Taiwan Tech under an Escalating Trade Tension

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Tensions between the U.S. and China could escalate if Donald Trump returns to the White House, with U.S. restrictions on Chinese technology and chip tariffs taking center stage. Trump's policies are unlikely to match his promises due to their contradictory nature and according to the promises he broke in his first term. Global markets remain focused on fundamentals, with Taiwan's tech sector expected to sustain strong growth despite political uncertainties.

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Trump's return to the White House could exacerbate tensions between the U.S. and China. Potential U.S. government sanctions on Chinese technologies and semiconductors will be the key issues to watch next.

Impact of U.S. restrictions should be minimal

Reuters reported that TSMC has been ordered by the U.S. Commerce Department to halt shipments of advanced chips, of 7 nanometer or more advanced designs, that are often used in AI applications to China. The U.S. order came after TSMC notified the Commerce Department that one of its chips had been found in a Huawei AI processor. In the wake of the news, Taiwan shares ended down 547.9 points as TSMC extended losses on 12 November.

The potential impact that the U.S. order may have on TSMC should be limited. Morgan Stanley's analysis suggests TSMC's revenue exposure to China's cloud AI semis is at perhaps just 1% of revenue. The main focus of the current restrictions would be on AI chips. That is, consumer- and auto-related chips such as smartphone SoC and ADAS chips, may be excluded from the restrictions. TrendForce also highlights that the major clients for TSMC's 7/6n, 5/4nm, and 3nm processes are primarily from the U.S., Europe, and Taiwan. Demand from other customers should be able to make up for the orders lost in China.

Tariffs are on the table, but not a certainty

Taiwan has been noticed by Trump for its strength in semiconductors. During an appearance on a podcast ahead of the election, Trump said that instead of moving fotward with the CHIPS Act, he would put tariffs on semiconductors from Taiwan to force chipmakers to build fabs in the U.S. to avoid having to pay the added tax. However, such arguments overlook the fact that only about 10% of global chips are produced in the U.S., and imposing tariffs on chips presents significant logistical and practical challenges.

First of all, tariffs will require complex audits across thousand of devices, which contain a variety of chips. Semiconductor ownership typically transfers after the chip has been manufactured and passed inspection. The chip then will be shipped from foundries to assembly and packaging plants, and finally to distribution channels. The products that eventually enter the U.S. are end-user goods, not raw semiconductors. Attempting to impose tariffs on specific semiconductor products within the BOM (Bill of Materials) could increase the costs across the chip supply chain. Chipmakers could simply move the added cost down the line to their customers. Such a move could end up cutting into profit margins for companies like Nvidia and AMD, which rely on chips built in Taiwan, unless they similarly pass those costs down to their customers. Ultimately, the ripple effects across the tech industry would undermine efforts to control U.S. inflation.

Trump has continuously pushed the idea of tariffs as the answer to all trade imbalance as well as a means of reshoring manufacturing to the U.S. However, we think Trump tariffs are more like political posturing for election season rather than a promise he would follow through. The average import tariffs on Chinese goods and ROW (rest of the world) goods were 19% and 3% respectively, according to PIIE. For context, Trump called for a 45% tariff on China imports into the U.S. during the 2016 presidential campaign.

Fundamentals and policy to shape the market

The global financial market will still mostly be governed by fundamentals and monetary policies. Earlier this year, a range of signals pointed to a slowdown in the three largest economies, each of which has its own challenges. i.e. demand in the U.S. and Europe constricted by restrictive monetary policy and China facing headwinds from a beleaguered housing sector. After the Fed kicked off easing cycle in September, the U.S. equity market showed signs of broadening outside tech sector, evidenced by the Dow Jones Industrial Average being the first to hit record high after July correction.

Investors appear to be on the sidelines to see how Trump's campaign promises would translate into policy which might take a few months to take effect after he is in office next year. Now, we are against a different backdrop from the 2018 trade war when the economy was in a downturn. The market envisions a soft landing or even a no-landing scenario. According to I/B/E/S estimates, Taiwanese companies are forecasted to deliver a year-on-year earnings growth of 41.1% and 14.63% in 2024 and 2025, powered by the electronic sector. The stock market might have overreacted to Trump's bombastic rhetoric.

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