EARNINGS AND DISTRIBUTION

PROFITS AVAILABLE FOR DISTRIBUTION

The financial assets held by the Reserve Bank to implement monetary policy yield substantial profits each year. The profits available for distribution have two components – underlying earnings on the RBA's portfolio plus gains or losses that are realised when it sells assets in the course of implementing monetary policy or when undertaking operations to manage the composition of its international reserves.

Underlying earnings mainly reflect profits earned from the RBA's role as issuer of currency in Australia. Both currency – the RBA's largest liability – and its capital and reserves are interest-free liabilities. The RBA's underlying earnings come from investing these interest-free funds in interest-earning assets. They are determined mainly by the size of the balance sheet and the interest margin on assets relative to the cost of liabilities. Fees from services the RBA provides, such as from banking and settlement operations, also add to underlying earnings. But its operating costs and interest paid on some liabilities, such as Government deposits and Exchange Settlement accounts, subtract from them.

In 2000/01, underlying earnings were $1 629 million, an increase of about $118 million from the previous year. The increase in 2000/01 was due to growth in the size of the balance sheet as the interest margin was little changed from the previous year. Underlying earnings in the past couple of years have been lower than in the second half of the 1990s, reflecting the abolition of non-callable deposits of banks in July 1999. Since the interest rate paid on these deposits was 5 percentage points below the yield on Treasury notes, while they were invested at market yields, the abolition of non-callable deposits had the effect of reducing the RBA's earnings.

In addition to underlying earnings, the RBA also makes gains or losses due to changes in the value of its assets as prices change in relevant financial markets. Valuation gains on the RBA's portfolio arise when the price of the securities it holds increases as interest rates fall, or when exchange rates of foreign currencies in which the RBA holds assets appreciate against the Australian dollar. Losses are made when interest rates and exchange rates move against the RBA. The RBA realises gains (losses) when it sells securities or foreign exchange at a higher (lower) prices than the cost of these items in its balance sheet.

The RBA's approach to accounting for realised gains (losses) arising from foreign exchange swap transactions has been changed in the past year. In earlier years, sales of foreign exchange under a swap were treated in the same way as an outright sale, with the RBA booking a gain or a loss on the transaction as it occurred. The growth of the swap book, associated with the increased use of swaps for domestic liquidity management, prompted a review of this accounting treatment. The new approach brings the treatment of swaps into line with the long-standing treatment of repurchase agreements, which are structured in the same way as a foreign exchange swap (except that the underlying instrument is a security rather than foreign exchange).

The new treatment recognises that realised gains (losses) on one leg of a swap are exactly offset by unrealised losses (gains) on the other leg. The new approach no longer sees swap transactions immediately realise a gain or loss. While this changed approach has no effect on accounting profits, total realised gains (losses) will be smaller and less volatile than in the past. The RBA's measured realised gains and losses from foreign exchange will now reflect the outcome only of its outright sales of foreign exchange.

In 2000/01, lower interest rates abroad and the lower Australian dollar exchange rate favoured the RBA so that realised gains on its portfolio totalled about $1 200 million, compared with realised losses of $708 million the previous year. Out of the total realised gains, operations associated with managing international reserves saw realised gains on foreign investments of $558 million in 2000/01, with interest rates falling globally. This was offset by sales of domestic securities, related to implementation of monetary policy and assisting the Commonwealth to reduce its debt on issue, which realised a loss of $101 million. Operations in the foreign exchange market saw realised gains of about $743 million. In addition to the gains realised on its portfolio of financial assets, the RBA realised a valuation gain of about $5 million on the sale of its building in Brisbane, a sum which is also available for distribution.

Total earnings available for distribution – the sum of underlying earnings and realised gains – amounted to $2 834 million in 2000/01, compared with $803 million available from profits in 1999/2000. The payment from 1999/2000 profits was supplemented by $676 million deferred from the previous year, with a total payment to the Commonwealth Government of $1 479 million made early in the 2000/01 financial year.

