

7. Banking Sector

Decrease in the Number of Depository Institutions

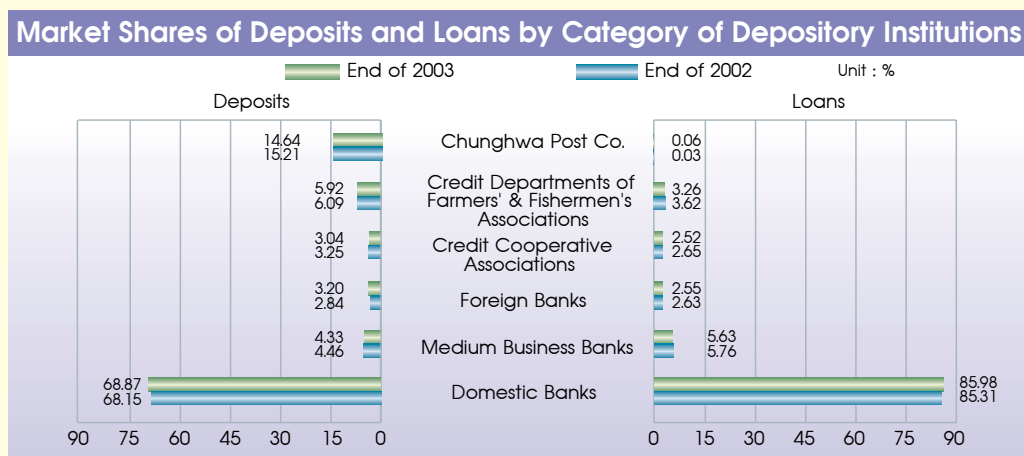
At the end of 2003 there were 400 depository institutions operating in Taiwan, a decrease of 4 from the previous year. Among depository institutions, the number of domestic banks decreased by 2 through mergers, while the number of credit cooperative associations also decreased by 2 as the result of takeovers. As of the end of 2003, 14 financial holding companies had been set up since the Financial Holding Company Act took effect in November 2001, an increase of one company as compared to the previous year-end.

With respect to the market shares of deposits and loans by category of depository institutions at the end of 2003, domestic banks accounted for 68.87 percent of deposits and 85.98 percent of loans. Both were higher than in the previous year and mainly the result of the fact that 2 credit cooperative associations were taken over by domestic banks. The market share of deposits at foreign banks continued to rise due to the marked growth of foreign currency deposits. Loans extended by foreign banks, however, trended down in 2003 on concerns of corporate customers' credit risk. As for the Chunghwa Post Co., its market share of loans edged up to 0.06 percent, slightly higher than in the previous year, while their share of deposits continued to decline to 14.64 percent.

Number of Depository Institutions by Category

	2003	2002	Annual Change
Combined Number of Main Offices	400	404	-4
Domestic Banks	45	47	-2
Medium Business Banks	5	5	0
Foreign Banks	36	36	0
Credit Cooperative Associations	35	37	-2
Credit Departments of Farmers' and Fishermen's Associations	278	278	0
Department of Savings and Remittances of Chunghwa Post Co.	1	1	0
Combined Number of Branches	5,923	5,851	72
Local Branches	5,772	5,701	71
Overseas Branches	81	78	3
Offshore Banking Units	70	72	-2

Sources: *Financial Statistics Monthly, Taiwan District, The Republic of China, Central Bank of China.*
Department of Financial Inspection, Central Bank of China.



Sources and Uses of Funds

With respect to the sources of funds in depository institutions, due to falling deposit rates and the rebounding stock market, demand deposits as a share of total sources of funds increased while that of time and savings deposits kept decreasing during the year 2003. With regard to the uses of funds by depository institutions, the growth of loans turned positive as banks actively expanded their consumer finance business, while the share of bank loans in the uses of funds still fell. Portfolio investments regressed in both amount and share of uses. However, the shares of foreign assets and CDs issued by the Bank increased.

