

Central Bank of the Republic of China (Taiwan)

Annual Report 2006

Taipei, Taiwan
The Republic of China



Fai-nan Peng, Governor

Foreword

In 2006, Taiwan's economy registered a steady growth of 4.62 percent, higher than the 4.03 percent in the previous year. The major driving force was exports, fuelled by a pickup in external demand for consumer electronics, which more than offset the weakness in private consumption caused by credit card defaults. Meanwhile, inflation remained low and stable. Surging oil prices fed through to electricity and transportation prices; yet vegetable prices declined markedly due to a higher base effect. Taken together, consumer prices edged up 0.6 percent and CPI excluding fresh fruits and vegetables increased 1 percent.

In the context of solid economic growth, subdued inflation and low real interest rates, the Bank adopted fine-tuning measures to help promote efficient fund allocation and financial stability. The Bank raised the discount rate four times during 2006, each time by 12.5 basis points, and ten times from October 2004 to the end of 2006 by a total of 137.5 basis points. Market rates were gradually guided upwards. Under the Bank's prudential policy, excess reserves, reserve money, bank credit and monetary aggregates all followed a reasonable course of growth. M2 grew by 6.22 percent for the year, staying within the Bank's 3.5 to 7.5 percent target zone.

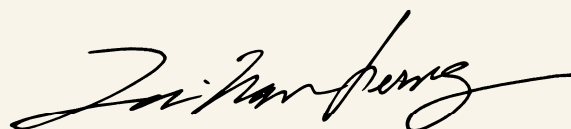
On the foreign exchange front, the NT dollar exhibited dynamic stability, closing at 32.596 against the US dollar at the end of the year, a moderate appreciation of 0.78 percent. Balance of payments remained in good shape. Foreign exchange reserves built up to US\$266.1 billion at the year-end, representing an increase of US\$12.9 billion year on year.

With respect to institutional reform, the Bank continued promoting the transparency of the interest rate pricing mechanism. From January 2006 onwards, financial institutions are required to link prime rates to base rates. The Bank also effectively combated counterfeit money. Payments systems functioned smoothly. To enhance settlement efficiency in capital markets, the Bank began incorporating funds transfers involving stock, bond and bills transactions into the Interbank Funds Transfer System.

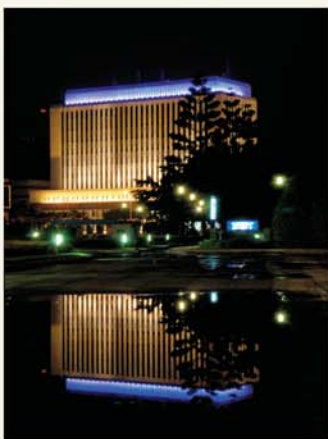
In addition, the Bank continued to promote financial liberalization and internationalization. New financial products were introduced to the domestic market, cross-border capital movements were further facilitated, and local financial institutions began extending NT dollar loans to non-residing foreigners. Moreover, cross-Strait remittances grew substantially in recent years, further enhancing the OBU's of domestic banks as a funding center for Taiwanese businesses operating overseas.

Many challenges still lie ahead as globalization and financial innovation complicate the task of carrying out monetary policy. Based on our legal mandate, the Bank will continue to implement appropriate monetary policy, devote itself to maintaining price and financial stability, ensure the sound operation of payments systems, and help promote sustainable development of the economy.

Finally, my sincere appreciation goes to my colleagues for their dedication during 2006. Together, we will work hard to meet the challenges in the year ahead.



Fai-nan Perng
Governor
March 22, 2007



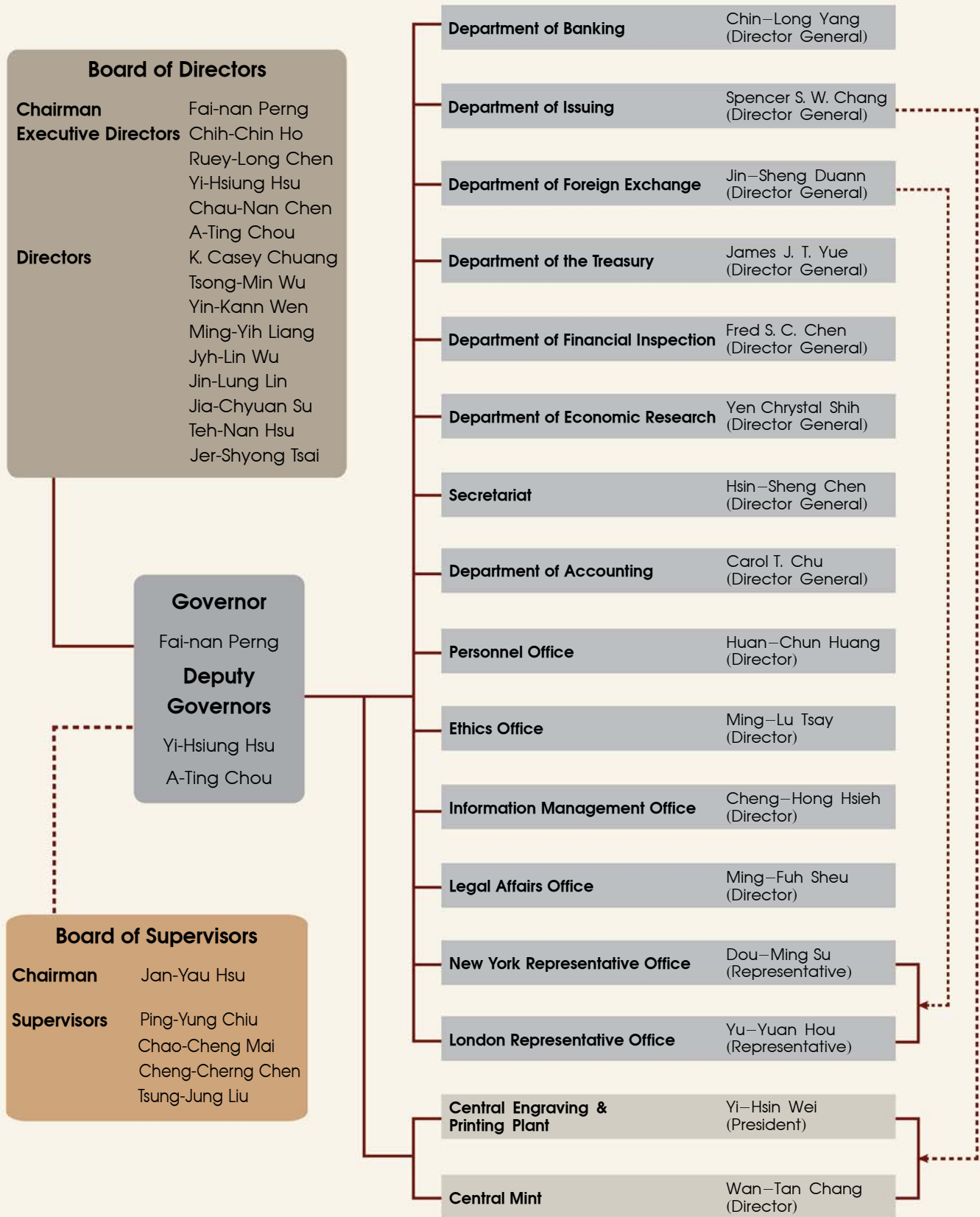
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Organization and Management of the CBC



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As of March 2007



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Board of Directors
Governor Fai-nan Perng



Executive
Director Chih-Chin Ho



Executive
Director Ruey-Long Chen



Executive
Director
Deputy Governor Yi-Hsiung Hsu



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Director Jyh-Lin Wu



Director Jin-Lung Lin



Director Jia-Chyuan Su



Director Teh-Nan Hsu



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Supervisor Ping-Yung Chiu



Supervisor Chao-Cheng Mai



Supervisor Cheng-Cheng Chen



Supervisor Tsung-Jung Liu



I. Developments in the Real Economy

1. Overview



Taiwan's economic growth accelerated to 4.62 percent in 2006 from the 4.03 percent in the previous year. Along with this solid performance, the balance of payments was in good shape and the labor market continued to improve at a faster pace. Inflation remained low and stable. Moreover, the central government was in a better fiscal position, exhibiting the first budget surplus since 2000.

The major driving force of economic expansion was exports, fuelled by a pickup in external demand for consumer electronics, which more than offset the weakness in private consumption caused by rising credit card defaults. Taiwan's economy grew by nearly 5 percent in the first three quarters, but slowed to 4 percent in the fourth quarter mainly due to the base effect. For the year as a whole, external demand (net exports) contributed 3.50 percentage points to economic growth and domestic demand contributed only 1.12 percentage points. Per capita GNP in nominal terms increased by US\$408 to US\$16,098 in 2006.

On the balance of payments front, it was characterized by an increase in the current account surplus and a net outflow in the financial account in 2006. The current account registered a surplus of US\$25,187 million, equivalent to 6.9 percent of nominal GNP. The capital account showed a relatively small deficit of US\$118 million. The financial account exhibited a net outflow of US\$22,987 million, the highest on record, mainly caused by a surge in overseas investment by residents. As a result, the foreign reserve assets held by the Bank increased by US\$6,086 million and foreign exchange reserves rose to US\$266.1 billion at the end of 2006.

Reflecting the surging international commodity prices, Taiwan's wholesale price index (WPI) increased by 5.64 percent in 2006. However, the consumer price index (CPI) inflation rate remained relatively low and stable. The CPI rose only by 0.60 percent as a decrease in vegetable prices, a decline in unit labor cost, intense competition in the domestic retail market and slackened domestic demand alleviated most of the upward pressure from higher tobacco health taxes and soaring energy prices. The core CPI rose by 0.54 percent.

Labor market conditions improved further. The sustained economic growth and continuous implementation of the government's *Project for the Creation of Job Opportunities* led to higher employment and a reduction in the unemployment rate in 2006. Total employment expanded by 1.7 percent and the annual average unemployment rate fell to a six-year low of 3.91 percent. The annual participation rate remained on a rising trend, averaging 57.92 percent in 2006, a record-high reading since year 2000. Unit labor cost in the manufacturing sector continuously fell by 2.37 percent, as the increase in labor productivity exceeded that in labor compensation.

The central government was in a better fiscal position. With steady economic expansion and curtailment of government expenditures, the central government's fiscal revenue outpaced its expenditure. As a result, the central government finance exhibited the first budget surplus of NT\$16.6 billion since 2000. The debt dependency ratio fell markedly from the previous year's 10.68 percent to 4.18 percent, the lowest level since 2000.

2. National Output and Income

During 2006, Taiwan's economy remained robust, benefiting from the strength in global markets. External trade posted brisk growth in the first three quarters, while domestic demand grew at a moderate pace due to the adverse effect of the credit and cash card debt problem on private consumption and a slowdown in investment activities. For the year as a whole, real GDP expanded at an annual growth rate of 4.62 percent, up from 4.03 percent in 2005.

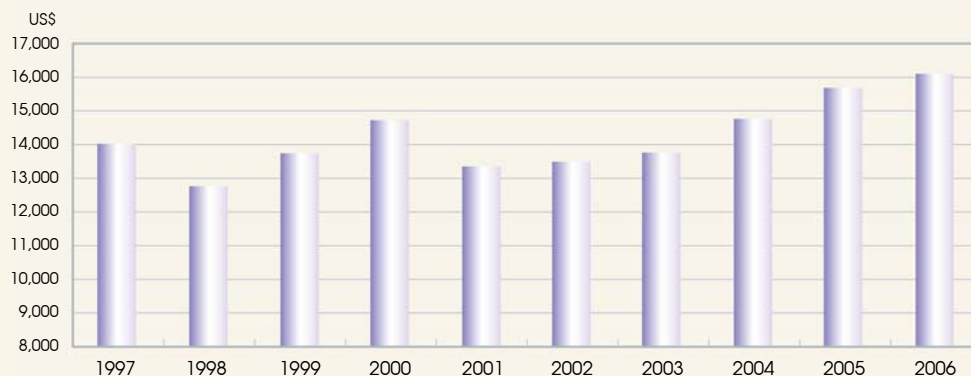
Largely driven by a surge in exports, real GDP increased by 4.92 percent year on year during the first quarter. Although growth appeared to be stable, gloom continued in the private sector. Both business investment and consumption expenditure showed signs of weakness amid concerns about unfavorable domestic macroeconomic conditions and soaring card debts and insolvent consumer loans. Accordingly, the pace of economic expansion decelerated during the second quarter with real GDP growth down to 4.57 percent. Due to a buoyant housing market, demand for equipment goods in industrial machinery picked up, and investment gradually recovered. Moreover, led by solid consumer electronics demand abroad, exports strengthened and pushed real GDP growth up to 5.02 percent in the third quarter. Nevertheless, due to a slowdown in export growth along with a high base effect, the fourth quarter's real GDP growth moderated to 4.02 percent. For the year, per capita GNP in nominal terms increased by US\$408, reaching US\$16,098.

Economic Growth Rate



Source: Statistics Abstract of National Income, DGBAS, Executive Yuan, February 2007.

Per Capita GNP



Source: *Statistics Abstract of National Income, DGBAS, Executive Yuan, February 2007.*

Expenditure Components of GDP

Given a favorable global economic environment, external trade (net exports) remained the main pillar of economic growth, contributing 3.50 percentage points to real GDP growth for the year. Domestic demand, however, remained relatively weak, contributing 1.12 percentage points for the year. Broken down by expenditure components, exports of goods and services accounted for 71.73 percent of GDP; however, the shares of both private consumption and gross fixed capital formation in GDP fell to 61.13 percent and 20.23 percent, respectively.

Expenditure on Gross Domestic Product

Unit: %

	2006			2005		
	Share	Real Growth Rate	Contribution to Real Growth Rate of GDP*	Share	Real Growth Rate	Contribution to Real Growth Rate of GDP*
Private Consumption	61.13	1.53	0.88	62.10	2.74	1.60
Government Consumption	12.98	-0.23	-0.03	13.43	0.92	0.12
Gross Fixed Capital Formation	20.23	0.26	0.05	20.47	1.17	0.23
Change in Inventory	0.05	—	0.22	-0.23	—	-0.43
Exports of Goods and Services	71.73	10.14	6.57	65.89	7.28	4.57
(Less : Imports of Goods and Services)	(66.12)	(5.72)	(3.07)	(61.66)	(3.82)	(2.05)
Expenditure on GDP	100.00	4.62	4.62	100.00	4.03	4.03

Note: * Percentage point.

Source: *Statistics Abstract of National Income, DGBAS, Executive Yuan, February 2007.*

(1) Slow Growth in Private Consumption

Despite ongoing improvement in the labor market, private consumption was subdued throughout the year with an annual growth rate of 1.53 percent, contributing 0.88 of a percentage point to economic growth. Since the beginning of the year, credit and cash card debt burdens led to increasing cases of consumer insolvency, which caused banks to contract their consumption loans. As a result, private consumption growth exhibited a downward trend, falling to 0.4 percent in the third quarter. Later, as local stock prices rose and the problem of card debts gradually subsided, consumption growth rebounded to 2.36 percent in the fourth quarter.

In terms of the private consumption categories, food consumption growth dropped from 1.06 percent in 2005 to 2.26 percent in 2006, and non-food consumption fell from 3.23 percent to 1.33 percent. Among the components of non-food consumption, outlays for household operation posted the largest growth because a persistent increase in the number of double-income households led to a rise in the demand for housekeeping services. Moreover, with greater popularity of IT products, such as internet-related products, digital audio players and game consoles, the consumption expenditure on recreation, entertainment, education and cultural services kept growing and made the second largest growth. On the other hand, household spending on transport and communication decreased considerably as banks tightened on car loan extension amid mounting credit and cash card defaults, decreasing motor vehicle purchases.

Real Growth Rate of Private Consumption Expenditure

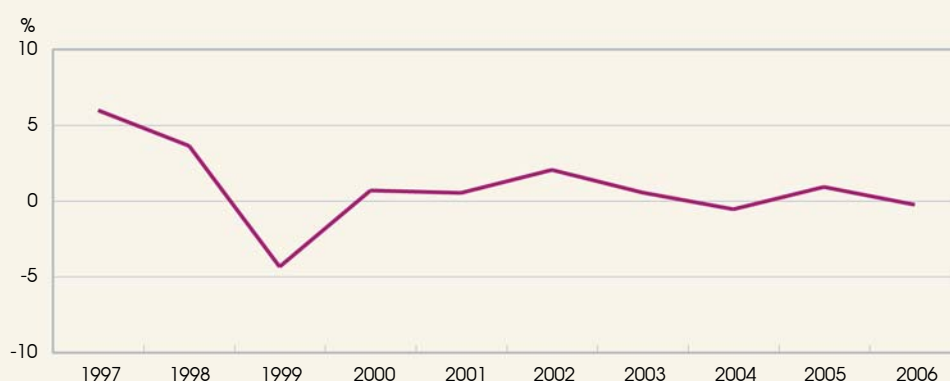


Source: *Statistics Abstract of National Income, DGBAS, Executive Yuan, February 2007.*

(2) Slight Decline in Government Consumption

Government consumption slightly declined by 0.23 percent in real terms, which led to 0.03 of a percentage point decrease in real GDP for 2006, compared to a growth of 0.92 percent and 0.12 of a percentage point contribution in the previous year. The contraction in government consumption was attributed to the government's spending cut policy in response to public finance difficulties over the past few years.

Real Growth Rate of Government Consumption Expenditure



Source: *Statistics Abstract of National Income, DGBAS, Executive Yuan, February 2007.*

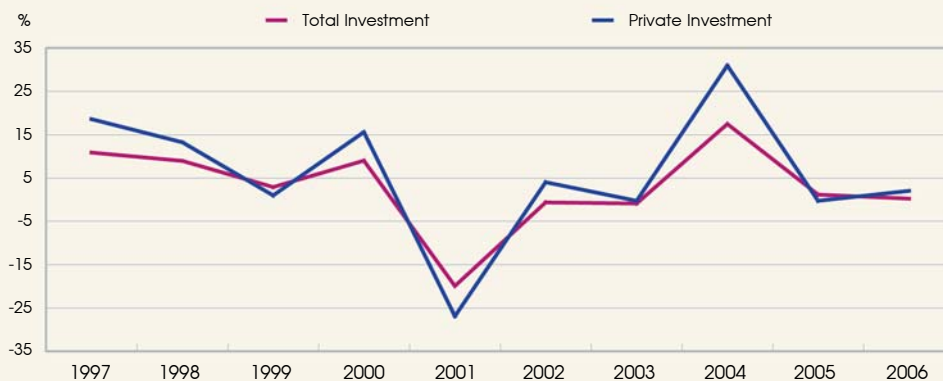
(3) Slackening Growth of Fixed Capital Formation

For 2006 as a whole, business investment exhibited a slackening growth. Real fixed capital formation lingered at a low level with the annual growth rate down to 0.26 percent, from 1.17 percent in the previous year, contributing a mere 0.05 of a percentage point to economic growth.

Broken down by the types of purchasers, real private investment showed a modest recovery after declining slightly in 2005. It gained 2.08 percent and contributed 0.29 of a percentage point to real GDP growth, reversing a negative 0.03 percentage point decrease in 2005. Due to the near completion of several major private investment projects, such as the high-speed rail and the fourth-stage expansion of the sixth naphtha cracking complex, the momentum of private investment slowed down, dragging the growth of private business spending into negative territory in the first two quarters. From third quarter onwards, real private investment was boosted by increased spending in industrial machinery as hi-tech firms enlarged their capacity and upgraded their technology. The rise in new capital outlays together with a low base effect led real private investment to post a double-digit growth in the fourth quarter. On the

other hand, investment carried by both government and public enterprise experienced a contraction as a result of the privatization of several public enterprises and the postponement of public construction projects. For the year as a whole, government investment and public enterprise investment declined by 4.06 percent and 6.35 percent, respectively.

Real Growth Rate of Investment



Source: *Statistics Abstract of National Income, DGBAS, Executive Yuan, February 2007.*

Among the types of capital goods, investment in intangible fixed assets posted the biggest progress for the year at 5.81 percent, attributable to a popular trend of Internet and e-commerce transactions. Likewise, investment in the construction sector rose steadily by 3.44 percent as a result of the strong demand in the housing market. The growth rate of investment in machinery and equipment returned to positive territory and was up to 3.02 percent, a moderate improvement from the 3.25 percent decline in 2005. However, investment in transportation equipment slumped 33.73 percent for the year due to the large decline in demand for airliners and passenger trains, as opposed to the sharp increase of 33.16 percent in a year earlier.

(4) Strong Expansion in Exports

Strengthening global economic growth, which started in mid-2005, continued over the course of 2006. Accompanied by vigorous worldwide demand for consumer electronics products, exports expanded at a double-digit growth rate during the first three quarters of the year. However, growth of exports went down to 2.69 percent in the final quarter due to a high base effect. Overall, real growth of exports of goods and services surged to 10.14 percent,

contributing 6.57 percentage points to economic growth in 2006. This expansion further pushed the share of exports in GDP up to 71.73 percent, from the 65.89 percent recorded in the previous year.

(5) Marked Increase in Imports

Driven by the derived demand from the brisk growth of exports, imports increased markedly over 2006 but with a slower pace than exports for lack of strong private spending support. For the year as a whole, the real imports of goods and services measured in NT dollars grew by 5.72 percent, subtracting 3.07 percentage points from real GDP growth. Like exports, the share of imports of goods and services in GDP grew as well, from 61.66 percent in 2005 to 66.12 percent in 2006.



Source: Statistics Abstract of National Income, DGBAS, Executive Yuan, February 2007.

Sectoral Components of GDP

Output in all sectors – agricultural, industrial and services – posted rising growth in 2006. The services sector remained the predominant driving force for economic growth, pitching in 2.59 percentage points to economic growth for the year, up from 2.46 percentage points in 2005. Likewise, the contribution of the industrial sector to overall GDP rose from 1.70 percent in 2005 to 1.96 percent in 2006, reflecting an increase in export orders to meet robust global demand. In addition, the contribution of agricultural production to overall GDP reversed from negative 0.13 of a percentage point in 2005 to 0.08 of a percentage point in 2006.

Looking at sector shares of GDP in nominal terms, the agricultural sector's share of GDP

remained on a downward trend, slipping to 1.57 percent of total output for the year. The services sector made up 73.44 percent of GDP as the economy experienced a continuous shift from goods-producing jobs to service-sector jobs. The industrial sector's share remained almost flat, accounting for 24.99 percent of total output.

(1) Stable Growth of Agricultural Output

Thanks to favorable weather conditions, agricultural production, covering agriculture, forestry, fishing, and animal husbandry industries, posted a stable growth of 5.38 percent in 2006.

(2) Solid Growth in Industrial Output

Industrial production, which covered mining and quarrying, manufacturing, construction, and electricity, gas and water, rose at a robust pace of 6.67 percent in 2006, with activity in the first three quarters especially vigorous. The strong growth in manufacturing, the marked

Gross Domestic Product by Type of Activity

Unit: %

	2006			2005		
	Share	Real Growth Rate	Contribution to Real Growth Rate of GDP*	Share	Real Growth Rate	Contribution to Real Growth Rate of GDP*
Agriculture	1.57	5.38	0.08	1.70	-8.07	-0.13
Industry	24.99	6.67	1.96	24.97	5.90	1.70
Mining & Quarrying	0.33	-10.16	-0.02	0.31	-4.49	-0.01
Manufacturing	21.39	7.15	1.80	21.40	6.50	1.60
Construction	1.74	5.25	0.08	1.66	0.50	0.01
Electricity, Gas & Water	1.53	4.00	0.11	1.59	5.71	0.11
Services	73.44	3.74	2.59	73.33	3.54	2.46
Trade	18.92	6.48	1.08	18.27	6.90	1.12
Accommodation & Eating-drinking Places	2.18	4.29	0.09	2.17	7.23	0.14
Transport, Storage & Communications	6.26	3.95	0.26	6.36	4.19	0.28
Finance & Insurance	10.27	1.34	0.14	10.72	1.51	0.16
Real Estate, Rental & Leasing	8.39	4.48	0.36	8.31	2.61	0.22
Professional, Scientific & Technical Services	2.58	9.58	0.21	2.41	1.86	0.04
Educational Services	1.89	3.24	0.06	1.88	2.48	0.04
Health Care & Social Welfare Services	3.09	2.49	0.07	3.06	2.46	0.07
Government Services	11.00	0.67	0.07	11.28	1.02	0.11
Gross Domestic Product	100.00	4.62	4.62	100.00	4.03	4.03

Note: * Percentage point.

Source: *Statistics Abstract of National Income, DGBAS, Executive Yuan, February 2007.*

improvement in construction, and the stable increase in electricity, gas and water were the main factors behind for the advance in industrial production.

Manufacturing production in 2006 grew by 7.15 percent, led by the the information and electronic industries, which showed a surge of 13.24 percent in the production index during the year. The strong gain in the the information and electronic industries was mainly attributed to a boom in internet related exports together with an optimistic outlook for the release of Microsoft Windows Vista. However, unlike the high growth of information and electronic industries, output growth in other manufacturing industries was relatively weak during 2006. For example, the production index of metal and machinery inched up a mere 0.09 percent and that of chemical industry, and food, textile and other industries decreased by 1.99 percent and 1.95 percent, respectively.

Production in the construction industry rose by 5.25 percent, up from the 0.05 percent in 2005. The significant growth, particularly in the second half of the year, reflected increased construction of residential building driven by an upward trend in housing prices.

Production in electricity, gas and water also increased steadily during 2006 at an annual growth rate of 4 percent, associated with a significant expansion in industrial output.

(3) Modest Growth in the Services Sector

Production growth in real terms in the services sector remained stable in 2006. While two major subsectors – trade, and finance and insurance – posted lower growth rates than those of the previous year, output of services gained 3.74 percent for the year, slightly higher than the previous year's 3.54 percent. The advance was mainly supported by the rising growth in professional services, real estate and educational services.

Professional, scientific and technical services experienced the largest increase in growth, from 1.86 percent in 2005 to 9.58 percent in 2006, mainly reflecting a higher demand for information and computer services. Real estate, rental and leasing posed a stable growth of 4.48 percent for the year, up from the previous year's 2.61 percent, reflecting the optimism in the housing market. Educational services registered a 3.24 percent growth because of an improvement in the quality of education and training. Moreover, an aging population led the growth of the health care and social welfare services industry to increase to 2.49 percent.

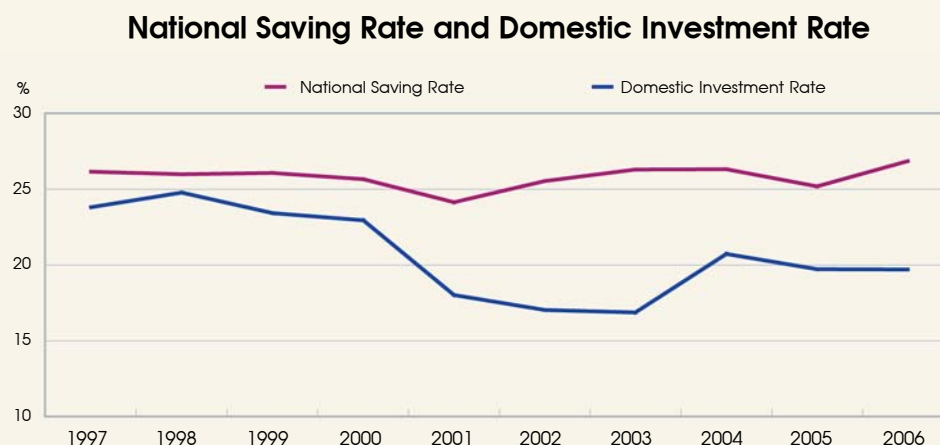
The other industries within the services sector recorded lower growth rates, compared with the previous year. For example, hampered by rising cash and credit card debt, growth of

tourism and eating-drinking places dropped from 7.23 percent in 2005 to a 4.29 percent in 2006. Growth of the trade industry also went down to 6.48 percent, compared with the 6.9 percent in the previous year. In addition, the government services sector recorded the smallest growth rate of 0.67 percent in 2006, down from 1.02 percent in 2005, reflecting the government's efforts to cut expenditure.

Rise in National Saving Rate

The national saving rate (national saving to GNP measured at current prices) increased from 25.19 percent in the previous year to 26.86 percent in 2005 as nominal national consumption (including both private consumption and government consumption expenditures) grew by a lower rate of 1.84 percent compared to the GNP growth rate of 4.11 percent. The decline in national consumption was due to the sluggish private consumption affected by credit and cash card defaults, and the decrease in the growth of government spending.

The excess saving, defined as national saving less gross domestic investment, to GNP ratio climbed up from 5.46 percent in 2005 to 7.16 percent in 2006 as a result of a greater increase in national saving than that in domestic investment.



Source: *Statistics Abstract of National Income, DGBAS, Executive Yuan, February 2007.*

3. BALANCE OF PAYMENTS

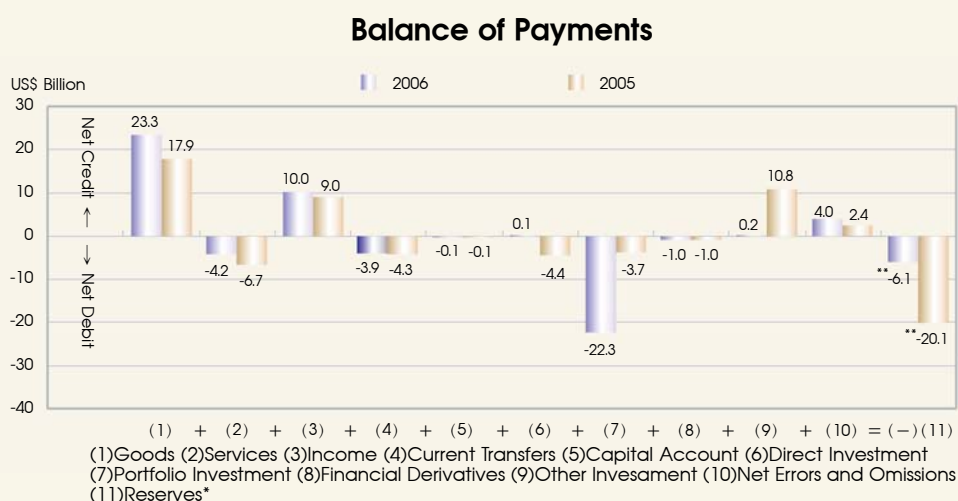
The balance of payments was characterized by an increase in the current account surplus and a net outflow in the financial account in 2006. The current account surplus registered the third highest figure on record of US\$25,187 million, which was up from the previous year's US \$16,019 million and accounted for 6.9 percent of nominal GNP. The capital account registered a relatively small deficit of US\$118 million. The financial account exhibited a net outflow of US \$22,987 million, which was the highest on record. As a result, the foreign reserve assets held by the Bank increased by US\$6,086 million.

