

2. Monetary Aggregates

The broad monetary aggregate M2 has been the Bank's intermediate target for monetary policy since 1992. For the year 2011, M2 recorded an annual growth of 5.83 percent, higher than the previous year's 4.53 percent and still within the Bank's target range of 2.5 percent to 6.5 percent. Overall, there was sufficient liquidity to sustain economic growth.

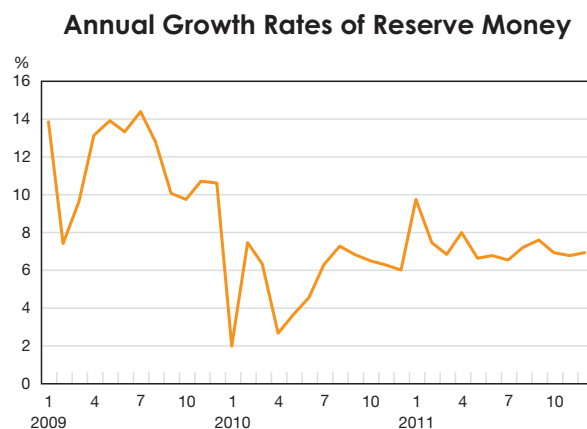
The annual growth rate of the narrow monetary aggregate M1B decelerated to 7.16 percent in 2011 when compared with the previous year's 14.93 percent. The decline in growth in M1B was mainly due to the shift from demand deposits to time deposits, the shrinkage in the stock market's transaction volume in the second half of the year, and a higher base effect.

Growth in Reserve Money Increased

Reserve money growth was up for the year 2011, registering a growth rate of 7.24 percent, and was 1.81 percentage points higher than the previous year's figure. Broken down by the components of reserve money, bank reserves posted higher growth of 5.46 percent when compared with the previous year's 2.74 percent, while the growth of currency held by the non-bank public slightly increased to 9.84 percent from 9.64 percent a year ago.

As for the monthly movements of reserve money, the annual growth rate for January reached its yearly high of 9.68 percent due to the seasonal demand for currency during the Chinese New Year holidays. In subsequent months, growth rates remained stable and hit an all-year low of 6.52 percent in July.

On the demand side, currency held by the non-bank public grew slightly faster as the low interest rates paid on bank deposits encouraged the willingness to hold cash. The continued economic expansion also helped to bolster demand for money for transactions motives. Regarding banks, new Taiwan dollar demand deposits held by non-residents were subject to a higher reserve requirement ratio from December 30, 2010. In addition, the substantial increase in bank credit to the private sector also raised banks' demand for reserves. On the supply side, in order to promote financial stability, the Bank fine-tuned its monetary policy stance,



leaving banks with less excess reserves. This partially offset the strong demand for bank reserves.

From the supply side perspective, the balance sheet of the Bank revealed the sources of reserve money. The increase in reserve money was mainly attributable to the increase of foreign assets held by the Bank and claims on financial institutions.

Steady Growth in M2

The monetary aggregate M2 is comprised of currency in circulation, deposits in banks' checking and demand accounts, and quasi money.

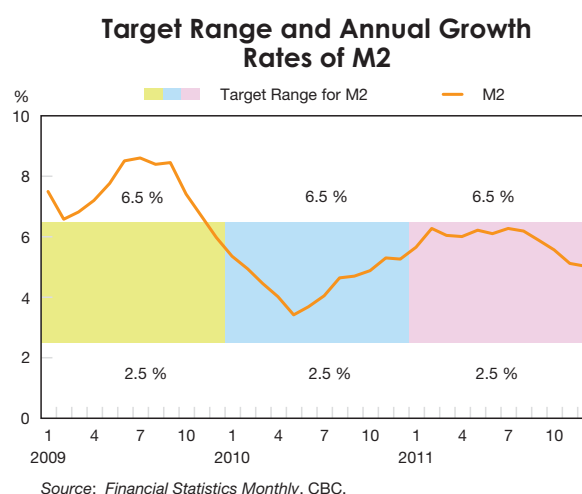
Since banks began to issue structured products in early 2001, the carrying values of the host contracts have been classified as banks' deposits, which is by definition a component of the monetary aggregate M2. However, structured products carry higher liquidity risk and market risk and, unlike deposits, do not necessarily guarantee the return of principal. For these reasons, such products will be removed from the components of the M2.

Pursuant to the Official Letter by the FSC, released in October 2010, requesting banks to exclude structured products from deposits, the CBC's Financial Statistics Monthly will, beginning from the February 2012 issue, modify the M2 definition by removing the carrying values of the host contracts of structured products from deposits. This modification applies to all relevant data collected since January 2001.

According to the modified M2 definition, the annual growth rate of M2 in 2011 was 5.83 percent, 1.3 percentage points up from the previous year's figure and was within the Bank's target range. The monthly changes of the M2 annual growth rate were as follows. In February, M2 growth rose to 6.24 percent from the 5.63 percent posted in January due to the Chinese New Year factor and the continued growth of bank loans and investments. Between March and August, growth rates remained relatively stable and were above 6 percent. The M2 growth rates trended down for the following months and recorded a yearly low of 5.01 percent in December in line with the economic slowdown, capital outflows, the decline in bank loans and investments growth, and a higher base effect.

Decline in M1B Growth

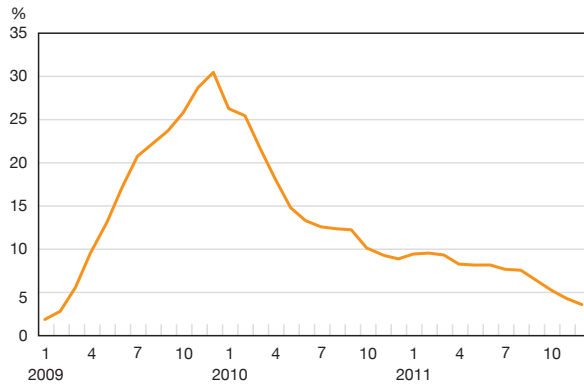
In 2011, M1B continued to grow with an average annual growth rate of 7.16 percent, which was much lower than that in the preceding



year. The decline mirrored, in large part, the shift from demand deposits to time deposits, the shrink in stock transactions in the second half of the year, and a high base effect.

As for the monthly movements of M1B, the annual growth rate reached its yearly high of 9.40 percent in February due to the Chinese New Year factor. In the subsequent months, the annual growth rate of M1B generally exhibited a downward trend except in June, which was mainly due to a slowdown in the decline of passbook savings deposits compared with the same period of the previous year. The M1B growth rate hit a yearly low of 3.51 percent in December.

Annual Growth Rates of M1B



Source: Financial Statistics Monthly, CBC.