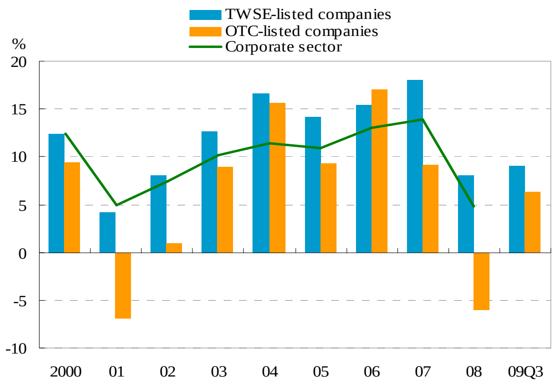
III. Non-financial sectors

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 the asset quality and profitability of financial institutions.

3.1 Corporate sector

From 2008 Q4 onwards, the profitability of the corporate sector[28] declined dramatically and its financial structure and indebtedness weakened, impacted by both domestic and international economic recessions. Nevertheless, as a result of the fiscal and monetary policies adopted by various countries aimed at boosting their economies, the global economy began to recover in the middle of 2009. The profitability of TWSE-listed and over-the-counter (OTC) listed companies[29] increased and their financial structures and short-term debt servicing capacity strengthened for the first three quarters of 2009, while non-performing loan (NPL) ratios of corporate loans declined slightly. In view of the closer trade and investment relations with China, Taiwan's corporations warrant giving more attention to business risks that may emerge as a result of tight monetary policy in China, increasing pressure on RMB appreciation as well as structural economic adjustments and serious labor shortage in China.

Chart 3.1 Return on equity in corporate sector



Notes: 1. Return on equity = net income before interest and tax / average equity.
2. The data are on an annual basis as 2009 Q3 figures are annualized results.
3. Latest data for the corporate sector is as of the end of 2008, while that for TWSE-listed and OTC-listed companies are as of the end of 2009 Q3.

Sources: JCIC and TEJ.

[28] The corporate sector data including TWSE-listed and OTC-listed companies are from the corporate financial report database operated by the Joint Credit Information Center (JCIC), excluding that for financial and insurance companies, public administration and defense, and compulsory social security.

[29] The data for TWSE-listed and OTC-listed companies are from the Taiwan Economic Journal Co., Ltd (TEJ), excluding that for financial and insurance companies and emerging stock-listed companies.

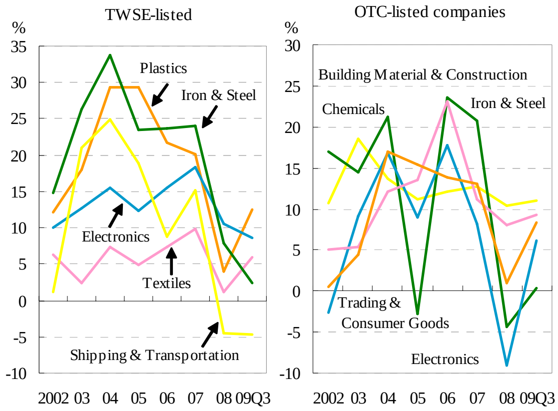
Profitability increased gradually in 2009

The profitability of the corporate sector declined dramatically in 2008, inflicted by the global recession in the second half of 2008, which resulted in a slump in exports and more cautious private consumption. The return on equity (ROE) for the corporate sector declined dramatically to 4.76% in 2008 as the Taiwan Stock Exchange (TWSE) listed and OTC-listed companies' ROEs dropped to 8.07% and -5.97%, respectively. From 2009, the easy monetary policies and economic stimulus packages employed by various countries provided a positive upshot that contributed to the global economic recovery. The rates of decline of Taiwan's exports and imports decelerated, private consumption confidence rose; thus, the profitability of the corporate sector improved gradually. The annual ROEs for TWSE-listed and OTC-listed companies rose to 8.99% and 6.37%, respectively, for the first three quarters of 2009, much higher than that reported in 2008 (Chart 3.1).

