# Taiwan strategy

## China-themed stocks up on market rescue measures

### Key message

1. The PBC introduced out three rare & strong market-rescuing measures.
2. Stimulation of consumption and the property market are the focus.
3. We are positive on domestic consumption, contact lenses, automobile parts, bicycle and industrial automation sectors.

### Event

The People's Bank of China (PBC; China's central bank) announced three adjustments to monetary policy on September 24.

### Analysis

**PBC rolls out three rare, strong market-rescuing measures.** First, the PBC lowered the reserve requirement ratio (RRR) by 0.5ppts, injecting Rmb1.0tn (NT$4.5tn) into financial markets. The PBC may lower the ratio by a further 0.25-0.5ppts by the end of the year, depending on market conditions. Second, the central bank cut the policy interest rate on seven-day reverse repo (the PBC releasing funds to the market), reducing it from 1.7% by 0.2ppts to 1.5%, which will lower loan and deposit interest rates. This was the first time in nine years, since August 2015, that the PBC launched "dual rate reductions", with an eye on achieving a 2024 economic growth target of "around 5%". Third, to stimulate the housing market, the PBC lowered interest rates on existing mortgages by 0.5ppts, lessening average household interest expenses by Rmb150bn a year (NT$684bn). In addition, the PBC standardized minimum down payments for first and second homes at 15%, down from 25%.

**Consumption & the property market are the targets.** Since Chinese consumption has been weakening, with a high leverage ratio, lowering interest rates will not greatly boost home-buying or consumption. This is why the PBC launched these three measures simultaneously. In particular, lower mortgage rates will ease interest burdens, shoring up consumption ability. According to our estimates, growth in annual retail sales of consumer goods will rise by 0.26ppts as a result of cutting mortgage rates by 0.5ppts. As the property market downturn is affecting the economy more, lower mortgage rates should improve housing demand, while reduced down payments will improve demand for housing upgrades. Moreover, the PBC has increased the ratio of central bank funds for indemnificatory refinancing houses from 60% to 100%. It is also studying the feasibility of allowing policy-oriented banks and commercial banks to purchase land from property developers. These measures should stimulate property demand and improve financial conditions for property developers.

**Stabilizing stock markets also a focus.** As well as new monetary policies to stimulate the housing market and consumption, the PBC announced the creation of monetary tools to support the stable development of stock markets. Specifically, it will establish a swap facility, initially of Rmb500bn, to allow qualified securities firms, funds and insurance companies to access, by pledging assets, PBC liquidity for investment in stock markets only. The first stage will initiate a special refinancing program of Rmb300bn, at an interest rate of 2.25%, for banks to lend to listed companies and major shareholders to buy back shares and increase share holdings. These measures will help to correct situations that arise when markets fluctuate violently or shares are undervalued.

**China local-demand plays to turn around on higher Chinese consumption.** The policy bazookas fired by the PBC may not mitigate long-term structural weaknesses in the Chinese economy. However, the stimulus policies could help lift consumer confidence. A stock market rebound and stabilized housing market, coupled with better financial conditions, would help the middle class to increase spending, which has been conservative on or downgrading consumption out of fears of economic pain and layoffs. China's domestic-demand and restaurant plays will benefit as a result.

Over the past two years, people in China have been prudent about consumption. Their negative views on economic growth prospects have restricted consumption across the board, with the restaurant, tourism and consumer discretionary sectors taking the brunt.

Falling asset prices due to the property market slowdown have also affected consumer sentiment. If the government consumption and property market spurring measures pay off, consumers will be more willing to spend as their interest expense burdens ease. Restaurant and consumer discretionary spending shares, which have been under pressure due to consumption cuts caused by an economic downturn and job security concerns, will improve earnings, including for Gourmet Master-KY (2723 TT), Wowprime (2727 TT), Chlitina (4137 TT) and contact lens OEMs Pegavision (6491 TT) and Vizionfocus (4771 TT).

A recovery in Chinese consumption will also drive up demand for commercial goods, further reviving the Chinese manufacturing sector. Since the post-pandemic reopening, corporates have been conservative on capex, as the recovery in end-consumer demand has been tepid. We believe the industrial automation cycle, which has already troughed, will trend up if the economy is bolstered by consumption growth and support from the new policies. Taiwanese automation component suppliers with larger exposure to the Chinese market, such as Airtac (1590 TT), Hiwin (2049 TT), TBI Motion (4540 TT) and China Steel Corp. (CPC; 1597 TT), will directly benefit from demand growth driven by recovering investment confidence in China.

