

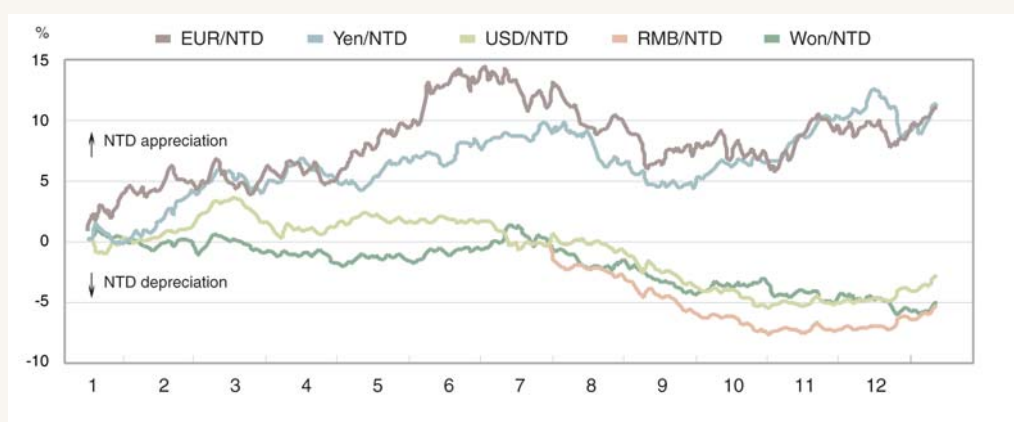
5. Foreign Exchange Market

Moderate Appreciation of the NT Dollar

On a daily average basis, the NT dollar appreciated against the US dollar, euro, and Japanese yen, but depreciated against the Korean won in 2005. Regarding the movement in the NT\$/US\$ exchange rate, reports that Asian central banks reduced their US dollar foreign reserve assets, coupled with foreign capital inflows to the Taiwan stock market, led the NT\$/US\$ exchange rate to appreciate from 32.263 at the beginning of 2005 to a yearly high of 30.790 on March 10. From the middle of March onwards, the NT dollar started to depreciate, caused by a continuous rise in US interest rates, a shrinkage in Taiwan's trade surplus, and foreign capital outflows from the Taiwan stock market. The NT dollar declined to 33.770 against the US dollar on October 24, the lowest level of the year. In December, due to Japan's economic recovery, a historically high US trade deficit, and the return of international capital to Asia, the NT dollar appreciated to close the year at 32.850 against the US dollar. Compared with the end of 2004, the NT dollar depreciated by 2.84 percent against the US dollar at the end of 2005. However, on a daily average basis, the NT\$/US\$ exchange rate appreciated 3.90 percent in 2005 from the previous year.

With respect to NT dollar exchange rates against the euro and the Japanese yen, as a result of the large appreciation of the euro against the US dollar in 2004, continuously rising

**Percentage Changes of NT Dollar against Major Currencies
(compared with End 2004)**



Note: Before July 21, the RMB was pegged to the US dollar. Therefore, the movements of the NT dollar against the RMB followed those against the US dollar.
Source: Department of Economic Research, the Central Bank of China.

US interest rates, economic weakness in the euro area and Japan, and the negative impact of higher oil prices on Japan's economy, the euro and the Japanese yen depreciated against the US dollar in 2005. Both currencies depreciated against the US dollar by a larger degree than the NT dollar. Therefore, the NT dollar appreciated against the euro and the Japanese yen by 11.16 percent and 11.30 percent, respectively, between the end of 2004 and 2005. On a daily average basis, the NT dollar appreciated against the euro and the Japanese yen by 3.66 percent and 5.75 percent, respectively, when compared with the previous year.

Due to the fact that trade with Asia exceeds 60 percent of Taiwan's total trade, the NT dollar exchange rates against other Asian currencies, such as the Chinese renminbi (RMB) and Korean won have aroused more attention in the market.

