

Investment management review of the Macao SAR Fiscal Reserve, For the year 2014

The Monetary Authority of Macao (AMCM) announced the preliminary financial figures of the Macao SAR Fiscal Reserve as of 31 December 2014. The total size of the Fiscal Reserve stood at MOP246.34 billion, which comprised of MOP116.46 billion as the Basic Reserve and MOP129.88 billion as the Excess Reserve.

Review for the year of 2014

During the year of 2014, the AMCM, like any other public institutions of similar investment profile, continued to face a persistent wave of various risks in major investment markets worldwide. With the transfer of the fiscal budget surplus of 2012 in the beginning of 2014, the size of the Fiscal Reserve grew significantly and so did the excess reserve part as a result. While safeguarding the legally required size of the Basic Reserve, the AMCM has adopted a more progressive and diversified strategy in asset allocations in order to strive for a better investment return.

Global interest rates remained at record lows in most of the major economies and traditional benchmark type government debt securities offered little interest income. The AMCM prudently adjusted the asset allocation of the Fiscal Reserve between high grade and high yield debt and increased its exposure to global corporate and financial bond sectors, aiming to lock in higher interest income from a diversified portfolio of bonds with strong credit ratings. The total allocation to bonds stood at approximately 47% by the end of the year, of which U.S. Dollar and Renminbi denominated bonds were the major components. China's monetary policy accommodation during the year created a favorable market environment for the bond investment of the Fiscal Reserve. Market yield level for onshore bond instruments went through a period of downward moves. Holdings of the Fiscal Reserve's onshore bond portfolio

recorded a general revaluation gain as a result. The Fiscal Reserve's efforts in diversifying its overseas bond portfolio into a wider product range, on the other hand, further helped the overall bond portfolio in securing a higher return. For the year 2014, despite widespread market volatilities, total income generated from bond investments amounted to MOP3.65 billion and continued to form the largest source of income for the Fiscal Reserve. Rate of return improved to 3.3% for the year 2014, versus 2.2% the previous year.

After a comprehensive consultation with the Advisory Board of the Fiscal Reserve, the AMCM started investing into the equity sector with a diversified spectrum covering global emerging markets, global developed markets and the onshore China equity market (through QFII). Total allocation of equities amounted to an approximate 7.7% of the Fiscal Reserve as a whole as at the end of 2014, providing further diversification benefits for the overall investment process. Revaluation losses from global emerging markets equity portfolios during the year, nevertheless, were fully recouped from the relatively good performance in global developed markets equity portfolios. The major engine behind the MOP1.4 billion overall income from equity investment came from the onshore China equity portfolio where the benchmark large and medium-capitalization sector recorded significant price gains, contributing to the overall 8.7% return for the Fiscal Reserve's equity investment in general.

The movements of global major currencies in the foreign exchange market were extremely volatile, thus the relevant risk was high in foreign exchange trading. At the end of the year, US dollar index surged 12.8%, the euro and the Japanese yen fell simultaneously by 12.0% while the Australian dollar, the Canadian dollar and the British pound fell 8.4%, 8.6 % and 5.9% respectively. Although the decline in offshore renminbi was more moderate, yet it fell 2.6%. During the year, AMCM increased some holdings of offshore renminbi and US dollar at appropriate levels, while the positions of other currencies remained unchanged at very low levels. In 2014, the FX revaluation loss of fiscal reserve reached MOP3.14 billion which was mainly due to the loss on revaluation of MOP2.63 billion in renminbi. However, after incorporating the total interest income MOP3.93 billion derived from renminbi bonds and

deposits, the actual renminbi investment income was MOP1.3 billion, representing an investment return about 1.11%. Had there been no holdings in the renminbi assets but holding in USD denominated assets instead, and by comparing with the rate of return of US Treasuries 1-3 years at 0.63%, the interest income in USD would have been MOP0.74 billion only.

In money market operations, AMCM held adequate amount of short-term deposits to await optimal opportunity for assets relocation while other funds were adequately allocated for longer term deposits at different time intervals, and taking the advantages of higher renminbi interest rates, and to strive for the maximization of interest income. As for the whole year, total deposits interest amounted to MOP2.75 billion, with the corresponding rate of return of 2.40%, which was about 67 basis points higher than the 1.73% in 2013.

