Taiwan’s softer inflation and weak exports should make the central bank pause and weaken the currency

Taiwan's recent economic data has been weak and today's inflation and export data reflect this trend. We expect the central bank to stay put in the second quarter. This would widen the interest rate differential between the US, which should continue to hike in the quarter

Taiwan's central bank

CPI was milder in March and exports were weaker than expected

Weaker inflation

CPI fell to 2.35% year-on-year in March from 2.43% in February while the PPI fell to 0.52% YoY in March from 3.97% YoY in February. The steep fall in PPI was mostly affected by lower energy prices. Export and import prices fell into negative territory, to -0.74% YoY in March from 1.99% in February, and -1.98% YoY from 3.37%, respectively.

This set of price data highlights the acute problem of weak demand from the US and Europe, which is hurting Taiwan's economy and has passed from exports to the domestic market through slower wage growth and therefore lower CPI inflation.

Very weak exports and imports

Exports contracted 19.1% YoY to USD$35.2 billion from a contraction of 17.1% YoY in February. Exports to Mainland China fell deeper, by -35.0% YoY in March from -30.2% YoY a month ago. The migration of some Taiwanese factories is likely one of the causes of this big fall. It is also partly due to the overall weakness in global demand for semiconductors. Exports of integrated circuits, Taiwan's main export item which contributes more than 41% of total exports, fell 13.4% YoY in March. Almost every export item experienced a yearly contraction in March except for exports of minerals, but minerals contribute only a bit more than 3% of Taiwan's overall exports.

Imports experienced similar issues, as Taiwan's imports are mostly used for its export-related manufacturing activities. Imports contracted 20.1% YoY in March after a contraction of 9.4% YoY in February. The big contraction came from imports from Saudi Arabia and South Korea, which shrank more than 30% YoY. Imports from Mainland China also saw a deeper contraction, falling 26.7% YoY in March from -20.8% YoY in February. Both electronics parts and minerals, which are used in the production of other electronic parts and goods fell the most, by 34.8% YoY and 31.7% YoY in the month.

The data points to a very weak export picture in March and in the coming months. We maintain our view that the recovery of Mainland China's economy cannot fill the gap left by a weaker economy in the US and a milder one in Europe.

Central bank should pause rate hikes

Taiwan's central bank surprised the market by hiking the policy rate by 12.5bp to 1.875% on 23 March 2023 when economic data had already been weak. Data released today shows that the economy has weakened further. Another rate hike would be very surprising. But the central bank could be concerned about the widening interest rate differential with the US as we expect the US to continue hiking in the second quarter.

Revising USD/TWD forecast

This interest rate differential, together with the deteriorating prospect of Taiwanese semiconductor companies, could easily drive capital outflows from Taiwan's stock market. And this would put extra pressure on the Taiwan dollar, at least in the second quarter. Our previous forecast of USD/TWD was 30.00 and 29.50 by the end of the second and third quarters, respectively. Due to this set of weak economic data and our expectation of a pause from the central bank, we are now revising the USD/TWD forecasts to 31.00 and 30.00 by the end of the second and third quarters, respectively.

We expect the Federal Reserve to cut interest rates aggressively by 100bp in the fourth quarter, and by that time, the dollar should weaken. Though the Taiwan central bank should follow the Fed's rate cut in the fourth quarter, the degree of the cut should be much smaller, by only 25bp. And we expect Mainland China should be on track for economic recovery, and provide some fresh demand for semiconductors. All in all, there is still a high chance that we can achieve our USD/TWD forecast of 29.00 by the end of 2023.

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