

## III. Central Bank Operations

### 1. Overview



In accordance with the Central Bank of China Act, the Bank has four operational objectives, namely, to promote financial stability, to guide sound banking operations, to maintain the stability of the internal and external value of the currency and, within the scope of the above-mentioned objectives, to foster economic development.

The Board of Directors, consisting of fifteen members, is the highest decision making body of the Bank. It holds regular meetings four times a year. Starting from the end of the year 2000, the Board decided to adopt an accommodative policy stance to add momentum to the recovery of the domestic economy. To stimulate the economy, the Bank cut the discount rate 15 times between December 2000 and the end of 2003.

At the beginning of 2004, the economic expansion became increasingly well established as external trade and private consumption and investment were on the rise. Although the economic expansion slowed in the second half of the year, for the year 2004 as a whole, real GDP still grew from the previous year's 3.33 percent to 5.71 percent, the highest level since 2001. Inflation in consumer prices also picked up to 1.62 percent in 2004 from its declining trend in the past three years. At the same time, core CPI inflation increased from a negative 0.61 percent growth in 2003 to a positive 0.71 percent. With respect to the labor market, unemployment decreased throughout the year. The average unemployment rate for 2004 was 4.44 percent, declining by 0.55 of a percentage point from 2003.

Against the backdrop of solid economic expansion and rising prices, the Bank gradually steered its monetary policy toward a neutral stance. The discount rates were raised by a total of 37.5 basis points at the Bank's September and December Board meetings to preempt inflation expectations and to prevent the negative real interest rate from going down further, which may distort fund allocation and discourage long-term financial stability. At the end of the year, the discount rate, the interest rate on accommodations with collateral and the interest

rate on accommodations without collateral stood at 1.75 percent, 2.125 percent and 4.0 percent, respectively. In response to the policy actions, money market short-term interest rates also gradually trended up.

As Taiwan is a small and highly open economy, exchange rate movements impose significant influences on external trade and economic growth. With a managed float regime, the NT dollar exchange rate is in principle determined by market forces. However, in cases when seasonal or irregular factors such as a surge in short-term capital movements, result in excessive volatility in the exchange rate, the Bank will step in, as deemed appropriate, to maintain the dynamic stability of the NT dollar. In the year 2004, under the influences of both internal and external factors, the NT dollar appreciated against the US dollar by 6.46 percent. Its volatility, however, remained relatively low as compared with major currencies and other Asian currencies.

Institutional reforms were continuously implemented throughout 2004. To make loan pricing more market-sensitive and transparent, credit cooperatives all adopted adjustable rate mortgages and the market rate-linked base lending rate regime in the year to increase their competitiveness. The Bills Depository and Clearing System also started its operations with assistance from the Bank in April 2004. Moreover, the Bank continued its efforts in financial liberalization and globalization. It introduced new financial products, streamlined application procedures for foreign portfolio investment, as well as promoted direct cross-strait financial businesses. The Financial Supervisory Commission (FSC) was established on July 1, 2004 to consolidate the supervision and examination of the banking, securities and insurance industries under one roof. Since its inception, the Bank has no longer undertaken financial examination responsibilities. However, it still retains its authority to carry out target examinations related to the Bank's monetary, credit and foreign exchange policies. A milestone in Taiwan's financial supervisory history was reached after years of effort.