INTERNATIONAL RESERVES MANAGEMENT REPORT

2023

CENTRAL BANK OF SEYCHELLES

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Acronyms

ACI	Association Cambiste Internationale
AfDB	African Development Bank
ARC	Audit and Risk Committee
AUD	Australian dollar
BIS	Bank for International Settlements
BofA	Bank of America
BOC	Bank of Canada
BOE	Bank of England
BSD	Banking Services Division

CAD	Canadian dollar
CAIM	Crown Agent Investment Management
CBS	Central Bank of Seychelles
CIA	Certified Internal Auditor
CFA	Chartered Financial Analyst
CNY	Chinese renminbi
COVID-19	Corona Virus Disease 2019
CU	Compliance Unit
ECB	European Central Bank
EFF	Extended Fund Facility
EUR	Euro
FEA	Foreign Exchange Auction
Fed	Federal Reserve Bank
FMD	Financial Markets Division
FRM	Financial Risk Manager
FSD	Financial Surveillance Division
FX	Foreign Exchange
GBP	Great British pound
GIR	Gross International Reserves
IAD	Internal Audit Division
IBRD	International Bank for Reconstruction and Development
IC	Investment Committee
ICE	Intercontinental Exchange
IFRS	International Financial Reporting Standard
IMF	International Monetary Fund
MMF	Money Market Fund
NAV	Net Asset Value
NIR	Net International Reserves
ORM	Operational Risk Management
PATII	Portfolio Analytical Tool II
PBOC	People's Bank of China
RAMP	Reserve Advisory and Management Partnership
RMU	Risk Management Unit

RSD	Research and Statistics Division
RSF	Resilience and Sustainability Facility
SAA	Strategic Asset Allocation
SCR	Seychelles Rupee
SDR	Special Drawing Rights
UBS	Union Bank of Switzerland
UK	United Kingdom
US	United States
USD	United States dollar
UST	United States Treasuries

Message from the Governor

It is with pleasure that I launch the International Reserves Management Report for 2023. Similar to previous editions, the report describes the activities of the Central Bank of Seychelles in managing the country's foreign currency reserves. The aim is to convey a transparent and fair account of the Bank's strategies, as deputised on behalf of the public.

2023 was marked by a variety of challenges for reserves management activities, mostly originating from the international side. The ongoing conflicts and slow economic recovery in the larger economies continued to impact global stability especially in commodity supply and prices. Despite an annual increase of 6.7 per cent in international reserves level, the indicator for reserves adequacy increased by only 0.2 months or about a week compared to 2022. International reserves adequacy is usually measured as the number of months reserves can sustain imports. High commodity prices along with increasing domestic demand implied that the country needed more foreign currencies to cover total imports. To ensure that the reserves level remained adequate, the Bank accumulated surplus foreign exchange from the domestic banking system when the opportunity arose.

Still, it was a year of notable strides, mainly in the achievement of the investment objectives of capital preservation and return generation. Both objectives were compromised in the past year, due to drastic interest rate actions by other central banks. However, the Bank remained steadfast in its strategic asset allocation (SAA) for the international reserves. Through a mostly passive investment strategy and money market investments, a historical return of US$35 million was generated in 2023. This was a stark turnaround compared to a loss of just below US$1 million in the previous year.

The Bank's achievements and resilience amid the challenges were possible with the support of its invaluable partners. The Bank kept its relationship with the World Bank's Reserve Advisory and Management Partnership (RAMP) and the Crown Agents Investment Management (CAIM) for asset management and capacity development. The technical guidance from the International Monetary Fund (IMF) supported reviews of current practices. Moreover, the collaboration with established counterparts, including foreign banks and central banks benefitted the Bank's development and investment endeavours.

To conclude, it is my wish that the Bank maintains best practices and capacity building at the core of all its activities. This will be crucial to drive the new 5-year strategic objective to enhance reserves management activities. For the years to come, trends in digital currencies and sustainable finance will continue to influence the global financial landscape. I am confident that the Bank will successfully navigate these developments as it enhances its resources and system capabilities. I am excited for the next chapters, whereby the Bank's openness to change will allow it to grow and remain relevant in its pivotal role of designated manager of the country's international reserves.

1.0 Introduction

This report details the activities and developments in international reserves management for 2023. It begins by providing an overview of the governance and operational setup. Then, the discussion expands on the performance indicators for the international reserves level and investment returns. Next, it explains the different elements of risks and how these are managed when investing the international reserves. The report also describes the various challenges and capacity expansion initiatives addressed during the year. At the end, it details the Bank's outlook on the developments for the upcoming year and beyond.

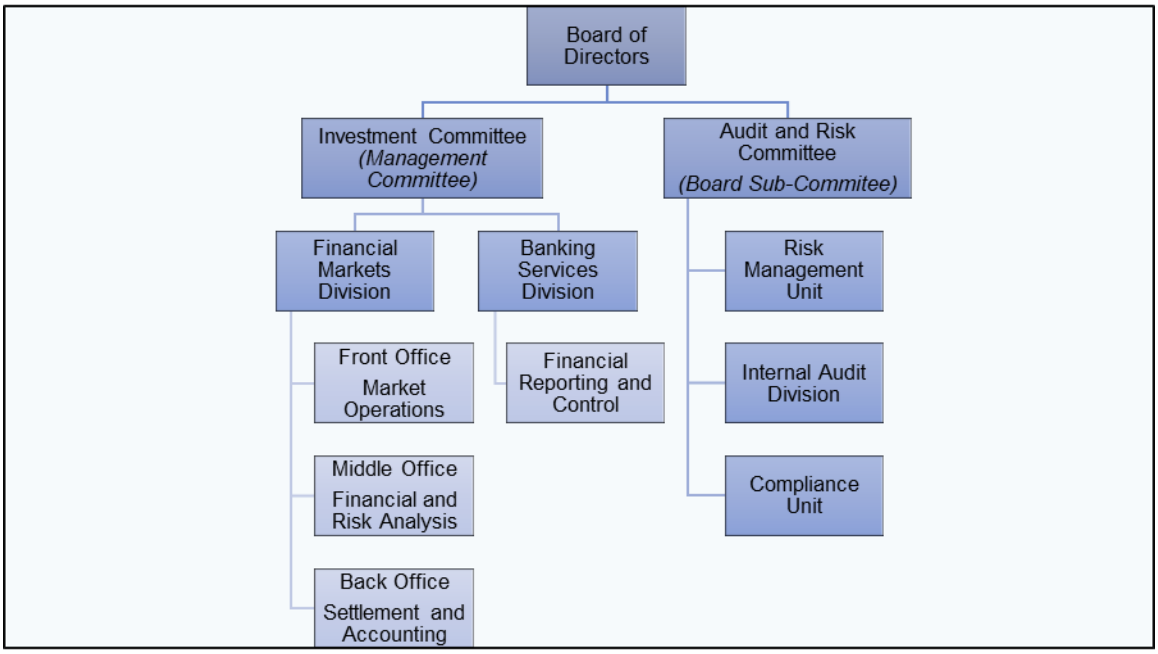
2.0 Governance Structure

The governance of the international reserves is set up in three tiers. The Board of Directors (the Board) is the highest level and is responsible for strategic decisions through its Investment Policy for International Reserves Management (the Investment Policy or the Policy). At the second tier lies the Investment Committee (IC), which operationalises the Investment Policy by the formulation of the Investment Guidelines (the Guidelines). At the third level are the operational areas directly undertaking the reserves management activities. The Financial Markets Division (FMD) and the Banking Services Division (BSD) are the operational units responsible for the day-to-day management of the reserves. The Second Deputy Governor is the Chairperson of the IC, which has the responsibility to ensure that the reserves management activities remain in compliance with the Investment Policy and Guidelines. Other members of the committee include the First Deputy Governor and heads or senior representatives from FMD and BSD, as well as from the Research and Statistics Division (RSD), and the Financial Surveillance Division (FSD).

The investment objectives are outlined in the Policy in order of priority; these are capital preservation, liquidity and return generation. The Board prescribes that investments be undertaken in a manner that seeks to preserve the principal value of the overall reserves. Also, portfolio managers should have the ability to sell an asset for cash in a short period and with minimal transaction costs. As the last objective, reserves management activities should achieve a competitive market rate of return corresponding to the risks taken in investment activities. The Guidelines are then derived from the Policy to specify the portfolio sizes, eligible asset classes, acceptable counterparties, as well as target currency composition of the international reserves.

