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### MACROECONOMICS

In the highest interest-rate hike in over five years, the Central Bank of the Republic of China (Taiwan) unexpectedly raised its benchmark discount rate in late June by 25 basis points to 3.125%, in a move analysts said was made to curb capital outflows and support a sagging Taiwan dollar. The hike, the twelfth since September 2004, followed an increase of 12.5 points in March. The Central Bank also ramped up its reserve requirement ratio for foreign exchange deposits to 5% from 0.125% to discourage the holding of foreign exchange.

The Taiwan dollar has been the third-worst performing currency against the U.S. dollar so far this year, behind the Japanese yen and Sri Lankan rupee. While some analysts said this hike indicated the Central Bank wanted to see increases in the Taiwan dollar and interest rates to encourage foreign funds to flow into Taiwan, Goldman Sachs said in a report that the move also revealed that the Central Bank was concerned about inflation. "Although headline and core CPI inflation has only averaged 0.7% this year, wholesale price inflation has averaged 7.4% this year," the Goldman Sachs report said. "The central bank cited the heightened risk of upstream inflation, amid rising global commodity prices."

Goldman Sachs said the bank was now taking a relatively more upbeat view of Taiwan's growth prospects. "They now foresee a better growth outlook in (the second half of) 2007, as they expect growth in Asia and Europe could help support Taiwan's export cycle," the report said. Goldman Sachs is expecting the bank to hike interest rates by 25 basis points again in September. Like the Central Bank, it appears optimistic about Taiwan's prospects, saying it expects GDP growth to be 4.5% this year and 5.5% in 2008. Goldman Sachs says there are signs of improvement in Taiwan's export cycle, setting the stage for a recovery in domestic demand, which the larger-than-expected rate hike is unlikely to stifle.

## CROSS-STRAIT

### TAIWAN SEEKS RETURN OF PILOTS' REMAINS

Taiwan is seeking to repatriate the remains of airmen shot down in China decades ago during top-secret missions nurtured by the U.S. Central Intelligence Agency (CIA), a defense ministry spokesman said. "(Defense) Minister Lee Tien-yu has attached great importance to these issues," the spokesman, Major General Yu Sy-tue, told the international media. "Hopefully those sacrificed for the country could eventually return to their homeland and their spirits be pacified," During the 1950s through to the 1970s, the island's air force set up two units with the assistance of the CIA to spy on Cold War enemy China. Local media reports said that at least 155 pilots were shot down or crashed. They said one unit, the "Black Bats," who received their nickname for the ability to fly at an ultra-low altitude to dodge radar, flew as far as Xin-jiang and took photos of China's nuclear test sites.

## DOMESTIC

### PRESIDENTIAL ELECTION ACTIVITY HEATS UP

Taiwan's presidential election might be a full eight months away, but June and July were brimming with pre-election maneuvering from both of Taiwan's main political parties. After weeks of speculation, Kuomintang (KMT) presidential candidate Ma Ying-jeou announced that his running mate would be Vincent Siew, who was premier under former President Lee Teng-hui between 1997 and 2000 during Taiwan's economic boom days. Ma promised that Siew, an economics specialist, would help revive the economy if the KMT is victorious. Legislative Speaker Wang Jin-pyng had previously turned down the second place on the ticket. Siew, from Chiayi, provides the Hong Kong-born Ma with a native Taiwanese running mate. But some in the KMT criticized the choice on the grounds of Siew's age (68) and the fact that he was the vice presidential candidate when Lien Chan was defeated in 2000.

Democratic Progressive Party (DPP) candidate Frank Hsieh has said he would select a running mate in mid-August and base the decision largely on public opinion polls. The two most likely prospects are former vice premier Yeh Chu-lan and former premier Su Tseng-chang. The Central Election Commission also announced in early July that the presidential and legislative elections would not be held currently, with the legislative balloting set for January 12 and the presidential vote for March 22.

### SIJHIH TRIO AGAIN GET DEATH SENTENCE

In an unexpected twist to one of Taiwan's most controversial human rights cases, the Taiwan High Court meted out the death sentence to three alleged murderers known as the Sijhih Trio, reversing an earlier ruling. The three men - Liu Bing-lang, Su Chien-ho, and Chuang Lin-hsun - were accused of killing a married couple during a break-in in 1991. Amnesty International and other human rights organizations have noted the absence of any physical evidence linking the three men to the deaths. Instead, the case was based on the testimony of the brother, executed in 1992, of a friend, plus confessions that the three later retracted as having been extracted under torture. "The confessions of the three differ on key points such as the timing of the offence, the kind of murder weapons used, and the motive for the crime," a 2003 Amnesty International report said, pointing to irregularities in the case.

After spending several years on death row, the three men were acquitted by the High Court in January 2003. But in the August of the same year the Supreme Court overturned that verdict after the prosecution appealed, ordering the retrial that has now taken place. The trio can still appeal the latest ruling.

## LY PASSES PORTION OF U.S. ARMS DEAL

After a more than six-year wait - which greatly frustrated U.S. officials - the opposition-dominated legislature in mid-June finally agreed to approve the purchase of a small portion of the multi-billion-dollar weapons deal first offered to Taiwan by the Bush administration in 2001. The budget of NT\$9.93 billion (US\$300 million) that was passed will cover the acquisition of submarine-hunting aircraft, the upgrading of the island's existing Patriot II anti-missile systems, and the financing of a feasibility study to look into the purchase of diesel electric submarines. It was a far cry from the original weapons package valued at around NT\$610 billion (US\$18.5 billion). Some analysts speculated that the passage will enable the government to restart talks with the United States on purchasing F-16 fighters, seen as essential for Taiwan's air defense. Washington was reportedly reluctant to discuss the F-16s as long as the other procurement items were still stalled in the legislature.

