IV. Non-financial sectors

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

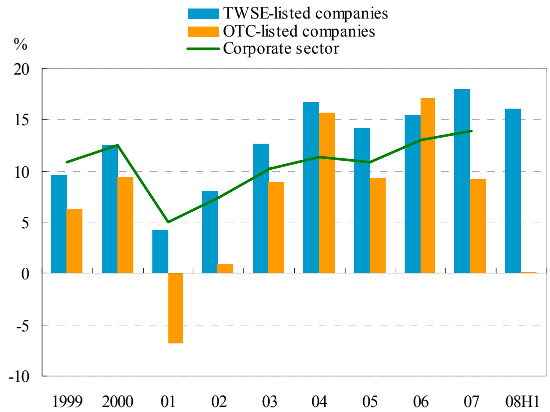
6. Corporate sector

The corporate sector's[61] profitability was strengthened, while its financial structure and solvency continued improving in 2007. The quality of corporate lending also remained satisfactory. In the first half of 2008, however, the impacts of skyrocketing international commodity prices, slowing global economic growth, and increasing operational costs in China could undermine the profitability, financial health, and short-term solvency of both TWSE-listed and OTC-listed companies,[62] which might increase their default risks.

Profitability decreased in the first half of 2008

In line with expanding exports, rebounding domestic demand, and steady growth in the industrial and service sectors in 2007, profitability in the corporate sector kept improving when ROE reached 13.09%. Profitability at TWSE-listed companies sustained an upward trend, while OTC-listed companies slid dramatically due to lower gross profit margins in the electronics sector. In the first half of 2008, the corporate sector faced several challenges arising from

Chart 6.1 Return on equity in corporate sector

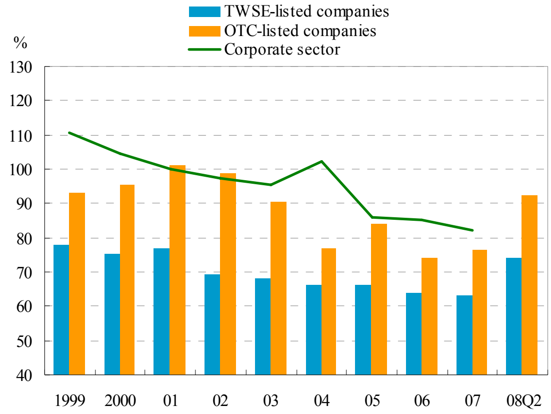


Notes: 1. Return on equity = net income before interest and tax / average equity.
2. Figures for 2008 H1 have been annualized. The ROE of the OTC-listed companies in 2008 H1 was only 0.12%.
Sources: JCIC and TEJ.

[61] The corporate sector data are from the corporate financial report database operated by the Joint Credit Information Center.
[62] The data for TWSE-listed and OTC-listed companies are from the Taiwan Economic Journal co., excluding that for financial and insurance companies and emerging stock-listed companies.

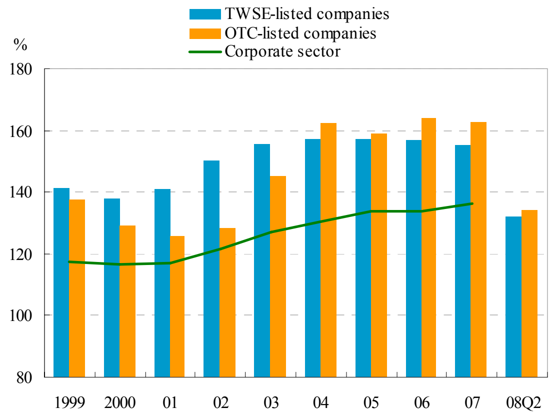
recognition of employee bonuses as expenses, appreciation of the NT dollar, skyrocketing international commodity prices, slowing growth in the global economy, and sluggish consumer demand brought about by inflation. Impacted by those unfavorable factors, the profitability of both TWSE-listed and OTC-listed companies began to shrink. ROE for TWSE-listed companies became declined to 16.01% from 18.03% in 2007, while ROE for OTC-listed companies sharply fell to 0.12% from 9.21% in 2007 due to significant losses suffered by the semiconductor sector (Chart 6.1).