Sources and Uses of Funds in Depository Institutions

Unit: NT\$ Billion

	End of 2003		End of 2002		Annual Change	
	Amount	Share (%)	Amount	Share (%)	Amount	Share (%)
Sources:						
Foreign Liabilities*	11,143	4.66	6,886	3.12	4,257	1.54
Demand Deposits**	59,116	24.70	49,643	22.49	9,473	2.20
Time and Savings Deposits***	148,814	62.17	147,321	66.75	1,493	-4.58
Government Deposits	7,731	3.23	7,500	3.40	231	-0.17
Borrowings from CBC	2,771	1.16	2,824	1.28	-53	-0.12
Other Items (Net)	9,795	4.09	6,537	2.96	3,258	1.13
Total	239,371	100.00	220,711	100.0	18,660	0.00
Uses:						
Foreign Assets *	17,367	7.26	15,102	6.84	2,264	-0.41
Loans	141,556	59.14	135,671	61.47	5,895	-2.23
Portfolio Investments	22,019	9.20	23,463	10.63	-1,444	-1.43
Purchases of CDs issued by CBC	29,242	12.22	19,085	8.65	10,157	3.57
Deposits with CBC	29,177	12.19	27,390	12.41	1,787	0.22

Notes: * Excluding valuation changes in the exchange rate of the NT dollar against foreign currencies when calculate their annual change.

** Including checking deposits, passbook deposits and passbook savings deposits.

***Including time deposits, time savings deposits, postal savings deposits and foreign currency deposits.

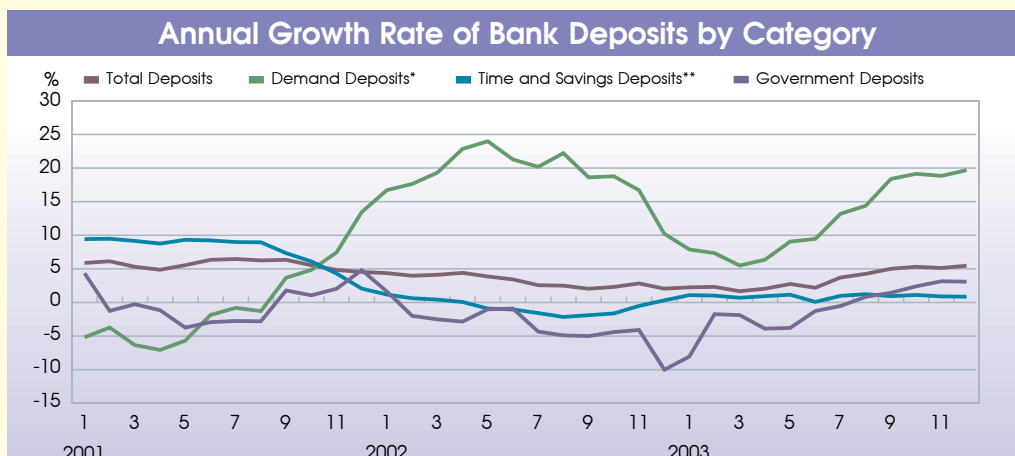
Source: *Financial Statistics Monthly, Taiwan District, The Republic of China, Central Bank of China.*

Uptrend in the Growth of Bank Deposits

Total deposits of depository institutions as of the end of 2003 increased by an annual rate of 5.52 percent, higher than the rate of 2.11 percent in 2002. Due to the lower-than-expected economic growth caused by the outbreak of the US-Iraq War and the SARS epidemic, along with the uptrend in overseas investment, deposits grew by a mere 2.25 percent, on an annual basis, in the first half of the year. In the second half, booms in consumer finance and firms' increasing demand for funds following the economic recovery led to the growth rate of banks loans and investments trending up. During the same period, foreign capital inflows, spurred by the bullish local stock market, continued to increase, and so did foreign exchange proceeds from external trade. As a result, the deposits growth rate climbed from 2.25 percent in June to its yearly high of 5.52 percent in December.

