
Minutes of the Monetary Policy Meeting

March 22, 2018

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

Minutes¹ of the Joint Meeting of the Board of Directors and the Board of Supervisors on March 22, 2018

Date and Time: March 22, 2018, at 3 p.m.

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

Members Present:

Chairman, Board of Directors: Chin-long Yang

Executive Directors:

Yu-jer Sheu, Jong-Chin Shen, Tzung-ta Yen, Nan-kuang Chen, Ming-yih Liang,
Sheng-cheng Hu

Directors:

Tsung-hsien Lin, Chen-chia Lee, Chung-dar Lei, Jin-lung Lin, Mei-lie Chu, Chao-hsi
Huang, Bih-jane Liu

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
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: Chin-long Yang

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

Agenda Item: Economic and Financial Conditions and Monetary Policy Decision

I. Review of Economic and Financial Conditions

The Department of Economic Research presented the following review:

1. International Economic and Financial Conditions

Since the December 2017 Board Meeting, growth in the advanced and emerging market economies has continued to pick up; a steady global expansion is anticipated for this year, even outpacing last year according to the projections of international forecasting institutions. Although growth in global trade volume could slightly weaken year on year owing to China's slowdown and growing world trade protectionism, it is projected to advance faster than global output, indicating that world trade is still thriving.

Global inflation is expected to rise steadily amid continued global economic growth and rising raw material prices. Inflation in advanced economies is rising gradually, whereas South Korea and ASEAN countries could see slower price growth because of a higher comparison base the previous year.

In the international financial markets, equity price volatility intensified at the beginning of the year but abated after mid-February, while VIX (the widely-followed measure of expected volatility) also dropped then and moved within a narrower range. The euro and Asian currencies broadly strengthened against the US dollar as positive economic prospects lured capital flows into the euro area and Asia.

While the global economy looks set for further expansion, three major risks could still hamper this growth scenario: (1) steeper path of monetary policy normalization by major central banks (Fed, ECB, and BoJ); (2) economic and trade fallout from elevated protectionism; (3) aggravated financial market turbulence that weigh on global economic growth and market confidence, compounding the uncertainties surrounding the global economic outlook.

2. Domestic Economic and Financial Conditions

(1) Economic situation

Recent developments showed that the domestic economy is largely expanding at a moderate pace; leading indicators continued to rise, and both manufacturing and non-manufacturing firms maintained a positive business outlook. Labor market conditions have been stable, with a steady downtrend in the unemployment rate and a mild increase in the average wage. Overall, economic growth this year is expected to be driven by domestic demand, as contribution from net external demand will be crimped by a higher comparison base from last year's export performance. **The Bank forecasts Taiwan's economy will grow 2.58% this year.**

For the first two months of the year, exports increased by 7.3%, thanks to a steady global economic expansion and a rise in international raw material prices. By product, base metal and articles thereof, electronic parts and components, and machinery were the main contributors to export growth. By market, exports to most of major destination economies registered positive growth. In general, although the demand for new technology applications, as well as continued global economic upturn, is likely to bolster exports of the related categories, Taiwan's exports are expected to register mild growth this year due to a higher base effect.

With corporate profits growing, employers might be more willing to increase hiring and hand out bonus pay. Strong consumer confidence will also stimulate spending. Therefore, private consumption is expected to gain more momentum and take the lead in bolstering this year's economic growth.

Private investment also exhibits brighter prospects. Firms are building up production capacity with greater investment in machinery and equipment as the global economy strengthens. Construction investment will benefit from an improving property sector and the government's infrastructure spending, as well as a lower base effect. This year's growth in private investment is anticipated to turn higher than the year before.

(2) Financial conditions

The nominal market interest rates in Taiwan remained stable. The Bank managed market

liquidity and helped keep bank reserves at an adequate level, and the overnight call loan rate of the banking sector was also steady. Taiwan's real interest rate, though slipping into negative territory, is relatively moderate compared to a host of major economies.

In terms of monetary growth, the M2 annual growth rate averaged 3.60% for the first two months of the year, within the Bank's target range. In regard to bank credit in the year so far, bank lending to the private sector grew steadily, but the pace was slower than the previous year as some companies issued corporate debt to repay bank loans, locking in lower funding cost for a longer term. The average annual growth rate of bank loans and investments was 4.45% for the first two months of the year, higher than the sum of the 2018 projected GDP and CPI annual growth rates (3.85%), which indicates sufficient supply in the credit market.

