

Taiwan's Securities Markets in the Shadow of Foreign Exchange Policies

Lessons from the Bubble in 1990s

Wang Wen-Yeu,
Professor and Director, Center for Corporate and Financial Law
College of Law, National Taiwan University

AGENDA

- Prologue
- The Central Bank's Financial Policies
- Review of Central Bank's Policies
- Impact on the Securities Market
- Lesson Learned



Prologue



- ◆ Main Features of Taiwan's Economy
 - ◆ International Isolation (e.g. Not a member of the IMF)
 - ◆ Export-Oriented Economy (e.g., U.S. Market)
- ◆ Central Bank and Capital Flow Management
 - ◆ Maintain Financial Stability
 - ◆ Need to Hold Sufficient Foreign Exchange Reserve
 - ◆ Fixed or Managed Exchanged Rates

Prologue



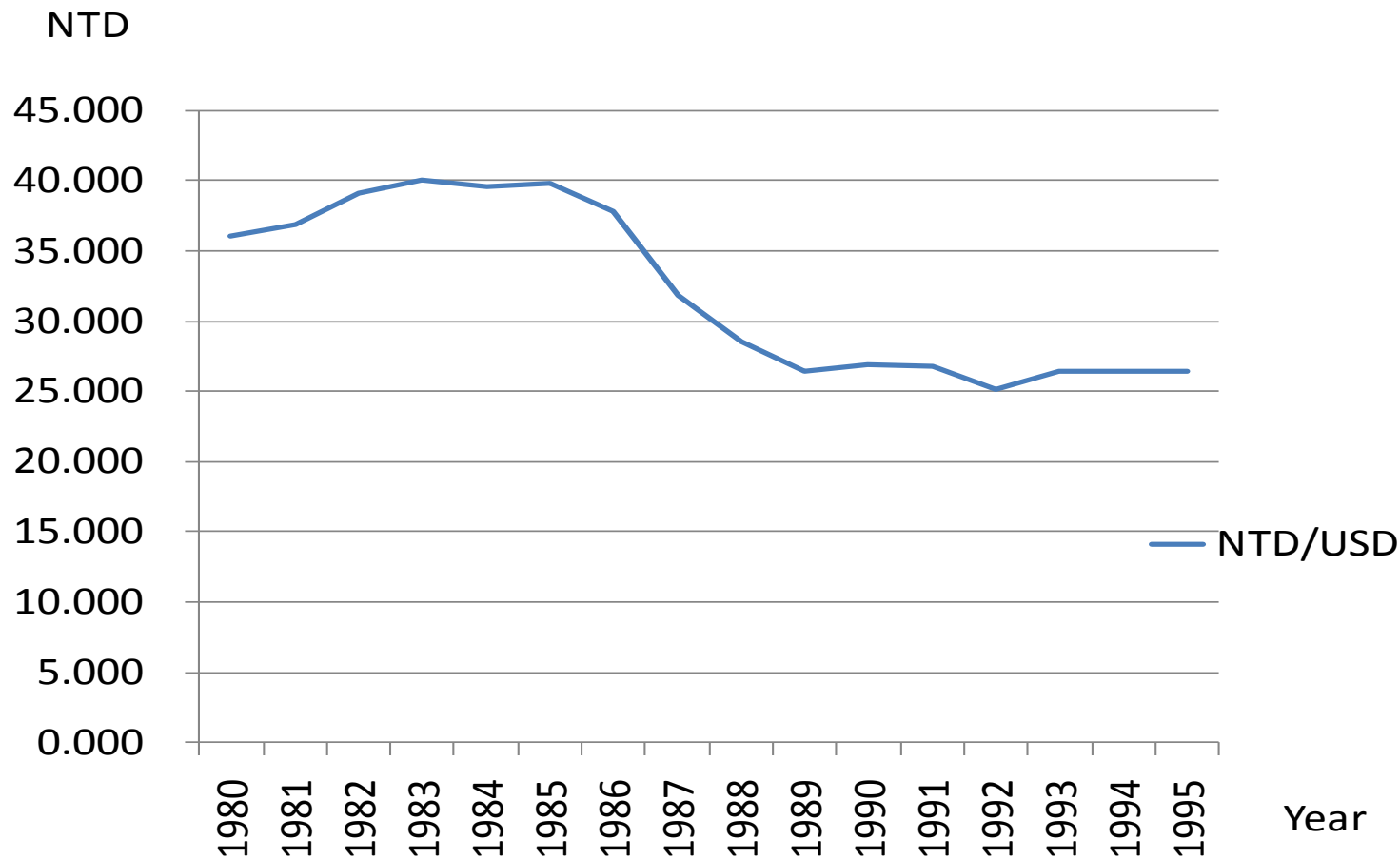
- ◆ Consequences of Surging Capital Flows
 - ◆ Overheated Economy
 - ◆ Speed up Growth of Bank Credit and Money Supply
 - ◆ Create Speculative Bubbles in Stock Markets and the Real Estate Sector
- ◆ How to Prevent or Respond to Hot Money?
- ◆ Lessons from the Bubble in the 1980s

