

## Foreword



After the Cold War, many countries embarked upon political and economic liberalization. This development, followed by the hi-tech revolution, promoted the trend toward globalization. As the 21st century unfolds, globalization has proceeded unabated. Flows of information, goods, services and financial assets, and personal interactions have all continued speeding up across borders.

Although globalization brings some wonderful changes to the world, it also exacerbates certain conditions via short-

term capital flows. Short-term capital movements are often volatile. They could disseminate the adverse impact of a panic from one market to neighboring countries or even the whole world in a very short period of time.

The Asian financial crisis broke out in Thailand in 1997. During the crisis period, large capital outflows from Asia exerted a downward pressure on the New Taiwan dollar (the NT dollar), tightened Taiwan's financial conditions, and threatened the stability of the economy. The Central Bank of China (CBC) reacted to these conditions by removing distortions from the foreign exchange market and adopting an accommodative monetary policy. As a result, Taiwan was largely unscathed by the crisis.

The Asian financial crisis also highlighted the importance of financial soundness. In the era of globalization, financial soundness is essential in protecting an economy from the contagion of crises in other countries. The financial system performs important functions in the economy. It settles payments and channels saving into investment. Confronting globalization and financial innovation, financial institutions need to handle increasingly complicated risk management problems.

In sum, volatile international capital flows and interwoven financial risks could pose serious threats to economic and financial stability. Based on this line of reasoning, the CBC seeks to improve policy formulation and implementation, and institutional arrangements to achieve the goals set out in the *Central Bank of China Act*.

Regarding monetary policy operations, the CBC reformed the reserve requirement system and open market operations in the past decade. Following the bursting of the IT bubble, it cut the interest rates 15 times from December 2000 to June 2003 and launched a preferential housing loan program in August 2000 to stimulate the economy. From June 2001 onwards, the CBC encouraged banks to introduce adjustable rate mortgages and adopt the new base rate lending system to increase the transparency and flexibility of interest rate adjustments.

Regarding the foreign exchange market, the CBC put equal emphases on management and development. On the one hand, to ensure orderly conditions in the market, the CBC established a real-time reporting system for large-value transactions. On the other, the CBC expanded the market by deregulating cross-border capital movements. Furthermore, the CBC helped introduce new financial products, expand the Taipei Foreign Currency Call-loan Market, and promote offshore banking units as funding centers for overseas Taiwanese businesses.

Regarding currency issuance, the CBC introduced a brand new series of NT dollar notes sequentially from July 2000 to July 2002 in denominations of 1000, 500, 100, 200 and 2000 dollars. Major changes included the denomination, tint, size, illustration, and anti-counterfeit features.

The CBC also modernized the payment system. It established the CBC Interbank Funds-Transfer System (CIFS) in 1995 and required all payments in the system to be settled on a real-time gross settlement basis in 2002 to minimize settlement risk. The CBC also promoted the use of electronic checks and strengthened the supervision of the payment systems.

In terms of its function as an agent of the treasury, the CBC reformed the Fiscal Agency System to reduce of agent banks' workload of handling the receipt and disbursement of funds. Moreover, the CBC established the book-entry government bond system based on both the experience of advanced countries and the characteristics of domestic bond markets. It also established the electronic bidding system to increase the efficiency of government securities trading.

In the area of financial examination, the CBC adopted risk-oriented procedures to accommodate financial innovation and improve risk management. The incorporation of advanced information technology has greatly increased the efficiency of financial examination.

To promote public awareness of the CBC's operations, the CBC published the first edition of *The Central Bank of China: Purposes and Functions (1961-1991)* in 1996. Many changes have taken place since then. To keep the public abreast of those developments, an updated edition was published in 2004. It covers such topics as institutional arrangements, monetary policy, foreign exchange management, currency issuance, the payment system, treasury management and financial examination in nine chapters. It also includes charts and illustrations, making it more accessible to general readers. We hope that through this book the public will gain a better understanding of the CBC's operations and the efforts it has made to promote financial stability and economic development. We apologize in advance for any possible errors or omissions and welcome any comments and suggestions.

More than 1,300 years ago, the Tang dynasty poet Wang Po wrote, "True friendship shortens the physical distance between people." In the era of globalization, we can now easily interact with people around the world. Looking into the future, international economic and financial systems will continue to integrate and become increasingly interdependent. In this new and challenging environment, the CBC will continue, as ever before, devoting itself to achieving its goal to maintain financial and price stability in Taiwan.

A handwritten signature in black ink, appearing to read 'Fai-nan Perng', written in a cursive style.

Fai-nan Perng  
Governor

