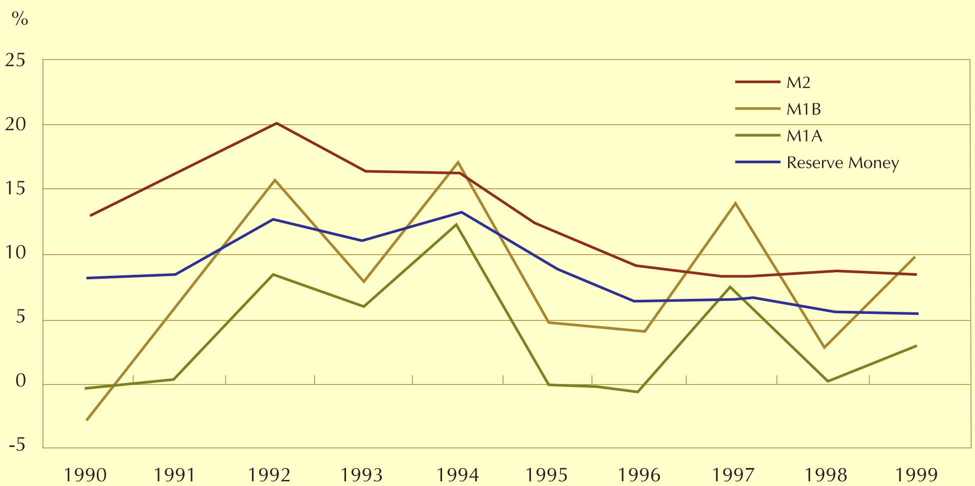
II. Financial Developments

6. Growth in Monetary Aggregates

The broadly-defined monetary aggregate M2 for 1999 was targeted to grow within a range of 6 to 11 percent on an annual basis. This target corridor was set to allow the economy to make full use of its production capacity without jeopardizing price stability. M2 grew by 8.33 percent in 1999, which was quite close to the middle of the M2 target range. The narrowly-defined monetary aggregates, M1B and M1A, registered accelerated growth of 9.87 percent and 3.09 percent, respectively, compared with the previous year. This accelerating reflected the strong demand for transaction balances associated with the buoyant stock market, the continued influx of foreign funds, as well as the lower base of the previous year.

Annual Growth Rates of Reserve Money and Money Supply
(Averages of Daily Figures)



Note: Figures for annual growth rates of reserve money are adjusted for changes in required reserve ratios.

Marginal Decrease in Reserve Money

In 1999, the Taiwan economy was at the stage of recovery. Bank lending to the private sector saw only marginal growth, as banks' attitudes towards lending were conservative, and the private sector's demand for funds was not strong. As a result, reserve money expanded moderately during the year. The annual growth rate of reserve money was 5.46 percent (adjusted for changes in required reserve ratios), slightly lower than the 5.77 percent recorded in the previous year. In January, reserve money registered a negative growth rate of 1.40 percent due to the higher base of the previous year (the Chinese lunar New Year fell in January in 1998.) While in February, the growth of reserve money reached 11.37 percent primarily because of the strong demand for currency before the Chinese lunar new year. In the months that followed, reserve money grew moderately between March and September. From October onwards, the weak demand of the private sector for investment funds further slowed down the growth of reserve money. The annual growth rates for October and November were only 3.08 and 3.54 percent, respectively. In December, demand for liquidity from the private sector to cope with the Y2K computer bug increased significantly, causing reserve money to rise by 5.51 percent when compared with the corresponding month of the previous year.

At the end of 1999, reserve money amounted to NT$1,643.3 billion, exhibiting a decrease of NT$21.8 billion over the end of the previous year. Of this amount, currency held by sectors other than monetary institutions and the Postal Savings System increased by NT$96.6 billion, while reserves held

Factors Affecting Changes in Reserve Money in 1999

(year-end v.s. year-end)

