

TAIWAN'S ECONOMIC SITUATION AND OUTLOOK



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CONTENTS

I. GLOBAL ECONOMY

II. DOMESTIC ECONOMY

1. Economic Growth
2. Foreign Trade
3. Domestic Investment
4. Industrial Production
5. Employment
6. Prices
7. Money and Interest Rates
8. Business Conditions

II. CURRENT ISSUES AND POLICIES

1. Issues
2. Policy Initiatives

III. PROSPECTS

I. GLOBAL ECONOMY

Latest IMF forecasts (September 2004) :

- ⇒ **World economic growth:** Forecasts for 2004 and 2005 are 5.0% and 4.3%, respectively.
- **United States:** Growth momentum has slowed from the second quarter. Growth forecast has been marked downward to 4.3%.
 - **Japan:** While growth slowed sharply in the second quarter, the near-term outlook remains solid. Growth forecast has been adjusted upward to 4.4%.
 - **Euro area:** The pace of the expansion is expected to remain moderate, with growth forecast marked up to 2.2%.
 - **Emerging Asia:** The boost from strong growth in China has fed through to the rest of east Asia, although growth rates vary significantly across countries depending on the strength of domestic demand. Growth forecasts for both NIEs and developing Asia are 5.5% and 7.6%, respectively.
- ⇒ **Trade volume:** Forecasts for 2004 and 2005 are 8.8% and 7.2% respectively.

World Economic Outlook

	IMF			Global Insight		
	2003	2004	2005	2003	2004	2005
World Economic Growth %	3.9	5.0	4.3	2.8	4.1	3.8
United States	3.0	4.3	3.5	3.0	4.2	3.4
Japan	2.5	4.4	2.3	2.5	4.2	2.1
Euro area	0.5	2.2	2.2	0.6	1.9	2.2
Developing Asia	7.7	7.6	6.9	-	-	-
Asia excluding Japan	-	-	-	6.4	6.9	6.1
Asian NIEs	3.0	5.5	4.0	-	-	-
CIS*	7.8	8.0	6.6	7.9	7.4	6.1
World Trade Volume Growth %	5.1	8.8	7.2	-	-	-

* Commonwealth of Independent States.

Sources: International Monetary Fund, *World Economic Outlook 2004*, September 2004.
Global Insight, September 15, 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 was able to grow 3.3% in 2003. The economy is preliminarily estimated to have grown 7.2% in the first half of 2004, as exports and production continued to expand with strengthened global recovery and as private investment stepped up in pace.

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	Govt	Subtotal	Private sector	Public enterprises	Govt				
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	3.3	0.4	0.4	0.1	-0.4	-0.2	-0.1	-0.1	0.2	2.9	6.1	3.2
2004(f)	5.9	5.2	1.6	0.0	2.4	2.7	-0.2	-0.09	1.2	0.7	10.3	9.6
Q1(r)	6.7	6.2	2.0	0.2	2.1	2.3	-0.2	0.0	1.8	0.5	11.2	10.7
Q2(p)	7.7	5.9	2.3	0.11	3.4	3.7	-0.2	-0.2	0.1	1.8	15.1	13.3
Q3(f)	5.3	4.8	0.9	-0.11	2.0	2.4	-0.2	-0.1	2.0	0.5	10.5	10.1
Q4(f)	4.1	4.1	1.2	-0.14	2.1	2.4	-0.3	-0.1	0.9	0.0	4.8	4.8
2005(f)	4.5	2.9	1.6	0.01	1.4	1.2	0.2	0.0	0.0	1.6	3.9	2.4

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

Source: Directorate-General of Budget, Accounting, and Statistics, 186th Commission on National Income Statistics Meeting, August 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 to grow in the first eight months of 2004.
- ⇒ In 2003, trade surplus amounted to US\$16.9 billion, the third highest historical level. It registered US\$5.6 billion in January-August 2004.

