

UOB Economics Projections	2008	2009	2010F	2011F
GDP	0.7	-1.9	6.0	4.6
CPI (average, y/y)	3.5	-0.9	1.5	1.5
Unemployment rate (sa, %)	5.0	5.7	5.0	4.2
Current account (% of GDP)	6.0	10.9	8.5	8.2
Fiscal balance (% of GDP)	-0.9	-4.0	-2.6	-2.0

- *Despite generally optimistic outlook, TWD has remained a laggard vs. its Asian peers and is likely to remain so as the authorities continue to keep a close watch. We see moderate downside for the USD/TWD, drifting down to 31.40 by end-2010.*
- *The CBC is on track to normalize its policy stance as economic activities gain traction, but outright rate hikes are unlikely until 3Q10. Meanwhile, liquidity tightening appears to be the preferred route with increased CD issuance from the CBC. We look for the official rediscount rate to edge up to 1.75% by end-2010, from 1.25% currently.*
- *Economic recovery continues to stay strong, as low base and external demand drive up incoming data. In particular, the remarkable surge in 4Q09 GDP suggests that momentum is likely to be strong in 1H10, although the sustainability into 2H10 is still an open question. Nevertheless, we are revising up Taiwan's 2010 growth forecast to 6.0% from our earlier projection of 4.1%, and well ahead of official forecast of 4.72%.*

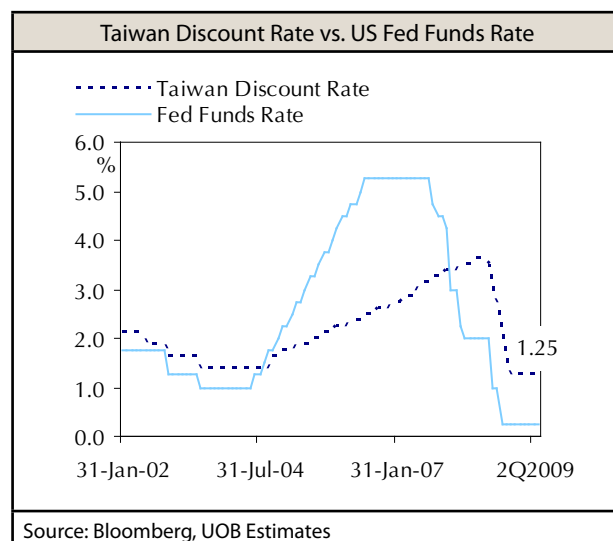
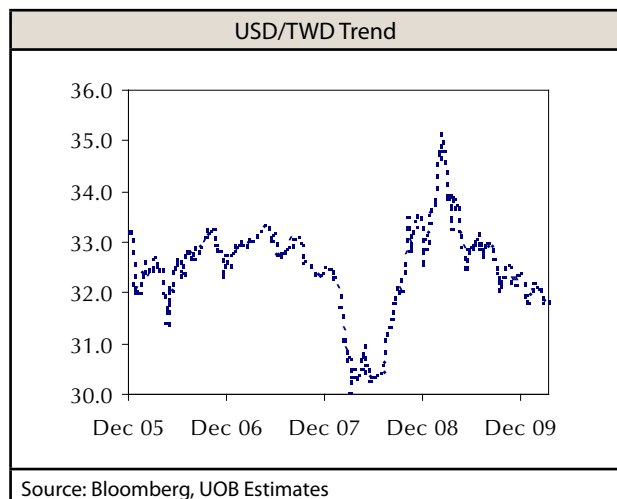
TWD Gain to Stay Subdued

Tracking the broader Asian currencies, TWD continued to firm against the USD, with a modest 0.8% gain in 1Q10, compared to the 2% to 5% gain seen in the likes of MYR and IDR. This is a similar situation as in 2009, with the TWD up just 2.6% against the USD while IDR and KRW jumped ahead with 8-16% rise for the year. One key factor is that CBC continues to keep close watch on TWD movements, thus dampening the currency's upside. Another factor is that the CBC is likely to continue to lag behind other Asian central banks in raising its key rate, which means there is very little incentive in terms of interest rate differential for the USD/TWD pair. As such, we still see only moderate

USD/TWD downside in the months ahead, and continue to look for the pair to shift just marginally lower towards 31.40 by end-2010, from 31.82 currently.

CBC on Track to Normalize Policy

As expected, Taiwan's central bank left its benchmark interest rate unchanged at 1.25% in its latest quarterly meeting at end-Mar, as it continued to stress the uncertain of global growth outlook, high domestic jobless rate, and modest wage growth. However, the CBC also noted the importance of maintaining both consumer price stability



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and financial sector stability (i.e. via asset prices and credit growth).

Nevertheless, the CBC has already begun its policy normalization process via the liquidity tightening route, with increased issuance of CDs, reducing excess reserves in the banking system to TWD33.0bn in Feb from a peak of TWD154.1bn in April 2009. M2 growth has slowed down since the second half of 2009, to an average of 5.25% in Jan-Feb, down from the 7.2% average growth in 2009, and close to the median of the 2010 target zone of 2.5% to 6.5%. Meanwhile, the overnight interbank call-loan rates have trended up recently.

