

7. Bond Market

In 2008, amid the global financial turmoil and its economic fallout, investors sought a safe haven in bond markets. New issues of bonds reached NT\$1,346.1 billion, a slight decrease of 2.69 percent from the previous year. Among them, corporate bonds gained significant momentum, as the credit rating spread widened, prompting state enterprises and other highly rated enterprises to increase bond issues to lock in low issuing costs. Banks slashed their issues of bank debentures except to meet capital requirements as they tightened credit and enhanced risk aversion. Issues of asset securitization also shrank due to the spillover of the global financial crisis and a slowing domestic housing market.

Despite the decrease in new bond issues, the outstanding amount continued to climb a new high of NT\$6,164.6 billion at the end of 2008. Government bonds accounted for the largest share with 60.61 percent of the total. Corporate bonds followed with 18.44 percent, bank debentures with 14.54 percent, beneficiary securities on asset securitization with 5.40 percent, and foreign and international bonds with 1.01 percent.

In the secondary market, capital inflows fueled by a local currency appreciation led to a bullish sentiment early in the year. Bond yields turned rising after the presidential election in March as stock markets and inflation both heated up, but fell in the second half of the year amid the global economic downturn. The decline accelerated after September with the Bank's successive rate cuts. Five-year government bonds recorded the largest drop of 145.61 basis points over the year. Bond transactions declined by 30.15 percent from the previous year to NT\$135,509.5 billion in 2008, mainly due to a lack of investment vehicles and the concentration of holdings for government bonds.

With respect to fixed income and quasi money market funds, net assets increased by 18.15 percent to NT\$942.7 billion over the year to the end of 2008.

Increase in Government Bond Issues

Government bond issues amounted to NT\$438.7 billion in 2008, an increase of NT\$36.5 billion or 9.08 percent from the previous year. The Ministry of Finance issued a total of NT\$410 billion in central government bonds, an increase of NT\$16.8 billion or 4.27 percent from the previous year, mainly to support infrastructure projects. Of this amount, ordinary government bonds and stripped government bonds accounted for NT\$350 billion and NT\$60 billion, respectively. Local governments issued a sum of NT\$28.7 billion in bonds, primarily to repay maturing debts.

Issues and Outstanding Values in Bond Market by Category

Unit: NT\$ Billion

Year/ Month	Total		Central Government Bonds		Local Government Bonds		Corporate Bonds		Bank Debentures		Beneficiary Securities**		Foreign & int'l bonds*	
	Issues	Outstanding	Issues	Outstanding	Issues	Outstanding	Issues	Outstanding	Issues	Outstanding	Issues	Outstanding	Issues	Outstanding
2006	1,220.1	5,887.6	440.0	3,239.3	28.0	145.4	230.1	1,151.4	172.5	925.9	337.8	342.4	11.7	83.2
2007	1,383.3	6,047.9	393.2	3,410.0	9.0	109.8	162.6	1,104.6	192.5	917.4	617.5	426.2	8.5	79.9
2008	1,346.1	6,164.6	410.0	3,609.7	28.7	126.5	287.3	1,136.9	161.2	896.0	457.6	333.0	1.3	62.5
2008/1	108.3	6,014.7	40.0	3,380.0	12.0	121.7	1.7	1,090.1	21.2	929.6	33.4	424.2	—	69.1
2	95.6	6,031.1	30.0	3,410.0	—	121.7	3.7	1,089.6	3.0	921.1	58.9	419.6	—	69.1
3	100.6	6,066.8	40.0	3,449.9	—	119.7	1.6	1,082.7	16.1	933.3	42.9	415.0	—	66.2
4	119.2	6,119.1	35.0	3,484.9	6.7	126.3	19.5	1,086.1	29.0	946.0	29.0	410.6	—	65.2
5	134.9	6,126.3	30.0	3,479.9	—	126.3	20.9	1,083.3	28.3	969.5	55.7	402.1	—	65.2
6	147.8	6,156.3	35.0	3,514.9	—	126.3	43.6	1,062.4	26.0	991.0	43.2	396.5	—	65.2
7	73.0	6,124.8	30.0	3,499.8	—	126.1	18.2	1,058.3	1.1	986.3	23.7	390.1	—	64.2
8	94.8	6,115.4	30.0	3,529.7	—	116.6	11.9	1,048.7	—	982.9	52.9	373.3	—	64.2
9	119.0	6,122.7	40.0	3,539.7	10.0	126.6	18.1	1,051.4	7.9	968.7	43.0	372.1	—	64.2
10	69.7	6,107.1	30.0	3,539.7	—	126.6	9.1	1,054.5	4.8	956.7	25.8	368.4	—	61.2
11	99.7	6,105.7	30.0	3,569.7	—	126.5	34.5	1,070.1	—	929.0	35.2	349.2	—	61.2
12	183.7	6,164.6	40.0	3,609.7	—	126.5	104.7	1,136.9	23.8	896.0	13.9	333.0	1.3	62.5

Notes: * Including NT dollar and foreign currency-denominated bonds issued in Taiwan by international financial institutions.

