Minutes of the Monetary Policy Meeting

June 22, 2017

Central Bank of the R.O.C. (Taiwan)

Minutes[1] of the Joint Meeting of the Board of Directors and the Board of Supervisors on June 22, 2017

Date and Time: June 22, 2017, at 3 p.m.

Location: Room A606, Main Building, Central Bank of the R.O.C. (Taiwan)

Members Present:

Chairman, Board of Directors: Fai-nan Perng

Executive Directors:

Yu-jer Sheu, Chih-kung Lee, Chin-long Yang, Tzung-ta Yen, Ming-yih Liang, Sheng-cheng Hu

Directors:

Tsung-hsien Lin, Chen-chia Lee, Tsan-chang Liao, Chao-yih Chen, Mei-lie Chu, Chao-hsi Huang, Bih-jane Liu, Jin-lung Lin (excused, appointing Tsung-ta Yen as proxy)

Chairman, Board of Supervisors: Tzer-ming Chu

Supervisors:

Chi-yuan Liang, Tsung-jung Liu, Ping-yung Chiu, Ching-fan Chung

Staff Present:

E-dawn Chen, Director General, Department of Banking

James T.H. Shih, Director General,Department of Issuing

Hui-huang Yen, Director General, Department of Foreign Exchange

[1] This English translation is provided for information purposes only; the Chinese version shall prevail in case of discrepancies.

Yue-min Chen, Director General, Department of the Treasury

Tsuey-ling Hsiao, Director General, Department of Financial Inspection

Tzong-yau Lin, Director General, Department of Economic Research

Chien-ching Liang, Director General, Secretariat

Kuei-chou Huang, Director General, Department of Accounting

Jhih-cheng Hong, Director, Personnel Office

Kun-shan Wu, Director, Legal Affairs Office

Lien-Hwa Hsiang, Secretary, Board of Supervisors

Chih-cheng Hu, Secretary, Board of Directors

Presiding: Fai-nan Perng

I. Staff Review of Economic and Financial Conditions

Review by Department of Economic Research

1. International Economic and Financial Conditions

As manufacturing activity and trade gathered pace, the global economy is expected to rebound in 2017 after dipping to a low in the previous year and will perform slightly better in the second half of the year than the first half. Most economies post brighter prospects, with solid growth in the US, Japan, and the euro area, as well as Asian economies largely registering higher growth than 2016. However, China could experience a modest slowdown. The economic recovery may bring forth mild inflation in advanced economies this year, while high inflation in emerging market economies is likely to ease owing to currency appreciation and policy actions in some countries.

International stock markets were up and the VIX index held flat, whereas the global Economic Policy Uncertainty (EPU) index rose higher. Meanwhile, the Fed's plan to begin trimming its balance sheet in the second half year may lead to financial strains around the world, a destabilizing force to global financial markets. Rising trade protectionism could dampen the global trade recovery. Together with the path of Brexit negotiations increasingly unclear and geopolitical risk mounting, the global economic outlook still faces many uncertainties.

2. Domestic Economic and Financial Conditions

(1) Economic situation

Labor market conditions have continued to improve since the March Board Meeting; thanks to the domestic economic pickup, the number of employed persons increased, the unemployment rate dropped further, and average monthly wages increased moderately. Despite the steady pace of economic expansion, growth in exports and capital equipment imports both slowed, while retail sales also posted limited growth. The overall monitoring indicator flashed a "yellow-blue" ("transitional" between "stable" and "sluggish") signal. Considering these and a higher base effect in the second half of the year, the pace of the economic recovery may moderate slightly. Major forecasting institutions at home and abroad project Taiwan's economy to advance between 2.04% and 2.20%. The Bank forecasts this year's GDP growth rate to be 2.13%, higher than last year's 1.48%.

