

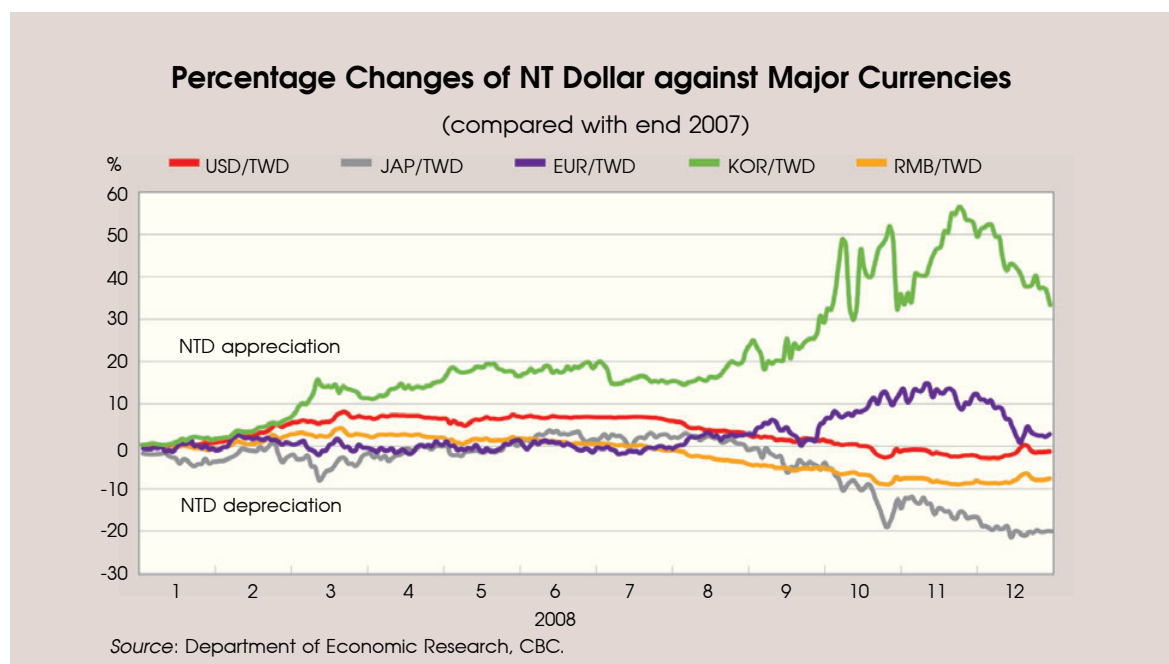
5. Foreign Exchange Market

Moderate Depreciation of the NT Dollar

On a daily average basis, the trade-weighted nominal effective exchange rate index of the NT dollar declined by 3.78 percent in 2008. However, the foreign exchange market had experienced a noticeable fluctuation for the year.

During the first three months, the US dollar weakened because of the continuous rate cuts by the Fed to curb the worsening subprime mortgage crisis. Meanwhile, inflows of capital to Taiwan were fueled by expectations of better political and economic relationships across the Taiwan Strait after the presidential election. The NT\$/US\$ exchange rate appreciated from 32.443 at the beginning of the year to a yearly high of 30.010 on March 26.

The US dollar fluctuated up and down reflecting the mixed message sent by America's better-than-expected economic outcome and surging oil prices. Therefore, the NT\$/US\$ exchange rate moved between 30 and 31 from the end of March to the middle of July. After that, the NT dollar started to depreciate following the outflows of foreign capital from Taiwan in response to the declining stock market. In addition, owing to the bankruptcy of Lehman Brothers and the escalating subprime mortgage crisis, investors tended to hold the US dollar to cope with the high liquidity risk under the crisis. The NT dollar depreciated to 33.550 against



the US dollar on December 4, the lowest level of the year.

However, from the middle of December to the end of the year, expectations of a gloomy American economy forced the Fed to cut the benchmark federal funds rate. In addition, direct shipping and flight links across the Taiwan Strait attracted the inflows of capital. Both factors caused an appreciation of the NT dollar. On December 31, the NT dollar stood at 32.860 against the US dollar, about 1.27 percent weaker than at the end of 2007. However, on a daily average basis, the NT\$/US\$ exchange rate appreciated by 4.20 percent compared with the previous year.

In the first half of 2008, the euro area exhibited relatively strong growth. Hence, the European Central Bank raised interest rates in July to relieve rising inflationary pressure. However, the euro against the NT dollar fluctuated within a narrow range because the NT dollar strengthened as a result of capital inflows during the same period. From July onwards, the euro fell sharply due to the spillover of the American subprime mortgage crisis. At the end of the year, the NT dollar against the euro was 3.02 percent above the level observed one year before. On a daily average basis, the NT dollar depreciated against the euro by 2.87 percent compared with the previous year.

