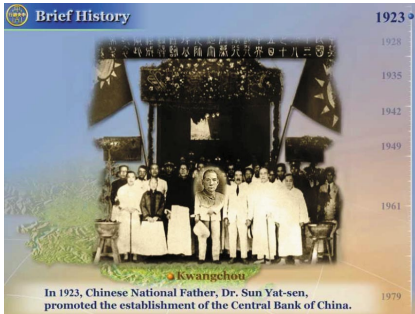


HISTORY

In 1923, Dr. Sun Yat-sen, Father of the Republic of China, promoted the establishment of the Central Bank of China with the primary goal of financing national development. The Bank was inaugurated in Kwangchou a year later. Following the promulgation of the Statute of the Central Bank of China, the Bank commenced operations in Shanghai in 1928. The Central Bank Act was formally enacted in 1935, superseding the 1928 Statute. The Regulation Governing the Unification of



the Issuance of Legal Tender formalized the mandate that the nation's currency was to be issued only by the Bank in 1942. Since then, the Bank has developed in line with the modern

concept of central banking. The Bank relocated to Taipei in 1949, but did not resume all its functions until 1961. Instead of being organized directly under the Office of the President, the Bank became an agency of the Executive Yuan, Taiwan's Cabinet, when the Central Bank Act was revised in 1979. The Bank has, however, continued to maintain its independence in the formulation and implementation of monetary policy. The 1979 legislation also vested the Bank with the authority to examine the activities of financial institutions.

ORGANIZATION

The Bank is the nation's sole monetary authority. The Board of Directors is the highest decision making body of the Bank



and is made up of fifteen Directors. The Board of Supervi-

sors audits the Bank's financial records. There are currently five Supervisors.

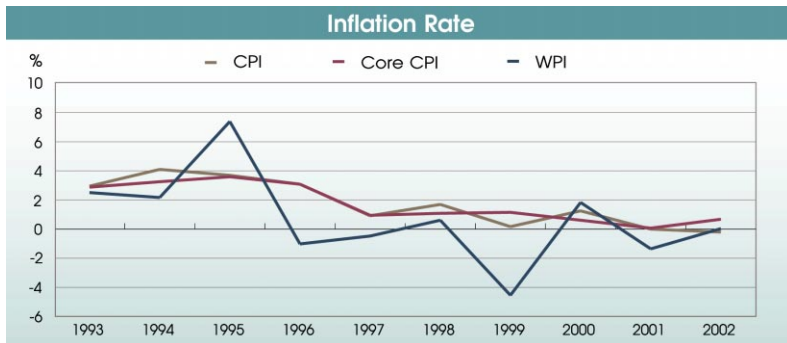


At the working level, there are eight departments in the Bank responsible for various central banking functions, including Department of Banking, Department of Issuing, Department of Foreign Exchange, Department of the Treasury, Department of Financial Inspection, Department of Economic Research, Secretariat, and Department of Accounting. In addition, there are four supporting offices, including Personnel Office, Civil Service Ethics Office, Information Management Office, and Legal Affairs Office. The Bank is represented overseas by representative offices in New York and London. The Central Engraving & Printing Plant and the Central Mint are affiliates of the Bank.

OBJECTIVES

The Bank conducts monetary and foreign exchange policy, issues the nation's currency, and serves as the bank of banks and the government's bank. These functions make it quite distinct from ordinary banks. The four operational objectives laid out by the Central Bank Act are (1) promoting financial stability, (2) guiding sound banking operations, (3) maintaining stable internal and external value of the national currency, and (4) within the scope of the above three objectives, fostering economic development.

While the Bank deals mainly with government agencies, banks, and foreign financial institutions, it also directly affects the life of ordinary people. For instance, notes and coins in circulation are issued by the Bank. In fact, one of the Bank's most important functions is to meet public demand for money and safeguard the purchasing power of the currency.