To break this down by sector, for TWSE-listed companies, the annual ROEs for plastics industry and textile industry rose moderately for the first three quarters of 2009. The ratios for the electronics industry and the iron and steel industry remained lower than that of 2008, but with a diminished rate of decline. However, the shipping and transportation industry's ROE remained negative. For OTC-listed companies, the ROE for the electronics industry, which accounted for more than 70% of the total revenue of OTC-listed companies, rose tremendously, while most of the other industries also saw better performance than 2008 (Chart 3.2).

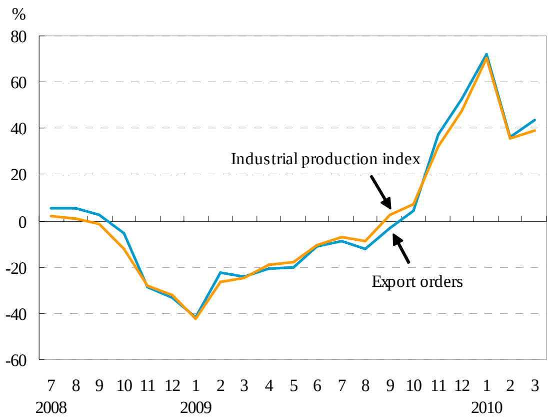
Owing to the downturn in global demand, Taiwan's annual growth rates for export

Chart 3.2 Return on equity of TWSE-listed and OTC-listed companies by major industries



Notes: 1. Return on equity = net income before interest and tax / average equity.
2. The data are on an annual basis as 2009 Q3 figures are annualized results.
Source: TEJ.

Chart 3.3 Annual growth rates of export orders and industrial production index



Note: Industrial production index in 2006 was 100.
Source: MOEA.

orders and the industrial production index were constrained dramatically from 2008 Q3 and reached historical lows of -41.67% and -42.64%, respectively, in January 2009. Then, the situation improved and both reported positive growth rates from October 2009. In 2010 Q1, due to the global expansion in demand and lower base year effect, the growth rates of export orders and the industrial production index increased prominently (Chart 3.3). Taiwan, an export-driven country,[30] benefited as export orders, industrial production and private consumption improvements enhanced the profitability of the corporate sector following the global economic recovery.

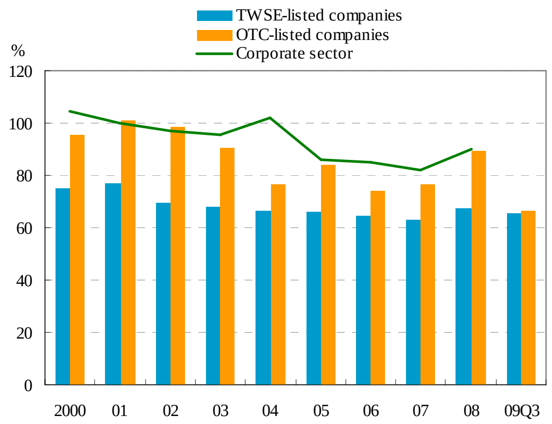
Financial structure enhanced

For the corporate sector as a whole, the financial structure deteriorated and the average leverage ratio rose to 90.02% at the end of 2008 due to the dramatic decrease in its profitability in the same year. In 2009, domestic corporations experienced contracted investments in the face of the economic downturn, which, in turn, led to a reduction in their liabilities. As a result, the average leverage ratio for TWSE-listed companies reported 65.26% at the end of September 2009, slightly down from 67.59% at the end of 2008. The financial structure for OTC-listed companies saw better improvement as the average leverage ratio dropped to a ten year low of 66.29%, supported by a great decrease in their liabilities (Chart 3.4).

