

II. Financial Developments

1. Overview

In 2015, market interest rates on deposits and loans both moved lower, mainly as a result of two policy rate cuts by the CBC to stimulate the domestic economy. Most money market rates exhibited a downward trend owing to ample liquidity. The average 10-year government bond yield also exhibited a downtrend, as hedging demand for NTD bonds increased in response to sluggish economic growth and a falling stock market. The economic downturn also dampened growth in loans and investments of monetary financial institutions; however, a net foreign capital inflow and an increase in foreign currency deposits boosted growth in M2.

With respect to the exchange rate, the NT dollar against the US dollar fluctuated in the first half of the year as the market reacted to the uncertainty surrounding the Fed's rate hike. In the second half of the year, renminbi devaluation by China's central bank in mid-August triggered downward pressure on Asian currencies including the NT dollar. On the whole, the NT dollar depreciated against the US dollar in 2015. In the stock market, despite favorable factors including rate cuts by several central banks and further monetary stimulus by the European Central Bank (ECB), domestic stock market indices were still dragged lower by the slowdown of global economic growth, net sales by foreign investors in the second half of the year, and the plunges of the world's major stock indices.

Growth in Monetary Aggregates Accelerated

The monetary aggregate M2, measured on a daily average basis, recorded a yearly growth rate of 6.34% in 2015. This was higher than the 5.66% in 2014 and yet remained within the CBC's 2.5% to 6.5% target range for the year. The pickup was mainly a reflection of a net foreign capital inflow and an increase in foreign currency deposits. The annual growth rate of M1B, measured on a daily average basis, decelerated to 6.10% in 2015 from 7.96% in 2014, mainly because sluggish economic growth and stock market trading lowered the demand for transaction money. Meanwhile, the annual growth rate of reserve money decreased in 2015, mainly owing to weak demand for funds, and slower growth in bank loans and investments and in demand deposits.

Growth in Bank Loans and Investments Slowed

The annual growth rate of loans and investments, compared with that at the end of 2014, decreased from 5.20% to 4.61% at the end of 2015. The decrease was due to contracted growth

in bank loans, mainly affected by weaker demand for funds by the private sector amid weakening export growth and an economic slowdown. For the year as a whole, the average annual growth rate of loans and investments of monetary financial institutions dropped from 4.96% in 2014 to 4.66% in 2015. 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 2.54% at the end of 2015, lower than the 4.14% recorded a year earlier.

Bank Asset Quality Improved

The asset quality of Taiwan's banks remained sound, thanks to their limited exposure to highly uncertain global financial markets. The overall non-performing loan ratio of monetary financial institutions decreased from 0.27% at the end of 2014 to 0.25% at the end of 2015. In contrast to steady increases in net interest revenue and net fee income during the year, the pre-tax profits of monetary financial institutions slightly decreased mainly owing to a decrease in investment revenues resulting from declined valuations of portfolio investments. In addition, their average return on assets and return on equity were both lower than those of the previous year, dropping from 0.68% and 11.80% to 0.65% and 10.84%, respectively.

Average Rates on Deposits and Loans Decreased Slightly

The CBC cut the policy rate twice in 2015 and, as a result, the posted interest rates on deposits and loans of banks went lower during the year. At the end of 2015, the average fixed rate on one-year time deposits and base lending rates of the five major domestic banks were all lower than those of 2014. Meanwhile, the weighted average rate on their new loans decreased slightly because of a downswing in rates on loans for current operations resulting from increases in low-interest loans of local governments and government enterprises.

The weighted average interest rates on deposits moved downward, mainly because the CBC lowered the policy rate twice and because the share of time deposits in total deposits shrank from the previous year. Meanwhile, the weighted average interest rates on loans also declined slightly, mainly because of increases in low-interest loans of local governments and government enterprises.

Bills Market Rates and 10-Year Government Bond Yields Declined

Reflecting the CBC's rate cuts, the interbank overnight call loan rate began to decline from the third quarter onwards. With regard to the bills market, weak demand for funds and easy funding conditions led money market rates to exhibit downtrends.

During the beginning months of 2015, the yield on the benchmark 10-year government bond

trended downward, mainly influenced by increased hedging demand for NTD bonds against the economic slowdown and stock market declines. The yield continued to move downwards as the CBC lowered policy rates twice in the later months of 2015. In terms of issuance, as tax revenue increased and issuance was approaching the statutory limit, the total amount of government bonds issued decreased from the previous year.

Exchange Rate Depreciated

At the beginning of 2015, the US dollar became stronger, supported by a steady US economic recovery. Yet, the discontinuation of the Swiss franc/euro exchange rate floor in mid-January gave rise to capital flight into emerging Asia including Taiwan, leading the NTD/USD exchange rate to fluctuate. Afterwards, the NT dollar appreciated as the US dollar weakened on the news of unsatisfactory first quarter GDP and the resulting market anticipation of the Fed postponing interest rate normalization; the NT dollar against the US dollar reached a yearly high on May 22. In mid-August, Asian currencies softened as the People's Bank of China lowered the central parity of the renminbi against the US dollar. Meanwhile, Taiwan's exports continued to contract and the CBC announced policy rate cuts. These combined to send the NT dollar lower towards a yearly low on September 25. At the end of 2015, the NT dollar depreciated against the US dollar by 4.08% compared to that at the end of the previous year. On an annual average basis, the NT dollar depreciated by 4.80% in 2015.

Stock Index Swung to Decline

During early 2015, the domestic stock market's mainboard index, the TAIEX, trended up to hit an all-year high at 9,973 on April 27, mainly driven by rises across major international stock markets following rate cuts by several central banks and the start of the ECB's new QE program. Afterwards, the TAIEX reached a yearly low of 7,410 points on August 24, mainly affected by the global economic slowdown, net sales by foreign investors, and international stock market crashes. In the following months, the TAIEX swung upwards owing to share buying by the National Financial Stabilization Fund to bolster the domestic stock market and the stabilization in major international stock markets. The TAIEX was 8,338 points at the end of the year, decreasing by 10.41% compared with the previous year end.