

Financial sector

Taiwan's central bank surprises with 12.5bps rate hike

Key message

1. Taiwan's central bank raised the rediscount rate by 12.5bps, mainly to offset expectations of higher inflation as a result of rising electricity prices.
2. Banks with larger NT-dollar loan positions and more deposits for securities trading settlement will benefit the most from the rate hike. Life insurers will also gain from lower recurring hedging costs with currency swaps, while leasing firms will suffer from narrowing interest spreads.
3. Banking is still our most preferred financial subsector, followed by insurance, brokerages, and leasing.

Event

To the market's surprise, Taiwan's central bank announced an interest rate hike of 12.5bps at the 1Q24 monetary policy meeting on March 21, bringing the benchmark rediscount rate to 2%, while the US Fed kept its interest rate unchanged at 5.25-5.5% in March.

Analysis

Rediscount rate of 2% is highest since 2009. At the 1Q24 monetary policy meeting, Taiwan's central bank slightly revised up 2024 GDP growth guidance by 0.1ppt to 3.22% in anticipation of export growth driven by the recovery of global trade. However, the central bank also raised 2024 CPI and core CPI growth guidance to a respective 2.16% and 2.03% YoY, versus estimates of 1.89% and 1.83% YoY in 4Q23, as the bank expects upcoming power tariff hikes in April to add inflationary pressure. To offset expectations of higher inflation as a result of rising electricity prices, the central bank believes a half-quarter point rate hike is appropriate. The rationale behind the latest rate hike is similar to the one announced in 1Q23. Whether or not inflation in Taiwan returns to 2% in 2Q-4Q24 will determine if more rate hikes are required, according to the central bank.

Impact on Taiwan's financial industry remains to be seen. Governor Yang Chin-long of Taiwan's central bank said the 12.5bps rate hike will apply in full to the interest rates of NCD and demand deposits, suggesting the funding costs for both NT-dollar demand and time deposits will rise by the same 12.5bps for interest-bearing assets of NT-dollar bank loans and NCD interest rates. To what extent bank NIM may advance following the rate hike remains to be seen, but we note that banks with larger NT-dollar loan positions and more deposits for securities trading settlement, such as Cathay United Bank, Yuanta Bank, and Hua Nan Bank, will benefit the most, with NIM likely to rise by 2-3bps. With the US-Taiwan interest spread narrowing by 12.5bps to 3.5%, the swap point for currency swaps (CS) should decline from the current average of 4.2-4.3% to 4% or even lower. For banks, this means income from forex swaps will decline gradually in the coming quarters. That said, we expect NT-dollar rate hikes and US dollar rate cuts in 2H24 to boost business demand for US dollar loans, which in turn should shore up bank NIM. A narrower US-Taiwan interest spread will also help most life insurers reduce recurring hedging costs with CS to 4% or lower, although overall hedging costs still hinge on the NT-dollar trend. Most life insurers still expect overall hedging costs to rise YoY to 1.0-1.5% in 2024. The latest interest rate hike will lead to higher financing costs for businesses in Taiwan, and we estimate the interest spreads of leasing firms will be squeezed further. Yulon Finance and Hotai Finance, which mainly operate with funds from local banks, will bear the brunt of the rate hike in Taiwan, while Chailease (5871 TT, NT\$171.5, N) should be less affected as it is set to benefit from lower funding costs for the US dollar and renminbi due to upcoming rate cuts in the US and China.

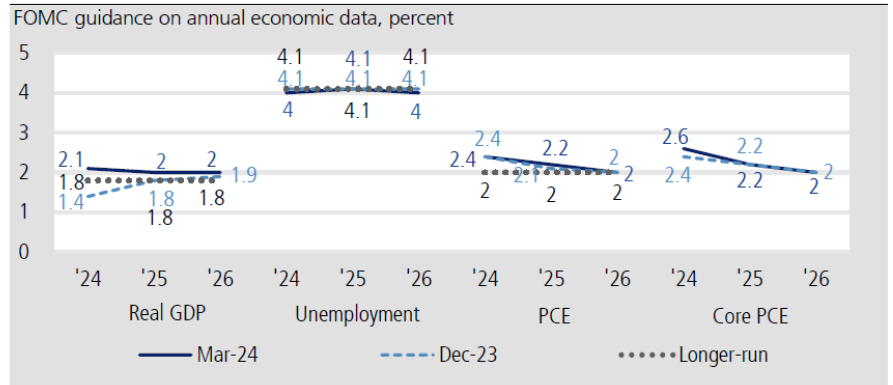
Stocks for Action

Taiwan's central bank raised the rediscount rate by 12.5bps to 2%, while the Fed kept its interest rate unchanged. Local banks may register marginal upticks in NT-dollar NIM, despite full application of the rate hike to deposits and loans. However, we note that a narrowing US-Taiwan interest spread will undermine forex swap income for banks. Life insurers should benefit from lower recurring hedging costs with CS, but overall hedging costs will still be determined mainly by the NT-dollar trend. Leasing firms will suffer from narrower interest spreads as funding costs rise. Within the financial sector, banking is still our most preferred subsector, followed by insurance, brokerages, and leasing. Our top picks are CTBC FHC (2891 TT, NT\$31.9, OP), Fubon FHC (2881 TT, NT\$69.6, OP), and Kings Town Bank (2809 TT, NT\$52.5, OP).

