

### **Summary**

Although Taiwan witnessed an economic downturn during 2008/2009, the country has managed to recover well, recording 10.9% growth in GDP in 2010. Relations with China, the country's most important export partner, have also improved. However, Taiwan's recovery could prove unsustainable, as the country's export-reliant economy is increasingly suffering from the global economic downturn. Furthermore, upcoming presidential elections in early 2012 could increase political tensions in Taiwan, as not all Taiwanese agree with China's growing influence in their country.

### **Things to watch:**

- Growing political tensions
- Improvement in relations with China
- Sustainability of economic recovery in light of global economic downturn

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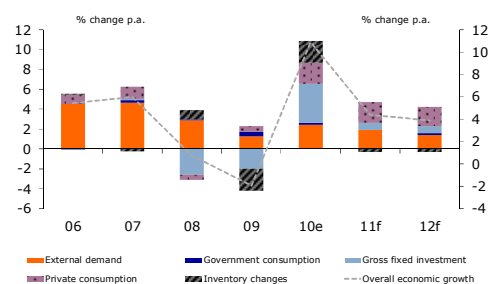
Taiwan			
<b>National facts</b>		<b>Social and governance indicators</b> rank / total	
Type of government	Republic	Human Development Index (rank)	na
Capital	Taipei	Ease of doing business (rank)	25/181
Surface area (thousand sq km)	36	Economic freedom index (rank)	25/179
Population (millions)	22.8	Corruption perceptions index (rank)	33/178
Main languages	Mandarin	Press freedom index (rank)	48/169
Main religions	Buddhism Taoism Confucianism	<b>Foreign trade</b> 2010	
Head of State (president)	Ma Ying-jeou	<i>Main export partners (%)</i> <i>Main import partners (%)</i>	
Head of Government (prime-minister)	Wu Den-yih	China	29
Monetary unit	New Taiwan dollar (NT\$)	Hong Kong	14
		United States	12
		Japan	7
		Japan	21
		China	14
		United States	10
		South Korea	6
<b>Economy</b> 2010		<b>Main export products (%)</b>	
<i>Economic size</i> <i>bn USD</i> <i>% world total</i>		<i>Main import products (%)</i>	
Nominal GDP	430	0.69	Electronic products
Nominal GDP at PPP	899	1.20	Basic metals
Export value of goods and services	314	1.69	Information & communications products
IMF quatum (in mln SDR)	2117	0.97	Textiles
<i>Economic structure</i> 2010      5-year av.		<i>Main import products (%)</i>	
Real GDP growth	10.9	3.0	Intermediate goods
Agriculture (% of GDP)	1	2	Capital goods
Industry (% of GDP)	32	27	Consumer goods
Services (% of GDP)	67	70	
<i>Standards of living</i> USD      % world av.		<i>Openness of the economy</i>	
Nominal GDP per head	18546	188	Export value of G&S (% of GDP)
Nominal GDP per head at PPP	38782	329	Import value of G&S (% of GDP)
Real GDP per head	19269	241	Inward FDI (% of GDP)

Source: EIU, CIA World Factbook, UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank.

### Introduction and update

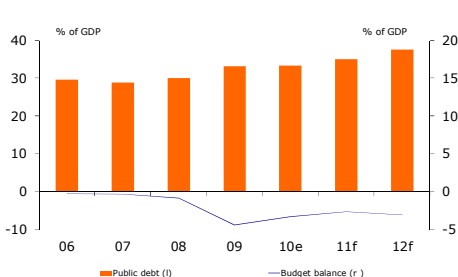
After experiencing a 1.9% contraction in GDP growth during 2009, Taiwan has managed to recuperate, staging an impressive 10.9% GDP growth in 2010. GDP growth is currently projected to settle at around 4% in 2011 and 2012. Although Taiwan seemed to be out of the woods, these prospects are now threatened. Next to growing public debt, Taiwan’s export-reliant economy is extremely vulnerable to exogenous demand shocks, such as the Japan earthquake and the global debt crises. Furthermore, no improvements have been made in Taiwan’s financial sector. A multitude of banks have made the sector overcrowded and inefficient, impeding Taiwan’s growth potential. The sector also suffers from a high degree of state intervention. A rise in FX-reserves in 2010 was somewhat neutralised by a rise in foreign debt, amounting to some 24% of GDP at the end of 2010. However, with a debt service cover of 466%, Taiwan’s external position is still very strong.

