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UOB Economics Projections	2007	2008	2009F	2010F
GDP	5.7	0.1	-5.2	3.6
CPI (average, y/y)	1.8	3.5	-0.2	0.3
Unemployment Rate (%)	3.8	5.0	6.4	5.8
Current account (% of GDP)	8.3	6.2	3.7	2.9
Fiscal balance (% of GDP)	-0.2	-0.8	-3.0	-2.3

TWD continued to move in tandem with most regional currencies in 2Q09. However, with external demand continued to stay depressed in the current global economic recession, we see little room for the USD/TWD to move substantially lower, and look for the pair to hover around 32.00 by end-2009 and dipping towards 31.50 by mid-2010 from 32.80 currently.

The aggressive rate easing cycle ended at the March quarterly meeting. With the policy rate at 1.25%, the central bank was clearly concerned about hitting the lower limits. The weak money supply and loans growth trend suggests CBC would hold on to its loose policy for some time and would not be looking at tightening until the second half of 2010.

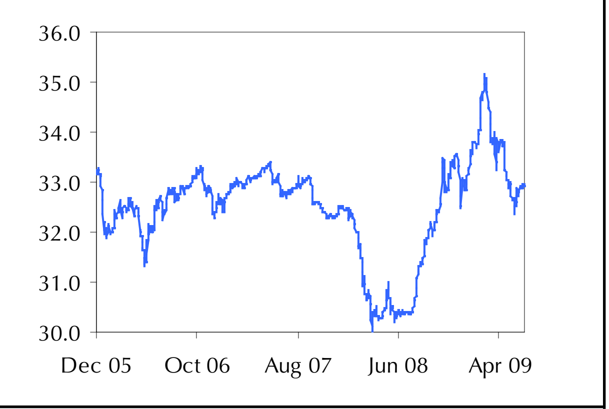
After the record decline of more than 8%y/y in 4Q08 GDP, Taiwan's economy shrank a further 10% in 1Q09, effectively marking the recession as the most severe in its modern history. We expect Taiwan's GDP to decline about 5% in 2009 vs. revised official forecast for 2009 of -4.25%. Nevertheless, the worst point of the cycle is has second half of 2009 should be marked with some form of stabilization. We expect Taiwan's economy to return to positive growth for the full year in 2010 as the base of comparisons turns lower.

TWD to Stay Flat on Weak Exports

TWD continued to move in tandem with most regional currencies in 2Q09. In particular, the return of risk appetite since March saw risky assets back in favour, including currencies such as TWD. Closer cooperation with mainland China since the KMT govt took over a year ago also helped boost asset prices in Taiwan.

However, with external demand continued to stay depressed in the current global economic recession, it is clear that the CBC prefer a softer TWD. This can be seen from the regular interventions in the FX to keep the TWD from moving too aggressively. Another that factor that would keep the pair supported for now is that the CBC is expected to keep interest rate on hold and unlikely to mull interest rate hikes until middle of 2010. As such we see little room for the USD/TWD to move substantially lower, and look for the pair to hover around 32.00 by end-2009, and dip towards 31.50 by mid-2010, from 32.80 currently.

USD/TWD Trend

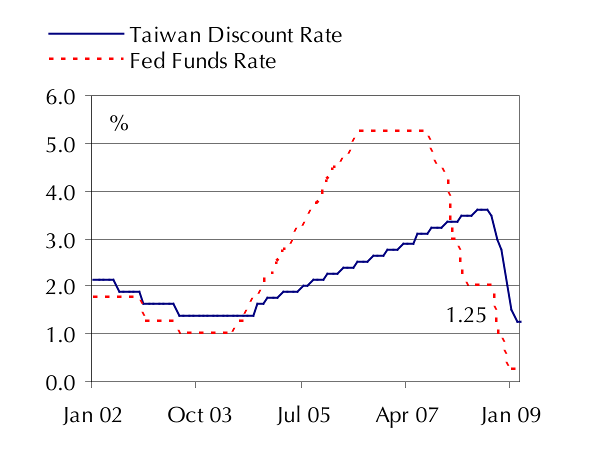


Source: Bloomberg, UOB Econ-Treasury Research Estimates

Interest Rate Policy to Stay on Hold

The aggressive rate easing cycle which began in Sep 2008 ended at the March quarterly meeting. The June quarterly meeting further reaffirmed the policy stance as the CBC cited return of stability in the economy, consumer prices, and financial markets. With the policy rate at 1.25%, the central bank was clearly concerned about hitting the lower limits as the US Fed has already reached the lower bound at the end of 2008.