Risks

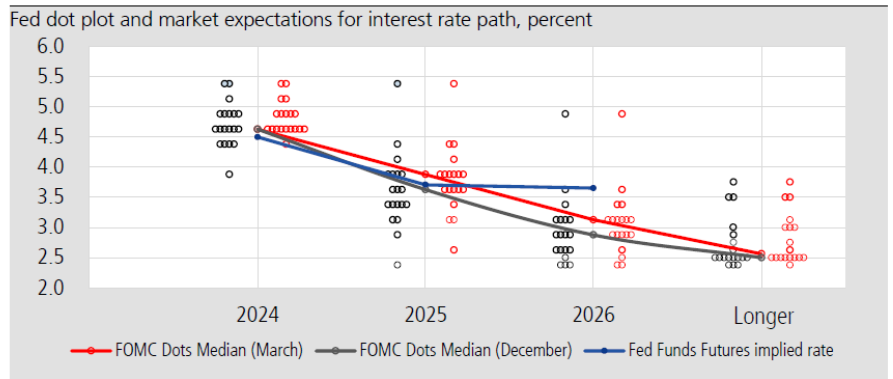
Weakening global financial markets; high credit costs for banks.

Figure 1: US Fed raised 2024 GDP growth & core PCE guidance to a respective 2.1% and 2.6%, but cut projected unemployment to 4%



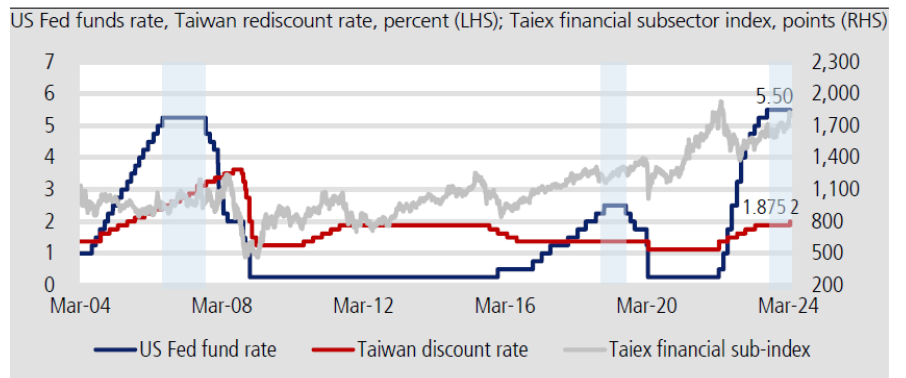
Source: Bloomberg; KGI Research

Figure 2: US Fed kept policy rate unchanged during March FOMC meeting; proposed rate cuts of 75bps for 2024 are same as in December 2023



Source: Fed; Bloomberg; KGI Research

Figure 3: US policy rate unchanged at 5.5% in March, but Taiwan raised interest rate to 2% to offset expectations of higher inflation on power tariff hikes in April



Source: Bloomberg; KGI Research

Figure 4: Interbank overnight cash rate in Taiwan to rise to 0.82% in wake of higher rediscount rate of 2%

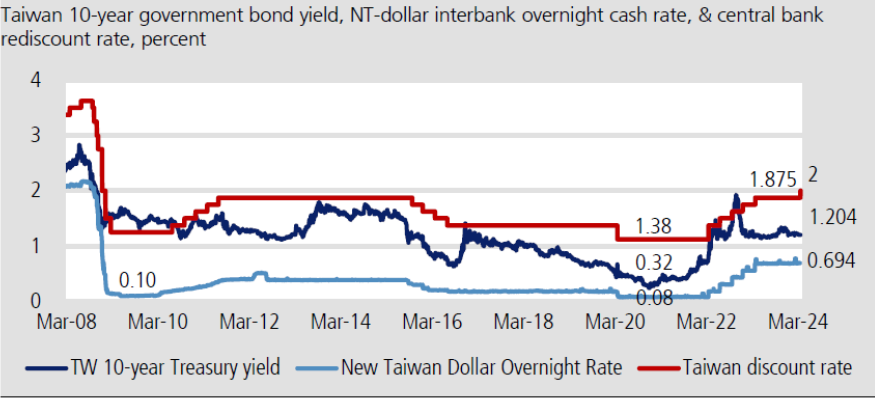


Figure 5: CS hedging costs have declined to 4.2% in 1Q24, & we expect it to hover around 4% on expectation of Fed announcing first US rate cut in 2Q24

