

Governor's Foreword

The period covered by this Report – the financial year 1998/99 – was a period of contrasts. The second half of 1998 was marked by financial turbulence during which the instability of Asia was transmitted to the financial markets of the developed world via Russia and Latin America. By late 1998 the world economic outlook had become very uncertain. Some quite activist financial and monetary moves by the US Federal Reserve and others, however, contained the crisis and 1999 so far has been a period of relative calm, not only in developed countries, but in emerging market economies as well. For Australia, it was a good year: although we were caught up in some of the early instability in world financial markets, it was not enough to deflect us from another year of strong economic growth, falling unemployment and low inflation. Australia's performance over the two years since the Asian crisis began has attracted international attention, and improved our standing in the international market-place.

From the Reserve Bank's perspective, monetary policy adjustments and involvement in the foreign exchange market all occurred in the first half of the year. The Bank was a purchaser of Australian dollars briefly in late August/early September 1998 when the exchange rate fell to US55 cents, but did not undertake any further intervention over the remainder of the year during which the Australian dollar recovered. The only monetary policy move was an easing in early December when the cash rate was reduced from 5 per cent to 4.75 per cent. Over the two years of instability in financial markets during the Asian crisis, the Bank did not have to resort to a monetary policy tightening at any stage – a relative rarity among OECD countries.

More detailed accounts of monetary policy are contained in the two *Semi-Annual Statements on Monetary Policy*, the two quarterly reports, testimony to the Parliamentary Committee on Economics, Finance and Public Administration, speeches and press releases. Aside from monetary policy, the main challenges that the Bank faced in 1998/99 are summarised below.

- 1998/99 was the first full year of operation of the real-time gross settlement (RTGS) system, which, as explained last year, was a huge advance in Australia's financial infrastructure. The day-to-day running has been carried out by the newly created Payments Settlements Department, which achieved a smooth and successful introduction, with considerably larger throughput than envisaged in the original system design. The Bank's domestic market operations, which are used to implement monetary policy, have also had to be adjusted to take into account the changed money market conditions arising from the introduction of RTGS.

- The Bank has greatly stepped up its involvement in Australia's international economic and financial policy, which, as in other countries, is mainly the responsibility of finance ministries and central banks rather than foreign ministries. Although to the lay person, understanding of current developments in this area is inevitably hampered by an excessive number of acronyms, it is useful to look behind these at the developments taking place. We think it is extremely important from the viewpoint of our national interest that Australia keep on top of developments and play a prominent role in reforms. The Reserve Bank can make an important contribution to Australia's efforts because so much of the subject matter, such as exchange rates, capital flows and the stability of financial markets, is essentially financial in nature, and thus at the core of our regular activities.
- 1998/99 was the first year in which the prudential supervision of banks was not carried out by the Reserve Bank, following the transfer of this responsibility to the Australian Prudential Regulation Authority (APRA) in July last year. The new arrangements are working well, and the Reserve Bank is giving them its whole-hearted support. The two institutions are working closely together on day-to-day matters, and are sharing responsibility for several aspects of the Year 2000 preparations in the financial system. Contact is further strengthened by the fact that one of the Assistant Governors and I sit on the APRA Board, and the Chief Executive of APRA sits on the Bank's Payments System Board.
- Although the Reserve Bank is no longer the prudential supervisor of banks, it still retains responsibility for the overall stability of the financial system. One vital aspect of this is responsibility for the payments system. This is carried out by the Payments Policy Department reporting to the Payments System Board, which contains a majority of non-executive members. Again, this is the first year of operation of these new arrangements, but already the Payments System Board has used its influence to good effect, firstly, by encouraging the move to a three-day cheque-clearing cycle (from at least five days previously) and, secondly, by ensuring early Australian participation in proposed new international arrangements for the settlement of foreign exchange transactions. The newly created and still very small System Stability Department has produced some useful research, and has assumed overall responsibility for co-ordinating the Bank's involvement in the Year 2000 preparations (which, at heart, is a system stability issue).
- Preparations for the Year 2000 have been a major part of the Bank's work in 1998/99, and will be even more important over the coming half-year. The first priority for the Bank was to make sure its own computer systems were Year 2000 compliant. Concurrently with this, it worked with APRA to ensure that the computer systems used by deposit-taking institutions, and the payments system which links these institutions, were up to the task. Further supplies of currency are being printed to cope with any extra demands by the public as Year 2000 approaches. Deposit-taking institutions will also need extra liquidity over this period, and the Bank has co-ordinated some improved

arrangements which will make this easier to achieve. Finally, a lot of work is going into assessing public and media attitudes, with a view to ensuring that sensible and informative messages are reaching the public, rather than alarmist or sensational ones.

- It was another busy year for the Bank's business services area, with 75 new banking customers added as a result of the Commonwealth Government's policy of devolution of banking. These customers formerly all banked via the one account at the Reserve Bank operated by the Department of Finance and Administration (DoFA). At the same time, the Bank lost the accounts of the Western Australian and ACT Governments, plus the account that DoFA runs for its own business. The coming year is going to be a particularly testing period as all Commonwealth Government departments and agencies are required to put their banking business out to tender.
- It has been a successful year for the Bank's wholly owned subsidiary – Note Printing Australia Limited. It has secured some good export orders and is now running a 24-hour operation six days a week. In the year ahead, production for export will, for the first time, exceed production of Australian currency notes.

The staff of the Bank have handled the many tasks they have been asked to perform this year in a professional and efficient manner. It has not been an easy assignment, and again the major management challenge has been to cope with change and with further reductions in staff. The reduction in the size of the Reserve Bank as measured by staff numbers has been exceptional; from a peak of more than 3 000 in 1983, staff numbers have fallen to about 880 at present. Even though some of this has occurred through outsourcing and thus led to increases in non-staff costs, overall costs have nonetheless fallen considerably. Underlying operating costs are now 19 per cent lower than their peak in 1991/92.

Falls of this magnitude in staff numbers and costs may give the impression that management has been engaged in a relentless crusade to downsize, as in some parts of the private sector. While this was partly true in earlier years, in recognition of some element of overstaffing, it has not been the case for most of the 1990s. Reductions have occurred only in response to changes in technology, changes in function, or where formerly in-house activities could no longer be performed at industry standard. The net effect of all these changes, however, is that a greatly increased output is now being produced by the Bank with considerably smaller input – another example of the increased productivity that has characterised Australia in the 1990s.



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Chairman, Reserve Bank Board

3 August 1999