Marked Increase in Current Account Surplus

The components of the current account include goods, services, income and current transfers. The current account surplus increased in 2006, mainly as a result of the widened surplus in both goods and income as well as the decline in the deficits of services and current transfers.

(1) Goods

For the year 2006, both on a balance of payments basis and a customs basis, the value of exports and imports reached historic highs. On a balance of payments basis, the value of exports grew by 12.8 percent to US\$223,783 million, mainly driven by strong expansion in the



Notes: * Excluding valuation changes in exchange rates.
 ** The minus sign (-) indicates an increase in foreign exchange reserves held by the Bank.
 Source: *Balance of Payments, CBC.*

Balance of Payments

Unit: US\$ Million

	2006	2005
A. Current Account	25,187	16,019
Goods: exports f.o.b.	223,783	198,456
Goods: imports f.o.b.	-200,514	-180,559
Balance on Goods	23,269	17,897
Services: credit	29,381	25,827
Services: debit	-33,563	-32,480
Balance on Services	-4,182	-6,653
Income: credit	19,779	17,394
Income: debit	-9,744	-8,355
Balance on Income	10,035	9,039
Current transfers: credit	3,837	3,463
Current transfers: debit	-7,772	-7,727
Balance on Current Transfers	-3,935	-4,264
B. Capital Account	-118	-117
Total, Groups A plus B	25,069	15,902
C. Financial Account	-22,987	1,717
Direct investment abroad	-7,316	-6,028
Direct investment in R. O. C. (Taiwan)	7,445	1,625
Portfolio investment assets	-44,124	-34,727
Portfolio investment liabilities	21,814	31,045
Financial derivatives assets	1,930	909
Financial derivatives liabilities	-2,896	-1,912
Other investment assets	-1,351	-6,014
Other investment liabilities	1,511	16,819
Total, Groups A through C	2,082	17,619
D. Net Errors and Omissions	4,004	2,437
Total, Groups A through D	6,086	20,056
E. Reserves and Related Items*	-6,086	-20,056

Note: * Excluding valuation changes in exchange rates.
Source: Balance of Payments, CBC.

global economy. The value of imports rose by 11.1 percent to US\$200,514 million. It was primarily led by surging international oil prices and stronger derived demand arising from the expansion in exports. The trade surplus on goods increased to US\$23,269 million for the year, an increase of 30.0 percent from the previous year, and represented the third highest figure in history.

As indicated by the Customs' statistics, the top three trading partners for Taiwan in 2006 were China including Hong Kong (hereafter referred to as China), the US and Japan. Exports to these three countries accounted for 61.5 percent of total exports, while imports from these three countries made up 47.2 percent of total imports.

In terms of Taiwan's trade with China, exports totaled US\$89,191 million for the year, representing a growth of 14.8 percent compared with the previous year. The marked growth

Direction of Trade in Goods by Country

Unit: %

	2006			2005		
	Amount (US\$ Million)	Share	Annual Change	Amount (US\$ Million)	Share	Annual Change
Exports						
China (including Hong Kong)	89,191	39.8	14.8	77,679	39.1	12.2
U. S. A.	32,362	14.4	11.2	29,114	14.7	1.3
Europe	26,149	11.7	10.6	23,650	11.9	-0.7
Southeast Asia 6*	30,652	13.7	13.8	26,931	13.6	13.8
Japan	16,301	7.3	7.9	15,111	7.6	9.4
Rest of the World	29,346	13.1	13.1	25,947	13.1	12.5
Total	224,001	100.0	12.9	198,432	100.0	8.8
Imports						
Japan	46,286	22.8	0.5	46,053	25.2	5.3
U. S. A.	22,664	11.2	7.1	21,171	11.6	-2.8
Europe	21,567	10.6	-1.6	21,920	12.0	2.4
Southeast Asia 6*	23,304	11.5	10.4	21,104	11.6	3.8
China (including Hong Kong)	26,666	13.2	20.1	22,203	12.2	16.2
Rest of the World	62,227	30.7	24.0	50,163	27.5	18.2
Total	202,714	100.0	11.0	182,614	100.0	8.2

Note: * Including Indonesia, Malaysia, the Philippines, Singapore, Thailand, and Vietnam.
Source: *Monthly Statistics of Exports and Imports, Ministry of Finance, R. O. C. (Taiwan).*

was attributable to China's strong economic growth, as well as the rising demand for IT products and parts from Taiwanese firms operating there. This increase appeared significant when compared with other major export markets, and the share of exports to China increased by 0.7 percentage points to 39.8 percent. China remained Taiwan's largest export market in 2006.

Imports from China totaled US\$26,666 millions, up by 20.1 percent, and its share of total imports rose to 13.2 percent in 2006, making China the second largest source of imports. The increase stemmed from the increased demand for Chinese machinery products and related parts due to the division of labor between Taiwanese industries across the Taiwan Strait. Taiwan's further opening to import items from China in recent years has contributed to this growth as well. The bilateral trade surplus with China climbed to US\$62,525 million, reflecting a 12.7 percent increase. China remained the largest source of Taiwan's trade surplus.

With respect to bilateral trade with the US, exports to the US increased by 11.2 percent in 2006, compared with an increase of 1.3 percent in the previous year. The share of exports to the US in total exports had decreased since 1998, and dropped further to 14.4 percent in 2006. The reasons behind the continuous declines were the increased trade activity between the US and the NAFTA (North American Free Trade Agreement) members, competition from China's low-priced products, and continued outward relocation (mainly to China) of local industries.

Imports from the US increased by 7.1 percent and its share of total imports declined from 11.6 percent in 2005 to 11.2 percent in 2006. Because the increase in exports was more than that in imports, the bilateral trade surplus with the US increased to US\$9,697 million, representing an increase of 22.1 percent. The US remained the second largest source of Taiwan's trade surplus.

Regarding bilateral trade with Japan, the recovery of the Japanese economy led to a rise in exports to Japan by 7.9 percent in 2006, while the share of exports to Japan declined to 7.3 percent. Imports from Japan slightly increased by 0.5 percent compared with the previous year, with the share of total imports rising to 22.8 percent in 2006. Japan remained Taiwan's largest source of imports. As the increase in exports was more than that in imports, Taiwan's trade deficit with Japan registered a decrease of 3.1 percent to US\$29,985 million for the year.

Exports to Europe increased by 10.6 percent in 2006, with the share of total exports falling to 11.7 percent. Imports from Europe decreased by 1.6 percent in 2006, with the share of imports decreasing to 10.6 percent of total imports. Due to the increase in exports and decrease in imports, Taiwan's trade surplus with Europe increased from US\$1,730 million in 2005 to US\$4,582 million in 2006.

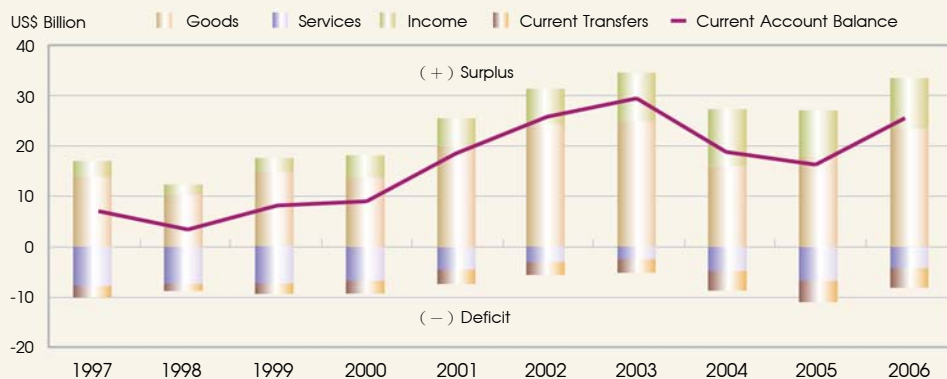
Owing to steady economic growth in Southeast Asia, exports to the six countries in the region, including Indonesia, Malaysia, the Philippines, Singapore, Thailand, and Vietnam, increased by 13.8 percent. In particular, exports to Thailand grew by 19.8 percent, the highest among the six countries. The share of exports to these countries rose to 13.7 percent. Imports from these countries rose by 10.4 percent in 2006, with the share of imports declining to 11.5 percent. As the increase of exports was more than that of imports, Taiwan's trade surplus with the six countries increased to US\$7,348 million in 2006 from US\$5,828 million in 2005.

(2) Services

In 2006, both service receipts and payments registered their highest amounts in history. With total service receipts expanding by US\$3,554 million to US\$29,381 million and total service payments increasing by US\$1,083 million to US\$33,563 million, the service deficit narrowed to US\$4,182 million in 2006 from the US\$6,653 million recorded in 2005.

Of the various components of the services account, net payments with respect to transportation increased from US\$2,515 million recorded a year earlier to US\$2,785 million in 2006, largely due to the increase in residents traveling abroad and import freight expenses paid to foreign carriers. Total travel receipts increased by US\$143 million to US\$5,120 million as

Current Account



Source: Balance of Payments, CBC.

a result of an increase in both the number and per person expenditure of nonresidents visiting Taiwan. Total travel payments for the year increased by US\$64 million to US\$8,746 million, due to an increase in overseas visits by residents. Net travel payments decreased to US\$3,626 million as total travel receipts increased at a greater pace than total travel payments. Other services receipts surged by US\$3,076 million to US\$18,002 million, while other services payments increased by US\$414 million to US\$15,773 million. As a result, net other services registered a surplus of US\$2,229 million in 2006 compared with a deficit of US\$433 million in 2005.

(3) Income

Both total income receipts and payments registered their highest levels ever in 2006. Total income receipts increased by US\$2,385 million to US\$19,779 million in 2006. Total income payments for the year amounted to US\$9,744 million, US\$1,389 million more than in 2005. The surplus on the income account increased from US\$9,039 million in 2005 to US\$10,035 million in 2006, mainly due to the increase in investment income on the Bank's foreign exchange reserves and in inward remittances of interests earnings by offshore banking units (OBUs).

(4) Current Transfers

Total current transfer receipts amounted to US\$3,837 million in 2006, US\$374 million more than in the previous year. Total current transfer payments for the year increased by US\$45 million to US\$7,772 million, reaching a historic high, on account of the increase in outward remittances by cross-border workers. Net current transfer payments decreased from US\$4,264

million in 2005 to US\$3,935 million in 2006.

Increase in Capital Account Deficit

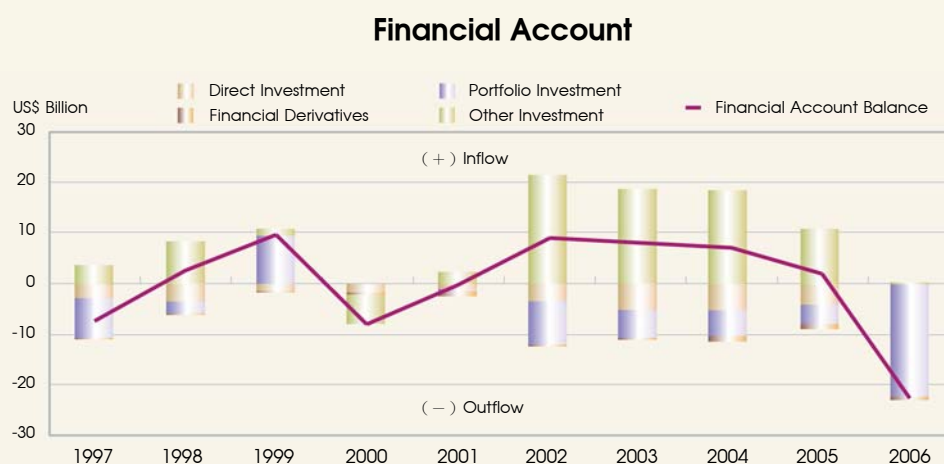
The capital account includes capital transfers (debt forgiveness, ownership transfers of fixed assets and migrants' transfers), and the acquisition and disposal of non-produced, non-financial assets. In 2006, the capital account continued to exhibit a deficit, and the size of this deficit slightly increased to US\$118 million from US\$117 million in 2005, as a result of the increased acquisitions of non-produced, non-financial assets.

Net Outflow in the Financial Account

In 2006, the financial account presented a net outflow of US\$22,987 million. In terms of sub-categories, direct investment and other investment posted a net inflow of US\$129 million and US\$160 million, respectively, while portfolio investment and financial derivatives posted a net outflow of US\$22,310 million and US\$966 million, respectively.

(1) Direct Investment

Direct investment abroad by residents showed a net outflow of US\$7,316 million, US\$1,288 million more than in the previous year. China remained the lion's share of Taiwan's direct investment abroad. Direct investment in Taiwan by nonresidents registered a net inflow of US\$7,445 million, a huge increase of US\$5,820 million from the previous year. Foreign investors' main targets included the electronic parts and components manufacturing industry and the financial industry. As a result, compared with a net outflow of US\$4,403 million in 2005, direct



Source: Balance of Payments, CBC.

investment registered a net inflow of US\$129 million in 2006, the first net inflow since 1988.

(2) Portfolio Investment

Portfolio investment abroad by residents recorded a net outflow of US\$44,124 million, the highest level ever recorded. It indicated increases in residents' investment in foreign mutual funds and in local insurance companies' investment abroad pursuing higher returns. Net inflows of local portfolio investment by nonresidents registered US\$21,814 million, the third highest level on record. The capital inflow to the domestic market could be largely attributed to the portfolio allocation of international funds in Asia. As a result, portfolio investment posted a huge net outflow of US\$22,310 million in 2006.

(3) Financial Derivatives

Financial derivatives assets recorded a net inflow of US\$1,930 million, mainly due to gains from financial derivatives deals by residents and OBUs. Financial derivatives liabilities registered a net outflow of US\$2,896 million, mainly due to losses from financial derivatives deals by residents. As a result, financial derivatives posted a net outflow of US\$966 million in 2006.

(4) Other Investment

Other investment abroad by residents recorded a net outflow of US\$1,351 million, representing an increase in other claims on nonresidents by residents. This outflow was mainly because of the increase in loans extended to foreign banks. Other local investments by nonresidents stood at a net inflow of US\$1,511 million, representing an increase in residents' other liabilities to nonresidents. The inflow was mainly due to the increased deposits of nonresidents in OBUs. As a consequence, other investment exhibited a net inflow of US\$160 million in 2006.

Increase in Foreign Exchange Reserves

For the year as a whole, the foreign exchange reserve assets held by the Bank increased by US\$6,086 million. Reserve assets increased as a result of the current account surplus, which is larger than the net outflow in the financial account.

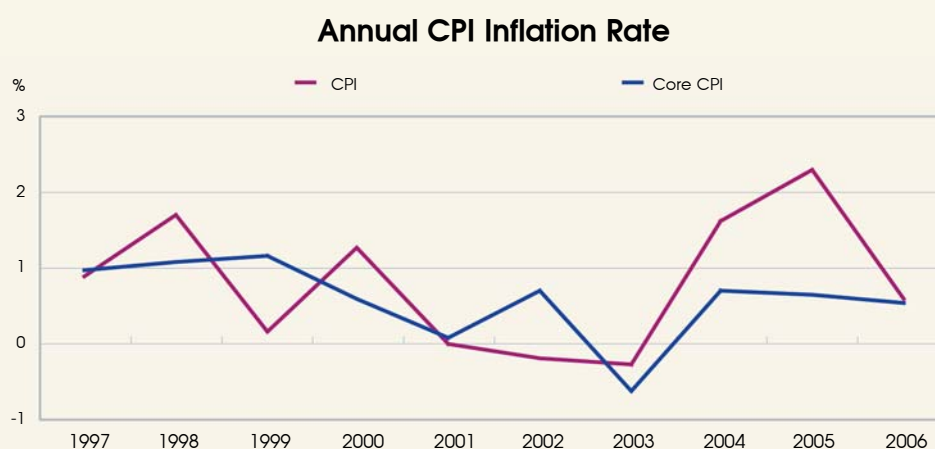
4. Prices

Taiwan's wholesale price index (WPI) rose by 5.64 percent in 2006, largely reflecting the continuing surge in international primary commodity prices and the weak New Taiwan dollar. However, the headline consumer price index (CPI) inflation rate remained low and stable. The CPI rose only by 0.60 percent as a decrease in vegetable prices, a decline in output unit labor cost, intense competition in the domestic retail market and slackened domestic demand alleviated most of the upward pressure from higher tobacco health taxes and soaring energy prices. The core CPI (consumer prices excluding fresh fruits and vegetables, fish and shellfish, and energy) rose by 0.54 percent.

Steep Increase in Wholesale Prices

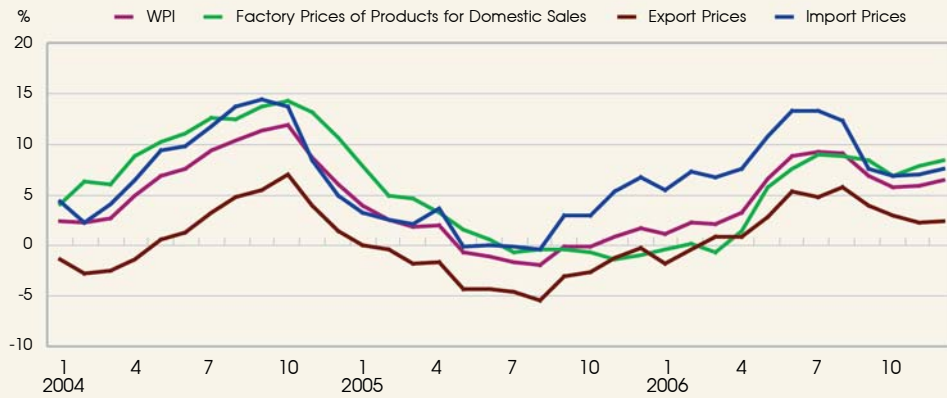
The WPI annual rate increased to 5.64 percent in 2006. Broken down by the major components of the WPI, factory prices of products for domestic sales and import prices rose markedly, while export prices remained moderate.

In US dollar terms, import prices increased by 7.61 percent as robust demand for crude oil, iron, steel, copper, rubber, chemicals and plastics pushed up prices of primary commodities. In local currency terms, import prices increased 8.82 percent as the 1.1 percent depreciation of the NT dollar against the US dollar aggravated the increases in prices. Factory prices of products for domestic sales rose by 5.27 percent, reflecting the increase in global primary commodity prices, despite the decline in domestic vegetable, fruit, livestock and poultry, and



Source: Price Statistics Monthly, Republic of China, DGBAS, Executive Yuan.

Annual Change Rate of WPI

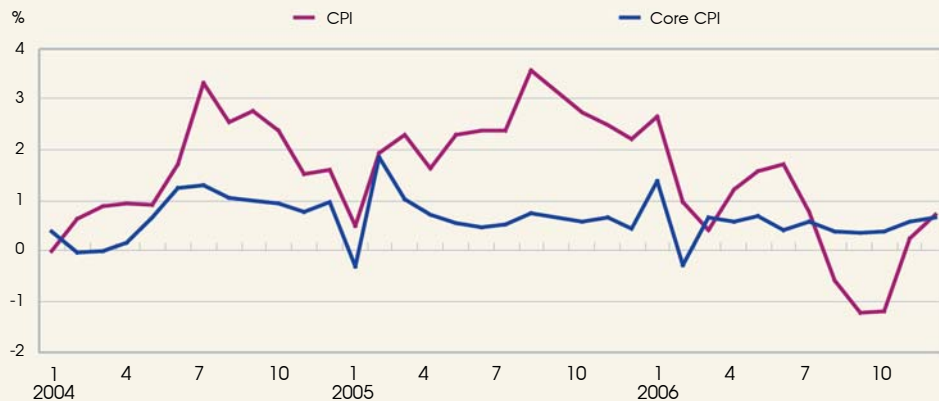


Source: Price Statistics Monthly, Republic of China, DGBAS, Executive Yuan.

electronic product prices. Export prices in terms of the US dollar and the NT dollar increased moderately by 1.32 percent and 2.50 percent, respectively, as prices of Taiwan's exports, especially IT products including computers, communication and audio-video equipment, went down due to highly competitive international markets.

Commodity prices typically increase as economic activity accelerates and capacity utilization rises, especially in cases where the supply is relatively fixed in the short run. The wholesale prices of products for domestic sales rose by 6.89 percent for the year 2006. Among the components, the prices of raw materials and intermediate materials rose by 14.54 percent and 7.96 percent, respectively. However, they accounted for a small share of total production costs, and thus the increases had little effect on overall CPI inflation. More importantly, market competition promoted by globalization made it difficult for firms to pass on higher input costs to consumers, thereby, the prices of finished goods only edged up by 0.25 percent.

Annual Change Rate of CPI



Source: Price Statistics Monthly, Republic of China, DGBAS, Executive Yuan.

Stable Consumer Prices

The core CPI inflation rate fluctuated remarkably in the first two months of 2006 due to seasonal factors influenced by the Chinese New Year holidays. However, from March onwards, the core CPI inflation rate remained in a steady range between 0.35 and 0.70 percent and edged up by 0.54 percent for the year as a whole. The mild core CPI rate reflected weak consumption demand, intense domestic market competition and relatively stable services prices.

The CPI rose by 0.60 percent in 2006, with most of the increase coming from the first half of the year. The CPI inflation rate fell to negative territory for three consecutive months starting from August mainly due to the high-base effect of vegetables and fruits prices.

The main upward factors contributing to CPI inflation in 2006 were as follows:

- (1) Tobacco and betel nut prices rose by 11.30 percent due to an upward adjustment in tobacco health taxes.
- (2) The hike in international petroleum prices caused significant increases in domestic oil and gas prices by 11.31 percent and 9.79 percent, respectively, pushing electricity and transportation fees up in Taiwan.

During the same period, however, the main factors offsetting CPI inflationary pressures

Percentage Changes in the Major Components of the CPI in 2006

Item	Annual change rate (%)	Contribution to CPI inflation rate (percentage point)
CPI	0.60	0.60
Food	-0.67	-0.18
Vegetables	-8.95	-0.33
Fruits	1.04	0.03
Fish & Shellfish	0.70	0.01
Energy	7.97	0.43
Oil	11.31	0.30
Gas	9.79	0.10
Electricity	1.36	0.03
Core CPI	0.54	0.46
Garments	-4.35	-0.14
Durable Consumer Goods	-1.65	-0.12
Communication Fees	-3.14	-0.09
Tobacco & Betel Nut	11.30	0.27
Medical Care Services	4.37	0.12
Tutorial Fees	2.29	0.06
Residential Rent	0.21	0.04

Source: Price Statistics Monthly, Republic of China, DGBAS, Executive Yuan.

were as follows:

- (1) The high-base effect brought the year-on-year vegetable prices down by 8.95 percent.
- (2) Services prices remained relatively stable. For example, communication fees continued on a downward stream since 1995 and helped to lessen inflationary pressures.
- (3) Driven by increased productivity and subdued upward pressure on wages, unit labor costs were down for the fifth consecutive year.
- (4) Domestic demand slackened as a result of the weak private consumption caused by credit card and cash card defaults, and this, in turn, led to decreases in prices of semi-durable consumer goods (such as garments) and durable consumer goods (such as computers, communication and audio-video equipment).



5. Public Finance of the Central Government

For 2006, central government finance continued to improve and recorded the first budget surplus since 2000. Revenue climbed by NT\$82.3 billion while expenditure decreased by NT\$36.8 billion, leading to a surplus of NT\$16.6 billion. This indicates that the government's efforts to cut expenditure and implement tax reforms have reached positive results.

Significant Rise in Central Government Revenue

Central government revenue increased by 5.62 percent over the previous year to NT\$1,546.8 billion in 2006. The increase was mainly supported by a surge in income tax revenue, a result of steady economic expansion, rising corporate dividend distribution, and a buoyant property market. Also contributing to the increase in revenue were the Central Bank's earnings and the flotation of the government's Chunghwa Telecom stock holdings. Broken down by sources of revenue, taxes and the surpluses of public enterprises and public utilities led the others, together making up a lion's share of 89.53 percent. In particular, taxes increased for the fourth consecutive year, greatly improving fiscal conditions.

Total Revenue and Expenditure of the Central Government

Unit: NT\$ Billion

	Fiscal Year*									
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006**
Total Revenue	1,025.2	1,251.5	1,228.6	2,030.8	1,417.2	1,304.7	1,321.0	1,368.2	1,464.5	1,546.8
(Ratio to GDP : %)	11.91	13.55	12.74	14.20	14.37	12.80	12.80	12.70	13.14	13.37
Total Expenditure	1,051.4	1,083.1	1,164.0	2,230.1	1,559.7	1,551.9	1,618.1	1,564.8	1,567.0	1,530.2
(Ratio to GDP : %)	12.21	11.72	12.07	15.59	15.81	15.22	15.68	14.53	14.06	13.22
Surplus/Deficit	-26.2	168.4	64.6	-199.3	-142.5	-247.2	-297.1	-196.6	-102.5	16.6
(Ratio to GDP : %)	-0.30	1.82	0.67	-1.39	-1.44	-2.42	-2.88	-1.83	-0.92	0.14
(Ratio to Total Expenditure : %)	-2.49	15.55	5.55	-8.94	-9.14	-15.93	18.36	-12.56	-6.54	1.08
Debt Repayment	100.4	103.9	118.0	193.4	122.2	55.5	46.5	56.1	64.1	65.0
Financing:	126.6	49.9	56.6	466.1	275.8	302.7	343.7	253.5	167.3	63.9
Debt Financing	117.3	49.9	56.6	466.1	275.8	244.4	300.8	253.5	167.3	63.9
Surplus of Previous Fiscal Years	9.3	-	-	-	-	58.3	42.9	-	-	-
Memorandum:										
Tax Dependency Ratio*** (%)	74.84	82.74	69.48	60.89	57.64	52.87	51.21	58.58	68.14	71.51
Debt Dependency Ratio**** (%)	11.16	4.61	4.86	20.90	17.68	15.75	18.59	16.20	10.68	4.18

Notes: * Effective 2001, the calendar year is adopted as the fiscal year. As a transition, fiscal year 2000 begins on July 1, 1999 and ends on Dec. 31, 2000, while the other fiscal years prior to 2000 run from July 1 of the preceding year to June 30 of the designated year.

** The figures for the year 2006 are preliminary estimates.

*** Tax dependency ratio is defined as the ratio of annual tax revenue to total government expenditure.

**** Debt dependency ratio is defined as the ratio of annual issuance of government bonds and borrowing from banks to total government expenditure.

Sources: Directorate-General of Budget, Accounting and Statistics, Executive Yuan.
Department of Statistics, Ministry of Finance (MOF).

The significant rise in tax revenue led the tax dependency ratio to rise further from 68.14 percent in 2005 to 71.51 percent this year, showing that the government's measures to improve fiscal positions have been gradually accomplished.

Decrease in Central Government Expenditure

Following a negligible year-on-year increase in 2005, central government expenditure contracted by 2.35 percent in 2006 to NT\$1,530.2 billion. In terms of spending categories, social welfare and education, science and culture topped the list with shares of 19.85 percent and 19.81 percent, hitting their respective record highs. The share of social welfare exceeded that of education, science and culture for the first time since 2002 and ranked first among all categories. Ranking third and fourth were national defense and economic development spending with shares of 15.49 percent and 12.87 percent, respectively. The share of economic development spending successively declined from a high of 18.76 percent in 2002, mainly because part of it was shifted to the special budget.

Financial ratios of the central government improved consistently over the four years to 2006. The ratio of central government expenditure to GDP, for instance, dropped from 14.06 percent in 2005 to 13.22 percent this year, as expenditure decreased while GDP expanded.

Total Revenue and Expenditure of the Central Government by Category

Unit: NT\$ Billion

	Fiscal Year									
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006*
Total Revenue	1,025.2	1,251.5	1,228.6	2,030.8	1,417.2	1,304.7	1,321.0	1,368.2	1,464.5	1,546.8
Taxes	749.1	858.8	772.9	1,280.7	841.5	820.1	828.6	916.6	1,067.7	1,094.3
Surpluses of Public Enterprises and Public Utilities	149.5	239.9	284.1	442.4	335.8	250.6	326.5	282.1	243.4	290.5
Fees, Fines and Indemnities	32.7	34.9	29.1	103.0	72.5	123.3	73.3	76.0	79.1	78.9
Revenues from Government-Owned Monopolies	37.8	37.4	35.9	77.3	57.5	0.4	—	—	—	—
Proceeds from Sales of Properties and Recalled Capital	31.1	60.5	91.9	88.4	80.9	73.9	65.8	70.4	52.6	58.5
Others	25.0	20.0	14.7	39.0	29.0	36.4	26.8	23.1	21.7	24.6
Total Expenditure	1,051.4	1,083.1	1,164.0	2,230.1	1,559.7	1,551.9	1,618.1	1,564.8	1,567.0	1,530.2
General Administration	108.0	112.7	134.6	234.9	167.0	162.3	167.3	164.1	165.5	167.4
National Defense	253.4	257.1	263.2	343.3	237.7	225.2	227.7	248.9	248.5	237.1
Education, Science and Culture	174.9	184.8	202.7	367.6	257.2	267.0	300.2	302.1	301.5	303.1
Economic Development	113.8	126.5	172.5	356.4	277.1	291.2	295.5	248.9	247.0	196.9
Social Welfare	150.0	150.2	157.6	411.0	293.3	262.2	284.4	279.8	285.7	303.7
Community Development & Environmental Protection	15.3	15.8	19.2	39.6	22.3	23.4	28.7	24.8	25.2	20.4
Pension & Survivors' Benefits	139.5	139.8	129.3	195.4	122.0	124.3	125.4	123.1	130.5	134.7
Obligations	58.9	63.5	80.3	249.6	151.2	152.2	144.6	127.1	117.9	125.2
Others	37.6	32.7	4.6	32.3	31.9	44.1	44.3	46.0	45.2	41.7

Note * The figures for the year 2006 are preliminary estimates.