Foreign Trade

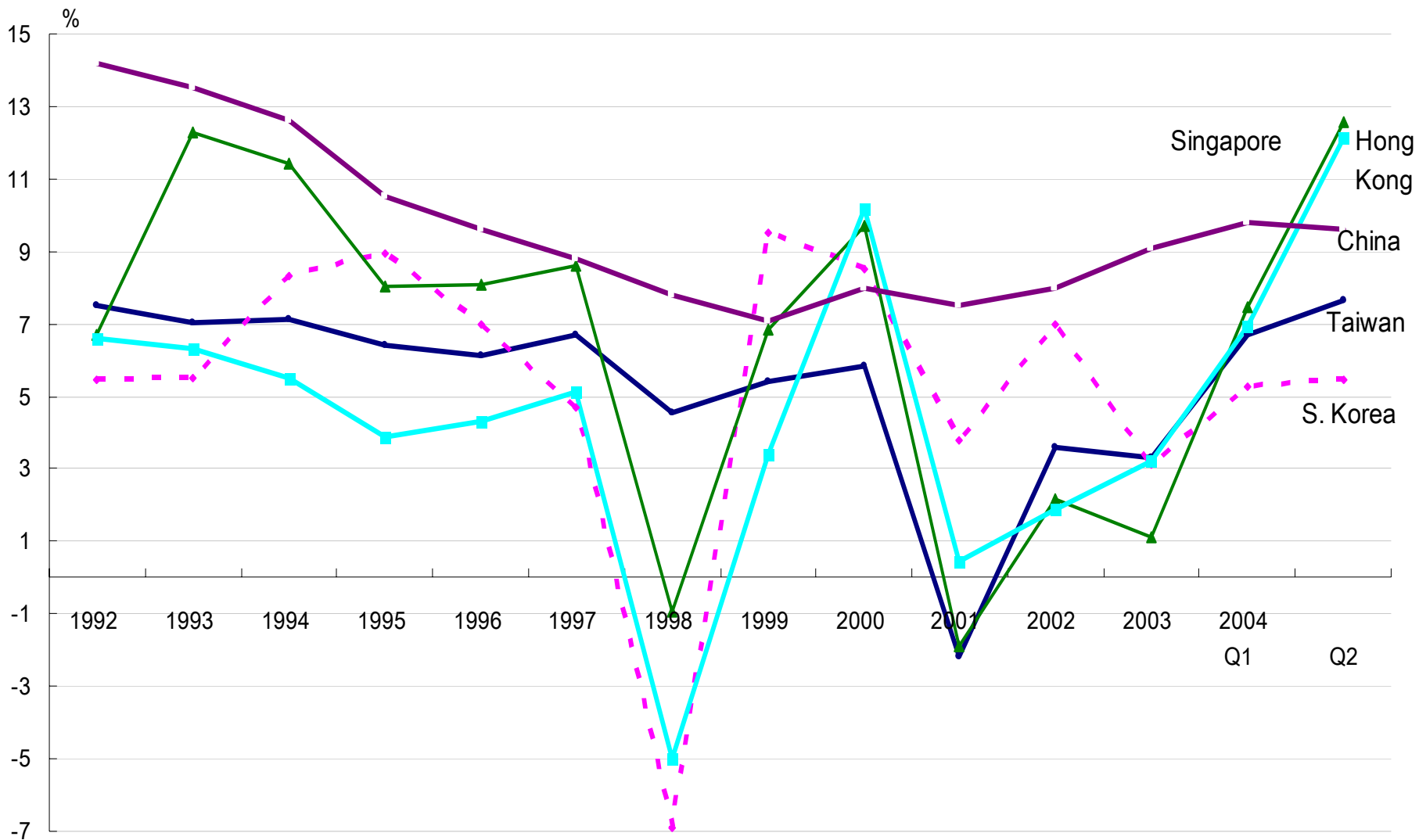
Unit: US\$ billion; yoy %

	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	16.9
2004 Jan-Aug	221.1	29.6	113.3	24.9	107.7	35.0	5.6

Source: Ministry of Finance.

Asian Tigers and China: Economic Growth

Singapore grew at the highest speed among the tigers and China.



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

II.2 DOMESTIC ECONOMY

(2) Major trading partners

- ⇒ Exports to and imports from Hong Kong and Mainland China, among major trading partners, have expanded the fastest since 2002.
- ⇒ Exports to and imports from the United States returned to positive growth in the first eight months of 2004 after declining for three consecutive years.

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 6*	USA	Japan	Europe	Hong Kong and Mainland China	ASEAN 6*
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-Aug	8.2	11.4	20.1	37.3	34.8	32.6	39.7	33.8	52.6	19.3

*ASEAN6 refers to Indonesia, Malaysia, the Philippines, Singapore, Thailand and Vietnam.

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 76.9% in the first eight months of 2004.
- ⇒ The share of imports of capital goods decreased to 20.5% in 2003 and increased slightly 20.8% in January-August 2004.

Composition of Foreign Trade

	Composition (%)						Change (yoy % in US\$)	
	1996	2000	2001	2002	2003	2004 Jan-Aug	2003	2004 Jan-Aug
Exports	100	100	100	100	100	100	10.4	24.9
Agricultural Products	0.4	0.2	0.2	0.3	0.3	0.2	8.4	-5.1
Processed Agricultural Products	3.1	1.2	1.4	1.3	1.2	1.2	4.1	16.4
Industrial Products	96.5	98.6	98.4	98.4	98.5	98.6	10.5	25.1
Heavy & Technology-intensive Industry*	60.5	71.4	71.1	73.1	75.3	76.9	13.8	29.3
Others	36.0	27.2	27.3	25.3	23.2	21.7	1.0	12.3
Imports	100	100	100	100	100	100	13.1	35.0
Capital Goods	17.9	28.0	25.0	23.0	20.5	20.8	0.4	40.9
Raw Materials	69.0	64.1	65.7	67.7	70.8	70.9	18.3	35.1
Consumer Goods	13.1	7.8	9.2	9.3	8.7	8.3	6.4	21.1

* 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*, September 2004.

II.3 DOMESTIC ECONOMY

3. Domestic Investment

Real gross fixed capital formation shrank 2.0% in 2003, compared to -2.1% in 2002. Thanks to a more assured trend of global recovery and the resultant acceleration in private investment, total investment is estimated to have expanded 17.1% in the first half of 2004 and is expected to increase 13.8% for the whole year.

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	1737.5	-2.0	1120.0	-1.5	223.6	-4.8	393.9	-1.9
2004(f)	1976.3	13.8	1389.0	24.0	202.0	-9.6	385.3	-2.2
Q1(p)	414.6	14.1	306.3	22.4	30.4	-11.5	77.9	-0.6
Q2(p)	472.7	20.1	337.3	35.0	43.5	-9.5	91.9	-4.0
Q3(f)	483.3	12.1	338.2	22.0	46.0	-11.2	99.1	-2.9
Q4(f)	605.7	10.2	407.1	18.9	82.1	-7.8	116.5	-1.2

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

Source: DGBAS, 186th Commission on National Income Statistics Meeting, August 20, 2004.