The demand deposits growth rate dropped from the previous year-end's 10.31 percent to 5.57 percent at the end of March, its lowest level of the year, due to the sluggish stock market during the first quarter of the year. Afterward, the rate rebounded and trended up steadily to reach an annual high of 19.75 percent at the year-end. At the end of the year, the share of demand deposits increased from the previous year's 24.25 percent to 27.52 percent.

The growth rate of time and savings deposits at year-end rose slightly from the previous year's 0.30 percent to 0.85 percent of this year, while its share of total deposits decreased from 72.09 percent to 68.9 percent. Time deposits registered negative growth of 6.45 percent at the end of 2003. The negative growth was mainly due to the bullish stock market, the narrowing interest rate spread between demand and time deposits, and the increased popularity of



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** Including time deposits, time savings deposits, postal savings deposits and foreign currency deposits.

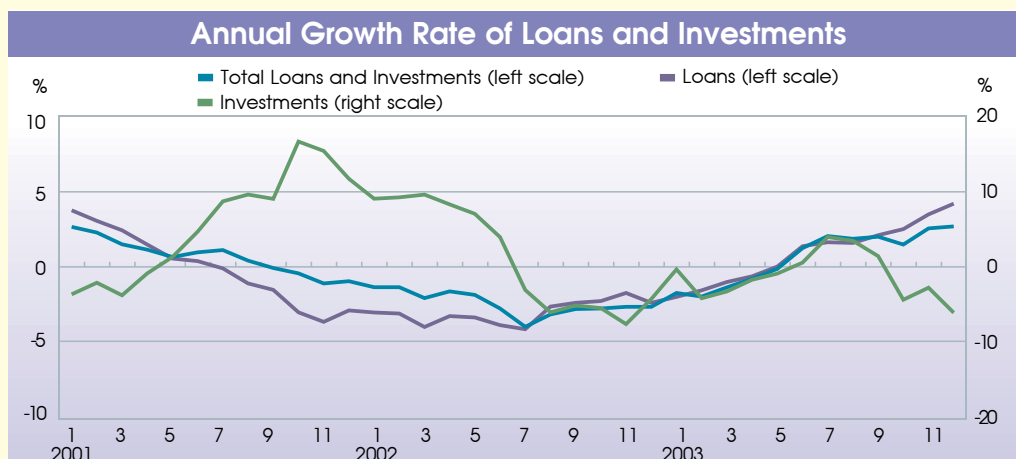
bond funds and other investment products. Postal savings deposits and time savings deposits showed mild growth in 2003. The annual growth rate of foreign currency deposits moved back into positive territory from negative 6.41 percent at the end of 2002 to 12.36 percent at the end of 2003.

Government deposits in depository institutions advanced 3.09 percent at year-end of 2003, reversing its decline of 10.26 percent in the previous year-end. While the ratio of government deposits to total deposits slightly declined from 3.66 percent to 3.58 percent.

Rise in Loans and Investments

Boosted by the domestic economic recovery and the Bank's accommodative monetary policy, the annual growth rates of loans and investments combined nudged back in to positive territory in June and recorded a rate of 2.73 percent at the end of the year. The annual growth rate of loans at year-end posted a rate of 4.27 percent, compared to the negative 2.41 percent recorded a year earlier. The annual growth rate of investments was negative 6.15 percent, following a contraction of negative 4.32 percent of the previous year. The further contraction was mainly attributable to the decrease in issues of Treasury bills and commercial paper.

Loans extended to private enterprises and individuals accounted for 83.18 percent of total loans at the end of 2003, higher than the 82.25 percent recorded a year earlier. The share of loans extended to government agencies to total loans decreased to 13.74 percent from the previous year-end's 14.24 percent, mainly because the central government repaid the loans contracted by the former Taiwan provincial government. The share of loans to public enterprises dropped from 2002's 3.51 percent to 3.08 percent at the end of 2003.

