

Taiwan

Taiwan Economics

Hold on tight as recession is confirmed with a bang

Joseph Lau / Research Analyst / 852 2101 7427 / joseph.lau@credit-suisse.com

Christiaan Tuntono / Research Analyst / 852 2101 7409 / christiaan.tuntono@credit-suisse.com

- 4Q08 GDP growth fell the most on record, collapsing 8.4% YoY on the back of an absolute meltdown in private fixed investment. No other indicator fared much better, with net trade providing no support and consumption likely to worsen over 2009.
- It is clear that any offset from government spending, ongoing and potential, would be modest against such a weak economy; Taiwan will float according to the tides of the global demand turmoil.
- Secondary growth impacts from an inventory correction and private consumption are likely to feature in 2009, although investment falls may still ease by 2H09.
- Policy responses are limited. Interest rates are effectively as low as they will go in this cycle. Fiscal policy is still constrained by resources and the authorities have to be careful with the TWD.
- Consequently, a major downturn seems unavoidable. We have revised down 2009E GDP growth to -7.2% with any material recovery pushed back to 2010.

GDP contracted sharply by 8.4% year on year in 4Q08. This is the worst contraction since the onset of our dataset in 1962. The magnitude of the fall was a shock and surpassed consensus expectations of a 6-7% YoY decline. On a quarter-on-quarter basis, the economy shrank markedly by 5.4%.

The sharp contraction was led by a collapse in private investments and negative external trade contribution. Private investments contracted sharply by 32.2% YoY, exacerbated by a 12% fall in the previous quarter. That alone deducted 4.6 percentage points (p.p.) from growth, almost half of the headline fall. The 2 p.p. deduction in net trade was also a surprise, despite a widening of the trade surplus in 4Q.

Private consumption and inventory fell, with a rise in government spending only slightly cushioning the drop. Private consumption fell 1.7% YoY in the quarter, and deducted 0.8 p.p. from growth. Inventory reduction deducted another 1.25 p.p. to the headline. Government

spending is the only offsetting factor, but its contribution is modest and is likely to remain so in future, regardless of any further stimulus efforts.

The government sharply lowered its expectations for 2009 economic growth. The official forecast for 2009 GDP was sharply lowered to a 3% contraction from 2.1% growth previously expected.

Credit Suisse has also revised its numbers lower with all of 2009 looking far more bearish. 2009 GDP is expected to fall 7.2% from the previous 1.1%. Apart from deeper falls in investment, we have also pushed back a material growth recovery until 2010 with inventories and private consumption likely to show deeper declines in this year.

One hope is that the abrupt adjustment in fixed investment turns into a deep, sharp shock. This would still make 4Q08 or 1Q09 the trough for the investment cycle. However, any upside is seen as limited and we still see declines of 29% YoY in 1H and 17% YoY in 2H.

Policy options here are thin. The Central Bank of China (CBC) cut the policy rate by another 25 bp, taking the rediscount rate to 1.25%. This is in line with our expectation, but really also shows up the limit for future cuts. Although there may still be further 25-50 bp of easing at this point, monetary policy is already about as low as it can go.

Some more fiscal support is inevitable. A follow-up stimulus package is likely, probably more focused on demand in 2Q. However, the problem of fiscal resources remains and also effective spending which can have an impact this year.

Even FX policy offers limited flexibility and we do not see aggressive depreciation as likely. The authorities will be wary about undermining confidence in TWD and triggering domestic capital flight. Instead, it looks increasingly like Taiwan will be forced to bite the bullet and hope that the global economy can take the edge off this recession. Until that happens, we project quarterly yoy GDP growth will fall by 11%, 10% and 7% in the upcoming three quarters, before rebounding to about zero in 4Q (in line with global scenarios).

Figure 1: Summary of economic indicators

(% year on year)	4Q08	3Q08	2Q08	1Q08	2007	2008	Credit Suisse				Gov't 2009E	
							Current		Revised			
							2009E	2010E	2009E	2010E		
GDP	-8.4	-1.1	4.6	6.2	5.7	0.1	-1.1	2.1	-7.2	3.5	-3.0	
Private consumption	-1.7	-2.1	0.5	2.1	2.3	-0.3	-0.7	1.5	-4.0	1.0	0.8	
Government consumption	2.2	1.2	-0.2	1.3	0.9	1.2	3.5	2.2	3.2	2.5	2.7	
Fixed asset investment	-23.2	-11.8	-8.0	3.7	1.9	-10.8	-3.0	2.0	-22.0	0.0	-17.8	
Exports of goods & services	-19.8	-0.6	9.9	12.7	8.8	-0.2	-2.5	2.0	-14.0	5.0	-10.7	
Imports of goods & services	-22.6	-2.6	0.2	9.6	3.8	-4.3	-4.3	2.5	-19.0	4.0	-14.3	
<i>GDP drivers:</i>												
Domestic demand contribution	-6.3	-2.1	-2.2	2.9	1.9	-2.1	-1.6	2.0	-7.3	2.4	-2.9	
Net trade contribution	-2.0	1.0	6.8	3.4	3.8	2.2	0.5	0.1	0.1	1.4	0.0	
Nominal exports	-24.7	8.0	18.6	17.5	10.1	3.6	-3.0	3.3	-31.2	2.8	-20.1	
Nominal imports	-22.7	20.1	19.2	26.0	8.2	9.8	-5.7	6.1	-36.9	1.1	-26.2	
Trade balance (US\$ bn)	6.4	0.4	4.7	3.3	27.4	14.8	23.0	17.2	23.9	27.1	26.5	
Current account balance (US\$ bn)	-	2.0	7.0	8.7	33.0	-	30.4	27.4	25.5	23.7	-	