The Japanese yen appreciated against the US dollar for the first two months in 2008 when Japan enjoyed a favorable economic performance and investors unwound their carry trade position in response to the international financial turmoil. Afterwards, the Japanese yen weakened because of diminishing domestic expenditure and trade surplus. The Japanese yen turned strong after August because investors eagerly unwound carry trade under the fierce international economic surroundings. The NT dollar kept stable against the Japanese yen for the first eight months, and then depreciated to 0.3721, a yearly low, on December 12. The NT dollar depreciated markedly against the Japanese yen by 19.78 percent between the end of 2008 and 2007. On a daily average basis, the NT dollar depreciated against the Japanese yen by 8.65 percent when compared with the previous year.

Due to the rapid growth of China's economy, increasing export surplus, and the expectation of an RMB appreciation, the RMB was strong against the NT dollar in 2008. Between the end of 2008 and 2007, the NT dollar depreciated by 7.77 percent against the RMB. On a daily average basis, the NT dollar depreciated by 4.84 percent against the RMB as compared with the previous year.

The Korean won kept weakening against the NT dollar almost all the year. The appreciation of the Korean won attracted capital inflows in 2006 and 2007 and resulted in a substantial increase in external debts. The global financial markets, therefore, expected a financial crisis

emerging in Korea, leading to a severe depreciation of the Korean won. The NT dollar appreciated by 32.85 percent against the Korean won between the end of 2008 and 2007. On a daily average basis, the NT dollar appreciated by 22.40 percent against the Korean won in 2008 when compared with the previous year.

Increase in Trading in the Foreign Exchange Market

Trading in the Taipei foreign exchange market increased in 2008. After deducting double counting on the part of inter-bank transactions, total net trading volume for the year increased by 4.6 percent from the previous year to US\$4,846.38 billion. The daily average turnover stood at US\$19.31 billion, representing an increase of 3.7 percent over the previous year. The increase in turnover mainly resulted from an expansion of international trade and intensive capital movements. However, transactions in third currencies decreased because countries adopted loose monetary policies to tackle the financial crisis, which narrowed the interest rate spreads between currencies.

In terms of trading partners, transactions between banks and non-bank customers accounted for 31.1 percent of the total net turnover, while inter-bank transactions made up a 68.9 percent share, including 17.5 percent for transactions among local banks and 51.4 percent for those between local banks and overseas banks.

As far as traded currencies are concerned, NT dollar trading against foreign currencies accounted for 46.0 percent of the total trading volume, of which the share of NT dollars against US dollars was 42.8 percent. Transactions in third currencies accounted for 54.0 percent of total trading volume, with trading in currency pairs of US dollar-Japanese yen and US dollar-euro accounting for shares of 20.6 percent and 14.2 percent, respectively. Compared with 2007, NT dollar trading against foreign currencies increased by 20.3 percent, but transactions in third currencies decreased by 5.9 percent.

Turnover of Major Products in the Taipei Foreign Exchange Market

Unit: US\$ Million

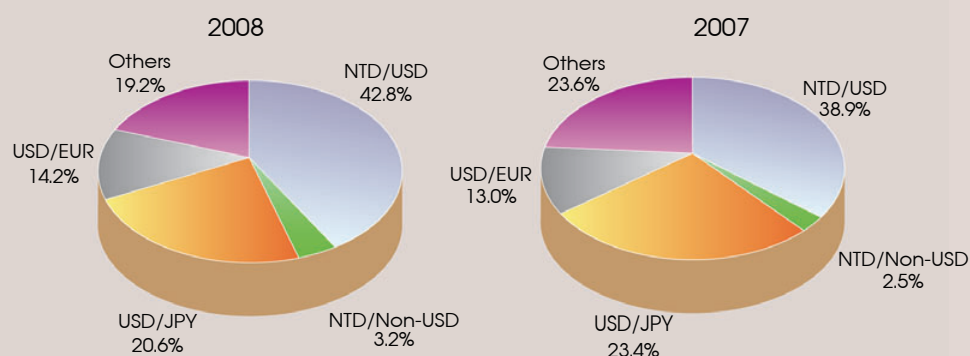
Year	Spots	Forwards	Forex Swaps	Margin Trading	Options	Cross Currency Swaps	Total
2004	1,289,872	273,931	617,577	30,299	350,514	17,764	2,579,955
2005	1,550,731	274,370	823,483	24,378	295,908	39,788	3,008,657
2006	1,910,270	411,182	1,107,646	37,809	396,578	47,353	3,910,838
2007	2,418,963	477,189	1,362,112	42,482	303,857	29,683	4,634,286
2008	2,455,394	459,393	1,548,763	34,871	307,857	40,097	4,846,375
2007-2008 Growth Rate (%)	1.5	-3.7	13.7	-17.9	1.3	35.1	4.6

Source: Department of Foreign Exchange, CBC.