Before July 21, 2005, the RMB was pegged at 8.27 per US dollar. Therefore, the movements of the NT dollar against the RMB followed those against the US dollar. On July 21, China adopted a managed floating exchange rate regime, and the RMB appreciated by 2.1 percent from 8.27 to 8.11 against the US dollar. Afterwards, due to the rapid growth of China's economy, and expectations of a RMB appreciation, the RMB strengthened against the US dollar, and hence against the NT dollar for most of the remainder of 2005. The NT dollar depreciated 5.26 percent against the RMB between the end of 2004 and 2005. On a daily average basis, the NT dollar appreciated 2.86 percent against the RMB in 2005 when compared with the previous year.

Due to strong domestic demand, an expansion in domestic consumption, and the stock market index reaching historic highs, the Korean won mostly appreciated against the US dollar, and hence against the NT dollar in 2005. The NT dollar depreciated 5.05 percent against the Korean won between the end of 2004 and 2005. On a daily average basis, the NT dollar depreciated 7.10 percent against the Korean won in 2005 when compared with the previous year.

Based on the trade-weighted average exchange rate against major trading partners (weighted by the sum of imports and exports of goods), the NT dollar appreciated by 1.70 percent between the end of 2004 and 2005.

Moderate Increase in Trading in the Foreign Exchange Market

Trading in the Taipei foreign exchange market increased moderately in 2005. After deducting double counting on the part of interbank transactions, total net trading volume for the year increased by 16.6 percent from the previous year to US\$3,008.66 billion. The daily average turnover stood at US\$12.08 billion, representing an increase of 18.0 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 depreciation of the euro and the Japanese yen against the US dollar.

In terms of trading partners, transactions between banks and non-bank customers accounted for 31.7 percent of total net turnover. Interbank transactions made up a 68.3 percent share, including 19.5 percent for transactions among local banks and 48.8 percent for those between local banks and overseas banks.

As far as traded currencies are concerned, transactions in third currencies accounted for 50.9 percent of total trading volume, with trading in currency pairs of US dollar-Japanese yen and US dollar-euro accounting for shares of 17.9 percent and 15.3 percent, respectively. NT dollar trading against foreign currencies accounted for 49.1 percent of total trading volume, of which the share of NT dollars against US dollars was 46.4 percent.

With respect to types of transactions, spot transactions accounted for the highest share with 51.6 percent of total turnover, followed by foreign exchange swaps with 27.4 percent, options with 9.8 percent, forwards with 9.1 percent, cross currency swaps with 1.3 percent, and margin trading with 0.8 percent. Compared with 2004, except for a decrease in margin trading and options transactions, the trading volumes of all the other types increased. The trading volumes of cross currency swaps and foreign exchange swaps recorded the highest growth rates of 124.0 percent and 33.3 percent, respectively. The increase was mainly because domestic insurance companies increased their overseas investments and utilized cross currency swaps and foreign exchange swaps to hedge risks, and because banks used the interbank swap market to adjust their currency composition.

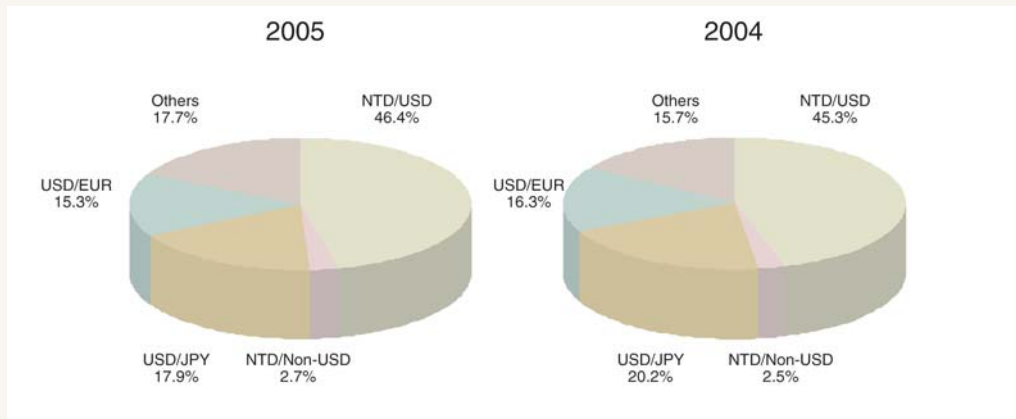
Turnover of Major Products in the Taipei Foreign Exchange Market