In terms of external demand, a steadily recovering international economy further shored up demand for semiconductors and Taiwan's exports of electronic parts and components increased. Combined with a lower base effect, the annual export growth rate was 12.5% for the first five months of the year, with positive growth registered in exports to all major destination economies. The outlook for the second half of the year points to steady growth in semiconductor demand supported by upward revision in forecasts for global economic and trade growth. Meanwhile, active business investment in the emerging applications related to the Internet of Things (IoT) and cloud services, among others, are also likely to fuel export growth. However, a slowing Chinese economy, lingering world trade protectionism and a higher base effect may combine to restrict export momentum in the second half of the year. For the year as a whole, though, exports are expected to register steady growth.

In terms of domestic demand, consumer spending is expected to gain strength as production activity expanded steadily, corporate demand for labor increased, and cash dividends to stockholders reached a five-year high. However, because of limited real wage growth and low consumer confidence, the second half of the year will see lower growth momentum for private spending than the first half.

Private investment is expected to be spurred by continued investment in machinery equipment and R&D among semiconductor manufacturers and the affiliated participants along the supply chain, as well as by firmer demand for commercial real estate. On the other hand, scores of leading indicators and coincident indicators continued on a downtrend, capital equipment import growth slowed in recent months, and investment in machinery equipment in the second half of the year faces a higher base effect. These factors combine to point to a more cautious outlook for private investment for the next half of the year.

(2) Financial conditions

Domestic market interest rates have kept steady, while the real interest rate was negative, similar to many other economies. Assessed against economic conditions, some of those economies enjoy higher GDP growth with a lower real interest rate when compared with Taiwan. This suggests the level of our real interest rate is appropriate and not too low.

In May, the M2 annual growth rate climbed to 4.07% as net foreign capital inflows rose. For the first five months of the year, the M2 annual growth rate averaged 3.72%, staying within the target range (2.5% - 6.5%) and higher than the sum of the 2017 projected GDP and CPI annual growth rates. Bank loans and investments exhibited slower annual growth at a pace of 5.06% in May, mainly because banks pared down investment positions as they turned in the income tax revenue collected over to the government treasury. For the first five months of the year, the average annual growth rate of bank loans and investments was 4.65%. On balance, market liquidity conditions are judged as sufficient in meeting the need of economic activity.

Since the beginning of the year, market liquidity has been ample, the overnight call loan rate has stayed steady, and the 10-year government bond yield has moved within a narrow range. Meanwhile, foreign capital showed a net inflow, the NT dollar appreciated, and Taiwan’s stock markets rallied. Steady interest rates and foreign buying of domestic stock shares have contributed to the easy conditions in money market and stock markets, which partially offset the tightening effect of a stronger currency. The overall Financial Conditions Index (FCI) indicated tighter conditions in June compared to the end of the previous year.

Looking ahead, the domestic economic pickup would help to support demand for funds; however, as the Federal Reserve may carry on with rate hikes and uncertainties may still threaten to affect the domestic economy, international capital flows will be a key factor behind M2 growth trends in the coming months. Meanwhile, bank loans and investments are likely to grow steadily as the domestic recovery and mild growth in fixed investment drive a stable demand for funds.

(3) Price Trends

In 2017 so far, as the NT dollar appreciation helped mitigate imported inflationary pressures and food prices stayed low, consumer prices have risen mildly. For the first five months of the year, the average CPI annual growth rate was 0.60%, mainly because a slump in vegetable prices mostly offset the increases in fuel and fruit prices. The average core CPI annual growth rate (excluding fruit, vegetables, and energy prices) for the same period was 0.97%.

The OPEC announced an extended production freeze at the end of May instead of further output cuts as expected by the market, while the US continued to increase production and crude stockpiles remained high. Consequently, oil prices moved downwards. The US Energy Information Administration (EIA) projects that by the end of 2018 crude oil supply will slightly exceed its demand, putting a lid on oil prices.

The forecasts made by major institutions at home and abroad suggest a mild inflation outlook for Taiwan in 2017. The median of domestic institutions' forecasts is 1.20%, and the median of international institutions' forecasts is 1.30%. The Bank forecasts this year's CPI annual growth rate to be 1.07% and core CPI 1.11%. Compared to March projections, the inflation outlook remains stable.

