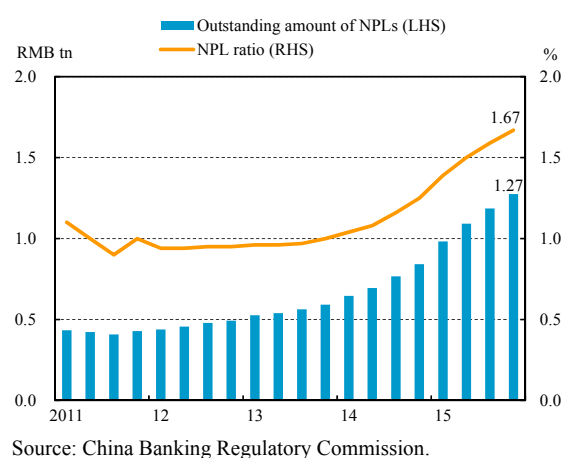


Despite a sustained rise in bank loans in the most recent four years, the NPL ratio edged up to 1.67% at the end of 2015 from the 1.25% recorded a year earlier as a result of moderate economic growth (Chart 2.19). Because Mainland China's government continually cut excessive industrial capacity and cleaned up indebted corporates, the NPL ratio may continue to increase.

**With local government debts coming due, various measures were successively launched**

**Chart 2.19 NPL ratios of Mainland China's commercial banks**



On account of local governments facing enormous debts due from 2015 onwards,<sup>24</sup> alongside increasing pressure to service their debts owing to ongoing economic slowdown and address the sources of financial stability pressure, Mainland China's government consented to launch a RMB3.2 trillion local government debt-swap program so as to enable local governments to tackle their debt due problems. Furthermore, the State Council determined to raise the limit the National Social Security Fund is allowed to invest in local government bonds and adopted a local government debt ceiling in order to reduce default risk of local government debts.

## 2.2 Domestic economic conditions

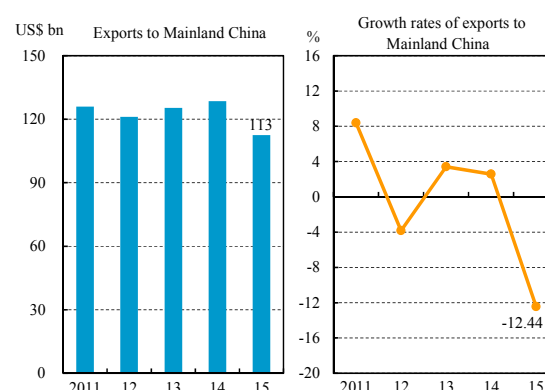
In 2015, because of a substantial decline in exports and sluggish momentum in investment, the domestic economy grew slowly along with stable inflation. Short-term external debt servicing ability remained strong on the back of a sustained surplus in the balance of payments and ample foreign exchange reserves. Meanwhile, the scale of external debt shrank and external debt servicing capacity improved. Although the government's fiscal deficits fell, the total government debt level slightly mounted; furthermore, the government kept implementing the *Fiscal Health Plan* to enhance a sound fiscal system.

<sup>24</sup> The National Audit Office of the People's Republic of China published the audit findings of public debts at all levels of government in December 2013. Based on the report, about RMB2.78 trillion of the total local government debts fell due in 2015, and about RMB1.52 trillion will fall due in 2016.

### 2.2.1 Exports declined sharply and domestic economic growth slowed

As a result of the continuous slump in international crude oil prices, global demand moderation and increasing threat from industrial supply chain localization in Mainland China, Taiwan's exports to major markets all declined in 2015, with an annual decrease of 10.90%, reaching the lowest level since 2009. Moreover, other major exporting countries in Asia also faced the same challenges.<sup>25</sup>

Chart 2.20 Exports and growth rates of exports to Mainland China



Source: MOF.