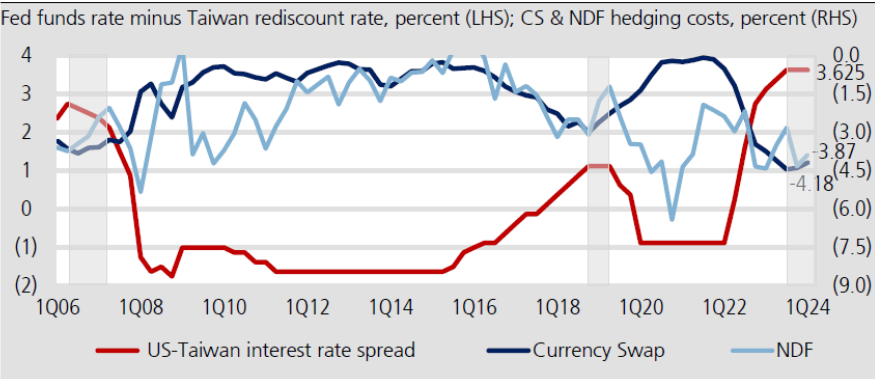


Figure 6: Bank-centric FHCs with more exposure to NT-dollar loans to see NIM upticks on central bank's 12.5bps rate hike

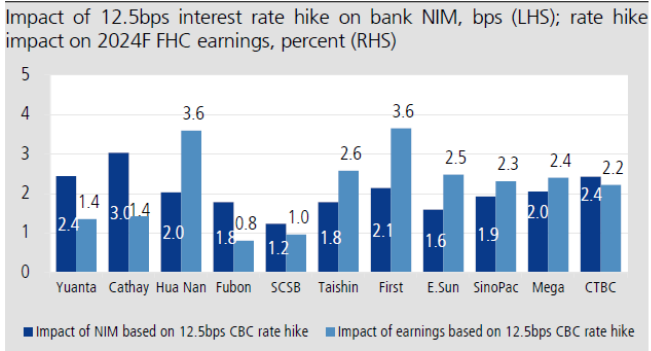


Figure 7: NT-dollar loans as share of total bank lending

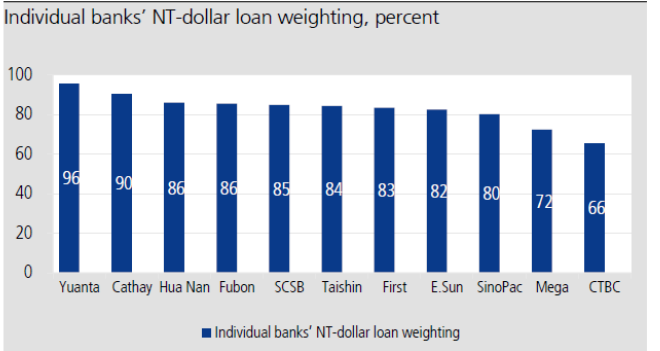


Figure 8: Most banks saw NIM improve slightly in 4Q23, & expect upticks to continue in 2024

Percent (%)	2017	2018	2Q19	2020	2021	2022	1Q23	2Q23	3Q23	3Q23 inc. FX	4Q23	4Q23 inc. FX	QoQ	2024F Forecast
2809 TT KTB	1.96	1.86	1.72	1.91	1.83	1.60	1.53	1.58	1.59		1.59		-	NIM rebounds
2880 TT Hua Nan	1.01	0.93	0.92	0.83	0.83	0.89	0.85	0.74	0.71		1.47	1.71	-	1.63-1.66 (inc. FX)
2891 TT CTBC	1.49	1.54	1.50	1.40	1.43	1.63	1.55	1.48	1.47	1.70	1.40	1.56	0.04	1.38
2884 TT E.Sun	1.34	1.36	1.36	1.22	1.18	1.26	1.30	1.30	1.30					
2887 TT Taishin	1.35	1.30	1.23	1.12	1.14	1.30	1.21	1.20	1.24	1.30	1.31		0.01	1.31-1.33
2882 TT Cathay	1.22	1.22	1.22	1.17	1.22	1.46	1.40	1.37	1.36		1.20	1.26	(0.04)	1.22-1.23
2885 TT Yuanta	1.22	1.25	1.23	1.03	0.94	0.90	0.88	0.89	0.92					
2881 TT Fubon	1.00	1.02	1.10	1.08	1.04	1.04	1.05	1.13	1.19	1.30				
2892 TT First	1.26	1.18	1.06	1.00	1.01	0.99	0.77	0.76	0.76		0.95		0.01	NIM rebounds
2890 TT Sinopac	1.09	1.07	0.96	1.03	1.06	1.20	1.02	1.00	0.98	1.26	0.86		(0.06)	Stay flat or slightly down
2886 TT Mega	1.12	1.15	1.10	0.85	0.81	1.03	1.03	1.02	0.94		0.76	1.15	-	1.10 (inc. FX)
5876 TT SCSB	1.15	1.17	1.13	0.93	0.92	1.23	1.36	1.40	1.41		0.71	1.05	-	NIM rebounds
Avg.	1.27	1.24	1.21	1.13	1.12	1.20	1.24	1.20	1.16					

Source: Company data; KGI Research

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