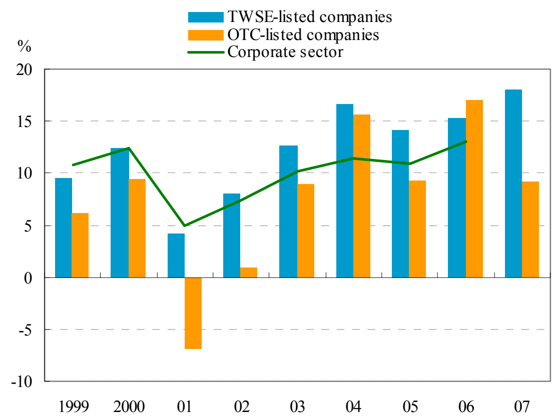
IV. Non-financial sectors

The corporate sector, household sector, and real estate market constitute the main sources of credit exposure for Taiwan's financial institutions. The degree of indebtedness and solvency in the corporate sector and household sector, and the real estate cycle have far-reaching impacts upon asset quality and profitability at financial institutions.

6. Corporate sector

Corporate sector profitability has strengthened, and its financial structure and solvency have improved markedly. The quality of corporate lending also has remained satisfactory. However, the impact of slowing global economic growth, skyrocketing international commodity prices, and appreciation of the NT dollar could undermine operating revenues and financial health of the corporate sector, and thus bear close watching. In addition, enterprises with investments in China could face increased risk due to the adverse effects arising from the implementation of the Employment Contract Law and the adoption of tax reforms in China.

Chart 6.1 Return on equity in corporate sector



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

Profitability improved notably

Profitability in the corporate sector[59] troughed in 2001 and has been gradually climbing since then. In 2006, thanks to moderate global economic expansion, stable production growth and booming international trade, average return on equity (ROE) hit 13.04%. ROE for

[59] Corporate sector data are from the corporate financial report database operated by the Joint Credit Information Center. The database includes the data of the all CPA audited financial reports of non-financial corporate sector. In selecting sample data, the enterprises meeting any of the following criteria are excluded: (1) shareholder equity is zero or negative; (2) operating revenues are less than NT$10 million; (3) a CPA issued an audit report containing an adverse opinion or disclaimer of opinion; (4) was established for less than one year; (5) is a financial or insurance enterprise (Industrial classification K); or (6) is a public administration, defense or compulsory social security enterprise (Industrial classification O). The number of samples taken in individual years are as follows:

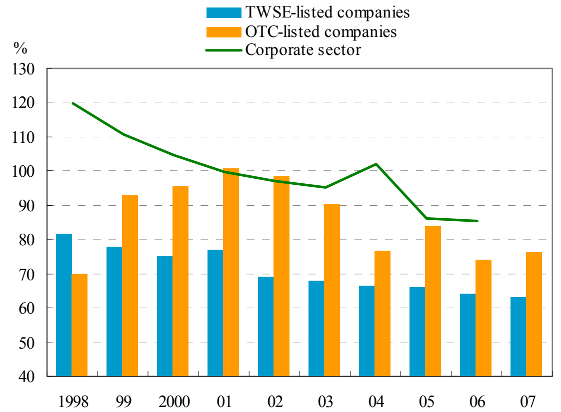
	1998	1999	2000	2001	2002	2003	2004	2005	2006
Total samples	22,998	23,372	23,918	24,973	25,957	27,474	28,162	25,480	29,772
Valid samples	16,821	17,287	17,859	18,667	19,584	20,960	21,417	19,459	22,660

most TWSE-listed companies[60] has trended upward, except for 2005, reaching an average of 18.03% in 2007, the highest level since 2001. Average ROE among OTC-listed companies[61] was more volatile, sliding steeply from 2006 to a figure of 9.21% for 2007, mainly because of lower gross profit margins in the electronics sector (Chart 6.1).