Additionally, the risk management framework is established with three distinct lines of defence. The first line of defence is the FMD and BSD, which have ownership of the risks arising from the day-to-day activities within the reserves management operations. The Risk Management Unit (RMU) is the second line of defence and is responsible for identifying, measuring, monitoring and reporting risks on an enterprise level. On the same level, the Compliance Unit (CU) ensures that reserves management activities are in accordance with the legislation, standards and procedures adopted by the Bank. As the third line of defence, the Internal Audit Division (IAD) conducts risk-based audits with the objective of providing assurance that the governance framework is effective and that policies and procedures are executed effectively. Consequently, the RMU, CU and IAD attend the IC meetings as observers, and escalate any concerns to the Audit and Risk Committee (ARC).

Figure 1: Governance Structure for International Reserves Management



3.0 Operational Aspects of International Reserves Management

To carry out the day-to-day operations related to reserves management, the FMD is structured into three distinct functional units, namely the front, middle and back offices. The front office duties are operated by the Reserve Management section which is responsible for the execution of trades and portfolio management. Meanwhile, the Settlement and Accounting section undertakes the back-office functions, responsible for the settlement of the trades initiated by the front office and maintaining accounting records of the activities in line with the International Financial Reporting Standards (IFRS). The middle office duty is performed by the Financial and Risk Analysis section which conducts market research and makes recommendations on the Policy and the Guidelines. The middle office also monitors the operations of the front and back offices to ensure compliance to the Policy and the Guidelines.

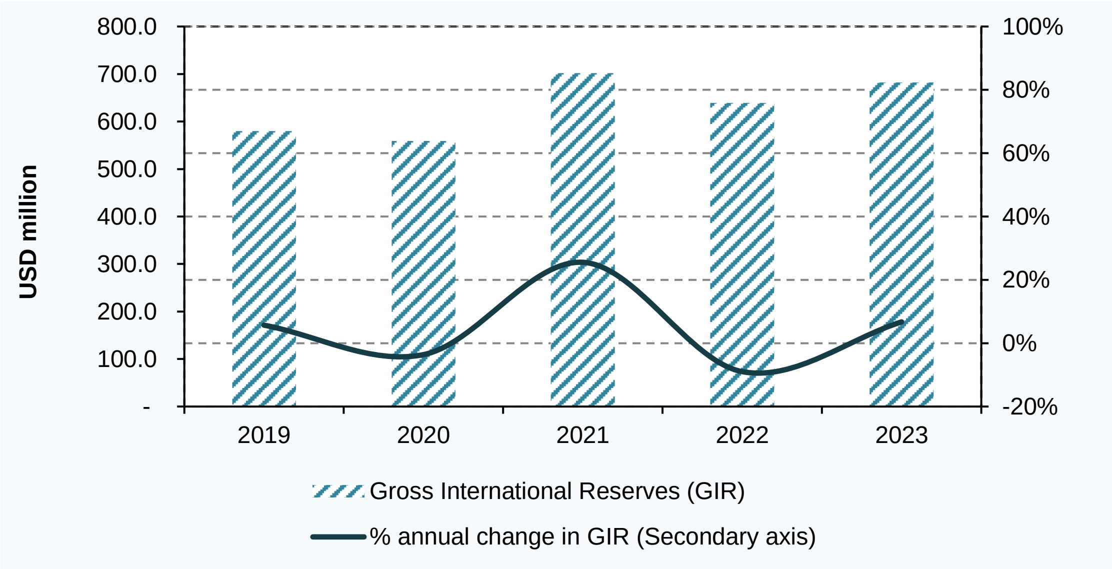
The reserves are segregated into three parts called tranches, concurrent to the conditions of the three main investment objectives. In the operational tranche funds are subject to a short investment horizon of up to three months. It provides the working capital for the daily undertakings of the government and its agencies, as well as potential FX interventions. The liquidity tranche services the country's short-term debt obligations of up to one year and the potential purchase of three months' worth of imports. It also serves to replenish the operational tranche as it is used up throughout the year. Hence, the tranche usually comprises of liquid assets with an investment horizon of not more than one year. Thirdly, the investment tranche is made up of the remaining funds from the operational and liquidity tranches. Investments within this tranche are targeted towards return generation and may be of longer investment horizons of up to five years. The investment tranche allows the country to meet potential longer-term contingencies, including debt obligations, national emergencies or severe economic crises.

4.0 Performance

4.1 International Reserves Position

The Gross International Reserves (GIR) was US$682 million at the end of 2023, representing an annual growth rate of 6.7 per cent from US$639 million recorded in the preceding year. The higher GIR position was mainly led by external financing from international organisations such as the African Development Bank (AfDB) and the International Bank for Reconstruction and Development (IBRD) in the form of budget support loans and grants. The purchases of foreign currency from the domestic market through foreign exchange auctions (FEA) by the Bank also supported the GIR level in 2023. The purpose of these auctions was to accumulate international reserves during periods of continuous surplus of foreign currency observed on the domestic market. As illustrated in Chart 1, the GIR position improved by 18 per cent over the past five years.

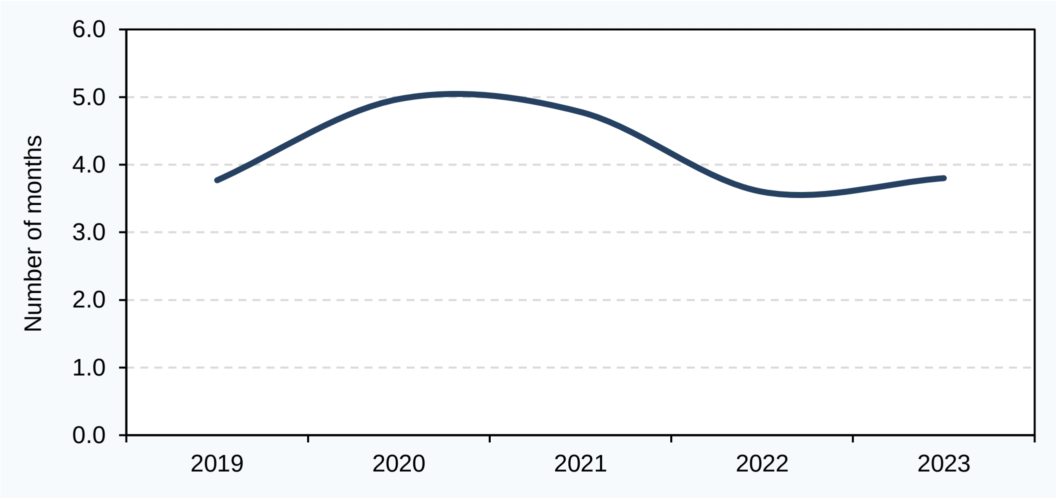
Chart 1: Gross International Reserves; 2019 – 2023



Note: end of year figures
Source: Central Bank of Seychelles

Chart 2 displays the international reserves level expressed in terms of months of imports cover. This is an internationally accepted standard to measure a country's reserves adequacy, whereby the broad rule-of-thumb is a minimum of 3.0 months as the ideal level. Based on the size of the GIR and prospective imports at the end of 2023, the reserves represented 3.8 months' worth of imports. This was an increase from the previous year's level of 3.6 months, primarily due to the improved international reserves level for the reporting year.

