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UOB Economics Projections	2006	2007	2008F	2009F
GDP	4.9	5.7	1.6	0.3
CPI (average, y/y)	0.6	1.8	3.5	-0.4
Unemployment Rate (%)	3.8	3.8	3.9	4.8
Current account (% of GDP)	6.8	8.0	5.6	4.5
Fiscal balance (% of GDP)	-0.6	-0.2	-1.9	-2.6

TWD reversed its fortune in 2H08 as risk aversion globally saw forced liquidation of all risky assets. TWD is down by nearly 3% YTD against the USD, still a relatively mild amount compared to other Asian units. Going forward, there is little upside for TWD at least in the first half of 2009 as we expect risk aversion trade to play a prominent role in buoying the USD and falling domestic interest rates also reduce the attractiveness of the local unit. We look for the TWD to edge slightly lower to 33.70/USD by mid-2009 and recovering slightly to 33.00 by end-2009.

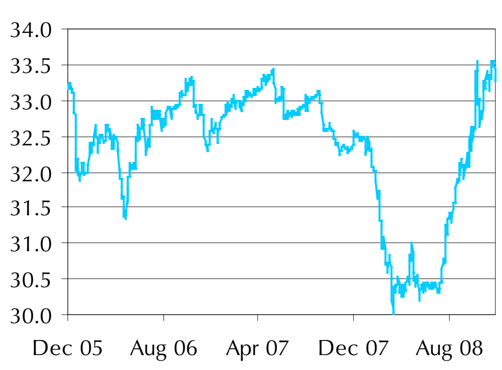
At the conclusion of its final meeting for 2008, the CBC has brought the key discount rate to 2.00%, its lowest level since 2005 after cutting a larger-than-expected 75bps, the biggest cut in more than 17 years. As the global economy spirals into a recession on the back of the global credit crisis, the CBC could bring its benchmark rate to 1.00% by mid-2009, and it is conceivable the rate could be lowered further to 0.50% by end-2009, especially if deflationary pressures prove to be much more severe.

Taiwan's 3Q08 GDP saw a -1.0%y/y pace reversing sharply from 5.4% expansion in 1H08. It is also worrying that domestic demand weakened sharply in 3Q while net exports also decelerated. Given the difficult external environment, we are projecting at least another three quarters of y/y contraction into 1H09 for Taiwan, bringing our 2009 growth forecast at just 0.3% (official forecast: +2.1%) from an estimated 1.6% growth for 2008.

TWD to See Further Weakness

While the Taiwan dollar was one of the few Asian units that rose against the USD in the first half of 2008, its fortune reversed in the second half, especially since late 3Q08 as risk aversion rose after the failure of US investment bank Lehman Brothers and the near-collapse of giant US insurer AIG. These events pushed the global credit crisis to an even worse turn and the resulting market volatility saw forced liquidation across all asset classes and markets, and pushed down prices of all assets except safe ones like the JPY, USD, US Treasuries, among others.

USD/TWD Trend



Source: Bloomberg, UOB

The selling also spread to Asian currencies, and TWD was no exception and perceived to be a risky currency. From a gain of about 6.8% against the USD in the first half (at 30.36/USD), driven partly by the presidential election in May which returned the Kuomintang back to power after 8 years in the wilderness, the unit turned to a loss of nearly 9% in the second half of 2008 (at 33.31/USD on 12 Dec), for a YTD decline of about 2.6% despite repeated interventions from the authorities. This is still a respectable performance considering other Asian units slump even more, e.g. KRW off by 32% YTD and IDR down 15% YTD. It should also be noted that even at the peak of the TWD's strength in the first half of this year, the authorities appear steadfast in protecting the 30.50/USD level and the unit is relatively firm vis-à-vis other Asian units against the USD so far, suggesting that trade competitiveness, and to a certain extent a stable currency are major considerations in policymaking.

