

# I. DEVELOPMENTS IN THE REAL ECONOMY

## 1. National Output and Income

Taiwan's economy posted modest growth in 2003, with real GDP growing at an annual rate of 3.24 percent, slower than the 3.59 percent pace of the previous year. The growth was mainly the result of strong export expansion and a small increase in domestic demand.

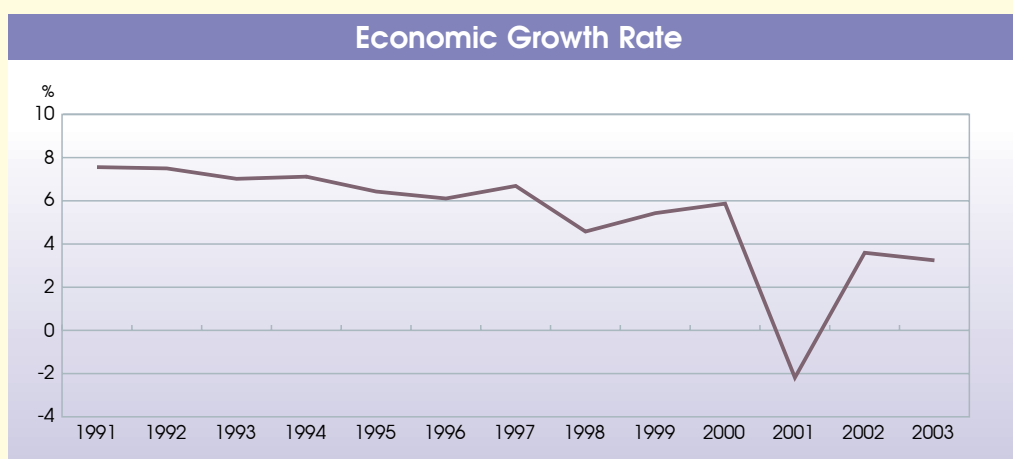
Although the US-Iraq War posed a threat to investor and consumer confidence, Taiwan's exports performed fairly well and provided crucial stimuli to growth in the first quarter. The adverse impact of Severe Acute Respiratory Syndrome (SARS) on trade and economic activities sapped consumer confidence and disturbed private investment plans in the second quarter, and real GDP contracted. After the US-Iraq War ended and the SARS epidemic came under control, Taiwan's exports recovered quickly, and domestic demand gradually revived in the second half of the year.

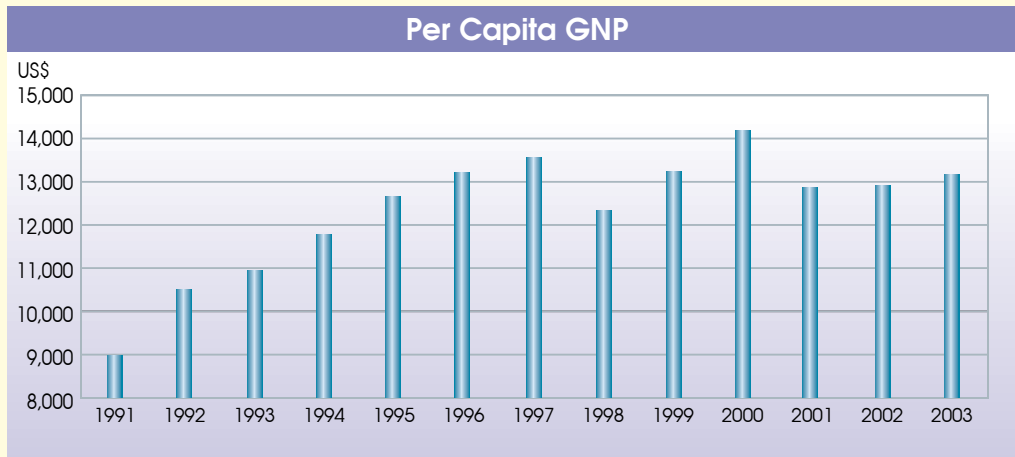
In year-on-year terms, real GDP grew by 3.53 percent in the first quarter and declined by 0.08 percent in the second quarter. It increased by 4.18 percent in the third quarter and 5.17 percent in the fourth quarter.

