

II. Financial Developments

1. Overview

In the first half of year 2011, Taiwan's economy expanded moderately. However, growth momentum slowed during the second half. For the whole year, the overall demand for funds grew steadily. The annual growth rate of bank loans and investments was slightly lower than that of the previous year. Meanwhile, the annual growth rate of M2 was higher than the previous year, while that of M1B was much lower. Market interest rates rose slightly in the first half of the year as guided by policy rate increases, and remained steady in the second half of the year. As for the exchange rate against the US dollar, the NT dollar modestly appreciated during 2011.

Steady Growth in Monetary Aggregates

Along with continuous growth of bank credit in 2011, the monetary aggregate M2 recorded an annual growth rate of 5.83 percent, higher than the previous year's 4.53 percent, and remaining within the Bank's 2.5 percent to 6.5 percent target range for the year. The annual growth rate of M1B decelerated to 7.16 percent, decreasing by 7.77 percentage points from the previous year. The decline mostly reflected the shift of funds from demand deposits to time deposits and decreased stock market trading in the second half of the year, as well as a higher base effect.

Slowing Growth in Bank Loans and Investments

Loans and investments of monetary financial institutions grew at an annual rate of 6.00 percent at the end of December, slightly down from 6.15 percent registered a year earlier, mainly because corporate demand for funds turned weak during the second half of the year due to the global economic slowdown. If the loans and investments of life insurance companies, non-accrual loans reclassified, and bad loans written off by monetary financial institutions, as well as funds raised directly from capital markets, were all taken into account, the total funds raised by the non-financial sector would register an annual growth rate of 5.06 percent at the end of December, lower than the 5.44 percent recorded a year earlier.

Continued Improvement in Financial Health of Domestic Banks

The asset quality of domestic banks continued to improve in 2011. The overall non-performing loan ratio decreased from the previous year-end's 0.61 percent to 0.43 percent at year end. The pre-tax profits of monetary financial institutions kept growing during the year, and their average return on assets and return on equity were both higher than those of the previous year, mainly due

to the gradual widening of interest spreads and declining bad debt allowances. As a result, the average capital adequacy ratio of domestic banks increased from the previous year-end's 11.96 percent to 12.07 percent.

Interest Rates on Deposits and Loans Steady After Initially Rising

The Bank raised policy rates twice in the first half of the year, thus guiding banks' posted interest rates on deposits and loans to trend up gradually. In the second half of the year, as the global economic and financial uncertainties intensified, the Bank decided to keep policy rates unchanged. As a result, almost all banks held their posted interest rates on deposits and loans steady for the rest of the year. The average fixed rate on one-year time deposits of the five major domestic banks moved upward to 1.36 percent at the end of 2011, 0.23 percentage points higher than that at the previous year-end, and their weighted average rate on new loans also edged up to 1.53 percent at the end of 2011.

Slight Rises in Money Market Rates and Bond Yields

Money market interest rates went up gradually as the Bank raised policy rates twice in the first half of the year, and then remained steady in the second half of the year. The average interbank overnight call-loan rate of 2011 rose to 0.34 percent, 0.15 percentage points higher than that of the previous year. Secondary market rates on commercial paper also went up. Regarding the bond market, yield rates slightly rose. The average yield rate on the 10-year government bond in 2011 was 1.38 percent, up by a mere 0.01 of a percentage point over the previous year.

Downtrend in Stock Indices

After large swings in the first half of the year, Taiwan's stock market tumbled in the second half of the year, mainly due to adverse impacts of the Japanese earthquake and the deepening European sovereign debt crisis. In early 2011, the TAIEX soared on foreign investor buying to reach the yearly high of 9,145 on January 28. The Japanese earthquake in March and the potential nuclear crisis dragged the TAIEX down briefly. From August onwards, as the European sovereign debt crisis became worse and the global economy slowed down, the TAIEX dropped. With domestic investors becoming more cautious before the presidential election, the TAIEX weakened further and tumbled to a yearly low of 6,633 on December 19. The TAIEX closed the year at 7,072, a decline of 21.2 percent from the end of 2010. In 2011, the TWSE market turnover, measured on a daily average basis, declined by 5.6 percent to NT\$106.1 billion.

Moderate Appreciation of the NT Dollar

The NT dollar appreciated against the US dollar from January to May, mainly because of the US dollar depreciation attributable to the US credit rating downgrade. The NT\$/US\$ exchange rate

soared to a yearly high of 28.632 on May 5. International stock markets slid in September as the European sovereign debt crisis deepened, and therefore foreign investors sold off in Taiwan's stock market, weakening the NT\$/US\$ exchange rate to a yearly low of 30.680 on October 4. Compared to the end of the previous year, the NT dollar appreciated by 0.26 percent against the US dollar. On a daily average basis, the NT\$/US\$ exchange rate appreciated by 7.39 percent compared with that of the previous year, and the trade-weighted nominal effective exchange rate index of the NT dollar increased by 2.26 percent for the year.

