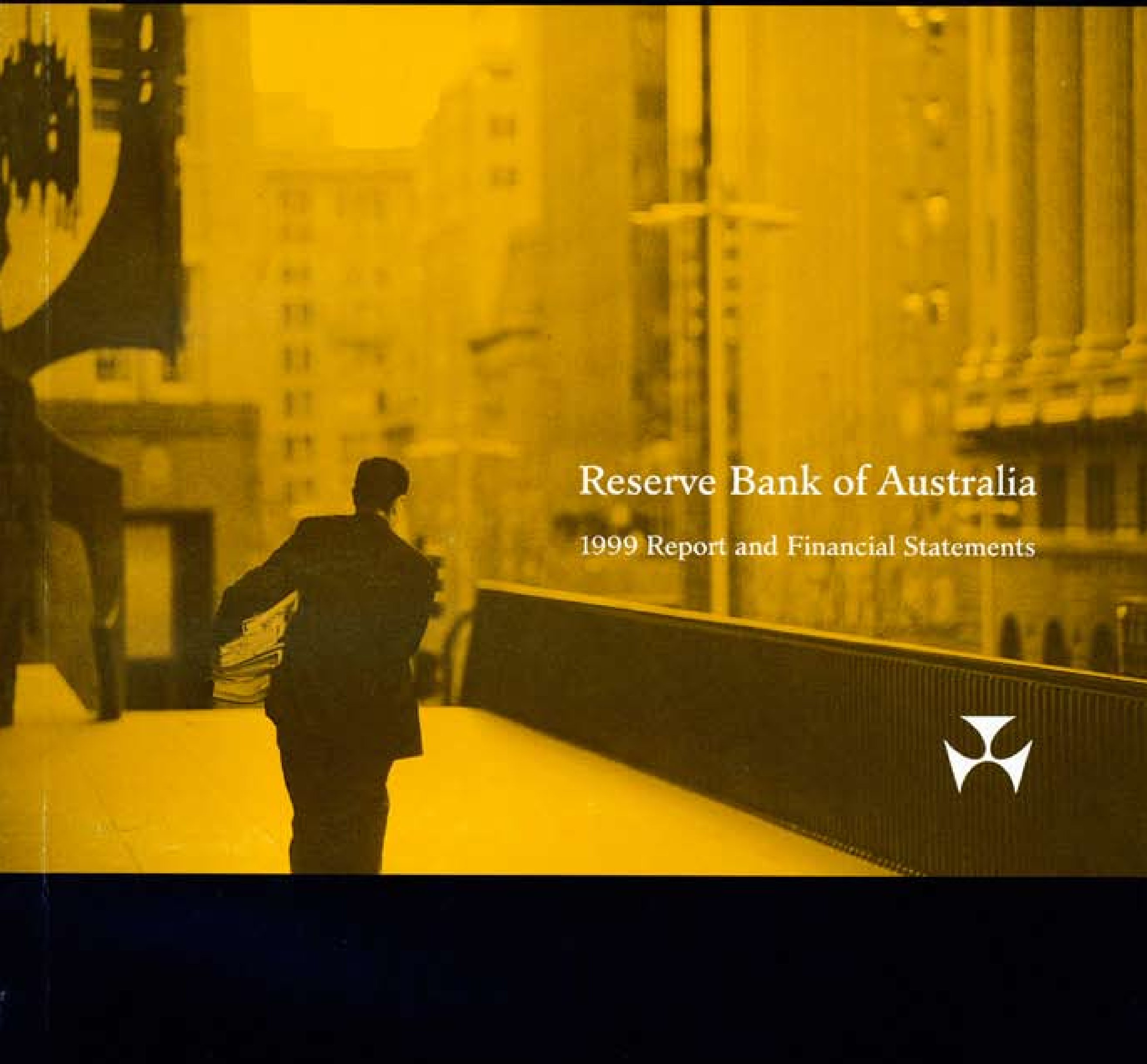

Reserve Bank of Australia

1999 Report and Financial Statements

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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.

IJ Macfarlane
Chairman, Reserve Bank Board
3 August 1999

Operations in Financial Markets

The Reserve Bank operates in financial markets to fulfil its monetary policy obligations. Although changes to monetary policy are infrequent, the Bank needs to transact in the money market on a daily basis to ensure that conditions do not depart too far from those consistent with the desired stance of monetary policy. The bulk of its market transactions consists of purchases and sales of domestic government securities to implement monetary policy. The Bank also undertakes some transactions in foreign exchange for policy purposes – namely intervention to influence the exchange rate – though there are long periods when no transactions occur for this purpose.

A description of these operations and the market background against which they were conducted is given in the first part of this chapter. The second part goes on to outline other market operations the Bank undertakes. These are directed either at meeting the needs of clients (mainly the Commonwealth Government, overseas central banks and official international institutions) or managing the Bank's own balance sheet.

Operations for Policy Purposes

The market background[1]

A key feature of the last financial year was the marked contrast in financial market behaviour between the first and second halves, not only in Australia, but worldwide. The first half was a very turbulent period in financial markets. It saw the final throes of the Asian financial crisis which began in mid 1997, the Russian moratorium on foreign debt repayments in August and the spread of the crisis to Latin America. It was marked by an extraordinary degree of overshooting in both currency and share markets. Even leaving aside the extreme movements in Indonesia, falls in currencies and share markets by 50 per cent from pre-crisis levels were not unusual. Australia was not directly part of this crisis but it was affected indirectly, mainly through pressure on the exchange rate, which, by August 1998, had reached an historical low against the US dollar of US55.3 cents, 25 per cent below its level a year earlier.

The problems were not confined to the smaller countries of the region. The exchange rate of the Japanese yen, which at the start of the Asian crisis in mid 1997 was trading at 115 against the US dollar, fell to 148 by August 1998.

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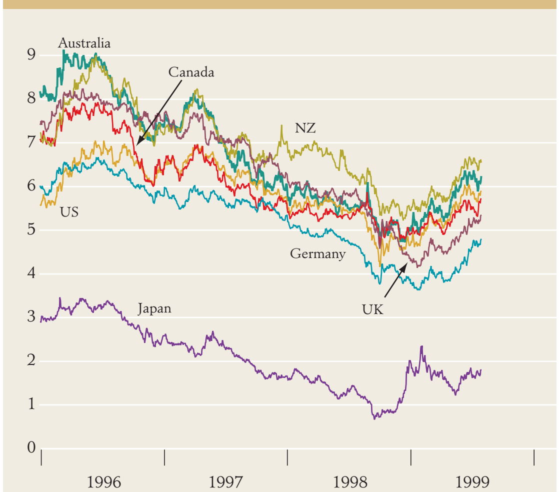
1 A detailed analysis of financial market conditions over the past year, both in Australia and overseas markets, is provided in the Bank's *Semi-Annual Statement on Monetary Policy* released in November 1998 and May 1999.

The turmoil in financial markets seemed to be much greater than would have been expected on the basis of changes in the underlying economic conditions. There was clear evidence that highly leveraged positions were being built up during the first half of 1998 and unwound about three-quarters of the way through the year. Although many types of financial institutions were involved, hedge funds were prominent, both in their own right, and through their capacity to influence market opinion.

Exchange rates against the US dollar

* Implied rate before January 1999

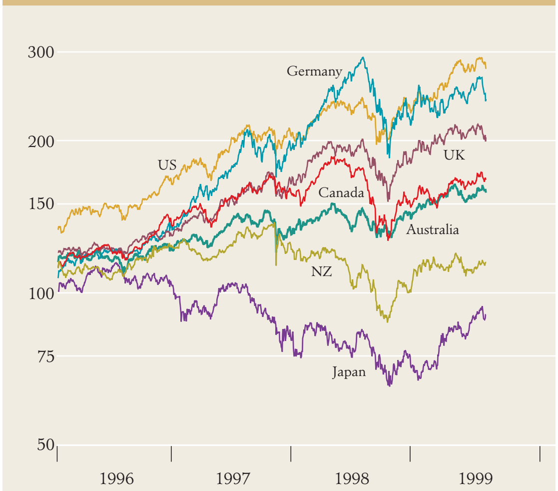
Ten-year bond yields



It was notable that the factor that eventually caused markets to correct was the near-collapse of a major US hedge fund, Long-Term Capital Management. This triggered a sharp contraction in bank funding of all hedge funds, forcing them to liquidate their short positions and allowing a rapid recovery in these markets. In Australia, the exchange rate of the Australian dollar rose sharply over September and October to around US65 cents – similar to its early 1998 level – as speculators reversed their short positions in the currency. The Japanese yen also strengthened markedly at the same time (including a rise of 15 per cent in the space of 30 hours) as did the exchange rates of most other Asian currencies. In the case of share markets, the biggest initial rise was in Hong Kong, where the earlier speculative selling had been very strong.

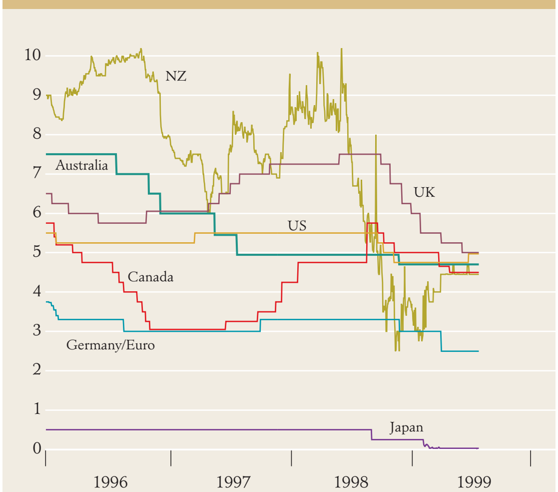
It was also notable that while these events allowed Asian markets to begin recovering in late 1998, they had a negative impact on markets in the major centres, particularly the US. These markets were suddenly disrupted by concerns

Share price indices – Log scale*
Index



* 31 December 1994 = 100

Cash rates
%



about credit exposures to highly leveraged institutions; credit spreads in bond markets rose and the volume of financing fell. Share prices of financial institutions were also marked sharply lower. More generally, the seizing-up of credit markets led to widespread concerns that the world economy might head into a deflationary phase, a factor which led the US Federal Reserve to ease monetary policy on three occasions, by a total of 0.75 of a percentage point, between late September and early November.

The combination of easier monetary policy in the US and reduced speculative activity by highly leveraged institutions saw much more settled conditions in financial markets around the world in the second half of the financial year. By March 1999, markets had become quite buoyant. Share prices in many industrial countries reached new peaks, and those in Asian markets went a long way to recovering their pre-crisis levels. The Australian dollar continued to rise, though at a more gradual pace, in line with the improving outlook for the world economy and commodity prices.

As it became clear that the market disruptions that had caused the US Federal Reserve to ease had largely disappeared, and as prospects for the world economy continued to improve, the market focus moved to the likelihood that the Federal Reserve would reverse at least some of the easing it had implemented in late 1998. The prospect of higher US interest rates dampened some of the buoyancy in markets over the last two months of the financial year, particularly share markets in developed countries, and there was a noticeable rise in longer-term interest rates which took them back to around their levels in mid 1998. Once the Federal Reserve decision was announced at end June – a 25 basis points rise in the Federal Funds rate, to 5.0 per cent – markets absorbed the news calmly.

Changes in exchange rates and share markets in the Asia/Pacific region

Exchange rates against US$	Change from July 1997 to trough (per cent)	Change from July 1997 to current (per cent)
Australia	-25	-14
Hong Kong	0	0
Indonesia	-85	-65
Japan	-22	0
Korea	-55	-26
Malaysia	-48	-34
Singapore	-20	-15
Taiwan	-20	-14
Thailand	-56	-34
Share markets		
Australia	-16	10
Hong Kong	-56	-13
Indonesia	-65	-19
Japan	-36	-12
Korea	-63	27
Malaysia	-76	-32
Singapore	-60	7
Taiwan	-39	-20
Thailand	-61	-14

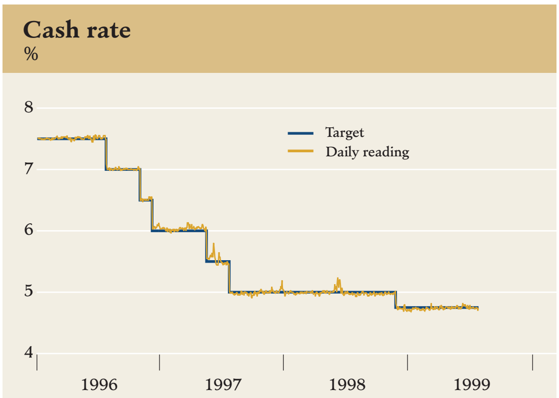
Overall, markets ended the year on a fairly confident note. The Asian crisis, at least as far as it affected financial markets, seemed to have largely passed, economic prospects for Japan and Europe were improving and there was optimism that the US authorities would be able to engineer a "soft landing" of the US economy. These developments meant that the general assessment of world economic and financial prospects was much more positive than it had been for the previous couple of years, providing a benign backdrop for Australian markets.

Policy implementation

Domestic operations

In Australia, as in most developed countries, the stance of monetary policy is expressed in terms of an operating target for the cash rate – the interest rate on overnight interbank loans in the money market. There was only one change in this rate in the past year – a reduction from 5.0 per cent to 4.75 per cent in early December 1998 which was made possible by the continuing good inflation performance of the economy (see the Reserve Bank's media release of 2 December 1998 and the *Bulletin* article "The Economy and Financial Markets" released in February 1999 for a detailed explanation of the circumstances underlying this policy change).

The cash rate is determined by the interplay of the daily supply of and demand for Exchange Settlement (ES) funds – the funds banks use to settle transactions with each other and with the Reserve Bank[2]. The Reserve Bank's domestic market operations – purchases and sales of securities either outright or under repurchase agreements – are used to adjust the supply of ES funds so as to maintain the cash rate close to the target.



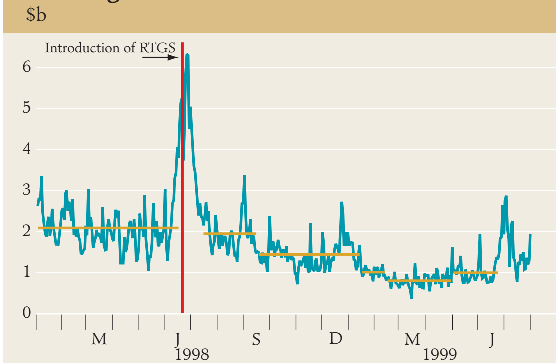
While domestic market operations are largely routine and carried out on a day-to-day basis, their execution can be affected by institutional changes to the money markets. Over the past year, the main change of this nature was the introduction in June 1998 of the real-time gross settlement (RTGS) system. Details of this settlement system were outlined in last year's Annual Report, but essentially it involves the settlement of high-value interbank transactions on a continuous and gross basis through the day, rather than on a net basis the following day as was the case under previous settlement arrangements. The Reserve Bank's domestic operations aimed to ensure that the transition to the new system proceeded as smoothly as possible, so that market conditions remained consistent with monetary policy objectives.

A central part of this task was to meet changes in banks' demand for ES funds arising from the RTGS system. Demand for ES balances had been running at a little over $2 billion in the period before the introduction of RTGS, but rose

2 ES funds take their name from the Exchange Settlement accounts at the Reserve Bank, in which these funds are held.

sharply in June 1998 to around $6 billion. Some of the rise was a response to the shocks in global markets at that time and the normal seasonal demand around financial-year end, but it mainly reflected banks wanting to hold larger precautionary balances as the new system came into operation.

Exchange Settlement balances



As these influences passed and banks became accustomed to operating under RTGS, demand for ES balances began to fall sharply. In order to maintain the cash rate at its target, the Reserve Bank responded by reducing the supply of balances correspondingly. ES balances soon returned to around the level prevailing prior to the introduction of the RTGS system, and then continued to decline as banks took advantage of the new system's features which enabled them to manage liquidity more efficiently than had been possible in the past. Balances eventually fell to an average of about $0.75 billion in March 1999, before increasing again over the June quarter and into early July. ES balances peaked early in July, following the release of banks' non-callable deposits (NCDs) of $5.25 billion; NCDs were held under the previous prudential regime which involved the Reserve Bank in supervising banks. As banks invested these funds in other assets, the level of ES balances declined to around $1.25 billion.

While RTGS allows banks to operate with lower ES balances, these holdings are still the critical buffer to system liquidity. It is, therefore, important that all banks should have adequate liquidity to meet unforeseen calls on them. While it appears that current levels of ES funds are comfortable, the need for banks to hold liquid assets might increase as the Reserve Bank's ability to forecast liquidity flows accurately may be reduced by recent changes to banking arrangements of the Commonwealth Government (see "Customer Services").

One of the facilities put in place by the Reserve Bank to help banks manage their liquidity under RTGS is an end-of-day borrowing facility based on repurchase agreements.[3] The facility is designed to provide some measure of certainty to individual ES account holders that there would always be scope to meet unexpected outflows from their accounts late in the day, albeit at an above-market cost of overnight funds (the rate charged on this facility is 25 basis points above the cash rate target). In 1998/99, there were 32 drawings on this facility,

3 Further details are contained in the box on 'Reserve Bank Dealing Operations under RTGS' in last year's Annual Report.

on 24 different days – i.e. on most days when it has been used, only one bank has done so. The average amount borrowed by individual banks under the facility was about $60 million.

