

3. BALANCE OF PAYMENTS

The balance of payments in Taiwan was characterized by a narrowing current account surplus and a net inflow in the financial account in 2004. The current account surplus shrank to US\$19,013 million, lower than the previous year's US\$29,266 million, and accounted for 6 percent of GDP. The capital account registered a small deficit of US\$77 million. The financial account exhibited a net inflow of US\$6,366 million. As a result, the foreign reserve assets held by the Bank at end-2004 increased by US\$26,595 million over a year earlier.

A Declining Current Account Surplus

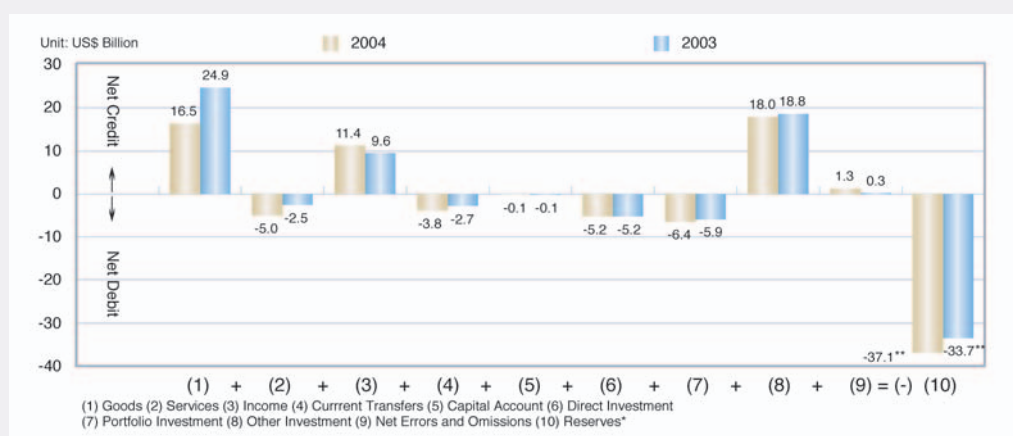
The components of the current account include goods, services, income and current transfers. The current account surplus decreased in 2004 mainly as a result of the decline in the trade surplus of goods and the widened deficits in services and current transfers.

(1) Goods

For the year 2004, both on a balance of payments basis and a customs basis, the value of exports and imports registered double-digit growth rates and hit historic highs. However, the trade surplus shrank as a result of a larger increase in imports than in exports.

On a balance of payments basis, the value of exports grew by 20.7 percent to US\$173,153 million, mainly driven by persistently steady growth in the global economy and in the information

Balance of Payments



Notes: * Excluding valuation changes in exchange rates.

**The minus sign(-) indicates an increase in foreign exchange reserves.

Source: *Balance of Payments, Taiwan District, Republic of China, Department of Economic Research, Central Bank of China.*

Balance of Payments

Unit: US\$ Million

	2004	2003
A. Current Account	19,013	29,266
Goods: exports f.o.b.	173,153	143,447
Goods: imports f.o.b.	-156,685	-118,548
Balance on Goods	16,468	24,899
Services: credit	25,777	23,166
Services: debit	-30,784	-25,635
Balance on Services	-5,007	-2,469
Income: credit	15,305	12,991
Income: debit	-3,927	-3,436
Balance on Income	11,378	9,555
Current transfers: credit	3,170	2,673
Current transfers: debit	-6,996	-5,392
Balance on Current transfers	-3,826	-2,719
B. Capital Account	-77	-87
Total, Groups A plus B	18,936	29,179
C. Financial Account	6,366	7,630
Direct investment abroad	-7,087	-5,682
Direct investment in Taiwan	1,898	453
Portfolio investment assets	-23,511	-35,620
Portfolio investment liabilities	17,074	29,693
Other investment assets	327	4,456
Other investment liabilities	17,665	14,330
Total, Groups A through C	25,302	36,809
D. Net Errors And Omissions	1,293	283
Total, Groups A through D	26,595	37,092
E. Reserves and Related items*	-26,595	-37,092

Note: * Excluding valuation changes in exchange rates.

