

TAIWAN'S ECONOMIC SITUATION AND OUTLOOK

January 2003



Council for Economic Planning and Development

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I. GLOBAL ECONOMY

Latest Global Insight forecasts (February 2004) :

- ⇒ **World economic growth:** Estimate for 2003 and forecast for 2004 are 2.6% and 3.8%, respectively.
- ⇒ **Trade volume:** Estimate for 2003 and forecast for 2004 are 4.6% and 6.9%, respectively.

	World Bank			Global Insight		
	2002	2003	2004	2003	2004	2005
World Economic Growth %	1.7	2.5	3.1	2.6	3.8	3.5
United States	2.3	2.6	3.1	3.1	4.8	3.8
Japan	0.0	0.8	1.3	2.2	2.5	2.3
Euro area	0.8	1.8	2.6	0.5	1.7	2.5
East Asia and Pacific developing	6.3	6.1	6.4	-	-	-
Asia excluding Japan				6.2	6.5	6.0
Developing countries	2.8	3.9	4.7	-	-	-
World Trade Volume Growth %	2.9	7.0	8.0	4.6	6.9	7.3

Sources: World Bank, *Global Economic Prospects 2003*, December 2003.
Global Insight, Inc., February 12, 2004.

II.1 DOMESTIC ECONOMY

1. *Economic Growth*

Thanks to a pick-up in export growth and the successful containment of the SARS epidemic in the latter half of 2003, Taiwan's economic growth rebounded to positive growth rate of 4.2% and 5.2%, respectively, in the third and fourth quarters. The economy grew 3.2% in 2003 and expected to grow 4.7% in 2004.

Contribution to Economic Growth

Percentage point

	Economic growth (yoy)	Domestic demand								Net foreign demand		
		Total	Consumption		Gross fixed capital formation			Increase in inventory	Total	Exports of goods & services	Less: Imports of goods & services	
			Private	Gov't	Subtotal	Private sector	Public enterprises					Gov't
1998	4.6	6.4	3.9	0.6	1.9	1.8	0.1	0.0	0.1	-1.8	1.2	3.0
1999	5.4	1.9	3.3	-0.9	0.4	-0.1	0.3	0.2	-0.9	3.5	5.7	2.1
2000	5.9	3.9	3.0	0.1	2.0	2.4	-0.1	-0.3	-1.2	2.0	8.8	6.9
2001	-2.2	-4.9	0.6	-0.1	-4.9	-4.8	0.1	-0.2	-0.5	2.8	-4.4	-7.1
2002	3.6	1.0	1.2	-0.02	-0.4	0.3	-0.1	-0.7	0.2	2.6	5.3	2.6
2003(p)	3.2	0.9	0.5	0.1	-0.3	-0.1	-0.1	-0.1	0.6	2.4	5.9	3.5
2004(f)	4.7	3.7	1.7	0.1	1.5	1.6	-0.2	0.05	0.4	1.0	4.2	3.2
Q1(f)	5.2	3.0	2.0	0.1	0.9	0.9	-0.2	0.1	0.0	2.2	6.4	4.3
Q2(f)	5.2	3.1	2.0	0.10	1.5	1.6	-0.2	0.1	-0.5	2.1	6.9	4.7
Q3(f)	4.6	4.2	1.5	0.0	1.7	1.8	-0.2	0.1	1.0	0.4	3.7	3.4
Q4(f)	4.1	4.4	1.3	0.02	2.0	2.2	-0.2	0.0	1.0	-0.3	0.4	0.7

p: Preliminary. f: Forecast. r: Revised.

Source: Directorate-General of Budget, Accounting, and Statistics, 184th Commission on National Income Statistics Meeting, February 20, 2004.

II.2 DOMESTIC ECONOMY

2. Foreign Trade

(1) Two-way Trade

- ⇒ Improving significantly from 2002, exports and imports posted double-digit increase rates in 2003. The trend continued in the first month of 2004.
- ⇒ In 2003, trade surplus amounted to US\$17.0 billion, the third highest historical level. It registered US\$1.2 billion in January 2004.

Foreign Trade

Unit: US\$ billion; yoy %

	Trade		Exports		Imports		Balance \$
	Value \$	Growth %	Value \$	Growth %	Value \$	Growth %	
1998	215.2	-9.0	110.6	-9.4	104.7	-8.5	5.9
1999	232.3	7.9	121.6	10.0	110.7	5.8	10.9
2000	288.3	24.1	148.3	22.0	140.0	26.5	8.3
2001	230.1	-20.2	122.9	-17.2	107.2	-23.4	15.6
2002	243.1	5.7	130.6	6.3	112.5	4.9	18.1
2003	271.5	11.7	144.2	10.4	127.3	13.1	17.0
2004 Jan	22.4	14.6	11.8	17.5	10.6	11.4	1.2

Source: Ministry of Finance.

