▪ Taiwan

UOB Economics Projections	2007	2008	2009F	2010F
GDP	5.7	0.1	-4.3	3.6
CPI (average, y/y)	1.8	3.5	-0.3	0.7
Unemployment Rate (%)	3.9	5.0	6.2	5.8
Current account (% of GDP)	8.3	6.2	7.6	6.6
Fiscal balance (% of GDP)	-0.2	-0.8	-3.0	-2.3

TWD continued to move in tandem with most regional currencies in 3Q09. Riskier assets and higher yielding currencies such as TWD and IDR have come back in favour. However, a depressed external demand environment coupled with CBC's preference for a softer currency means that there is limited upside for the TWD. We see little room for the USD/TWD to move substantially lower, and continue to look for the pair to shift marginally lower to around 32.00 by end-2009, and towards 31.50 by mid-2010, from 32.40 currently.

At the September MPC meeting, the CBC cited return of stability in the economy, consumer prices, and financial markets, but failed to mention when it would shift its policy stance. Like other central banks, we expect CBC to hold on to its loose policy until more concrete signs of recovery, which means rate tightening would only materialise toward mid-2010.

After the record declines of GDP in 4Q08 and 1Q09, Taiwan has effectively gone past the worst point in the current cycle. However, external demand remains weak as exports are likely to contract in double digit term in 2009. Overall outlook for Taiwan has improved, with the leading composite index continues to be "less bad", which should presage a return to positive headline growth as early as 4Q09. We have thus revised 2009 GDP figure to contract at 4.3% vs. our earlier projection of -5.2%.

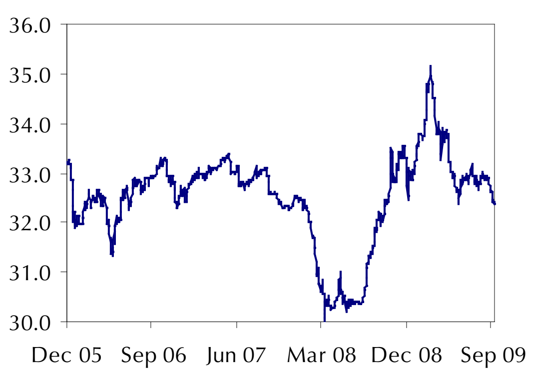
TWD Firming Cautiously

TWD continued to move in tandem with most regional currencies in 3Q09. Riskier assets and higher yielding currencies such as TWD and IDR have come back in favour as risk appetite returned since asset prices hit their trough in March, and at the same time interest rate spread has moved against the dollar. The Fed continues to hold its key interest rate at near 0% compared to most global central banks' above-zero policy rates.

However, with external demand staying depressed in the current global economic recession, it is clear that the CBC prefer a softer, or at least stable TWD. This can be seen from the regular interventions to keep TWD from moving too aggressively. In a report dated 24 Sep, Bloomberg News quoted traders as saying that CBC has urged them to reduce bets against the USD, and we expect the authority to intensify its monitoring of TWD's moves given the USD weakness backdrop. Against the USD, TWD has gained about 1.2% YTD, and this is far below IDR's 15% gain and KRW's 5.3% rise during this same period.

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. The resolve to keep to its accommodative policy stance is expressed clearly at the 3Q09 CBC monetary policy meeting, which did not mention a shift in policy despite sounding upbeat on macro outlook.

USD/TWD Trend



Source: Bloomberg, UOB estimates

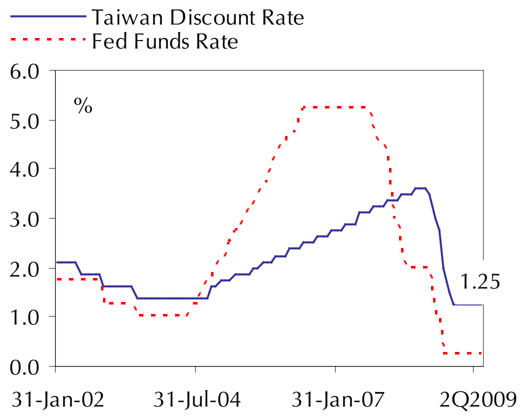
▪ Taiwan

We see little room for the USD/TWD to move substantially lower, and continue to look for the pair to shift marginally lower to around 32.00 by end-2009, and towards 31.50 by mid-2010, from 32.40 currently.

Monetary Policy Continues to Stay Accommodative

The aggressive rate easing cycle began in Sep 2008 in response to the global credit crisis and ended at the March 2009 quarterly meeting. During thist cycle, the key policy rate was slashed by a total 237.5bps in less than 6 months to 1.25%. The speed of the policy reaction was unprecedented in its recent history, as CBC last delivered the same quantum of rate cut back in 2000/01, but spread out over about 12 months. While its key policy interest rate is hovering at record low of 1.25%, there is still little cause for concern of such an easy policy, and the September policy meeting largely reaffirmed the accommodative stance. At the September MPC meeting, the CBC cited return of stability in the economy, consumer prices, and financial markets, but failed to mention when it would shift its policy stance.