Source: Balance of Payments, Taiwan District, Republic of China, Department of Economic Research, Central Bank of China.

technology (IT) industry worldwide. The value of imports rose by 32.2 percent to US\$156,685 million. It was primarily led by stronger derived demand arising from the expansion in exports and the recovery in domestic investment, along with surging international oil and commodity prices. The trade surplus on goods decreased to US\$16,468 million for the year, a decrease of 33.9 percent from the previous year.

As indicated by the Taiwan Customs' statistics, the three major trading partners for Taiwan in 2004 were mainland China (including Hong Kong), the U.S. and Japan. Exports to these three countries accounted for 60.5 percent of total exports, while imports from these three countries made up a 50.1 percent of total imports.

In terms of Taiwan's trade with mainland China (including Hong Kong), exports totaled US \$63,846 million for the year, with a growth rate of 28.3 percent when compared with the previous

Current Account



year. The marked growth was attributable to mainland China's strong economic growth, as well as the rising demand for raw materials, IT products and parts from Taiwanese firms operating in mainland China. This increase appeared significant when compared with other major export markets, and the share of exports to mainland China (including Hong Kong) increased by 2.2 percentage points to 36.7 percent. Mainland China (including Hong Kong) remained Taiwan's largest export market in 2004.

Imports from mainland China (including Hong Kong) rose by 48 percent, and its share of total imports rose to 11.2 percent in 2004. The large increase stemmed from the increased demand for Chinese electronics, information products and related parts due to the division of labor between Taiwanese industries on either side of the Taiwan Strait. The opening to import items from mainland China after both economies joined the WTO contributed to this growth as well. The bilateral trade surplus with mainland China (including Hong Kong) climbed to US \$45,074 million, reflecting a 21.5 percent increase. Mainland China (including Hong Kong) remained the largest source of Taiwan's trade surplus.

With respect to bilateral trade with the U.S., exports to the U.S. increased by 8.4 percent in 2004, compared with a contraction of 3.1 percent in the previous year. The share of exports to the U.S. as a proportion of total exports has been decreased since 1998, and further decreased to 16.2 percent in 2004. The reasons behind the continuous declines were the increased trade activity between the U.S. and NAFTA (North American Free Trade Agreement) members, the competition from mainland China's low-priced products, and the continued outward relocation (mainly to mainland China) of local industries. Imports from the U.S. increased by 28.6 percent,

while its share of total imports declined slightly from 13.2 percent in 2003 to 12.9 percent in 2004. Because the increase in imports was more than that in exports, the bilateral trade surplus with the U.S. decreased to US\$6,490 million, representing a decline of 28.8 percent. The U.S. remained the second largest source of Taiwan's trade surplus.

Regarding bilateral trade with Japan, the recovery of the Japanese economy led to a rise in exports to Japan by 10.8 percent in 2004, and the share of exports to Japan further fell to 7.6 percent from 8.3 percent a year earlier. Imports from Japan increased by 33.7 percent compared with the previous year, with the share of total imports rising to 26.0 percent in 2004. Japan remained Taiwan's largest source of imports. As the increase in imports was more than that in exports, Taiwan's trade deficit with Japan registered a considerable increase of 46.8 percent to US\$30,428 million for the year, the highest in history.

Exports to Europe increased by 14.6 percent in 2004, with the share of total exports falling to 13.5 percent. Imports from Europe increased by 31.1 percent in 2004, with the share of imports decreasing slightly to 12.7 percent of total imports. As the increase of imports was more than that of exports, Taiwan's trade surplus with Europe decreased from US\$4,212 million in 2003 to US\$2,137 million in 2004.

