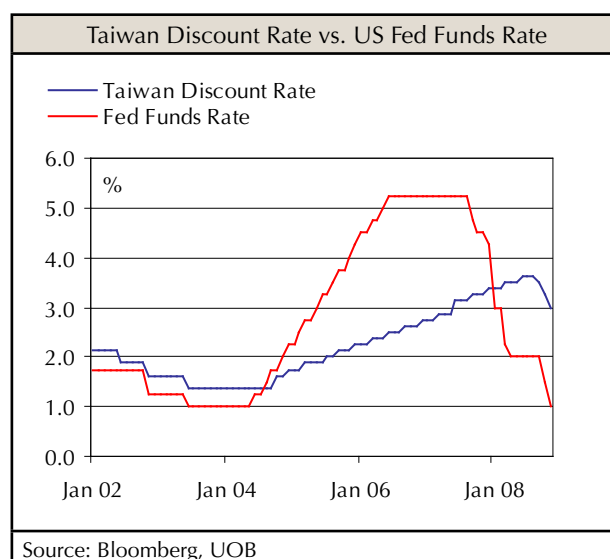


Taiwan: Surprise Interest Rate Cut

Taiwan's central bank (CBC) announced this morning (Thur 30 Oct) a surprise rate cut of 25bps, bringing the benchmark discount rate to 3.00%, with immediate effect. It was clear that CBC followed close on the heel of US Fed's decision late 29 Oct (early 30 Oct in Asia) to reduce its target rate by 50bps to 1.00% and China's PBoC third rate cut this year, announced after market close on 29 Oct. This is the third rate cut for CBC within the space of 6 weeks, and underscoring the authorities' concerns of the deteriorating external and domestic environment.

In its post-meeting statement, CBC cited three reasons for its latest decision, namely: easing inflationary pressures; slowing domestic economic activities from indicators in exports, production, consumer, and employment; and maintain stability in the banking sector.

Indeed, data releases in recent months show a clear downtrend as a result of weakening external demand as the global credit crisis deepened. This explains the aggressive nature of past two interest rate cuts, as the CBC is clearly concerned about the deterioration of both external and domestic economic environment. To recap on some of the recent key data, Taiwan's exports saw a decline of -1.7%/y/y in Sep, in a typically busy period of the year while the figure is likely to dip into negative by October on a 12 month moving average basis, which would possibly be the start of the downtrend matching those in the 2000/01 tech bubble burst. Exports orders are also showing distinct signs of weakness in the past four months, rising at just 2.8%/y/y in Sep compared to average of 14.5% in the first half of 2008. The labour force is already reflecting the slackening exports sector, as jobless rate spiked up to hit 4.12% seasonally adjusted in Sep, the highest in more than 3 years.



Going forward, we expect the CBC to continue to bias towards easier policy, as key data appear to head towards the downtrend seen in the last downturn in the bursting of 2000/01 tech bubble. Jobless rate then hit a high of 5.35% by late 2001 and resulting in job losses of around 160,000 during that period. We had earlier expected the key discount rate to reach 3.00% at end-1Q09. **With the latest development, we look for CBC to keep cutting interest rates at 25bps pace in the next quarterly meeting (at end-2008), as well as the four quarterly meetings in 2009, bringing the benchmark discount rate to 1.75% by end of 2009. This would be a repeat of CBC's last easing cycle in 2002/03 when the benchmark rate was brought down to 1.375% by June 2003, in lock-step with easing of the Fed funds target rate to 1.00% back then.**

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