Unit: NT$ Billion

Factors	Contributing to Increase in Reserve Money	Contributing to Decrease in Reserve Money
1. Relating to Foreign Transactions		
Increase in CBC's Foreign Assets*	607.2	
2. Relating to Government Transactions		
Decrease in CBC's Claims on Government		19.5
Increase in Government Deposits Placed with CBC		53.3
3. Relating to Financial Institutions' Transactions		
Increase in CBC's Claims on Financial Institutions	65.2	
Increase in CBC's Treasury Deposits and Foreign Currency Deposits Placed by Banks		35.4
Increase in CBC's Time Deposits Placed by Financial Institutions		159.0
Decrease in CBC's Holdings of Securities other than Government Securities		10.1
Increase in Treasury Bills, Certificates of Deposit and Savings Bonds Issued by CBC		426.5
4. Changes in Other Factors	9.6	
Total	682.0	703.8
Change in Reserve Money	-21.8	

Note : * Excludes valuation changes in the exchange rates of the NT dollar against foreign currencies.

Source: Financial Statistics Monthly, Taiwan District, the Republic of China, the Central Bank of China.

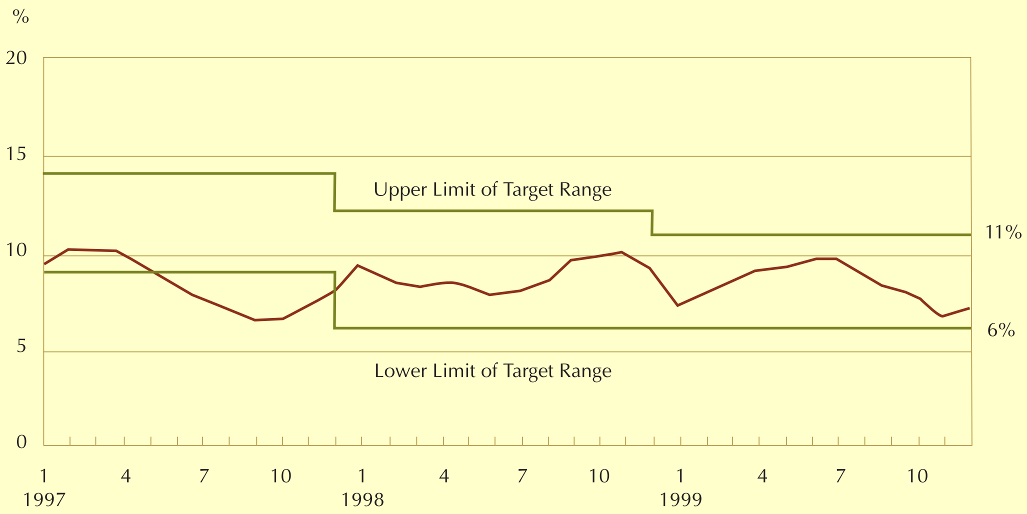
by financial institutions decreased by NT$118.4 billion.

Moderate Growth of M2

Over the year of 1999 as a whole, M2 grew by 8.33 percent, which was very close to the midpoint of the 6 to 11 percent target range. However, when compared with the previous year, the growth rate of M2 expanded at a slower pace. The demand-side factors behind this slowdown were mainly the moderate economic growth and comfortably low inflation (real GDP grew by 5.67 percent and the CPI inflation by 0.18 percent in 1999), as well as the slower growth of loans and investments of the banking sector (loans and investments of major financial institutions for 1999 grew by only 3.41 percent.)

The M2 growth rate for each month of the year fell within the target range of 6 to 11 percent. In January, as the recovery of the domestic economy was not yet on track, demand for funds from the private sector was sluggish. In addition, banks' attitude towards lending was conservative. All these factors suppressed M2 growth to 7.37 percent, down from 9.04 percent in December 1998. In February, demand for cash funds increased due to the Chinese lunar New Year. Also spurred on by an increasing trade surplus, M2 grew 7.85 percent. Then due to active stock transactions, inflows of foreign capital and the expanding trade surplus, the annual growth rate of M2 edged up from 8.57 percent in March to 9.64 percent in June. Similar economic conditions prevailed in July, while the lower base in the previous year helped boost the M2 growth rate further to 9.69 percent. In August, the Ministry of Finance issued large volumes of government bonds and Treasury bills, causing funds to temporarily transfer from the banking sector to the government. Furthermore, banks slowed down their credit granting business to prevent non-performing loans from rising further. These two factors dragged M2 growth downward to 9.05 percent. In September, affected partly by the severe earthquake, the demand for financial capital from the private sector was weak, which slowed banks' credit extension business further. Therefore, M2 growth declined to 8.14 percent. From October to December, affected by both the slowdown of loans and investments of banks and the higher base in the previous year, the M2 growth rates for these three months were all below 8 percent.

