

TAIWAN'S ECONOMIC SITUATION AND OUTLOOK



Council for Economic Planning and Development

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I. CURRENT DOMESTIC SITUATION

Economic Growth

In the second quarter of 2006, exports of goods and services increased 12.4%, rising faster than expected and helping boost manufacturing growth to 8.7%. Despite improving performance in employment and the stock market, private consumption was held back by rising oil price and deteriorating consumer credit, growing 1.4%. Investment in construction rose 9.0%, thanks to a recovery in the real estate market. Nonetheless, total private investment fell by 2.8% following the completion of purchases of heavy transport and capital equipment. The economy grew 4.9% and 4.6% in the first and second quarters of 2006, respectively, leading to a 4.7% growth for the first half of the year.

Contribution to Economic Growth (in percentage points)

	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				
2000	5.8	3.8	2.8	0.1	2.1	2.4	-0.1	-0.2	-1.2	2.0	8.5	6.5
2001	-2.2	-4.6	0.4	0.1	-4.7	-4.4	0.03	-0.3	-0.4	2.5	-4.2	-6.7
2002	4.3	1.6	1.5	0.3	-0.1	0.5	-0.03	-0.6	-0.01	2.6	5.1	2.5
2003	3.4	0.7	0.6	0.1	-0.2	-0.03	-0.1	-0.04	0.3	2.7	5.7	3.0
2004	6.1	6.3	2.3	-0.1	3.1	3.7	-0.4	-0.2	1.0	-0.2	8.2	8.5
2005	4.0	1.5	1.6	0.1	0.2	-0.03	0.3	0.0	-0.4	2.5	4.6	2.1
Q3	4.2	3.3	2.2	0.1	0.4	0.1	0.2	0.1	0.6	1.0	4.3	3.3
Q4	6.4	-2.6	1.1	0.2	-2.5	-2.8	0.2	0.1	-1.4	9.0	10.0	1.0
2006	4.3	1.1	1.0	-0.02	-0.1	0.1	-0.1	-0.1	0.2	3.2	5.9	2.7
Q1r	4.9	1.2	1.3	-0.01	-0.8	-0.7	-0.1	-0.1	0.8	3.7	8.2	4.5
Q2p	4.6	-0.8	0.8	-0.2	-0.9	-0.4	-0.3	-0.1	0.6	5.4	8.2	2.8

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

Source: Directorate-General of Budget, Accounting, and Statistics (DGBAS), 194th Commission on National Income Statistics Meeting, August 17, 2006.

CURRENT DOMESTIC SITUATION

Foreign Trade

- ⇒ Exports and imports expanded by 14.9% and 11.4%, respectively, in the first nine months of 2006.
- ⇒ Trade surplus registered US\$13.6 billion in January-September 2006, up US\$5.9 billion from the same period last year.

Foreign Trade

US\$ billion; yoy %

	Trade		Exports		Imports		Balance
	Value	Growth	Value	Growth	Value	Growth	
1999	234.9	7.9	123.7	9.9	111.2	5.7	10.9
2000	292.7	24.6	151.9	22.8	140.7	26.6	8.3
2001	234.3	-20.0	126.3	-16.9	108.0	-23.3	15.6
2002	248.6	6.1	135.3	7.1	113.2	4.9	22.1
2003	278.6	12.1	150.6	11.3	128.0	13.0	22.6
2004	351.1	26.0	182.4	21.1	168.8	31.8	13.6
2005	381.1	8.5	198.4	8.8	182.6	8.2	15.8
2006 Jan-Sep	316.5	13.2	165.0	14.9	151.4	11.4	13.6

Note: Trade data are adjusted according to the United Nations IMTS Compilers Manual (2004). Total exports include “exports” and “re-exports,” and total imports include “imports” and “reimports.”

Source: Ministry of Finance.

CURRENT DOMESTIC SITUATION

Major trading partners

- ⇒ Imports from and exports to Hong Kong and Mainland China have expanded the fastest during most of the last five years. Exports to ASEAN economies have gained momentum in the past two years.
- ⇒ Trade shares of the United States, Europe and Japan have narrowed in contrast to increasing shares of Hong Kong and China and ASEAN.

Changes in Two-way Trade with Major Trading Partners

	Exports					Imports					Yoy %
	USA	Japan	Europe	Hong Kong and Mainland China	ASEAN 6*	USA	Japan	Europe	Hong Kong and Mainland China	ASEAN 6*	
2000	13.6	40.2	16.9	26.2	28.8	27.5	26.1	8.3	27.3	39.8	
2001	-20.9	-22.9	-16.3	-9.5	-19.1	-27.2	-32.9	-21.2	-7.4	-20.9	
Share	22.3	10.3	15.8	26.6	11.9	17.0	24.0	14.0	7.4	14.9	
2002	-2.7	-5.0	-5.9	29.4	7.4	-0.8	5.5	-2.2	24.2	3.7	
2003	-3.0	0.5	10.4	23.6	10.5	-6.9	19.6	10.7	30.9	5.2	
2004	8.3	11.1	14.7	28.8	33.0	28.2	33.6	31.1	47.7	16.2	
2005	1.3	9.4	-0.7	12.2	13.8	-2.8	5.3	2.4	16.2	3.8	
2006 Jan-Sep	14.0	8.9	8.4	17.3	18.0	3.3	-0.5	-2.4	20.0	15.3	
Share	14.8	7.3	11.2	39.6	13.9	11.0	22.9	10.6	12.8	11.7	

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

Source: Ministry of Finance.

CURRENT DOMESTIC SITUATION

Domestic Investment

Private investment fell 3.8% in the first half of 2006 as a number of large construction engineering projects and the imports of airplane approached to end. It is expected to returned to a positive growth of 5.0% in the second half of 2006, with the anticipated expansion in semiconductor production capacity, leading to a growth of 0.5% for the entire year.