There was some indication early in the year that some banks were reluctant to avail themselves of this facility, even if it meant having to pay a higher cost for funds elsewhere. It seemed that they were concerned that use of the facility might be seen as a sign of weakness or inadequate liquidity management on their part. The Reserve Bank made clear its views that the facility is an important part of the RTGS framework and it would be normal for banks over time to access the facility occasionally. The Reserve Bank would be concerned about use of the facility only if there were continual recourse to it by one bank. To date, there has been no evidence of this.

In the lead-up to RTGS, the Bank also foreshadowed that it would be prepared to deal a second time during the day to address system liquidity problems arising from significant and unforeseen changes in demand for liquidity, major liquidity forecasting errors or system problems. Because liquidity flows are less predictable under RTGS, it was expected that such operations might be required more often than in the past. Experience, however, is that recourse to second rounds of dealing has been limited. Additional rounds of dealing have been required on eight occasions in the past year.

Overall, the first year of operating in the cash market under RTGS has gone smoothly. Aside from the advantages in terms of reduced payments risks, banks have found that they can operate with less liquidity than required under previous arrangements. In terms of meeting the Bank's monetary policy objectives, the cash rate has remained stable around the target level. In 1998/99, the daily volatility of the cash rate averaged 3 basis points around the target, little different from previous years.

Over the course of the financial year, the Bank undertook domestic market operations amounting to around $334 billion, about 8 per cent more than in the previous year. Repurchase agreements remain the work-horse of the Bank's domestic market operations. However, with the continued contraction in the stock of Commonwealth Government securities (CGS) on issue – which fell from $92 billion to about $84 billion over the year, due to the Commonwealth's surplus – collateral for repurchase agreements has moved increasingly away from CGS to State government securities. By end June 1999, State government stock represented around 70 per cent of the collateral underpinning the Reserve Bank's repurchase operations.

Market operations for liquidity management purposes
($ billion)

	1995/96	1996/97	1997/98	1998/99
Repurchase agreements*				
– Purchases	74	201	275	300
– Sales	14	9	8	13
Short-term CGS				
– Purchases	25	23	26	21
– Sales	2	1	0	0
Total domestic operations	115	234	309	334

* First leg of transaction

As in earlier years, the Reserve Bank also made some use of foreign exchange swaps to help in liquidity management. Foreign exchange swaps work like a repurchase agreement in government securities, with the difference being that, rather than exchanging Australian dollars for government securities, the Australian dollars are exchanged for foreign currency. Over the year the amount of foreign exchange swaps the Reserve Bank had outstanding increased by $4 billion.

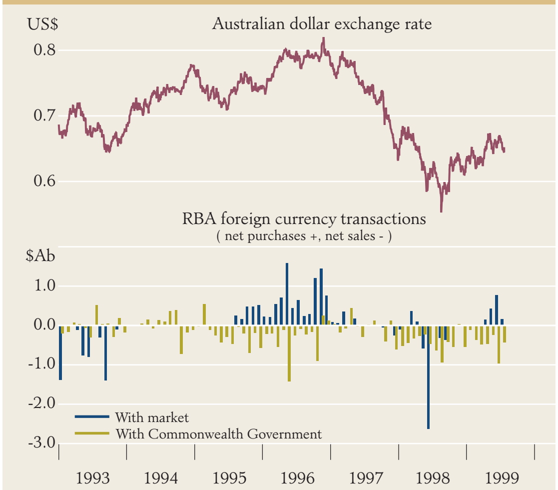
Towards the end of the financial year, the Reserve Bank announced a couple of variations to its dealing arrangements to assist banks in their preparations for the Year 2000. These are discussed in "The Reserve Bank's Role in Preparations for the Year 2000".

Foreign exchange intervention

The arrangements regarding the exchange rate of the Australian dollar and the Bank's approach to intervention have been outlined in past Annual Reports. Essentially, the exchange rate moves up and down in response to changes in the demand for and supply of the currency. Australia has a floating exchange rate regime in which the currency has been allowed to move over a wide range, an arrangement which has proved beneficial to the economy because of its capacity to cushion the impact on the economy of external shocks.

That said, the Bank intervenes in the market occasionally to moderate movements that seem excessive relative to changes in economic or financial conditions. In extreme cases, such instances of "overshooting", which are exhibited by most floating exchange rates, can become self-sustaining and have adverse impacts on business and consumer sentiment and on inflationary expectations.

Australian dollar and RBA foreign exchange operations



The circumstances that give rise to intervention tend to occur infrequently, but during 1998 the Bank intervened on several occasions in support of the Australian dollar. This intervention began after the exchange rate had fallen against the US dollar for about a year, and by more than 15 per cent in total. As noted in last year's Annual Report, the scale of the Bank's interventions in early 1998 had been small but, in June, when speculative selling of the Australian dollar on a large scale commenced, the Bank responded with intervention in significant amounts, buying about $A2.6 billion in the spot market.

Although the Australian dollar recovered from that episode by mid July, it again came under very heavy speculative selling in late August following the Russian crisis and the resulting turmoil in markets. With "herd" behaviour prevalent, and the exchange rate against the US dollar having fallen by about 25 per cent to record lows, the Bank decided to intervene again in the market to support the currency. Instead of relying simply on outright purchases of the currency, as it had done in the past, the Bank also purchased call options on the Australian dollar – i.e. the right to buy Australian dollars at a predetermined price. This permitted the Bank, for a limited outlay, to stimulate significant market demand for the currency, triggered initially by the dealers who had sold the options, as they sought to hedge against the possibility that the options would be exercised. In the event, the overshooting of the exchange rate was quickly reversed, and the Bank resold the options (which were by then in profit) once it judged the danger period had passed.

Such techniques increase the flexibility with which the Bank can intervene in the foreign exchange market. The purchase of call options involves very low risk to the Bank: it has no obligation to exercise the option, but if it does so the overall effect on its assets would be the same as if it had purchased the currency in the spot market (though the purchase prices may be different). Overall, intervention in 1998/99 amounted to $665 million, all of it occurring in late August/early September 1998.

Neil Mackrell (left rear), Chief Representative, New York and staff of the New York Representative Office receive Assistant Governor (Financial Markets), Ric Battellino (right rear).

Other Operations

Transactions for the Commonwealth Government

The Reserve Bank undertakes operations in both government securities and foreign exchange on behalf of the Commonwealth Government.

In the case of the former, the main task during the past year was to assist the Commonwealth to repurchase some of its debt from the market. The background to this was that a Budget surplus, coupled with the Government's commitment to maintain an issuance program to underpin certain "benchmark" lines of stock, meant that the Commonwealth had surplus cash over the year. This was used to buy back selected lines of stock both from the market and from the Reserve Bank. Purchases by the Commonwealth from the market totalled $0.9 billion (face value). The Reserve Bank undertook these transactions on the Commonwealth's behalf. In addition, the Commonwealth purchased $3.3 billion of short-dated stock directly from the Reserve Bank, of which $0.8 billion was due to mature in 1998/99 and which the Bank had acquired as a part of its daily liquidity operations.

As a further measure to help the Commonwealth manage its surplus cash, the Bank also introduced a term deposit facility for the Commonwealth. The Commonwealth used this facility on several occasions during the year to invest funds temporarily surplus to its needs. As at 30 June 1999, the Commonwealth had $2 billion on term deposit with the Bank. A market interest rate is paid on the facility.

The Commonwealth Government typically has a large volume of foreign exchange transactions each year, mostly reflecting foreign currency payments associated with purchases of defence equipment and expenses involved in maintaining embassies etc. The Bank undertakes these transactions for the Commonwealth Government and its agencies. They are all carried out at market prices. In 1998/99, the Bank bought $A1.4 billion from the Government and sold $A7.0 billion to it; net sales were $A5.6 billion, a little higher than the average in recent years.

Normally, these transactions with the Government are passed more or less directly through to the market, so that they do not act as a drain on (or a source of augmentation for) foreign reserves. However, at times when the exchange rate is under downward pressure and well below its long-run average, such as in 1998, the Bank usually refrains from passing the transactions through to the market, to avoid exacerbating market pressures. These transactions are initially met from the Bank's holdings of foreign exchange and put through the market at a later time, when the exchange rate is more favourable. In the past year, the Bank met sales to the Government between July and mid April from its own foreign exchange holdings, but later it fed Government transactions into the market.

Stock lending

The Reserve Bank maintains a large portfolio of domestic government securities, and for some years it has also been willing to lend this stock to the market to alleviate temporary shortages in specific lines of stock. Such shortages typically arise as a result of settlement failures or difficulties in accessing stock held by offshore investors. It is quite likely that such liquidity problems will become more prevalent as the amount of CGS on issue continues to decline.

Stock loans are structured using repurchase agreements, the effect being that the securities in demand are exchanged for other securities. As a result, this activity has no impact on the level of cash in the system.

In operating its stock lending facility, the Reserve Bank has always been sensitive to the need to minimise its presence in the market so as not to discourage the development of the private sector stock lending market. To this end, a number of changes were made to the facility towards the end of 1997 – lending charges became market-based but incorporated a penalty element, and allocation limits were imposed to prevent any one counterparty from accessing too much of the Bank's stock.

Stock lending by the RBA

	Number of transactions	Amount lent (face value, $ billion)	Income ($ million)
1994/95	350	12.1	0.6
1995/96	485	16.9	0.7
1996/97	540	11.9	0.7
1997/98	935	16.7	1.1
1998/99	805	14.6	0.9

As in previous years, the lines of stock in greatest demand were those included in the 3 and 10-year futures baskets for the contracts traded on the Sydney Futures Exchange.

Reserves management

Foreign currency investments, which form Australia's international reserves, comprise a substantial part (on average about half) of the Bank's assets. They are held primarily for the purpose of permitting intervention in the foreign exchange market. Hence, the Bank invests them in such a way as to give priority to security and liquidity, because the reserves must be available at short notice to meet intervention needs. Subject to these considerations, the Bank seeks to earn the highest possible return on these assets.

The Bank's objectives and the past patterns of return and risk in the major world markets are reflected in a benchmark portfolio, against which the actual performance in managing the portfolio is assessed. This benchmark, which has been in place since the early 1990s, has three main parts. The first is the allocation of investments among the three countries in which assets are mainly held: the United States, Japan and Germany. The distribution is 40 per cent in US assets, and 30 per cent each in Japan and Germany. Recognising that it is possible to separate the exposure to assets from the exposure to currencies, the currency distribution of the portfolio is managed independently, though the benchmark allocation is the same as that for assets – namely 40 per cent US dollars, and 30 per cent each in yen and euro[4]. The other aspect of the benchmark is the maturity of assets or, more precisely, their duration. The maximum maturity of assets (most of which are government securities) is 10 years, with the duration of the overall portfolio having a benchmark of 30 months.

Composition of the benchmark portfolio

	United States	Japan	Germany
Asset allocation (per cent)	40	30	30
Currency allocation (per cent)	40	30	30
Duration (months)	30	30	30

The investment of the reserves portfolio is undertaken by a team of portfolio managers in International Department, who can make changes to the currency and asset allocations, and the duration of investments, within parameters approved by the Governor.

The market background to investment decisions over the past year was particularly turbulent:

- in the United States, bond yields fell to very low levels in the September and December quarters of 1998, as various market crises raised concerns that the world economy might move into a deflationary phase;
- at about the same time, bond yields fell to extremely low levels in Japan, with 10-year bond yields falling from 1.7 per cent at the start of the year to a low of about 0.7 per cent in September, before ending the year around where they started. Short-term interest rates in Japan, already low at the start of the year, were reduced progressively by the Bank of Japan until they reached an effective level of zero in January 1999, where they have remained since;

4 With the introduction of the euro at the start of 1999, the part of the benchmark portfolio allocated to Germany was re-denominated from German marks to euros. No other changes were made; until the passage of time permits a review of the risk/return performance of euro-based investments, it will not be possible to make informed decisions about the impact of the euro's introduction on the characteristics of the benchmark portfolio.

- the Japanese yen fluctuated between 108 and 148 against the US dollar, apparently driven more by large-scale speculative players than by underlying economic events; and
- the euro, which emerged strongly in January 1999, depreciated quickly during its first six months.

Consistent with the approach in previous years, the Bank throughout the year maintained an exposure to the Japanese market which was less than benchmark. The low level of yields made it difficult to justify holding substantial long-term investments in that country. In the event, with yields showing little net change over the year, returns on this portfolio were broadly in line with benchmark.

Exposure to the US market was also maintained, on average, at less than benchmark, given the possibility that yields would rise and result in capital losses. This "underweight" position was partly offset by a larger-than-benchmark exposure to the German market. With the economic cycle in Europe lagging well behind that in the US, the risk of rises in interest rates (and therefore of capital losses) was seen as lower. This allocation of the portfolio contributed prominently to returns for the year.

Towards the end of the year, with the euro falling to quite low levels against the US dollar, the Bank began to increase the share of the portfolio in euros. But, with the exchange rate of the euro continuing to fall into the end of the year, the average rate at which those purchases were made was higher than the rate at which the position was revalued at the end of the year, leading to an underperformance relative to benchmark.

The overall return on the portfolio, using the Special Drawing Right (SDR) as a numeraire, was 4.9 per cent, a little higher than in the previous three years, but below the benchmark return of 5.1 per cent. The underperformance relative to the benchmark was equivalent to about $26 million. Details are shown in the table.

Actual and benchmark returns

	Rates of return (per cent) Actual	Benchmark	**Value of difference** ($A million)
1991/92	9.8	8.9	165
1992/93	16.3	11.6	420
1993/94	4.0	3.8	31
1994/95	5.2	7.4	-331
1995/96	4.0	3.7	40
1996/97	4.5	4.2	34
1997/98	4.5	4.6	-19
1998/99	4.9	5.1	-26

Over the eight years in which the Bank has been managing reserves against the benchmark, returns have exceeded benchmark levels in five years and fallen short in three. In net terms there has been an outperformance of a little over $300 million over the eight years.

In addition to foreign currency assets, the Bank also holds a small part of its assets – approximately 80 tonnes, or about $A1.0 billion – in gold. This asset continued to show poor returns, its value falling by about 12 per cent (measured in SDRs) over the year. Since the Bank's decision to sell two-thirds of its gold in early 1997, the price of gold has fallen by about 21 per cent and the cumulative effect of the sale and the reinvestment of proceeds in other reserve assets has been to increase the Bank's income to date by about $795 million.

Most of the Bank's gold is on loan. This returned about $18 million over the year, compared with $21 million in the previous year. The gold loan market was very active over the past year. Poor sentiment towards gold meant that there was heavy selling by speculators and producers, creating a strong demand for gold loans to fund delivery of those sales. Normally, this would have been expected to put upward pressure on loan rates, but this did not happen. Loan rates for short-term loans averaged about 0.5 per cent over the year, less than in the previous year. Loan rates were held down by the substantial increase in the amount of gold loans on offer, as some large European central banks entered the market as lenders. Gold on loan from central banks is estimated to have broadly doubled over the past five years, to over 4 500 tonnes. This is equivalent to about $1\frac{1}{2}$ years of annual world production.

Reform of the International Financial System

The financial crises of the past two years, which began in Asia in mid 1997 and spread during 1998 to Russia and then to Latin America, have created a period of flux for the international financial system. They have raised questions about the stability of open international capital markets, the role of the International Monetary Fund (IMF), disclosure practices of governments and private agents, and the procedures for handling financial crises. In addition, the question of how to reconstruct the membership of the various financial fora (G7, G10, etc.) so as to make them more representative of current economic reality has become more pressing. The questioning was as intense as any seen since the current international financial architecture was set up in the immediate post-World War II years, and changes resulting from the current debate are likely to shape the system for many years to come.

Australia, itself, was not directly affected by the crises, but its close association with the Asian region gave a good perspective on some of the problems in current international financial arrangements, and reinforced to the Australian authorities the importance of achieving reforms. As many of the issues being discussed related to international financial markets and capital flows – areas in which central banks have a keen interest – the Reserve Bank saw it as important to contribute actively to the debate.

Along with other arms of government, particularly the Treasury, the Bank participated in a wide range of international meetings dealing with the Asian crisis and reforms to the international financial system. The Governor was a member of the Prime Minister's Task Force on International Financial Reform, and the Bank is a regular participant in the ongoing work of the Government's International Economic Policy Group, an interdepartmental committee which also includes the Treasury, the Department of Foreign Affairs and Trade and the Department of the Prime Minister and Cabinet.

In the international sphere, there was a lot of activity as several new international groupings were created in the search for reform. The first of these was the "Willard" Group of Finance Ministers and Central Bank Governors (the G22), which brought together a useful mix of developed and emerging market economies, including a good representation from Asia. In this respect, G22 was more representative than G7 or G10, which contain no emerging market economies and give heavy representation to Europe. G22 proved to be an effective forum for examining issues of transparency, financial system strength, and the handling of crises. Australia, represented by the Treasurer and the Governor, was one of the countries which participated. Officials of the Reserve Bank and Treasury also participated in two of the working parties which carried out detailed analysis and formulated specific proposals.

The G22 met twice, once in April 1998 and a second time in October 1998, the latter meeting chaired by President Clinton. Its recommendations, as embodied in its working party reports, have been influential in setting the reform agenda in other established bodies, such as the Bank for International Settlements (BIS) and the IMF. The G22 format, however, was not fully accepted by all members of the international community – particularly the European ones – and the G22 itself was disbanded after the recommendations were published. Nevertheless, the value of such an informal grouping of diverse countries has been widely recognised and the major industrial countries moved in mid 1999 to establish another such forum.

