

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 2005. The current account surplus decreased to US\$16,366 million, lower than the previous year's US\$18,493 million, and accounted for 4.6 percent of GNP. The capital account registered a small deficit of US\$117 million. The financial account exhibited a net inflow of US\$1,779 million. As a result, the foreign reserve assets held by the Bank increased by US\$20,056 million.

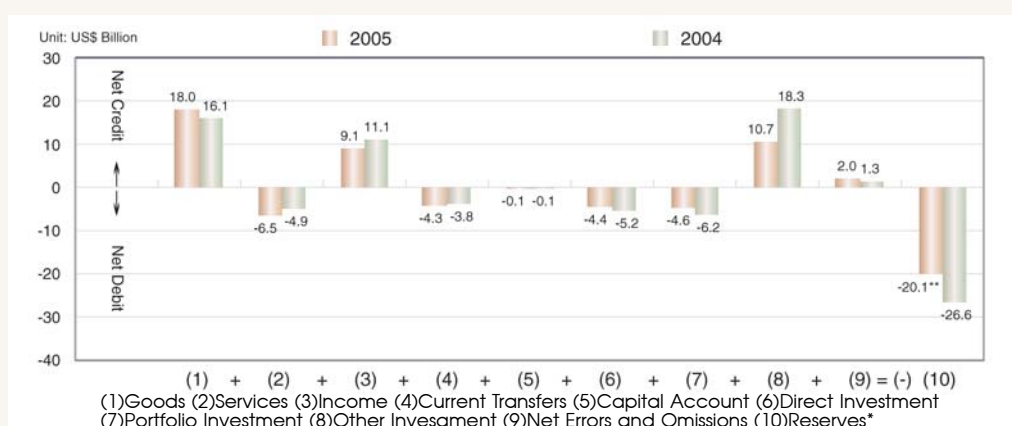
A Declining Current Account Surplus

The components of the current account include goods, services, income and current transfers. The current account surplus decreased in 2005, mainly as a result of the decline in the income surplus and the widened deficits in both services and current transfers.

(1) Goods

For the year 2005, both on a balance of payments basis and a customs basis, the value of exports and imports registered historic highs. The value of exports grew by 8.8 percent to US\$188,408 million, mainly driven by persistent expansion in the global economy. The value of imports rose by 8.5 percent to US\$170,423 million. It was primarily led by surging international oil price and stronger derived demand arising from the expansion in exports. The trade surplus

Balance of Payments



Notes: * Excluding valuation changes in exchange rates.

**The minus sign (-) indicates an increase in foreign exchange reserves held by the Bank.

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

Balance of Payments

Unit: US\$ Million

	2005	2004
A. Current Account	16,366	18,493
Goods: exports f.o.b.	188,408	173,154
Goods: imports f.o.b.	-170,423	-157,026
Balance on Goods	17,985	16,128
Services: credit	26,002	25,789
Services: debit	-32,476	-30,731
Balance on Services	-6,474	-4,942
Income: credit	17,471	15,485
Income: debit	-8,345	-4,353
Balance on Income	9,126	11,132
Current transfers: credit	3,463	3,170
Current transfers: debit	-7,734	-6,995
Balance on Current transfers	-4,271	-3,825
B. Capital Account	-117	-77
Total, Groups A plus B	16,249	18,416
C. Financial Account	1,779	6,831
Direct investment abroad	-6,028	-7,145
Direct investment in R. O. C.	1,625	1,898
Portfolio investment assets	-35,807	-23,513
Portfolio investment liabilities	31,256	17,317
Other investment assets	-6,370	754
Other investment liabilities	17,103	17,520
Total, Groups A through C	18,028	25,247
D. Net Errors and Omissions	2,028	1,348
Total, Groups A through D	20,056	26,595
E. Reserves and Related Items*	-20,056	-26,595

Note: * Excluding valuation changes in exchange rates.

