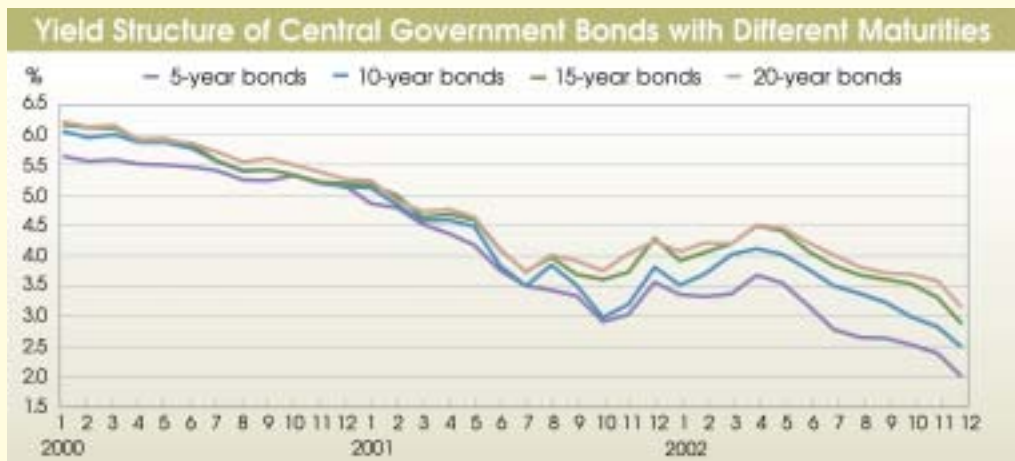


11. Bond Market

The bond market was very active in 2002. Total issues of bonds amounted to NT\$962.3 billion, an annual growth rate of 18.1 percent from a year earlier. Among them, issues of central government bonds recorded the second highest issue value in history, a close second to 2001, to meet budget deficits. Issues of corporate bonds hit their historic high in association with the weak stock market and declining interest rates. Moreover, bank subordinated debenture issues also significantly increased as banks managed to improve their capital structure. However, NT dollar-denominated bonds issued by international financial institutions fell substantially due to rising issuance costs and declining real returns.

Owing to falling interest rates, the repeal of the bond transaction tax and implementation of the computerized pricing negotiation system of government bonds, transactions in the secondary market registered a record high for 2002. Bond yields were generally on a downward trend during the last three quarters after a mild bounce in the first quarter. In addition, bond funds continued to grow this year because of their higher returns and tax-free advantage, along with sluggish stock market performance and declining bank deposit rates.



Surge in Central Government Bond Issues

The Ministry of Finance issued central government bonds to the value of NT\$426.2 billion in 2002, the second highest level recorded in history, reflecting the tight fiscal position of the

government budget. In order to establish the benchmark yield curve, four different maturities of government bonds, namely 2, 5, 10, and 20 years, began to be issued regularly. Moreover, due to easy funding conditions, the weighted average interest rates on winning bids with different maturities all moved down during the year.

Large Increase in Corporate Bond Issues

Demand for corporate bonds strengthened owing to the continuous expansion of bond funds, associated with a weak stock market and declining bank deposit rates in 2002. From July 2001, companies are required to obtain credit ratings in order to issue unsecured corporate bonds. As a result, the proportion of corporate bonds issued by large enterprises with high ratings increased in 2002. Local small and medium-sized enterprises preferred to issue unsecured convertible bonds mainly because the convertibility might help the issuers to save interest payments and relieve redemption pressures. The new issue of corporate bonds was NT\$285.8 billion for 2002, a robust upsurge of 44.34 percent from the previous year. Of the total issue, unsecured bonds accounted for 80 percent.