Meanwhile, some of the work initiated by the G22 working parties was progressed further by groups set up by the BIS. The BIS established working groups to examine disclosure in financial markets, including by highly leveraged institutions (both of individual information and of aggregate positions), and the interaction of banks with highly leveraged institutions. The Reserve Bank participated in two of the three working groups.

At the same time as the BIS work was proceeding, the G7 countries set up their own body, which had its inaugural meeting in April 1999, to ensure that the work of the G22 working parties was brought to fruition. This new body – the Financial Stability Forum – initially consisted of representatives from the G7 countries plus the main international organisations. In June 1999, the G7 decided to broaden representation in the Financial Stability Forum to Australia, Hong Kong, the Netherlands and Singapore. This was an important step for Australia, particularly in an environment where the membership of the "new" international grouping is in a process of evolution. The Governor will represent Australia on the Forum, along with his counterparts from the other new countries. Ric Battellino, Assistant Governor (Financial Markets) represents Australia on the Financial Stability Forum's working group on highly leveraged institutions.

In all these groups, the Reserve Bank has focused on two main areas where it believed that reform was most critical: improvements to disclosure by, and supervision of banks' dealings with, highly leveraged institutions (often referred to by the shorthand term "hedge funds"); and greater involvement of the private sector in crisis management. These were also endorsed as key issues by the Prime Minister's Task Force on International Financial Reform in December 1998.

Highly leveraged institutions

As part of its involvement in the BIS, the Executive Meeting of East Asia and Pacific central banks (EMEAP) and Financial Stability Forum work, the Bank has prepared papers on *Hedge Funds, Financial Stability and Market Integrity* (in March 1999) and *The Impact of Hedge Funds on Financial Markets* (in June 1999). These papers drew on recent episodes of leveraged speculation in the Australian dollar market.

There has been some shift in the centre of gravity of opinion on hedge funds. The initial reluctance by many countries to interfere in the workings of financial markets has been replaced by recognition that the prudential system had allowed core financial institutions (mainly banks) to provide excessive leverage to the hedge funds. The focus in these discussions was on the prudential ramifications. The recommendations of the two BIS working groups, together with the recommendations of the Basel Committee on Banking Supervision Working Group on Highly Leveraged Institutions, have since been endorsed by leaders of the major industrial countries. They provide a blueprint aimed at putting the relationship between highly leveraged institutions and lenders on a more prudent footing and increasing the degree of transparency in markets. If they prove to be insufficient in achieving this, further measures may need to be considered. There is less unanimity on a second aspect – the possibility that the activities of highly leveraged institutions damage market integrity, adding to price volatility and exacerbating a crisis. The Financial Stability Forum's working group on highly leveraged institutions is expected to assess the cases for and against further measures as part of its preliminary report in September 1999 and final report in early 2000.

Involvement of the private sector in orderly workouts

The G22 working group on international financial crises, in which the Bank took part, recommended the development of an enhanced framework for management of future crises, in which the private sector could be included in an orderly and co-operative way. The Bank, together with other Australian representatives, has continued to press for such development in regional discussions and in the key international organisations.

The need to involve the private sector has been apparent since the Mexican crisis of 1994/95, where foreign investors had been fully repaid by IMF/US assistance at the time of the crisis. While this undoubtedly helped to bring the crisis under control, it created "moral hazard" – where risk-takers are protected from the consequences of an unfavourable outcome and which seriously distorts investors' risk considerations in future investment decisions. The answer is to ensure that private sector creditors bear some of the costs when things go wrong. How to achieve this is still hotly debated but, again, opinion has swung substantially over the past two years in the direction of searching for a way of effectively "bailing-in" the private sector to provide significant burden-sharing, not only to address the problem of moral hazard, but also to assist in managing outflows during the crisis and to alleviate the burden on official assistance.

Already there have been significant steps in the right direction, such as the IMF's willingness to consider, on a case-by-case basis, continuing to lend under a program to a country in arrears on old debt. There remains, however, a need for further exploration, particularly of how to stabilise financial flows during the period between a crisis emerging and the development and implementation of a credible management program. Difficult issues are involved, such as the problems of identifying creditors. There is also a need to minimise the risks of unilateral action which creates panic or contagious reactions by creditors.

Deputy Governor, Stephen Grenville, and Head of International Department, Bob Rankin, attend a meeting of EMEAP Deputies, hosted by the Reserve Bank in Melbourne in March 1999.

There is now general agreement that there needs to be a broad *ex-ante* framework which sets out the principles and procedures which would be applied to ensure that the workout of a crisis can be done in an orderly fashion, without a destructive race by lenders to be the first out the door once the crisis breaks. This consensus now needs to be translated into something practical.

None of the very real progress which has been made over the past year or two will abolish crises. International financial integration – an aspect of globalisation – brings benefits and risks. The aim, in attempting to improve the international architecture, is to produce a more favourable balance between risk and benefit.

Other international involvement

Within the region, the Bank has continued its close involvement with other central banks, mainly within the EMEAP framework. Governors of the eleven regional central banks meet each year, with more frequent meetings at Deputy Governor level. The three specialised working groups (covering financial market issues, prudential supervision and payments systems) each have ongoing work programs covering issues of a more operational and technical nature. The Asian crisis has diverted attention (and key personnel) away from these medium-term issues, but as these economies recover, the regional network will provide opportunities for co-operative exchanges as the reform elements – the beneficial aspects of the crisis – are put in place. The Bank has also participated, along with the Treasury, in the Manila Framework Group (which consists of representatives from finance ministries and central banks of 12 Asian economies plus the United States, Canada and the main international financial institutions).

In the past year, the Bank has provided technical assistance on information technology issues to the Bank of Thailand, in conjunction with the Australian Government's Overseas Aid Program (AusAID), on foreign exchange management to Bank Indonesia and the Reserve Bank of Fiji, on financial risk measurement and management to Bank Indonesia, and on infrastructure for the implementation of market-based monetary policy to the Reserve Bank of Vanuatu.

The Bank is also participating in an initiative on the development of domestic bond markets sponsored by the Asia-Pacific Economic Cooperation (APEC) Group, which will establish a compendium of sound practices in the areas of market infrastructure, liquidity, risk management, regulation, and government policies. These are intended to serve as benchmarks for APEC economies seeking to develop their local bond markets in order to improve the access of government or private borrowers to domestic savings.

Although the Bank no longer has responsibility for bank supervision in Australia, its experience in the past and its close relationships with Indonesia led to the appointment of the Bank's Deputy Governor to the Independent Review Committee of the Indonesian Bank Restructuring Agency (IBRA). The role of the Committee is to review and verify the activities of IBRA, which took over during the year responsibilities for the restructuring and recapitalisation of Indonesia's troubled banks.

Surveillance of the Financial System

The Reserve Bank has a general responsibility to safeguard the stability of the Australian financial system. This mandate was reconfirmed by the Government when it introduced landmark changes to Australia's financial regulatory structure, which came into effect from 1 July 1998. These changes included the transfer of responsibility for the supervision of banks in Australia to a new integrated regulator, the Australian Prudential Regulation Authority (APRA), and the establishment of the Payments System Board within the Bank, with the backing of strong regulatory powers.

The bedding-down of the new financial regulatory framework during 1998/99 coincided with a difficult global environment, as the Asian economic and financial crisis engulfed other regions, and with bouts of turmoil in international financial markets. Buoyed by the ongoing strength of the domestic economy, however, the Australian financial system continued to perform resiliently and, as the year ended, there were no discernible threats to system stability.

The Reserve Bank's responsibility for system stability

The Reserve Bank no longer has an obligation to protect the interests of bank depositors nor does it have powers to direct the affairs of an individual financial institution; its previous powers in this area have passed, in expanded form, to APRA. The new financial regulatory structure, instead, allows the Reserve Bank to concentrate its attentions fully on the overall stability of the financial system. Financial instability and the associated disruption to the normal processes of financial intermediation can impose severe costs on an economy. This has been illustrated all too graphically by recent events in Asia, but industrial countries have not been immune. Preventing financial instability is therefore an important goal of public policy. The Bank's objective is to ensure that financial disturbances in *any* part of the financial system do not ultimately threaten the health of the economy. The Bank can contribute, in various ways, to building the foundations for a stable financial system and it can also help limit the potentially adverse effects of financial disturbances if they occur.

Financial stability is built on a number of foundations. The first is a low-inflation environment. Such an environment reduces distortions in the financial sector and discourages asset speculation financed by borrowings. On this score, Australia's excellent inflation performance in recent years is paying valuable dividends. However, low inflation itself does not guarantee financial stability, as Japan's experience in the late 1980s confirms. Excessive credit growth and asset-price bubbles can still occur, putting at risk the financial system and the performance of the economy more broadly. In setting monetary policy, the

Reserve Bank needs to be cognisant of any vulnerabilities of these types in the financial system.

A second foundation is a safe and robust payments system – one in which difficulties in a single financial institution do not cascade through the financial system. Reflecting this, the Reserve Bank has been given formal responsibility for the safety and efficiency of the Australian payments system, a responsibility exercised by the Payments System Board. Australia's real-time gross settlement (RTGS) system, which has now successfully completed its first full year of operation, plays a vital role in this regard by eliminating settlement risk for those high-value payments between financial institutions which are at the core of the payments system.

A third foundation for financial stability is efficient and smoothly functioning financial markets. As recent events in Asia and elsewhere have confirmed, financial instability arising from disturbances in financial markets can be as costly as instability caused by financial institutions in distress. The Reserve Bank closely monitors developments in, and the integrity of, the major financial markets in Australia – namely, the money, bond and foreign exchange markets – which are essential to the conduct of monetary policy and relevant for financial stability more generally. The Bank is also currently responsible for authorising institutions to deal in foreign exchange but this responsibility is intended to pass to the Australian Securities and Investments Commission (ASIC).

A sound framework of prudential supervision is also, of course, a critical foundation for financial stability. Supervision is now the immediate responsibility of APRA. However, where it sees the need, the Reserve Bank also seeks to influence the nature of the regulatory environment, both domestically and internationally. The Bank's involvement in financial markets and its broad macro-economic responsibilities give it a unique perspective. Over the past year, the Bank has participated in numerous international meetings and working groups on reform of the international financial architecture – described in more detail in "Reform of the International Financial System." In the various fora the Bank has been a strong advocate for better disclosure, particularly by highly leveraged institutions. Through improved disclosure, counterparties and regulators are better able to assess accurately the risks that various institutions pose for the stability and integrity of financial markets.

In addition to the contribution it can make in a preventative way, the Reserve Bank also has a key role to play in responding to financial disturbances if they occur. On occasions, such disturbances might first reveal themselves in the payments system, in the form of liquidity pressures on a particular institution. Australia's RTGS system has been designed to allow institutions and the Reserve Bank a good deal of scope to deal with such pressures. The mechanism by which "queued" payments are tested and settled is specifically designed to minimise liquidity needs and reduce the possibility of liquidity pressures facing one institution being transmitted to others. The Bank monitors the system's operation in real time and ensures that market participants are aware of building pressures. Through its domestic market operations, the Bank can quickly provide increased liquidity to the market to allow it to negotiate periods of stress; RTGS operating hours can also be extended to allow participants to complete daily payments. These safety devices were effectively tested on several occasions over the past year, not because of financial pressures but because operational problems in particular institutions caused some payments to be temporarily delayed.

More broadly, and unlike the other regulatory agencies in Australia, the Reserve Bank is able to use its balance sheet to provide emergency liquidity support to the financial system. It would seek to do so, wherever possible, by making funds available to the market as a whole through its normal domestic market operations; the market would then be responsible for allocating funds to individual institutions. The Reserve Bank could also lend directly to a fundamentally sound institution in liquidity difficulties; it would do so, however, only if it were of the view that the failure of the institution to make its payments could have serious implications for the rest of the financial system, and there was a need to act expeditiously. In principle, a lender-of-last-resort loan could be made to any institution supervised by APRA. The Bank does not see its balance sheet as available to support insolvent institutions.

Australia's new financial regulatory structure calls for close and effective co-operation between the Reserve Bank, with its mandate for financial system stability, and APRA, which has responsibility for supervising individual financial institutions. A number of mechanisms have been put into place to achieve this. The Reserve Bank has two representatives on the APRA Board, and APRA has a representative on the Payments System Board. The two institutions have also signed, and published, a Memorandum of Understanding, covering such matters as information sharing, prompt notification of regulatory decisions that have an impact on the other institution's responsibilities, and arrangements for dealing with financial crises. In addition, a Reserve Bank/APRA Co-ordination Committee, chaired by the Bank, has been established to ensure that the co-ordination arrangements work smoothly.

An early priority for the Co-ordination Committee has been to establish a framework for information sharing. For its part, the Reserve Bank is providing APRA with relevant data from the payments system and regular briefings on the Australian economy. In turn, APRA is supplying the Bank with data needed to construct the monetary and credit aggregates, as well as prudential data in aggregate form which are used to assess developments in the financial system. In the normal course, the Reserve Bank will not receive confidential prudential data on individual institutions. The Co-ordination Committee has also been examining how Australia can contribute to the widely used International Banking Statistics compiled by the Bank for International Settlements (BIS).

The International Conference of Banking Supervisors, jointly hosted by the Reserve Bank and APRA in Sydney in October 1998: (left to right) William McDonough, President of the Federal Reserve Bank of New York and Chairman of the Basel Committee on Banking Supervision; The Hon Peter Costello, Federal Treasurer; Graeme Thompson, Chief Executive of the APRA; and Governor Ian Macfarlane.

Australia's participation in this collection is in line with the recommendations of the Prime Minister's Task Force on International Financial Reform. Other issues discussed by the Co-ordination Committee over the past year include Australian banks' exposures to highly leveraged institutions; the impact of financial market turbulence in late 1998 on banks' willingness to lend; progress in reform of the Basel capital arrangements; and the financial system's preparations for the Year 2000.

During the year, the Reserve Bank participated in a small number of APRA's regular on-site reviews of supervised institutions as a way of staying abreast of supervisory processes and risk management practices in financial institutions. The schedule of visits is designed to ensure that the Bank's understanding of the operations of different types of financial institutions remains up to date.

The Reserve Bank and APRA, together with ASIC, are members of the Council of Financial Regulators; the Governor acts as chair. This umbrella body provides a high-level forum for co-operation and collaboration among its members, as a means of contributing to the efficiency and effectiveness of regulation. A particular focus of the Council over the past year has been the Year 2000 issue (see "The Reserve Bank's Role in Preparations for the Year 2000").

In October, the Reserve Bank and APRA jointly hosted in Sydney the biennial International Conference of Banking Supervisors, held under the auspices of the Basel Committee on Banking Supervision. The Bank covered the cost of Australia's contribution to the Conference. The Conference, which brought together banking supervisory authorities from about 120 countries, focused on the Core Principles for Effective Banking Supervision (as published by the Basel Committee) and on the various operational risks facing banks.

The Australian financial system

Over the course of 1998/99, the Australian financial system faced a number of developments which, taken together, might have been sources of potential pressures on system stability. These were the continuing economic and financial problems in Asia, the turmoil in world financial markets following Russia's moratorium on foreign debt repayments and the near-collapse of Long-Term Capital Management. The Australian financial system has coped well with these developments and remains in strong condition, underpinned by the robust growth of the Australian economy.

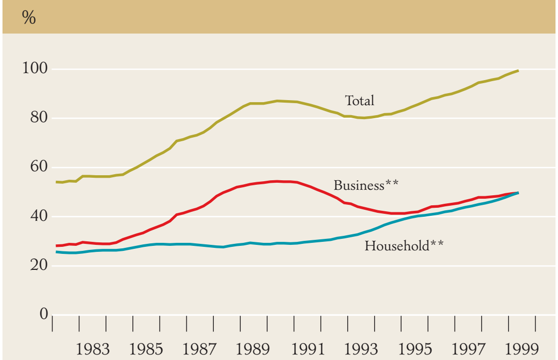
Notwithstanding Australia's close geographical and economic ties with the Asian region, international confidence in the Australian financial system has never waned throughout the Asian crisis. The credit ratings of the major Australian banks, even those with larger exposures to Asia, have been maintained. During the early stages of the crisis there were concerns that Australian banks could be adversely affected, either through their direct exposures to borrowers in Asia or through their exposures to Australian corporates reliant on Asian markets. These concerns have proven unwarranted, a consequence in part of the successful diversification of Australia's export sales away from Asia. Some Australian banks incurred losses on their Asian lending but these losses were easily absorbed by other profitable parts of their businesses. Asian exposures now account for around 4 per cent of banks' total assets, down from around 6 per cent before the Asian crisis emerged.

The Russian moratorium on foreign debt repayments in August, followed shortly after by the near-collapse of Long-Term Capital Management, precipitated a period of considerable stress in global financial markets, discussed in "Operations in Financial Markets". Financial institutions reassessed credit and market risks and reduced their appetite for accepting risk. The consequence was a sharp rise in credit spreads in the second half of 1998, associated with greater volatility and a loss of liquidity in many financial markets. Initially, this instability triggered fears – especially in the United States – of a "credit crunch" and a resulting pronounced slowdown in world economic activity. These fears, however, were relatively short-lived and while there were some flow-on effects to Australia, they were relatively mild and subsided quickly. Credit spreads rose in September and October and for a brief period new debt issues by Australian companies fell significantly, both in Australia and overseas. However, there was no evidence that Australian financial institutions reduced their willingness to provide credit to sound companies.

