TAIPEI,CHINA

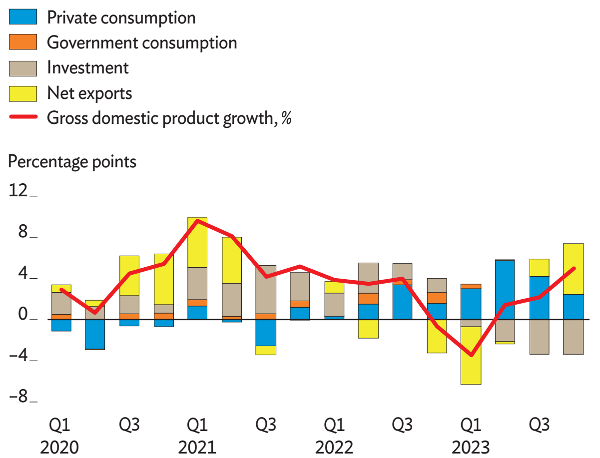
With demand for exports weakening, growth slowed in 2023 and inflation edged down. Growth is expected to rise in 2024 as exports and investment pick up and then fall slightly in 2025 as consumption moderates. Inflation will moderate as supply shocks from the October typhoon dissipate and global commodity prices moderate. Policies are needed to prevent housing from becoming increasingly unaffordable.

Economic Performance

After contracting in the first half of 2023, the economy picked up on strong consumer spending. GDP contracted by 1% in the first half of the year following a mild contraction in the fourth quarter of 2022. Strong consumption growth and a modest recovery in exports in the second half of 2023 (following a 10% drop in the first half) pushed GDP growth to 1.3%, its slowest pace since 2015 (Figure 2.13.1). With mobility restrictions gone, “revenge spending” on services drove consumption in 2023. Consumption also benefited from one-off cash payments to individuals and other stimulus from the post-pandemic special budget for 2023–2025 which, overall, amounted to roughly 1.6% of 2023 GDP. Private spending on services, after growing by almost 5% in 2022, rose by 13% last year. By contrast, private spending on goods grew by just 2% in both 2022 and 2023. Overall, private consumption growth accelerated to 8.3%, up from 3.7% in 2022, and contributed 3.8 percentage points to GDP growth. Public consumption spending was tepid, growing by less than 1%.

Figure 2.13.1 Demand-Side Contributions to Growth

Strong consumption drove modest GDP growth in 2023.



GDP = gross domestic product, Q = quarter.
Source: Haver Analytics.

Weak external demand pushed down exports and investment. Exports fell by 4.3% in 2023 as demand faltered for electronics and high-tech products, which account for about 25% of GDP. Demand was weak in the economy’s two largest markets. In the People’s Republic of China (PRC), spending was modest due to slower growth and uncertainty surrounding its property market. In the United States (US), the demand for electronics slowed as consumers continued shifting back to services. However, imports contracted more, by 5.7%, leaving net exports with a small positive impact on growth. Weak external demand also held down investment as firms postponed capacity expansion. The resulting weak business confidence and bloated inventories led in turn to an 8.7% fall in fixed investment and a drawdown of inventories, leaving a negative 0.5 percentage points impact on growth.

This chapter was written by David Keith De Padua and Henry Ma of the Economic Research and Development Impact Department, ADB, Manila.

