III. Central Bank Operations

1. Overview

Taiwan's external trade grew steadily from its vigorous trade relations with Asian nations in 2007, despite a global economic slowdown caused by the subprime mortgage crisis in the U.S. Domestic demand exhibited a gradual pickup as private investment and consumption improved against the backdrop of improved employment and a dwindling impact of credit card defaults. For the year as a whole, Taiwan's economy registered a growth of 5.70 percent, higher than the 4.89 percent in the previous year.

Taiwan's headline consumer price index (CPI) inflation rate remained stable in the first half of 2007. The surging international commodity prices and a typhoon-induced vegetable price increase both weighed on inflationary pressure in the second half of the year. During 2007, the CPI rose by 1.80 percent and the core CPI grew by 1.35 percent, both of which were moderate compared with those of major countries.

Labor market conditions continued to improve, attributed to steady economic expansion and the implementation of the government's job-creating programs. The unemployment rate was 3.91 percent in 2007, the same as in 2006 and the lowest level since 2001.

Soaring international commodity prices weighed on inflationary pressure. To promote both price stability and economic growth, the Bank fine-tuned its monetary policy by raising policy rates four times by a total of 62.5 basis points in 2007. At the end of 2007, the Bank's discount rate stood at 3.375 percent.

For price stability and financial stability, the Bank also issued certificates of deposit (CDs) to mop up excess liquidity. The outstanding amount of CDs at the end of 2007 was NT$3,460.3 billion. In addition, the Bank accepted redeposits from financial institutions of around NT$2 trillion to absorb excess liquidity.

For further financial liberalization and internationalization, the Bank continued to approve new financial products, enact regulations for insurance companies conducting foreign exchange businesses, and deregulate foreign investment in the domestic securities market. In addition, as the offshore banking units (OBUs) of domestic banks allowed NT dollar assets to serve as collateral for foreign currency loans and commenced foreign currency check deposits, their function as the funding center for Taiwanese businesses operating overseas was further enhanced.

With respect to institutional reform, the Bank further improved overall settlement efficiency in capital markets. In terms of central government securities, the Electronic Bidding System and Auction System were integrated into one single platform in May 2007. In addition, the Bank incorporated fund transfers made through Taiwan Stock Exchange and the over-the-counter (OTC) market into its Interbank Funds-Transfer System (CIFS) in July 2007. Meanwhile, in line with its responsibility to safeguard financial stability, the Bank actively engaged in the establishment of a financial stability assessment framework to detect potential systemic risk in the financial sector and adopt timely corrective measures.

During the year, the Bank issued commemorative coin sets as usual, including the Chinese Zodiac Year of the Pig and the Taiwan Indigenous People's Cultural Series—the Thao tribe. These coin sets were popular among the public.

2. Monetary Management

In 2007, the Bank's monetary management focused on continuing the gradual pace of policy tightening, absorbing excess liquidity in the banking system, promoting preferential loans, and enhancing the financing mechanism for small and medium-sized enterprises (SMEs).

Continuing the Gradual Pace of Policy Tightening

Year 2007 witnessed a global run-up in energy and raw material prices, posing upside risks to domestic inflation. To maintain price stability and promote sustainable economic growth, the Bank utilized the fine-tuning policy to bring down the inflationary pressure. The discount rate, the rate on accommodations with collateral, and the rate on accommodations without collateral were raised 4 times within the year by a total of 62.5 basis points each to the levels of 3.375 percent, 3.750 percent, and 5.625 percent, respectively. From October 2004 to the end of 2007, the Bank had raised its policy rates 14 times continuously with a total increase of 200 basis points.

As increases in the policy rates were by and large moderate, their impacts on funding costs for businesses were limited and did not interrupt normal economic activities. The new loan interest rates of the five major banks were raised by only 55.4 basis points within the year. The lending rate on loans with a maturity of three years and above was only raised by 46 basis

Central Bank Interest Rates

Unit: %

Effective Date	Discount Rate	Accommodation Rate with Collateral	Accommodation Rate without Collateral
2003 / June 27	1.375	1.750	3.625
2004 / Oct. 1	1.625	2.000	3.875
Dec. 31	1.750	2.125	4.000
2005 / Mar. 25	1.875	2.250	4.125
July 1	2.000	2.375	4.250
Sept. 16	2.125	2.500	4.375
Dec. 23	2.250	2.625	4.500
2006 / Mar. 31	2.375	2.750	4.625
June 30	2.500	2.875	4.750
Sept. 29	2.625	3.000	4.875
Dec. 29	2.750	3.125	5.000
2007 / Mar. 30	2.875	3.250	5.125
June 22	3.125	3.500	5.375
Sept. 21	3.250	3.625	5.500
Dec. 21	3.375	3.750	5.625

Source: Financial Statistics Monthly, Republic of China (Taiwan), Central Bank of the Republic of China (Taiwan).

Adjustment Magnitudes of the Interest Rates

Unit: % ; percentage point

	Discount Rate	Accommodation Rate with Collateral	Deposit Rates Offered by Five Major Banks	Mortgage Lending Rate by the TCB*
2004 September	1.375	1.084	1.400	2.800
2007 Year End	3.375	2.054	2.617	3.260
Differences	2.000	0.970	1.217	0.460

Note: * TCB stands for Taiwan Cooperative Bank; the lending rates are for loans with a maturity of three years and above.
Source: Financial Statistics Monthly, Republic of China (Taiwan), Central Bank of the Republic of China (Taiwan).

points and therefore had little impact on mortgage burdens for home buyers. The general public, on the other hand, gained more interest revenues due to higher deposit rates following the rise of the policy rates.