II.2 DOMESTIC ECONOMY

(2) Major trading partners

- ⇒ Exports to and imports from Hong Kong and Mainland China, among major trading partners, expanded the fastest in the year 2003. In January 2004, exports to ASEAN increased the fastest.
- ⇒ Exports to and imports from the United States have been on the decline since 2001.

Changes in Two-way Trade with Major Trading Partners

	Exports (annual change rate %)					Imports (annual change rate %)				
	USA	Japan	Europe	Hong Kong and Mainland China	ASEAN 5*	USA	Japan	Europe	Hong Kong and Mainland China	ASEAN 5*
1999	5.2	27.6	3.5	11.3	21.3	0.1	13.3	-14.6	9.2	15
2000	12.7	39.5	16.7	24.5	29.3	27.6	26	8.1	27.1	40.4
2001	-20.6	-23.1	-16.5	-10.8	-21.6	-27.4	-33	-21.2	-7.8	-21.2
2002	-3.2	-6.1	-6.3	28.7	2.9	-0.7	5.5	-2.3	24.9	3.7
2003	-3.1	-0.5	10.2	22.1	8.9	-7.0	19.6	10.9	31.0	5.4
2004 Jan	-2.3	11.1	22.7	27.3	33.2	9.9	24.9	14.2	28.2	2.8

*ASEAN5 refers to Indonesia, Malaysia, the Philippines, Singapore, and Thailand.

Source: Ministry of Finance.

II.2 DOMESTIC ECONOMY

(3) Trade Structure

- ⇒ The share of heavy and technology-intensive industrial products of total exports continued to rise after it shrank slightly in 2001. It rose considerably to 75.3% in 2003 and further to 77.6% in the first month of 2004.
- ⇒ The share of imports of capital goods decreased to 20.5% in 2003 and further to 19.7% in January 2004.

Composition of Foreign Trade

	Composition (%)						Change (yoy % in US\$)	
	1996	2000	2001	2002	2003	2004 Jan	2003	2004 Jan
Exports	100	100	100	100	100	100	10.4	17.5
Agricultural Products	0.4	0.2	0.2	0.3	0.3	0.2	8.4	-5.8
Processed Agricultural Products	3.1	1.2	1.4	1.3	1.2	1.1	4.1	-8.8
Industrial Products	96.5	98.6	98.4	98.4	98.5	98.7	10.5	18.0
Heavy & Technology-intensive Industry*	60.5	71.4	71.1	73.1	75.3	77.6	13.8	23.0
Others	36.0	27.2	27.3	25.3	23.2	21.1	1.0	2.5
Imports	100	100	100	100	100	100	13.1	11.4
Capital Goods	17.9	28.0	25.0	23.0	20.5	19.7	0.4	12.2
Raw Materials	69.0	64.1	65.7	67.7	70.8	70.6	18.3	12.0
Consumer Goods	13.1	7.8	9.2	9.3	8.7	9.8	6.4	5.9

* Including industries of chemicals, chemical products, rubber products, plastic products, basic metals, fabricated metal products, machinery & equipment, electrical & electronic machinery, transport equipment, and precision instruments.

Source: Ministry of Finance, *Monthly Statistics of Exports and Imports*, February 2004.

II.3 DOMESTIC ECONOMY

3. Domestic Investment

Real gross fixed capital formation shrank 1.6% in 2003, improving from -2.1% in 2002. Thanks to a more assured trend of global recovery and the resultant acceleration in high-tech investment by the private sector, total investment is expected to increase 8.7% in 2004.

Real Gross Fixed Capital Formation

NT\$ billion; yoy %

	Total		Private investment		Public enterprises investment		Government investment	
	Amount	Growth rate	Amount	Growth rate	Amount	Growth rate	Amount	Growth rate
1999	2101.2	1.8	1352.6	-0.7	239.2	13.3	509.3	3.6
2000	2282.0	8.6	1565.6	15.7	230.9	-3.5	485.5	-4.7
2001	1811.6	-20.6	1108.9	-29.2	240.3	4.1	462.4	-4.8
2002	1773.0	-2.1	1136.7	2.5	234.7	-2.3	401.6	-13.1
2003(p)	1744.7	-1.6	1128.7	-0.7	221.7	-5.5	394.3	-1.8
2004(f)	1896.9	8.7	1292.1	14.5	205.2	-7.5	399.7	1.4
Q1(f)	384.4	5.8	272.6	9.2	31.1	-10.5	80.6	2.2
Q2(f)	431.5	8.7	290.7	14.5	43.5	-8.4	97.4	1.6
Q3(f)	475.4	9.9	325.2	16.3	47.0	-7.8	103.1	1.2
Q4(f)	605.6	9.8	403.6	16.8	83.5	-5.6	118.5	0.7

f: Forecast. p: Preliminary. r: Revised.