Chart 6.2 Leverage ratio in corporate sector



Note: Leverage ratio = total liabilities / equity.
Sources: JCIC and TEJ.

Chart 6.3 Current ratio in corporate sector



Note: Current ratio = current assets / current liabilities.
Sources: JCIC and TEJ.

Financial structure aggravated

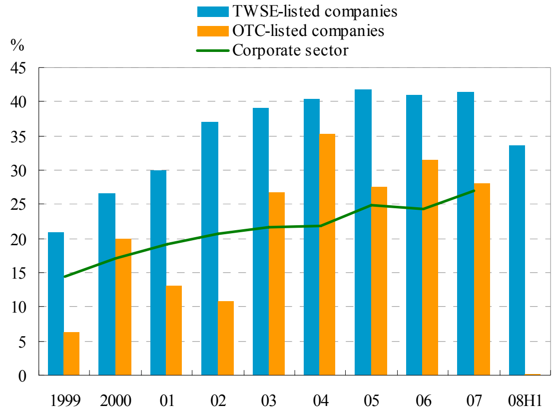
The financial structure of the corporate sector continued to improve as average leverage ratios declined to 82.20% in 2007. The average leverage ratio of TWSE-listed companies was on a downward trend, while that of OTC-listed companies turned to rise owing to an increase in long-term liabilities. The average leverage ratios for both TWSE-listed and OTC-listed companies were lower than the average ratio for the corporate sector as a whole. In the first half of 2008, the financial structures of both TWSE-listed and OTC-listed companies became aggravated. The average leverage ratios for TWSE-listed companies and OTC-listed companies rose dramatically to 74.09% and 92.54%, respectively, as a consequence of a significant increase in short-term liabilities (Chart 6.2).

Short-term debt servicing capacity eroded

Supported by a declining debt level and increasing profitability, the debt servicing capacity for the corporate sector as a whole kept improving in 2007, as the average current ratio climbed to 136.31% and the average cash flow ratio rose to 26.99%. The figures for both TWSE-listed companies and OTC-listed companies were well above those for the corporate sector. In the first half of 2008, the average current ratios for both TWSE-listed and OTC-listed companies began to decline noticeably and stood at 132.15% and 134.08%, respectively, as of the end of June 2008. This was mainly because the sharp rise in oil and commodity prices added the need for working capital, thus raising current liabilities. Even if the average cash flow ratio of TWSE-listed companies declined significantly, their short-term debt servicing capacity remained satisfactory because they still held sufficient cash equivalents as compared to their assets. The average cash flow ratio of OTC-listed companies, however, registered a significant drop to 0.17% on a dramatic decline in profitability. This showed that their debt servicing capacity, with net cash flows from operational activities to cover short-term debts, was weakening and thus called for special attention (Chart 6.3, 6.4).

The average interest coverage ratio for the corporate sector as a whole ascended to 10.78 times in 2007, reflecting continued improvement in the interest covering capacity. The average interest coverage ratio of TWSE-listed companies rose to 19.08 times, well above that of the corporate sector, while that of OTC-listed companies dramatically fell to 7.89 times due to a contraction in profitability, but their interest servicing capacity remained sufficient. In the first half of 2008, the average interest coverage ratio of TWSE-listed companies fell to 17.19 times due to a decline in earnings, while that of OTC-listed companies dropped substantially to 0.08 times because of considerably lower profits in 2007the same period. The short-term debt servicing capacity of OTC-listed companies weakened as earnings may be insufficient to cover interest servicing requirements (Chart 6.5).