Sources: Directorate-General of Budget, Accounting and Statistics, Executive Yuan.
Department of Statistics, MOF.

Steep Decrease in Debt Financing Demand

The central government's demand for debt financing dropped steeply in 2006. With the NT\$16.6 billion fiscal surplus partly offsetting the NT\$65 billion debt repayment, debt financing demand shrank to NT\$48.4 billion, a large reduction from the NT\$166.6 billion in the preceding year and the lowest level since 1999. The central government met the debt financing demand by issuing government bonds and borrowing from banks, totaling NT\$63.9 billion in 2006.

Moderate Increase in Debt Obligations

Debt obligations of the central government increased in a decelerating pace. Total outstanding debt of the central government increased moderately to NT\$3,629.5 billion at the end of 2006, while its ratio to GDP dropped slightly to 31.37 percent from 31.88 percent in the previous year.

Public Debt of the Central Government

Unit: NT\$ Billion

	Fiscal Year									
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006*
Outstanding Debt	1,382.2	1,369.4	1,312.9	2,450.5	2,759.4	2,849.4	3,127.5	3,364.9	3,553.6	3,629.5
(Ratio to GDP : %)	16.05	14.82	13.62	17.14	27.98	27.95	30.31	31.24	31.88	31.37
Government Bonds	1,129.3	1,078.0	1,024.9	1,362.8	1,682.9	1,939.1	2,318.8	2,543.8	2,831.0	3,046.0
Borrowing from Banks	252.9	291.4	288.0	1,087.7	1,076.5	910.3	808.7	821.1	722.6	583.5

Note * The figures for the year 2006 are preliminary estimates.

Sources: Directorate-General of Budget, Accounting and Statistics, Executive Yuan.
National Treasury Agency, MOF.

6. Labor Market

Taiwan's labor market conditions improved further in 2006, mainly attributable to the sustained economic growth, combined with the continuous implementation of the *Project for the Creation of Job Opportunities in the Government Sector*. The average unemployment rate was 3.91 percent, its lowest level since 2001, while the average labor force participation rate rose to its highest level since 2000.

Continuous Improvement in the Labor Market

For the year 2006, the number of unemployed dropped to an average of 411 thousand persons, representing a decrease of 4.01 percent over the previous year. The unemployment rate fell by 0.22 of a percentage point over the previous year to a six-year low of 3.91 percent.

In 2006, male and female unemployment rates fell to 4.05 percent and 3.71 percent, respectively. Most age-education groups recorded lower unemployment rates from a year ago. Within the same education group, younger persons suffered higher unemployment rates than older ones as many were inexperienced and tended to change jobs more frequently. The unemployment rate for the age group of 45-64 dropped most significantly, highlighting the fact that steady economic expansion improved the job market conditions for the senior group. The number of long-term unemployed (persons who have been continuously unemployed

Unemployment Rate



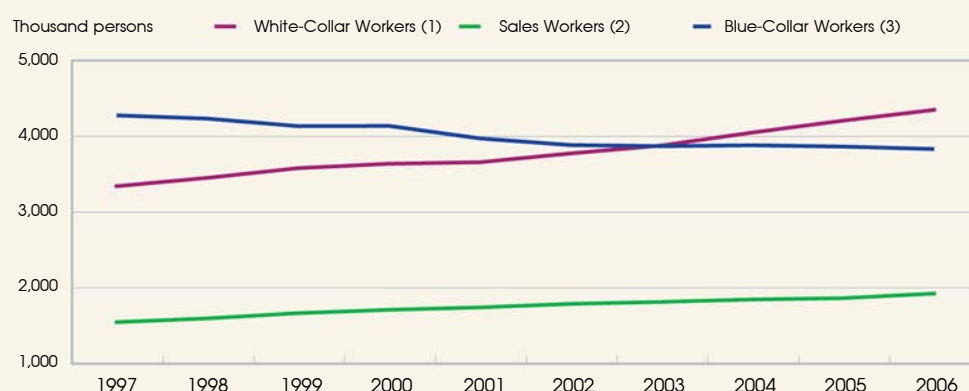
Source: *Monthly Bulletin of Manpower Statistics, DGBAS, Executive Yuan.*

for 53 weeks or more) dropped to 56 thousand from 74 thousand persons a year ago. The average duration of unemployment also showed improvement and shortened to 24.28 weeks in 2006. Following the mushrooming growth in the number of universities and graduate schools, the education group of university or above registered a historic high unemployment rate of 4.36 percent. In the meantime, its share in the total number of long-term unemployed increased to 21.49 percent. With regard to the factors behind unemployment, job dissatisfaction still accounted for the largest share of 34.42 percent. Firm closedown and business downsizing accounted for the second largest share of 28.57 percent, however it was the lowest level in eight years.

Increase in Total Employment

On the back of sustained expansion of economic activities and the government's employment creation plan, the annual average employment grew by 169 thousand persons or 1.70 percent in 2006, exceeding the previous year's gain of 156 thousand persons or 1.60 percent. The healthy employment creation brought the total number employed to a new high of 10,111 thousand persons in 2006. Employment of white-collar and sales workers grew by 3.37 percent and 3.22 percent, respectively. Among them, employment of technicians and associate professionals increased most significantly. However, over the same period, blue-collar workers' employment

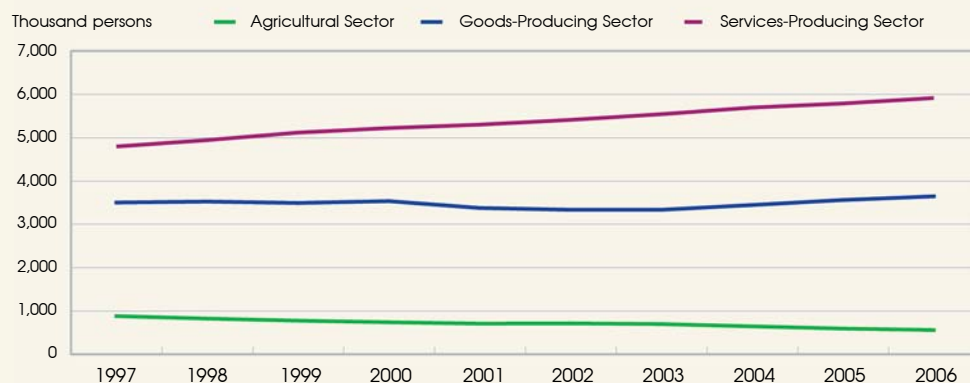
Employment by Occupation



Notes:(1)Including legislators, government administrators, business executives and managers, professionals, technicians and associate professionals, and clerks.
 (2)Including service workers, shop and market sales workers.
 (3)Including agricultural, animal husbandry, forestry, and fishing workers, production and machine operators and related workers.

Source: *Monthly Bulletin of Manpower Statistics, DGBAS, Executive Yuan.*

Employment by Sectors



Source: *Monthly Bulletin of Manpower Statistics, DGBAS, Executive Yuan.*

edged down by 0.85 percent. This was mainly due to the continuous outward relocation of labor-intensive industries and the transition of the manufacturing sector towards technology-intensive. The occupational profile of employment has undergone a major change from blue-collar to white-collar jobs over the past years.

Broken down by sectors, the services-producing sector still accounted for most of the total employment and registered an annual growth rate of 2.09 percent. All major components of services industries expanded their employment, including trade, accommodation, eating-drinking places, as well as the professional, scientific and technical services industries. Following a pickup in external demand for consumer electronics and the steady expansion in the domestic construction industry, employment in the goods-producing sector exhibited a stable annual growth rate of 2.36 percent. Within the goods-producing sector, manufacturing employment continued to trend up and amounted to 2,772 thousand persons, a record high since 1990. Employment in the agricultural sector posted a further reduction of 6.16 percent over the previous year.

Increase in Labor Force Participation Rate

The number of labor force and non-labor force increased by 1.46 percent and 0.87 percent over the previous year, respectively, as more workers were willing to participate in the labor market when the economy expanded steadily. While the male labor force participation rate

Labor Force Participation Rate



Source: Monthly Bulletin of Manpower Statistics, DGBAS, Executive Yuan.

edged down to an all-time low, the female rate reached an all-time high, resulting in an increase in the average participation rate. The annual participation rate remained on a rising trend, averaging 57.92 percent in 2006, a record-high reading since 2000. In terms of age structure, the participation rate for the working population aged 25-44 increased by 1.11 percentage points to its highest level on record of 82.98 percent, while all the other age groups experienced downward trends. Broken down by education groups, the participation rate for the working population with junior high school degrees or below decreased by 1.19 percentage points to a record low, while the participation rates for all the other education level groups continued to rise.

Mild Increase in Earnings of Non-Farm Workers

The average monthly earnings of the non-farm sector workers, i.e. those hired in the goods-producing and services-producing sectors, increased by 1.13 percent over the previous year to NT\$44,107 in 2006. After deflated by the CPI, real monthly earnings grew by 0.53 percent, compared to the negative 0.90 percent recorded a year ago.

With respect to different sectors, the goods-producing sector experienced more favorable wage adjustment than the services-producing sector. The average monthly earnings of goods-producing sector workers increased by 1.51 percent to NT\$42,503, and real monthly earnings increased by 0.90 percent. All industries in the goods-producing sector showed improvements in real monthly earnings. The average monthly earnings of services-producing sector workers

increased by 0.77 percent to NT\$45,584, and real monthly earnings inched up by 0.17 percent, the first annual increase in three years. However, the real monthly earnings performance was mixed across services component industries. While the finance and insurance industry, cultural, sporting and recreational services industry, and the professional, scientific, and technical services industry showed marked improvements, all the other component industries saw declines during 2006. Regarding regular earnings by sectors, the average monthly regular earnings of goods-producing sector and services-producing sector workers increased by 1.7 percent and 0.82 percent over the previous year, respectively.

Rising Labor Productivity in the Goods-Producing Sector

As the increase in total production outpaced that in total working hours, the labor productivity index for the goods-producing sector rose by 4.51 percent in 2006. The largest gain in labor productivity were in the electronic parts and components industry, which grew by 12.22 percent. However, traditional industries, such as the leather, fur and allied products manufacturing industry, and the pulp, paper and paper products manufacturing industry, exhibited negative productivity growth.

Higher growth in the labor productivity index than in earnings resulted in a decrease of 2.11 percent in the index of unit labor cost in the goods-producing sector. The lower unit labor cost indicated a continuous drop in labor cost in Taiwan's goods-producing sector and thereby

Labor Productivity and Unit Labor Cost Indices in the Goods-Producing Sector



Source: Monthly Bulletin of Earnings and Productivity Statistics, DGBAS, Executive Yuan.

enhanced its international competitiveness. However, the increase in unit labor cost in some industries, such as in the leather, fur and allied products manufacturing industry, transport equipment manufacturing and repairing industry, and apparel, clothing accessories, and other textile products industry, exceeded 10 percent, which indicated a likely weakening in the competitiveness of these industries.





II. Financial Developments

1. Overview



Domestic financial conditions remained accommodative in 2006, although monetary policy continued to be tightened. Meanwhile, growth of reserve money slowed. Along with the pace of the Bank's policy rate rises, both bank interest rates and short-term market rates rose gradually over the course of the year. Yields on longer-term bonds climbed a bit in the first half of the year, but edged down subsequently towards the end of the year.

Loans and investments by major financial institutions expanded at a slower annual rate of 4.08 percent at the end of 2006, down from 7.77 percent registered at the previous year-end. Among the components of bank credit, unsecured consumer loans, in particular, decreased over the course of the year, mainly reflecting the influx of new NPLs and the cautious attitude adopted by banks after the card debt problem broke out in early 2006. At the same time, the amounts outstanding of commercial paper and corporate bonds were also below the levels seen at the previous year-end. As a result, gross financing extended through the banking system and financial markets showed an annual growth rate of 4.03 percent at the end of 2006, down from 6.96 percent at the end of 2005.

Although foreign capital continued to flow in, its effect on money growth was reduced by a moderation in bank credit growth and an increase in overseas portfolio investment by residents. The M2 annual growth rate was 6.22 percent in 2006, the same level as in 2005. It continued to stay within the 3.5 to 7.5 percent target zone set by the Bank for 2006.

Profitability of financial institutions declined sharply in 2006. The large decline was mainly attributable to a decrease in net interest revenues and a surge in non-performing consumer

loans written off by leading card issuers. The average capital adequacy ratio of domestic banks dropped slightly to 10.11 percent at the end of the year from 10.34 percent reported at the previous year-end. However, the quality of bank assets continued to improve. The non-performing loan ratio of domestic banks declined slightly from 2.24 percent to 2.13 percent during the same period.

The NT dollar exchange rate came under upward pressure during the first five months of this year due to large capital inflows and the appreciation of Asian currencies. It then depreciated gradually toward the end of October, reflecting an increase in outward portfolio investments by domestic investors and a strong US dollar in international markets. The NT dollar closed the year at 32.596 against the US dollar, showing an appreciation of 0.78 percent compared to the previous year-end. On a daily average basis, the NT dollar, however, depreciated by 0.22 percent against the US dollar in 2006 over the previous year.

In the equity market, the Taiwan Stock Exchange weighted stock price index (TAIEX) began the year on a weak note on expectations of continuous rate hikes by the US Federal Reserve and the low season in the electronics sector. The market rebounded in April, but plunged to a yearly low in July as tensions in Middle East pushed up oil prices and foreign capital retreated from Asian markets on concerns that global inflationary pressure accelerated. Since then, however, stock prices trended upwards on a series of upbeat news. The TAIEX closed the year at an annual high of 7,824 points, 19.49 percent higher than a year earlier. The daily average turnover for the year also increased by 26.51 percent from the previous year.

2. Monetary Aggregates

The broad monetary aggregate M2 has been the Bank's intermediate target for monetary policy since 1992. In 2006, M2 grew at an annual rate of 6.22 percent and fell within its target range of 3.5 to 7.5 percent set for the year.

The growth of the narrow monetary aggregate, M1B, declined to 5.30 percent in 2006 from 7.10 percent of the previous year, despite the favorable performance of the stock market. This development mainly reflected the shift from transaction deposits into foreign currency deposits due to widened interest rate differentials, which made the latter more attractive to depositors.

Slower Growth of Reserve Money

The average annual growth rate of reserve money fell from the previous year's 7.84 percent to 5.33 percent this year. As for the components of reserve money, bank reserves grew by 5.41 percent, and currency held by the non-bank public expanded at a rate of 5.23 percent.

As for the monthly movements of reserve money, the annual growth rates fluctuated excessively in January and February, reflecting the seasonal demand for currency during the Chinese New Year holidays (For this year, the new year holidays fell in January as opposed to February in 2005). In subsequent months, growth rates remained broadly stable and were below 6 percent.

Annual Growth Rates of Reserve Money



Source: *Financial Statistics Monthly*, CBC.

On the demand side, several factors influenced the growth of reserve money over the course of 2006. For banks, the slower expansion of loans to the private sector – notably consumer credits – depressed banks' demand for reserves. In addition, the shift of money from transaction deposits to foreign currency deposits induced by the widened interest rate differentials also reduced banks' demand for reserves. For the non-bank public, the feeble demand for currency largely mirrored the flagging private consumption caused by the deterioration of the problem of delinquency in card debts. Overall, the demand for reserve money was modest by historical standards.

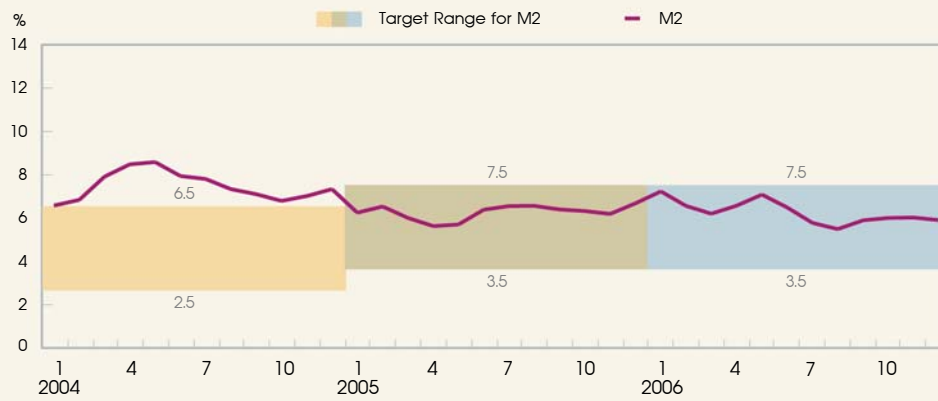
On the supply side, the Bank's balance sheet reflected the sources of reserve money. On the one hand, the reduction in both re-deposits placed by financial institutions and government deposits were the foremost sources for the increase in reserve money. On the other hand, to drain the glut of liquidity in the market, the Bank conducted open market operations, mainly through issuing certificates of deposit (CDs). As a result, the increase in the issuance of CDs partly offset the above-mentioned increase in reserve money, causing the annual growth rate of reserve money to decrease when compared to that of the previous year.

Mild Growth of M2

M2 is the Bank's intermediate target for conducting monetary policy. In 2006, M2 grew by 6.22 percent from a year earlier, lying within the target range of 3.5 to 7.5 percent.

The monthly changes of M2 annual growth rates were as follows. In January, M2 growth peaked at 7.2 percent as credit extended by financial institutions picked up and a considerable amount of foreign capital flowed in. The Chinese New Year factor also contributed to the high growth rate as the holidays fell in this month. By contrast, the annual growth rate of M2 decreased in February due to the “base effect” (The Chinese New Year fell in February a year earlier). In March, M2 declined further to 6.15 percent, pulled down by a slowdown in the growth of bank loans and investments. In April and May, M2 growth rebounded somewhat due to an upswing in credit growth and a surge in foreign capital inflows. The rate slipped again in June, however, as a result of massive capital outflows and a moderation in bank credit growth. From July onwards, following the continued decline in the growth of bank loans and investments, M2 growth slid to below 6 percent and hit an all-year low of 5.43 percent in August. M2 growth then edged up to around 5.9 percent during the rest of the year.

Target Range and Annual Growth Rates of M2



Source: Financial Statistics Monthly, CBC.

Decelerating M1B Growth

In 2006, the average annual growth rate of M1B was 5.30 percent, lower than the 7.10 percent posted in the preceding year. The decline mirrored, in large part, the subdued transactions demand of money as interest rate differentials between transaction deposits and foreign currency deposits widened and business activity remained sluggish.

Annual Growth Rates of M1B



Source: Financial Statistics Monthly, CBC.

The monthly changes of M1B annual growth rates were as follows. This rate topped at the beginning of the year as the amount of currency issuance sharply increased due to the Chinese New Year holidays. In contrast, M1B plummeted in February as the higher base of comparison in the same month of 2005. In March, due to capital outflows and the lackluster performance of the stock market, M1B growth declined further. In April and May, a rebound on the stock market as well as large foreign capital inflows helped strengthen the M1B growth, and pushed the figure up to 7.08 percent in May. From June to August, M1B growth continued to fall and bottomed at 2.77 percent in August due to the loss of momentum in the stock market and foreign capital outflows. From September to November, the growth rate of M1B bounced back steadily. However, owing to the high-base effect, the M1B growth rate slipped again in December.



3. Banking Sector

A Drop in the Number of Depository Institutions

At the end of 2006, the number of depository institutions was 383, a decrease of seven from the previous year-end. Of which, the number of domestic banks decreased by two while the number of medium business banks decreased by one, as a result of the conversion of a medium business bank into a domestic bank and three merger cases of domestic banks. The number of foreign banks decreased by three as the UFJ Bank was merged into the Bank of Tokyo-Mitsubishi and the Toronto Dominion Bank and Union Bank of California closed their branches in Taiwan. The number of credit cooperatives decreased by one because a credit cooperative was merged by a domestic bank.

The numbers of financial holding companies and money market mutual funds remained at 14 and 2 at year-end 2006, respectively.

Market Shares of Deposits and Loans

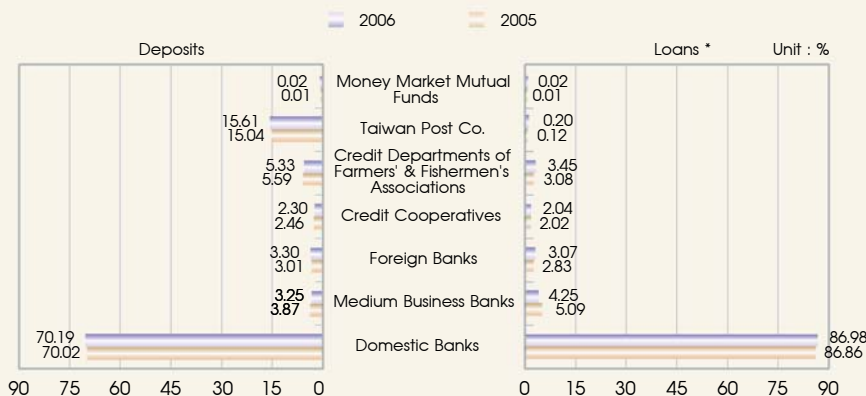
Domestic banks have played a major part in the market of deposits and loans. At the end of 2006, domestic banks' market shares of deposits and loans increased to 70.19 percent and 86.98 percent, respectively. The increase was mainly due to the conversion of a medium business bank and a merger of a credit cooperative into domestic banks. While focusing on

Number of Depository Institutions by Category

	End of 2006	End of 2005	Annual Change
Combined Number of Main Offices	383	390	-7
Domestic Banks	40	42	-2
Medium Business Banks	3	4	-1
Foreign Banks	33	36	-3
Credit Cooperatives	28	29	-1
Credit Departments of Farmers' and Fishermen's Associations	278	278	0
Department of Savings and Remittances of Taiwan Post Co.	1	1	0
Combined Number of Branches	5,961	5,938	23
Local Branches	5,815	5,789	26
Overseas Branches	80	79	1
Offshore Banking Units	66	70	-4

Sources: 1. *Financial Statistics Monthly*, CBC.
2. *Department of Financial Inspection*, CBC.

Market Shares of Deposits and Loans by Category of Depository Institutions



Note: * Including data for securities acquired under reverse repurchase agreements.
 Source: *Financial Statistics Monthly*, CBC.

their foreign exchange related business, foreign banks' market shares of deposits and loans increased slightly to 3.30 percent and 3.07 percent, respectively, despite that two foreign banks closed their branches. As for the Department of Savings and Remittances of the Taiwan Post Co., its market share of deposits continued to show an upward trend to 15.61 percent at the end of 2006. Its share of total loans, however, due to the restrictions on the Taiwan Post Co.'s loan business, only edged up to 0.20 percent, higher than that of the previous year.

Depository Institutions' Sources and Uses of Funds

The composition of the sources of funds was broadly unchanged. Owing to successive rises in non-transaction deposit interest rates and the widening interest rate differentials between the foreign currency deposits and the NT dollar deposits during this year, part of transaction deposits were shifted to non-transaction deposits. The share of non-transaction deposits, especially for foreign currency deposits, edged up in 2006, while the share of transaction deposits edged down. At the year-end, the shares of transaction deposits and non-transaction deposits were 27.44 percent and 64.62 percent, respectively.

With respect to the uses of funds, banks shrank their consumer finance business due to rising credit and cash card debt defaults. As a result, the share of bank loans in the uses of funds dropped down from the previous year's 66.47 percent to 64.69 percent at the end of 2006. Meanwhile, the share of net foreign assets increased from 0.57 percent to 1.73 percent. With banks' efforts in reducing excess funds and containing their investment risk, banks increased their purchases of government-issued securities. As a result, the share of bank portfolio

Sources and Uses of Funds in Depository Institutions

Unit: NT\$ Billion

	End of 2006		End of 2005		Annual Change	
	Amount	Share (%)	Amount	Share (%)	Amount	Share (%)
Sources:						
Transaction Deposits **	7,464	27.44	7,141	27.67	323	-0.23
Non-transaction Deposits***	17,576	64.62	16,625	64.42	951	0.20
Government Deposits	717	2.63	729	2.82	-13	-0.19
Borrowings from CBC	151	0.56	122	0.47	29	0.08
Other Items (Net)	1,293	4.75	1,193	4.62	99	0.13
Total	27,200	100.00	25,810	100.00	1,390	0.00
Uses:						
Net Foreign Assets *	472	1.73	148	0.57	324	1.16
Loans	17,594	64.69	17,154	66.47	440	-1.78
Portfolio Investments****	2,555	9.39	2,202	8.53	353	0.86
Purchases of CDs Issued by CBC	3,683	13.54	3,444	13.34	240	0.20
Deposits with CBC	2,896	10.65	2,863	11.09	34	-0.44

Notes:* Excluding valuation changes in the exchange rate of the NT dollar against foreign currencies when calculating their annual change.

** Including checking account deposits, passbook deposits and passbook savings deposits.

*** Including time deposits, time savings deposits, foreign currency deposits, postal savings deposits, non-residents NT dollar deposits, and repurchase agreements.

**** Being measured at original costs.

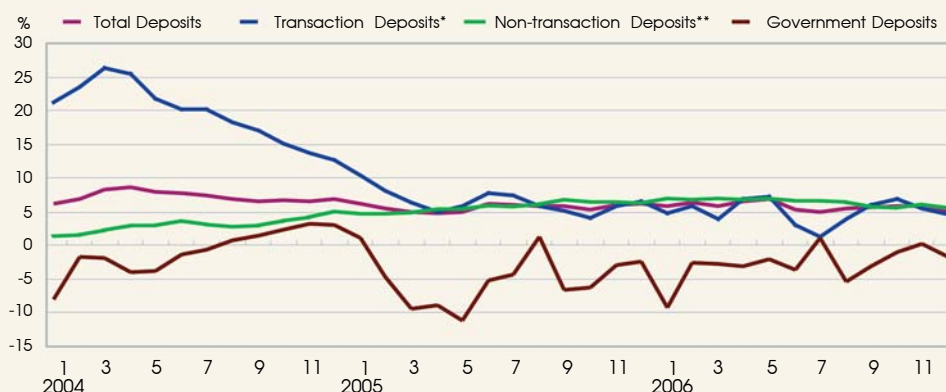
Source: *Financial Statistics Monthly*, CBC.

investments in the uses of funds increased from 8.53 percent to 9.39 percent. The share of holdings of certificates of deposit issued by the Bank also increased slightly from the previous year, while the share of deposits with the Bank decreased.

Downtrend in the Growth of Deposits

Total deposits of depository institutions at the end of 2006 grew by 5.10 percent, lower than the rate of 6.19 percent recorded in 2005. The decline was mainly caused by slower growth in the banks' loans and investments, a deceleration in foreign capital inflow, as well as a surge in overseas financial investments by residents. The monthly changes in the annual growth rate of deposits were as follows. Due to the continuous slowdown in the expansion of bank credit, the annual growth rate of deposits trended down to 5.86 percent at end-March. Afterwards, the annual growth rate of deposits climbed up to 6.82 percent at end-May following the rebound in the growth of bank credit and an increase in foreign capital inflow. In June and July, slower growth of bank credit, increased overseas portfolio investments by residents, coupled with foreign capital outflow, pushed the annual growth rate of deposits down to the year low of 5.03 percent at end-July. From August to October, deposits growth went up as a

Annual Growth Rate of Deposits by Type



Notes:* Including checking account deposits, passbook deposits and passbook savings deposits.

** Including time deposits, time savings deposits, foreign currency deposits, postal savings deposits, non-residents NT dollar deposits, repurchase agreements, and money market mutual funds.

Source: *Financial Statistics Monthly*, CBC.

result of the continued increase in foreign capital inflow. From November onwards, mostly due to the base effect, the annual growth rate of deposits dropped despite a significant increase in foreign capital inflow. Deposits growth declined to 5.10 percent at the year-end.

Among different types of deposits, the annual growth rate of transaction deposits fell from the previous year's 6.61 percent to 4.53 percent at the end of 2006, and its share in total deposits edged down from 29.14 percent to 28.98 percent. This was mainly due to the rising interest rates on time deposits and favorable interest rates on foreign currency deposits. At the end of 2006, non-transaction deposits at all depository institutions grew by a smaller pace of 5.65 percent, lower than the rate of 6.42 percent recorded last year-end, while its share in total deposits edged up from 67.88 percent to 68.24 percent.

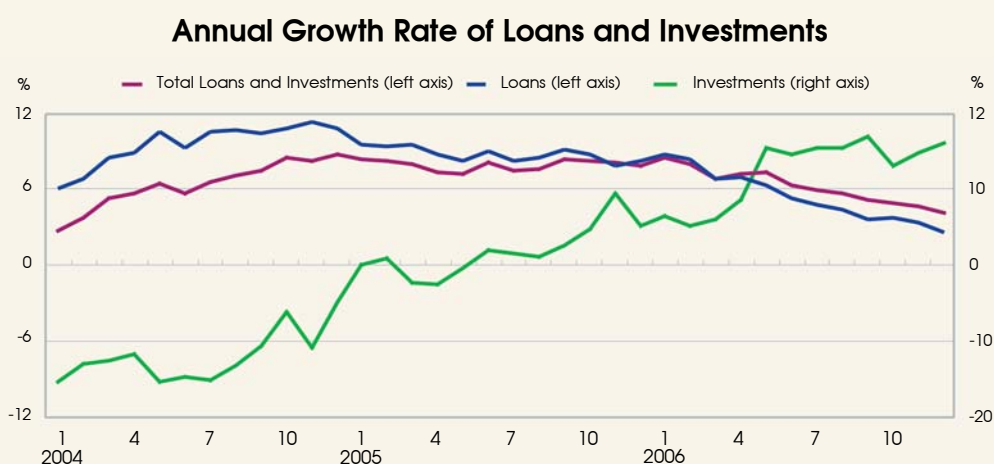
When compared among different types of non-transaction deposits, the annual growth rate of time deposits rose from the previous year's 4.87 percent to 7.45 percent at the end of 2006, and its share in total deposits edged up from 12.32 percent to 12.60 percent. The annual growth rate of time savings deposits declined largely from the previous year's 4.81 percent to 0.53 percent at the end of 2006, and its share fell from 31.65 percent to 30.28 percent. The postal savings deposits dropped to 9.34 percent while its share increased from 14.94 percent to 15.54 percent. Foreign currency deposits expanded from 13.99 percent to 18.59 percent due to the widening interest rate differential. Its share also rose from 6.15 percent to 6.94 percent. As for the outstanding amount of the repurchase agreements, it grew by an annual rate of 4.16 percent while its share dropped to 1.99 percent. NT dollar deposits held by foreigners

rose by 14.33 percent while its share edged up to 0.87 percent. The outstanding amount of money market mutual funds significantly grew by an annual rate of 175.98 percent over the previous year, however, its share remained relatively small when compared with other deposits

Government deposits in depository institutions contracted 1.73 percent in year-end 2006, compared to a 2.47 percent contraction at the previous year-end, and its share dropped from 2.98 percent to 2.78 percent.