Absorbing Excess Liquidity through Open Market Operations

Due to abundant liquidity in the banking system, the Bank issued Certificates of Deposit (CDs) continuously to mop up excess reserves. In 2007, the total value of CDs issued amounted to NT$13,672 billion. At the end of the year, the total outstanding amount of CDs issued by the Bank was NT$3,460 billion. The Bank also conducted repurchase agreement transactions, releasing NT$36 billion to accommodate temporary demand for funds from commercial banks.

Following the adjustments of the policy rates, the Bank also announced its non-competitive bidding rates for new CD issuance to guide market interest rates upwards. In 2007, the 30-day

Open Market Operations

Unit: NT$ Billion

Year/	Amount Absorbed*	Amount Offered*	Outstanding Amounts*	Weighted Average Rates on CDs Issued				
Month	Issues of CDs	Redemptions of CDs	CDs Issued	1-30 days	31-91 days	92-182 days	274-364 days	2 years
2005	20,007	20,049	3,521	1.29	0.34	1.44	—	—
2006	13,526	13,290	3,756	1.55	1.63	1.69	1.84	—
2007	13,672	13,968	3,460	1.91	1.95	1.94	2.29	—
2007 / 1	1,447	1,481	3,722	1.45	1.52	1.60	—	—
2	711	880	3,553	1.45	1.52	1.60	1.70	—
3	529	511	3,571	1.45	1.55	1.64	1.72	—
4	1,152	1,152	3,571	1.52	1.59	1.67	1.77	—
5	599	766	3,404	1.52	1.59	1.67	—	—
6	675	683	3,396	1.54	1.65	1.74	1.89	—
7	1,243	1,358	3,282	1.59	1.66	1.74	1.91	—
8	1,574	1,522	3,334	1.59	1.66	1.74	1.88	—
9	1,404	1,469	3,268	1.60	1.68	1.74	1.84	—
10	1,699	1,556	3,411	1.66	1.73	1.74	1.85	—
11	1,253	1,242	3,423	1.66	1.73	1.81	1.85	—
12	1,386	1,348	3,460	1.66	1.74	1.81	1.87	

Note: * End-of-period data.
Source: Financial Statistics Monthly, Republic of China (Taiwan), Central Bank of the Republic of China (Taiwan).

Non-Competitive Bidding Rates on CDs Issued by the Central Bank

Unit: %

Effective Date	30 days	91 days	182 days
2005 / Mar. 25	1.270	1.310	1.360
July 01	1.330	1.380	1.440
Sept. 16	1.390	1.450	1.520
Dec. 23	1.450	1.520	1.600
2006 / Mar. 21	1.520	1.590	1.670
June 30	1.590	1.660	1.740
Sept. 29	1.660	1.730	1.810
Dec. 29	1.690	1.760	1.840
2007 / Mar. 30	1.720	1.790	1.870
June 22	1.920	1.990	2.070
Sept. 21	1.980	2.060	2.150
Dec. 21	2.040	2.130	2.230

Note: * The auction rates on 364-day or above CDs were not shown on this table.
Source: Press Releases on Open Market Operations, Central Bank of the Republic of China (Taiwan).

CD rate moved up by 35 basis points to 2.04 percent at the end of the year, leading the overnight call-loan rate to rise from 1.685 percent early in the year to 2.083 percent at the year-end.

Redeposits of Financial Institutions

Accepting redeposits from Taiwan Post Co. and commercial banks is another instrument for the Bank to influence banks' reserve positions to enhance financial stability. At the end of 2007, outstanding postal savings redeposits increased from NT$1,487 billion at the end of 2006 to NT$1,581 billion. At the same time, banks' redeposits slightly edged up from NT$328 billion to NT$359 billion.

In addition, the three domestic agricultural banks, namely the Taiwan Cooperative Bank, the Land Bank of Taiwan and the Agricultural Bank of Taiwan, were allowed to accept deposits from community financial institutions and make redeposits with the Bank. At the end of 2007, their outstanding redeposits decreased to NT$117 billion, compared to NT$136 billion in 2006.

Encouraging Banks to Accept Long-Term Deposits

In view of excess liquidity in the banking system, banks have the tendency to refuse long-term deposits from the public. In both June and July, the Bank issued statements requesting banks not to turn down deposits that were in line with banks' publicly-announced board rates, which are legally binding between the banks and depositors. Banks may redeposit their funds with the Bank if their long-term deposits increase. At the end of 2007, such redeposits received by the Bank amounted to NT$112 billion.

Promoting Preferential Loans

To help encourage the real estate market and relieve the mortgage burden on home buyers, the Bank, the Ministry of Finance and the Ministry of the Interior jointly initiated a preferential mortgage loan program in August 2000. After having expanded this program six times since its inauguration, the total amount of the loanable funds under this program increased to NT$1,800 billion. In September 2006, the Executive Yuan decided to continue this program until the loanable funds as planned were used up—as opposed to the original deadline of September 2006. By the end of 2007, NT$1,695.5 billion of the loanable funds had been obtained by 867,637 households with a total mortgage amount of NT$2,666.7 billion under this program.

