II. Financial Developments

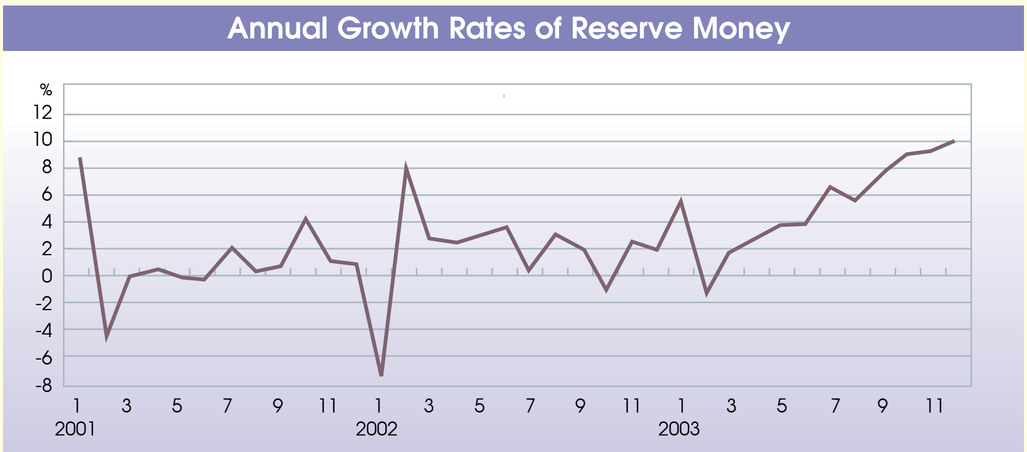
6. Monetary Aggregates

The Bank's easy monetary stance in the year 2003 provided significant support for domestic economic activities. The economy regained momentum during mid-2003, the demand for funds began to expand and inflows of foreign capital increased. As a result, money growth was largely on the rise during course of the year. For the year as a whole, the broad monetary aggregates M2 and M2 plus bond funds grew by an annual rate of 3.77 percent and 5.25 percent, respectively, both within their target zones (1.5 to 5.5 percent and 3 to 7 percent) set for the year.

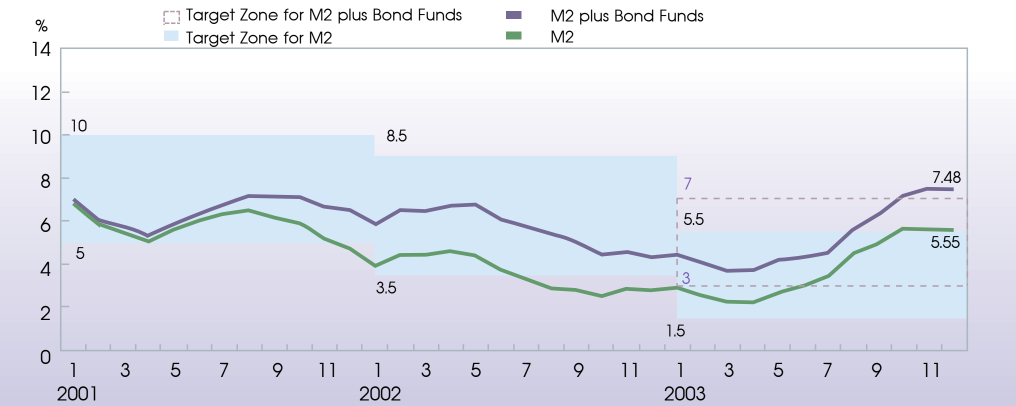
Accelerating Growth of Reserve Money

In 2003 the average annual growth rate of reserve money rose to 5.28 percent, higher than that of the previous year by 3.5 percentage points. This rising growth of reserve money was mainly attributable to an economic upturn, increasing currency demand, and foreign capital inflows.