II.4 DOMESTIC ECONOMY

4. Production

Industrial production continued to grow, at a pace of 7.1%, in 2003. It increased 13.2% in January-August 2004, as manufacturing industry expanded 14.4%.

Growth Rate of Industrial Production %

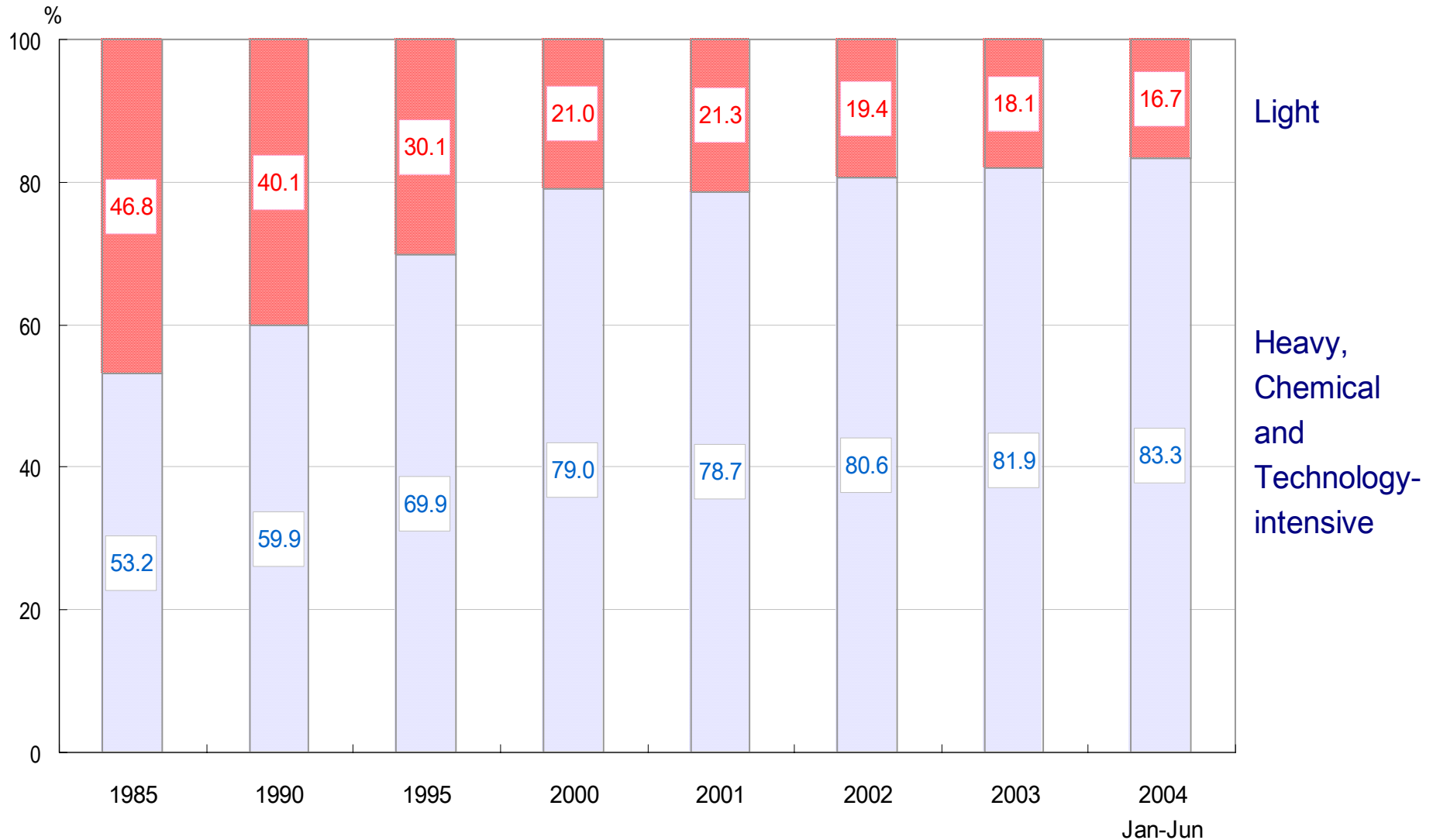
	Industrial production	Mining	Manufacturing	Electricity, gas, and water	Construction
2000	6.9	-8.5	8.1	7.7	-14.7
2001	-7.8	0.1	-8.4	1.1	-11.2
2002	7.9	8.3	9.4	3.3	-20.7
2003	7.1	-7.4	7.4	3.8	8.9
Q2	1.4	-0.03	1.6	1.5	-2.7
Q3	7.4	-8.9	7.0	5.9	32
Q4	12.6	-23.3	13.3	4.4	17.9
2004 Jan-Aug	13.2	-6.6	14.4	4.1	-2.5

*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*.

Structure of the Manufacturing Industry

The share of heavy, chemical and technology-intensive industry in manufacturing increased from 81.9% in 2003 to 83.3% in the first half of 2004.



II.5 DOMESTIC ECONOMY

5. Employment

Nonagricultural employment has displayed marked improvement since the third quarter of 2003. The unemployment rate gradually lowered to below 5% in the fourth quarter of 2003, after increasing to a record high in 2002. It fell further to 4.5% in January-August 2004.

