Condition and Performance of Domestic Banks

Third Quarter 2007

■ *Summary of Condition and Performance*

Despite the US sub-prime mortgage and the high oil price resulting in the slowdown of global economy, the bullish Asian economies remained upbeat. Fuelled by the continued expansion of external sector, the Taiwanese domestic economic growth was in an upward trend. The external sector, lead by electronic products and related products, kept robust in the third quarter of 2007. Nevertheless, with no major drive to stimulate investments and consumption, it is difficult for consumption to leap forward. However, the improving unemployment rate and the tailing-off negative impact of consumer debt, Taiwan's economic growth is anticipated to stay in a bullish outlook. According to the statistics of Directorate-General of Budget, Accounting and Statistics, Executive Yuan, the preliminary real GDP growth rate was 6.92% in the third quarter of 2007, increasing 1.58 percentage points from 5.34 % at the same quarter of the previous year.

Aside from traditional deposit taking and lending, the domestic banks have aggressively expanded into wealth management, asset management, treasury, and trust business to diversify their revenues. The low interest rate margin had driven banks to tap into fee-based business. Benefited from the remarkable performance, the banks developed sustainable income from fee-based business. Meanwhile, assets quality has improved significantly and is expected to remain at current levels, supported by continuing write- offs and efforts to strengthen risk controls. However, banks still needed to further enhance their risk management to keep pace with further expansion into new products.

■ Key Trend

The domestic banks continue to suffer from low interest spreads and fierce competition. The net interest income was subdued in the first nine months of 2007 compared with the same period in 2006. The major income components are tabulated as follows.

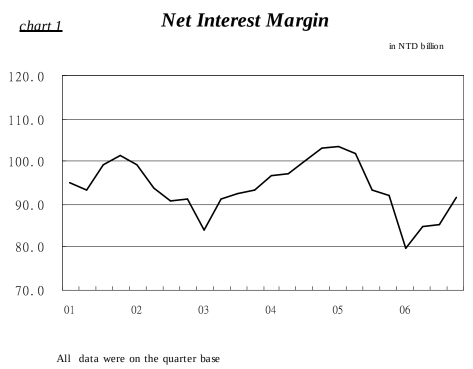
Major income components

NT$ billion

	Jan.-Sep. 2006	Jan.-Sep. 2007	% Change
Income			
Net interest income	287.3	261.9	-25.4
Net revenues other than interest	64.4	101.8	58.1
Expense			
Loan loss provision	119.1	94.4	-20.7
Other expense	197.6	241.2	22.1
Net income	35.0	28.1	-19.7

Net Interest Margin（NIM） increasing slightly

The NIM was NT$ 91.8 billion during this quarter, slightly increasing by NT$ 6.4 billion（7.49%） compared with the previous quarter due to the interest spread leveling off. (Chart 1)



Deposits decreased

Total deposits as of the third quarter's end of 2007 were NT$20,820.6 billion, decreasing by NT$ 17.2 billion compared with the preceding quarter. It was mainly due to the decrease in time deposits and saving deposits. The annual growth rate of total deposits slowed to 3.11%, 2.92 percentage points down from 6.03% as of the third quarter's end of 2006. (Chart 2)

Loans grew slightly

The total loans were NT$ 17,708.8 billion at this quarter's end, increasing by NT$ 123.3 billion (0.70%) compared with preceding quarter. The annual growth rate was 5.24% compared to the same period of 2006, as a result of a smaller increase in bank claims against the private sector. (Chart 3)

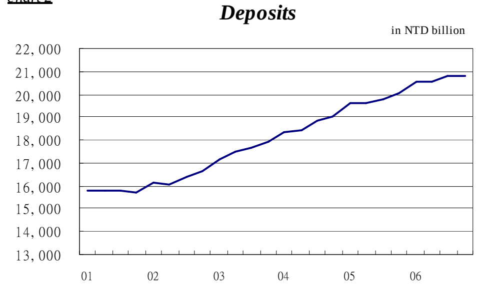
Investments decreased slightly

The total investments amounted to NT$3,686.6 billion, decreasing by NT$ 93.9 billion (2.48 %) compared with the previous quarter, resulting from the decrease in government bonds held by banks. (Chart 4)