Unit: US\$ Million

Year	Spot	Forward	Forex Swaps	Margin Trading	Options	Cross Currency Swaps	Total
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
2005	1,550,731	274,370	823,483	24,378	295,908	39,788	3,008,657
2004-2005 Growth Rate (%)	20.2	0.2	33.3	-19.5	-15.6	124.0	16.6

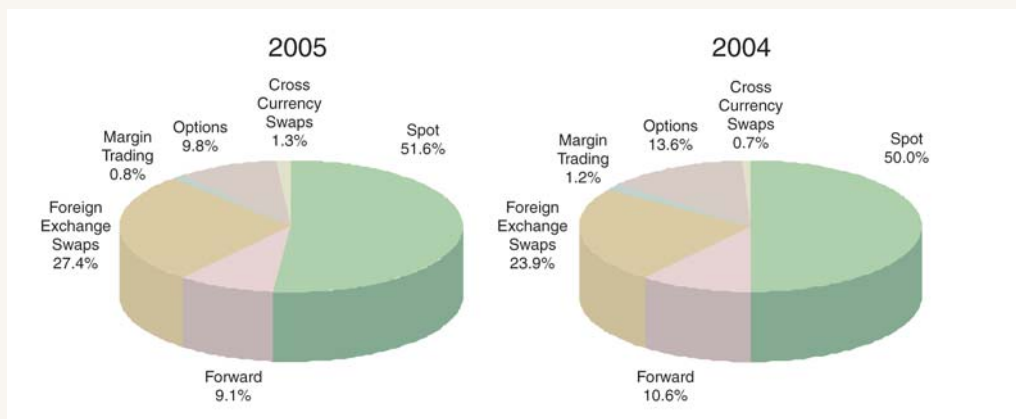
Source: Department of Foreign Exchange, the Central Bank of China.

Composition of Foreign Exchange Transactions by Traded Currency



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

Composition of Foreign Exchange Transactions by Product



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

In 2005, the turnover of forwards, swaps and options based on foreign currency interest rates, stock price indices, commodity prices, and credit amounted to US\$162.24 billion. Of this amount, interest rate-related derivatives accounted for the lion's share of US\$156.67 billion or 96.6 percent, representing an annual growth rate of 0.6 percent.

Contraction in the Foreign Currency Call-Loan Market

The transaction volume in the foreign currency call-loan market in 2005 was equivalent to US\$937.21 billion, a decrease of 37.1 percent over the previous year. Of this amount, US dollar transactions accounted for US\$936.41 billion, a reduction of 37.1 percent over 2004. The decrease was mainly because some banks raised interest rates on US dollar deposits to increase their sources of foreign currency funds, hence reducing demand for foreign currency call loans, and some banks used foreign exchange swaps in place of call-loan transactions. Japanese yen transactions totaled ¥17.55 billion in 2005, representing a large increase of 12.6 times the

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			
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
2005	25,089	78,528	23,668	29,385	0	4,594	389	581	162,235
2004-2005 Growth Rate (%)	25.3	1.1	-48.1	135.1	0.0	-31.8	-64.7	245.4	-1.0