** Including those purchased back by originators for credit enhancement.

Sources: Financial Statistics Monthly, CBC.

The outstanding amount of government bonds continued to climb to a new high of NT \$3,736.2 billion at the end of 2008, an increase of NT\$216.4 billion or 6.15 percent from the previous year-end.

Large Increase in Corporate Bond Issues

New issues of corporate bonds reached NT\$287.3 billion in 2008, a large increase of NT \$124.7 billion or 76.69 percent from the previous year. Although the demand for funds from enterprises was relatively weak, the credit rating spread continued to widen. The latter prompted state enterprises and other highly rated enterprises to increase bond issues to lock in low issuing costs. The state-owned Taiwan Power Company, the private Formosa Plastics Group and China Steel issued NT\$67 billion, NT\$61 billion and NT\$29.6 billion in bonds, respectively, while financial holding companies, including Cathay Financial Holdings, Mega Holdings and Shin Kong Financial Holding, issued a total of NT\$56.2 billion during the year.

In terms of different bond types, unsecured corporate bonds and secured corporate bonds accounted for 69.35 percent and 30.65 percent of the total amount issued, respectively. Convertible corporate bonds only made up 10.93 percent, a major decrease of 27.37 percentage points from the previous year, affected by a decline in stock markets.

The outstanding amount of corporate bonds stood at NT\$1,136.9 billion at the end of 2008, an increase of NT\$32.3 billion or 2.92 percent from the previous year-end. The issuing rates on

3-year, 5-year and 7-year corporate bonds averaged 2.5375 percent, 2.5473 percent and 2.9371 percent, respectively, all of which were slightly higher than the previous year.

Marked Decrease in Bank Debenture Issues

In 2008, domestic banks issued a total of NT\$161.2 billion in bank debentures, a marked decrease of NT\$31.3 billion or 16.26 percent from the previous year. Bank debentures issued during the first half of 2008 accounted for 76.68 percent of the total amount, as banks took actions to avoid rising issuing costs under inflationary expectations. However, in the second half of the year, banks tightened credit and reduced debenture issues except to raise their capital adequacy ratios or to repay maturing debts.

The outstanding amount of bank debentures was NT\$896 billion at the end of 2008, a decrease of NT\$21.4 billion or 2.33 percent from the previous year-end. As more than 80 percent of bank debentures are subordinated debt securities, limited purchasers, on top of the risk premium required by investors, made the issuing rates more volatile. Nevertheless, the weighted average issuing rates in 2008 were still slightly lower or remained flat compared with the previous year.

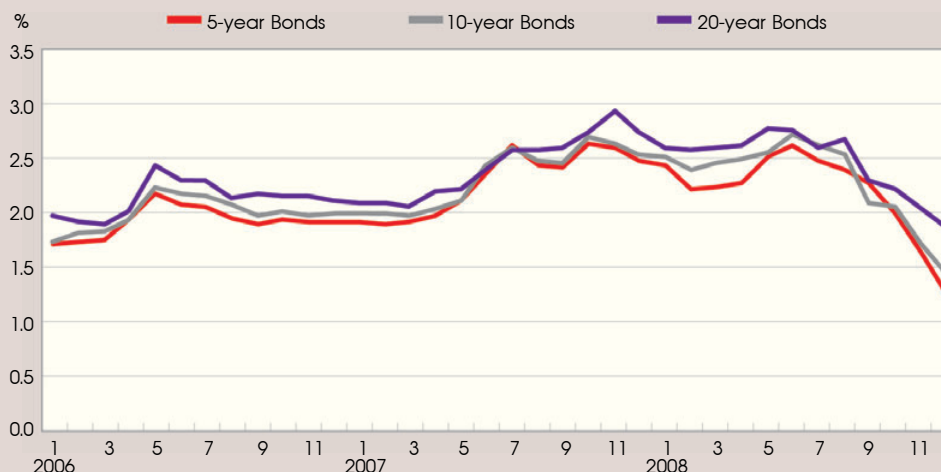
Decline in Asset Securitization

In 2008, asset securitization declined significantly reflecting the influence of the global financial crisis and the slowdown in the domestic housing market. Issues of beneficiary securities on asset securitization amounted to NT\$457.6 billion, a large decrease of NT\$159.9 billion or 25.89 percent from the previous year. Their share in total bond issuance also went down by 10.65 percentage points from the previous year to 33.99 percent. Of the components, issues of financial asset securitization reached NT\$454.1 billion in 2008, representing a 24.88 percent decrease from the previous year. There were no new issues of real estate securitization in the year and the outstanding amount was NT\$333 billion at the year-end, a 21.87 percent decrease from the previous yearend.