Slower Growth in Banks' Loans and Investments

As a result of weak demand for funds caused by the slower consumption growth and sluggish investments in the private sector, the annual growth rate of loans and investments of depository institutions fell to 4.08 percent at year-end 2006, compared to the 7.77 percent recorded in the previous year. Of which, loans posted an annual growth rate of 2.54 percent at the end of 2006, lower than that of 8.13 percent a year earlier, while the annual growth rate of investments rose to 16.04 percent in 2006 from a 5.04 percent reported in 2005.



Source: *Financial Statistics Monthly, CBC.*

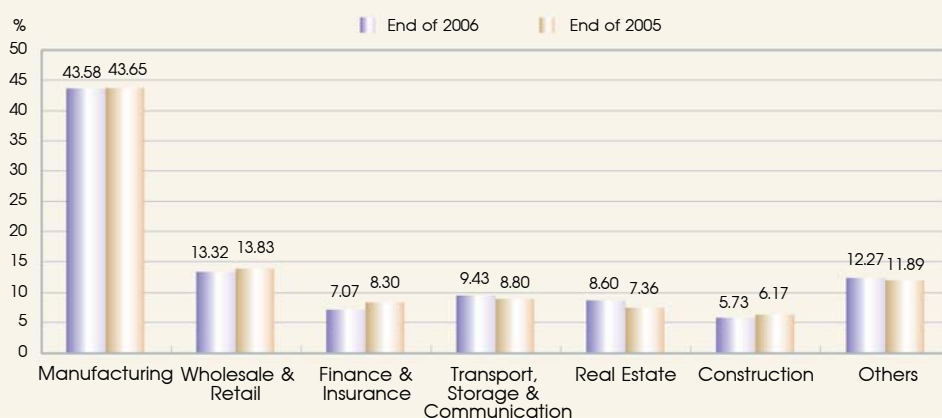
Loans by Sector

Mainly owing to the stronger demand for funds in the booming real estate market, loans extended to the private sector commanded the lion's share of 87.85 percent of total loans at the end of 2006, higher than that of 86.36 percent recorded a year earlier. The share of total loans extended to government agencies and public enterprises decreased to 9.16 percent and 2.99 percent, respectively, from 10.39 percent and 3.25 percent at the previous year-end.

Loans by Industry

The share of loans extended to real estate ascended from the previous year-end's 7.36 percent to 8.60 percent as the real estate market remained active; while the share of loans extended to finance and insurance descended from the previous year-end's 8.30 percent to 7.07 percent. The shares of loans to other industries were largely unchanged.

Share of Loans by Industry



Source: Financial Statistics Monthly, CBC.

Consumer Loans

Of consumer loans, revolving credit balance of credit cards and cash card loans shrank in this year, while home mortgages increased. At the year-end, the outstanding consumer loans extended by domestic banks, local branches of foreign banks, and medium business banks recorded an annual increase of NT\$65.8 billion or 0.99 percent of total loans from the previous year-end.

Share of Loans by Currency

At year-end 2006 the share of foreign currency loans to total loans remained the same of 2.98 percent as a year earlier. The corresponding share of NT dollar loans to total loans was therefore 97.02 percent. Moreover, the NT dollar loan-to-deposit ratio decreased to 71.22 percent at the end of 2006 from 72.38 percent a year earlier.

Investments

Portfolio investments by depository institutions measured at fair values showed an annual

increase of NT\$492.0 billion. After deducting revaluation adjustments of NT\$138.8 billion, portfolio investments measured on a cost basis recorded an annual increase of NT\$353.2 billion or 16.04 percent. Measured on a cost basis, government bonds accounted for the largest share of depository institutions' total investment of 55.54 percent in 2006, up from 53.29 percent a year ago, mainly due to the massive purchase of government bonds by the Department of Savings and Remittances of the Taiwan Post Co. Corporate bonds, second to government bonds in total investment shares, jumped to 13.66 percent from 12.45 percent a year earlier as banks increased their purchases to reduce excess liquidity. During the year, the share of commercial paper also leaped to 10.12 percent from 9.91 percent. Stocks, in contrast, dropped to 15.16 percent from 19.40 percent.

Increasing Share of Indirect Finance

Based on the flow data, the total amount of funds raised during the year by the non-financial sector, comprising enterprises, households, and the government, decreased from the previous year's NT\$1,961.6 billion to NT\$1,215.4 billion. The share of direct finance to total funds raised decreased from 9.24 percent to negative 12.73 percent as the growth of asset-backed securities shrank and the outstanding amount of short-term securities, corporate bonds and offshore bonds decreased. As for the share of indirect finance, that is, those borrowed from financial institutions including depository institutions, investment and trust companies, and life insurance companies, rose from 90.76 percent in 2005 to 112.73 percent in 2006.

Indirect Finance vs. Direct Finance*

Unit: NT\$ Billion

Year	Total Funds Raised (3)=(1)+(2)	Indirect Finance(1)			Share (1)/(3)(%)	Direct Finance(2)	
		Amount	Loans	Investments		Amount	Share (2)/(3)(%)
1997	2,278.0	1,670.2	1,548.0	122.2	73.32	607.8	26.68
1998	1,935.4	1,404.4	886.5	517.9	72.56	531.0	27.44
1999	1,289.1	1,041.3	954.0	87.3	80.78	247.8	19.22
2000	1,377.1	1,203.2	1,053.2	150.0	87.37	173.9	12.63
2001	665.2	594.5	200.6	393.9	89.38	70.7	10.62
2002	807.5	424.8	71.7	353.1	52.61	382.7	47.39
2003	1,677.1	716.0	711.5	45	42.69	961.1	57.31
2004	2,129.3	1,815.9	1,569.7	246.2	85.28	313.4	14.72
2005	1,961.6	1,780.3	1,458.5	321.8	90.76	181.3	9.24
2006	1,215.4	1,370.2	833.2	537.0	112.73	-154.8	-12.73

Notes: * Measured in terms of flow data.

- (1) Refers to loans and investments (measured on a cost basis) made by depository institutions, trust and investment companies, and life insurance companies, after taking account of their reclassifying of non-accrual loans and bad loans written-offs.
- (2) Refers to the total amount of new issues of various marketable securities, including government bonds, corporate bonds and stocks, offshore bonds and depository receipts, and short-term bills and asset-backed securities directly held by the non-financial sectors.

Source: *Financial Statistics Monthly*, CBC.

Decline in the Non-Performing Loan Ratio

With the efforts made by local banks to speed up their disposal of non-performing loans (NPLs), the book value of accumulated NPLs sold recorded an increase of \$172.2 billion in 2006. Owing to the impact of rising cash card debt defaults, the average NPL ratio of financial institutions (including banks, community financial institutions, and trust and investment companies) as a whole trended up during the first four months. Afterwards, as local banks kept writing off

Non-Performing Loan Ratios of Financial Institutions*



Notes: * Including domestic banks, medium business banks, foreign banks, credit cooperatives and credit departments of farmers' and fishermen's associations.

** Including loans under surveillance.

Source: Department of Financial Inspection, CBC.

Non-Performing Loan Ratios by Type of Financial Institutions



Source: Department of Financial Inspection, CBC.

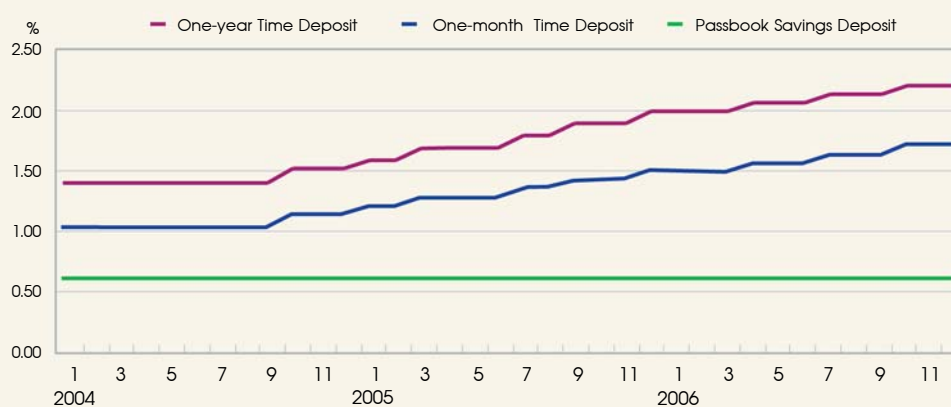
bad loans, the NPLs ratio began to decline and recorded 2.38 percent at the end of the year, lower than the previous year's 2.59 percent.

The corresponding NPL ratio for domestic banks and medium business banks combined (including their offshore banking units and overseas branches) increased from 2.24 percent at year-end 2005 to 2.54 percent at the end of April, 2006, then dropped to 2.13 percent at year-end 2006. The NPL ratios for community institutions declined from the previous year's 8.90 percent to 6.94 percent at year-end 2006.

Increase in Bank Interest Rates

Bank interest rates moved up steadily throughout 2006 along with increases in the discount rate. In the case of the interest rates of the five major domestic banks, the average fixed rates on one-month and one-year time deposits moved upward to 1.71 percent and 2.20 percent by the end of 2006, respectively, from 1.50 percent and 1.99 percent at the previous year-end. In the same period, the average base lending rate rose to 4.12 percent from 3.85 percent.

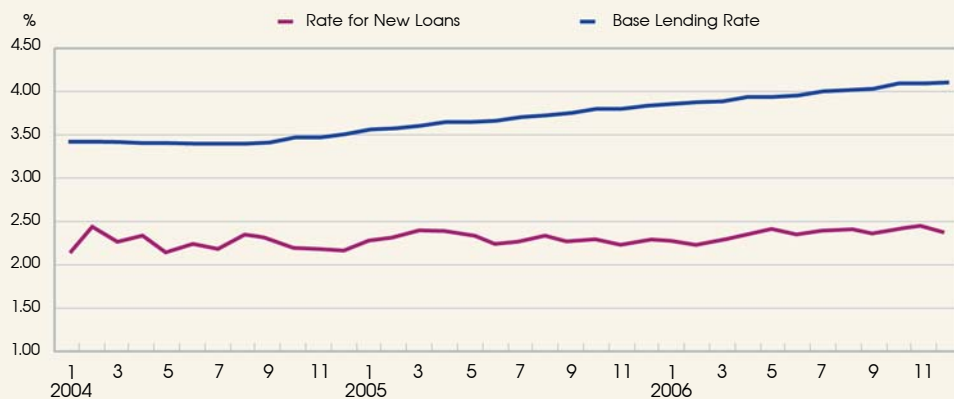
The Average Deposit Rates of the Five Major Domestic Banks*



Note: * The five major domestic banks are the Bank of Taiwan, the Taiwan Cooperative Bank, the First Commercial Bank, the Hua Nan Commercial Bank and the Chang Hwa Commercial Bank.
Source: *Financial Statistics Monthly*, CBC.

The increase in the weighted average interest rate of new loans extended by the five major domestic banks was relatively modest as compared with the increase in the base lending rate. This was mainly due to the increase in low interest rate loans to the government and enterprises with good credit records, and the increase in mortgages that preferential loan rates were applied during the initial periods of the loans. On the whole, the weighted average lending rate slightly increased from 2.31 percent in 2005 to 2.37 percent in 2006. Not counting government loans, the lending rate was 2.41 percent for 2006 from 2.34 percent in 2005.

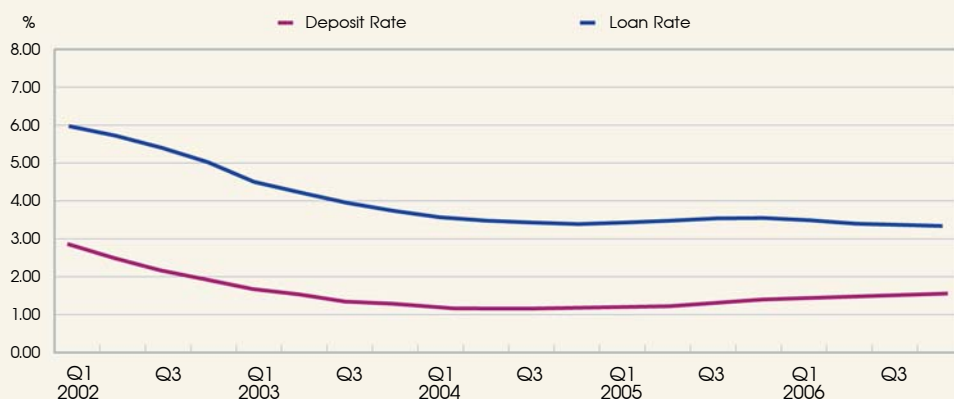
The Average Lending Rate of the Five Major Domestic Banks*



Note: * The five major domestic banks are the Bank of Taiwan, the Taiwan Cooperative Bank, the First Commercial Bank, the Hua Nan Commercial Bank and the Chang Hwa Commercial Bank.
 Source: *Financial Statistics Monthly, CBC.*

The weighted average rates of deposits and loans of domestic banks exhibited a different trend during 2006. With base lending rate climbing smoothly, the weighted average deposits rate rose to 1.54 percent in the fourth quarter of 2006 from 1.38 percent in the same quarter of 2005. On the contrary, the weighted average loans rates moved downward from 3.55% to 3.31% during the same period, mainly because banks cut down extensions of high interest rate consumer loans and provided lower credit card interest rate for cardholders with good creditworthiness following the FSC's new measure regarding the adoption of differential interest rates on credit and cash cards. For 2006, the weighted average rates of deposits and loans are 1.47% and 3.39%, respectively. The interest rate spread between deposits and loans continuously shrank to 1.92 percent in 2006, lower than the 2.21 percent in 2005.

The Weighted Average Interest Rates of Domestic Banks



Source: *Financial Statistics Monthly, CBC.*

A Shrinkage in Banks' Profitability

Affected by rising card debt defaults, the profitability of banks shrank significantly during 2006. The combined pre-tax earnings of all depository institutions fell by NT\$103.6 billion to NT\$12.9 billion, resulting from a decrease in banks' net interest earnings and a sizable writing off of their bad loans. Of this amount, the pre-tax earnings of domestic banks and medium business banks combined plunged by NT\$86.0 billion and posted a loss of NT\$7.3 billion. This was primarily attributed to banks' writing off of bad loans and a loss from the sale of bad assets. The pre-tax profits of foreign banks dropped by NT\$15.8 billion, mainly due to a rise in provisions for credit and cash card defaults. As for the credit cooperatives and the credit departments of farmers' and fishermen's associations, pre-tax earnings rose as banks' provisions for bad loans dwindled, owing to an improvement of their asset quality. In addition, the pre-tax profit of the Department of Savings and Remittances of the Taiwan Post Co. dropped by NT\$2.4 billion, owing to a decrease in interest income and a rise in personnel costs.

A Decrease in ROA and ROE

The average return on assets (ROA) and return on equity (ROE) for all depository institutions fell to 0.04 percent and 0.65 percent in 2006, respectively, from 0.34 percent and 5.95 percent a year earlier. Among depository institutions, the Department of Savings and Remittances of the Taiwan Post Co. remained ahead in terms of ROAs and ROEs. Except for the credit departments of farmers' and fishermen's associations, ROAs and ROEs for all other depository institutions were lower than those of the previous year.

Profitability of Depository Institutions by Type

Unit: NT\$ Billion

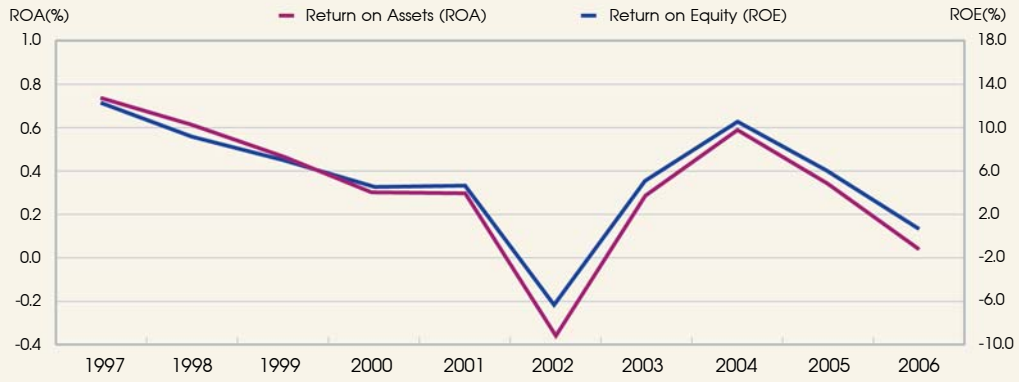
	Profit before Tax			Return on Assets (%)*			Return on Equity (%)**		
	2006	2005	Annual Change	2006	2005	Annual Change	2006	2005	Annual Change
Domestic Banks and Medium Business Banks	-7.3	78.7	-86.0	-0.03	0.29	-0.32	-0.42	4.55	-4.97
Foreign Banks	4.3	20.1	-15.8	0.18	1.10	-0.92	8.61	37.88	-29.27
Credit Cooperatives	1.3	1.5	-0.2	0.21	0.23	-0.02	3.07	3.75	-0.68
Credit Departments of Farmers' and Fishermen's Associations	3.7	2.9	0.8	0.25	0.19	0.06	4.37	3.48	0.89
Department of Savings and Remittances of Taiwan Post Co.	10.9	13.3	-2.4	0.26	0.35	-0.09	13.88	24.90	-11.02
Total Depository Institutions	12.9	116.5	-103.6	0.04	0.34	-0.30	0.65	5.95	-5.30

Notes: * Return on Assets = Profit before Tax / Total Assets

** Return on Equity = Profit before Tax / Net Worth

Source: Department of Financial Inspection, CBC.

The Return on Assets and Equity of Depository Institutions



Source: Department of Financial Inspection, CBC.



4. Money Market

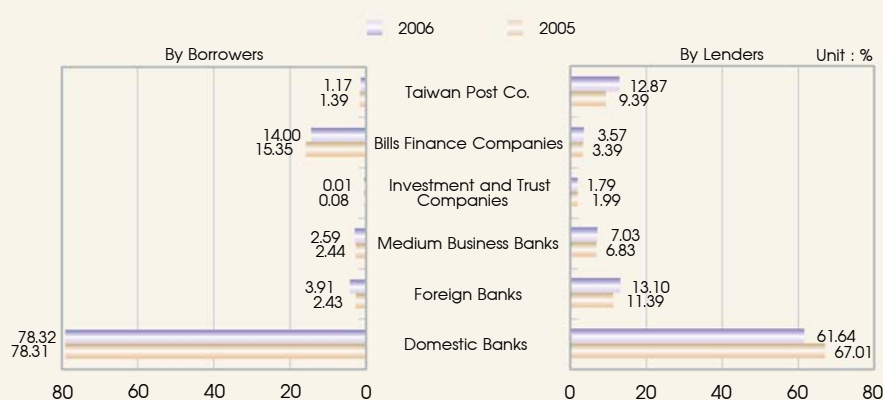
The money market consists of the interbank call-loan market and the short-term bills market. In 2006, the total turnover in the interbank call-loan market increased by 20.60 percent, but the trading volume in short-term bills market decreased by 8.32 percent. Money market rates trended mildly upwards as the Bank kept raising the discount rates.

Increase in Interbank Call-Loan Market Transactions

Activity in the interbank call-loan market grew briskly in the year, mainly because dealers for the Bank's open market operations were required to offer fixing rate quotations and bolster trading in the market after the Taipei Interbank Offered Rate (TAIBOR) system began in October 2005. Especially in the second quarter, the recovery of local stock markets further fueled trading in the interbank call-loan market. For the year as a whole, the total annual turnover in the interbank call-loan market was NT\$23,838.9 billion, an increase of 20.60 percent compared to the previous year.

In terms of borrowers in the interbank call-loan market, domestic banks were the largest borrower during the year, accounting for 78.32 percent of total trading, followed by bills finance companies, foreign banks and medium business banks, with shares of 14.00 percent, 3.91 percent and 2.59 percent, respectively. Compared with the previous year, the share of domestic banks and medium business banks remained almost the same. The share of foreign banks

Composition of Interbank Call-Loan Market by Participant



Source: Financial Statistics Monthly, CBC.

climbed by 1.48 percentage points to support their extension of loans, which expanded faster than deposits. The share of bills finance companies kept dropping due to their weak demand for funds.

With regard to lenders, domestic banks continued to be the largest supplier of funds, accounting for 61.64 percent of total transactions, a 5.37 percentage-point decrease from a year ago. Following domestic banks were foreign banks, Taiwan Post Co. and medium business banks, with respective shares of 13.10 percent, 12.87 percent and 7.03 percent. Among these lenders, as Taiwan Post Co. received large amounts of time deposits, and foreign banks received abundant funds through foreign capital inflows, their shares climbed by 3.48 and 1.71 percentage points, respectively.

Regarding the maturities of interbank call loans, the Interbank Money Center actively encouraged dealers to engage in interbank call-loan transactions with longer maturities. In April, the Center expanded the interbank call-loan maturities from 6 months to one year. Therefore, although overnight interbank call loans remained most actively traded in the market with a predominant share of 49.11 percent, the share represented a decrease of 5.62 percentage points compared to the previous year. Second to them were those with maturities of 1 week and 2 weeks, respectively accounting for 29.33 percent and 17.00 percent. Trading of those with new maturities above 6 months accounted for a negligible share of 0.03 percent.

Less Active Short-Term Bills Market

In 2006, new issues of short-term bills totaled NT\$7,004.0 billion, 1.64 percent less than in the previous year. Of the new issues of short-term bills, commercial paper continued to account for the lion's share of 83.95 percent. Second to it were negotiable certificates of deposit, with a share of 14.89 percent. Bankers' acceptances made up a marginal share of 0.52 percent. Compared to the previous year, the issues of negotiable certificates of deposit decreased by 18.79 percentage points due to the ease funding conditions of banks. However, the issues of commercial paper kept growing in 2006. As of the end of 2006, total outstanding bills amounted to NT\$1,092.4 billion, 6.48 percent less than the previous year-end.

In the secondary market, total turnover of short-term bills declined by 8.32 percent to NT\$48,551.3 billion. Of the total transactions, commercial paper still made up the largest share of 80.70 percent, slightly higher than in 2005. It was followed by negotiable certificates of deposit with a share of 14.33 percent, which was slightly lower than in 2005. Treasury bills accounted for 4.91 percent, a small decrease from the previous year. With respect to market

Short-Term Bills Market

Unit: NT\$ Billion

Year	Total			Treasury Bills			Commercial Paper			Bankers' Acceptances			Negotiable Certificates of Deposit		
	Issue	Redemption	Year-end Outstanding	Issue	Redemption	Year-end Outstanding	Issue	Redemption	Year-end Outstanding	Issue	Redemption	Year-end Outstanding	Issue	Redemption	Year-end Outstanding
1997	11,348.9	11,056.8	2,042.2	57.3	52.3	20.0	8,872.1	8,670.8	1,296.5	1,018.7	1,155.2	131.9	1,400.7	1,178.5	593.8
1998	13,691.2	13,347.5	2,386.0	55.0	20.0	55.0	11,497.9	11,029.9	1,764.5	486.6	581.4	37.2	1,651.7	1,716.2	529.3
1999	10,676.5	11,029.2	2,033.3	315.0	220.0	150.0	9,390.6	9,663.8	1,491.3	66.0	90.0	13.2	904.9	1,055.4	378.8
2000	10,324.6	10,552.9	1,805.0	95.0	200.0	45.0	9,032.7	9,267.8	1,256.3	46.2	49.2	10.2	1,150.8	1,036.0	493.5
2001	9,901.5	10,218.8	1,487.8	85.0	80.0	50.0	8,926.8	9,080.6	1,102.4	36.1	38.1	8.3	853.6	1,020.1	327.1
2002	8,378.1	8,556.4	1,309.5	180.0	50.0	180.0	7,525.1	7,757.5	870.1	40.1	40.5	7.9	632.9	708.4	251.5
2003	7,547.7	7,662.8	1,194.4	60.0	180.0	60.0	6,815.1	6,876.3	808.8	34.5	35.6	6.8	638.1	570.9	318.7
2004	6,888.8	6,766.7	1,316.5	130.9	60.0	130.9	5,642.8	5,676.0	775.6	35.2	34.4	7.6	1,080.0	996.3	402.4
2005	7,121.0	7,269.7	1,168.1	115.0	200.9	45.0	5,690.4	5,719.0	747.0	31.1	31.1	7.7	1,284.5	1,318.4	368.5
2006	7,004.0	7,079.7	1,092.4	45.0	65.0	25.0	5,879.8	5,909.2	717.6	36.1	35.7	8.1	1,043.1	1,069.9	341.7
2005-2006 Changes	-117.0	-189.7	-75.7	-70.0	-135.9	-20.0	189.4	190.2	-29.4	5.0	4.6	0.4	-241.4	-248.5	-26.8
Growth rate (%)	-1.64	-2.61	-6.48	-60.87	-67.65	-44.44	3.33	3.33	-3.94	16.08	14.79	5.19	-18.79	-18.85	-7.27

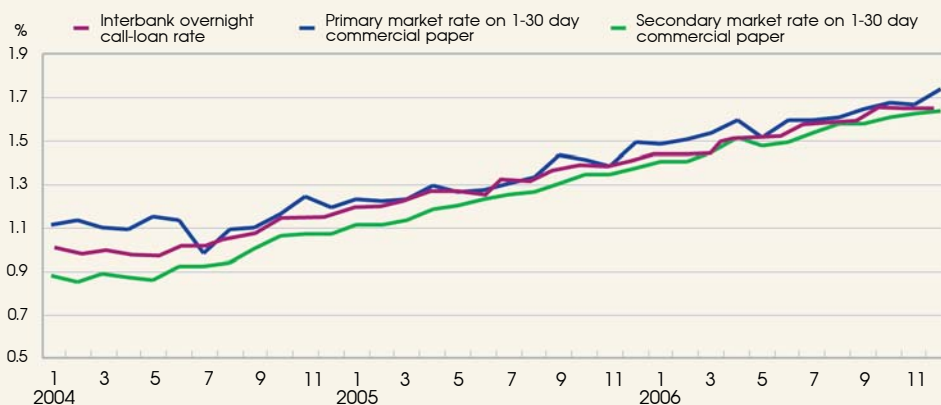
Source: Financial Statistics Monthly, CBC.

participants, private enterprises remained the largest player in the market with a share of 49.48 percent, followed by banks with a share of 21.09 percent.

Money Market Rates Trended Upwards

During 2006, funding conditions in the banking system remained easy. In the first-half of 2006, while private investment remained weak, and banks tightened consumer credit in response to emerging credit card bad debts, the demand for funds was subdued. In the second half of the year, funding conditions remained easy as private investment rose slightly. Along with the Bank's rate hikes in March, June, September and December, the overnight interbank call-loan rate and other money market rates trended upwards during the year.

Money Market Interest Rates



Source: Financial Statistics Monthly, CBC.

The interbank overnight call-loan rate rose from 1.41 percent at the previous year-end to 1.66 percent at the end of 2006. Over the same period, the average issuing rate on commercial paper with maturities of 1 to 30 days kept moving upwards to reach 1.74 percent at the end of the year. The secondary market rate on commercial paper with maturities of 1 to 30 days stepped up from 1.38 percent to 1.64 percent.



5. Foreign Exchange Market

Slight Depreciation of the NT Dollar

Although Taiwan's trade surplus continued to increase and foreign capital flowed in, the enormous portfolio investment abroad by Taiwan's residents kept the NT dollar relatively weak. The trade-weighted average nominal effective exchange rate index of the NT dollar slightly declined by 0.22 percent for the year of 2006. The movements of the NT dollar against other currencies, including the US dollar, the euro, the Japanese yen, the Chinese renminbi (RMB) and the Korean won, in 2006 are analysed as follows.

Regarding the movements of NT\$/US\$ exchange rates, the NT dollar fluctuated between 31.338 and 33.316. From the beginning of 2006 to January 12, due to large foreign capital inflows and the foreign exchange sale by domestic firms, the NT\$/US\$ appreciated from 32.818 to 31.880. Subsequently, since the market expected that the Fed's stance towards rate hikes would turn conservative, and the economy of the Euro Area continued to recover, the US dollar depreciated in the international market. However, the effect of these international factors was offset by the outward remittances of oil payments and the enormous demand for foreign exchange from insurance companies to invest abroad, the NT\$/US\$ depreciated to 32.669 on March 24.

**Percentage Changes of NT Dollar against Major Currencies
(compared with End 2005)**



Source: Department of Economic Research, CBC.

Afterwards, the G7 summit urged China and other Asian countries to adopt more flexible exchange rate regimes, the market expected the Fed to halt rate hikes, and Japan's economy boomed remarkably. These factors caused the US dollar to continue depreciating in the international market. On top of these, the continuous inflows of foreign capital and the sale of foreign exchange by domestic banks caused the NT\$/US\$ to appreciate to a yearly high of 31.338 on May 10.

Later, the US economy showed sign of weakness and the Fed suspended rate hikes. Nevertheless, heightened geopolitical risk, including the missile test of North Korea and the Middle East tension, prompted the market to hold more US dollars. On the domestic front, outward remittances of foreign capital and insurance companies, and demand for foreign exchange by banks and importers reinforced the downward trend in the NT dollar. The NT\$/US\$ depreciated to a yearly low of 33.316 on October 25.

In November 2006, as the US economy slowed down and rate hikes by the European Central Bank (ECB) narrowed the interest rate spread with the US, the US dollar turned weak. Meanwhile, the Asian currencies also strengthened against the US dollar and foreign capital inflows continued. These factors reversed the depreciation trend of the NT dollar, which stood at 32.596 against the US dollar at the end of 2006. Compared with the previous year-end, the NT dollar slightly appreciated by 0.78 percent against the US dollar at the end of 2006. However, on a daily average basis, the NT\$/US\$ exchange rate depreciated by 1.05 percent in 2006 from the previous year.