Asset quality improved continuously

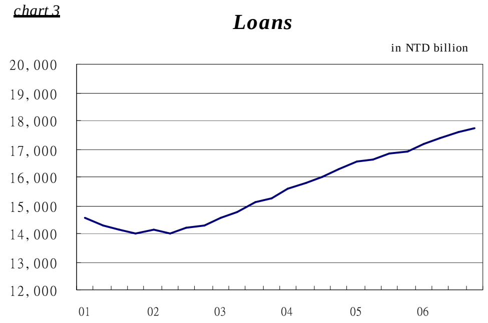
The average ratio of non-performing loans at this quarter went down by 0.16 percentage points to 2.16%. Supported by continuing write-offs and efforts to strengthen risk controls, the non-performing assets of the overall banking sector remained improving and were expected to keep at current level. The average provision coverage ratio was58.51%, 4.2 percentage points up from 54.31% as of previous quarter's end. It seemed the sector's average provision coverage ratio was on a rising trend to safeguard against downturns in the credit cycle. (Chart 5)

chart 2



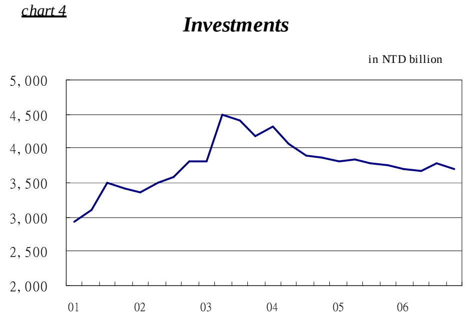
All data as of month-end

chart 3



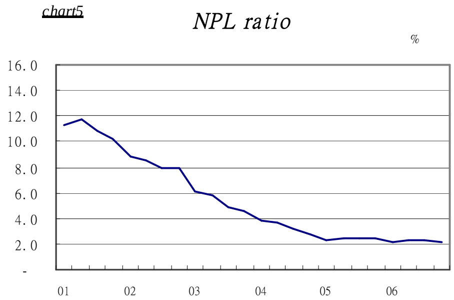
All data as of month-end

chart 4



All data as of month-end

chart5



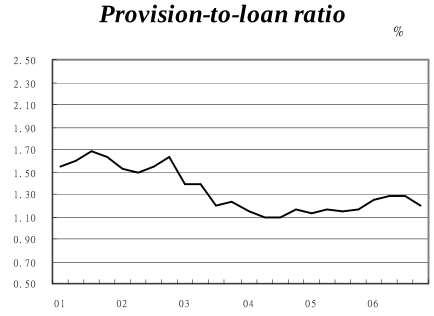
all data as of month-end

Provision-to-loan ratio leveled off

The provision-to-loan ratio was 1.19% , slightly leveled off from 1.28% at the end of preceding quarter. It was due to the decrease of loan loss provisions. （Chart 6）

chart 6

Provision-to-loan ratio

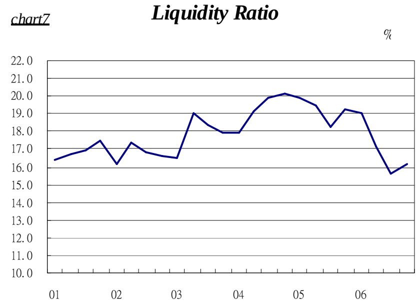


All data as of month-end

Liquidity Ratio increasing slightly

The liquidity ratios of all domestic banks were over the statutory minimum ratio (7%) in September 2007. The average liquidity ratio was 16.17%, increasing by 0.52 percentage points from 15.65% in June 2007. Generally speaking, the domestic banking sector had ample liquidity. (Chart 7)

chart7 ***Liquidity Ratio***



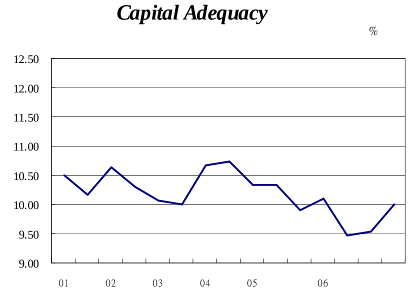
All data were in terms of the average of the last month of quarters.

Average Capital Adequate Ratio increased

The average BIS capital adequacy ratio was 10.00% as of the end of September 2007, increasing by 0.46 percentage points from 9.54% at the end of June 2007. Taken as a whole, most of the domestic banks have adequate capital. The average capital adequate ratio was disclosed quarterly since the third quarter of 2006. The data disclosed was based on unaudited basis.　(Chart 8)

chart 8

Capital Adequacy



All data as of month-end