

12. Monetary Management

Cutting the Discount Rate to Its Historic Low

The SARS epidemic impinged on the domestic economy severely during the second quarter of the year. In order to stimulate consumption and investment, the Bank cut the discount rate and the interest rates on accommodations with collateral by 0.25 of a percentage point on June 27, bringing the total number of rate cuts to 15 since the end of 2000, with a total rate decrease for the period of 337.5 basis points. During the same period, the interest rate on accommodations without collateral was also cut 10 times by 6 percentage points. As a result, the above three rates all stood at their historic lows of 1.375 percent, 1.75 percent, and 3.625 percent, respectively, throughout the rest of the year.

Lowering the Remunerative Rate on Banks' B Reserve Accounts

In order to reasonably reflect market interest rates, the Bank lowered the remunerative rate on banks' B reserve accounts (55 percent of banks' required reserves were deposited in B accounts) by 0.5 of a percentage point on March 21, from 2.25 percent to 1.75 percent.

Conducting Open Market Operations

Open market operations remains the most important policy instrument for regulating banks'

Central Bank Interest Rates

Unit: %

| Effective Date | Discount Rate | Accommodation Rate with Collateral | Accommodation Rate without Collateral |
|----------------|---------------|------------------------------------|---------------------------------------|
| 2000 / Dec. 29 | 4.625 | 5.000 | 9.625 |
| 2001 / Feb. 2 | 4.375 | 4.750 | 9.625 |
| Mar. 3 | 4.250 | 4.625 | 9.625 |
| Mar. 30 | 4.125 | 4.500 | 9.625 |
| Apr. 23 | 4.000 | 4.375 | 9.625 |
| May 18 | 3.750 | 4.125 | 6.000 |
| June 29 | 3.500 | 3.875 | 5.750 |
| Aug. 20 | 3.250 | 3.625 | 5.500 |
| Sep. 19 | 2.750 | 3.125 | 5.000 |
| Oct. 4 | 2.500 | 2.875 | 4.750 |
| Nov. 8 | 2.250 | 2.625 | 4.500 |
| Dec. 28 | 2.125 | 2.500 | 4.375 |
| 2002 / June 28 | 1.875 | 2.250 | 4.125 |
| Nov. 12 | 1.625 | 2.000 | 3.875 |
| 2003 / June 27 | 1.375 | 1.750 | 3.625 |

Source: Financial Statistics Monthly, Taiwan District, Republic of China, Central Bank of China.

reserves. During the year, liquidity in the banking system was apparently loose. The Bank therefore issued certificates of deposit (CDs) to stabilize market interest rates and to maintain the proper growth of the monetary aggregates of M2 and M2 plus bond funds. On occasion, the Bank also conducted Repo transactions on government securities to inject funds into the banking system to meet seasonal demand. For the year 2003, the Bank issued a total of NT \$6,028 billion in CDs, and paid NT\$4,983 billion for matured CDs. By the end of the year, the outstanding amount of CDs issued by the Bank was NT\$2,992 billion. During 2003, the Bank purchased Repo worth NT\$1,371 billion, which were all due by the end of the year.

Receiving Redeposits from Financial Institutions

Receiving redeposits from financial institutions was another instrument of the Bank to influence banks' reserve positions. Due to excess liquidity in the banking system, the Bank allowed financial institutions to increase their redeposits with the Bank during the year of 2003. At the year-end, outstanding postal savings redeposits of Chunghwa Post Co. with the Bank rose to NT\$1,349.1 billion, an increase of NT\$82.5 billion from the year before. The Taiwan Cooperative Bank, the Land Bank of Taiwan and the Farmers Bank of China, Taiwan may receive deposits from community financial institutions and make redeposits with the Bank. The outstanding amount of their redeposits was NT\$144.6 billion at the end of 2003. To absorb excess liquidity, the Bank also took redeposits from banks and the outstanding amount was NT\$562 billion at the end of the year.