Per capita GNP in nominal terms reached US\$13,157 for the year, up US\$241 from 2002.

### Expenditure Components of GDP

Real GDP growth in 2003 was mainly driven by foreign trade, which made a net contribution





of 2.39 percentage points to the real economic growth rate. Meanwhile, domestic demand only made a small contribution of 0.85 of a percentage point for the year.

#### (1) Slowdown in Private Consumption

Among all the expenditure components, private consumption accounted for the largest share, or 62.82 percent, of GDP in 2003. As private consumption expenditure for the year went up by only 0.79 percent in real terms, lower than the 1.99 percent increase in 2002, its contribution to economic growth for the year declined to 0.48 of a percentage point from 1.23 percentage points a year ago.

Several factors dragged on the momentum of private consumption in the first half of 2003.

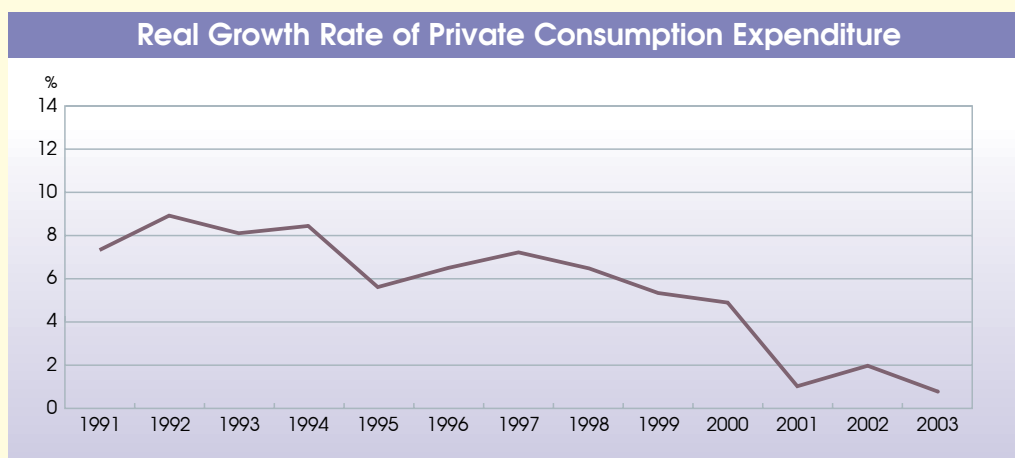
### Expenditures on Gross Domestic Product

unit: %

	2003			2002		
	Share	Real Growth Rate	Contribution to Real Growth Rate of GDP*	Share	Real Growth Rate	Contribution to Real Growth Rate of GDP*
Private Consumption	62.82	0.79	0.48	63.08	1.99	1.23
Government Consumption	12.81	0.83	0.10	12.64	-0.2	-0.02
Gross Fixed Capital Formation	17.51	-1.60	-0.29	17.73	-2.13	-0.41
Change in Inventory	-0.35	—	0.56	-0.86	—	0.16
Exports of Goods and Services	58.11	10.49	5.87	53.81	9.98	5.26
( Less : Imports of Goods and Services)	(50.90)	(7.56)	(3.48)	(46.40)	(5.84)	(2.63)
Expenditure on GDP	100.00	3.24	3.24	100.00	3.59	3.59

Note: \* Percentage point.

Source: *Statistical Abstract of National Income, Taiwan Area, the Republic of China (1951-2004)*, Directorate-General of Budget, Accounting and Statistics, Executive Yuan.