In general, investments in bonds and equities for the capital market portfolios generated an overall positive income on the back of benign market performance, together with interbank deposits in the money market section, bringing together a reasonable annual return for the Fiscal Reserve. Although the renminbi exchange rate fell again at the end of the fourth quarter and thus suffered further FX revaluation loss. But after including the higher renminbi interest income, the actual earnings of overall renminbi investment were still at a reasonable level after incorporating comparatively higher interest income in renminbi. For the Fiscal Reserve as a whole, the year 2014 registered a total income of MOP4.67 billion, representing an approximate annual return of 2.0%.

Outlook for the year 2015

It is anticipated that the rising trend of official U.S. interest rate, the economic situation and the direction of financial policies of major countries will lead to the volatility of global bond markets, exchange rates and stock market. Such risk factors in turn could substantially affect the short term revaluation results of the Fiscal Reserve. Against this backdrop, the AMCM will closely track market developments and aim to safely and effectively implement dynamic portfolio allocations based on an overall appropriate risk level. In particular, the Fiscal Reserve will make

use of market opportunities to further strengthen the portfolio's weighting on the equity sector. In regard to the outlook on the renminbi exchange rate, it is predicted that, under the backdrop of foreseeable rate cuts by world's major central banks, the PBOC may possibly follow the rate cut to stimulate the economy during the year, and therefore there will be sustainable downward pressure on the renminbi. AMCM will monitor closely the relevant developments in the market, make timely assessment on the consolidated income between the loss on FX revaluation and interest income, follow up closely and execute necessary hedging strategy, and adjust appropriately the ultimate asset allocation in renminbi based on risk and return consideration, thus ensuring the safety of funds invested while at the same time pursue a steady medium to long term rate of return.

Monetary Authority of Macao

19 March 2015

Table 1. ASSET BREAKDOWN OF THE FISCAL RESERVE AS AT 31 DEC 2014

	%	Of Which:		
		Bond Market	Money Market	Equity Market
U.S. Dollar	26.9%	15.1%	6.2%	5.6%
H.K. Dollar	14.1%	4.3%	9.8%	
Offshore Renminbi*	37.3%	8.3%	29.0%	
Onshore Renminbi**	13.3%	11.2%	0.0%	2.1%
Australian Dollar	7.1%	7.1%	0.0%	
Macao Pataca	0.3%		0.3%	
Others	1.0%	1.0%	0.0%	
Total	100.0%	47.0%	45.3%	7.7%

* Mainly offshore Dim Sum bonds and bank deposits

** Investment quota for Onshore Interbank Bond Market of CNY20 billion approved by PBOC and investment quota of QFII of USD 500 million

Table 2. INVESTMENT-INCOME BREAKDOWN OF THE FISCAL RESERVE FOR YEAR 2014*

(10 ⁶ Patacas)					
Income type	1st Quarter 2014	2nd Quarter 2014	3rd Quarter 2014	4th Quarter 2014	Total
Interest from Money Market	578.4	690.2	745.6	738.4	2,752.6
Bond Market (including coupon income)	883.8	908.4	874.1	985.9	3,652.2
Foreign Exchange	-2,537.0	-339.2	948.0	-1,211.1	-3,139.3
Equity related exposure	(N.A.)	183.5	-19.8	1,248.9	1,412.6
Total Investment Income	-1,074.8	1,442.9	2,547.9	1,762.1	4,678.1

* Rate of return for the Fiscal Reserve in 2014 was 2.0%, while those of 2012 and 2013 stood at 1.4% and 3.0% respectively. The FX revaluation loss of renminbi was approximately MOP2.63 billion, but after incorporating the renminbi interest income of MOP3.93 billion, the investment return was around 1.11%. If there were no holdings in the renminbi assets but holding USD dollar investment instead, based on the rate of return of US Treasuries 1-3 years of 0.63%, and by comparison, the return of renminbi investment would still be higher by 0.48%.