

Positive economic outlook clouded by political uncertainties

General Information



GDP	USD490 bn (IMF 2013)
Population	23.4 million (National statistics 2014)
Form of state	Multiparty Democracy
Head of government	MA Ying-jeou
Next elections	2016, presidential and legislative



Strengths

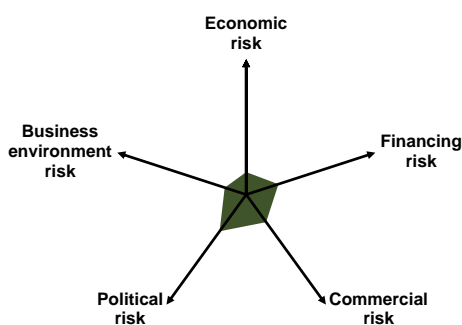
- Functioning, stable democracy
- Good record of sound economic management, pro-business environment, well educated workforce
- Demonstrated economic flexibility, enabling rapid shifts along the value-added scale
- High domestic savings and investment
- Very strong external liquidity

Weaknesses

- Uncertain and tense relations with Mainland China
- Heavy concentration on the IT/electronics sector
- 51% of trade focused on China, Hong Kong and USA
- Openness of the economy leaves it vulnerable to demand shocks

Country Rating

A1



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

Exports	Rank	Imports
China, People's Rep. Of	27% 1	16% Japan
Honk Kong, China	13% 2	16% China, People's Rep. of
United States	11% 3	9% United States
Singapore	6% 4	6% South Korea
Japan	6% 5	6% Saudi Arabia

By product (% of total)

Exports	Rank	Imports
Electrical machinery, apparatus and appliances	28% 1	19% Petroleum and related materials
Petroleum and related materials	7% 2	17% Electrical machinery, apparatus and appliances
Professional and scientific instruments	6% 3	5% Specialised machinery
Telecommunication apparatus	5% 4	4% Organic chemicals
Plastics in primary forms	5% 5	4% Non-ferrous metals

Source: UNCTAD (2012)

Economic Overview

A good mix: strong economic growth (+3.5 % in 2015) and decreasing insolvencies (-6%)

After 2 years of weak growth, economic activity picked up momentum in 2014 (3.4%). Export growth accelerated supported by gradual increase in global demand, and improving performance in the electronic and the IT sectors. Domestic demand strengthened boosted by rising investment and increasing consumer spending.

Risk of non-payment is set to continue to decrease. After a fall of -14% in 2014, insolvencies will decrease by -6% in 2015. Economic activity is set to remain strong in 2015 (+3.5%). Exports will likely remain the key driver, benefitting from external demand increase. Investment cycle is set to continue in line with (i) rising new orders in the tech sector, (ii) and 4G developments projects. Private consumption growth is expected to strengthen gradually with rising wages, and less inflationary pressure due to weak energy prices. We expect that the policy mix will likely be balanced going forward. Fiscal consolidation will continue, acting as a drag on growth. However, less inflationary pressures will give more leeway to the Central Bank to support growth.

2 main risks in the short run: deteriorating trade relationships with Mainland China and lack of improvement in global demand

We see 2 main risks to the baseline scenario. The first one is related to the (geo) political context. The ruling party loss recent elections and there is a rising discontent about its rapprochement policy towards China. Further discontent can have impact on domestic activity limiting investment, but also on trade if current relationship with China were to deteriorate. The second risk stems from the external demand especially from mainland China and the USA. As a trade hub, Taiwan will be the first hit, if China were to decelerate further below 7%, if USA recovery were to be delayed.

Monetary policy: weak inflation suggests a more accommodative stance

The first objective of the CBC is to maintain macro-financial stability and enhance growth. The institution has been very responsive during the 5 past years. After monetary stimulus during the crisis (reduction of the policy interest rate by -2.1 bps between 2007 and 2009), the Central Bank started to tighten its monetary stance on the back of a strong recovery and rising inflationary pressures. Between 2009 and 2013, the policy rate rose by 0.625 bps to 1.875. In Q2 2014, with rising inflationary pressures, and diverging monetary policy in the advanced economies, the institution warned of possible rate hike.