### Sector Analysis

**Automobile sector.** According to the China Association of Automobile Manufacturers (CAAM), China's January-August cumulative automobile sales volume edged up by 3% YoY to 18.77mn units, while new energy vehicle (NEV) sales were up by 31% YoY to 7.04mn units, accounting for 37.5% of the market. The performance was solid as policies continued to encourage private purchases of NEVs. We expect automobile demand to be boosted by interest rate and RRR cuts. Nevertheless, as industrial involution lingers, we recommend investors cautiously select companies with solid margins and higher exposure to NEVs. Our top pick is Hu Lane (6279 TT), with China revenue accounting for 77% of 1H24 sales and an NEV weighting exceeding 30%. The firm also has Chinese brand clients such as BYD, Geely, Changan and Chery.

**Raw materials sector.** China's RRR cuts and benchmark lending rates reductions will provide positive incentives to the raw material industry in the short term. The stock prices of plays in the plastics industry have hit their lowest points since 2007-08, while those of the steel industry also hit record lows over the past three years. However, considering unfavorable supply & demand and weak fundamentals, we remain conservative on the sustainability of the rebound in share prices of raw material plays.

Petrochemicals & chemical fiber sectors. The current Brent crude oil price is US$75/ metric ton (mt), 10% lower than the average price of US$84/mt in 1H24. This sharp slump in oil prices in 3Q24 has dragged down quotations of many plastic products, while losses for most companies will widen on inventory write-offs. Future oil price trends still hinge on production cuts from OPEC and developments in the Middle East. The market sees bearish prospects ahead. Another sticking point that led to weakness for the petrochemical and chemical fiber industries in China is excess capacity. China has been actively developing petrochemical and chemical fiber production capacity in recent years, to maintain economic growth post-COVID. Production capacity for many products has been expanding by 10-20% each year. New supply for some products will ramp up in 2026-27F. However, demand has only risen by 3-5%, or even declined slightly in recent years, leading to slow utilization of production capacity. Despite poor market conditions, Chinese companies have not yet implemented voluntary production capacity controls. For example, capacity utilization rates will not be lowered as long as losses are partially offset by meager profits from joint products, resulting in excessive competition in the industry, and weighing on prices. We believe the RRR cut and benchmark lending rate reductions from the PBC will only provide limited improvement to the fundamentals of the petrochemicals and chemical fiber industries.

**Steel sector.** Iron ore and coking coal prices rebounded by 3-5% yesterday, while Chinese steel product prices rose by 3%, registering a rare increase over the past year. However, improvement in fundamentals will be capped by sluggish demand. China accounts for

50% of global steel consumption, versus 15-20% from Europe and the US combined. For judging the effects of the new policies, the murky prospects for China's real estate market mean the impact on demand will be more important, as China's construction industry accounts for 55% of China's steel consumption. This contraction is too large to be offset by the US Fed’s interest rate cut, dragging down a recovery in global steel prices. 4Q24F steel prices for Taiwanese steelmaker CPC and Formosa Ha Tinh Steel Corporation (VT) have started to fall.

### Conclusion & top picks

The PBC introduced three new measures, which are rare but quite substantial, to revive economic growth. Although China’s economy will inevitably weaken structurally, the measures will boost consumer confidence. We are thus upbeat on China domestic-oriented plays in Taiwan reaching a turning point, with subsectors including domestic consumption, contact lenses, auto parts, bicycles and industrial automation. Our top picks are Gourmet Master, Airtac, Hu Lane, Giant Manufacturing (9921 TT) and Merida (9914 TT).

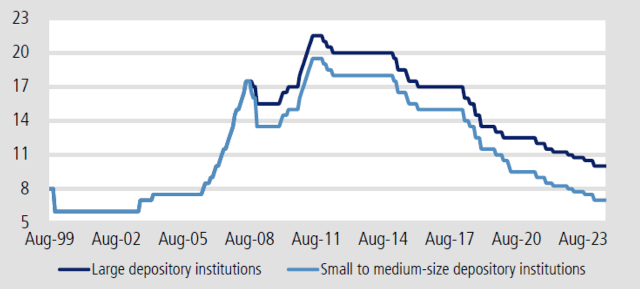
**Figure 1: China revenue sales weightings of China-themed plays in Taiwan**

| Sector | Sales weighting of China revenue (%) |
|---|---|
| Domestic consumption | Uni-President (1216, 41); Gourmet (2723, 51); Wowprime (2727, 27); Chlitina-KY (4137, 97); UNIVERSAL (3218, 23) |
| Bicycle | Giant (9921) (24); Merida (9914) (19) |
| Cement | TCC (1101) (25); ACC (1102) (41) |
| Industrial automation | Airtac (1590) (94); Hiwin (2049) (20) |
| Contact lenses | VF (4771) (61); Pegavision (6491) (40) |
| Tyres | CST (2105) (46); Kenda (2106) (26) |
| Auto parts | Hu Lane (6279) (77) |