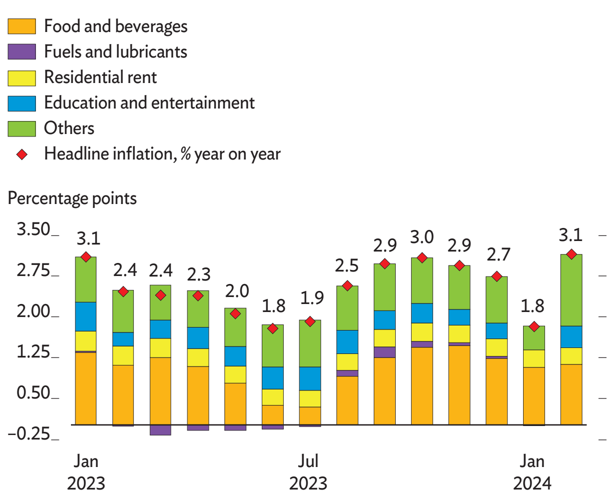
The improvement in the trade balance in the second half of 2023 widened the current account surplus. Supported by a depreciation in the NT dollar from an average of NT$29.8 per US dollar in 2022 to NT$31.1 in 2023, a gradual increase in exports later in the year combined with the sustained import contraction raised the trade surplus to 12.7% of GDP from 9.0% of GDP in 2022. This offset a decline in net services receipts, which fell from 1.7% of GDP to 1.3% in 2023 due to flourishing outbound tourism. On balance, the current account surplus increased from 13.3% of GDP in 2022 to 13.9% of GDP in 2023. There remained ample foreign currency reserves by end-2023, covering roughly 20 months of imports.

Consumer demand and supply shocks drove inflation. Headline inflation was on a downward trajectory in the first half of 2023 and came in below 2% in June and July (Figure 2.13.2). In October, however, Typhoon Koinu damaged crops, driving up food prices and inflation to 3.0%, leaving the average full-year inflation at 2.5%. Inflation slowed in January this year, but renewed seasonal pressures from the lunar holiday drove food prices and miscellaneous services higher.

Monetary policy was tightened in response to higher inflation, and the financial system remained solid. The central bank hiked its policy rate in March 2023, bringing it to 1.87%. Since then, despite a spike in inflation in December, the central bank has kept the policy rate constant, judging that price pressures were temporary. Broad money growth slowed from 7.0% in 2022 to 5.3% in 2023, while credit growth crept up from 6.4% to 6.5%. Nonperforming loans were 0.1% of total loans and the average capital adequacy ratio was 14.7% in 2022, relatively unchanged since 2020. Banks' pretax earnings were at a record high.

Figure 2.13.2 Monthly Inflation

Food prices have pushed inflation higher in recent months.



Source: Haver Analytics.

Fiscal policy was modestly expansionary. Higher public spending on infrastructure and on research and development along with slightly lower revenues turned the fiscal balance from a surplus of 0.3% of GDP in 2022 to a deficit of 1.0% of GDP in 2023. Public debt decreased and remained manageable at 26.6% of GDP at the end of 2023.

Despite slower growth, labor market indicators improved, but inflation eroded real wages. Unemployment slid to 3.3% in 2023 from its recent peak of 3.9% in 2020–2021 during the worst of the COVID-19 pandemic. The labor force participation rate, after marginally falling in 2021, regained its upward trend and reached a historic peak of 59.2% in 2023. The steady increase since 2010 has been attributed to increased female participation. Higher inflation, however, led to the average real monthly wage falling by about 1%, the first decline since 2016.

Economic Prospects

The economy faces significant long-term challenges. Its current advantages include a highly skilled labor force, strategic location for trade, and strong base of high-tech industries. Its prudent macroeconomic policies will also help, although there may be some concerns arising from the long-term performance of state-owned enterprises, pension funds, and the health insurance system. Nevertheless, estimates point to potential growth slowing from 3.5% to 3.0% due to population aging and increasing constraints to investment and trade as geopolitical tensions continue. Climate change risks will also increase. For example, changing rainfall patterns could negatively affect water-intensive chip production. The authorities are taking steps to mitigate other risks, including managing the inflow of migrant labor, helping youth acquire skills through enterprise apprenticeships, and promoting female labor force participation.

In the near term, economic growth will pick up. The economy is projected to grow by 3.0% in 2024 as exports and investment expand (Table 2.13.1). The 1.1% growth of merchandise exports in the fourth quarter of 2023—after contracting the previous 4 quarters—suggests the sector has bottomed out. The boom in artificial intelligence is expected to boost demand for semiconductors. Exports to the US grew by 57% in January and to the PRC by 22%. Export orders point to a continued recovery (Figure 2.13.3), which will in turn help investment bounce back. The pickup in the leading indicators index and purchasing managers' index supports this outlook. Consumption growth will already start to moderate this year and continue to slow through 2025, slowing growth to 2.7% in 2025. An early indication is that retail sales fell by 1.5% in December after averaging 5.5% growth in January-November. Consumer spending will also be held back by weak growth in real earnings.

