

2.2 Domestic economic conditions

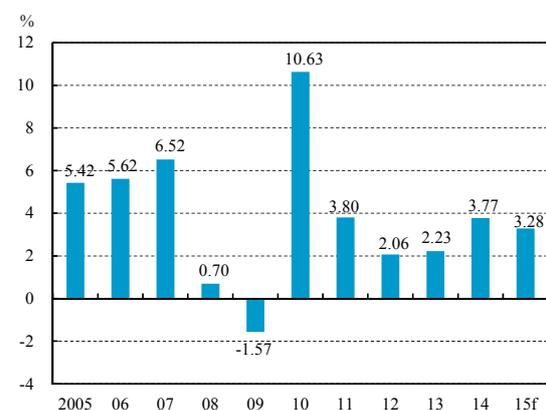
As economic growth in the US and euro area gained momentum, the global economy expanded moderately in 2014. Consequently, the domestic economy grew steadily and labor market conditions improved constantly along with mild inflationary pressure. Short-term external debt servicing ability remained strong on the back of a sustained surplus in the current account and ample foreign exchange reserves. Although the scale of external debt continued to expand, overall external debt servicing ability stayed robust. Moreover, the government's fiscal deficit rebounded and total government debt continuously mounted; nevertheless, the government kept implementing the "Fiscal Health Plan" to enhance a sound fiscal system.

2.2.1 Domestic economy grew steadily and labor market improved constantly

With the moderate global economic expansion and an active domestic stock market, the economic growth rates of the first three quarters in 2014 rose gradually thanks to growing exports and increasing private consumption and investment. The economic growth rate registered 4.32% in Q3. However, it fell to 3.47% in Q4 owing to receding exports of mineral products, chemicals, and plastics and slowing private consumption affected by food safety scandals. Eventually, the annual economic growth rate stood at 3.77%³² in 2014, higher than the 2.23% of the previous year (Chart 2.18).

Owing to the recovering domestic economy and increasing profitability of the corporate sector, the domestic labor market improved constantly in 2014. As a result, domestic unemployment rates trended downwards,

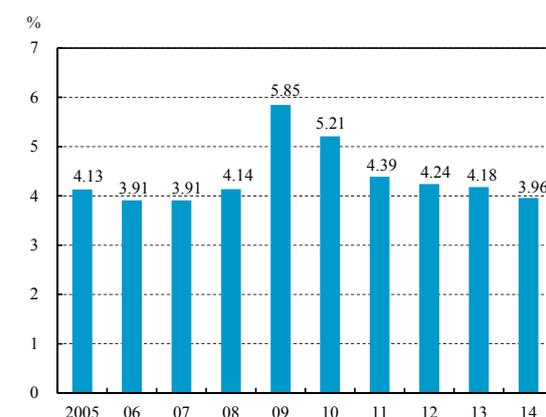
Chart 2.18 Economic growth rates in Taiwan



Note: Figure for 2015 is forecast by DGBAS.

Source: DGBAS.

Chart 2.19 Unemployment rates in Taiwan



Source: DGBAS.

³² See Note 6.

except from June to August when the rates rose slightly owing to the seasonal effect of graduates pursuing jobs. It fell to 3.79% in December, and the average unemployment rate of 2014 dropped to 3.96%, the lowest level since the financial crisis in 2008 (Chart 2.19).

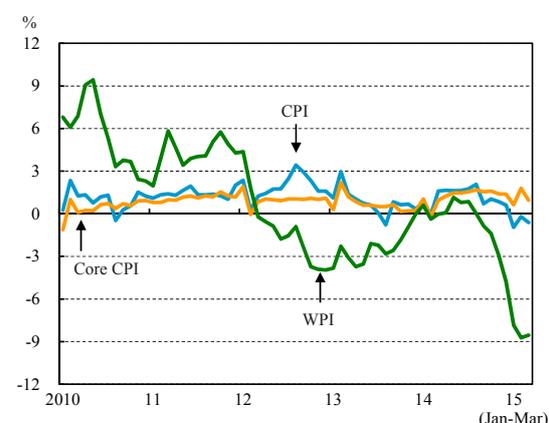
Taking a glance into 2015, global prices of crude oil remain low, which is beneficial to domestic economic developments (Box 2). However, global economic growth momentum is more measured than expected, and the localization of industry supply chains in Mainland China is showing a preliminary effect, resulting in more competition for domestic companies. Both of these may have an impact on export growth. Moreover, food safety scandals continue to curb private consumption momentum. As a result, the DGBAS forecasts Taiwan's economic growth rate to fall to 3.28%³³ in 2015 (Chart 2.18).