Significant Increase in Bank Debenture Issues

Many local banks issued subordinated debentures in order to strengthen their tier II capital. In addition, several banks took advantage of the low cost of funds to issue bank debentures

Issues and Outstanding Value in Bond Market by Category

Unit: NT\$ Billion

	Total		Central Government Bonds		Local Government Bonds		Corporate Bonds		Bank Debentures		Foreign Bonds*	
	Issues	Outstanding	Issues	Outstanding	Issues	Outstanding	Issues	Outstanding	Issues	Outstanding	Issues	Outstanding
2000	611.8	2,392.4	346.5	1,409.0	16.0	71.3	181.2	707.3	46.1	91.7	22.0	113.1
2001	814.5	3,012.4	437.0	1,772.6	20.0	85.7	198.0	808.5	119.0	202.6	40.5	143.0
2002	962.3	3,748.6	426.2	2,124.1	10.0	90.4	285.8	1,007.2	214.3	377.3	26.0	149.6
2002/1	109.2	3,119.7	70.0	1,842.4	-	85.7	29.0	836.1	10.2	212.5	-	143.0
2	62.2	3,179.0	40.0	1,882.4	-	85.7	8.7	841.9	6.5	219.0	7.0	150.0
3	110.2	3,247.8	50.0	1,908.2	10.0	95.7	10.1	845.7	26.1	236.2	14.0	162.0
4	38.9	3,276.2	-	1,907.9	-	93.7	21.8	863.0	12.1	244.6	5.0	167.0
5	110.2	3,370.6	60.0	1,967.5	-	93.6	32.5	890.2	17.7	259.1	-	160.2
6	30.1	3,391.1	-	1,967.4	-	93.6	10.8	892.5	19.3	277.4	-	160.2
7	95.5	3,473.2	30.0	1,997.3	-	93.6	32.8	912.1	32.7	310.0	-	160.2
8	71.6	3,517.0	40.0	2,037.2	-	93.6	21.0	917.3	10.5	315.3	-	153.6
9	84.6	3,595.5	30.0	2,067.2	-	92.7	26.8	939.0	27.8	343.0	-	153.6
10	72.7	3,653.9	31.2	2,098.3	-	92.7	14.7	947.4	26.8	361.9	-	153.6
11	75.1	3,678.5	45.0	2,113.2	-	90.4	17.1	956.3	13.0	368.0	-	150.6
12	102.0	3,748.6	30.0	2,124.1	-	90.4	60.4	1,007.2	11.6	377.3	-	149.6

Note: * Refers to the NT dollar-denominated and foreign currency-denominated bonds issued in Taiwan by international financial institutions.

Sources: *Financial Statistics Monthly, Taiwan District, the Republic of China, Central Bank of China. Major Indicators of Securities & Futures Market, Securities & Futures Commission, Ministry of Finance.*

in order to increase their medium- and long-term funding sources. Bank debenture issues recorded an all time high of NT\$214.3 billion in 2002, growing by 80.1 percent from a year earlier.

Marked Decrease in Foreign Bond Issues

In 2002, as narrowing interest rate spread and NT dollar depreciation led to rising issuance costs and declining real returns, the new issues of NT dollar-denominated bonds by international financial institutions decreased to NT\$26 billion, a decrease of 35.8 percent from the previous year. Of these issues, the Inter-American Development Bank (IADB) accounted for the largest share of NT\$10 billion. The weighted-average issuing rate on 5-year NT dollar bonds was 2.16 percent, lower than those on bank debentures and corporate bonds with the same maturity.

Booming Transactions in the OTC Market

The downward trend in interest rates from April 2002 onwards prompted bullish sentiment in the bond market, pressing yields of government bonds down to new lows at the end of the year. Taking 10-year government bonds as an example, from January to April, the weighted average yield slightly rose from 3.52 percent to 4.12 percent due to the recovery in the local and international economies, new issues of government bonds and the local stock market's rebound. Since then, the average yield of government bonds slid month by month to a record low of 2.48 percent in December, owing to the downturn of the TAIEX, uncertainty over economic recovery, and the rising tensions between the U.S.A. and Iraq.