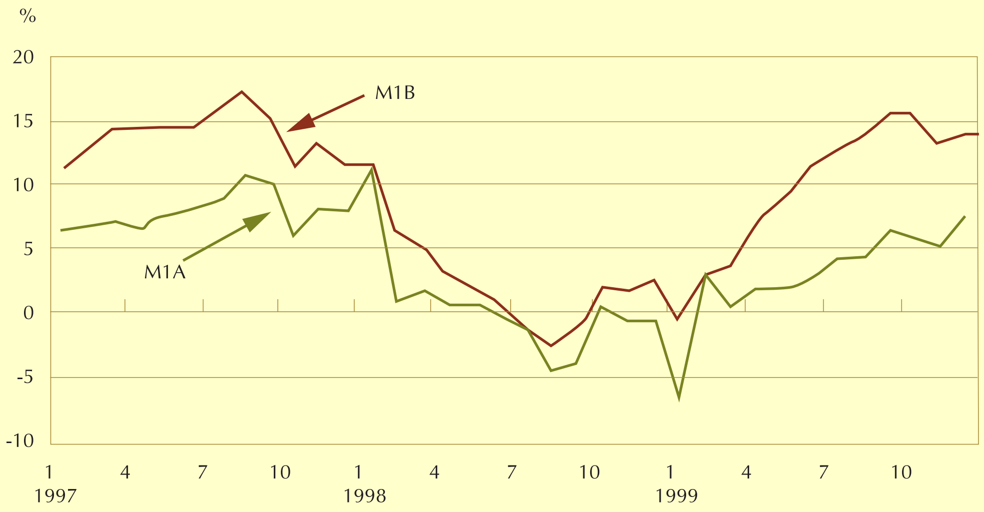
Annual Growth of M2 and Its Target Range



Accelerated Growth in M1B and M1A

For 1999 as a whole, the annual growth rates of M1A and M1B were 3.09 percent and 9.87 percent, respectively, which were considerably faster than the corresponding 0.39 percent and 2.52 percent recorded in the previous year. In January, due to the higher base in the previous year (the Chinese lunar New Year fell in January in 1998), money supply M1A and M1B recorded negative annual growth rates of 6.62 percent and 0.33 percent, respectively. Both rates turned positive in February due to the Chinese lunar New Year. In March, owing to the return of currency in circulation to the banking sector, M1A declined. M1B, on the other hand, rose because of a rally in the stock market. The annual growth rates of M1A and M1B were steadily on the rise from April to September, mainly due to active stock transactions, continuous inflows of foreign capital and the sustained trade surplus. M1A and M1B grew 6.55 percent and 15.49 percent, respectively, in September, the latter recording an all-year high. Owing to the adverse impact on the economy from the earthquake in September, the stock market declined temporarily with shrinking average daily turnover during October and November. Therefore, M1A and M1B both decreased. In December, people tended to hold sufficient currency in preparation for the potential Y2K crisis. This caused M1A to rise to an all-year high of 7.87 percent. M1B also rose to 14.08 percent mainly due to the Y2K phenomenon as well as a booming stock market.

Annual Growth Rates of M1A and M1B



conservative attitude of banks toward lending as a result of their high past-due loan ratios. Although the past-due loan ratio of domestic banks rose from 4.36 percent at the end of December 1998 to 5.08 percent at the end of September 1999, it went down to 4.88 percent at the end of the year due to banks' speedily writing off their bad loans. The return on assets and equity in the banking sector dropped as banks increased their provisions for bad loans and decreased their disposing of long-term investments. On the other hand, the risk-weighted capital ratio of domestic banks went up to 11.2 percent as banks increased their capitalization and holdings of default-free government securities and certificates of deposit issued by the Central Bank.