2.2.2 Domestic prices rose mildly

In the beginning of 2014, owing to a modest upswing in the international prices of commodities and raw materials, the wholesale price index (WPI) inflation rate showed a slight rise, registering 1.15% in May. However, in the second half of the year, affected by the descending prices of crude oil, the WPI inflation rate declined significantly from June and turned negative in September, registering -4.78% in December (Chart 2.20). The annual WPI inflation rate stood at -0.57% in 2014, higher than the -2.43% recorded a year earlier, according to the DGBAS.

Attributed to infected piglets and unfavorable weather conditions, prices of meat and food-away-from-home went up from early 2014. As a result, the CPI inflation rate rose and registered 2.07% in August. Subsequently, domestic prices of vegetables and gasoline dropped owing to good weather and the descending price of crude oil, leading the CPI inflation rate to trend downwards and register 0.60% in December (Chart 2.20). Overall, domestic prices rose mildly in 2014 as the average CPI inflation rate was 1.20%, higher than the 0.79% of the previous year, whereas the core CPI³⁴ inflation rate was 1.26%, higher than

Chart 2.20 Consumer and wholesale price inflation rates



Note: Figures are measured on a year-on-year change basis.
Source: DGBAS.

³³ See Note 6.

³⁴ The term "core CPI" in this report refers to the consumer price index excluding fresh fruits, vegetables and energy.

the 0.66% recorded a year earlier.

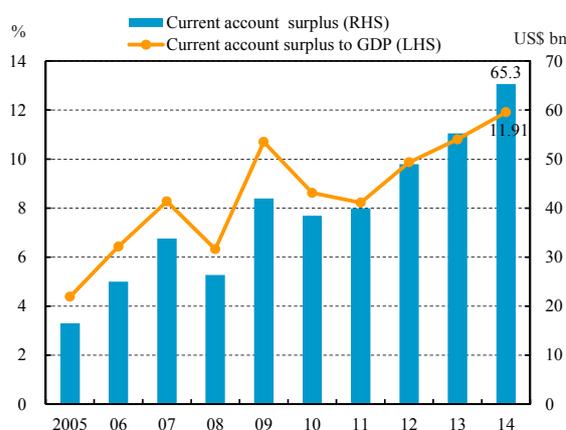
In 2015, with global economic growth slowing down and the international prices of crude oil and cereals remaining low, the DGBAS projects the annual WPI inflation rate and CPI inflation rate to decline to -6.42% and 0.13%,³⁵ respectively.

2.2.3 Current account surplus persisted and foreign exchange reserves stayed abundant

Benefiting from stable growth of the global economy in 2014, both exports and imports increased. The merchandise trade surplus trended up on account of exports increasing more than imports. This, combined with a larger services and income surplus and contracted current transfers deficit, caused the annual current account surplus to reach US\$65.3 billion, or 11.91%³⁶ of annual GDP, increasing by US\$10.1 billion or 18.24% compared to 2013 (Chart 2.21).