Sources of Earnings Available for Distribution

($ million)

	Underlying Earnings	Realised Gains and Losses	Earnings Available for Distribution
1985/86	1 292	1 371	2 663
1986/87	1 412	2 035	3 447
1987/88	1 508	18	1 526
1988/89	971	-554*	417
1989/90	1 248	-153*	1 095
1990/91	1 322	391	1 713
1991/92	1 516	1 038	2 554
1992/93	1 760	2 803	4 563
1993/94	1 556	-48*	1 508
1994/95	1 649	123	1 772
1995/96	1 784	702*	2 486
1996/97	1 715	1 990	3 705
1997/98	1 750	1 524	3 274
1998/99	1 816	1 860*	3 676
1999/2000	1 511	-708	803
2000/01	1 629	1 205	2 834

* Includes unrealised losses in excess of previous years' unrealised gains held in reserves

ACCOUNTING PROFITS

Since 1998, the RBA has followed accepted accounting practice in calculating net accounting profit as the sum of underlying earnings plus valuation changes – both realised and unrealised – in the RBA's portfolio. Valuation changes resulted in gains totalling $1 520 million in 2000/01 which, with underlying earnings of $1 629 million, give a net accounting profit of $3 149 million (this compares with $2 292 million in 1999/2000).

In terms of the *Reserve Bank Act* and in line with international central banking practice, unrealised gains are not available to be paid to the Commonwealth Government. Unrealised gains are set aside in the Unrealised Profits Reserve as a buffer against future unrealised losses, or are realised when the relevant assets are sold.

RESERVES

Section 30 of the *Reserve Bank Act* provides for the Treasurer to determine, after consultation with the Board, the amount, if any, to be credited to the RBA's reserves from earnings available for distribution. The balance of distributable earnings, after any transfer to reserves, is payable to the Commonwealth Government.

Like other banks, the RBA holds capital and reserves to absorb losses that might arise in the course of its operations. While in past years the RBA had maintained two major reserves to deal with such contingencies, the Board decided to consolidate these into the one fund, the Reserve Bank Reserve Fund (RBRF). The balance in the enlarged RBRF stood at $6 152 million on 30 June 2001, the equivalent of 10.6 per cent of the RBA's total assets. The Board regarded this level of reserves as adequate and saw no need to seek from the Treasurer any transfer from profits to the RBRF. Accordingly, all of the funds available for distribution from the RBA's profits in 2000/01 will be paid to the Commonwealth. The practice in recent years has been for the Commonwealth's dividend to be paid early in the financial year following that in which it was earned. The exception was in 1998/99, when the Treasurer decided to defer the receipt of some of that year's profits, spreading the dividend over the following two years. The Reserve Bank has not made an interim payment from the current year's earnings since 1995/96.

The RBA also maintains unrealised profits and asset revaluation reserves, with the balances in these reserves reflecting the amount by which the market value of the RBA's traded assets, gold and property holdings exceed the price at which they were purchased. They are not available for distribution to the Government until they are realised. The amounts in these reserves vary with market prices but at 30 June 2001 stood at $3 239 million.

The total amount of earnings available for distribution from profits earned in 2000/01 was paid to the Commonwealth Government in August 2001.

Reserve Bank Payments to Government

($ million)

	Earnings Available for Distribution	Transfers to Reserves	Payments to the Commonwealth				
			Balance Available from Current Year's Profit	Interim Payment from Current Year's Profit	Payment from Previous Year's Profits	Payment Delayed from Earlier Years	Total Payment
1990/91	1 713	210	1 503	400	275	-	675
1991/92	2 554	200	2 354	400	1 103	-	1 503
1992/93	4 563	750	3 813	600	1 954	-	2 554
1993/94	1 508	-	1 508	-	3 213	-	3 213
1994/95	1 772	-	1 772	200	1 508	-	1 708
1995/96	2 486	150	2 336	200	1 572	-	1 772
1996/97	3 705	2 005	1 700	-	2 136	-	2 136
1997/98	3 274	548	2 726	-	1 700	-	1 700
1998/99	3 676	-	3 676	-	2 726	-	2 726
1999/2000	803	-	803	-	3 000	-	3 000
2000/01	2 834	-	2 834	-	803	676	1 479
2001/02	-	-	-	-	2 834	-	2 834

The RBA's 2000/01 Financial Statements are presented in the following pages.