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.

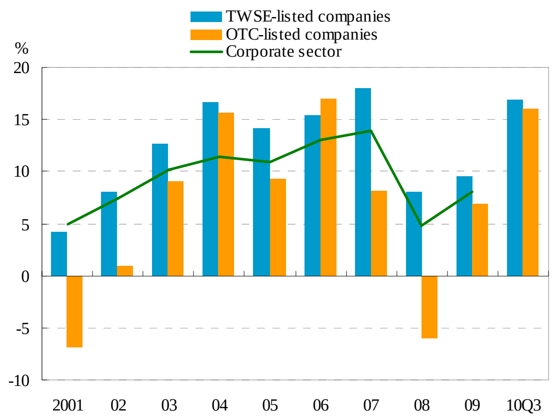
3.1 Corporate sector

From the second half of 2009 onward, overall profitability of the corporate sector improved amidst gradual recovery of the global and domestic economies. Driven by increased foreign and domestic demand, the performance of both Taiwan's export and industrial production was strong in 2010, which resulted in significantly increase of the profitability of TWSE-listed and OTC-listed companies for the first three quarters of 2010 compared to the same period of the previous year. The leverage ratio increased slightly due to rising liabilities caused by an expansion in production capacity, while the current ratio showed some decrease. However, the interest servicing capacity of corporate sector enhanced and the credit quality of corporate loans remained sound, as the NPL ratio continuously decreased. Nevertheless, the impact of the Japan's earthquake and the price hikes in energy and raw materials on the profitability of domestic corporations and supply chain requires continuous attention and timely responses.

Profitability increased continuously throughout 2010

The profitability of the corporate sector gradually increased amidst the recovery of the global economy and improvements in domestic economic indicators from the second half of 2009. The return on equity

Chart 3.1 Return on equity in corporate sector



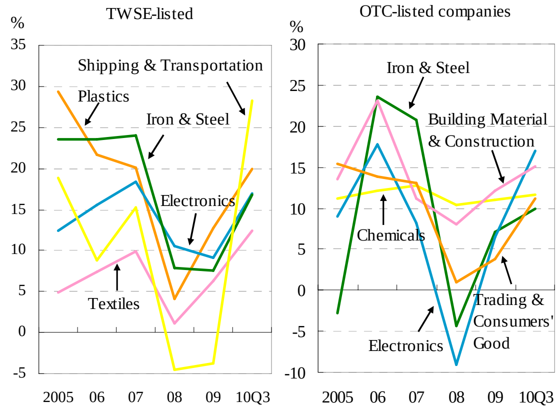
Notes: 1. Return on equity = net income before interest and tax / average equity.
2. The data are on an annual basis as 2010 Q3 figures are annualized results.
3. Latest data for the corporate sector is as of the end of 2009, while that for TWSE-listed and OTC-listed companies are as of the end of 2010 Q3.

Sources: JCIC and TEJ.

(ROE) for the corporate sector increased to 8.07% in 2009 as TWSE-listed and OTC-listed companies' ROEs rose to 9.58% and 6.91%, respectively. Thanks to the strong growth of emerging countries and increased demand from Europe and the United States, total export/import value, export orders, the industrial production index and its annual growth rate in 2010 all reached historical highs. All of these, together with a steady increase in private consumption, greatly enhanced the profitability of the corporate sector. The annual ROEs for TWSE-listed and OTC-listed companies rose to 16.95% and 16.01%, respectively, for the first three quarters of 2010, much higher than those reported in 2009 (Chart 3.1).

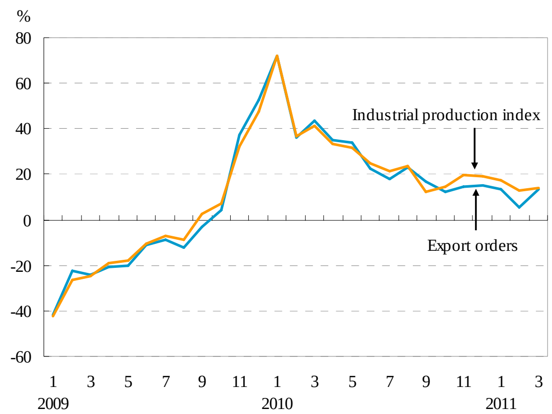
All major industries for TWSE-listed companies reported rebounding profitability for the first three quarters of 2010. Among them, the shipping and transportation industry stood out, returning to profit from loss and delivering an ROE that hit a 10-year high. For OTC-listed companies, the profitability of the electronics industry, which accounted for more than 75% of total revenue of OTC-listed companies, was the best. Other industries also saw better performance than in 2009 (Chart 3.2).

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 2010 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.

