Oil Price Shocks and Monetary Policy Responses in Taiwan: Review and Counterfactual Simulation with a Financial CGE Model

Jin-Xu Lin, Jingyu Liu, Jun-Chiang Feng, and Shih-Mo Lin

Price inflation following an oil price shock has been a common phenomenon globally since the mid-70s. It is even more commonly observed in economies which rely heavily on imported oil, such as Taiwan. This oil price shock-triggered inflation may sometimes be exacerbated by an expansionary fiscal policy that intended to stimulate the economy. In response to this potential cost-push and demand-pull inflationary pressure, the Central Bank usually undertakes a series of monetary actions, which have, in some cases, resulted in fluctuated real output. The purposes of this paper are two-folds. First, we review and examine the monetary and fiscal policy actions that have been undertaken by the Taiwanese authorities over the past two decades in responding to oil price shocks to gain some knowledge about the possible reactions of the Taiwanese economy when facing oil price shocks. Second, we perform several policy and counterfactual simulations using a financial computable general equilibrium (CGE) model for Taiwan benchmarked at two points in time to explore whether alternative policy actions have had resulted in smoother output effects during the past.

Keywords: Financial computable general equilibrium model, monetary policy, oil price shock.