At the same time, in the face of global financial turbulence, Australian banks have taken a more cautious approach to their financial market exposures. Many have reviewed and updated their internal risk-management practices. Over the year, banks' exposure to the risk of losses from market movements, as measured by the capital charge for market risk, fell by around 30 per cent. The capital charge for credit risk on off-balance sheet exposures also declined, after increasing strongly for three years.

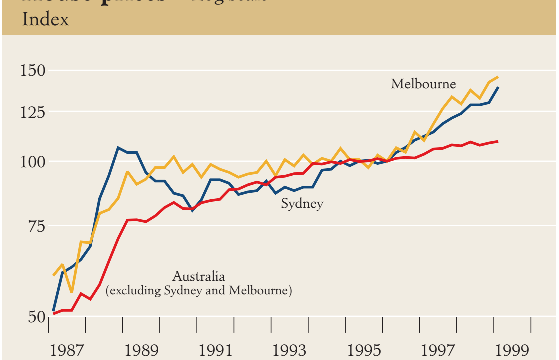
Domestically, the continued rapid expansion of credit has been the most noteworthy development in the Australian financial system over the past year. Credit extended by Australian financial institutions rose by 11.0 per cent, after four years of above 11 per cent annual growth; the major contributor was credit provided by banks, which account for around four-fifths of total credit. By year end, the ratio of credit to GDP was about 100 per cent, well above its peak at the end of the 1980s.

Credit – Per cent of nominal GDP*



* Nominal GDP for June 1999 is an estimate.
** Adjusted for breaks in series

House prices – Log scale*

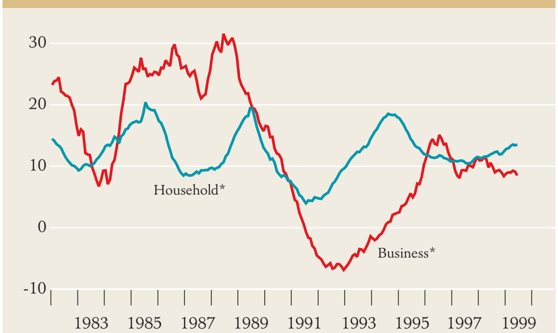


* March 1996 = 100
Source: REIA

The pattern of credit growth, however, is quite different from the experience of the late 1980s. For one thing, growth in credit to households has outstripped growth in credit to business. Over 1998/99, household credit grew by 13.5 per cent, a little above the average rate for the previous seven years. The ratio of household debt to household disposable income has increased from around 55 per cent in 1992 to over 90 per cent, putting the indebtedness of Australian households, on this measure, on a par with a number of other developed economies. Contributing factors include high levels of consumer confidence and the strong performance of the Australian economy, improved access to housing finance as a result of low interest rates and the increasing attractiveness of a range of personal credit products secured by residential property. These same factors, in turn, have been putting upward pressure on residential property prices, most noticeably in Sydney and Melbourne where prices have risen substantially over the past two years. Elsewhere in Australia, house price increases have not been as strong.

Some gearing-up of household balance sheets and rises in real property prices are a natural part of the adjustment to low inflation and improved access to credit. There is always a risk that borrowers and financial institutions will come to expect that ongoing rises in property and other asset prices will become the norm, which could tempt them into excessive levels of debt. If this were to happen, borrowers and financial institutions alike would become more vulnerable to the risk of future slowdowns in economic activity and falls in asset prices. This point is not in sight, in part because low interest rates have helped to keep the repayment burden on the higher debt levels quite manageable. Even so, the Bank will continue to monitor closely movements in household credit and in property and other asset prices.

Credit – Year-ended percentage change

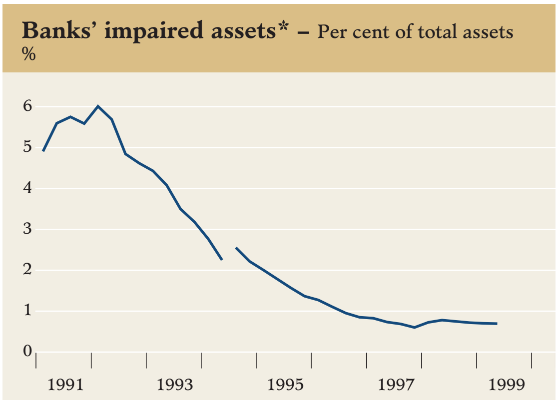


* Adjusted for breaks in series

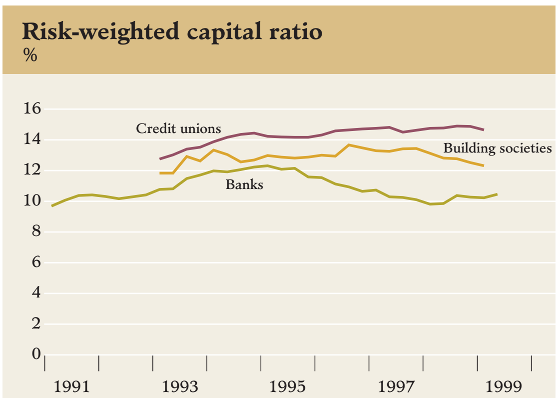
Business credit has grown at a solid pace, but well below rates experienced during the late 1980s. As a consequence, the ratio of business credit to GDP remains below its 1990 peak, and the combination of low leverage and low interest rates means that debt repayment burdens are well below historical averages. There is also little evidence of overheating in the commercial property market, another point of contrast with the late 1980s. Office construction has grown strongly over the past couple of years, particularly in Sydney, but activity levels and commercial property prices both remain well below their previous peaks.

Importantly, the financial system is much less exposed to commercial property than was the case in the late 1980s. Exposures are also better managed, with institutions assessing lending for commercial property on a portfolio basis rather than simply loan-by-loan. Property trusts have increasingly replaced traditional lenders as a source of finance for property; over the past two years their net new purchases of property have grown substantially and now exceed $5 billion per annum. These trusts borrow from banks but on a relatively small scale. The growing number of property trusts listed on the Australian Stock Exchange has helped to provide a market-based indicator of the current state of the commercial property sector. This should improve transparency, and thus investment decisions, in a market characterised by relatively infrequent trading of actual properties.

Notwithstanding the different undercurrents during 1998/99, the Australian financial system has ended the year with a strong asset base, high levels of profitability and a well-capitalised position. With the credit cycle still in a benign phase, the impaired assets and loan losses of financial institutions remain very low. In the case of banks, the ratio of impaired assets to total assets rose a little in the first half of 1998, partly because of fall-out from the Asian crisis, but some of the increase has subsequently been reversed; the ratio stands around



* Break in series in September 1994



0.7 per cent, just above its minimum point this decade. The favourable loan loss experience, strong growth in non-interest income and cost-cutting initiatives have enabled financial institutions to maintain their profitability in the face of further falls in interest margins.

The capital ratios of banks, building societies and credit unions remain comfortably above minimum required levels. The aggregate risk-weighted capital ratio for banks rose over the year to 10.5 per cent, following three consecutive years of falls. The issue of preference shares by a number of banks was a factor in this increase. The major Australian banks have also been moving to forward-looking provisioning policies which supplement historical loss experience with expectations about future economic conditions; this contributed to a build-up in general provisions for bad and doubtful debts in the second half of 1998.

Payments system developments

The Payments System Board of the Reserve Bank was formally established on 1 July last year. The Board has responsibility for the safety of the Australian payments system and for promoting efficiency and competition within that system, consistent with overall financial stability. The Board oversees the Reserve Bank's new and comprehensive powers in this area which allow the Bank, amongst other things, to determine rules for participation or set standards for safety and efficiency in a particular payment system. These responsibilities and powers are unique amongst central banks and supervisory authorities.

Non-executive members of the new Payments System Board: (left to right) Joe Gersh, Graeme Thompson, Sue McCarthy and John Thom.

The Payments System Board did not draw on these broad powers during 1998/99. Its initial task has been to undertake a "benchmarking" of the Australian payments system, addressing both its safety and its efficiency. That benchmarking has confirmed the general soundness of the domestic payments system, particularly following the successful implementation of the RTGS system, allowing the Board to turn its attention to a major global initiative to reduce foreign exchange settlement risk (the Continuous Linked Settlement Bank), which will include the Australian dollar. At the same time, the benchmarking has identified some areas – such as cheque-clearing times and the usage of direct debits – where there is obvious potential to improve efficiency. Though recent progress has been made in reducing cheque-clearing times, the Board has indicated that it wishes to see all banks work to a three-day cheque-clearing cycle as "best practice" in Australia. The Board's activities will be described in a separate Annual Report to be published in September.

The Reserve Bank's Role in Preparations for the Year 2000

The Year 2000 problem has been a major preoccupation for financial institutions, which are heavily dependent on computer systems and electronic communications for their normal operations. The problem has arisen because some computer hardware and software are unable to deal correctly with dates beyond 31 December 1999. The Bank's preparations for the Year 2000 have embraced most areas of its operations. They involve a comprehensive program to ready its own systems and a number of initiatives to deal with system-wide issues, such as the preparedness of the Australian payments system, the availability of cash and the maintenance of public confidence in the financial system.

The Reserve Bank's technical preparations

The Bank's systems, services, processes and facilities are all Year 2000 ready.

The Bank will be able to offer normal banking services to its customers over the New Year. These include the payment of pensions and other social security payments on behalf of the Commonwealth Government, as well as the settlement of interbank obligations and the Bank's normal transactions in financial markets.

The Bank began its technical preparations for the Year 2000 in 1996. Since 1997, the Year 2000 project has been controlled by a Steering Committee which reports to the Governor and to the Reserve Bank Board. The Steering Committee, which is chaired by the Assistant Governor (Corporate Services), receives reports on progress from all business areas; Audit Department has been reviewing the project to identify risks and provide an independent check on reported progress. The Australian National Audit Office also conducted a Year 2000 performance audit, which included the Bank, with its positive Report (Report No. 22) tabled in Parliament in December 1998.

A "preservation strategy" has been implemented to ensure that any essential system changes through the remainder of 1999 do not threaten the Bank's Year 2000 compliance. The cost of the Bank's Year 2000 project is estimated at around $5 million, the bulk of which is for existing staff redeployed from other activities.

System-wide initiatives

Because of its responsibilities for the payments system and for financial system stability, the Reserve Bank has been closely involved in the Year 2000 preparations of the financial industry; the Australian Prudential Regulation Authority (APRA) and its predecessors have been overseeing the preparations of individual financial institutions. The Bank is an active member of a number of interbank groups addressing Year 2000 issues and has been closely involved,

The Year 2000

The Australian financial system is ready for the Year 2000.

Banks and other financial institutions have been working hard over recent years to ensure that the so-called "millennium bug" will not disrupt their normal operations. They have spent more than $1 billion and devoted a large number of staff to checking and updating their computer systems. Where problems have been found, they have been fixed. Outmoded ATMs and EFTPOS machines have been replaced; computer programs have been rewritten; and where necessary, new software has been installed.

Throughout this process, financial institutions have been exhaustively testing and re-testing their computer systems, both individually and on an industry-wide basis. Many institutions have also participated in a successful worldwide test conducted by major international banks. The industry-wide testing program, which is now complete, has been closely monitored by the financial regulators, under the auspices of the Council of Financial Regulators chaired by the Reserve Bank. With all this effort, the Australian financial system rightly enjoys a world-class reputation for its high level of Year 2000 preparedness.

In a recent public statement, the Governor has said "All financial institutions have extensive back-up systems to ensure that each night they keep multiple physical records of all account information. While some members of the public have expressed concerns for the safety of their deposits because they think records might disappear, there is no basis for this type of concern. The safest place for people to keep their savings is in the financial institution that they are already with. Withdrawal and conversion to cash would expose them to a lot of unnecessary risks."

Banks and other financial institutions expect to provide their usual range of financial services, including the processing of payrolls and other payments, through the New Year. ATMs and EFTPOS machines are Year 2000 ready. If there were to be any disruptions to these facilities, comprehensive contingency plans will be in place to restore services quickly and efficiently. Of course, cheques and credit cards will also be able to be used over the New Year.

The Reserve Bank's own computer systems are Year 2000 ready. In particular, those systems that the Reserve Bank uses to distribute pension and other government payments to banks, building societies and credit unions on behalf of Centrelink have been thoroughly tested. Pension payments will be made on time.

The Reserve Bank sees no need for people to withdraw more money over the New Year than they normally would for a long weekend. However, if people want to take out more cash to tide them over, the Reserve Bank has built up ample stocks of currency notes to meet that demand. These stocks can be readily accessed by financial institutions if the need arises.

The Reserve Bank has been working closely with banks and other institutions to ensure that the financial system functions smoothly over the Year 2000 date change. Financial institutions will not have to curtail their normal activities because of concerns that there will not be adequate liquidity in the financial system.

Overall, the Reserve Bank's view is that the Australian financial system will be able to operate on a "business as usual" basis and the public should view the New Year as just another long weekend.

through its membership of the Australian Payments Clearing Association, in the testing of domestic payments clearing systems. The Bank has also been co-operating closely with other financial regulators in Australia under the auspices of the Council of Financial Regulators.

Industry-wide testing in the payments system was successfully completed, on schedule, by 30 June this year. Importantly, this included testing of the real-time gross settlement (RTGS) system for high-value interbank transactions, which is the core of the Australian payments system. In June, the Bank also participated in a successful worldwide test of international payments conducted by major international banks.

Financial institutions have undertaken comprehensive remedial action and extensive testing of their computer systems, and are now finalising contingency plans to deal with any unexpected Year 2000 problems. Contingency planning is also well under way in the payments system. The Bank is leading a review of existing contingency procedures for the RTGS system and for net settlement arrangements; it is also involved in industry contingency planning for low-value retail payments systems, including cheques, direct entry, ATMs and EFTPOS. These various efforts mean that the Australian financial system is very well prepared for the Year 2000.

To meet additional demands for the traditional means of making payments – namely, cash – the Reserve Bank is increasing its stock of currency notes ahead of the Year 2000. This is being done by printing additional notes and by retaining some used notes that would otherwise have not been reissued on quality grounds.

The Bank is also liaising with banks, building societies and credit unions, as well as armoured car companies, on arrangements for the distribution of cash. Later in the year, the Bank will distribute additional notes to financial institutions to ensure the ready availability of currency around the Year 2000. Financial institutions will be required to pay for these notes, as well as transportation and insurance costs, if and when they are used. The Bank has established a working

As part of its contingency planning in preparation for the Year 2000, the Reserve Bank has stockpiled additional supplies of cash in its vaults.

group involving financial institutions and the armoured car companies to co-ordinate these arrangements.

The Reserve Bank has also been working closely with banks and other financial institutions to ensure that they will have liquidity over the date change period. In June, the Bank announced measures it would be willing to take to provide financial institutions with greater certainty about their liquidity flows around the Year 2000. These were the extension of the term of repurchase agreement transactions out into the new calendar year, and a term deposit facility for institutions with Exchange Settlement accounts, to provide an additional avenue for them to hold liquid balances. The Bank also foreshadowed that, as the Year 2000 approached, it would operate in the market to ensure that market conditions remained consistent with the cash rate target. To the extent necessary, it would supplement its dealings in government securities with increased use of foreign exchange swaps and repurchase agreements in bank bills and certificates of deposit issued by banks operating in Australia.

With the technical preparations for Year 2000 all but complete, the priority over the remaining months of 1999 is to reassure the Australian community that their deposits are safe and that they can have full confidence in their financial institutions. The best-laid plans of institutions could be threatened if the public were to over-react to Year 2000 concerns. For this reason, the Reserve Bank has been talking to banks, building societies and credit unions about the need for clear communications with their customers and adequate training of staff to deal with customer queries. Over coming months, depositors can expect to receive reassurances from their financial institutions that their financial records will not be lost and that their deposits are not at risk from Year 2000 computer problems. The Bank is also closely monitoring public attitudes to, and media discussion of, the Year 2000 issue.

The Reserve Bank has been involved in a number of other initiatives designed to encourage public understanding of the Year 2000 problem. The Governor addressed the Year 2000 issue in a statement to the House of Representatives Standing Committee on Economics, Finance and Public Administration in June. Under the auspices of the Council of Financial Regulators, the Bank has jointly published a series of booklets on *Year 2000 Preparations in the Australian Banking and Financial System,* as a means of disclosing the Year 2000 progress of financial institutions to a wide audience. Together with APRA, the Bank has organised two industry seminars to discuss Year 2000 preparations in the financial system and other key sectors, and has taken part in Infrastructure Forums in a number of capital cities, sponsored by the year2k Industry Program of the Commonwealth Government.

Over the New Year period itself, the Reserve Bank and APRA will operate a joint communications centre. This centre will enable both institutions to be kept fully informed of developments in the payments system and more generally, and to communicate as necessary with financial institutions and other relevant parties.

Customer Services

The Reserve Bank provides banking facilities for governments, and registry services for the Commonwealth and some State government and overseas agencies; electronic settlement services for securities transactions and payments through the Reserve Bank Information and Transfer System (RITS); and a bulk currency note issue facility.

Some of the services provided by the Bank are contestable in that they can also be provided by private sector organisations, while others such as note issue and interbank settlement facilities are core, non-contestable, central bank functions. To facilitate transparency and accountability, contestable activities are set up on a business-unit basis with each unit operating in accordance with the competitive neutrality guidelines established under the Government's competition policy. Separate accounts are prepared for each business unit reflecting full costs, revenues, taxation and notional capital attributable to the business (these are detailed in the Appendix to this chapter). In 1998/99, pre-tax profits from contestable activities were $6.6 million. Revenues from contestable activities were $30.2 million, compared with costs of $23.6 million.

