Impacts of JPY and KRW Depreciation on Taiwan-China Fastener Industries After QE

by Wayne Sung

The U.S. Fed announced on Oct. 29, 2014 the end of its quantitative easing (QE) policy effective from 2008 through 2014, which was the largest economic stimulus plan in the history of the U.S. Because the QE had stimulus effects on the U.S. and global economies, and on cash flows of emerging markets and Asian financial market, its end means the beginning of another wave of global economic instability of the global economic conditions. Over the past 6 years, the Fed's assets reached a record high of US$ 4.5 trillion on Jan. 1, 2014, which was 5.6 times of its assets (0.8 trillion) before 2008. To reduce its assets to the level before 2008, it will take a long time and such a process will be full of uncertainty.

The QE lowered the lending costs of banks as well as pressure of firms and individuals applying for loans. Many countries adopted super-low interest rates to boost their economic recovery. However, in the mean time, a large amount of money flowed into the stock markets of industrial and emerging countries. For example, in the U.S., though its economic condition had not fully recovered, its Dow Jones Index reached 17,000 points and even surged to 18,410 points on Feb. 21, 2015, which then led to a booming global stock market. Thanks to the QE, U.S. economy was revitalized; its unemployment was down; its economic growth has returned to the normal level with more job opportunities. The QE, which successfully helped its economic condition return to a normal level and which is unprecedented in the U.S. history, finally said farewell to the public.

After the U.S. successfully came out of the financial storm, other countries began to face the impacts caused by the end of QE. The supply of U.S. dollars was reduced and yields of U.S. bonds were raised, which increased the value of U.S. dollars, increased the attraction of assets quoted in dollars, and provided incentives to make overseas capital re-flow to the U.S. In the mean time, foreign capital left their parent countries. As more money left these industrial countries, countries in Europe, Asia, and emerging economic regions began to face difficult time. The amount of money leaving the euro zone reached a 15-year high in 2014. According to the data of European Central Bank released on Oct. 29, 2014, the amount of fixed income capital withdrawn from the euro zone reached US$ 239 billion as of the end of June 2014. As a result, Europe started to implement its own QE policy at the end of 2014 and countries (e.g., China, Taiwan, Japan and S. Korea) started to depreciate their currencies to ensure their earnings from exports. Since April 2013, when the Japanese Central Bank started to put its large-scale economic stimulus plan into force, Japanese yen has depreciated by 20% against Korean won. As products exported from S. Korea are very similar to those exported from Japan (mainly automobiles and electronics), the depreciation of Japanese yen inflicted much more impacts on Korean economy as compared to the minor impacts on China and Taiwan. The depreciation of Japanese and Korean currencies would bring about tremendous amounts of impacts on China, Taiwan, and other southeastern countries.

Impacts from JPY Depreciation on Japanese Fastener Market

Japan has been a leading country in the production of high quality fasteners. The big quake, which heavily struck northeastern Japan in 2011, had a big adverse effect on Japanese fastener industry. In recent years, the shortage of power also plagued Japan. Therefore, Japanese fastener industry recovered quite slowly. Japanese fastener output has been in the range

of 3-3.5 million tons. The rapid depreciation of Japanese yen brought about by Prime Minister Abe Shinzo has brought new business opportunities to Japanese fastener industry, in which 10% of the fasteners made in Japan have been for export. The biggest impact of the depreciation of Japanese yen has been on Korean fastener industry and its impact on Taiwanese fastener industry cannot be overlooked, either. Especially, it has a tremendous impact on the export of machine tools made in Taiwan and indirectly affects the domestic demand and the exports of Taiwanese fasteners.

