds

S&P Global Ratings

# Sophisticated Risk Controls, Stable Credit Outlook And Stringent Regulations Support Fund Credit Quality

## Fund credit store by rating category (simple average)

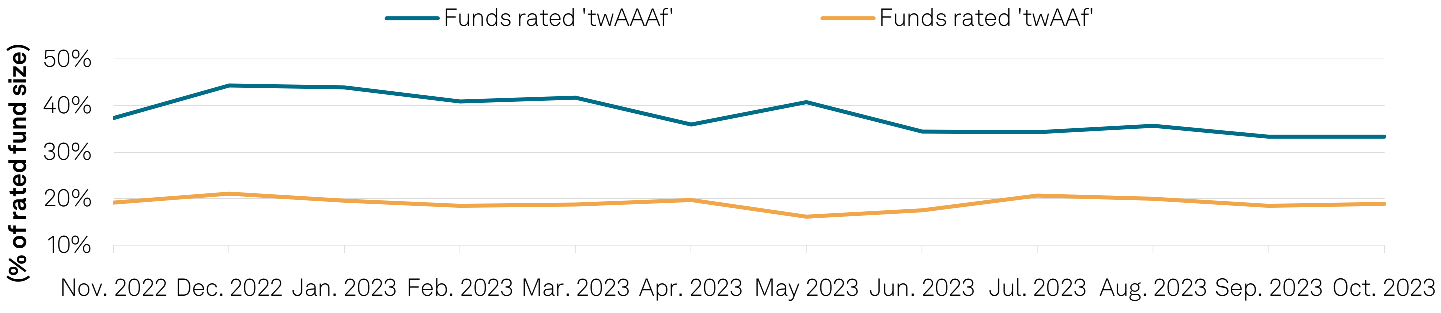



Data are as of October 31, 2023. Source: Taiwan Ratings Corp.

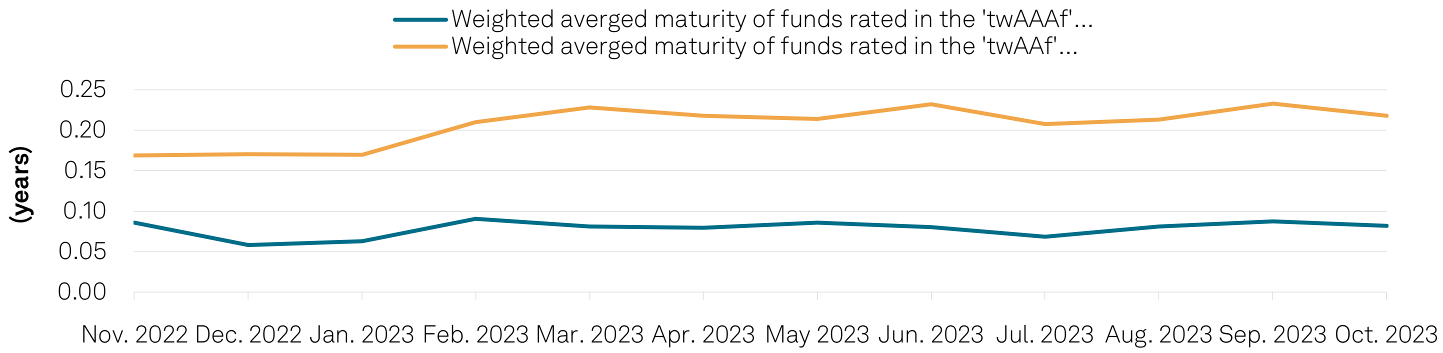
- The pool credit quality of the 'twAAAf'-rated funds is unlikely to see severe deterioration even if overall credit market conditions in Taiwan come under some stress. This is because they are mostly managed by foreign-based fund houses in Taiwan which are generally influenced by their regional teams with stringent risk management.
- Local fund houses whose fund ratings are in the 'twAAf' category could pursue riskier investment strategies; however, we don't see them sacrificing the credit quality of the invested entities over yield competitiveness, rather they will focus on duration management.
- Stringent regulatory requirement on fund management also underpins our view.

# Interest Rate Plateau Could Incentivize Managers To Lift Duration But Liquidity Will Remain Sufficient

## Average liquidity preparation (repos and demand deposit) by rating category (simple average)




## Weighted average maturity by ratings category (simple average)




Data as of Oct. 31, 2023. Source: Taiwan Ratings Corp.

- Fund managers could enhance yield by expanding the duration of the portfolio considering the tightening policy rate might pause or possibly even reverse during the next few quarters.
- Higher duration of the fund will not significantly jeopardize pool credit quality because the longest tenor the fund can invest per regulations is one year. We view this is manageable, given that the ratings of the pool's investment are generally at least satisfactory.
- Offshore yield remains more attractive to institutional investors than local money market funds, with aggregated fund size remaining at NT$800 billion under our base case assumption.

# Analytical Contacts

## David Hsu

Associate Director, Corporate Ratings

+886-2-2175-6828

david.hsu@spglobal.com

## Yuhan Lan

Director, Financial Services Ratings

+886-2-2175-6810

yuhan.lan@spglobal.com

## Joe Lin

Director, Structured Finance & Fixed-income Fund Ratings

+886-2-2175-6832

joe.lin@spglobal.com

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