Gross Fixed Capital Formation: Real Growth and Current-price Value

NT\$ billion; yoy %

	Total		Private investment		Public enterprises investment		Government investment	
	Amount	Growth rate	Amount	Growth rate	Amount	Growth rate	Amount	Growth rate
2000	2394.0	9.0	1670.4	15.6	233.9	-3.0	489.7	-4.1
2001	1910.0	-19.9	1218.6	-26.8	234.6	1.4	456.8	-6.4
2002	1878.7	-0.6	1252.2	4.1	226.8	-1.3	399.7	-12.8
2003	1874.9	-0.9	1253.1	-0.3	219.2	-4.1	402.6	-1.1
2004	2279.6	17.5	1686.2	31.0	181.6	-18.2	411.8	-5.7
2005	2282.2	1.2	1660.0	-0.2	204.8	16.3	417.3	-0.1
Q3 _r	554.2	1.8	402.3	0.4	47.5	13.1	104.4	2.9
Q4 _r	602.7	-10.9	401.4	-16.7	73.2	9.0	128.2	1.6
2006 Q1	514.3	-4.8	395.2	-5.0	34.0	-4.4	85.0	-3.7
Q2 _p	581.3	-4.2	445.2	-2.8	39.9	-17.4	96.2	-4.2

Note: All national account data are revised according to System of National Accounts 1993 (1993 SNA).

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

Source: DGBAS, 194th Commission on National Income Statistics Meeting, August 17, 2006.

CURRENT DOMESTIC SITUATION

Production

Industrial production displayed slower growth at 4.7% in the third quarter of 2006, from an average rate of 7.7% during the first two quarters. It grew 6.6% in the first three quarters, with manufacturing and construction industries increasing 6.7% and 12.0%, respectively.

Growth of Industrial Production %

	Total	Mining	Manufacturing	Electricity, gas, and water	Construction
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
2004	9.9	-4.4	10.6	3.0	4.9
2005	3.4	-9.9	3.2	3.8	11.4
2006 Jan-Sep	6.6	-5.3	6.7	3.2	12.0

Source: Ministry of Economic Affairs.

CURRENT DOMESTIC SITUATION

Employment

Nonagricultural employment growth decelerated in 2005 and slightly further in the first nine months of 2006. The unemployment rate continued to display a declining trend, dropping to 3.92% in January-September 2006.

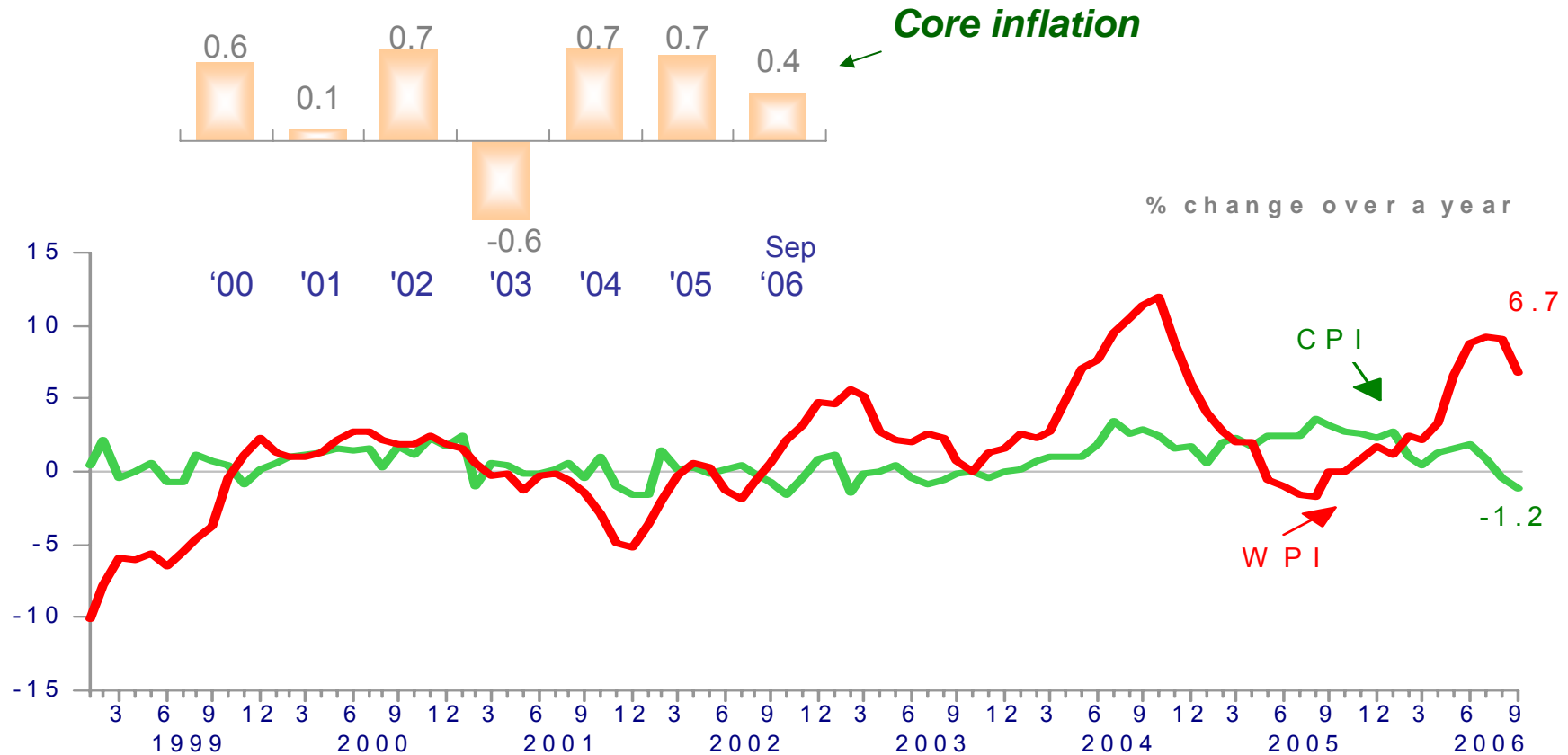
	Labor Force		Unemployment		Nonagricultural employment	
	1,000 persons	Participation %	1,000 persons	Rate %	1,000 persons	yoy, %
2001	9,832	57.2	450	4.57	8,677	-0.9
2002	9,969	57.3	515	5.17	8,745	0.8
2003	10,076	57.3	503	4.99	8,877	1.5
2004	10,240	57.7	454	4.44	9,144	3.0
2005	10,371	57.8	428	4.13	9,351	2.3
2006						
Jan-Sep	10,491	57.9	412	3.92	9,523	2.2

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

CURRENT DOMESTIC SITUATION

Prices

Thanks to higher prices of energy, chemical, mineral and basic metal products, wholesale prices in September 2006 increased 6.7% from a year ago. Consumer prices fell 1.2%, with decreases in vegetables, fruits and mobile phone rate offsetting rises in oil, gas and tobaccos. Core prices (excluding fresh food and energy prices) rose 0.4%.