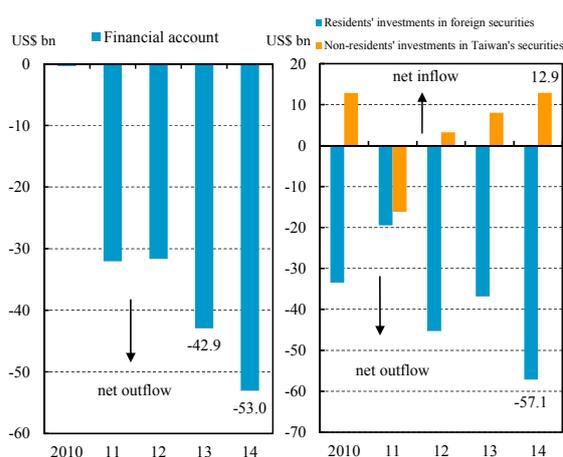
As for the financial account, in 2014, the annual balance of outflows registered a record high of US\$53 billion, primarily because net outflows of securities investments registered a record high. Analyzing the components of the financial account, the net outflows of residents' investments in foreign securities in 2014 recorded US\$57.1 billion, mainly owing to more foreign debt investments by insurance companies. During the same period, the net inflows of non-residents' investments in Taiwan's securities registered US\$12.9 billion because of greater investments by foreign institutional investors in the domestic stock market (Chart 2.22).

Chart 2.21 Current account surplus



Note: Current account surplus and GDP are annual figures. Sources: CBC and DGBAS.

Chart 2.22 Financial account and net inflow/outflow of securities investments



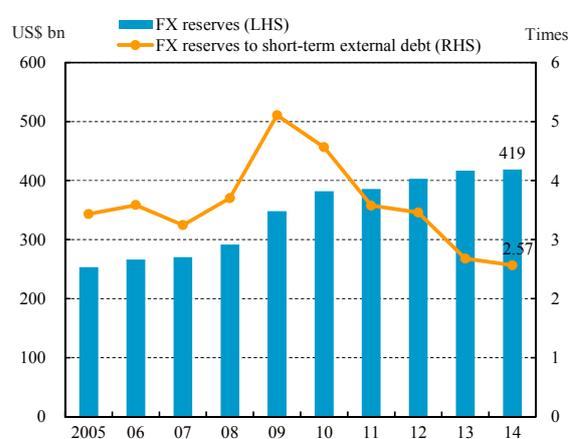
Source: CBC.

³⁵ See Note 6.

³⁶ For the ratio of current account deficit to GDP, the cutoff point for risk is 3%. A country in which the reading is greater than 3% and has risen by at least 5 percentage points from the previous year is considered to be at relatively high risk.

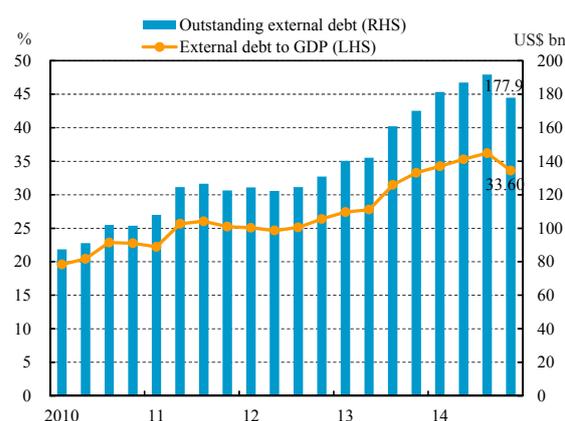
With rising outflows on the financial account but a greater increase in the current account surplus, the balance of payments surplus expanded to US\$13 billion in 2014, increasing by 14.99% from a year earlier. Over the same period, continuously ascending investment earnings of reserve assets contributed to accumulating foreign exchange reserves, which reached US\$419 billion at the end of December. As the euro and other major currencies depreciated against the US dollar, the dollar value of foreign exchange reserve assets denominated in those currencies diminished. Consequently, the total amount of foreign exchange reserves merely increased by 0.52% from the previous year. At the end of March 2015, this total amount declined to US\$414.7 billion, yet remained ample. At the end of 2014, the ratio of foreign exchange reserves to short-term external debt decreased to 2.57 times³⁷ owing to a greater rise in external debt. Nevertheless, it was higher than internationally recognized minimum levels, implying that Taiwan's foreign exchange reserves have a robust capacity to meet payment obligations (Chart 2.23).

Chart 2.23 Short-term external debt servicing capacity



Notes: FX reserves and external debt are end-of-period figures.
Sources: CBC, DGBAS and MOF.

Chart 2.24 External debt servicing capacity



Notes: 1. External debts are end-of-period figures.

