

2. Monetary Management

Holding Policy Rates Steady to Maintain Price and Financial Stability

For the year 2019, the global economy witnessed moderate growth yet remained shrouded in many uncertainties. Meanwhile, the domestic economy posted a mild expansion, a slightly negative output gap continued, and the inflation outlook stayed stable. Furthermore, domestic real interest rates registered around the middle range among a host of economies. Based on the above assessment, the Bank held policy rates unchanged in the course of the year in order to maintain price and financial stability and achieve sustained economic growth.

At the end of 2019, the discount rate, the rate on accommodations with collateral, and the rate on accommodations without collateral were kept unchanged at their current levels of 1.375%, 1.75%, and 3.625%, respectively.

Conducting Open Market Operations to Ensure the Smooth Functioning of Financial Markets

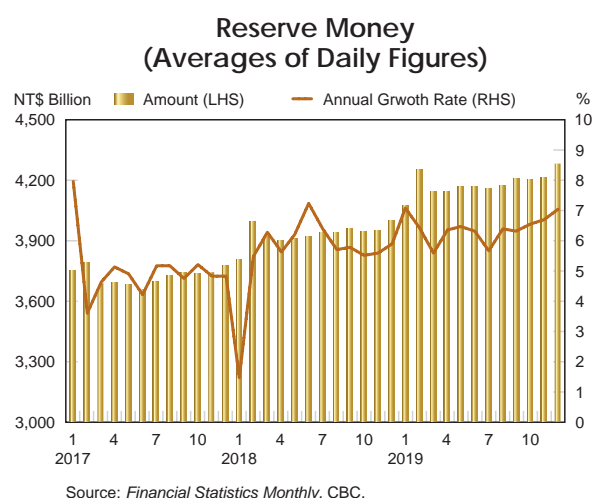
In 2019, the Bank managed market liquidity through open market operations by issuing certificates of deposit (CDs) in response to domestic economic and financial conditions, which helped maintain reserve money, monetary aggregates, and the overnight call loan rate at appropriate levels.

(1) Managing Market Liquidity

The Bank continued to conduct open market operations by issuing CDs. At the end of the year, the total outstanding amount of CDs issued by the Bank was NT\$7,858 billion.

(2) Higher Growth in Reserve Money

Reserve money grew at a faster pace of 6.42% for the year 2019, 0.81 percentage points higher than the previous year's figure. In terms of the monthly movements of reserve money, owing to stronger demand for funds prior to the Lunar New Year holidays, the annual growth rate of reserve money reached a yearly high of 7.11% in January. Afterwards, the annual growth rate hit a yearly low of 5.59% in March, mainly because of a reverse flow of currency back to the banking system after the Lunar New



Year holidays. In subsequent months, growth rates remained relatively stable.

On the demand side, reserve money, measured on a daily average basis, increased by NT\$253 billion over the previous year. Of the components, net currency increased by NT\$167 billion and the annual growth rate rose to 8.77% from 7.60% the previous year; reserves held by financial institutions expanded by NT\$86 billion, with the annual growth rate trending up to 4.22% from 3.80% the previous year. Currency held by the non-bank public grew moderately because the low interest rates paid on bank deposits enhanced the willingness to hold currency in hand. Meanwhile, the overall growth rate of banks' reserves increased compared to the previous year as higher growth in transaction deposits raised banks' demand for reserves.

From the supply side perspective, reserve money increased by NT\$244 billion at the end of the year. According to the balance sheet of the Bank, which revealed the sources of changes in reserve money, the increase was mostly attributable to the growth in foreign assets held by the Bank and the decrease in time redeposits placed by banks.

