

2017 Taiwan Market Report

22nd Asia Securities Forum AGM, November 27, 2017

By Taiwan Securities Association

A. Taiwan's Economic Situation shows some signs of recovery

YoY % change	2013	2014	2015	2016	2017 July	2017 August	2017 (Jan-Aug)
GDP growth	2.20	4.02	0.72	1.48	-	-	2.11 ¹
CPI	0.79	1.20	-0.31	1.40	0.77	0.96	0.66
Exports	1.6	2.8	-10.9	-1.7	12.5	12.7	12.5
Imports	0.3	1.4	-15.8	-2.7	6.4	6.9	13.8
Export orders	0.4	6.7	-4.4	-1.6	10.5	7.5	10.6
Industrial Production Index (IPI)	0.7	6.4	-1.8	1.5	2.1	3.3	3.14
Unemployment rate (%)	4.18	3.96	3.78	3.92	3.84	3.89	3.78

1. Note: An August estimation, the projected GDP growth for the whole 2017 is 2.11%.
2. Sources: The Central Bank of China (CBC), Financial Supervisory Commission (FSC), Directorate-General of Budget, Accounting and Statistics (DGBAS).

Taiwan's exports increased by 12.7% and imports by 6.9% year over year in August. In August 2017, the overall monitoring indicator flashed the "green" signal for the first month, and the trend-adjusted leading index increased by 0.13%, while the trend-adjusted coincident index increased by 0.62% from previous month. The annual growth rates of export orders and Industrial Production Index were 7.5% and 3.3% (YoY), respectively.

On the financial side, the Consumer Price Index (CPI) annual growth rate went up by 0.96%, and the unemployment rate rose to 3.89% in August from 3.84% a month earlier.

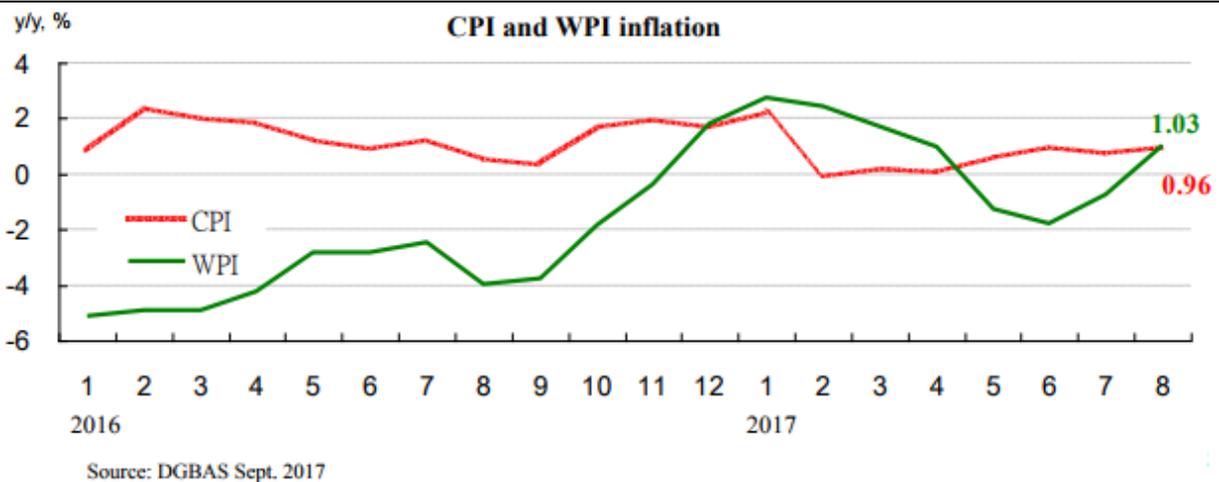
Currently, Taiwan is undergoing some major reforms, adapting to new labor regulations, justice reform, and the pension reform on public servants. The government is doing every effort to stimulate consumption, expand public construction, drive investment, encourage participation in public construction, and implement economic upgrading in order to accelerate Taiwan's economic development.