	Labor Force		Unemployment		Nonagricultural employment	
	1,000 persons	Participation %	1,000 persons	Rate %	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-Aug						
Average	10,219	57.6	462	4.50	9,105	3.0

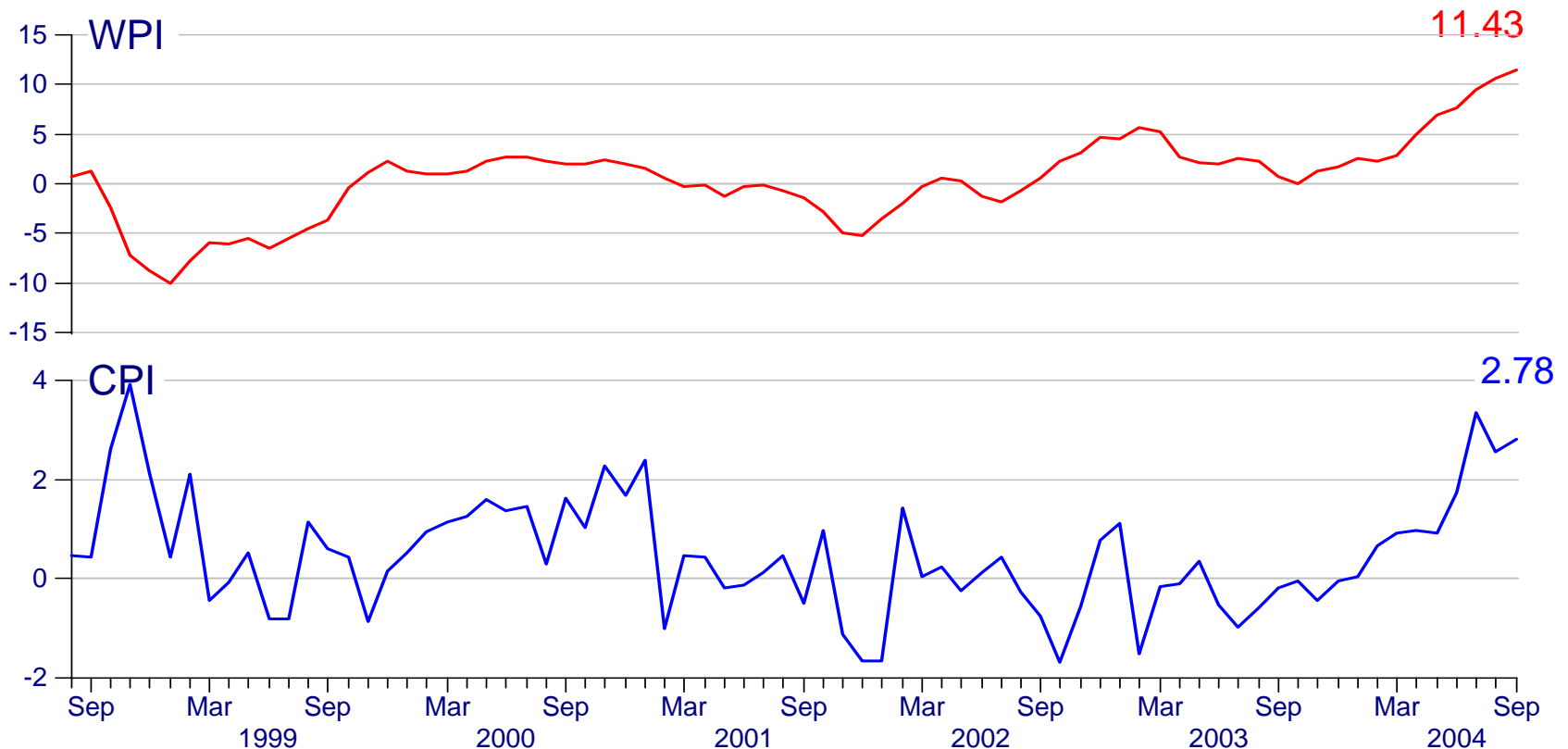
Source: Directorate General of Budget, Accounting, and Statistics.

II.6 DOMESTIC ECONOMY

6. PRICES

Wholesale prices increased 2.5% and consumer prices decreased 0.3% in 2003. Since the second quarter of 2004, prices rose more rapidly with the steep increase in oil prices. Wholesale prices and consumer prices rose 6.5% and 1.5%, respectively, during January –September 2004.

Price Change (% change over a year)