With respect to the NT dollar exchange rate against the euro, as the economy of the Euro Area grew strongly in 2006, the ECB raised interest rates six times in a row since December 2005, narrowing the interest rate spread between the US and the Euro Area. Consequently, the euro appreciated against the US dollar significantly, and also against the NT dollar, in 2006. The NT dollar depreciated by 9.82 percent against the euro between the end of 2005 and 2006, and by 2.24 percent on a daily average basis in 2006 over the previous year.

Regarding the NT dollar against the Japanese yen, since Japan's economy continued to recover, the Bank of Japan (BOJ) ended the quantitative monetary easing policy in early March 2006. Moreover, the market expected that the Japanese yen to appreciate along with the RMB after the G7 summit. As a result, the yen appreciated remarkably against the US dollar after the middle of April 2006. In July, the BOJ indicated a slowdown in the pace of policy rate rises, leading the market to expect limited rate rises by the BOJ for the rest of 2006.

Moreover, missile and nuclear tests conducted by North Korea triggered concerns over geopolitical risk in East Asia. Furthermore, the interest rate spread between the Euro Area and Japan expanded as a result of continuous rate rises in the Euro Area. The above-mentioned factors caused the yen to depreciate against the US dollar. Since the yen depreciated by a greater extent than the NT dollar against the US dollar, the NT dollar appreciated against the Japanese yen by 1.44 percent between the end of 2005 and 2006, and by 4.40 percent on a daily average basis in 2006 over the previous year.

Although China implemented macro-tightening policy to curb an overheating economy, its economy continued to grow rapidly and large trade surplus built up. As a result, the RMB appreciated gradually against the US dollar and also against the NT dollar. Compared with the end of 2005, the NT dollar depreciated by 2.63 percent against the RMB at the end of 2006. On a daily average basis, the NT dollar depreciated by 3.77 percent against the RMB in 2006 over the previous year.

Despite North Korea's missile and nuclear tests, South Korea's economic growth accelerated to 5.0 percent in 2006, mainly due to a slide in crude oil prices, an increase in private investment, as well as an expansion in exports. With fast economic growth and large capital inflows, the Korean won significantly appreciated against the US dollar and also against the NT dollar in the year. The NT dollar depreciated by 7.11 percent against the Korean won between the end of 2005 and 2006 and by 7.8 percent on a daily average basis in 2006 compared with the previous year.

Significant Increase in Foreign Exchange Trading

Trading in the Taipei foreign exchange market increased significantly in 2006. Total net trading volume for the year increased by 30.0 percent from the previous year to US\$3,910.84

Turnover of Major Products in the Taipei Foreign Exchange Market

Unit: US\$ Million

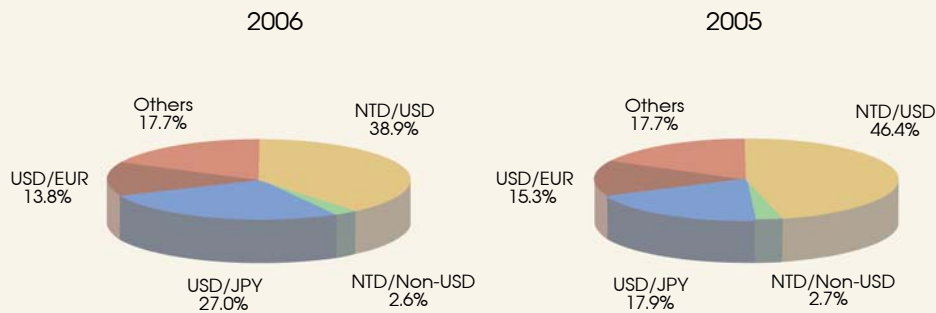
Year	Spots	Forwards	Forex Swaps	Margin Trading	Options	Cross Currency Swaps	Total
2002	872,844	114,341	238,807	25,869	149,630	8,875	1,410,366
2003	1,058,850	156,323	361,490	33,907	213,198	13,930	1,837,698
2004	1,289,872	273,931	617,577	30,299	350,514	17,764	2,579,955
2005	1,550,731	274,370	823,483	24,378	295,908	39,788	3,008,657
2006	1,910,270	411,182	1,107,646	37,809	396,578	47,353	3,910,838
2005-2006 Growth Rate (%)	23.2	49.9	34.5	55.1	34.0	19.0	30.0

Source: Department of Foreign Exchange, CBC.

billion. The daily average turnover stood at US\$15.64 billion, representing an increase of 29.5 percent over the previous year. The increase in turnover mainly reflected increases in external trade, capital movements, and third currency transactions. The marked appreciation of the euro against the US dollar, and the slowdown in the BOJ's rate rises, which caused the interest rate spread between Japan and the US and Europe to remain significant, both contributed to the increase in third currency transactions.

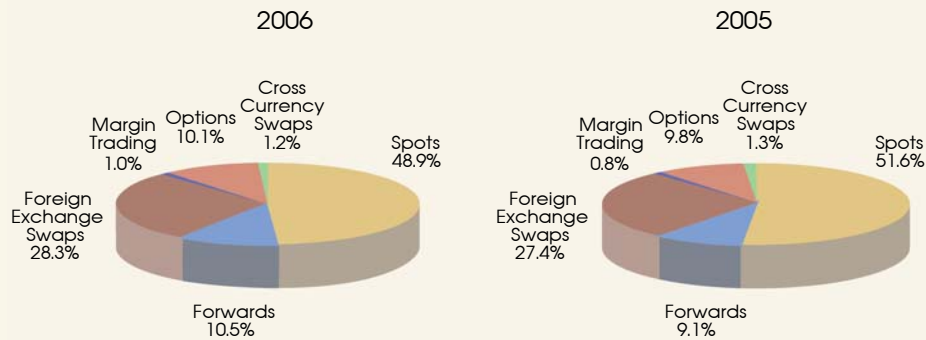
In terms of trading partners, transactions between banks and non-bank customers accounted for 33.6 percent of total net turnover. Interbank transactions made up a 66.4 percent share, including 17 percent for transactions among local banks and 49.4 percent for those between local banks and overseas banks.

Composition of Foreign Exchange Transactions by Traded Currency



Source: Department of Foreign Exchange, CBC.

Composition of Foreign Exchange Transactions by Product



Source: Department of Foreign Exchange, CBC.

Turnover of Other Products in the Taipei Foreign Exchange Market

Unit: US\$ Million

Year	Interest rate-related Products				Commodity-related Products		Stock Index Options	Credit Derivatives	Total
	Forward Rate Agreements	Interest Rate Swaps	Interest Rate Options	Foreign Currency	Commodity Options	Commodity Price Swaps			
2002	30,518	22,488	4,479	2,458	1,826	305	556	–	62,630
2003	20,121	41,855	10,066	12,036	3,313	175	663	–	88,229
2004	20,020	77,664	45,635	12,500	6,733	–	1,012	168	163,823
2005	25,089	78,528	23,668	29,385	4,594	–	389	581	162,235
2006	24,796	69,219	11,970	40,992	1,827	–	1,005	964	150,772
2005-2006 Growth Rate (%)	-1.2	-11.9	-49.4	39.5	-60.2	0.0	158.3	65.8	-7.1

Source: Department of Foreign Exchange, CBC.

As far as traded currencies are concerned, NT dollar trading against foreign currencies accounted for 41.5 percent of total trading volume, with the NT dollars trading against the US dollars accounting for a major share of 38.9 percent. Transactions in third currencies accounted for 58.5 percent of total trading volume, with trading mainly in currency pairs of US dollar-Japanese yen and US dollar-euro, which accounted for 27.0 percent and 13.8 percent of total trading, respectively. In particular, the trading volume of the NT dollar against other currencies only increased by 9.9 percent, while that of third currencies grew significantly by 49.4 percent.

With respect to types of transactions, spot transactions accounted for the highest share with 48.9 percent of total turnover, followed by foreign exchange swaps with 28.3 percent, forwards with 10.5 percent, options with 10.1 percent, cross currency swaps with 1.2 percent, and margin trading with 1.0 percent. Compared with those in 2005, the trading volumes of all the types increased.

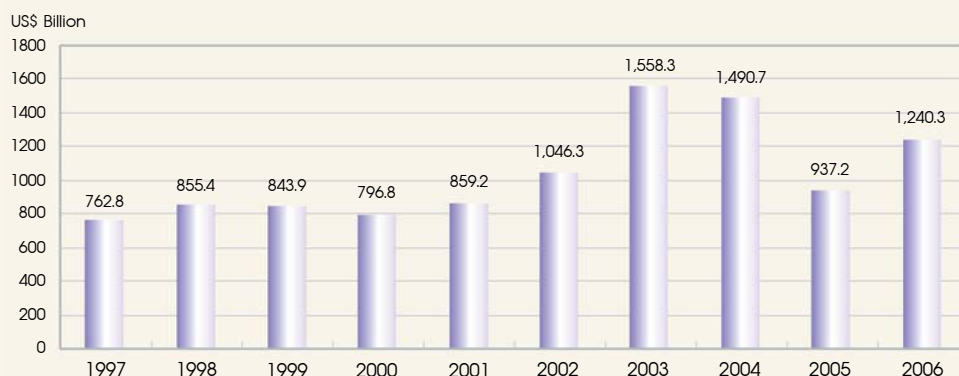
In addition, the turnover of forwards, swaps and options based on foreign currency interest rates, stock price indices, commodity prices, and credit in the bank-customer market amounted to US\$150.77 billion in 2006. Of this amount, interest rate-related derivatives accounted for the lion's share of US\$146.98 billion or 97.5 percent, representing a year-on-year decrease of 6.2 percent.

Expansion in the Foreign Currency Call-Loan Market

The transaction volume in the foreign currency call-loan market in 2006 was US\$1,240.25 billion, an increase of 32.3 percent over the previous year. Of this amount, US dollar transactions accounted for US\$1,238.79 billion. The increase was mainly because banks increased their overnight call-loan transactions for efficient fund utilization. In addition, Japanese yen transactions totaled ¥72.77 billion in 2006, representing a large increase of 3 times the figure recorded in

2005. As the BOJ slowed down its pace of policy rate rises, the interest rate spread between the US and Japan remained conducive to carry trade. Therefore, the amount of Japanese yen call loans increased largely, but the share was still small at only 0.05 percent. Finally, the amount of euro transactions totaled only €530 million, increasing by 4.8 percent from 2005.

Transactions in the Taipei Foreign Currency Call-Loan Market



Source: Department of Foreign Exchange, CBC.

Considerable Increase in the Assets of Offshore Banking Units

At the end of 2006, there were 66 offshore banking units (OBUs) in operation. Domestic banks operated 39 of the OBUs, while foreign banks ran the other 27. The assets of all OBUs totaled US\$76.69 billion at the end of the year, representing a remarkable increase of US\$6.53 billion or 9.3 percent from the previous year-end, mainly because claims on nonresidents and financial institutions increased. Of the total assets, domestic bank OBUs accounted for US\$57.71 billion or 75 percent, and foreign bank OBUs accounted for US\$18.98 billion, or 25 percent.

The OBUs' main sources of funds were due to their affiliated branches and deposits by financial institutions, together accounting for 60.9 percent of total liabilities. These were followed by deposits of non-financial institutions, which accounted for 31.6 percent of total liabilities, with an increase of 17 percent from the 2005 level. OBUs have been gradually developing into funding centers for overseas Taiwanese firms. Moreover, the OBUs' main uses of funds were due from affiliated branches and deposits with financial institutions. These accounted for 52.6 percent of total assets, followed by loans extended abroad and locally with a share of 26.8 percent. In terms of geographical origin, 71 percent of funds came from Asia, and 23 percent from the Americas. In terms of fund destination, 61 percent of funds went to Asia, and 25 percent to the Americas.

The forex-trading turnover of all OBUs in 2006 was US\$114.86 billion, a decrease of 14.1 percent over the previous year, primarily as a result of the impact of mergers and acquisitions among some local banks. Of the total turnover, US\$72.51 billion was for spot transactions and US\$15.89 billion for forward transactions, decreasing by 24.2 percent and 8.0 percent, respectively, compared with the previous year. In contrast, the turnover of swap transactions amounted to US\$26.46 billion, a significant growth of 27.1 percent over the previous year, primarily because the interest rate spread between the US and Japan fueled carry trade activities. Moreover, the total turnover of other derivative products, including interest rate swaps, margin trading, forward rate agreements, financial futures, options, cross currency swaps, commodity price swaps, commodity forward contracts, stock index swaps and credit derivatives, amounted to US\$145.88 billion, representing a significant increase of 61.0 percent over the previous year.

Consolidated Balance Sheet of Offshore Banking Units in Banking System

Unit: US\$ Million

Year / Month	Loans to Non-financial Institutions	Portfolio Investment	Claims on Financial Institutions	Other Assets	Total Assets= Total Liabilities	Deposits of Non-financial Institutions	Due to Financial Institutions	Other Liabilities
2004/12	18,066	6,734	37,105	7,314	69,219	18,810	42,688	7,721
2005/12	18,697	8,718	38,432	4,311	70,158	20,712	44,305	5,141
2006/12	19,473	10,805	40,352	6,056	76,686	24,227	46,664	5,312
2006/ 1	18,889	8,896	35,137	4,149	67,071	21,034	41,370	4,667
2	18,643	9,165	35,533	4,975	68,316	21,076	41,666	5,574
3	18,773	9,397	35,535	4,689	68,394	21,417	41,746	5,231
4	18,729	9,572	37,369	4,675	70,345	21,794	43,202	5,349
5	18,955	9,752	37,760	4,739	71,206	21,701	44,046	5,459
6	19,231	9,937	36,350	4,550	70,068	21,903	43,218	4,947
7	19,205	10,151	34,702	5,361	69,419	22,140	41,488	5,791
8	18,491	10,093	36,875	5,677	71,136	22,824	43,267	4,558
9	19,032	10,173	40,402	5,354	74,961	23,379	46,603	4,494
10	19,279	10,255	34,888	5,389	69,811	23,589	41,001	4,739
11	19,622	10,218	35,629	5,829	71,298	24,083	41,251	5,476
12	19,473	10,805	40,352	6,056	76,686	24,227	46,664	5,312

Source: Financial Statistics Monthly, CBC.

6. Stock Market

The Taiwan Stock Exchange (TSE) weighted stock price index (TAIEX) closed the year 2006 with an increase of 19.5 percent from the previous year-end. All industrial groups rose with construction and steel and iron shares being the best performers. The daily average trading value for the year was NT\$96.4 billion, 26.5 percent higher than that of the previous year.

The GreTai Securities Market (GTSM), an over-the-counter market, weighted stock price index finished the year with a strong increase of 23.3 percent from the previous year-end. All stock groups went up, while steel and iron, construction, and textile shares recorded the largest gains. The daily average turnover for the year was NT\$20.7 billion, surging by 61.7 percent from the previous year.

The TSE Market

Market Capitalization Increased Substantially

There were a total of 688 listed companies at the end of 2006, representing a decrease of 3 companies from the previous year-end. During the same period, the par value of total

Major Statistics of the TSE Market

	Stock price Index* (1966=100)	Daily Average Trading Value (NT\$Billion)	Turnover Rate (%)	Market Capitalization* (NT\$ Billion)	Net Buying / Sale Positions** (NT\$ Billion)		
					Foreign Investors Net Buy/Sell	Securities Investment Trust Companies Net Buy/Sell	Securities Dealers Net Buy/Sell
2004	6,139.7	95.5	177.5	13,989	284.0	-14.1	-15.4
2005	6,548.3	76.2	131.4	15,634	719.4	-86.3	16.9
2006	7,823.7	96.4	142.2	19,377	558.1	-54.3	6.9
2006/ 1	6,532.2	120.2	13.9	15,610	37.9	-15.8	-4.5
2	6,561.6	92.7	10.0	15,701	66.0	-13.2	-4.4
3	6,614.0	89.8	13.0	15,917	-7.1	-10.7	-0.5
4	7,171.8	122.8	13.4	17,483	170.1	-11.8	11.8
5	6,847.0	132.0	16.6	16,742	-30.1	-0.2	-16.4
6	6,704.4	89.9	12.5	16,389	-46.3	3.7	-8.6
7	6,454.6	70.0	9.3	15,790	-28.9	-0.6	3.1
8	6,611.8	74.0	10.5	16,198	73.6	1.6	7.7
9	6,883.1	74.4	9.3	16,863	78.8	-5.8	6.1
10	7,021.3	82.4	9.5	17,345	58.1	-2.7	-0.6
11	7,567.7	105.8	12.4	18,723	113.4	0.0	10.3
12	7,823.7	109.7	11.9	19,377	72.6	1.3	3.0

Notes: * Refers to end-of-period data.

** Minus sign "-" indicates net sale positions.

Source: Taiwan Stock Exchange Corporation.

shares issued increased slightly by 1.9 percent to NT\$5.5 trillion, while total market capitalization rose substantially by 23.9 percent to NT\$19.4 trillion.

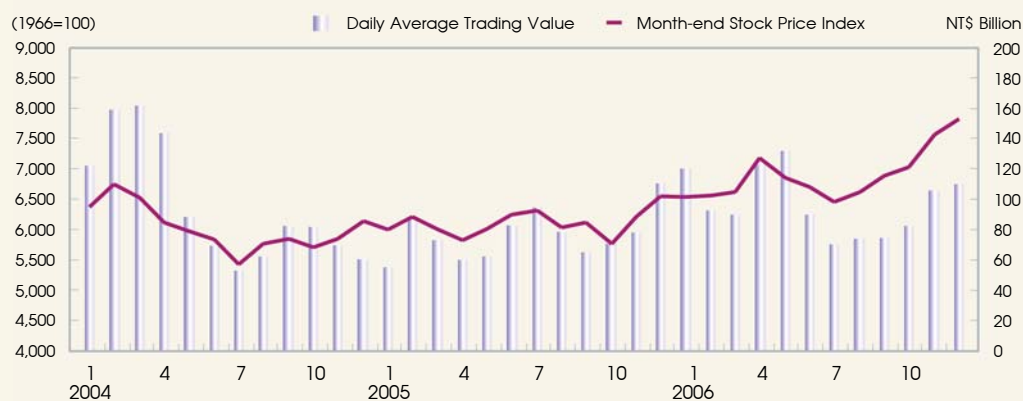
Share Prices Trended Upwards

During the first three months of 2006, international stock markets weakened on expectations of continuous rate hikes by the US Federal Reserve. Meanwhile, the electronics sector, which weighs heavily on the TSE market, entered a cyclical trough, prompting foreign institutional investors to downgrade local investment. The TAIEX fell to 6,365 points on March 23. During the subsequent two months, international markets rebounded and foreign investors purchased the relatively cheap local shares. The easing of cross-strait relations also helped send asset-related stocks upwards. The TAIEX rallied to 7,474 points on May 8.

From then to July, tensions in Middle East pushed up oil prices. International markets were overshadowed by inflationary pressure and interest rate rise possibilities. Capital retreated from Asia, leading stock prices across the region lower. In Taiwan, political unrest sapped the confidence of local investors. All these factors caused the TAIEX to plunge to a yearly low of 6,258 points on July 17.

Since then, however, stock prices trended upwards on a series of upbeat news. International stock markets gained momentum as the US Federal Reserve halted rate hikes. The Dow Jones Industrial Average Index climbed new highs. On the domestic front, the Carlyle Group's buyout of Taiwan's Advanced Semiconductor Engineering intensified expectations of potential mergers and acquisitions, which prompted foreign investors to engage in large purchases in the local

TSE Stock Price Index and Trading Value



Source: TSEC Monthly Review, Taiwan Stock Exchange Corporation.

Changes in Industrial Group Stock Price Indices in the TSE Market



Source: TSEC Monthly Review, Taiwan Stock Exchange Corporation.

market. The TAIEX closed the year at an annual high of 7,824 points, showing a 19.5 percent increase over the previous year-end.

All industrial group stock price indices went up this year. Shares of traditional industries largely outperformed electronics and electric machinery shares and financial shares. Construction shares recorded a steep increase of 97.3 percent, driven by a buoyant housing market and the pending commencement of the high-speed railway. Iron and steel shares surged by 52.1 percent, as continuously rising international steel prices contributed to the profits of local companies. Tourism stocks advanced by 31.2 percent on expectations that the restrictions on tourists from China would be further lifted. Textile, cement and ceramics, and plastics and chemicals shares also rose mainly because renminbi appreciation and the rapid growth of demand from China fuelled related shares. On the other hand, electronics and electric machinery shares rose by 14.7 percent, a much smaller rise than most traditional industrial groups. This reflected that investors were conservative on the outlook of the electronics sector and therefore shifted investment to traditional sectors. Financial shares gained 18.9 percent, as credit and debit card defaults were expected to gradually subside and the buyout of Hsinchu International Bank by Standard Chartered Bank propped up hopes of other merger and acquisition cases.

Substantial Increase in Turnover

Driven by bullish sentiment, the daily average turnover for the year increased significantly by 26.5 percent from the previous year to NT\$96.4 billion. As rising share prices prompted

individual investors, usually with high turnover rates, to engage in the market, the turnover rate for this year rose to 142.2 percent from the previous year's 131.4 percent.

Large Net Buying by Foreign Investors

Foreign investors registered a net purchase of NT\$558.1 billion in the TSE market. Local securities dealers recorded a net purchase of NT\$6.9 billion, while local securities investment trust companies showed a net sale of NT\$54.3 billion.

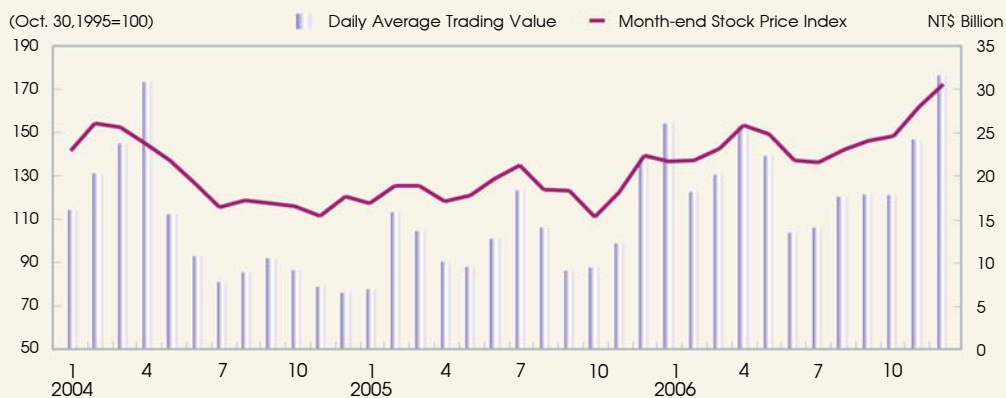
Foreign investors were attracted to Taiwan this year mainly due to the strong rally of international stock markets and the merger and acquisition possibilities of local enterprises. Local securities investment trust companies registered net sales in most of the months except June, August and December. They were pressured by investors, who remained conservative and would rush to redeem their holdings when prices went up. Local securities dealers usually engage in short-swing trading, and they often buy on rising prices and sell on falling prices to meet the hedging demand of stock warrants. Therefore, local securities dealers net sold in January, February, May and June amid gloomy market conditions, and net bought in April, August, September, November and December when the market rose. In April and November, they net bought more than 10 billions worth of stocks amid sharply rising prices.

The GTSM Market

Market Capitalization Increased Sharply

The number of listed companies in the GTSM market increased to 531 at the end of 2006,

GTSM Stock Price Index and Trading Value



Source: GTSM Monthly Review, GreTai Securities Market.

Changes in Industrial Group Stock Price Indices in the GTSM Market



Source: GTSM Monthly Review, GreTai Securities Market.

an increase of 28 companies from the previous year-end. The par value of total shares issued amounted to NT\$726.2 billion at the end of 2006, 12.9 percent higher than that of the previous year-end. Market capitalization was valued at NT\$1.9 trillion at the end of 2006, recording a steep rise of 44.7 percent when compared with the previous year-end.

Share Prices Consolidated before Rising

GTSM stock prices consolidated in the first three months of 2006 amid lackluster international stock markets and cyclical troughs of the electronic sector. In April, the GTSM stock price index swung upwards along with rising international markets and easing of cross-strait relations. From May onwards, concerns over global inflationary pressure prompted capital to retreat from Asia, tumbling regional stock markets. The GTSM index fell to an all-year low of 119.0 points on June 21. Beginning from August, rate hikes by the US Federal Reserve were ended, international capital returned to Asia, and the merger and acquisition potential among Taiwan's enterprises was heightened. The GTSM index rose all the way to an all-year high of 164 points at the year-end, a strong gain of 23.3 percent from the previous year-end.

Foreign investors recorded a net sale of NT\$5.8 billion, while local securities investment trust companies and securities dealers bought a net of NT\$11.0 billion and NT\$1.1 billion, respectively, for the year.

Sharp Increase in Turnover

The daily average turnover in the GTSM market for the year was NT\$20.7 billion, a sharp

increase of 61.7 percent from the previous year. Turnover in the first three months was suppressed by the prolonged consolidation. Daily turnover was NT\$20.1 billion in March. As the market picked up in April, the daily average turnover expanded to NT\$25.8 billion. From May onwards, turnover shrank as investors stood on the sidelines due to bearish sentiment and political unrest. Daily turnover in June declined to NT\$13.5 billion. As market sentiment turned bullish again, daily turnover for the period from August to October stayed at around NT\$17.8 billion. In the final two months, prices surged, leading daily turnover to expand to NT\$31.6 billion in December.



7. Bond Market

In 2006, new issues of bonds hit a record high of NT\$1,212.1 billion. Among them, issues of government bonds remained large, issues of asset securitization and bank debentures rapidly increased, and issues of corporate bonds continued to rise. Moreover, the Financial Supervisory Commission (FSC) endorsed Deutsche Bank Frankfurt to issue US dollar-denominated bonds, marking the first issuance of foreign currency bonds in the local market.

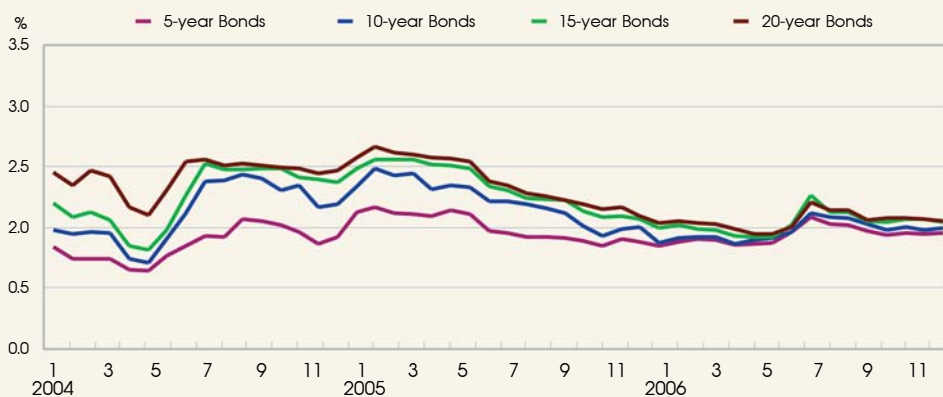
The secondary bond market remained buoyant in 2006. Meanwhile, bond yields exhibited a rising trend for the first five months and a downward trend for the rest of the year, reflecting the movements in US bond yields, the conduct of monetary policy, and local market players' strategies.

In addition, the size of domestic bond funds continued to shrink this year. It was mainly because the rates of return on domestic bonds remained low, causing money to shift from domestic bond funds to other investment instruments.

Government Bond Issues Remained Large

The Ministry of Finance (MOF) issued central government bonds to a total value of NT\$440 billion in 2006, while local governments issued a sum of NT\$20 billion. Both were slightly lower than the previous year's issues. The outstanding amount of central and local government bonds

Yield Structure of Central Government Bonds with Different Maturities



Source: Department of Economic Research, CBC.

Issues and Outstanding Values in Bond Market by Instrument

Unit: NT\$ Billion

Year/ Month	Total		Central Government Bonds		Local Government Bonds		Corporate Bonds		Bank Debentures		Foreign Bonds*		Beneficiary** Certificates	
	Issues	Outstanding	Issues	Outstanding	Issues	Outstanding	Issues	Outstanding	Issues	Outstanding	Issues	Outstanding	Issues	Outstanding
2004	1,018.2	4,947.9	465.0	2,729.2	42.0	123.4	231.4	1,215.6	218.3	709.1	10.5	126.5	52.1	62.5
2005	987.0	4,463.6	445.0	3,013.1	24.0	129.2	204.1	1,191.9	131.2	811.2	—	104.0	182.7	214.2
2006	1,212.1	5,878.5	440.0	3,239.3	20.0	137.4	230.1	1,151.4	172.5	925.9	11.7	83.2	337.8	341.3
2007/1	51.4	5,445.5	40.0	2,998.4	—	129.1	6.7	1,193.3	3.7	814.2	—	97.0	1.0	213.5
2	74.2	5,488.7	30.0	3,028.3	—	129.1	1.1	1,172.1	5.0	818.6	—	97.0	38.1	243.6
3	70.0	5,525.5	40.0	3,068.3	10.0	139.1	5.0	1,165.0	7.0	822.4	—	92.6	8.0	238.1
4	104.2	5,558.8	40.0	3,058.3	—	139.1	6.7	1,154.6	22.6	845.0	—	92.1	34.9	269.7
5	102.4	5,591.2	35.0	3,093.3	—	139.1	13.0	1,141.4	16.5	857.7	—	91.1	37.9	268.6
6	104.1	5,648.6	40.0	3,133.2	10.0	149.1	14.1	1,119.7	16.6	873.0	—	90.7	23.4	282.9
7	62.1	5,671.7	35.0	3,168.1	—	149.1	15.1	1,103.9	3.2	876.0	—	85.7	8.8	288.9
8	107.3	5,711.0	30.0	3,198.1	—	147.1	23.0	1,113.4	6.0	871.4	—	81.2	48.3	299.8
9	86.1	5,728.9	45.0	3,213.5	—	147.1	13.3	1,105.9	3.1	862.4	—	80.7	24.7	319.3
10	109.7	5,773.6	30.0	3,213.8	—	147.1	25.6	1,115.6	14.1	874.8	3.5	76.5	36.5	345.8
11	178.5	5,861.4	35.0	3,248.6	—	147.1	58.4	1,146.4	24.2	892.5	8.2	83.7	52.7	343.1
12	162.1	5,878.5	40.0	3,239.3	—	137.4	48.1	1,151.4	50.5	925.9	—	83.2	23.5	341.3

Notes : * Including NT dollar and foreign currency-denominated bonds issued in Taiwan by international financial institutions.

