Condition and Performance of Domestic Banks

Second Quarter 2007

■ *Summary of Condition and Performance*

Supported by the bullish Asian economies, the global economy would go forward on a stable growth. Meanwhile, benefited from continued expansion of international recovery, the domestic economic growth in Taiwan remains stable. The external sector, bolstered by the exports of consumption electronic products and the related products, kept robust in the second quarter of 2007. The smooth external demand contributed to the domestic consumption and the manufacturing of traditional industry. Moreover, with the improving unemployment rate and the tailing-off negative impact of consumer debt, Taiwan’s economic growth is anticipated to stay in an ongoing trend. Generally speaking, thanks to the robust external demand and the modest private consumption, Taiwan’s domestic economy showed rebound in the global market. According to the statistics of Directorate-General of Budget, Accounting and Statistics, Executive Yuan, the preliminary real GDP growth rate was 5.07% in the second quarter of 2007, increasing 0.37 percentage points from 4.70% at the same quarter of the previous year.

Although recovered from a legacy of impaired assets in consumer’s loans gradually, the domestic banking sector’s risk management capacity and discipline are still developing. Most domestic banks had diversified their businesses to enlarge the profits. The domestic banks had aggressively expanded into wealth management, asset management, treasury, and trust business to enhance revenue diversification. The low interest rate margin had driven banks to tap into fee-based business. Fortunately, benefited from the remarkable performance, they gradually turned in fairly good performance in the first half of this year. Besides, based on the adequate capital and ample liquidity, the banking sector grasped new business opportunities and performed better management of risks.

■ Key Trend

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

Major income components

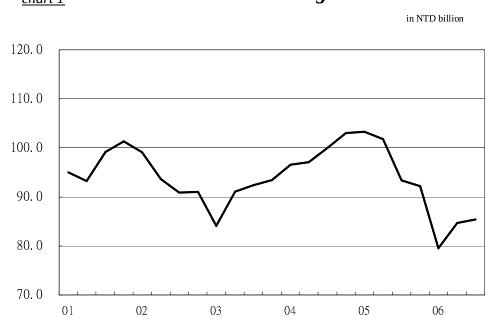
NT$ billion

	Jan.-Jun. 2006	Jan.-Jun. 2007	% Change
Income			
Net interest income	195.1	170.1	-12.8
Net revenues other than interest	57.0	61.6	8.1
Expense			
Loan loss provision	89.1	63.5	-28.7
Other expense	127.0	135.9	7.0
Net income	36.0	32.3	-10.3

Net Interest Margin（NIM） increasing

The NIM was NT$85.4 billion during this quarter, increasing by NT$0.7 billion（0.83%） compared with the previous quarter due to the interest spread remaining on a downward trend. (Chart 1)

chart 1 **Net Interest Margin**



All data were on the quarter base

Deposits increased

Total deposits as of the second quarter's end of 2007 were NT$20,837.8 billion, increasing by NT$255.5 billion (1.24%) compared with the preceding quarter. It was mainly from a large increase in foreign deposits. The annual growth rate of total deposits was 5.70%, 0.68 percentage points up from 5.02% as of the second quarter's end of 2006. (Chart 2)

Loans grew slightly

The total loans were NT$ 17,585.5 billion at this quarter's end, increasing by NT$ 185.9 billion (1.07%) compared with preceding quarter. The slight growth rate was due to the bank claims on private sector, especially in the real estate sector and mortgage loans. (Chart 3)

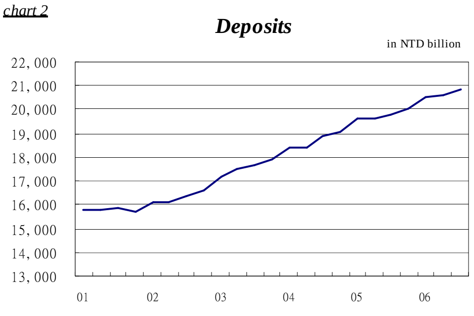
Investments increased slightly

The investments were classified based on the Statements of Financial Accounting Standards No.34 "Financial instruments：Recognition and Measurement" issued by the Accounting Research and Development Foundation of the R.O.C. The total investments amounted to NT$3,780.5 billion, increasing by NT$117.8 billion (3.22 %) compared with the previous quarter. (Chart 4)

