

5. Foreign Exchange Market

Moderate Appreciation of the NT\$/US\$ Exchange Rate

Due to an increase in the US trade deficit, a recovery of the Japanese economy, coupled with foreign capital inflows to the Taiwan stock market, the NT\$/US\$ exchange rate appreciated from 33.976 at the beginning of 2004 to 32.798 by mid-April. In late April, the NT dollar started to depreciate, caused by the risk arising from China's macroeconomic tightening, expectations of rising US interest rates, and higher oil prices. The NT dollar declined to 34.199 against the US dollar on July 28, the lowest level of the year. After the middle of August, with the US trade deficit reaching historic highs, international funds returned to Asian countries. Consequently, the oversupply of foreign exchange led the NT dollar to appreciate. In December, due to further weakening of the US dollar, and the devastating tsunami in South and Southeast Asia on December 26, foreign funds flowed to Northeast Asia. The NT dollar finished 2004 at a yearly high of 31.917 against the US dollar.

Compared with the rate of 33.978 registered at the end of 2003, the NT dollar appreciated by 6.46 percent against the US dollar in 2004. On a daily average basis, the NT\$/US\$ exchange rate for 2004 was 33.422, representing an appreciation of 2.98 percent when compared with the previous year.

With respect to other major currencies, the NT dollar appreciated against the Japanese yen by 1.68 percent and depreciated against the euro by 1.15 percent, between the end of 2003 and 2004. When based on the trade-weighted average exchange rate against major

NT Dollar Spot Exchange Rate



Source: Taipei Forex Inc.

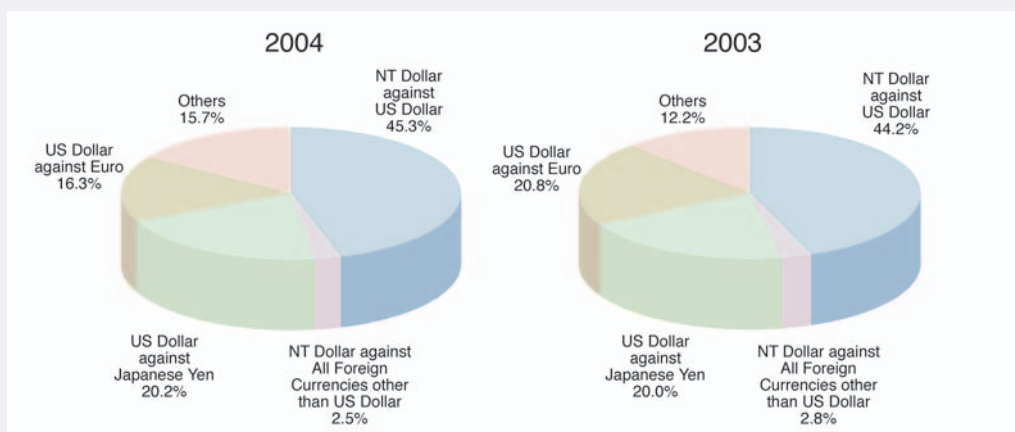
trading partners (weighted by the sum of imports and exports of goods), the NT dollar appreciated by 3.39 percent between the end of 2003 and 2004.

Active Trading in the Foreign Exchange Market

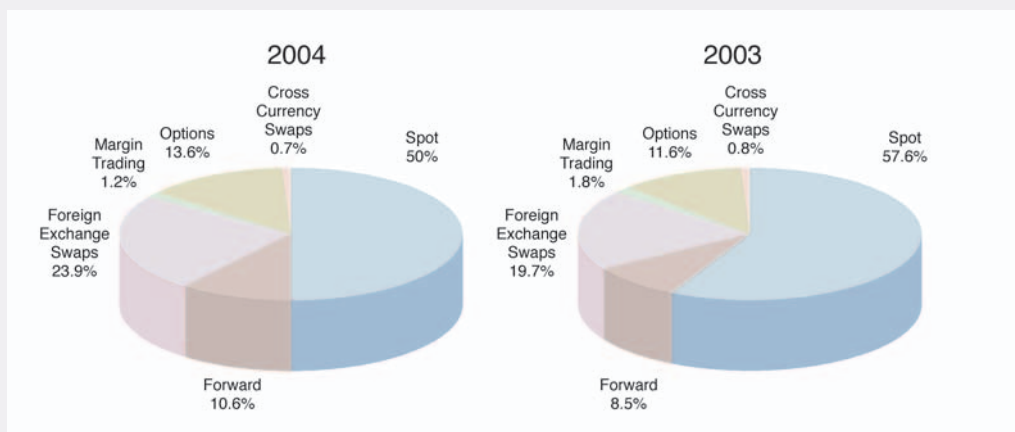
Trading in the Taipei foreign exchange market significantly increased in 2004. After deducting double counting on the part of interbank transactions, total net trading volume for the year increased by 40.4 percent from the previous year to US\$2,579.95 billion. The daily average turnover stood at US\$10.24 billion, representing an increase of 39.8 percent over the previous year. The increase in turnover mainly resulted from an expansion in external trade, and a marked rise in third currency transactions following the sharp appreciation of the euro and the Japanese yen against the US dollar.