Because Taiwan's exports are highly concentrated on Mainland China's market, and greatly affected by the industrial supply chain localization and their slowdown in economic growth, the growth rate of exports to Mainland China (including Hong Kong) sharply shrank to -12.44% in 2015 (Chart 2.20). Broken down by industry, exports of optical instruments registered the greatest decline in both amount and growth rate. In the short run, the emergence of the industrial supply chain in Mainland China will directly influence exports of intermediate goods from Taiwan. Meanwhile, the gradual completion of Mainland China's supply chain and the *Go Global* strategy promoted by Mainland China's government will jeopardize the importance of the role played by Taiwan's industries in the international specialization over the longer run.

The slump in exports, uncertainty over market prospects and a shortage of domestic investment led the economic growth rate to significantly decline in Q2 2015. Moreover, growth rates dropped to -0.80% in Q3 and -0.89% in Q4. Overall, the annual economic growth rate stood at only 0.65% in 2015, much lower than the 3.92% of the previous year (Chart 2.21).

<sup>25</sup> Affected by global business cyclical factors, the annual export growth rates in major Asian countries dropped substantially, e.g., Singapore (-19.8%), Hong Kong (-15.3%), Malaysia (-14.6%), Japan (-9.5%), South Korea (-8.0%), Thailand (-5.8%) and Mainland China (-2.5%).

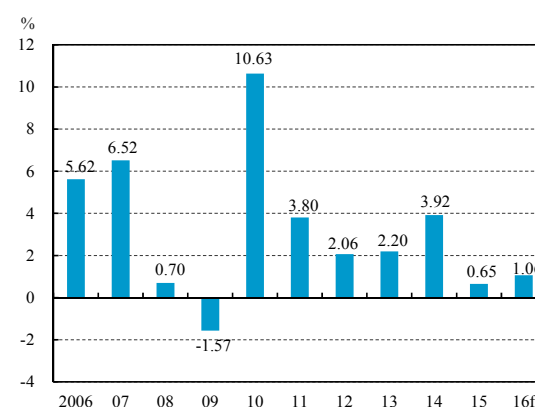
Taking a glance into 2016, the growth rate of exports is likely to continue to drop alongside sluggish momentum in private investment and insufficient growth in consumption. As a result, the DGBAS preliminarily estimates Taiwan's economic growth rate to reach -0.68% in Q1 and forecasts the annual economic growth rate to stand at 1.06%<sup>26</sup> in 2016 (Chart 2.21).

### 2.2.2 Domestic prices remained stable

In 2015, dragged down by the decrease in the international prices of raw materials, such as crude oil, the wholesale price index (WPI) inflation rate showed a downward trend, which continuously magnified from January and turned to narrow after registering -10.23% in July. Afterwards, the WPI inflation rate reached -7.30% in December (Chart 2.22). The annual WPI inflation rate stood at -8.84% in 2015, lower than the -0.57% in the previous year, and reached the lowest level on record. The DGBAS projects the annual WPI inflation rate to remain in negative territory at -2.88% in 2016.<sup>27</sup>

Attributed to a prolonged weakness in international crude oil prices and the plunges in prices of gasoline, electricity and gas, the CPI inflation rates were negative from January to August in 2015. However, domestic prices of vegetables and fruits rose considerably owing to the influence of typhoons and torrential rain, and the CPI inflation rate turned positive from September, whereas the core CPI inflation rates all kept positive during the whole year (Chart 2.22). Eventually the annual CPI inflation rate registered -0.31% in 2015, lower than the 1.20% of the previous year, while the core CPI inflation rate rose moderately and reached 0.79%, lower than the 1.26% recorded a year earlier. With global economic recovery