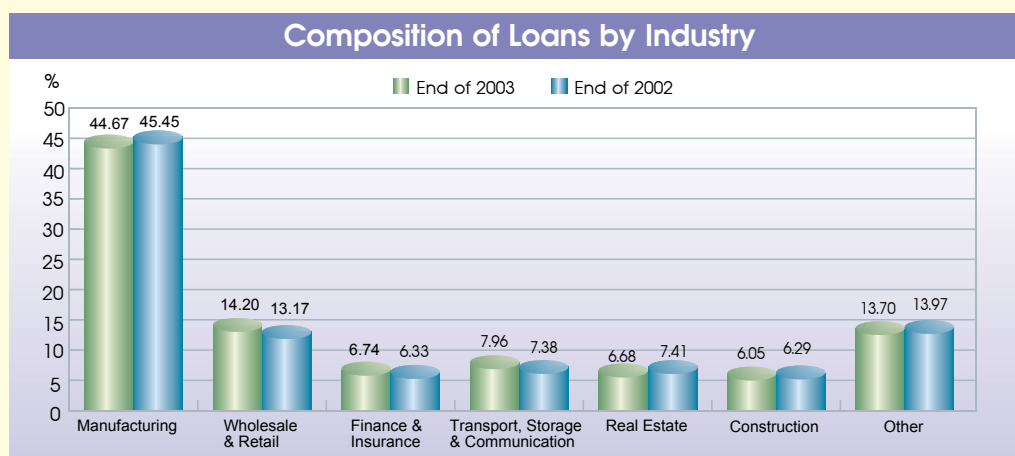


Regarding the composition of domestic banks' loans by industry, the share of loans to the manufacturing industry continued to fall and posted a rate of 44.67 percent at the year-end, down from the previous year-end's 45.45 percent. The share of loans to the real estate and construction industries fell from the previous year-end's 6.29 percent and 7.41 percent, to 6.05 percent and 6.68 percent, respectively. The revival in the stock market triggered loans extended to the financial and insurance industries with the share climbing up from the previous year-end's 6.33 percent to 6.74 percent. Loans to the retail and wholesale industries expanded as well.

In regard to consumer loans, because of banks' aggressive attempts to expand the scope of the consumer finance business, consumer loans of domestic banks trended up and recorded an increase of NT\$546.0 billion or 12.78 percent from a year earlier.

With regard to loans by currency, the share of foreign currency loans to total loans rose to 3.55 percent at the end of 2003 from 3.25 percent at the previous year-end. The increase was mainly due to the strengthening of external trade and the rising expectations of the NT dollar's appreciation from the third quarter onwards. The corresponding share of NT dollar loans to total loans therefore contracted slightly from 96.75 percent to 96.45 percent. As for the NT dollar loan-to-deposit ratio, it dropped to 66.84 percent at the end of 2003 from 67.61 percent recorded at the end of the previous year.

With respect to the composition of investments of depository institutions, government bonds accounted for the largest share, followed by commercial paper. In the case of domestic banks, government bonds accounted for 38.84 percent of their total investments, up from the previous year-end's 32.71 percent. This was mainly due to the increased issue of government



bonds for financing the fiscal deficit, along with banks' efforts in reducing excess liquidity and risk of their investment. The ratio of investment on commercial paper to their total investment dropped to 19.15 percent from 24.18 percent a year earlier, primarily reflecting the decline in commercial paper issued by local firms.

Decreased Intermediate Financing vs. Increased Market Financing

Due to the domestic economic recovery in the second half of the year, the total amount of funds raised during the year by the non-financial sector, comprising enterprises, households and the government as a whole, showed a marked increase from the previous year's NT\$776.8 billion to NT\$1,653.1 billion, the highest figure since 1999. With regard to the composition of the sources of funds, the share of intermediate financing, that is those borrowed from financial institutions including depository institutions, investment and trust companies and life insurance companies, fell from 50.73 percent in 2002 to 41.88 percent in 2003. Conversely, the share of market financing, i.e., the funds raised directly from financial markets via the issues of various marketable securities by issuers to the general public without the involvement of financial institutions increased from 49.27 percent to 58.12 percent. The increase was mainly from larger issues of government bonds and offshore corporate bonds.