Short-term debt servicing capacity remained acceptable

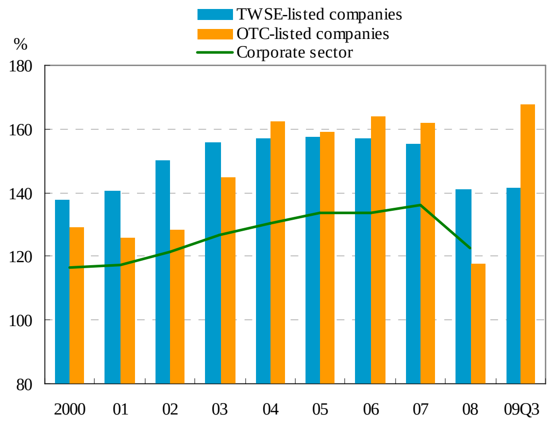
In 2008, short-term debt servicing capacity of

Chart 3.4 Leverage ratio in corporate sector



Notes: 1. Leverage ratio = total liabilities / equity.
2. End-of-period figures.
3. Latest data for the corporate sector is as of the end of 2008, while that for TWSE-listed and OTC-listed companies are as of the end of 2009 Q3.
Sources: JCIC and TEJ.

Chart 3.5 Current ratio in corporate sector

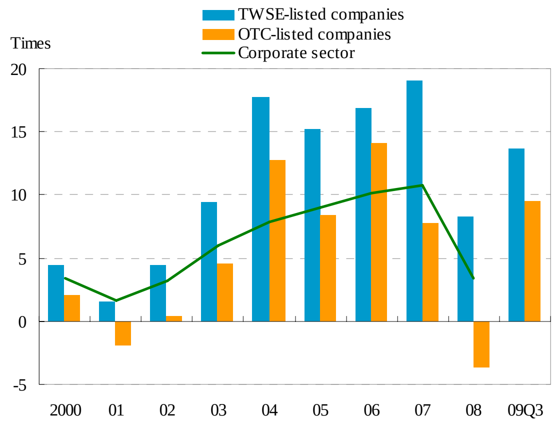


Notes: 1. Current ratio = current assets / current liabilities.
2. End-of-period figures.
3. Latest data for the corporate sector is as of the end of 2008, while that for TWSE-listed and OTC-listed companies are as of the end of 2009 Q3.
Sources: JCIC and TEJ.

30 The export to GDP ratio climbed annually from 46.58% in 2000 to reach 63.49% in 2008 before dropping to 53.68% in 2009.

the corporate sector as a whole eroded when both the current ratio and the interest coverage ratio declined moderately. The short-term debt servicing capacity remained acceptable for TWSE-listed companies for the first three quarters of 2009 as the current ratio stopped declining and remained over 140% with steady cash flows and higher cash positions. The current ratio for OTC-listed companies also surged to over 160% (Chart 3.5) as short-term liabilities contracted dramatically. Moreover, interest expenses for TWSE-listed and OTC-listed companies decreased prominently for the first three quarters of 2009 compared to the same period of the previous year due to diminished liabilities and lower interest rates. As a result, the interest coverage ratio for TWSE-listed companies rose to 13.70, while the ratio for OTC-listed companies surged to 9.53, representing improved interest servicing capacity (Chart 3.6).

Chart 3.6 Interest coverage ratio in corporate sector

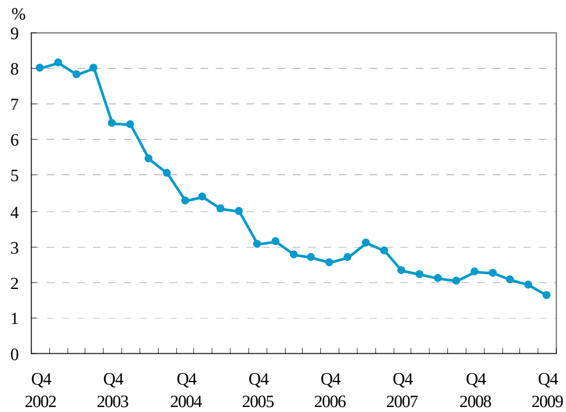


Notes: 1. Interest coverage ratio = income before interest and tax / interest expenses.
2. Figures are on an annual basis as 2009 Q3 referred to the accumulation from January to September 2009.
3. Latest data for the corporate sector is as of the end of 2008, while that for TWSE-listed and OTC-listed companies are as of the end of 2009 Q3.
Sources: JCIC and TEJ.