Financial structure improved

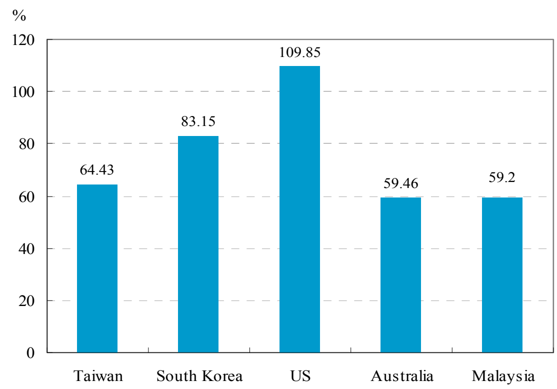
Average leverage ratios in the corporate sector have been on a long-term downward trend, standing at 85.21% at the end of 2006, the lowest level in ten years, reflecting a pronounced improvement in overall financial structure. The average leverage ratio of TWSE-listed companies has also been going down, and has been lower than the average ratio for the corporate sector as a whole, dropping to 63.20% at the end of 2007. OTC-listed companies have also been performing better than the corporate sector as a whole in this regard, but their average leverage ratio has actually deteriorated of late, going up to 76.45% at the end of 2007 from 74.10% in the previous year (Chart 6.2), mainly due to an increase in long-term liabilities. The average leverage ratio at Taiwan's listed companies was lower than those in South Korea and the United States, but was higher than in Australia and Malaysia[62] (Chart 6.3).

Chart 6.2 Leverage ratios in corporate sector



Notes: 1. End of period figures.
2. Leverage ratio = total liabilities / equity.
Sources: JCIC and TEJ.

Chart 6.3 Corporate sector leverage ratios in selected countries



Note: Figures for Taiwan, US and Malaysia are at the end of December 2007, while for South Korea and Australia are at the end of June 2007.
Sources: TEJ, BOK, Fed, ABS and BNM.

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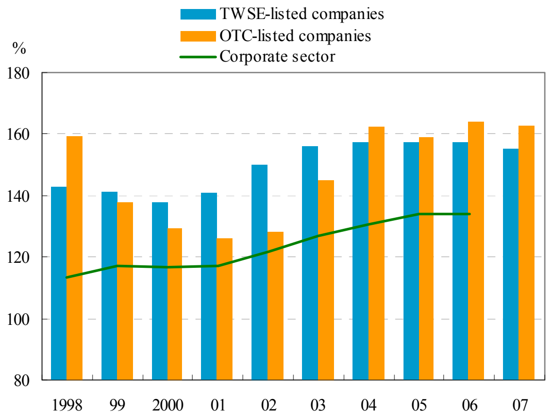
[60] TWSE-listed companies are listed on Taiwan Stock Exchange Corporation (TWSEC). With the exception of financial and insurance companies, data for TWSE-listed companies are from the Taiwan Economic Journal Co., Ltd.

[61] OTC-listed companies are listed on the GreTai Securities Market. With the exception of financial and insurance companies and emerging stock board companies, data for OTC-listed companies are from the Taiwan Economic Journal Co., Ltd.

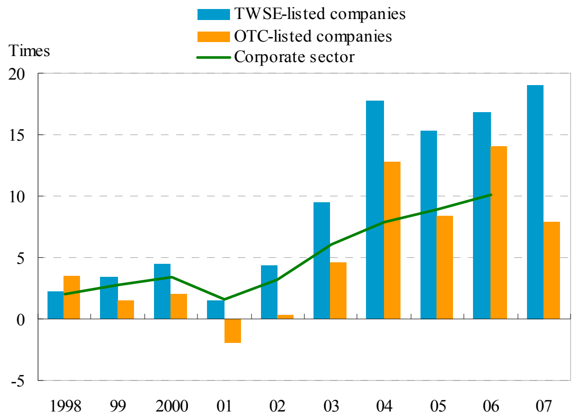
[62] The figures herein are non-financial listed companies for Taiwan, large non-financial listed businesses for South Korea, non-farm and non-financial corporate businesses for US, non-financial corporations for Australia, and 100 listed corporations for Malaysia.

Chart 6.4 Current ratios in corporate sector



Notes: 1. End of period figures.
2. Current ratio = current assets / current liabilities.
Sources: JCIC and TEJ.