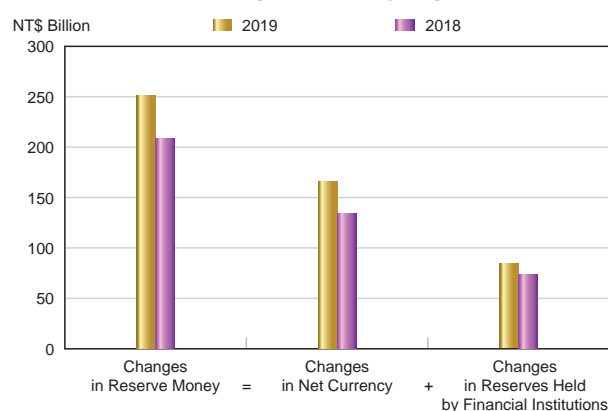
(3) Overnight Call Loan Rate Broadly Stable

In 2019, the Bank continued to conduct open market operations to maintain excess reserves and the overnight call loan rate at appropriate levels. The annual average excess reserves of financial institutions reached NT\$45 billion, slightly lower than the NT\$48 billion of the previous year. The annual average overnight call loan rate remained broadly stable at around 0.180% during the year except for June, in which the overnight call loan rate moved up to 0.202%.

(4) M2 Growth Stable and Within Target Range

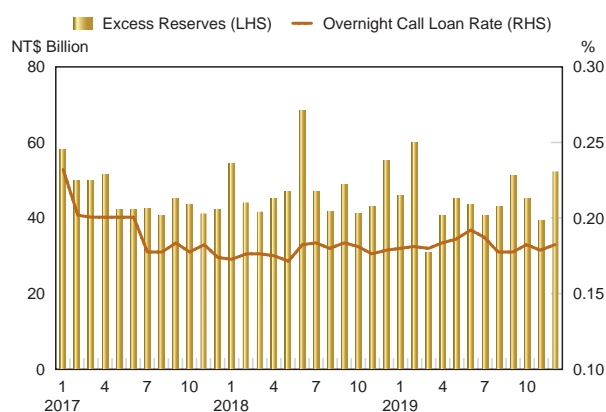
The M2 growth target range for 2019 was set at 2.5% to 6.5%, the same as the previous year. For the year as a whole, M2 registered an annual growth rate of 3.46%, down by 0.06 percentage

**Changes in Reserve Money
(Averages of Daily Figures)**



Source: *Financial Statistics Monthly*, CBC.

**Excess Reserves and
Overnight Call Loan Rate**



Source: *Financial Statistics Monthly*, CBC.

points from the previous year. The annual growth rates of M2 in every month of the year remained within the Bank's target range.

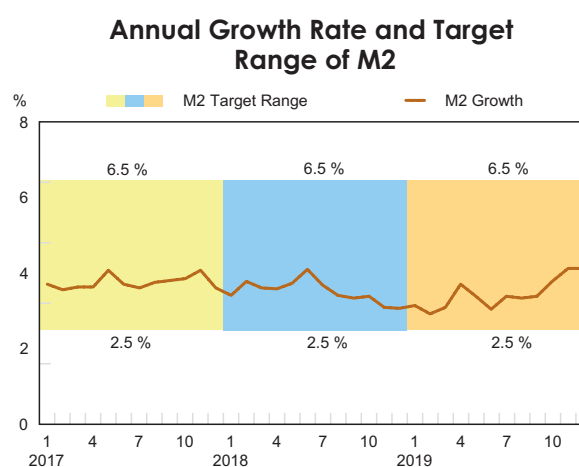
With regard to the monthly movements in 2019, an increase in bank loans and investments as well as net foreign capital inflows brought the M2 growth rate up to 3.14% in January. Later, it reached a yearly low of 2.92% in February, reflecting slower growth in bank loans and investments. In the following two months, the M2 growth rate trended upward on account of capital inflows and reached 3.71% in April. Then, the M2 growth rate moved down to 3.05% in June because of net foreign capital outflows and weaker growth in bank loans and investments.

From July onwards, the M2 growth rate returned to an uptrend and hit a yearly high of 4.14% in November, driven by stronger expansion in bank loans and investments and net foreign capital inflows. The M2 growth rate marginally dropped to 4.12% in December.

