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## IV. Measures to maintain financial stability

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In 2013, under the circumstances of stable recovery in the global and domestic economies and moderate inflation, Taiwan's financial market performed smoothly. Profitability of financial institutions kept trending up, and asset quality continued to improve, while most financial institutions maintained satisfactory capital levels except for a few life insurance companies. The three systemically important payment systems also operated soundly. As a whole, Taiwan's financial system remained stable.

The CBC has been closely watching the changes in global and domestic economic and financial conditions and noted several issues, especially the spillover effects of the US gradual exit from its easy monetary policy, slowing economic growth and rising shadow banking risks in Mainland China, and the potential impacts of domestic house price movements on the asset quality of real estate loans of financial institutions. The CBC will continually monitor the influence of those issues on the domestic economy and financial system and implement appropriate monetary, credit and foreign exchange policies. Meanwhile, the FSC also continues to amend financial laws and regulations and undertakes measures to strengthen financial supervision, aiming at maintaining the soundness of financial institutions and improving financial stability.

### 4.1 Measures taken by the CBC to promote financial stability

#### **4.1.1 Adopting sound monetary policies to address the changes in economic and financial conditions**

##### ***Policy rates remained unchanged in 2013***

Considering the moderate prospects for domestic economy growth and inflation, as well as the uncertainties in the global economic outlook, the CBC kept policy rates unchanged<sup>69</sup> in 2013 so as to maintain price and financial stability and promote economic growth.

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<sup>69</sup> 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.

### ***Reserve money growth remained moderate***

The CBC adopted open market operations to keep reserve money at appropriate levels. In 2013, the total loans and investments of all banks grew by 5.60%, while M2 grew by 4.78% year on year, both of which were higher than the GDP growth of 2.11% in the same period. This illustrated that market liquidity was sufficient to support economic activity.

### ***The CBC will implement appropriate monetary policies in a timely manner***

The CBC will keep closely monitoring inflation, the output gap, as well as global and domestic economic and financial developments and undertake appropriate monetary policies in a timely manner.

#### ***4.1.2 Continually implementing risk management policies for real estate loans to promote the soundness of banks and financial stability***

To maintain financial stability and urge financial institutions to control the risks associated with real estate loans, the CBC has implemented targeted prudential measures against housing loans in specific areas, land collateralized loans and high-value housing loans since June 2010. The effort has come to fruition.

In 2013, the CBC continued to implement risk management policies for real estate loans. Firstly, the CBC urged banks to strengthen their risk management for real-estate lending in “non-specific areas” with considerable housing price surges in March. To follow the CBC’s policies, most big banks adopted self-restraint measures, such as expanding the scopes of specific areas, lowering loan-to-value ratios, removing grace periods and raising mortgage interest rates. In December, to prevent banks’ funds from being used for real estate speculation, the CBC further urged those banks with greater business volumes in collateralized industrial land lending to rigorously comply with credit regulations.

#### ***4.1.3 Stabilizing the NT dollar exchange rate under a managed float regime***

##### ***Implementing flexible foreign exchange rate policies***

Taiwan adopts a flexible managed floating exchange rate regime, and 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 inflow 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. The exchange rate of the NTD against the USD has been relatively stable since the onset of the global financial crisis.

#### ***4.1.4 Maintaining an orderly foreign exchange market and improving its sound development***

To prevent excessive volatility of the NTD exchange rate from endangering financial stability, the CBC continued to adopt management measures targeting massive short-term capital inflows and outflows, mainly including (1) implementing a Real Time Reporting System for Large-Amount Foreign Exchange Transactions to closely monitor the inflows and outflows of foreign capital; (2) overseeing the usage of NTD demand deposit accounts of foreign capital to ensure the funds were invested in domestic securities as declared and not placed in demand deposit accounts for a long time.

The CBC urges authorized foreign exchange banks to strengthen their foreign exchange rate management in order to mitigate the risk exposures of individual banks and systemic risks of the whole market.

The CBC strengthens on-site inspections on foreign exchange forward transactions to ensure they were undertaken for real demand purposes in order to restrain foreign exchange speculation. Moreover, target examinations on foreign exchange transactions were implemented when necessary to maintain an orderly foreign exchange market.

#### ***4.1.5 Continually opening the market for new foreign currency derivatives and expanding foreign currency call loan and swap markets***

In order to expand the services provided by financial institutions and satisfy customer demand for risk hedging and portfolio management, 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. At the end of 2013, 24 foreign currency derivative products and five NTD-linked derivative products had been approved. The transaction volume of these products totaled US\$4.54 trillion in 2013.

Furthermore, the CBC has appropriated US\$20 billion, €1 billion, and ¥80 billion as seed funds from its foreign exchange reserves to participate in the operation of the Taipei Foreign Currency Call Loan Market. The CBC also continued to extend foreign currency call loans to

banks and conduct currency swaps with banks to meet corporate funding needs and maintain foreign currency liquidity in the domestic banking system. In 2013, the turnover amounts of the Taipei foreign currency call loan and interbank USD/NTD currency swap markets were US\$1.36 trillion and US\$1.13 trillion, respectively, and the outstanding of both markets at the end of the year registered US\$24.2 billion and US\$158.8 billion, respectively.

#### **4.1.6 Continually developing financial stability assessment tools**

To strengthen its function of financial stability assessment, the CBC continued to collect and study the new assessment tools developed around the world, and explored the possibilities to incorporate them into the domestic financial system for reference. Among them, the Bank Health Index (BHI) and Health Assessment Tool (HEAT), developed by the IMF,<sup>70</sup> have the merits of easy operation and effectively testing bank soundness.

Referring to HEAT, the CBC conducted a practice run using domestic banking data from 1998 to 2013. The result showed that, in general, the HEAT assessment tool could capture the influences of severe financial events and banking M&A on banks' soundness. Meanwhile, it should be noted that the BHI index only reflected the relative but not absolute soundness or weakness of individual banks. In addition, HEAT may have some room for improvement when implemented in Taiwan, such as including more financial indices and considering the appliance of different weights on individual banks based on their importance to the whole banking sector.

## **4.2 Measures undertaken by the FSC to maintain financial stability**

From 2013 onwards, the FSC launched several policy measures to facilitate financial development and financial deregulation, including, among others, expedited promotion of a Taiwan-centric wealth management platform, development of financial services with cross-strait characteristics, and inclusion of the financial industry in the government's free economic pilot zones plan. Concurrently, the FSC continually revised financial laws and regulations and undertook supervisory reforms to preserve financial stability.

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<sup>70</sup> Li Lian Ong, Phakawa Jeasakul and Sarah Kwoh, (2013) "HEAT! A Bank Health Assessment Tool," *IMF Working Paper*, WP/13/177, August.