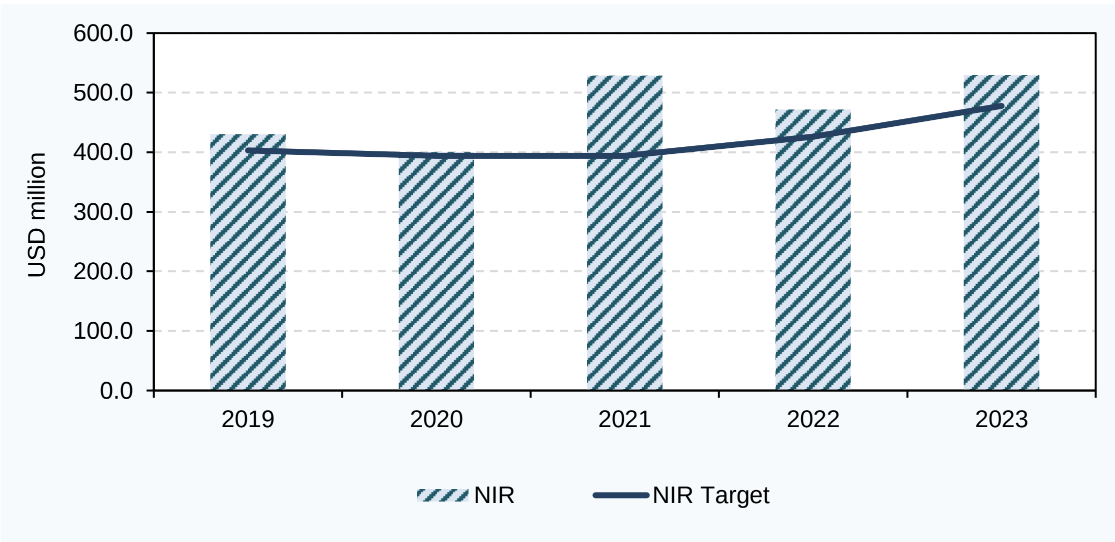
Chart 2: Import Cover; 2019 – 2023



Note: End of year figures
Source: Central Bank of Seychelles

The country embarked on a successive Extended Fund Facility (EFF) arrangement as well as a new arrangement under the Resilience and Sustainability Facility (RSF) during the first half of the year. Both of these new arrangements were approved by the IMF Executive Board in May 2023. Under the successive program, the country was subject to economic performance criteria as agreed with the IMF. One performance indicator was the end of quarter Net International Reserves (NIR), whereby the end of quarters two and four were the key performance dates. As illustrated in Chart 3, at the end of 2023, the NIR reached US$529 million, surpassing the fourth quarter target of US$478 million. The level was also an improvement of 12 per cent compared to US$472 million in 2022.

Chart 3: Net International Reserves against Target; 2019 – 2023

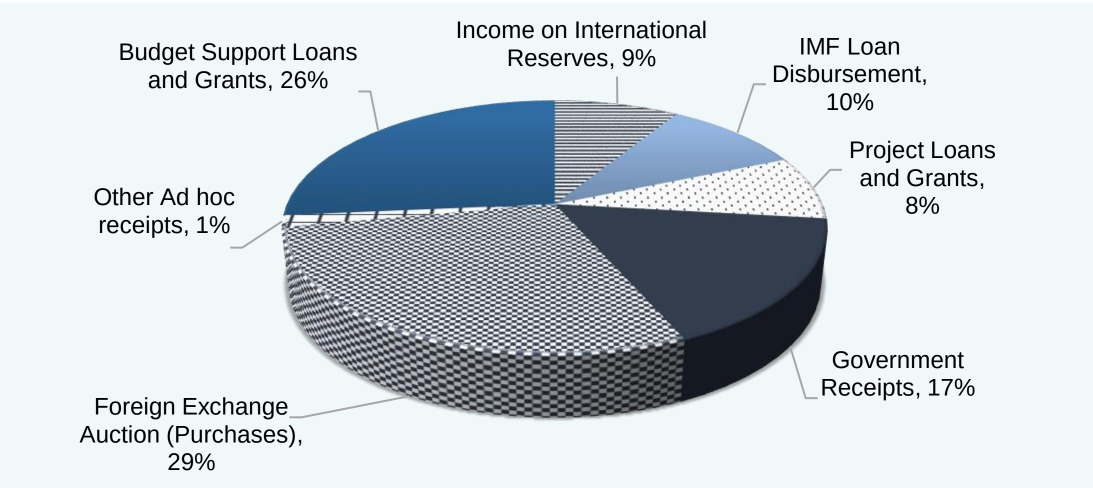


Note: End of year figures
Source: Central Bank of Seychelles

4.2 Sources and Uses of International Reserves

Foreign exchange (FX) inflows into the GIR for the year being reviewed totalled US$208 million. The main contributor were the inflows from multilateral and bilateral partners comprising of funds for budget support and projects, amounting to US$92 million or 44 per cent of the overall inflows. These included general budget support loans and grants at 26 per cent of inflows, whereby the IBRD and AfDB provided US$30 million and US$25 million respectively. In addition, the IMF budget support loan disbursements of US$20 million through the EFF and the RSF contributed 10 per cent to the total FX inflows. Furthermore, project loans and grants represented 8 per cent of the overall FX inflows at a total of US$17 million. The second highest contributor was the purchase of US$60 million from the domestic FX market through the FEA, which accounted for 29 per cent of the overall inflows. Thirdly, government receipts represented 17 per cent of FX inflows and it mostly included license fees for fishing in the Seychelles' maritime zone. Chart 4 illustrates the sources of the international reserves for 2023.

Chart 4: Sources of International Reserves; 2023

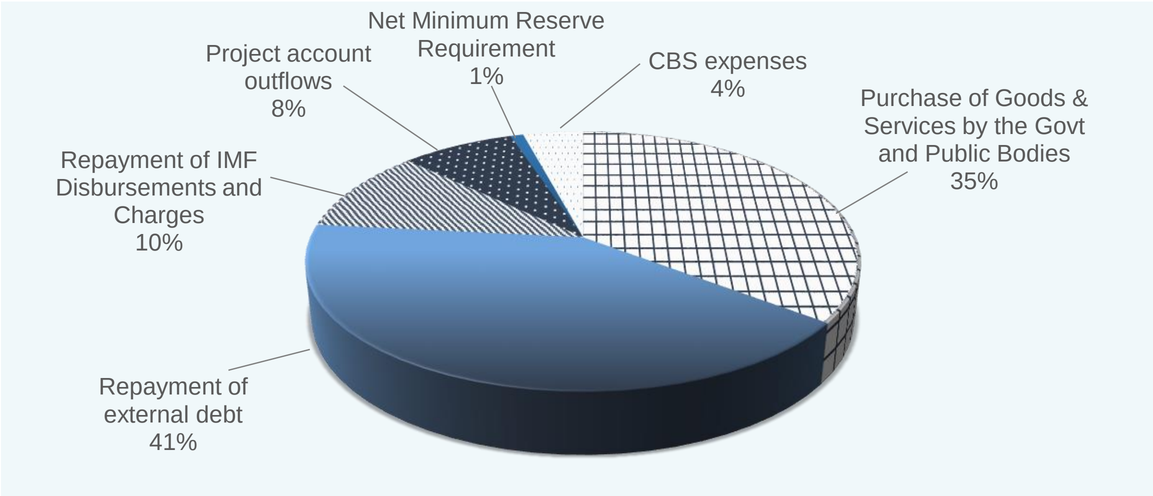


Note: End of year figures[1]
Source: Central Bank of Seychelles

With regards to the usage of the international reserves during 2023, as depicted in Chart 5, the largest FX outflows went towards the repayments of external debt to the country's multilateral and bilateral creditors, accounting for 51 per cent of the outflows. These included the general repayments to multilateral and bilateral partners, representing 41 per cent of the outlays and repayments to the IMF at 10 per cent of total FX outflows. Another main contributor to the drawdown of the international reserves was the purchase of goods and services by the government and the public bodies which included payments made by various ministries and departments. By the end of the year under review, FX outflows from the GIR stood at US$178 million.

[1] In view of decimals, figures may be subject to rounding error.

Chart 5: Uses of International Reserves; 2023



Note: End of year figures[2]
Source: Central Bank of Seychelles

4.3 Asset Allocation and Currency Composition of International Reserves

Reserves managers globally are faced with multiple objectives related to international reserves management. One key driver towards the achievement of these objectives is the SAA, which provides a set of strategic currency and asset compositions needed for the effective management of the international reserves. Through the Policy and the Guidelines, the ideal currency composition at tranche levels is defined, to benchmark the currency exposures in line with the country's obligations. These requirements allow for the achievement of the objectives of each tranche which consequently satisfy the overall objectives for holding international reserves.

The Bank conducts an annual review of the SAA, to ensure the strategic positioning of its investments and determine the optimal diversification of assets. This exercise considers the expected changes in the current economic conditions on the domestic and international fronts. It also factors in the expected drawdown of the international reserves in light of the expected market risks. Through this process, the Bank realigns the allocation of the international reserves to hedge against potential market risks and mitigate capital losses. This is important as the preservation of capital is considered as the primary objective when investing the country's international reserves.

The strategic currency composition of each tranche is measured as a weight of the total value of the tranche, excluding Special Drawing Rights (SDR) and any other non-reserve currencies. Each benchmark component is allocated a maximum and minimum deviation of 5.0 per cent from its ideal position at individual tranche level. Additionally, to optimise international reserves management activities, the IC allows for minor deviations from the strategic composition benchmark. The outcome of the strategic currency composition per tranche for the year under review is illustrated in Table 1.

[2] In view of decimals, figures may be subject to rounding error.