OPERATIONS

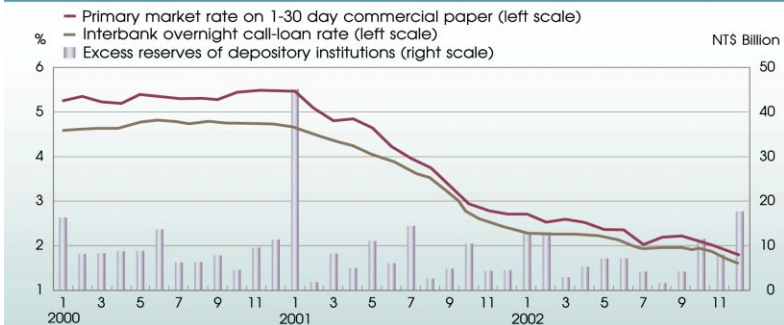
Monetary Policy

Monetary policy is the primary means through which the Bank can achieve its operational objectives. The Bank uses the broad monetary aggregate M2 as the intermediate target for monetary policy.



Monetary policy instruments available to the Bank include open market operations, discount lending, reserve requirements, re-deposits of financial institutions, and selective credit controls and accommodations. Among these, open market operations is generally considered the most effective and flexible in the implementation of monetary policy. Through purchases or sales of eligible securities, the Bank can directly influence the amount of reserves and inter-bank call-loan rates in the banking system.

Money Market Rates and Excess Reserves of Depository Institutions



Foreign Exchange Management

Taiwan formally adopted a managed float exchange rate system in 1979, the same time that the Taipei Foreign Exchange Market was established. Under this exchange rate regime, the NT dollar exchange rate is determined, in principle, by market supply and demand. However, when the market is disrupted by seasonal or irregular factors, the Bank will step in.

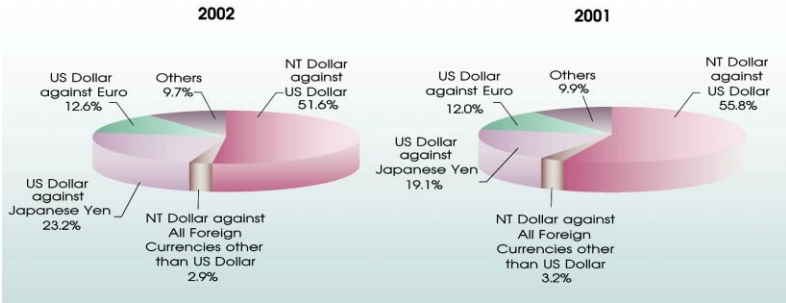


The Foreign Exchange Department has been on the forefront of financial liberalization. Among various reforms, an authorized foreign exchange bank can, with prior consultation with the Bank, determine the level of its own foreign exchange exposure and engage in derivatives transactions such as swaps and options beginning from 1987. More significantly, foreign exchange derived from exports of goods and services can be retained and managed by the private sector.

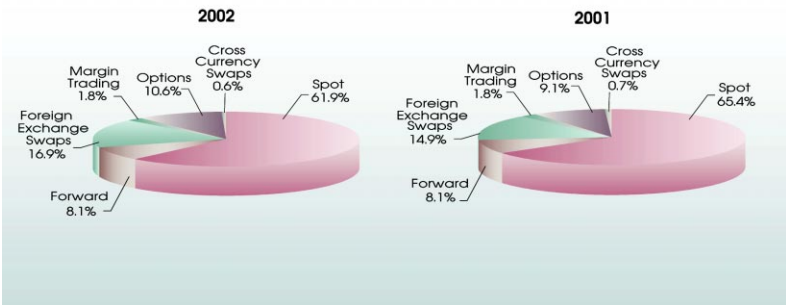
With respect to the capital account, foreign exchange transactions not involving the NT dollar are completely deregulated. Foreign exchange transactions involving the NT dollar but supported by transactions of goods and services,

direct investment, and approved portfolio investment are also liberalized. Some limits on other forms of short-term capital flows are still in place.

