

2. Monetary Aggregates

The broad monetary aggregate M2 has been the Bank's intermediate target for monetary policy since 1992. For the year 2009, the annual growth rate of M2 registered 7.21 percent, not only higher than the previous year's 2.67 percent, but also exceeding the upper bound of the Bank's 2.5 to 6.5 percent target zone. This was mainly attributable to net foreign capital inflows and the increase in net foreign exchange receipts. In addition, the Bank's easy monetary policy stance to boost economic activity amid low inflation also contributed to the rise in M2.

The narrow monetary aggregate M1B trended up and registered a much higher growth rate of 16.54 percent for the year 2009, when compared with the previous year's negative 2.94 percent. The sharp growth in M1B was mainly attributable to a recovery of economic activity, the shift from term deposits to demand deposits resulting from a rebounding stock market, and a lower base effect.

Rapid Growth in Reserve Money

Reserve money growth accelerated for the year of 2009, with the annual growth rate increasing by 9.36 percentage points to 12.60 percent from the previous year's figure. Broken down by the components of reserve money, bank reserves posted faster growth of 14.86 percent when compared to the previous year's 3.02 percent, while the growth of currency held by the non-bank public increased to 9.31 percent from 3.57 percent one year earlier.

The monthly movements of reserve money in 2009 were as follows: (i) Because the exact

Annual Growth Rates of Reserve Money



Source: Financial Statistics Monthly, CBC.

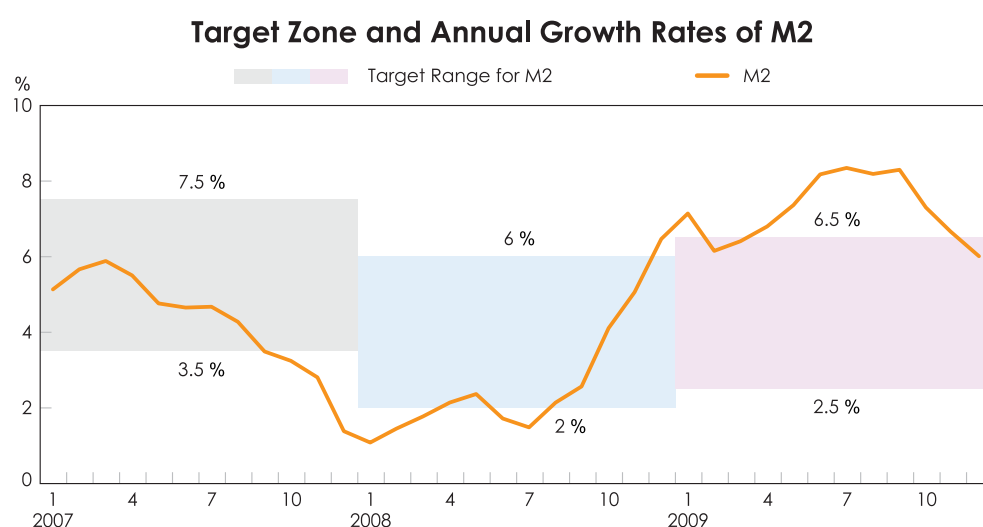
timing of the Chinese lunar new year shifts on the Gregorian calendar each year, the annual growth rates for January and February are more volatile, and posted a combined growth rate of 12.00 percent during this period; (ii) Afterwards, the annual growth rates of reserve money generally trended up and reached its yearly high of 15.59 percent in July; (iii) In line with the Bank's gradual removal of banks' excess reserves, as well as the high base effect, the annual growth rates of reserve money trended down for the following months but remained above 10 percent.

On the demand side, growth of currency held by the non-bank public increased because the low opportunity cost of holding currency given the low interest rates paid on bank deposits enhanced their willingness to hold currency. Banks' demand for reserves also rose as the Bank's monetary policy stance loosened in response to the unfavorable economic outlook. Coupled with the shift from term deposits to demand deposits, banks were left with excess reserves.

From the supply side perspective, the Bank's balance sheet revealed the sources of changes in reserve money. On the one hand, against the backdrop of continued capital inflows, the Bank's intervention in the foreign exchange market to smooth excessive fluctuations in exchange rates led to a net increase in the Bank's foreign assets and a simultaneous rise in reserve money. On the other hand, reserve money declined mainly because the Bank increased the issuance of certificates of deposit (CDs) to conduct open market operations in order to mop up excess liquidity in the banking sector.