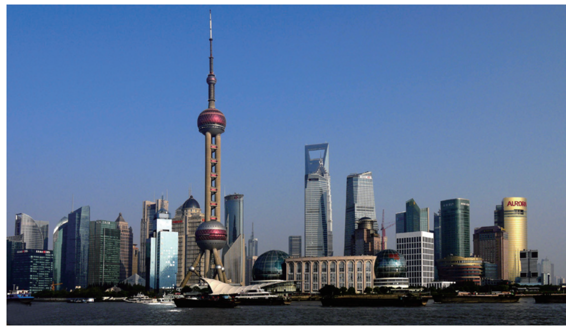
In fact, since the eruption of global financial storm in 2008, Japan has started to implement its QE plan. Since Oct. 28, 2010, Japanese Central Bank has announced 9 times of "Asset Purchase Program". By the end of 2013, the cumulative assets purchase reached 101 trillion yens. In 2013, the Abe's government started to actively carry out economic stimulus plans and increase the scale of its QE. Meanwhile, Japanese Central Bank announced it would carry out its QE measures indefinitely and would purchase more than 7 trillion yens worth of long-term government bonds each month and assets of the private sector. In Oct. 2014, Japanese Central Bank increased its assets purchase from 60 trillion to 80 trillion per year. In the first half of 2015, the Japanese government will continue to carry out its QE measures to ease the social pressure brought forth by the increase in the consumption tax. In addition, if U.S. Fed raises the interest rate, Japanese government will sell yens and buy green backs and thus the economic recovery of Japan will be adversely affected owing to the fast depreciation of yen that increases the import prices of materials and energy.

The QE measures and depreciation of Japanese yen have produced positive results in the exports of automobiles and electronics products. Japanese trade surplus (545.5 billion yens) against the U.S. in Jan. 2015 exhibited a 48.7% monthly growth, which has lasted for 5 months, but its trade deficits against China and Europe have exerted tremendous pressure on Abe's economic policies. Although the depreciation of yen benefits export, it causes the price hike of imported goods. With regard to Japanese fastener industry, its high quality products can definitely compete with fasteners made in Europe and S. Korea. With regard to overseas factories of Japan, such as factories in Thailand, these factories will benefit from depreciation of yen and this will pose a threat to other countries that mainly export automotive fasteners.

Korean Won Depreciation and Its Impacts on Korean Fastener Market

There are over 700 fastener manufacturers in S. Korea. These manufacturers produce 0.8 million tons of fasteners per year. 3/4 of the production is for domestic use (e.g., construction, automobiles, machines, and shipbuilding) and merely 20% of the production is for export. In recent years, these manufacturers have been improving and upgrading their fasteners according to needs and specification requirements of the market. 140,000 to 160,000 tons of fasteners are exported from S. Korea to other countries per year and the main export destination countries are the U.S., China, Japan, Canada and the EU. The main types of fasteners exported from S. Korea to the EU include self-tapping screws, carbon steel screws, stainless steel screws, carbon steel hex screws and stainless steel nuts. Fasteners made in S. Korea are very similar to those made in Japan, especially fasteners used for automobiles and electronics, and both countries are "mutually exclusive" in terms of prices and quality. Of course, if the currency of a country appreciates or depreciates, such a change will have a direct impact on the exports. The depreciation of yen will have a big impact on the fastener exports of S. Korea.

In addition, when the FTA between S. Korea and the U.S. became effective, customs taxes for 87.3% of industrial products (7,694 items) and 57.54% of agricultural products (1,057 items) were immediately reduced to zero, and customs taxes for auto parts as well as assembled cars also dropped to zero. This agreement has caused impacts on fasteners made in Taiwan and China. With years of assistance of the Korean government in the development of commonly used and high quality fasteners, manufacturers of these kinds of products have grown into a big industry cluster, which has its own supply chain. In addition, the domestic fastener market of S. Korea has been saturated. Although the Korean government could offer preferential measures to the U.S. fastener manufacturers who invest their production lines



in Korea (and then sell fasteners back to the U.S.), a better option for U.S. fastener manufacturers would be to erect fastener production lines in China, because, by doing so, they may sell their fasteners to both China and U.S. markets. Whether U.S. fastener manufacturers will be attracted to investment in S. Korea or not is yet unclear; if so, such investments would cause structural changes to Asian fastener market.