*Source: KGI Research and KGI estimates*

**Figure 2: Required reserve ratio to be slashed by 0.5ppts**

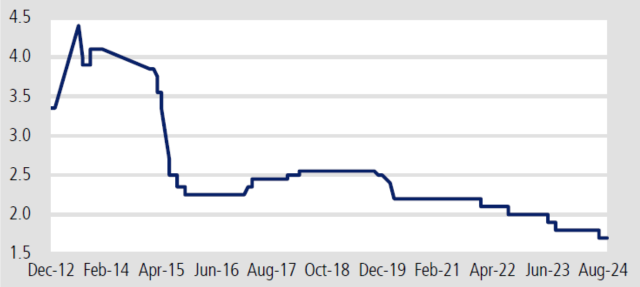
Required reserve ratio, percent




*Source: Wind; KGI Research*

**Figure 3: 7-day reverse repos cut by 0.2ppts**

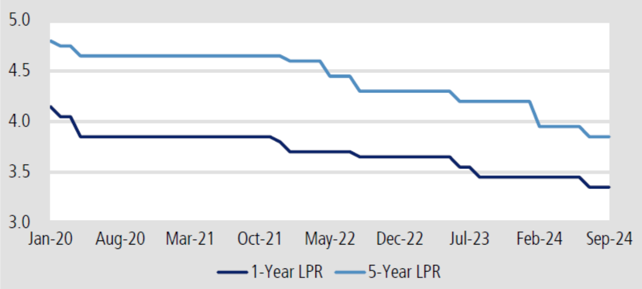
7-day reverse repos, percent




*Source: Wind; KGI Research*

**Figure 4: LPR to be cut by 0.2ppts in October**

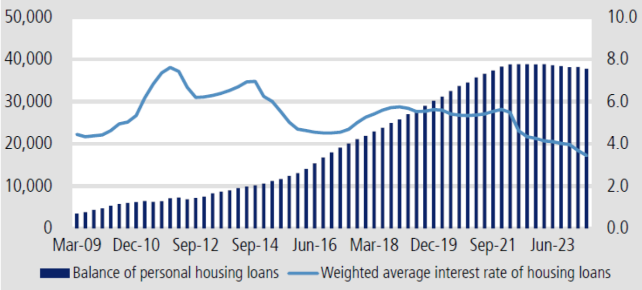
LPR, percent




*Source: Wind; KGI Research*

**Figure 5: Mortgage rates to fall, outstanding mortgage rates also reduced**

Balance of personal housing loans, Rmb bn (LHS); mortgage rate, percent (RHS)




*Source: Wind; KGI Research*

**Figure 6: Our top picks**

| Company | Code | Investment rating | Target price (NT$) | Mkt cap (US$mn) | Share price (NT$) | Change +/- (%) | EPS (NT$) 2024F | EPS (NT$) 2025F | PE (x) 2024F | PE (x) 2025F | P/B (x) 2024F | P/B (x) 2025F | ROE (%) 2024F | ROE (%) 2025F | Cash yield (%) 2023 | Cash yield (%) 2024F | Cash yield (%) 2025F |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Airtac | 1590 TT | Neutral | 1010.0 | 5,111 | 819.0 | 23.3 | 39.05 | 42.09 | 21.0 | 19.5 | 3.5 | 3.2 | 17.5 | 17.3 | 2.1 | 2.4 | 2.6 |
| Hiwin | 2049 TT | Outperform | 304.0 | 2,263 | 205.0 | 48.3 | 7.37 | 10.86 | 27.8 | 18.9 | 2.0 | 1.9 | 7.3 | 10.2 | 1.2 | 1.6 | 2.3 |
| Gourmet | 2723 TT | Neutral | 82.0 | 475 | 84.5 | (3.0) | 5.48 | 6.71 | 15.4 | 12.6 | 1.4 | 1.3 | 8.9 | 10.7 | 4.1 | 5.4 | 6.6 |
| Hu Lane | 6279 TT | Outperform | 196.0 | 596 | 187.0 | 4.8 | 12.80 | 14.44 | 14.6 | 12.9 | 2.8 | 2.6 | 20.1 | 20.7 | 2.7 | 3.7 | 4.3 |
| MIC | 9914 TT | Outperform | 280.0 | 2,295 | 246.0 | 13.8 | 8.43 | 12.72 | 29.2 | 19.3 | 3.4 | 3.2 | 12.0 | 17.1 | 2.4 | 2.1 | 3.1 |
| Giant | 9921 TT | Outperform | 274.0 | 2,826 | 231.0 | 18.6 | 8.91 | 11.42 | 25.9 | 20.2 | 2.6 | 2.4 | 10.2 | 12.4 | 2.2 | 2.2 | 2.8 |

*Source: KGI Research*

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