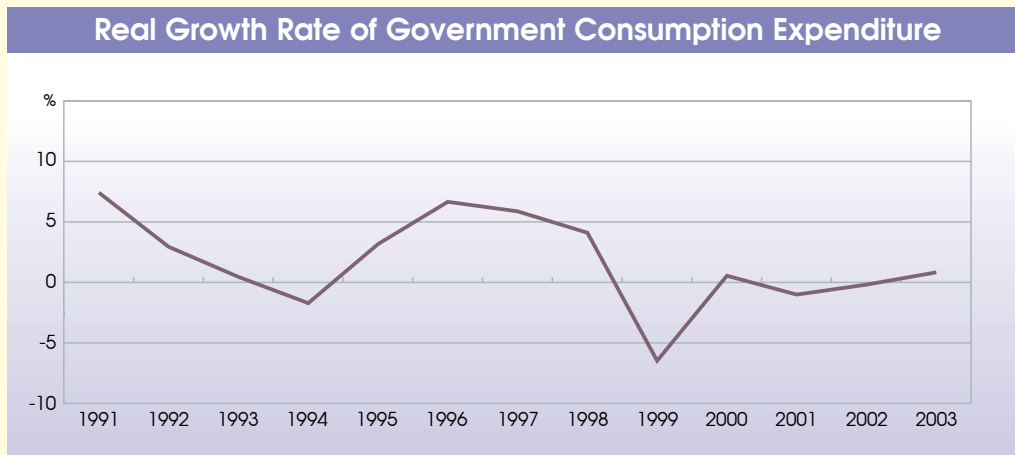


Against the backdrop of a high unemployment rate, consumers remained cautious about spending, which was even further overshadowed by the general uncertainty about the US-Iraq War and the SARS outbreak. Private consumption suffered a decline of 1.81 percent in the second quarter. Later, as these uncertainties dissipated, consumers turned more optimistic about the economy's prospects in the months ahead. Furthermore, the buoyant stock market in the fourth quarter also played a role in encouraging consumer spending. Private consumption set off again on a positive course in the second half of the year.

As far as the private consumption categories are concerned, the growth rate of food consumption increased to 1.84 percent in 2003, up from last year's rate of 1.10 percent. Nonfood consumption increased at a rate of 0.45 percent, lower than the 2.27 percent growth rate registered a year earlier. Among the components of nonfood consumption, the categories of "furniture, furnishings and household equipment", "fuel and power" and "medical care and health expenses" posted the largest growth. This was primarily a reflection of households getting more access to IT products such as computers, Internet-related products and mobile phones, combined with higher fuel expenditures arising from the rise in world oil prices, as well as ongoing increase in health care expenditures incurred by our aging population.

## (2) Slight Increase in Government Consumption

Government consumption was up by 0.83 percent in real terms during 2003, compared with the decline of 0.2 percent in the previous year, which led to a 0.10 of a percentage point increase in real GDP for the year. The slight increase in government consumption was due to the government's Expansion of Employment through Public Services Plan to arrange for



temporary jobs with the aim of bringing down the unemployment rate.

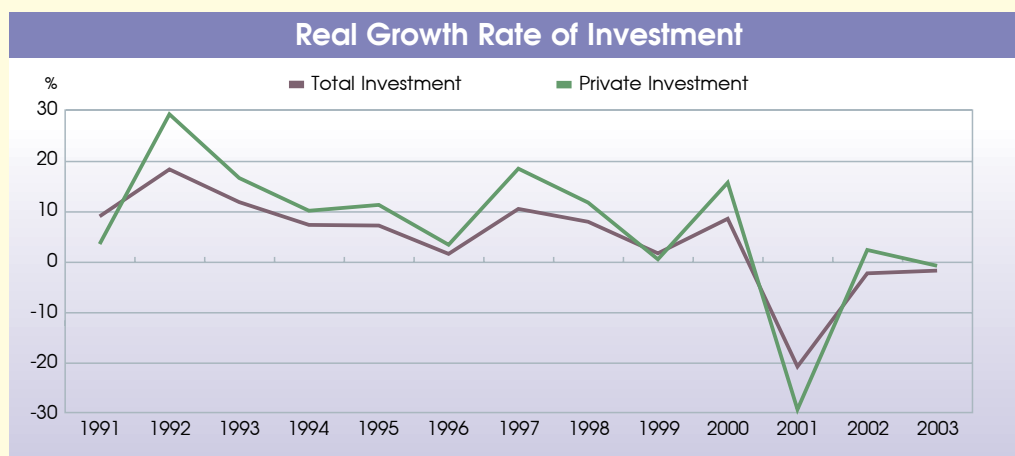
### (3) Modest Decline in Fixed Capital Formation

Fixed capital formation declined at a more moderate rate compared with the previous year and edged 1.60 percent lower in 2003. Its contribution to GDP growth for the year was negative 0.29 of a percentage point, following a negative contribution of 0.41 of a percentage point a year earlier. Among all the expenditure components of GDP, fixed capital formation expenditure accounted for 17.51 percent of GDP, slightly lower than the previous year's 17.73 percent.