Source: DGBAS, 184th Commission on National Income Statistics Meeting, February 20, 2004.

II.4 DOMESTIC ECONOMY

4. Production

Industrial production continued to increase, at a pace of 5.5%, in 2003. It declined 1.1% in January 2004, thanks to the Chinese New Year holiday effect.

Growth Rate of Industrial Production %

	Industrial production	Mining	Manufacturing	Electricity, gas, and water	Construction
2000	7.4	-6.7	8.0	10.0	-15.1
2001	-7.3	7.9	-8.0	1.8	-12.3
2002	6.4	2.1	7.5	3.7	-23.1
2003	5.5	-13.6	5.4	5.0	13.0
Q2	-0.4	-15.4	-0.6	2.1	0.3
Q3	6.6	-14.4	6.0	7.7	34.6
Q4	9.5	-22.0	9.7	5.3	20.7
2004 Jan	-1.1	-8.8	-0.4	0.9	-32.8

*Including industries of chemicals, chemical products, rubber products, plastic products, basic metals, fabricated metal products, machinery & equipment, electrical & electronic machinery, transport equipment, and precision instruments.

Source: Ministry of Economic Affairs, *Industrial Production Statistics Monthly, Taiwan*.

II.5 DOMESTIC ECONOMY

5. Employment

Nonagricultural employment has displayed marked improvement since the second quarter of 2003. The unemployment rate increased to a record high in 2002 and gradually lowered to below 5% in 2003. It fell further to 4.53% in January 2004.

	Labor Force		Unemployment		Nonagricultural employment	
	1,000 persons	participation %	1,000 persons	Unemployment Rate (% , Average)	1,000 persons	yoy, %
2000	9,784	57.7	293	2.99	8,753	1.6
2001	9,832	57.2	450	4.57	8,677	-0.9
2002	9,969	57.3	515	5.17	8,745	0.8
2003	10,076	57.3	503	4.99	8,877	1.5
Q2	10,034	57.2	501	5.00	8,836	1.1
Q3	10,117	57.5	524	5.14	8,897	1.6
Q4	10,129	57.4	480	4.74	8,964	2.3
2004						
Jan	10,157	57.4	460	4.53	9,030	2.4

