

TAIWAN'S ECONOMIC SITUATION AND OUTLOOK

June 2004



Council for Economic Planning and Development

Executive Yuan, Taiwan, R.O.C.

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I. GLOBAL ECONOMY

Latest IMF forecasts (April 2004) :

- ⇒ **World economic growth:** Estimate for 2003 and forecast for 2004 are 3.9% and 4.6%, respectively.
- ⇒ **Trade volume:** Estimate for 2003 and forecast for 2004 are 4.5% and 6.8%, respectively.

	IMF			Global Insight		
	2003	2004	2005	2003	2004	2005
World Economic Growth %	3.9	4.6	4.4	2.7	4.2	3.6
United States	3.1	4.6	3.9	3.1	4.6	3.8
Japan	2.7	3.4	1.9	2.5	4.5	2.3
Euro area	0.4	1.7	2.3	0.5	1.8	2.2
Developing Asia	7.8	7.4	7.0	-	-	-
Asia excluding Japan	-	-	-	6.4	6.8	6.0
Asian NIEs	3.0	5.3	5.0	-	-	-
World Trade Volume Growth %	4.5	6.8	6.6	5.2	7.9	6.7

Sources: International Monetary Fund, *World Economic Outlook 2004*, April 2004.
Global Insight, Inc., July 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 3.2% in 2003. The economy is preliminarily estimated to have grown 6.3% in the first quarter 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	3.2	0.9	0.5	0.1	-0.3	-0.1	-0.1	-0.1	0.6	2.4	5.9	3.5
2004(f)	5.4	4.8	1.8	0.1	2.4	2.6	-0.2	0.00	0.6	0.6	7.9	7.3
Q1(p)	6.3	5.1	2.0	0.2	2.1	2.2	-0.2	0.0	0.9	1.2	10.5	9.3
Q2(f)	6.8	5.3	2.5	0.10	3.0	3.1	-0.2	0.0	-0.3	1.4	12.3	10.8
Q3(f)	4.6	4.7	1.4	0.02	2.4	2.6	-0.2	0.0	0.9	-0.1	7.5	7.6
Q4(f)	4.2	4.3	1.3	0.00	2.2	2.4	-0.3	0.0	0.9	-0.1	2.1	2.3

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

Source: Directorate-General of Budget, Accounting, and Statistics, 185th Commission on National Income Statistics Meeting, May 14, 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 improve in the first half of 2004.
- ⇒ In 2003, trade surplus amounted to US\$16.9 billion, the third highest historical level. It registered US\$3.9 billion in January-June 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-June	164.0	30.3	84.0	25.7	80.1	35.6	3.9

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, have expanded the fastest since 2002.
- ⇒ Exports to and imports from the United States returned to positive growth in the first half 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-June	7.5	10.0	22.1	39.6	37.9	40.0	38.3	35.5	53.5	16.5

*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 half of 2004.
- ⇒ The share of imports of capital goods decreased to 20.5% in 2003 and remained at the same level in January-June 2004.

Composition of Foreign Trade

	Composition (%)						Change (yoy % in US\$)	
	1996	2000	2001	2002	2003	2004 Jan-Jun	2003	2004 Jan-Jun
Exports	100	100	100	100	100	100	10.4	25.7
Agricultural Products	0.4	0.2	0.2	0.3	0.3	0.2	8.4	-5.2
Processed Agricultural Products	3.1	1.2	1.4	1.3	1.2	1.1	4.1	12.6
Industrial Products	96.5	98.6	98.4	98.4	98.5	98.6	10.5	25.9
Heavy & Technology-intensive Industry*	60.5	71.4	71.1	73.1	75.3	76.9	13.8	30.6
Others	36.0	27.2	27.3	25.3	23.2	21.8	1.0	11.8
Imports	100	100	100	100	100	100	13.1	35.6
Capital Goods	17.9	28.0	25.0	23.0	20.5	20.5	0.4	44.3
Raw Materials	69.0	64.1	65.7	67.7	70.8	71.1	18.3	35.0
Consumer Goods	13.1	7.8	9.2	9.3	8.7	8.3	6.4	21.8