2. GDP is annual figures.

Sources: CBC, DGBAS and MOF.

2.2.4 Scale of external debt expanded slightly and debt servicing capacity remained strong

Taiwan's external debt³⁸ increased continuously in the first three quarters of 2014 owing to the increases of domestic banks' due from affiliated banks and foreign banks. In Q4, domestic

³⁷ The general international consensus is that a ratio of foreign exchange reserves to short-term external debt higher than 100% indicates relatively low risk.

³⁸ The CBC defines external debt as the combined amount owed to foreign parties by Taiwan's public and private sectors, including long-term debt with a maturity of greater than one year and short-term debt with a maturity of one year or less. The term "public external debt" refers to debt that the public sector is either obligated to repay directly or has guaranteed (starting from December 2004, figures for public external debt include outstanding foreign debt arising from repo transactions between the CBC and international financial institutions). The term "private external debt" refers to private-sector foreign debt that is not guaranteed by the public sector.

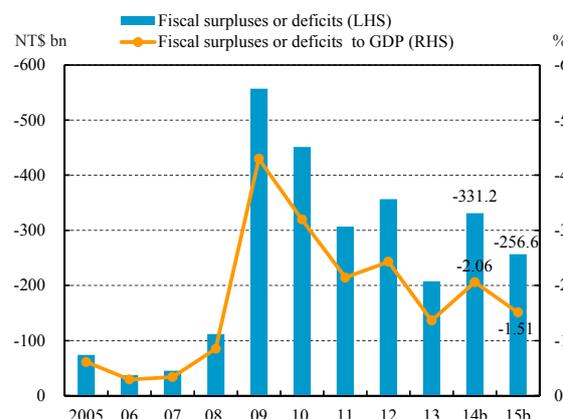
banks repaid foreign loans with abundant capital. As a result, external debt registered US\$177.9 billion, or 33.60% of annual GDP, at the end of the year, indicating that the capacity to service external debt remained robust³⁹ (Chart 2.24).

2.2.5 Fiscal deficits rebounded while government debt kept accumulating

Since the times of peak spending on public infrastructure construction and domestic demand expansion plans ended, fiscal deficits at all levels of government have notably contracted from 2009 onwards. In order to support domestic economic growth momentum, annual expenditure increased appropriately in 2014. Consequently, the amount of the fiscal deficits expanded to NT\$331.2 billion, or 2.06 % of annual GDP, after reaching a relatively low level in 2013. It is expected that fiscal deficits will decline to NT\$256.6 billion alongside a fall in the ratio of fiscal deficits to annual GDP to 1.51%⁴⁰ in 2015 (Chart 2.25).

As fiscal deficits stayed high and both central government and local governments relied on debt issuance to finance debt servicing expenditures, outstanding public debt at all levels of government⁴¹ in 2014 expanded to

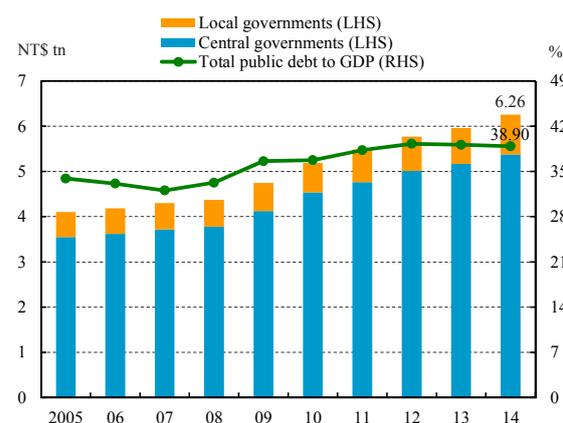
Chart 2.25 Fiscal deficits position



Notes: 1. Fiscal position data include those of central and local governments.
2. Data of fiscal deficits are annual figures. Figures for 2014 and 2015 are budgets.

Sources: MOF and DGBAS.

Chart 2.26 Public debt



Notes: 1. Outstanding public debt refers to non-self-liquidating debt with a maturity of one year or longer, excluding external debt.