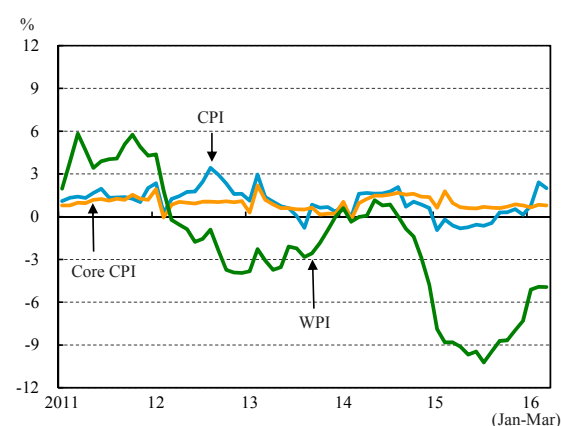
Chart 2.21 Economic growth rates in Taiwan



Note: Figure for 2016 is forecast by DGBAS.

Source: DGBAS.

Chart 2.22 Consumer and wholesale price inflation rates



Note: Figures are measured on a year-on-year change basis.

Source: DGBAS.

<sup>26</sup> See Note 3.

<sup>27</sup> See Note 3.

remaining slow and the international prices of crude oil and cereals continuing at low levels, the DGBAS forecasts the annual CPI inflation rate to ascend to 1.09%<sup>28</sup> in 2016.

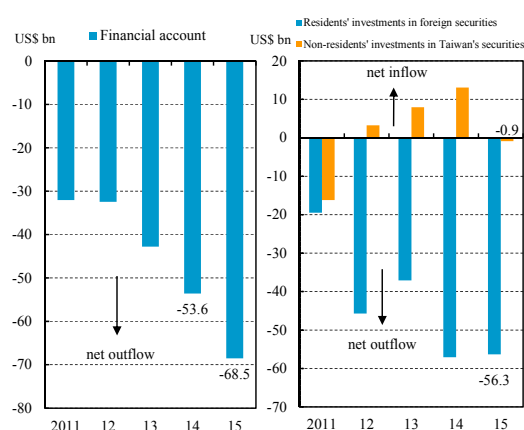
### 2.2.3 Current account surplus persisted and foreign exchange reserves stayed abundant

In 2015, despite both merchandise exports and imports decreasing compared to the previous year, the trade surplus rose as exports decreased less than imports, causing the annual current account surplus to reach US\$75.5 billion, or 14.44%<sup>29</sup> of annual GDP, with an increase of US\$13.0 billion or 20.83% compared to 2014.

The annual balance of outflows expanded to a record high of US\$68.5 billion in 2015. Focusing on the components of the financial account, residents' investments in foreign securities in 2015 held at a high level primarily resulting from the continuously increasing foreign bond investments by insurance companies. Meanwhile, non-residents' investments in Taiwan's securities shrank, owing to the reduced investments by foreign institutional investors in the domestic stock and bond markets (Chart 2.23). With rising outflows on the financial account but a greater increase in the current account surplus, the balance of payments surplus climbed to US\$15 billion in 2015, increasing by 15.34% from a year earlier.

On account of the continuous balance of payments surplus, the accumulation of investment earnings from foreign exchange reserve assets and the appreciation of major currencies, such as the euro, against the US dollar, the foreign exchange reserves climbed to US\$426 billion at the end of December 2015, a slight increase of 1.68% from the previous year. At the end of April 2016, the amount of foreign exchange reserves continued to increase to US\$433.2 billion. Furthermore, at the end of 2015, the ratio of foreign exchange reserves to short-term external debt turned to rise to 2.94 times

**Chart 2.23 Financial account and net inflow/outflow of securities investments**



Source: CBC.

<sup>28</sup> See Note 3.

<sup>29</sup> For the ratio of current account deficit to GDP, the cutoff point for risk is 3%. A country in which the reading is greater than 3% and has risen by at least 5 percentage points from the previous year is considered to be at relatively high risk.

owing to an increase in foreign exchange reserves and a decrease in short-term external debt. Consequently, it was higher than internationally recognized minimum levels,<sup>30</sup> implying that Taiwan's foreign exchange reserves have a robust capacity to meet payment obligations (Chart 2.24).

