3. Banking Sector

Number of Monetary Financial Institutions

At the end of 2016, the number of monetary financial institutions (defined hereafter in this chapter as excluding the central bank) amounted to 404. The number of foreign and Mainland Chinese banks decreased by one due to the closing of one business. The number of credit departments of farmers' and fishermen's associations increased by two owing to new openings, while the numbers of the other types of institutions all remained unchanged.

Number of Monetary Financial Institutions by Type

Types of institutions	End of 2016	End of 2015	Annual Change
Total Number of Main Offices	404	403	1
Domestic Banks	40	40	0
Foreign and Mainland Chinese Banks	29	30	-1
Credit Cooperatives	23	23	0
Credit Departments of Farmers' and Fishermen's Associations	311	309	2
Chunghwa Post	1	1	0
Total Number of Branches	6,111	6,119	-8
Local Branches	5,908	5,925	-17
Overseas Branches	141	132	9
Offshore Banking Units	62	62	0

Sources: 1. *Financial Statistics Monthly*, CBC.
2. Department of Financial Inspection, CBC.

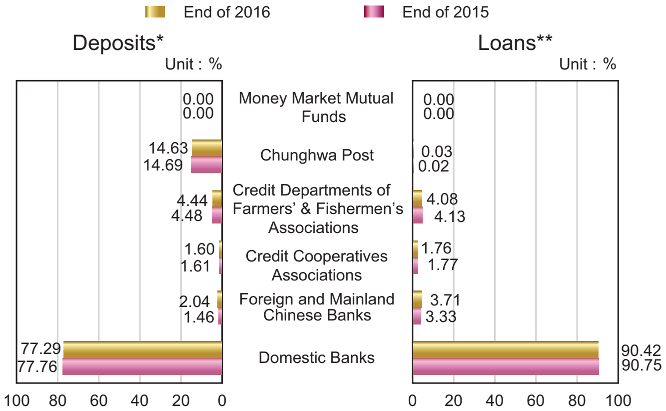
The number of money market mutual funds and the number of financial holding companies remained at one and 16, respectively, with the former being a fund raised and managed by Yuanta Commercial Bank.

Market Shares of Deposits and Loans

The growth of deposits slowed down in 2016 partly because deposit rates were still low. Moreover, the FSC announcement to lower the interest rates on some insurance policy reserves from 2017 onwards prompted some savers to buy endowment savings policies with the money from their matured CD contracts before the premium of insurance policies rose.

In terms of market shares of deposits, the market share of foreign and Mainland Chinese banks grew considerably to 2.04% because some of these banks offered better rates or appealed to savers with preferential rates or by issuing negotiable certificates of deposit. In contrast, the market shares of domestic banks, Chunghwa Post, credit departments of farmers' and fishermen's associations, and credit cooperatives declined to 77.29%, 14.63%, 4.44%, and 1.60%, respectively.

Market Shares of Deposits and Loans by Category of Monetary Financial Institutions



Notes: * The carrying values of the host contracts of structured products issued by banks are excluded.
** Including data for securities acquired under reverse repurchase agreements.
Source: *Financial Statistics Monthly*, CBC.

In terms of loans, the market share of domestic banks shrank to 90.42%, whereas that of foreign and Mainland Chinese banks went up to 3.71%. As public enterprises enjoyed good profits, they borrowed less from domestic banks, resulting in slower loan growth. Domestic banks also lost some loan customers, including SMEs, to foreign banks whose lending rates were lower. For the other institution types, Chunghwa Post's market share of loans increased modestly to 0.03%. For credit departments of farmers' and fishermen's associations and credit cooperatives, higher lending rates caused their market shares to decrease to 4.08% and 1.76%, respectively.

Sources and Uses of Funds

At the end of 2016, the total amount of funds in monetary financial institutions was NT$46,436 billion, increasing by NT$1,653 billion compared to the end of 2015. The combined share of transaction and non-transaction deposits still accounted for 85%, but they both grew at a much slower pace than the previous year. Their declines in growth resulted from some savers switching to insurance products for higher returns in response to low deposit interest rates following the CBC's rate cuts since September 2015. As for foreign currency deposits, market expectation of the Fed's rate hike caused both the balance and the pace of growth of foreign currency deposits to increase compared to the previous year. As for other items, its balance increase largely came from gains in banks' profits.