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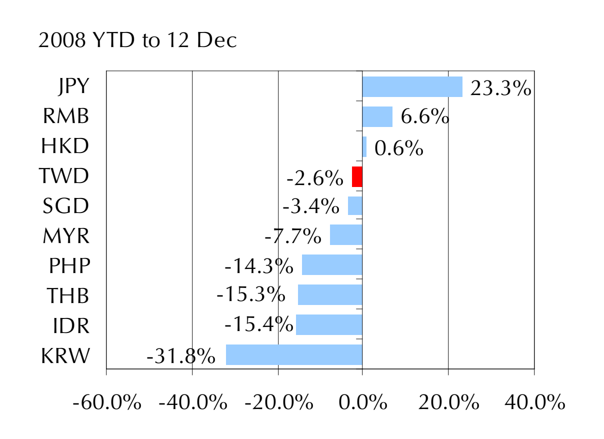
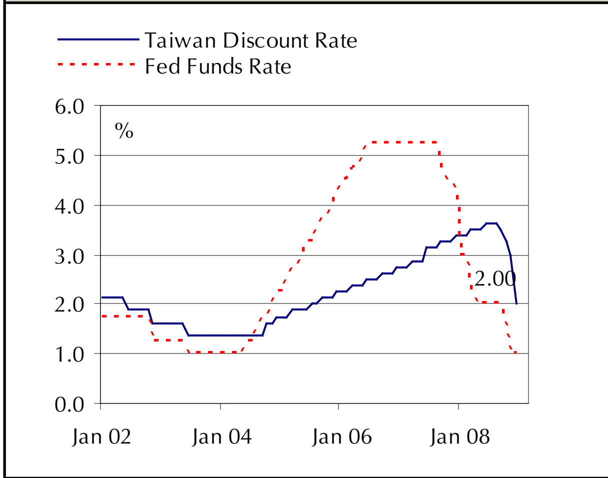
Asian Currencies' Performance Against USD



Source: Bloomberg, UOB

Taiwan Discount Rate vs. US Fed Funds Rate



Source: Bloomberg, UOB

Going forward, there is little upside for the TWD at least in the first half of 2009. We expect risk aversion trade to play a prominent role in suppressing most Asian currencies and buoying the USD. Deterioration of domestic fundamentals and falling domestic interest rates also reduce the attractiveness of the local units, and we expect the same for TWD. We look for the TWD to edge slightly lower to 33.70/USD by mid-2009 and recovering slightly to 33.00 by end-2009 as outlook is likely to improve by 4Q next year.

CBC Likely to Cut Rates Further

At its final MPC meeting for 2008 on 11 Dec, Taiwan's central bank CBC cut its key interest rate by a larger-than-expected 75bps to 2.00%, compared to market expectation of just 50bps. This is the lowest level for the benchmark discount rate since 2005 and the fifth interest rate cut since the current easing cycle started in late September, in conjunction with other global central banks' rate cut cycles. Prior to its last action, the CBC's previous moves were on 9 Nov (-25bps; unscheduled), 30 Oct (-25bps; unscheduled), 9 Oct (-25bps; unscheduled); and 25 Sep (-12.5bps; scheduled MPC). All in, the CBC has reduced its key interest rate by 162.5bps since 25 Sep. Thus, the 75bp-move is the largest in the current cycle and the biggest cut in more than 17 years, stretching back to Sep 1991.

The CBC noted in its post-meeting statement the impact from both external and domestic factors weighing on domestic economic growth (see section below for further exposition). This means that the CBC has further room to lower interest rates. In addition, as the chart shows, Taiwan's discount rate has generally moved in lockstep with the Fed funds rate in both easing and tightening cycles, this means that the CBC's downward bias is likely to remain. Going forward, we continue to see CBC slashing another 100bps to bring the benchmark discount rate to 1.00% by mid-2009 (50bps reductions each in 1Q09 and 2Q09), which would be in line with the previous easing cycle when the discount rate hit 1.375% in Jun 2003-Sep 2004 as the Fed funds rate settled at 1.00%. With the US Fed expected to hold its interest rate at the sub-1% levels for some time, it would be conceivable that Taiwan's discount rate could be lowered further to 0.50% by end-2009, especially if deflationary pressures prove to be much more severe.

Taiwan's Economic Growth Under Strain

A combination of both external and domestic factors is straining Taiwan's economic growth into 2009. On the external front, the ongoing global credit crisis continues to heighten uncertainty in the financial markets and has morphed into a global economic recession of unknown depth and duration. This is reflected in a string of dismal domestic data releases especially for Oct and Nov which are absorbing the full impact of the global credit crisis.

Taiwan's exports have shrunk for the third consecutive month and by a sharp 23.9%y/y in Nov (vs. -8.1% in Oct and -1.7% in Sep), despite the base in Nov last year being unusually low compared to preceding two months. Going by the 200/01 experience, it is likely that Taiwan's exports could shrink for another 12 months before any meaningful turnaround could be seen.