New Foreign Bond Issuance

There was one foreign bond (NT dollar-denominated bonds issued by a foreign entity) issuance in 2008. The Central American Bank for Economic Integration issued NT dollar-denominated bonds in Taiwan with a total worth of NT\$1.3 billion and an issuing rate of 2.6 percent, accounting for a mere 0.10 percent of total bond issuance. At the end of 2008, foreign bonds and other international bonds (foreign currency-denominated bonds issued in Taiwan) combined to an outstanding balance of NT\$62.5 billion, a decrease of 21.78 percent from the previous yearend.

Yield Structure of Central Government Bonds with Different Maturities



Source: Department of Economic Research, CBC.

Lackluster Transactions in the OTC Market

In early 2008, the bond market exhibited a bullish sentiment as a significant appreciation of the NT dollar attracted capital inflows. After the presidential election in March, bond yields rose from the earlier decline as stock markets and inflation both heated up. In the middle of June, the yield on benchmark 10-year government bonds rebounded to a four-year high of 2.8247 percent as raw material prices surged and bond investors turned conservative.

78

Bond Transactions in the Over-the-Counter Market

Unit: NT\$ Billion

Year/ Month	Total	Outright Transactions		Repurchase Agreement Transactions	
		Amount	Share (%)	Amount	Share (%)
2006	275,833.3	169,992.0	61.6	105,841.3	38.4
2007	194,005.5	93,787.6	48.3	100,217.9	51.7
2008	135,509.5	59,749.0	44.1	75,760.5	55.9
2008/1	15,267.1	7,713.7	50.5	7,553.4	49.5
2	9,964.3	4,857.0	48.7	5,107.3	51.3
3	16,350.3	9,318.1	57.0	7,032.2	43.0
4	14,830.3	7,953.5	53.6	6,876.8	46.4
5	11,088.4	4,689.8	42.3	6,398.6	57.7
6	10,288.4	4,148.6	40.3	6,139.8	59.7
7	8,872.8	2,664.5	30.0	6,208.3	70.0
8	9,745.7	3,914.3	40.2	5,831.4	59.8
9	10,380.7	4,090.8	39.4	6,290.0	60.6
10	9,798.5	3,253.6	33.2	6,544.9	66.8
11	8,502.2	3,124.8	36.8	5,377.4	63.2
12	10,421.0	4,020.3	38.6	6,400.7	61.4

Source: Taiwan Securities Exchange & GreTai Securities Market.

Turnover in Bond Market by Category

Unit: NT\$ Billion

Year/ Month	Total	TSE Market Corporate Bonds (Convertible)	Gre Tai Market						
			Subtotal	Government Bonds	Corporate Bonds		Bank Debentures	Beneficiary Securities	Foreign & int'l bonds
					Nonconvertible	Convertible			
2006	275,833.3	0.1	275,833.2	273,496.1	960.9	615.0	518.8	133.9	108.5
2007	194,005.5	—	194,005.5	192,241.6	412.1	932.7	170.9	162.2	86.0
2008	135,509.5	—	135,509.5	133,753.9	502.5	882.9	205.4	81.9	82.9
2008/1	15,267.1	—	15,267.1	15,115.6	9.6	94.9	40.9	6.1	—
2	9,964.3	—	9,964.3	9,869.7	11.7	57.8	4.6	13.8	6.7
3	16,350.3	—	16,350.3	16,188.5	16.4	92.7	22.9	22.3	7.5
4	14,830.3	—	14,830.3	14,702.6	36.3	71.1	11.9	0.0	8.4
5	11,088.4	—	11,088.4	10,962.5	31.8	67.6	19.0	0.0	7.5
6	10,288.4	—	10,288.4	10,133.6	28.4	74.0	27.3	17.5	7.6
7	8,872.8	—	8,872.8	8,740.3	35.5	86.1	5.5	—	5.4
8	9,745.7	—	9,745.7	9,647.3	14.4	71.1	0.8	5.5	6.6
9	10,380.7	—	10,380.7	10,204.5	47.7	72.2	30.8	16.8	8.8
10	9,798.5	—	9,798.5	9,630.9	66.6	75.0	10.0	0.0	16.0
11	8,502.2	—	8,502.2	8,382.9	56.9	54.0	5.4	—	3.0
12	10,421.0	—	10,421.0	10,175.6	147.2	66.3	26.4	—	5.5

Source: Taiwan Securities Exchange & GreTai Securities Market.