In terms of trading partners, transactions between banks and non-bank customers accounted

Composition of Foreign Exchange Transactions by Traded Currency



Composition of Foreign Exchange Transactions by Product



Source: Department of Foreign Exchange, Central Bank of China.

for 32.5 percent of total net turnover. Interbank transactions made up a 67.5 percent share, including 20.8 percent for transactions among local banks and 46.7 percent for those between local banks and overseas banks.

As far as traded currencies are concerned, transactions in third currencies accounted for 52.2 percent of total trading volume, with trading in currency pairs of US dollar-Japanese yen and US dollar-euro accounting for shares of 20.2 percent and 16.3 percent, respectively. NT dollar trading against foreign currencies accounted for 47.8 percent of total trading volume, of which the share of NT dollars against US dollars was 45.3 percent.

With respect to types of transactions, spot transactions accounted for the highest share with 50 percent of total turnover, followed by foreign exchange swaps with 23.9 percent, options with 13.6 percent, forwards with 10.6 percent, margin trading with 1.2 percent, and cross currency swaps with 0.7 percent. Compared with 2003, except for a decrease in margin trading transactions, the trading volumes of foreign exchange swaps, options, and forwards all recorded growth rates of above 60 percent. This indicated the trend that banks tended to use the interbank swap market to adjust their currency composition, and that businesses inclined to utilizing financial derivatives to hedge the increasing risks they faced.

In 2004, turnover of forwards, swaps and options on foreign currency interest rates, commodity

Turnover of Major Products in the Taipei Foreign Exchange Market

Unit: US\$ Million

Year	Spot	Forward	Forex Swaps	Margin Trading	Options	Cross Currency Swaps	Total
2000	793,024	99,702	176,299	20,056	112,485	3,536	1,205,104
2001	758,827	93,687	172,551	21,320	105,609	8,427	1,160,421
2002	872,844	114,341	238,807	25,869	149,630	8,875	1,410,366
2003	1,058,850	156,323	361,490	33,907	213,198	13,930	1,837,698
2004	1,289,872	273,931	617,577	30,299	350,514	17,764	2,579,955
2003-2004 Growth Rate (%)	21.8	75.2	70.8	-10.6	64.4	27.5	40.4

Source: Department of Foreign Exchange, Central Bank of China.

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 Price Swaps	Commodity Options			
2000	5,417	4,097	1,471	152	201	1,541	37	--	12,916
2001	12,170	12,114	1,018	74	259	644	34	--	26,313
2002	30,518	22,488	4,479	2,458	305	1,826	556	--	62,630
2003	20,121	41,855	10,066	12,036	175	3,313	663	--	88,229
2004	20,020	77,664	45,635	12,500	0	6,733	1,102	168	163,823
2003-2004 Growth Rate (%)	-0.5	85.6	353.4	3.9	-100.0	103.2	66.3	--	85.7

Source: Department of Foreign Exchange, Central Bank of China.

prices, stock price indices and credit amounted to US\$163.82 billion. Of this amount, interest rate-related derivatives accounted for the lion's share of US\$155.82 billion or 95.1 percent, representing an annual growth rate of 85.3 percent. This was mainly because of the sharp increase in euro convertible bond-related asset swaps, such as interest rate swaps and interest rate options.

