

II. Financial Developments

1. Overview

The financial markets in 2007 were accommodative, reflecting the weak demand for funds and banks' conservative lending attitude partly in response to increased uncertainties in the markets. The reserve money grew slowly. Market interest rates went up under the influence of the Bank's tightening policy. The short-term interest rates moved upward gradually, while the long-term rates also exhibited a similar pattern. The NT dollar exchange rate against the US dollar depreciated in the first five months of the year and then appreciated afterward.

Loans and investments of major financial institutions grew at a low gear with the annual growth rate dropping from the preceding year-end's 4.10 percent to 2.40 percent. The slowing growth was mainly attributable to the enterprises' weaker demand for funds, the central government's repayment of bank loans, and banks' cautious behavior in their portfolio investments. Among the loans extended by major financial institutions, the balance of consumer loans shifted to an increase, reversing the previous year's negative growth, primarily led by an expansion in residential loans. In addition to the loans and investments of major financial institutions, if those of life insurance companies and trust and investment companies, and direct finance were included, then the total funds extended by the financial system to the non-financial sector registered an annual growth rate of 3.28 percent at the end of the year, lower than the 4.06 percent at the previous year-end.

With respect to monetary aggregates, the daily average of M2 for the year, affected by an increase in domestic residents' investments in foreign financial assets and a slower growth in banks' loans and investments, grew by 4.25 percent, a slower pace than the 6.22 percent of the preceding year. However, the growth rate of M2 still remained in the target zone of 3.5 percent to 7.5 percent set by the Bank in the beginning of the year.

The earnings before tax of depository institutions turned to an increase due to increases in net fee income and reductions in the provision for non-performing loans incurred from credit card defaults. As a consequence, their return on assets and return on net worth were both higher than those of the previous year. The improvement in performance was also reflected in the capital adequacy ratio of domestic banks, which increased from the previous year-end's 10.11 percent to 10.57 percent, while their ratio of non-performing loans decreased from 2.13 percent to 1.83 percent.

The NT\$/US\$ exchange rate underwent downward pressure in the first four and a half months of the year as the US dollar became stronger in the international markets and the demand for US dollar forwards by local firms and insurance companies increased. It depreciated to a yearly low in mid-May, and then appreciated gradually through the rest of the year, reflecting the narrowing interest rate differential between the NT dollar and the US dollar. The NT\$/US\$ exchange rate closed the year at 32.443, showing a slight appreciation of 0.47 percent compared with the previous year-end. On a daily average basis, however, it depreciated by 0.95 percent in 2007 over the previous year.

In the stock market, the TAIEX (Taiwan Stock Exchange Weighted Stock Price Index) in general showed a rising trend for the year. The index, after a mild increase in the first two months of the year, underwent a slight setback and reached a yearly low in March under the influences of the financial fraud of the Rebar Group and the global stock market turmoil. From then on, the TAIEX, stimulated by an upbeat global stock market and the interest rate cuts in the US, experienced a strong upward trend and hit a yearly high in October. The index moved downwards in the last two months of the year as the market became concerned about the gloomy prospects of the US economy. The TAIEX closed the year at 8,506 points, 8.70 percent higher than a year earlier. The daily average turnover for the year increased by 38.80 percent compared with the previous year.