Composition of Foreign Exchange Transactions by Traded Currency



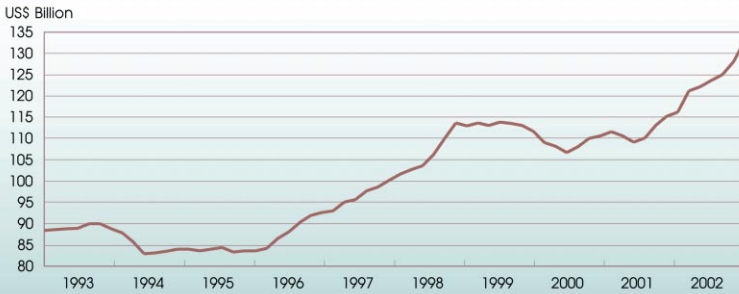
Composition of Foreign Exchange Transactions by Product



The level of Taiwan's foreign exchange reserves is among the highest in the world. Foreign exchange reserves are important national assets. The philosophy of the Bank's management of foreign exchange reserves centers around security, liquidity, and profitability. Within this basic framework, for-

Foreign exchange reserves can also be used to achieve other financial or economic objectives. Creating depth and liquidity in the foreign exchange market and developing the asset management industry are two such examples.

Foreign Exchange Reserves



Payment System

The CBC Interbank Fund Transfer System (CIFS) is operated and regulated by the Bank. The CIFS is an on-line fund transfer system. Participants of the CIFS include banks, investment and trust companies, and bills finance companies. Payment instructions can be transmitted through the CIFS for adjusting reserve balances or making interbank transfers. The Interbank Remittance System operated by the Financial Information Service Company and net clearing positions from the Clearing House System are both settled through the CIFS. Beginning from September 2002, all participants of the CIFS settle through the new Real-Time Gross Settlement System (RTGS). In contrast to the old Designated-Time Net Settlement System (DNS), the RTGS speeds up the flow of funds and reduces counter party risk.

Currency Issuance

The Bank is responsible for planning, designing, and producing bank notes and coins. Old notes and coins no longer fit for use are also withdrawn from circulation by the Bank. The Central Engraving and Printing Plant and the Central Mint, both owned by the Bank, are responsible for printing and minting the NT dollar. The Bank of Taiwan, a state-owned commercial bank, distributes new issues and processes damaged notes and coins.

The amount of currency issued by the Bank is affected by seasonal factors, general economic climate, and institutional arrangements. For instance, a temporary surge in demand for cash usually occurs around the Chinese Lunar New Year. The Bank closely monitors demand fluctuations and takes appropriate actions.



Treasury Functions

As a fiscal agent, the Bank acts as the central government's banker and provides several services for the Treasury. For instance, the Bank processes receipts and disbursements of funds for the central government and its agencies. The issuance, redemption, and interest payment of government securities are also handled by the Bank.

Following the introduction of the Central Government Securities Settlement (CGSS) system in 1997, bonds are no longer issued in physical form. The Bank upgraded the CGSS to facilitate the conversion of outstanding physical bonds in 1999. The Book-Entry Treasury Bills Program was introduced in 2001. These measures have accelerated the dematerialization of government securities and enhanced the efficiency and security of trading government securities. In order to achieve delivery versus payment and reduce settlement risk of government securities transactions, the CGSS system will soon be linked to the CIFS system.

The Bank's Electronic Bidding System came into operation in 2001. It is designed to improve the auction process of government securities and minimize errors and delays arising from handling bids manually. Augmented by the Auto-