The Bank also continued to provide subsidies to victims of the earthquake in 1999 for interest payments on their mortgage loans. By the end of 2007, a total of NT$67 billion loans had been approved for 34,856 housing units under this program.

Enhancing the SME Financing Mechanism

To provide easier access to financing for SMEs, the Bank continued to promote the two-track guarantee system to support SMEs in obtaining loans. In addition, since June 2003, the Bank has monitored banks' performance of SME financing on a monthly basis to encourage banks to extend loans to SMEs. At the end of 2007, the outstanding guarantees and loans extended to SMEs by domestic banks were NT$338.4 billion and NT$3,056.6 billion, showing an increase of NT$112.7 billion and NT$922.1 billion, respectively, as compared with the end of July 2004.

3. Foreign Exchange Management

In addition to foreign exchange market management and reserve management, the Bank continued to approve more banks to conduct foreign exchange business and to allow authorized foreign exchange banks to introduce more financial products to the market, and further deregulated capital movement in 2007.

Foreign Exchange Market Management

The NT dollar exchange rate regime is a managed float, where in principle the exchange rate is determined by supply and demand in the foreign exchange market. However, if the market is disrupted by seasonal or irregular factors (e.g. large flows of hot money), causing the exchange rate to become excessively volatile, the Bank may step in to maintain an orderly foreign exchange market.

During 2007, various foreign and domestic factors affected the NT$/US$ exchange rate. However, the exchange rate still reflected Taiwan's fundamentals and thus maintained its dynamic stability. It fluctuated between 32.268 and 33.398 during 2007, closing the year at 32.443, up 0.47 percent from 32.596 at the end of 2006.

To monitor the market activities, the Bank continued to implement the Real-Time Reporting System for Large-Amount Foreign Exchange Transactions. In addition, the requirement that forward transactions should be made only upon real transactions, such as trade and financing, was reinforced in order to curb foreign exchange speculation. The Bank also urged authorized banks to enhance their exchange rate risk management so as to lower their risk exposures and systemic risks. To provide a legal basis for insurance companies participating in foreign exchange business, the Bank promulgated the Regulations Governing Foreign Exchange Business of Insurance Enterprises on April 23. Moreover, the Bank strengthened target examinations to maintain an orderly foreign exchange market.

Enlargement of Foreign Exchange Market

To enlarge the scale of the foreign exchange market, the Bank authorized another 60 branches of local banks to conduct foreign exchange business in 2007. By the end of 2007, there were 1,210 authorized foreign exchange banks, which included 61 foreign banks, and 38 domestic bank headquarters and their 1,111 branches. In addition, another 48 non-authorized foreign exchange banks were approved to buy/sell foreign currency banknotes and traveler's checks during the year.

The Bank continued to approve new financial products in 2007. These were as follows: (1) NTD time deposits linked to the hedge fund index dbX-Diversified Alpha using the CPPI (Constant Proportion Portfolio Insurance) strategy; (2) foreign currency-denominated foreign exchange derivatives involving domestic equity; (3) foreign currency loans linked to the DMA (Diversified Municipal Arbitrage) Index. For the year 2007, banks introduced 30 new financial products, which effectively promoted bank services and further enriched foreign exchange trades.

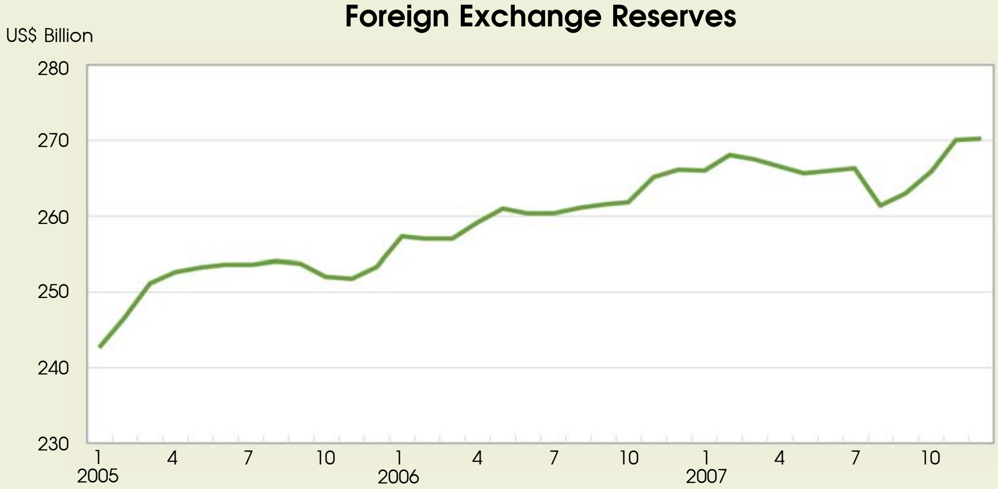
Due to the increases in the number of market participants and diversity of financial products, the daily average transaction amount of the Taipei foreign exchange market further increased to US$18.6 billion in 2007, 19.2% higher than US$15.6 billion of the previous year.

In order to provide banks with sufficient foreign currency liquidity to meet corporate funding needs, the Bank continued to carry out foreign currency swap transactions with banks and extend foreign currency call loans to banks. During 2007, foreign exchange call loan transactions reached US$1,605 billion, while foreign currency-NT dollar swap transactions reached US$288 billion.

