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.

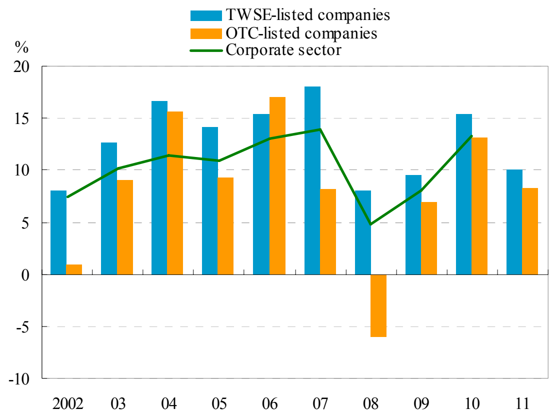
3.1 Corporate sector

Amid weak global economic growth and the European sovereign debt crisis, the profitability of listed companies weakened during the second half of 2011, while corporate leverage ratios showed mixed movements. Short-term debt servicing capacity was still at an acceptable level, though impaired by a deterioration in profitability. The credit quality of corporate loans remained sound as NPL ratios continuously decreased, but some industries began to show signs of increasing credit risk as their operating performance deteriorated in the face of diminishing market demand and global competition. In addition, rising international oil prices, eurozone economic recession, slow recovery of the US economy and China's lowered GDP target may affect future performance of the corporate sector and, therefore, warrant close attention.

Profitability of listed companies weakened in 2011

In the second half of 2011, weak global economic growth and the European sovereign debt crisis not only hit Taiwan's industrial production and exports but also hampered private consumption due to a contraction in wealth. Under these circumstances, the profitability of TWSE-listed and OTC-listed companies in 2011 weakened compared to the

Chart 3.1 Return on equity in corporate sector

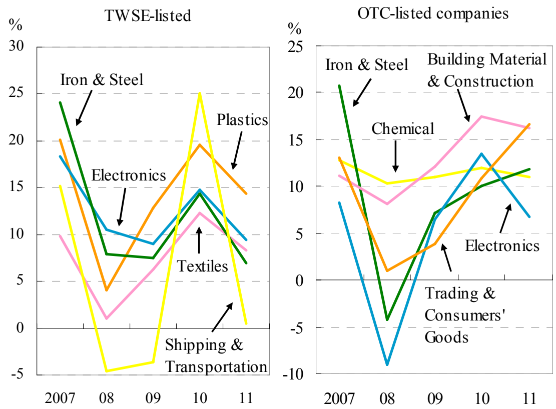


Notes: 1. Return on equity = net income before interest and tax / average equity.
2. Latest data for the corporate sector is as of 2010, while those for TWSE-listed and OTC-listed companies are as of 2011.
Sources: JCIC and TEJ.

previous year as their returns on equity (ROEs) decreased to 10.07% and 8.32%,[47] respectively (Chart 3.1).

All major industries for TWSE-listed companies reported plummeting profitability in 2011, especially the shipping and transportation industry with an ROE that was down to almost zero. For OTC-listed companies, except for the trading & consumers' goods and the iron & steel industries that steadily increased profitability, all other industries experienced deteriorating performance (Chart 3.2). In addition, TWSE-listed and OTC-listed optoelectronics companies reported increasing losses of NT$152.9 billion and NT$2.9 billion, respectively, in 2011.

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

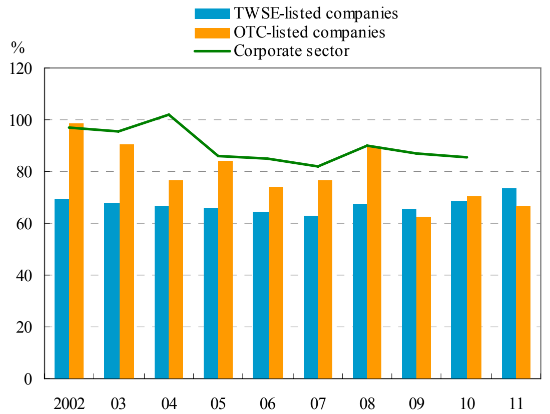


Notes: Return on equity = net income before interest and tax / average equity.
Source: TEJ.

