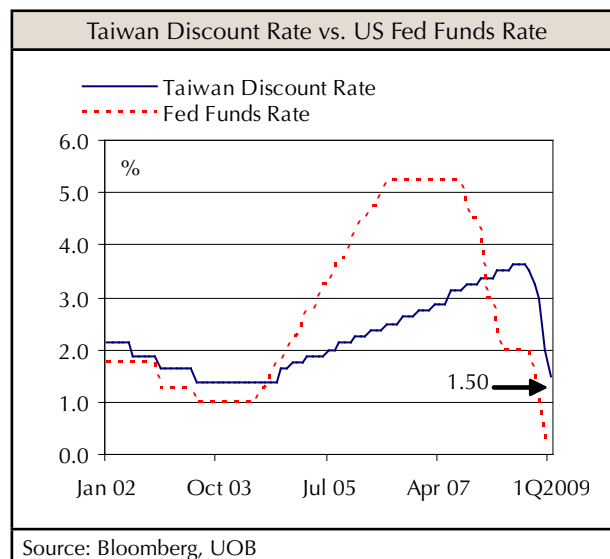


Taiwan: CBC Cuts Interest Rate and Heads Towards Lower Bounds

Immediately after a dismal set of exports numbers for December released today (7 Jan), Taiwan's central bank CBC cuts its key interest rate by 50bps to 1.50% at its unscheduled meeting. This is the sixth interest rate cut in just three months, bringing the cumulative quantum of reductions to 212.5bps since 26 Sep, when the rate cut cycle began as central banks worldwide responded to the global credit crisis. As a recap, CBC had prior to today's decision, moved on 11 Dec 08 (-75bps, scheduled quarterly MPC meeting), 9 Nov (-25bps, unscheduled); 30 Oct (-25bps, unscheduled); 9 Oct (-25bps, unscheduled); and 25 Sep (-12.5bps, scheduled quarterly MPC meeting).

What prompted CBC's move today was the plunge in December exports data, which fell a record 41.9%/y vs. -23.9% in Nov and expectations of around -30%. Taiwan's exports have declined for the fourth consecutive months and even more alarming, is the accelerating pace of the declines each month. The destruction in end-demand has been spreading around the world and export-driven Asian countries such as Singapore and Taiwan are feeling the brunt. Taiwan's exports to China declined 57.1%/y in Dec, while exports to US fell 23.5% and to Europe contracted 29.5%/y. As such, we estimate Taiwan's economic recession to have begun in early 4Q08 and we estimated its GDP to have contracted by 2.5%/y during the quarter, after -1%/y in 3Q08. For 2009, we project Taiwan's economy to experience further contraction in 1H09, before stabilizing in 2H09 for a GDP growth of 0.3% vs. estimated 1.6% in 2008 (official forecast: 1.87%). As for inflation, CBC is projecting a mild positive rate of 0.37% in 2009, although we believe deflationary pressure is likely to take hold for most part of the year, for a -0.4% rate for the CPI, on the back of demand destruction and overcapacity.



Against a backdrop of rapid deterioration in the external environment and reduced inflationary pressures, there is still some room for the CBC to lower interest rates further. **However, the central bank is running towards the zero bounds of interest rate just like monetary authorities elsewhere. As such, further aggressive moves are now less likely with its official interest rate at just 1.5%. We see another 50bps cut in the current quarter (1Q09) and another 50bps early in 2Q09, bringing the benchmark rate to 0.5%, which is likely to be the tolerance limits for the CBC.**

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