Deflationary risks have also risen in Taiwan, with the headline consumer prices contracting for the fourth consecutive month on a m/m seasonally adjusted ba-

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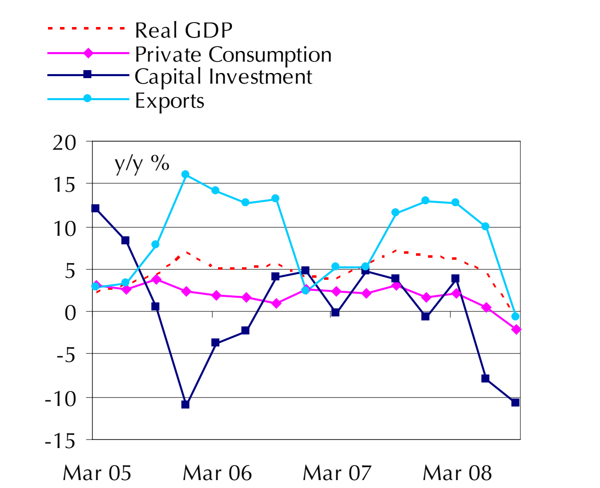
sis, matching the SARS period in 2003. On a y/y basis, headline inflation slowed to just 0.6% in Nov vs. 2.8% in Oct and is headed towards at least 6 months of deflation if the experience in 2003 is any guide, as consumers pull back spending and excessive production capacity depresses prices.

In terms of headline GDP growth, Taiwan saw a -1.0%y/y pace in 3Q08, compared to 4.6% in 2Q08 and 6.3% in 1Q08. Looking through the details, it is worrying that the key contributors to the weak 3Q08 data were from both private spending (-1.1%pt) and investment spending (-2.1%pt), while net exports' contribution has decelerated sharply to just 0.9%pt (vs. +6.8%pt in 2Q08 and +3.4%pt in 1Q08). Of note is that 3Q data could have been worse if not for an inventory building in the quarter but the collapse in end demand means that this factor will work in reverse in the quarters ahead and thus putting further strains on growth. Government's spending has been lackluster in the past 2-3 years but this is expected to reverse in the coming year as it picks up the slack from the private sector, just as it did during the tech bubble burst period in 2000/01.

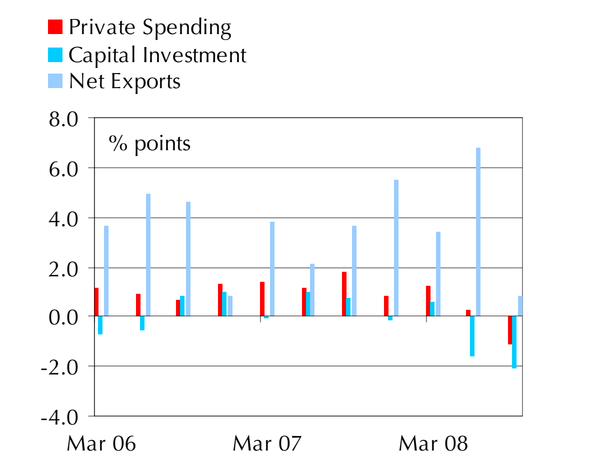
Taiwan: Real GDP Growth



Source: CEIC, UOB

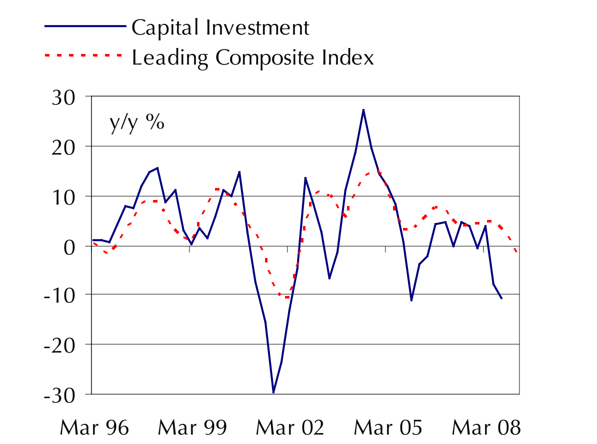
Given the difficult external environment in the year ahead, we are projecting at least another three quarters of y/y contraction into 1H09 for Taiwan, bringing our 2009 growth forecast at just 0.3% (official forecast: +2.1%) from an estimated 1.6% growth for 2008. The slump in the leading index also reaffirms concerns of a deep decline in 4Q08 to first half of 2009, which we expect could see as much as 2.0-2.5%y/y contraction in output. One key positive driving factor is the govt's late November announcement that it would give each individual TWD3,600 (US$108) in shopping vouchers in a bid to spur private spending. The govt estimates that the plan would cost about TWD82.9bn and add 2009 GDP growth by 0.64%.

Taiwan: % Point Contributions to GDP Growth



Source: CEIC, UOB

Taiwan: Leading Composite Index



Source: CEIC, UOB