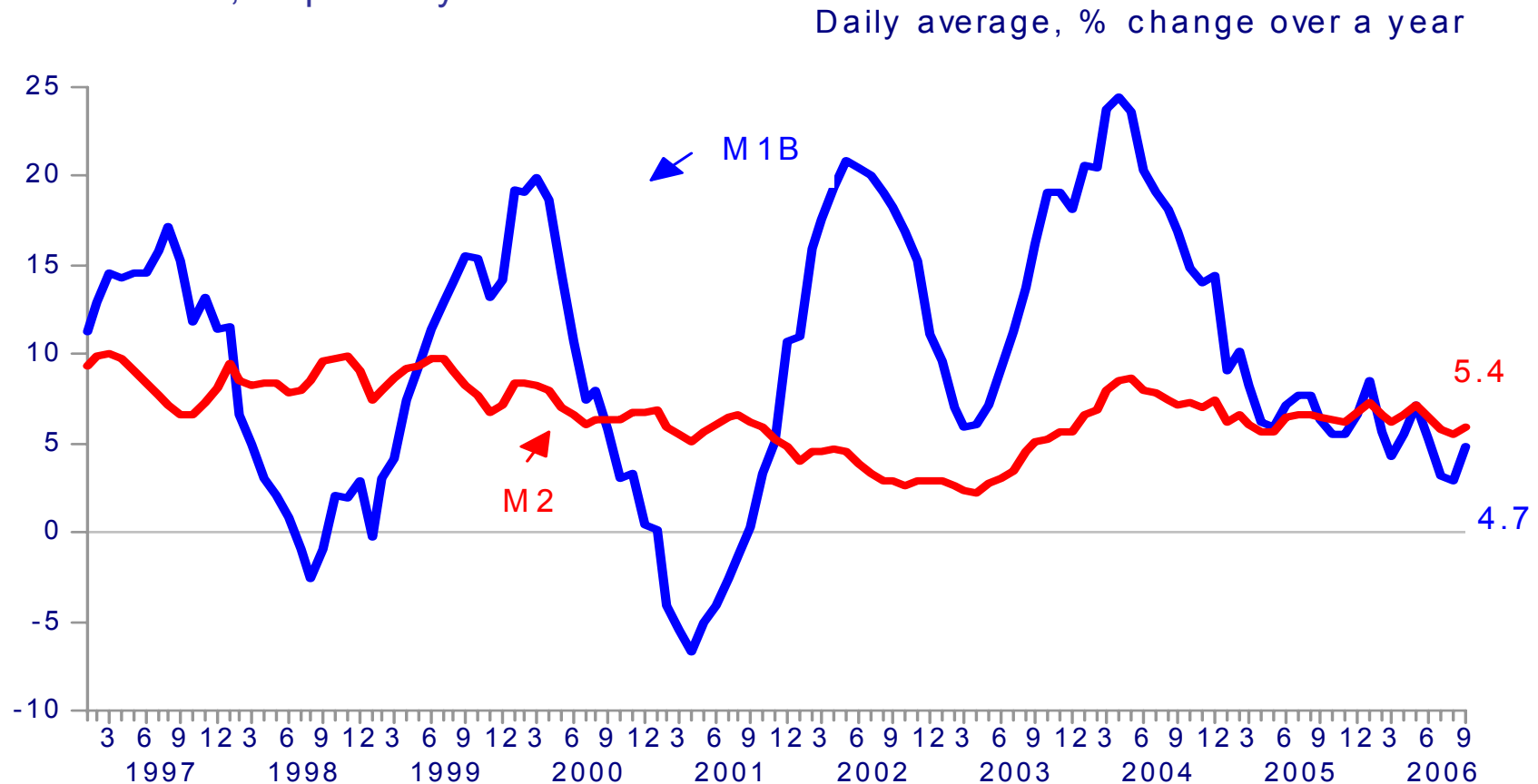


Source: Directorate General of Budget, Accounting, and Statistics.

CURRENT DOMESTIC SITUATION

Money Supply

In September 2006, M1B and M2 growth from the previous year recorded 4.7% and 5.4%, respectively. For the first nine months in 2006, M1B and M2 expanded 5.2% and 6.3%, respectively.