* 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 Finance, *Monthly Statistics of Exports and Imports*, July 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 private investment, total investment is estimated to have expanded 15.9% 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	1744.7	-1.6	1128.7	-0.7	221.7	-5.5	394.3	-1.8
2004(f)	1985.3	13.8	1387.5	22.9	203.1	-8.4	394.7	0.1
Q1(p)	413.5	13.8	303.8	21.7	30.6	-12.1	79.1	0.2
Q2(f)	468.3	17.9	327.6	29.1	44.1	-7.2	96.7	0.9
Q3(f)	494.6	14.3	346.2	23.8	46.6	-8.6	101.7	-0.2
Q4(f)	608.9	10.4	409.9	18.6	81.8	-7.5	117.3	-0.4

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

Source: DGBAS, 185th Commission on National Income Statistics Meeting, May 14, 2004.

II.4 DOMESTIC ECONOMY

4. Production

Industrial production continued to grow, at a pace of 7.1%, in 2003. It increased 14.6% in January-June 2004, as manufacturing industry expanded 15.8%.

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-Jun	14.6	-9.5	15.8	5.9	-1.0

*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 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-June 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-Jun						
Average	10,188	58.5	457	4.48	9,076	2.9

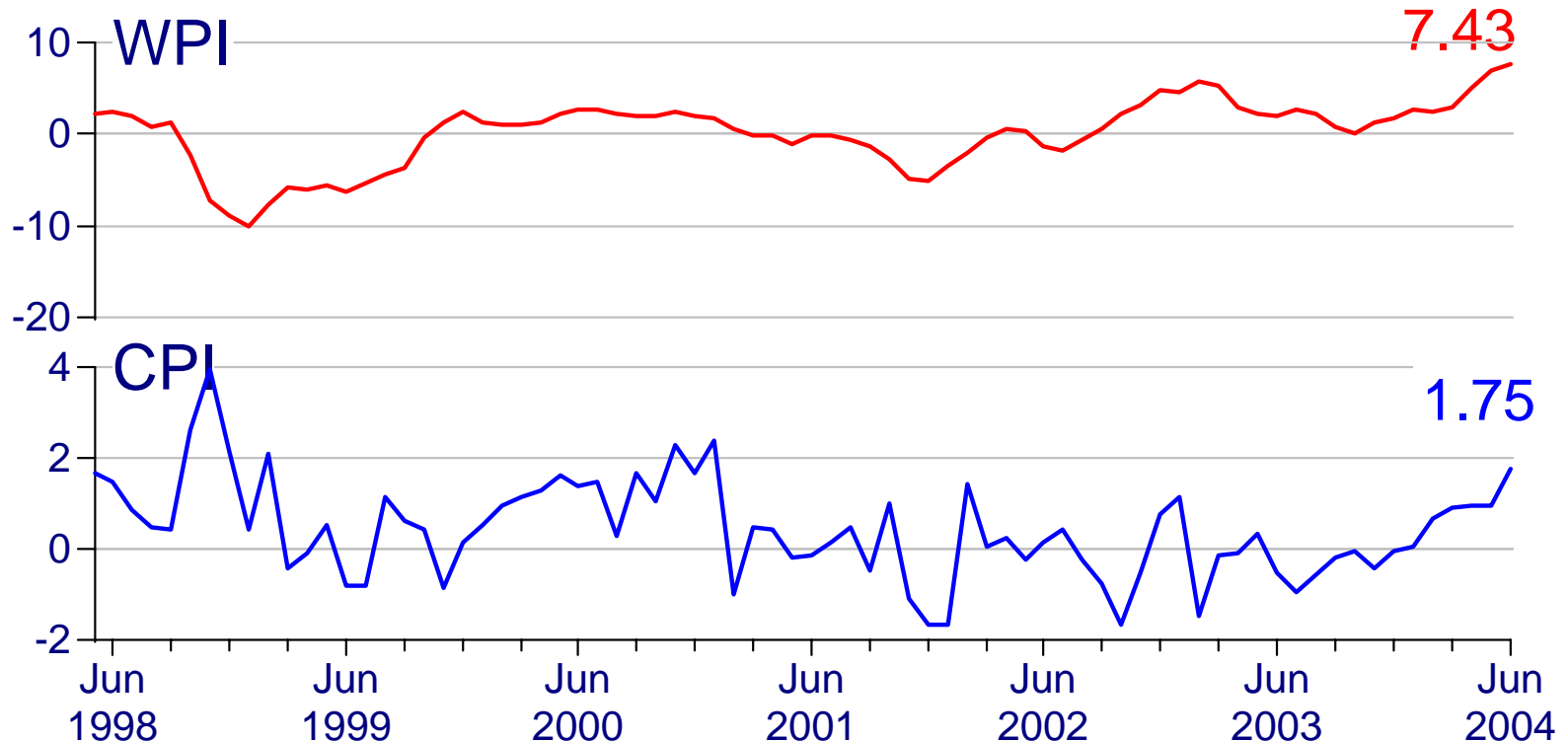
Source: Directorate General of Budget, Accounting, and Statistics.