Direction of Trade in Goods by Country

Unit: %

	2004			2003		
	Amount (US\$ Million)	Share	Annual Change	Amount (US\$ Million)	Share	Annual Change
Exports						
Mainland China(including Hong Kong)	63,846	36.7	28.3	49,771	34.5	22.0
U. S. A.	28,123	16.2	8.4	25,942	18.0	-3.1
Europe	23,435	13.5	14.6	20,452	14.2	10.2
Southeast Asia 6*	22,821	13.1	33.7	17,073	11.8	10.0
Japan	13,204	7.6	10.8	11,913	8.3	-0.6
Rest of the World	22,604	13.0	18.8	19,030	13.2	12.1
Total	174,034	100.0	20.7	144,180	100.0	10.4
Imports						
Japan	43,632	26.0	33.7	32,635	25.6	19.6
U. S. A.	21,633	12.9	28.6	16,820	13.2	-7.0
Europe	21,298	12.7	31.1	16,240	12.8	10.9
Southeast Asia 6*	20,229	12.0	16.1	17,431	13.7	5.3
Mainland China(including Hong Kong)	18,773	11.2	48.0	12,686	10.0	31.0
Rest of the World	42,331	25.2	34.7	31,436	24.7	19.6
Total	167,895	100.0	31.9	127,248	100.0	13.1

Note: * Including Indonesia, Malaysia, the Philippines, Singapore, Thailand, and Vietnam.

Source: *Monthly Statistics of Exports and Imports, Taiwan District, Republic of China, Department of Statistics, Ministry of Finance.*

Owing to steady growth in Southeast Asia, exports to the six countries in the region, including Indonesia, Malaysia, the Philippines, Singapore, Thailand, and Vietnam, increased by 33.7 percent. Exports to the Philippines grew by 69.3 percent, the highest among the six countries. The share of exports to these countries rose to 13.1 percent. Imports from these countries rose by 16.1 percent in 2004, with the share of imports declining to 12.0 percent. As the increase of exports was more than that of imports, Taiwan's trade surplus with the six countries increased to US\$2,592 million in 2004 from a trade deficit of US\$358 million in 2003.

(2) Services

In 2004, both service receipts and payments registered their highest amounts in history. With total service receipts increasing by US\$2,611 million to US\$25,777 million in 2004 and total service payments increasing by US\$5,149 million to US\$30,784 million, the service deficit widened to US\$5,007 million from the US\$2,469 million recorded in 2003.

Of the various components of the services account, net payments with respect to transportation increased from US\$2,327 million recorded a year earlier to US\$2,845 million in 2004, largely due to the increase in international freight expenses paid to foreign vessels, coupled with the expansion in imports. Total travel receipts surged by US\$1,063 million to US\$4,040 million, as the result of an increase in both the number and per person expenditure of nonresidents visiting Taiwan. Total travel payments for the year increased by US\$1,690 million to US\$8,170 million, due to an increase in overseas visits by residents. Net travel payments expanded to US\$4,130 million as a result of the increase in total travel receipts being less than that in total travel payments. Other services receipts and payments both hit historic highs. Total other services receipts increased by US\$639 million to US\$16,441 million, while total other services payments increased by US\$2,032 million to US\$14,473 million. As the increase in total other services payments was more than that in total other services receipts, the surplus in net total other services decreased from US\$3,361 million in 2003 to US\$1,968 million in 2004.

(3) Income

Total income receipts increased by US\$2,314 million to US\$15,305 million in 2004, the highest level ever recorded. Total income payments for the year amounted to US\$3,927 million, US\$491 million more than in 2003. The surplus on the income account increased from US\$9,555 million in 2003 to a new high of US\$11,378 million in 2004. The increase was mainly from residents' overseas investment income.

(4) Current Transfers

Total current transfer receipts amounted to US\$3,170 million in 2004, US\$497 million more than in the previous year. Total current transfer payments for the year expanded by US\$1,604 million to US\$6,996 million, reaching a historical high, on account of the sharp increase in outward remittances by residents to support their overseas relatives. Net current transfer payments increased from US\$2,719 million in 2003 to US\$3,826 million in 2004.

Shrinking Capital Account Deficit

The capital account includes capital transfers (debt forgiveness, ownership transfer of fixed assets and migrants' transfers), and the acquisition and disposal of non-produced, non-financial assets. In 2004, the capital account consistently exhibited a deficit, but the gap narrowed by US\$10 million to US\$77 million, the lowest figure recorded since 1990. The decline was the result of shrinking acquisitions of non-produced, non-financial assets.