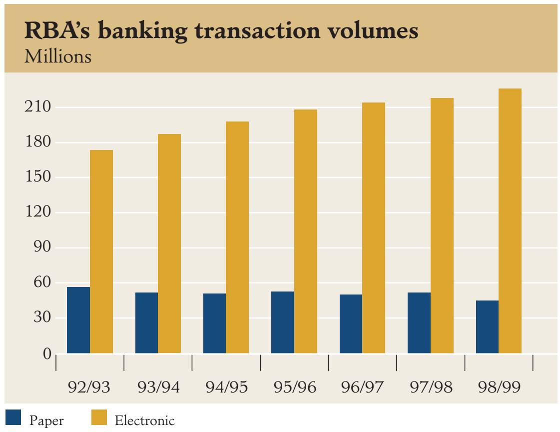
Activity in the banking business continued to follow the trend towards greater use of electronic facilities. Substantial resources were committed during the year to the establishment of direct banking relationships with individual Commonwealth Government departments and agencies in preparation for their acceptance of responsibility for their own banking arrangements on 1 July 1999. Following the loss of the Tasmanian Government banking business, the Hobart branch was closed on 30 October 1998. Two other government customers, Western Australia and Australian Capital Territory, have recently selected other banks to conduct their banking business.

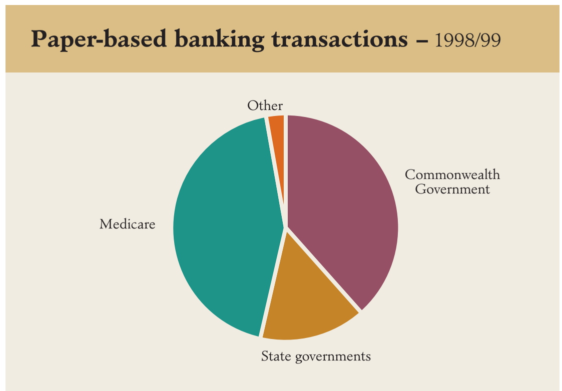
1998/99 was the first full year of operation of the Bank's real-time gross settlement (RTGS) system for interbank payments. The performance of the system exceeded expectations and has positioned Australia at the forefront of countries in providing an efficient, robust platform for minimising interbank settlement risk.

During the year, work also continued on the reorganisation of the bulk cash distribution arrangements. This was done with a view to reducing the volume of currency note processing undertaken by the Bank, reflecting the benefits of increased durability and lower counterfeit experience of polymer notes.

Banking

During the year, the Reserve Bank continued its program of implementing operational improvements to enhance the quality of its banking services and to strengthen the profitability of the business. Outsourcing of the Bank's cheque-processing operations to the Commonwealth Bank was completed with the transfer of the remaining part of the activity, the data capture of cheques drawn on other financial institutions deposited by Reserve Bank customers.

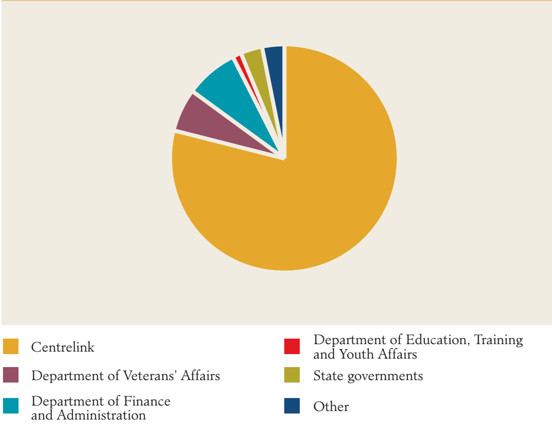




The Bank also participated in the industry-wide implementation of electronic exchanges of presented and dishonoured cheque data. This project has enabled the banking industry to shorten the cheque-clearing cycle and allow customers earlier access to funds. While the Reserve Bank always has allowed its government customers same-day access to deposited funds, the move to electronic presentment and dishonour has streamlined the cheque-clearing process and, together with the outsourcing of cheque-processing, has enabled costs to be held down at a time of continuing decline in paper volumes. Paper transactions declined by 15 per cent to 45 million items in 1998/99, from 53 million items in 1997/98.

On the other hand, electronic transactions through the Government Direct Entry System (GDES) (which receives payments data from various customers and subsequently sorts and electronically distributes them to a wide range of financial institutions) increased in 1998/99 by around 3.7 per cent to 226 million items. This increase was partly the result of the Health Insurance Commission's efforts to gain increased acceptance of electronic crediting of Medicare rebates

Electronic banking transactions – 1998/99



instead of cash and cheque-based payments: around one million payments were switched to direct entry during the year. During 1998/99 the Federal Reserve Bank of New York, on behalf of the US Government, commenced using GDES to distribute pension payments to United States pensioners resident in Australia.

Devolution and market testing

During 1998/99, the banking business was restructured in preparation for the devolution of the Commonwealth's banking business on 1 July 1999. From that date, all Commonwealth departments and agencies became responsible for their own individual banking arrangements. Prior to devolution, the Bank had direct links with only five government departments and statutory authorities – the departments of Veterans' Affairs, Attorney-General and Finance and Administration, and Centrelink and the Australian Taxation Office. The Department of Finance and Administration (DoFA), in turn, handled overall government banking facilities for a further 75 government departments and agencies. In preparation for the post 1 July arrangements, direct banking links were established with each of the 75 separate government departments and agencies.

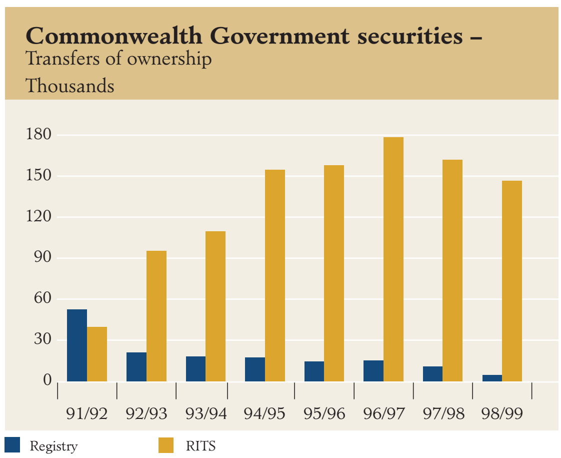
The competitive neutrality and devolved banking arrangements necessitated the separation of the Reserve Bank's banking business into two parts – the core account-keeping function and the contestable transaction-processing business. The Commonwealth Public Account, now known as the Official Public Account (OPA), has remained with the Reserve Bank as it is important for the implementation of monetary policy and for the smooth operation of the RTGS system. The Commonwealth's foreign exchange requirements also continue to be provided by the Bank. The new arrangements do not preclude the processing of government transactions by other banks so long as net balances end up in the OPA at the Reserve Bank at the end of each day. A new system has been developed to sweep Commonwealth department and agency balances from their transactional bankers to the OPA each night. The Bank's desktop banking package, Reservelink, was also upgraded to facilitate the new agency banking arrangements. In addition to its core account-keeping function, the Bank also provides a range of financial reports and interest payment facilities to assist DoFA in the management of the new agency banking arrangements.

Under the new devolved banking arrangements, government departments and agencies are, within a reasonable time, required to test the services provided by the Reserve Bank against what is available from other service-providers. This process has already commenced and DoFA moved its departmental banking business to another service provider on 1 July. It is anticipated that the full working-out of the new arrangements will be a gradual process extending over at least twelve months.

Registry and Security Settlement Services

The Reserve Bank provides registry services for the Commonwealth Government and other domestic and foreign official organisations. Services are provided through the Bank's branches and include the issue, transfer and registration of securities, maintenance of ownership records, periodical payment of interest and the redemption of securities at maturity.

As with previous years, activity levels in the registry area continued to decline as a result of growth in electronic settlements. Activity was also significantly affected in 1998/99 by the loss of the Western Australian Treasury Corporation business. In this contracting environment, the Bank has kept the business under continuous review to ensure that services are delivered in a cost-effective manner, whilst retaining a focus on quality of service. As a result of this process, improved operational efficiencies have allowed reductions in the cost of registry services to be passed on to the Bank's larger clients during 1998/99.



RITS provides its 143 members (representing 260 organisations) with facilities for the electronic settlement of transactions in Commonwealth Government securities (CGS). RITS handles 98 per cent of CGS turnover in the market and has securities with a face value of $80 billion (92 per cent of total CGS on issue) lodged in it.

The system also provides facilities for electronic tendering for CGS, automatic interest and maturity payments for securities lodged in the system and for settling the interbank component of equity transactions on CHESS, the Australian Stock Exchange's electronic settlement system.

RITS is also the system through which banks access their Exchange Settlement (ES) accounts with the Bank. It was substantially enhanced in 1997/98 to be the platform for Australia's RTGS system, which commenced operation on 22 June 1998.

RTGS system

The Reserve Bank's RTGS system for interbank payments is one of the most advanced and comprehensive in the world. About 90 per cent of the total values exchanged between Australian banks is settled across RITS on an RTGS basis and hence is not subject to domestic interbank settlement risk. RTGS payments include securities markets settlements, the Australian dollar leg of foreign exchange transactions and payments, including time-critical ones, on behalf of corporate customers. The system has now been in full operation for over twelve months and its performance has exceeded expectations.

RTGS transactions

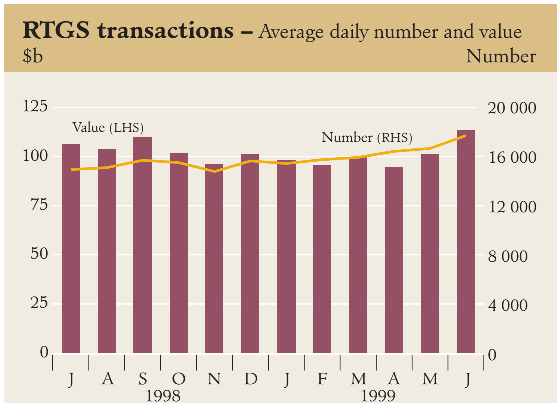
(June quarter 1999, daily average)

	Value ($ billion)	Number (thousands)	Average payment size ($ million)
Commonwealth Government securities	14	1	18
Other securities	22	3	8
Foreign exchange transactions and customer payments	67	13	5
Total (excluding intraday repurchase agreements with the Bank)	103	17	6

For most of 1998/99, the average daily value of RTGS transactions fluctuated at around $100 billion, with significantly higher values recorded in June, reflecting the relatively high activity in markets in the last month of the financial year.

Average daily RTGS transaction numbers rose from around 15 000 in the September quarter of 1998 to nearly 17 000 in the June quarter of 1999. This largely reflects an increase in the number, but not value, of foreign exchange transactions and customer payments; the average size of these transactions fell from $6.0 million to $4.9 million over the same period. On busy days, activity increases substantially: on the peak day in 1998/99, 25 000 transactions with a value of $160 billion were settled.

The RTGS system has proved to be very efficient in its operation and, importantly, is economical in its liquidity requirements. An indication of this is given by the size of the queue at its peak compared with total payments settled. On average, the peak number and value of queued transactions represent only about 10 per cent of total payments settled each day.



To supplement banks' holdings of cash in their ES accounts, inexpensive intraday liquidity is provided by the Reserve Bank by means of repurchase agreements in eligible Commonwealth and State Government securities. On an average day, 15 to 20 banks use this facility, with $4 to $5 billion of intraday liquidity provided.

Total daily liquidity sourced from intraday repurchase agreements and ES account balances currently averages around $6 billion, equivalent to about 6 per cent of the total daily value of RTGS transactions. As banks gained more experience with the settlement of transactions on an RTGS basis, and with the ready availability of intraday liquidity, over the year banks reduced the amount they held in the form of ES account balances (this is discussed in detail in "Operations in Financial Markets").

The Bank strives to ensure that the operation and performance of the RTGS system matches world best practice and that the system is responsive to the needs of the industry. Contingency arrangements involving recourse to back-up systems are tested regularly. Performance upgrades have recently been introduced to ensure system throughput and capacity comfortably exceed current and expected future peak load requirements. Several enhancements to the system have already been made and others are planned after the Year 2000 moratorium. Two of the more important prospective changes are linkages with the Australian Stock Exchange to permit optional RTGS settlement of high-value equity transactions and inclusion of the Australian dollar in the Continuous Linked Settlement Bank initiative to reduce settlement risk in foreign exchange transactions.

Settlement services are also provided for the Bank's own transactions in the domestic securities and foreign exchange markets, as well as for those arising from business transacted by official customers domestically and abroad. The Bank also acts as collator of banks' obligations arising from the low-value clearing streams (paper, and bulk and retail electronic) managed by the Australian Payments Clearing Association.

Note Issue

The note issue functions of the Bank involve the bulk issue of notes; the processing of notes returned from circulation for fitness and authentication; and research into and development of note designs and security features.

The move to polymer-based currency notes has had an effect on all areas of the Bank's note issue activities. Polymer notes have been in circulation in Australia for over seven years. It is now three years since the final note in the current series of polymer notes was issued and, for practical purposes, all Australian currency notes in active circulation are now polymer. Primarily, the move to polymer substrate was based on the need for enhanced bank note security. Our experience has confirmed that, not only are the polymer notes more difficult to counterfeit, they are more durable and can be more efficiently processed by a range of different types of machines.

Note processing and distribution

The community's demand for currency continues to grow broadly in line with the economy despite the rise in electronic payments facilities such as EFTPOS and direct entry. The value of notes on issue in 1998/99 rose by 8.8 per cent, a higher rate of increase than last year. Demand for $50 and $100 notes continued to grow strongly. About 88 per cent of the value of notes on issue is accounted for by these two denominations. During the year, the Reserve Bank issued into circulation around $79 billion in currency notes and had $77 billion in notes returned. Around one billion notes (with a value of around $40 billion) returned from circulation were processed through the Bank's high-speed note-processing machines compared to 1.4 billion last year (with a value of around $52 billion). About 94 per cent of these notes were classified as fit for reissue. The high rate of reissue, which has grown over recent years, reflects durability and cleanliness of polymer notes compared with paper-based notes.

* GDP for 1998/99 is an estimate; currency includes notes and coin.

Value of notes on issue

($ million)

At end June	$1 (a)	$2 (b)	$5	$10	$20	$50	$100	Total	Increase (per cent)
1994	21	69	313	634	1 795	6 837	7 907	17 577	7.4
1995	20	49	332	614	1 848	7 193	8 482	18 538	5.5
1996	19	48	337	583	1 868	7 928	8 399	19 182	3.5
1997	19	47	351	601	1 837	8 912	8 297	20 064	4.6
1998	19	47	361	617	1 804	9 523	9 280	21 651	7.9
1999	0(c)	46	379	639	1 850	10 356	10 282	23 552	8.8

(a) Last issued May 1984

(b) Last issued June 1988

(c) See Notes To and Forming Part of the Financial Statements, Note 1(i)

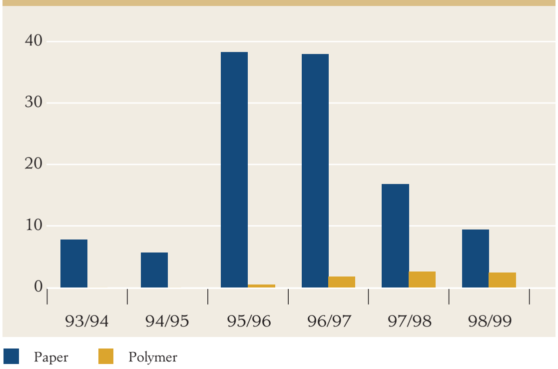
From July 1998, the Reserve Bank introduced new currency distribution arrangements involving an increase in the number and geographical dispersion of holding points of Reserve Bank note stocks. Armoured car companies service the needs of their bank customers from these note pools. These new arrangements have unlocked significant productivity gains inherent in the move to polymer. Under the former arrangements, polymer notes were being processed by the Bank as frequently as paper notes, thereby negating somewhat the durability and security benefits of the move to polymer. The new distribution arrangements allow greater recycling of notes in the community from more convenient distribution points, thereby improving the efficiency of distribution arrangements.

The new arrangements have led to a reduction in the number of Bank staff and machines involved in note-processing Australia-wide. The cash services areas of the Bank have been restructured and cash-processing and distribution activities were discontinued in Canberra and Hobart in October 1998. Armoured car companies are now responsible for providing notes in those cities just as they are in other areas of the country outside the main distribution centres where the Bank has branches.

Counterfeiting activity

The level of counterfeiting of Australia's currency notes during the year was again very low. Around 1 700 low quality counterfeits were detected. The vast majority of counterfeits were paper reproductions of the paper and polymer series of notes, although a small number were on plastic substrate. The total number of counterfeits detected was down from around 2 300 in the previous year and around 4 400 in 1996/97.

Counterfeits per million notes in circulation



The Bank believes that the reduction in the number of counterfeits is a direct result of the use of polymer notes in Australia instead of paper notes. In particular, the move to a polymer substrate appears virtually to have stopped the casual or "crime of opportunity" counterfeiter. There is, however, always a risk of counterfeiting and the Bank continues to conduct research and develop a new array of advanced features to improve even further the security of polymer notes.

New $5 note design – Centenary of Federation

Last year, the Reserve Bank announced plans to issue in early 2001 a newly designed $5 note, in conjunction with celebrations for the Centenary of Federation. The new note designed by Mr Garry Emery, one of Australia's leading graphic designers, will feature Sir Henry Parkes and Catherine Helen Spence.