Steady Growth of Foreign Exchange Reserves

In 2007, the Bank's foreign exchange receipts amounted to US$1168.4 billion, while foreign exchange expenditure was US$1164.2 billion. At the end of 2007, total foreign exchange reserves amounted to US$270.3 billion, a US$4.2 billion increase from the end of 2006. The increase was mainly attributed to a current account surplus, foreign capital inflows and a higher return on investment of foreign exchange reserves.

Foreign Exchange Reserves



Source: Department of Foreign Exchange, CBC.

Capital Flow Management

With the progress of financial liberalization and internationalization, the Bank has largely deregulated capital movement restrictions. In general, capital can flow freely in and out of Taiwan. As of 2007, restrictions only remained on a few short-term financial transactions involving the conversion of the NT dollar. For example, each domestic company and resident could conduct inward and outward remittances up to US$50 million and US$5 million within one year, respectively. Non-residents could remit up to US$100 thousand per transaction. For remittances exceeding the respective ceilings, transactions could be made with the approval from the Bank.

Key measures with regard to the management of foreign exchange in 2007 included:

(1) In order to loosen the restrictions on foreign investment in domestic securities, the Bank agreed to the following measures: (i) Effective March 21, privately placed foreign mutual funds and unit trusts were allowed to borrow securities. (ii) Effective April 14, foreign investors were allowed to engage in trading of over-the-counter equity derivatives. The premiums on equity option and equity swap investments plus the investments in money market instruments shall not exceed 30 percent of each foreign investor's net inward remittances. (iii) Effective May 7, foreign investors investing in component stocks of the Taiwan 50 Index were exempt from the restriction against short sales below the previous day's closing price. (iv) Effective May 22, the remittance limit on realized futures trading profits via direct accounts and synthetic accounts was raised to NT$300 million for each foreign investor. (v) Effective June 15, foreign investors were allowed to borrow securities from securities finance enterprises. (vi) Effective July 30, foreign investors were allowed to obtain the discretionary investment services provided by securities investment trust enterprises, securities investment consulting enterprises, trust enterprises, and securities brokers. (vii) Effective August 24, foreign investors investing in component stocks of Taiwan Mid-Cap 100 Index and Taiwan Technology Index were exempt from the restriction against short sales below the previous day's closing price.

(2) In order to promote the internationalization of capital markets, the Bank agreed to the following measures: (i) Domestic enterprises were allowed to issue overseas marketable securities to raise funds. In 2007, 6 corporations issued overseas depository receipts amounting to US$4.32 billion; 8 corporations issued convertible bonds amounting to US$1.33 billion. (ii) The Central American Bank for Economic Integration (CABEI) was allowed to issue NTD-denominated bonds worth NT$7 billion, in order to enhance Taiwan's relation with international financial organizations.

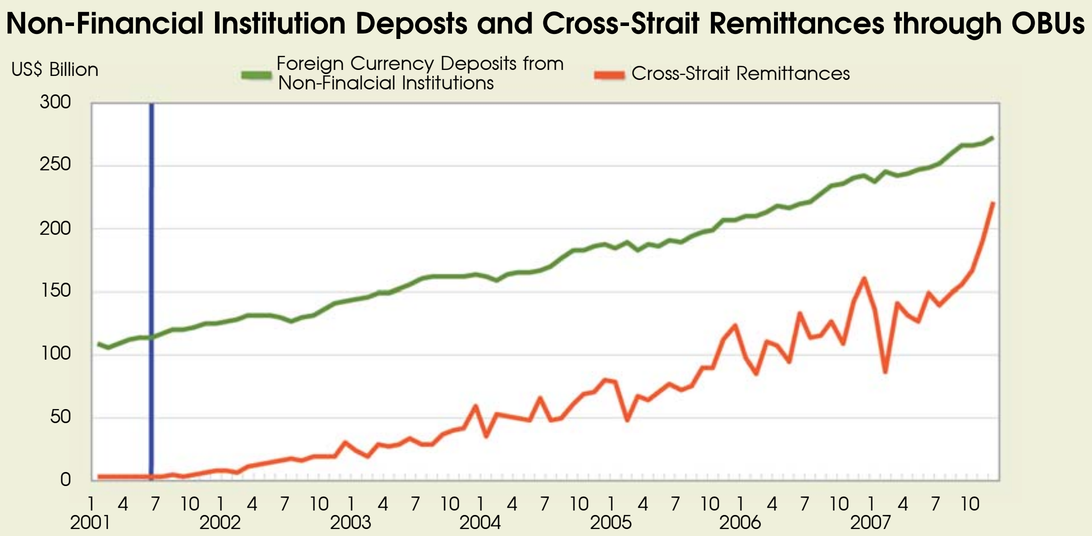
(3) The Bank agreed to the following applications for overseas securities investment: (i) securities investment trust enterprises were allowed to issue 63 publicly placed securities investment trust funds to invest in foreign securities, with a total amount of NT$587 billion; (ii) securities investment trust companies were allowed to issue 19 privately placed securities investment trust funds, amounting to NT$30.3 billion to invest in foreign securities; (iii) 12 insurance companies were allowed to invest in foreign securities through direct remittances, swaps or cross currency swaps, which totaled US$2.9 billion ; (iv) 2 insurance companies were allowed to invest in foreign securities through specified pecuniary trusts with a total of US$0.2 billion; (v) 10 commercial banks were allowed to invest in foreign securities through collectively managed accounts worth about US $0.7 billion.

