

Earnings and Distribution

The Reserve Bank manages a balance sheet of financial assets to conduct operations in financial markets to pursue its monetary policy objectives. The balance sheet fluctuates in size according to these operations; total assets averaged around \$89 billion in 2012/13. These assets include Australia's foreign exchange reserves as well as domestic securities used to manage liquidity in Australia. Management of the Bank's assets is discussed in the chapter on 'Operations in Financial Markets'; a discussion of the associated risks appears in the chapter on 'Risk Management'. Liabilities on the balance sheet are composed of banknotes on issue, deposits of the Australian Government and other customers, and capital and reserves.

The Reserve Bank's earnings come from two sources of income. The first, underlying earnings, arises because the Bank earns interest on almost all of its assets while it pays no interest on a large portion of its liabilities, including banknotes in circulation and capital and reserves. With interest rates around the world at exceptionally low levels, underlying earnings have also been very low in recent years. The second source of income arises from valuation gains or losses resulting from fluctuations in the value of the Bank's assets that reflect changes in exchange rates or security yields. An appreciation of the Australian dollar or a rise in interest rates reduces the value of the Bank's securities, resulting in valuation losses. Conversely, a depreciation of the Australian dollar or a decline in market yields has the opposite effect and results in valuation gains. These valuation gains and losses are realised only when the Bank sells the underlying asset.

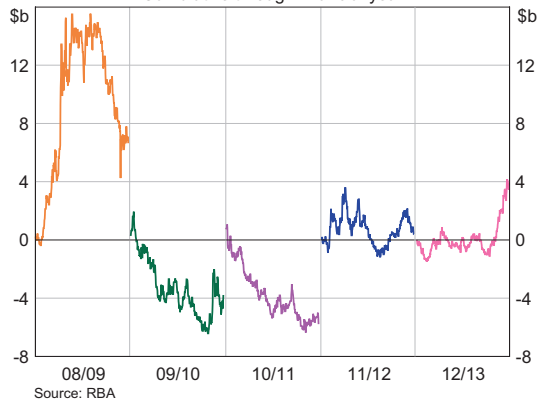
Valuation gains and losses are volatile as market interest rates and the exchange rate can fluctuate across wide ranges over time. The Reserve Bank has limited discretion to manage these foreign exchange and interest rate risks since, as noted, its financial assets are mainly held for policy purposes and are managed accordingly. If the exchange rate depreciates, as it did this year, valuation gains are recorded. In some recent years, by contrast, large valuation losses occurred as the exchange rate appreciated.

Reserves-weighted Exchange Rate*
30 June 2009 = 100



* Australian dollar exchange rate weighted by composition of the RBA's foreign reserves
Source: RBA

Valuation Gains and Losses
Cumulative through financial year



Source: RBA

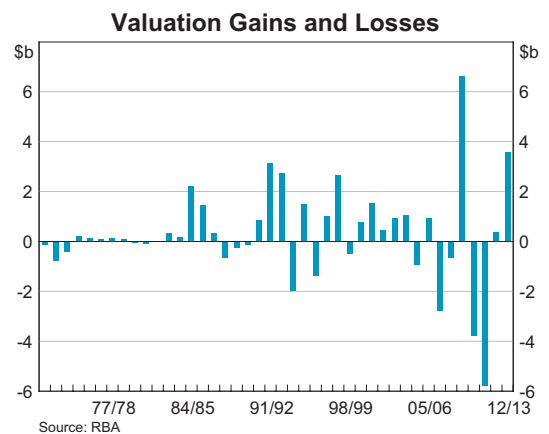
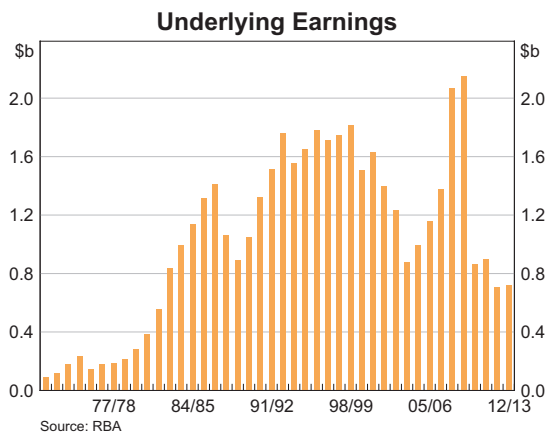
The distribution of the Reserve Bank's net profits is determined by section 30 of the *Reserve Bank Act 1959*. In terms of the Act, underlying earnings and realised gains and losses are available for distribution. Unrealised gains are not available for distribution, but are transferred to an unrealised profits reserve where they are retained to absorb future valuation losses or until the relevant assets are sold and the gains realised. The legislative provision to retain unrealised gains reflects sound central banking practice, as the distribution of the unrealised gains would reduce the Bank's capacity to absorb any future valuation losses. Unrealised losses are, in the first instance, also transferred to this unrealised profits reserve, and are offset against unrealised gains accumulated from previous years. For purposes of calculating distributable earnings, any unrealised losses that exceed retained unrealised gains are initially offset against other sources of income, namely underlying earnings and realised gains, with any remaining losses charged against the Reserve Bank Reserve Fund, the Bank's permanent reserve. Such a charge has occurred in some recent years.