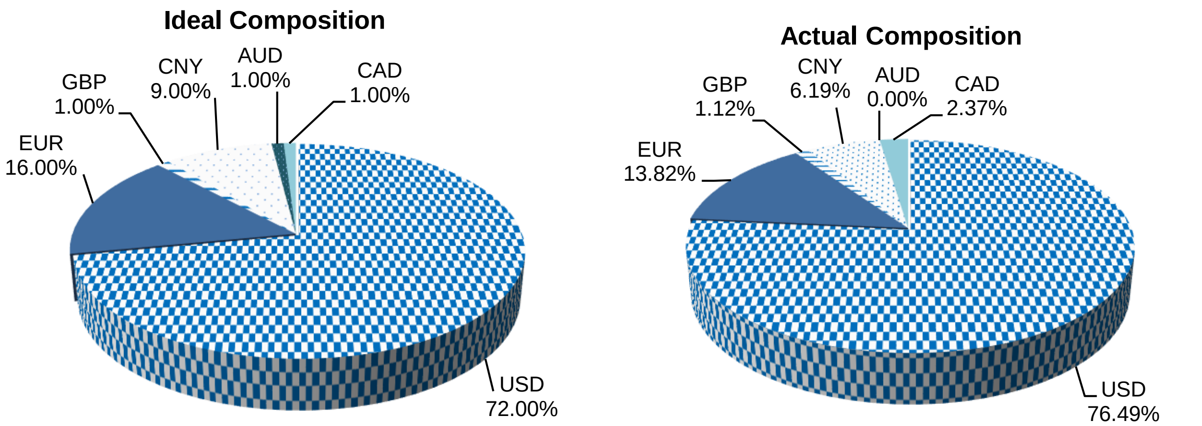
Table 1: Benchmark for Strategic Currency Composition per Tranche

	Lower (-5%)	Operational Tranche (Ideal)	*Upper (+5%)*	*Lower (-5%)*	Liquidity Tranche (Ideal)	*Upper (+5%)*	Lower (-5%)	Investment Tranche (Ideal)	Upper (+5%)
USD	*64%*	**69%**	*74%*	*70%*	**75%**	*80%*	45%	**50%**	55%
EUR	*15%*	**20%**	*25%*	*11%*	**16%**	*21%*	-	-	-
GBP	*6%*	**11%**	*16%*	*0%*	**1%**	*6%*	-	**-**	-
CNY	-	**-**	-	*1%*	**6%**	*11%*	45%	**50%**	55%
AUD	-	**-**	-	*0%*	**1%**	*6%*	-	**-**	-
CAD	-	**-**	-	*0%*	**1%**	*6%*	-	**-**	-
		100%			**100%**			**100%**	

Source: Central Bank of Seychelles – Investment Guidelines

Based on this outcome, the Bank continued to maintain the international reserves in US dollar (USD), Pound sterling (GBP), Euro (EUR), Chinese renminbi (CNY), Canadian dollar (CAD) and Australian dollar (AUD), throughout 2023. The overall currency composition of the international reserves as at the end of 2023 is illustrated in Chart 6, showing the ideal levels compared to the actuals.

Chart 6: Currency Composition of GIR at the end of 2023



Note: End of year figures
Source: Central Bank of Seychelles

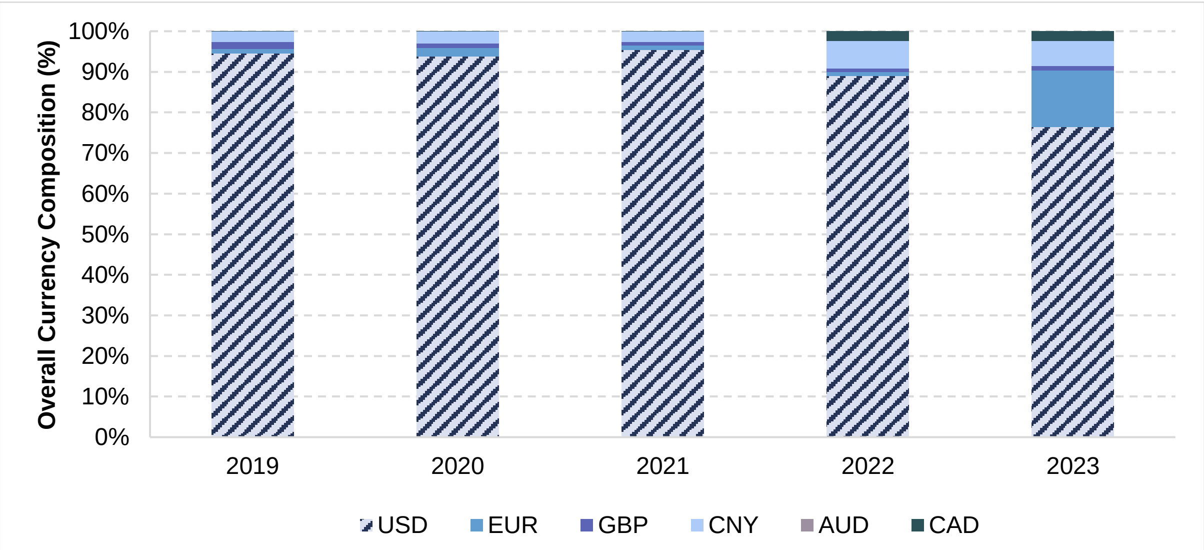
Similar to the previous years and consistent with the outcome of the SAA conducted during the year, the majority of the international reserves were kept in USD, given its safety and reporting currency status. As depicted in Chart 6, the USD accounted for 76 per cent of total holdings; approximately 4.5 per cent above the benchmark for the currency. The USD portion of the operational tranche was revised from 75 per cent to 69 per cent. Likewise, the USD composition in the liquidity tranche was revised downward from 87 per cent to 75 per cent and comprised of various short-term investments as prescribed by the Guidelines. As for the investment tranche, this comprised of bonds managed externally by the CAIM. As mandated in 2022, the funds held with CAIM comprised a 50-50 split between the USD and CNY in support of portfolio diversification. Notably, the composition of CNY within the liquidity tranche was adjusted downwards from 10 per cent to 6 per cent, considering the performance of short-dated CNY investments.

The performance of the EUR remained positive following its official transition from negative interest rates in 2022. In addition to the currency being maintained for operational requirements, in 2023 the Board approved a re-introduction of EUR in the liquidity tranche to its strategic ideal level of 16 per cent. Of note, the reallocation in the currency was supported by the purchases of EUR through the FEAs in the domestic market. This was a tactical strategy adopted to mitigate the costs of purchasing EUR on the international market using the other foreign currencies in the reserves. At the end of 2023, total EUR holdings stood at 14 per cent of the GIR.

Similar to peers, the Bank of England (BOE) also made consecutive interest rate hikes during the year under review. For 2023, the composition of GBP within the operational tranche was adjusted from 6 per cent to 11 per cent, to cater for operational payments. Given positive yields on the money market investments in GBP, the Bank also invested in fixed-term deposits in the currency. At year end, the actual composition of GBP stood at 1.1 per cent, within the bounds of the benchmark.

The allocations in respect of the commodity currencies being CAD and AUD were unchanged, as per the SAA review. For the former, the Bank maintained the existing minimal short-term money market investments. To note, the CAD fixed deposits had been reinstated since 2022 following interest rate hikes by the Bank of Canada (BOC). At the end of 2023, total holdings in the CAD stood at 2.4 per cent of the GIR, well within the benchmarks for the liquidity tranche. There was no fixed deposit investment in the AUD. Chart 7 illustrates the trend in the overall foreign currency allocation over a five-year period.

