# Taipei,China

The collapse in global trade reverberated through this economy, knocking manufacturing output and depressing private investment. Recovery started in the second quarter of 2009 and then accelerated, so that the contraction in GDP was milder than earlier anticipated. Supported by the strengthening world trade performance, GDP is forecast to expand this year and next. Inflation has returned (after consumer prices fell last year), but is forecast to be low this year and next.

## Economic performance

An economy that relies heavily on trade (merchandise imports and exports together equal nearly 100% of GDP), Taipei,China suffered a sharp recession when global trade collapsed in 2008. During the slump, exports of goods in value terms plunged by about 30% year on year for several quarters. GDP contracted from the second quarter of 2008 for 4 quarters on a sequential basis (Figure 3.13.1), or by nearly 10% over that period.

Still, the economic contraction in 2009 was not as severe as earlier anticipated. Exports picked up as the year progressed. So did private consumption and public investment, supported by fiscal and monetary stimulus. These developments contained the decline in 2009 GDP to 1.9% (Figure 3.13.2). (GDP was flat in 2008 and grew by 5.2% on average over the previous 5 years.)

Private consumption eased in the first half of 2009, owing to a weak labor market and decline in consumer confidence. It firmed in the second half, partly a result of government stimulus measures, to be up by 1.5% for the year. Layoffs, mainly in manufacturing and construction, pushed the unemployment rate up to 6.1% in August, before employment started to pick up again. Average monthly earnings in nominal terms fell for 8 consecutive months through October.

Government consumption grew by 3.6% in 2009, in part a result of its fiscal stimulus measures. Net exports were also positive—the fall in exports of goods and services from 2008 was outpaced by an even steeper drop in imports.

However, these positive factors were more than offset by a fall in private investment. Fixed capital investment, which is strongly correlated with the performance of merchandise exports, dropped by 29.4% in the first quarter, a deeper dive than seen after the global information technology bubble deflated in 2001. For the full year, fixed investment fell by 11.8%. Investment was particularly weak in machinery and equipment (down by 21.0%). The fall in fixed investment would have been worse if the government had not pumped up its capital works as part of the fiscal stimulus.

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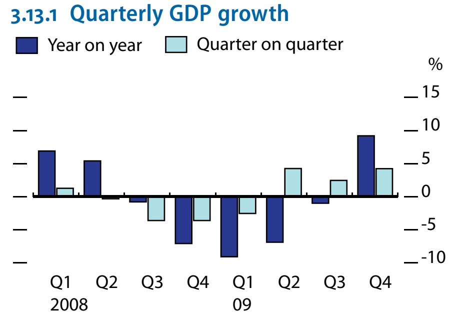
**3.13.1 Quarterly GDP growth**




*Source:* Directorate General of Budget, Accounting and Statistics. http://eng.dgbas.gov.tw (accessed 8 March 2010).

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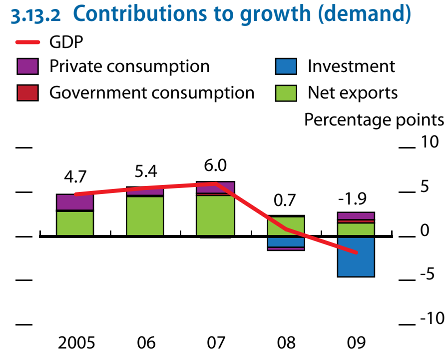
**3.13.2 Contributions to growth (demand)**




*Sources:* Directorate General of Budget, Accounting and Statistics. http://eng.dgbas.gov.tw (accessed 8 March 2010); ADB estimates.

*Click here for figure data*

Manufacturing production (27% of GDP) slumped early in 2009 as export orders dwindled, and was down by 4.6% for the year. The pace of contraction later slowed, and manufacturing rebounded in the fourth quarter (Figure 3.13.3) along with exports.

Construction activity contracted by 6.7%. The services sector was virtually flat in 2009, with trade-oriented and transportation activities slack. Agriculture, too, put in a poor performance—production fell by 3.1% owing to bad weather. Typhoon Morakot, which hit the island in August 2009, left more than 700 people dead or missing and inflicted damage to agriculture and infrastructure.