In the case of fund uses, foreign currency loans by the corporate sector decreased owing to the expectation of USD appreciation, whereas all the other items increased at the end of 2016 compared to the end of 2015. Bank loans accounted for over 50% of total uses of funds. Despite the significantly weaker demand from government and public enterprises, growth of loans still rose from 3.26% to 3.57% thanks to a greater demand from private enterprises amid a recovering economy in the second half of 2016. Furthermore, the balance and the share of net foreign assets both increased over the end of the previous year, largely driven by USD strength.

Because of ample liquidity in the banking system, both portfolio investments and banks' purchases of CDs issued by the CBC rose at the end of 2016 compared to the end of 2015. Growth in portfolio investments by monetary financial institutions slowed, mainly affected by the Fed's policy stance change, the new US administration's policy direction and the impact of Brexit. In addition, both the share and growth of banks' purchases of CDs issued by the CBC declined, continuing the trend of the past few years.

Sources and Uses of Funds in Monetary Financial Institutions[1]

Unit: NT$ Billion

	End of 2016			End of 2015			Annual Change	
	Amount	Share (%)	Annual Growth Rate (%)	Amount	Share (%)	Annual Growth Rate (%)	Amount	Share (%)
Sources:								
Transaction Deposits[2]	14,497	31.22	5.61	13,727	30.65	6.83	770	0.57
Non-transaction Deposits[3]	25,124	54.10	2.63	24,480	54.67	4.34	645	-0.57
NT Dollar Deposits	20,122	43.33	1.14	19,895	44.43	3.48	227	-1.10
Foreign Currency Deposits	5,002	10.77	9.12	4,584	10.24	8.27	418	0.53
Government Deposits	895	1.93	5.83	846	1.89	9.61	49	0.04
Other Items	5,919	12.75	3.29	5,731	12.79	13.04	189	-0.04
Total	46,436	100.00	3.69	44,784	100.00	6.24	1,653	0.00
Uses:								
Net Foreign Assets[4]	4,518	9.73	8.99	4,145	9.26	27.70	373	0.47
Loans	25,123	54.10	3.57	24,256	54.16	3.26	866	-0.06
NT Dollar Loans	24,295	52.32	3.78	23,409	52.27	4.03	886	0.05
Foreign Currency Loans[4]	828	1.78	-2.27	847	1.89	-14.17	-19	-0.11
Portfolio Investments[5]	5,425	11.68	5.76	5,129	11.45	10.59	295	0.23
Purchases of CDs Issued by CBC	7,487	16.12	1.00	7,412	16.55	5.59	74	-0.43
Deposits with CBC	3,884	8.37	1.15	3,840	8.58	2.20	44	-0.21

Notes: 1. Monetary Financial Institutions include Domestic Banks, Local Branches of Foreign and Mainland Chinese Banks, Credit Cooperatives, Credit Departments of Farmers' and Fishermen's Associations, Chunghwa Post and Money Market Mutual Funds.
2. Including checking accounts, passbook deposits and passbook savings deposits.
3. Including time deposits, time savings deposits, foreign currency deposits, postal savings deposits, non- residents' NT dollar deposits, repurchase agreements, and money market mutual funds.
4. Excluding valuation changes in the exchange rate of the NT dollar against foreign currencies
5. Measured at original costs.

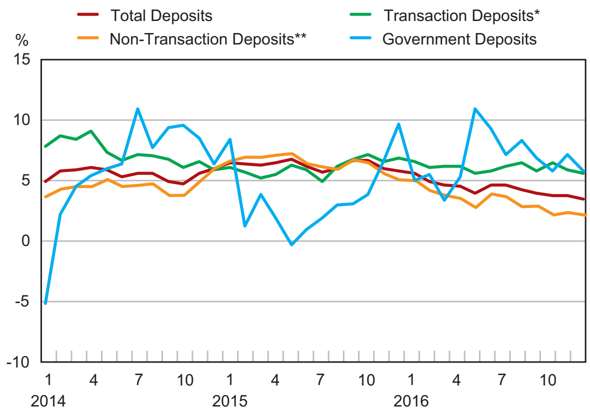
Source: *Financial Statistics Monthly*, CBC.

Downtrend in Deposit Growth

In 2016, the global economy performed weaker than expected, domestic economic growth slowed down and inflation expectations were mild. The CBC cut interest rates in March and July to ease conditions of market liquidity, which drove down deposit rates. Owing to low deposit rates, some people moved their funds from bank deposits to insurance products, causing the growth rate of deposits to decline to 3.45% at the end of 2016.

