Taipei, China

Higher growth is forecast for 2014 and 2015, but inflation will remain low. The current account surplus will expand. As export competition stiffens, this export-dependent economy needs a new engine of growth and strengthened cross-strait relations. Also crucial is to further deregulate the economy and shift resources toward more productive sectors.

Economic performance

GDP expanded by 2.1% in 2013. This outpaced the 1.5% growth recorded in 2012 but was less than expected as exports and private investment both grew more slowly than projected. Exports of goods and services, which account for nearly 75% of the economy’s GDP, were the main engine of growth in 2013, expanding by 3.8% and adding 2.8 percentage points to growth, up from essentially nil in the previous year. Imports of goods and services also rose on higher demand for capital goods and consumer goods alike, climbing by 4.0% and reversing a 2.2% decline in 2012. Net exports expanded by 3.2%, lifting economic growth in 2013 by 0.6 percentage points.

Private investment grew by 7.4% in anticipation of stronger external demand, especially for machinery, but budgetary consolidation reduced government investment (Figure 3.13.1). As a result, total investment rose by 3.5%, reversing the slump of the past 2 years and contributing 0.6 percentage points to growth.

The same trend was apparent with consumption expenditure. Private consumption grew by 1.8%, aided mainly by lower unemployment, healthy increases in earnings across sectors, and rising consumer confidence. This more than offset a 0.3% decline in government consumption to lift total consumption by 1.4%, contributing 0.9 percentage points to growth (Figure 3.13.2).

On the supply side, growth was driven by the service sector, which expanded by 1.5% and contributed 0.9 percentage points to GDP growth. Expansion in all services remained strong, boosted by the doubling of tourist arrivals from the People’s Republic of China (PRC), which have cumulatively exceeded 8 million since Taipei, China opened to PRC tourists in 2009 (Figure 3.13.3). Industrial output rose by 1.8% on a modest rise of 2.0% in manufacturing and contributed 0.6 percentage points to growth. Construction expanded by 0.8% in line with the rise in investment, but mining and quarrying weakened by 5.7%. Growth in agriculture was almost flat at 0.2% as typhoons hit crop production.

Average inflation slowed to 0.8% from 1.9% in 2012 in line with lower global energy prices, education fees, and clothing prices, which offset the lifting of electricity subsidies and a series of fuel price hikes.

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Excluding fruit, vegetables, and energy, core inflation slowed to an average of 0.7% from 1.0% a year earlier (Figure 3.13.4).

The budget deficit stood at 1.0% of GDP in 2013, down from 1.6% in 2012 and 1.8% in 2011. Continued fiscal consolidation limited the increase in expenditure to 1.3%. Revenues increased by 3.9% as the government issued new licenses to telecommunications companies, and as receipts from customs duties and business and commodity taxes grew. Meanwhile, income taxes, which comprise 54.9% of total tax revenues, declined by 2.3%, as receipts from both corporate and individual income taxes were lower. They were dragged down by the uncertain global environment, which affected the profitability of firms operating locally and in the PRC.

In view of inflation being tamed, the central bank kept the rediscount rate unchanged at 1.875%. The accommodative monetary policy, positive business sentiment, and steadily improving consumer confidence pushed up credit to the private sector by 4.1%. The rise in credit last year, especially to the real estate sector, led the central bank to tighten rules on issuing collateralized loans, despite the ratio of nonperforming loans remaining very low. Real estate lending by banks rose by 4.1% to account for 44.0% of all loans at the end of 2013, up from 43.5% a year earlier. The rise in domestic credit and a sizeable increase in net foreign assets lifted the money supply (M2) by 5.8% in 2013, which outpaced the 3.5% recorded in 2012 but remained well within the central bank’s target range of 2.5%–6.5% (Figure 3.13.5).

The current account improved in 2013 to $57.4 billion, or 11.7% of nominal GDP, as the increase in both the trade surplus and net service receipts more than compensated for a narrower income account surplus (Figure 3.13.6). The balance of trade recorded a surplus of $37.0 billion, up 17.1% from $31.6 billion a year earlier. The services surplus widened to $9.3 billion (equal to 1.9% of GDP) from $6.3 billion in 2012 (1.3%), buoyed by higher travel receipts and lower royalty and license fee payments.

The improved trade balance reflected a 1.4% rebound in exports, which reversed a 2.3% slump in 2012, as well as a decline in imports. Exports to all destinations improved, especially to the US and Japan, two of the economy’s biggest markets. Exports to the PRC and to Hong Kong, China also remained high, but their combined share of the export total slipped to 39.7% from 41.1% in 2009 as a growing share of exports went to the five largest economies in the Association of Southeast Asian Nations: Indonesia, Malaysia, the Philippines, Thailand, and Viet Nam.

Reflecting these developments, the overall balance of payments recorded a surplus of 2.3% of GDP, despite net capital outflows of $41.2 billion. Foreign exchange reserves increased by 3.4% and amounted to $416.81 billion at the end of December 2013. The NT dollar depreciated against the US dollar by 0.5% in nominal terms in 2013 but appreciated by 1.4% in real effective terms.