Leverage ratio rose slightly for TWSE-listed companies but fell for OTC-listed companies

At the end of 2011, as some large companies issued bonds to raise long-term funds, the average leverage ratio for TWSE-listed companies slightly rose to 73.53% from 68.45% at the end of the previous year. However, the average leverage ratio for OTC-listed companies fell to 66.25% as a result of decreasing liabilities (Chart 3.3).

Chart 3.3 Leverage ratio in corporate sector



Notes: 1. Leverage ratio = total liabilities / equity.
2. Latest figure for the corporate sector is as of the end of 2010, while those for TWSE-listed and OTC-listed companies are as of the end of 2011.
Sources: JCIC and TEJ.

Short-term debt servicing capacity for listed companies remained acceptable though weakened

At the end of 2011, short-term debt servicing capacity of TWSE-listed companies weakened with both the current ratio and the interest coverage ratio decreasing to 133.23%

[47] The financial data for listed companies came from the Taiwan Economic Journal (TEJ) database, which excluded the data for Nanya Technology Corporation and Powerchip Technology Corporation as both were in the full cash delivery stock category as of the end of 2011. The losses for Nanya and Powerchip were NT$39.9 and NT$22.1 billion, respectively, in 2011. Including these two companies would cause the ROEs of TWSE-listed and OTC-listed companies to decrease to 9.67% and 5.97%, respectively.

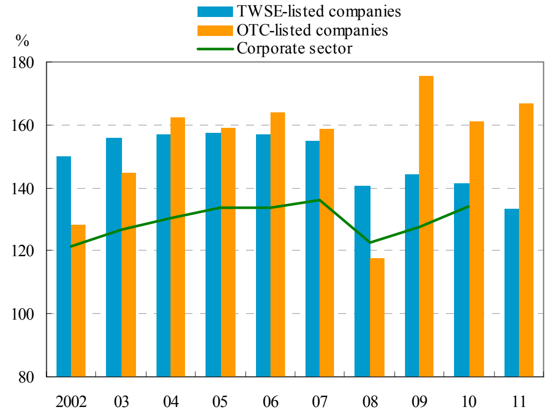
and 18.89, respectively, due to increases in current liabilities and deteriorations in profitability. The current ratio for OTC-listed companies rose to 166.73% as a result of decreased current liabilities, while their interest coverage ratio decreased to 14.82 owing to deteriorations in profitability (Chart 3.4 and 3.5). Overall short-term debt servicing capacity for listed companies remained acceptable though weakened.

Credit quality of corporate loans remained sound, but credit risk for certain industries increased

At the end of 2011, the NPL ratio for corporate loans granted by financial institutions continued to decline to 0.60% from 0.87% at the end of the previous year, reflecting sound credit quality for the corporate sector as a whole (Chart 3.6). However, due to diminishing market demand and global competition, some industries, especially dynamic random access memory (DRAM) and thin film transistor-liquid crystal display (TFT-LCD) manufaturers, saw weakened operating performances that may undermine their debt servicing capacity and negetively impact the loan quality of their creditor banks.

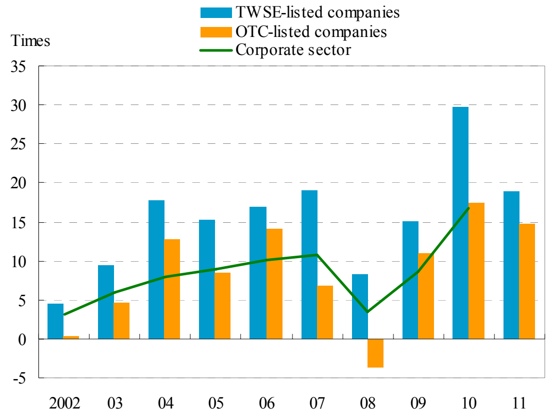
Meanwhile, in response to the global economic slowdown that adversely affected Taiwan's exports and investments during the second half of 2011, the Executive Yuan set up an "Economic Strategic Panel" on 3 November 2011 and put forth countermeasures to provide necessary assistance to industries in need. Starting 2012, global economic conditions began to show signs of stabilization and the DGBAS forecasted that the GDP growth rate of Taiwan would gradually pick up quarter by quarter. In addition, local market liquidity is