Chart 7: Trend in Overall Currency Composition as a percentage of the GIR; 2019 – 2023



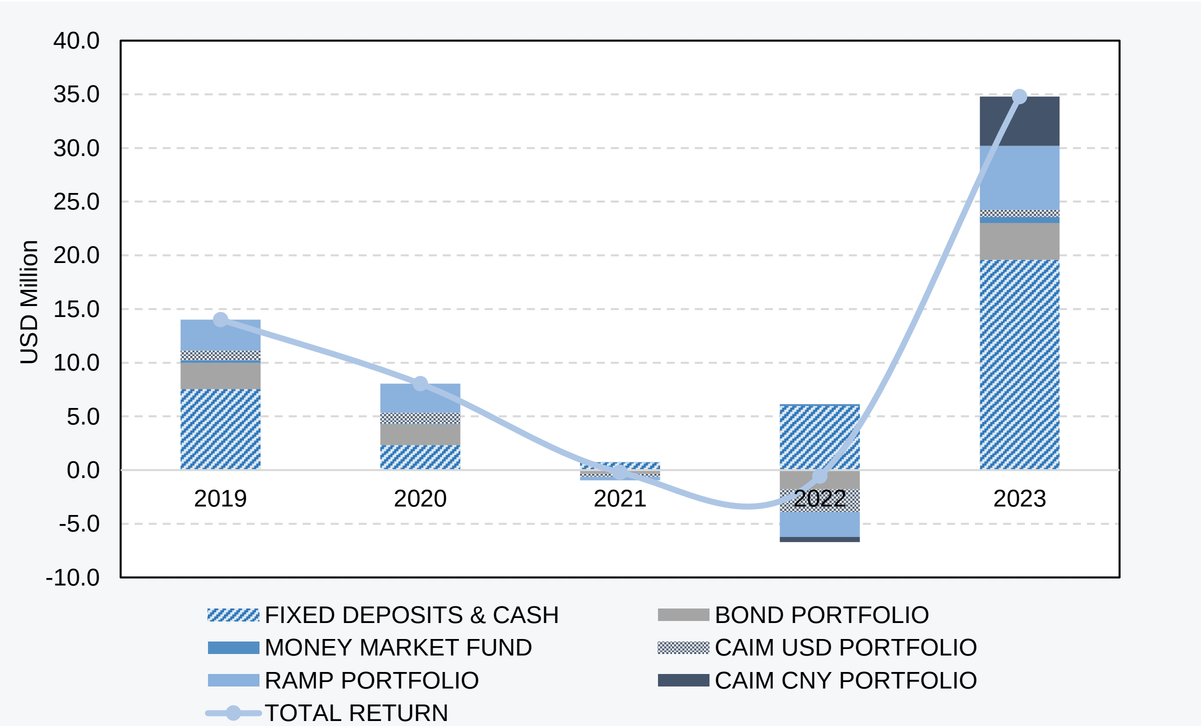
Note: End of year figures
Source: Central Bank of Seychelles

4.4 Return Generated

An important aspect of investment management is diversification, as this allows for effective risk management while also ensuring various sources of return. As such, for 2023 the Bank continued to hold a diverse mix of investments, featuring portfolios being managed both in-house and under external management mandates. Investments managed internally included fixed term deposits and a portfolio of US Treasury (UST) bonds, with the latter following a passive management strategy. Additionally, externally managed investments were maintained with the Union Bank of Switzerland (UBS) Money Market Fund (MMF), the RAMP and the CAIM.

As illustrated in Chart 8, 2023 was a positive year in terms of return generation, whereby an overall US$35 million was recorded, compared to the negative performance of $0.6 million in the preceding year. While all investment portfolios booked an increase in return generation compared to 2022, the return from the fixed deposits and cash portfolio was the main contributor to the positive performance in 2023. This followed the higher interest rates offered by the Bank's counterparts.

Chart 8: Interest Return on International Reserves per Investment Portfolio; 2019 – 2023

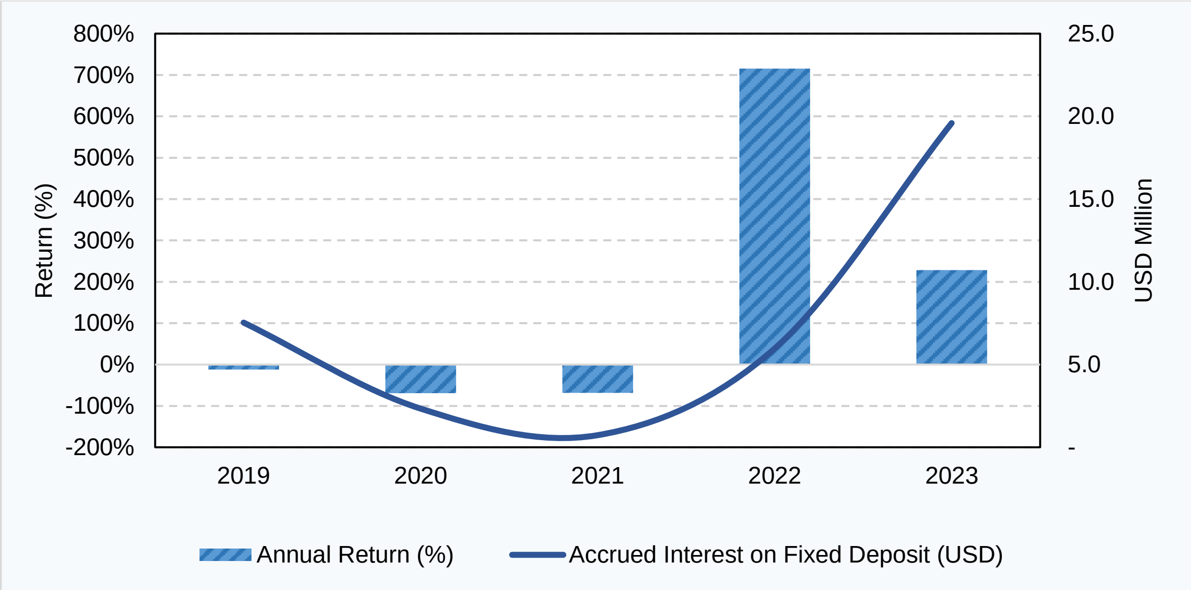


Note: End of year figures
Source: Central Bank of Seychelles

4.4.1 Return Generated from Fixed Deposits

The highlight of the major central bank actions in 2023 was the tightening of their respective monetary policy, causing interest rates to reach highs not seen in more than a decade. As such, the fixed deposit portfolio benefitted from the higher interest rates, bringing the total income earned to US$19.6 million. This represented a considerable increase of 228 per cent from the return recorded in 2022 and a 160 per cent increase compared to 2019, as illustrated in Chart 9.

Chart 9: Interest Return Generated from Fixed Deposits; 2019 – 2023



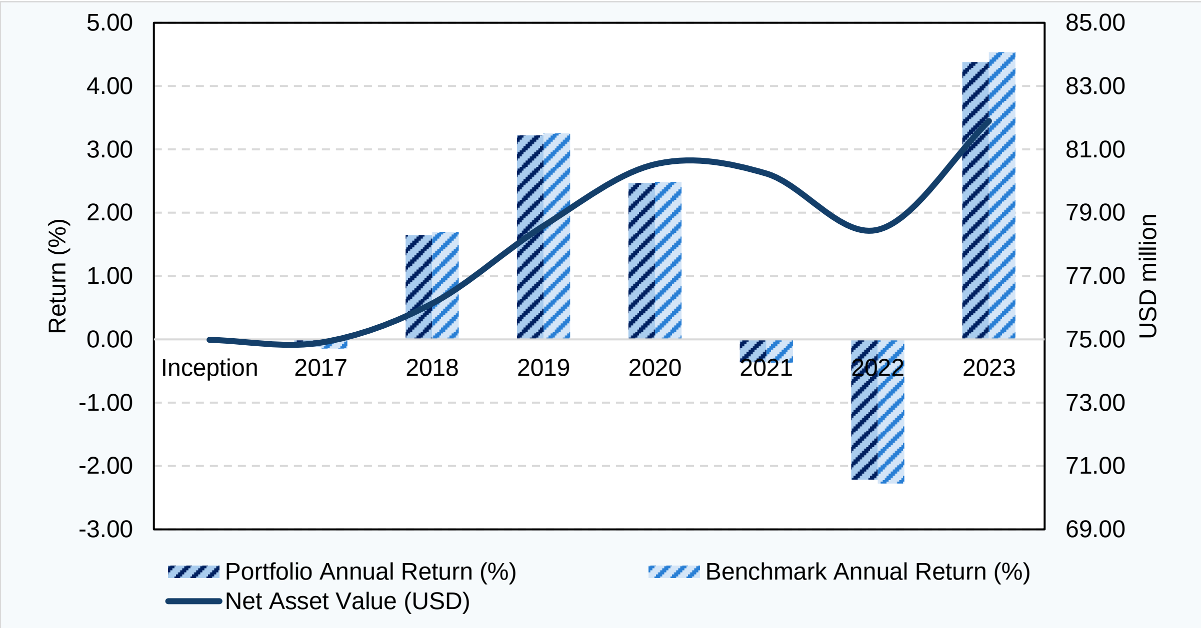
Note: End of year figures
Source: Central Bank of Seychelles

In terms of currency, fixed deposit investments were maintained in USD, GBP, CAD and CNY in 2023. However, for the CNY, a drop of 25 per cent was recorded in the returns generated, compared to 2022. Notably, the Bank re-introduced fixed deposit investments in EUR in 2023, following the revision of the SAA limits for the currency.