The Central Bank's Open Market Operations

Unit: NT\$ Billion

| | Amount Absorbed | | | Amount Offered | | | Weighted Average Rates on CDs Issued (%) | | |
|----------|-----------------|-------------------------------------|---------------|----------------|-----------------------|--------------------|--|-------------|-----------|
| | Total | Maturities of Repurchase Agreements | Issues of CDs | Total | Repurchase Agreements | Redemptions of CDs | 1-30 days | 92-182 days | 1-2 years |
| 2000 | 4,077 | 55 | 4,021 | 4,174 | 93 | 4,081 | 4.64 | 4.91 | 5.34 |
| 2001 | 4,469 | 396 | 4,072 | 4,040 | 359 | 3,681 | 3.24 | 3.81 | 3.72 |
| 2002 | 8,754 | 841 | 7,913 | 7,759 | 841 | 6,918 | 2.11 | 2.12 | 2.26 |
| 2003 | 7,399 | 1,371 | 6,028 | 6,354 | 1,371 | 4,983 | 1.15 | 1.18 | 1.40 |
| 2003 / 1 | 644 | 10 | 634 | 620 | 46 | 620 | 1.45 | 1.47 | 1.64 |
| 2 | 588 | 60 | 528 | 382 | 71 | 382 | 1.21 | 1.23 | 1.46 |
| 3 | 415 | 47 | 368 | 363 | -- | 363 | 1.21 | 1.19 | 1.46 |
| 4 | 412 | -- | 412 | 342 | -- | 342 | 1.23 | 1.19 | 1.46 |
| 5 | 516 | 44 | 472 | 480 | 56 | 424 | 1.23 | 1.19 | 1.46 |
| 6 | 507 | 210 | 296 | 525 | 207 | 318 | 1.18 | 1.19 | -- |
| 7 | 692 | 124 | 567 | 552 | 128 | 424 | 1.09 | 1.07 | 1.28 |
| 8 | 857 | 152 | 705 | 670 | 143 | 527 | 1.08 | 1.08 | 1.30 |
| 9 | 713 | 88 | 625 | 455 | 126 | 329 | 1.07 | 1.08 | 1.30 |
| 10 | 914 | 253 | 662 | 764 | 328 | 436 | 1.07 | 1.08 | 1.30 |
| 11 | 598 | 248 | 351 | 580 | 138 | 441 | 1.09 | 1.08 | -- |
| 12 | 542 | 135 | 407 | 506 | 128 | 378 | 1.04 | 1.08 | -- |

Source: Financial Statistics Monthly, Taiwan District, Republic of China, Central Bank of China.

Promoting Preferential Loans

A preferential mortgage loan program which was jointly initiated by the Bank, the Ministry of Finance and the Ministry of the Interior in August 2000, continued to be promoted, to help boost the real estate market and to relieve the burden of home buyers. This consisted of NT \$120 billion in preferential loans and credit guarantees to the young buying their first homes, and NT\$200 billion in preferential loans to general home buyers. The government subsidized 0.85 of a percentage point of the annual interest rate, contributing to the program's popularity. The program was expanded in August 2001 and April 2002, respectively, with a lower interest subsidy. In January and August 2003, the upper limits on the preferential loan program was raised by NT\$200 and 280 billion, respectively, with 0.25 of a percentage point of interest subsidy. The total amount of the program was thus extended to NT\$1,200 billion. By the end of 2003, a total of 508,034 households had obtained an amount of NT\$1,443 billion under this government-subsidized mortgage loans program, the amount included NT\$460 billion parallel lending by banks applying ordinary interest rates.

The Bank continued to support the Preferential Loans and Credit Guarantees for Traditional Industries program, which was jointly initiated with the Ministry of Finance in October 2000 with an initial upper limit on total loans of NT\$450 billion raised from the local banking system to help traditional industries acquire the funds necessary for business operations. The Bank and the Ministry of Finance raised the upper limit of the total preferential loans in September 2001 and September 2002. The upper limit was further raised by NT\$350 billion in September 2003, bringing the total amount for this program to NT\$1,400 billion. By the year-end, a total of 147,754 cases had received loans amounting to NT\$1,251 billion under this package.

The Bank continued to provide subsidies to victims of the earthquake in 1999 for their interest payments on mortgage loans. This subsidy also applied to banks assuming the mortgage assets of earthquake victims. Starting from March 1, 2003, the fixed interest rate for mortgage loans was lowered from 3 percent to 2 percent; and from November 1, 2003 onward, the fixed interest rate for house-repairing loans was also lowered from 3 percent to 2 percent. By the end of 2003, 31,041 housing units had been approved for a total of NT\$51.5 billion worth of loans under this policy. At the same time, the Bank also appropriated a total of NT\$2.56 billion from postal savings redeposits for banks to make loans for the reconstruction of quake-ravaged schools, medical institutions, shrines and temples, and historical sites.

To continue to help small and medium-sized enterprises to get sufficient funds, the Bank

kept on extending special loans to small and medium-sized enterprises. The program was initiated in November 1998, and the total amount of this program was NT\$27 billion. By the end of 2003, there were a total of 3,114 cases receiving a total amount of NT\$25.7 billion in loans.

Enhancing the SME Credit Guarantee System

To facilitate small and medium-sized enterprise (SME) financing, the credit guarantee system was enhanced. Those SMEs whose loan applications are rejected by banks may look for assistance via a window at the SME One-Stop Solution Center of the Ministry of Economic Affairs, which coordinates relevant agencies to handle such cases. The Bank has seconded staff to the SME One-Stop Solution Center to assist the operations. Starting from June 2003, the Bank monitored each bank's performance on SME financing on a monthly basis.

Promoting Adjustable Rate Mortgages and Flexible Base Rate

In the past, downward rigidity of mortgage interest rates prevailed in Taiwan's banking system. Moreover, although bank lending to large enterprises was mostly based on floating money market rates, that to general consumers and SMEs was based on a mark up to prime rates, which were also downwardly rigid. This rigidity undermined client interests and retarded the effective transmission of monetary policy. To solve these problems, the Bank encouraged banks to commence adjustable rate mortgages and flexible base rates. These rates were automatically adjusted according to benchmark market interest rates, which made pricing more market-sensitive and transparent. By the end of 2003, there were 51 banks adopting flexible base rates.