Significant Increase in M2 Growth

M2, which comprises currency in circulation, deposits in banks' checking and demand



Source: Financial Statistics Monthly, CBC.

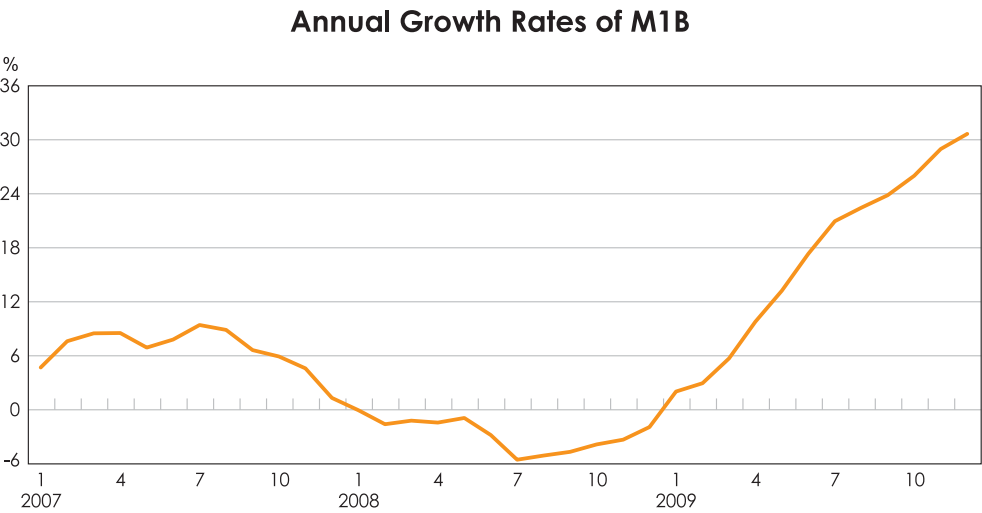
accounts, and quasi money, is the Bank's intermediate target for conducting monetary policy. The annual growth rate of M2 in 2009 was 7.21 percent, up from the previous year's 2.67 percent and exceeded the upper limit of the Bank's target zone. The rise of M2 growth rates was due to the increase of net foreign exchange receipts resulting from a larger decline in imports than exports and massive net foreign capital inflows induced by the rebounding stock market. Moreover, the Bank's easy monetary policy stance to boost economic activity in a low inflation environment also contributed to the rise in M2.

In terms of M2's monthly movement in 2009, because demand for money increased at the start of the year as the Chinese lunar new year fell in January, the M2 growth rate increased to 7.12 percent. The M2 growth rate fell to 6.13 percent in February because the Chinese lunar new year fell in its base month bank loans and investments declined. The M2 growth rate gradually rose from March onwards due to continued net inflows of foreign capital and the lower base effect, and reached its yearly high of 8.33 percent in July. In August, due to net capital outflows and the slow growth of bank loans and investments, the M2 growth rate dropped to 8.17 percent. As bank loans and investments started to pick up and foreign capital flooded in, M2 growth rose to 8.28 percent in September. However, due to the high base effect, the rising trend of M2 growth reversed from October onwards and recorded a yearly low of 5.99 percent in December, falling within the Bank's M2 growth target zone.

Accelerated Growth in M1B

M1B grew rapidly in 2009, primarily reflecting the sharp increase in demand deposits owing to the shift of term deposits to demand deposits, the bullish stock market, net foreign capital inflows and the lower base in the previous year. The average annual growth rate of M1B recorded 16.54 percent, far higher than the previous year's negative 2.94 percent.

The M1B's monthly movements in 2009 were as follows: (i) Because local stock market remained sluggish earlier in the year, the M1B annual growth rate registered a yearly low of 1.78 percent in January; (ii) Afterwards, the rebounding stock market and net capital inflows led the M1B growth rate to rise and reach 12.95 percent in May against the backdrop of massive foreign capital inflows; (iii) In June, although the scale of net foreign capital inflows decreased and the stock market moderated slightly, the M1B growth rate rose to 17.03 percent due to the lower base in the previous year; (iv) From July onwards, the M1B growth rate trended up due to the rising transaction volume in the stock market, foreign capital inflows and the continued shift from term deposits to demand deposits, coupled with a lower base effect. The M1B growth rate hit a yearly high of 30.30 percent in December.



Source: Financial Statistics Monthly, CBC.