The conceptual design has been completed and designers and technicians at Note Printing Australia, the subsidiary of the Bank that produces Australia's currency notes, are currently translating the conceptual design into a production prototype. This involves addressing practical printing issues, as well as incorporating security features of various types.

Appendix

Transactional Banking Business

		1997/98 $ million	1998/99 $ million
Revenue	– Service fees	31.6	20.4
	– Other revenue	4.0	3.0
	Total	35.6	23.5
Expenditure	– Direct costs	26.3	12.7
	– Indirect costs	6.7	6.2
	Total	33.0	18.9
Net profit/(loss)		2.6	4.6
Net profit/(loss) after taxes (a)		1.6	2.8
Assets (b)	– Domestic market investments	539.7	587.9
	– Other assets	25.6	23.0
	Total	565.3	610.9
Liabilities (b)	– Capital & reserves	25.0	25.0
	– Deposits	529.8	576.2
	– Other liabilities	10.5	9.7
	Total	565.3	610.9

Appendix *(continued)*

RITS Business

		1997/98 $ million	1998/99 $ million
Revenue	– Service fees	4.2	3.8
	– Other revenue	0.2	0.2
	Total	4.4	4.0
Expenditure	– Direct costs	2.2	2.4
	– Indirect costs	0.2	0.4
	Total	2.4	2.8
Net profit/(loss)		2.0	1.2
Net profit/(loss) after taxes (a)		1.2	0.7
Assets (b)	– Domestic market investments	4.2	4.1
	– Other assets	0.7	0.8
	Total	4.9	4.9
Liabilities (b)	– Capital & reserves	4.0	4.0
	– Other liabilities	0.9	0.9
	Total	4.9	4.9

Registry Business

		1997/98 $ million	1998/99 $ million
Revenue	– Service fees	3.0	2.6
	– Other revenue	0.2	0.1
	Total	3.2	2.7
Expenditure	– Direct costs	1.7	1.4
	– Indirect costs	0.7	0.5
	Total	2.4	1.9
Net profit/(loss)		0.8	0.8
Net profit/(loss) after taxes (a)		0.5	0.5
Assets (b)	– Domestic market investments	3.6	2.6
	– Other assets	0.3	0.3
	Total	3.9	2.9
Liabilities (b)	– Capital & reserves	3.0	2.0
	– Other liabilities	0.9	0.9
	Total	3.9	2.9

(a) In accordance with competitive neutrality guidelines, income tax expense has been calculated and transferred to the Commonwealth as a notional part of the Bank's annual profit distribution.

(b) As at 30 June

Management of the Bank

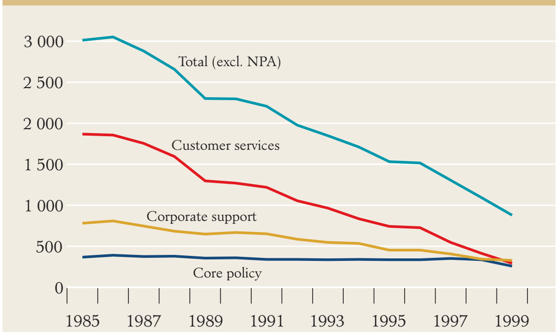
This was the first year that the Bank had operated under the new administrative framework introduced in mid 1998. An important part of this had been the restructuring of the Financial Institutions Group to assist in the implementation of the Bank's responsibilities under Australia's new system of financial regulation. This had involved the abolition of Bank Supervision Department on 1 July 1998 with the transfer of most of its 65 staff to the Australian Prudential Regulation Authority (APRA) and, in its place, the creation of a smaller System Stability Department to support the Reserve Bank's role in protecting the stability of the financial system. This provided a suitable opportunity for the Bank to bolster its capacity for research in the areas of financial and systemic risk. The Bank also responded to its enhanced powers in the payments system, by restructuring the former Financial System Department as the renamed Payments Policy Department, again with a more focused policy function.

For the Business Services Group, an important achievement this year was the bedding-down of the new Payments Settlements Department established to manage and operate the RTGS system, which became fully operational in June 1998. While this created a number of new positions, staffing numbers in the Group as a whole fell significantly over the year as steps taken to improve the efficiency of cheque-clearing and cash-handling operations continued to flow through to staffing levels. The new cash distribution arrangements that were introduced in July 1998, for example, ended the Bank's specialised currency distribution service for individual bank branches in metropolitan areas; and in October cash-processing and distribution services were discontinued altogether in Canberra and Hobart. With the loss of the Tasmanian banking business, the existence of a Hobart branch could not be justified and it was closed on 30 October 1998. Two other government customers, Western Australia and the Australian Capital Territory, have recently gone to tender and selected other banks to conduct their banking business. In response, staff numbers in Perth are being reduced from 35 to 14. In Canberra, the outcome is less certain as the branch is fully employed in the tasks associated with the devolution of the Commonwealth's banking business from 1 July 1999.

As a result of these changes, in 1998/99 staff numbers fell below 1 000 for the first time, to reach 878 by end June, a fall of nearly 20 per cent over the year.

On the remuneration front, staff received a 4.4 per cent increase in salary in July 1998, which was the second tranche payment provided for in the 1997/98 productivity bargaining agreement which was negotiated in 1997. A new productivity bargaining agreement was concluded in April 1999 covering the calendar years 1999-2000. The agreement provides for two annual salary increases of 3.5 per cent with the initial increase effective from July this year. In return, staff agreed to a number of productivity-related changes to employment conditions, including a streamlining of staff selection and appeal procedures. These will continue to emphasise the principles of merit selection to all positions in the Bank with a strengthening of the existing panel process, but without the avenue of appeal to a separate Promotions Board of Review.

RBA staff numbers – As at 30 June



The reduction in staff numbers during the course of 1998/99 resulted in a fall in staff costs; these costs have declined by around 26 per cent over the past two years. Outsourcing arrangements have contributed to this decline but were partly offset by payments included in other costs, including for services such as guards and cheque-processing now provided by outside suppliers. In 1998/99, other costs stayed around the higher level reached the previous year; costs associated with the operation of the real-time gross settlement system and the establishment of Payments Settlements Department were offset by lower premises and equipment costs for note production. Overall, underlying operating costs (excluding redundancies and certain other one-off items) fell further in 1998/99, to be 19 per cent lower than their peak in 1991/92. In real terms, the decline has been even more marked.

Operating costs (a)

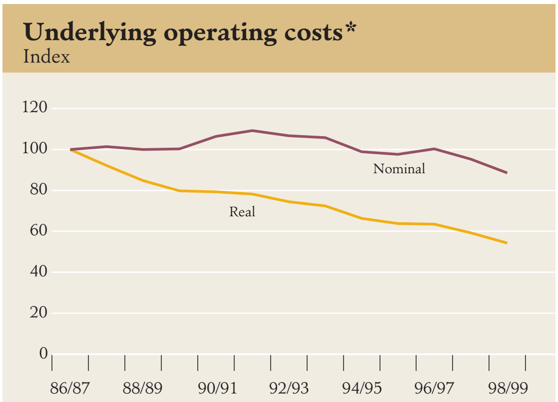
($ million)

	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99
Staff costs#	116.4	112.3	111.7	108.0	106.6	111.9	93.8	82.6
Other costs*	68.6	68.7	67.7	59.6	58.8	58.0	67.7	67.5
Underlying operating costs	185.0	181.0	179.4	167.6	165.4	169.9	161.5	150.1
Cost of redundancies	18.8	2.7	9.8	18.1	1.3	12.9	29.7	18.4

(a) Includes NPA

Excludes redundancies and, from 1994/95, additional charges to comply with accounting standard AAS30

* Includes premises and equipment (including depreciation), but excludes IMF maintenance of value payment



* Includes NPA

In the table on page 53, 1997/98 figures for other costs and underlying operating costs have been revised down by $13.7 million from those shown in last year's Annual Report, due to a change in accounting treatment. Previously, operating cost figures included certain outlays which were exactly matched by revenues; these "pass through" expenses have now been netted against their corresponding revenues. The expenditures and revenues concerned are those associated with the management of the Australian Taxation Office's Billpay services and with note substrate purchased for subsequent export. Figures prior to 1997/98 were not affected by this change in approach.

Changes in the distribution of operating costs reflect changes in the Reserve Bank's activities in 1998/99. The share of operating costs associated with financial system surveillance declined due to the move of bank supervision responsibilities to APRA. The share of costs absorbed by note distribution fell because of the Bank's exit from retail cash distribution; these costs represented 24 per cent of operating costs two years ago compared to 15 per cent in the latest year. With these declines, monetary policy accounted for an increased share of costs, while the rise in settlement costs was associated with the real-time gross settlement system and the new Payments Settlements Department.

Distribution of operating costs (a)
(Per cent)

	Monetary policy	Financial system surveillance	Note distribution	Note purchases	Banking and registry	Settlement
1996/97	23	11	24	19	18	5
1997/98	24	11	18	22	18	7
1998/99	27	6	15	24	17	11

(a) Excludes NPA

The Reserve Bank continues to support staff undertaking further development. Five staff are currently studying full-time under the Bank's Post-Graduate Study Award Scheme, four of them at overseas universities. Over the year, the Bank also provided financial support to 93 staff undertaking part-time tertiary studies in Australia.

Work experience has again been provided to a number of students and support has continued to be provided for the employment of trainees through the Reserve Bank New Apprenticeship and Training System Agreement 1999.

The Reserve Bank holds a licence to self-insure its workers' compensation claims. These have continued to decline reflecting both falling staff numbers and efforts to raise staff awareness of health and safety issues and involvement in hazard reduction. While claim numbers have decreased, their average cost has risen because of a small number of complex ongoing claims. Self-insurance costs continued to be lower than premiums charged by Comcare.

The Reserve Bank in the Community

The Bank has a wide-ranging record of community involvement. Over time, this has been adapted to changing expectations and demands, and to the evolving policy environment.

Worldwide, the clearer delineation of central bank independence has brought with it an obligation of greater accountability – to explain the framework of policy and how it is being implemented over time. One aspect of this in Australia takes the form of twice-yearly public appearances by the Governor before the House of Representatives Standing Committee on Economics, Finance and Public Administration. At these hearings, the Governor presents a statement reviewing events since the last hearing and addressing particular issues in which the Committee and the wider community may have an interest; this is followed by an extended question-and-answer session. As background to this, the *Semi-Annual Statement on Monetary Policy* – a detailed economic assessment of around 50 pages – is published shortly before the hearings. To provide continuity and frequent commentary, the Bank also publishes two similar analyses of the economy and financial conditions in the quarters between issues of the *Semi-Annual Statements.*

In addition to these appearances before the Parliamentary Committee, the Governor and other senior officers give speeches and other less formal presentations in a wide range of fora, both in Australia and overseas. While many of these presentations – particularly those to overseas audiences – focus on current economic and financial conditions in Australia, some of the more formal speeches take a longer-term perspective on the issues which are at the heart of the Bank's role. For example, during the latest year, the Governor gave the Shann Memorial Lecture in Perth, under the auspices of the University of Western Australia, on "Australian Monetary Policy in the Last Quarter of the Twentieth Century". In July 1999, the subject of his RC Mills Memorial Lecture at Sydney University was "The Stability of the Financial System". Other recent speeches have covered the Australian experience of inflation targeting, and the causes and effects of the recent Asian financial crisis.

Articles in the Bank's *Bulletin* contribute to the general debate on public policy. These have included the implications of changes to the consumer price index for monetary policy and the inflation target, labour demand and the economic cycle, developments in interest rates on bank lending, demutualisation in Australia, Australia's new financial regulatory framework, the Australian payments system, and the role of Exchange Settlement accounts. In the June 1999 *Bulletin*, new material was published on bank fees in Australia, largely in response to interest in this subject by the Parliamentary Committee.

During the year the web site (http://www.rba.gov.au) was further developed, with a view to facilitating access to the majority of the Bank's "publications", on a timely and minimum cost basis to the widest possible audience. The four major assessments of the economy during the year are reproduced on the web site and, in 1997/98, the Annual Report was also reproduced in full, for the first time, in this format. The Research Discussion Papers (RDPs) section of the site was expanded during the year to include the full texts of all RDPs published since the beginning of 1993, with abstracts of the RDPs since 1976, and a search function has been added to this part of the site; previously only synopses of recent RDPs had been published together with a full listing of titles of the RDP series. Fifteen RDPs were published during 1998/99. The web site is now updated daily, with daily media releases being reproduced in full on the site, for ease of access by the public.

Over the year, support has been given to various academic conferences, both by way of financial sponsorship and by providing keynote speakers. These include conferences held by the Australian National University (one on the financial crisis in Thailand; and a PhD conference in Economics and Business run jointly with the University of Western Australia), the University of New South Wales (the annual Australasian Conference in Finance and Banking) and the University of Sydney (the annual Conference of Economists). Financial assistance is also provided for various research projects and teaching initiatives by universities. There was ongoing funding for several such projects during the year: the monthly survey of consumers' inflationary expectations by the Institute of Applied Economic and Social Research at the University of Melbourne; the quarterly survey of union inflation and wage expectations by the Australian Centre for Industrial Relations, Research and Teaching at the University of Sydney; and the Securities Trading and Research Laboratory ("Starlab") within the Australian Graduate School of Management at the University of New South Wales.

The longstanding relationship with the broader education community continues. During the year, senior staff from Economic Group gave presentations to groups of teachers of secondary-level economics and commerce in Sydney, Adelaide, Brisbane and Perth, under the auspices of various State-based associations of teachers. Similarly, senior staff from Economic Group gave lectures to student classes in economics at a number of capital city and regional universities. There was also continuing involvement in the co-operative education program in Information Technology with the University of Technology, Sydney.

The Small Business Finance Advisory Panel, established in 1993, draws together owners of small businesses from across Australia and different industries to discuss issues relating to the provision of finance and other banking services, as well as developments in financial markets. The panel meets annually, the last meeting being in September 1998.

During the year, a contribution of $10 000 was made to support the HC Coombs Memorial Medical Fellowship, sponsored by the Florey Trust in Melbourne;

Dr Coombs, a former Governor of the Bank, was a long-time supporter of the Howard Florey Institute. The Bank also joined a number of other major institutions in providing financial assistance to the Sydney City Council towards the cost of upgrading Martin Place; the Bank's contribution to these works in the precinct outside its Head Office was $200 000 in 1998/99, with a commitment to provide a like amount in 1999/2000. The Bank is also a corporate sponsor of the "Work-A-Day 4 Kids" fund-raising event which is organised by the Financial Markets Foundation for Children; the Governor is the Chairman of the Foundation which is based around staff members of institutions in the financial markets and which raises money to be directed towards research into medical and social problems affecting children.

Statutory Obligations

Equal employment opportunity

The Reserve Bank has continued to pursue its equal opportunity objectives. The current Equal Employment Opportunity (EEO) Plan 1997-1999 was extended by 12 months to June 2000. The Plan is designed to assist in the achievement of the overall EEO program goals regarding staff selection, conditions of employment, career development and staff training. Details of the Plan are contained in a separate EEO Annual Report, which is tabled in the Australian Parliament each year; the report for 1997/98 was tabled in November 1998.

Health and safety, compensation and rehabilitation

The Reserve Bank is required by Section 74 of the *Occupational Health and Safety (Commonwealth Employment) Act 1991* and Section 107 of the *Safety, Rehabilitation and Compensation Act 1988* to report on health and safety matters as they relate to the Bank.

During the year, an Occupational Health and Safety Plan was implemented and considerable progress was made in raising staff awareness and involvement in identifying, assessing and managing hazards in the workplace. Two Occupational Health and Safety audits by representatives of the Safety Rehabilitation and Compensation Commission during the year indicated that significant improvements in safety awareness had been achieved. Health and Safety Committees have continued to monitor health and safety issues and provide contributions to policies/procedures as well as providing input to a revised Health and Safety Agreement which was developed during the period in consultation with unions represented in the Bank.

Partly reflecting these initiatives, but also in response to lower staff numbers generally, new claims for workers' compensation fell. Mostly, claims were for simple injuries and the Bank's claims management and rehabilitation arrangements worked effectively in determining the claims and returning the employees to work with little lost time. However, there were a small number of more complex claims which involved lengthy periods of lost time. These resulted in average claim costs rising over the year. The Reserve Bank's performance in managing claims in terms of its licence to self-insure was also the subject of an audit by the Safety, Rehabilitation and Compensation Commission during the year. As a result of this audit the Bank implemented a number of initiatives to ensure that it continues to manage claims in terms of its Licence and the requirements of the Act.

Freedom of information

Section 8 statement

The Reserve Bank is an exempt agency under the *Freedom of Information Act 1982* in respect of documents concerning banking operations (including individual open market operations and foreign exchange dealings) and exchange control matters.

Organisation and functions: The Reserve Bank is Australia's central bank. It was established by Commonwealth legislation in 1911. Its functions, powers and responsibilities are specified in the *Reserve Bank Act 1959,* the *Banking Act 1959,* the *Financial Corporations Act 1974,* the *Commonwealth Authorities and Companies Act 1997,* the *Payment Systems (Regulation) Act 1998,* and the *Payment Systems and Netting Act 1998* and in Regulations made under those Acts. An organisation chart appears at the end of this Report.

Categories of documents: Lists of publications, including speeches, articles, occasional papers, information booklets, conference volumes, regular media releases and other publications, are published from time to time in the Reserve Bank *Bulletin*; most of this information is also included on the web site (http://www.rba.gov.au). Other documents held are in the form of working notes and files covering policy and operational matters, statistical data, personnel, premises and general administration.