At the same time, the Government will fully promote to increase salaries by 3 percent for government employees starting next year, and this measure is expected to encourage private companies to follow suit. Moreover, the Government is also working on overall tax reform, relaxing laws and regulations, and planning to spend NT\$ 420 billion on a 4-year public infrastructure project, and continuing with the 5+2 industrial innovation program.

1. GDP is up: According to the DGBAS's latest estimation in August, GDP growth rate in 2017 is forecast at 2.11%, up 0.06% on May 2017's forecast, mainly due to better than expected performance of exports and private consumption in the first half of this year. In addition, the government will actively strengthen infrastructure and implement the 5+2 Industrial Innovation Plan. These initiatives should build a strong foundation for Taiwan to build a vigorous and sustainable economy in years to come. In 2018, GDP is expected to rise by 2.27%.

2. CPI remains very low: The annual change of CPI in August 2017, compared with the same month of 2016, rose 0.96%. For the first eight months of 2017, the CPI increased 0.72% over the same period of the previous year.

The WPI increased by 1.03% in August. For the first eight months of 2017, the WPI increased 0.64% over the same period of the previous year.

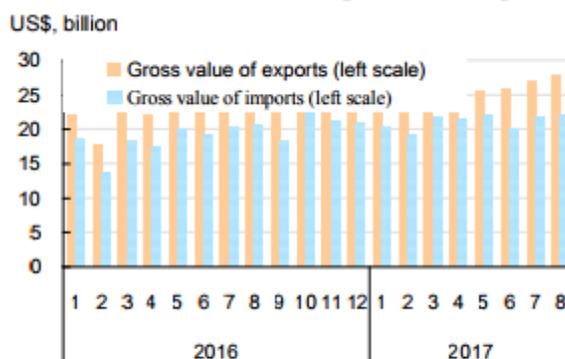


3. Foreign Trade Continues to Increase: Total exports increased by 12.7% year-on-year in August 2017, expanding for the 11th consecutive month, mainly due to continuous recovery of world trade, solid demand for electronic components and low base effect. In the first eighth months of this year, Taiwan's exports rose 12.5% from a year earlier.

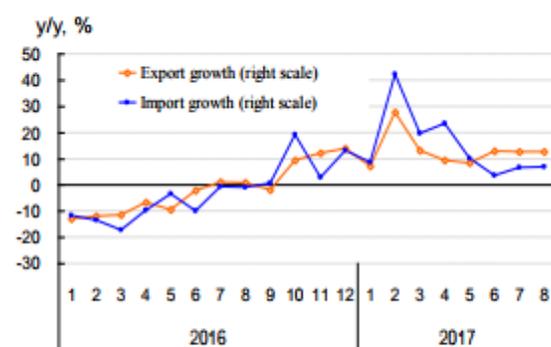
Imports increased by 6.9% in August over the previous year, imports of parts of electronic products and mineral products grew by 20.8% and 12.5%, respectively, however imports of machinery decreased 26.4%. The annual change rate of January-August was 13.8%.

Export order increases by 10.6%, an early indicator of export, which is expected to grow in the coming quarter.