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

on goods increased to US\$17,985 million for the year, an increase of 11.5 percent from the previous year.

As indicated by the Taiwan Customs' statistics, the top three trading partners for Taiwan in 2005 were mainland China (including Hong Kong), the US and Japan. Exports to these three countries accounted for 60.5 percent of total exports, while imports from these three countries made up 48.9 percent of total imports.

In terms of Taiwan's trade with mainland China (including Hong Kong), exports totaled US \$71,608 million for the year, representing a growth of 12.2 percent compared with the previous year. The marked growth was attributable to mainland China's strong economic growth, as well as the rising demand for IT products and parts from Taiwanese firms operating there. This increase appeared significant when compared with other major export markets, and the share

of exports to mainland China (including Hong Kong) increased by 1.1 percentage points to 37.8 percent. Mainland China (including Hong Kong) remained Taiwan's largest export market in 2005.

Imports from mainland China (including Hong Kong) rose by 16.2 percent, and its share of total imports rose to 12.0 percent in 2005. The large increase stemmed from the increased demand for Chinese electronics, information products, machinery and related parts due to the division of labor between Taiwanese industries on either side of the Taiwan Strait. The bilateral trade surplus with mainland China (including Hong Kong) climbed to US\$49,793 million, reflecting a 10.5 percent increase. Mainland China (including Hong Kong) remained the largest source of Taiwan's trade surplus.

With respect to bilateral trade with the US, exports to the US increased by 1.4 percent in 2005, compared with 8.4 percent the previous year. The share of exports to the US in total exports has decreased since 1998, and dropped further to 15.1 percent in 2005. The reasons behind the continuous declines were the increased trade activity between the US and NAFTA (North American Free Trade Agreement) members, competition from mainland China's low-priced products, and continued outward relocation (mainly to mainland China) of local industries. Imports from the US decreased by 3.0 percent and its share of total imports declined from 12.9 percent in 2004 to 11.6 percent in 2005. Because of the increase in exports and the decrease in imports, the bilateral trade surplus with the US increased to US\$7,522 million, representing an increase of 15.9 percent. The US 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 9.7 percent in 2005, and the share of exports to Japan remained at 7.6 percent. Imports from Japan increased by 5.3 percent compared with the previous year, with the share of total imports rising to 25.3 percent in 2005. 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 an increase of 3.4 percent to US\$31,461 million for the year, the highest in history.

Exports to Europe decreased by 0.8 percent in 2005, with the share of total exports falling to 12.3 percent. Imports from Europe increased by 2.3 percent in 2005, with the share of imports decreasing to 12.0 percent of total imports. Due to the decrease in exports and increase in imports, Taiwan's trade surplus with Europe decreased from US\$2,137 million in 2004 to US\$1,464

Direction of Trade in Goods by Country

Unit: %

	2005			2004		
	Amount (US\$ Million)	Share	Annual Change	Amount (US\$ Million)	Share	Annual Change
Exports						
Mainland China(including Hong Kong)	71,608	37.8	12.2	63,838	36.7	28.3
U. S. A.	28,510	15.1	1.4	28,122	16.2	8.4
Europe	23,257	12.3	-0.8	23,435	13.5	14.6
Southeast Asia 6*	26,128	13.8	14.5	22,818	13.1	33.7
Japan	14,481	7.6	9.7	13,200	7.6	10.8
Rest of the World	25,410	13.4	12.4	22,602	13.0	18.8
Total	189,394	100.0	8.8	174,015	100.0	20.7
Imports						
Japan	45,942	25.3	5.3	43,627	26.0	33.7
U. S. A.	20,988	11.6	-3.0	21,633	12.9	28.6
Europe	21,794	12.0	2.3	21,298	12.7	31.1
Southeast Asia 6*	21,015	11.6	3.9	20,229	12.0	16.1
Mainland China(including Hong Kong)	21,815	12.0	16.2	18,773	11.2	48.0
Rest of the World	50,052	27.6	18.2	42,330	25.2	34.7
Total	181,606	100.0	8.2	167,890	100.0	31.9

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

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

million in 2005.