(4) In response to the Ministry of Finance's request for nationals' remittance information for taxation purpose, the Bank required banks on August 24 to submit monthly reporting files to the Bank from January 2, 2008 onwards. The files should cover data regarding remittances for investing in marketable securities abroad in the following categories: NTD specified pecuniary trust funds, securities firms' consigned trading of foreign marketable securities, offshore fund master agents' investment in offshore funds, insurance companies' investment-type insurance products, securities investment trust enterprises' publicly and privately placed funds, and securities investment trust and consulting enterprises' discretionary services.

(5) The Chinese renminbi (RMB) exchange business was open for banks located in Kinmen and Matsu on October 3, 2005, and has operated smoothly since then. Up to the end of 2007, local bank branches in Kinmen and Matsu in total purchased 66.12 million RMB dollars and sold 390.63 million RMB dollars.

Development of Offshore Banking Business

Offshore banking units (OBUs) of local banks have been in operation since December 1983 to stimulate Taiwan's international financial activities and to establish Taiwan as a financial center in Asia. The overall OBU development is analyzed in the Foreign Exchange Market segment in Section II of this *Annual Report*. Since June 2001 with official approval, OBUs have conducted cross Taiwan-Strait financial business, which has shown rapid growth. At the end of 2007, foreign currency deposits from non-financial institutions totaled US$27.26 billion, or a 138 percent increase from June 2001, while cross Taiwan-Strait remittances grew to US$179.5 billion, a US$39.71 billion or 28.4 percent increase from last year. This rapid growth of cross-Strait remittances helped promote OBUs as the funding center for Taiwanese businesses operating overseas.



Source: Department of Foreign Exchange, CBC.

4. Banking Supervision

To ensure sound operation of financial institutions and maintain the stability of the financial system, the Bank conducts banking supervision in accordance with the mandate endowed by the Central Bank of the Republic of China (Taiwan) Act. The Bank also actively engages in the establishment of financial soundness indicators and other financial stability indicators to systematically monitor, analyze, and evaluate the possible sources of financial system risks in order to adopt appropriate policies and measures in a timely manner.

Implementing On-site Examinations

According to the Central Bank of the Republic of China (Taiwan) Act, the Bank only conducts target examinations related to monetary, credit, and foreign exchange policies and payment systems when necessary.

Following up Banks' Compliance with the Examination Opinions

In light of the Bank's examination opinions and the Financial Supervisory Commission's examination opinions related to the Bank's business or regulations, the Bank monitors how the examined financial institutions have done for improvement, penalizes the institutions according to the law when necessary, urges the financial institutions to rectify related deficiencies, and thus ensures the successful implementation of the Bank's policy.

Enhancing Off-site Monitoring

Based on the periodical reports submitted by financial institutions, the Bank assesses the operation, financial conditions and regulatory compliance of individual financial institutions by utilizing the report auditing system. The Bank then compiles analyses on various business practices and other information to provide a reference for relevant supervisory agencies.

Establishing a Framework to Evaluate Financial Stability

The Bank refers to the IMF guidelines for compiling financial soundness indicators to draw up the Financial Soundness Indicators Reporting Items and Explanations for domestic banks and to establish a related databank, thus forming the basis of financial stability evaluation.

With the databank, the Bank can regularly draw up financial soundness indicators for domestic banks and non-bank financial institutions, study and present depository institution management status and exposure analysis reports, thus gradually establishing the evaluation framework of Taiwan's financial stability.

Monitoring Mismanaged Financial Institutions

The Bank closely monitors mismanaged financial institutions and collects information for the Bank's policy decisions. Moreover, the information is forwarded to the Financial Supervisory Commission and/or the Bureau of Agricultural Finance in order to adopt prompt corrective actions.

Other Important Measures

Other important measures implemented in 2007 included: (i) The Bank supported the Financial Supervisory Commission to establish a single window for the reporting of financial supervision-related information by domestic banks, foreign banks, and bills finance companies, and completed the design of data exchange format and file conversion. (ii) The Bank published financial institution statistics and new financial regulations, and disclosed public information on the Bank's website, in order to strengthen the transparency of the operation of financial institutions. (iii) The Bank established the Financial Stability Evaluation Committee and the Financial Stability Working Group to bolster financial stability analysis and evaluation. (iv) According to the revised Regulations Governing the Establishment and Administration of Foreign Currency Exchange Bureaus, the Bank incorporated currency exchange bureaus in the scope of financial examination and performed on-site examinations on these bureaus.

5. Payment and Settlement Systems

Taiwan's payment systems mainly include the Check Clearing House System (CCHS), the Interbank Remittance System (IRS), the CBC Interbank Funds-Transfer System (CIFS), and the Central Government Securities Settlement System (CGSS). Among them, the CCHS and the IRS are retail payment systems, while the CIFS and the CGSS are the two main subsystems operated by the Bank. The Bank plays a key role in Taiwan's payment systems. All these payment systems make use of banks' A reserve accounts with the Bank for final settlement. In addition to operating the CIFS and CGSS, the Bank also monitors major payment systems based on international standards to ensure sound operation of these systems.