Private investment experienced a sharp decline of 11.49 percent in the second quarter of 2003 as private companies refrained from making investments due to such an uncertain economic climate in the first half of the year. As economic conditions turned better in the second half, firms expanded their production facilities. However, in the third-quarter, investments were only limited to those in high-tech industries such as optic-electronics.

Thanks to global economic recovery, the world's largest producers outsourced more information-technology products from Taiwan, which helped contribute to a double-digit growth in private investment in the fourth quarter. Nevertheless, private investment edged down 0.7 percent for the year as a whole, compared with the previous year's growth of 2.5 percent, and contributed negative 0.08 of a percentage point to GDP growth.

Likewise, government investment and investment by public enterprises in real terms shrank by 1.82 percent and 5.54 percent, respectively, together contributing negative 0.21 of a



percentage point to economic growth for the year. This was because most large-scale construction projects made little progress, along with fewer investments made by major public enterprises as they were moving toward privatization.

In terms of different types of capital goods in fixed capital formation, the real growth rate of investment in the construction sector posted negative 3.67 percent for the year, compared with a decline of 1.05 percent in 2002. The reduction was owing to the slack activity in the overall construction industry. Investment in transportation equipment turned to increase by 4.02 percent for the year, as against the negative growth of 12.41 percent in 2002. This was mainly the result of increased procurement of large-sized aircraft by local airlines, and of motor vehicles for business usage. As the rebound in the fourth quarter did not counterbalance the weak performance in the first three quarters, investment in machinery and equipment fell by merely 0.68 percent in 2003, compared with the significant decline of 1.55 percent registered a year earlier.

#### (4) Robust Growth of Exports

Exports continued to be a key trigger of GDP growth in 2003. Although the general economic picture in major industrial countries initially appeared to be unclear after the turn of the year, Taiwan's exports benefited from strong demand from neighboring Asian countries in the first quarter. The uncertainties over the SARS outbreak adversely hit exports in the second quarter. As SARS was contained, export growth gradually picked up from the third quarter onward amid a recovery in intra-regional trade in Asia.

Moreover, as the global economy rapidly turned around, more Taiwanese manufacturers



benefited from international enterprises' outsourcing strategies and global alliances, which fueled the expansion of export orders of electronics, IT-related and basic metal products.

The growth of real exports of goods and services measured in NT dollar terms stood at 10.49 percent in 2003, higher than the 9.98 percent growth in the previous year. Exports of goods and services accounted for 58.11 percent of GDP in 2003, and its contribution to economic growth was 5.87 percentage points, compared with 5.26 percentage points in 2002.

#### (5) Continued Expansion in Imports

Meanwhile, import growth turned negative in the second quarter of 2003, which was primarily due to the weaker derived demand arising from sluggish exports and industrial production, together with a weak domestic demand. Imports of goods and services also improved, causing the real growth rate of imports, measured in NT dollar terms, to rise by 7.56 percent for the year, also higher than the 5.84 percent in 2002. Imports of goods and services accounted for 50.9 percent of GDP for the year, higher than the share of 46.4 percent posted a year earlier.

#### GDP by Sector of Production

Viewed from the production side, the industrial and services sectors both registered positive growth rates, while the agricultural sector posted a negative growth rate during 2003. The services sector replaced the industrial sector as the key driver for Taiwan's economy during the year, contributing 1.65 percentage points to economic growth, down from the previous year's 1.80 percentage points. The industrial sector made a contribution of 1.60 percentage