Asset quality improved continuously

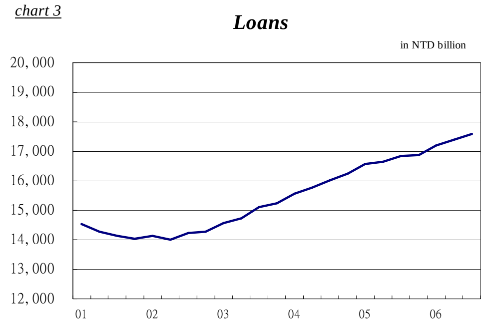
The average ratio of non-performing loans at this quarter went down by 0.03 percentage points to 2.32 %. Based on the adequate capital and ample liquidity, the banking sector performed better management of risk. The non-performing assets of the overall banking sector remain manageable. Besides, the average provision coverage ratio was54.31%, 1.49 percentage points up from 52.82% as of previous quarter's end. More broadly, the consumer credit problem is likely to ameliorate in 2007. (Chart 5)

chart 2



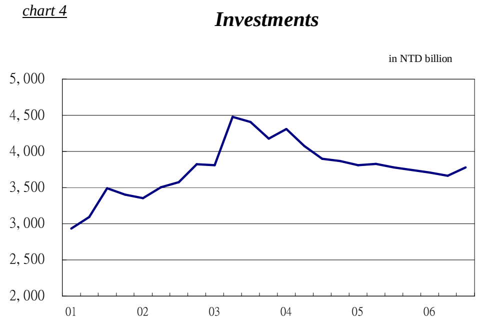
All data as of month-end

chart 3



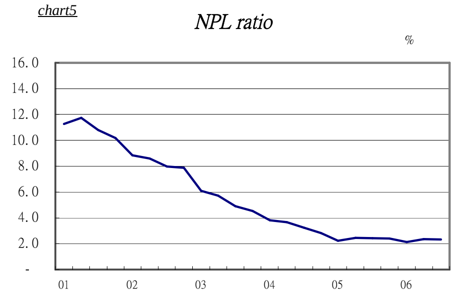
All data as of month-end

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 1.28% , slightly leveled off from 1.29% at the end of preceding quarter. It was due to the increase of loans outpacing the increase of loan loss provisions. （Chart 6）

Liquidity Ratio decreasing slightly

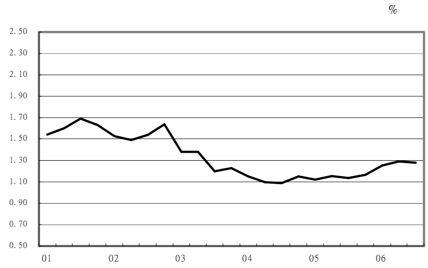
The liquidity ratios of all domestic banks were over the statutory minimum ratio (7%) in June 2007. The average liquidity ratio was 15.65%, decreasing by 1.54 percentage points from 17.19% in March 2007. Generally speaking, the domestic banking sector had ample liquidity. (Chart 7)

Average Capital Adequate Ratio increased

The average BIS capital adequacy ratio was 9.54% as of the end of June 2007, increasing by 0.08 percentage points from 9.46% at the end of March 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 6

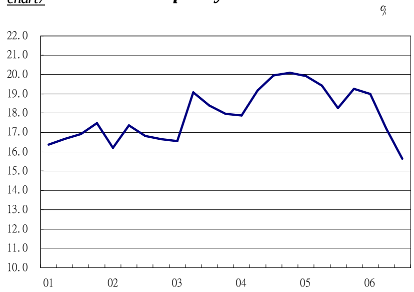
Provision-to-loan ratio



All data as of month-end

chart7

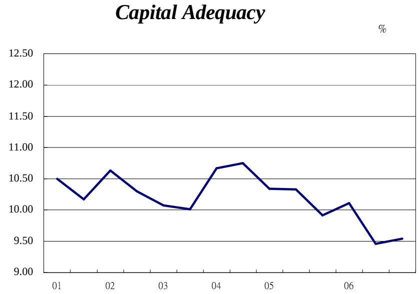
Liquidity Ratio



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

chart 8

Capital Adequacy



All data as of month-end