The fall in merchandise exports, at just over 20% in US dollar terms for the full year, was the sharpest in more than 2 decades. External demand slumped for a wide range of exports—chemicals, electronics, machinery, optical products, plastics, and others.

Imports fell even more steeply, by 27%, reflecting the slide in exports (which use a high proportion of imported materials), slack demand for imported capital equipment, and lower prices for imported oil and commodities. By the fourth quarter of 2009, exports were growing again year on year, driven by a 46% surge in shipments to the People's Republic of China (PRC), whose expansion was benefiting from an aggressive fiscal and monetary stimulus.

The current account surplus rose to the equivalent of 11.2% of GDP, buttressed by a larger surplus in goods trade (as imports plunged), an uncommon surplus in services trade (freight payments for imports fell), and a surplus in the income account (including repatriated profits and dividends).

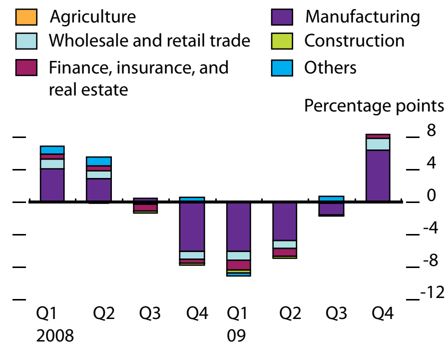
Inbound portfolio investment surged, to an extent that the monetary authorities expressed concerns about the speculative nature of these inflows. Residents' portfolio investment abroad was also substantial. Large net inflows totaling US$14 billion in the financial account (after 3 years of net outflows) were mainly attributable to an increase in withdrawals of overseas deposits by the private sector. The overall balance of payments recorded a very large surplus of US$54.1 billion, and gross international reserves grew to US$348.2 billion, to nearly three times as high as in 2001.

Consumer prices fell in 2009, owing to a large output gap and lower global oil and commodity prices. The consumer price index declined by 0.9% on a year-average basis. The pace of decline eased late in the year (Figure 3.13.4) owing to rising oil and commodity prices.

During the depths of the slump, the monetary authorities lowered the policy interest rate by a total of 238 basis points, to 1.25%, between September 2008 and February 2009. Broad money supply (M2) grew by 7.0% on average in 2009, but demand for credit contracted from March through December (Figure 3.13.5).

Fiscal stimulus measures deployed to combat the weakness in domestic demand included shopping vouchers for all citizens, cash transfers to low-income families, subsidies for car purchases, tax breaks, and a public infrastructure program to cost about US$16 billion over 4 years. Higher spending and weakness in revenue led to a budget deficit equal to 1.1% of GDP.

**3.13.3 Contributions to growth (supply)**

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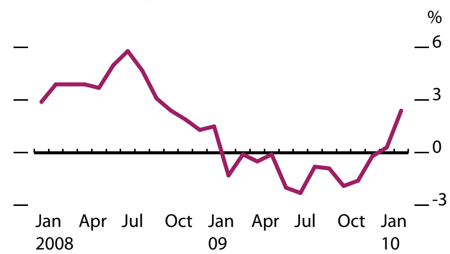
**3.13.4 Monthly inflation**




*Source:* CEIC Data Company (accessed 1 April 2010).

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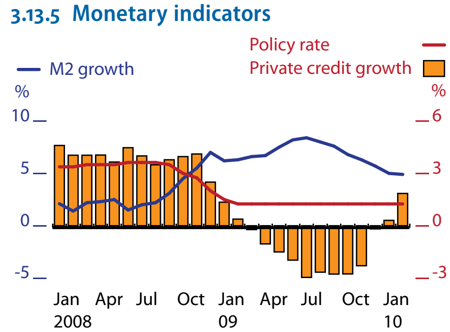
**3.13.5 Monetary indicators**




*Source:* CEIC Data Company (accessed 1 April 2010).