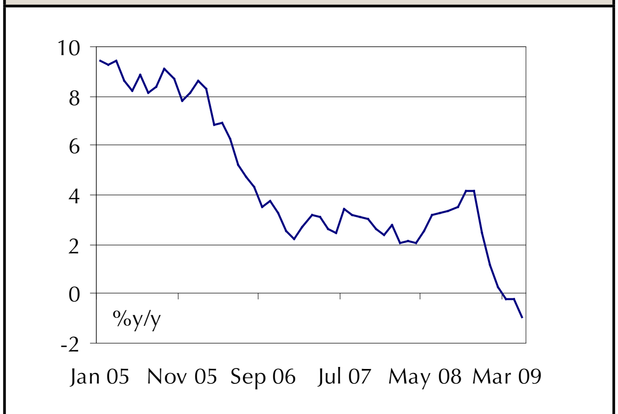
Taiwan Discount Rate vs US Fed Funds Rate



Source: Bloomberg, UOB Econ-Treasury Research Estimates

Going forward we expect the CBC to hold the key rate unchanged towards end-2009 as there is little evidence of an asset price in Taiwan. The equity market has saw a sharp run this year with a 41% gain YTD, but still down about 34% from its Oct 2007 peak. Money supply growth is running at around 6-7%y/y pace so far in 2009, it is still well below the 15-20% pace seen during the early 1990s. Loans growth, which began its deceleration in late 2004, went into contraction in the Mar-May period. The weak money supply and loans growth trend, and a generally flush banking system (reflected in its low loans-to-deposit ratio), suggests the central bank would hold on to its loose policy for some time and would not

TW: Loans Growth



Source: Bloomberg, UOB Econ-Treasury Research Estimates

TW: Loans to Deposit Ratio

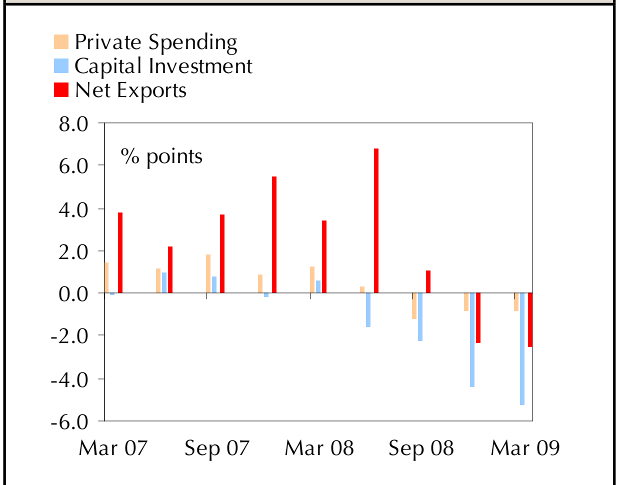
Source: Bloomberg, UOB Econ-Treasury Research Estimates

be looking at tightening until the second half of 2010.

Getting Past the Worst Point of the Cycle

After the record decline of more than 8%y/y in 4Q08 GDP, Taiwan's economy shrank a further 10% in 1Q09, effectively marking the recession as the most severe in its modern history. Except for government spending, all sectors contributed the declines in 4Q08 and 1Q09. In particular, investment spending has shrunk for the fourth consecutive quarter while inventories depletion accelerated as exports demand plunged. Even with an expected stabilization toward end of the year, Taiwan's exports are likely to contract by more than 20%.

Taiwan: % Point Contributions to GDP Growth



Source: CEIC, UOB Econ-Treasury Research Estimates

Nevertheless, some stability has returned with exports orders in May shrinking a smaller 20.1%y/y compared to 20.9% in Apr and well ahead of the 42% drop in Jan. The improvement in exports orders were led by electronics products, which were on the mend for the fourth

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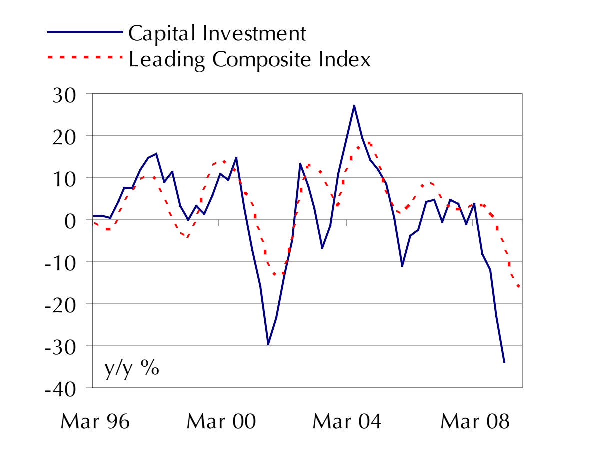
consecutive month. Meanwhile, manufacturing output fell 18.3%y/y in May, an improvement from the 19.9% drop in Apr. We expect Taiwan's GDP to decline about 5% in 2009 (down from our previous forecast of -3.5%). Similarly, official forecast for 2009 has also been downgraded to -4.25% from -2.97% after the release of the 1Q data. Nevertheless, the worst point of the cycle is has second half of 2009 should be marked with some form of stabilization. One indication is that the leading composite index has declined at a smaller pace and that should presage a return to positive headline growth as early as 4Q09. We expect Taiwan's economy to return to positive growth for the full year in 2010 as the base of comparisons turns lower.

Taiwan: Leading Composite Index



Source: CEIC, UOB Econ-Treasury Research Estimates