The Gross Value of Exports and Imports



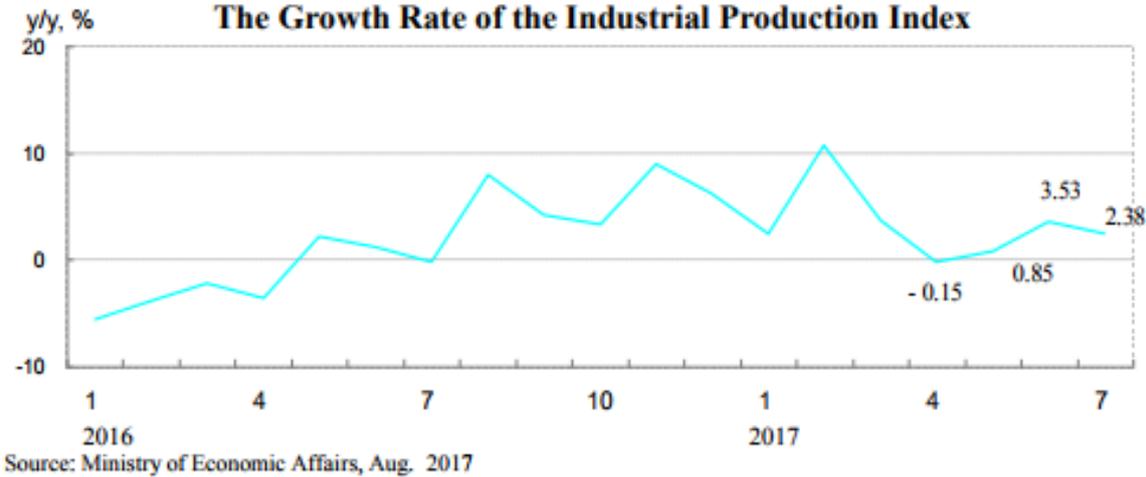
The Gross Rate of Exports and Imports



Note: Since FY2016, the general trade system applied for compilation of external trade statistics and the historical data has been revised to FY2001.
Source: Ministry of Finance, Sept. 2017

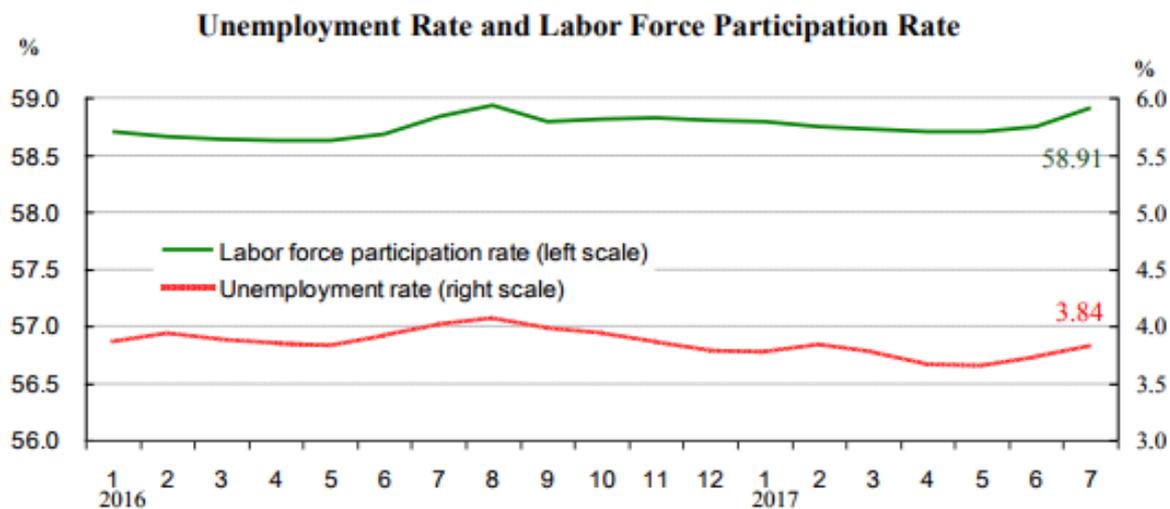
4. Industrial Production Index is up slightly: The Industrial Production Index (IPI) posted an annual increase of 2.38% in July 2017. For the first seven months of 2017, the IPI increased 3.17% over the same period of previous year.

The growth came largely from increasing demand for electronic parts and components due to the increase in sales of consumer electronics, and increasing demand for machinery and equipment due to automatic production.



5. Unemployment Rate remains low: The unemployment rate increased by 0.10% to 3.84% in July, however, the seasonally adjusted unemployment rate remained the same at 3.78%.