Marked drop in the Non-performing Loan Ratio

With the efforts made by asset management companies and deposit money banks to speed up the disposal of non-performing loans (NPL), the book value of accumulated NPLs

Intermediate Financing vs. Market Financing*

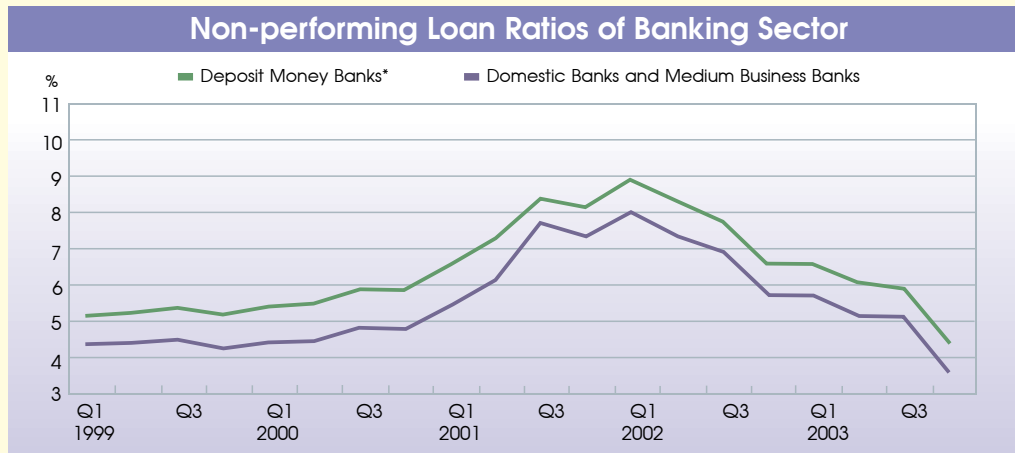
Unit: NT\$ Billion

	Total Funds Raised (3)=(1)+(2)	Intermediate Financing(1)				Market Financing(2)	
		Amount			Share (1)/(3)(%)	Amount	Share (2)/(3)(%)
			Loans	Investments			
1994	1,859.5	1,599.2	1,536.6	62.6	86.00	260.3	14.00
1995	1,442.4	1,304.9	1,033.8	271.1	90.47	137.5	9.53
1996	1,625.9	1,372.6	721.4	651.2	84.42	253.3	15.58
1997	2,233.2	1,625.4	1,503.2	122.2	72.78	607.8	27.22
1998	1,916.6	1,385.6	867.7	517.9	72.29	531.0	27.71
1999	1,279.8	1,032.0	944.7	87.3	80.64	247.8	19.36
2000	1,353.7	1,179.8	1,029.8	150.0	87.15	173.9	12.85
2001	639.6	568.9	175.0	393.9	88.95	70.7	11.05
2002	776.8	394.1	41.0	353.1	50.73	382.7	49.27
2003	1,653.1	692.4	687.8	4.6	41.88	960.7	58.12

Notes: * Measured in terms of flow data.

- (1) Refers to loans and investments made by depository institutions, investment and trust companies, and life insurance companies, after taking into account their reclassifying of non-accrual loans and written-off bad loans.
- (2) Refers to the total amount of new issues of various marketable securities, including government bonds, corporate bonds and stocks, offshore bonds and depository receipts, short-term bills and asset-backed securities directly held by the non-financial sectors.

Source: Department of Economic Research, Central Bank of China.