II.6 DOMESTIC ECONOMY

6. PRICES

Wholesale prices increased 2.5% and consumer prices decreased 0.3% in 2003. In June 2004, wholesale prices and consumer prices rose 7.4% and 1.8%, respectively, from a year earlier.

Price Change (% change over a year)



Source: CEIC.

II.7 DOMESTIC ECONOMY

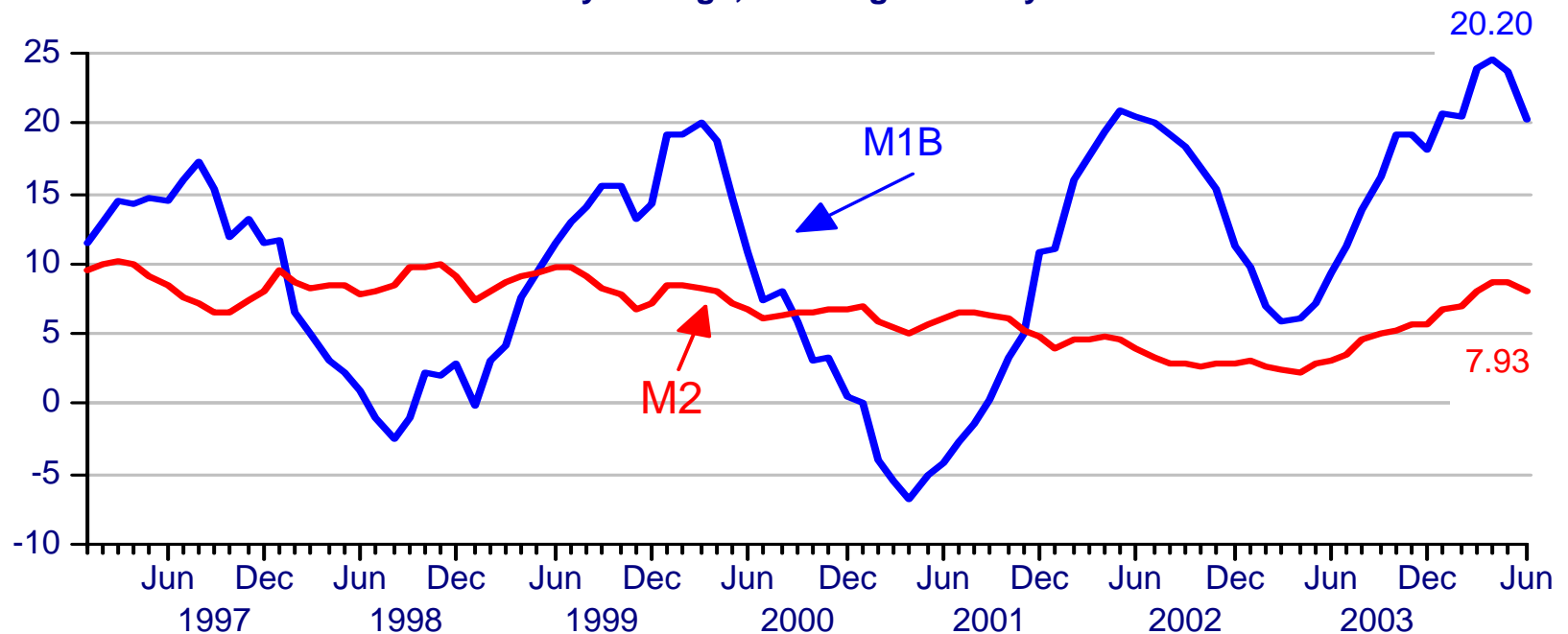
7. Money & Finance

(1) Money Supply

The annual growth rate of M1B and M2 recorded 11.8% and 3.8%, respectively, in 2003. In June 2004, M1B grew 20.2% while M2 expanded 7.9%.

Money Supply

Daily average, % change over a year



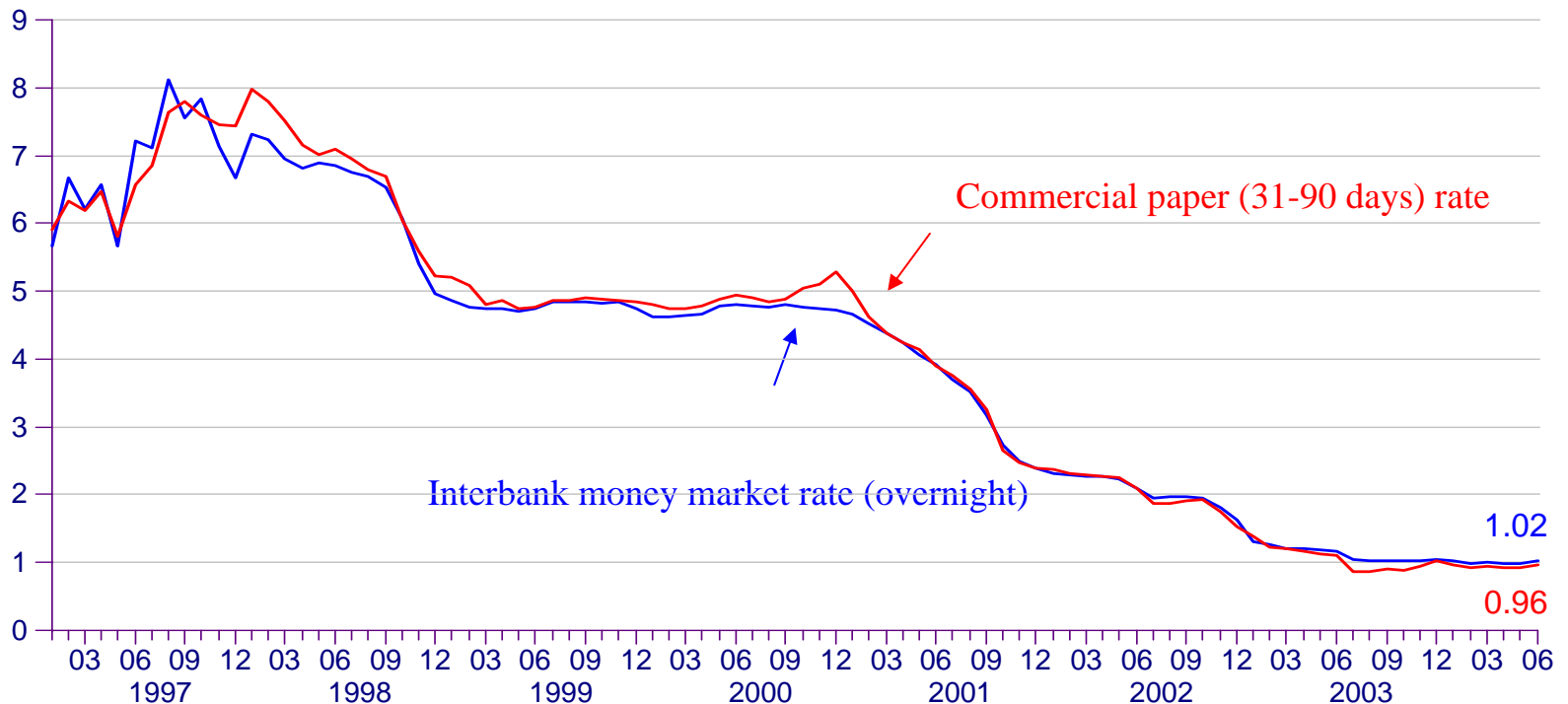
Source: CEIC.

