

Foreword

Bouncing back from a mild contraction the year before, Taiwan's economy began an export-driven recovery in 2002. As the world economy turned the corner, our exports gathered strength, while domestic demand increased slightly. For 2002 as a whole, real GDP expanded 3.54 percent. Meanwhile, the general price level gently drifted downward, with the CPI decreasing 0.2 percent and the core CPI increasing only 0.69 percent.

With inflationary pressure subdued, the Bank continued to keep monetary conditions accommodative throughout 2002 to provide more thrust for the economy. Continuing with the cycle of discount rate cuts that began in December 2000, the Bank lowered the discount rate twice by a total of 50 basis points in 2002. To make the transmission mechanism of rate cuts more effective, the CBC urged banks to initiate adjustable rate mortgages and adopt the new flexible prime rate benchmark scheme. These structural changes aimed to align banks' lending rates more closely with market rates, thereby lowering borrowing costs for the general public.

Primarily reflecting the weak demand for credit and a shift of funds from bank deposits to bond funds, the broad monetary aggregate M2 grew only at an annual rate of 3.55 percent in 2002, remaining within the target zone. With respect to the foreign exchange market, the NT dollar exchange rate fluctuated against the US dollar in the course of 2002, and finished at 34.753 at year-end, depreciating by 0.71 percent from the previous year-end. With foreign exchange reserves rising to US\$161.7 billion as of the end of 2002, our external liquidity remained in good shape.

During 2002, the Bank has also undertaken a number of projects to help facilitate systemic financial stability. In particular, to be in line with

best international practice, the Bank implemented a new real-time gross settlement, or RTGS, system to minimize settlement risk and enhance the efficiency of the payment system. In addition, the issuance of a new series of New Taiwan dollar notes was completed last year. During the changeover period, the Bank actively took measures to prevent counterfeiting with the aim of ensuring financial stability.

Looking ahead, economic recovery in Taiwan should continue into 2003. Nevertheless, growing uncertainties over geopolitical tensions and global economic developments will likely overshadow this outlook.

In 2003, the Bank's monetary policy faces the challenges posed by swiftly changing information technology, increasing global integration and more financial deregulation. The threat of deflation in East Asia and lingering geopolitical risks further complicate the Bank's monetary-policy decisions. Under these conditions, the Bank will continue to pursue policies that will promote price and financial stability as a basis for fostering economic growth. Moreover, we will keep on coordinating with other relevant government agencies in pushing for financial reforms, thereby making our economy more resilient to external shocks.

Last but not least, I would like to thank my colleagues, the most precious asset to the Bank, for their dedication during 2002. Once again, we are working together for the success of another year ahead.



Fai-nan Perng

Governor

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