In part, mild domestic inflation also reflects a negative output gap. As demand softened, a widening negative output gap helped to contain inflationary pressures. The key factors behind domestic price trends include the following. Upward pressures on prices may come from (1) price increases for services such as buses and restaurants owing to higher labor costs under the five-day workweek system, (2) higher cigarette prices as a result of the June 12 hike of the cigarette tax by NT$20 per pack, and (3) an expected upsurge in vegetable prices owing to torrential rain in June. Meanwhile, the negative output gap and insufficient aggregate demand might create downward pressures on prices.

3. Considerations for Monetary Policy

(1) Global economy is set for a steady recovery, but uncertainties remain.

As manufacturing activity and trade gradually picked up, global economic growth is expected to rebound from the low level of last year. Looking ahead, prospects are brighter for most economies. Nevertheless, the global economy is still clouded by uncertainties. In contrast to monetary easing in the euro area and Japan, the US Fed is gradually moving towards policy normalization, which might amplify financial market turbulence around the world. Global economic and trade policy uncertainties, progress of Brexit negotiations, and geopolitical risks could also hinder the global recovery.

(2) Taiwan's growth momentum might slightly soften in the next half of the year; current inflationary pressures and expected inflation are both mild.

Slower growth in exports and capital equipment imports in recent months, as well as limited growth in retail sales, may put a drag on economic growth. For the first five months of this year, the price increase was mild. In terms of the inflation outlook for the second half of the year, the recent cigarette tax hike may exert upward pressures on prices. However, global inflation expectations are moderate, international oil prices stay low; domestically, demand growth is still slow and the output gap continues to be negative. On balance, the inflation outlook for this year remains stable.

(3) Taiwan's real interest rate in relation to economic growth stands at an appropriate level compared to major economies.

Among a selected group of economies, many register negative real interest rates. Compared to Taiwan, some of them have higher economic growth but lower real interest rates. This may indicate that Taiwan's real interest rate stands broadly appropriate compared with the economies in the group.

II. Proposition and Decision about Monetary Policy

1. Policy Proposition: To keep the discount rate, the rate on accommodations with collateral, and the rate on accommodations without collateral unchanged at 1.375%, 1.75%, and 3.625%, respectively.

2. All Board members approved of keeping policy rates unchanged. The discussions are summarized as follows.

Regarding the international economic situation, one Board Director expressed the view that though a global economic pickup is expected for this year, the longer-term growth trend is still weak. With the support of robust financial markets in recent years and a cyclical recovery in global manufacturing activity and trade since the second half of 2016, growth momentum for global economy will strengthen and world trade volume is expected to register faster growth too. With regard to advanced economies, the US expansionary fiscal stimulus is likely to drive up global economic growth, while the outlook for Europe and Japan seems brighter on the back of growth in global manufacturing sectors and world trade. With respect to emerging market economies, growth in this group is likely to gain stronger momentum as a rebound of commodity prices from early 2016's low has brought forth a gradual upturn in commodity exporters while commodity importers including China have seen signs of improvement.

The same Board Director also pointed out that although international forecasting institutions made similar projections for a global economic pickup, some of them recently revised down the forecasts for global GDP and trade growth for the coming years. The main rationales of the downward revision included (1) both supply-side and demand-side factors resulting in the low global growth trend have not receded, and (2) long-term structural factors will require more time to resolve. The global economy also faces several risks, including: (a)

Decreases in trade and cross-border investment as a result of trade protectionism could cause global economic growth to falter; (b) a steeper-than-expected path of rate hikes in major economies could bring forth a sharper tightening of global financial conditions, carrying adverse implications for economies with vulnerabilities, and (c) re-emergence of financial deregulation in the world and financial tensions in some emerging market economies could hamper global financial stability.