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 leveled off since the last quarter of 2003. In June 2004, both commercial paper rate and interbank rate posted around 1.0%.

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							
		6	7	8	9	10	11	12	1	2	3	4	5	6	
Total Scores															
		20	24	26	29	31	30	34	35	34	36	37	39	36	
Financial Sector	Monetary Aggregates M1B, yoy%														20.2
	Direct and Indirect Finance, yoy%														9.8 _p
	Bank Clearings and Remittance, yoy %														7.9
	Stock Price Index, 1966=100, yoy%														
Real Sector	Manufacturing New Order Index, 1996\$, 1976.1=100, yoy %														7.6 _p
	Exports, 2001\$, yoy %														23.0 _p
	Industrial Production Index, 1996=100, yoy%														14.8 _p
	Manufacturing Inventory-to-Sales ratio, %														50.7 _p
	Nonagricultural Employment, yoy%														3.4

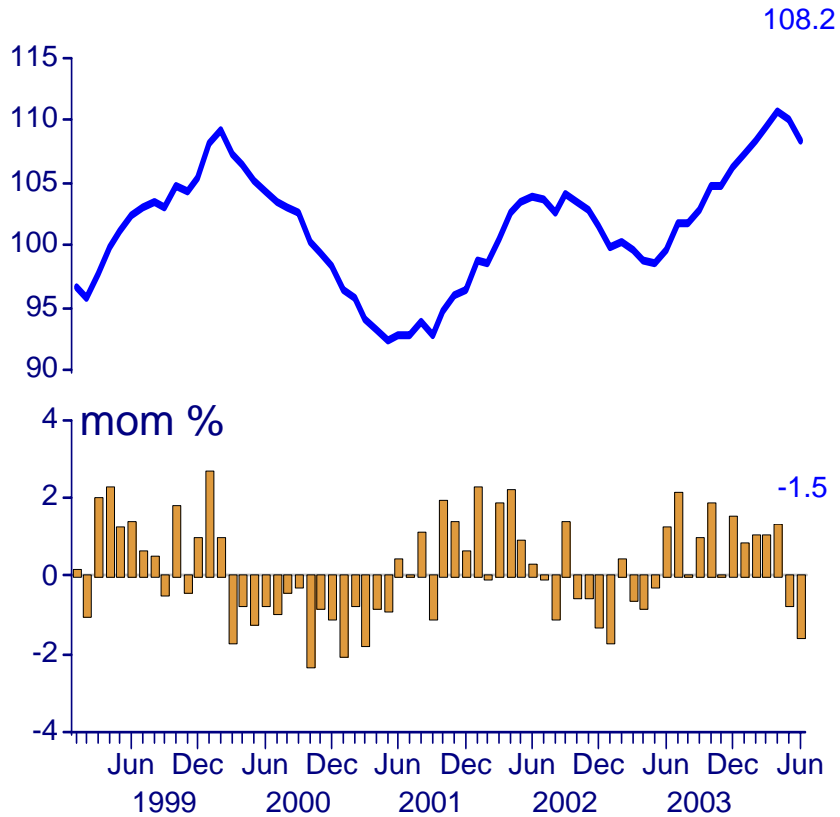
Overheating
 Transition in need of watching
 Steadily moving forward
 Transition in need of watching
 Recession