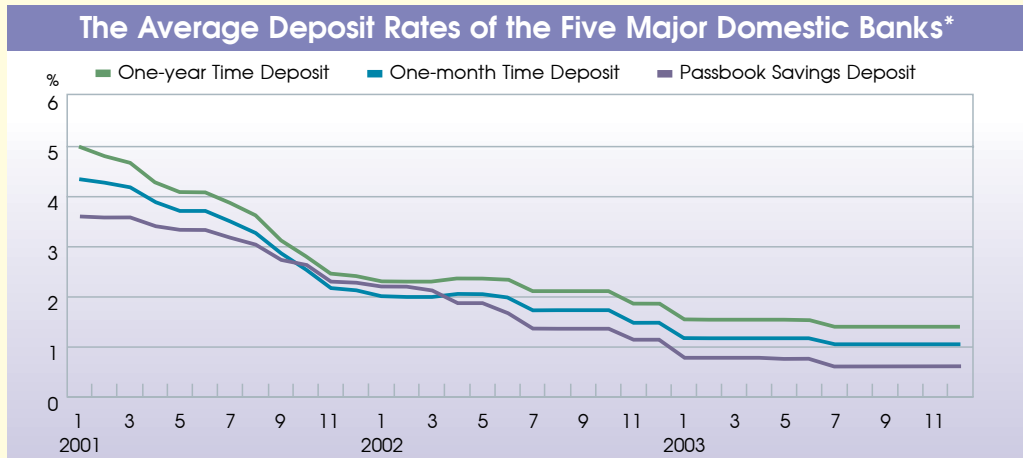
Note: * Including domestic banks, medium business banks, foreign banks, credit cooperatives and credit departments of farmers' and fishermen's associations.

sold reached NT\$256.1 billion during the year 2003. As local banks continued to write off bad loans with funds from their own earnings, the NPL ratio was significantly improved during the year.

Because banks speeded up the sale and writing-off of bad assets, coupled with the improved debt-servicing ability of borrowers following the economy's steady recovery, the average NPL ratio of deposit money banks as a whole trended down quarter by quarter during 2003. As of the end of 2003, the ratio had declined to 5.00 percent from 6.84 percent recorded a year earlier. The corresponding NPL ratio for domestic banks and medium business banks (including their offshore banking units and overseas branches) also dropped from the previous year-end's 6.12 percent to 4.33 percent, the lowest level since 1998.

Decline in Bank Interest Rates

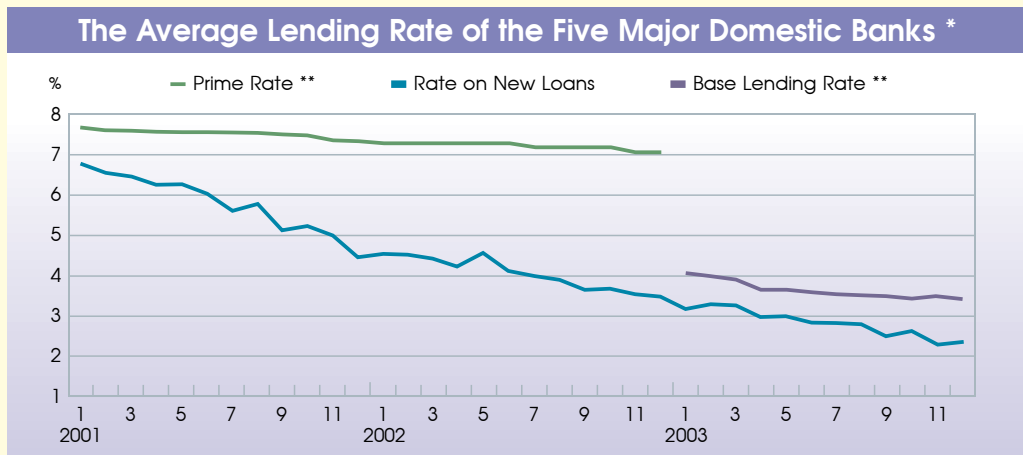
Banks' posted interest rates exhibited a downward trend throughout the year. In the case of the interest rates of the five major domestic banks, the average fixed rates on one-month and one-year time deposits at the end of 2003 dropped to 1.05 percent and 1.40 percent from 1.48 percent and 1.86 percent, respectively, recorded a year earlier. In view of the downward rigidity of banks' prime rates, the Bank urged banks to adopt the new flexible prime rate benchmark scheme (base lending rates) so that lending rates could reflect the funding conditions of the market more efficiently. As a result, the base lending rates of the five major domestic banks were lowered on several occasions during the year and reached a low of 3.43 percent at the end of December, as compared with the 4.08 percent posted at the end of January. Furthermore, in order to remove the downward rigidity of mortgage rates, the Bank also encouraged banks to commence adjustable rate mortgages. As of December 2003,



Note: * The five major domestic banks include Bank of Taiwan, Taiwan Cooperative Bank, First Commercial Bank, Hua Nan Commercial Bank and Chang Hwa Commercial Bank.