In terms of monthly movement, except for June and July, the growth rate of deposits roughly trended downward in 2016, mainly because some deposits were shifted to insurance products. With larger net foreign capital inflows and a buoyant domestic stock market causing foreign currency deposits and passbook savings deposits to both increase, the growth rate of deposits went up in June and July.

Annual Growth Rates of Deposits



Notes: * Including checking accounts, passbook deposits and passbook savings deposits.
** Including time deposits, time savings deposits, foreign currency deposits, postal savings deposits, non-residents' NT dollar deposits, repurchase agreements, and money market mutual funds.

Source: *Financial Statistics Monthly*, CBC.

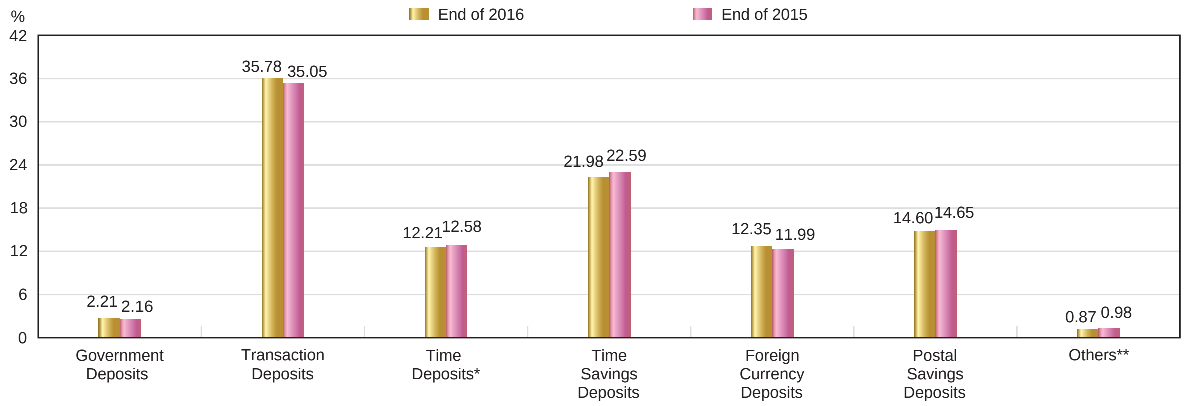
Afterwards, net foreign capital inflows continually decreased and even turned into net foreign capital outflows from October to December. Furthermore, some depositors switched to endowment savings insurance policies before insurance premiums were set to rise once the related FSC announcement became effective in 2017. As a result, the growth rate of deposits dipped through to December.

For transaction deposits, the annual growth rates in January and February declined because of a higher comparison base in the corresponding period of the previous year. The annual growth rate increased to 6.12% in March on account of active trade in the stock market. In April and July, there were both notable rises in checking accounts, so the annual growth rates went up. However, the annual growth rates significantly decreased because enterprises and residents filed tax returns in May and June. Between August and December, the annual growth rates rose first and fell shortly after. This was largely because the deposit balance of securities giro accounts fell after rising as well. At the end of 2016, the annual growth rate of deposits dropped to 5.61% from 6.83% the previous year end.

For the year as a whole, non-transaction deposits posted a decline in annual growth rate from 5.15% in 2015 to 2.17% in 2016 owing to low deposit interest rates and a shift of funds from deposits to insurance products for higher returns. However, the annual growth rate in June significantly increased to 3.90% from 2.78% in May because enterprises preparing to pay dividends parked their funds in time deposits.

By type of non-transaction deposits, the share of foreign currency deposits went up to 12.35%, but its annual growth rate fell from 12.87% in 2015 to 6.52% in 2016 owing to a higher comparison base in the corresponding period of the previous year. The shares and annual growth rates of time savings deposits and postal savings deposits all declined because some people moved their deposits to insurance products.

Shares of Deposits by Type



Notes: * Including NCDs.
** Including repurchase agreements, non-residents' NTD deposits and money market mutual funds.

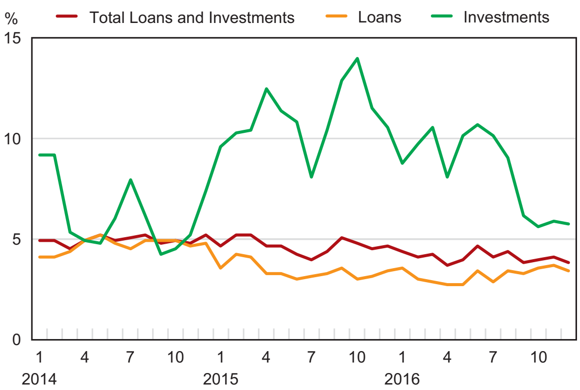
Source: *Financial Statistics Monthly*, CBC.