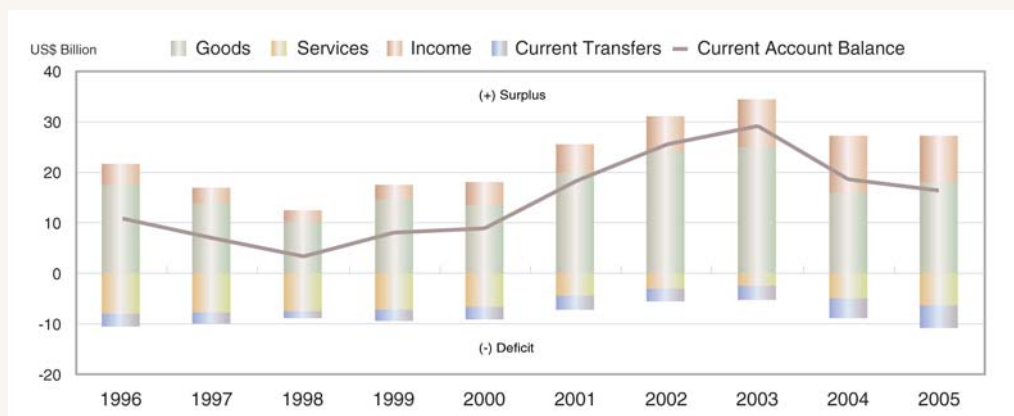
Owing to steady growth in Southeast Asia, exports to the six countries in the region, including Indonesia, Malaysia, the Philippines, Singapore, Thailand, and Vietnam, increased by 14.5 percent. Exports to Indonesia grew by 25.1 percent, the highest among the six countries. The share of exports to these countries rose to 13.8 percent. Imports from these countries rose by 3.9 percent in 2005, with the share of imports declining to 11.6 percent. As the increase of exports was more than that of imports, Taiwan's trade surplus with the six countries increased to US\$5,112 million in 2005 from US\$2,589 million in 2004.

(2) Services

In 2005, both service receipts and payments registered their highest amounts in history. With total service receipts increasing by US\$213 million to US\$26,002 million in 2005 and total service payments increasing by US\$1,745 million to US\$32,476 million, the service deficit widened to US\$6,474 million from the US\$4,942 million recorded in 2004.

Of the various components of the services account, net payments with respect to transportation decreased from US\$2,838 million recorded a year earlier to US\$2,504 million in 2005, largely due to the increase in international freight receipts. Total travel receipts surged

Current Account



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

by US\$986 million to US\$5,040 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\$512 million to US\$8,682 million, due to an increase in overseas visits by residents. Net travel payments decreased to US\$3,642 million as a result of total travel receipts increasing at a greater pace than those of total travel payments. Total other services receipts decreased by US\$1,410 million to US\$15,031 million, while total other services payments increased by US\$930 million to US\$15,359 million. Due to the decrease in total other services receipts and the increase in total other services payments, net total other services registered a deficit of US\$328 million in 2005 compared with a surplus of US\$2,012 million in 2004.

(3) Income

Both total income receipts and payments registered their highest levels ever in 2005. Total income receipts increased by US\$1,986 million to US\$17,471 million in 2005. Total income payments for the year amounted to US\$8,345 million, US\$3,992 million more than in 2004, mainly because the U.S. offered a special low tax rate on homebound remittances of overseas earnings, and cash dividend distributions by local listed companies boosted non-residents' income from investment in equity securities. Due to the increase in total income receipts being less than that in total income payments, the surplus on the income account decreased from US\$11,132 million in 2004 to US\$9,126 million in 2005.