II.7 DOMESTIC ECONOMY

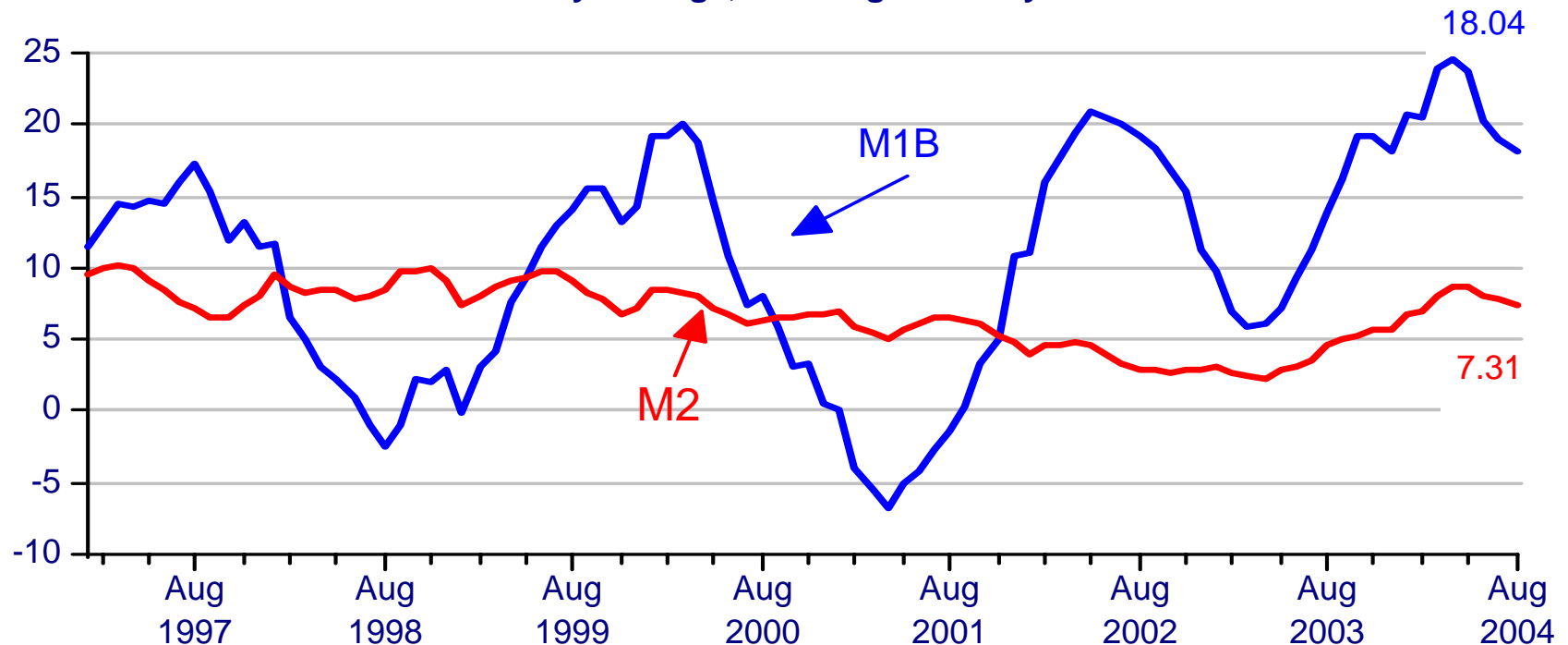
7. Money & Finance

(1) Money Supply

The annual growth rate of M1B and M2 recorded 11.8% and 3.8%, respectively, in 2003. In August 2004, M1B grew 18.0% while M2 expanded 7.3%.

Money Supply

Daily average, % change over a year



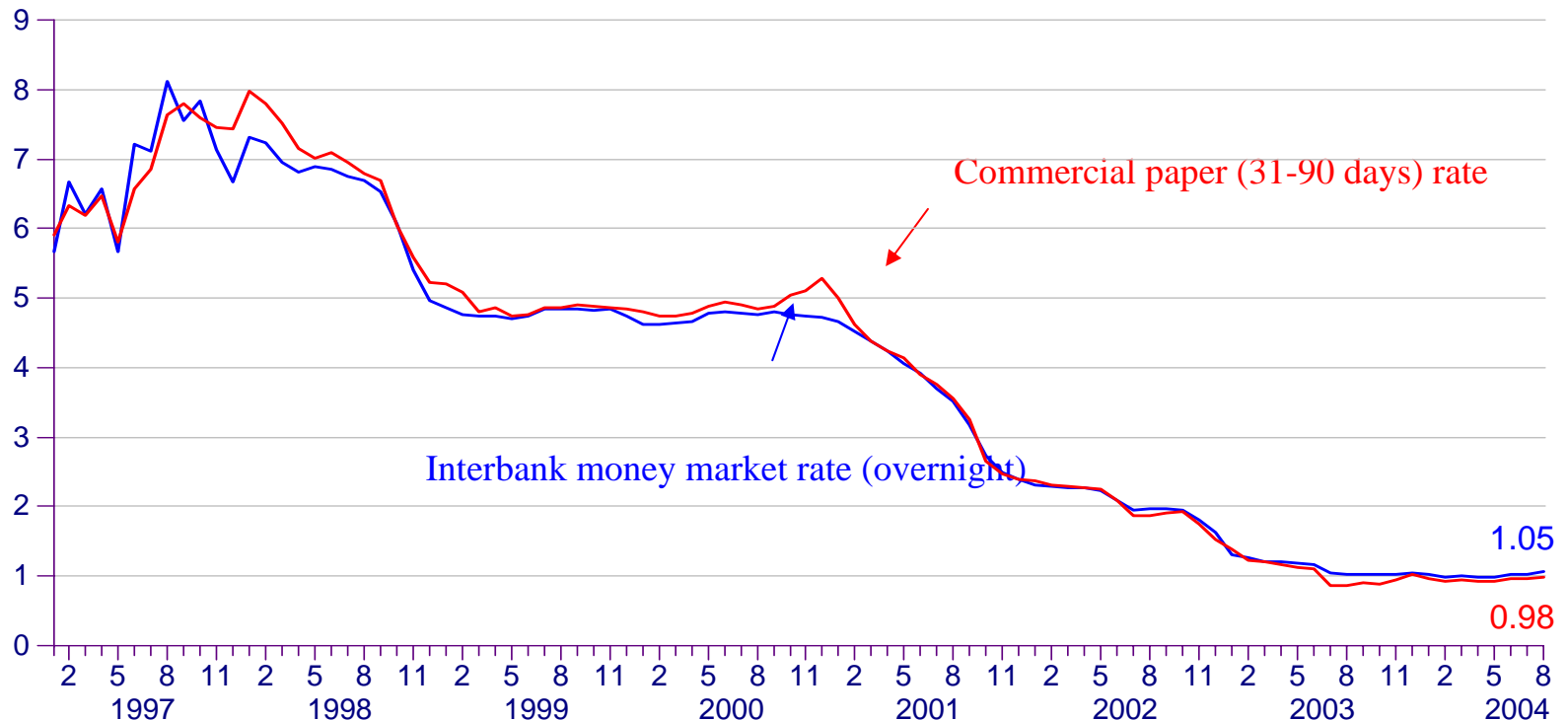
Source: CEIC.