Background of The Bubble



- ◆ Huge Trade Surplus and Trade Imbalance: In 1986, Foreign Trade Surplus Constituted 20% of Gross National Product “GNP”
- ◆ Huge Trade Deficit Caused the U.S. to Pressure Taiwan to Appreciate New Taiwan Dollars (NTD)
- ◆ Hot Monies Flowed into Taiwan
- ◆ To Prevent Drastic Appreciation, the Central Bank Continued to Purchase U.S. Dollars in Foreign Exchange Market
- ◆ The Strategy of “Orderly Appreciation”

New Taiwan Dollar Exchange Rates (NTD/USD)



資料來源：中央銀行全球資訊網 > 統計資料 > 我國與主要貿易對手通貨對美元之匯率

<http://www.cbc.gov.tw/content.asp?mp=1&Cultem=36599>

圖表由作者自行整理繪製

Foreign Exchange Rate Fluctuations

- **Drastic Exchange Rate Fluctuations**
 - NTU/USD in January 1986 was 37/1,
 - NTU/USD in July 1988 was 27/1

The Central Bank's Policies

Central Bank continuously purchased foreign currency to control the appreciation

Significant over-supply of the currency

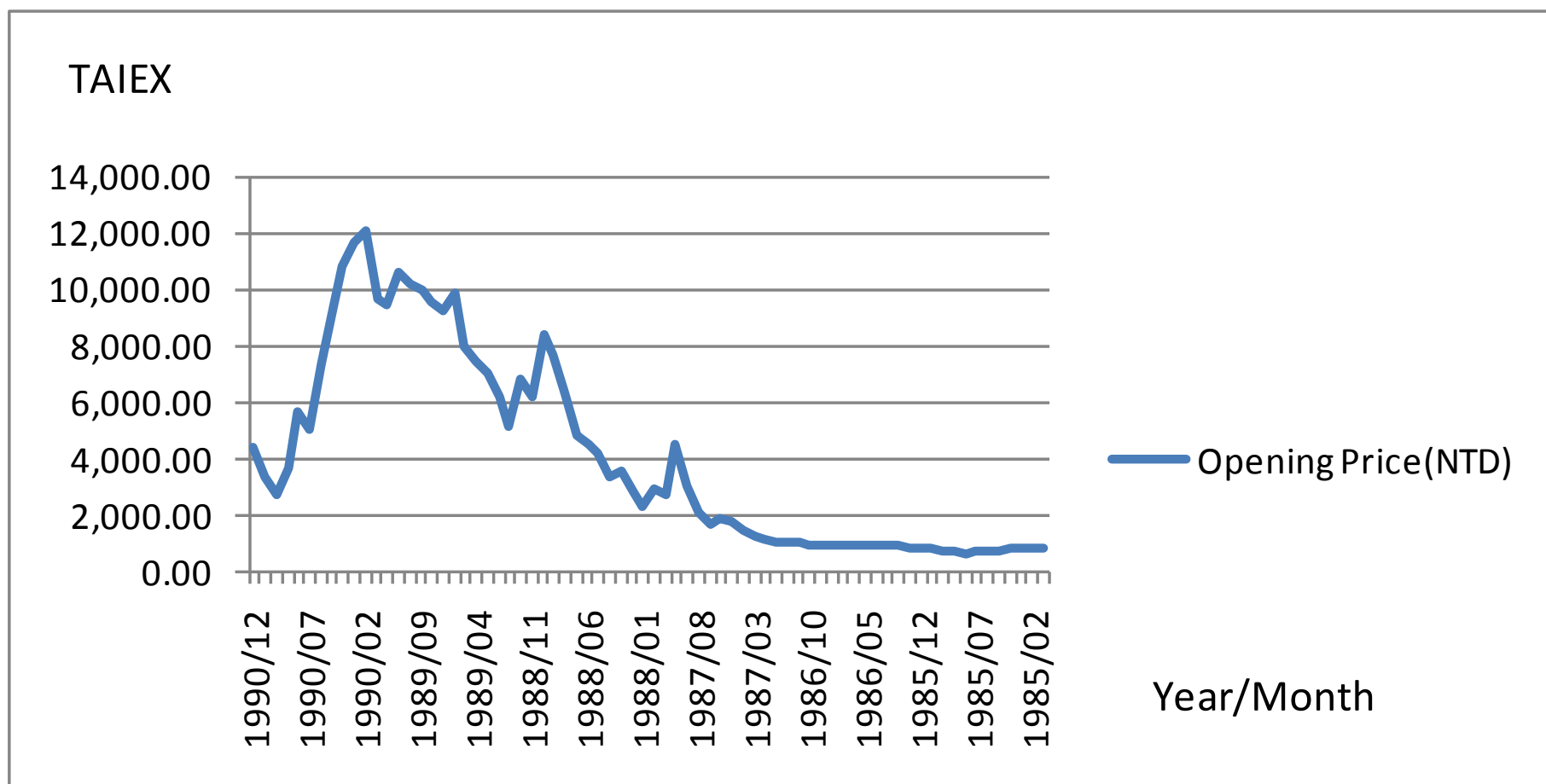
Overbearing inflationary pressures

Failure to adequately manage currency

Impact on the Securities Market

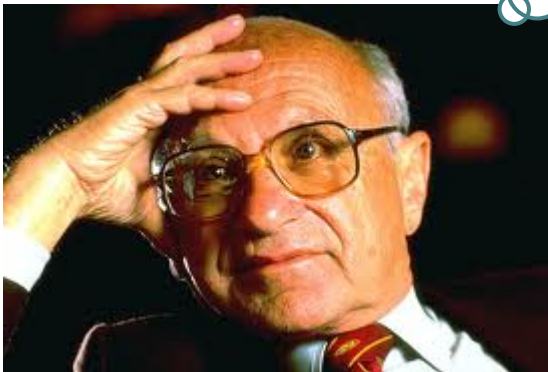
- **From May 1987 to October 1988, the Taiwan Stock Exchange Index Increased from 2000 Points to 8000 Points.**

Taiwan Stock Exchange Capitalization Weighted Stock Index of 1980-1990



The Central Bank's Financial Policies

**Too late and too much has been
the general practice**



Milton Friedman

The Central Bank's Financial Policies

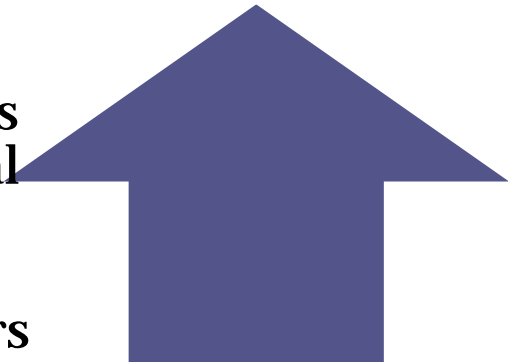


the U.S warned the Taiwan Central Bank against interventions of the hindering of the NT Dollar's appreciation

