Effects of monetary policy on market volatility in Taiwan

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Abstract

The Taiwan Central Bank sequentially reduced the rediscount rate six times from June 1 to December 31, 2008. This study focuses on examining the mitigating influence of monetary relaxation on the Taiwan stock market. Referring to Tsay (2005), this investigation uses the GARCH (1, 1) model to determine policy effectiveness in terms of reducing share volatility. Empirical findings indicate that monetary easing has mitigated, though insignificantly, returns volatility for the Taiwan weighted share index, electronics share index and financial share index.

Keywords and phrases: Monetary loosening policy, stock volatility.

1. Introduction

The global financial crisis caused by excessive issuance of low quality secondary mortgages in the United States has indirectly reduced most economic indicators in Taiwan, contributing to the economic decline of Taiwan during the latter half of 2008. To slow the continuing economic downturn and restore investor confidence, the Taiwan Central Bank reduced the rediscount rate six times from June 1 to December 31, 2008, on June 27, September 26, October 9, October 30, November 10, and December 12. Since monetary policy decisions of Taiwan always follow those of the United States, the use of numerous successive actions to reduce the rediscount rate is rare in Taiwan, and the interest rate is currently at a historic relative low. The anticipated performance of the discount rate reduction policy remains unknown, and this phenomenon...