II.7 DOMESTIC ECONOMY

(2) Interest Rates

Market interest rates lowered continuously and reached historically low levels during end of 2000 and the third quarter of 2003. The downward trend leveled off since the last quarter of 2003, and has seen a reverse tendency more recently. In August 2004, both commercial paper rate and interbank rate posted around 1.0%. Effective on October 1, the rediscount rate was raised from 1.375% to 1.625% by the Central Bank.

Interest Rate (%)



Source: CEIC.

II.8 DOMESTIC ECONOMY

8. Business Monitoring Indicators

During the latter half of 2003, the steady recovery achieved in 2002 resumed as the SARS epidemic was brought under control. The monitoring indicators have flashed "yellow-red" light since December 2003, except in May 2004.

Monitoring Indicators

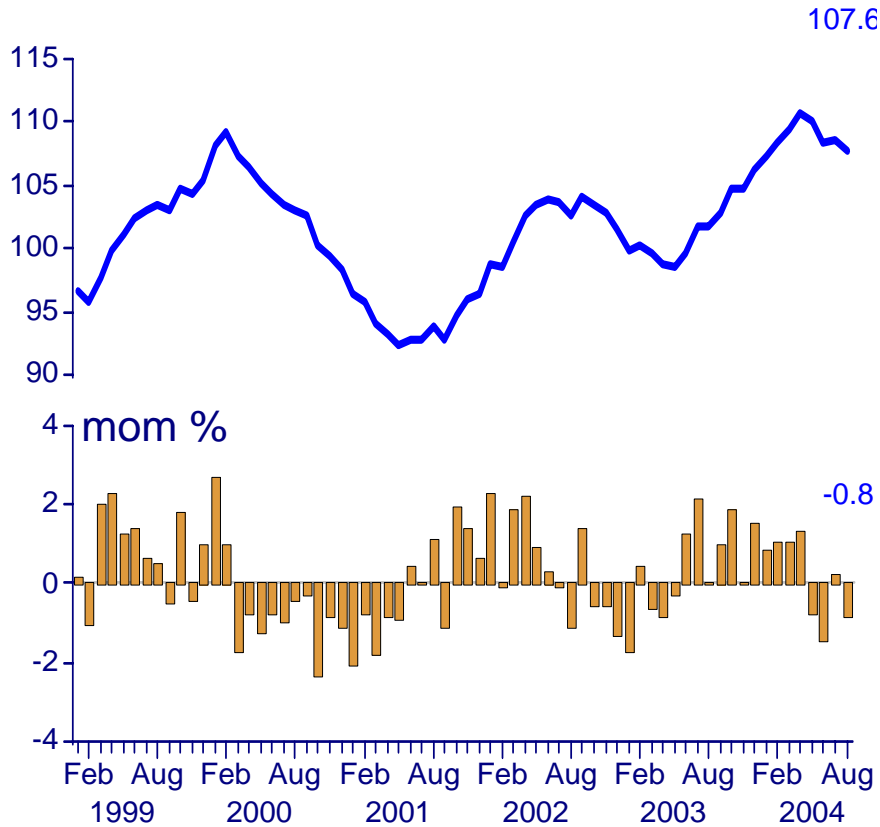
		2003					2004								
		8	9	10	11	12	1	2	3	4	5	6	7	8	
Total Scores		26	29	31	30	34	35	34	36	37	39	36	35	33	
Financial Sector	Monetary Aggregates M1B, yoy%														18.0
	Direct and Indirect Finance, yoy%														9.7 _p
	Bank Clearings and Remittance, yoy %														2.5
	Stock Price Index, 1966=100, yoy%														0.9
Real Sector	Manufacturing New Order Index, 1996\$, 1976.1=100, yoy %														9.7 _p
	Exports, 2001\$, yoy %														12.7 _p
	Industrial Production Index, 1996=100, yoy%														8.9 _p
	Manufacturing Inventory-to-Sales ratio, %														49.9 _p
	Nonagricultural Employment, yoy%														3.2