With regard to domestic economic conditions, one Board Director expressed views on the strength of the domestic recovery. In the second half of 2016, as a buoyant semiconductor market and a stabilizing global economy helped drive a surge in export growth, and increases in capital outlay by semiconductor firms resulted in robust growth in private investment, Taiwan's economy expanded faster by 2.46% from the former half year's 0.46%. For this year as a whole, the domestic economy is likely to grow faster than last year at a pace of 2.05%, according to the DGBAS' forecast. Although the economy has gradually regained strength from the trough in 2015, Taiwan could still face a long-term trend of lower growth encumbered by still weak momentum for a global recovery. Recently, some international forecasting institutions gave slightly downward revision to Taiwan's GDP growth projections for the period between 2017 and 2020.

In terms of domestic financial conditions, one Board Director discussed Taiwan's M2 and credit growth. This Director stated that the M2 annual growth rate averaged 3.72% for the first five months of the year, lower than the median value (4.5%) of the 2017 M2 growth target range (2.5% - 6.5%). The main reason was that insurance companies bought more foreign currency-denominated bonds with the funds shifted into insurance policies from bank deposits. However, the 3.72% M2 growth was still higher than the sum of the projected GDP and CPI annual growth rates, which indicate sufficient liquidity to support economic activity. Despite some moderation in bank loans and investments in recent months, the annual growth rate remained on an upward path, suggesting no anomaly regarding M2 and credit growth.

Board Directors expressed their opinions on the impact of exchange rate and stock price movements on financial conditions. One Board Director noted that both the NT dollar exchange rate vis-à-vis the US dollar and the NTD NEER (nominal effective exchange rate) index showed that the NT dollar has appreciated more than the Japanese yen, the Korean won, the renminbi, the Singapore dollar, and the euro. As of June, the overall financial conditions have tightened because of NTD appreciation since the beginning of the year. Another Board Director pointed out that, although rising stock prices helped to mitigate a tightening in financial conditions, the wealth effect of stock rallies mainly benefited foreign investors, who collectively hold about 40% of the shares listed on Taiwan's stock markets. In particular, a large proportion of IT stocks, one of the most actively traded groups, are held by foreign investors, depriving local investors of the opportunity to fully enjoy the rewards of a stock rally while foreign investors garner most of the cash dividends. In this view, the influence of foreign investors' activity in stock markets should also be considered when analyzing financial conditions.

In addition, one Board Director noted there seem to be an increasingly significant correlation between the actions of foreign investors and movements in Taiwan's foreign exchange and stock markets. This Director pointed out that co-movements between stock prices and exchange rates could create risks. Whether a high correlation of the two types of markets implies a rising risk is something worth exploring. There is also the question of whether foreign capital inflows are actually attracted by the stock market boom or meant for other purposes. Another Board Director concurred that frequent inflows and outflows of foreign capital will certainly pose a higher risk.

Several Board Directors discussed the US Fed's rate hike, and the movements and spread of the US and Taiwan's bond yields. One Board Director shared the observation that the US bond yields declined in spite of the Fed's continued policy rate hikes, showing the Fed's rate decisions are not the only force behind bond yields. Another Board Director noted that investors still find the US treasuries attractive because Japan's 10-year bond yield was close to zero and the yields on German and French short-term (under 5 years) bonds slipped into negative territory, but the US treasuries, with a large market and among the most liquid assets, still exhibited positive yields across all maturities. Many Board Directors shared similar views. One Board Director said that although the risk was elevated with the US being the source, investors have generally considered US Treasuries to bear the lowest risk and thus increased their holdings. As a result, the US bond yields did not rise in response to the US rate hikes but dropped instead. Such trends would therefore narrow the spread between Taiwan's and US longer-term bills. It is important to heed how this would affect international capital movements.

In sum, the Board Directors expressed their views in favor of the monetary policy proposition. Several Directors noted that, in the second half of the year, the strength in Taiwan's economic recovery may be dampened by limited growth in exports and slower upturns in private consumption and private investment. Meanwhile, the economic growth is forecast to run below potential. Considering a sustained increase in exports, it would be reasonable to keep the policy rates at their current levels.

Several Board Directors also pointed out that monetary policy decisions should take into account both current inflationary pressures and the future inflation outlook. At present, domestic prices were relatively moderate and inflation expectations were mild, while a negative output gap remained with real output below potential output. The circumstances do not necessarily warrant monetary tightening.

