

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.

In 2005, the domestic economy slowed in the first half of the year and regained momentum in the second half. The labor market improved for the third year in a row, capacity utilization rates remained high and inflationary pressures heightened. Nevertheless, both short-term and long-term interest rates continued to remain at low levels. To keep inflation expectations contained and to prevent the real interest rate from dropping, the Bank raised the discount rate by 12.5 basis points at each of its board meetings. At the end of the year, the Bank's three policy rates, namely the discount rate, the interest rate on accommodations with collateral and the interest rate on accommodations without collateral, stood at 2.25 percent, 2.625 percent and 4.5 percent, respectively, 50 basis points higher than the previous year-end.

With respect to foreign exchange policy, 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 lead to excessive volatility in the exchange rate, the Bank will step in, as deemed appropriate, to maintain the dynamic stability of the NT dollar. At the end of 2005, the NT dollar stood at 32.85 against the US dollar, showing a depreciation of 2.84 percent compared to the previous year-end. On a daily average basis, the NT dollar, however, appreciated by 3.90 percent against the US dollar.

Institutional reforms of pricing bank lending rates were implemented in 2005. Since 2002, the Bank has encouraged the adoption of 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. By June 2005, all domestic banks and community financial institutions had adopted this pricing system. From the beginning of 2006, the old prime rate pricing system will no longer be applied to banks' loans.

In addition, the Bank continued its efforts in financial liberalization in 2005. It introduced new financial products, streamlined application procedures for foreign portfolio investment, as well as promoted direct cross-strait financial transactions, which, in turn, encouraged overseas Taiwanese enterprises to use OBUs (offshore banking units) as their funding management centers. Due to the strong demand for renminbi exchange services, from Oct. 2005, those via the "mini three links" route have been allowed to convert NT dollars into renminbi and vice versa at the banks on the outlying islands of Kinmen and Matsu.

To ensure the soundness and stability of the financial system, the Bank developed a framework for financial stability and reorganized the Department of Financial Inspection during the year. It also launched the trust system for book-entry government bonds and introduced the STRIPS (Separate Trading of Registered Interest and Principal of Securities) system, which provided more diversified products in the bond market and helped establish a benchmark yield curve. As for the issuance of banknotes, new versions of NT\$500 and NT\$1000 notes were issued by the Bank in July 2005 with enhanced design in security features.