For time deposits, the share and annual growth rate both went down partly because some banks provided preferential interest rates for large-value transaction deposits leading to some funds flowed from time deposits to transaction deposits. In addition, owing to a higher base effect, the annual growth rate of government deposits trended down to 5.82%.

Lower Growth in Bank Loans and Investments

The annual growth rate of loans and investments of monetary financial institutions was 3.88% at the end of 2016, decreasing from 4.61% at the end of 2015. Growth in loans slightly increased to 3.48% at the end of 2016 from 3.43% at the end of the previous year, mainly owing to a greater demand from private enterprises amid a recovering economy. In contrast, growth in portfolio investment decelerated to 5.76% at the end of 2016 from 10.59% a year earlier. Banks became more conservative with their investments in response to the uncertainties over the global economy such as the Brexit effect, the path of the Fed's policy rate and the policy direction under the new US administration. In general, growth in banks' investments in all types of instruments exhibited a downward trend.

Annual Growth Rates of Loans and Investments



Source: *Financial Statistics Monthly*, CBC.

Loans by Sector

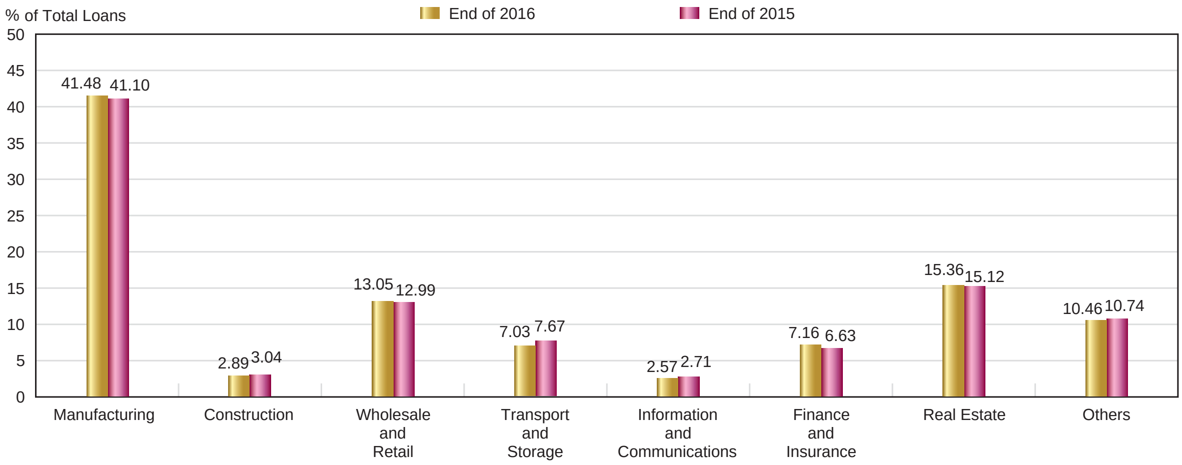
The annual growth rate of private sector loans by banks (defined in the following paragraphs as including domestic banks and local branches of foreign and Mainland Chinese banks) rose to 4.84% at the end of 2016 from 3.80% at the end of 2015. The upturn was mainly due to a stronger demand from private enterprises. The annual growth rate of loans to government enterprises decreased significantly to -15.64% at the end of 2016 from -3.40% at the end of the previous year, mainly because the CPC Corporation, Taiwan, and the Taiwan Power Company reduced their borrowing from banks, largely reflecting their considerable gains in annual profits. Meanwhile, the annual growth rate of loans to government agencies was -3.51% at the end of 2016, mainly on account of increased tax revenues thanks to the economic recovery. Though negative, the growth rate still represented an improvement compared to the -4.56% of the previous year end mainly as a result of a lower base effect.

In terms of loan composition, loans extended to the private sector accounted for 92.15% of total loans at the end of 2016, higher than the 91.22% recorded at the end of 2015. Loans extended to government agencies and public enterprises accounted for 5.65% and 2.20% at the end of 2016, respectively, lower than 6.08% and 2.70% at the end of the previous year.