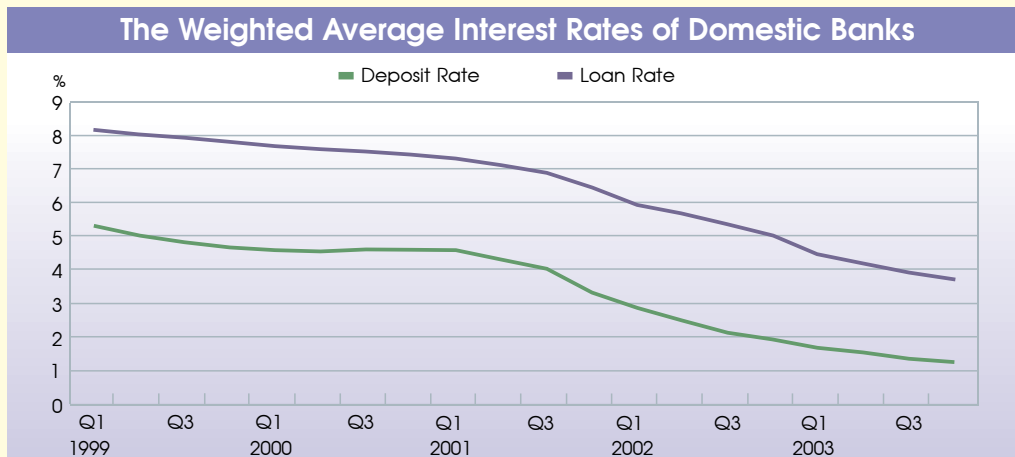
43 banks from a total of 50 domestic banks had adopted adjustable rate mortgages and 47 banks had changed their pricing methods to base lending rates.

Against the backdrop of easy funding conditions and pursuant to the government's financial reform plan of lowering NPL ratios, banks expanded loans to government agencies and enterprises with good credit records with a lower rate, and extended preferential consumer credit to government employees. In addition, the government also implemented various policy-based loans with preferential rates. As a result, the weighted average rates on new loans of the five major domestic banks trended down throughout the year and hit a record low of 2.29 percent in November. The weighted lending rate slightly rose to 2.36 percent in



Notes: * The five major domestic banks include Bank of Taiwan, Taiwan Cooperative Bank, First Commercial Bank, Hua Nan Commercial Bank and Chang Hwa Commercial Bank.

** Beginning in Jan. 2003, data on the base lending rate is released to the public, while the prime rate is no longer published.



December due to a higher seasonal demand for funds from private enterprises.

Both the weighted average rates for all deposits and loans of domestic banks exhibited a downward trend throughout the year of 2003. The weighted average deposit rate for the whole year continued to fall to 1.48 percent from 2.38 percent a year earlier. The corresponding lending rate declined from the previous year's 5.53 percent to 4.10 percent. Because the declines in lending rates were more rapid than in deposits rates, the interest spread between deposits and loans shrank steadily to 2.47 percentage points in the fourth quarter, less than the 3.07 percentage points recorded in the fourth quarter of 2002.

Significant Increase in Profitability

The profitability of banks increased significantly during 2003. The combined pre-tax earnings of all depository institutions grew by NT\$187.7 billion to NT\$86.8 billion, a substantial improvement when compared with the loss of NT\$100.9 billion in the previous year. Of this amount, the pre-tax earnings of domestic banks and medium business banks combined increased by NT\$159.3 billion to NT\$50.4 billion after posting a loss of NT\$108.9 billion in the previous year. The increase was primarily attributable to banks' lower provisions for bad loans as nonperforming loans reduced, as well as increased fees income after banks started charging fees for various banking services. The pre-tax profit of foreign banks increased by NT\$4.3 billion, mainly due to a decline in business and administrative costs. As for credit cooperative associations and the credit departments of farmers and fishermen's associations, pre-tax earnings remained negative because of increased provisions for bad loans. Owing to the revaluation gains from equities investments, the pre-tax profit of the Chunghwa Post Co. improved as the stock market turned bullish in the second half of the year.

