
IV. Measures to maintain financial stability

In 2012, due to slowing global and domestic economies, the industrial sector saw profits shrink and a few companies suffered insolvencies caused by huge losses. However, in spite of the disadvantageous macroeconomic conditions, financial markets in Taiwan continued to function well in 2012. Financial institutions enjoyed considerably increasing profits and good asset quality, while the capital level of all financial institutions, except for a few insurance companies, remained satisfactory. The three main payment systems functioned smoothly as well. Therefore, on the whole, Taiwan's financial system remained stable.

In face of the dramatic changes in economic and financial conditions both domestically and globally, especially the evolving European sovereign debt crisis, the US fiscal cliff and the Japanese yen's sharp depreciation caused by the BOJ's easing monetary policies, the CBC continually monitored the above impacts on the domestic economy and financial system and implemented corresponding monetary and foreign exchange policies. The FSC also reviewed and amended several laws and regulations and took efforts to strengthen financial supervision, all aimed at maintaining the soundness of financial institutions and stability of the financial system.

4.1 Measures taken by the CBC to promote financial stability

Adopting sound monetary policies to address the economic environment and maintain price stability

Policy rates remained unchanged in 2012

Owing to global economic uncertainties, moderate domestic economic recovery and the alleviation of inflation pressures, the CBC kept policy rates unchanged⁷³ in 2012 to maintain price and financial stability and promote economic growth.

⁷³ From 1 July 2011, the CBC has kept the discount rate, the rate on accommodations with collateral, and the rate on accommodations without collateral unchanged at 1.875%, 2.25%, and 4.125%, respectively.

Monetary growth was adequately controlled to support economic activity

To address slowing economic recovery, the CBC adopted open market operations to maintain reserve money at appropriate levels. In 2012, under the watchful management of the CBC, excess reserves of banks were maintained at a suitable level, and the total loans and investments of all banks grew at 5.08%, while M2 grew by 4.17% year on year, both of which were higher than the GDP growth of 1.26% in the same year. This illustrates that market liquidity was sufficient to support economic activity.

Inflation rate maintained at low and stable levels

Relative to other countries, Taiwan's inflation rate remained low and stable. From 1998 to 2012, the average annual growth rate of inflation stood at only 1.06%, with a low volatility of 1.17%. This benefits the purchasing power of citizens and helps people to make reasonable economic decisions. The prudential monetary policies conducted by the CBC have been positively recognized by credit rating agencies.⁷⁴

The CBC will continue with timely implementation of appropriate monetary policies

Mindful of current domestic and foreign economic conditions, especially the aftermath of the European sovereign debt crisis and the US debt ceiling and fiscal cliff problems, as well as the impacts of Japanese yen depreciation on domestic economic and financial conditions, the CBC will closely monitor new developments and implement corresponding monetary policies in a timely manner.

Continually implementing risk management policies for real estate loans to ensure the soundness and financial stability of banks

To urge banks to strengthen their risk management of real estate loans, the CBC has implemented targeted prudential measures against land collateralized loans and housing loans in specific areas since June 2010. The effort has been come to fruition. Furthermore, in view of banks having granted high-value housing loans with overly high loan-to-value (LTV) ratios, which went against sound principles of credit risk management and undermined banks' soundness, the CBC announced an additional macroprudential measure targeting high-value

⁷⁴ Standard & Poor's indicated in its 2012 Taiwan Sovereign Rating Report that Taiwan's Central Bank has been flexible in its monetary policy while pursuing a low and stable inflation environment. Another credit rating agency, Moody's, also pointed out in its 2012 report that a prudential monetary policy has contributed to Taiwan's low and stable inflation, superior to other countries with Aa and Aaa ratings.

housing loans in June 2012. The key points of the new measure include:

- High-value housing loans refer to the loans for purchasing any one of the properties listed below that are registered as housing:
 - Properties located in Taipei City or New Taipei City with the appraisal value or trading value exceeding NT\$80 million.
 - Properties located in the area outside of Taipei City or New Taipei City with the appraisal value or trading value exceeding NT\$50 million.
- The restrictions on loan terms include: (1) no grace period; (2) the maximum of loans granted should not exceed 60% of the appraisal value or the trading value of the collateral, whichever is the lower; (3) no additional loans against the same collateral for purposes of home refurbishments, current operation or others.

After the implementation of the above measures, the average LTV ratio of high-value housing loans dropped from 80%-90% pre-restriction to 56.74% in April 2013.

Implementing a managed float regime to stabilize the exchange rate of the NT dollar

Considering that Taiwan is a small highly open economy with large amounts of short-term capital frequently flowing in and out, the CBC implements a flexible managed floating exchange rate regime to ensure the stability of the domestic economy and financial markets. The exchange rate of the NT dollar is in principle guided by the market mechanism. Only when there are aberrations - such as an abnormally large influx or outflow of short-term capital and seasonal changes causing the exchange rate to over-fluctuate with adverse implications - that could destabilize the domestic economy and financial markets, does the CBC step in to maintain an orderly foreign exchange market.

In addition, the CBC will continue to monitor the impacts from the recent monetary easing policy in Japan and Japanese yen depreciation on the NTD exchange rate. Should there be an inordinate inflow or outflow of capital, the CBC will take actions to maintain an orderly exchange market, as its duty requires.

Continuing to open the market for new foreign currency derivatives and expand foreign currency call loan and swap markets

In order to expand the services provided by financial institutions and satisfy customer demand for portfolio management and risk hedging, the CBC has continually granted licenses to investment trusts, investment consulting firms, securities firms and bills houses to provide onshore and offshore financial services and products. To date, 24 foreign currency derivative products and 5 NTD-linked derivative products have been approved. The total transaction volume of these products totaled US\$3.76 trillion in 2012.

Furthermore, the CBC continued to finance banks through foreign currency call-loans and currency swaps in order to meet the funding needs of industry and maintain sufficient foreign currency liquidity in the domestic banking system. In 2012, the turnover amounts of the Taipei call-loan and interbank USD/NTD currency swaps markets were US\$1.81 trillion and US\$1.13 trillion, respectively, and the outstanding of both markets at the end of the year stood at US\$22.3 billion and US\$145 billion, respectively.

4.2 Measures undertaken by the FSC to maintain financial stability

From 2012 onwards, the FSC continually amended financial laws and regulations, and undertook several supervisory reforms in order to ensure financial stability.

Strengthening risk management of financial institutions

- Amending the Regulations Governing the Capital Adequacy and Capital Category of Banks and related regulations to raise the quality and level of capital in accordance with the international capital standards stated in Basel III (Box 5).
- Setting the minimum loan coverage ratio⁷⁵ of 1% as an important criterion when reviewing the applications submitted by banks, and gradually raising the ratio of loan loss provisions to performing credit assets to above 1%.
- Revising bank soundness criteria to require a bank intending to distribute cash dividends that exceed 15% of its total capital to meet the following conditions: (1) the post-distribution legal reserves of the bank must be higher than 75% of paid-in capital; and

⁷⁵ When calculating the loan coverage ratio (allowance for bad debts to total loans), loans to the government have been deducted from the denominator.