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

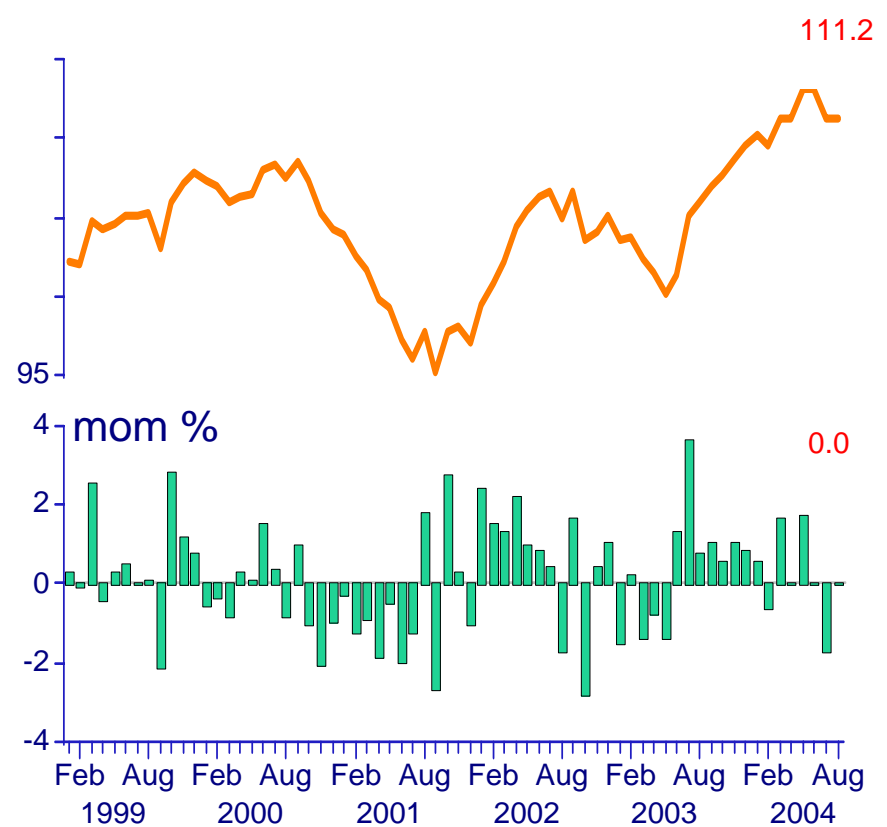
Note: All data, except stock price index, have been seasonally adjusted.

II.8 DOMESTIC ECONOMY

Composite Leading Index 1996=100

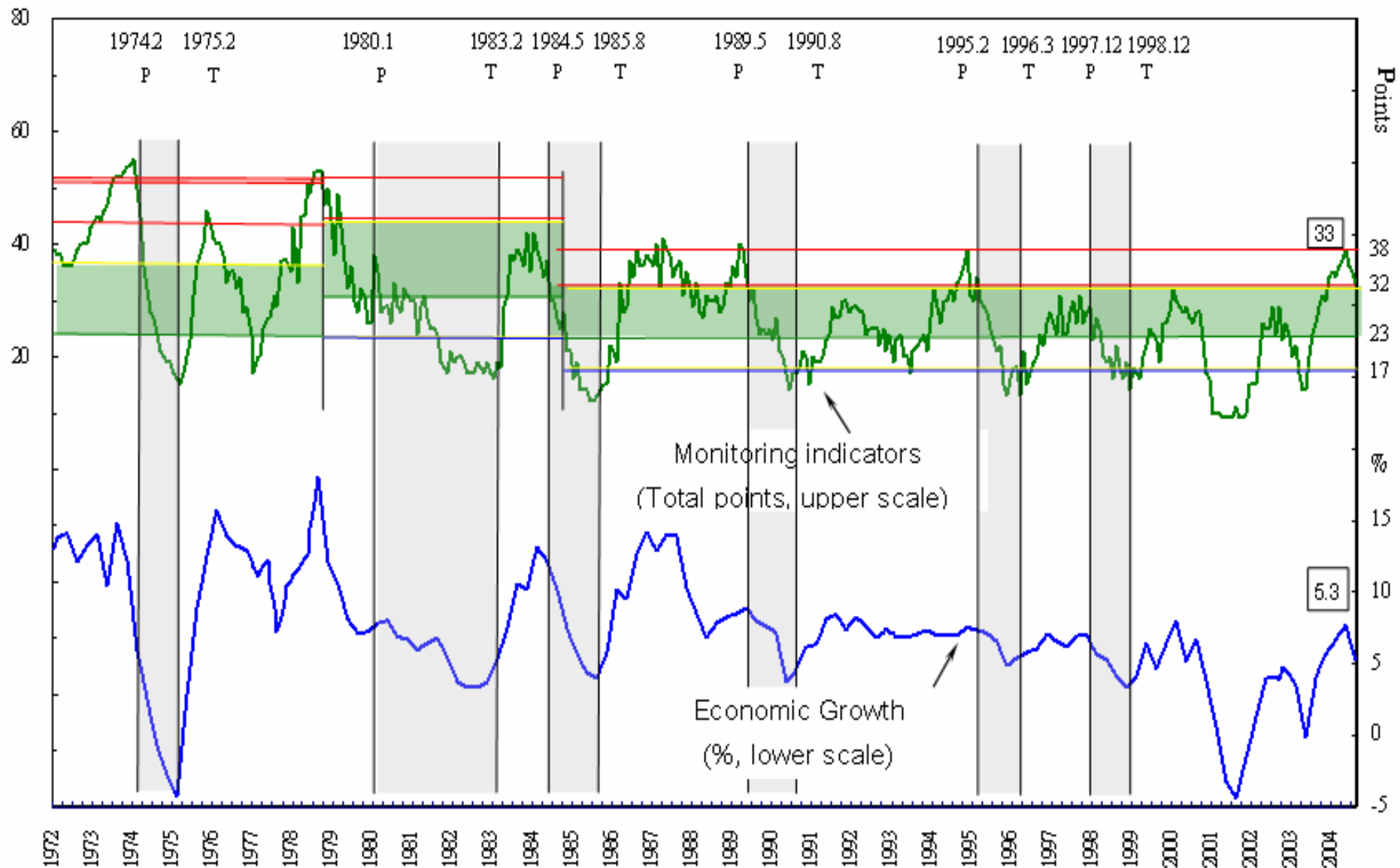


Composite Coincident Index 1996=100



Source: CEPD.