Table 2.13.1 Selected Economic Indicators, %

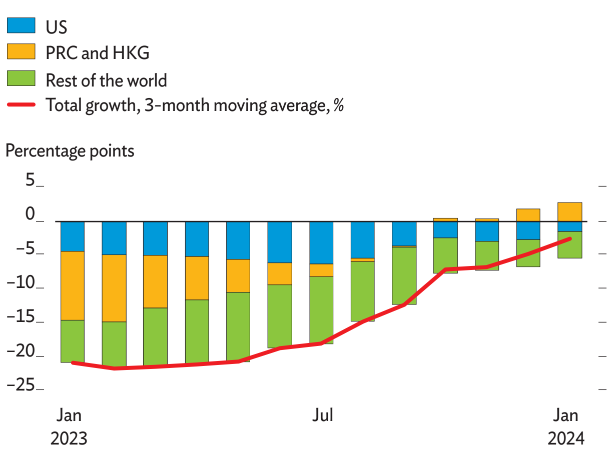
Growth will rebound then moderate, and inflation will slow.

	2022	2023	2024	2025
GDP growth	2.6	1.3	3.0	2.7
Inflation	2.9	2.5	2.3	2.0

GDP = gross domestic product.
Source: Asian Development Bank estimates.

Figure 2.13.3 Export Orders

Export orders, a leading indicator for exports, have been trending upwards.

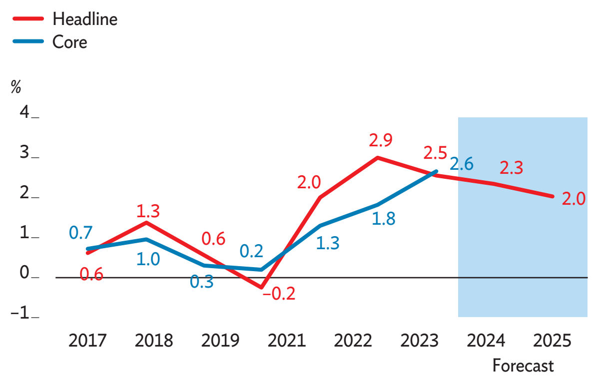


HKG = Hong Kong, China, PRC = People's Republic of China, US = United States.
Source: CEIC Data Company.

The near-term inflation outlook is sanguine. As consumption slows and supply shocks from the typhoon and higher global commodity prices wane, inflation should moderate. The central bank is also likely to maintain its monetary policy stance. Food and beverage prices accounted for over a third of headline inflation, and continue to be its main driver. The contribution of fuel and lubricants has been negligible with oil prices relatively stable and government price controls minimizing fuel price volatility. Inflation is thus projected to fall to 2.3% in 2024 and 2.0% in 2025 (Figure 2.13.4).

Figure 2.13.4 Headline and Core Inflation

Inflation moderated in 2023 and will continue to decline.



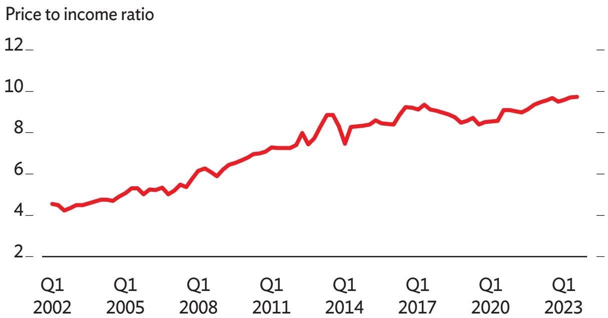
Source: CEIC Data Company.

