

Global Emerging Markets

Tension in Taiwan...

In this report we analyse the internal political situation in Taiwan (14% of our portfolio exposure). Specifically, we investigate how the very recent internal instability within the island state is materially changing the broader geopolitical situation across the Taiwan Straits.

Taiwan's Current Political Instability – A Boon for China

In July and August Taiwan saw several 'recall' elections of members of the opposition KMT party – a result of a grassroots campaign to remove them following political gridlock post the January 2024 general election. These recall elections failed to remove any sitting KMT parliamentarian's which means that the government administration of President Lai will continue to face a hostile, gridlock parliament, a situation that over the longer term will benefit China's desire to reunify with Taiwan.

The current turmoil within Taiwan's parliament (known as the Legislative Yuan or LY) stems from the state's general election, held in January 2024. Under the leadership of Tsai Ing-wen the Democratic Progressive Party (DPP) had held power since 2016, but following several political missteps and a misfiring economy, party popularity has waned. Tsai resigned as party chairperson after the DPP suffered losses in the 2022 local elections.

The 2024 general elections were therefore a significant test for the DPP facing a rejuvenated China friendly Kuomintang (KMT) party and a "third way" party, the Taiwan People's Party (TPP), founded in 2019 under the leadership of charismatic former Taipei

major Ko Wen-je. For the DPP government, Ko Wen-je's TPP posed a particularly difficult problem given his popularity amongst younger voters (traditionally DPP voters) who were bearing the brunt of the COVID isolation fallout and 2022 and 2023 economic downturn.

The result was the DPP lost a significant amount of political skin at the 13 January 2024 election with their share of the vote falling from 57% in the 2020 election to 40% in 2024. The three-way nature of the contest meant this was enough for the DPP Presidential candidate Lai Ching-te to become the head of state. However, the DPP was only able to gain 51 of the 113 seats in the Taiwanese Legislative Assembly, losing its majority to the KMT - TPP alliance.

Exhibit 1: Frustrations boil over in Taiwan's Legislative Council in May 2025 (Source: ABC News)



This redistribution of power generated political gridlock. In the period since, President Lai and his supporters have grown increasingly frustrated with legislative efforts to change the institutional balance of power between the Legislative Yuan (controlled by the KMT) and the executive branch. Under this amendment, government officials could have been compelled to testify, provide documents, and face steep penalties for non-compliance. Ultimately, the High Court struck down these proposed amendments, but frustrations also grew as the KMT led Legislative Yuan was unwilling to pass a government-wide annual budget bill, which included a proposed increase in defence spending to over 3% of GDP. As shown in Exhibit 1, these frustrations boiled over within the Taiwan parliament into physical altercations.

Recall Elections in July and August 2025

DPP supporters began questioning whether opposition legislators were acting at the behest of the China Communist Party (CCP) and whether they should be removed from office for the sake of Taiwan's national defence. This frustration coalesced in a grassroots campaign known as the *Bluebird Movement* to recall KMT legislators. Under Taiwanese law, if a petition with 10% of voters in a particular electorate is presented to Central Election Commission, a recall election will be called.

The grass roots campaign eventually was able to secure this 10% threshold in 31 KMT held seats, thus forcing recall elections over July and August of 2025. Polling leading up to the recall elections showed that most Taiwanese opposed these new elections, it appears that many voters saw the widespread use of recalls as a partisan tool rather than a legitimate check on the Legislative Yuan.

At first, President Lai was cautious in his support for the recall elections, but he was in a political dilemma. Many of his voter base were enthusiastically supporting the recalls but he could

also see the danger in appearing to use the political system for his partisan benefits, particularly if the recall elections did not get up, signaling a rejection of him personally by the electorate. Ultimately, Lai came out in support of the recall elections, framing the recall elections as resisting China's influence in Taiwan. In the end, not a single result from the KMT legislator was overturned, and all 31 KMT legislators retained their seats. This proved to be a politically disastrous choice for President Lai.

The Likely Future Course of Taiwan's Domestic Politics

The result of the July recall elections means that the KMT/TPP coalition will almost certainly look to press its majority in the Legislative Yuan and continue to advance its agenda. This will most likely mean efforts to expand the powers of parliament at the expense of the executive branch of government.

We would also expect the KMT to obstruct President Lai's government agenda to create the perception that the DPP are not fit for government, as we saw in the KMT enacting deep budget cuts in early 2025. However, such tactics risk backfiring if they are seen working for partisan objectives and their obstructive tactics could be viewed by voters as not in the best interests of Taiwan.

