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Asia

Other

Equity Research

Industry Overview

Taiwan's Twin Elections: KMT For Two?Alastair Newton
(44) 20 7102 3940
anewton@lehman.com
LBIE, London**Sector View:**

New: 0-Not Rated

Old: 0-Not Rated

Investment Conclusion

- KMT wins in upcoming legislature and presidential elections should see an up-tick in market sentiment over Taiwan, in our opinion.

Summary

- Taiwan's upcoming legislative and the presidential elections stand to be close run. But the KMT looks favourite to secure victory in both – and, thereafter to move to negotiations with China which should, in due course, lift at least some of the restrictions on cross-strait economic ties.

2008 – A TALE OF TWO POLLS

Taiwan goes to the polls twice in 08Q1.

On 12 January, elections will take place for the Legislative Yuan under new rules which reduce the number of seats from 225 to 113 and which – to bring legislative elections in line with the presidential cycle – extend the legislators' term from three years to four. 73 of the 113 members will be elected from single member constituencies, the delimitation of which was a major political issue which was only resolved in several cases by drawing lots.¹

The sharp reduction in the number of seats and accompanying boundary shifts make the outcome of the election hard to predict with any degree of certainty. But the main opposition "pan-blue" alliance, which is dominated by the Kuomintang (KMT) and the People First Party (PFP) and which holds a majority in the current legislature, is widely expected to emerge as the largest political grouping. The outcome of the legislative elections could bear on the second ballot, ie the presidential election in March.

Two Elections, Two Major Issues...

In an effort to divert attention from the economic record of his ruling Democratic Progressive Party (DPP) and confound expectations, Taiwanese President Chen Shui-bian (who remains dogged by corruption scandals) may intensify his anti-China rhetoric.² Mr Chen's attempts to secure popular approval for UN membership under the name of "Taiwan" – rather than "Republic of China" as in the formal membership bid the UN rejected in September – are symptomatic.³ However, he may feel constrained by Washington's publicly stated disapproval of conduct which may provoke China (even though we believe Beijing is in any case likely to exercise restraint, in the belief that threatening statements are only likely to aid the DPP).

Reflecting the electorate's concern over the economy, DPP presidential candidate Frank Hsieh – who is widely seen as a moderate – is running principally on a platform of economic reinvigoration, coupled with greater flexibility in dealings with

¹ Of the remaining seats, 34 are elected in one "national district" by list-proportional representation and six are reserved for aboriginal people in a separate district.

² The DPP forms the "pan-green" alliance with and the Taiwan Solidarity Union, both favouring independence from mainland China.

³ Related, on 19 November Taiwan took the highly unusual step of unilaterally blocking the appointment of a Chinese attorney to the appeals body of the World Trade Organisation – which China has condemned while avoiding more confrontational steps. Its candidate was the first Chinese official to be nominated to a WTO post.

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China. For example – and notably – if elected he has promised an amnesty for all Taiwanese companies invested in China in breach of Taiwan’s restrictions on business links.

And reflecting the electorate’s second preoccupation – ie Taiwan’s marginalisation on the international stage – the KMT’s candidate, Ma Jing-jeou, is running on a similar platform to Mr Hsieh’s. Indeed, the KMT has even gone as far as to match the DPP’s promise of a referendum on national identity, albeit in somewhat watered down form.

...And Two Post-Election Prospects

Given this apparent convergence between the two main parties, does the outcome of the elections matter? In our view, it does. The key here is that we judge the authorities in Beijing to be more likely to engage with a KMT government than they would be with a DPP one. Indeed, Beijing has already been in informal talks with KMT-supporting business leaders in the hope of the party’s returning to power in the 2008 elections.

This is not to say that we expect a President Ma to preside over an immediate break-through in cross-strait economic relations. While not ruling out the possibility of early gestures by Beijing, eg around the 2008 Olympics, some lengthy negotiations would likely be required before there was any relaxation in key areas such as direct flights; permitting Taiwanese companies to invest more than 40% of their net worth on the mainland; and/or lifting the total bar on investment on the mainland in banking and infrastructure investment and in some more advanced technologies. Nevertheless, even a post-election prospect of the launch of formal talks is likely to provide a much-needed fillip to investor sentiment over Taiwan’s economic prospects.

Figure 1: Comparison of China Policies and Financial Reform Policies of KMT and DPP Presidential candidates

	KMT Candidate—Ma Ying-jeou	DPP Candidate—Frank Hsieh	Bottleneck
China Policy			
Direct investment to China market	Full lift of the 40% cap (as % of equity), judging it by technology sensitivity.	Provide a “grace period” for those illegal investments in the past; apply a flexible case-by-case review for necessary lifts.	Taiwan government
Lift of restrictions on banking investment in China	Open		Both PRC and Taiwan government
Allowing Chinese capital to invest in Taiwan	Open	Open except for sensitive industries such as national defense, agricultural technology	Taiwan government
Direct links	Open	Open - start with charter flights	Mostly PRC government
PRC tourists visiting Taiwan	Open	Open	PRC government
Immigration by PRC nationals	Open but not for blue collar workers	Open to professionals	Taiwan government
Long-term goal	Sign a “peace agreement” with China; achieve a “common market” between Taiwan and PRC		
Financial Reform			
State-controlled bank merger/disposal	Doesn't intend to set a goal but respect the market mechanism; decrease government’s intervention in state-controlled banks		
Tax Reform			
Inheritance tax /gift tax rate		Lower to 10%	

Source: Lehman Brothers research

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