Funds Transfers via the CIFS

The CIFS launched in May 1995 is an on-line, large-value funds transfer system. Since September 2002, the System has been operated based on the real-time gross settlement (RTGS). Under the RTGS, payments are settled on a real-time basis and the banks involved are required to hold sufficient account balances with the Bank. Those who maintain transaction accounts with the Bank may directly use the CIFS to transfer funds. Payment instructions are sent over the CIFS for settling obligations on check clearing, adjusting reserve account balances, or making payments associated with interbank loans, bill transactions, and bond transactions. On January 5, 2007, the Chinese Bank and the Great Chinese Bills Finance Corporation encountered fund shortages at the end of the business day. Fortunately, the RTGS already in place prevented systemic risk and insulated other banks from possible impacts.

At the end of 2007, participants of the CIFS included 72 banks, 12 bills finance companies, and 6 other institutions, including Taiwan Post Co., two investment trust companies, the Taiwan Stock Exchange (TSE), and the GreTai Securities Market (GTSM). For the year as a whole, the daily average value of funds transferred via the CIFS was NT$1,012 billion, while the daily average number of transactions reached 3,244.

Transactions via the CGSS

Established in September 1997, the CGSS is an RTGS system for the issuance, transfer, redemption, and interest payment of book-entry central government securities. Since its inception, central government bonds have been issued in book-entry form. In October 2001, treasury bills were included in the system and have been issued in book-entry form since then. The registration of central government securities transfers is handled by 16 clearing banks and their 1,602 branches. A total of 978 thousand transfers with a value of NT$63,787 billion were processed by the system in 2007, compared to the 510 thousand transfers with a total value of NT$17,481 billion recorded in 1998. Also, the outstanding balance of the book-entry central government bonds amounted to NT$3,404 billion, or 99.8 percent of the total outstanding balance of central government bonds at the end of 2007. The total transaction value of the book-entry central government bonds reached NT$178 trillion, or 91.9 percent of the total transaction value of the entire bond market in 2007.

Currently, the book-entry transactions of central government securities within a clearing bank can be made on a delivery-versus-payment (DVP) basis while those between clearing banks cannot. To reduce the settlement risk in interbank transactions, the Bank plans to link the CGSS with the CIFS to allow clearing banks to handle these settlements on a DVP basis as well. The project is currently underway and is expected to be completed in 2008.

Improving and Monitoring Payment Systems

The Bank and other government agencies implemented a plan to improve payment and clearing processes of the securities market on July 23. Under this plan, the TSE and the GTSM are able to process net payment clearing of stocks and bonds through the CIFS. The Bank also planed to link the CIFS and CGSS by 2008 to allow clearing banks to handle settlements on a DVP basis.

Based on the Core Principles for Systemically Important Payment Systems and Recommendations for Securities Settlement Systems issued by the Bank for International Settlements (BIS), the Bank monitors the payments system to maintain its safety and efficiency as one of its foremost goals. Large-value payment systems monitored by the Bank include the CIFS, the CGSS, the CCHS, and the Depository and Clearing System (DCS). The Bank also monitors interbank settlement and clearing activities involving retail payment and electronic money.

The Bank's monitoring activities include the following:

(1) To require each payment system operator and payment instrument issuer to provide detailed data and information on a periodic basis regarding their operations and activities.

(2) To supervise clearing institutions to make contingency plans and business continuity plans in case of emergency.

(3) To invite the Financial Information Services Co. (FISC), the Taiwan Depository and Clearing Corporation (TDCC), and the Taiwan Clearing House (TCH) to participate in the panel discussions held regularly on promoting sound operation of the payments system. In June, the Bank instructed the FISC to manually conduct an exercise of

interbank remittance batch operation in case of emergency. Also in April and December, the Bank instructed the TDCC and the TCH to conduct remote backup exercises on securities depository, settlement, and trading systems.

(4) To manage clearing institutions based on the Clearing Institutions section in the Directions for the Central Bank of China (Taiwan) to Govern Electronic Interbank Funds Transfer and Settlement. Certain articles in the Directions were amended to expand the CIFS operation in securities market transaction settlement and allow the TSE and the GTSM to set up accounts in the Bank for settlement.

(5) To follow the Core Principles for Systemically Important Payment Systems of the BIS as guidance to govern payment systems.

6. Currency Issuance

Currency Issued Slightly Increased

An important function of the Bank is to ensure a smooth and efficient supply of banknotes and coins to meet public demand, which is dependent on the level of economic activity, seasonal factors, and the development of noncash payments.

In 2007, the currency issued reached a peak at NT$1,377 billion on February 16, the day before the Chinese Lunar New Year holidays, reflecting a temporary seasonal surge in cash demand. The outstanding amount of the currency issued stood at NT$961.7 billion at the end of 2007 with an increase of NT$1.9 billion or 0.2 percent compared with the end of 2006.