Profitability of Depository Institutions by Category

Unit: NT\$ Billion

	Profit before Tax			Return on Assets* (%)			Return on Equity ** (%)		
	2003	2002	Annual Change	2003	2002	Annual Change	2003	2002	Annual Change
Domestic Banks and Medium Business Banks	50.4	-108.9	159.3	0.22	-0.50	0.72	3.49	-7.61	11.10
Foreign Banks	21.0	16.7	4.3	1.31	1.34	-0.03	38.06	30.84	7.22
Credit Cooperative Associations	-2.0	-1.3	-0.7	-0.29	-0.18	-0.11	-4.87	-2.81	-2.06
Credit Departments of Farmers' and Fishermen's Associations	0.0	-1.7	1.7	0.00	-0.13	0.13	-0.02	-2.25	2.23
Departments of Savings and Remittances of Chunghwa Post Co.	17.4	-5.7	23.1	0.52	-0.18	0.70	36.95	-35.29	72.24
Total Depository Institutions	86.8	-100.9	187.7	0.29	-0.36	0.65	5.22	-6.21	11.43

Notes: * Return on Assets = Profit before Tax / Total Assets

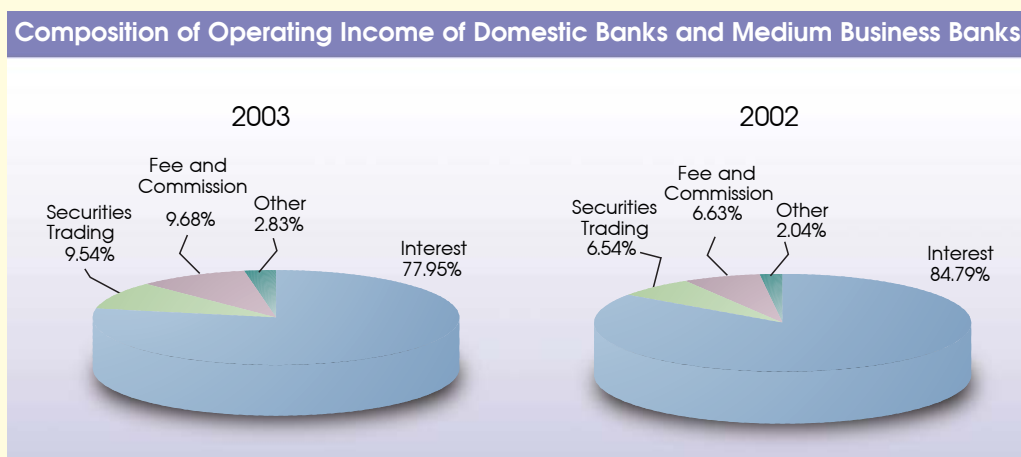
** Return on Equity = Profit before Tax / Net Worth

Source: Department of Financial Inspection, Central Bank of China.

In terms of the components of operating income of domestic banks and medium business banks combined, the share of interest income to total operating income declined from the previous year's 84.79 percent to 77.95 percent. The share of fee and commission income rose from 6.63 percent to 9.68 percent this year. The share of earnings from securities trading also increased to 9.54 percent from the previous year's 6.54 percent as banks actively conducted outright bond deals for arbitrage purposes due to the falling interest rates.

Strong Rebound in Both ROA and ROE

The average return on assets (ROA) for all depository institutions registered positive 0.29 percent from last year's negative 0.36 percent. Furthermore, the average return on equity (ROE) posted a positive figure of 5.22 percent this year, a marked improvement over last year's negative 6.21 percent. Except for credit cooperative associations and the credit departments



of farmers' and fishermen's associations, ROEs and ROAs for all other depository institutions reached positive territory during the year. Foreign banks remained leaders in terms of ROEs and ROAs.