One Board Director stated that Taiwan's real interest rate, though negative, was still higher than those of the US, Singapore, South Korea, and Hong Kong, while Taiwan's 2017 GDP growth projections by forecasting institutions were broadly lower than these economies. A comparison regarding Taiwan's real interest rate and GDP growth rate suggest that Taiwan did not post a relatively low real interest rate, while our monetary policy stance was not particularly loose and even tighter than some economies. This indicated there was no urgent need for a rate hike.

With respect to monetary policy outlook, one Board Director further expressed the approval of maintaining current policy rate levels. Meanwhile, the Fed carried on with rate hikes, there remained international economic uncertainties, and some central banks made prudent decisions to hold rates unchanged, including Taiwan's major trading partners such as China, Japan, and the euro area, and a primary export rival South Korea. Against this backdrop, the Bank should carefully examine future developments and take appropriate actions in response as warranted.

Based on the assessment of domestic and international economic and financial conditions and prospects, the Board Directors expressed approval of keeping policy rates unchanged.

3. **Monetary Policy Decision:** Board members reached a unanimous vote to keep the discount rate, the rate on accommodations with collateral, and the rate on accommodations without collateral unchanged at 1.375%, 1.75%, and 3.625%, respectively.

Voting for the proposition:

Fai-nan Perng, Yu-jer Sheu, Chih-kung Lee, Chin-long Yang, Tzung-ta Yen, Ming-yih Liang, Sheng-cheng Hu, Tsung-hsien Lin, Chen-chia Lee, Tsan-chang Liao, Chao-yih Chen, Mei-lie Chu, Chao-hsi Huang, Bih-jane Liu, Jin-lung Lin (voting by proxy)

Voting against the proposition: None.

III. The Press Release

The Board Directors and Supervisors approved unanimously to issue the following press release in the post-meeting press conference, together with the Supplementary Materials for the Post-Monetary Policy Meeting Press Conference prepared by the Bank.

Date: June 22, 2017

Central Bank of the Republic of China (Taiwan)

PRESS RELEASE

Monetary Policy Decision of the Board Meeting

I. Global economic and financial conditions

Since the beginning of the year, world trade has gradually picked up and the international economic recovery has gained a more solid footing. The near-term outlook points to moderate US economic expansion, a sustained eurozone recovery, and modest acceleration in Japan. Growth in emerging market economies is likely to gather pace, while the Chinese economy might experience a mild slowdown.

In the context of the economic uptick and subdued inflation, central banks in the euro area and Japan both maintained monetary easing policies. The US Fed, however, continued on the path toward gradual normalization, which could heighten financial market volatility. The global economic outlook also faces other causes for concern, including uncertainties associated with international economic and trade policies, the progress of Brexit negotiations, and geopolitical risks.

II. Domestic economic and financial conditions

1. As the domestic economic upswing bolstered labor market conditions, employment increased and the unemployment rate dropped further. With weaker momentum in exports and capital equipment imports during recent months, combined with limited growth in retail sales, Taiwan's economy is expected to moderate slightly in the second quarter. The Directorate-General of Budget, Accounting, and Statistics (DGBAS) forecasts that, in the second

half of the year, the economy will advance at 1.76%, slower than the first half year's 2.37% owing to a higher base effect. For the year as a whole, the economic growth projection is 2.05%.

2. Since early 2017, NT dollar appreciation has helped ease the pressure on imported inflation and domestic food prices have exhibited a downtrend. The CPI annual growth rate averaged 0.60% for the first five months of the year. Core inflation (excluding vegetables, fruit, and energy items) grew at an average pace of 0.97%, indicating mild inflationary pressures at present.

   Factors including the newly-increased cigarette tax are expected to drive the CPI higher in the second half of 2017 than the first half. Nevertheless, considering subdued global inflation expectations, falling oil prices, and soft domestic demand, the CBC forecasts CPI and core CPI inflation for 2017 to rise 1.07% and 1.11% year on year, respectively, reflecting a stable inflation outlook.