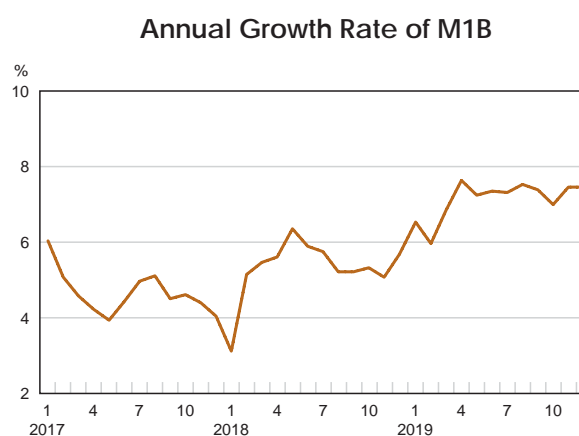
The annual growth rate of the monetary aggregate M1B, measured on a daily average basis, went up by 1.83 percentage points to 7.15% in 2019. The rise in M1B growth was primarily due to an increase in the transaction demand for money amid moderate expansion in the domestic economy.

As for the monthly movements, continuous net foreign capital inflows and a gradual rise in stock prices led to the M1B growth rate displaying a broad uptrend for the first four months except in February, in which it was dragged down by softer growth in passbook deposits held by enterprises because of longer Lunar New Year holidays in 2019. After registering an all-year high of 7.65% in April, the growth rate of M1B dropped to 7.23% in May as it was the annual individual income tax declaration period and income tax revenues rose compared to the previous year.

From June onwards, despite decelerated growth in transaction deposits sending the M1B growth rate down to 6.99% in October, the growth rate broadly exhibited a steady uptrend and reached 7.44% in December.



Source: Financial Statistics Monthly, CBC.



Source: Financial Statistics Monthly, CBC.

Continuing with Macroprudential Policy on High-Value Housing Loans

For the year 2019, as largely volatile high-value housing prices could still raise banks' real estate-associated credit risks, the Bank kept the loan-to-value ratio capped at 60% on high-value housing loans and continued to urge financial institutions to strengthen risk management of real estate loans.

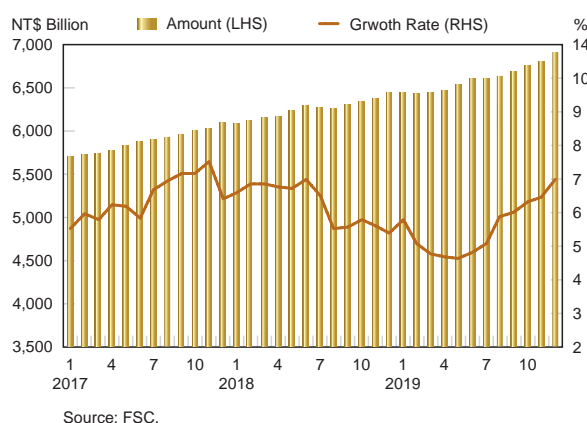
In the housing market, transactions increased and prices gradually trended up in 2019. Furthermore, homebuilders stepped up land acquisition and the offering of new housing projects, while banks recorded faster year-on-year rises in loans for home purchases and building construction. Looking ahead, the Bank will continue to keep a watchful eye on financial institutions' management of risks associated with real estate lending and developments in the housing market. Appropriate monetary policy actions will be adopted in a timely manner to safeguard financial stability.

Facilitating SME Funding

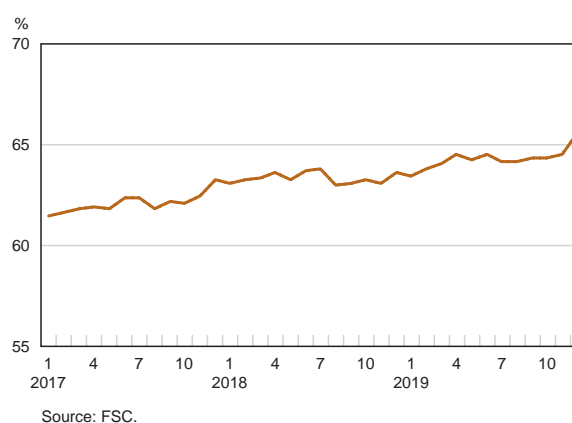
To sufficiently meet the funding needs of small and medium-sized enterprises (SMEs), the Financial Supervisory Commission (FSC) continued to encourage lending to SMEs by domestic banks, while the Bank also urged commercial banks to increase lending to SMEs.