With respect to transaction types, spot transactions accounted for the highest share of 50.6 percent of total turnover, followed by foreign exchange swaps with a share of 32.0 percent, forwards of 9.5 percent, options of 6.4 percent, cross currency swaps of 0.8 percent, and margin trading of 0.7 percent. Compared with 2007, except for a decrease in forwards and margin trading transactions, the trading volumes of all the other types increased, and cross currency swaps and foreign exchange swaps posted the highest growth rates of 35.1 percent and 13.7 percent, respectively. The main reason was increasing domestic hedging actions in response to the volatile movements of interest rates in 2008.

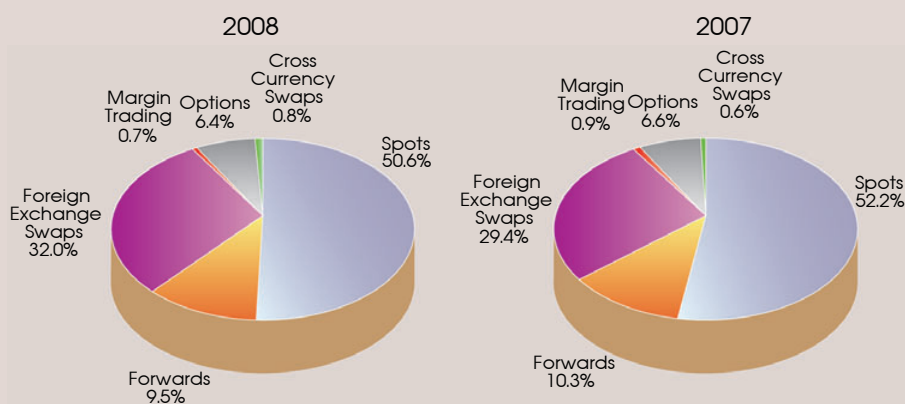
In 2008, the turnover of forwards, swaps and options based on foreign currency interest rates, stock price indices, commodity prices, and credit derivatives amounted to US\$428.08

Composition of Foreign Exchange Transactions by Traded Currency



Source: Department of Foreign Exchange, CBC.

Composition of Foreign Exchange Transactions by Product



Source: Department of Foreign Exchange, CBC.

Turnover of Other Products in the Taipei Foreign Exchange Market

Unit: US\$ Million

Year	Interest Rate-related Products				Commodity-related Products		Stock Index Options	Credit Derivatives	Total
	Forward Rate Agreements	Interest Rate Swaps	Interest Rate Options	Foreign Currency Interest Rate Futures	Commodity Options	Commodity Price Swaps			
2004	20,020	77,664	45,635	12,500	6,733	—	1,102	168	163,823
2005	25,089	78,528	23,668	29,385	4,594	—	389	581	162,235
2006	24,796	69,219	11,970	40,992	1,827	—	1,005	964	150,772
2007	12,958	93,072	17,475	176,723	6,947	—	627	5,243	313,044
2008	18,799	205,911	8,860	172,918	17,875	—	126	3,586	428,075
2007-2008 Growth Rate (%)	45.1	121.2	-49.3	-2.2	157.3	—	-79.9	-31.6	36.7

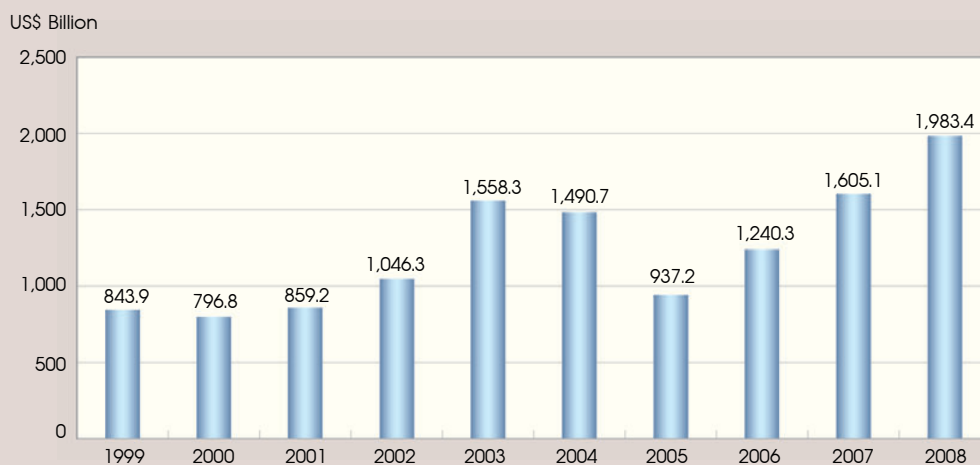
Source: Department of Foreign Exchange, CBC.

billion. Of this amount, interest rate-related derivatives accounted for the lion's share of US \$406.49 billion or 95.0 percent, representing an annual growth rate of 35.4 percent.