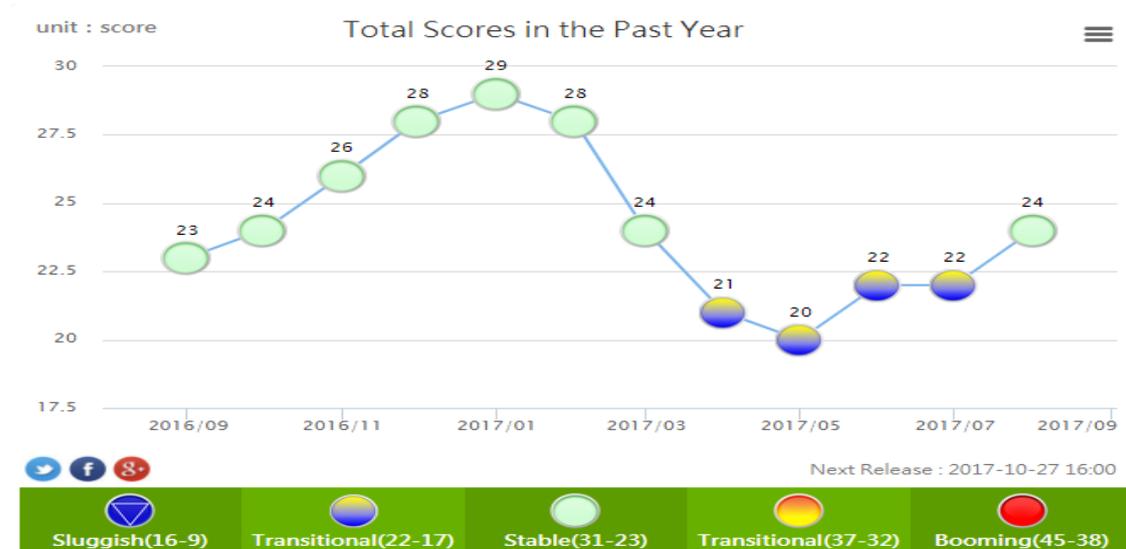
Labor force participation rate was 58.91% in July, which increased by 0.16% and 0.07% on the previous month and the previous year, respectively.



Source: DGBAS, Aug 2017

Overall Performance: Monitoring Indicators Flashing "Green" Signal

In August 2017, the Monitoring Overall economic Performance Indicators shows total score stood at 24, and flashed the "green" signal for the first month over the past four months, and the trend-adjusted leading index increased by 0.13%, while the trend-adjusted coincident index increased by 0.62% from previous month. Taiwan Business Indicators indicated that the current domestic economic recovery is in a stable status.



B. Taiwan Securities Market is getting better

Equity Market Performance

	2015	2016	2017 (1-9)	Estimated annual change
TAIEX stock Index (point)	8,338	9,253	10,383	↑ 11%
Market Capitalization (NT\$ Billions)	24,504	27,248	30,942	↑ 12%
P/E Ratio (%)	13.46	16.51	15.97	↓ 0.54%
Dividend Yield (%)	4.60%	4.35%	~	~
Total Trading Value (NT\$ Billions)	22,505	18,915	18,082	↑ 26%
Daily Trading Value (NT\$ Billions)	92.23	77.52	98.28	↑ 26%
Turnover Ratio (%)	77.55	64.59	55.89	↑ 15%

Trading Value Percentage by Investors

	2015	2016	2017 (1-9)	2017 vs. 2016
Domestic Individual (%)	52.3	52.0	62.6	↑ 10.6%
Foreign Institutional (%)	28.4	30.4	24.8	↓ 5.6%
Domestic Institutional (%)	18.3	17.6	12.5	↓ 5.1%

1. The Taiwan Stock Exchange Capitalization Weighted Stock Index (TAIEX)

Since April 2017, the TAIEX has climbed to over 10,000, a historical high ever seen back in 2000, and stayed up to 10,383 in September. This is a milestone to Taiwan, as it is a relatively height over the past ten year, ever since the 2008 economic downturn at 4,591.

2. Market Capitalization

The total market capitalization of TWSE-listed stocks amounted to NT\$30.94 trillion as of September 2017, growing by 12%.

3. P/E Ratio

In 2016, TWSE stocks traded at a price-to-earnings ratio of 16.51. In September 2017, price-to-earnings ratio has stayed at 15.97, which is considered globally competitive.