Policy Challenge—Affordable Housing

House prices have climbed faster than incomes over the past decade, raising concerns among policymakers over housing affordability for a large part of the population. The average price of a residence grew by an average 4.3% annually during 2013–2023. House prices are now among the highest in the region and comparable to prices in high-income economies. During the same period, the average nominal wage grew by only about 1.9% annually. The ratio of house prices to incomes has climbed from 4.5 in 2002 to nearly 10 in 2023 (Figure 2.13.5). In response, people are delaying home purchases. In 2013, the average homebuyer was from 30 to 35 years old; in 2023 it was 35 to 40 years old.

Figure 2.13.5 House Price to Income Ratio

The house price to income ratio has more than doubled since 2002.



Q = quarter.

Source: CEIC Data Company.

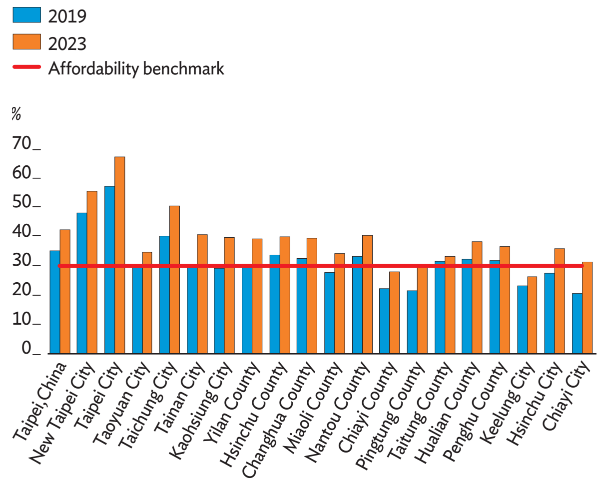
Despite high prices, home ownership remains prevalent. In 2019, the home ownership rate was about 85%. There is a strong preference for buying a home instead of renting, and property is generally seen as a good investment asset. Government policies also play a part, through mortgage subsidies and low property taxes that incentivize home ownership. Although the population is aging, the number of households continues to grow. In January 2023, they grew by 1.6%, or about 150,000 more households, compared to the same month in 2022. Roughly 36% of the population remains below the age of 35, so housing demand will likely remain robust in the near future.

Mortgage debt service is also rising. Mortgage debt reached 48.3% of GDP in 2023, an all-time high and higher than the Republic of Korea (35%) and Singapore (40%). Consequently, the cost of servicing housing loans rose from an already substantial 35% of income in 2019 to 42% in 2023, well above the widely used international affordability benchmark of 30% (Figure 2.13.6). As a result, the number of households seeking relief increased to 18,633 in 2021, more than double the annual average of 7,300 applicants during 2010–2020.

The high cost of housing has negative economic and social implications. The increasing share of income that goes to debt service reduces consumer spending on other items. It can also discourage fertility, especially among younger couples, contributing to population aging. More broadly, household debt remained high at 88.7% of GDP in 2022, with the higher interest rate environment and variable mortgage rates making some households vulnerable to shocks.

Figure 2.13.6 Housing Loan Payments to Income Ratios

Housing loan payments have increased and are above the affordability benchmark across most cities.



Source: CEIC Data Company.

The authorities are taking measures to address the problem but there is scope for enhancement. To increase supply, the Housing Act was revised in 2017 with a target of building 200,000 social housing units. As of February 2024, 168,000 have been built and the target is expected to be met by end-2024. But the target may now be outdated and insufficient. The government should assess whether more socialized housing is needed, potentially expand the program, and expedite construction to ensure there is adequate supply of affordable housing. To help moderate demand and speculation, the Ministry of Finance will raise the tax on non-owner occupied homes to 2.0%–4.8% from 1.5%–3.6%, and reduce the tax on owner-occupied homes to 1.0%. The tax on homes for lease will be reduced, which should help increase the supply of rental units. Mortgage subsidies should be reexamined and rationalized as well. The rental market also remains small in scale and underregulated. Policies that encourage renting properties, such as tax incentives, would expand the rental market and encourage the creation of more professional rental companies. As the rental market expands, it should be complemented with enhanced regulations that safeguard landlord and tenant rights.