Monitoring Indicators and Economic Growth



II.8 DOMESTIC ECONOMY

⇒ According to surveys conducted by the Council for Economic Planning and Development, the manufacturing firms kept optimistic for eleven consecutive months until April 2004. The percentage of optimists surpassed that of pessimists again in August 2004.

		Business Expectation 3 months later				Capacity Utilization (%)	Profit (%)
		% of manufacturing firms surveyed					
		Better (1)	Unchanged	Worse (2)	Net (1)-(2)		
2003	Aug	22	65	13	9	78.7	4.8
	Sep	22	65	13	9	78.7	4.8
	Oct	18	69	13	5	80.2	5.0
	Nov	20	65	15	5	79.5	4.9
	Dec	24	66	10	14	80.4	5.1
2004	Jan	34	59	7	27	77.1	4.7
	Feb	32	58	10	22	79.3	5.2 _r
	Mar	19	70	11	8	80.9	5.4 _r
	Apr	13	74	13	0	80.5	5.2 _r
	Mar	14	69	17	-3	80.3	5.2 _r
	Jun	12	73	15	-3	80.3	5.0
	Jul _r	12	71	17	-5	80.7	5.1
	Aug _p	18	72	10	8	80.5	5.0

Source: CEPD.

III.1 CURRENT ISSUES

1. *Current Economic Issues*

- ⇒ **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** expanded modestly during 1999-2003, averaging 0.4% per year. Although forecasted to increase 6.0% in 2004, faster than the overall economy's 5.9%, domestic demand needs to be sustained to keep the growth momentum.
- ⇒ **Fiscal deficits** have expanded rapidly in the past decade, as it has become more difficult in raising fiscal revenues and contracting expenditures.
- ⇒ **Inadequate infrastructure** has been on the top list of impediments to Taiwan's competitiveness improvement by major competitiveness researchers.
- ⇒ **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 3.5% in July 2004, community financial institutions still saw a level of 11.9%.
- ⇒ **The unemployment** rate has risen from 3.0% in 2000 to around 5% in 2002. Although declining to 4.5% in the first half of 2004, it is still above historical level.

III. POLICY INITIATIVES

1. *Key Policy Initiatives*

⇒ **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 strengthen domestic demand**

The "Taiwan's investment first" 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.

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 state-owned properties to help relieve fiscal burden.

⇒ **Financial reform:** The establishment of financial restructuring fund (RTC) and the passage of Financial Holding Company Law have helped liquidate and consolidate troubled financial institutions. As a result, domestic banks' non-performing loan ratio lowered to 3.5% in July 2004 from 8.3% three years ago, and community financial institutions; lowered to 11.9%.from 17.9%. Moreover, a plan to develop Taiwan as a regional financial services center is being launched to help form a funding center, promote asset management business, develop a variety of new financial products, and to strengthen the health of the financial market.

⇒ **Infrastructural development** A spending around US\$15 billion by the government plus US\$6 billion by private investment for the next five years has been launched to step up development in transportation, high-technology, higher education, cultural creativity, harbors, water resources and sewage management.

⇒ **Measures to increase employment:** An increase of US\$215 million in public services spending is extended to create about 40,000 jobs in public services 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

- Taiwan's economy returned to positive growth in 2002, following its unprecedented contraction in 2001. The recovery was maintained in 2003, except for when an outbreak of SARS caused a temporary dip that pulled the second-quarter growth rate down to minus 0.1%. After the SARS epidemic had been contained, the economy picked up strongly in the second half of the year, thanks to rising optimism about the global economy and the emerging effect of increased government spending.
- ⇒ The economy grew 3.3% in 2003 with consumer prices falling by 0.3%.

2004

- ⇒ Exports are expected to continue posting double-digit growth in the last quarter of 2004, though at a somewhat more subdued pace than in the first three quarters.
- ⇒ The positive wealth effects created by the pepping-up of the stock and real estate markets helped bolster private consumption in the first half of the year. But consumer sentiment is expected to be more conservative through the year's second half under the impact of soaring oil prices, the expectation of interest rate rises, and the weakening of the stock market.
- ⇒ Capacity utilization has seen continued improvement. 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-scale projects as the high-speed railway and the 6th naphtha-cracker plant.
- ⇒ Economic growth is expected to reach 5.9% with a moderate inflation of 2%.

2005

- ⇒ Export trade is expected to cool off from exceptionally rapid growth to more sustainable levels following signs of weaker global expansion.
- ⇒ With domestic economic prospects remaining buoyant and forthcoming fiscal measures, the economy is anticipated to achieve a growth rate around 5% with the CPI increasing less than 2%.

ECONOMIC FORECASTS FOR TAIWAN

		Growth rate %		
		2004	Difference from last projection	2005
World Bank	(Apr 2004)	5.1	+2.1	4.5
IMF	(Sep 2004)	5.6	+0.7	4.1
Global-Insight	(Sep 2004)	5.7	+0.4	4.5
CIER	(Jul 2004)	5.35	+0.68	4.44
TIER	(Jul 2004)	5.67	+0.59	
DGBAS	(Aug 2004)	5.87	+0.46	4.49
Academia Sinica	(Jul 2004)	5.76	-	

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.