Chart 3.4 Current ratio in corporate sector



Notes: 1. Current ratio = current assets / current liabilities.
2. Latest figure for the corporate sector is as of the end of 2010, while those for TWSE-listed and OTC-listed companies are as of the end of 2011.
Sources: JCIC and TEJ.

Chart 3.5 Interest coverage ratio in corporate sector



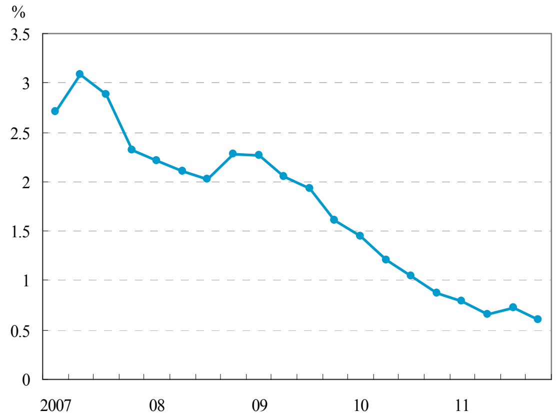
Notes: 1. Interest coverage ratio = income before interest and tax / interest expenses.
2. Latest figure for the corporate sector is as of 2010, while those for TWSE-listed and OTC-listed companies are as of 2011.
Sources: JCIC and TEJ.

abundant and interest rates remain at low levels. All these will help to improve the operating enviornment and financial soundness of the corporate sector. However, rising international oil prices, economic recession in the eurozone, slow recovery of the US economy and China's lessened GDP growth target may affect future performance of the corporate sector and, therefore, warrant close attention.

3.2 Household sector

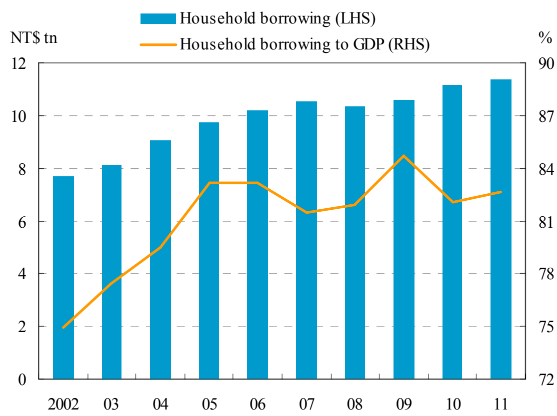
As the growth of total household borrowing slowed and disposable income expanded faster than borrowing, the household debt burden slightly eased. Overall credit quality of household borrowing also remained satisfactory. Moreover, the gradual easing of the unemployment rate and the continuous growth of regular earnings may help to enhance the debt servicing capacity of households.

Chart 3.6 NPL ratio of corporate loans



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

Chart 3.7 Household borrowing to GDP



Sources: CBC, JCIC and DGBAS.

Growth of household borrowing slowed

Total household borrowing[48] at the end of 2011 reached NT$11.36 trillion, equivalent to 82.65% of annual GDP (Chart 3.7). The year-on-year growth rate of household borrowing for 2011 declined from 5.61% at the end of the previous year to 1.71%, mainly attributable to decreased growth of residential mortgage loans. The largest share of household borrowing went for the purchase of real estate (72.24%), with a decreased annual growth rate of 2.53%,

[48] 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.