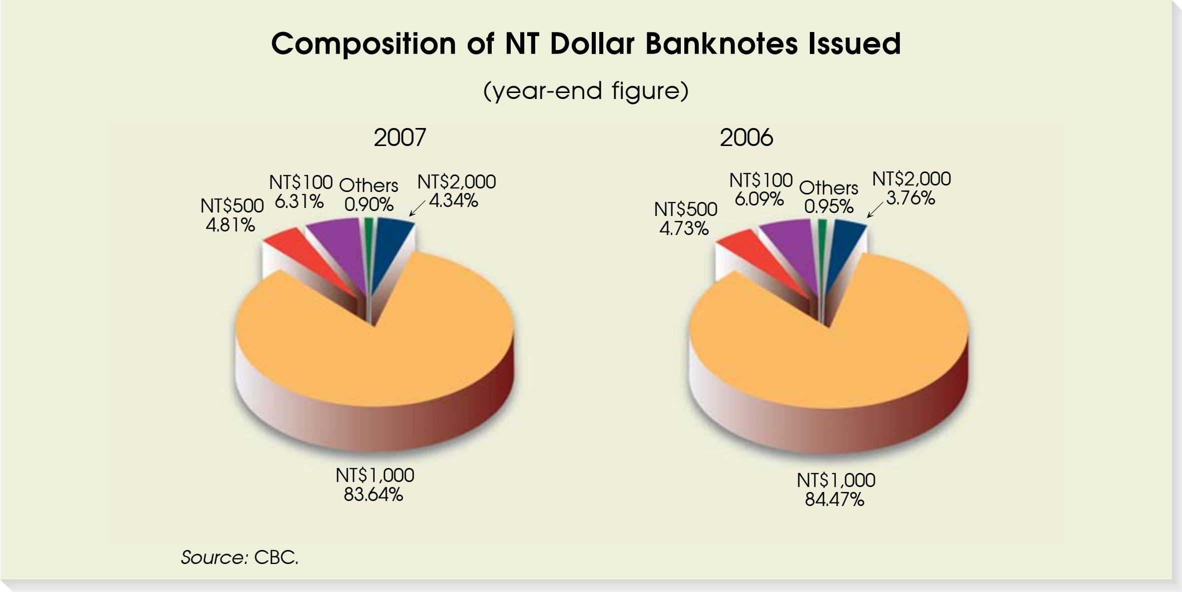
With regard to the denominations of the NT dollar banknotes, the NT$1,000 note still registered the lion's share, or 83.64 percent, of the total value of banknotes issued, followed by the NT$100 note with a share of 6.31 percent at the end of 2007. Meanwhile, the share of the largest denomination note, the NT$2,000, rose to 4.34 percent at the end of the year.

Currency in Circulation Mildly Trended Downward

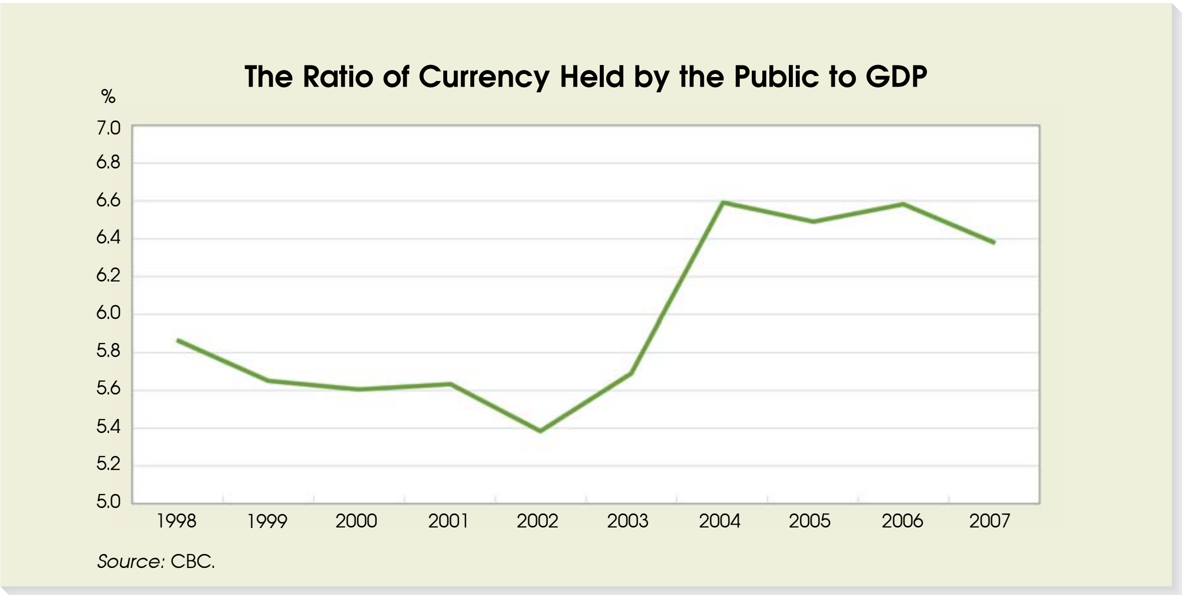
Driven by continuous innovation in payment instruments, consumers and businesses were increasingly using debit and credit cards instead of paper checks and cash at the point of sale from the mid-1990s. The ratio of currency in circulation to nominal GDP dropped from 7.50

Currency Issued

Source: CBC.



percent in 1994 to as low as 5.38 percent in 2002. Thereafter, because of the increased willingness to hold cash as interest rates trended lower and the improved convenience of cash withdrawal due to the widespread ATM access, the ratio of currency in circulation to nominal GDP increased to 6.58 percent in 2004. However, from the fourth quarter of 2005 onwards, currency demand for transaction purposes decreased as credit card defaults weakened private consumption. In 2007, the ratio of currency in circulation to nominal GDP trended down to 6.37 percent, a mild decrease of 0.20 of a percentage point from a year before.