4.4.2 Return on Internally Managed Fixed Income Securities

In 2023, the Bank continued the in-house management of the UST bond portfolio that was initiated in September 2017. The portfolio continued to follow a passive investment strategy against the Intercontinental Exchange (ICE) Bank of America (BofA) Merrill Lynch 0–3 Year UST index with the aim of replicating the risk and return characteristics of the benchmark. The yields on short-term US treasuries surged over the last year as they were impacted by the decisions on interest rates by the Fed. The securities held in the internal bond portfolio benefited greatly from the higher applicable yields over time. This was evidenced by the increase in the Net Asset Value (NAV) from US$78.5 million in 2022 to US$81.9 million in 2023, as illustrated in Chart 10. It represented a growth of 9.2 per cent since the initial investment of US$75 million in 2017. The return for the year under review was 4.38 per cent against a benchmark return of 4.45 per cent. Despite the good positive outcome, it was an underperformance of 1.6 percentage points compared to the benchmark.

Chart 10: US Treasury Portfolio Performance against the ICE BofA Merrill Lynch Benchmark since Inception; 2017 – 2023

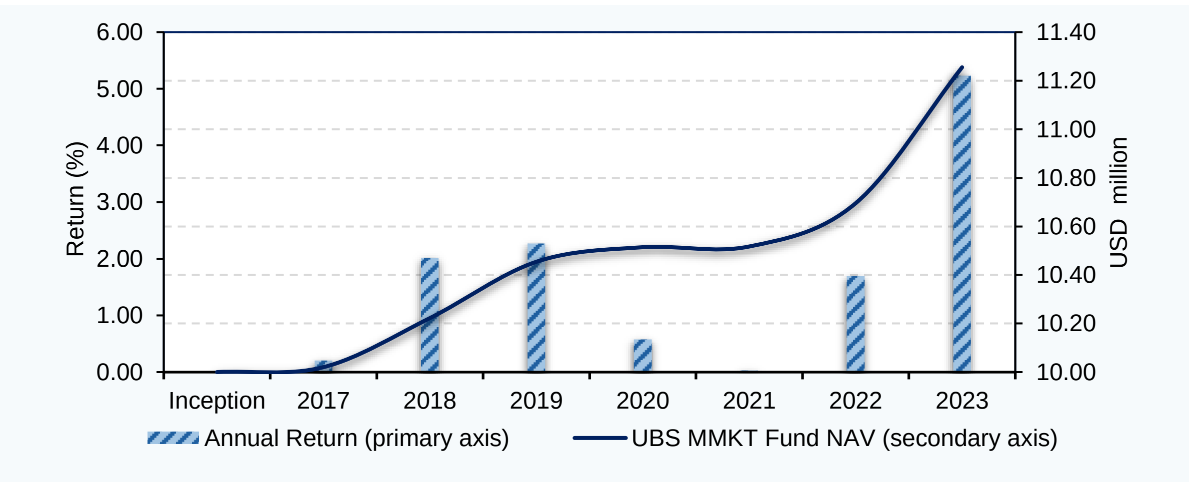


Note: End of year figures
Source: Central Bank of Seychelles

4.4.3 Return Generated from Money Market Fund

The UBS MMF investment started in 2017 with an initial funding amounting to US$10 million. As shown in Chart 11, the investment value was US$11.3 million for the year under review, which was a growth of 13 per cent since its inception. This also represented an annual growth of 5.3 per cent from the end of 2022 position, benefiting from the improvement in US yields.

Chart 11: UBS MMF Performance since Inception; 2017 – 2023

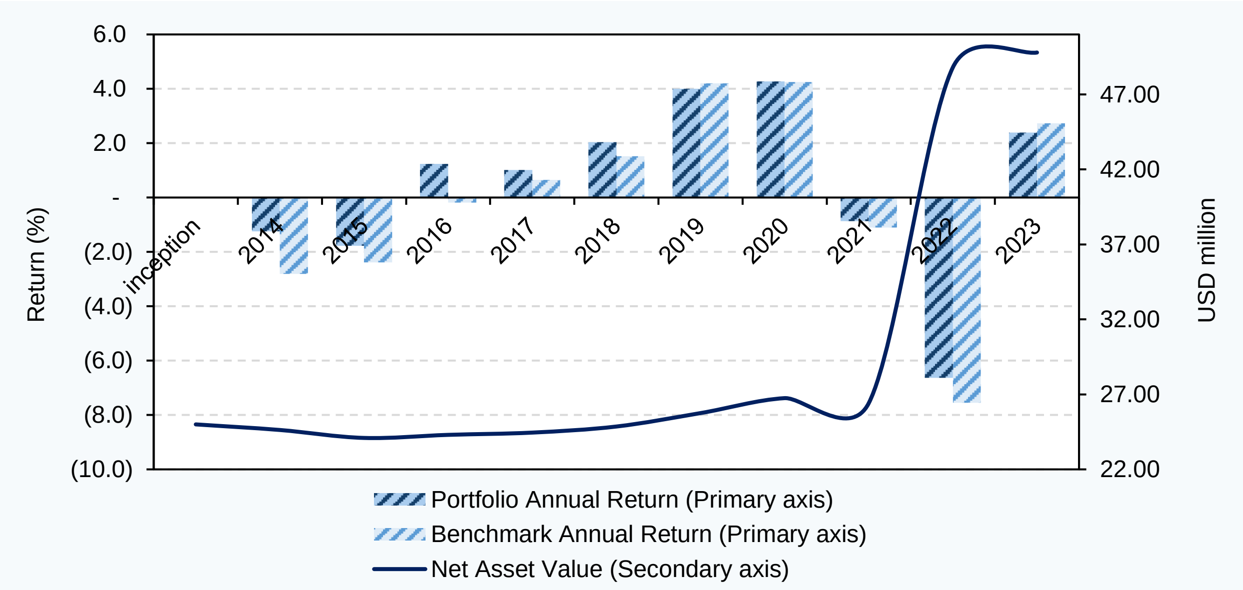


Note: End of year figures
Source: Central Bank of Seychelles

4.4.4. Return generated from the Crown Agents Investment Management

The CAIM external management was initiated in 2014, with US$25 million for active management in fixed income securities. In April 2022, the portfolio was funded further, with US$25 million, converted to an equivalent of CNY162 million. Since then, the portfolio has been managed in a 50-50 allocation against the ICE BofA 1-5 Year US Treasury Index and the ICE BofA 1-5 Year China Government Index. The total value of the CAIM portfolio at the end of 2023, including both USD and CNY investments, was US$49.2 million, which was an improvement of 0.8 per cent compared to US$48.8 million in 2022. Chart 12 displays the performance of the CAIM overall portfolio since its inception.

Chart 12: CAIM Externally Managed Portfolio Performance against the 50-50 ICE BofA Benchmark since inception; 2014 – 2023