Marked Increase in Transactions in the Foreign Currency Call-Loan Market

The transaction volume in the foreign currency call-loan market in 2008 was US\$1,983.43 billion, an increase of 23.6 percent over the previous year. Of this amount, US dollar transactions accounted for US\$1,969.60 billion, as high as 99.3 percent of the total and about 23.0 percent higher than that in 2007. The increase was mainly because banks used over-night call loans to allocate short-term funds efficiently or to relieve the credit crunch resulting from America's subprime mortgage crisis. Japanese yen transactions totaled ¥ 888.91 billion in 2008, representing a large increase of 2.42 times the figure recorded in 2007, but the share remained rather small

Transactions in the Taipei Foreign Currency Call-Loan Market



Source: Department of Foreign Exchange, CBC.

at only 0.44 percent. The increase in turnover mainly reflected that funds demanders were willing to make use of short-term loans because of the decreasing interest rates in the call-loan market. The amount of euro transactions totaled only 2.89 billion, but representing 1.84 times the figure in the previous year.

Moderate Increase in the Assets of Offshore Banking Units

There were 63 offshore banking units (OBUs) in operation at the end of 2008. Domestic banks operated 36 of the OBUs, while foreign banks ran the other 27 units. Owing to the increases in claims on foreign financial institutions and nonresidents and in portfolio investment, the combined assets of all OBUs reached a historic high of US\$98.63 billion at the end of the year, representing an increase of US\$7.35 billion or 8.1 percent from the previous year-end. Domestic bank OBUs accounted for US\$71.57 billion or 73 percent of these combined assets, and foreign bank OBUs accounted for US\$27.06 billion, or 27 percent of the total. The OBUs' main uses of funds were due from affiliated branches and deposits with financial institutions. These accounted for 49 percent of total assets. Second to these were loans with a share of 33 percent. In terms of fund destination, 60 percent of funds went to Asia, and 24 percent went to the Americas.

The OBUs' main sources of funds were due to affiliated branches and deposits by financial institutions, which together accounted for 61 percent of total liabilities. These were followed by deposits of non-financial institutions, which accounted for 32 percent of total liabilities. OBUs have been gradually developing into funding centers for overseas Taiwanese firms. In terms of geographical origins, 70 percent of funds came from Asia, and 22 percent from the Americas.

The forex-trading turnover of all OBUs in 2008 was US\$172.61 billion, of which US\$107.79 billion was for spot transactions, US\$37.57 billion for forward transactions, and US\$27.25 billion for foreign exchange swap transactions, increasing by 61.1 percent, 39.3 percent and 13.8 percent, respectively, compared with the previous year. The main reasons were the increases in companies' risk hedging actions and investors' speculation, which reflected expectations over an appreciation of the Japanese yen and a depreciation of the euro and the British pound against the US dollar. The total turnover of other derivative products, including margin trading, options, foreign currency interest rate swaps, financial futures, foreign currency forward rate agreements, cross currency swaps, commodity swaps, and credit derivatives, amounted to US\$30.31 billion, a moderate increase of 11.3 percent over the previous year.

Consolidated Balance Sheet of Offshore Banking Units in Banking System

Unit: US\$ Million

Year/Month	Loans to Non-financial Institutions	Portfolio Investment	Claims on Financial Institutions	Other Assets	Total Assets= Total Liabilities	Deposits of Non-financial Institutions	Due to Financial Institutions	Securities Issued	Other Liabilities
2004/12	18,066	6,734	37,105	7,314	69,219	18,810	42,688	0	7,721
2005/12	18,697	8,718	38,432	4,311	70,158	20,712	44,305	0	5,141
2006/12	19,473	10,805	40,352	6,056	76,686	24,227	46,664	483	5,312
2007/12	23,931	11,969	47,788	7,593	91,281	27,263	55,939	499	7,580
2008/12	32,481	10,851	48,141	7,169	98,632	31,133	60,198	724	6,577
2007/12-2008/12 Growth Rate (%)	35.7	-9.3	0.7	-5.7	8.1	14.2	7.6	45.1	-13.2

Source: Financial Statistics Monthly, CBC.