Slightly Declining Transactions in the Foreign Currency Call-Loan Market

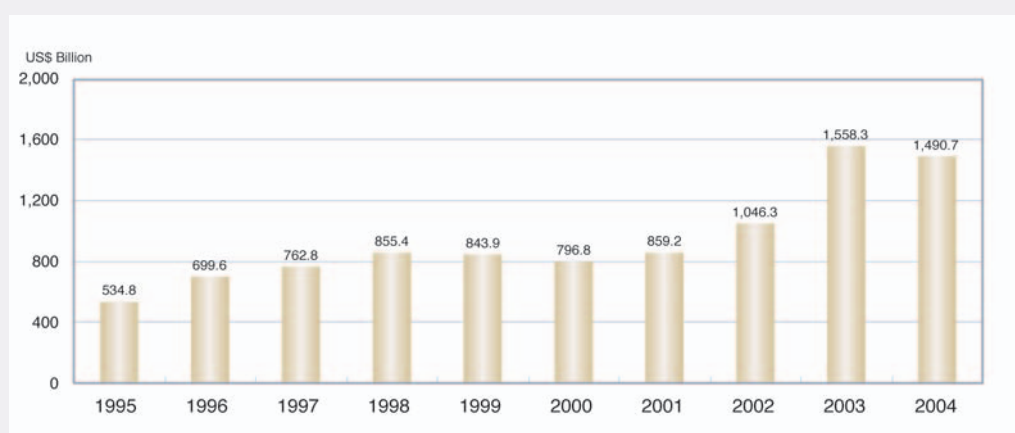
The transaction volume in the foreign currency call-loan market in 2004 was equivalent to US\$1,490.7 billion. Of this amount, US dollar transactions accounted for US\$1,488.9 billion, a reduction of 4.4 percent over 2003. The decrease was mainly because some banks raised interest rates on US dollar deposits to increase their sources of foreign currency funds, hence reducing their demand for foreign currency call loans.

Continued Expansion in the Assets of Offshore Banking Units

At the end of 2004, there were 70 offshore banking units (OBUs) in operation. Domestic banks operated 42 of the OBUs, while foreign banks ran the other 28. The combined assets of all OBUs totaled US\$69.22 billion at the end of the year, representing an increase of US\$6.7 billion or 10.7 percent from the previous year-end. This was a result of increases in loans to non-financial institutions and claims on financial institutions. Domestic bank OBUs accounted for US\$48.21 billion or 69.6 percent of these combined assets, and foreign bank OBUs accounted for US\$21.01 billion or 30.4 percent of the total.

The OBUs' main sources of funds were due to affiliated branches and deposits by financial institutions, which together accounted for 61.7 percent of total liabilities. These were followed

Transactions in the Taipei Foreign Currency Call-Loan Market



Source: Department of Foreign Exchange, Central Bank of China.

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	Other Liabilities
2002/12	15,160	5,896	27,454	1,808	50,318	14,326	33,443	2,549
2003/12	15,939	7,648	37,420	3,541	64,548	16,307	44,288	3,953
2004/12	18,066	6,734	37,105	7,314	69,219	18,810	42,688	7,721
2004/ 1	16,383	7,684	35,043	3,851	62,961	16,212	42,571	4,178
2	16,506	7,913	35,146	5,334	64,899	15,920	43,232	5,747
3	16,981	7,830	35,131	6,542	66,484	16,426	43,224	6,834
4	17,347	7,906	36,344	7,275	68,872	16,475	44,533	7,864
5	17,790	7,790	36,247	7,352	69,179	16,583	44,589	8,007
6	18,528	7,624	38,643	6,725	71,520	16,629	47,458	7,433
7	18,322	7,593	34,645	6,243	66,803	17,002	42,879	6,922
8	18,380	7,311	35,660	5,890	67,241	17,633	42,950	6,658
9	18,192	7,121	35,170	6,042	66,525	18,233	41,641	6,651
10	18,406	7,012	35,284	6,196	66,898	18,337	41,813	6,748
11	18,426	6,752	37,157	7,258	69,593	18,557	43,212	7,824
12	18,066	6,734	37,105	7,314	69,219	18,810	42,688	7,721

Source: Financial Statistics Monthly, Taiwan District, the Republic of China, Department of Economic Research, Central Bank of China.

by deposits of non-financial institutions, which accounted for 27.2 percent of total liabilities. OBUs have been gradually developing into capital management centers for overseas Taiwanese firms. In terms of the geographical origin, 64 percent of funds came from Asia, and 20 percent from the Americas..

The OBUs' main uses of funds were due from affiliated branches and deposits with financial institutions. These accounted for the lion's share, or 53.6 percent of total assets. Second to these were loans extended abroad and locally with a share of 26.1 percent. Additionally, portfolio investments accounted for 9.7 percent of total assets. In terms of fund destination, 67 percent of funds went to Asia, and 20 percent to the Americas.

The forex-trading turnover of all OBUs in 2004 was US\$117.88 billion, of which US\$75.06 billion was for spot transactions, US\$23.1 billion for forward transactions, and US\$19.72 billion for foreign exchange swap transactions. Compared with 2003, forward transactions increased 3.2 times, mainly because Taiwanese firms in mainland China used non-deliverable forwards of the US dollar against the Chinese renminbi to hedge risks. Foreign exchange swap transactions also increased by 93 percent, mainly because the significant appreciation and large fluctuations of the euro and the Japanese yen against the US dollar led firms to use them to hedge risks. 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\$62.95 billion, representing a slight increase of 6.5 percent over the previous year.