## Gross Domestic Product by Kind of Activity

Unit:%

	2003			2002		
	Share	Real Growth Rate	Contribution to Real Growth Rate of GDP*	Share	Real Growth Rate	Contribution to Real Growth Rate of GDP*
Agriculture	1.82	-0.22	-0.01	1.86	4.73	0.12
Industry	30.38	4.74	1.60	31.05	5.04	1.68
Mining & Quarrying	0.37	-16.67	-0.04	0.43	2.11	0.01
Manufacturing	25.54	5.82	1.63	25.85	6.26	1.71
Construction	2.23	-3.49	-0.10	2.21	-2.86	-0.09
Electricity, Gas & Water	2.24	4.63	0.12	2.56	2.18	0.06
Services	67.79	2.59	1.65	67.10	2.79	1.80
Trade & Eating-drinking Places	19.85	2.94	0.51	19.44	2.37	0.41
Transport, Storage & Communications	6.85	4.17	0.35	6.93	4.86	0.40
Finance, Insurance & Real Estate	21.01	2.97	0.59	20.87	4.29	0.85
Business Services	2.82	2.46	0.06	2.77	-0.06	0.00
Government Services	10.81	2.05	0.20	10.51	1.83	0.18
Social Services & Personal Services	10.57	2.98	0.27	10.35	4.17	0.38
Gross Domestic Product	100.0	3.24	3.24	100.0	3.59	3.59

Note: \* Percentage point.

Source: *Statistical Abstract of National Income, Taiwan Area, the Republic of China (1951-2004)*, Directorate-General of Budget, Accounting & Statistics, Executive Yuan.

points in 2003, slightly decreasing from 1.68 percentage points a year earlier. The contribution of agricultural production to overall GDP for the year reversed from 0.12 of a percentage point in 2002 to negative 0.01 of a percentage point.

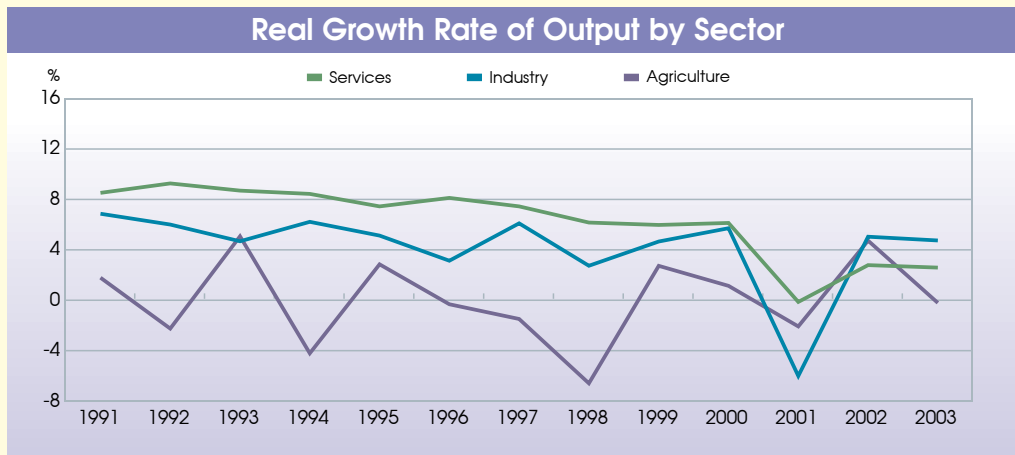
Regarding the share of each sector's output in GDP, the shares of agricultural output and industrial output continued to shrink in 2003 and accounted for 1.82 percent and 30.38 percent of total output, respectively. The share of services output to GDP kept on rising to 67.79 percent for the year.

**(1) A 0.22 Percent Decrease in Agricultural Output**

Following WTO entry, the real agricultural value-added production in 2003 declined by 0.22 percent, compared with an increase of 4.73 percent posted a year earlier.

**(2) A 4.74 Percent Growth in Industrial Output**

Industrial production in real terms grew by 4.74 percent in 2003, lower than the 5.04 percent recorded in 2002. Industrial production covers the secondary industries of mining and quarrying, manufacturing, construction, and electricity, water and gas.



Production in mining and quarrying posted a sharp negative growth of 16.67 percent, compared with positive growth of 2.11 percent in 2002. The shrinkage was mainly due to the sluggishness in the construction sector.

Manufacturing production in real terms expanded 5.82 percent for the year, compared with 6.26 percent in the previous year. The decrease largely reflected the adverse impact from the SARS outbreak in the second quarter.

In terms of the production indices of the 22 items within the manufacturing sector, the precision instruments, petroleum & coal products and the transportation equipment industries posted strong real growth rates of 16.41 percent, 15.16 percent and 12.24 percent, respectively. On the other hand, seven industries, which mostly were domestically oriented and labor-intensive industries, posted negative growth rates. Among them, the wood and bamboo products and leather and fur industries declined by 14.74 percent and 6.40 percent, respectively, largely because of weak demand together with firms' moving their operations overseas to get a competitive advantage. Additionally the tobacco industry dropped by 7.90 percent, mainly due to a plunge in demand for domestically made tobacco products after the introduction of tax on such products following WTO entry.