Source: Directorate-general for Budget, Accounting and Statistics, Credit Suisse

Taiwan Market Strategy ----- Maintain UNDERWEIGHT

Taiwan GDP downgrade – limited policy options means it rides along with the global economy

Ernest Fong / Research Analyst / 886 2 2715 6366 / ernest.fong@credit-suisse.com

- Taiwan's 4Q08 GDP declined sharply by 8.4%, the worst on record, leading our economist to revise down the FY09 GDP forecast to -7.2% from -1.1%.
- More importantly, these figures highlight a 22% forecast decline in fixed asset investments, a doubling of the unemployment rate to 10%, a limited scope for NTD depreciation and limited policy options.
- The forecast for a sharp decline in fixed asset investments and spike in unemployment remains negative for financials, consumer and property, on which we remain cautious.
- Likewise, we see near-term disappointment for cement and long-steel stocks, as domestic demand and ASPs remain weak.
- While demand for tech remains weak (and a lack of NTD depreciation does not help), we expect tech to fare better in the near term given revenue snapbacks.
- We remain cautious overall and have a bar-bell strategy for our model portfolio, sticking largely with high-quality names.

Figure 1: Top picks in Taiwan

Company	Rating	Target price (NT\$)	Implied upside %	P/B (x)	P/E (x)			ROE (%)
					09E	08E	09E	
ASE	O	16	33	1.12	10.9	n.a.	94.3	-8.41
HTC	O	490	32	4.09	9.7	11.4	10.7	35.6
Delta	N	65	17	1.73	11.7	14.7	12.6	11.7
ChungHwa	O	68	32	1.51	11.8	12.6	12.6	11.9
China Steel	O	29	29	1.27	10.8	12.1	9.1	10.5

Source: Company data, Credit Suisse estimates.

Taiwan's 4Q08 GDP figures declined sharply by 8.4% YoY – the worst on record – on the back of a meltdown in private fixed investments, while other indicators, like consumption and net trade, fared no better. As a result, our economist, Joseph Lau, revised down his GDP forecast for FY09 from -1.1% to -7.2% with a recovery delayed to 2010.

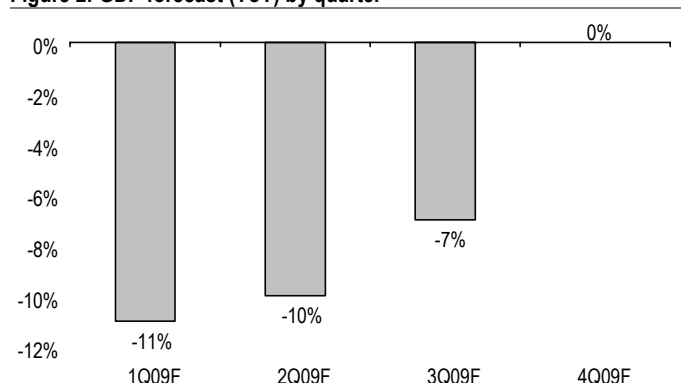
Accompanying this revision, we highlight the other significant forecasts of leading indicators as well as the issues facing Taiwan's government:

- Forecasting a 22% decline in fixed asset investments in FY09 after a 10.8% decline in FY08.
- Unemployment rate forecast to rise from 5% in 2008 to 10% over the next 12-18 months.
- There is limited room for aggressive depreciation of the NTD, as it would undermine confidence in the NTD, which could trigger domestic capital flight.
- With policy rates already at 1.25%, we see a further 25-50 bps of easing but monetary policy is as low as it can go.

Implications for Taiwan market strategy

First and foremost, points 3 and 4 above highlight that policy options for Taiwan's government are limited. Moreover, any fiscal stimulus focused on demand or infrastructure spending is also limited given the problem of fiscal resources.

Figure 2: GDP forecast (YoY) by quarter



Source: Credit Suisse estimates

The -22% YoY in fixed asset investment should not come as a surprise, given contracting demand and the ongoing credit squeeze. However, it does not bode well for unemployment and capex, reaffirming our recent downgrade on cement and long steel as domestic demand and ASP for materials remain soggy. The government's "i-12" infrastructure spending is only expected to kick in from 2H09, but this has been mitigated by continued declines in the private sector.

Similarly the forecast of a doubling in the unemployment rate (exacerbated by the fall in private investment) is another negative for consumer, property and more importantly financials, which could exacerbate the NIM decline and rise in credit costs. We remain cautious on financials, property and consumer.

Given the resource constraints, we see limited scope for the NTD to depreciate vis-a-vis other competing Asian currencies. As such, any hope that the authorities would aggressively depreciate the NTD to spur exports is at best wishful thinking – we currently have a three-month forecast for the NT\$ of 35. As such, it is unclear at this stage if tech exports can show a meaningful recovery in 2009.

However our slight OW on tech in our model portfolio currently is based largely on a revenue snapback, due to the realignment of inventory to end-demand, which should drive near-term performance. Conversely, we expect some near-term disappointment in the non-tech space. Overall, though, our model portfolio is still a bar-bell shape, illustrating our overall cautious stance.