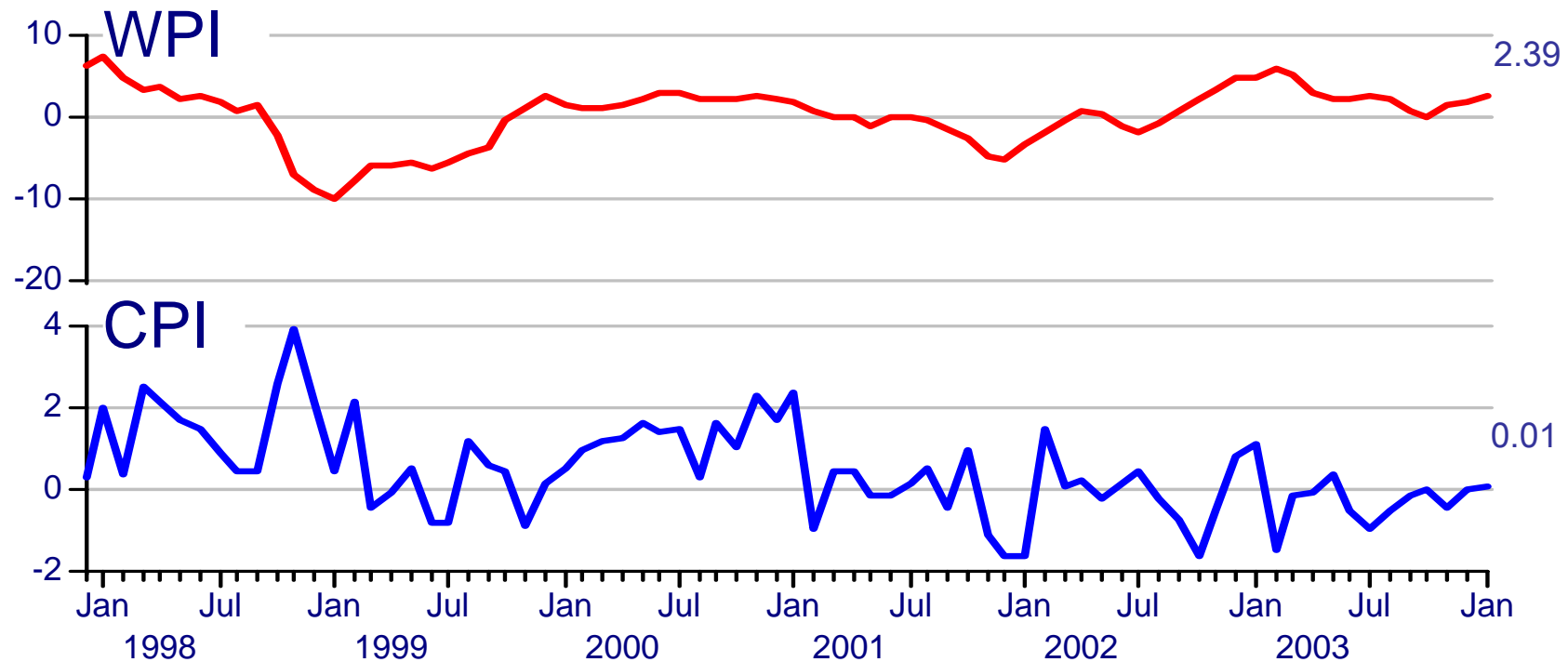
Source: Directorate General of Budget, Accounting, and Statistics.

II.6 DOMESTIC ECONOMY

6. PRICES

Wholesale prices increased 2.5% and consumer prices decreased 0.3% in 2003. In January 2004, wholesale prices rose 2.39% from a year earlier, while consumer price increase posted 0.01%, turning from negative rates in 2003.

Price Change (% change over a year)



Source: CEIC.

