2. Monetary Management

Raising the Discount Rate

Economic recovery accelerated from the beginning of 2004, while inflation remained low and no significant improvement was seen in the labor market. The Bank thus maintained its discount rate unchanged in the first half of the year to ensure sustained economic growth. Inflation started to surge in the third quarter as domestic food and energy prices both soared. In light of the solid economic expansion and rising prices, the Bank switched its low interest rate policy adopted since the end of 2000 into a neutral monetary policy stance at its September meeting. The discount rate, the interest rate on accommodations with collateral and the interest rate on accommodations without collateral were adjusted upwards by 25 basis points, respectively. This action was aimed 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. The aforementioned three rates were each raised again by 12.5 basis points on December 31. At the end of the year, the three policy rates stood at 1.75 percent, 2.125 percent and 4.0 percent, respectively.

Lowering the Remunerative Rate on Banks' B Reserve Accounts

Since the remunerative rate on banks' B reserve accounts (55 percent of banks' required reserves were deposited in B accounts with the Bank) was adjusted down to 1.75 percent on March 21, 2003, market interest rate on deposits and loans both trended downward. In order to narrow the interest rate spread and reasonably reflect market interest rates, the Bank lowered the remunerative rate by a further 0.25 of a percentage point on March 29, 2004 to 1.50 percent.

Central Bank Interest Rates

Unit: %

Effective Date	Discount Rate	Accommodation Rate with Collateral	Accommodation Rate without Collateral
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
2004 / Oct. 1	1.625	2.000	3.875
Dec. 31	1.750	2.125	4.000

Source: Financial Statistics Monthly, Taiwan District, the Republic of China, Department of Economic Research, Central Bank of China.

Conducting Open Market Operations

The Bank's certificates of deposit (CDs) remain the primary instrument for the Bank to manage banks' day-to-day reserves. Its interest rates also played an important role to guide market rates when they were issued on a fixed-rate basis. For the year as a whole, Taiwan experienced a net capital inflow creating ample liquidity in the banking system. The Bank therefore issued CDs mostly with a fixed-rate to drain excess liquidity and to stabilize market interest rates. At the end of the year, the outstanding amount of CDs issued by the Bank was NT$3,563 billion, an increase of NT$570 billion from a year earlier. In addition, foreign exchange swaps with banks were used extensively to absorb excess liquidity. To meet seasonal demand, the Bank occasionally arranged Repos on the Bank's CDs to inject funds into the banking system. During this year, the Bank purchased Repos worth NT$618 billion, which were all due by the end of the year.

Decreasing Redeposits from Financial Institutions

Receiving redeposits from Chunghwa Post Co. and commercial banks is another instrument of the Bank to influence banks' reserve positions, although they are not used as frequently as open market operations. During the year 2004, Chunghwa Post Co. and commercial banks both shifted some of their redeposits to the Bank's CDs. At the end of the year, the outstanding postal savings redeposits and banks' redeposits declined to NT$1,351 billion and NT$383 billion, a decrease of NT$18 billion and NT$159 billion, respectively, from a year before. In addition,

The Bank's Open Market Operations

Unit: NT$ Billion

	Amount Absorbed			Amount Offered			Weighted Average Rates on CDs Issued (%)		
	Total	Maturity of Repurchase Agreements	Issues of CDs	Total	Repurchase Agreement	Redemptions of CDs	1-30 days	92-182 days	1-2 years
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
2004	12,741	618	12,123	12,171	618	11,553	1.08	1.09	1.30
2004 / 1	888	25	863	733	28	705	1.03	1.08	1.30
2	867	97	770	400	109	291	1.04	1.08	1.30
3	809	184	625	800	177	623	1.03	1.08	--
4	1,011	158	853	784	152	632	1.02	1.08	--
5	839	29	810	922	25	897	1.00	1.08	--
6	543	74	469	679	74	605	1.03	1.08	--
7	755	3	752	931	4	927	1.03	1.08	--
8	1,100	5	1,095	1,205	5	1,200	1.04	1.08	--
9	1,528	43	1,485	1,678	44	1,634	1.06	1.08	--
10	1,330	--	1,330	1,222	--	1,222	1.15	1.20	--
11	1,235	--	1,235	1,120	--	1,120	1.15	1.20	--
12	1,836	--	1,836	1,697	--	1,697	1.15	1.21	--

Source: Financial Statistics Monthly, Taiwan District, the Republic of China, Department of Economic Research, Central Bank of China.

the three major domestic farmers' banks, namely the Taiwan Cooperative Bank, the Land Bank of Taiwan and the Farmers Bank of Taiwan, may receive deposits from community financial institutions and make redeposits with the Bank. At the end of the year, their outstanding redeposits remained at NT$144.6 billion, the same level as in 2003.

Continuing to Promote Preferential Loans

To help boost the real estate market and relieve the mortgage burden of home buyers, the Bank, the Ministry of Finance and the Ministry of the Interior jointly initiated a preferential mortgage loan program in August 2000. This program 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 popularity of the program. The program was expanded several times since the launch of the program, but with a lower interest subsidy. In May 2004, the upper limit of the program was further raised by NT$300 billion, with only 0.125 of a percentage point interest subsidy. The total amount of the program was thus increased to NT$1,500 billion. By the end of 2004, a total of 686,943 households had obtained an amount of NT$2,045 billion under this program. The amount included NT$724 billion in parallel lending by banks applying ordinary interest rates.

The Preferential Loans and Credit Guarantees for Traditional Industries was another preferential loan program initiated by the Bank and the Ministry of Finance in October 2000. The program with an initial upper limit of NT$450 billion raised from the local banking system was provided to help traditional industries acquire the funds necessary for business operations. The total amount of the preferential loans has been expanded continuously. In November 2004, its upper limit was lifted again by NT$450 billion, bringing the total amount of this program to NT$1,850 billion. By the yearend, a total of NT$1,610 billion in loans were extended by banks to support 198,801 cases under this package.

During the year, 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. By the end of 2004, a total of NT$55.8 billion worth of loans had been approved for 32,206 housing units under this program. At the same time, the Bank also appropriated a total of NT$2.66 billion from postal savings redeposits for banks to make loans for the reconstruction of quake-ravaged schools, medical institutions, shrines and temples, as well as historical sites.

Enhancing the SME Credit Guarantee System

To facilitate small and medium-sized enterprise (SME) financing, the credit guarantee system has been enhanced continuously by the Bank. 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. Since December 2002, the Bank has seconded staff to the Center to assist the operations. The work continued until March 2004. In June 2003, the Bank also started to monitor banks' performance on SME financing on a monthly basis. At the end of 2004, the guarantee balances and loans extended to SMEs by domestic banks were NT$332.6 billion and NT$2,983.6 billion, showing an increase of NT$141 billion and NT$ 341billion, respectively, as compared with the end of May 2003.

Promoting Adjustable Rate Mortgages and Flexible Base Rates

Since 2002, the Bank has actively promoted adjustable rate mortgages and flexible base rates pricing system to make banks' loan pricing more market-sensitive and transparent, thereby increasing the effectiveness of monetary policy transmission. The new pricing system was introduced to substitute downwardly rigid prime rates. At the same time, banks were urged to apply the new pricing system to their old loans. By the yearend, loans extended by domestic banks still using the old prime rates accounted for merely 5.8 percent of total loans. In view of the success of this pricing system, from April 2004, the Bank urged all community financial institutions to adopt the same pricing system to increase their competitiveness and to fairly protect the interests of both lenders and borrowers. At the end of the year, all credit cooperatives had adopted this new pricing system.