At the end of 2019, the outstanding loans extended to SMEs by domestic banks amounted to NT\$6,898 billion, increasing by NT\$460 billion from the end of the previous year and far exceeding the annual target of increased lending of NT\$270 billion set by the competent authorities. The outstanding SME loans recorded an annual growth rate of 7.14% at the end of 2019, higher than the 5.50% at the end of 2018. Furthermore, the ratio of outstanding SME loans to loans extended to all private enterprises rose slightly from 63.63% at the previous year end to 65.61% at the end of 2019.

Outstanding Loans Extended to SMEs



Ratio of Outstanding Loans Extended to SMEs to Those Extended to Private Enterprises



Accepting Redeposits from Financial Institutions

Accepting redeposits from Chunghwa Post, the Agricultural Bank of Taiwan, and commercial banks is another instrument for the Bank to influence banks' reserve positions in order to promote financial stability. At the end of 2019, the outstanding redeposits of Chunghwa Post stayed broadly unchanged at NT\$1,624 billion, whereas the redeposits of the Agricultural Bank of Taiwan and of commercial banks decreased modestly to NT\$143 billion and NT\$359 billion, respectively.

Box 2

Adjusting M2 Growth Target Range to a Reference Range from 2020 Onwards

1. Considerations for Adjusting M2 Growth Target Range to a Reference Range from 2020 Onwards

Starting from 2020, the M2 annual growth target range will be adjusted to a reference range. The main considerations are as follows:

- (1) In addition to M2 growth, the Bank also closely monitors and considers other key economic and financial indicators, such as inflation expectations, the output gap, interest rates and exchange rates, credit conditions, and asset prices. M2 growth remains one of the crucial reference indicators for monetary policy.
- (2) According to the Bank's past experiences, M2 growth was easily affected by factors such as cross-border capital flows, asset portfolio diversification, and financial innovations. Following the global financial crisis, Taiwan has witnessed a weakening in the short-term relationship between M2 and prices. Nevertheless, the mid- to long-term relationship among M2, output, and prices remains relatively stable. An appropriate pace of M2 growth would be conducive to attaining the ultimate objective of price stability. Furthermore, M2 also conveys important information with regard to financial stability.
- (3) As Taiwan is a small open economy, it is important to ensure monetary policy autonomy and flexibility. Adjusting the target range for M2 growth into the reference range would provide greater operational flexibility. Allowing M2 growth within an appropriate range to account for the uncertainties over macroeconomic and financial variables would help guard against excess volatility in short-term interest rates and would be consistent with the Bank's efforts in maintaining dynamic stability of the exchange rate.

2. The Bank's Future Policy Practice

- (1) From 2020 onwards, the target range of M2 growth will become a reference range. In fact, since 2009, the M2 annual growth rate has generally stayed within the target range of 2.5%

to 6.5%, which has been conducive to attaining a low and stable inflation rate and sufficient to support economic activity. Furthermore, the model-projected annual growth rate of M2 demand in 2020 remained within the aforementioned range.¹ Therefore, the M2 growth reference range for 2020 remains at 2.5% to 6.5%.

- (2) Considering that M2 is a mid- to long-term indicator, the Bank will not set the reference range of M2 growth on an annual basis. However, as M2 growth still serves as a valuable reference, the Bank will continue to keep track of M2 growth trends in the monthly monetary growth forecast meetings. Moreover, at the end of each year, the Bank will also review the developments of M2 growth during the year and the outlook for money demand in the following year. The review will be used as a reference for monetary policymaking.
- (3) A multitude of uncertainties such as frequent international capital flows, asset portfolio diversification, and the rapid development of financial technology may cause the M2 growth rate to deviate from the reference range. In the event of continued deviation from the 2.5%-6.5% range or structural changes, the Bank would conduct a review to analyze the potential factors contributing to the changes or deviations, so as to make adjustments as warranted and in a timely fashion.

¹ For the model-projected results, please refer to "Adjusting M2 Growth Target Range to a Reference Range from 2020 Onwards," *Quarterly Bulletin*, Central Bank of the Republic of China (Taiwan), Vol.41, No.4, pp.7-12 (in Chinese).