

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.

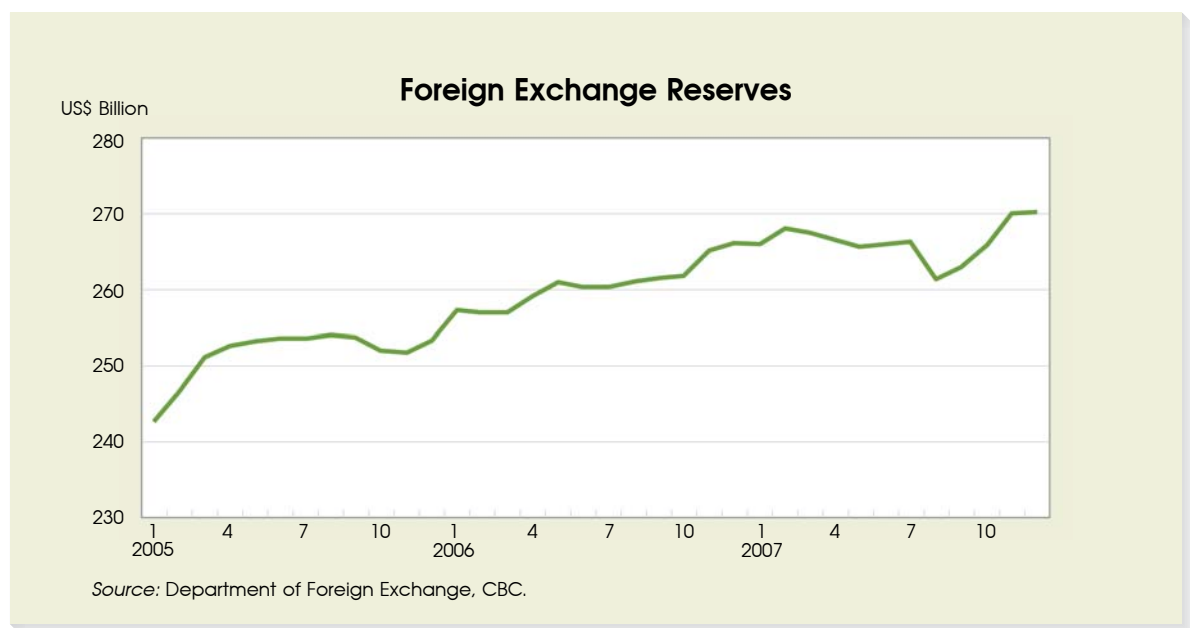
The Bank continued to approve new financial products in 2007. These were as follows: (1) NTD time deposits linked to the hedge fund index dbX-Diversified Alpha using the CPPI (Constant Proportion Portfolio Insurance) strategy; (2) foreign currency-denominated foreign exchange derivatives involving domestic 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.



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.

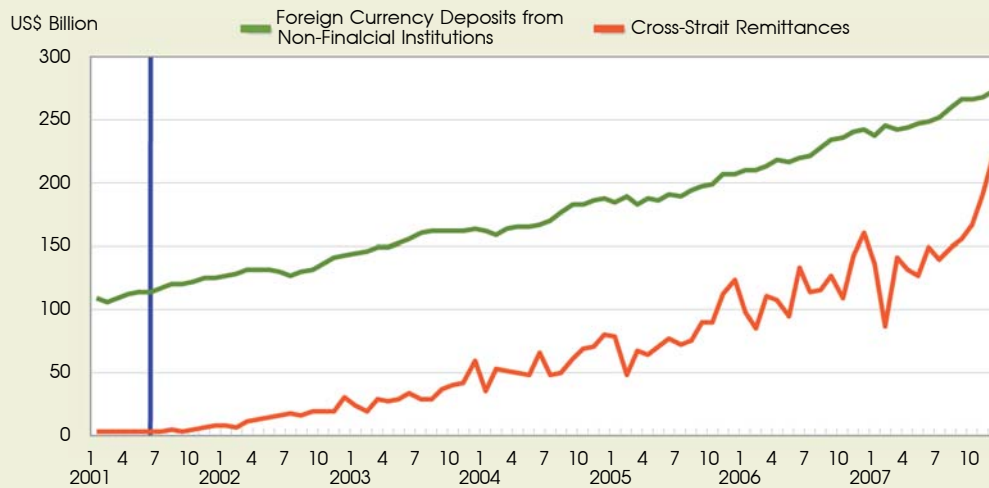
- (3) The Bank agreed to the following applications for overseas securities investment: (i) securities investment trust enterprises were allowed to issue 63 publicly placed securities investment trust funds to invest in foreign securities, with a total amount of NT\$587 billion; (ii) securities investment 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.



Non-Financial Institution Deposits and Cross-Strait Remittances through OBUs



Source: Department of Foreign Exchange, CBC.