



Daily Note: 25 August 2008

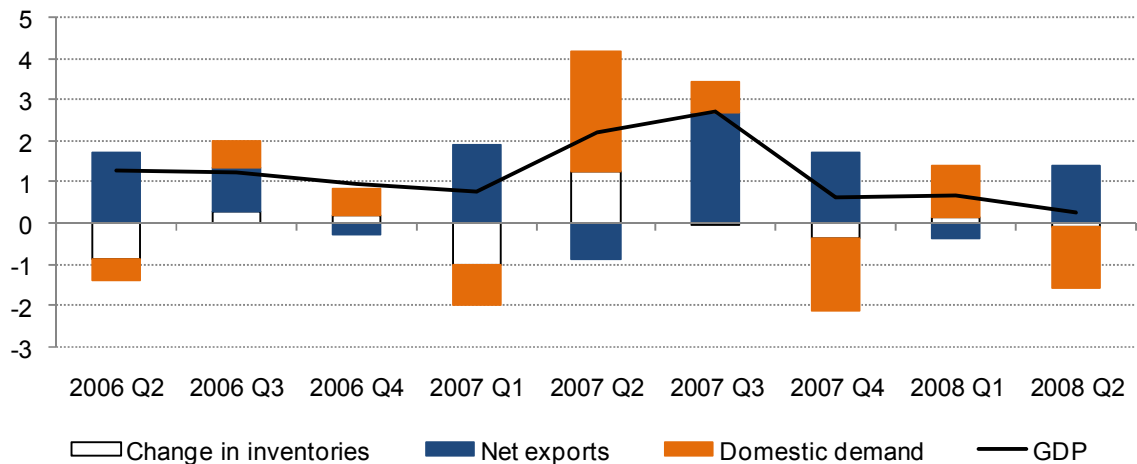
Taiwanese output growth halves

WE SUGGEST: New Taiwan dollar, Taipei stocks to fall further

SUMMARY: Taiwanese growth halved to 0.3% in Q2. While the main weakness was in domestic demand, net exports were only positive because imports fell by more than exports. Taiwan has been somewhat sheltered by the global slowdown in past months, but is now beginning to feel the force. Growth is likely to slow further in 2008 and 2009.

The habit of a number of countries to report GDP in the form of a four-quarter number can occasionally be confusing. So it was only after downloading the latest Taiwanese national accounts data, seasonally adjusting it and looking at the result that it was clear what was going on. According to the press release from the Taiwanese authorities, GDP growth slowed from 6.25% in the year to Q1 (revised up from 6.09%) to 4.32% in the year to Q2. But annual figures are very prone to base effects. Quarterly figures are therefore usually a better guide to the current state of output growth momentum.

Taiwanese GDP, contributions to quarterly growth, %



In Q2, the Taiwanese economy grew by 0.3%, less than half the 0.7% registered in Q1. There was a marked slowdown in private consumption (from 0.4% to -0.1%), and an even bigger swing in corporate investment (from 5.6% to -6.3%). Since government spending also contracted, it is not surprising that overall domestic demand fell by 1.8%, the second fall in three quarters. As in many other countries, there is a strong correlation (r-square of 0.6) between domestic demand and imports. The weaker domestic demand was therefore paralleled by a 3.7% fall in imports. As a result, although exports also contracted, falling by 0.8% in the quarter, the contribution from net exports returned to positive from a small drag in Q1.

Taiwan has so far been reasonably sheltered from the global slowdown. This is partly thanks to the recently accelerated opening to China, which is by far the country's biggest export market (together with Hong Kong, China takes in about 40% of Taiwanese exports). In the longer term, greater integration between the two economies should also boost Taiwanese shares, which have tended to suffer from geopolitical risk considerations. But in the near term, the dependence on exports is bad news for the Taiwanese economy as all its major export markets either already are slowing (the US, the UK, Euroland) or are likely to slow over the next year (China, Hong Kong). Admittedly, net exports could remain a support for GDP – but only because imports are likely to do far worse than exports. The first data for July continue to point to weak domestic demand. Car sales fell to an 11-year low (this series only goes back to 1997), while retail sales fell by 3.8% from a year earlier, a second monthly fall amidst general weakness since January.

The government has just approved a budget for 2009, which includes some fiscal stimulus. The aim is to take the deficit to NT\$183.7bn. While this is substantially more than the NT\$89.6bn deficit in 2006 (latest available data), it is less than in previous years of this decade and the impact may therefore be muted. The release of the Q2 data was accompanied by a downward revision of growth forecasts for 2008 from 4.7% to 4.3%. Moreover, in the face of weakening, the Central Bank of China is unlikely to raise interest rates more than possibly one more time this year, particularly if inflation now has peaked. The New Taiwan dollar has already retreated from highs reached earlier in the year. This is further bad news for the currency, likely to be reinforced by a weakening stock market.

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