Loans by Industry

Broken down by industry sector, bank loans to the manufacturing sector continued to account for the largest portion, at 41.48% at the end of 2016, increasing from 41.10% at the end of 2015. This increase was mainly due to faster growth in loans extended to electronic parts and components manufacturing as intelligent technology is increasingly applied to related products. Meanwhile,

Loans by Industry



Note: Figures include the data of domestic banks and local branches of foreign and Mainland Chinese banks but exclude their data on securities acquired under reverse repurchase agreements.
Source: *Financial Statistics Monthly*, CBC.

compared with the end of 2015, the share of loans extended to the construction industry slightly decreased from 3.04% to 2.89% at the end of 2016, reflecting a cautious outlook for the housing market.

The shares of loans extended to the transport and storage industry and the information and communications industry both shrank. The shares of loans extended to the remaining industries went up. In the finance and insurance industry, for example, as the money market interest rates moved upward in the fourth quarter of 2016, some industries repaid their commercial paper debts with bank loans, which contributed to an increase in loans extended to this industry.

Consumer Loans

The annual growth rate of consumer loans extended by banks decreased from 3.42% at the end of 2015 to 2.86% at the end of 2016. Among them, house-purchasing loans increased NT$232.9 billion, or 3.80%, in 2016, a slower year-on-year increase mainly because of a higher comparison base as transactions rose in the previous year before the enforcement of the integrated housing and land tax. As for the shares of various consumer loans, house-purchasing loans remained the largest component, with its share rising from 82.32% at the end of 2015 to 83.07% at the end of 2016. Car loans accounted for 1.65%, increasing from 1.60%, mainly because car sales were stimulated by the commodity tax cut for vehicle trade-ins. Meanwhile, house-repairing loans, revolving credit for credit cards and other consumer loans accounted for 1.82%, 1.41% and 11.40%, respectively, all decreasing from the end of the previous year.

Investments

Portfolio investments by monetary financial institutions, measured on a cost basis, showed slower growth with an annual increase of 5.76% in 2016, mainly because banks became more conservative with their investments in response to a number of uncertainties such as the Fed policy rate path, the new US administration's policy direction and the impact of Brexit.

Among the investment instruments, government bonds accounted for the largest share with 63.70%, higher than the 61.46% a year ago, mainly bolstered by massive purchases of government bonds by banks and the Department of Savings and Remittances of Chunghwa Post to seek low-risk investments. Meanwhile, banks began to adjust their asset allocation, investing more in commercial paper instead of corporate bonds in view of expectation of rising interest rates. At the end of 2016, commercial paper accounted for a share of 14.46%, larger than a year ago. Corporate bonds accounted for a share of 13.99%, decreasing from the end of 2015.

In terms of valuation changes, portfolio investments by monetary financial institutions, measured at fair value, recorded a year-on-year increase of NT$293.6 billion, while the increase was larger, at NT$295.4 billion, when measured on a cost basis.

Direct Finance and Indirect Finance

Financing channels of the non-financial sector comprise direct finance and indirect finance, referring respectively to issuing securities in the markets and credit made by financial institutions. Direct finance and indirect finance combined to increase from the previous year's NT$1,073.9 billion to NT$1,130.6 billion in 2016. Direct finance increased NT$229.5 billion during 2016, higher than the previous year's increase of NT$64.3 billion. Indirect finance decreased from the previous year's NT$1,009.6 billion to NT$901.1 billion, which was mainly due to slower growth in investments by financial institutions.

Based on the outstanding balance, the share of direct finance in total funds raised increased from 20.53% a year ago to 20.63% at the end of 2016, while the share of indirect finance decreased from 79.47% to 79.37%.

Direct Finance vs. Indirect Finance*

Unit: NT$ Billion

Year	Direct Finance (1)	Indirect Finance (2)			Total Funds Raised (3)=(1)+(2)
		Loans	Investments	Subtotal	
2007	82.7	737.0	228.6	965.6	1,206.4
2008	-316.1	649.2	563.0	1,212.2	1,048.3
2009	142.8	133.0	259.3	392.3	896.1
2010	165.5	1,242.6	433.8	1,676.4	535.1
2011	19.0	1,141.4	642.5	1,783.9	1,841.9
2012	17.0	809.4	880.7	1,690.1	1,802.9
2013	62.6	1,007.2	803.3	1,810.5	1,707.1
2014	234.3	1,248.6	217.8	1,466.4	1,873.1
2015	64.3	865.1	144.5	1,009.6	1,073.9
2016	229.5	909.4	-8.3	901.1	1,130.6