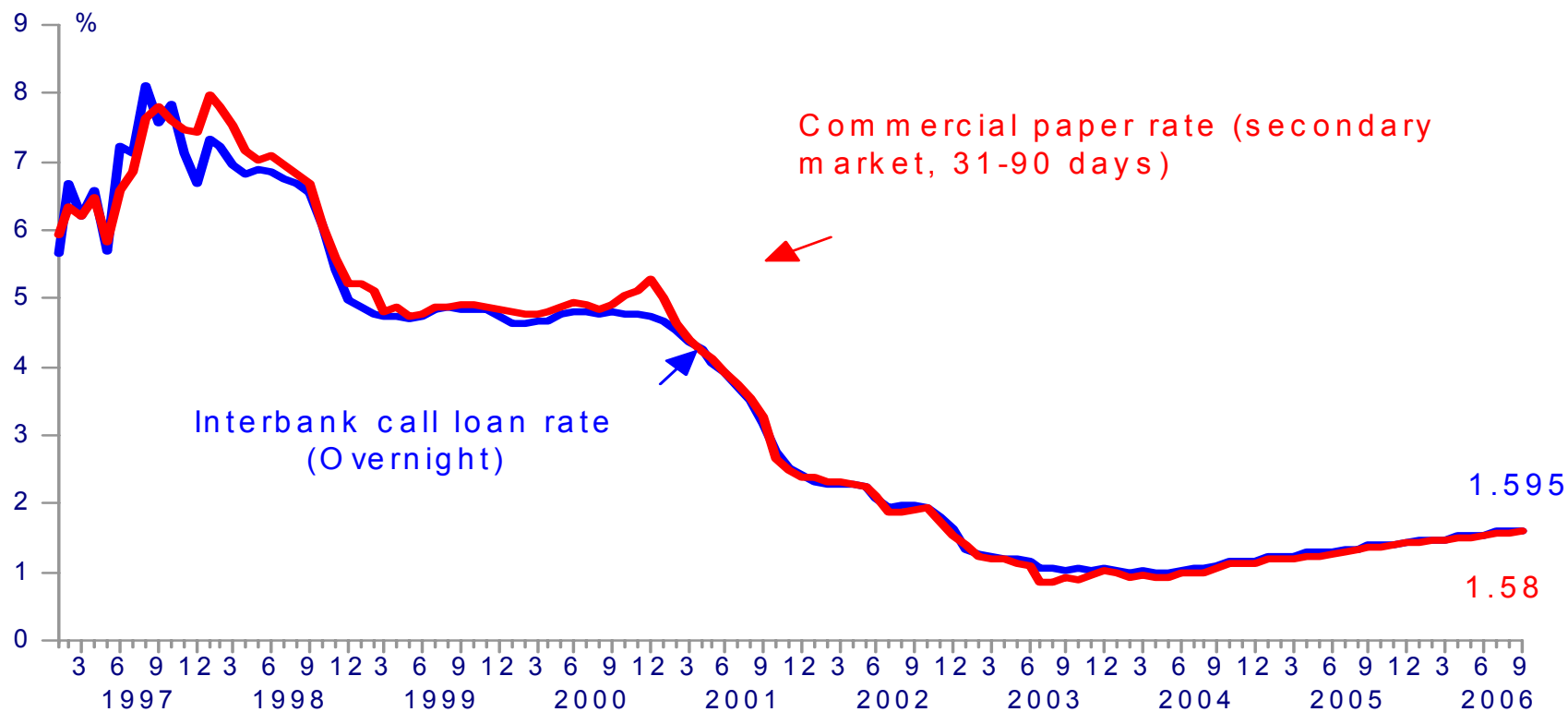


Source: Central Bank of China (Taiwan).

CURRENT DOMESTIC SITUATION

Short-term Interest Rates

Market interest rates have seen a slightly upward trend since the second half of 2004, but are still considered below their normal levels. In September 2006, commercial paper rate and interbank rate recorded 1.58% and 1.595%, respectively. The Central Bank has raised the rediscount rate eight times since October 2004 from 1.625% to 2.625%.



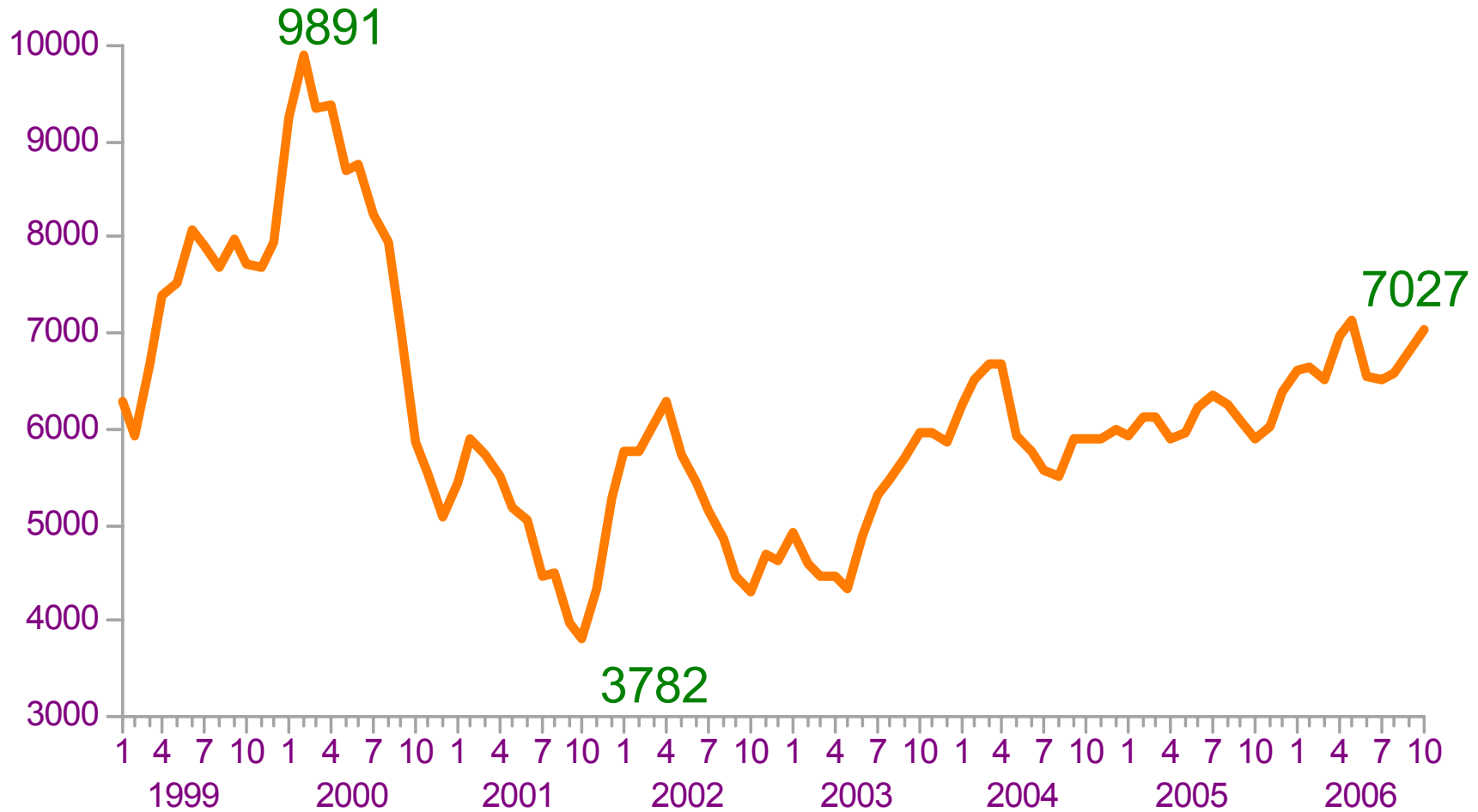
Source: Central Bank of China (Taiwan).

