

Snap | 18 March 2021 FX | Taiwan

Taiwan: The policy rate, the currency and the chip shortage

Taiwan's central bank has kept its policy rate on hold at 1.125% while raising its GDP forecast. But risks remain. We revise our USD/TWD forecasts



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Central bank on hold

As expected, Taiwan's central bank has kept its policy rate on hold at 1.125%. The central bank governor suggested that the bank will not tighten monetary policy unilaterally; so long as other central banks keep rates on hold, Taiwan will do the same.

USD/TWD is another monetary policy tool

The central bank governor noted that the other monetary policy tool is the Taiwan dollar. We have seen a softening of the TWD against the USD to 28.315 today from a low of below 27.80 on 3 March.

After the pair broke the 28.00 level, trading has been more stable near the close every day. The market has interpreted this as a sign that the central bank is more comfortable with the 28.00 level.

Snap | 18 March 2021 1 We revise our forecast of USD/TWD to 28.40 by end of 1Q21 from 27.50 as the previous forecast looks too agressive, and we are revising the pair to 28.10 from 26.88 by the end of 2021.

Revising upward GDP forecast

The interesting part of the monetary policy meeting is that the central bank has revised upward its GDP forecast from 3.68% to 4.53% for 2021. Our forecast is unchanged at 4.3%.

This upward revision matches the market consensus. But there could be a risk to the economy that may not be reflected in the forecast.

Chip shortage is a big risk and opportunity for Taiwan

It is well known that Taiwan is dependent on semiconductors in the whole verticle production chain from design to production. Taiwan

is benefiting from semiconductor shortages, handling production orders at full capacity, with industrial production and exports set to enjoy good growth this year. The lack of water due to little rainfall since last year is affecting the production of chips but that could be solved by some backup source of underground water.

However, there are risks.

The chip shortage is estimated to last into next year and maybe even the year after that. This is because demand is likely to rise along with the global recovery but building new production lines can be a slow process. New production plants are built to cater for future business needs and to produce more advanced chips rather than the chips in high demand today, so the planning and building of these factories takes time.

This means that industrial production may not enjoy growth next year, as today's production is already at full capacity.

Another point to note is that the new production plants built by Taiwanese companies could be located in Mainland China, the US or Vietnam. As such, they would not count as part of Taiwan's industrial production and exports, although the companies themselves should, in theory, enjoy bigger sales, if demand continues to be strong.

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