**Economic prospects**

Economic prospects for the next 2 years are positive, with GDP growth accelerating to 2.7% in 2014 and 3.2% in 2015, inflation accelerating slightly but remaining low, and the current account balance improving. Domestic demand will likely grow as consumer confidence is trending up,
supported by government efforts to boost the service sector and the continued rise in tourist arrivals from the PRC. Investment is expected to rise in line with the improving outlook for exports. The economy should also benefit from free economic pilot zones and new infrastructure for tourism including hotels.

As global economic recovery gains momentum in 2014, external demand is expected firm. Exports are expected to be the key driver of economic growth in the next 2 years. Recent data on export orders show an increase of 5.7% year on year in February 2014 (Figure 3.13.7), suggesting a likely pickup in exports, especially for electronics. Imports are also expected to climb during the forecast period in line with the expected rise in private consumption and strengthening trade ties with the PRC. The trends in external trade and services, together with a large surplus in the income account as earnings from overseas investments are repatriated, will likely lift the current account balance to 12.3% of GDP in 2014 and 12.5% in 2015. The balance of payments surplus is expected to increase to around 3% as capital inflows expand.

Inflation is expected to remain low but trend marginally higher to 1.1%–1.3% in 2014–2015 as production costs rise with higher wages and stronger demand for inputs, and as electricity rates and transportation fares increase. The likely rises in global commodity prices are expected to be too modest to significantly affect domestic prices.

Monetary policy is expected to remain accommodating in 2014, but perhaps less so in 2015. The central bank is likely to keep the policy rate unchanged, given expectations for low inflation. Fiscal policy is expected to remain prudent, but a slightly bigger fiscal deficit is expected for 2014 as budgetary revenue is forecast to be lower than in 2013, when a one-time issuance of wireless communications licenses boosted nontax receipts.

The economic outlook for Taipei, China depends largely on developments in its major trading partners. A highly open economy, it is vulnerable to fluctuations in external demand because of its heavy reliance on electronics exports. While the major industrialized economies have shown signs of improvement, the slowdown in the PRC will have significant downside risks for the economy. The likely appreciation of the NT dollar could also tamp down export growth (Figure 3.13.8), while delays in establishing the free economic zones could curb business expansion.

### Policy challenge—boosting investments and exports

The growing localization of productive capacity in the PRC, under which local manufacturers move to produce or source some inputs domestically, is putting pressure on the Taipei, China economic model. For the past 3 decades, Taipei, China has occupied a central position in Asian supply chains, manufacturing semiconductors and other electronic parts and components to be incorporated into products that are assembled in the PRC for export to the major industrialized economies. Taipei, China has invested heavily in the PRC for this
purpose and transferred some of its manufacturing plants there. This economic model is now strained by growing localization and rising production costs in the PRC, especially for wages and property.

These factors helped depress Taipei, China's investments in the PRC since 2010 (Figure 3.13.9). Although these investments remain large, their downward trend indicates eroding profit margins and stiffening competition from domestic PRC production facilities, which have gradually shifted parts orders away from Taipei, China suppliers (Figure 3.13.10). Recent data confirm this trend. Some leading technology companies, particularly those involved in manufacturing notebook computers (in which Taipei, China is a leader), report shrinking profit margins and market shares in 2013. PRC imports of intermediate goods from Taipei, China have steadily declined, though the decline can be attributed to competition from the US, the Republic of Korea, and other Asian countries as well as to production localization in the PRC. Recent data indicate that Taipei, China's production base for tech products has started to shift to other countries such as Viet Nam, reflecting both PRC localization and manufacturers' search for cheaper production venues.

These trends indicate that Taipei, China may not be able to benefit to the same extent as before from investing in and exporting to the PRC. However, as the PRC grows, the scale effect easily compensates for the declining share of the PRC import market occupied by Taipei, China. Meanwhile, an analysis of spillover effects shows that, taking into account income elasticity and scale effects, changes in PRC economic activity have the largest impact on Taipei, China exports and GDP growth. Changes in other neighboring Asian economies have somewhat less effect, and changes in the major industrialized economies have much less effect (Figure 3.13.11). Moreover, the analysis indicates that the spillover effect from the PRC relative to that of other trade partners of Taipei, China has been on a rising trend, with a pronounced increase in 2012.

Against this background, the strategies by which Taipei, China can minimize its vulnerability to developments in the PRC are twofold. It can diversify its industrial base, and it can continue its efforts to tap neighboring markets for more export and investment opportunities. To improve competitiveness, the government has established free economic pilot zones where customs, investment regulations, and tax incentives are more competitive. It has signed two free-trade agreements, with New Zealand and Singapore. It aims to expand the service sector with a focus on tourism, medical services, and cultural and creative industries by further easing restrictions on tourists from the PRC, upgrading tourism infrastructure, opening new service-oriented manufacturing industries, and bolstering research and development investments and innovations.

While these initiatives are expected to boost competitiveness, other factors such as widespread restrictions on foreign direct investment and excessive regulation should also be addressed. Success depends on when and how quickly the much-needed reforms are implemented, and on reform overcoming such obstacles as the medium-term priority on fiscal consolidation and domestic lobbies for protectionism. Spillover effects mean economic conditions in major trading partners and developments in the PRC will also play major roles.