However, recent figures point to a more balanced approach. Inflation decelerated in Q4 2014 (0.9% y/y) and continued low energy prices point to weak inflationary pressures in the coming quarters. As the Central Bank target is 2%, further tightening is not expected and if growth figures were to disappoint, it is likely that the CBC will intervene.

Public finances are improving

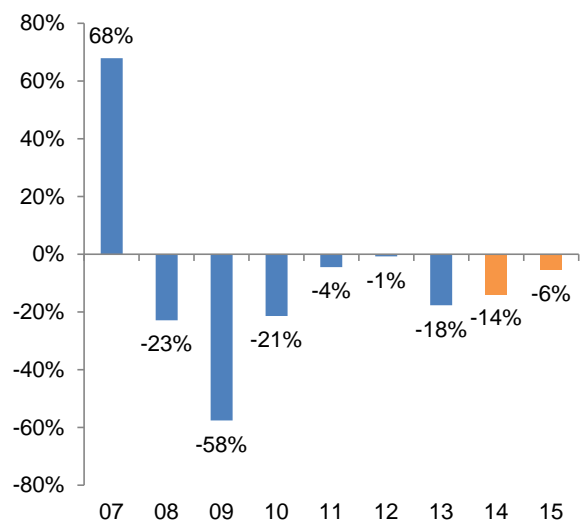
Public finances are well oriented. After a huge slippage in 2009, the government balance returned to safer level (above -3% in 2014). Public deficit is expected to remain under control in 2015. While public expenditures are set to rise by 2.3% from higher social welfare costs and infrastructure investment. Revenues are expected to increase by 5.4% due to better economic prospects.

Key economic forecasts

	2012	2013	2014f	2015f
GDP growth (% change)	2.1	2.2	3.4	3.5
Inflation (% year average)	0.8	1.4	1.2	1.0
General gov. net lending (% of GDP)	-4.2	-3.1	-2.3	-2.1
Public debt (% of GDP)	41.0	40.9	40.0	38.9
Current account (% of GDP)	10.6	11.7	11.8	11.0
External debt (% of GDP)	27.5	34.8	37.2	36.5

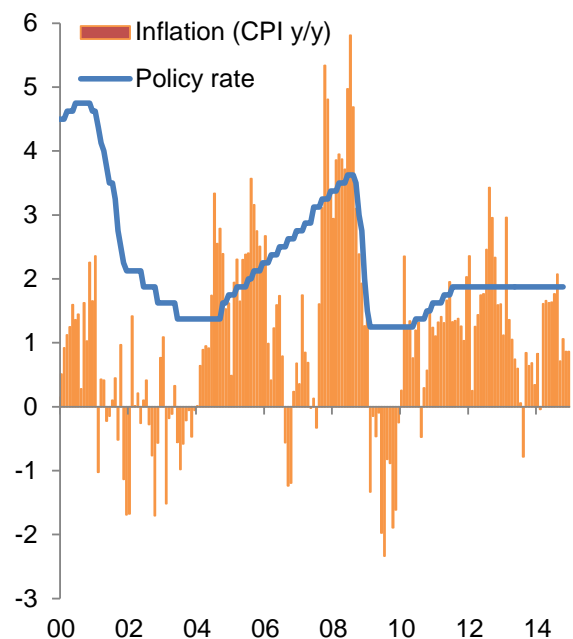
Sources: IMF, National sources, IHS, Euler Hermes

Insolvencies (y/y)



Sources: National sources, Euler Hermes

Monetary policy and inflation



Sources: National sources, IHS, Euler Hermes

General government debt (40.9% GDP) is at acceptable levels by international standards. The debt sustainability risk is low, as the government debt ratio is relatively low as compared with other high-income countries and regional economies. However national constraint (debt ceiling at 40.6% GDP for the Central government, 50% for overall public debt) put some pressures on the government to speed up the deleveraging process. Under the current scenario, the overall government debt should decrease to 38.9% by 2015.