Bond Transactions in the Over-the-Counter Market

Unit: NTS Billion

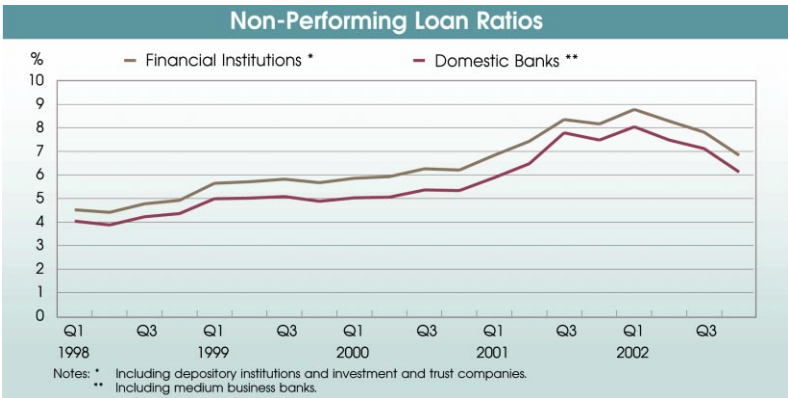
	Outright Transactions		Repurchase Agreement Transactions		Total
	Amount	Share (%)	Amount	Share (%)	
2000	16,691	24.2	52,152	75.8	68,843
2001	53,024	44.6	65,969	55.4	118,993
2002	60,660	45.1	73,739	54.9	134,399
2002/1	4,358	40.4	6,438	59.6	10,796
2	2,348	37.1	3,973	62.9	6,321
3	2,786	31.9	5,944	68.1	8,730
4	2,508	31.1	5,547	68.9	8,056
5	3,074	33.7	6,055	66.3	9,129
6	4,666	44.6	5,799	55.4	10,465
7	4,479	39.9	6,756	60.1	11,235
8	5,179	43.0	6,870	57.0	12,049
9	5,661	47.0	6,384	53.0	12,045
10	7,060	50.9	6,798	49.1	13,858
11	8,458	57.0	6,381	43.0	14,839
12	10,082	59.7	6,794	40.3	16,876

Source: Taiwan Securities Exchange & GreTai (Over-the-Counter) Securities Market.

mated Auction System, participants can access information related to auctions and transmit data through the system without delay.

Bank Examination

The Bank oversees the operations of financial institutions in line with the power and functions set out by the Central Bank Act. Financial supervision involves both on-site examinations and off-site monitoring. In the case of on-site examinations, the Bank's examiners conduct either full-scope or targeted examinations and routinely verify compliance with financial regulations, review operational procedures, and evaluate risk and internal controls. Through off-site monitoring, the Bank analyzes financial records, minutes of board meetings, and public disclosures.

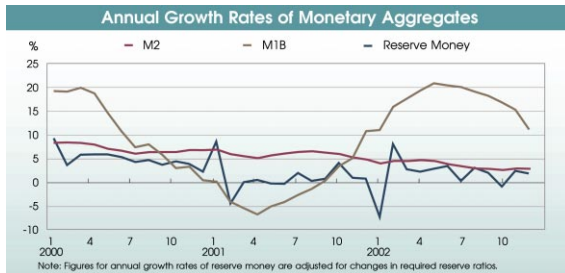
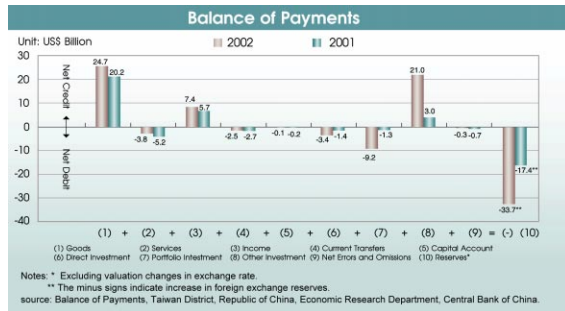


Economic Research

The Bank compiles a rich data set on domestic banking statistics, flow of funds, and balance of payments. Financial information collected by the Bank is reported in *Financial Statistics Monthly*, *Flow of Funds Annual*, and *Balance of Payments Quarterly*. The Bank also publishes an *Annual Report* and a *Quarterly Review*. The Bank's publications are distributed to domestic and foreign financial institutions.

Research undertaken by the Bank covers a wide range of economic and financial issues, including monetary aggregates, reserve money, interest rates, prices, flow of

funds, balance of payments, exchange rates, financial markets, industrial development and economic growth. The Bank also monitors conditions in the world economy and follows developments in global financial markets closely.



International Financial Cooperation



The Bank represents the Republic of China in a number of international financial organizations including the Asian Development Bank, the Central American Bank for Economic Integration, and the Conference of Governors of South East Asian Central Banks. The Bank also maintains close working relationships with the Inter-American Development Bank, the European Bank for Reconstruction and Development, and the Bank for International Settlements.