From July 2008 onwards, bond yields embarked on a downward trend amid a world economy mired in the aftereffect of the US mortgage crisis and gloomy local stock markets. Starting in September, the Bank engaged in monetary easing with successive rate cuts and an expansion of the scope of repurchase agreement (repo) transactions. Short-term interest rates had since come down quickly, and hence the decline in bond yields had accelerated. Among the different maturities, the bond yield on 5-year government bonds posted the steepest decline over the year, plunging by 145.61 basis points to 1.0259 percent at the year-end. During the same period, the bond yield on 10-year government bonds decreased from 2.5686 percent

Portfolio Composition of Fixed Income and Quasi Money Market Funds

Unit: % : NT\$ Billion

Year / Month End	Total	Outright Purchases		Repurchase Agreements		Bank Deposits		Short-term Securities	
		Amount	Share	Amount	Share	Amount	Share	Amount	Share
2006	1,101.5	261.0	23.7	608.5	55.2	209.2	19.0	22.8	2.1
2007	797.9	150.0	18.8	410.2	51.4	216.5	27.1	21.3	2.7
2008	942.7	101.3	10.8	374.1	39.7	448.4	47.6	18.9	2.0
2008/ 1	848.3	156.1	18.4	407.7	48.1	262.6	31.0	21.9	2.6
2	871.3	156.9	18.0	400.2	45.9	293.7	33.7	20.4	2.3
3	916.6	154.4	16.8	393.9	43.0	346.3	37.8	22.1	2.4
4	948.9	155.1	16.3	375.5	39.6	387.7	40.9	30.6	3.2
5	926.2	153.5	16.6	321.9	34.8	422.1	45.6	28.6	3.1
6	903.7	146.4	16.2	313.2	34.7	422.4	46.7	21.7	2.4
7	931.5	139.1	14.9	311.4	33.4	460.5	49.4	20.6	2.2
8	901.5	139.1	15.4	264.0	29.3	483.6	53.6	14.8	1.6
9	749.8	127.0	16.9	188.6	25.2	431.6	57.6	2.7	0.4
10	686.6	114.2	16.6	229.8	33.5	340.2	49.5	2.3	0.3
11	746.9	107.4	14.4	265.3	35.5	371.5	49.7	2.7	0.4
12	942.7	101.3	10.8	374.1	39.7	448.4	47.6	18.9	2.0

Source: Securities Investment Trust & Consulting Association of the R.O.C.

to 1.3748 percent, while that on 20-year government bonds decreased from 2.7428 percent to 1.8522 percent.

In 2008, total bond transactions in the OTC market contracted by NT\$58,496.0 billion or 30.15 percent from the previous year to NT\$135,509.5 billion. Of the components, outright transactions decreased by NT\$34,038.6 billion or 36.29 percent from the previous year. Repo transactions decreased by NT\$24,457.4 billion or 24.40 percent. Regarding the different bond types, government bonds continued to be the most actively traded, making up 98.71 percent of total bond transactions. Compared with the previous year, however, government bond transactions shrank by NT\$58,487.7 billion or 30.42 percent, mainly due to a lack of investment vehicles and the concentration of holdings in the hands of large traders. The second most actively traded were corporate bonds. Their total transactions increased by only 3.02 percent from the previous year, constrained by the shrinkage in convertible corporate bond transactions. In addition, bank debenture transactions expanded by 20.19 percent over the previous year.

Expansion in Fixed Income and Quasi Money Market Funds

Fixed income and quasi money market funds are considered less volatile with more stable returns. Hence during the financial market turmoil in 2008, they became popular targets among risk averse investors. At the year-end, there were two fixed income funds and 49 quasi money market funds amounting to total assets of NT\$942.7 billion, an increase of NT\$144.8 billion or 18.15 percent over the year-ago level. In terms of their portfolio composition, nearly 90 percent of fund assets were allocated to time deposits and repo transactions. The ratio of outright bond purchases had continued to decline over the years and accounted for roughly 10 percent of the total portfolio at the end of 2008.