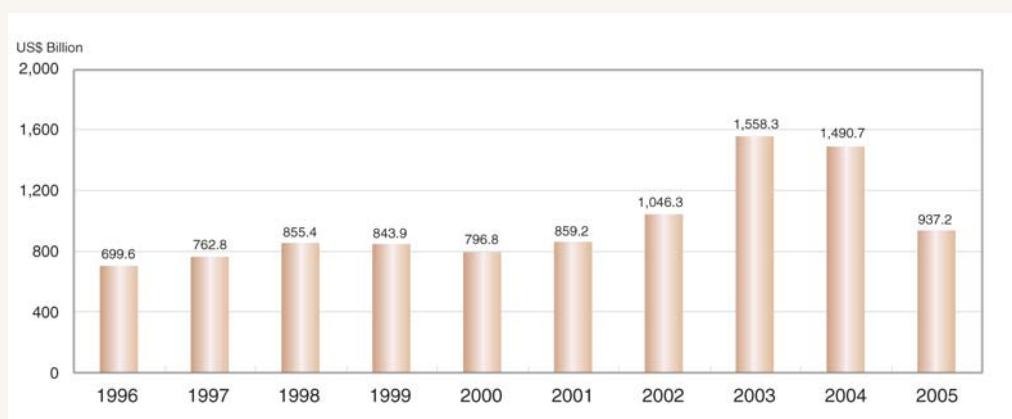
Source: Department of Foreign Exchange, the Central Bank of China.

figure recorded in 2004, but the share remained rather small at only 0.02 percent. The amount of euro transactions totaled only €510 million, decreasing 64.9 percent from 2004.

Slight Increase in the Assets of Offshore Banking Units

At the end of 2005, there were 70 offshore banking units (OBUs) in operation. Domestic banks operated 41 of the OBUs, while foreign banks ran the other 29. The combined assets of all OBUs totaled US\$70.16 billion at the end of the year, representing a slight increase of US \$939 million or 1.4 percent from the previous year-end. This was primarily the result of an increase of US\$2.17 billion in deposits with financial institutions and US\$1.98 billion in securities investments, outweighing a decrease of US\$3.07 billion in other assets caused by changes in the accounting method of US dollar-RMB non-deliverable forwards and margin trading from June 2005. Domestic bank OBUs accounted for US\$50.52 billion or 72 percent of these combined

Transactions in the Taipei Foreign Currency Call-Loan Market



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

assets, and foreign bank OBUs accounted for US\$19.64 billion, or 28 percent of the total.

The OBUs' main sources of funds were due to affiliated branches and deposits by financial institutions, which together accounted for 63.1 percent of total liabilities. These were followed by deposits of non-financial institutions, which accounted for 29.5 percent of total liabilities. OBUs have been gradually developing into capital management centers for overseas Taiwanese firms. In terms of geographical origin, 67 percent of funds came from Asia, and 21 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 54.8 percent of total assets. Second to these were loans extended abroad and locally with a share of 26.6 percent. Additionally, portfolio investments accounted for 12.4 percent of total assets. In terms of fund destination, 62 percent of funds went to Asia, and 23 percent to the Americas.

The forex-trading turnover of all OBUs in 2005 was US\$133.67 billion, of which US\$95.57 billion was for spot transactions, US\$20.82 billion for foreign exchange swap transactions, and US\$17.28 billion for forward transactions. Compared with 2004, forward transactions decreased 25.2 percent, mainly because of changes in the accounting method of US dollar-RMB non-deliverable forwards and margin trading from June 2005. 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\$90.6 billion, representing a significant increase of 43.9 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	Other Liabilities
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
2005/12	18,697	8,718	38,432	4,311	70,158	20,712	44,305	5,141
2005/ 1	18,155	6,747	37,894	7,352	70,148	18,389	44,169	7,590
2	17,891	6,737	36,205	7,255	68,088	18,942	41,570	7,576
3	17,909	6,847	36,179	7,426	68,361	18,239	42,311	7,811
4	17,764	7,079	37,031	7,527	69,401	18,769	42,510	8,122
5	18,090	7,362	36,743	8,460	70,655	18,679	43,023	8,953
6	18,275	6,886	34,587	5,022	64,770	19,111	40,636	5,023
7	18,296	7,729	33,581	3,909	63,515	19,009	40,373	4,133
8	18,734	7,994	33,034	3,990	63,752	19,431	40,018	4,303
9	18,752	8,110	32,700	4,432	63,994	19,656	39,513	4,825
10	18,998	8,649	33,249	4,176	65,072	19,945	39,971	5,156
11	18,940	8,722	34,699	4,339	66,700	20,680	40,663	5,357
12	18,697	8,718	38,432	4,311	70,158	20,712	44,305	5,141

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