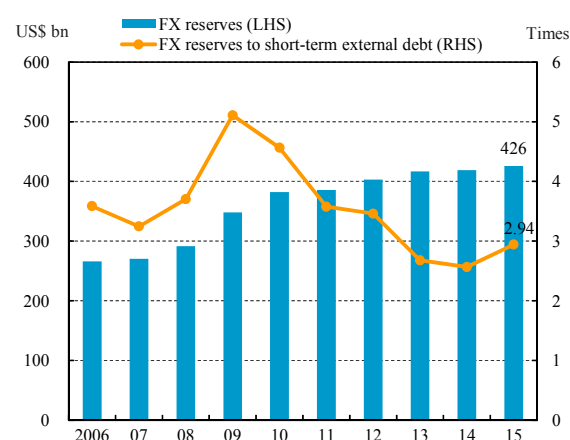
### 2.2.4 Scale of external debt shrank and debt-servicing capacity improved

Taiwan's external debt<sup>31</sup> slightly rose in the first half of 2015 owing to the increases of offshore banking units' due from foreign banks and foreign deposits. Domestic banks repaid foreign loans with abundant capital from Q3, causing external debt to fall to US\$159 billion, or 30.39% of annual GDP, at the end of the year, suggesting that the capacity to service external debt improved<sup>32</sup> (Chart 2.25).

### 2.2.5 Fiscal deficits fell but government debt slightly rose

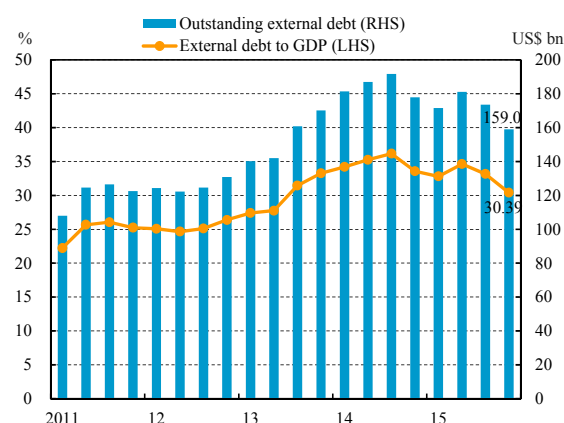
To promote economic growth in 2015, the government appropriately increased expenditures and boosted spending on public infrastructure construction investment and technology development. However, the excess of central government tax revenues

Chart 2.24 Short-term external debt servicing capacity



Note: FX reserves and external debt are end-of-period figures. Source: CBC.

Chart 2.25 External debt servicing capacity



Notes: 1. External debts are end-of-period figures. 2. GDP is annual figures. Sources: CBC and DGBAS.

<sup>30</sup> The general international consensus is that a ratio of foreign exchange reserves to short-term external debt higher than 100% indicates relatively low risk.

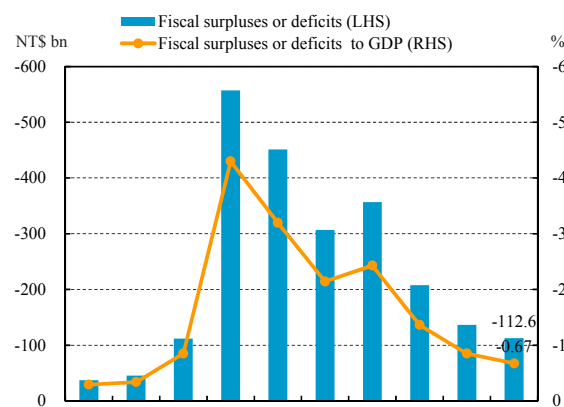
<sup>31</sup> The CBC defines external debt as the combined amount owed to foreign parties by Taiwan's public and private sectors, including long-term debt with a maturity of greater than one year and short-term debt with a maturity of one year or less. The term "public external debt" refers to debt that the public sector is either obligated to repay directly or has guaranteed (starting from December 2004, figures for public external debt include outstanding foreign debt arising from repo transactions between the CBC and international financial institutions). The term "private external debt" refers to private-sector foreign debt not guaranteed by the public sector.

