

# *The Taiwan Economy 2011 – A Review and Outlook*

## **I、Economic Overview**

### **(I) International Economy**

The 2011 world economy saw a slowdown – a trend which had been developed since the second half of 2010. Amongst all of the reasons that had led to an economic slowdown, the European sovereign debt crisis, which is still simmering, represented the most significant cause. Not only had it affected the European Union, it had spilled over to impact the world economy. As the world's major economies softened in 2011, many countries appeared to have encountered economic phenomenon of rising prices, thus aggravating the world economic downturn. Thus, the global economy in 2011 concluded with high risks of uncertainty for future. Such environment led to high volatility in the stock market as well as the currency market. In addition, investors in the world financial market have become more conservative in the wake of the European sovereign debt crisis. This phenomenon is likely to extend beyond 2011. Whether or not the economy will pick up again is greatly depended on whether the European sovereign debt crisis can be resolved. Based on the Global Insight Inc.'s latest world economic outlook report, the world's economic growth rate fell from 4.2% in 2010 to 2.8% in 2011.

In April 2011, rating agency Standard & Poor's lowered its rating outlook for America's long-term credit rating to "negative" because of US's large national deficit and a lack of an agreed plans to bring down the nation's deficits. The unprecedented rating decision further increased market concerns. In the third quarter of 2011, the situation in the US labor market deteriorated, consumption slugged, and commercial real estate investment stagnated. Moreover, real estate market was so severely hit that it deepened the nation's economic risks. Simultaneously, the Standard & Poor's downgraded its long-term sovereign credit rating on America to 'AA+' from 'AAA' and rated the outlook on the long-term rating as negative. In the fourth quarter, the US labor market gradually turned around. Unemployment rate fell to 8.6%, the lowest seen in the recent two years and a half. Additionally, economic performance for the last quarter is expected to outshine other quarters and to raise the annual economic growth rate up to 1.6%.

Although Japan's unemployment rate did not deteriorate and prices remained stable, Japan still suffered an economic downturn in 2011 mainly due to the earthquake in March. The appreciation of Japanese yen against US dollar was another important factor affecting the economy of Japan. One of the reasons for the appreciation was the overflowing amount of capital transferred by corporates from abroad to Japan after the earthquake.

Moreover, as Europe and America were overshadowed by dimming economic outlooks and unstable fiscal policy and financial market, investments were poured into Japanese yen for risk hedging purposes. The appreciation yen brought negative impact to the export markets of Japan leading the export growth to slide. On the opposite side, import goods became relatively affordable, lowering the competitiveness of domestic goods whilst facilitating imports to continue to grow.

In 2011, the Euro-zone was deeply troubled by the sovereign debt crisis as well as challenged by investors' lack of confidence and weakened domestic and international demand that led to a sluggish economy. As the world economy continues to be impacted by the sovereign debt crisis, it is important for governments of Euro-zone to stabilize the debts in order to regain market confidence; otherwise, it may escalate the effects on the region's economic activities or create more economic polarization in continental Europe economy.

In China, the economic growth rate reached 9.7% in the first quarter then slowed down to 9.1% in the third quarter. Although growth remained strong, it was gradually reducing quarter after quarter. In addition, the economy was under the shadow of inflation throughout the year. Inflation is now the biggest obstacle hindering the Chinese economy from continuing its rapid development, and it is now forcing China to accelerate the pace for economic reform. Under the Twelfth Five-Year Guideline, economic restructure is named one of the main goals for the next phase of its economic policy. The economic growth rate for 2011 was down to 9.2% from the 10.4% achieved in the previous year.

For the outlook in 2012, the Global Insight Inc. forecasted that the global economic growth rate will be slightly lower than 2011, reaching 2.7%. The international economic situation has entered into a short-term fix or even an economic contraction pattern due to the uncertainty behind the recovery of the US's market demand, Europe sovereign debts' impact on the world economy, and China's financial crunch together with other adverse factors. Because major economies in the world and emerging economies are unlikely to turnaround in the short run, the forecast for 2012 global economy was made with conservative views.

## (II) Domestic Economy

The Taiwanese economy delivered an outstanding performance in 2010, obtaining economic growth rate of 10.72%, after underwent financial tsunami. It is the best record since 1987. The growth momentum extended into the first quarter of 2011, pushing the economic growth rate to reach 6.62%. At the same time, private consumption and investment continued to expand. However, the earthquake in Japan and the Europe

sovereign debt crisis in the second quarter increased the uncertainty for the future world economy. Moreover, emerging economies such as China, in the wake of the mounting inflation pressure, have tightened money supply and caused the economic expansion to slowdown. Such a phenomenon has also impacted the economic momentum of Taiwan. In July, the outbreak of the U.S. national debt problem shook global financial markets. In August, the Standard & Poor's unprecedented downgrading of the rating of the US Treasury debt triggered the US stocks to plunge and dragged the world stock market to drop including Taiwan's. In the fourth quarter of 2011, private investment remained declining, and growth of private consumption slowed in Taiwan as a whole. According to the statistics data of Directorate-General of Budget, Accounting, and Statistics (DGBAS), Executive Yuan, the estimated economic growth for the fourth quarter is 1.89%. Combining the previous three quarters, the growth rate for the entire year stands at 4.04% (the economic growth rates for first, second, and third quarter were 6.62%, 4.52%, and 3.45%, respectively.)

As for the 2012 outlook, a weak international economy is expected to impact world trade. Since Taiwan's economic structure is heavily depended on international demand, and the private fixed capital formation in the domestic demand is under the adverse effects of exports slowdown, contraction in export demand will definitely hinder the economic growth of Taiwan. DGBAS forecasts the 2012 economic growth rate to be 3.85%.