3. Against the backdrop of the domestic economic recovery and stable inflation, the CBC has continued to conduct open market operations to manage market liquidity and maintain banks' excess reserves at a sufficiently accommodative level. Bank credit expanded steadily, with its year-on-year growth averaging 4.65% for the first five months of the year. Growth of the monetary aggregate M2 stayed within the target range. The M2 annual growth rate for the first five months of the year was 3.72%. All these reflect ample market liquidity in support of economic activity.

   In the year to date, liquidity in the banking system has been abundant, overnight call loan rates have remained steady, and the 10-year government bond yield has moved within a narrow range. Meanwhile, net foreign capital inflows have led to NT dollar appreciation and a domestic stock market rally.

III. Interest rate decision

Current domestic inflationary pressures and inflation expectations are both mild. Meanwhile, domestic real interest rate relative to GDP growth is still at an appropriate level among major economies (see Appendices 1 and 2). However, uncertainties remain in the global economy, and growth momentum in the domestic economy may slightly weaken in the second half of the year. Taking into account the above factors and the expansionary fiscal policies implemented by the government, the Board judged that a policy rate hold and an accommodative monetary policy stance are conducive to price and financial stability and help to foster economic growth.

The Board reached the following decision unanimously at the Meeting today:

> The discount rate, the rate on accommodations with collateral, and the rate on accommodations without collateral are kept unchanged at 1.375%, 1.75%, and 3.625%, respectively.

The CBC will continue to closely monitor both inflation developments as well as international and domestic economic and financial conditions. We will undertake appropriate monetary policy actions in line with the central bank's statutory mandate.

IV. In recent years, international capital flows have become the dominant factor behind exchange rate movements. In the first half of this year, substantial foreign capital inflows have brought about an upsurge in foreign currency supply, resulting in NT dollar appreciation against the US dollar.

In principle, the NT dollar exchange rate is determined by market forces. If irregular factors (such as massive inflows or outflows of short-term capital) lead to excess volatility and disorderly movements in the NT dollar exchange rate with adverse implications for economic and financial stability, the CBC will, in line with its mandate, step in to maintain an orderly market so as to ensure economic and financial stability.