2. Figures for 2014 are preliminary final accounts and budgets for the central government and local governments, respectively.

Sources: MOF and DGBAS.

³⁹ The general international consensus is that a country with a ratio of external debt to GDP lower than 50% is deemed to be at relatively low risk.

⁴⁰ See Note 7.

⁴¹ The term “outstanding debt at all levels of government” as used in this report refers to outstanding non-self-liquidating debt with a maturity of one year or longer. As of February 2015, the outstanding one-year-or-longer non-self-liquidating public debts are NT\$5.33 trillion, NT\$0.58 trillion, NT\$0.17 trillion, and NT\$1.0 billion for central government, municipalities, counties, and townships, respectively. The figures account for 34.74%, 3.81%, 1.08%, and 0.01% of the average GDP for the preceding three fiscal years, which are below the ceilings of 40.6%, 7.65%, 1.63%, and 0.12% for central government, municipalities, counties, and townships, separately, set out in the *Public Debt Act*.

NT\$6.26 trillion,⁴² or 38.90% of annual GDP,⁴³ well above the NT\$5.96 trillion recorded in 2013 (Chart 2.26).

To promote fiscal health, the Ministry of Finance kept implementing the “Fiscal Health Plan” that seeks to enhance a sound fiscal system through the following directions: implementing all the measures of increasing income and reducing expenses; improving the structures of revenue and expenditure; controlling the scale of debt; coordinating all the resources; diversifying sources of finance; and timely modifying taxation.

2.3 Non-financial sectors

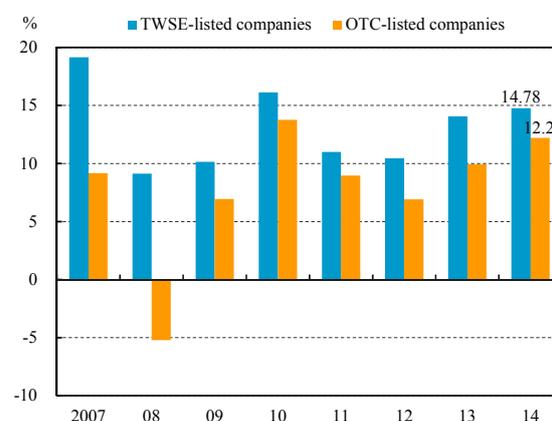
2.3.1 Corporate sector⁴⁴

The profitability of listed companies increased in 2014. Likewise, their financial structure was stable and short-term debt servicing capacity enhanced. The credit quality of corporate loans stayed sound, as NPL ratios were at their lowest recorded level. However, owing to strong industrial competition among countries, economic slowdown and promotion of industrial supply chain localization in Mainland China, as well as aggravated fluctuations in foreign exchange rates of major international currencies recently, the corporate sector’s profit outlook still faces challenges.

Profitability of listed companies grew in 2014

In 2014, benefiting from the modest recovery in the global economy and stable export growth in Taiwan, average ROEs of TWSE-listed and OTC-listed companies rose to 14.78% and 12.21%, respectively, compared to 14.06% and 9.92% in 2013 (Chart 2.27). Profitability enhanced, mainly

Chart 2.27 Return on equity in corporate sector



Note: Return on equity = net income before interest and tax / average equity.

Source: TEJ.

⁴² The figure is based on preliminary final accounts and budgets for central government and local governments, respectively. Outstanding non-self-liquidating debt at all levels of government with a maturity of one year or longer stood at NT\$6.08 trillion as of the end of February 2015.

⁴³ See Note 8.

⁴⁴ Corporate sector originally includes the data of overall corporations, TWSE-listed companies, and OTC-listed companies. Because listed companies have adopted the TIFRSs since 2013 and other corporations are still in accordance with ROC GAAP in Taiwan, the integration of financial information is not available. Therefore, this section starts to include only listed companies which are the targets for analysis since this issue. Throughout this section, figures for listed companies are consolidated financial data; prior to 2011 are under ROC GAAP, while from 2012 are under the TIFRSs. In light of changes in accounting treatment and presentation, readers should interpret these figures prudently when comparing statistics before and after IFRSs adoption.