** Including those purchased back by originators for credit enhancement.

Sources : *Financial Statistics Monthly, CBC.*

reached NT\$3,376.7 billion at the end of 2006, an increase of 7.5 percent from the previous year-end, with the government bonds outstanding as a percentage of GDP rising from 28.2 percent in 2005 to 29.2 percent.

The MOF also issued re-opened government bonds 5 times in 2006 with different maturities, namely 5, 10 and 20 years, in order to build an effective bond yield curve and extend the

Outright and Repurchase Agreement Transactions in Bond Market

Unit: NT\$ Billion

Year/ Month	Total	Outright Transactions		Repurchase Agreement Transactions	
		Amount	Share (%)	Amount	Share (%)
2004	205,925.2	123,445.6	59.9	82,479.6	40.1
2005	319,476.5	222,174.5	69.5	97,302.0	30.5
2006	275,668.5	169,991.9	61.7	105,676.6	38.3
2006/1	27,872.1	18,930.7	67.9	8,941.4	32.1
2	24,341.2	16,411.0	67.4	7,930.2	32.6
3	30,096.4	20,272.0	67.4	9,824.4	32.6
4	22,564.3	13,628.7	60.4	8,935.6	39.6
5	18,098.2	8,753.4	48.4	9,344.8	51.6
6	21,260.6	11,961.0	56.3	9,299.6	43.7
7	22,385.0	13,520.5	60.4	8,864.5	39.6
8	24,618.8	15,535.7	63.1	9,083.1	36.9
9	22,228.0	14,223.9	64.0	8,004.1	36.0
10	20,360.4	12,367.9	60.7	7,992.5	39.3
11	22,706.4	14,131.4	62.2	8,575.0	37.8
12	19,137.1	10,255.7	53.6	8,881.4	46.4

Source: *TSE & GTSM.*

duration of benchmark bonds.

In addition, stripped government bonds were issued to a sum of NT\$65 billion in 2006, rising by NT\$25 billion from 2005. Stripped government bonds can be stripped into two separate components, coupons and face values. Both of them are zero-coupon bonds with no re-investment risk. Therefore, stripped government bonds offer greater liquidity than coupon-bearing government bonds of the same maturities and coupon rates. Besides, bondholders can enjoy 10-percent separate taxation on the returns from stripped government bonds.

Steady Increase in Corporate Bond Issues

For the year as a whole, total issues of corporate bonds were NT\$230.1 billion, a rise of 12.7 percent from 2005. Among them, the share of secured corporate bonds and unsecured corporate bonds were 6.2 percent and 93.8 percent, respectively.

New issues of corporate bonds were relatively sluggish in the first four months of 2006, as banks competed for good credit enterprises by extending loans with low interest rates. In May, due to expectations of rising interest rates, some enterprises issued corporate bonds to lock in long-term capital cost. Consequently, the corporate bond issuing market turned bullish. From June onwards, the issuance of corporate bonds further increased mainly because declining bond yields pushed the cost of issuing bonds lower than that of bank loans for large enterprises. In October, the proposed amendment to raise the 35-percent ceiling on life insurance companies' foreign investment was voted down at the Legislative Yuan, encouraging large enterprises to

Transaction Amount in Bond Market by Instrument

Unit: NT\$ Billion

Year/ Month	Total	TSE Market	Gre Tai Market						
		Corporate Bonds (Convertible)	Subtotal	Government Bonds	Corporate Bonds		Foreign Bonds	Bank Debentures	Beneficiary Certificates
					Nonconvertible	Convertible			
2004	205,925.2	4.58	205,920.6	202,015.2	2,328.5	441.1	636.1	457.2	42.5
2005	319,476.5	0.43	319,476.1	314,099.4	3,198.7	364.3	320.0	1,413.5	80.2
2006	275,668.5	0.10	275,668.4	273,496.2	960.8	450.2	108.5	518.8	133.9
2006/1	27,872.1	0.02	27,872.1	27,666.3	114.6	35.5	16.6	35.6	3.5
2	24,341.2	0.00	24,341.2	24,217.1	62.9	17.6	1.2	33.8	8.6
3	30,096.4	0.01	30,096.4	29,942.4	81.0	23.7	6.5	25.6	17.2
4	22,564.2	0.01	22,564.2	22,348.3	85.6	48.2	7.9	54.2	20.0
5	18,098.2	0.00	18,098.2	17,881.5	85.7	56.3	7.3	65.9	1.5
6	21,260.6	0.03	21,260.6	21,031.1	89.0	34.4	4.2	79.7	22.2
7	22,385.0	0.03	22,385.0	22,280.3	49.9	21.6	7.6	24.7	0.9
8	24,618.8	0.00	24,618.8	24,484.2	57.5	25.9	18.6	26.8	5.8
9	22,228.0	0.00	22,228.0	22,041.1	84.3	28.7	15.6	36.1	22.2
10	20,360.4	0.00	20,360.4	20,235.2	61.2	34.3	0.6	28.9	0.2
11	22,706.4	0.00	22,706.4	22,558.1	58.6	60.2	6.5	22.1	0.9
12	19,137.1	0.00	19,137.1	18,810.6	130.5	63.8	15.9	85.4	30.9

Source: TSE & GTSM.

increase their corporate bond issues in the following months.

Large Increase in Bank Debenture Issues

In 2006, domestic banks issued a total of NT\$172.5 billion in bank debentures, an increase of NT\$41.3 billion or 31.5 percent from the previous year. Among them, more than 85 percent were subordinated bank debentures.

In the first three months of 2006, issues of bank debentures slightly increased mainly because banks urgently wrote off their non-performing credit card and cash card loans, leading to the need to strengthen their capital structure by issuing bank debentures. From April to June, the issuance of bank debentures continued to increase mainly because Taiwan Cooperative Bank issued large amounts of bank debentures to fill up its shortage of working capital incurred from the transfer of its farmers' & fishermen's deposits to Agricultural Bank of Taiwan. However, starting from July, the issuance of bank debentures sharply decreased due to the relatively easy funding conditions in the banking system. After September, many domestic banks showed their strong needs to issue bank debentures to meet the rising demand for funds before the year-end and in response to the capital adequacy requirements of the New Basel Capital Accord to be implemented at the beginning of 2007.

Rapidly Growing Structured Bond Securitization

In 2006, the total issuance of beneficiary securities on asset-backed securitization amounted to NT\$337.8 billion. Although this amount accounted for only 27.9 percent of total bond issuance, it presented a jump of NT\$155.1 billion or 84.9 percent from that recorded in 2005. The sharp increase was mainly because some banks and securities firms securitized their holdings of structured bonds to enhance liquidity. Of the components, issues of financial asset securitization reached NT\$314.5 billion, and those of real estate securitization amounted to NT\$23.3 billion.

New Issue of Foreign Currency Denominated Bonds

To attract more foreign financial institutions to participate in Taiwan's bond market, the FSC endorsed Deutsche Bank Frankfurt to issue US dollar-denominated bonds traded on the GreTai Securities Market (GTSM) on November 1, 2006. This new bond issue was named Formosa Bonds with a sum of US\$250 million, a coupon rate of 4.85 percent, and interest payment once a year. Formosa Bonds drew many investors because of stable returns, the low minimal investment requirement of US\$10 thousand, and the tax-free advantage.

Large Transactions in the OTC Market

In 2006, bond transactions in the OTC market amounted to NT\$275.7 trillion, a decrease of 13.7 percent from 2005 and the second highest on record. Of this amount, outright transactions decreased by 23.5 percent, while repurchase agreement transactions went up by 8.6 percent. Outright transactions markedly decreased mainly because the disparity between bond yields moving downward and short-term interest rates shifting upwards narrowed the spread for arbitrage transactions.

As for the long-term trend of bond yields, for the first five months of the year, as the United States bond yields went upwards and the Bank continued to issue 364-day NCDs to recall surplus funds from the market, the yield on benchmark 10-year government bonds rose continually from 1.73 percent in January to 2.23 percent in May. From June to September, due to a slowdown in economic growth and declining bond yields in the United States, the domestic bond market turned bullish. Therefore, the yield on 10-year government bonds fell from 2.17 percent to 1.96 percent. In the final three months, although easy funding conditions fueled the demand for bonds, the Taiwan Post Co. and some insurance companies increased their bond positions, leading to a short supply of bonds in the trading market. In contrast, the FSC claimed that bond trading, which was tax-free, would be liable to a 10 percent separate tax. Affected by these factors, the yield on 10-year government bonds exhibited a narrow swing around 1.98 percent.

Portfolio Composition of Bond Funds

Unit: NT\$ Billion

Year / Month	Total	Outright Purchases		Repurchase Agreements		Bank Deposits		Short-term Securities	
		Amount	Share (%)	Amount	Share (%)	Amount	Share (%)	Amount	Share (%)
2004	1,883.3	1,015.5	53.9	562.5	29.9	258.7	13.7	46.6	2.5
2005	1,308.4	498.2	38.1	582.2	44.5	200.6	15.3	27.4	2.1
2006	1,101.5	261.0	23.7	608.5	55.2	209.2	19.0	22.8	2.1
2006/ 1	1,322.6	481.5	36.4	607.1	45.9	207.2	15.7	26.8	2.0
2	1,290.6	455.5	35.3	606.7	47.0	199.1	15.4	29.3	2.3
3	1,286.7	445.6	34.6	617.2	48.0	195.8	15.2	28.0	2.2
4	1,276.4	427.6	33.5	622.7	48.8	199.3	15.6	26.7	2.1
5	1,242.8	396.3	31.9	624.3	50.2	196.5	15.8	25.6	2.1
6	1,229.2	368.1	29.9	640.1	52.1	195.6	15.9	25.5	2.1
7	1,236.3	343.1	27.8	658.5	53.3	210.3	17.0	24.4	2.0
8	1,205.6	328.9	27.3	631.4	52.4	222.9	18.5	22.4	1.9
9	1,156.0	308.7	26.7	601.7	52.1	224.2	19.4	21.3	1.8
10	1,141.2	297.9	26.1	612.9	53.7	209.9	18.4	20.6	1.8
11	1,130.0	296.3	26.2	607.4	53.8	203.8	18.0	22.5	2.0
12	1,101.5	261.0	23.7	608.5	55.2	209.2	19.0	22.8	2.1

Source: Securities Investment Trust & Consulting Association of the R.O.C.

Continuous Shrinkage in Net Assets of Bond Funds

Since early 2006, the FSC had actively promoted the transformation of bond funds. Securities investment trust firms were required to progressively adjust the portfolios of existing bond funds so that bond funds would be transformed into quasi money market funds or fixed income funds by the end of 2006. At the end of the year, more than 90 percent of domestic bond funds have been transformed into quasi money market funds.

With respect to portfolio allocation, local bond funds mainly invested in outright purchases of corporate bonds, repurchase agreements of government bonds, bank time deposits and purchases of money market instruments. At the end of 2005, their portfolio allocation ratios were 38.1 percent, 44.5 percent, 15.3 percent and 2.1 percent, respectively. During 2006, in line with the FSC's bond fund transformation measures, securities investment trust firms progressively adjusted the portfolios of bond funds. At the end of 2006, the above ratios became 23.7 percent, 55.2 percent, 19.0 percent and 2.1 percent, respectively.

Meanwhile, the rates of return on domestic bond funds became lower than most other investment instruments as bond yields exhibited a downward trend. As a result, the net assets of domestic bond funds fell by NT\$206.9 billion to NT\$1,101.5 billion at the end of 2006 from the previous year-end.



III. Central Bank Operations

1. Overview



In accordance with the Central Bank of the Republic of China Act, the Bank has four operational objectives, namely, to promote financial stability, to guide sound banking operations, to maintain the stability of the internal and external value of the currency and, within the scope of the above-mentioned objectives, to foster economic development. The Board of Directors, consisting of fifteen members, is the highest decision making

body of the Bank. It holds regular meetings four times a year.

In the context of solid economic growth, subdued inflation and low real interest rates, the Bank fine-tuned monetary policy by raising the discount rate by 12.5 basis points at each of its board meetings in 2006. At the end of the year, the Bank's three policy rates stood at 2.75 percent, 3.125 percent and 5.0 percent, respectively, which were 50 basis points higher than the previous year-end. Market rates were also gradually guided upwards. M2 grew at a pace with rate of 6.22 percent, staying within the Bank's 3.5 to 7.5 percent target zone.

The Bank also closely monitored the demand and supply conditions in the foreign exchange market. In 2006, the effect of current account surplus on the NT dollar exchange rate was largely reduced by capital outflows. As a result, the NT dollar was mostly stable, closing at 32.596 against the US dollar at the year-end, a slight appreciation of 0.78 percent.

In regard to institutional reforms, the Bank continued to promote the transparency of the loan pricing mechanism. From January 2006 onwards, financial institutions are required to link prime rates to their base rates, which are posted to the public. In addition, the Bank proceeded with its progressive pace in financial liberalization and internationalization. New financial products were introduced to the market, cross-border capital movements were further facilitated,

and local financial institutions were allowed to extend NT dollar loans to non-resident foreigners. Moreover, cross-Strait remittances grew substantially in recent years, further promoting the OBUs' role as a funding center for Taiwanese businesses operating overseas.

As for the payment systems, the Bank not only effectively prevented counterfeit money, but began incorporating funds transfers involving stocks and bonds transactions into the Bank's Interbank Fund-Transfers Settlements System to enhance settlement efficiency in capital markets. At the end of the year, the relevant information systems were nearly established. During the year, the Bank issued the commemorative coin sets as usual, including the Chinese Zodiac Year of the Dog and the Taiwan Indigenous Peoples Cultural Series-SAISYAT. The Taiwan High Speed Rail Commemorative Silver Coin was also issued to celebrate the remarkable achievement in Taiwan's transportation history.



2. Monetary Management

In 2006, the Bank's monetary management focused on continuing the gradual pace of policy tightening, reforming bank loan pricing system and enhancing the SME financing mechanism.

Continuing the Gradual Pace of Policy Tightening

Taiwan's economy benefited from the respectable global growth in 2006, although domestic demand moderated. The labor market improved for the fourth year in a row. Capacity utilization rates also remained high. Due to moderate domestic demand and high-base effect on fruit and vegetable prices, CPI inflation was tame at 0.6 percent for the year. Nevertheless, high raw material prices pushed up wholesale prices, which may gradually feed into general price level. At the same time, both short-term and long-term interest rates continued to remain at low levels. Against the backdrop, the Board of the Bank judged that the fine-tuning of the policy rates would safeguard price stability, foster efficient fund allocation, and promote long-term financial stability. The discount rate, the interest rate on accommodations with collateral and the interest rate on accommodations without collateral were raised by 12.5 basis points, respectively, at each of the Bank's board meetings of the year.

In the recent rate-hiking cycle since October 2004, the Bank has raised its policy rates ten times for a total increase of 137.5 basis points. At the end of the year, the three policy rates stood at 2.75 percent, 3.125 percent and 5.0 percent, respectively. The Bank believed that the moderate rate rise would not affect domestic economic activity and would only cause a

Central Bank Interest Rates

Unit: %

Effective Date	Discount Rate	Accommodation Rate with Collateral	Accommodation Rate without Collateral
2003 / June 27	1.375	1.750	3.625
2004 / Oct. 1	1.625	2.000	3.875
Dec. 31	1.750	2.125	4.000
2005 / Mar. 25	1.875	2.250	4.125
July 1	2.000	2.375	4.250
Sept. 16	2.125	2.500	4.375
Dec. 23	2.250	2.625	4.500
2006 / Mar. 31	2.375	2.750	4.625
June 30	2.500	2.875	4.750
Sept. 29	2.625	3.000	4.875
Dec. 29	2.750	3.125	5.000

Source: *Financial Statistics Monthly*, CBC.

limited increase in borrowing costs for businesses. The banking sector still has large liquidity to meet the demand for funds.

Liquidity-Absorbing Open Market Operations

The Bank mainly uses open market operations to absorb liquidity. Certificates of deposit (CDs) issued by the Bank remain the primary instrument to manage banks' day-to-day reserves. Its interest rates also play an important role in guiding market rates when issued on a fixed-rate basis. In 2006, as net foreign capital inflows were mostly offset by the surge in outward portfolio investments by domestic investors, liquidity in the banking system was not accumulated as rapidly as in previous years. However, the level of excess liquidity remained high due to weak demand for funds in the private sector. In order to lock in more longer-term funds with the Bank, the Bank resumed to issue one-year CDs through an interest rate based auction in February 2006, in addition to the issues of short-term CDs with maturities ranging from 30 days to 182 days. At the end of the year, the total outstanding amount of CDs issued by the Bank was NT\$3,756 billion, higher than a year earlier.

In addition, foreign exchange swaps with banks were also used continuously to reduce excess liquidity. At the end of the year, its outstanding balance decreased from the previous year, mainly because the needs for hedge by insurance companies declined. In regard to

Open Market Operations

Unit: NT\$ Billion

Year/ Month	Amount Absorbed*	Amount Offered*	Outstanding Amounts**	Weighted Average Rates on CDs Issued				
	Issues of CDs	Redemptions of CDs	CDs Issued	1-30 days	31-91 days	92-182 days	274-364 days	2 years
2004	12,741	12,171	3,563	1.08	1.15	1.09	1.23	1.30
2005	20,007	20,049	3,521	1.29	1.34	1.44	—	—
2006	13,525	13,290	3,756	1.55	1.63	1.69	1.84	—
2006 / 1	2,116	2,282	3,355	1.45	1.52	1.60	—	—
2	860	656	3,559	1.45	1.52	1.60	1.70	—
3	982	977	3,564	1.45	1.55	1.64	1.72	—
4	1,730	1,604	3,690	1.52	1.59	1.67	1.77	—
5	604	706	3,588	1.52	1.59	1.67	—	—
6	596	728	3,456	1.54	1.65	1.74	1.89	—
7	1,795	1,692	3,559	1.59	1.66	1.74	1.91	—
8	980	985	3,554	1.59	1.66	1.74	1.88	—
9	714	716	3,552	1.60	1.68	1.74	1.84	—
10	1,715	1,665	3,602	1.66	1.73	1.74	1.85	—
11	793	763	3,632	1.66	1.73	1.81	1.85	—
12	640	516	3,756	1.66	1.74	1.81	1.87	—

Note: * Data in 2004 included NT\$618 billion repurchase agreements traded in open market operations.

** End-of-period data.

Source: *Financial Statistics Monthly*, CBC.

fund-supplying operations, the Bank did not arrange any repos during the year given the large liquidity in the market.

To guide market interest rates upwards, the Bank continued to use non-competitive bidding rate on each CD issuance with maturities ranging from 30 days to 182 days. Following the adjustment of the discount rate, the Bank also announced its non-competitive bidding rates for new CD issuance. In 2006, the 30-day CD rate was moved up by 24 basis points to 1.69 percent at the end of the year, leading the overnight call-loan rate to rise from 1.46 percent early in the year to 1.69 percent at the year-end.

Non-Competitive Bidding Rates on CDs Issued by the Central Bank

Effective Date	Unit: %			
	30 Days	91 Days	182 Days	364* Days
2004 / Oct. 01	1.150	1.170	1.200	–
Oct. 11	1.150	1.170	1.200	1.225
Dec. 31	1.210	1.240	1.280	–
2005 / Mar. 25	1.270	1.310	1.360	–
July 01	1.330	1.380	1.440	–
Sept. 16	1.390	1.450	1.520	–
Dec. 23	1.450	1.520	1.600	–
2006 / Mar. 21	1.520	1.590	1.670	–
June 30	1.590	1.660	1.740	–
Sept. 29	1.660	1.730	1.810	–
Dec. 29	1.690	1.760	1.840	–

Note: * The auction rates on 364-day CDs were not shown on this table.
Source: Press Releases on Open Market Operations, CBC.

Decreasing Redeposits from Financial Institutions

Accepting redeposits from Taiwan Post Co. and commercial banks is another instrument for the Bank to promote financial stability and to influence banks' reserve positions. However, it's not used as frequently as open market operations. At the end of 2006, outstanding postal savings redeposits increased from NT\$1,417 billion at the end of 2005 to NT\$1,487 billion. At the same time, banks' redeposits was down from NT\$428 billion to NT\$ 328 billion as part of the redeposits was shifted to the Bank's CDs.

In addition, the three domestic agricultural banks, namely the Taiwan Cooperative Bank, the Land Bank of Taiwan and the Agricultural Bank of Taiwan are allowed to accept deposits from community financial institutions and make redeposits with the Bank. At the end of the year, their outstanding redeposits decreased to NT\$136 billion, compared to NT\$159 billion in 2005.

Continuing to Promote Preferential Loans

To help boost the real estate market and relieve the mortgage burden of home buyers, the Bank, the Ministry of Finance and the Ministry of the Interior jointly initiated a preferential mortgage loan program in August 2000. After expanding this program 6 times since its inauguration, the total amount of the mortgage loans was thus increased to NT\$1,800 billion. By the end of 2006, a total of 862,361 households had obtained an amount of NT\$2,645.3 billion under this program. The amount included NT\$994 billion in parallel lending by banks applying ordinary interest rates. Having approved by the Executive Yuan, this program will end until the funds are used up -- as opposed to the original deadline of September 2006.

The Bank also continued to provide subsidies to victims of the earthquake in 1999 for interest payments on their mortgage loans. By the end of 2006, a total of NT\$66.7 billion worth of loans had been approved for 34,619 housing units under this program.

Reforming Bank Loan Pricing System

Since 2002, the Bank has encouraged the adoption of adjustable rate mortgages and flexible base rates pricing system to substitute the downwardly-rigid prime rates for new loans, allowing lending rates more sensitive to market conditions and loan pricing more transparent. At the same time, banks were also urged to apply this new pricing system to their existing loans. As of the end of 2006, loans extended by domestic banks still using the prime rates pricing mechanism accounted for merely 0.96 percent of total loans.

To ensure that the new pricing system is implemented thoroughly, as requested by the Bank, the Banker Association of the Republic of China (Taiwan) requires banks to link prime rates to their base rates. At the same time, the Bank conducted target examination on banks' new pricing practice to carry out the reform.

Enhancing the SME Financing Mechanism

To provide easier access to financing for small- and medium-sized enterprises (SMEs), the Bank continued to promote the two-track guarantee system to help SMEs in obtaining loans. In addition, since June 2003, the Bank has monitored banks' performance on SME financing on a monthly basis to encourage banks to extend loans to SMEs. At the end of 2006, the outstanding guarantees and loans extended to SMEs by domestic banks were NT\$381 billion and NT\$2,097 billion, showing an increase of NT\$155 billion and NT\$ 638 billion, respectively, as compared with the end of May 2003.

3. Foreign Exchange Management

In addition to regular foreign exchange market management and reserve management, the Bank continued to approve more banks to conduct foreign exchange business and to allow authorized foreign exchange banks to introduce more financial products to the market, and further deregulated capital movement in 2006.

Foreign Exchange Market Management

The NT dollar exchange rate regime is a managed float, where in principle the exchange rate is determined by supply and demand in the foreign exchange market. However, if the market is interrupted by seasonal or abnormal factors (e.g. large flows of hot money), causing excessive exchange rate fluctuations not reflecting Taiwan's economic fundamentals, the Bank may step in to maintain an orderly foreign exchange market.

To monitor the market activities, the Bank continued to implement the Real-Time Reporting System for Large-Amount Foreign Exchange Transactions. In addition, the requirement that forward transactions should be made only upon real transactions, such as trade and financing, was reinforced in order to curb foreign exchange speculation. The Bank also urged banks to enhance their foreign exchange risk management so as to lower individual bank's risk exposure and systemic risk. Moreover, the Bank increased target examinations to maintain an orderly foreign exchange market.

During 2006, various foreign and domestic factors affected the NT\$/US\$ exchange rate. However, the exchange rate still reflected Taiwan's fundamentals, thus maintained its dynamic stability. It fluctuated between 31.338 and 33.316 during 2006, closing the year at 32.596, up 0.78 percent from 32.850 from 32.850 at the end of 2005.

Enlargement of Foreign Exchange Market

To enlarge the foreign exchange market, the Bank approved another 33 branches of local banks to conduct full-fledged foreign exchange business and another 92 branches to conduct limited business of buying/selling foreign currencies and traveler's checks in 2006. By the end of 2006, there were 1,152 authorized foreign exchange banks, which included 69 foreign banks, and 39 domestic bank headquarters and their 1,050 branches.

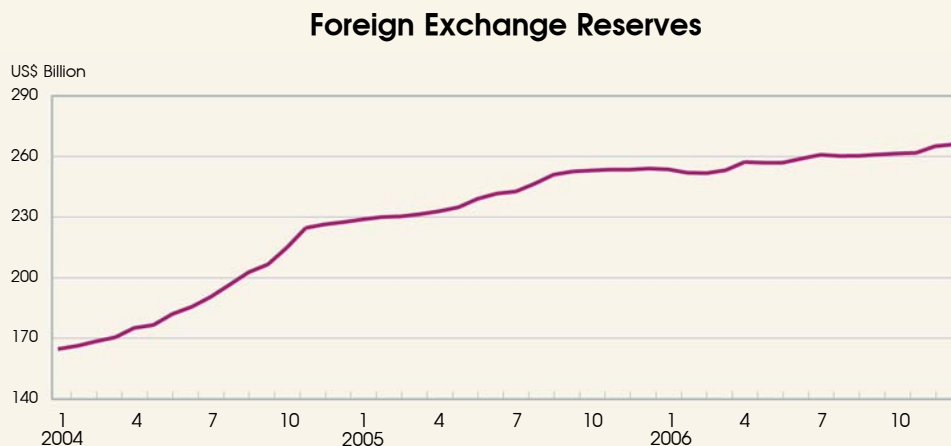
The Bank continuously approved new financial products in 2006. The newly approved financial products were as follows: (1) NTD time deposits linked to the hedge-fund index dbX-Harmony II using the CPPI (Constant Proportion Portfolio Insurance) strategy; (2) new and structured foreign exchange credit derivative financial products, such as basket default swaps, first-to-default swaps, n-to-default swaps, and structured basket default swaps; (3) new business such as NTD denominated ABN AMRO CQII fund index swap business and NTD time deposit linked to NTD denominated ABN AMRO CQII fund index. The introduction of these new derivative products provides local firms with more hedging instruments. For the year 2006, banks introduced 38 new financial products upon the approval of the Bank.

Due to the increases in market participants and diversity of financial products, the daily average transaction amount of the Taipei foreign exchange market further increased to US \$15.655 billion in 2006, 29.66% higher than US\$12.074 billion of the previous year.

In order to provide banks with sufficient foreign exchange liquidity to meet corporate funding needs, the Bank continued to carry out foreign currency swap transactions with banks and extend foreign currency call loans to banks. During 2006, foreign currency call loan transactions reached US\$1,240 billion, while foreign currency-NT dollar swap transactions reached US\$242 billion. The year-end balance for swap transactions was US\$44 billion.

Steady Growth of Foreign Exchange Reserves

In 2006, the Bank's foreign exchange receipts amounted to US\$712.4 billion, while foreign exchange expenditure was US\$699.5 billion. At the end of 2006, total foreign exchange reserves



Source: Department of Foreign Exchange, the CBC.

amounted to US\$266.1 billion, a US\$12.9 billion increase from the end of 2005. The increase in foreign exchange reserves was mainly attributed to a current account surplus, foreign capital inflows and the return on investment of foreign exchange reserves.

Deregulation on Capital Flow Management

With the progress of financial liberalization and internationalization, the Bank continued to deregulate capital movements. In general, capital can flow freely in and out Taiwan. As of 2006, restrictions only remained on a few short-term financial transactions involving the conversion of the NT dollar. For example, each domestic company and a resident could conduct inward and outward remittances up to US\$50 million and US\$5 million annually, respectively. Nonresidents could remit up to US\$100 thousand per transaction. For remittances exceeding the respective ceilings, applications could be made through authorized foreign exchange banks upon the approval from the Bank.

Key deregulation measures with regard to the management of capital flows in 2006 included:

- (1) In November, the Bank and the Financial Supervisory Commission (FSC) approved the guidelines proposed by Bankers Association of the Republic of China to allow non-resident foreigners to take up NTD loans from local banks.
- (2) In order to loosen the restrictions on foreign investments in domestic securities, the Bank agreed with the following measures: (i) effective February 24, foreign investors were allowed to invest in warrants underwritten before an Initial Public Offering; (ii) effective March 27, foreign investors were allowed to engage in non-hedging futures trading and to introduce USD-denominated futures products; (iii) effective March 27, transaction amount of foreigners' trading on futures and options was no longer limited by 30% of total inward remittances; (iv) effective May 16, foreign investors were allowed to invest in securities investment trust funds privately placed by securities investment trust enterprises; (v) effective August 16, foreign investors were allowed to invest in foreign currency-denominated international bonds; (vi) effective August 18, foreign investors were allowed to borrow securities from domestic security firms.
- (3) In order to promote the internationalization of the domestic capital market, the Bank agreed with the following measures: (i) enterprises were allowed to issue overseas securities for fund raising. In 2006, 7 corporations issued overseas depository receipts amounting to US\$3.15 billion; 16 corporations issued convertible bonds amounting to

USD\$4.98 billion; (ii) Deutsch Bank and Bank of Paris were allowed to issue USD-denominated international bond worth 0.2 billion and Australian dollar-denominated international bond worth 0.5 billion, respectively.

