# Taipei,China

A powerful recovery last year reflected a rebound in domestic demand and a surge in exports. Growth will moderate this year, owing to the high base set in 2010. Inflation has picked up, but is forecast at relatively modest levels. The outlook is improved by tariff reductions on exports to the People's Republic of China (PRC) and the opening of more industries to investment from there.

## Economic performance

This trade-dependent economy rebounded vigorously from recession in 2009. Surging demand for its manufactured exports in 2010 drove a burst of investment and supported increased private consumption. The 10.8% rise in GDP—the fastest in almost a quarter century—was partly a result of the low-base effect from the contraction in the previous year.

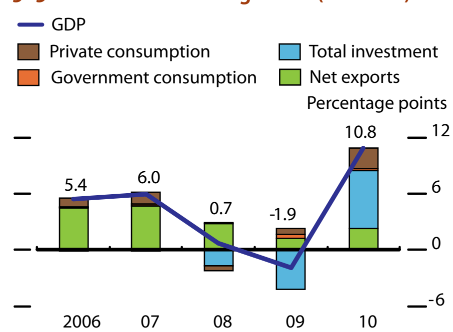
Private investment soared by nearly 33% in 2010, after contracting in 2009, with substantial increases in manufacturing, information and communications, and construction. Public investment also rose, albeit modestly, as the authorities continued with infrastructure spending, including reconstruction in areas hit by the severe Typhoon Morakot of August 2009. Overall, higher gross fixed capital formation contributed most of the boost to GDP in 2010 (6.1 percentage points of the total) (Figure 3.13.1).

Rebounding exports and manufacturing spurred employment and income growth, in turn buttressing private consumption. Unemployment declined to 4.7% by end-year, from 5.7% the previous year. Real average monthly earnings in manufacturing rose by 7.5% in 2010, after declines in the 2 previous years. The stronger labor market buoyed consumer confidence (Figure 3.13.2). Private consumption grew by 3.7% in 2010 and added 2.1 percentage points to GDP growth.

Sectorally, growth was dominated by manufacturing (constituting about 84% of industry), which surged by 26.8% and contributed 7.2 percentage points to GDP growth. Construction increased by 10.9%, though its contribution to GDP was slight, as it is a much smaller industry. Services grew by 4.8%, with wholesale and retail trading the major contributors to growth in this sector.

Strong global demand for manufactured goods drove growth of nearly 40% in exports of electronic products and chemicals, and increases of over 30% in metal products and plastics. Total exports shot up by nearly 35% in United States (US) dollar terms. The major markets were the PRC; Hong Kong, China; and the US, which collectively took 53% of total exports (Figure 3.13.3). Merchandise imports bounced back even more,

**3.13.1 Contributions to growth (demand)**




*Source:* Directorate-General of Budget, Accounting and Statistics. http://eng.dgbas.gov.tw (accessed 16 March 2011).

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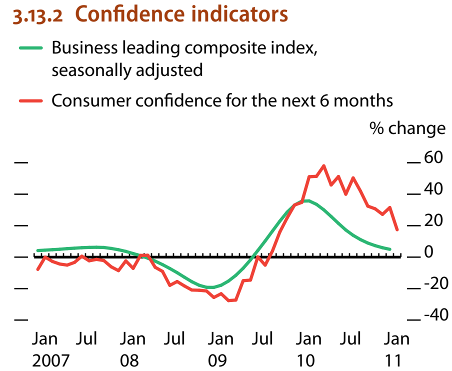
**3.13.2 Confidence indicators**




*Source:* CEIC Data Company (accessed 16 March 2011).

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This chapter was written by Akiko Terada-Hagiwara and Shiela Camingue of the Economics and Research Department, ADB, Manila.

by 43.2%, fueled by imported materials for manufacturing industries and capital goods required by the investment boom.

The merchandise trade surplus therefore fell by 12% to US$26.9 billion. After accounting for small surpluses in services and income, the current account surplus declined, to a still significant 9.4% of GDP. The overall balance of payments was in surplus and international reserves rose to US$382 billion by end-2010.

On the back of tighter economic links with the PRC through the Economic Cooperation Framework Agreement signed last year and abundant global liquidity, short-term portfolio inflows picked up and reached US$10 billion in the fourth quarter of 2010. A rapid increase in purchases of government bonds by foreign institutional investors, speculating on an appreciation of the NT dollar, prompted the monetary authorities in November 2010 to put limits on short-term debt that foreigners can hold. The local currency appreciated against the US dollar from NT$35.2 in March 2009 to NT$29.1 by end-2010.

After cutting interest rates in 2008 and 2009, the monetary authorities started to normalize rates as the economy rebounded. From June 2010, they raised the discount rate in three steps to 1.625% by year-end. Bank credit grew by 7.8% in 2010, after it had declined by 1.4% in 2009 (Figure 3.13.4). M2 money supply growth averaged 5.3% for the year, within the 2.5%–6.5% target range set by the central bank.