Bond Transactions in the Over-the-Counter Market

Unit: NT\$ Billion

	Outright Transactions		Repurchase Agreement Transactions		Total
	Amount	Share (%)	Amount	Share (%)	
2000	16,691	24.2	52,152	75.8	68,843
2001	53,024	44.6	65,969	55.4	118,993
2002	60,660	45.1	73,739	54.9	134,399
2002/1	4,358	40.4	6,438	59.6	10,796
2	2,348	37.1	3,973	62.9	6,321
3	2,786	31.9	5,944	68.1	8,730
4	2,508	31.1	5,547	68.9	8,056
5	3,074	33.7	6,055	66.3	9,129
6	4,666	44.6	5,799	55.4	10,465
7	4,479	39.9	6,756	60.1	11,235
8	5,179	43.0	6,870	57.0	12,049
9	5,661	47.0	6,384	53.0	12,045
10	7,060	50.9	6,798	49.1	13,858
11	8,458	57.0	6,381	43.0	14,839
12	10,082	59.7	6,794	40.3	16,876

Source: Taiwan Securities Exchange & GreTai (Over-the-Counter) Securities Market.

Total trading in the bond market was very active and amounted to a record high of NT \$134,399 billion in 2002, an annual increase of NT\$15,406 billion, or 13 percent. Of this amount, outright transactions rose by 14.4 percent and repurchase agreement transactions went up by 11.8 percent from the previous year. The share of outright transactions and the share of repurchase agreements in total transactions were 45.1 percent and 54.9 percent, respectively.

Significant Increase in Bond Funds

Owing to the sluggish stock market and declining bank deposit rates, local bond funds continued to expand during the year 2002. At the end of the year, the net value of bond funds amounted to NT\$1,847 billion, an impressive increase of 29.7 percent from the previous year-end. The rapid growth indicated a shift of funds from bank deposits to bond funds in view of tax-free benefits on capital gains, quick redemption, and higher returns.

With respect to portfolio allocation, local bond funds primarily invested in outright purchases of corporate bonds, repurchase agreements of government bonds and bank time deposits. Of total investment at the end of 2002, outright purchases of bonds accounted for 43.3 percent, bonds with repurchase agreements made up 25.6 percent, and deposits with financial institutions represented 28.2 percent.

Portfolio Composition of Bond Funds

Unit: NT\$ Billion

	Total	Outright Purchase		Repurchase Agreements		Bank Deposits		Short-term Securities	
		Amount	Share (%)	Amount	Share (%)	Amount	Share (%)	Amount	Share (%)
2000	777.3	313.8	40.4	163.5	21.0	280.1	36.0	19.9	2.6
2001	1,426.6	520.6	36.5	409.2	28.7	457.0	32.1	37.8	2.7
2002	1,847.6	798.3	43.3	472.8	25.6	521.4	28.2	54.5	2.9
2002/1	1,525.6	547.0	35.9	455.0	29.8	485.3	31.8	38.3	2.5
2	1,590.0	576.5	36.3	480.6	30.2	499.1	31.4	33.8	2.1
3	1,587.9	609.0	38.3	450.4	28.4	501.9	31.6	26.6	1.7
4	1,656.6	622.3	37.6	504.9	30.5	500.8	30.2	28.6	1.7
5	1,716.9	655.2	38.2	525.5	30.6	510.1	29.7	26.1	1.5
6	1,733.3	674.5	38.9	477.9	27.6	538.1	31.0	42.8	2.5
7	1,858.1	734.7	39.6	535.6	28.8	530.4	28.5	57.4	3.1
8	1,883.4	746.2	39.7	541.0	28.7	537.1	28.5	59.1	3.1
9	1,827.2	773.9	42.3	503.7	27.6	522.6	28.6	27.0	1.5
10	1,843.7	778.8	42.2	512.4	27.8	520.0	28.2	32.5	1.8
11	1,899.3	779.5	41.1	530.6	27.9	532.7	28.0	56.5	3.0
12	1,847.0	798.3	43.3	472.8	25.6	521.4	28.2	54.5	2.9

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