## INTERNATIONAL

### OTHER COUNTRIES OPPOSE CHEN'S REFERENDUM PLAN

Ignoring international opposition, President Chen Shui-bian in early July said he would push ahead with plans for a referendum on whether the island should apply for U.N membership under the name "Taiwan." In an interview with The Washington Post, the president said that canceling plans for the referendum would deny the democratic rights of Taiwan's 23 million people to express their views and guide government policies. "The plan we have embarked on is the right one and we will continue to follow it," he said.

The DPP initiative has been slammed by the Beijing government for allegedly threatening peace in the Taiwan Strait. "Their aim is to provoke conflict between the two sides, cheat the Taiwan people to get more votes, and realize their plans for Taiwanese independence," said Yang Yi, a spokesman for Beijing's Taiwan Affairs Office. The U.S. State Department has also voiced strong opposition, with spokesman Sean McCormack saying in late June that Washington opposed "any initiative that appears designed to change Taiwan's status unilaterally," adding that "this would include a referendum on whether to apply to the United Nations under the name 'Taiwan.'" In addition, Singapore labeled the proposed referendum as "provocative and irresponsible," and Cambodia also condemned it.

In The Washington Post interview, Chen dismissed U.S. concerns that the move violates one of the "Four No" pledges he made to Washington by changing the island's official name from the Republic of China. Chen said that name is defined in the Constitution and would not be affected. He also noted that polls show 71% popular support for holding the referendum. The government wants to conduct the referendum at the same time as the presidential elections.

So as not to appear opposed to efforts to expand Taiwan's diplomatic space, the KMT central standing committee came up with its own version of a referendum on Taiwan's entry into the United Nations, but it took a more flexible stance on the name issue.

### COSTA RICA SWITCHES DIPLOMATIC RELATIONS

Vice President Annette Lu and Foreign Minister James Huang in early July made separate overseas trips, to Latin America and Africa respectively, to visit eight diplomatic allies in what was seen as damage control following the decision of Costa Rica to recognize Beijing, leaving Taiwan with diplomatic relations with only 24 countries. Amid fears that China's increasing economic clout might soon lure away more allies, President Chen also announced that he will go to

Honduras in August to attend a conference with the remaining Latin American countries that maintain ties with Taipei.

## TAIWAN GETS BETTER RATING REGARDING HUMAN TRAFFICKING

The United States removed Taiwan from a watch list for human trafficking in recognition of its "significant efforts" to battle the problem over the past year, an annual report released by the U.S. Department of State said in mid-June. Secretary of State Condoleezza Rice singled out Taiwan as one of a handful of countries making "major improvements" in the fight against the global sex and worker slave trade. Taiwan was removed from the so-called "Tier 2 Watch List" of 32 countries having some of the world's worst records, and placed on the regular Tier 2 list, which includes nearly 80 countries. In response, Premier Chang Chun-hsiung said the government would work to further improve Taiwan's standing in this regard.

## BUSINESS

### CARLYE TO INVEST IN DOMESTIC BANK

The Carlyle Group, a Washington-based private equity firm, said in mid-July it would buy 36% of the Ta Chong Bank in a US\$656 million deal - the latest in a series of foreign investments in the banking sector. The firm, which oversees US\$59 billion of global investments, plans to acquire a combination of common shares, preferred shares, and convertible bonds. Financial Supervisory Commission officials as of press time said they still had not received an application from Ta Chong, and Carlyle will also need to find one to two other strategic investors to help seal the deal as Taiwan law does not allow single shareholders other than financial holding companies to own more than 25% of a bank's shares. The move is expected to significantly boost Ta Chong's capital adequacy ratio and asset coverage ratio.

Earlier last month the Tokyo-based Longreach Group purchased a 51% stake in the financially ailing EnTie Commercial Bank in a US\$694-million deal. The buyout firm, founded by former UBS AG investment banker Mark Chiba, will buy both common and preferred shares from the bank, as well as acquire an additional 442 million shares from EnTie shareholders. EnTie, which controls 1.2% of deposits in Taiwan, began losing money last year as credit card defaults mounted. The deal marks Longreach's first purchase of a majority stake in a consumer bank and is expected to be completed in October.

In another recent transaction, ABN AMRO Holding NV won an auction in early June to take over the failed Taitung Business Bank, which has been under state supervision since December, in exchange for a NT\$6.9 billion subsidy from the government.

### RUSSIA PASSES TAIWAN IN FOREX HOLDINGS

Petrodollar-rich Russia has replaced Taiwan in third place among the world's holders of foreign exchange reserves, the China Times said, quoting the Central Bank. At the end of June, Taiwan's foreign currency reserves totaled US\$266 billion, up US\$353 million from the end of May. But Russia's reserves have been building quickly, rising from US\$260 billion in April to US\$284 billion in May, the daily said. The paper said the Bank's latest data show that China and Japan hold the world's largest and second-largest foreign currency reserves, followed by Russia, Taiwan, and South Korea.

### PENSION INVESTMENT COMMISSION FORMED

A supervisory commission to manage labor pension retirement funds of over NT\$600 billion was inaugurated in early July, a month earlier than expected. The 21-member commission, which comes under the Council of Labor Affairs (CLA), will be chaired by Huang Chao-hsi, chief secretary of the Council for Economic Planning and Development. President Chen had pushed for the commission to be inaugurated as soon as possible, saying the earlier the funds could be invested, the better the returns for future pensioners. Media reports said the commission is authorized to invest up to 40% of the funds in the local stock market, but at first will only invest around 20% or about NT\$120 billion in the local

bourse. According to the CLA, total labor retirement pension funds accumulated at the end of May include NT\$433 billion under the old retirement pension system and NT\$172.2 billion under the new system.