Appendix 1

Real Interest Rates and Economic Growth of Selected Economies

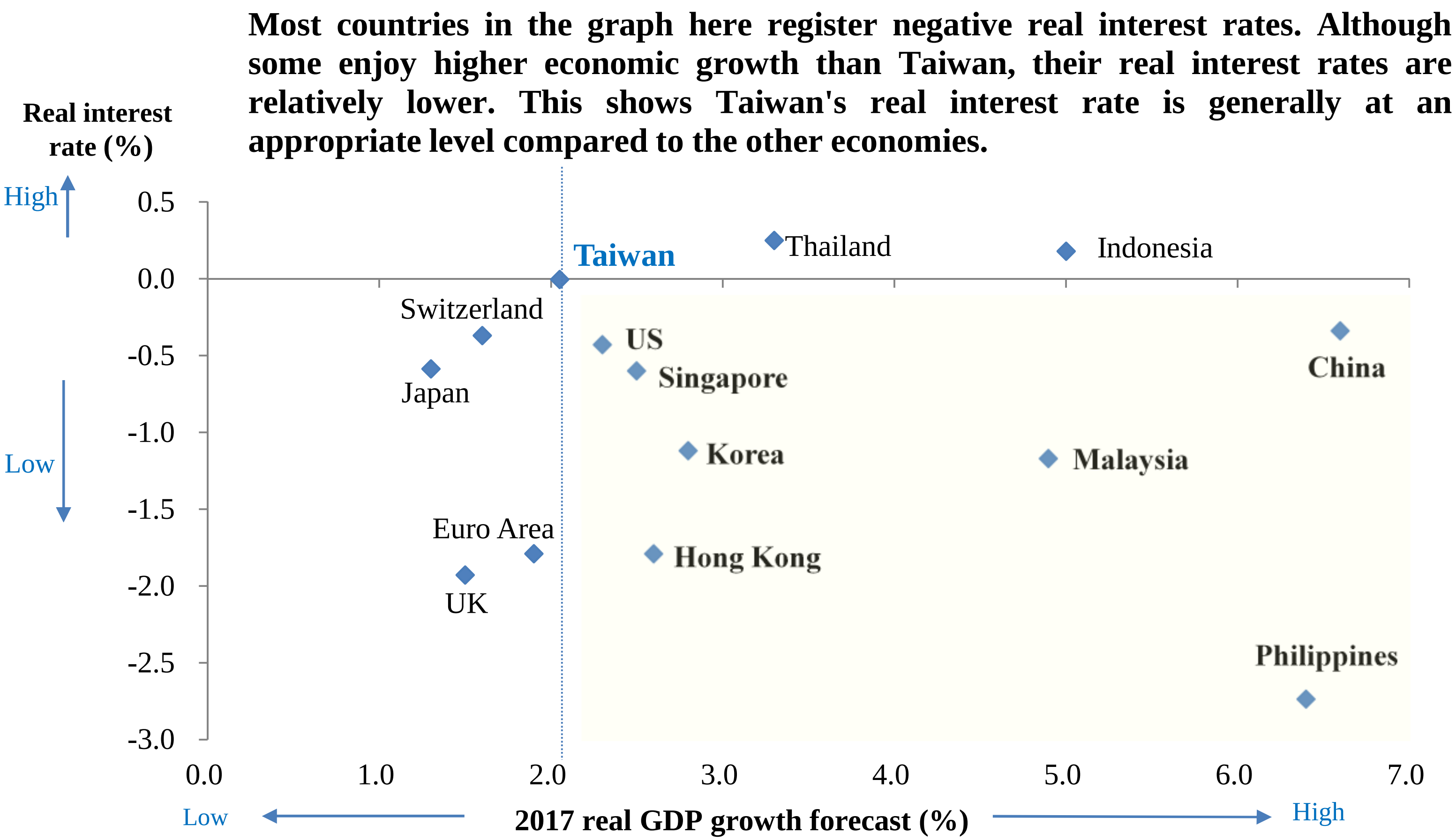
Unit: %

Economies	(1) 1-year time deposit rate (As of 2017/6/22)	(2) CPI annual growth rate ** (2017 forecast)	(3)=(1)-(2) **Real interest rate**	**Real GDP growth rate (2017 forecast)** **
Thailand	1.500	1.25	0.250	3.3
Indonesia	4.750	4.57	0.180	5.0
Taiwan	**1.065***	**1.07**	**-0.005**	**2.05**
China	1.500	1.84	-0.340	6.6
Switzerland	0.160	0.53	-0.370	1.6
US	1.760	2.19	-0.430	2.3
Japan	0.014	0.60	-0.586	1.3
Singapore	0.250	0.85	-0.600	2.5
Korea	1.000	2.12	-1.120	2.8
Malaysia	2.850	4.02	-1.170	4.9
Hong Kong	0.050	1.84	-1.790	2.6
Euro Area	-0.100	1.69	-1.790	1.9
UK	0.800	2.73	-1.930	1.5
The Philippines	0.500	3.24	-2.740	6.4

* 1-year time-deposit floating rate of the five major domestic banks.

** IHS Global Insight projections, as of June 15, 2017. Forecasts for Taiwan are: CBC's projection for the CPI annual growth rate and DGBAS's projection for the real GDP growth rate.

Appendix 2 Real Interest Rates and Economic Growth of Selected Economies



Notes: 1. Real interest rates are 1-year time-deposit rates (as of June 22, 2017; Taiwan uses 1-year time-deposit floating rate of the five major domestic banks) minus the CPI annual growth rates (2017 forecast).

2. Taiwan's CPI and GDP growth projections are forecasts by the CBC and the DGBAS, respectively. Forecast figures for the other economies are IHS Global Insight projections, as of June 15, 2017.