(4) Current Transfers

Total current transfer receipts amounted to US\$3,463 million in 2005, US\$293 million more than in the previous year. Total current transfer payments for the year expanded by US\$739 million to US\$7,734 million, reaching a historical high, on account of the increase in outward remittances by residents to support their overseas relatives. Net current transfer payments increased from US\$3,825 million in 2004 to US\$4,271 million in 2005.

An Increasing 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 2005, the capital account consistently exhibited a deficit, and the size of this deficit increased to US\$117 million from US\$77 million in 2004, as a result of the increased acquisitions of non-produced, non-financial assets.

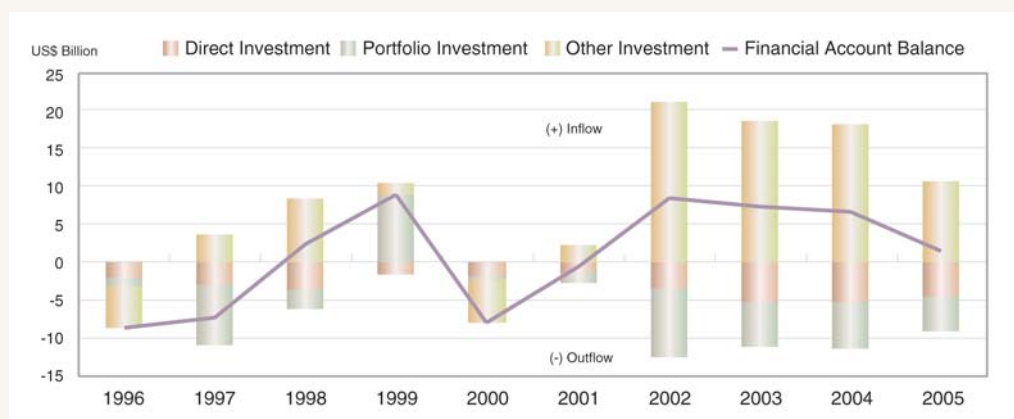
Net Inflow in the Financial Account

In 2005, the financial account presented a net inflow of US\$1,779 million. In terms of sub-categories, direct investment and portfolio investment posted a net outflow of US\$4,403 million and US\$4,551 million, respectively, while other investment posted a net inflow of US\$10,733 million.

(1) Direct Investment

Direct investment abroad by residents accounted for a net outflow of US\$6,028 million, US\$1,117 million less than in the previous year. Mainland China received the lion's share of Taiwan's direct investment abroad. Direct investment in Taiwan by nonresidents registered a net inflow of US\$1,625 million, a decrease of US\$273 million from the previous year. The net outflow of

Financial Account



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

direct investment declined to US\$4,403 million in 2005, compared to US\$5,247 million in 2004.

(2) Portfolio Investment

Portfolio investment abroad by residents recorded a huge net outflow of US\$35,807 million, the highest level ever recorded. It showed that residents increased investment in foreign securities through the purchase of overseas mutual funds and large portfolio investment abroad by local insurance companies and banks' offshore banking units pursuing higher returns. Net inflow of local portfolio investment by nonresidents registered US\$31,256 million, also the 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. As a result, portfolio investment posted a net outflow of US\$4,551 million in 2005.

(3) Other Investment

Other investment abroad by residents recorded a net outflow of US\$6,370 million, representing an increase of other claims on nonresidents by residents. This outflow was mainly because of the increase in loans extended to foreign banks. Other local investments by nonresidents stood at a net inflow of US\$17,103 million, representing an increase of residents' other liabilities to nonresidents. The inflow was mainly due to the monetary authorities' increase of repurchase agreement transactions for higher returns on foreign exchange reserves. As a consequence, other investment exhibited a net inflow of US\$10,733 million in 2005.

An Increase in Foreign Exchange Reserves

For the year as a whole, the foreign exchange reserve assets held by the Bank increased by US\$20,056 million. Reserve assets increased as a result of the current account surplus, as well as the net inflow in the financial account, which resulted from a massive inflow of foreign funds invested in the local stock market.