4. Dividend Yield

TWSE-listed companies distributed NT\$1.15 trillion in dividends to investors in 2016, up 5.43% from 2015. The dividend yield of 4.35% was higher than the rate of return on bank deposits and exceeded levels attained in other major markets. The average dividend yield of TWSE stocks from 2012 to 2016 averaged at 3.98%.

5. Total Trading Value

The aggregated trading value from January to September this year has reached NT\$18.082 trillion, nearly reaching last year's total. It is expected to exceed NT\$20 trillion by the end of this year.

6. Daily Trading Value

The average daily trading value in 2016 dropped to the 5-year low at NT\$77.52 billion, however, bounced back by 26% to NT\$98.28 billion as of September 2017. The figure indicates that the stimulus plans promoted by Taiwan's regulators and related securities agencies over the year have successfully regain investors' confidence.

7. Trading Value Percentage by Investors

As of September, 2017, the percentage of domestic individual investors has exceeded 62.6%, 10.6% increase compared to last year. This indicates more and more domestic retail investors regain their confidence on Taiwan's the equity market. This phenomenon may be attributed to the adoption of day trading tax cuts starting from April, 2017, boosting the rise of domestic investors.

And the proposed tax reform on dividend income tax by the Government expected to take effect on Q1 next year is expected to close the tax gap between domestic investors and foreign investors. As Taiwan’s current capital gains tax scheme favors foreign investors, many domestic firms have registered overseas and invest Taiwan’s securities market in the name of foreign investors.

8. Turnover Ratio

From January to September this year, TWSE’s turnover ratio has reached 55.89%, and it is estimated to reach 74.52% by the end of this year, growing by 15% than last year.

Bond Market

1. Bond Issuance is up

				(NT\$ Billion)
Bond type	2015	2016	2017 (1-9)	Estimated annual change
International Bond	57.82	94.79	125.16	↑ 76%
Corporate Bond	1,863.56	1,825.95	1,850.54	↑ 35%
Government Bond	5,569.37	5,605.33	5,548.83	↑ 32%
Financial Debenture	988.91	977.43	950.83	↑ 30%
Beneficiary Securities	8.61	12.41	11.60	↑ 25%
Foreign Bond	9.69	9.81	15.29	↑ 107%
Total	8497.96	8525.72	8502.25	↑ 32%

The aggregated bond issuance from January to September 2017 was NT\$85.02 trillion, which is equivalent to the figure of whole 2016. The growth is attributed to the rise of corporate bond and government bond issuance. It is estimated that the total bond issuance will grow by 32% by the end of 2017.

2. Bond Trading is staying put

(NT\$ Billion)

Bond type	2015	2016	2017 (1-9)	Estimated annual change
International Bond	1,051.41	1,363.94	868.24	↓ 15%
Corporate Bond	964.48	829.36	714.31	↑ 15%
Government Bond	6,726.85	6,312.61	4,246.31	↑ 10%
Financial Debenture	233.00	138.42	102.89	↑ 1%
Beneficiary Securities	0.00	3.19	0.00	~
Foreign Bond	12.38	8.38	8.79	↑ 39%
Total	8,988.12	8,655.90	5,940.55	↑ 8%

Although the bond issuance has shown major growth, it is estimated the growth of trading value will up by only 8% in 2017.

Taiwan Government Bond 10Y

The 10-year benchmark bond yield closed around 1.03% as of mid-October, staying at the global average level.



C. Two Key Challenges in Taiwan’s Securities Market

Challenge 1 - Unreasonable Tax Regime of Securities Market

(Billion US\$)

Year	2006	2011	2016	2017(1-9)
Total Trading Value	737.2	889.9	513.5	543.4

In 2016, total trading value of Taiwan Stock Exchange (TWSE) reduced by 42.30% compared to the figure in 2011 (US\$ 89.99 billion) when the capital gains tax had not been imposed. After the capital gains tax was imposed, Taiwan’s decline of trading volume was the worst among major securities markets in the world. During the same period, Tokyo grew by 41.46%, and Shanghai, 87.26%. The decline of Taiwan’s stock market was mainly caused by the unseasonable tax levied on securities transaction, in addition to the impact of domestic and global economic and financial situations.