Facilities for access and Freedom of Information procedures: Inquiries under the *Freedom of Information Act,* including requests for access to documents, should be directed to the Secretary, Head Office, or the Managers of branches. Applications should be accompanied by the application fee (currently $30). Facilities to inspect documents to which access has been granted are available in the Bank's branches.

Section 93 statement

Three requests for access to documents under the Act were received in 1998/99, compared with six in the previous year. Access to the documents sought this year was granted in full for two requests and in part for one. There were no applications for internal review or for review by the Administrative Appeals Tribunal. The cost of administering the Act in 1998/99 is estimated to have been approximately $67 100, compared with approximately $8 800 in the previous year; application fees of $30 and charges of around $5 180 were collected by the Bank.

Note Printing Australia

Note Printing Australia Limited (NPA) is based at Craigieburn in Victoria and is, since its corporatisation in July 1998, a wholly owned subsidiary of the Reserve Bank. NPA prints all of Australia's currency notes on Guardian® polymer substrate and is now also printing polymer banknotes for a growing number of other countries. NPA is the world leader in polymer banknote printing and continues to develop its expertise in this technology for the Bank and as the basis for further export growth.

The Board of NPA consists of chairman Graeme Thompson (formerly a Deputy Governor of the Bank and now Chief Executive of the Australian Prudential Regulation Authority), Dick Warburton (a non-executive member of the Reserve Bank Board) and Mark Bethwaite; Les Austin (an Assistant Governor of the Bank) was appointed to the Board on 1 July 1999. John Leckenby was appointed as Chief Executive in August 1998.

Australia introduced polymer notes in 1988, and became the first country to convert its entire note series from traditional paper to polymer following the issue of the $100 note in 1996. Polymer notes have shown a number of superior characteristics to paper, including enhanced resistance to counterfeiting, longer life, greater cleanliness, improved machine-processing performance and recycling capability. Because of these advantages, a number of countries have decided to adopt the technology. NPA has exported polymer notes in increasing numbers and in the year ahead, NPA will, for the first time, be exporting more than it produces for Australia. New Zealand's 1998 decision to convert its entire note issue to polymer was a significant step in the widening acceptance of polymer technology. Towards the end of the year NPA received a large order to print some currency notes for Indonesia.

As part of its export drive, NPA has established three overseas marketing offices – covering the Americas, Europe/Middle East/Africa and Asia – to liaise more closely with existing and potential customers. The Australia and Pacific region is serviced from Craigieburn.

NPA has also supplied high-level authentication systems to central banks in three overseas countries. NPA's close association with the Reserve Bank also enables it to provide support to overseas central banks adopting polymer technology. This support includes assistance with introducing new notes to the public and training in note-processing techniques, note-handling and storage.

Polymer notes export orders

Year of first issue	Customer	Denomination	Issue
1990	Singapore	50 Dollar	Commemorative
1992	Western Samoa	2 Tala	Circulating
1992	Papua New Guinea	2 Kina	Circulating
1992	Kuwait	1 Dinar	Commemorative
1994	Indonesia	50 000 Rupiah	Commemorative/ circulating
1996	Brunei Darussalam	1, 5, 10 Dollar	Circulating
1996	Thailand	50, 500 Baht	Commemorative
1997	Thailand	50 Baht	Circulating
1998	Sri Lanka	200 Rupee	Circulating
1998	Malaysia	50 Ringgit	Commemorative
1999	New Zealand	5, 10, 20, 50 & 100 Dollar	Circulating
		$10 Millennium Note	Commemorative
1999	Papua New Guinea	50 Kina	Circulating
1999	Romania	2000 Lei	Commemorative

Australia's unique polymer technology was developed as a result of joint research activity between the Bank, NPA and the CSIRO. This co-operation is continuing, with the current focus being on new security features specific to polymer. Patent protection of new developments is vigorously pursued.

Increased interest from central banks is generating requests for assistance with note design, and NPA's design facilities are being enhanced in response. This includes investment in new equipment and additional artists and graphic designers. The drive to increase efficiency at Craigieburn also continued in 1998/99. Improved quality in all aspects of the operation was achieved through machine upgrades and the creation of shop-floor-based improvement teams. NPA continues to invest in areas such as vision systems, ultraviolet drying and improved ink technology to enhance quality and increase throughput rates, thus reducing costs.

During the year NPA produced 351 million notes, an increase of 14 per cent over 1997/98. This included 189 million notes for the Reserve Bank; export sales totalled 162 million notes, an increase of 32 per cent over the previous year.

The Bank has ordered additional notes as a contingency for possible Year 2000 requirements. This demand, plus export orders, means NPA will be running a 24-hour operation six days a week over much of the coming year. The flexibility and co-operation of all staff in making this step up to higher levels of production is greatly appreciated.

NPA has made a considerable effort to ensure all of its systems are Year 2000 compliant and all critical systems were signed off at the end of July. A Business Continuity Program has also been developed to cover a range of potential risks for the Year 2000 and beyond. Quality systems are subjected periodically to external audit and NPA continues to maintain its ISO 9001 certification.

Securency

Securency Pty Ltd is the RBA joint-venture company formed in 1996 with UCB Films PLC, a manufacturer of polypropylene films. Securency produces polymer substrate, known as Guardian®, by applying special coatings and security features to polypropylene film purchased from UCB. This film is now produced at UCB's new plant located next to the NPA/Securency complex at Craigieburn in Victoria.

Up until 1998/99, NPA purchased the film from UCB and applied the coatings to create the substrate which was then marketed by Securency. In July 1998, Securency purchased the coating equipment used to do this from NPA and also invested in a new printing press and building extension. The new press enables the incorporation in the polymer substrate of a greater range of patented security features which are unique to polymer.

Securency markets and supplies Guardian® to countries having their own note printing plant but wishing to introduce polymer notes. All polymer notes issued in the world to date have been printed on Guardian®.

Securency's marketing efforts over the past year have seen a significant increase in interest from around the world. Orders have been met – or are in the pipeline – from Asia, Europe and the Americas. For example, Guardian® has been supplied to Thailand and Taiwan, while Brazil has announced its intention to print a note on Guardian® early next year. A large number of other encouraging prospects are being followed up. The success of polymer banknotes has resulted in similar technology being used for other security products, such as land title certificates and share certificates.

The Bank's Earnings

Earnings available for distribution to the Government come from two principal sources – underlying earnings, and the gains or losses which come from realised valuation changes in the Bank's portfolio. Taken together, these two components are available to vary reserve holdings and for distribution to the Government. This procedure – whereby only *realised* profits are available for distribution – is in accordance with the *Reserve Bank Act* and widely accepted central bank practices.

Underlying earnings are dominated by net interest income on the Reserve Bank's portfolio. The Bank does not pay interest on around three-quarters of its liabilities. The largest such liability is the note issue, but others include capital, reserves and, until recently, non-callable deposits. On the assets side, interest income is received from government securities, both domestic and foreign. The Bank also receives some non-interest income (e.g. banking service fees, numismatic and other note sales) and must meet its expenses. Underlying earnings, the net outcome of these influences, tend to be relatively steady from year to year, varying slightly with interest rates and the size of the balance sheet. It is worth noting, however, that the abolition of non-callable deposits from 1 July 1999 will mean that the Bank's underlying earnings will be around $250 million lower in 1999/2000 and thereafter.

Sources of earnings available for distribution

($ million)

	Underlying earnings	Realised gains and losses	Earnings available for distribution
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

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

In 1998/99, underlying earnings were $1 816 million, up from $1 750 million in the previous year. Major factors which have enhanced underlying earnings are increased income from growth in the domestic portfolio; a reduction in the interest cost of deposit liabilities; write-down of notes on issue; and a lower level of staff costs and other expenses. The main offsetting factor was lower returns on foreign currency assets because of lower average interest rates.

Realised gains arise when domestic or foreign securities are sold for more than their original purchase price. Sales of foreign currency made in the course of changing the composition of the Bank's foreign currency portfolio and the roll-over of foreign exchange swaps resulted in realised valuation gains during the year. Some of these swaps had been entered into at the time of the intervention in the foreign exchange market during the middle of last calendar year. In 1998/99, realised gains were $2.3 billion, the highest since 1992/93. It is also in accordance with central bank practices that unrealised *losses* through marking to market of the Bank's portfolio reduce the amount available for distribution, except to the extent that there are reserves which were built up from earlier unrealised gains, which can be used to offset these unrealised losses. Unrealised losses on marking to market in the current year were around $1.7 billion. After allowing for balances in the unrealised profits reserve available as a partial offset, unrealised losses reduced earnings available for distribution by $424 million in 1998/99.

Realised gains on gold sales boosted earnings in 1996/97 (by $1 637 million), and in 1997/98 ($548 million) when some gold sold earlier was delivered and the proceeds received. Such sales were not, of course, a factor in 1998/99.

Reserve Bank payments to Government

($ million)

	Earnings available for distribution	Transfers to reserves	Balance available for Commonwealth	Final payment from previous year	Interim payment from current year	Total payment
1989/90	1 095	520	575	140	300	440
1990/91	1 713	210	1 503	275	400	675
1991/92	2 554	200	2 354	1 103	400	1 503
1992/93	4 563	750	3 813	1 954	600	2 554
1993/94	1 508	–	1 508	3 213	–	3 213
1994/95	1 772	–	1 772	1 508	200	1 708
1995/96	2 486	150	2 336	1 572	200	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*	–	–	–	3 000	–	3 000

* A second tranche of $676 million will be paid in 2000/01

The Reserve Bank's earnings available for distribution are paid to the Commonwealth Government, after any transfers to the two reserve funds the Bank maintains to deal with contingencies. Reserves had been increased over the previous two years when, with the approval of the Treasurer, the proceeds of gold sales totalling $2 185 million were transferred to them. In view of this, no additions were made to these reserve funds from 1998/99 earnings and the full amount of $3 676 million was available for payment to the Government. This will be paid in two tranches: the first, of $3 000 million, will be paid in August 1999; and the balance of $676 million will be paid in July 2000.

Following changes introduced in 1998 and explained in last year's Annual Report, the Bank's accounting profit is calculated according to general accounting principles, in which all valuation changes resulting from marking to market the Bank's portfolio during the year – whether realised or unrealised – are brought into the profit and loss account. The appreciation of the Australian dollar over the course of the year meant that the Bank's foreign exchange holdings are worth less in Australian dollars, while higher interest rates were associated with a fall in the value of its government security portfolio. These valuation changes were partially offset by gains realised during the year of around $1.2 billion which arose mainly from foreign exchange swap transactions; after allowing for these, there was a net $490 million loss on investments. This, combined with the underlying profit of $1 816 million, resulted in an accounting profit of $1 326 million.

The Reserve Bank's 1998/99 Financial Statements are presented in the following pages.

Balance Sheet as at 30 June 1999

Reserve Bank of Australia and controlled entities

	Note	1999 $M	1998 $M
ASSETS			
Cash and liquid assets	5, 19	587	369
Domestic government securities	1(d), 18	21 633	21 012
Foreign exchange	1(c), 18	25 370	24 198
Gold	1(b), 18	1 013	1 237
Loans, advances and bills discounted		76	95
Other assets	6	129	125
Property, plant and equipment	7	265	274
Total		49 073	47 310
LIABILITIES			
Due to other financial institutions	8	–	5
Deposits	9	10 383	11 073
Profit distribution payable to Commonwealth		3 676	2 726
Other liabilities	10	4 225	2 027
Australian notes on issue	1(i)	23 552	21 651
Capital and Reserves			
Reserves:			
Unrealised Profits Reserve	4	–	2 349
Asset revaluation reserves	4	1 045	1 287
Reserve for Contingencies and General Purposes	4	3 323	3 323
Reserve Bank Reserve Fund	4	2 829	2 829
Capital		40	40
Capital and reserves		7 237	9 828
Total		49 073	47 310

Profit and Loss Appropriation Statement for year ended 30 June 1999

Reserve Bank of Australia and controlled entities

	Note	1999 $M	1998 $M
Net Profit	2	1 326	4 403
Net transfers from/(to)			
Unrealised Profits Reserve	4	2 349	(1 687)
Transfer from asset revaluation reserves	4	1	558
Earnings available for distribution		3 676	3 274
Earnings applied:			
Reserve Bank Reserve Fund	4	–	548
Reserve for Contingencies and General Purposes	4	–	–
Commonwealth of Australia		3 676	2 726
Total		3 676	3 274

Notes To and Forming Part of the Financial Statements – 30 June 1999

Reserve Bank of Australia and controlled entities

Note 1 Summary of accounting policies

The financial statements have been prepared in accordance with the Reserve Bank Act and the Commonwealth Authorities and Companies Act.

The form and content of the financial statements have been amended to incorporate the requirements of Order Number 5 of the Commonwealth Authorities and Companies Orders 1998. Clause 3 (4) of Schedule 2 of this Order provides:

> "The Reserve Bank of Australia must comply with Australian Accounting Standards (including AAS32, entitled Specific Disclosures by Financial Institutions) and Urgent Issues Group Consensus Views. In the event of a conflict between the requirements of the standards and the requirements of this Schedule, the Bank must comply with the requirements of the standards."

The Bank has been granted certain exemptions from the requirements of the Orders as detailed in Note 1 (k). These exemptions relate to matters of disclosure and presentation which are of a minor nature and are adequately dealt with in these financial statements.

The statements are a general purpose financial report prepared in accordance with Australian Accounting Standards. Unless otherwise stated, the accounting policies and practices followed in these statements are consistent with those followed in the previous year.

All amounts are expressed in Australian dollars unless another currency is indicated. Current market values are used for the Bank's major assets, including domestic and foreign marketable securities, gold and foreign currency, as well as for premises and shares in international financial institutions. In other cases, an historical cost basis of accounting is used. Revenue and expenses are brought to account on an accrual basis.

(a) Consolidation and associated company The financial statements show information for the economic entity only; this reflects the consolidated results for the parent entity, the Reserve Bank of Australia and its wholly owned subsidiary, Note Printing Australia Limited. The results of the parent entity do not differ materially from the economic entity and have therefore not been separately disclosed other than in Note 15, Related party and other disclosures.

Note Printing Australia Limited was incorporated as a wholly owned subsidiary of the Bank on 1 July 1998, with an initial capital of $20 000 000.

The assets, liabilities, profit and loss account of Note Printing Australia Limited have been consolidated with the parent entity accounts in accordance with AAS24 "Consolidated Financial Reports". All internal transactions and balances have been eliminated on consolidation. Note Printing Australia Limited is subject to income tax; its income tax expense is included in Other Expenses in Note 2.

The Bank accounts for Securency Pty Ltd in accordance with AAS14 "Accounting for Investments in Associated Companies". The carrying amount of the Bank's investment in Securency Pty Ltd is reviewed annually to ensure it is not in excess of its recoverable amount. The Bank's investment in Securency Pty Ltd is included in Note 6.

Note 1 *(continued)*

(b) Gold Gold holdings (including gold on loan to other institutions) are valued at the Australian dollar equivalent of the 3pm fix in the London gold market on the last business day of June. The Bank loans gold to financial institutions participating in the gold market. All gold loans are secured to 110% of their market value by Australian denominated collateral security. Loans are usually for periods between 3 and 12 months, with very few extending beyond 12 months. Interest on gold loans is accounted for on a standard accrual basis.

(c) Foreign exchange Foreign exchange holdings are invested mainly in securities (issued by the governments of the United States, Japan and Germany) and bank deposits (with major OECD foreign commercial banks and central banks). The Bank engages in interest rate futures and foreign currency swaps, and has purchased call options.

Assets and liabilities denominated in foreign currency, other than those subject to swap contracts, are converted to Australian dollar equivalents at exchange rates ruling on the last business day of June. Realised and unrealised gains or losses on foreign currency are immediately taken to profit and loss.

Foreign government securities
Foreign government securities comprise coupon and discount securities and repurchase agreements. Coupon securities have bi-annual or annual interest payments depending on the currency and type of security. Interest earned on discount securities is the difference between the actual purchase cost and the face value of the security. The face value is received at maturity. Interest earned on securities is accrued over the term of the security.

Marketable securities, other than those contracted for sale under repurchase agreements, are reported at market values on the last business day of June; realised and unrealised gains and losses arising from changes in market valuations during the year are taken to the profit and loss account. Earnings on foreign currency investments are converted to Australian dollars using the exchange rate of the date they are received.

Foreign currency swaps
The Bank uses foreign currency swaps to assist daily domestic liquidity management or to smooth the impact of other foreign currency transactions on Official Reserve Assets. A currency swap is the simultaneous purchase and sale of one currency against another currency for specified maturities. The cash flows are the same as borrowing one currency for a set period, and lending another currency for the same period. The pricing of the swap must therefore reflect the interest rates applicable to these money market transactions. Interest rates are implicit in the swap contract but interest itself is not paid or received.

Foreign exchange holdings contracted for sale beyond 30 June 1999 (including those under swap contracts) have been valued at contract exchange rates.

Interest rate futures
The Bank uses interest rate futures contracts on overseas exchanges to hedge its portfolio of foreign securities. An interest rate futures contract is a contract to buy or sell a specific amount of securities for a specific price on a specific future date.

Interest rate futures, foreign currency swaps and call options purchased are off-balance sheet items. The Bank did not trade in any other derivative instruments during 1998/99.

