

Foreword

In 2008, the world economy was engulfed in a financial turmoil set off by the US subprime mortgage debacle. Taiwan, a small and highly open economy, was severely affected by weakened external demand. GDP growth remained steady at 5.40 percent in the first half of the year but plunged to a negative 4.74 percent in the second half with a sharp contraction of exports and a slowdown in private consumption and investment. As a result, GDP recorded a growth of only 0.12 percent for 2008 as a whole, accompanied by a marked rise in unemployment. Inflation was more pronounced early in the year led by surging international raw material prices, but subsided later with waning demand both at home and abroad. The CPI increased by 3.53 percent in 2008, a relatively stable level among major countries.

Maintaining price stability is the primary goal of the Bank. In response to heightened pressures from imported inflation, the Bank conducted two fine-tuning rate hikes in the first half of 2008. In the second half of the year, Taiwan's financial sector remained largely sound supported by solid fundamentals, but the domestic economy suffered the fallouts from the global financial crisis. As inflation pressures lessened, the Bank shifted to monetary easing in September 2008 to stimulate domestic demand. By the end of March 2009, the Bank had slashed the policy rates seven times by a total of 237.5 basis points. Lower interest rates can reduce the funding costs of individuals and enterprises and help boost private consumption and investment.

Promoting financial stability is another key mandate of the Bank. In 2008, the Bank adopted various measures to ensure sufficient market liquidity. These include: lowering required reserve ratios on bank deposits; expanding the scope of repurchase agreement operations; helping to strengthen the Small and Medium Enterprise Credit Guarantee Fund to share banks' credit risk; requesting banks to switch the frequency of lending rate reviews from quarterly to monthly to more promptly reflect the Bank's rate cuts. In addition, the Bank also urged banks to continue to extend credit to fulfill their financial intermediary function. Following these actions, M2 grew by 2.67 percent in 2008, falling within the Bank's 2 to 6 percent target zone. On the foreign exchange front, at the end of 2008, the NT dollar stood at 32.860 against the US dollar, a depreciation of 1.27 percent from a year earlier; foreign exchange reserves built up to US\$291.7 billion, an increase of US\$21.4 billion from the end of 2007.




Fai-nan Perng, Governor

The Bank also pursues further financial liberalization while safeguarding financial stability. More financial products were introduced for trading in Taiwan during 2008, allowing greater convenience for capital movement. On June 30, financial institutions were given licenses to commence renminbi exchange business, making renminbi currency conversion possible in Taiwan. Moreover, interbank transactions of book-entry government bonds were incorporated into the CBC Interbank Funds-Transfer System on a delivery-versus-payment basis to enhance settlement safety and efficiency. The Bank compiles financial soundness indicators on a regular basis and began issuing Financial Stability Report in 2008 to monitor potential systemic risks.

At the current juncture, central banks around the world are actively taking steps to address the worst economic recession since World War II. Likewise, the Bank is adopting a loose monetary policy. Complemented with the government's expansionary fiscal policy, these joint efforts are expected to help bring the economy back on track.

Finally, my sincere appreciation goes to my colleagues for their dedication during past years. Together, we will work hard to meet the challenges in the year ahead.



Fai-nan Perng
Governor
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