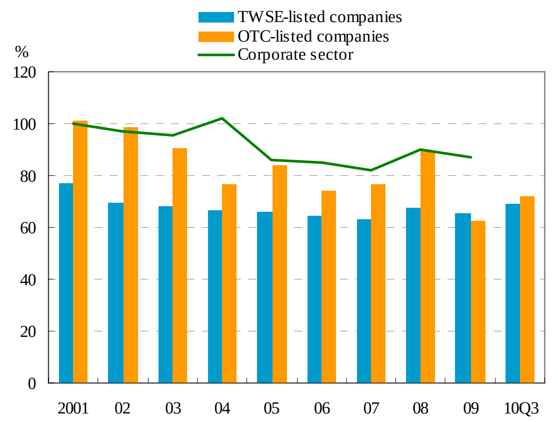
In 2010, driven by rising global demand, Taiwan's export orders and the industrial production index increased by 26.14% and 26.93%, respectively, for the whole year, and registered double-digit annual growth for each month. Moreover, underpinned by strong sales of smartphones and tablet computers, and the surging demand for inventory amid concerns over supply chain disruption caused by the Japan's earthquake, Taiwan's export orders and the industrial production index hit a record high in March 2011 with annual growth rates of

13.37% and 13.82%, respectively (Chart 3.3). Looking ahead, steady global economic growth, strong demand from Mainland China and tariff cuts on items included in the Early Harvest List under the Cross-Strait Economic Cooperation Framework Agreement (ECFA) that came into effect on 1 January 2011 are expected to support the profitability of the corporate sector in the future.

Rising leverage ratio for listed companies

For the corporate sector as a whole, the financial structure improved and the average leverage ratio fell to 86.88% at the end of 2009 as the recovery of profitability increased its equity. In 2010, with expectations of further economic recovery, domestic corporations expanded production capacity and in turn increased liability. As a result, the average leverage ratios for TWSE-listed and OTC-listed companies rose to 69.01% and 72.17%, respectively, at the end of September 2010, but still lower than those for the entire corporate sector in 2009 (Chart 3.4).

Chart 3.4 Leverage ratio in corporate sector

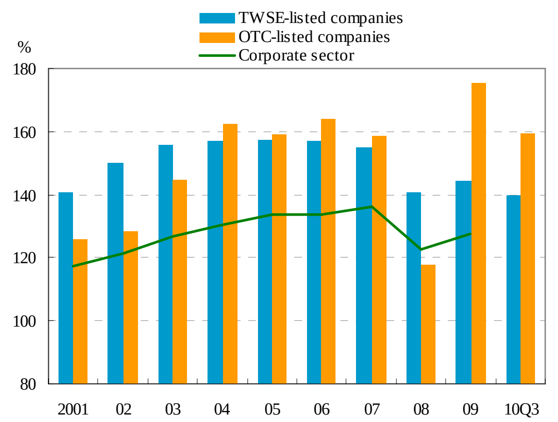


Notes: 1. Leverage ratio = total liabilities / equity.
2. End-of-period figures.
3. Latest figure for the corporate sector is as of the end of 2009, while those for TWSE-listed and OTC-listed companies are as of the end of 2010 Q3.
Sources: JCIC and TEJ.

Decreasing current ratio for listed companies, but interest servicing capacity remained strong

In 2009, short-term debt servicing capacity of the corporate sector as a whole improved with both the current ratio and the interest coverage ratio rising to 127.65% and 8.54, respectively, due to increases in current assets and income. The current ratios for TWSE-listed and OTC-listed companies fell to 139.71% and 159.69%, respectively, at the end of September 2010 as a result of increased short-term liabilities. Owing to the

Chart 3.5 Current ratio in corporate sector



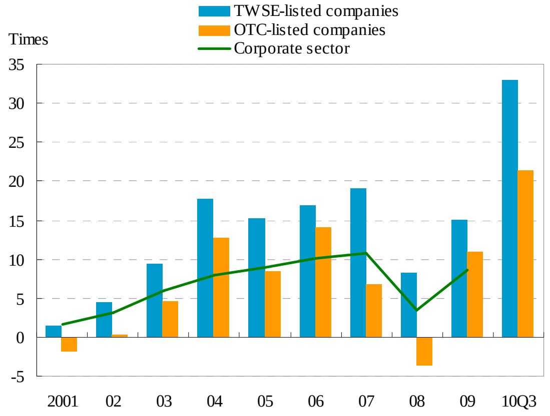
Notes: 1. Current ratio = current assets / current liabilities.
2. End-of-period figures.
3. Latest figure for the corporate sector is as of the end of 2009, while those for TWSE-listed and OTC-listed companies are as of the end of 2010 Q3.
Sources: JCIC and TEJ.

profitability boom in the first three quarters of 2010, however, the interest coverage ratios for TWSE-listed and OTC-listed companies leaped to 33.07 and 21.38, respectively, the highest levels since 2001 (Chart 3.5 & 3.6), reflecting that interest servicing capacity of corporate sector significantly improved.