NPL ratio of corporate loans remained low

The NPL ratio of corporate loans continued to decline throughout 2009 and reached 1.62% at the end of December (Chart 3.7). This is partially a result of the Debt Renegotiation Relief Program launched by the Bankers Association of the Republic of China, an effort aimed at assisting Taiwan's corporations to overcome financial difficulties, whereby some restructured loans were exempted from being counted as non-performing loans.[31] The likelihood of a surge in the NPL ratio for corporate loans remains low in the short run under the following considerations: (1) the Debt Renegotiation Relief Program was extended

Chart 3.7 NPL ratio of corporate loans



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

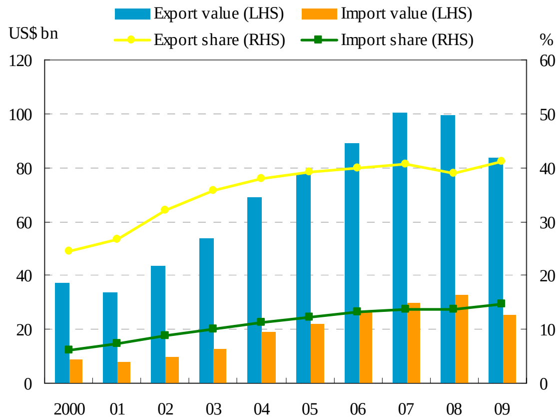
[31] According to the news release of the Bankers Association of the Republic of China on 26 November 2009, debt renegotiations submitted to and approved by financial institutions amounted to 2,766 cases, or NT$ 83.2 billion; applications made via the Ministry of Economic Affairs amounted to 135 cases, or NT$ 166.5 billion.

to the end of 2010; (2) the SMEs Guarantee Fund offered more guarantee facilities to SMEs that faced difficulties in obtaining finance from financial institutions; and (3) the improved performance of the corporate sector resulting from the global economic recovery.

Evolving China's economic and financial environment has a greater influence on Taiwan's corporations

China has become Taiwan's largest export market and the second largest origin of imports next to Japan. The export ratio to China and Hong Kong reached 41.09% in 2009, up from 24.44% in 2000, while the import ratio reported 14.65% in 2009 from 6.11% in 2000 (Chart 3.8), representing Taiwanese corporations' closer trade relations with China. Therefore, the evolution of China's economy and financial markets will impact Taiwanese corporations to an increasing extent. Consequently, this warrants closer attention with respect to business risks that may arise in China resulting from a combination of the following: tight monetary policy; increasing pressure for RMB appreciation; structural economic adjustments; and serious labor shortages.

Chart 3.8 Exports to and imports from China and Hong Kong

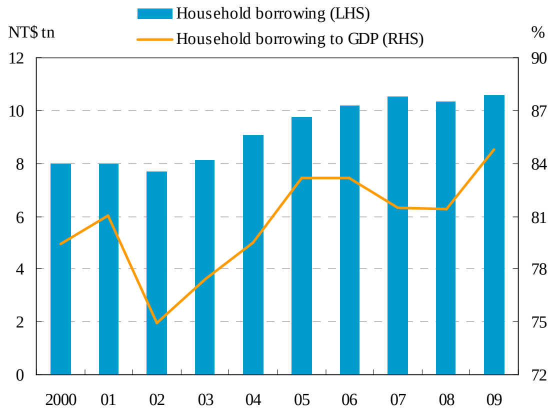


Source: Directorate General of Customs, MOF.

3.2 Household sector

As interest rates declined, short-term household debt servicing capacity strengthened even as borrowing increased and debt burdens became heavier. Furthermore, overall credit quality remained satisfactory. Household debt servicing capacity should strengthen as the domestic economy recovered gradually and regular earnings resumed positive growth from November 2009. Nevertheless, the potential impacts caused by the high unemployment rate and possible reversal of interest rates warrant closer attention.

Chart 3.9 Household borrowing to GDP



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