The outcomes of the recall elections suggest that voters are increasingly urging parliament to shift its focus beyond geopolitical concerns and prioritise pressing domestic issues, particularly the economy, energy policy, and housing, as the 2026 local elections approach.

The first test for the KMT's approach following the recall election will be the DPP government's renewed push to increase defence spending by 23% in 2026 to 3.3% of GDP, the highest proportion of GDP in 20 years. The passing of this bill through Taiwan's Legislative Yuan over the next month will be a strong test of whether we are headed for compromise between the KMT controlled

parliament and DPP government or political gridlock over the next few years.

Trump and Taiwan – Another Boon for China

Of all the countries that have seen their fates altered negatively by President Donald Trump's second term, Taiwan ranks near the top of the list – a further complication to the messy domestic political situation. Taiwan's misguided strategy with Trump started to become obvious the very day Trump was re-elected in November 2024, when Lai failed to attempt to call Trump to offer his congratulations.

It was rumoured that Lai was advised by friends with ties to Trump not to attempt the phone call, which in the end was bad advice given Trump's deep need for continual validation.

This decision not to call the incoming President Trump came back to haunt the Taiwanese President quickly with President Trump personally making the decision to cancel Lai's planned "transit visit" to New York and Dallas on his way to one of the dwindling number of countries in Latin America with which Taiwan has formal diplomatic relations.

Taiwan's challenges with the incoming Trump administration were set in motion even before the election, due in part to its close diplomatic alignment with the Obama and Biden administrations. During the Biden administration, Taiwan's diplomatic outreach in the United States was led by former DPP legislator Bi-khim Hsiao, who is well known in both Taiwan and the U.S. for her strong advocacy on human rights issues, including same-sex marriage, women's rights, and animal welfare. Aligning herself with organisations such as the National Endowment for Democracy which likened Trump to authoritarians such as Hitler, Stalin, and Mussolini, further soured the Taiwan-Trump relationship. By making Bi-khim Hsiao his running mate in the presidential election (where she was eventually confirmed as Vice President) Lai Ching-

te has cemented the view in the eyes of the current US administration that Taiwan is pursuing a "woke" agenda, anathema to Trump and his minions.

Taiwan's annual defence expenditure is only about \$20 billion. For comparison, often-threatened Israel, with less than half of Taiwan's population, spends more than twice that. Trump and his top policy appointee at the Defence Department, Bridge Colby, have both suggested Taiwan should be spending a whopping 10% of its GDP on defence. Taiwan's inability to increase its defence budget (as we have already discussed) therefore continues to be a further festering sore in its relationship with the US. The strategic calculus of the current US administration is: if you aren't prepared to defend yourself why should the US come to your aid.

Taiwan appears to have played its hand very poorly in dealing with the Trump administration and leaves itself vulnerable to the capricious nature of the President. This deterioration in its external relationships combined with the internal discord makes Taiwan much more vulnerable to China's tactics to unsettle the island nation.

China - Biding Its Time

In April 2025, China's most senior military leaders gathered for what appeared to be a routine tree-planting ceremony. However, the ceremony became notable when He Weidong, the second-highest ranking officer in the People's Liberation Army, failed to appear and has not been seen since. He appears to be the latest casualty of a sweeping purge that had already taken down two former defence ministers. His disappearance fits a growing pattern under President Xi. China's leader has ousted almost a fifth of the generals whom he has personally appointed since he took power in 2012. These purges have clearly signalled a lack of confidence in the leadership of the PLA, and by extension in the PLA itself, to meet Xi's goals. This lack of confidence combined with Russia's experience in Ukraine would surely give Xi pause for

thought about the risks involved in a full-scale invasion of Taiwan. Indeed, we continue to see no real signs that China is preparing such an audacious move on Taiwan. There is no sign of Xi preparing China's population psychologically for the costs of war with Taiwan over an extended period.