Commemorative Coin Sets Successively Issued

With the authority of currency issuance, the Bank may also issue gold and silver coins, and commemorative notes and coins on a non-periodic basis, such as for important ceremonies, national holidays, major international events or other significant national events. During the year 2007, the Bank issued a coin set for the Chinese zodiac year of the pig, and the 10th coin set of the Taiwan Indigenous Peoples Cultural Series—the Thao tribe.

7. Fiscal Agency Functions

The Central Bank acts as a banker to other banks as well as the government. It also functions as the fiscal agent for the government by holding the Treasury Deposit Account (TDA) and central governmental agency deposit accounts, and undertaking the issuance, registration, redemption, and interest payment of central government bonds and treasury bills.

Managing the Treasury Deposit Account

The Bank manages the TDA on behalf of the Ministry of Finance (MOF), processing receipts and disbursements of the central government. The Bank delegates the handling of treasury transactions to 14 financial institutions and their 352 branches, including 5 overseas branches located in New York, Los Angeles, Seattle, and Paris. There are another 4,530 tax revenue agent banks all over the country, offering convenient services to government agencies and the general public. In 2007, the Bank received a total of NT$2,455.5 billion worth of treasury deposits, a decrease of NT$38.9 billion or 1.56 percent over the previous year. Payments made for the Treasury were NT$2,458.3 billion, a decrease of NT$68.2 billion or 2.70 percent from 2006. The outstanding balance in the TDA was NT$38.1 billion at the end of 2007, a decrease of NT$2.8 billion or 6.85 percent from a year earlier.

Handling Central Government Agency Deposits

Central government agencies are required to make their deposits with the Bank or other delegated banks subject to the approval of the MOF. However, the delegated banks are required by law to redeposit a certain percentage of the deposits with the Bank, except those in interest-bearing accounts. At the end of 2007, the balance of central government agencies' deposits with the Bank amounted to NT$148.0 billion, an increase of NT$3.7 billion or 2.56 percent over the previous year. Deposits with other delegated banks were NT$427.3 billion, an increase of NT$1.4 billion or 0.33 percent. Redeposits registered only NT$17.7 billion, decreasing by NT$1.7 billion or 8.76 percent from a year earlier.

Managing Central Government Bonds

As a fiscal agent, the Bank, on behalf of the MOF, performs services related to the issuance, registration, transfer, redemption, and interest payment of central government bonds. The Bank also conducts the auctions of central government bonds. There are 66 domestic dealers qualified to submit tenders to the Bank in the auctions.

All central government bonds issued since 1997 have been in book-entry form. The paperless system expedites trading and saves the cost of printing, safekeeping, and bond delivery. In 2007, the Bank managed 13 issues of central government bonds amounting to NT$393.2 billion. The weighted average yields of successful bids for these issues ranged from 1.905 percent to 3.003 percent per annum. During 2007, the Bank paid a total of NT$222.5 billion in principal and NT$117.4 billion in interest payments for central government bonds. At the end of 2007, the outstanding amount of central government bonds was NT$3,410.0 billion, an increase of NT$170.7 billion or 5.27 percent from the previous year-end, of which 99.80 percent was in book-entry form.

Managing Treasury Bills

Treasury bills are sold at discounts through auctions. Participants include banks, investment trusts, insurance companies, bills finance companies, and Taiwan Post. In 2007, the Bank arranged 3 issues of book-entry treasury bills with a total amount of NT$88 billion. The yields of successful bids for these issues ranged from 1.760 percent to 2.320 percent. At year-end 2007, the outstanding amount of treasury bills was NT$28 billion, an increase of NT$3 billion or 12 percent from the previous year-end.

Improving Operational Efficiency

The interest paid on central government agencies' time deposits with the Bank was previously calculated according to a rate offered by the Bank of Taiwan. Since April 4, 2007, it has been shifted to one offered by the Bank to reflect the Bank's cost of capital. In addition, the Bank integrated the Electronic Bidding System and Auction System into one single platform, which was launched on May 28, 2007. This system streamlines the bidding process and enhances the security and efficiency of tender operation.

8. Participation in International Activities

In the context of globalization and financial innovation, the Bank actively participates in international activities to promote international cooperation and exchange. The Bank hosts conferences, provides training courses, and attends the annual meetings organized by international organizations such as the Asian Development Bank (ADB), the Central American Bank for Economic Integration (CABEI), and the Conference of Governors of South East Asian Central Banks (SEACEN). In addition, the Bank also maintains close relationships with the Inter-American Development Bank (IDB), the European Bank for Reconstruction and Development (EBRD), and the Bank for International Settlements (BIS). In recent years, the Bank has strengthened its interaction with other central banks to exchange views on key economic and financial issues.

The Bank held the SEACEN Seminar on Financial Stability Analysis and Reports in November 2007. A total of 36 participants from 13 countries attended the seminar. The lecturers comprised instructors and technical experts from the BIS, Bank Indonesia and the Bank. The objectives of this seminar were to assist supervisors in employing financial stability assessment tools, and to provide participants with the opportunity to share experiences concerning systemic analysis and report compilation for issues in the development of macroeconomic and financial sectors.

Financial Stability Analysis and Reports Seminar of the SEACEN Centre held at CBC on Nov. 4, 2007