Chart 1: Growth performance



Source: EIU

Chart 2: Government finances



Source: EIU

**Taiwan’s economic performance: high dependency on external developments**

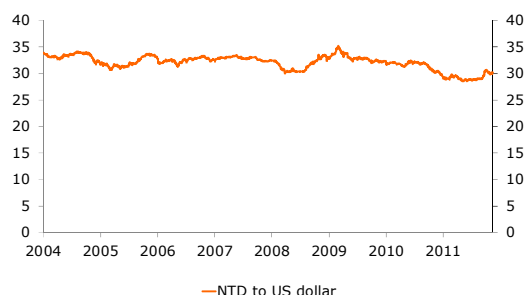
Although Taiwan succeeded in curbing the economic downturn, and in spite of private consumption supporting economic growth, there are dark clouds on the horizon. With exports amounting to some 73% of GDP, Taiwan’s economy depends heavily on its export partners, making the country overly vulnerable to exogenous shocks.

Taiwan’s most important export partners are China, Hong Kong, Japan, and the US. An interruption of any sort in the economic performance of these four countries directly and adversely influences the Taiwanese economy, dampening economic growth. For example, the Japanese earthquake earlier this year, which disrupted economic activities in entire South-East Asia, has thus far caused a decrease of some 8% in Taiwanese exports to Japan. Furthermore, the negative effects of the debt crises in the EU and the US on markets worldwide also pose an increasing threat to Taiwan’s growth potential. Although increasing instability in global financial markets is also causing an increasing amount of uncertainty in the Taiwanese economy exports are not expected to decline, but export growth is. Over 2011, exports are expected to grow with only 6%, compared to 25.7% in 2010.

An increasing budget deficit is another potential problem for the Taiwanese economy. After the economic downturn in 2009, the Taiwanese government set up elaborate spending schemes to re-ignite the economy. With gross investment growing by 23.4% in 2010, the government budget has been put under an increasing amount of pressure, with public debt at 33% of GDP in 2010 and growing towards 38% over 2011-12. If Taiwan’s growth turns out to be less than expected, the debt burden will increase even further, posing a significant problem to Taiwan’s economy.

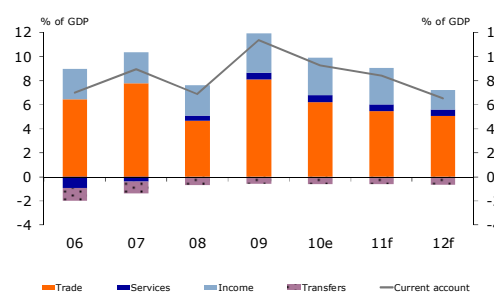
Taiwan external position is quite strong, with a current account surplus of 9.3% of GDP in 2010 and high FX-reserves. However, this strong external position is also considered a potential problem. With financial markets worldwide being plagued by increasing amounts of uncertainty, investors are drawn towards Taiwan’s good external position. The loss of confidence in major currencies, such as the euro and the dollar, have led to an increasing amount of hot money inflows into Taiwan. This increased demand for the New Taiwan dollar (NTD) is expected to result in an appreciation of the currency, undermining Taiwan’s competitive potential. However, the attractiveness of Taiwan’s strong external position to international investors should not be overstated, as the country’s vulnerability to exogenous shocks deters investors, who have become risk-averse due to the current volatile financial markets.

**Chart 3: Exchange rate**



Source: Reuters EcoWin

**Chart 4: Current account balance**



Source: EIU

**Relationship with China is the main political issue**

Although Taiwan, also known as the Republic of China (ROC), is still a relatively young country – the country was founded in 1949- and an even younger democracy-since the late 1990s-, political institutions are quite well developed. An import problem for the country is that it is not recognized by many important countries and institutions, such as the UN, the IMF, the US and the EU

(although unofficial relations do exist with most countries). This unofficial status is caused mainly by pressure from China, which still considers Taiwan as Chinese territory.

With presidential elections scheduled for early 2012, the major issue that is dominating the election debate is Taiwan's relationship with China. Under Ma Ying-jeou, who was elected president in 2008, relations with China have warmed up. In June 2010, Taiwan and China officially signed an Economic Cooperation Framework Agreement (ECFA), which enables freer trade between both countries. Furthermore, Ma Ying-jeou's party, Kuomintang (KMT), has expressed the wish to expand the cooperation with China even further over the next couple of years. This continuing policy of appeasing China is not falling well with all Taiwanese, as China is still considered a security threat for Taiwan because the country refuses to deny potentially winning Taiwan back by force.

The main opposition party in Taiwan, the Democratic Progressive Party (DPP), acknowledges the economic importance of China for Taiwan, but presses for an emphasis on building better relations with other countries than China, such as Japan and the US. According to the DPP, negotiations with China should only be continued if this can be done on an equal footing. Furthermore, the party advocates a new institutional framework, which would imply a change in Taiwan's constitution. This would put significant strain on the relationship between Taiwan and China, as the Chinese have warned that any change in Taiwan's constitution will be seen as a move towards permanent separation.

