

## II. Financial Developments

### 1. Overview

In the first half of 2008, the expansion in Taiwan's foreign trade continued, although the global economy slackened under the impact of a surge in international fuel and food prices. In the second half of the year, however, dragged down by the global financial market turmoil, withering external demand severely dampened Taiwan's trade and economic activity. Against the backdrop of weak demand for funds, liquidity in the financial system continued to remain ample and reserve money grew at a modest pace. Along with the Bank's policy rate adjustments, market interest rates went up in the first half of the year, and turned down from September onwards. The NT dollar exchange rate against the US dollar appreciated in the first three months of the year and then depreciated afterward.

With respect to monetary aggregates, the daily average of M2 grew by 2.67 percent in 2008, a slower pace than the 4.25 percent of the preceding year, mainly reflecting net capital outflows and the sluggish growth in bank loans and investments. However, the growth rate of M2 still fell within the target zone of 2.00 percent to 6.00 percent set by the Bank.

Loans and investments of major financial institutions grew at an annual growth rate of 3.42 percent at the end of 2008, up from 2.35 percent registered a year earlier. The increasing growth was mainly due to a stronger demand for funds from government and government enterprises and an increase in portfolio investments by banks. Among the loans extended by major financial institutions, the balance of consumer loans turned to a decrease, primarily led by banks' conservative attitude toward lending and a shrinkage in consumer spending. 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 2.75 percent at the end of the year, lower than the 3.33 percent at the previous year-end.

The earnings before tax of depository institutions declined in 2008, mainly due to reductions in the fair value of financial assets and the profits of portfolio investments. As a consequence, their return on assets and return on net worth were both lower than those of the previous year. The average capital adequacy ratio of domestic banks increased from the previous year-end's 10.80 percent to 11.00 percent, and the overall non-performing loan ratio decreased

from 1.83 percent to 1.54 percent.

In the stock market, the TAIEX (Taiwan Stock Exchange Weighted Stock Price Index) moved down in January, triggered by the global stock market turmoil. Subsequently, with the interest rate cuts in the US and optimistic expectations over an improvement in cross-strait relationships, the TAIEX rebounded and reached a yearly high in May. From then on, owing to a spillover of the global financial storm, the TAIEX experienced a strong downward trend and hit a yearly low in November. The index moved upward in the last month of the year as worldwide stock markets rebounded, the government successively adopted economic stimulus programs, and direct transportation links across the Taiwan straits began in December. The TAIEX closed the year at 4,591 points, 46.0 percent lower than a year earlier. The daily average turnover for the year decreased by 21.6 percent compared with the previous year.

The NT dollar against the US dollar started the year strong and hit a yearly high in March due to a weak US dollar, reflecting the impact of the US subprime mortgage crisis. From July onwards, due to some US big financial groups facing financial distress, US investors sold their foreign assets and repatriated the proceeds, causing the US dollar to become stronger in the international markets. The NT dollar against the US dollar depreciated to a yearly low in early December. From then on, it appreciated and closed the year-end at 32.860, showing a slight depreciation of 1.27 percent compared with the previous year-end. On a daily average basis, however, it appreciated by 4.20 percent in 2008 over the previous year.