Current Domestic Situation

Stock Price

Taiwan Stock Exchange Index

Capitalization weighted, monthly average, 1966 Avg=100



Source: Taiwan Stock Exchange.

CURRENT DOMESTIC SITUATION

Monitoring Indicators

In September, the monitoring indicators signaled "green" to end a three-month run on "yellow-blue," an improvement that suggests a return of vitality in the economy. However, a slackening performance in industrial production makes it hard to assess the sustainability of the resurgence.

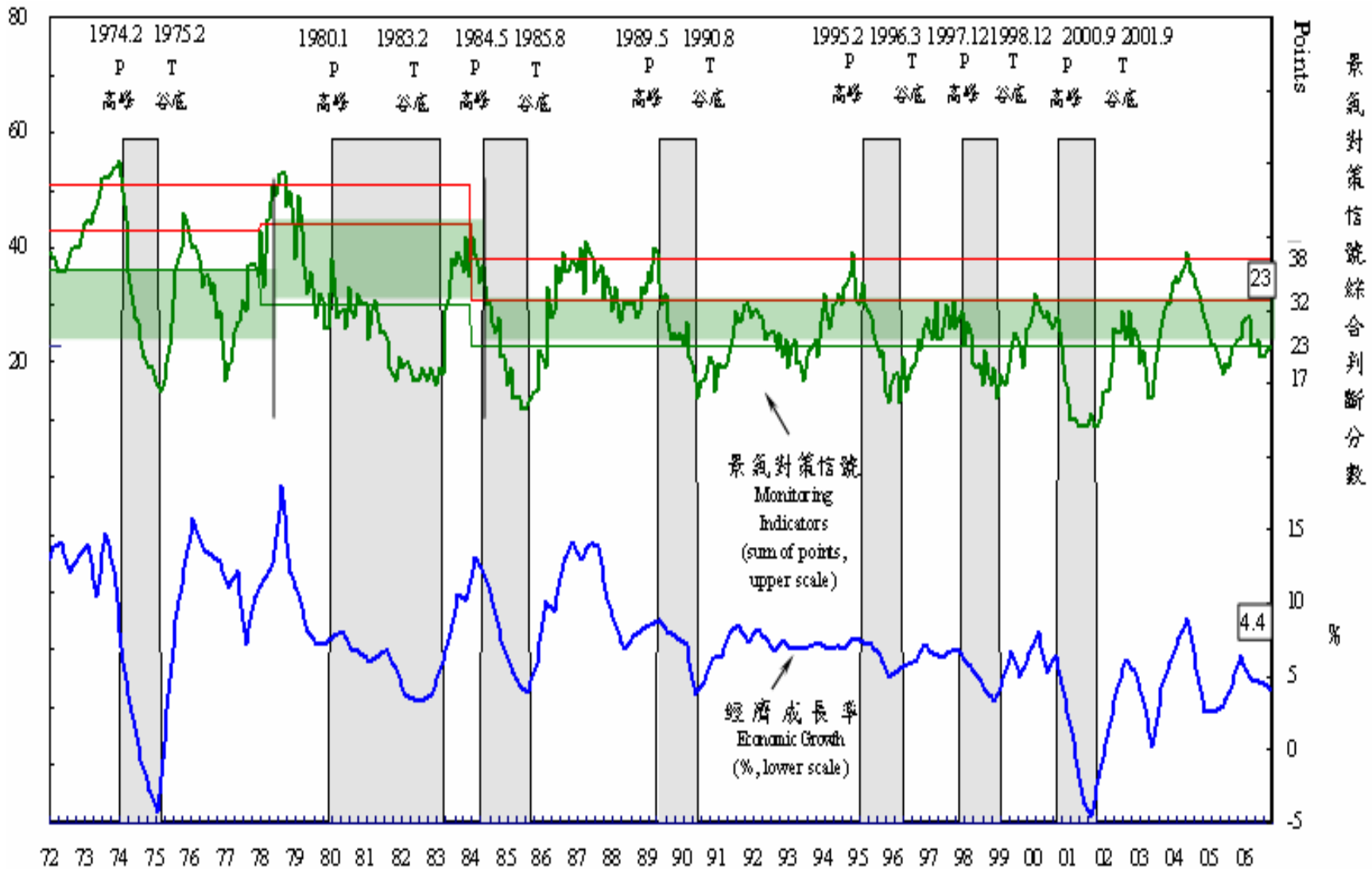
		2005				2006									
		9	10	11	12	1	2	3	4	5	6	7	8	9	
Total Scores															
		23	24	24	27	28	28	23	23	24	21	21	22	23	
Financial Sector	Monetary Aggregates M1B, yoy%														4.6
	Direct and Indirect Finance, yoy%														3.8
	Bank Clearings and Remittance, yoy%														0.8
	Stock Price Index, 1966=100, yoy%														11.8
Real Sector	Manufacturing New Order Index, 1996\$, 1976.1=100, yoy %														-4.6 _p
	Exports, 2001\$, yoy%														17.2
	Industrial Production Index, 2001=100, yoy %														2.7
	Manufacturing Inventory-to-Sales ratio, %														65.5
	Nonagricultural Employment, yoy%														2.5

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

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

Source: Council for Economic Planning and Development.