II.7 DOMESTIC ECONOMY

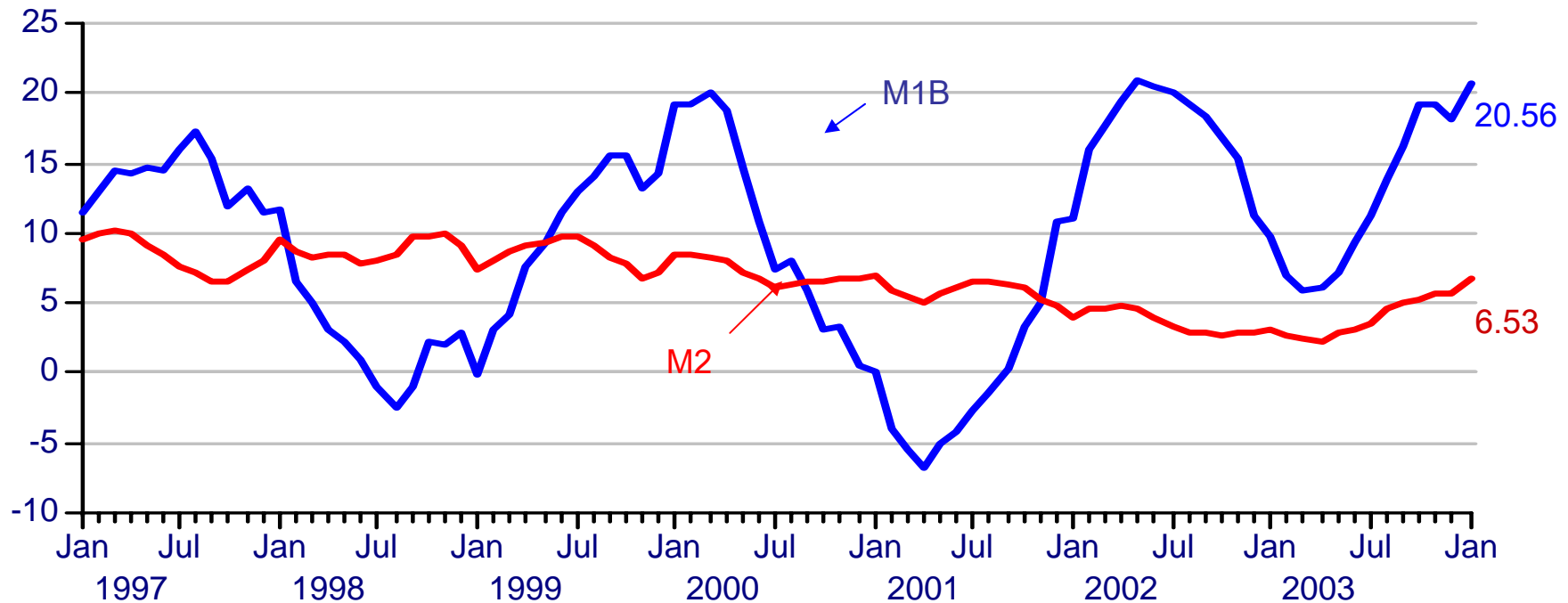
7. Money & Finance

(1) Money Supply

The annual growth rate of M1B and M2 increased 11.8% and 3.8%, respectively, in 2003, and 20.6% and 6.5%, respectively, in January 2004.

Money Supply

Daily average, % change over a year



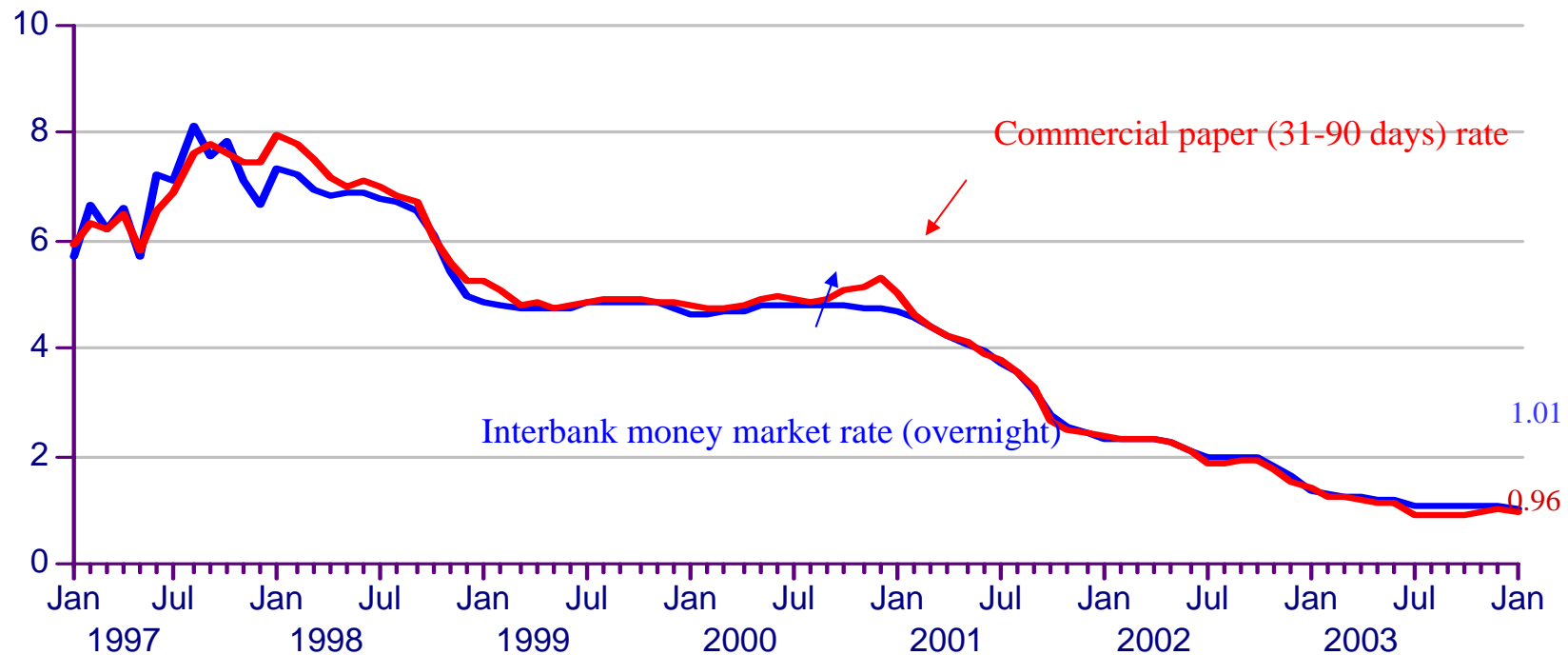
Source: CEIC.