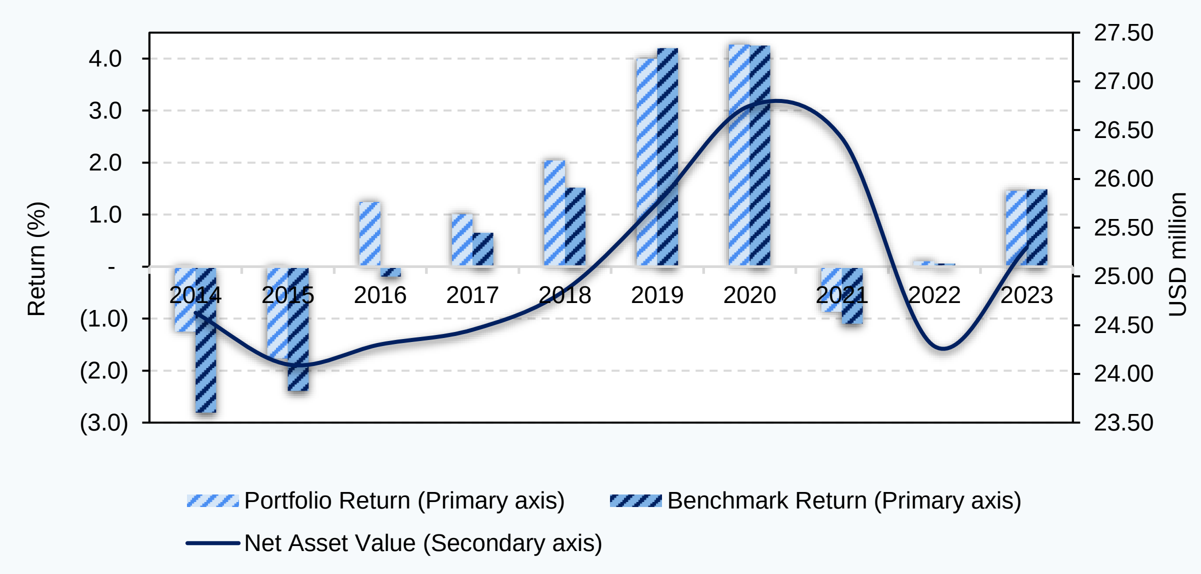


Note: End of year figures
Source: Central Bank of Seychelles

4.4.4.1 Return Generated from the USD-denominated portfolio

The USD portion of the CAIM portfolio improved compared to the previous year's closing position; from US$24.3 million in the previous year to US$25.3 million by the end of 2023. This represented an increase of 4.2 per cent for the year compared to a decline of 8.1 per cent observed in 2022. The USD bond investments were positively impacted by the sustained improvement in yields observed over the past two years. This has helped to produce positive performance for investments in USD. In December 2023, the sub-portfolio return was 1.46 per cent; 0.03 percentage points below the benchmark return of 1.49 per cent. Chart 13 highlights the performance of the CAIM USD sub-portfolio since inception.

Chart 13: CAIM Externally Managed USD Portfolio Performance against the ICE BofA Benchmark since inception; 2014 – 2023

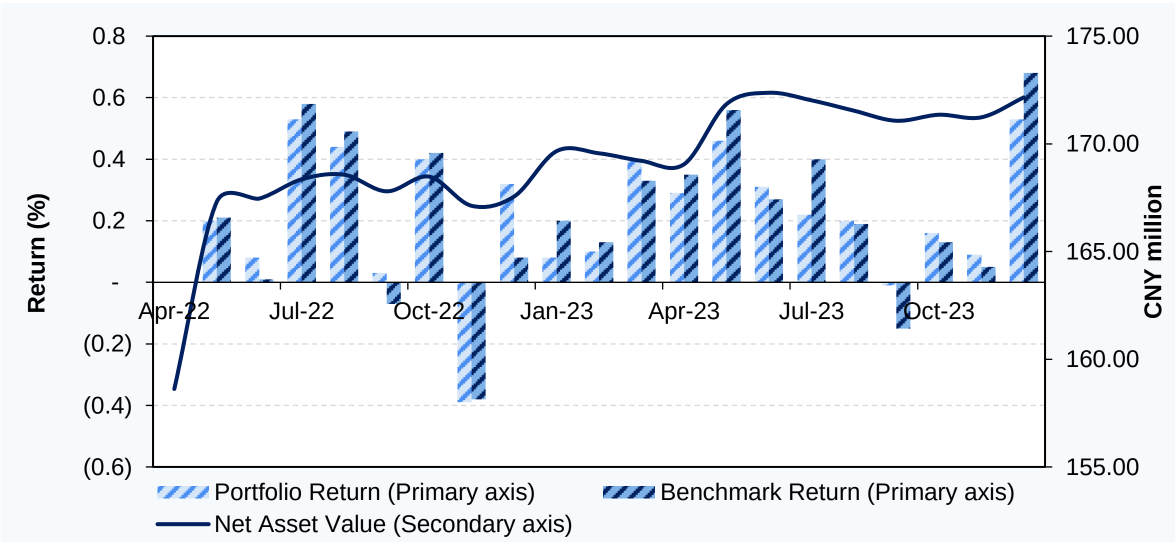


Note: End of year figures
Source: Central Bank of Seychelles

4.4.4.2 Return Generated from the CNY-denominated portfolio

As for the return on the CNY sub-portfolio of the CAIM investment, this fluctuated around the benchmark performance throughout the year under review. The CNY sub-portfolio closed the year at approximately CNY172 million representing an increase of 6.5 per cent since inception. Chart 14 shows the performance of the CAIM CNY sub-portfolio since its inception.

Chart 14: CAIM Externally Managed CNY Portfolio Performance against the ICE BofA Benchmark since inception; April 2022 – December 2023

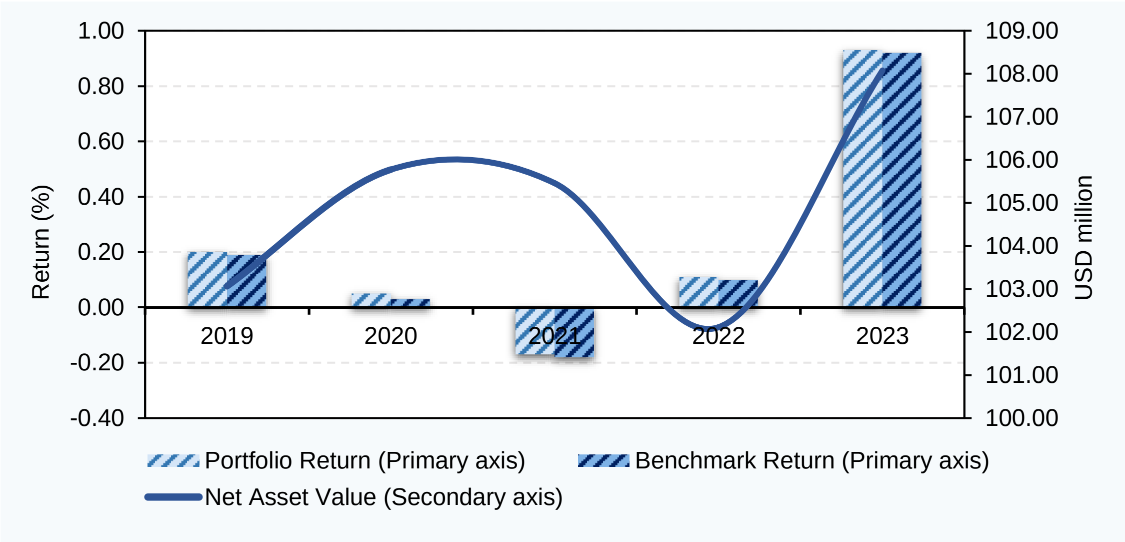


Note: End of year figures
Source: Central Bank of Seychelles

4.4.5 Return Generated from the Reserve Advisory and Management Partnership

For 2023, the Bank maintained its asset management relationship with the World Bank through the RAMP. The RAMP managed a portfolio of approximately US$100 million worth of USD denominated fixed income securities against the ICE BofA US Treasury 0-3 Year Index since 2019. At the end of the year under review, the RAMP portfolio stood at US$108 million, representing an increase of 4.8 per cent over the previous year. Moreover, the portfolio recorded a return of 1.59 per cent since inception, surpassing the benchmark return of 1.47 per cent. Overall, the portfolio return remained above the benchmark as the continued Fed interest rate hikes improved the yield return for fixed income securities compared to the previous year. Chart 15 illustrates the annual performance of the RAMP portfolio since its inception.

Chart 15: RAMP Externally Managed Portfolio Performance against the ICE BofA 0-3 Years Benchmark since inception; 2019 – 2023



Note: End of quarter figures
Source: Central Bank of Seychelles

5.0 Risk Management

The Bank is responsible for monitoring and managing risks related to the international reserves management activities. This is achieved through the formulation of policies and guidelines and subsequent procedures manuals. These documents clearly articulate processes and procedures that effectively govern risks related to undertakings in the management of reserves. To uphold the three objectives of investment of international reserves, the Bank remains vigilant in monitoring and adapting to changes in the main risk exposures within the international reserves landscape. The risks include market, liquidity, credit and operational risks.

5.1 Market Risk

Market risk refers to the risk of losses on financial investments caused by movements in market variables such as asset prices, interest rates and foreign exchange rates. Given that the international reserves is held in multiple foreign currencies it is predisposed to the effects of movements in exchange rates. For 2023, the SCR remained fairly stable against major currencies. Nevertheless, the Bank continued to maintain its strategic currency composition to provide a natural hedge through mirroring the composition of the country's foreign currency liabilities.