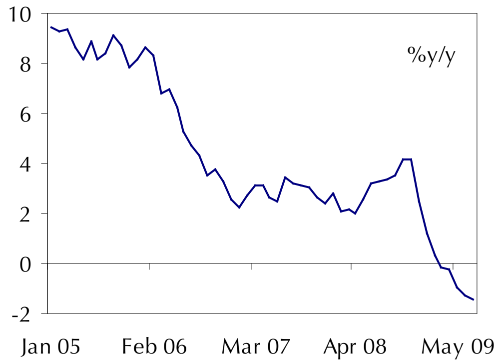
Taiwan Discount Rate vs. US Fed Funds Rate



Source: Bloomberg, UOB estimates

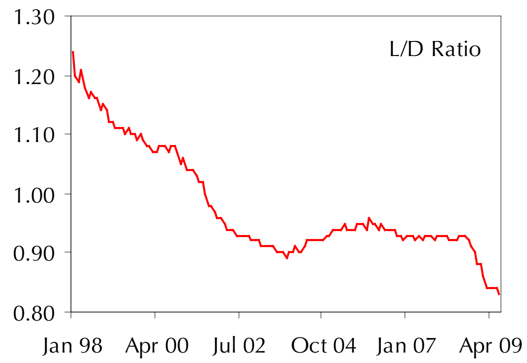
Taiwan's money supply M2 growth has picked up slightly in recent months, but is still running at around the 8%y/y pace so far, well below the 15-20% pace seen during the early 1990s. Loans growth, which began its deceleration in late 2004, went into contraction in March, and has contracted for the fifth consecutive month with the rate of decline deepening. The weak money supply and loans growth trend, coupled with lack of concrete signs of recovery, suggests the central bank would hold on to its loose policy for some time and would not be looking at reversing its policy until the second half of 2010.

TW: Loans Growth



Source: Bloomberg, UOB estimates

TW: Loans to Deposit Ratio



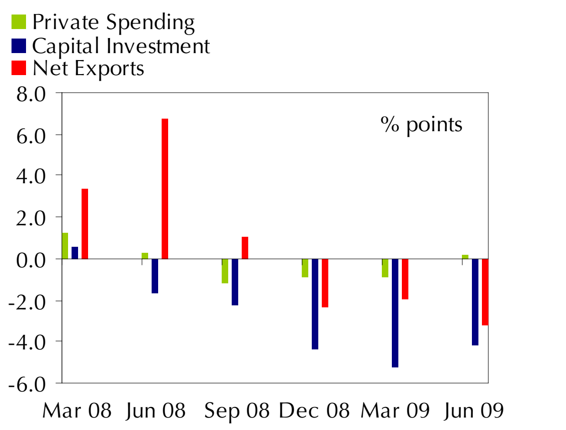
Source: Bloomberg, UOB estimates

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. As mentioned in our 3Q09 Quarterly report, first quarter should mark the worst point of the cycle. Indeed, Taiwan's economy subsequently contracted a smaller 7.5%y/y in 2Q09. External sector and investment spending remain the main drag in first half of 2009, contributing the bulk of the decline in headline GDP. Of note however, is that inventory draw down has slowed sharply in 2Q09 (to around NT10bn vs. NT90bn in 4Q08 and 1Q09), which means that rebuilding of inventory should begin to contribute positively in the second half of 2009. Nevertheless, outlook for external sector is still negative and we still expect exports to fall by about 24% for the full year. The latest export orders figure (Aug: -11.96%y/y vs. -8.77% for Jul) further underscores the uncertainty in external demand, though fiscal stimulus

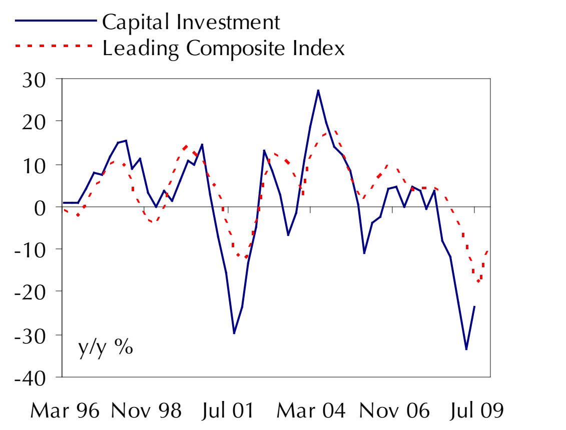
▪ Taiwan

Taiwan: % Point Contributions to GDP Growth



Source: CEIC, UOB estimates

Taiwan: Leading Composite Index



Source: CEIC, UOB estimates

plans are providing some support in domestic economy. Overall outlook for Taiwan has improved, with the leading composite index continues to improve, which 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 improves. We have thus revised 2009 GDP figure to contract at 4.3% vs our earlier projection of -5.2%.