Impacts on Taiwanese and Chinese Fastener Industries

In the past decade, fastener manufacturers in China and Taiwan made effort to elevate the quality of their products and enhance their competitiveness, and now they have secured their positions in the U.S. and Europe in the supply of low to medium priced fasteners. In recent years, some big fastener manufacturers in the U.S. and Europe merged with each other to cut costs or consolidate their global business, and at the same time, relocate the production of medium to low end fasteners to Asian countries with lower costs, especially China and Taiwan. There are two reasons that multinationals invest in China: one is that the market in China is vast with unlimited business opportunities, and the other is that manufacturing in China costs less. The reason that orders have been placed on Taiwanese fastener manufacturers is due to their excellent manufacturing technology and management (in addition to those of Japan well known in Asia). Other reasons include the formation of production clusters in Taiwan, finer labor division, high quality and punctual delivery. These reasons are what make Taiwan outpace Korea. Although Taiwanese electroplating industry once stumbled in 2013 to stricter environmental protection policies, they have fully resumed the operations at the end of 2014 after one year of facility renovation. As of now, with regard to the fastener industry of Taiwan, in addition to the fact that finer labor division in production has been implemented, integrations have been achieved to form partnerships and supply chains and the whole industry has broken away from the price cutting war among individual manufacturers and aimed at raising the competitiveness of the supply chain and the industry as a whole – acting as a team in order to jointly take up and share orders placed by big overseas distributors. Such integrations are a characteristic of Taiwanese fastener industry; therefore, in the competition of exchange rates, such integrations may ensure mobility, lower management and marketing costs, and optimize flexibility and competitive advantages. In another aspect, the Chinese government indicates that it will maintain its currency policy without promoting too many stimulus plans in order to steadily implement market reforms. Since 2012, RMB has appreciated by nearly 30% against yen thanks to the fast depreciation of yen and this has affected the bilateral trade between China and Japan. Plus, the sovereignty dispute over Diaoyu Islands has also affected the bilateral trade and investment between China and Japan. However, this dispute does work in favor of Taiwan. As in tourism, many Chinese and Japanese tourists come to Taiwan. The friendly relationship between Taiwan and Japan, and the unselfish, humanitarian assistance provided by and shown by Taiwan and its people for the 2011 quake-devastated region in Japan have come into play with regard to Taiwan's ability to attract Japan's overseas investment.

After the withdrawal of QE from the market, U.S. dollar started to appreciate and such appreciation in turn caused the following depreciation of RMB, euro, yen, won, NT dollar, and other currencies. For every country, with regard to the adjustment of its currency exchange rate, maintaining balance between export competitiveness and domestic inflation will be a big challenge to its finance department. After the election in Greece in Jan. 2015, the new ruling party is against the austerity measures stipulated by the EU; therefore, it is yet to be seen whether Greece will stay with euro. Therefore, as in the Greek case, the ruling party's economic decision may not necessarily reflect that of the majority of people. With such a new ruling party, which is a left-wing party in power, we can see Greece's future is full of uncertainty.

Promoting exports is a goal that both China and Taiwan must strive for. A feature of this wave of international currency war is the fact that it is a war of persistence and endurance. Because Abe's government intends to let yen stay low for a long period, this has caused the governments of China, Taiwan, Korea, Singapore and Europe to keep a close watch on the fluctuation of yen. Another thing worthy of our attention is international hot money – where it goes to would play a key role in the international currency war of the future -- as evident by the lesson we'er learned from the Asian financial storm at the end of the 20th century- When several countries tried to outdo each other in depreciating their currencies, international hot money capitalized on such occasion and it, by doing so, could dictate the outcome and winner of such international currency war. The goal of China and Taiwan after entering into such a war is to preserve or secure their positions in the global fastener market – on the one hand, in order to enjoy the success brought by U.S. economic recovery, and on the other hand, to increase the global market shares of medium to high priced fasteners.