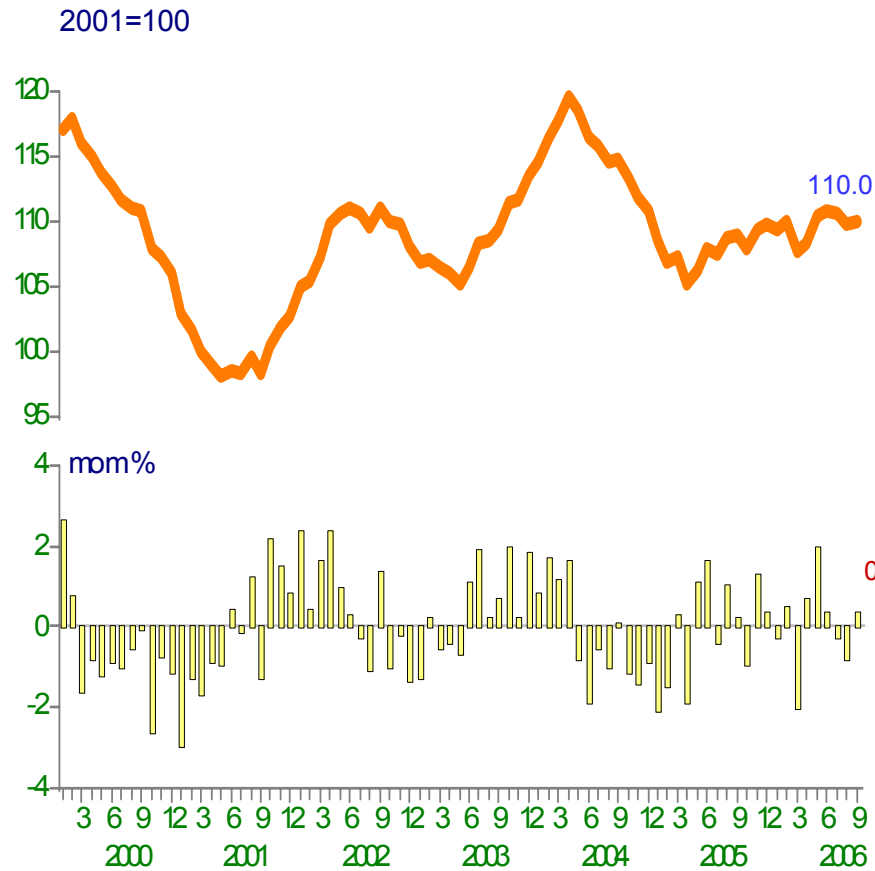
Monitoring Indicators and Economic Growth



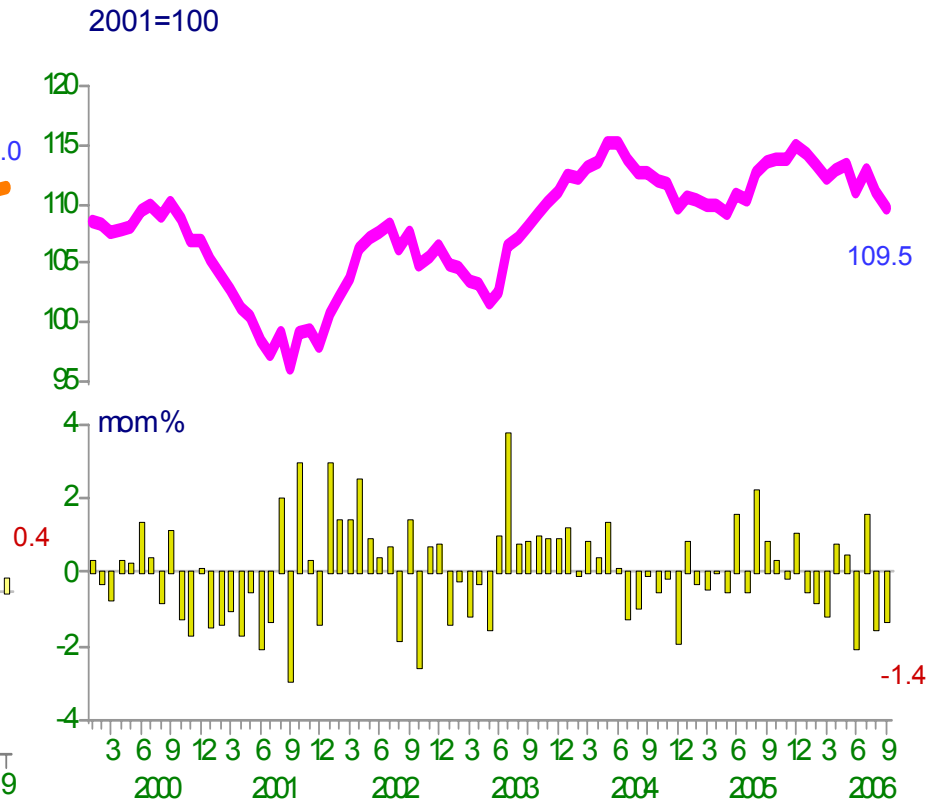
Source: Council for Economic Planning and Development.

CURRENT DOMESTIC SITUATION

Composite Leading Index



Composite Coincident Index



Source: CEPD.

II. POLICY INITIATIVES

Mid-range Economic Development Plan (2005-2008)

- 1) Expand investment in infrastructure to improve living environment.
- 2) Develop industrial clusters such as Hsinchu biology park, science parks in central and southern Taiwan.
- 3) Promote such major industries as semiconductor, image display, digital content, and biotech, while keeping up the development of communications, petrochemical, machinery and equipment, and iron and steel.
- 4) Step up value-adding efforts for such traditional industries as high-tech textile, health food, high-end materials, chemicals for optic electronics.
- 5) Carry out the guidelines and action programs for service sector development.
- 6) Develop free port zones and encourage businesses to set up operations headquarters in Taiwan.
- 7) Build up a regional financial services center that will help increase the share of financial services in GDP from 11.5% in 2003 to 13% in 2008, expand assets of financial institutions by more than 30%.

POLICY INITIATIVES

Conference on Sustaining Taiwan's Economic Development (COSTED)

- The conference and relevant meetings were held between May and July, with a view to bringing together diverse views concerning the economy's controversial, longer-term, structural issues.
- The Conference reached a total of 516 consensus policy recommendations for stepping up social security, business competitiveness, fiscal and financial reform, global positioning and cross-strait relations, and government efficiency.
- The implementation of these policy recommendations require passage of 17 new laws and revision of 37 existing laws. Amendments to existing laws will be submitted to the legislature for review by December 2006; and new laws, by June 2007. For policy recommendations within the scope of the executive responsibility and authority, the ministries concerned will submit specific implementation plans or programs within by September 15.
- The CEPD expects that by implementing these policy recommendations, the Taiwan economy will continue to grow at a rate near 5% per year until 2015, with the unemployment rate kept below 4% and per capita GDP reaching over US\$30,000 by 2015. Moreover, it is hoped that the new prosperity will be shared by all citizens and will not be at the expense of environment.