## **II、 External Trade and Import & Export Structure**

In the fourth quarter of 2011, international demands for electronics, communications, mechanics, and other basic metal products considerably slowed down under the impact of weak global economy. The accumulative commodity export in 2011 reached USD 308.3 billion, seizing a growth rate of 12.27% year over year. The accumulative customs import in 2011, on the other hand, totaled USD 281.6 billion, posted 12.09% growth rate year over year. Despite that the rising crude oil prices had led to an expansion in mineral imports, the import demand derived from export and investment was weak in 2011. After adding product and service trade and excluding the price factor, trade surplus reached USD 31.9 billion, up by 4.93% when compared with USD 30.4 billion in the previous year.

For export destinations, the proportion of Taiwan's export to China and Hong Kong slightly slip to 40.24% of the total export in 2011. Trade with China and Hong Kong continued to make the largest contribution to Taiwan's trade surplus. In 2011, the proportion of export to six ASEAN countries and the US rose marginally to 16.46% and 11.80% of the total export, respectively. For import sources, import from Japan continued to generate the largest trade deficit. Import from China and Hong Kong represented

16.08% of the total import. Trade deficit with the Middle East soared due to rising international crude oil prices, whilst trade imbalance in the region remained.

Looking into 2012, due to weak international economy's impact on the global trade market along with Taiwan's heavy reliance on international export, the softening of export demand is likely to hinder the nation's economic growth.

### **III、 Price Change**

In the fourth quarter of 2011, international crude oil price and raw material price surged to high level. Moreover, the import prices for mineral goods, basic metals and chemical materials were significantly higher than the prices in the same period 2010, but appreciation of TWD helped offset a portion of the price change. The wholesale price index (WPI) for the entire year increased 4.32%. Import price deflector also rose 5.40%. Export price deflector reached -0.44%. Consumer price index (CPI) upraised 1.42% in 2011 as the result of bad weather and price rising on vegetables and fruits.

For 2012 outlook, international crude oil prices are expected to stay high as the situations in the Middle East remain unsettled. Raw materials prices will be relatively softened. WPI is forecasted to increase by 1.2%. Although the rising crude oil prices may escalate the pressure to increase prices of energy related products, government can help ease price rally by imposing various stabilization measures and keeping steady home-rental prices. It is forecasted that CPI will increase 1.46% in 2012.

### **IV、 Employment Market**

As the domestic economy bounced back, corporates have increased employment. Together with numerous employment stimulation measures implemented by the government, the average number of persons employed in 2011 reached 10.71 million, up by 2.06% year over year. The unemployment rate in the fourth quarter fell to 4.25%, indicating gradual improvement in the labor market. The average unemployment rate in 2011 was 4.39%, which is lower than the rate of 5.21% in the previous year. In 2012, government must continue to watch unemployment rate closely in order to introduce appropriate employment stimulation packages and offer job training measures in a timely manner, and at the same time continue to assist labors to find jobs to relieve unemployment problems.

## V、Monetary Policy, Exchange Rates, and Interest Rates

### (I) The Currency Market

The annual M1B growth rate fell to 4.3% in the fourth quarter from the third quarter's 7.1%, reducing by 2.8 percentage points. The annual M1B growth rate was 7.2%. On the other hand, M2 growth rate increased from 4.5% to 5.8%, supported by bank loans and investment growth. The annual growth rate of major bank loans and investment balance (based on cost) rose from 5.3% in the end of September to 6.2% in the end of the year due to banks' slowing down the credit given to the private sector and state-owned business.

### (II) Exchange Rates

Taiwan Dollar started the year on an appreciation trend then followed by depreciation trend. Large amount of capital was poured into Asia countries in the first half of 2011, setting TWD on a rising trend, because of the implementation of quantitative easing in the US combining with the sovereign debt issues in Europe. However, mounting market panic in August and risk hedging needs led to the appreciation of US dollar. Consequently, TWD depreciated to TWD 30 against US dollar. Due to the uncertain outlook of the international economy in the short-run, it is predicted that the exchange rate of Taiwan will remain stable.

In 2012, TWD exchange rate is expected to stay on the ground of dynamic stability whilst facing uncertain outlooks for international financial market. Taiwan Institute of Economic Research forecasts that the average exchange rate against US dollar will stand at TWD 30.09 in 2012.

### (III) Interest Rates

The Central Bank of the Republic of China (CBC) strategically forced the average interbank call-loan rate to increase from 0.344% in June to 0.349% in September through upward adjustment of rediscount rate and open market operations in the first half of 2011. In the third quarter, due to international unrest and international raw materials prices plummet, the pressure of prices increase was alleviated, allowing CBC to cease interest rate hike. In response to changes in economic situations as well as to stabilize financial market and prices, CBC continued to issue certificate of deposits to restore the excessive capital in the monetary market. Market funds faced relax yet slightly tight situation. In November, the average interbank call-loan rate slowly climbed to 0.396%. The average interbank call-loan rate in 2011 stood at 0.400%, up by 0.161% when compared with 0.239% in the same period 2010.

The performance of Taiwan's financial sector is likely to remain unsteady under the

adverse factors that are challenging export-oriented countries and region. Domestic corporate are holding conservative views on the current economic situation. In preparation for potential economic changes, the CBC will retain a moderate monetary policy and then gradually step towards a neutral monetary policy, whilst interbank call-loan rate will increase gradually. Due to the aforementioned reasons, the Taiwan Institute of Economic Research forecasts that the average interbank call-loan rate is to reach 0.62% in 2012.

#### Source of Data:

1. Quarterly National Economic Trends, February 2012 by Directorate-General of Budget, Accounting, and Statistics, Executive Yuan, ROC (Taiwan).
2. Data by Central Bank of the Republic of China (CBC) for exchange rates and interbank call loan rates.