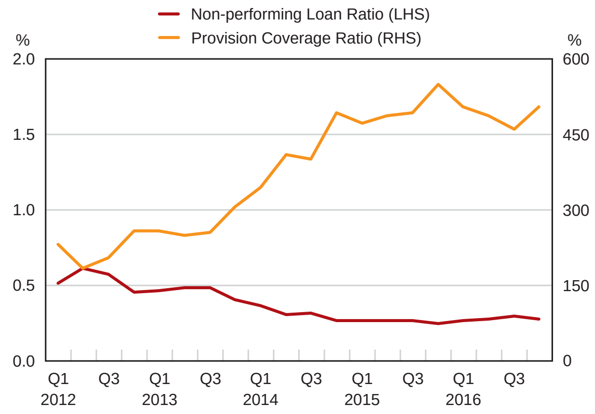
Notes: * Measured in terms of flow data.
(1)refers to the total amount of new issues of various marketable securities, including government bonds, corporate bonds, listed stocks, offshore bonds, depositary receipts, short-term bills, and asset-backed securities held by the non-financial sector.
(2)refers to loans and investments (measured on a cost basis) made by monetary financial institutions, trust and investment companies, and life insurance companies, after taking account of their non-accrual loans reclassified and bad loans written off.
Source: *Financial Statistics Monthly*, CBC

Increase in Non-performing Loan (NPL) Ratio

Because of declined asset quality, non-performing loans of monetary financial institutions as a whole increased by NT$11.5 billion to NT$81.9 billion in 2016, and their average NPL ratio also increased to 0.28% at the end of 2016 from the previous year's 0.25%.

Owing to an increase in non-performing loans, the average provision coverage ratio of monetary financial institutions decreased to 503.11% at the end of 2016 from 547.47% the previous year end.

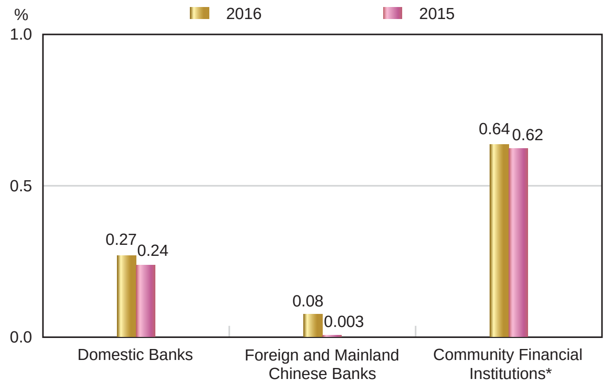
Non-performing Loan Ratio and Provision Coverage Ratio of Monetary Financial Institutions*



Note: * Including domestic banks, foreign and Mainland Chinese banks, credit cooperatives, credit departments of farmers' and fishermen's associations.
Non-performing Loan Ratio = Non-performing Loans / Total Loans
Provision Coverage Ratio = Loan Loss Provisions / Non-performing Loans

Source: Department of Financial Inspection, CBC.

Non-performing Loan Ratios by Type of Monetary Financial Institutions



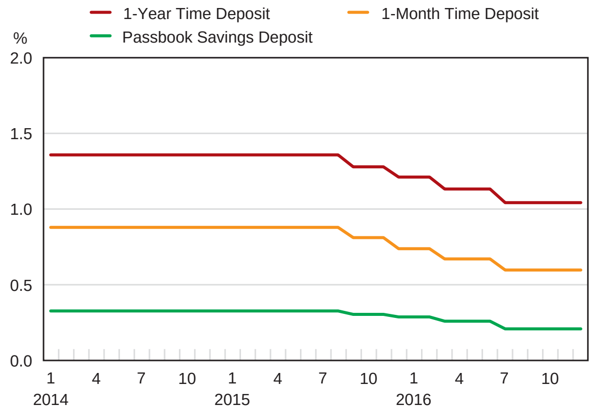
Note: * Including credit cooperatives and credit departments of farmers' and fishermen's accociations.

Source: Department of Financial Inspection, CBC.

Decline in Bank Interest Rates

The CBC lowered policy rates twice, effective on March 25 and July 1, respectively, by a total of 25 basis points to stimulate the economy. As a result, bank interest rates on deposits and loans went down. However, in the second half of the year, as the global economy was more clearly on track for a recovery and the domestic economy also stabilized, the CBC decided to keep policy rates unchanged; hence, domestic bank interest rates remained broadly steady. In the case of the interest rates of the five major domestic banks, their average fixed rates on one-month and one-year time deposits decreased to 0.60% and 1.04% at the end of July 2016 from 0.74% and 1.21% at the end of January, respectively, and then remained steady until the end of the year. Moreover, the average base lending rate decreased to 2.63% at the end of 2016 from 2.83% at the previous year-end.