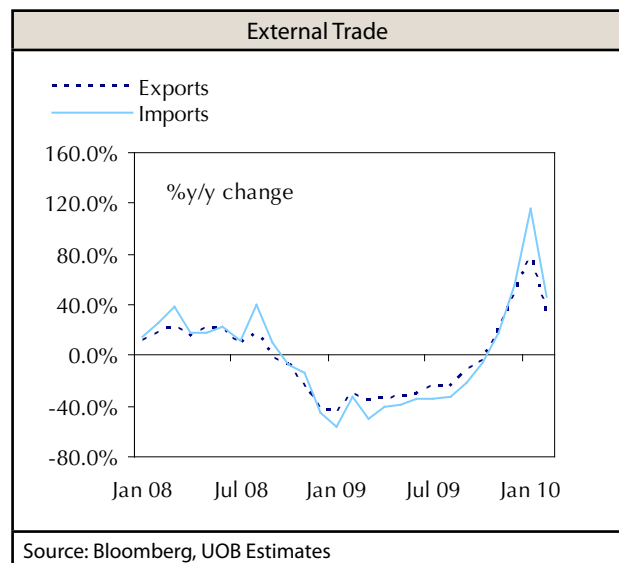
With the aggressive nature of the rate cuts earlier in 2009 (which amounted to a total of 237.5bps in interest rate cuts in less than 6 months to 1.25% vs. the same quantum of rate cut back in 2000/01, but spread over about 12 months) and continued improvements in most incoming data, the CBC would need to restore from the emergency setting, a similar situation faced by most other central banks in the world.

One factor to watch for is whether there are any inflationary pressures given the loose policy and rebounding growth. Taiwan's inflation rate is still relatively muted, at an average of 1.3%/y/y in Jan-Feb, within the full year official forecast of 1.27%. We see CBC staying at the sideline in its interest rate policy until 3Q this year, with the official rediscount rate edging up to 1.75% by end-2010, from 1.25% currently.

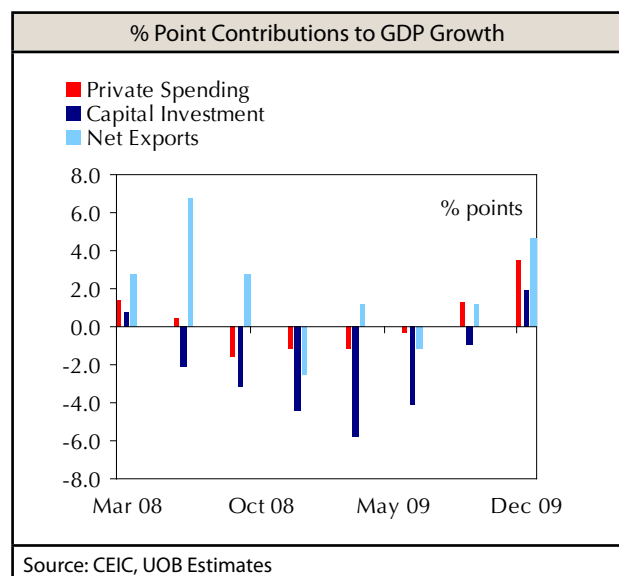
Data Flows Turning Positive

After the severe dislocation during the global financial crisis in 2008, incoming data for Taiwan in recent months have turned increasingly positive, helped by the low base in early 2009 as well as inventory rebuilding during the second half of 2009. The positive data trend is likely to remain in 1H2010, although the sustainability in 2H10 remains an open question.

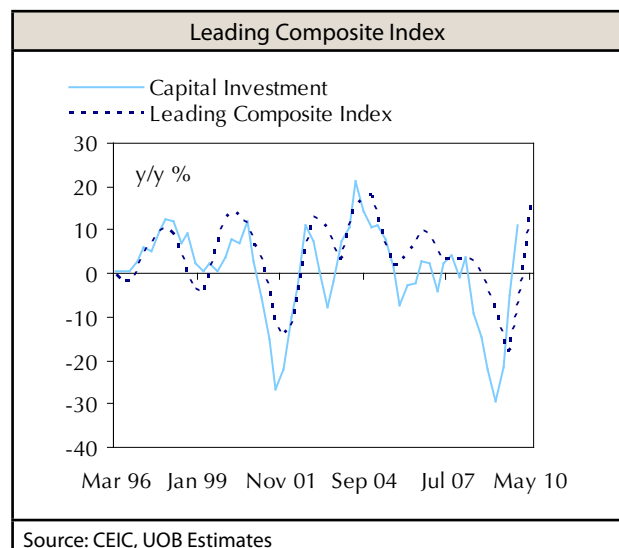
Industrial production rose a sharp 35.2%/y/y in Feb, after the revised 70.1% rise in Jan, with tech output up a sharp 4.6%/m/m sa in Feb (vs. 0.3% for non-tech output). The rise in industrial output is tied to the export sector, which saw orders gaining further in Feb with 36.25%/y/y, vs. 71.8% gain in Jan, despite the impact of Lunar New Year holidays. Exports orders gains are even more impressive on a seasonally adjusted basis, surging 5.6%/m/m in Feb vs. 2.5%/m/m in Jan, driven by both nontech (+6.5%/m/m sa) and tech (+2.7%/m/m sa) orders. The strength in export orders are also consistent with the external trade data, with exports accelerating 32.6%/y/y in Feb vs. 75.8% in Jan. Labour market is also on the mend, with jobless rate



Source: Bloomberg, UOB Estimates



Source: CEIC, UOB Estimates



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edging down to 5.65% sa in Feb vs. 5.73% in Jan, and job creation entering into its seventh consecutive month.

Earlier, the 4Q09 GDP report has already indicated the remarkable recovery momentum, with an above-expectation headline growth figure of 9.2%/y vs. a

revised -1.0% in 3Q09, fueled by external demand, private consumption, and more importantly, private sector investment spending. Based on the continued momentum in recent data, we have revised up Taiwan's 2010 growth forecast to 6.0% from our earlier projection of 4.1%, and well ahead of official forecast of 4.72%.