The Reserve Bank's Earnings

In accordance with Australian Accounting Standards (AAS), the Reserve Bank reports accounting profit as earnings from all sources, including realised and unrealised valuation gains and losses. In the 12 months to 30 June 2013, the Bank recorded an accounting profit of \$4 313 million, compared with a profit of \$1 076 million in the previous financial year. The accounting profit in 2012/13 comprised:

- Underlying earnings of \$723 million, which were slightly higher than in the previous financial year, but still exceptionally low in historical terms, reflecting the continuing low level of interest rates in Australia and in the countries in which Australia's international reserves are held.
- Realised valuation losses of \$135 million, primarily from maturing domestic securities purchased during the year at a premium that reflected the high coupon at which they were issued. The Bank purchased these securities to help manage the impact on liquidity as the large line of stock matured. Taking account of coupon payments while the stock was held, the relevant bond holding was profitable for the Bank. Gains were realised on foreign exchange transactions associated with managing the portfolio of foreign reserves.
- Unrealised valuation gains of \$3 725 million, mainly from holdings of foreign exchange as the Australian dollar depreciated later in the year against currencies in which international reserves are held.

Earnings available for distribution amounted to \$588 million in 2012/13, comprising underlying earnings less realised valuation losses.



The composition and distribution of the accounting profit in 2012/13, and of historical profits and losses, are summarised in the table on page 72.

Reserves and Distribution

The Reserve Bank Reserve Fund (RBRF), the Bank's permanent general reserve, is established by the Reserve Bank Act. In terms of this Act, sums are credited to the RBRF from earnings available for distribution, as determined by the Treasurer after consulting the Reserve Bank Board. The balance of distributable earnings after any such transfer is payable as a dividend to the Commonwealth.

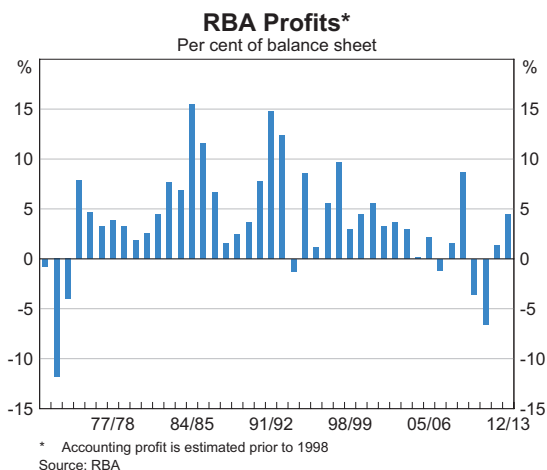
The RBRF is essentially the Reserve Bank's capital. Its primary purpose is to provide a capacity to absorb losses when it is necessary to do so. The RBRF served this purpose when it was substantially depleted in 2009/10 and 2010/11 by large accounting losses as the exchange rate appreciated. Following these losses, the Reserve Bank Board considered the balance of the RBRF to be below a level appropriate to the market risks on the Bank's balance sheet. The Treasurer determined, after consulting the Board, that \$596 million from earnings available for distribution in 2011/12 be transferred to the RBRF with \$500 million paid as a dividend to the Commonwealth. In 2012/13, the Treasurer determined that all earnings available for distribution be credited to the RBRF. With this transfer of \$588 million, the balance of the RBRF at 30 June 2013 stood at \$2 501 million. The Board considers that further transfers to this reserve will be needed in future years to restore its balance to a level that adequately reflects the Bank's risks.