POLICY INITIATIVES

⇒ *Social security*

Closing Income Gap

- Increase educational and job opportunities for the poor and in the rural area

Population Aging

- National pension system by 2007
- Establish long-term care for the elderly
- Extend the mandatory retirement age to 65

Low Birth Rate

- Paid maternity leave
- Subsidy for child care

National Health Insurance

- Financial soundness
- Close the black hole in drug pricing
- Pricing of new drug to award IPR

POLICY INITIATIVES

⇒ *Enhancing business competitiveness*

- Place equal emphasis on manufacturing and service sectors as engines for economic growth
- Increase effort to recruit talent from overseas
- Establish a mechanism to control greenhouse gas emissions
- Enact an “energy tax law” (to gradually increase the tax on gasoline)
- Provide incentive for developing renewable energy and energy saving industries
- Liberalize the prices of gasoline, fuel, electricity and water.

POLICY INITIATIVES

⇒ *Fiscal reform*

- Balanced budget by 2011.
- Closing tax loopholes for teachers and military personnel.
- Improving the management of state-owned properties and enterprises to help increase government revenues.
- Implementing the alternative minimum tax to achieve equality of taxation while tending industrial development.
- Possible revenue source: increase in the energy tax.
- Continue to encourage private participation in public construction projects to reduce budget deficit.

Unit: %

	Tax Burden	<u>Outstanding Debt as a Percent of GDP</u>	
		Government	
		Central	All levels
Japan	15.6 (03)	154.7 (04)	-
UK	29.0 (03)	48.8 (00)	51.7 (04)
USA	18.8 (03)	38.0 (04)	54.5 (03)
Germany	21.1 (03)	-	67.7 (04)
Singapore	14.5 (05)	108.9 (04)	-
Taiwan	14.1 (05)	31.9 (05)	36.9 (05)

POLICY INITIATIVES

⇒ *Financial reform*

- Internationalize Taiwan's financial market, and develop Taiwan as a regional fund raising and asset management center
- Strengthen financial supervision and corporate governance
- Establish a fair and open environment conducive to financial consolidation
- Promote non-banking financial institutions to enhance the overall competitiveness of the financial sector
- Enact the "financial company law."

POLICY INITIATIVES

⇒ *Global positioning and cross-strait economic and trade relations*

- Seek free trade agreements and bilateral tax agreements with strategic trade partners
- Strengthen international trade negotiation mechanisms.
- Providing assistance to Taiwanese businesses to deploy globally while avoiding over dependence on a single market
- Review the possibility of easing restrictions on setting bank branches in China
- Establish a sound mechanism for cross-strait financial supervision on which basis to gradually promote cross-strait financial interactions
- Push for direct flights
- Lift the ban on Chinese tourists traveling *directly* from China

POLICY INITIATIVES

⇒ *Global positioning and cross-strait economic and trade relations (continued from previous page)*

- Consensus has not been reached on the issue regarding a “review of the 40% ceiling on business investment in China for possible adjustment.” However, the government will carefully study this item and continue dialogue with different interest groups.
- Negotiations on chartered flights are already underway. To work out complicated details is time-consuming. Hopefully satisfactory results will be achieved by the end of the year.
- Facilitate mobility of personnel. (Some more than 300 Chinese staff members of Microsoft were already allowed to attend the company’s staff meeting in August.)

POLICY INITIATIVES

⇒ *Promoting government efficiency*

- Fight corruption by establishing a code of ethics and increase administrative efficiency and launching action plans to fight against corruption
- Strengthen local government organizations and promote the effectiveness and efficiency of policy implementation.
- Strengthening the cooperation between central and local governments in attracting private investment
- Strengthen the mechanism for evaluating the environmental impact of public and private development projects
- Create a financial and economic institutional environment conducive to improvement of businesses competitiveness:
Reform tax laws to meet international norms
- Impose fiscal discipline norm to ensure fiscal stability.

III. PROSPECTS

2006

- ⇒ In 2006, two-way trade could expand slightly faster than 2005, while private consumption would increase marginally with tightening consumer credit offsetting the boost by improving job market. Private investment is estimated to see a moderate rate of growth. Overall growth is forecasted to be around 4% by major domestic research institutions.

2007

- ⇒ Growth in 2007 could reach 4%. With the global economy cooling somewhat, the expansion of foreign demand would return to historical path. More stable growth in private consumption is foreseen, given continuing improvements in job and consumer credit markets. Process upgrading in semiconductor production and new acquisitions of airplanes should help boost private investment. Spending by the public sector, however, would see limited growth. Inflationary pressure is likely to ease, with wholesale prices and consumer prices increasing 3.3% and 1.9%, respectively.

FORECASTS FOR ECONOMIC GROWTH

Forecasting institution	Release time	2005	2006	Difference from last projection	2007
		%	%		%
World Bank	Mar 2006	4.1	4.1	0.0	4.1
IMF	Sep 2006	4.1	4.0	-0.5	4.2
Global-Insight	Oct 2006	4.0	3.8	0.0	3.6
CIER	Oct 2006	4.09	4.11	0.0	4.10
TIER	Jul 2006	4.09	3.95	+0.04	-
DGBAS	Aug 2006	4.03	4.28	-0.03	4.1
Academia Sinica	Jun 2006	-	4.13	-0.12	-

