

II. Financial Developments

1. Overview

In the year 2010, along with global economic recovery, Taiwan's domestic economic activity steadily picked up, which in turn stimulated the overall demand for funds and an expansion of bank credit. In addition, net foreign capital inflows contributed to the continued growth in monetary aggregates. However, the growth rates of M2 and M1B were lower than those of the previous year due to the higher base effect. Market interest rates trended up gradually as the Bank raised policy rates three times in the second half of the year. Meanwhile, during the corresponding period, the NT dollar moderately appreciated.

Slower Growth in Monetary Aggregates

The annual growth rate of M2 declined from 7.21 percent in the previous year to 4.59 percent in 2010, close to the median of the Bank's 2.5 percent to 6.5 percent target zone for the year. As the robust recovery in the economy led to the rise in transaction demand for money, coupled with bullish stock markets and continued net capital inflows, the average annual growth rate of M1B recorded 14.93 percent, slightly lower than the previous year's 16.54 percent due to the higher base effect.

Continued Growth in Banks' Loans and Investments

Loans and investments of major financial institutions grew at an annual rate of 6.19 percent at the end of 2010, up from 0.75 percent registered a year earlier, mainly because economic activity had recovered from the global financial crisis, and enterprises' demand for funds strengthened. If the loans and investments of life insurance companies, non-accrual loans reclassified, and bad loans written off by major financial institutions, as well as funds raised directly in the financial markets were taken into account, the total funds raised by the non-financial sector registered an annual growth rate of 5.47 percent at the end of the year, higher than the 1.62 percent recorded at the previous year-end.

Improvement in Financial Performance of Domestic Banks

The pre-tax profits of depository institutions went up in 2010, mainly due to increases in the fair value of financial assets and the profits of portfolio investments. As a result, their average return

on assets and return on equity were both higher than those of the previous year. The average capital adequacy ratio of domestic banks increased from the previous year-end's 11.83 percent to 11.96 percent. Meanwhile, the overall non-performing loan ratio decreased from 1.15 percent to 0.61 percent during the same period.

Uptrend in Market Interest Rates

The Bank gradually adjusted its monetary easing policy and raised policy rates three times since June. This effectively guided banks' posted interest rates on deposits and loans to inch up. The average fixed rate on one-year time deposits of the five major domestic banks moved upward from 0.89 percent at the previous year-end to 1.13 percent at the end of 2010, and their weighted average rate on new loans also edged up to 1.39 percent at the end of 2010.

Rise in Money Market Rates and Continuous Decline in Bond Yields

As the Bank raised policy rates, the interbank overnight call-loan rate rose from 0.11 percent of the previous year-end to 0.24 percent at the end of 2010. Primary market rates on commercial paper also slightly went up. Regarding the bond market, yield rates kept falling. The average yield rate on the 10-year government bond in 2010 was 1.37 percent, down by 0.14 of a percentage point over the previous year.

Gains in Stock Shares

In the stock markets, the TAIEX was boosted by the effects of the cross-strait MOU on financial cooperation in the beginning of the year. As Mainland China raised reserve requirements and the sovereign debt crisis erupted in Greece and other Southern European countries, the TAIEX took a plunge in early February. Thereafter, boosted by easing concerns over the Greek debt crisis, the TAIEX regained its previous losses and reached 8,172 points on April 15. From May to mid-June, as Mainland China raised required reserve ratios for the third time and the Southern European sovereign credit crisis reemerged, the TAIEX was dragged down to a yearly low of 7,072 points on June 9. In the second half of the year, owing to the relief of the Southern European sovereign debt crisis from mid-June, the effect of the ECFA and the Fed's continued quantitative easing policy, the TAIEX rose steadily to reach an all-year high of 8,973 points on December 31, 2010, posting an increase of 9.6 percent from the 8,188 points recorded at the end of 2009. The daily average turnover in the TAIEX market in 2010 decreased by 5.0 percent from the previous year.

Moderate Appreciation of the NT Dollar

The NT dollar exchange rate (NT\$/US\$) was stable from January to March. Afterwards, the NT

dollar appreciated against the US dollar as the appreciation expectation of the RMB induced foreign capital inflows. In May, the increasing sovereign credit risk in the euro area and the political tension on the Korean peninsula caused foreign capital flight out of East Asia, and consequently the NT dollar depreciated to a yearly low of 32.528 on June 7. From September on, as the US Fed continued its easy monetary policy, foreign capital inflows pushed the NT dollar to reach a yearly high of 30.217 on December 30. On a daily average basis, the NT\$/US\$ exchange rate appreciated by 4.45 percent compared with that of the previous year, and the trade-weighted nominal effective exchange rate index of the NT dollar increased by 1.30 percent for the year.

