

## 4. Prices

After three years of downward price pressure, Taiwan's consumer price index (CPI) inflation entered mildly positive territory in 2004 and rose by 1.62 percent, while core CPI (consumer prices excluding fresh fruits and vegetables, fish and shellfish, and energy) increased a modest 0.71 percent. Consumer prices grew due to a combination of factors, including an accommodative monetary policy, the recovery in domestic demand, and the rise in raw material prices internationally.

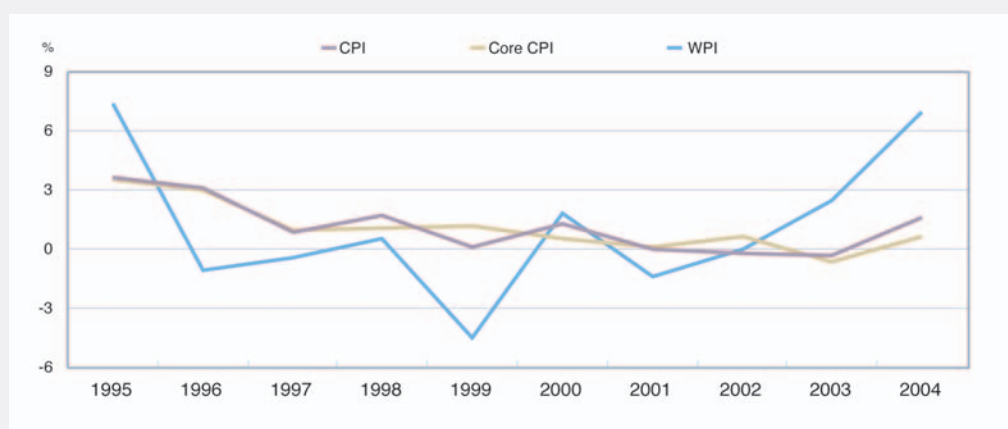
Food prices rose significantly in 2004 because of unfavorable weather conditions. In addition, rising international oil and commodity prices drove domestic wholesale prices up. The wholesale price index (WPI) in 2004 increased by 7.03%. However, intense competition in the domestic retail market made it difficult for firms to raise prices and pass on the extra costs to consumers.

### Steep Increase in Wholesale Prices

The WPI soared during the first three quarters of 2004. The upward pressure abated in the last quarter due to stabilizing oil prices and a strengthening New Taiwan dollar.

As global economic recovery accelerated in 2004, the strong demand for crude oil, petrochemicals, and primary metal products pushed up commodity prices. Import prices rose by 8.57 percent despite the 3 percent appreciation of the NT dollar against the U.S. dollar. This, in turn, led to an increase in factory prices of products for domestic sale by 10.28 percent. As a result, the WPI rose to 7.03 percent in 2004, the highest since 1996.

### Inflation Rate



Source: Price Statistics Monthly in Taiwan Area of the Republic of China, Directorate-General of Budget, Accounting and Statistics, Executive Yuan.

## Moderate Increase in Consumer Prices

During the first half of 2004, the CPI inflation rate rose moderately. In the second half of the year, heavy rain and severe typhoons caused significant increases in food prices for four consecutive months from July. However, after October, this price pressure eased and annualized monthly price increases returned to less than 2 percent. Therefore, for the year as a whole, the CPI increased by 1.62 percent, while the core CPI edged up by only 0.71 percent.

The major factors leading to the CPI inflation include the weather-induced spike in food prices and the surge in oil prices. The food price index rose by 4.36 percent, contributing 1.10 percentage points to the CPI inflation rate, accounting for 68 percent of the overall advance in the CPI. In addition, the respective climb in oil and gas prices by 10 percent and 5.42 percent resulted in a 5.30 percent increase in the energy price index, contributing 0.29 percentage points to the CPI inflation rate, or 18 percent of the overall advance in the CPI.

Significant increases in commodity prices are typical as economic activity accelerates and capacity utilization rises, especially for products with relatively fixed supply in the short run. The prices of products for domestic sales increased 9.52 percent for the year 2004. Among the components, the prices of raw materials and intermediate materials rose 21.46 percent and 11.46 percent, respectively. However, a portion of these increases usually proves to be transitory. More importantly, cyclical swings in commodity prices tend to have a minor effect on overall inflation. The reason is that they account for a small share of total costs and that changes in commodity prices tend to be temporary and partly absorbed by firms, thus the

### Major items of the CPI change in 2004

Item	CPI inflation rate (%)	Contribution to CPI inflation rate (percentage point)
CPI	1.62	1.62
Food	4.36	1.10
Fruits	16.42	0.38
Vegetables	9.61	0.26
Meat	7.07	0.18
Energy	5.30	0.29
Oils	10.00	0.23
Gas	5.42	0.05
CPI Excluding Food and Energy	0.33	0.23
Durable Consumer Goods	-1.68	-0.13
Residential Rent	-0.64	-0.13

Source: Price Statistics Monthly in Taiwan Area of the Republic of China, Directorate-General of Budget, Accounting and Statistics, Executive Yuan.

prices of finished goods only edged up 0.67 percent.

Other factors offsetting the CPI inflation include the decline in output unit labor cost driven by strong productivity and subdued upward pressure on retail prices due to intense market competition. Furthermore, falling rents for commercial property helped retard inflationary pressures. Among the components, the durable consumer goods price index continued its downward trend since 1997, the services index, which accounts for a sizable proportion of CPI, remained stable, and residential rent, a component of the services index, fell for the fourth year.

The price index for all items less food and energy advanced 0.33 percent in 2004, contributing 0.23 of a percentage point to the CPI inflation rate, or 14 percent of the overall advance in the CPI.