13. Foreign Exchange Management

Interbank Market Operations

The NT dollar exchange rate exhibited dynamic stability in 2000. Early in the year, due to inflows of foreign capital into the local stock market and the sale of foreign currencies by local exporters, the NT dollar followed an appreciating trend against the US dollar. At the end of March, the NT$/US$ exchange rate was 30.49, showing a 2.79 percent appreciation of the NT dollar from the end of the previous year. Afterwards, the NT dollar depreciated because of rising oil prices, the slowing global economy, the shrinking trade surplus and outflows of foreign capital. The Bank responded with certain appropriate measures, such as monitoring foreign exchange forward transactions and imposing reserve requirements on foreign currency deposits. At the end of the year, the NT$/US$ exchange rate was 31.395. Compared with the end of 1999, the NT dollar depreciated by 4.84 percent against the US dollar. However, the NT dollar was relatively stable, compared with other major currencies, such as the euro, the Japanese yen and the Korean won, which depreciated by 6.34 percent, 10.69 percent and 10.32 percent against the US dollar during the year, respectively.

To further strengthen the development of the foreign exchange market, the Bank continued to adopt the following measures: (1) implementing a real-time reporting system on large transactions to monitor the foreign exchange market; (2) strengthening banking examination by requiring banks to enhance risk management and imposing penalties on banks violating relevant regulations; (3) providing banks with sufficient foreign currency liquidity to meet corporations' demand by means of swaps or call loans; and (4) providing foreign currency funds to banks facing liquidity problems to prevent systematic risk of bank failure. Due to local banks' effective fund allocation, swap transactions in the Taipei Foreign Exchange Market grew by 108.25 percent from the previous year. This significant growth partially substituted foreign currency call-loan transactions, which decreased by 5.58 percent from the level of the previous year.

Utilizing Foreign Exchange Reserves

In addition to maintaining liquidity, security, and profitability, the objectives of the management and utilization of foreign exchange reserves have also been focused in recent years on the objective of promoting economic development and upgrading industries. The bulk of these foreign exchange reserves are deposited in foreign correspondent banks and overseas branches of domestic banks that have excellent ratings. At the end of 2000, total foreign exchange reserves amounted to US$106.7 billion, a US$500 million increase from the end of 1999. The US dollar accounts for the major share of total foreign exchange reserves, followed by the euro and the Japanese yen. This currency composition is similar to those of other major central banks around the world.

The following measures have been adopted in order to utilize foreign exchange reserves more efficiently:

(1) Through the foreign exchange market, the Bank appropriates the funds needed by local enterprises to import major items of machinery and equipment.

(2) The Bank has already appropriated US$10 billion, Euro 1 billion, and ¥15 billion as seed funds for the Taipei Foreign Currency Call-Loan Market. A computerized network system with brokerage firms in major international financial centers has been established to facilitate transactions.

(3) The Bank has deposited a portion of its foreign exchange reserves in the overseas branches of domestic banks to promote international financial activities and to support Taiwanese firms operating overseas.

(4) The Bank has appropriated US$10 billion as refinanced funds for local banks to participate in major investment projects relating to the promotion of domestic industrial upgrading and economic development.

Foreign Exchange Liberalization and Management

With the progress of financial liberalization in recent years, the foreign exchange system has operated in accordance with market mechanisms. Funds not involving NT dollar transactions can flow in and out of Taiwan freely. With regard to inflows and outflows of foreign currencies that involve NT dollar transactions, not only are current-account related transactions completely liberalized, but capital account-related transactions for investment and trade purposes are also completely free with prior authorization by the monetary authorities. Massive capital flows resulting from consolidation and strategic alliances of multi-national enterprises are encourged to be made through cross currency swaps. Only financial account transactions of a short-term nature are mildly restricted. For example, at present, each overseas natural and juridical person may not invest more than US$5 million and US$ 50 million, respectively, in domestic securities; each resident and company may inwardly or outwardly remit up to US$5 million and US$50 million, respectively, in each year.

Major policy measures with regard to improving foreign exchange management and relaxing foreign exchange controls include:

(1) The ceiling on the amount of investment each qualified foreign institutional investor (QFII) is allowed to make in domestic securities was raised from US$1.2 billion to US$1.5 billion on October 20, and further to US$2 billion on November 21. By the end of 2000, 543 investment cases by QFIIs in domestic securities had been approved with a total amount of US$47.2 billion.

(2) By the end of 2000, 47 banks had been approved to manage trust funds earmarked for investment in foreign securities, which had outwardly remitted a sum of US$9 billion. Financial institutions managing trust funds earmarked for investment in foreign securities are prohibited from investing in highly speculative funds or financial derivatives and from acting as domestic agents for selling unapproved overseas funds.

(3) The Bank strictly enforced the application procedure of local corporations investing in mainland China to prevent over-investment, excessive borrowing or illegal appropriation of company assets. In addition, as an accommodating measure of the government's "Three Mini-links" policy referring to direct transportation between the Kimen-Matsu area in the R.O.C. and mainland China, the Bank implemented regulations for remittances and foreign currency transactions by residents of the two sides.

(4) The Bank emphasized that banks issuing letters of credit to guarantee the overseas subsidiaries of domestic corporations borrowing from offshore financial institutions should carefully evaluate the financial conditions and solvency of the guaranteed party. The Bank also requires local banks to report any corporation with accumulated applications above US$5 million.

(5) In line with the trend of internationalization in Taiwan's financial market, some well-known international financial institutions, including the European Bank for Reconstruction and Development (EBRD), the European Investment Bank (EIB), the Inter-American Development Bank (IADB), and the Council of Europe Development Bank (CEB), issued bonds worth a total of NT$22 billion in Taiwan during 2000. To maintain the dynamic stability of the NT dollar exchange rate, these financial institutions were required to use swap derivatives when outwardly remitting the funds.