Chart 6.5 Interest coverage ratios in corporate sector



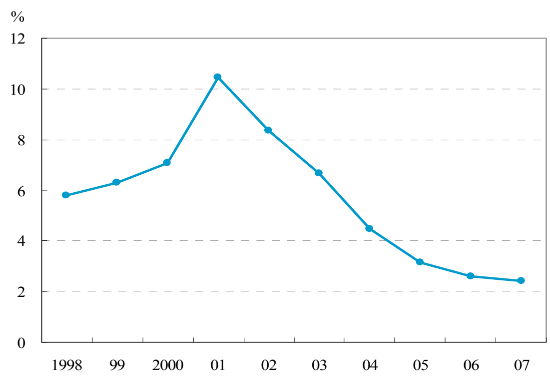
Note: Interest coverage ratio = income before interest and tax / interest expenses.
Sources: JCIC and TEJ.

Debt servicing capacity improved

Debt servicing capacity for the corporate sector as a whole began improving in 2002. The average current ratio registered a significant increase of 133.84% at the end of 2006 from 121.58% as of 31 December 2002, indicating that overall liquidity was sufficient to cover short-term debt servicing requirements. The average current ratios for both TWSE-listed and OTC-listed companies were well above that for the corporate sector as a whole, and stood over 155% despite a decline in both ratios at the end of 2007 (Chart 6.4).

Supported by annually rising earnings, the average interest coverage ratio for the corporate sector soared from 1.59 times in 2002 to 10.10 times in 2006, showing that annual profits were quite sufficient to cover interest servicing requirements. The average interest coverage ratio continued to ascend to 19.08 times in 2007 among TWSE-listed companies, while that for OTC-listed companies fell to 7.90 times due to a contraction in profitability (Chart 6.5).

Chart 6.6 Non-performing ratios of loans to corporate sector



Note: End of period figures.
Source: JCIC.

Non-performing ratio of loans to the corporate sector declined

As profitability and solvency improved steadily, the non-performing (delinquency) ratios of loans to the corporate sector began falling in 2001 and reached 2.40% as of 31 December 2007, the lowest level in ten years (Chart 6.6). During the reporting period, the credit quality of loans to the corporate sector remained satisfactory, but the slowing global economic growth, skyrocketing international commodity prices and appreciation of the NT dollar may bring about adverse impacts on the future profitability of the corporate sector. In addition, for many Taiwanese enterprises that have made investments in China, the implementation of the Employment Contract Law and the adoption of tax reforms in China could adversely affect their operations and profitability.

7. Household sector

For the household sector, borrowing growth has moderated and debt servicing capacity has strengthened, but debt burdens are still heavy. The credit quality of loans to households remains satisfactory. But the real income and debt repayment capacity of households may be undermined in the future as inflationary pressures increase and monthly payments on high loan-to-value mortgages spike upward with the expiration of interest-only periods.

Growth in household borrowing decelerated

Total household borrowing[63] began a steady rise in 2003, due to falling interest rates, continuation of the government's preferential mortgage programs, and active expansion by banks of consumer finance activities. This growth momentum softened, however, after the credit and cash card debt crisis erupted in 2005. By the end of 2007, total household borrowing reached NT$10.52 trillion (Chart 7.1) on year-on-year growth of 3.09%, down from a peak of 10.58% posted in 2004. The single biggest share of household borrowing at the end of 2007 went for the purchase of real estate (67.23%), followed by working capital loans[64] (24.13%) and revolving balances on credit cards (2.71%) (Chart 7.2). Loans for the purchase of real estate grew 6.95% year-on-year in 2007, while revolving balances on credit cards plummeted by 18.76%.

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[63] The term "household borrowing" as used in this section refers to outstanding loans and revolving credit card balances taken out by households from the following financial institutions:
(1) Depository institutions: Domestic banks (including medium business banks), local branches of foreign banks, credit cooperatives, credit departments of farmers' associations, credit departments of fishermen's associations, and the Remittances & Savings Department of Chunghwa Post Co.
(2) Other financial institutions: Trust and investment companies, life insurance companies, securities finance companies, and securities firms.

[64] The term "working capital loans" includes outstanding cash card loans.