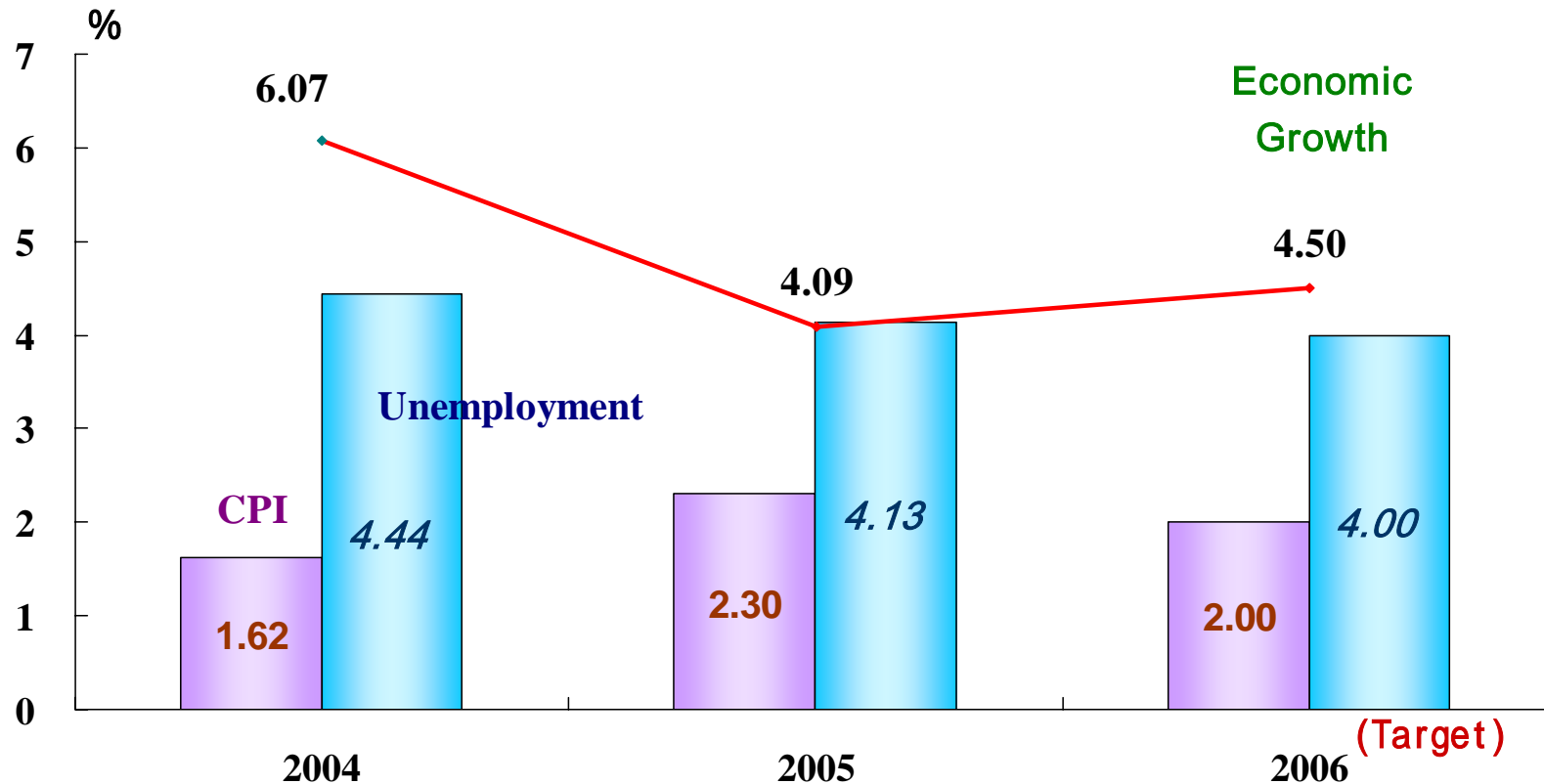
CIER: Chung-hua Institute for Economic Research, Taipei.

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

TIER: Taiwan Institute of Economic Research, Taipei.

Development Targets for 2006

- ▶ **Economic growth: 4.5%** with per capita GDP increasing to US\$16,280
- ▶ **Unemployment rate: 4.0%** with employment increasing 1.1%
- ▶ **Consumer price increase: no more than 2.0%**



Macroeconomic Targets for 2006

⇒ Sources of targeted growth mainly come from private consumption and exports.

	Real Growth Target*(Forecast)	Percent of Nominal GDP Target*(Forecast)	Contribution Percentage pt.
GDP	4.5 (4.3)	100.0 (100.0)	4.50
Private consumption	3.8 (2.5)	62.7 (62.8)	2.17
Government consumption	1.1 (0.3)	13.0 (13.1)	0.13
Fixed capital formation	3.8 (2.5)	20.6 (20.3)	0.74
Private	4.8 (3.6)	15.3 (14.8)	0.70
Public enterprises	-1.6 (-1.8)	1.7 (1.8)	0.07
Government	2.3 (0.3)	3.7 (3.7)	-0.03
Exports of goods and services	8.0 (8.1)	66.5 (64.8)	4.90
Less: Imports of goods and services	6.8 (5.7)	62.9 (61.1)	3.50

*Based on results of the target scenario.

Sources: Council for Economic Planning and Development; Directorate-General of Budget, Accounting, and Statistics.

Vision for National Development up to the year 2015 (draft)

Advancing to

- ✓ 2007-2015 average growth: 4~5%
- ✓ Per capita GDP in 2015: US\$30,000
- ✓ Unemployment kept below 4%

Economy -innovalue

- Innovation driven
- Manpower development
- Brand value
- Integration for value-added
- Fiscal & financial reform

Society -fair, just, caring

- Social security
- Narrowing wealth gap
- Manpower policy



Environment -green, sustainable

- Win-win-win for environment, energy, and industry
- Sustainable use of resources
- Friendly ecology

Global -tolerant, open, multiplicity

- Invest Taiwan first
- Global positioning
- Cross-strait economic links

Government -able, honorable, slim, professional

- Able and anti-corrupt
- Fiscal strength
- Legal reengineering

Medium-term National Development Targets

Targets	2008	2015
Growth of potential Economic growth GDP	4.9%	5% Per capita GDP US\$30,000
Employment increase	1.4%	1.2%
Unemployment rate	< 4.0%	< 4.0%
CPI increase	< 2.0%	< 2.0%

Thank you

This summary is prepared by the Department of Economic Research of the Council for Economic Planning and Development (CEPD). Monthly updates can be found on the CEPD's website at <http://www.cepd.gov.tw/encontent/index.jsp>. For inquiries call 886-2-2316-5681 or send an e-mail to bci@cepd.gov.tw.