II.7 DOMESTIC ECONOMY

(2) Interest Rates

Market interest rates have been lowered continuously until the third quarter of 2003, reaching historically low levels and reflecting the loosening situation in the money market. The downward trend has slightly reversed since the last quarter of 2003. In January 2004, commercial paper rate and interbank rate rose 0.96% and 1.01%, respectively.

Interest Rate (%)



Source: CEIC.

II.8 DOMESTIC ECONOMY

8. Business Cycle Indicators

During the first half of 2003, the steady recovery achieved in 2002 was disrupted due to the spread of SARS. As the epidemic was gradually brought under control, green lights flashed again for five consecutive months during July-November. In December 2003, the monitoring indicators flashed yellow-red for the first time in about four years, indicating a strong improvement of the economy. The indicators repeated the yellow-red signal in January 2004.

Monitoring Indicators

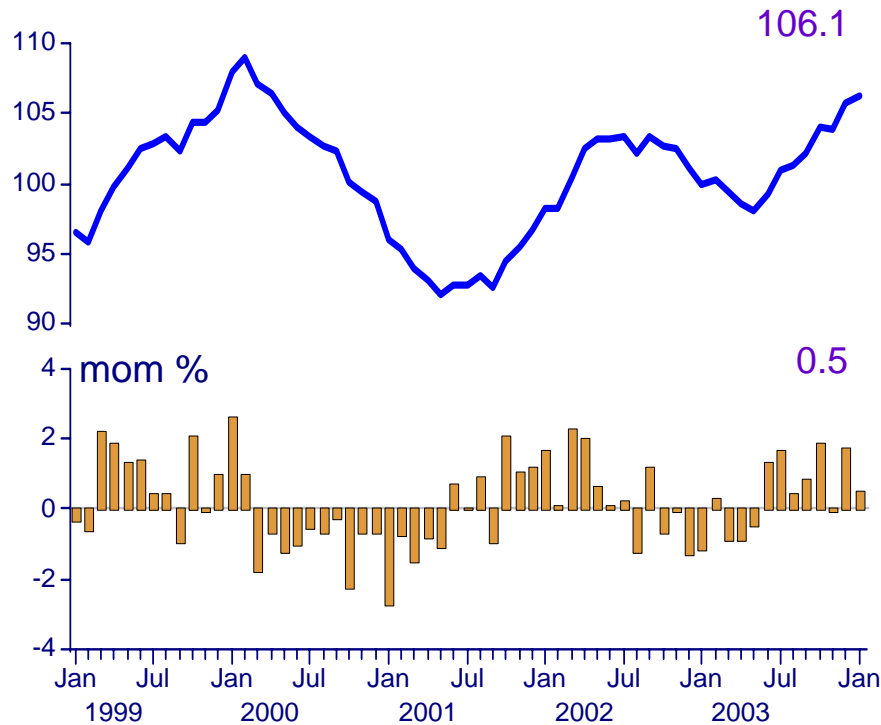
		2003												2004	
		1	2	3	4	5	6	7	8	9	10	11	12	1	
Total Scores		20	22	17	14	14	20	24	26	29	31	30	34	35	
Financial Sector	Monetary Aggregates M1B, yoy %														19.2
	Direct and Indirect Finance, yoy %														7.7 _P
	Bank Clearings and Remittance, yoy %														10.3
	Stock Price Index, 1966=100, yoy%														27.5
Real Sector	Manufacturing New Order Index, 1996\$, 1976.1=100, yoy %														8.0 _P
	Exports, yoy %														23.2 _P
	Industrial Production Index, 1996=100, yoy %														12.7 _P
	Manufacturing Inventory-to-Sales ratio, %														55.4 _P
	Nonagricultural Employment, yoy %														2.7

Overheating
 Transition in need of watching
 Steadily moving forward
 Transition in need of watching
 Recession