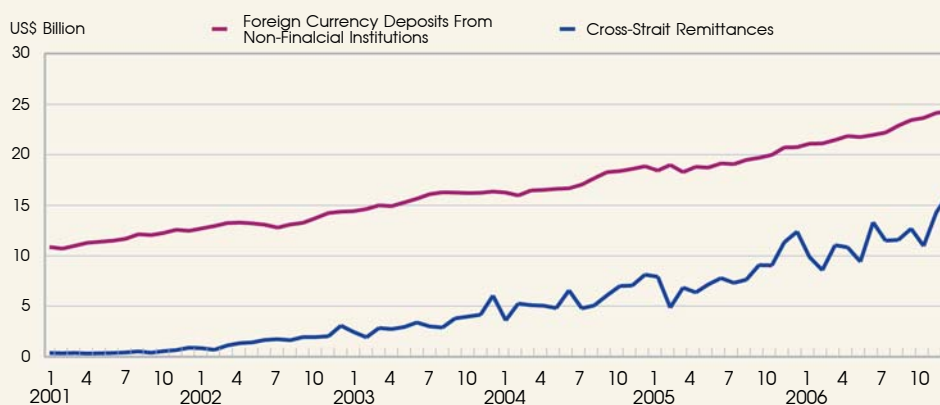
- (4) The Bank agreed with the following applications on overseas securities investment: (i) securities investment trust enterprises were allowed to issue 87 securities investment trust funds to invest in foreign securities amounting to NT\$610 billion; (ii) 13 insurance companies were allowed to invest in foreign securities through direct remittances, swaps or cross currency swaps amounting to US\$6.9 billion; (iii) 5 insurance companies were allowed to invest in foreign securities through specified pecuniary trusts amounting to US\$1.4 billion; (iv) 10 commercial banks were allowed to invest in foreign securities through managed accounts amounting to US\$0.7 billion.
- (5) In order to facilitate capital movement, the Bank revised the Regulation Governing the Declaration of Foreign Exchange Receipts and Disbursement and Transactions with the following changes: (i) to develop the domestic foreign currency-denominated futures market, and to allow foreign investors to engage in non-hedging futures transactions, the above regulation was revised on March 27. Several agencies were allowed to conduct remittance business: (a) the Futures Exchange may handle exchange settlement for their members; (b) Futures enterprises may handle exchange settlement for local residents when fulfilling the margin requirement for futures trading; (c) Futures enterprises for foreigners may engage in foreign currency-denominated futures trading; and (d) Managed Futures Enterprises can discretionarily engage in futures trading or foreign currency-denominated margin transactions for trustors; (ii) to relax remittance restrictions, the above regulation was again revised on July 7 with the following measures: (a) the margin for foreign currency-denominated futures was not counted toward the accumulated remittance amount of the futures merchant or the trustor for the current year; (b) remittance made by the domestic charity or public welfare public body for international humanity assistance was not counted toward the yearly accumulated remittance amount; (c) juridical person or public body were allowed to remit to China for tourist purpose.
- (6) In order to simplify the Renminbi exchange business of banks located in Kinmen and Matsu and to monitor the relevant information, on May 15 the Bank revised the Regulation Governing the Purchase or Sale of Renminbi Bills Managed by Banks Located in Kinmen

and Matsu, including the permission for banks to establish new exchange offices and to entrust other organizations to manage renminbi exchange business, the permission for travel agencies to remit for customers, the requirement for filing the trading information, and the rule for reporting the trading information during weekends and holidays. Up to the end of 2006, banks in Kinmen and Matsu in total purchased Renminbi 30.16 million dollars and sold Renminbi 197.95 million dollars.

Development of Offshore Banking Business

Offshore banking units (OBUs) of local banks have been in operation since December 1983 to stimulate Taiwan's international financial activities and to establish Taiwan as a financial center in Asia. Since June 2001, OBUs have been allowed to conduct cross Taiwan-strait financial business, and their business has been growing rapidly. At the end of 2006, foreign currency deposits from non-financial institutions totaled US\$24.23 billion, a US\$12.78 billion or 11.63% increase from June 2001, while cross Taiwan-strait remittances increased to US\$16.11 billion, a US\$15.76 billion or 4547.52% increase during the same period. This rapid growth of cross-strait remittances helped promote OBUs as the funding center for Taiwanese business operating overseas.

Non-Financial Institution Deposits and Cross-Strait Remittance through OBU



Source: Department of Foreign Exchange, CBC

4. Banking Supervision

To ensure the sound operations of financial institutions and maintain the stability of the financial system, the Bank conducted banking supervision in accordance with the mandate endowed by the Central Bank of the Republic of China (Taiwan) Act. The Bank also actively planned to establish a framework to evaluate financial stability, including the establishment of financial soundness indicators and other financial stability indicators to systematically monitor, analyze, and evaluate the possible sources of financial system risks in order to adopt appropriate policies with the objective of financial stability.

Implementing On-Site Examinations

According to the mandate endowed by the Central Bank of the Republic of China (Taiwan) Act, the Bank only conducted target examinations related to monetary, credit, and foreign exchange policies, and payment systems when necessary.

Monitoring the Compliance with the Examination Opinions

Focusing the Bank's examination opinion and the Financial Supervisory Commission's examination opinion involving the Bank's business or regulations, the Bank monitored the improvement of the examined financial institutions, punished the misbehaving institutions according to the law when necessary, and urged the financial institutions to actually improve related deficiencies, to make the Bank's policy implementation successful.

Enhancing Offsite Monitoring

Based on the periodical reports submitted by financial institutions, the Bank assessed the operations, financial conditions and regulatory compliance of individual financial institutions by utilizing the report auditing system. The Bank then compiled analysis on various business practices and other information to serve as a reference for relevant supervisory agencies.

Establishing a Framework to Evaluate Financial Stability

The Bank referred to the IMF guidelines for compiling financial soundness indicators to draw up the Financial Soundness Indicators Reporting Items and Explanations for domestic banks and to establish related databank, thus forming the basis of financial stability evaluation.

With the databank, the Bank can regularly draw up financial soundness indicators for

domestic banks and non-bank financial institutions, can study and present depository institution management status and exposure analysis reports, thus gradually establishing the evaluation framework of Taiwan's financial stability.

Monitoring Mismanged Financial Institutions

The Bank closely monitored mismanged financial institutions and collected the information for the Bank's policy decisions. Moreover, the information was forwarded to relevant competent authorities in order to adopt prompt corrective actions.

Other Important Measures

Other important measures included: (i) The Bank supported the Financial Supervisory Commission to establish a single reporting window for financial supervisory information of domestic banks, foreign banks, and bills finance companies. (ii) The auditing system for the financial statements of insurance companies, securities firms, and futures firms was established.

(iii) The Bank continued to urge financial institutions to use the currency sorters and processors in an aim to take counterfeit bills out of circulation.



5. Payment and Settlement Systems

Taiwan's payment systems mainly include the Check Clearing House System, the Interbank Remittance System (IRS), the CBC Interbank Fund-transfers Settlement System (CIFS) and the Central Government Securities Settlement System (CGSS). Among them, the Check Clearing House System and the IRS are retail payment systems, while the CIFS and the CGSS are the two main subsystems under the CBC wire. All these payment systems make use of banks' reserve accounts A held with the Bank for final settlement.

Decreasing Funds Transfers by the CIFS

The CIFS launched in May 1995 is an on-line, large-value funds transfer system. Since September 2002, the system has been operated in a real-time gross settlement (RTGS) basis. For those who maintain transaction accounts with the Bank, they may directly use the CIFS to transfer funds. Payment instructions are also sent over the CIFS for settling obligations on check clearing, adjusting reserve account balances, or making payments associated with interbank loans, bill transactions, and bond transactions. At the end of 2006, participants of the CIFS included 79 banks, 3 investment and trust companies, 14 bills finance companies and Taiwan Post Co.

For the year of 2006, the total value of funds transferred by the CIFS fell to NT\$244,683 billion from NT\$246,279 billion in 2005 due to the declining turnover of bonds and the Bank's CDs. In contrast, its annual trading volume increased from 794 thousand to 817 thousand.

In Taiwan, the infrastructure for securities trading has been fairly segmented. The Taiwan Securities Central Depository Co., Ltd. (TSCD) engaged itself in providing central custody, book entry as well as clearing and settlement services for equity and fixed income securities traded on the Taiwan Stock Exchange (TSE) and the GreTai Securities Market (GTSM), while the Debt Instruments Depository and Clearing Co., Ltd. Taiwan (DIDC) undertook the same business functions for short-term bills exchange in money market. The Bank conducted book-entry operation for central government bond issuances and transactions.

In order to promote greater efficiency in securities clearing and settlement system and to facilitate funds arrangement, the Bank has planned to use central bank money in the clearing and settlement of stocks and debt securities in recent years. With the help of the Bank, the

Bills Depository and Clearing System run by DIDC was set up in April 2004. The system has been linked with the Bank's CIFS at its inception. Transactions of bills in a book-entry form have also been processed on a delivery-versus-payment (DVP) basis.

Effective on March 27, 2006, directed by the Bank and the Financial Supervisory Commission, DIDC merged into TSCD to form the Taiwan Depository & Clearing Corporation (TDCC). To enhance the settlement efficiency in capital markets, the Bank thus planned on incorporating funds settlement systems for shares and debt securities engaged by former TSCD into the CIFS. By the end of the year, information infrastructure for such operations has been set up. Together with the Bills Depository and Clearing System as well as the CGSS, these three central depository and clearing systems will contribute to the smooth operation of the financial system in Taiwan.

Shrinking Transactions by the CGSS

Established in September 1997, the CGSS is a real-time gross settlement system for the issuance, transfer, redemption, and interest payment of book-entry central government securities. Since its inception, central government bonds have been issued in the book-entry form. In October 2001, Treasury bills were added to the system and have been issued in the book-entry form since then.

Due to the sharp fall in turnover of bonds, transactions through the System decreased in 2006. A total of 1,173 thousand transfers with a value NT\$80,076 billion were processed by the system, compared to 1,202 thousand transfers with a total value of NT\$85,278 billion recorded in 2005.

Currently, the book-entry transactions of central government securities within a clearing bank can be made on a DVP basis while those between clearing banks cannot. To reduce the settlement risk in interbank transactions, the Bank plans to link the CGSS with the CIFS to allow clearing banks to handle these settlements on a DVP basis as well. The project is currently under development and is expected to be completed in 2007.

Declining Check Clearing by the Clearing House System

The Taiwan Clearing House (TCH) is responsible for the operation of the Check Clearing House System. The system handles the clearing and settlement of checks, promissory notes, and drafts among banks. Participants of the system include banks, credit co-operative associations, as well as credit departments of farmers' and fishermen's associations. All financial institutions in Taiwan using these facilities should hold reserve accounts at the Bank. The Bank

also participates in this System.

Both the volume and value processed by this System have been decreasing over the past few years mainly due to the growth of interbank remittance transactions. In 2006, checks and bills settled by the system amounted to NT\$23,879 billion, slightly lower than 2005. The annual clearing volume also decreased from 154,538 thousand to 149,200 thousand.

Increasing Transactions through the Interbank Remittance System

The Interbank Remittance System, launched in August 1987 and operated by the Financial Information Service Co., Ltd (FISC), is the largest retail electronic payment system in the country. This system provides remittance services to the general public, government agencies, and banks.

Credit cards and ATM (automatic teller machine) cards are the most popular payment cards in the country. The interbank settlements of credit card transactions between card-issuing banks and retail merchant's banks are mostly made by the FISC. The CD/ATM (cash dispenser/ automatic teller machine) System, which provides 24-hour cross-bank withdrawal, balance inquiry, funds transfer, credit card cash advance, and IC card loading services, is also operated by the FISC. All the participants in the IRS can join the system. In addition, the FISC handles funds transfers for on-batch payments, debit cards, electronic and mobile banking, etc.

In 2006, the FISC handled a total value of NT\$111,853 billion in funds transactions, a moderate increase of 4.4 percent from the previous year. However, the number of transactions fell from 409,193 thousand to 395,863 thousand.

Transactions of Payment Systems

Year	CBC Interbank Funds Transfer System		Central Government Securities Settlement System		TCH Check Clearing System		FISC Interbank Remittance System	
	Volume (thousand)	Value (NT\$ billion)	Volume (thousand)	Value (NT\$ billion)	Volume (thousand)	Value (NT\$ billion)	Volume (thousand)	Value (NT\$ billion)
1997	310	112,022	20	1,055	170,950	54,957	185,770	58,232
1998	379	129,513	510	17,048	171,959	53,492	215,660	63,097
1999	389	118,166	765	24,342	170,228	41,489	249,160	65,361
2000	435	134,376	1,340	46,858	175,019	40,835	292,370	79,698
2001	466	141,078	1,814	79,669	171,509	37,975	313,370	76,545
2002	443	153,467	1,446	76,368	162,791	31,985	342,230	85,245
2003	447	160,729	1,345	81,464	158,345	28,228	371,114	89,777
2004	630	193,662	1,186	75,822	159,635	26,597	396,169	104,566
2005	794	246,279	1,202	85,278	154,538	23,961	409,193	107,166
2006	817	244,683	1,173	80,076	149,200	23,879	395,863	111,853

Source: Financial Statistics Monthly, CBC.

6. Issuance of Currency

The Bank is responsible for planning and producing banknotes and coins. The volume of currency issued is mainly determined by the demand of the public, which is associated with the rate of economic growth, seasonal factors, and the development of noncash payments. The Bank closely monitors demand fluctuation. During the year 2006, the currency issued peaked at NT\$1,319 billion on January 27, the day before the Chinese Lunar New Year holidays, reflecting a temporary seasonal surge in cash demand. At the end of 2006, the outstanding amount of the currency issued increased by NT\$36.9 billion or 4.0 percent to NT\$959.8 billion, lower than the previous year's NT\$66 billion or 7.7 percent. The slower growth of currency issued mirrored the weakness of private consumption caused by credit card defaults. The NT \$1,000 note still accounted for the lion's share, or 84.47 percent, of the total value of banknotes issued, followed by the NT\$100 note with a share of 6.09 percent at year-end 2006.

Because of innovations in payment instruments, the use of payment cards such as charge cards, debit cards, and credit cards became increasingly popular and the use of cash consequentially declined since the mid-1990s. The ratio of currency in circulation to nominal GDP dropped from 7.50 percent in 1994 to as low as 5.43 percent in 2002. Thereafter, because of the increased willingness to hold cash as interest rates continually trended lower and the improved convenience of cash withdraw due to increased ATM access, the ratio of currency in circulation to nominal GDP increased to 6.24 percent in 2004. However, from the fourth quarter of 2005 onwards, currency demand for transaction purposes decreased as credit card

Currency Issued



Source: Department of Issuing, CBC.

Composition of NT Dollar Banknotes Issued (Year-end figure)

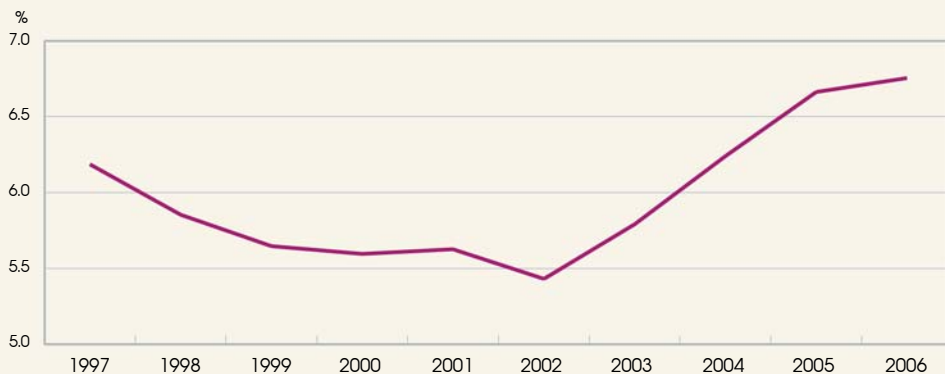


Source: Department of Issuing, CBC.

defaults weakened private consumption. In 2006, the ratio of currency in circulation to nominal GDP slightly rose to 6.75 percent, 0.09 of a percentage point higher than the year before.

During the year of 2006, the Bank issued a Commemorative Coin Set for the Chinese Zodiac Year of the Dog, the 9th coin set of the Taiwan Indigenous Peoples Cultural Series, and the Commemorative Silver Coin for Taiwan High Speed Rail, which started operating on January 5, 2007.

The Ratio of Currency Held by the Public to GDP



Source: Department of Issuing, CBC.

7. Fiscal Agency Functions

The Bank serves as the fiscal agent of the government. It manages the Treasury Deposit Account (TDA), and central governmental agencies deposit accounts. It also undertakes the issuance and redemption of central government bonds and treasury bills.

Managing the Treasury Deposit Account

The Bank acts as the government's bank and manages the TDA on behalf of the MOF. All receipts and disbursements of the central government are made through this account. The Bank delegates the handling of treasury transactions to 14 financial institutions and their 349 branches, including 5 overseas branches. There are another 4,474 revenue agent banks over the country, offering services to government entities and the general public. In 2006, the Bank received a total of NT\$2,494.4 billion worth of treasury deposits, a decrease of NT\$195.4 billion or 7.26 percent over the previous year. Payments made for the Treasury were NT\$2,526.5 billion, a decrease of NT\$141.2 billion or 5.29 percent. The outstanding balance in the TDA was NT\$40.9 billion, a decrease of NT\$32.3 billion or 44.13 percent from a year earlier.

Handling Central Government Agencies Deposits

Central government agencies are required to deposit their money with the Bank or other delegated banks subject to the approval of the MOF. However, the delegated banks are required by law to redeposit a certain percentage of the deposits with the Bank, except those in interest-bearing accounts. At the end of 2006, the balances of central government agencies' deposits with the Bank amounted to NT\$144.3 billion, an increase of NT\$15.5 billion or 12.03 percent over the previous year. Deposits with delegated banks were NT\$425.9 billion, declining by NT\$2.7 billion or 0.63 percent. Re-deposits registered only NT\$19.4 billion, decreasing by NT\$1.4 billion or 6.73 percent from a year earlier.

Managing Central Government Bonds

As a fiscal agent, the Bank, on behalf of the MOF, provides services related to the issuance, buyback, registration, redemption, and interest payment of central government bonds. The Bank also arranges auctions of central government bonds. There were 71 domestic dealers qualified to submit tenders to the Bank in the auctions. In 2006, the Bank arranged 12 issues of book-entry central government bonds with a total amount of NT\$440 billion. The weighted

average yields of successful bids for these 12 issues ranged from 1.720 percent to 2.131 percent per annum. In addition, the Bank paid a total of NT\$213.8 billion in principal and NT\$119.4 billion in interest payments for central government bonds during the year 2006. At the end of 2006, the outstanding amount of central government bonds was NT\$3,239.3 billion, an increase of NT\$226.3 billion or 7.51 percent from the previous year-end, and of which 99.76 percent were in book-entry form.

Managing Treasury Bills

Treasury bills are sold at discounts through auctions. Participants are limited to institutions such as banks, investment trusts, insurance companies, bills finance companies, and the Taiwan Post Co. In 2006, the Bank arranged 2 issues of book-entry treasury bills with a total amount of NT\$45 billion. The weighted average yields of successful bids for these 2 issues were 1.517 percent and 1.715 percent, respectively. The outstanding amount of treasury bills at year-end 2006 was NT\$25 billion, representing a decrease of NT\$20 billion or 44.44 percent from the previous year-end.

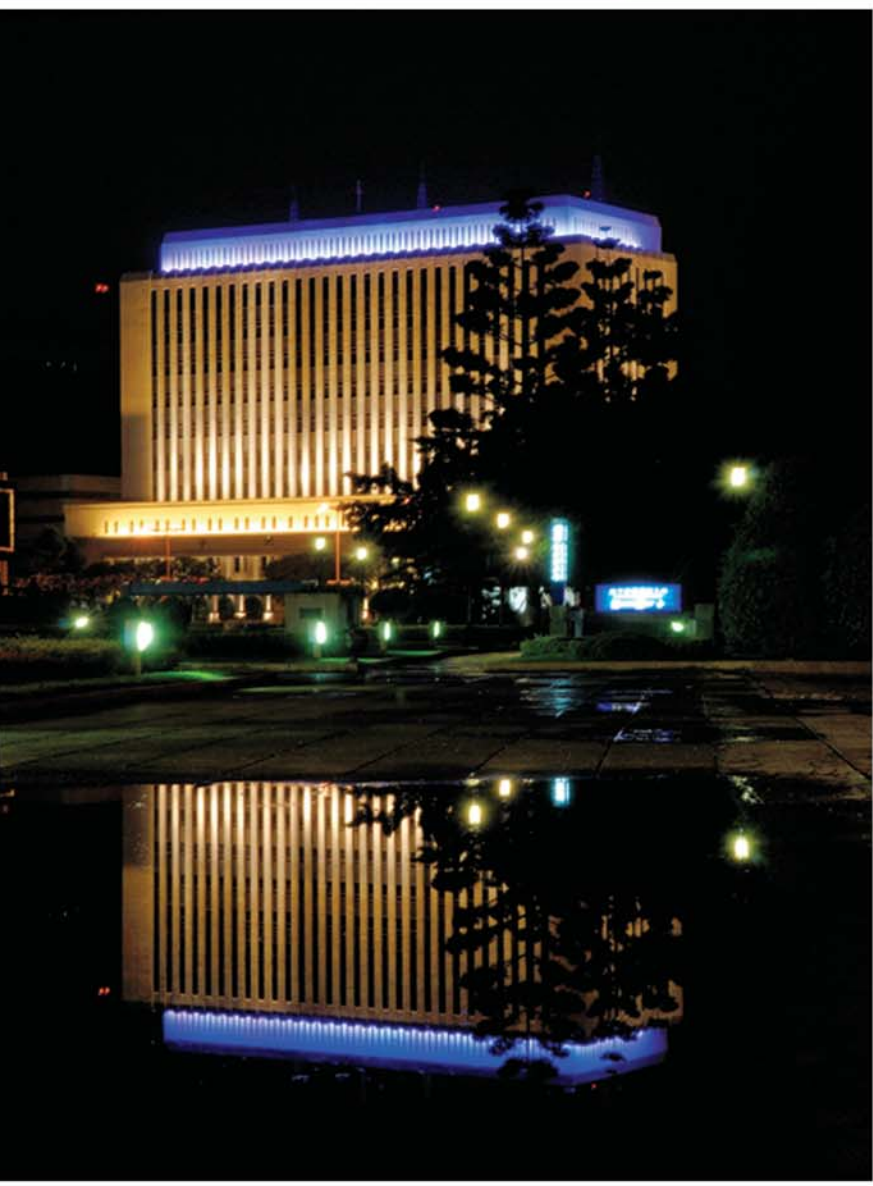


8. Participation in International Activities

The Bank hosts conferences, provides training courses, and attends the annual meetings organized by international organizations such as the Asian Development Bank (ADB), the Central American Bank for Economic Integration (CABEI), and the Conference of Governors of South East Asian Central Banks (SEACEN). In addition, the Bank also maintains close working relationships with the Inter-American Development Bank (IDB), the European Bank for Reconstruction and Development (EBRD), and the Bank for International Settlements (BIS).

In 2006, as a part of SEACEN activities, the Bank held “the 6th SEACEN-Toronto Centre Leadership Seminar for Senior Bank Management of Central Banks on Financial System Oversight.” A total of 30 participants from 14 institutions representing 11 countries attended the seminar. The lecturers comprised of 8 instructors and technical experts from the Toronto Centre, the Bank and other sources. The main objectives of the seminar were to strengthen participants’ supervisory leadership skills, to enhance their knowledge of compliance with international standards, and to provide participants with the opportunity to share experiences concerning systemic failures and rescues of financial institutions.





IV. ANNEX

1. The Provision of NT Dollar Loans to Non-Resident Foreigners in Taiwan



Introduction

Domestic banks have been prohibited from lending NT dollar funds to non-resident foreigners since 1990. However, following the large-scale opening in Taiwan's equity market, foreign investors' demand for NT dollar financing arose accordingly in recent years. To promote more foreign investment in Taiwan and to effectively use the loanable funds in the banking system, the Bank and the FSC in November

2006 allowed domestic financial institutions to provide NT dollar loans to foreigners without domicile in Taiwan. This annex aims to provide a brief introduction to this deregulation measure.

Prohibiting Foreign Investors Taking NT Dollar Loans in the 1990s

Over the past two decades, the Bank has consistently taken a gradual approach to liberalize its foreign exchange management. Since July 1987, Taiwan's residents have been able to freely hold and use their foreign exchange incomes. Capital account liberalization has been undertaken on a step-by-step basis as well. For instance, restrictions on long-term investment were lifted first, followed by portfolio investment. However, in September 1990, on concerns that large-scale capital account opening might jeopardize the stability of the financial system, the monetary authorities forbade domestic financial institutions to provide NT dollar loans to foreigners without domicile in Taiwan. In December 1990, to promote the development of local securities market, the government allowed the Qualified Foreign Institutional Investors (QFIIs) to invest directly in Taiwan's equity market. In March 1996, the market was further relaxed to Generalized Foreign Individual Investors (GFIIIs.) However, both QFIIs and GFIIIs were subject

to the restrictions on taking NT dollar loans from local financial institutions before the implementation of this new deregulation measure.

Gradual Removal of Restrictions on the Provision of NT Dollar Loans to Non-Resident Foreigners

To enlarge the scale and expedite internationalization of domestic securities market, the QFII system was abolished in October 2003. This policy move has attracted considerable foreign capital pouring into domestic securities market as foreigners' portfolio investment in Taiwan has been nearly completely liberalized.

Owing to the rapid growth of foreign investment into domestic equity market, foreign investors' demand for NT dollar funds arose simultaneously. The Bank has therefore relaxed several restrictions on extending NT dollar loans to non-residents in May 2004, to allow domestic financial institutions to provide intra-day credit to foreign investors with the ceiling not exceeding the amount required to complete the settlement.

In August 2006, the Bank convened the FSC and the local Bankers Association in regard to the deregulation for extending NT dollar loans to non-resident foreigners and agreed to designate the Bankers Association to draft the guideline. On October 26 2006, the Bankers Association stipulated the *Operation Guideline for Member Banks Providing NT Dollar Loans to Foreigners without Domicile in Taiwan*, which has been put into effect since November 2006.

Major Reasons for the Deregulation

There are three major reasons for the provision of NT dollar loans to non-residents:

First, Taiwan has enjoyed excess savings in recent years. After the government removed the ceilings on foreign portfolio investment, vast foreign capital flowed into local stock market. Coupled with the relatively low level of domestic investment, liquidity in the banking system remained ample. To allow domestic financial institutions to extend NT dollar loans to foreign investors will help to channel these excess funds more effectively.

Second, lifting the restrictions on the extension of NT dollar loans to foreign investors will not curb foreign investment; in the mean time, it will help reduce continuous foreign capital inflow and mitigate its impacts on the foreign exchange market.

Finally, because the scope of the deregulation is limited to portfolio, long-term equities, and real estate investments, the new loan business will not only help to increase the demand

for NT dollar funds from banks, but also increase incentives for foreign investments in Taiwan.

Current Regulations on Foreigners' NT Dollar Loans

Current regulation on the provision of NT dollar loans to foreigners in Taiwan are summarized as follows:

First, the new policy allows local financial institutions to extend NT dollar loans to non-resident foreign natural persons as well as foreign juridical persons.

Second, foreign investors can now take out NT dollar loans to finance their investment in domestic securities, long-term equities, real estates, or for any other purposes with the approval from the FSC and the Bank.

Third, to contain credit risk, these loans have to be secured by collaterals. The collateral margin requirement for loans secured by stocks is limited to 60% worth of loans.

Finally, the regulation requires that funds borrowed from a stock-secured loan should be directly disbursed to the seller's accounts or deposited at the accounts with the custodian bank, while the custodian bank is responsible for monitoring flows of fund. Funds derived from the sale of stocks shall be used exclusively for loan repayment.

In sum, recent deregulation on the provision of NT dollar loans to foreign investors intends to channel liquidity more efficiently and lessen the impact of foreign capital inflows on the foreign exchange market, thus leading to more foreign investment in Taiwan.

2. Seasonal Adjustment of Monetary Aggregates in Taiwan

Introduction

Monetary aggregates have been important information variables for the Bank's monetary policy-making. The Bank has regularly published data on monetary aggregates in its *Financial Statistics Monthly*. However, monetary aggregates time series in Taiwan exhibit several seasonal movements that recur during public holidays, tax payment days, the start of a new school year, and the calendar year-ends. It is therefore important to capture the nature and the effects of the seasonal factors when analyzing monetary aggregates. In 2006, the Bank has completed a study on seasonal adjustment of monetary aggregates in Taiwan. This annex briefly introduces the seasonal adjustment method and procedures for monetary aggregates in Taiwan.

X-12-ARIMA Adjustment Method Adopted by Major Countries

To seasonally adjust time series data on monetary aggregates, central banks in major countries such as the Federal Reserve, the Bank of England, the European Central Bank, and the Bank of Japan, generally adopt the X-12-ARIMA adjustment method developed by the US Census Bureau. The popularity of the X-12 ARIMA program was due to its stronger filter function as well as many new diagnostics. Seasonally adjusted monetary aggregates data are usually produced in the form of percentage changes and are disseminated in monetary authorities' official publications and websites. However, methods used to calculate percentage changes are different among countries¹. In addition, to minimize variations in the seasonally adjusted data series, the time period for the identification of seasonal adjustment models in most central banks are not changed for one year.

Studies on the Moving-Holiday Effect of the Chinese New Year

The Chinese New Year, the most important holiday in Taiwan, is based on a lunar calendar. It is a moving holiday on the Gregorian calendar. The effect of the shifting Chinese New Year on monetary aggregates data has been studied for long. The earliest study regarding this

¹ For instance, the Federal Reserve and the Bank of England use quarterly and 6-month percentage changes to calculate annualized percentage changes, while monthly and annual percentage changes are not annualized. The European Central Bank transforms the seasonal adjusted data into an index series and calculates the year-on-year growth rate. As for the Bank of Japan, all the percentage changes of the seasonally adjusted data are annualized.

subject could trace back to Perng (1982)², using US Census Bureau's X-11 program to seasonally adjust the end-of-period data for M1, currency held by the public, and deposit money, after adjusting for the shifting Chinese New Year.

Lin and Liu (2003)³ used regARIMA model in the X-12-ARIMA program for the first time to deal with the moving holiday effect arising from the shifting Chinese New Year in Taiwan. They constructed three explanatory variables-- before, during, and after the Chinese New Year, and applied the AICC (F-corrected AIC) method to test if these variables can improve the explanatory power of the model. Due to the lack of daily data, the distributions of these three variables were assumed to be rectangular distribution. The authors tested on M1A, M1B, and M2 and found that the duration of the influences were fifteen days before and after, and six days during the Chinese New Year holidays. This result was very close to Perng (1982)'s findings.