In recent months, narrow fluctuations in the domestic stock market, steady market interest rates, and a year-on-year decline in the real effective exchange rate index of the NT dollar represented easier financial conditions, as reflected in the uptrend of the Bank's financial condition index. Meanwhile, housing transaction volume has gained a better footing, in tandem with price corrections.

Looking ahead, Taiwan's monetary growth this year might be affected by frequent cross-border capital flows on concerns that global financial stability and economic growth could be impaired by monetary policy normalization of major central banks, the US economic and trade policies, and the concomitant spread of protectionism from the US to the rest of the world. As for bank loans and investments, steady growth is expected, as continued domestic economic growth could reinforce demand for funding.

(3) Price Trends

International oil prices touched a three-year high in late January and later fluctuated at a lower, narrow range in line with the changes in US crude oil inventories. For the year as a whole, oil prices are going to move higher than last year according to forecasts by several international institutions. In terms of grains, unfavorable weather in key growing areas led to worries about lower crop yields, pushing up international grain futures prices in the year to date.

In addition to international oil and grain prices, domestic consumer prices were also affected by the lingering effect of last year's cigarette tax hike and recent rises in vegetable

prices. For the first two months of the year, Taiwan's consumer price index (CPI) posted an average annual growth rate of 1.54%, while the core CPI (excluding vegetables, fruit, and energy) grew 1.61%. Current inflation is mild.

Generally speaking, the overall CPI changes tend to be more gradual than steep, whereas prices of individual commodity items could sometimes surge or slump. Moreover, what each household purchase and how often they make these purchases vary from one to the next. As a result, there is often a gap between price changes as gauged by the CPI and as perceived by the public. Among the items people buy more frequently, the prices of 17 consumer commodities, closely monitored by the Cabinet's task force on price stabilization, have trended up recently and recorded an annual growth rate of 3.22% in February. The increase was mainly driven by steeper price rises in milk, eggs, pork, and poultry, and consumers tend to feel pinched when these items become more expensive.

Despite the public perception, there was not an across-the-board increase but a mixed trend for different items. It is often the case that consumers are sensitive to price rises in what they buy more frequently (such as food products) and relatively unconcerned when those occasionally-purchased items (such as computers/communication/consumer electronics) exhibit price changes. For the first two months of this year, more frequently-purchased items (bought at least once every quarter) registered a higher CPI annual growth rate (3.87%) than the overall CPI annual growth rate (1.54%), which explains a stronger public concern for price rises.

Meanwhile, although prices of some household paper products hiked to factor in international pulp price movements, and electricity rates are to be raised from April onwards to reflect higher costs of fuel imports for power generation, these factors only made a modest influence on the overall price trend. Nevertheless, close attention is warranted should inflation expectations become biased upwards.

Moderate domestic demand has led the output gap, a key indicator of future inflation, to be negative, suggesting subdued inflationary pressures as reflected by the forecasts from major foreign and domestic institutions. The median of domestic institutions' CPI forecasts is 1.18% and that of international institutions' forecasts is 1.30%. **According to the Bank's forecasts, the CPI annual growth rate is projected to be 1.27% this year and core CPI is**

expected to rise 1.26%. The inflation outlook remains mild.

As for key factors behind this year's price trends, upside pressures might come from the following: (1) private sector pay increases spurred by rises in minimum wage and public sector wage a while earlier; (2) the effect of the cigarette tax hike carrying forward to the year-end; (3) an upsurge in food prices including vegetables and fruit owing to a lower comparison base the previous year; (4) higher inflation expectations as a result of the anticipation of global oil prices rises, a scheduled hike in electricity rates, and the recent price increases of some daily necessities. Sources of downside pressures include a continued downtrend of tele-communication rates and the persistence of a negative output gap.

3. Considerations for Monetary Policy

(1) Current inflationary pressures and expected inflation are both mild

The annual CPI growth rate averaged 1.54% for the first two months of the year. International prices of crude oil and other raw materials are expected to move higher, and domestic prices might also be lifted by wage increases. On the other hand, the output gap remains negative, and demand-pull inflationary pressures are gentle. Overall, the inflation outlook is moderate, with the 2018 annual CPI growth rate projected to be 1.27% by the Bank.

(2) Taiwan's real interest rate stands at an appropriate level compared to those of major economies

(3) Uncertainties facing the global economic outlook might thwart domestic growth momentum

Although the global economy is expected to pick up further, there remain uncertainties surrounding the outlook as well as financial stability, including monetary policy normalization by major central banks, intensifying international trade tension and protectionism, and greater volatility in financial asset prices.