Average Deposit Rates of the Five Major Domestic Banks*



Note: * The five major domestic banks are Bank of Taiwan, Taiwan Cooperative Bank, First Commercial Bank, Hua Nan Commercial Bank and Land Bank of Taiwan.

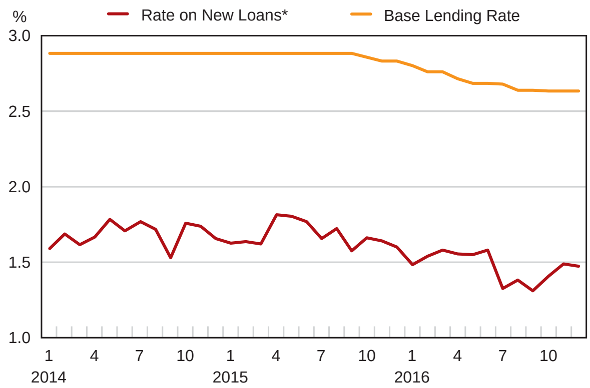
Source: *Financial Statistics Monthly*, CBC.

The weighted average rates on deposits and loans of domestic banks showed a downward trend in 2016 as well. Owing to the CBC's rate cut, the weighted average deposit rate decreased to 0.69% in the first quarter from 0.74% the previous quarter, and declined further to 0.57% in the fourth quarter of the year. On the whole, the weighted average interest rate on deposits of domestic banks was 0.63% in 2016, which was 0.14 percentage points lower than that recorded in the previous year.

With respect to the weighted average interest rate on new loans of the five major domestic banks, it fluctuated within a narrow range between 1.49% and 1.58% during the January to June period. In July, it decreased to 1.33% due to the decreases in base lending rates and the index rates on adjustable-rate mortgages owing to eased funding conditions in the banking system. Then, it declined further to 1.31% in September and moved upward to 1.48% in December. On the whole, the weighted average interest rate on new loans slightly decreased from 1.67% in 2015 to 1.47% in 2016, down by 0.20 percentage points. Excluding central government loans, the weighted average interest rate on new loans decreased from 1.73% in 2015 to 1.56% in 2016, down by 0.17 percentage points.

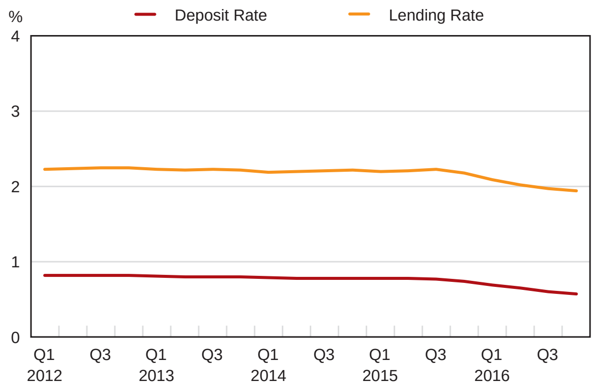
In the first quarter of the year, as a result of the CBC's rate cut, an increase in bank claims on local governments and government enterprises, and repayment of some corporate loans for land and construction, the weighted average interest rate on total loans of domestic banks moved downward from 2.18% in the previous quarter to 2.09%. In the fourth quarter, the weighted average interest rate on loans declined to 1.94% as a result of a delayed effect of the CBC's rate cut and an increase in bank lending for low-interest loans to local governments and government enterprises and for large-value loans to renowned firms. For the year as a whole, the weighted average interest rate on loans of domestic banks was 2.01%, which was 0.19 percentage points lower than that recorded in the previous year.

Average Lending Rates of the Five Major Domestic Banks



Note: * Including housing loans, capital expenditure loans, current operations loans and consumer loans.
Source: *Financial Statistics Monthly*, CBC.

Weighted Average Interest Rates of Domestic Banks



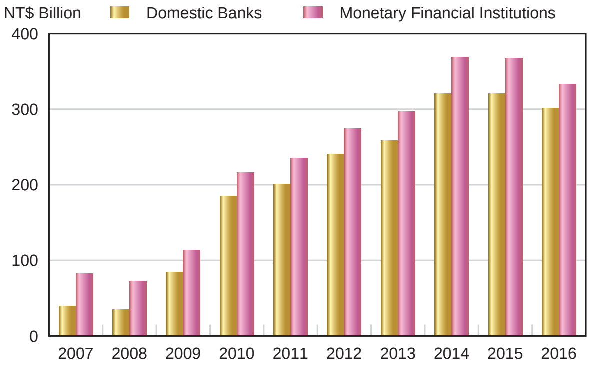
Source: *Financial Statistics Monthly*, CBC.