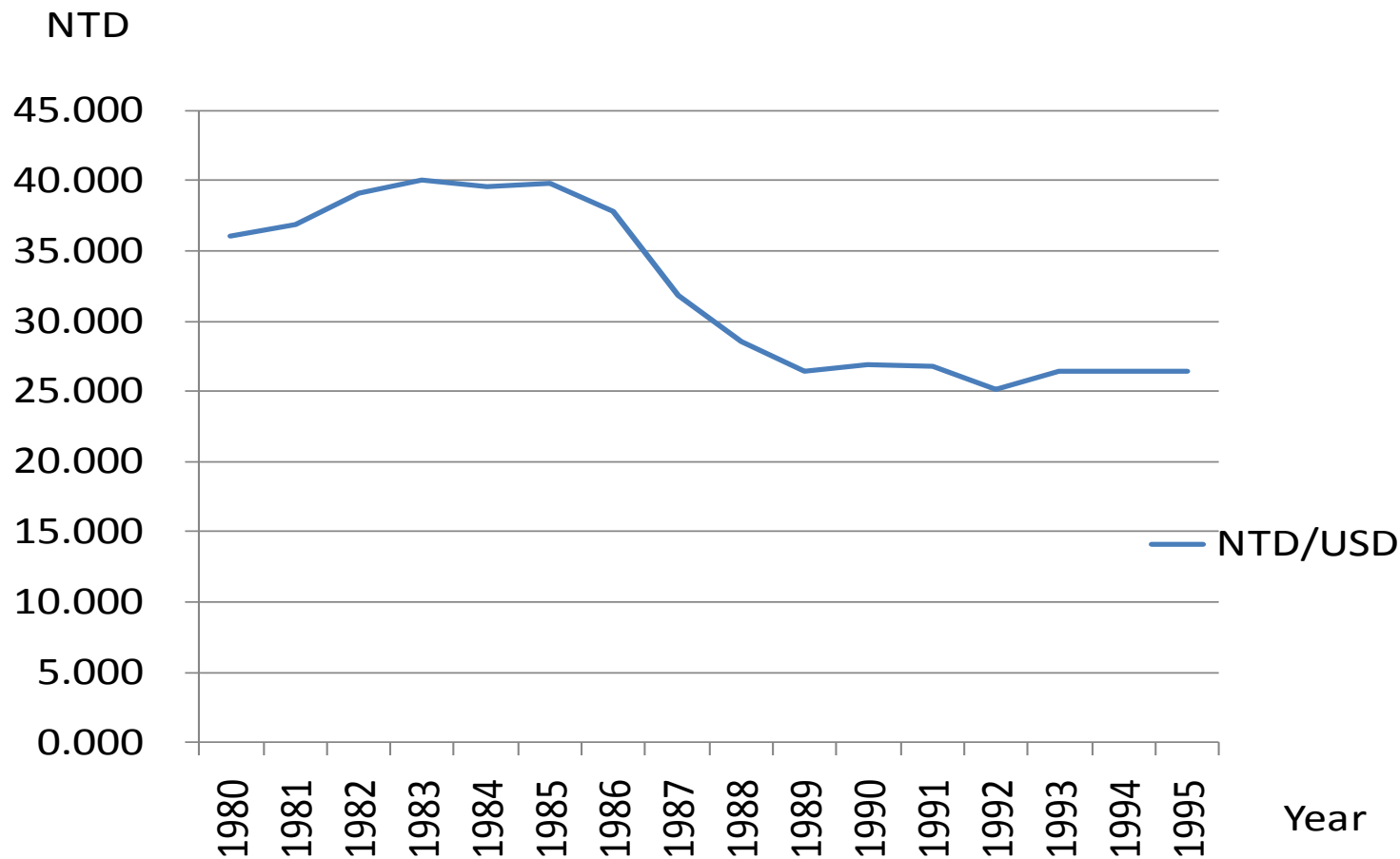


The pressure of general public: Drastic over-supply of currency, triggering a spiraling of domestic housing and share prices

Domestic exporters criticize the Central Bank for its total disregard for the damage to exporters



New Taiwan Dollar Exchange Rates (NTD/USD)



資料來源：中央銀行全球資訊網 > 統計資料 > 我國與主要貿易對手通貨對美元之匯率

<http://www.cbc.gov.tw/content.asp?mp=1&Cultem=36599>

圖表由作者自行整理繪製

The Central Bank's Financial Policies

- **The Causes of the triple escalation in the supply of NT Dollar :**
 1. **Sharp increase in the current account surplus.**
 2. **Inappropriate interventions into foreign exchange brought about expectations and huge inflow of hot money.**
 3. **Failure of the Central Bank to promptly implement a strict tightening policy in relation to the currency.**

Lesson Learned

- **The Central Bank Should Adopt An independent monetary policy.**
- **Interventions in the foreign exchange May not Have Lasting Effects to the economy.**
- **Avoid “Too Late and Too Much”**



Thank You for Your Attention