

II. Financial Developments

1. Overview

In 2016, market interest rates on deposits and loans both moved lower, mainly owing to two policy rate cuts by the CBC in the first half of the year. From January to August, most money market rates and the average 10-year government bond yield generally exhibited a downward trend because of ample liquidity and a sluggish economy. Thereafter, they turned upwards as the CBC held policy rates unchanged in view of a stabilizing economy. Although growth in loans increased, the conservative attitude of commercial banks towards investments dampened growth in loans and investments of monetary financial institutions, which in turn caused growth in M2 to decrease.

With respect to the exchange rate, the NT dollar against the US dollar depreciated at the beginning of 2016, extending the weak trend of the previous year. Afterwards, affected by factors including the Bank of Japan's negative interest rate policy, the Brexit referendum result, the US presidential election, and the Fed's rate hike, the NT dollar against the US dollar swung into depreciation after appreciation in the preceding months. In the stock market, concerns over the Fed's possible rate hike led the domestic stock market indices to swing lower in the first half of the year. Then, owing to favorable factors including net purchases by foreign investors, rallies across international stock markets, and the domestic economic recovery, the local indices trended up in the second half of the year.

Growth in Monetary Aggregates M2 Decelerated

The monetary aggregate M2, measured on a daily average basis, recorded a yearly growth rate of 4.51% in 2016. This was lower than the 6.34% in 2015 and remained within the CBC's 2.5% to 6.5% target range for the year. The drop was mainly due to slower growth in bank loans and investments. The annual growth rate of M1B, measured on a daily average basis, rose to 6.33% in 2016 from 6.10% in 2015, mainly because of higher growth in bank transaction deposits. Meanwhile, the annual growth rate of reserve money increased in 2016 as a result of higher growth in transaction deposits.

Growth in Bank Loans and Investments Slowed

Although loan growth increased owing to the economic recovery and increasing demand for funds by the private sector in the second half of the year, the annual growth rate of loans and investments, compared with that at the end of 2015, decreased from 4.61% to 3.88% at the end of 2016. The decrease was because commercial banks became conservative in investment decisions

on concerns about increasing uncertainty in international financial markets. If loans and investments of life insurance companies, non-accrual loans reclassified and bad loans written off by monetary financial institutions, and funds raised directly from capital markets were all taken into account, the total outstanding amount of funds raised by the non-financial sector would register an annual growth rate of 2.56% at the end of 2016, close to the 2.54% recorded a year earlier.

Bank Asset Quality Slightly Declined

The asset quality of Taiwan's banks slightly declined and the overall non-performing loan ratio of monetary financial institutions slightly increased from 0.25% at the end of 2015 to 0.28% at the end of 2016. In addition, the pre-tax profits of monetary financial institutions decreased mainly owing to growing expenses for bad loans written off. Their average return on assets and return on equity were both lower than those of the previous year, dropping from 0.65% and 10.84% to 0.59% and 9.13%, respectively.

Average Rates on Deposits and Loans Dropped

The CBC cut the policy rate twice in 2016 and, consequently, the posted interest rates on deposits and loans of banks went lower during the year. At the end of 2016, 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 2015. Meanwhile, the weighted average rate on their new loans also decreased mainly because of a drop in rates on loans for current operations resulting from increases in low-interest loans of governments and government enterprises.

For domestic banks as a whole, the weighted average interest rate on deposits moved downward, mainly because the CBC lowered the policy rate and the share of time deposits in total deposits shrank from the previous year. Meanwhile, the weighted average interest rate on loans also declined, mainly reflecting lower policy rates and increases in low-interest loans of governments.

Bills Market Rates and 10-Year Government Bond Yields Swung to Increase

Reflecting the CBC's rate cuts, the interbank overnight call loan rate declined during the year of 2016. With regard to the bills market, from January to August, weak demand for funds and easy funding conditions led money market rates to exhibit a downtrend. Thereafter, they trended up because of the economic recovery.

From January to August of 2016, the yield on the benchmark 10-year government bond trended downward, mainly influenced by increased hedging demand for NTD bonds against the slow economic recovery and the CBC's rate cuts. The yield then rose owing to the domestic economic upturn and the Fed's rate hike. In terms of issuance, as tax revenue increased and the amount of issuance was approaching the statutory limit, the total amount of government bonds issued

decreased over the previous year.

Exchange Rate Rose After a Weak Start, Then Depreciated

At the beginning of 2016, the NT dollar against the US dollar remained weak as in the previous year and reached a yearly low on January 21. Afterwards, the NT dollar appreciated owing to the Bank of Japan's negative interest rate policy and the international capital influx into Asia's emerging economies. As the Fed became wary of lifting rates after the Brexit vote at the end of June, the NT dollar climbed up further against the US dollar to a yearly high on August 10. Thereafter, the US dollar strength was affected by uncertainty surrounding the US presidential election, leading the NT dollar against the US dollar to fluctuate in a narrow range. As the US dollar firmed after Trump's election as the US president in November, and the Fed raised the policy rate in mid-December, the NT dollar generally depreciated in the last two months. At the end of 2016, the NT dollar appreciated against the US dollar by 2.44% compared to that at the end of the previous year. However, the NT dollar against the US dollar depreciated by 1.30% on an annual average basis.

Stock Index Fluctuated, Then Closed Higher

During early 2016, the domestic stock market's mainboard index, the TAIEX, trended up to 8,813 on March 21, mainly driven by net purchases by foreign investors and rises across major international stock markets. Afterwards, the TAIEX declined to 8,054 points on May 13, mainly affected by concerns over a possible Fed rate hike and less-than-expected domestic economic growth. In the following months, although there were uncertainties about Brexit and the US presidential election, the TAIEX swung upwards owing to the domestic economic recovery, net purchases by foreign investors, an international stock market rally and US stocks renewing record highs. The TAIEX closed at 9,254 points at the end of the year, increasing by 10.99% compared with the previous year end.