

GOVERNOR'S FOREWORD

The Australian economy entered the past financial year growing strongly, as it had done for most of the 1990s. But the year was to prove eventful both for the world economy and our own. The long-expected slowdown in the United States finally became apparent at the beginning of 2001, and signs of weakness emerged in other major countries at about the same time. Australia's economic developments showed a number of similarities with the rest of the world, but with one important difference – the transition effects of the introduction of the GST caused an exceptionally sharp temporary contraction in house-building in the second half of 2000. This, in turn, resulted in a small fall in GDP in the same period, before moderate growth resumed in the first half of 2001.

Notwithstanding this "once-off" timing effect, Australian monetary policy moved broadly in line with monetary policy in most other major countries. The monetary policy tightening in August 2000 was the last in a series of five that began in November 1999. By early February, with the world cycle having turned, inflation remaining low and domestic conditions weaker, the first of three easings occurred which brought the cash rate down from 6.25 per cent to 5.0 per cent.

The development of monetary policy and the economy over the year have been thoroughly explained in the regular *Statements on Monetary Policy*, testimony before the House of Representatives Standing Committee on Economics, Finance and Public Administration, media releases accompanying the changes in monetary policy, and in speeches by senior officers of the RBA. For this reason, the *Annual Report* has for some years now concentrated on

giving an account of the other activities of the RBA during the year, as well as presenting the financial statements. The following points summarise the main activities for the year – more detail is to be found in the body of the *Annual Report*.

- Financial market operations, in both domestic and foreign markets, are carried out by the Financial Markets Group. As well as implementing monetary policy through domestic market operations and, from time to time, conducting foreign exchange intervention, the Group has a substantial ongoing role transacting in financial markets to manage the RBA's portfolio and act as agent for the Government. These transactions involve buying and selling Commonwealth Government securities and other highly rated Australian dollar securities outright and under repurchase agreement, buying and selling foreign exchange outright and under swap arrangements, buying and selling foreign government securities, and lending gold. In total, these transactions average about \$19 billion per day. Their size and complexity inevitably mean that the RBA cannot avoid exposing itself to an element of financial risk. We have taken the opportunity to devote a major section of the first chapter of this *Report* to outlining the risk management procedures adopted to monitor and control the RBA's exposure.
- The Financial System Group has responsibility for payments system policy (under the purview of the Payments System Board) and for general oversight of financial system stability. In the first area, the major

development during 2000/01 was the designation of the three credit card schemes operating in Australia so that the Payments System Board could determine whether the regulations applied by the schemes – which govern the setting of wholesale (interchange) fees, scheme membership and the rights of merchants to recover costs – are in the public interest. This is a major project involving extensive consultation with interested parties, a public discussion paper and a final report probably by the end of 2001. A fuller account of this project can be found in the forthcoming *Payments System Board Annual Report*. In the second area, a description of the recent developments that have influenced the stability of the Australian financial system is given in this *Annual Report*. It concludes that, overall, the system has shown itself to be prudentially sound by our past standards or standards prevailing overseas, with the one exception being in the area of general insurance (including reinsurance).

- The new National Note Processing Centre located in the premises of Note Printing Australia Limited (NPA) at Craigieburn outside Melbourne opened in June. This replaces the separate note-processing facilities located in each branch, including Sydney, that have operated until recently. At the same time, commercial banks will progressively assume ownership of working stocks of currency currently owned by the RBA, but held externally in Note and Coin Pools operated by armoured car companies. Two results of this change are that the RBA will no longer own notes that are held outside its own premises,

and the commercial banks will establish a market for currency that will operate directly between them, and not pass through the RBA as an intermediary.

- The new Regional Offices in Melbourne, Brisbane and Perth are now up and running. They have established good links with businesses, State governments and industry groups in their respective States, and are also fully participating in the work of Economic Group in Sydney, as is an economist added to the RBA's branch in Adelaide.
- The Federation \$5 note began circulating on 1 January and was well received by the public. Total note production by NPA was lower in 2000/01 than the previous year when additional stocks of notes were produced to cater for possible increased demand associated with the new millennium. The only new export orders for NPA were from Mexico, Kuwait and the Solomon Islands, but Securrency was able to secure export orders for substrate for new notes printed in Mexico, Vietnam, Romania and Austria.

The large reductions in our staff numbers that have occurred virtually every year for nearly 20 years seem to be in the process of levelling out. While further reductions will no doubt occur in some areas in future years, there is also the prospect that increases will occur in other areas, or new functions be taken on. Examples of the latter are the Regional Offices, the new section in Economic Group devoted to regional and industry analysis, and the National Note Processing Centre. The RBA may now be close to the size that is commensurate with discharging its responsibilities using “first best” technology and management practices.