Credit quality of corporate loans remained sound

The NPL ratio for corporate loans continued to decline to 0.88% at the end of 2010 due to a continuation of decreasing non-performing corporate loans (Chart 3.7). During the global financial crisis, Taiwan's government adopted several special financing measures in support of corporations, such as the Debt Renegotiation Relief Program and associated supporting arrangements that expired at the end of 2010. The expiration of the aforementioned program, which brought corporate financing back to the market mechanism, together with rising market interest rates that followed the policy rate rises of the CBC, resulted in doubts about whether some weaker or less competitive corporations may once again face financing and interest repayment pressures. This situation is worthy of close attention.

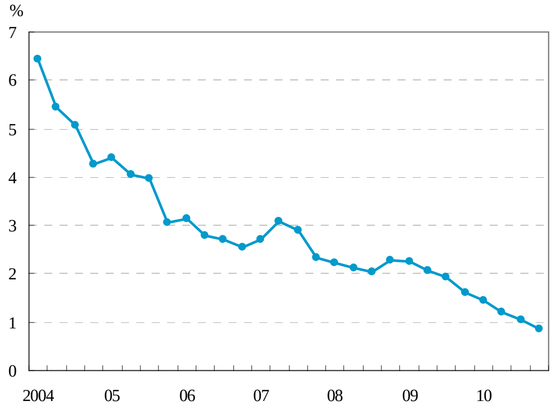
Chart 3.6 Interest coverage ratio in corporate sector



Notes: 1. Interest coverage ratio = income before interest and tax / interest expenses.
2. Figures are on an annual basis as 2010 Q3 referred to the accumulation from January to September 2010.
3. Latest figure for the corporate sector is as of the end of 2009, while those for TWSE-listed and OTC-listed companies are as of the end of 2010 Q3.

Sources: JCIC and TEJ.

Chart 3.7 NPL ratio of corporate loans



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

Meanwhile, the recent price hikes on imported raw materials may put industries that consume a lot of energy or rely heavily on imported raw materials for production under pressure of rising costs and shrinking profits. In addition, the impact of the Japan's earthquake and nuclear plant crisis on domestic electronics and automobile industry's supply chains, the rise in the price of oil as a result of turmoil in North Africa and the Middle East, and the aggravated exchange rate volatility in emerging economies all contributed to an environment of elevated business risk for corporations, which warrants close attention and timely responses.

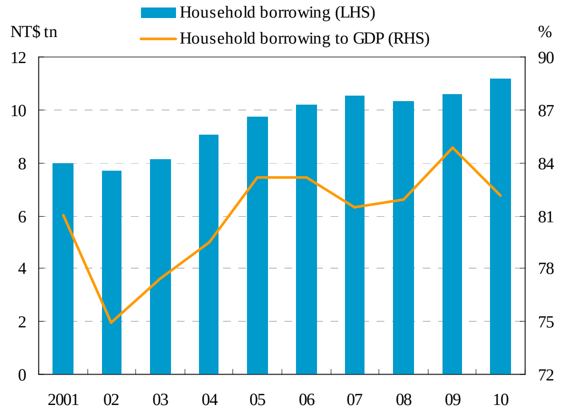
3.2 Household sector

The household debt burden eased and debt servicing capacity strengthened as disposable income expanded faster than borrowing. Overall credit quality of household borrowing also remained satisfactory. However, as interest rates gradually move upwards, highly leveraged households may face even heavier indebtedness. Thus, the debt repayment capacity for those households warrants close attention.

Household borrowing slightly increased

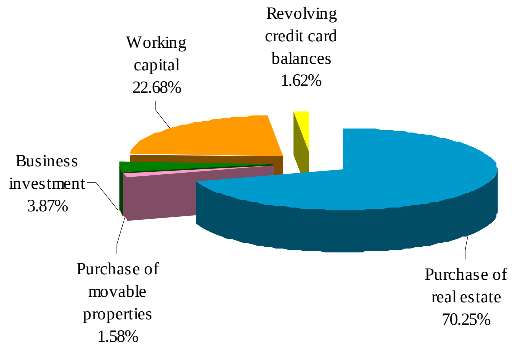
Following booming local stock and real estate markets, total household borrowing[44] at the end of 2010 reached NT$11.19 trillion (Chart 3.8) with an year-on-year growth rate of 5.69%. The largest share of household borrowing went for the purchase of real estate (70.25%), followed by working capital loans[45] (22.68%), while revolving balances on credit cards accounted for only 1.62% (Chart 3.9). Except for revolving credit card balances, the balances for every other kind of loan increased in 2010. Among them, business investment loans, mainly for margin purchases, had the greatest annual growth rate of 29.92%, while real estate purchase loans increased by 4.72%.

Chart 3.8 Household borrowing to GDP



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

Chart 3.9 Household borrowing by purpose



Note: Figures are as of the end of 2010.
Sources: CBC and JCIC.

[44] 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.

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