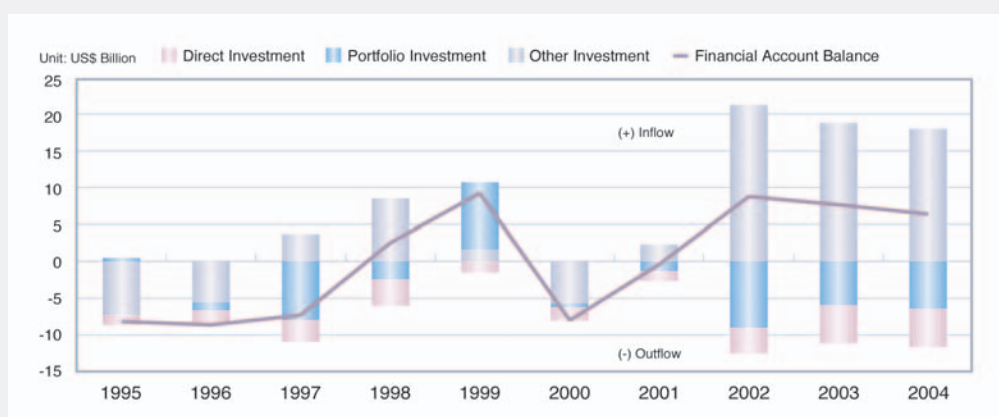
Net Inflow in the Financial Account

In 2004, the financial account presented a net inflow of US\$6,366 million. In terms of sub-categories, direct investment and portfolio investment posted a net outflow of US\$5,189 million and US\$6,437 million, respectively, while other investment posted a net inflow of US\$17,992 million.

(1) Direct Investment

Direct investment abroad by residents accounted for a net outflow of US\$7,087 million, the highest in history, and US\$1,405 million more than in the previous year. Mainland China

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received the lion's share of Taiwanese direct investment abroad, which was perhaps driven by an expectation of an appreciation of the Renminbi. Direct investment in Taiwan by nonresidents registered a net inflow of US\$1,898 million, a sharp increase of US\$1,445 million or 3.19 times that of the previous year, indicating a recovery of foreign direct investment. The net outflow of direct investment declined to US\$5,189 million in 2004, compared to US\$5,229 million in 2003.

(2) Portfolio Investment

Portfolio investment abroad by residents recorded a huge net outflow of US\$23,511 million, the second highest level ever recorded. It showed that residents increased their holdings of foreign securities through the purchases of overseas mutual funds. Net inflow of local portfolio investment by nonresidents registered US\$17,074 million, also the second highest level ever recorded. The capital inflow in the domestic market can largely be attributed to the massive portfolio allocation of international funds in Asia and the expectation of better earnings outlooks for locally listed companies. In addition, domestic enterprises preferred to raise funds through the international market and therefore increased the issuance of European (offshore) convertible bonds and depository receipts overseas. As a result, portfolio investment posted a net outflow of US\$6,437 million in 2004.

(3) Other Investment

Other investment abroad by residents recorded a net inflow of US\$327 million, representing a decrease of other claims on nonresidents by residents. This inflow was mainly because of the withdrawal of residents' overseas claims, following the weakening of the US dollar in the international market. Other local investments by nonresidents stood at a net inflow of US\$17,665 million, representing an increase of residents' other liabilities to nonresidents. The inflow can be mainly attributed to the borrowings from abroad by the local non-bank private sector and banking sector in expectation of the NT dollar's appreciation against the US dollar. As a consequence, other investment exhibited a net inflow of US\$17,992 million in 2004.

Considerable Increase in Foreign Exchange Reserves

For the year as a whole, the foreign exchange reserve assets held by the Bank increased by US\$26,595 million to a historic high of US\$241.74 billion at year-end. Reserve assets posted sharp increases as a result of huge current account surpluses, as well as the net inflow in the financial account, which resulted from a massive inflow of funds from overseas branches to local banks and brisk foreign portfolio investment in Taiwan.