Related tax rate in Taiwan’s securities market:

- Securities transaction tax: 3‰ of the value traded is levied from selling.
- Capital gains tax: 15% of gains from selling equities: (From 2012 to 2015)
- Dividend tax:
 - Non-Taiwan resident: 20% withholding tax
 - Taiwan resident: Dividends are included in the consolidated income. As of 2015, maximum tax rate was 45%.
 - Supplementary NHI premium: 2% (from 2012); 1.91% (cuts in 2014)

Why the tax regime has impacted Taiwan’s stock market?

- **Increase of trading cost:** Among 3‰ of securities transaction tax, investors consider 2‰ is transaction tax, while 1‰ is the implied capital gains income tax is already included. Therefore, if additional 15% of

capital gains tax were added, it will increase investment costs.

- **Big investors avoiding tax inspection:** Capital gains tax must be validated and declared to the taxation bureau. To avoid potential income inspection, many big investors suspend their trading in TWSE, or transfer their capital to overseas market for investment.
- **Dividend tax regime unfair:** Dividend tax levy for domestic investors is included in the consolidated income, with maximum 45% tax rate; however, foreign investors only apply to 20% withholding tax. With the widened gap of dividend tax between domestic investors and foreign investors, more and more domestic investors resort to measures of tax avoidance or tax savings, such as selling their holdings and move their capital overseas, establishing an offshore investment company in disguise of a foreign investor, undergo corporate capital payback before 2015, etc.

The tax regime has severely affected Taiwan’s capital market momentum, and created a vicious cycle.

1. Big investors out of the game; retail investors fled away

Number of big/middle investors (persons)	2011	2016	2017.9
Quarterly trading value > NT\$0.5 B	1,188	396	1,198
NT\$0.5 B > Quarterly trading value > NT\$0.1 B	10,847	4,250	9,822

% of total trading value	2011	2016	2017.9
By domestic individual investors	62.7	52.0	62.6
By domestic institutional investors	15.4	17.6	12.5
By foreign institutional investors	21.8	30.4	24.8

2. Shrinking trading volume in Taiwan stock market

Total trading value (Billion NT\$)	2007-2011 Average	2012-2016 Average	2017.9
Average daily trading	134.6	97.7	152.2

2012-2016 average daily trading value was NT\$ 97.7 billion, which decreased by 27% than the figure of 2007-2011 average.

3. Accelerating capital outflow

Central Bank Financial Account (Billion US\$)	2007-2011 Average	2012-2016 Average	2017 Average
Quarterly money outflow	2.3	13.4	-

From 2012 to 2016, our quarterly net outflow of financial account was US\$ 13.4 billion on average. This figure showed 5.8 times growth of US\$2.3 billion outflow compared to the figure from 2007-Q3 to 2011.

Solutions:

Over the past few years, Taiwan Securities Association (TSA) has been committed to framing a reasonable tax regime for our capital market, ensuring it is in line with the global standard. Moreover, we have constantly explained to the general public about the unfriendliness and unreasonableness of the existing tax regime, how it has severely affected the soundness and development of Taiwan's capital market. As well, we continue to lobby the Executive Yuan and the Legislature Yuan to undergo the tax reform in securities market:

Achievements:

1. 2015/11 - Abolish capital gains tax
2. 2016/12 - Continue to stop levying securities transaction tax of corporate bond and financial debenture for the next 10 years
3. 2017/04 - Halving day trading transaction tax (3.0‰→1.5‰)

In progress:

4. Expected 2018/Q1 Dividend tax reform

Ever since the abolishment of capital gains tax and halving of day trading transaction tax (3.0‰→1.5‰), the market trading value has shown significant improvement:

1. **Average daily trading value increase:** As of September, average daily trading value in TWSE and TPEX markets grew to NT\$152.2 billion, 29.8% or NT\$99.8 billion growth compared to the entire year of 2016.
2. **Day trading percentage increase:** Percentage of day trading accounts 23.39%, 2.4 times growth compared to 9.63% in 2016. And this measure also has indirectly invigorated the overall trading of the stock market.
3. **Big individual investors come back to the market:** The number of big investors (quarterly trading value >NT\$ 0.5 billion) has increased from 396 as of last yearend to 1,198 in Q3, 2017. As well, the number of middle investors (NT\$ 0.5 billion >quarterly trading value >NT\$ 0.1 billion) also shows great improvement from 4,520 as of last yearend to 9,822 in Q3, 2017.
4. **More domestic investors come back to the market:** Percentage of domestic individual investors also grows from 52% last year to 63% this year, returning to the same level before 2011 when the 15% of capital gains tax rate was adopted.
5. **Day trading transaction tax cuts does not impact tax revenue:** The halving of day trading transaction tax has successfully invigorated Taiwan's stock market, by lowering the transaction cost of investors, while the tax revenue does not fall short of the target, achieving a win-win situation. The hype of day trading transactions can not only drive the growth of trading volume of the centralized market, but also effectively facilitate the growth and vitality of Taiwan's stock market.

In order to further facilitate the development of Taiwan securities market, TSA is currently working on the dividend tax reform, hoping to redirect the dividend tax regime for individual investors to the same standard of the global market. It is estimated that the Government will propose a fair and friendly dividend tax regime in Q1, 2018, ensuring sound development of Taiwan's capital market.

Challenge 2 - Facilitate the relaxation of laws and regulations; adopt negative listing approach

Taiwan's securities industry is subdivided into different sectors, in which, businesses such as securities, securities finance, futures, securities investment trust, securities investment consulting and trust have different operations and are strictly divided, at the same time, different businesses are required to comply with respective regulations. As a result, an issue like "overlapping of supervision" may rise, which will hinder the development of diversified businesses, restrict the business scope, as well as undermine capital market development.

In addition, the Government is currently encouraging FinTech companies to innovate new business models, and promoting the regulatory sandbox for the financial industry, in the hope of enhancing the competitiveness of the financial industry. The "Drafted Bill of Financial Technology Innovation and Experiment Act" is currently in the legislative procedure, forcing the securities companies in the face of bigger pressure.

Solutions:

1. At the press conference of the inauguration ceremony on September 12, new chairman Wellington Koo of the Financial Supervisory Commission (FSC) vowed to "strengthen corporate governance of financial industry" as the regulatory priority, hence it is expected the current regulations could be lessened.
2. TSA is working on facilitating the relaxation of laws and regulations to support securities companies to cope with the transition. Our proposal is that the regulatory authority should adopt the negative listing approach in authorizing securities companies to launch new products or services within the permitted scope. This approach is expected to enable the companies to innovate, seize business opportunities and improve their competitiveness within a less restricted legal framework.
3. Promote the regulatory sandbox, while preventing adverse impacts to existing companies.

Under the prerequisite of consumer rights protection, TSA supports FinTech innovation. With the approach of innovation experiments, we expect to enhance the usability, service quality and security of FinTech innovation. And we hope the “Drafted Bill of Financial Technology Innovation and Experiment Act” will be announced and implemented as soon as possible.

Moreover, new act should follow the principle of fairness to prevent adverse impacts.

- (1) The regulatory authority has implemented a very high basic regulatory standard to existing financial companies, such as requirements of BIS ratio and minimum operational fund. Such basic regulatory standard should also apply to the FinTech companies.
- (2) The regulatory authority should try to minimize impacts to exiting companies. When FinTech companies join the game, it is advised that they will partner with current financial companies to develop businesses.
- (3) When it comes to inconsistent treatment between the financial industry and the FinTech industry, such as operation criteria or penalty treatment, the necessity of existing regulations should be reviewed. If they are mandatory, both the financial industry and the FinTech industry should comply with. On the other hand, if the regulations are determined not needed after the review, relevant adjustment or abolishment of the regulations should be adopted through innovation experiment validation, ensuring all players to operate and compete fairly under the same legal framework.