Taiwan central bank on hold while we cut our GDP forecast

We expect the central bank to stay put for 2018 and perhaps even for 2019 as it is difficult to cut interest rates to help a gradually slowing economy. The central bank has to save rate cuts as a last resort.

In the meantime, the trade war between China and US makes us revise our GDP forecast downward.

Source: Shutterstock

Economy is not good but not bad either for a rate cut, but it deserves a GDP downgrade

As the economy is too reliant on the manufacturing sector, and the trade war between Mainland China and the US could hurt the supply chain of the semi-conductor industry, Taiwan may be hurt by this trade war indirectly.

This makes us revise our GDP forecasts downward for 3Q18 from 2.4% YoY to 2.0% YoY, from 2.5% to 2.4% for 2018, and from 2.4% to 2.0% in 2019.

We had thought that Taiwan might be able to gain from this trade war as a substitute manufacturer, but it seems that either this takes a long time or Taiwan's products are in fact part of China's products, which is very likely. Therefore Taiwan is hardly benefiting from the substitution effect of China's slower production of electronics due to this trade war.

So the Taiwan economy is not growing as fast as we have thought.

But it is not as bad as in a recession either. The central bank can only stay put for now and save the rate cut as a last resort.

2.0% YoY

GDP forecast for 3Q18 from 2.4% YoY

Manufacturing growing too slowly

Industrial production fell sharply to a low growth level in August from a decent growth level in July. Though there is a high base effect the growth is just too slow. According to the Ministry of Economic Affairs, wholesale trade has started to turn negative on a yearly basis since June, and was at -2.7% YoY in August compared with -1.31% in July.

Exports slowed too

Exports grew at 1.9% YoY in August after growing 4.7% in July, and there was a similar trend for imports, growing 7.9% YoY in August and 20.5% in July.

All these show that an economy that is already skewed towards the manufacturing sector could grow even slower under the China-US trade war if there is damage done to the supply chain in the electronics sector, which we believe is likely.

31.00

USDTWD by end-2018

Spot on 27 September 2018 was 30.69

USDTWD only to depreciate gradually

We realise that the USDTWD is less volatile than other currencies. One of the reasons could be that the market does not expect any change in central bank policy rate, and therefore the interest rate would be stable in Taiwan.

However, as a US rate hike in December is in the cards, and further rate hikes in 2019, we expect the New Taiwan Dollar to depreciate against the dollar gradually from 30.6 (spot on 27 September 2018) to 31.0 by the end of 2018, and further to 32.0 by the end of 2019.

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