The electricity, gas and water sector grew 4.63 percent, rising from a 2.18 percent growth in 2002, as a result of the pickup in industrial production.

The real estate market showed signs of recovery in the second half of 2003. However, there were still many unused housing units island wide, combined with slow progress in large construction projects. Together, these factors led to a negative growth of 3.49 percent in the



construction sector for the year, following a decline of 2.86 percent in 2002.

### **(3) A 2.59 Percent Increase in the Services Sector**

Services output rose by 2.59 percent in 2003, slightly lower than the 2.79 percent growth rate of the previous year. The growth rate was mainly supported by the 4.17 percent expansion in the transportation, storage and communications sector, as communication businesses were not unfavorably affected by the SARS outbreak. In addition, the air passengers and cargo flight businesses rebounded amid an improved economic environment in the second half of the year.

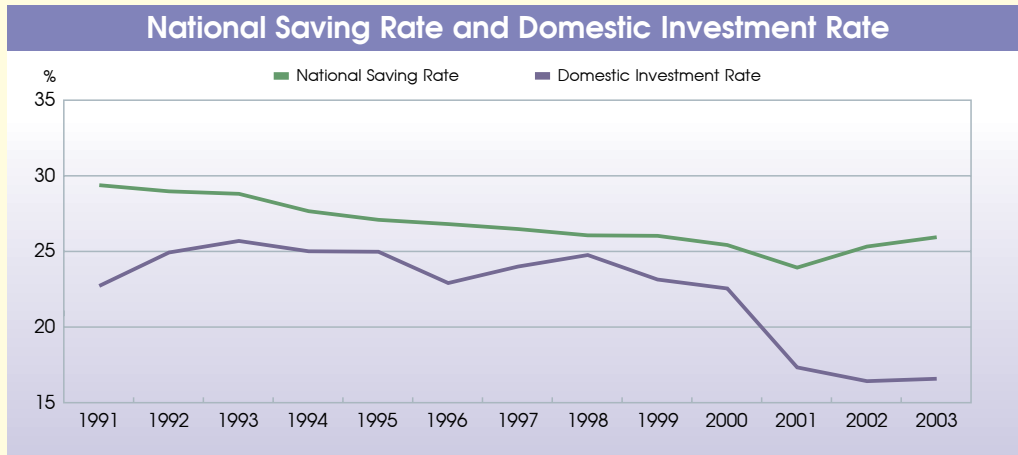
The social services and personal services sector grew 2.98 percent for the year, attributable to the rising expenditure on medical care and education services. Financial, insurance, and real estate services posted growth of 2.97 percent for the year, which was essentially buoyed by the Bank's easy monetary measures and, particularly, increasing receipts from relevant transaction fees associated with brisk stock and real estate market activities in the second half. Nevertheless, the growth rates of the above three sectors in 2003 were all lower than their respective rates posted a year ago.

The trade and eating-drinking places sector, which shrank in the second quarter, turned to rise by 2.94 percent for the year, compared with 2.37 percent in the previous year, largely reflecting improved consumer confidence in the second half. The government services sector posted a slightly higher growth rate of 2.05 percent in 2003, primarily on account of the government's Expansion of Employment through Public Services Plan aiming to reduce the unemployment rate.

### **Slight Increase in National Saving Rate**

The national saving rate (national saving to GNP measured at current prices) increased from 25.34 percent in the previous year to 25.96 percent in 2003, mainly because national consumption (including both private consumption and government consumption expenditures) grew by a slower rate of 0.89 percent compared to the GNP growth rate of 1.78 percent. The slower growth of national consumption mostly reflected weak private consumption amid a high unemployment rate environment.

Taiwan has continued to sustain positive excess saving since 1981. The excess saving (national saving less gross domestic investment) to GNP ratio jumped from 8.9 percent a year ago to 9.37 percent in 2003. The rise was the consequence of a large trade surplus, together



with a slower growth rate of domestic investment than that of national saving.