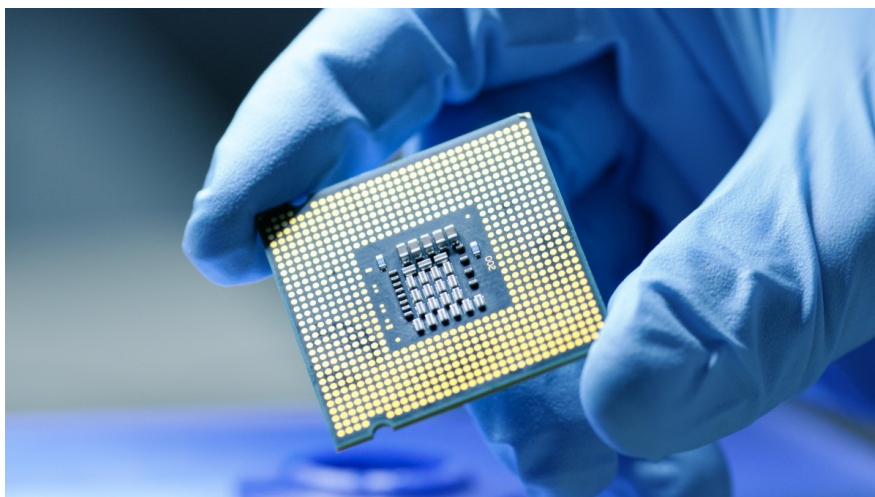


Taiwan's GDP contracted more than expected in first quarter

The Taiwanese economy fell 3.02% YoY in 1Q23 after a 0.41% YoY contraction in 4Q22. If we look at the economy based on quarterly growth, it also contracted in two consecutive quarters. This means the Taiwanese economy has entered into recession. GDP growth could turn positive in 2Q but mainly on a low-base effect, which could mask the weakness of the economy



Recession is here

Taiwan has suffered from negative GDP growth for two consecutive quarters, which means the economy entered into a recession in the first quarter of 2023. GDP was -3.02% year-on-year in the first quarter after a 0.41% YoY contraction in the fourth quarter of last year. According to Taiwan's statistics department, the economy contracted 1.63% QoQ in 1Q after a 0.37% QoQ contraction in 4Q22.

The reason for the GDP contraction in 1Q23 was due to very weak global demand for Taiwan's semiconductor chips. This is reflected in shrinking international trade and investment in Taiwan. Net exports deducted 5.41 percentage points from the GDP growth rate. This alone was a big factor for manufacturers to defer investment, which contracted 4.15% YoY in 1Q23.

Consumption contributed 3.07 percentage points to GDP growth in 1Q23. But this should not last

long as trade and investment were hit hard and wages should fall in the second quarter, which would put pressure on consumption.

Revising GDP growth forecast for 2023

From this set of data, and our in-house forecast of a weakening US economy, a pretty flat European economy and a recovering Mainland China economy, we expect global demand for semiconductors for the rest of 2023 to be similar to 1Q23, if not worse. This is not helpful for the Taiwanese economy which specialises in semiconductor manufacturing and trade.

We do not think the government's investment policy to encourage Taiwanese manufacturers to invest in Taiwan will be effective in 2023 as demand for semiconductor chips is too weak.

We, therefore, downgrade Taiwan's GDP growth estimate to -0.3% for 2023 from 1.7% previously, with the new forecasts at -0.8% YoY, -1.0% YoY and 3.8% YoY for 2Q, 3Q and 4Q, respectively.

Taiwan's central bank should cut interest rates but probably won't

As Taiwan has entered into recession, the central bank should cut the policy interest rate by at least 12.5bp in the second quarter from 1.875% to 1.75% but we believe that this won't happen. The central bank's main concern is still to minimise capital outflows. And if the Federal Reserve continues to hike in May, a cut by Taiwan's central bank would widen the interest rate differential between the two economies, which could induce even more capital outflows from Taiwan. This has already happened as foreign investors have sold Taiwanese stocks.

We believe the most likely scenario is that the central bank stays put in the second quarter, and then starts to cut the policy interest rate when the Fed starts to cut, which should happen in the fourth quarter.

USD/TWD could be higher in 2Q23

As we do not expect the Taiwan central bank to cut in 2Q23, the TWD against the USD should be supported at around 30.8 by the end of 2Q23 with the current spot rate at 30.743 and would be going higher to around 31.0 in May when the Fed potentially hikes and Taiwan's central bank likely stays put.

USD/TWD might not stabilise until 4Q23 when the Fed could start to cut aggressively by 100bp and Taiwan's central bank cuts by just 25bp in the same quarter.

In short, USD/TWD could be quite volatile for the rest of 2023.