

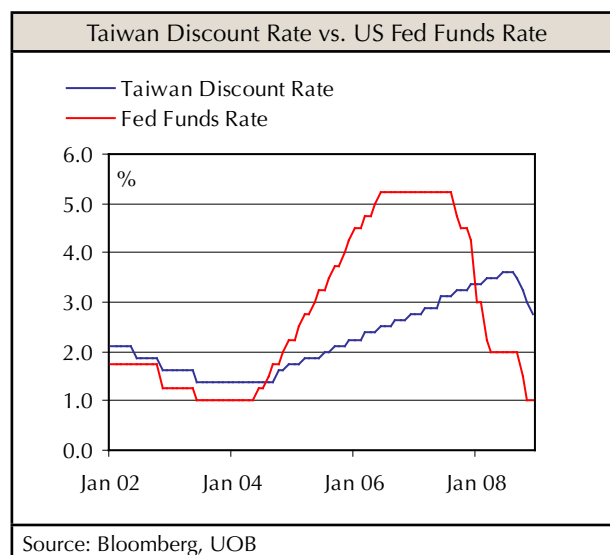
Monday, 10 November 2008

Flash Notes

Taiwan: Another Surprise Interest Rate Cut

Taiwan's central bank unexpectedly cut interest rates by 25bps yesterday (Sunday, 9 Nov) to 2.75%, the lowest level since March 2007 for the benchmark interest rate and the fourth reduction in a little over a month as fears of a global recession threatens the export-led economy. The move came after Taiwan's exports declined sharp 8.3%/y/y in Oct from the 1.6% decline in Sep as it was evident that demand from key exports destinations slumped on the back of the global credit crisis. Before Sunday's decision, CBC had announced cuts in its main policy rate on 25 Sep (scheduled MPC meeting, -12.5bps), 9 Oct (unscheduled, -25bps) and 30 Oct (unscheduled; -25bps). All in, the usually steady CBC has reduced its benchmark discount rate by 87.5bps in just little over a month, underscoring the speed of the deterioration of the global credit crisis and the extent of the impact on export-driven Taiwan.

Going forward there is still room for the CBC to reduce interest rate further given the massive headwind to growth outlook and as the US Federal Reserve is verging on tilting below 1% on the key overnight Fed funds target rate. The Fed funds futures market is now fully pricing in a 25bps cut by the Fed and also some non-trivial possibility of a 50bps move at the 16 Dec US Fed FOMC meeting. This suggests that the CBC's bias remains to the downside and is likely to move again before the end of 2008, by another 25bps to 2.50% at its scheduled MPC meeting in December. Beyond 2008, we are expecting a further 150bps before the middle of 2009, bringing the discount rate to 1.00%. This would be in line with the previous easing cycle when the CBC brought its key rate down to 1.375% in Jun 2003-Sep 2004, as the Fed funds rate settled at 1.00%. With the severity of the global credit crisis and the unknown depth/duration of the global recession, the downward bias for Taiwan's interest rate remains significant.



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