

Foreword

Taiwan's economy slowed down in the first half of 2005 and regained momentum in the second half of the year. Growth was mainly attributed to a pickup in exports driven by global economic expansion and IT industry recovery. GDP grew by 4.09 percent for the year as a whole. Consumer prices rose by 2.30 percent as international oil prices surged and harsh weather pushed up fruit and vegetable prices.

In response to solid economic growth and rising inflationary pressure, the Bank aimed to maintain price stability and divert from ultra-low interest rates that could hamper long-term financial stability. From October 2004 to the end of 2005, the Bank raised the discount rate six times, gradually guiding market rates upwards. In addition, the Bank urged banks to reform their pricing systems to enhance the transparency of rate adjustment. As a result, all domestic banks and community financial institutions have adopted the base rate pricing system and launched adjustable rate mortgages.

Under the precondition of price and financial stability, the Bank set out to foster sustainable economic growth. It continued promoting policy lending, including preferential housing loans and project finance for traditional industries, and also encouraged banks to increase credit to small and medium-sized enterprises. Monetary aggregates expanded moderately throughout 2005. M2 grew by 6.22 percent on average, staying within the Bank's 3.5 to 7.5 percent target zone.

The NT dollar exchange rate remained largely stable during 2005. After peaking at 30.79 against the US dollar early in the year, the NT dollar closed the year at 32.85, showing a depreciation of 2.84 percent over a year earlier. However, on a daily average basis, the NT dollar appreciated against the US dollar, the Japanese yen and the euro by 3.90 percent, 5.75 percent and 3.66 percent, respectively, over the 2004 levels. Foreign exchange reserves continued to build up to US\$253.3 billion at the end of 2005, representing an increase of US\$11.6 billion from the previous yearend.

On a separate front, the Bank continued its efforts in financial liberalization and internationalization. It simplified the approval process of new foreign exchange products, streamlined foreign investment application procedures, and promoted financial interaction across the Taiwan Strait. Renminbi exchange business commenced in Kinmen and Matsu. The book-entry government bond market developed further with the introduction of bond trust and stripped government bonds. New versions of NT\$500 and NT\$1,000 notes were issued with advanced anti-counterfeit features.

Many challenges still lie ahead as globalization and financial innovation complicate the task of monetary policy. The Bank's monetary policy will continue to focus on maintaining price and financial stability, and sustainable development of the economy.

Finally, my sincere appreciation goes to my colleagues for their continued dedication during 2005. Together, we will work hard to meet the challenges in the year ahead.



Fai-nan Perng
Governor
April 4, 2006