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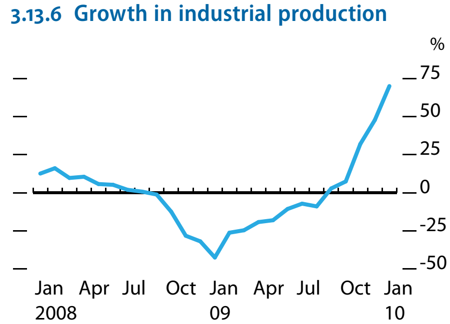
**3.13.6 Growth in industrial production**




*Source:* CEIC Data Company (accessed 1 April 2010).

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## Economic prospects

Just as the slump in global trade sent reverberations through this economy in 2008 and 2009, the trade upturn that is expected to continue over the next 2 years will have positive spillover effects economywide, buoying consumption and investment.

Rising export orders propelled both industrial production and exports early in 2010 (Figures 3.13.6 and 3.13.7), though from a low base in the prior-year period. Strengthening global markets and the launch of new electronic products are expected to support export growth this year. So will improving economic links with the PRC (whose GDP is forecast to expand by nearly 10%). The PRC and Hong Kong, China together account for about 40% of Taipei,China's exports. Furthermore, economic growth in Southeast Asia, which accounts for 15% of exports, is forecast to accelerate sharply this year, and that subregion's overall imports are projected to jump by 20%.

The public infrastructure program will also support economic growth. About US$5 billion of the program's funds are allocated for this year. In addition, reconstruction work for areas hit by Typhoon Morakot in 2009 will add about NT$50 billion (US$1.5 billion) to public investment this year. Fiscal measures to stimulate consumption, though, largely expired in 2009. A fiscal deficit equal to 1.4% is projected for 2010.

Leading indicators of the economy have been broadly trending up. Domestic inventories of manufactured products bottomed in August 2009 and both export orders and permits for construction rose from early last year (Figure 3.13.8). Exporters are expected to ramp up fixed investment provided the rebound in export orders is sustained. Private fixed investment is projected to be a key driver of growth in 2010

Consumer confidence, too, strengthened headed into 2010 (Figure 3.13.9), assisted the pickup in the labor market and generally improved outlook for the economy. Gains in asset markets have contributed to the more positive outlook—stock prices rallied by 86% from the 2009 low point through March 2010, and Taipei city house prices rose by 20% year on year in February 2010. Private consumption is expected to grow this year but only moderately, constrained by relatively high unemployment and slight growth in wages.

Taking these influences into account, GDP is projected to increase by 4.9% this year (Figure 3.13.10) and by 4.0% in 2011 (as the low-base effect ends and the PRC's growth moderates).

Higher prices for imported oil and commodities, coupled with strengthening domestic demand and a firmer labor market, will revive inflation this year and next, but to low rates of about 1.5% (Figure 3.13.11), The consumer price index rose by an average of 1.3% in the first 2 months of 2010. As economic growth gathers pace and inflation edges up, the expansionary monetary stance adopted during the global financial crisis is expected to be withdrawn gradually. As a step in this direction, the monetary authorities increased issuance of certificates of deposit in the first quarter of 2010 to absorb excess liquidity from the financial system.

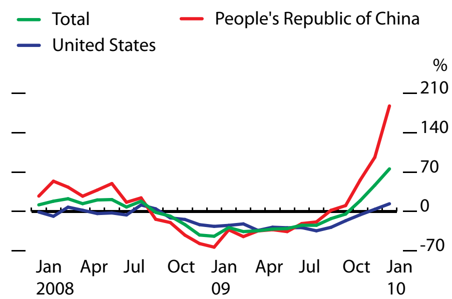
Merchandise exports in US dollar terms are forecast to increase by nearly 20% this year. Imports will rise faster than that, by a forecast 26.5%, driven by the rebound in export industries and their investment,

**3.13.1 Selected economic indicators (%)**

| | 2010 | 2011 |
|---|---|---|
| GDP growth | 4.9 | 4.0 |
| Inflation | 1.5 | 1.6 |
| Current account balance (share of GDP) | 8.2 | 6.7 |

*Source:* ADB estimates.

