



Tuesday 6 October 2009

Overnight Releases

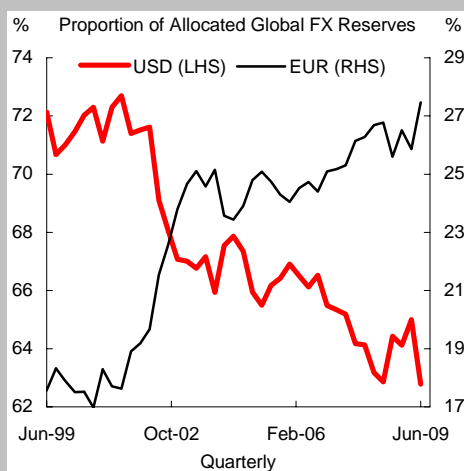
- Wall St up over 1% and currencies firmer.
- ECB's Weber saying he expects to see Asian countries make their fx rates more flexible.
- NZ Fin Min English saying he wishes the NZD to reflect economic fundamentals not fx flows.
- EZ Final Services PMI up to 50.9 from 50.6.
- EZ Retail Sales at -0.2% for Aug vs -0.5% exp.
- UK Services PMI rising to 55.3 in Sep (highest since Sep 07) vs forecasts for 54.4.
- BoE saying that it will widen the eligibility for banks to hold reserve accounts with it, to help smaller institutions manage their liquidity.
- US non-manuf. ISM out with a 50.9 vs 50.0 exp.
- A number of analyst/media reports forecasting a 25pt rate hike by the RBA today.

Overnight Currency Ranges

	High	Low	NY Close
AUD/USD	0.8797	0.8719	0.8778
NZD/USD	0.7314	0.7176	0.7307
AUD/NZD	1.2166	1.2008	1.2007
EUR/USD	1.4670	1.4593	1.4648
GBP/USD	1.6025	1.5903	1.5936
USD/JPY	89.97	89.41	89.52
AUD/JPY	78.73	78.26	78.58

Source: Reuters, Macquarie FX, October 2009

The proportion of allocated FX reserves in USD's fell in Q2



Source: Reuters, Macquarie FX, October 2009

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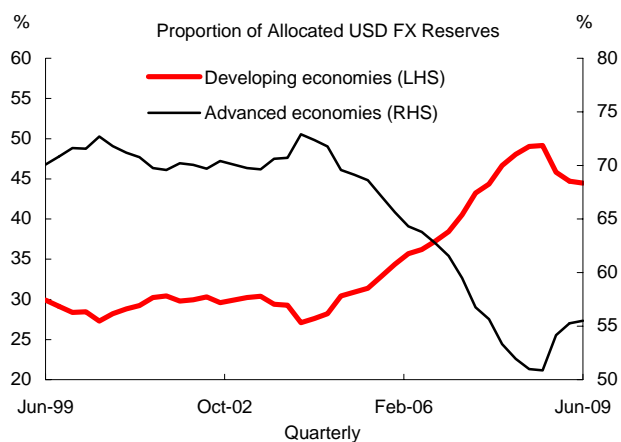
Currency Perspective

With more FX reserves, comes more responsibility.

- The IMF released their Q2 update to their Currency Composition of Official Foreign Exchange Reserves (COFER) data last week.
- Last quarter, the data revealed that the value of global FX reserves contracted and contrary to popular market belief the proportion of USD FX reserves actually increased. But Q2 painted a very different picture.
- In Q2, FX reserve accumulation re-started with the value of total FX reserves increasing to US\$6.8 trillion, highest level since 3Q08. Of this amount, US\$4.3 trillion (up from US\$4.0 trillion), allocation details are provided by central banks.
- The proportion of USD reserves, at least on an allocated basis (includes 33 advanced economies and 107 emerging/developing economies - China not included), fell to 62.8% from 65% in Q1 (see chart opposite). The proportion of EUR reserves, however, increased to 27.5% from 25.9%. The proportion of JPY rose to 3.1% from 2.9%.
- Perhaps more interestingly, especially for FX participants who believe that the days of USD supremacy are numbered, is that the proportion of allocated USD reserves has been declining since 2002. Although it is important to consider the decline in the value in the USD dollar over this time, as a key driver of this trend.
- The change in the proportion of USD reserves over the 1H09 illustrates the impact that currency moves can have on the composition of FX reserves. In Q1, the proportion of allocated FX reserves in the USD increased to 65% from 64.1% and during this time the USD index strengthened by more than 5%. Throughout Q2, the USD index fell by more than 6%. Furthermore, since 2000, the correlation between the quarterly change in the proportion of FX reserves held in the USD and the quarterly percent change in the USD index is over 80%. So with the USD index continuing to fall over the 2H09 it is fair to expect that the proportion of USD FX reserves will continue to fall over the remainder of the year.
- A breakdown of the Q2 data indicate that the allocation of FX reserves in USD's by Developed Economies continued to rise to 55.2% from 55.5% as a proportion of allocated FX reserves (see first chart on page 2). For Developing Economies (does not include China) the USD allocation fell slightly in Q2 to 44.5% from 44.7% while the allocation assigned to EUR's fell to 54% from 56.2%, dismissing claims that these central banks are eyeing the Euro as a replacement for the USD as the world's reserve currency.
- The major issue with the COFER data is that several countries (more than one third of developing/emerging economies) do not report the currency composition of their FX reserves to the IMF - including China. And if you consider that the FX reserves of many advanced economies remains static, while the reserves of emerging/developing economies are soaring, the validity of the data can and should be questioned.



Advanced Economies increased their proportion of USD holdings



Source: IMF, Macquarie FX, October 2009

- Arguably though, if these economies are to assume a greater responsibility in the global economy (as indicated by the G20 becoming the new G7), economies like China, India, Brazil, and Russia will need to become more transparent. And the composition of their FX reserves (i.e. where are they investing their money) is one area China (the largest holder of FX reserves) will need to come clean on, if only for the sake of the global economy. Shifting to a flexible exchange rate is another.

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