In January the seasonal demand for currency during the Chinese Lunar New Year Holidays brought the annual growth rate of reserve money up to 5.57 percent. However, the growth rates of reserve money fell below 4 percent between March and May due to the weak demand for funds resulting from the outbreak of the SARS epidemic. As the spread of SARS came under control in late June, optimism about the economic recovery together with the prevalence of



Target Zones and Annual Growth Rates of M2 and M2 plus Bond Funds

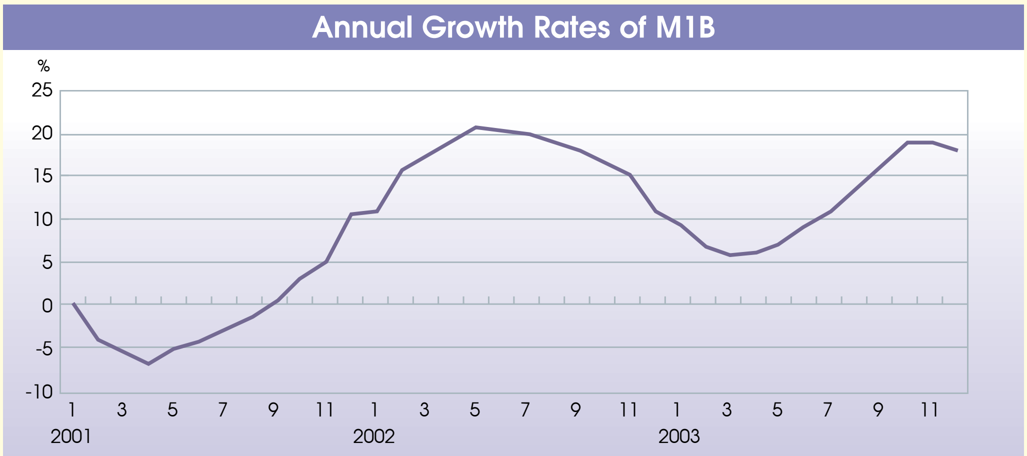


low interest rates on time deposits began to stimulate currency demand. These factors also encouraged more money to be kept in transaction deposits, which are subject to higher reserve requirements, and therefore boosted the demand for bank reserves. On the supply side, foreign capital continuously flooded into the market in the second half of the year further spurring the growth of reserve money. As a result, reserve money grew firmly month by month and posted a year-high annual growth rate of 9.88 percent in December.

Rising Growth of M2 and M2 plus Bond Funds

The monetary aggregate M2 has served as the intermediate target of the Bank's monetary policy since 1992. To keep abreast of the diversification and innovation in financial products, the Bank started to set a target corridor for M2 plus bond funds to facilitate a more comprehensive reference in 2003. By taking into account economic growth and price movements, the spread between domestic and foreign interest rates, and the impact of financial asset diversification on money demand, the target zone for M2 growth was set at 1.5 to 5.5 percent and for M2 plus bond funds growth at 3 to 7 percent.

For 2003 as a whole, M2 and M2 plus bond funds expanded at an annual rate of 3.77 percent and 5.25 percent, respectively, both within the Bank's monetary growth target ranges. M2 growth rates lingered between 2 and 3 percent in the first half of the year due to the weak economic activity resulting from the SARS epidemic, as well as the successive increases in portfolio investment abroad made by the local residents. After July, as the SARS threat had been relieved and the domestic economy began to stage a stable recovery, M2 resumed its momentum and grew steadily along with the influx of foreign capital as well as the expansion of bank credit. Specifically, a surge of foreign capital inflows in October, associated with the



bullish stock market, pushed M2 growth rate up to 5.66 percent, above the upper bound of the target zone. Nevertheless, owing to higher comparison base of the previous year, M2 annual growth rate slightly declined to 5.55 percent in December.

Regarding the growth rate of M2 plus bond funds, it ascended persistently during the year partly due to the strong demand for bond funds. At the end of December, the net asset value of bond funds held by the non-bank private sector was NT$1,133 billion and the average growth rate of M2 plus bond funds was 7.48 percent for the month.

Strong Growth of M1B

In 2003, the M1B growth rate continued to rise and posted an average annual growth rate of 11.82 percent. The strong growth of M1B mainly reflected increasing demand for transaction balances along with the rising turnover in the stock market as well as less incentive for depositors to shift their money to time deposits due to the lower interest rate spread between time deposits and transaction deposits.

In the beginning of the year, M1B growth rates gradually trended downward due to the lackluster performance in the stock market and the higher bases of the previous year. However, as the interest rates of time deposits were so low, the opportunity cost of holding transaction deposits was little, which pushed M1B up. Since July, M1B growth rates soared along with the strong demand for transaction balances for the active stock market trading and the massive foreign capital inflows resulting from the optimistic outlook for the Taiwanese economy. Double-digit growth rates continued to be posted in the following months and an annual growth rate of 18.10 percent was registered in December.