The Procedures Used by the Bank for Seasonal Adjustment

The Bank's research team adopts X-12-ARIMA method for seasonal adjustment. However, with a shifting Chinese New Year holiday, the holiday effect adjustment procedure developed for fixed holidays cannot be applied to the Bank's model. To improve the accuracy of seasonal decomposition, the Bank follows Perng (1982) and Lin and Liu (2003), using daily data to transform the rectangular distribution with a constant daily effect into bell-shape distribution with a variable daily effect. In other words, the research team uses daily data to construct three monthly factors to capture effects before, during, and after the Chinese New Year and applies the regARIMA model to deal with the effect of the shifting Chinese New Year, and produce the seasonally adjusted monetary aggregates.

To facilitate greater use of the financial statistics data as well as to improve transparency, the Bank starts to publish the seasonally adjusted data on the "Seasonally Adjusted Key Financial Indicators Table" in the appendix to the *Financial Statistics Monthly* in 2007. The table presents the seasonally adjusted statistics for currency held by the public, reserve money, M1A, M1B, M2, deposits, and bank credit. All series are traced back to January 1992. The data will also be available on the Bank's website.

To avoid the confusion caused by model changing and recalculation, past seasonal factors remain fixed, which is the same treatment used by major central banks. The Bank follows this

² Perng, Fai-nan, 1982, "Seasonal Adjustment of Monetary Aggregates and the Effect of Shifting Chinese New Year on Currency and Deposit Money," *Quarterly Bulletin of the Central Bank of the Republic of China (Taiwan)*, Vol. 4, No.1, March 1982. (only in Chinese version)

³ Lin, Jin-Lung and Tian-Syh Liu, 2003, "Modeling Lunar Calendar Holiday Effects in Taiwan," *Taiwan Economic Forecast and Policy*, Vol 33, No 2, Institute of Economics, Academia Sinica, Taiwan.

approach and revises the seasonally adjusted series in each June and December to ensure a better quality of seasonal adjustment.



Chronology of Events of the CBC in 2006

Date Effective	Events
Jan. 1	The Bank requested financial institutions to link their lending rates to the benchmark base rate.
25	The Bank allowed futures enterprises that engage in consigned trading in overseas futures market to make remittance directly with approval documents.
27	The Bank amended the <i>Offshore Banking Act</i> regarding credit lines limits and tax exemption regulations, allowing the OBUs to conduct business with more flexibility.
Feb. 9	The Financial Supervisory Commission (FSC) and the Bank allowed the Taiwan Futures Exchange (TAIFEX) to launch three new US dollar-denominated products: Gold Futures contracts, MSCI Taiwan Index Futures and MSCI Taiwan Index Options, effective March 27, 2006.
24	The FSC and the Bank allowed foreign investors to invest in warrants during the underwriting period before their initial public offering.
Mar. 21	The Bank allowed banks to use their qualified asset-backed securities as liquid reserved assets.
23	The FSC and the Bank allowed foreign investors to trade domestic futures and options and excluded these transactions from foreign investors' investment cap (30% of their inward remittance).
27	In line with the liberalization of Taiwan Futures market, allowing foreign investors to engage in transactions for non-hedging purposes, to trade through

		omnibus accounts, and the launch of foreign currency-denominated futures products, the Bank amended the <i>Directions for Banking Enterprises on Assisting Customers to Declare Foreign Exchange Receipts and Disbursements or Transactions</i> .
	27	The Bank agreed the Taiwan Securities Central Depository Co., Ltd (TSCD) and the Debt Instruments Depository and Clearing Co., Ltd. Taiwan (DIDC) to merge into the Taiwan Depository & Clearing Corporation (TDCC), and allowed the TDCC to use the CBC Interbank Fund-Transfers Settlements System for funds settlements.
	31	The Bank raised the discount rate, the rate on accommodations with collateral, and the rate on accommodations without collateral by 12.5 basis points to 2.375 percent, 2.75 percent and 4.625 percent, respectively.
Apr.	14	The Bank expanded the scope of foreign investments for the Taiwan Post Co. to invest in foreign government bonds with credit ratings equal to or higher than Taiwan's long-term sovereign rating, and mortgage backed securities issued by American Government-Sponsored Enterprises (GSEs).
May	15	The Bank allowed more banks located in Kinmen and Matsu to engage in purchasing and selling RMB banknotes and simplified associated remittance processes.
	15	The Bank allowed credit cooperatives to invest in the Bank's certificates of deposit and to serve as the eligible bidders.
	16	The Bank allowed foreign investors to invest in securities investment trust funds through private placements.
	30	The Bank amended the <i>Directions for Displaying Interest Rate by Financial Institutions</i> to allow financial institutions to post differential rates by types.

Jun.	16	The Bank amended the <i>Directions for the Central Bank of the Republic of China (Taiwan) to Govern Electronic Interbank Fund Transfers and Settlements</i> to extend the pending acceptance period for designated-time transfers from six months to one year, effective June 26, 2006.
	20	The Bank allowed foreign investors to take secured loans from securities firms for settlement needs.
	30	The Bank raised the discount rate, the rate on accommodations with collateral, and the rate on accommodations without collateral by 12.5 basis points to 2.5 percent, 2.875 percent and 4.75 percent, respectively.
July	1	The Bank, the FSC and the Central Deposit Insurance Corporation (CDIC) excluded structured financial instruments from insurance coverage from July 2006.
	4	The Bank agreed the GreTai securities market to provide clearing services for foreign currency securities through an electronic platform and to apply for foreign currency loans from banks for their settlement needs.
	5	The Bank set the qualifications for securities firms that wish to provide underwriting service for foreign currency-denominated bonds and stocks traded in domestic market.
	7	The Bank excluded remittances associated with foreign currency-denominated futures transactions and international humanitarian assistance made by domestic charity organizations from their annual foreign exchange remittance quotas.
Aug.	4	The Bank agreed foreign investors to invest in foreign currency funds issued by local securities investment trust enterprises (SITs).
	9	The Bank agreed foreign investors to take secured loans from securities

		finance enterprises for their settlement needs, effective September 13, 2006.
	13	The Bank agreed overseas Chinese and foreign investors to borrowed securities from securities firms, effective August 18, 2006.
	16	The Bank amended the <i>Directions Governing Designated Dealers for Open Market Operations</i> to allow a financial institution or the Taiwan Post Co. to act as both a general designated dealer and a primary dealer in central government bond market, upon the Bank's approval.
	16	The Bank agreed foreign investors to invest in foreign currency-denominated international bonds issued by foreign issuers and listed in the GreTai securities market. The first foreign currency-denominated bond was issued on November 1, 2006.
Sept.	19	The Bank allowed banks to operate structured NT dollar deposits linked with dbX-Harmony II of hedged fund index with constant proportion portfolio insurance (CPPI) technique.
	29	The Bank raised the discount rate, the rate on accommodations with collateral, and the rate on accommodations without collateral by 12.5 basis points to 2.625 percent, 3.0 percent and 4.875 percent, respectively.
	29	The Bank amended the <i>Directions for the Extension of Housing Loans by Financial Institutions Under the Preferential Housing Loan Program</i> to extend its effective period until the loan quota is used up.
Oct.	25	The Bank agreed banks to engage in several new credit derivatives businesses, including Basket Default Swaps, First-to-Default Swaps, N-to-Default Swaps, and Structured Basket Default Swaps.
Nov.	15	The Bank agreed banks to extend their NT dollar loans to foreign investors without domicile in Taiwan.

- Dec. 1 The Bank simplified enterprises' overseas investment application procedures. Investment projects under US\$ 20 millions will not be required to obtain the Bank's approval.
- 8 The Bank agreed banks to engage in NT dollar swaps linked to ABN AMRO CQII index and structured products composed of NT dollar time deposits linked to ABN AMRO CQII index.
- 28 The Bank set the intermediate target zone for M2 growth in 2007 at 3.5 to 7.5 percent.
- 30 The Bank raised the discount rate, the rate on accommodations with collateral, and the rate on accommodations without collateral by 12.5 basis points to 2.75 percent, 3.125 percent and 5.0 percent, respectively.

Financial Statements of the CBC

1. Balance Sheet

Unit: NT\$ Million

	December 31 2006	December 31 2005	Change	
			Amount	%
Assets				
Foreign Assets	8,842,916	8,476,663	366,253	4.32
Deposits to Financial Institutions	140,821	22,461	118,360	526.96
Loans and Accommodations to Financial Institutions	298,853	403,150	-104,297	-25.87
Other Assets	167,395	192,296	-24,901	-12.95
Total Assets	9,449,985	9,094,570	355,415	3.91
Liabilities				
Currency Issued	959,792	922,910	36,882	4.00
Reserve Deposits of Financial Institutions	926,319	837,644	88,675	10.59
Certificates of Deposit Issued	3,755,930	3,520,820	235,110	6.68
Redeposits of Financial Institutions	1,969,985	2,025,113	-55,128	-2.72
Government Deposits	186,171	203,643	-17,472	-8.58
Other Liabilities	564,098	701,917	-137,819	-19.63
Total Liabilities	8,362,295	8,212,047	150,248	1.83
Net Worth	1,087,690	882,523	205,167	23.25
Total Liabilities and Net Worth	9,449,985	9,094,570	355,415	3.91

2. Income Statement

Unit: NT\$ Million

	2006	2005
Income		
Interest Income	344,822	320,579
Fee Income	81	116
Subsidiaries Investment Income	1,096	913
Revenue from Trust Investment	8,454	5,701
Others	18,376	15,581
Total Income	372,829	342,890
Expenses		
Interest Expenses	135,051	102,700
Fee Expenses	21	22
Expenses for Coin Issuance	522	742
Expenses for Bank Note Issuance	3,379	3,667
Operating Expenses	1,764	1,877
Administrative Expenses	393	376
Others	314	45,648
Total Expenses	141,444	155,032
Net Income	231,385	187,858

Key Economic and Financial Indicators of the Republic of China (Taiwan)

Year / Month	I. Business Indicators			II. National Income and Aggregate Demand										
	C.E.P.D. ⁽¹⁾ Total Score of Monitoring Indicator (average)	T.I.E.R. ⁽²⁾ Business Climate Index		Economic Growth Rate (%)	Per Capita GNP (US\$)	Unemploy- ment Rate (%)	Manufacturing Sector					Annual Rate of Change of Industrial Production Indices(%)		
		Manufacturing Sector (1991=100) (average)	Services Sector (2001=100) (average)				Labor Productivity Index (2001=100)	Average Monthly Earnings (NT\$) (per Employee)	Average Monthly Working Hours (hrs)	Capacity Utilization Rate (%)	Ratio of Operating Profit to Sales (%)	General Index	Manufacturing Index	Index of Construction
1996	20	96.11	-	6.30	13,714	2.60	76.36	33,911	201.1	78.3	5.1	1.87	2.67	-17.46
1997	27	104.35	-	6.59	14,048	2.72	80.64	35,492	201.8	78.7	5.2	6.16	7.23	-16.16
1998	20	94.58	101.22	4.55	12,773	2.69	84.93	36,546	198.0	78.8	4.9	3.39	3.18	0.55
1999	22	103.06	112.58	5.75	13,737	2.92	90.70	37,882	199.1	78.9	4.6	7.37	7.79	6.61
2000	26	100.29	112.19	5.77	14,721	2.99	96.36	39,080	198.7	80.4	4.8	6.92	8.06	-14.65
2001	10	92.39	100.00	-2.17	13,348	4.57	100.00	38,586	184.4	76.3	4.0	-7.81	-8.36	-11.19
2002	23	106.89	115.94	4.25	13,476	5.17	109.55	38,565	187.6	77.0	4.7	7.92	9.39	-20.66
2003	23	108.10	122.19	3.43	13,752	4.99	115.34	39,583	188.3	78.3	4.8	7.13	7.40	9.02
2004	33	110.74	122.18	6.07	14,770	4.44	122.13	40,611	190.7	80.1	5.0	9.82	10.52	4.79
2005	22	102.43	116.91	4.03	15,690	4.13	128.50	41,751	188.8	80.1	5.0	4.56	4.48	11.37
2006	22	108.48	118.80	4.62	16,098	3.91	134.47	42,293	187.3	80.3	4.8	4.99	5.04	9.02
2006/ 1	28	102.95	126.47			3.80	135.02	81,917	179.5	78.9	4.9	4.16	3.87	20.31
2	28	105.33	125.56			3.92	139.54	39,772	158.2	78.1	4.6	13.87	15.55	-23.70
3	23	106.25	125.31	4.92	4,141	3.87	130.35	37,720	200.8	81.0	4.9	7.22	6.63	51.13
4	23	103.73	123.84			3.78	139.91	37,871	179.9	80.4	4.9	5.60	5.67	10.81
5	24	100.49	124.05			3.84	136.67	38,949	190.6	80.8	5.0	8.80	8.72	32.33
6	21	99.54	120.69	4.57	3,777	3.98	129.96	38,311	195.0	80.5	5.0	5.37	5.77	-0.47
7	21	105.10	119.33			4.05	131.27	39,539	189.9	80.4	4.9	7.41	7.60	9.36
8	22	116.54	118.46			4.09	130.07	37,879	199.2	80.8	4.9	5.37	5.52	2.62
9	22	119.63	113.97	5.02	4,033	3.96	133.53	39,102	189.6	80.6	4.8	2.96	2.90	9.89
10	20	117.02	110.15			3.90	142.09	38,580	181.7	80.8	4.7	1.79	2.13	-8.24
11	21	113.51	106.99			3.86	134.31	37,374	193.7	80.8	4.6	2.15	1.63	17.55
12	16	111.62	110.82	4.02	4,147	3.81	133.05	40,917	189.5	80.4	4.4	-1.91	-2.17	-1.83

Notes:(1) C.E.P.D.: Council for Economic Planning and Development, Executive Yuan.

(2) T.I.E.R.: Taiwan Institute of Economic Research.

Key Economic and Financial Indicators of the Republic of China (Taiwan) Cont.

Year / Month	II. National Income and Aggregate Demand														
	Annual Rate of Change of Private Consumption Expenditure (%)	Annual Rate of Change of Gross Fixed		Gross National Savings / GNP (%)	Gross Domestic Investment / GNP (%)	External Trade of Goods on Customs basis (In US Dollars)									
		Capital Formation (%)	Private Sector (%)			Annual Rate of Change of Total Exports ⁽³⁾					Annual Rate of Change of Total Imports ⁽³⁾		Trade Balance ⁽³⁾ (US\$ Million)	Annual Rate of Change of Export Orders (%)	
						China and H.K. (%)	U.S. (%)	Japan (%)	Europe (%)	Southeast Asia ⁽⁴⁾ (%)	Capital Equipment (%)				
1996	6.66	1.80	3.72	26.51	22.78	3.7	3.5	1.7	3.9	7.8	3.1	-1.0	8.8	14,659	4.76
1997	7.08	10.85	18.61	26.15	23.82	5.6	6.9	10.0	-14.3	8.7	5.1	11.7	18.4	9,215	4.07
1998	6.19	8.94	13.24	25.99	24.77	-9.3	-12.5	-0.6	-20.2	6.6	-27.8	-8.5	11.8	7,366	-4.00
1999	5.51	2.94	1.01	26.07	23.42	9.9	11.3	5.2	27.8	3.5	20.2	5.7	20.3	12,537	7.26
2000	4.59	9.02	15.61	25.67	22.94	22.8	24.5	12.7	39.6	16.7	28.8	26.6	34.3	11,218	20.36
2001	0.67	-19.91	-26.83	24.15	18.01	-16.9	-10.8	-20.5	-23.1	-16.5	-19.2	-23.3	-31.4	18,344	-11.54
2002	2.34	-0.63	4.07	25.54	17.04	7.1	28.6	-3.2	-6.0	-6.3	6.4	4.9	-3.4	22,072	11.23
2003	0.94	-0.90	-0.26	26.31	16.86	11.3	22.1	-3.1	-0.5	10.2	10.0	13.0	0.5	22,590	12.64
2004	3.91	17.48	30.96	26.32	20.73	21.1	28.3	8.4	10.8	14.6	33.7	31.8	37.8	13,613	26.50
2005	2.74	1.17	-0.22	25.19	19.73	8.8	12.2	1.4	9.7	-0.8	14.5	8.2	-4.1	15,817	19.20
2006	1.53	0.26	2.08	26.86	19.71	12.9	14.8	11.2	7.9	10.6	13.8	11.0	-0.5	21,319	16.74
2006/ 1						4.5	0.3	13.0	-4.4	4.0	5.2	-7.1	-31.2	2,334	20.01
2						26.3	44.5	9.6	23.7	11.8	17.1	47.0	22.2	-610	25.13
3	2.01	-4.78	-5.01	23.91	17.51	8.4	12.3	0.6	8.6	-1.6	11.7	-0.5	-17.2	1,726	19.33
4						15.0	19.2	26.6	0.5	-11.7	8.8	5.0	-12.3	2,374	18.57
5						10.4	15.0	9.4	1.4	1.1	10.1	12.3	-16.3	709	26.01
6	1.38	-4.23	-2.77	26.72	20.39	16.5	16.0	5.8	12.9	13.7	37.9	11.9	6.0	1,225	20.61
7						21.1	18.6	23.0	9.9	13.1	35.3	17.5	14.7	1,804	19.44
8						16.6	17.5	16.2	13.9	12.6	26.2	17.0	8.0	1,216	18.34
9	0.40	3.53	5.62	25.91	19.84	18.1	18.8	21.5	16.6	11.5	13.2	10.8	0.4	2,834	12.00
10						5.6	5.5	9.1	3.6	15.1	-3.0	6.1	-5.5	2,355	10.88
11						8.2	12.8	-2.5	6.2	11.8	7.0	7.8	25.5	2,424	10.62
12	2.36	5.74	10.63	30.81	21.12	9.3	7.6	3.6	5.7	22.3	6.0	16.4	27.6	2,928	7.32

Notes: (3) Since Jan. 2006, the Ministry of Finance has revised total exports, total imports and trade balance based on the United Nation's International Merchandise Trade Statistics Compilers Manual 2004.

(4) Only includes six major countries in the region, i.e., Indonesia, Malaysia, the Philippines, Singapore, Thailand, and Vietnam.

Key Economic and Financial Indicators of the Republic of China (Taiwan) Cont.

Year / Month	III. Prices					IV. Money, Banking and Finance						
	Consumer Price Indices		Wholesale Price Index	Import Price Index	Export Price Index	Unit Labor Cost Index	Reserve Money (average)		Monetary Aggregates (average)			
	General Index	Core CPI ⁽⁵⁾					Amount	Adjusted Annual Growth Rate ⁽⁶⁾	M1B		M2	
			(NT\$ Billion)	(%)	Amount	Annual Growth Rate (%)			Amount ⁽⁷⁾	Annual Growth Rate (%)		
(Annual Rate of Change, %; 2001=100)												
1996	3.08	3.07	-1.01	-2.49	1.67	-0.61	1,641.9	5.63	3,160.8	4.13	13,318.3	9.23
1997	0.89	0.96	-0.45	-1.40	2.05	-1.24	1,695.4	7.30	3,597.8	13.82	14,417.9	8.26
1998	1.69	1.07	0.60	0.74	5.57	-0.18	1,646.0	4.78	3,688.5	2.52	15,680.5	8.76
1999	0.17	1.16	-4.55	-4.10	-8.53	-3.38	1,518.7	5.37	4,052.6	9.87	16,986.2	8.33
2000	1.26	0.60	1.82	4.63	-0.88	-2.63	1,566.8	5.00	4,481.5	10.58	18,182.6	7.04
2001	-0.01	0.08	-1.34	-1.25	0.32	2.69	1,539.1	1.13	4,435.8	-1.02	19,236.0	5.79
2002	-0.20	0.69	0.05	0.40	-1.49	-10.28	1,417.4	1.78	5,190.4	17.01	19,918.3	3.55
2003	-0.28	-0.61	2.48	5.14	-1.49	-2.84	1,492.3	5.28	5,803.9	11.82	20,669.8	3.77
2004	1.62	0.71	7.03	8.57	1.61	-4.26	1,662.2	11.38	6,905.4	18.98	22,209.3	7.45
2005	2.30	0.65	0.61	2.43	-2.46	-1.11	1,792.5	7.84	7,395.8	7.10	23,590.7	6.22
2006	0.60	0.54	5.64	8.82	2.50	-2.37	1,888.1	5.33	7,787.5	5.30	25,057.1	6.22
2006/1	2.66	1.39	1.13	5.54	-1.76	14.17	1,941.5	12.42	7,857.9	8.39	24,656.4	7.20
2	0.98	-0.29	2.31	7.29	-0.36	-32.27	1,970.1	3.11	7,839.6	5.58	24,852.5	6.52
3	0.41	0.66	2.11	6.71	0.82	-4.04	1,881.9	5.25	7,689.9	4.27	24,784.4	6.15
4	1.23	0.59	3.31	7.57	0.95	-2.94	1,869.7	4.77	7,697.1	5.45	24,899.0	6.53
5	1.58	0.70	6.58	10.85	2.83	-3.41	1,869.3	5.54	7,781.5	7.08	25,061.4	7.05
6	1.73	0.43	8.78	13.25	5.32	-4.85	1,865.1	5.05	7,646.4	5.22	24,979.2	6.45
7	0.79	0.58	9.19	13.36	4.78	-4.78	1,865.8	4.83	7,639.7	3.12	25,024.1	5.72
8	-0.57	0.38	9.10	12.33	5.78	-2.85	1,859.7	3.78	7,703.2	2.77	25,063.0	5.43
9	-1.23	0.35	6.90	7.61	3.97	-0.59	1,865.9	4.40	7,838.0	4.72	25,163.0	5.84
10	-1.19	0.40	5.76	6.91	2.99	1.26	1,881.9	4.91	7,855.1	5.90	25,206.7	5.95
11	0.24	0.59	5.96	7.01	2.31	0.12	1,889.8	5.36	7,863.5	5.81	25,344.6	5.97
12	0.67	0.63	6.39	7.54	2.35	2.54	1,896.7	4.97	8,038.4	5.36	25,650.4	5.85

Notes: (5) Core CPI refers to CPI excluding the categories of fresh fruits & vegetables, fish & shellfish and energy.

(6) The annual growth rates are adjusted for most recent changes in required reserve ratios on October 4 and banks' required reserves with the Bank's B account in November 2001.

(7) Data from Oct. 2004 onwards included the net present value of money market mutual funds.

Key Economic and Financial Indicators of the Republic of China (Taiwan) Cont.

Year / Month	IV. Money, Banking and Finance											
	Major Financial Institutions ⁽⁸⁾				Past-Due Loan Ratio of Domestic Banks ⁽⁹⁾ (%)	Interest Rates (%)						
	Deposits		Loans & Investments ⁽⁸⁾			CBC's Discount Rate (end of period)	Interbank Call-Loan Rate (average)	31-90 Day Commercial Paper Secondary Market Rate (average)	Five Major Domestic Banks ⁽¹⁰⁾		Domestic Banks	
	Amount (NT\$ Billion)	Annual Rate of Change (%)	Amount (NT\$ Billion)	Annual Rate of Change (%)	Base Lending Rate ⁽¹¹⁾ (end of period)				New Loan Rate (average)	Deposit Rate (average)	Loan Rate (average)	
1996	14,260.9	8.61	13,051.8	7.86	N.A.	5.000	5.44	5.79	7.38	8.16	5.79	8.55
1997	15,421.3	8.14	14,352.0	9.96	N.A.	5.250	6.85	6.83	7.50	8.12	5.36	8.25
1998	16,696.9	8.27	15,471.6	7.80	N.A.	4.750	6.56	6.81	7.70	8.26	5.72	8.48
1999	18,064.2	8.19	16,024.9	3.58	N.A.	4.500	4.77	4.88	7.67	7.10	5.00	8.03
2000	19,308.7	6.89	16,622.0	3.73	N.A.	4.625	4.73	4.91	7.71	6.72	4.62	7.61
2001	20,160.7	4.41	16,489.3	-0.80	11.29	2.125	3.69	3.69	7.38	5.75	4.09	6.99
2002	20,609.8	2.23	16,078.0	-2.49	8.85	1.625	2.05	2.03	7.10	4.04	2.38	5.53
2003	21,746.9	5.52	16,535.1	2.84	6.08	1.375	1.10	1.05	3.43	2.80	1.47	4.10
2004	23,256.5	6.94	17,964.0	8.64	3.80	1.750	1.06	0.99	3.52	2.16	1.17	3.47
2005	24,709.5	6.25	19,360.2	7.77	2.24	2.250	1.31	1.27	3.85	2.31	1.29	3.50
2006	25,942.0	4.99	20,149.3	4.08	2.13	2.750	1.55	1.54	4.12	2.37	1.47	3.39
2006/ 1	24,668.1	5.82	19,510.8	8.37	2.31	2.250	1.45	1.43	3.87	2.29		
2	24,852.2	6.23	19,492.5	7.94	2.39	2.250	1.45	1.44	3.89	2.23		
3	24,865.9	5.79	19,442.4	6.71	2.46	2.375	1.45	1.44	3.90	2.30	1.41	3.49
4	25,098.7	6.74	19,547.4	7.12	2.54	2.375	1.52	1.48	3.95	2.36		
5	25,122.5	6.94	19,733.8	7.27	2.53	2.375	1.52	1.50	3.95	2.41		
6	25,267.9	5.45	19,756.9	6.31	2.39	2.500	1.53	1.53	3.96	2.35	1.46	3.40
7	25,220.1	5.19	19,681.6	5.90	2.41	2.500	1.59	1.55	4.01	2.41		
8	25,262.5	5.13	19,723.3	5.56	2.41	2.500	1.59	1.56	4.03	2.41		
9	25,358.4	5.28	19,863.5	5.05	2.40	2.625	1.60	1.58	4.04	2.38	1.49	3.34
10	25,389.8	5.65	19,814.5	4.80	2.39	2.625	1.66	1.62	4.10	2.44		
11	25,602.5	5.59	19,913.0	4.59	2.35	2.625	1.66	1.65	4.10	2.45		
12	25,942.0	4.99	20,149.3	4.08	2.13	2.750	1.66	1.67	4.12	2.37	1.54	3.31

Notes: (8) The data are from the consolidated balance sheet of the monetary institutions and the Taiwan Post Co.

(9) From Jan. 2004, includes data for securities acquired under reverse repurchase agreements. Portfolio investments are measured at original costs.

(10) The data are based on the new NPL definition, which includes 90-day overdue loans.

(11) Includes Bank of Taiwan, Taiwan Cooperative Bank, Chang Hwa Commercial Bank, First Commercial Bank and Hua Nan Commercial Bank.

(12) Between 1993 and 2002, the figures represent prime lending rates.

Key Economic and Financial Indicators of the Republic of China (Taiwan) Cont.

Year / Month	V. Securities Market					VI. Balance of Payments and Foreign Exchange Market						
	TSE Stock Market		OTC Bond Market			Balance of Payments				Foreign Exchange Reserves (end of period) (US\$Billion)	Exchange Rate (End of period) NT\$ US\$	Daily Average Value of Foreign Exchange Transactions (US\$ Million)
	Stock Price Index (1966=100) (average)	Total Trading Value (NT\$ Billion)	Outstanding (end of period) (NT\$ Billion)	Trading Value		Current Account	Capital Account	Financial Account	Change in CBC's Net Foreign Assets ⁽³⁾			
				Share of Outright Transactions (%)								
				(US\$ Million)								
1996	6,004	12,907.6	1,281.5	28,297.7	9.30	10,923	-653	-8,633	-1,102	88.04	27,491	4.40
1997	8,411	37,241.1	1,426.9	40,392.0	6.41	7,050	-314	-7,291	728	83.50	32,638	4.86
1998	7,738	29,619.0	1,655.3	54,957.7	13.02	3,436	-181	2,495	-4,827	90.34	32,216	4.72
1999	7,427	29,291.5	1,933.2	52,432.6	13.84	7,993	-173	9,220	-18,593	106.20	31,395	4.18
2000	7,847	30,526.6	2,279.3	68,843.1	24.25	8,899	-287	-8,019	-2,477	106.74	32,992	4.89
2001	4,907	18,354.9	2,869.4	118,992.5	44.56	18,237	-163	-384	-17,353	122.21	34,999	4.71
2002	5,226	21,874.0	3,599.1	134,399.0	45.13	25,612	-139	8,750	-33,664	161.66	34,753	5.61
2003	5,162	20,333.2	4,306.6	203,624.0	62.16	29,234	-87	7,630	-37,092	206.63	33,978	7.30
2004	6,034	23,875.4	4,777.3	205,925.2	59.95	18,478	-77	6,831	-26,595	241.74	31,917	10.24
2005	6,092	18,818.9	5,145.3	311,386.8	71.35	16,019	-117	1,717	-20,056	253.29	32,850	12.07
2006	6,842	23,900.4	5,454.1	256,878.8	66.18	25,187	-118	-22,987	-6,086	266.15	32,596	15.66
2006/ 1	6,609	2,163.5	5,135.0	26,725.5	70.83					257.30	31,985	14.17
2	6,614	1,575.6	5,148.2	23,013.3	71.31					256.98	32,455	14.67
3	6,501	2,066.2	5,194.9	28,493.5	71.15	5,790	-12	-3,762	-2,242	257.05	32,460	14.23
4	6,941	2,333.8	5,197.0	20,601.9	66.15					259.04	31,913	15.18
5	7,123	2,771.2	5,231.5	16,256.7	53.84					260.94	32,019	16.09
6	6,548	1,977.9	5,274.9	19,291.2	62.00	4,614	-43	-6,318	-482	260.35	32,399	15.64
7	6,504	1,470.9	5,297.1	20,548.4	65.80					260.37	32,756	15.30
8	6,552	1,701.6	5,329.9	22,976.5	67.62					261.02	32,906	14.95
9	6,782	1,561.7	5,328.8	21,227.0	67.01	6,283	-22	-5,107	-1,128	261.55	33,098	16.49
10	7,029	1,647.7	5,351.3	19,009.6	65.06					261.82	33,260	16.43
11	7,267	2,327.0	5,434.6	21,068.9	67.07					265.14	32,432	17.36
12	7,630	2,303.2	5,454.1	17,666.3	58.05	8,500	-41	-7,800	-2,234	266.15	32,596	17.07

Note: (3) The minus sign "-" represents an increase.

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