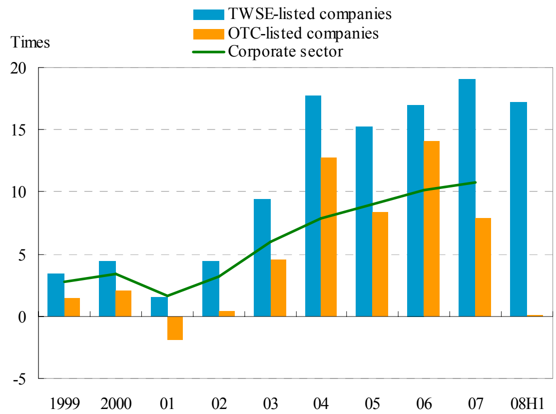
Chart 6.4 Cash flow ratio in corporate sector



Notes: 1. Cash flow ratio = net cash flows from operational activities / current liabilities.
2. Cash flow ratio of OTC-listed companies in 2008 H1 was only 0.17%.

Sources: JCIC and TEJ.

Chart 6.5 Interest coverage ratio in corporate sector



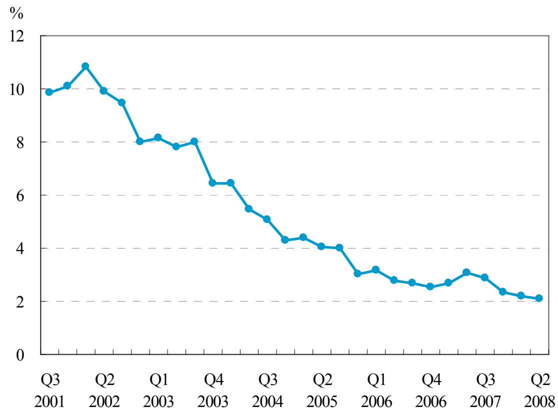
Notes: 1. Interest coverage ratio = income before interest and tax / interest expenses.
2. Interest coverage ratio for OTC-listed companies in 2008 H1 was only 0.08 times.

Sources: JCIC and TEJ.

The credit quality of loans to the corporate sector remained satisfactory, but default risk rose

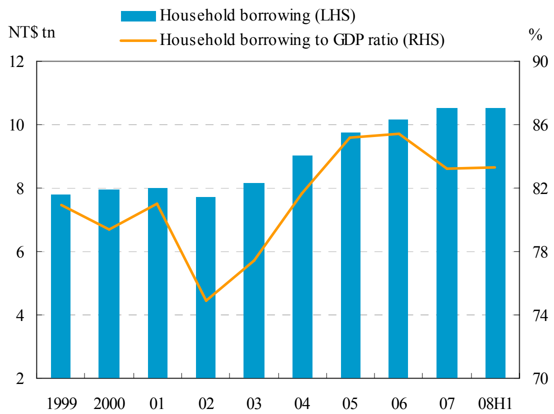
The non-performing ratio of loans to the corporate sector kept falling to 2.11% in June 2008 (Chart 6.6), demonstrating that its credit quality remained satisfactory. Thereafter, however, profitability of the corporate sector might be undermined by several adverse factors, including increasing downside risks to domestic economic growth, declining consumer expenditures due to inflation, and a heavy slump in stock market prices, as well as increasing commodity prices and rising operational costs in China. In addition, affected by the global credit crunch arising from the US subprime crisis, domestic financial institutions became more conservative in extending credit. Enterprises with an unsound financial structure, or SMEs with insufficient transparency in financial reporting might face the pressure of rising financing costs and increasing refinance difficulty, thus increasing their default risk.

Chart 6.6 NPL ratio of corporate loans



Note: End-of-period figures.
Source: JCIC.

Chart 7.1 Household borrowing to GDP



Note: Household borrowing data are end-of-period figures.
Sources: CBC, JCIC and DGBAS.

7. Household sector

For the household sector, prior to the end of June 2008, borrowing growth moderated and short-term debt servicing capacity strengthened, but debt burdens remained heavy. The credit quality of loans to households continued to be satisfactory. Thereafter, the assets and real income of households might be undermined as the global stock market slumped, domestic economic growth declined, and the unemployment rate rose. Furthermore, debt repayment pressures for borrowers increased as their interest-only periods of high loan-to-value mortgages successively expired. These joint developments could have adverse impacts on the credit quality of loans to households.