(4) Domestic growth momentum could weaken slightly; actual output is below potential

Exports might grow a little more slowly because of a higher base effect, whereas domestic demand will be the key driving force of economic growth given a rebound in private investment and steady private consumption growth. According to the Bank's forecast, this year's economic growth rate will be a moderate 2.58%, slightly lower than last year's 2.86%.

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.

In respect of the international economic situation, several board directors expressed concerns that uncertainties over the global economic and trade outlook could affect Taiwan's economic growth. One board director pointed out that, according to several recent studies on global risks published by major international institutions, the biggest source of global risks come from a potential trade war. If the US trade protectionism triggers retaliatory actions by the countries affected, then it would very likely spark a trade war. In this case, Taiwan's economy could suffer direct impacts, while supply chain disruptions and a global economic downturn stemming from a trade war could also indirectly affect the domestic economy.

Another board director cited the forecasts by international institutions and pointed out that while Europe, the US, and the world will register faster growth this year than last year, Asian economies, including Japan and China, will slightly decelerate. In the meantime, the global economic outlook remains clouded by many uncertainties. Future developments in protectionist measures and the effects of tax reforms in the US, geopolitical risks, and the fact that China has been investing significantly more to expand semiconductor production capacity could all undermine domestic economic growth.

With regard to domestic economic conditions, a number of board directors noted that moderate momentum and uncertainties exist for the domestic economy. One board director pointed out that domestic forecasting institutions have just revised up this year's growth projections for Taiwan, but the projected growth still trails last year's performance. Another board director mentioned that domestic demand, Taiwan's growth engine this year, has been picking up, but it is also important to monitor the progress and potential influence of pension reforms.

In terms of domestic financial conditions, multiple board directors expressed their views regarding the housing market and home mortgage regulations imposed by the Bank. One board director noted that, since high-value housing projects tend to serve as a benchmark for pricing homes for sale, the Bank needs to continue monitoring high-value housing transactions in 2018 and 2019. Another board director observed that banks might in some cases loosen risk control over high-value home mortgages on account of the special qualifications of borrowers for such loans. Also, it is important to ensure housing justice. Therefore, this director considered it to be the right move to keep related regulations in place. One other board director expressed a similar view that restrictions on high-value housing loans are still necessary, mainly because such regulations have contributed partly to the positive development where more new property projects have begun to offer other housing types rather than focusing on luxury homes.

In discussing about domestic price trends, several board directors and supervisors gave their opinions regarding current inflation, inflation outlook, and inflation expectations. One board director explained that it was the seasonal factor that pushed the February CPI to a 13-month high, as this year's Lunar New Year holidays fell in February; however, the average CPI annual growth rate for the first two months of the year and the median of 2018 CPI forecasts by major institutions were both moderate. One board supervisor added that the CPI spike in February was also attributable to the deferred impact of last year's cigarette tax hike, and the same price measure would be significantly lower by excluding the seasonal factor and the tax effect. Another board director stated that current inflation was mild; in the coming months, oil prices and electricity rates might turn higher but the increase will be within a manageable range.

One board director noted that a recent rush for household paper products warranted attention as this might be an indication of public expectations of price rises. Another board director pointed out that, based on a newly-released survey by a domestic institution, inflation expectations did increase but not to a great extent, which suggested inflation expectations remained well-anchored. In addition, surveys on inflation expectations in several other countries show that consumers seem inclined to interpret higher prices in their recent purchases as price rises on a full scale; as a result, inflation expectation could easily exceed the projected or actual level by more than one percentage point.

While discussing the interest rate decision, many board directors said that they have taken stock of domestic inflation outlook, economic growth, and the real interest rate and noted that current and expected inflation were both mild, the output gap was still negative, and uncertainties continued to weigh on economic prospects at home and abroad. Accordingly, they shared the view that it would be appropriate to keep policy rates unchanged. In particular, one board director pointed out that, while the real interest rate turned negative as opposed to the positive value when the board convened last time, this measure was just one of the elements for the Bank's monetary policy deliberation. The primary objectives of the Bank's operations have long been price and financial stability while fostering economic growth within the scope of these objectives. Since the increase in current inflation was small and acceptable, a policy rate hold would be in order.

One other board director also agreed, citing that the domestic output gap was still negative, and, despite price rises, the average CPI annual growth rate for the first two months of the year was below 2%. However, the Bank should pay close attention to price changes and give careful consideration about policy rate adjustment should inflation rise above 2% in the coming months.