<sup>32</sup> The general international consensus is that a country with a ratio of external debt to GDP lower than 50% is deemed to be at relatively low risk.

and surplus of debt expenditures<sup>33</sup> caused fiscal deficits to decline to NT\$112.6 billion alongside a fall in the ratio of fiscal deficits to annual GDP to 0.67%<sup>34</sup> in 2015 (Chart 2.26).

As fiscal deficits stayed high and both central government and local governments relied on bond issuance to finance debt servicing expenditures, outstanding public debt at all levels of government<sup>35</sup> in 2015 expanded to NT\$6.19 trillion,<sup>36</sup> or 37.11% of annual GDP,<sup>37</sup> from the NT\$6.10 trillion registered in the previous year (Chart 2.27).

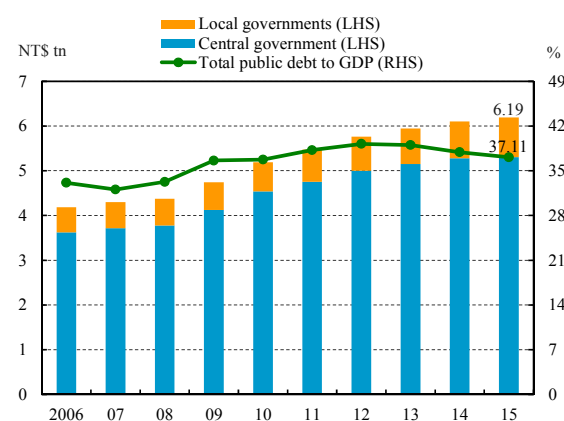
In order to promote fiscal health, the Ministry of Finance continued to implement the *Fiscal Health Plan* and *Central Government Debt Improvement Plan* that seek to enhance a sound fiscal system through the following approaches: implementing all the measures of increasing income and reducing expenses; improving the structures of revenue and expenditure; controlling the scale of debt; coordinating all resources; diversifying sources of finance; and timely modifying taxation.<sup>38</sup>

**Chart 2.26 Fiscal deficits position**


Notes: 1. Fiscal position data include those of central and local governments.

2. Data of fiscal deficits are annual figures. Figures for 2015 are final accounts and budgets for the central government and local governments, respectively.

Sources: MOF and DGBAS.

**Chart 2.27 Public debts**


Notes: 1. Outstanding public debt refers to non-self-liquidating debt with a maturity of one year or longer, excluding external debt.

2. Figures for 2015 are preliminary final accounts and budgets for the central government and local governments, respectively.

Sources: MOF and DGBAS.

<sup>33</sup> The figures are based on a DGBAS press release on 21 April 2016.

<sup>34</sup> See Note 4.

<sup>35</sup> The term “outstanding debt at all levels of government” as used in this report refers to outstanding non-self-liquidating debt with a maturity of one year or longer. As of April 2016, the outstanding one-year-or-longer non-self-liquidating public debts are NT\$5.40 trillion, NT\$0.59 trillion, NT\$0.16 trillion, and NT\$0.6 billion for central government, municipalities, counties, and townships, respectively. The figures account for 33.73%, 3.69%, 1.00%, and 0.004% of the average GDP for the preceding three fiscal years, which are below the ceilings of 40.6%, 7.65%, 1.63%, and 0.12% for central government, municipalities, counties, and townships, separately, set out in the *Public Debt Act*.

<sup>36</sup> Outstanding non-self-liquidating debt at all levels of government with a maturity of one year or longer stood at NT\$6.15 trillion as of the end of April 2016.

<sup>37</sup> See Note 5.

<sup>38</sup> It includes the restoration of the business tax on financial services to 5 percent and the implementation of the integrated housing and land tax system since January 1, 2016.