External position is solid: high current account surplus and large reserves

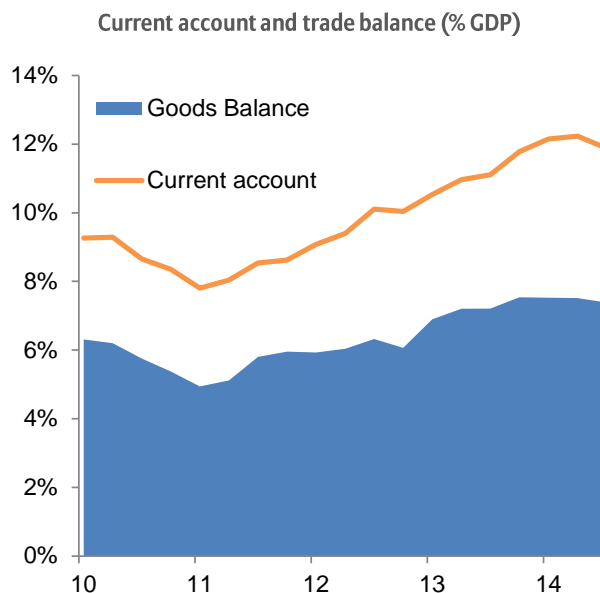
Thanks to its strong competitive advantage as a manufacturing hub, the country continues to record strong current account surplus. Trade surplus in 2014 amounted 7.4% GDP in 2014 (from 7.2% in 2013), and current account surplus remained at high level (11.8% GDP). Going forward, the country is set to maintain this performance thanks to improving global demand and increasing demand for mobile devices and advanced technology products. Current account surplus will likely remain large at 11% of GDP in 2015.

From a financing point of view, net FDI remain negative (estimated at -2% GDP) reflecting Taiwanese investment abroad. Inflows are relatively low in GDP terms (estimated at 0.5 % GDP in 2014) underscoring Taiwan's longer term issue of relative isolation. However, net FDI outflows are not a short term problem given the current account surplus.

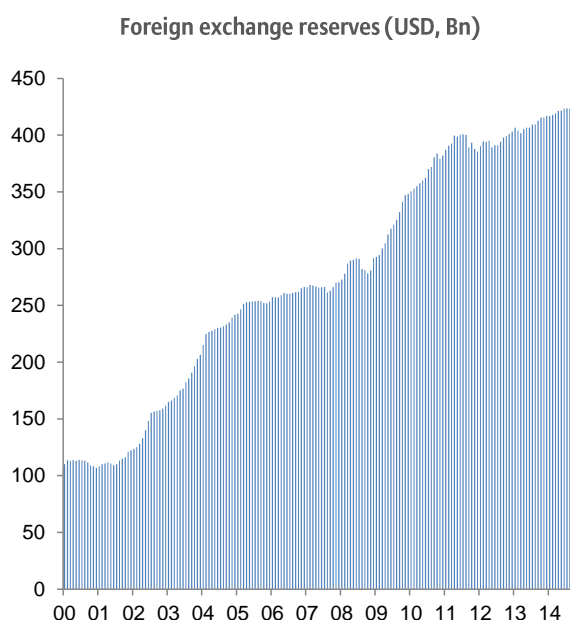
External debt is not a source of concern. Estimated at 37.2% of GDP, it should decrease to around 36% by 2015. Short term debt is large (USD156 bn in 2013) but not a concern as it is easily covered by foreign exchange reserves. Foreign exchange reserves represent USD 422 bn (end 2014) and cover more than 15 months of imports.

Strengthen political relations with China will be key

Recent defeats of the KMT (the ruling party favourable to further rapprochement with China) in local elections should delay further cooperation with China. Last declarations from mainland China officials show that an agreement on closer cross-strait economies ties (ratification of Cross-Strait Agreement on Trade in Services by Taiwan legislature) will be vital for further trade partnerships. Since China is the first trade partner, delaying the ratification process will be detrimental for Taiwanese exports performance: Mainland China imports of goods represent around 1/3 of Taiwanese exports, 17% of Taiwanese GDP. This is all the more important as South Korea, an economy with the similar export structure, and Mainland China signed a free trade agreement.



Sources: National sources, IHS, Euler Hermes



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