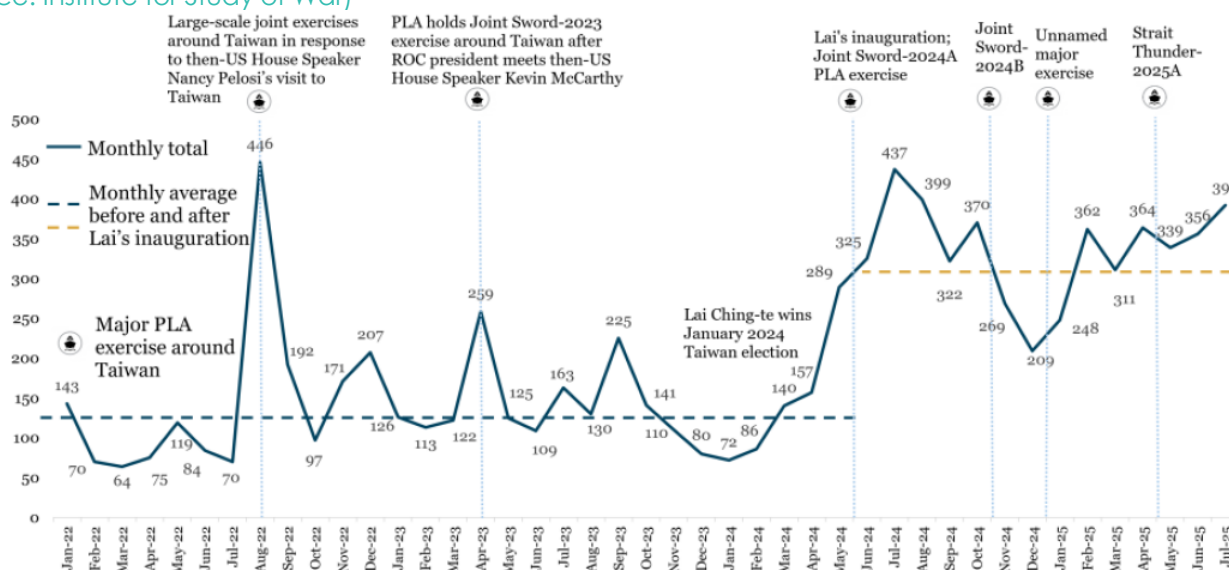
With internal tensions rising in Taiwan, a weakened DPP following the recall elections, a revitalised pro-China KMT, and increasing diplomatic distance from the United States, China is likely to view the evolving situation in Taiwan over the past 18 months as increasingly favorable to its interests.

With an increasingly China-friendly KMT now in control of Taiwan's legislature at least until 2028, China's ability to use the strength of the KMT party to neutralise the pro-independence forces of the DPP have been greatly enhanced. To be sure, not all KMT lawmakers support China's political takeover of Taiwan, but enough of them are sufficiently sympathetic to it to give China a higher chance of success than had previously been the case. Paradoxically, this has somewhat reduced China's incentive to pursue aggressive military actions against Taiwan such as a full-scale invasion, a blockade, or even a partial quarantine since it

now sees greater strategic gains through less risky, non-military means. After all, why resort to risky military action when you can get what you want through non-risky, non-military means? At the same time however, it is still highly likely that China will accelerate its already robust gray-zone, short of war campaigns in and around the Taiwan Strait in a continuing bid to further undermine the already problematic Taiwanese morale and ultimately make its KMT abetted political campaign that much more effective. On the ground, this translates into a greater likelihood of increased Chinese military exercises around the Taiwan Strait, intensified political subversion efforts within Taiwan, and more strategic attempts by China to gradually erode traditional American support for Taiwan's de facto independence until that support potentially fades. In short, Taiwanese people of all political stripes reluctantly conclude that they have no choice but to surrender to the Chinese political juggernaut.

This is exactly what we have been seeing on the ground with China ramping up incursions into Taiwan's Air Defence Identification Zone (ADIZ) since the start of the year (see Exhibit 2).

Exhibit 2: China's incursions into Taiwanese Air Defence Identification Zone (ADIZ)
(Source: Institute for Study of War)



Additionally, China's naval and coast guard vessels have been circling outer lying islands (such as a Chinese Coast Guard ship patrolling Pratas island for over 24 hours on August 23) amongst other actions by the PLA, with the goal of normalising such actions. Taiwan's isolation and internal political turmoil has therefore had the effect of making it much more likely that China and President Xi bide their time and wait for the opportunity to take the island without firing a shot. This status quo situation is likely to persist until at least 2028 whilst the KMT have control of the Taiwan legislature and Trump is in the White House.

Summary

In our view, the risks of China looking to undertake heightened military action, or full-on invasion, of Taiwan have receded for the foreseeable future (next 2-3 years). This is good news for foreign investors in Taiwan. Taiwan's political instability and strained US relationship allows Beijing to bide its time and try and seek a diplomatic solution on reunification. However, the vexed issue of China's claim over Taiwan very much remains, and military action cannot be dismissed long-term. As such, we continue to monitor the situation very closely given the risks, and we stand prepared to adjust our Taiwan portfolio position (currently 14% of assets).

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