Consumer prices also turned up last year, although average inflation was just 1.0%. Of greater concern was a surge in residential property prices (Figure 3.13.5) caused mainly by speculative buying. The authorities moved to curb bank lending for second homes and directed banks to reduce loan-to-valuation ratios for such properties, which helped to damp speculation.

Government expenditure fell by 0.8% in 2010 from 2009, as the authorities gradually withdrew 2009's fiscal stimulus measures. Revenue also declined, by 0.4%, and the budget deficit narrowed only slightly in terms of the ratio to GDP, to 3.2% from 3.5% in 2009. Outstanding government debt rose to 33.6% of GDP, though still below a 40% limit set by law.

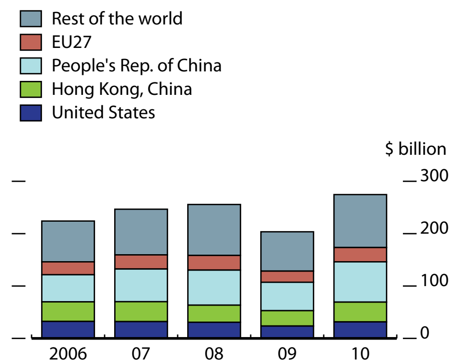
## Economic prospects

Further growth in world trade in 2011 (though moderating from 2010's sharp rebound) and continuing expansion of the PRC economy will underpin growth in 2011. The pace will be around trend, however, as the base effect from the 2009 recession that propelled the 2010 outturn dissipates. Growth is expected to be broad-based, with contributions from both domestic and external demand.

The Economic Cooperation Framework Agreement with the PRC will support growth. (The PRC and Hong Kong, China together account for about 40% of Taipei,China's exports.) The first set of tariff reductions under the agreement came into effect in January 2011. Nearly 2,000 certificates of origin valued at over US$400 million, about 5% of merchandise exports to the PRC, were issued in January–February 2011 for Taipei,China products that receive preferential duties from the PRC.

The number of visitors from across the strait surged by 68% in 2010,

**3.13.3 Total exports, by major trading partners**




*Source:* Department of Statistics, Ministry of Economic Affairs. http://2k3dmz2.moea.gov.tw/gnweb/English (accessed 1 March 2011).

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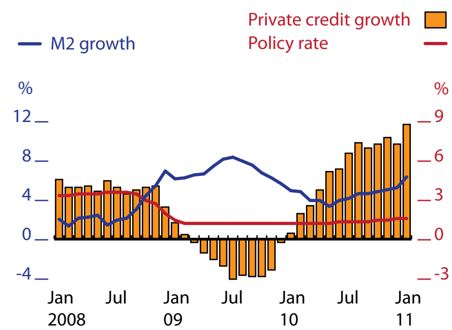
**3.13.4 Credit indicators**




*Source:* CEIC Data Company (accessed 16 March 2011).

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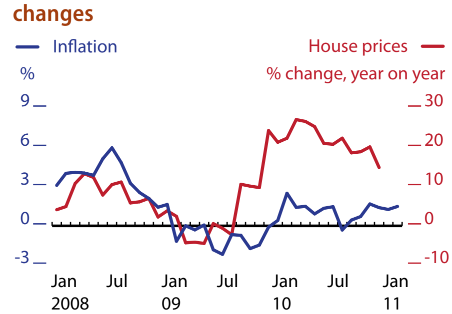
**3.13.5 Monthly inflation and house price changes**




*Source:* CEIC Data Company (accessed 16 March 2011).

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**3.13.1 Selected economic indicators (%)**

| | 2011 | 2012 |
|---|---|---|
| GDP growth | 4.8 | 5.0 |
| Inflation | 2.8 | 2.9 |
| Current account balance (share of GDP) | 6.9 | 7.0 |

*Source:* ADB estimates.

and further growth in inbound travel is expected as more tourist groups from the PRC are allowed to visit this year.

Further, the authorities in March 2011 opened up more industries to PRC investors, including the semiconductor and flat-panel subsectors, which were excluded in the first round of investment liberalization last year. PRC investment in these subsectors is expected to lead to increases in exports to the mainland.

Growth in export orders for manufactured goods (such as mobile telephones and tablet computers) moderated to about 5% in the first 2 months of 2011 compared with the prior-year period (Figure 3.13.6). Merchandise exports increased by about 21% in January–February 2011, year on year.

Private consumption is expected to grow by 1.2% in 2011, against the background of a firm labor market. Businesses in sectors with strong external demand—semiconductors and telecommunications equipment for example—are likely to increase investment, but private investment overall is projected to contract by 2.3% this year from the high base set in 2010.

On the balance of these influences, GDP is forecast to grow by 4.8% in 2011 and about 5.0% in 2012 (Figure 3.13.7). Downside risks to this outlook come from higher than expected global oil and commodity prices, any significant slowdown in the PRC, and a prolonged supply disruption to manufactured components from plants in Japan affected by the earthquake and tsunami.

Global price increases for commodities, food, and oil will likely mean that the value of imports rises faster than exports in 2011. (The import bill rose by 25.0% year on year in the first 2 months.) The trade surplus is forecast to fall and the current account surplus decline to 6.9% of GDP.