RETROSPECT AND PROSPECT

During the past forty years, the Taiwan economy has grown at an annual rate of 8.9%, while consumer prices have risen by 3.2% per annum. Rapid economic growth and stable prices characterize the "Taiwan Success Story," a phenomenon that has been widely documented in modern economic literature. Throughout this period, the Bank has played a key role in fostering conditions conducive to stable long-term economic growth.

During the 1960s, Taiwan's economic base was primarily agricultural. The Bank had to rely on interest rate controls and foreign exchange controls to mobilize scarce capital and foreign exchange reserves to fund national economic development.

In order to provide the corporate sector with greater access to short-term capital and to promote the deregulation of interest rate controls, the Bank sponsored the establishment of the money market in 1976. Subsequently, interest rate controls were gradually phased out and market mechanism replaced state intervention in the determination of interest rates. The revised Banking Law completely abolished controls over

interest rates in 1989.

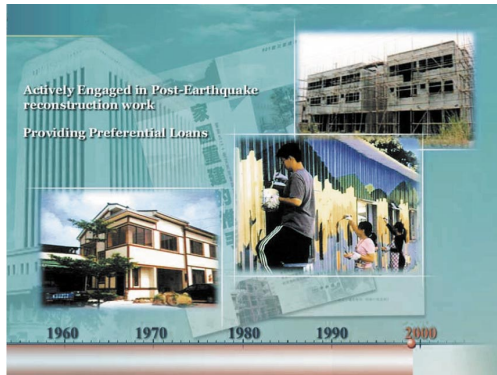
Following the establishment of the foreign exchange market in 1979, the Bank adopted a managed float exchange rate regime. Since the 1980s, the Bank has taken a series of steps to promote financial liberalization and internationalization. All foreign exchange controls on trade-related current account transactions were abolished in 1987. By 1990, all remaining restrictions on exchange rate movements were removed.

The 1997 Asian Financial Crisis represents one of the most serious challenges for the Bank in recent years. Sound economic



fundamentals and appropriate sequencing in financial deregulation and capital account liberalization largely explain why Taiwan was able to escape the Crisis unscathed.

The Bank responded quickly to the earthquake of September 21, 1999 by appropriating NT\$100bn from the postal savings re-deposits to provide subsidized housing loans to earthquake victims. By the end of 2002, close to 30,000 households have benefited from this program.



Since the fourth quarter of 2000, the global economic downturn has created a drag on Taiwan's economic performance and the Bank has taken a variety of measures to shore up the domestic economy. Steps that have been taken include (1) lowering the discount rate fifteen times by 3.375 percentage points, (2) promoting the preferential housing loans program, (3) supporting the preferential loans program for traditional industries, and (4) endorsing the replenishment of the Small and Medium-sized Enterprise Credit Guarantee Fund. The Bank and the Ministry of Finance have also undertaken broad-based financial reforms to tackle the rising non-performing loans problem and to improve the competitiveness of the

domestic financial sector.

Promoting adjustable rate mortgages and flexible prime rates has also been a policy priority for the Bank. In the past, mortgage interest rates tended to exhibit downward rigidity. Moreover, while banks charged large enterprises floating money market rates, retail customers and small and medium-sized enterprises (SME) were charged a premium or discount on prime rates. Prime rates, however, were downwardly rigid. This rigidity worked against the interest of retail customers and SME and obstructed the monetary transmission mechanism. To alleviate these problems, the Bank began to encourage banks to introduce adjustable rate mortgages and flexible prime rates in 2002. These rates are auto-



rates, a mechanism that makes pricing more market sensitive and transparent.

Looking ahead, globalization and techno-

logical progress have opened a new chapter in global finance. Under this exciting yet challenging environment, the Bank must keep pace with the forces that are reshaping the international financial architecture. While the conditions under which we operate might have shifted considerably, our duty remains the same. In the best interests of our nation, the Bank will continue to carry out its mission of maintaining price and financial stability and fostering sustainable and equitable economic growth in Taiwan.