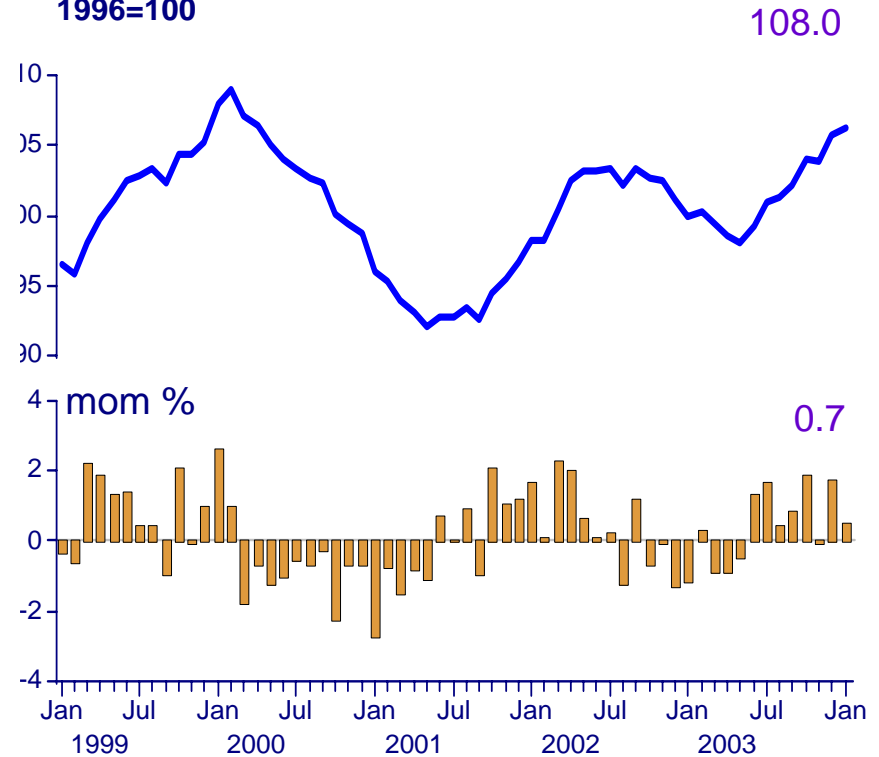
Note: All data, except stock price index, have been seasonally adjusted.

II.8 DOMESTIC ECONOMY

Composite Leading Index 1996=100



Composite Leading Index 1996=100



Source: CEPD.

II.8 DOMESTIC ECONOMY

⇒ According to surveys conducted by the Council for Economic Planning and Development, the manufacturing firms continued to be optimistic in the first two months of 2003. As uncertainties increased with the spread of SARS, the optimistic view lessened in March and April. However, as the outlook for the economy has become significantly brighter, business expectations has regained momentum since May 2003.

Business Expectations

% of manufacturing firms surveyed

		Business conditions 3 months later			
		Better (1)	Unchanged	Worse (2)	Net (1)-(2)
2003	Jan	25	65	10	15
	Feb	26	61	13	13
	Mar	19	65	16	3
	Apr	13	61	26	-13
	May	16	69	15	1
	June	17	75	8	9
	July	17	70	13	4
	Aug	22	65	13	9
	Sep	22	65	13	9
	Oct	18	69	13	5
	Nov _r	20	65	15	5
	Dec _r	24	66	10	14
2004	Jan _p	34	58	8	26

Source: CEPD.

III.1 CURRENT ISSUES

1. *Current Economic Issues*

- ⇒ **The SARS and Avian** influenza (bird flu) pose high risks to the economy in case of an outbreak of either of such epidemic.
- ⇒ **Dependence** on exports to and investment in mainland China is rapidly increasing yet the development of a cross-straits communications and consultation mechanism is at a standstill.
- ⇒ **Domestic demand** remains below historical level, though gaining momentum since 2003.
- ⇒ **Fiscal deficits** have expanded rapidly in the past decade, as it has become more difficult in raising fiscal revenues and contracting expenditures.
- ⇒ **The banking sector** reached very high levels of non-performing loan ratio, at 8.8% in the first quarter of 2002, with problems most severe among community financial institutions. Although domestic banks as a whole improved to below 5% in December 2003, community financial institutions still saw a level above 14%.
- ⇒ **The unemployment** rate has risen from 3.0% in 2000 to around 5% in 2002. Although declining to below 5% in the end of 2003, it is still above historical level.

III.2 POLICY INITIATIVES

2. Key Policy Initiatives

- ⇒ **A cabinet-level taskforce** has been formed to monitor the potential impact of SARS and bird flu and prepare for quick response to the appearance of such diseases. About 58,000 businesses or 404,000 individuals in tourism industries and passenger transportation have benefited from funding for business operations, interest payment and payroll spending in 2003.
- ⇒ **Easing restrictions on economic links with mainland China:**
 1. The “no haste, be patient” mainland investment policy has been replaced with a less restrictive “proactive liberalization with effective management” approach.
 2. The preparatory phase of cross-strait direct transportation links is already underway.
 3. "Measures on cross-Strait freight facilitation" are to be announced at appropriate time.
- ⇒ **Measures to stimulate the economy:**
 1. The "Taiwan first investment" program was introduced to promote private investment. Among the key initiatives are land cost reduction, trillion-dollar financing for traditional industries and small and medium enterprises, five-year tax holiday for new investment in manufacturing, and infrastructural development. The program is designated to keep annual investment above US\$35 billion over the next five years.
 2. A further spending of US\$15 billion for the five years from 2004 is scheduled to step up development in transportation, high-technology, higher education, and water resource management.