The higher costs of imports will put upward pressure on inflation, which is projected at around 2.8% in the forecast period (Figure 3.13.8). The NT dollar appreciated by 2.7% against the US dollar from the start of 2011 to mid-March, and is expected to remain firm. Given that forecast GDP growth is broadly in line with trend potential, the monetary authorities are expected to edge up interest rates to contain inflation.

Public investment will play a smaller role in the next 2 years. About US$3.6 billion is allocated for public infrastructure this year, compared with US$5.1 billion in 2010. General government revenue is expected to outpace expenditure, narrowing the fiscal deficit.

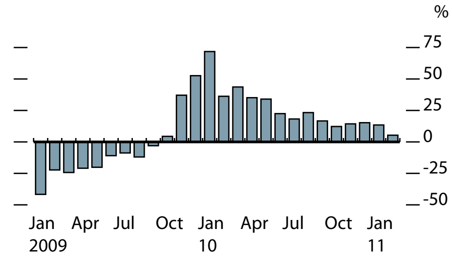
## Development challenges

Longer-term growth potential is constrained by an aging, and shrinking, labor force.

The ranking of sources of GDP growth, in terms of production factors, in the decades of fast growth in the 1980s and 1990s put growth of the capital stock first, followed by total factor productivity, labor, and education. In 2000–2007, the capital stock was still the largest growth contributor; labor and education were equal second.

The labor force is projected to decline to below 10 million workers by 2030, from 11.1 million in 2010, and the age-dependency ratio could triple in that period.

**3.13.6 Growth in export orders**




*Source:* CEIC Data Company (accessed 16 March 2011).
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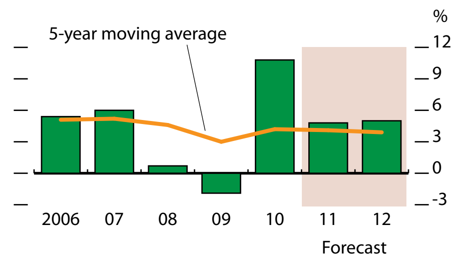
**3.13.7 GDP growth**




*Sources:* Directorate-General of Budget, Accounting and Statistics. http://eng.dgbas.gov.tw (accessed 16 March 2011); ADB estimates.
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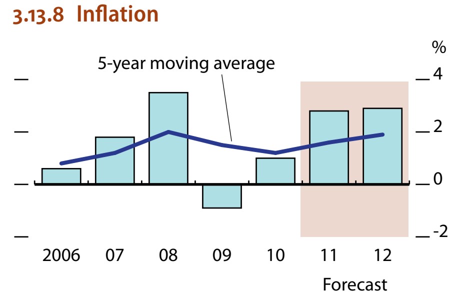
**3.13.8 Inflation**




*Sources:* Directorate-General of Budget, Accounting and Statistics. http://eng.dgbas.gov.tw (accessed 16 March 2011); ADB estimates.
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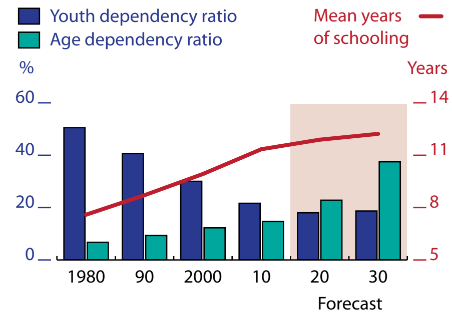
Taipei,China's labor force participation rate, at 58% of the working-age population, is the lowest among newly industrialized economies and almost 10 percentage points lower than Singapore's. The population in Singapore is aging faster, but an active immigration policy there means that labor is projected to add to its growth in the long term, while the reduction in the Taipei,China labor force will lower its growth.

To address this issue, some local authorities, such as Taipei city, are providing conditional cash transfers to households with pre-school-age children to encourage women, in particular, not to quit work when they have children. Such measures could be rolled out more widely to raise labor force participation.

With regard to education, the average number of years of schooling in Taipei,China is expected to reach developed-country levels of 12 years by 2030 (Figure 3.13.9). Hence, there is probably greater room to enhance growth potential by focusing on policies that raise the labor force participation rate, stimulate investment, and foster advanced technology.

The reductions in tariffs on exports to the PRC may well encourage some of the manufacturers that relocated factories to the PRC to bring back some production to the island. Further, the eased tariffs, proximity to the PRC, and a cut in the corporate tax rate to 17% last year all improve the odds of broadening the investor base by attracting firms from rapidly developing countries, such as India, that aim to produce for the large PRC market.

**3.13.9 Dependency ratios and years of schooling**




*Sources:* J.-W. Lee and R. Francisco. 2010. Human Capital Accumulation in Emerging Asia 1970–2030. *ADB Economics Working Paper Series* No. 216. Asian Development Bank, Manila; Population Division of the Department of Economics and Social Affairs of the United Nations Secretariat, *World Population Prospects: The 2008 Revision*. http://esa.un.org/unpp (accessed 28 April 2010).

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