Because the decrease in average deposit rates was less than that in average lending rates, the average interest rate spread between deposits and loans shrank to 1.38 percentage points in 2016, which was 0.05 percentage points smaller than that recorded in the previous year.

Reduction in Profitability

Affected by the slow economic recovery, the pre-tax profits of monetary financial institutions decreased by NT$35.5 billion in 2016. Those of domestic banks decreased by NT$18.7 billion to NT$301.9 billion mainly owing to increased expenses for bad loans written off. The pre-tax profits of foreign and Mainland Chinese banks decreased by NT$14.6 billion mainly because their net interest revenues dropped, and the pre-tax profits of Chunghwa Post also decreased by NT$1.1 billion.

Pre-tax Profits



Source: Department of Financial Inspection, CBC.

Profits of Monetary Financial Institutions

Unit: NT$ Billion

	Pre-tax Profits			Return on Assets (%)*			Return on Equity (%)**		
	2016	2015	Annual Change	2016	2015	Annual Change	2016	2015	Annual Change
Domestic Banks	301.9	320.6	-18.7	0.66	0.73	-0.07	9.23	10.65	-1.42
Foreign and Mainland Chinese Banks	11.2	25.8	-14.6	0.44	0.57	-0.13	12.67	22.45	-9.78
Credit Cooperatives	2.4	2.5	-0.1	0.35	0.37	-0.02	5.28	5.54	-0.26
Credit Departments of Farmers' and Fishermen's Associations	4.8	5.8	-1.0	0.25	0.31	-0.06	3.86	4.90	-1.04
Chunghwa Post	12.4	13.5	-1.1	0.20	0.23	-0.03	10.95	12.46	-1.51
Total	332.7	368.2	-35.5	0.59	0.65	-0.06	9.13	10.84	-1.71

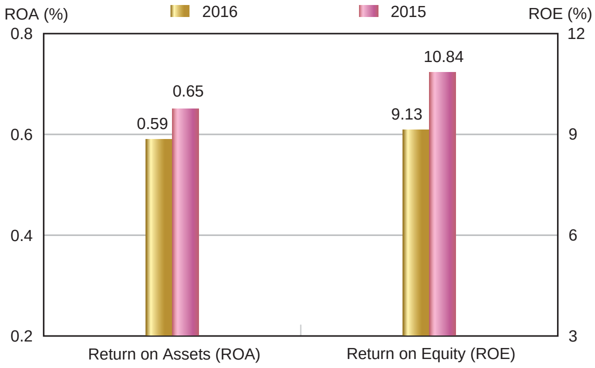
Notes: * Return on Assets = Pre-tax Profits / Average Assets
** Return on Equity = Pre-tax Profits / Average Equity
Source: Department of Financial Inspection, CBC.

Decreases in ROA and ROE

The average return on assets (ROA) of monetary financial institutions in 2016 decreased to 0.59% from 0.65% the previous year, and their return on equity (ROE) also went down to 9.13% from 10.84% a year earlier. Among monetary financial institutions, domestic banks were the best performers in terms of ROA, and foreign and Mainland Chinese banks posted the highest ROE.

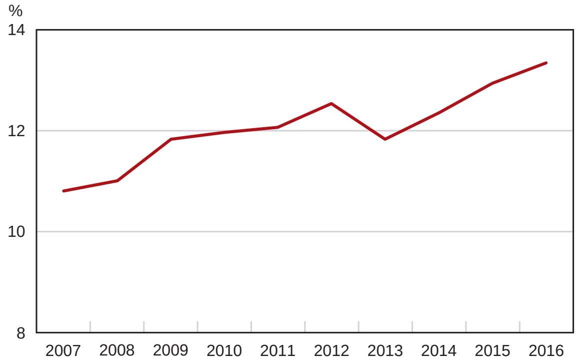
With regard to capital adequacy ratios, the average ratio for domestic banks increased to 13.33% at the end of 2016 from 12.93% a year before, mainly because some domestic banks recorded increases in cumulative earnings and common stock.

ROA and ROE of Monetary Financial Institutions



Source: Department of Financial Inspection, CBC.

Capital Adequacy Ratio of Domestic Banks



Source: Department of Financial Inspection, CBC.