III.2 POLICY INITIATIVES

⇒ **Fiscal reform**

- The government has established a fiscal reform committee to draw up plans for achieving a balanced budget within five to ten years.
- Another committee has been formed to consolidate the management of national properties to help relieve fiscal burden.

⇒ **Financial reform:** A financial restructuring fund (RTC) was established, with which 43 insolvent financial institutions have been liquidated since August 2001. At the same time, AMCs (Asset Management Companies) were encouraged to form to help dispose bad assets and the Financial Holding Company Law was passed to speed up integration across industries.

⇒ **Measures to increase employment:** An increase of US\$575 million in public services spending is expected to create about 80,000 jobs in public services for those who need employment the most in 2003. Unemployment rate is expected to fall to around 4% in 2004.

III.2 POLICY INITIATIVES

3. *Challenge 2008: Six-Year National Development Plan*

- ⇒ The comprehensive six-year national development plan is designed to foster the creativity and talent Taiwan needs to transform itself into a “green silicon island.”
- ⇒ Total expenditure under the plan will be NT2.6 trillion (approximately US\$75 billion.)
- ⇒ The major goals of the plan are:
 1. To develop at least 15 products or technologies that rank among the world's best
 2. To double the number of foreign tourists visiting Taiwan
 3. To increase R&D expenditures to 3% of GDP
 4. To reduce the unemployment rate to less than 4%
 5. To boost the economic growth rate to over 5%
 6. To expand the number of broadband Internet users to over 6 million
 7. To create 700 thousand jobs

III.2 POLICY INITIATIVES

⇒ The plan includes three major reforms, of government, banking and public finance, and ten major investment areas as follows:

1. Cultivate talent for the E-generation
2. Develop the cultural creativity industry
3. Develop an international base for R&D and innovation
4. Develop high value-added industries
5. Double the number of tourists visiting Taiwan
6. Develop a digital Taiwan
7. Develop Taiwan as an operations headquarters
8. Improve the transportation infrastructure
9. Conserve water resources and the ecology
10. Construct new hometown communities

IV. PROSPECTS

2003

- ⇒ The Taiwan economy resumed positive growth in 2002, following the unprecedented negative growth in 2001. The momentum continued in the first quarter of 2003, as growth reached 3.5%. However, the domestic economy was severely affected by the spread of the SARS epidemic in the second quarter, turning to a negative growth of 0.1%.
- ⇒ Growth strengthened to 4.2% in the third quarter, as the spread of SARS was brought under control by late June. Thanks to rising optimism about the global economy and the emerging effect of increased government spending, the last quarter saw 5.2% expansion.
- ⇒ The economy grew 3.2% in 2003 with consumer prices falling by 0.3%.

2004

- ⇒ In 2004, the momentum of the global economic recovery and world trade acceleration is expected to be notable and strong enough to keep Taiwan's export expansion as fast as 2003.
- ⇒ The positive wealth effects created with the warming-up of the stock and real estate markets will help boost private consumption.
- ⇒ Private investment is expected to grow at a double-digit rate, driven by plant expansions in the opto-electronic and semiconductor industries and such large projects as high-speed railway and the 6th naphtha cracker plant .
- ⇒ Economic growth is officially forecasted to be 4.7% with very moderate inflation of 0.5%.

ECONOMIC FORECASTS FOR TAIWAN

		Growth rate %		
		2003	Difference from last projection	2004
World Bank	(Sep 2003)	2.0	-0.5	3.0
IMF	(Sep 2003)	3.2	0.0	4.1
Global-Insight (formerly DRI-WEFA)	(Feb 2004)	3.3	+0.2	4.9
CIER	(Dec 2003)	3.12	+0.04	4.26
TIER	(Jan 2004)	3.34 _p	-0.17	4.81
DGBAS	(Feb 2004)	3.24	+0.09	4.74
Academia Sinica	(Dec 2003)	3.19	+0.54	4.35

P: preliminary estimate.

CIER: Chung-hua Institute for Economic Research, Taipei.

DGBAS: Directorate-General of Budget, Accounting and Statistics, Taiwan, ROC.

TIER: Taiwan Institute of Economic Research, Taipei.