One board director contended that, aside from inflation and the unemployment rate, exchange rate movements also play a key role in monetary policy-making. First, the inflation rate remained below 2%. Second, while the unemployment rate has dropped to a recent low, the common phenomenon of low wages suggested that slack remained in the labor market. Third, many companies are sensitive to exchange rate movements as Taiwan is an export-oriented economy. With the NT dollar already strengthening against the US dollar, a policy rate hike could cause the NT dollar to appreciate further and disturb corporate investment strategies, which would contradict the government's efforts in promoting domestic investment. Based on the consideration that policy rate decisions should not induce excess volatility in the foreign exchange market and a surge in capital inflows, a policy rate hold would be warranted.

Another board director also expressed support for a rate hold. At present, the government is reinforcing its efforts to promote investment in Taiwan, with an aim to industry restructuring through greater investment in external and internal demand-oriented sectors. Against this backdrop, stable monetary policy will provide some predictability for firms and

investors in their investment decisions and thus galvanize domestic investment, which justifies keeping the policy rates unchanged for the time being.

One board director stated that maintaining the current policy rate levels would be appropriate, and that policy rate adjustments generally serve two purposes. In addition to the announcement effect, policy rates are often fine-tuned instead of sharply changed, and there tends to be a transmission lag. Therefore, policy rate changes, once initiated, could come in several small increments so as to achieve the intended effect. In this view, present domestic and international economic situations warrant a rate hold, with future adjustments dependent on the overall economic and financial developments.

Furthermore, several board directors also approved of keeping rates steady, taking into account the trajectory of monetary policies in major economies. One board director noted that neighboring Asian economies, rivals and partners alike, have held off policy rate adjustments in recent months, and Taiwan, facing a similar background, had little reason to break ranks and hike rates. Another board director pointed out that the recent US rate hike will be followed by further gradual increases, and the euro area and Japan will also raise rates albeit at a slower pace; given the current economic and financial conditions, it will serve Taiwan well to stay put. Nevertheless, the zero interest rate policy of major advanced economies since the 2008 global financial crisis could have unhealthy influences on the economy in general. Interest rates, in the long term, should allow market forces to play out, and policymakers shall be prepared that interest rate changes would eventually set in for the market mechanism to function.

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

3. Monetary Policy Decision: The board directors 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:

Chin-long Yang, Yu-er Sheu, Jong-Chin Shen, Tzung-ta Yen, Nan-kuang Chen, Ming-yih Liang, Sheng-cheng Hu, Tsung-hsien Lin, Chen-chia Lee, Chung-dar Lei, Jin-lung Lin, Mei-lie Chu, Chao-hsi Huang, Bih-jane Liu

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.

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 Board met in late December last year, advanced and emerging market economies have posted solid expansion, which may lead global economic growth to strengthen further in 2018. Among major economies, growth in the US economy is expected to accelerate, the euro area continues to exhibit robust growth, while Japan and China are likely to expand at a slower pace. Amid the continued global economic pickup, raw material prices may register an uptrend, and therefore inflation in major economies is expected to move up gradually.

Looking ahead, the progress of monetary policy normalization implemented by central banks in major economies, US economic and trade policies, which could cause trade protectionism to spread on a global scale, and heightened volatility of financial asset prices may have an impact on global financial stability and economic outlook.

II. Domestic economic and financial conditions

1. For the year to date, exports have risen moderately, while capital equipment imports have recorded a smaller decrease. Consumer confidence has been robust, and the domestic economy has continued to grow. Labor market conditions were stable, with employment steadily increasing and the unemployment rate declining further.

Growth momentum in exports may slightly weaken this year owing to the base effect. Nevertheless, the Forward-Looking Infrastructure Development Program rolled out by the government may shore up private investment, while mild wage increases are likely to boost private consumption, which will combine to bolster domestic demand as a major driving force for economic growth. The CBC forecasts Taiwan's economy to advance at an annual rate of 2.58%, slightly slower than the 2.86% of the year before.

2. For the first two months of the year, the average annual CPI growth rate was 1.54%, mainly driven by higher vegetable and cigarette prices. Core inflation (excluding vegetables, fruit, and energy items) recorded an average annual growth rate of 1.61%, indicating a moderate price uptrend.