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

II.8 DOMESTIC ECONOMY

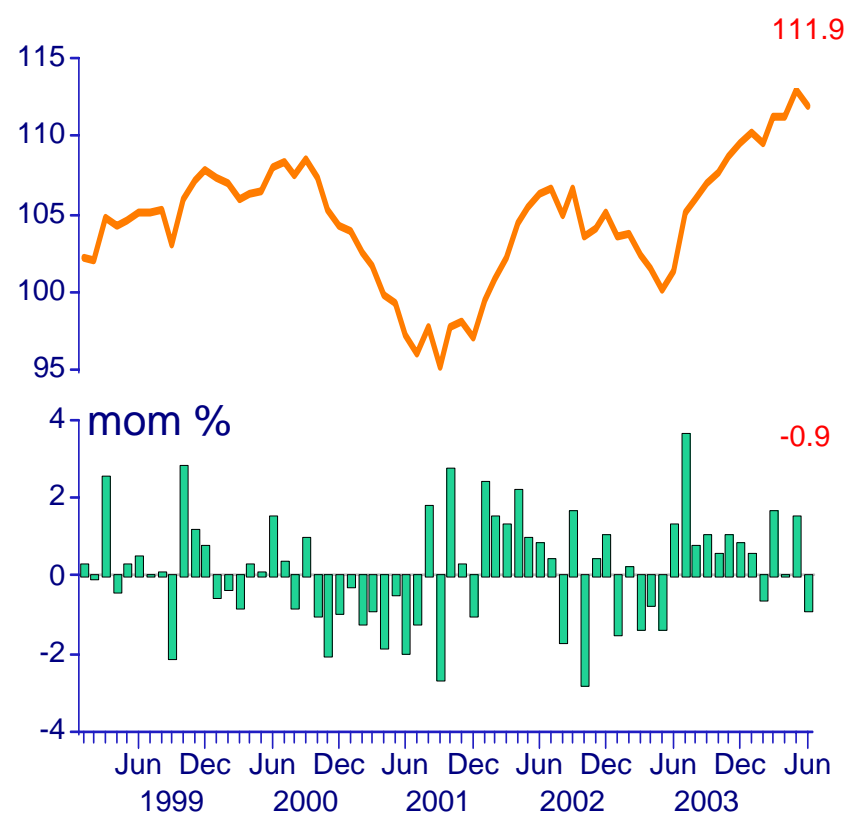
Composite Leading Index

1996=100



Composite Coincident Index

1996=100



Source: CEPD.

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 pessimists slightly surpassed the optimists in June 2004.

		Business Expectation 3 months later				Capacity Utilization (%)	Profit (%)
		% of manufacturing firms surveyed					
		Better (1)	Unchanged	Worse (2)	Net (1)-(2)		
2003	June	17	75	8	9	77.5	4.5
	July	17	70	13	4	79.2	4.9
	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	5.0
	Mar	19	70	11	8	80.9	5.2
	Apr	13	74	13	0	80.5	5.1
	Mar _r	14	69	17	-3	80.3	5.1
	Jun _p	13	72	15	-2	80.3	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 (0.6%) in 2003, and is targeted to grow 5.2% in 2004.
- ⇒ **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 4.4% in March 2004, community financial institutions still saw a level above 13%.
- ⇒ **The unemployment** rate has risen from 3.0% in 2000 to around 5% in 2002. Although declining to below 4.5% in the first quarter 2004, it is still above historical level.

III.2 POLICY INITIATIVES

2. *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 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.

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 4.4% in March 2004 from 8.3% three years ago, and community financial institutions; lowered to 13.1%.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 companies, develop a variety of 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 five years from 2004 will be launched to step up development in transportation, high-technology, higher education, cultural creativity, harbors, water resource 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

- ⇒ 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 targeted to be 5.0% with very moderate inflation of 0.7%.

ECONOMIC FORECASTS FOR TAIWAN

		Growth rate %		
		2004	Difference from last projection	2005
World Bank	(Apr 2004)	5.1	+2.1	4.5
IMF	(Apr 2004)	4.9	+0.8	4.9
Global-Insight (formerly DRI-WEFA)	(Jul 2004)	5.3	-	4.6
CIER	(Jul 2004)	5.35	+0.68	4.44
TIER	(Jul 2004)	5.67	+0.59	
DGBAS	(May 2004)	5.41	+0.67	
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.