In addition to the RBRF, the Reserve Bank maintains a number of other financial reserves. As noted, unrealised gains are transferred to an unrealised profits reserve where they are retained to absorb future valuation losses or are realised, and become available for distribution, when the relevant assets are sold. Unrealised gains of \$3 725 million were transferred in 2012/13 to this reserve, the first time such a transfer has been possible since 2008/09. By contrast with the RBRF, which is a permanent reserve, the balance of the unrealised profits reserve fluctuates in response to movements in the exchange rate or bond yields. This balance is nevertheless available as a buffer to absorb unrealised losses that would occur if the exchange rate appreciated or bond yields rose.

Asset revaluation reserves are held for non-traded assets such as gold holdings, property, plant and equipment. Balances in these reserves represent the difference between the market value of these assets and the cost at which they were acquired. The total balance in these reserves stood at \$3 705 million at 30 June 2013, \$670 million lower than a year earlier, mainly reflecting the fall in the Australian dollar value of the Bank's holdings of gold.

The balance of the RBRF plus asset revaluation reserves and unrealised profits reserves stood at 10.1 per cent of total assets at 30 June 2013.

The Reserve Bank's financial statements (and accompanying Notes to the Financial Statements) for the 2012/13 financial year were prepared in accordance with AAS, consistent with the Finance Minister's Orders issued under the *Commonwealth Authorities and Companies Act 1997*.



Composition and Distribution of Reserve Bank Profits

\$ million

	Composition of profits				Distribution of profits				Payments to government		
	Underlying earnings	Realised gains and losses ^(a)	Unrealised gains and losses(-)	Accounting profit or loss(-)	Unrealised profits reserve	Asset revaluation reserves	Reserve Bank Fund	Dividend payable	Payment from previous year's profit	Payment from delayed from previous year payment	Total
1997/98	1 750	966	1 687	4 403	1 687	-558	548	2 726	1 700	-	1 700
1998/99	1 816	2 283	-2 773	1 326	-2 349	-1	-	3 676	2 726	-	2 726
1999/00	1 511	-708	1 489	2 292	1 489	-	-	803	3 000	-	3 000
2000/01	1 629	1 200	320	3 149	320	-5	-	2 834	803	676	1 479
2001/02	1 400	479	-11	1 868	-11	-10	-	1 889	2 834	-	2 834
2002/03	1 238	1 157	-222	2 173	-222	-2	133	2 264	1 889	-	1 889
2003/04	882	-188	1 261	1 955	1 261	-	-	694	1 300	-	1 300
2004/05	997	366	-1 289	74	-1 289	-	-	1 363	374	964	1 338
2005/06	1 156	4	933	2 093	933	-17	-	1 177	1 063	320	1 383
2006/07	1 381	72	-2 846	-1 393	-2 475	-3	-	1 085	1 177	300	1 477
2007/08	2 068	614	-1 252	1 430	27	-	-	1 403	1 085	-	1 085
2008/09	2 150	4 404	2 252	8 806	2 252	-	577	5 977	1 403	-	1 403
2009/10	866	-128	-3 666	-2 928	-2 248	-	-680	-	5 227	-	5 227
2010/11	897	-1 135	-4 651	-4 889	-23	-	-4 866	-	-	750	750
2011/12	710	405	-39	1 076	-20	-	596	500	-	-	-
2012/13	723	-135	3 725	4 313	3 725	-	588	-	500	-	500
2013/14											

(a) Excludes gains or losses realised from the sale of fixed assets that had been held in Asset Revaluation Reserves
Source: RBA