As imported raw material prices such as crude oil are expected to rise this year and the hikes in minimum wage and public sector employee pay may spur wage increases for workers in the private sector, domestic prices are likely to go up. However, with the output gap remaining negative, demand-pull inflationary pressures are subdued, and the inflation outlook is stable. The CBC projects CPI and core CPI to grow at a pace of 1.27% and 1.26% year on year in 2018 (see Appendix 1).

3. Against a backdrop of continued economic growth and stable inflation, the CBC has continued to manage market liquidity through open market operations and bank reserves have stood at an appropriate level. For the first two months of the year, bank loans and investments and the monetary aggregate M2 posted average annual growth rates of 4.45% and 3.60%, respectively, deemed sufficient to support economic activity.

In recent months, market liquidity has remained ample and market interest rates have held steady. The NT dollar has strengthened against the US dollar, but the real effective exchange rate (REER) index of the NT dollar trended down as major currencies appreciated more markedly against the US dollar. Overall, the financial condition index has generally reflected easy financial conditions.

III. Monetary policy decisions

In sum, both current inflationary pressures and future inflation expectations are mild, and Taiwan's real interest rate stands at an appropriate level among major economies (see Appendix 2). In addition, global economic outlook still faces uncertainties, while the domestic growth momentum could soften modestly from the previous year and the actual output remains below potential. Based on the above assessment, the Board judged that a policy rate hold will help safeguard price and financial stability and 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 watch the latest developments in domestic economic and financial conditions including actual and expected inflation and the output gap. We will closely monitor the progress of policy normalization by major central banks, monetary policy changes in emerging market economies, and risks likely induced by heightened financial market turmoil around the world. The CBC will timely undertake appropriate monetary policy actions as warranted by these developments in order to fulfill the central bank's statutory mandate.

IV. The CBC has adopted consistent exchange rate policy aimed at dynamic stability. 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 step in to maintain an orderly market.

Appendix 1

Taiwan's Inflationary Pressures and Inflation Outlook

Unit: %

Forecast institutions		Inflationary pressures	Inflation outlook	
		Jan.-Feb. 2018	2018 (f)	
Domestic institutions	TIER (2018/1/25)	1.54 (CPI) 1.61 (Core CPI*)	1.03	Median: 1.18% (domestic institutions)
	Yuanta-Polaris (2017/12/27)		1.10	
	Academia Sinica (2017/12/22)		1.18	
	DGBAS (2018/2/13)		1.21	
	CBC (2018/3/8)		1.27 (CPI) 1.26 (Core CPI*)	
Foreign institutions	HSBC (2018/3/19)		1.20	Median: 1.30% (foreign institutions)
	Credit Suisse (2018/3/15)		1.20	
	Citi (2018/3/8)		1.20	
	Goldman Sachs (2018/3/19)		1.30	
	BoA Merrill Lynch (2018/3/19)		1.30	
	Barclays Capital (2018/3/16)		1.30	
	EIU (2018/3/1)		1.30	
	Standard Chartered (2018/2/2)		1.30	
	IHS Markit (2018/3/15)		1.32	
	Nomura (2018/3/16)		1.50	
	Deutsche Bank (2018/3/19)		1.70	

*Excluding vegetables, fruit, and energy.

Sources: DGBAS, Executive Yuan; forecasts by respective institutions.

Appendix 2

Real Interest Rates and Economic Growth of Selected Economies

Unit: %

Economies	(1) 1-year time deposit rate (As of 2018/3/22)	(2) CPI annual growth rate ** (2018 forecast)	(3)=(1)-(2) Real interest rate	Real GDP growth rate (2018 forecast) **
Indonesia	4.750	3.48	1.270	5.1
Malaysia	2.950	1.94	1.010	5.5
US	2.710	2.23	0.480	2.7
Thailand	1.500	1.16	0.340	3.8
South Korea	1.300	1.28	0.020	2.8
Taiwan	1.065*	1.27	-0.205	2.58
Singapore	0.250	0.66	-0.410	2.7
Switzerland	0.160	0.73	-0.570	2.5
China	1.500	2.15	-0.650	6.7
Japan	0.011	1.06	-1.049	1.4
UK	1.030	2.87	-1.840	1.4
Euro Area	-0.250	1.68	-1.930	2.4
Hong Kong	0.050	2.18	-2.130	2.9
The Philippines	0.500	3.94	-3.440	6.6

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

** IHS Markit projections, as of Mar. 15, 2018. Forecasts for Taiwan's CPI annual growth rate and the real GDP growth rate are CBC's projections.