Interest rate risk also remained one of the main factors affecting international reserves for the year under review. This was mainly as the major central banks, including the European Central Bank (ECB), raised interest rates in their respective economies. To note, after over a decade of low interest rates, the ECB continued with interest rate hikes which began in 2022. Therefore, at the start of 2023, the new SAA incorporated an increase in the EUR allocation due to positive return expectations for the currency. On another note, the elevated interest rates had a reverse effect on the market value of fixed income investments in USD due to the inverse relationship between interest rates and prices of bonds. Nonetheless, the lower market value was mitigated by the slower hikes nearing the end of the year, income from higher yields through security selection as well as the diversification expertise of external managers.

5.2 Liquidity Risk

For the year under review, the Bank continued to manage liquidity risks through the maintenance of its second investment objective, with tolerance for only liquid instruments with active secondary markets or those that may be readily liquefied when required.

5.3 Credit Risk

Credit risk is the potential default of an issuer or counterparty on its payment obligation. During the year under review the Bank maintained its diligent monitoring of counterparty credit rating to ensure compliance to approved credit rating limits. Scheduled due diligence reviews were conducted on current counterparties to ensure consistency with the Bank's risk tolerance. Additionally, as a result of the collapse of noteworthy international banks and the threat of a global banking crisis, the risk function within reserves management intensified by carrying out additional due diligence examinations on potentially affected counterparties.

5.4 Operational Risk

Operational risk is the prospect of loss resulting from inadequate or failed procedures, systems, policies or any event that disrupts business processes. For 2023, the Bank continued to adhere to the Operational Risk Management (ORM) framework as approved by the Board in 2021. This included monitoring and recording of operational risk occurrences for diagnostics and corrective measures.

6.0 Challenges

The geo-political tensions that emerged in the preceding year had more repercussions in 2023. The ongoing Russia-Ukraine war continued to cause restrictions to global supply chains, causing fuel and commodity prices to remain elevated. The mounting inflationary pressures led to central banks maintaining hawkish interest rate approaches throughout the most part of 2023, especially in the first half of the year, resulting in central banks' policy rates reaching record-breaking levels.

The Fed announced its first interest rate hike of the year in February, to raise the Fed fund rate from 4.50% to 4.75%. This was in continuation to its previous 50 basis points hike in December 2022 given the slight progress in curbing inflation rate to its 2.00% target. Another 25-basis points rate hike followed in March, reflecting the Fed's commitment in achieving its inflation goals, despite growing concerns over the stability of the US banking system following the collapse of major US banks. The Fed remained prudent about the impact of its monetary policy decisions over the US banking system through super-advisory measures. It also maintained a hawkish stance in the subsequent months, reaching a peak base interest rate of 5.25% in August 2023, which was held steady through to the end of the year. The rising yields caused the Bank's fixed income portfolios to decline in mark-to-market value at certain time in the year. However, due to careful security selection, internally and externally managed fixed income portfolios recorded positive year-on-year returns as at the end of December 2023. Additionally, heightened concerns about the US economy possibly heading towards a recession as opposed to a soft landing, kept the treasury yield curve inverted throughout the year, with the inversion being more pronounced in May 2023. This represented an opportunity cost in the passive management of the Bank's internally managed USD bond portfolio, as higher yields were forgone on the shorter end of the yield curve due to the obligation to match benchmark duration.

Similarly, the BOE started off the year with a 25-basis point hike in February as headline inflation began to edge back. However, underlying inflation stemming from a tight labour market and wage pressures led to further interest rate hikes in the ensuing months. The BOE eventually ended its run of 14 interest rate hikes in September, reaching a 15-year high benchmark rate of 5.25%. Moreover, the UK headline inflation fell to an annual rate of 4.6% in October and the BOE later announced that the restrictive monetary policy stance may be prolonged as inflation remained above the desired level. To this end, the interest rate level remained unchanged for the remainder of the year.

As for the ECB, the bank increased the interest rates on its main refinancing operations and standing facilities by 50 basis points for its first two monetary policy meetings of the year. The interest rates on its main refinancing operations reached a peak of 4.00% in 2023, the highest since the global financial crisis of 2008. Overall, the ECB hiked interest rates a total of 10 times since July 2022. Consistent with the Fed and BOE, the ECB took a more dovish stance towards the end of the year given the view of disinflationary pressures.

Amid these changes in macroeconomic fundamentals, the Bank reviewed the SAA at the start of the year. The better performance of the EUR following the end to ECB's run of negative interest rates, provided for an increase in allocation for the currency. As such, in March 2023, the Bank gradually converted some of the USD deposits to EUR by maturing approximately US$51 million with the Bank for International Settlements (BIS).

Conversely, the People's Bank of China (PBOC) announced their first interest rate cut in 10 months at their June monetary policy meeting, with the aim of injecting liquidity in the banking system and influencing interest rate on loans after a sluggish post COVID-19 recovery. This led to a decline in the return on CNY fixed deposits as counterparts passed on the lower interest rates. As such, the Bank placed deposits on slightly longer tenors to mitigate expected rollover risk due to the declining CNY interest rates. The easing of monetary policy conditions also resulted in a depreciation of the CNY against the USD. Particularly in the second half of the year, the depreciation of the CNY negatively impacted the market value of the CNY bond investments in the externally managed portfolio by the CAIM, when measured in USD. However, in both local currency and USD terms, the CNY component of the portfolio recorded positive growth on a year-on-year basis. Despite the depreciation of the CNY, the Bank maintained its exposure to the currency in view of its economic significance for the country as determined by the SAA.

Furthermore, the internal reserve management activities remained susceptible to operational challenges and counterparty risks due to limited external counterparts. In response, the Bank continued to improve its counterparty on-boarding policies and guidelines, while looking for opportunities to engage new partners. Notwithstanding the unfavourable external macroeconomic conditions, the international reserves demonstrated resilience given the improved performance relative to the preceding year.

7.0 Training and Capacity Building

Throughout the year, the Bank has maintained the importance of reinforcing and building the capacity of its staff, to ensure development in the management of international reserves. During 2023, staff attended in-person or virtual trainings, forums and workshops. The sessions were facilitated by the World Bank's RAMP and other counterparts such as the CAIM and UBS.

Face-to-face and virtual sessions were provided by service providers such as Bloomberg and credit rating agencies. These sessions allowed staff to gather insights into the trending tools for portfolio management and risk management. Furthermore, it allowed them to interact with experts in technical discussions on challenges and developments on the international financial markets.

Overall, twelve workshops were attended as part of the Bank's engagement with the RAMP throughout the year; seven were attended virtually and the remainder in-person. These workshops included portfolio management and governance subjects such as SAA, market risk, legal aspects of asset management, along with investing in China's financial market. Other topics that were selected for capacity reinforcement included custodial relationship, application of IFRS for investment portfolios as well as Excel and Python modelling techniques. These areas for development were selected in view of the evolving nature of the international financial markets. Similar to previous years, seven staff were able to engage in professional training sponsored by the RAMP. Two staff attempted the Association Cambiste Internationale (ACI) exams, three others pursued the Certified Internal Auditor (CIA) qualification, one staff undertook the Chartered Financial Analyst (CFA) and another took the Financial Risk Manager (FRM) exam.

In line with its strategy to expose staff involved in reserves management activities to best practices by its counterparts, ten staff participated in a five-day attachment with the CAIM. Topics addressed related to macroeconomic developments, bond market performance and outlook, portfolio management strategies and yield curve modelling. The attachment also included a visit to the London financial hub, where the attendees could interact with brokerage firms and practitioners in the London financial markets. Also, one member of the IC attended a forum for reserve managers hosted by the UBS. This was an opportunity for senior decision makers to network and exchange ideas on best practices in reserves management.

8.0 Way Forward

For 2024, the Bank will intensify the work towards the acquisition of a new reserves management system, which will replace the current software–the Portfolio Analytical Tool (PAT II). The current system was provided under the RAMP and is expected to cease operation in 2026. The request for proposal phase of the procurement is expected to be completed in 2024. The implementation phase will commence subsequent to the deployment of the Bank's new core banking system, scheduled to 'go live' in 2024. This will allow for the seamless integration of both software platforms and optimise resource allocation for the execution of the projects.

On the risk and governance aspects, the Bank will continue to enhance the international reserves management framework through ongoing review of the Investment Policy and Guidelines. In terms of day-to-day management, work will continue to improve the diversification of the various risks associated with the management of international reserves. This will be done through ongoing reviews of asset allocations, market monitoring as well as new counterparty engagements.

Undoubtedly, to achieve the plans and objectives in international reserves management, the continuous development of the staff and Management will remain as a core driver for 2024 and the years to come. To accomplish this, the Bank will continue the engagements with its development partners and seek out new learning opportunities for its employees.

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