<b>Taiwan</b>							
Selection of economic indicators	2006	2007	2008	2009	2010	2011e	2012f
<i>Key country risk indicators</i>							
GDP (% real change pa)	5.4	6.0	0.7	-1.9	10.9	4.4	3.1
Consumer prices (average % change pa)	0.6	1.8	3.5	-0.9	1.0	1.5	1.3
Current account balance (% of GDP)	7.0	8.9	6.9	11.4	9.3	8.0	7.3
Total foreign exchange reserves (mln USD)	266148	270311	291707	348198	382005	384910	375120
<i>Economic growth</i>							
GDP (% real change pa)	5.4	6.0	0.7	-1.9	10.9	4.4	3.1
Gross fixed investment (% real change pa)	0.1	0.6	-12.4	-11.0	23.4	-3.1	1.2
Private consumption (real % change pa)	1.5	2.1	-0.9	1.1	3.7	3.2	2.3
Government consumption (% real change pa)	-0.7	2.1	0.8	3.9	1.8	0.7	2.7
Exports of G&S (% real change pa)	11.4	9.6	0.9	-8.7	25.7	4.0	1.9
Imports of G&S (% real change pa)	4.6	3.0	-3.7	-12.8	28.2	-1.6	0.2
<i>Economic policy</i>							
Budget balance (% of GDP)	-0.3	-0.4	-0.9	-4.5	-3.3	-2.7	-3.1
Public debt (% of GDP)	30	29	30	33	33	35	38
Money market interest rate (%)	1.5	1.9	1.9	0.2	0.4	0.7	0.9
M2 growth (% change pa)	5	1	7	6	5	4	0
Consumer prices (average % change pa)	0.6	1.8	3.5	-0.9	1.0	1.5	1.3
Exchange rate LCU to USD (average)	32.5	32.8	31.5	33.1	31.6	29.5	30.0
Recorded unemployment (%)	3.9	3.9	4.1	5.9	5.2	4.4	5.1
<i>Balance of payments (mln USD)</i>							
Current account balance	26300	35154	27505	42911	39899	38200	34860
Trade balance	24197	30445	18478	30553	26513	24470	23600
Export value of goods	223789	246500	254897	203399	273823	305110	317070
Import value of goods	199592	216055	236419	172846	247310	280640	293470
Services balance	-3543	-1640	1847	1991	2649	3800	3850
Income balance	9581	10132	9978	12512	13447	12850	10560
Transfer balance	-3935	-3783	-2798	-2145	-2710	-2910	-3150
Net direct investment flows	25	-3338	-4855	-3072	-9061	-9970	-5400
Net portfolio investment flows	-17817	-39376	-10814	-9868	-23094	-20660	-8610
Net debt flows	-770	8522	-4797	-8644	19575	70	-9450
Other capital flows (negative is flight)	5150	3226	14323	35251	6921	-4820	-21180
Change in international reserves	12888	4187	21362	56578	34240	2810	-9780
<i>External position (mln USD)</i>							
Total foreign debt	85833	94525	90360	81958	101679	102470	93050
Short-term debt	74243	83283	78773	68174	83766	85560	77370
Total debt service due, incl. short-term debt	82595	82742	92594	89679	81932	100640	102640
Total foreign exchange reserves	266148	270311	291707	348198	382005	384910	375120
International investment position	3132	21288	21890	34444	57816	n.a.	n.a.
Total assets	154673	165855	177994	206097	210703	n.a.	n.a.
Total liabilities	151541	144567	156104	171653	152887	n.a.	n.a.
<i>Key ratios for balance of payments, external solvency and external liquidity</i>							
Trade balance (% of GDP)	6.4	7.7	4.6	8.1	6.2	5.1	5.0
Current account balance (% of GDP)	7.0	8.9	6.9	11.4	9.3	8.0	7.3
Inward FDI (% of GDP)	2.0	2.0	1.4	0.7	0.6	0.4	1.4
Foreign debt (% of GDP)	23	24	23	22	24	21	20
Foreign debt (% of XGSIT)	31	31	28	31	30	27	24
International investment position (% of GDP)	0.8	5.4	5.5	9.1	13.5	n.a.	n.a.
Debt service ratio (% of XGSIT)	30	27	29	34	24	26	26
Interest service ratio incl. arrears (% of XGSIT)	2	2	2	3	2	2	2
FX-reserves import cover (months)	13.7	12.9	12.9	20.6	16.1	14.3	13.5
FX-reserves debt service cover (%)	322	327	315	388	466	382	365
Liquidity ratio	186	187	188	236	217	200	194

Source: EIU

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