**3.13.7 Merchandise export growth, by destination**




*Source:* CEIC Data Company (accessed 1 April 2010).

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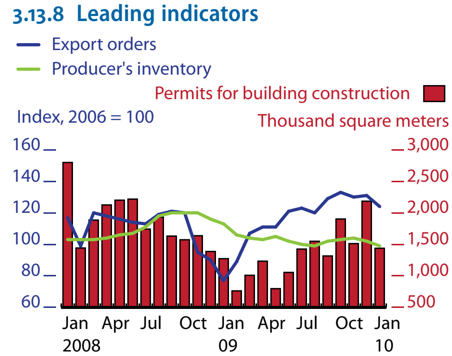
**3.13.8 Leading indicators**




*Source:* CEIC Data Company (accessed 1 April 2010).

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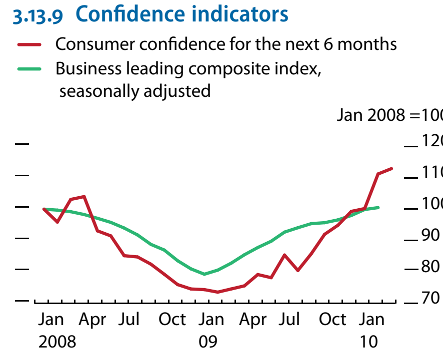
**3.13.9 Confidence indicators**




*Source:* CEIC Data Company (accessed 1 April 2010).

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as well as higher oil and commodity prices. The current account surplus is seen at a touch over 8% of GDP in 2010, declining to a little under 7% next year.

## Development challenges

Closer trade and investment links have been forged with the PRC in recent years. Annual trade between the two economies has increased to about US$100 billion, and the PRC's share of Taipei,China's exports rose from less than 3% in 2000 to 26% in 2008, or 40% taking Hong Kong, China into account. (The share of exports going to Europe, Japan, and the United States declined in this time.)

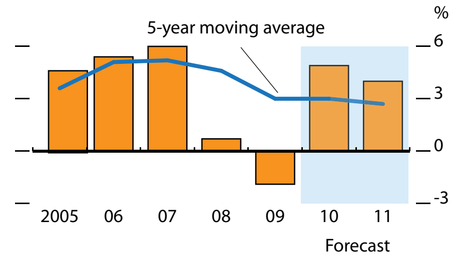
Companies from Taipei,China have invested at least US$80 billion in the PRC over the past couple of decades (some estimates are substantially higher), relocating production of electronic components, computers, and optical products to take advantage of lower costs in the PRC.

The challenge now is to broaden and deepen the economic ties. Cross-strait negotiators have reached several agreements in the past 2 years, covering areas such as financial cooperation and transport. However, the direct economic impact of these agreements has been limited so far.

Negotiators from both sides are now working on an Economic Cooperation Framework Agreement. This pact could include reductions in tariffs (on selected items to start) and in other trade barriers, investment protection measures, protection of intellectual property rights, and a mechanism for dispute mediation. Cooperation has been proposed in industries including solar energy and automobiles.

Successful conclusion of the agreement would facilitate trade and investment between the two economies and could pave the way for Taipei,China to be able to negotiate trade pacts with other economies. Taipei,China is likely to face heightened competition in the PRC market unless it gains some trade concessions there, since a free trade agreement between the Association of Southeast Asian Nations and the PRC came into force on 1 January this year.

**3.13.10 GDP growth**

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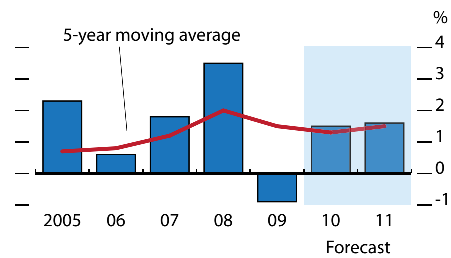
**3.13.11 Inflation**

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