Note 1 *(continued)*

(d) Domestic government securities The Bank holds Commonwealth Government Bonds, Treasury Notes, Capital Indexed Bonds, and Treasury Adjustable Bonds. It also holds Australian dollar-denominated securities issued by the central borrowing authorities of State and Territory Governments where these are acquired under repurchase agreements. Realised and unrealised gains or losses on domestic government securities are immediately taken to profit and loss.

Commonwealth Government Bonds are coupon securities; the interest is payable bi-annually at the coupon rate. Commonwealth Treasury Notes are discount securities; the interest earned is the difference between the purchase price and the face value on redemption. Capital Indexed Bonds are coupon securities with the nominal value of the security indexed in line with movements in the consumer price index each quarter until maturity; interest is paid quarterly. Treasury Adjustable Bonds are securities whose coupon rate is periodically reset by reference to movements in the Australian Bank Bill Swap Reference Rate; interest is payable each quarter.

Securities are valued at market prices on the last business day of June except when contracted for sale under repurchase agreements.

(e) Repurchase agreements In the course of its financial market operations, the Bank engages in repurchase agreements involving foreign and domestic marketable securities.

Securities sold but contracted for purchase under repurchase agreements are reported on the balance sheet within the relevant investment portfolio and are valued at market prices; the counterpart obligation to repurchase is included in "Other liabilities". The difference between the sale and repurchase price was previously recognised in the profit and loss account as an offset to interest income over the term of the agreement. The difference between the sale and repurchase price has been reclassified as interest expense in the profit and loss account. Comparative figures have been adjusted.

Securities held but contracted for sale under repurchase agreements are reported within the relevant investment portfolio at contract amount. The difference between the purchase and sale price is recognised as interest income over the term of the agreement.

(f) Property, plant and equipment A formal valuation of the Bank's properties is conducted on a triennial basis. The most recent valuation was at 30 June 1998, when Australian properties were valued by officers of the Australian Valuation Office and overseas properties were valued by local independent valuers. The valuations have been incorporated in the accounts.

Annual depreciation is based on market values and assessments of useful remaining life.

Plant and equipment are recorded at cost less depreciation, which is calculated at rates appropriate to the estimated useful life of the relevant assets. Depreciation rates are reviewed annually, and adjusted where necessary to reflect the most recent assessments of the useful life of assets.

In the opinion of the Board, values of plant and equipment in the financial statements do not exceed recoverable values.

Details of annual net expenditure, revaluation adjustments and depreciation of these assets are included in Note 7.

Note 1 *(continued)*

(g) Reserves Reserves are maintained to cover the broad range of risks to which the Bank is exposed. The Reserve Bank Reserve Fund is a general reserve which provides for potential losses arising from fraud and other non-insured losses. The Treasurer determines each year, after consultation with the Board, the amount to be credited to the Reserve Fund.

The Reserve for Contingencies and General Purposes provides cover against risks relating to events which are contingent and non-foreseeable. The major risks in the category arise from movements in market values of the Bank's holding of domestic and foreign securities. Amounts set aside for this Reserve are determined by the Treasurer after consultation with the Board.

Asset revaluation reserves reflect the impact of changes in the market values of a number of the Bank's assets (gold, premises, and shares in international financial institutions).

Unrealised gains on foreign exchange and domestic government securities are recognised in the profit and loss account. Until such gains are realised, they are not available for distribution to the Commonwealth of Australia; in the interim the amounts are retained in the Unrealised Profits Reserve.

(h) Provisions The Bank maintains provisions for accrued annual leave, calculated on salaries prevailing at balance date and including associated payroll tax. The Bank also maintains provisions for long service leave and post-employment benefits, in the form of health insurance and housing assistance, and associated fringe benefits tax; these provisions are made on a present value basis in accordance with AAS 30. In addition, the Bank makes provision for future workers' compensation claims in respect of incidents which have occurred before balance date, based on an independent actuarial assessment.

(i) Australian notes on issue The Bank assesses regularly the value of notes still outstanding at least five years after the note issue ceased which are judged to have been destroyed and therefore unavailable for presentation. $19 million was written off Australian notes on issue in 1998/99; no amounts were written off in 1997/98.

(j) Rounding Amounts in the financial statements are rounded off to the nearest million dollars unless otherwise stated.

(k) Exemptions The Bank has been granted exemptions from the following requirements of Order Number 5 of the Commonwealth Authorities and Companies Orders:

Clause	Description	Detail of exemption
5 (1)	Rounding	Amounts are rounded to the nearest million dollars in these financial statements rather than to the nearest hundred thousand dollars in view of the size of the Bank's balance sheet.
9 (1) (c)	Standard forms to be used	The cash flow statement is provided in Note 19.
10	Items of revenue and expense	Details of revenues and expenses are disclosed in Note 2.
18	Analysis of property, plant and equipment	Information is included in Note 7 of these financial statements. These disclosures are more relevant than the dissections required by Clause 18 of the Orders.

	Note	1999 $M	1998 $M
Note 2 Net profits			
Interest revenue			
Overseas investments	1 (c)	963	1 121
Domestic government securities	1 (d)	1 199	1 106
Loans and advances		5	4
Overnight settlement systems		19	9
Gold loans		18	21
		2 204	2 261
Net gains/(losses) on securities			
Overseas investments		(106)	105
Domestic government securities		(276)	64
Foreign currency	1 (c)	(108)	2 484
		(490)	2 653
Dividend revenue			
Earnings on shares in Bank for International Settlements	6	3	3
Fees and commissions			
Banking services fees received		21	22
Other revenue			
Reimbursement by Commonwealth for loan management and registry expenses		2	2
Rental of Bank premises		7	7
Sales of numismatic and other note products		14	21
Gain on sale of plant and equipment		1	1
Australian notes on issue write-off	1 (i)	19	–
Other		13	21
		56	52
Total		1 794	4 991
Less:			
Interest expense			
Deposit liabilities		181	248
Repurchase agreements	1 (e)	116	124
		297	372
General administrative expenses			
Staff costs		87	102
Special redundancy/retirement payments	12	18	30
Depreciation of property	7	7	7
Depreciation of plant and equipment	7	7	7
Premises and equipment		24	25

	Note	1999 $M	1998 $M
Note 2 *(continued)*			
Materials used in note production		10	13
Travel		2	2
Consultants' fees	14	1	2
Other		5	5
		161	193
Other expenses			
Maintenance of Value payment to International Monetary Fund		–	15
Agency business reimbursement		1	1
Other		9	7
		10	23
Total		468	588
Net Profit		1 326	4 403

Note 3 Interest revenue and interest expense
Analysis for the year ended 30 June 1999

	Average Balance $M	Interest $M	Average Interest Rate %
Interest revenue			
Overseas investments	23 766	963	4.1
Domestic government securities	20 490	1 199	5.9
Loans and advances	161	5	3.1
Overnight settlements	389	19	5.0
Gold loans	1 169	18	1.5
	45 975	2 204	4.8
Interest expense			
Exchange settlement accounts	1 338	62	4.6
Non-callable deposits	4 975	–	0.0
Deposits from governments	2 386	113	4.7
Deposits from overseas institutions	81	2	2.2
Overseas repurchase agreements	1 824	77	4.2
Domestic repurchase agreements	864	39	4.5
Other deposits	149	4	3.0
	11 617	297	2.6

	1999 $M	1998 $M
Note 4 Reserves		
Changes in the Bank's various Reserves are shown below.		
Unrealised Profits Reserve (Note 1 (g))		
Opening balance	2 349	662
Net transfers from (to) Profit and Loss Appropriation	(2 349)	1 687
As at 30 June	–	2 349
Asset revaluation reserves (Note 1 (g))		
Gold		
Opening balance	1 130	1 589
Net revaluation adjustments	(227)	89
Transfers to Profit and Loss Appropriation – realised (gains)/losses	–	(548)
As at 30 June	903	1 130
Shares in international financial institutions (Note 6)		
Opening balance	77	68
Net revaluation adjustments	(14)	9
As at 30 June	63	77
Bank properties (Note 1(f), 7)		
Opening balance	80	71
Net revaluation adjustments	–	19
Transfers to Profit and Loss Appropriation – realised (gains)/losses	(1)	(10)
As at 30 June	79	80
Total asset revaluation reserves		
Opening balance	1 287	1 728
Net revaluation adjustments	(241)	117
Transfers to Profit and Loss Appropriation – realised (gains)/losses	(1)	(558)
As at 30 June	1 045	1 287

	1999 $M	1998 $M
Note 4 *(continued)*		
Reserve for Contingencies and General Purposes (Note 1 (g))		
Opening and closing balance	3 323	3 323
Reserve Bank Reserve Fund (Note 1 (g))		
Opening balance	2 829	2 281
Appropriation from profits in terms of section 30 of the Reserve Bank Act	–	548
As at 30 June	2 829	2 829

Note 5 Cash and liquid assets

This includes net amounts of $478 million owed to the Bank for overnight clearances of financial transactions through the clearing houses, Austraclear and Reserve Bank Information and Transfer System (RITS); an amount of $284 million was owed to the Bank at 30 June 1998.

	1999 $M	1998 $M
Note 6 Other assets		
Shareholding in Bank for International Settlements	65	80
Gold coin	13	16
Investment in Securency	11	1
Other	40	28
As at 30 June	129	125

The Reserve Bank of Australia has a 50 per cent share in Securency Pty Ltd, which is incorporated in Victoria Australia, and whose principal activity is the marketing and manufacture of polymer substrate. The capital of Securency increased during 1998/99 from $1 500 001 to $21 530 001; the Bank increased the amount of its investment in Securency from $750 000 to $10 765 000. Securency Pty Ltd has a 31 December balance date.

	1999 $M	1998 $M
Note 7 Property, plant and equipment (Note 1(f))		
Properties		
Opening balance	244	239
Disposals	(2)	(7)
	242	232
Depreciation prior to revaluation	(7)	(7)
Book valuation prior to revaluation	235	225
Net revaluation adjustments (Note 4)	–	19
As at 30 June	235	244
The triennial revaluation of Bank properties occurred at 30 June 1998.		
Plant and equipment		
Opening balance	103	98
Additions less disposals	(10)	5
	93	103
Accumulated depreciation	(63)	(73)
As at 30 June	30	30
Total property, plant and equipment	265	274
Note 8 Due to other financial institutions		
Remittances in transit	–	5
	–	5
Note 9 Deposits		
Banks		
Exchange Settlement accounts	1 909	5 019
Non-callable deposits	5 255	4 682
Government & government instrumentalities		
Commonwealth	2 511	756
State	388	365
Foreign governments, foreign institutions and international organisations	61	68
Other depositors	259	183
As at 30 June	10 383	11 073

	1999 $M	1998 $M
Note 10 Other liabilities		
Provisions (Note 1(h))		
Salaries and wages accrued	2	2
Provision for accrued annual leave	7	7
Provision for long service leave	18	22
Provision for post-employment benefits	50	46
Provision for workers' compensation	1	1
As at 30 June	78	78
Other		
Amounts outstanding under repurchase agreements (contract price) (Note 1 (e))	4 104	1 887
Interest accrued on deposits	18	28
Other	25	34
As at 30 June	4 147	1 949
Total other liabilities	4 225	2 027

Note 11 Contingent liabilities and other items not included in the balance sheet

Contingencies

The Bank has a contingent liability, amounting to $55.4 million at 30 June 1999 ($67.6 million at 30 June 1998), in respect of the uncalled portion of its shares held in the Bank for International Settlements.

In the course of providing banking services to its customers, the Bank provides performance guarantees to third parties in relation to customer activities. Such exposure is not material and has not given rise to losses in the past.

Other items

The Reserve Bank had been a respondent on appeal from a judgement given in the Bank's favour by the Federal Court; in the appeal the Full Court of the Federal Court found in favour of the applicants; the Bank has lodged an application with the High Court of Australia seeking leave to appeal from the decision of the Full Court of the Federal Court. The Bank is a defendant in one common law matter. The Bank is an appellant in a case regarding a payroll tax assessment. No case is likely to have a materially adverse effect on the activities, financial condition or operating results of the Bank.

The Bank has commitments of $2.9 million at 30 June 1999 payable within one year.

The Bank carries its own insurance risks except where administrative costs are estimated to be excessive.

Note 12 Special redundancy/retirement payments

The Bank's expenses in 1998/99 include $18.4 million paid or payable to, or on behalf of, staff who accepted special redundancy/retirement offers. Corresponding payments in 1997/98 totalled $29.7 million. Staff leaving the Bank in 1998/99 under these arrangements numbered 155 (249 in 1997/98).

Note 13 Remuneration of executives

The number of executives whose remuneration packages, measured in terms of costs to the Bank, fell within the following bands was:

Remuneration band	Number 1999	Number 1998
$100 000 – $109 999		2
$110 000 – $119 999	1	
$120 000 – $129 999	2	2
$130 000 – $139 999	6	8
$140 000 – $149 999	3	3
$150 000 – $159 999	4	4
$160 000 – $169 999		1
$170 000 – $179 999		2
$180 000 – $189 999	1	2
$190 000 – $199 999	2	4
$200 000 – $209 999	5	
$220 000 – $229 999		2
$230 000 – $239 999	1	2
$240 000 – $249 999	3	1
$250 000 – $259 999	1	

Total remuneration received or due and receivable by these executives amounted to $5.026 million ($5.422 million in 1997/98). Remuneration includes cash salary, the Bank's contribution to superannuation, housing assistance, motor vehicles and health insurance and the fringe benefits tax paid or payable on these benefits. Remuneration excludes amounts paid to executives posted outside Australia for the whole or part of the financial year. Remuneration excludes amounts paid to executives who are also members of the Bank Board (refer Note 15).

On 1 July 1998, 5 executives, who were included in the 1997/98 column, were transferred to the newly established Australian Prudential Regulation Authority and no remuneration or termination payments were payable by the Bank to these executives in 1998/99 ($0.722 million paid in 1997/98) and beyond.

During 1998/99 5 executives resigned or retired and received termination payments totalling $0.941 million ($0.055 million paid in 1998 for 2 executives) which are not reflected in the above table.

Note 14 Remuneration of auditor

Fees paid or payable to the statutory auditor (Auditor-General of the Commonwealth of Australia) for audit services totalled $160 000 in 1998/99 ($307 000 in 1997/98). They are included in “Consultants’ fees” in Note 2, which also covers legal fees and payments made to specialists for “review and advice” services.

Note 15 Related party and other disclosures

The Remuneration Tribunal determines the remuneration appropriate to the Bank’s non-executive Board members. In 1998/99, payments to executive and non-executive board members totalled $979 786 ($1 260 452 in 1997/98).

The number of directors whose remuneration packages, measured in terms of costs to the Bank, fell within the following bands was:

Remuneration band	Number 1999	Number 1998
$0 – $9 999		2
$20 000 – $29 999		4
$30 000 – $39 999	5	1
$50 000 – $59 999	1	1
$280 000 – $289 999		1
$300 000 – $309 999	1	
$330 000 – $339 999		1
$430 000 – $439 999		1
$450 000 – $459 999	1	

The Bank is not empowered to lend to non-executive members of the Board. Loans to the Governor and Deputy Governor are permitted only in terms of section 71 of the Reserve Bank Act; at 30 June 1999, there was one such loan of $77 007 (three loans aggregating to $378 260 at 30 June 1998) which had been made for a home in which the officer resides, and is on the same terms and conditions as for other officers of the Bank.

There were no other related-party transactions with Board members; transactions with director-related entities which occurred in the normal course of the Bank’s operations were conducted on terms no more favourable than similar transactions with other employees or customers.

In addition, $41 408 was paid for the services of non-executive members of the Board of Note Printing Australia Limited who are not employees of the Bank or members of the Bank Board. The Bank also paid $94 504 for the services of members of the Payments System Board who are not employees of the Bank.

Note 16 Superannuation funds

Two superannuation funds are operated pursuant to the Reserve Bank Act: the Reserve Bank of Australia Officers' Superannuation Fund (OSF) and the Reserve Bank of Australia UK Pension Scheme. A small part of the assets of the OSF are held by the Bank as nominee for the trustees of the OSF; such assets are not included in these statements. Payment of the funds' current and future benefits is funded by member and Bank contributions and the funds' existing asset bases. The Bank's contributions to the OSF in accordance with the Reserve Bank (Officers' Superannuation) Rules, and to the UK Pension Scheme in accordance with the UK Trust Deed, are included in staff costs in Note 2. Administration and other operational costs (eg salaries, overheads, legal costs and valuation fees) incurred by the Bank for superannuation arrangements are also included in Note 2. There were no other related-party transactions between the Bank and the funds during 1998/99.

At 30 June 1999, the OSF had a surplus of assets over accrued benefits of $185 million ($158 million at 30 June 1998). The UK Pension Scheme had a surplus equivalent to $5 million ($7 million at 30 June 1998). During 1998/99, the Bank made superannuation contributions of $3.0 million ($3.3 million in 1997/98).

Details of the Funds as at 30 June 1999 are as follows:

	1999 $M	1998 $M
Reserve Bank Officers' Superannuation Fund		
Accrued benefits	398	411
Net market value of assets	583	569
Surplus	185	158
Vested benefits	396	414
Reserve Bank of Australia UK Pension Scheme		
Accrued benefits	19	18
Net market value of assets	24	25
Surplus	5	7
Vested benefits	19	21
Total Superannuation Funds		
Accrued benefits	417	429
Net market value of assets	607	594
Surplus	190	165
Vested benefits	415	435

Accrued benefits refer to the present value of future benefits payable to current fund members, taking into account assumed future salary increases. Vested benefits are the benefits payable if all current members were to terminate their fund membership at balance date.

Note 17 Segment reporting

The Bank operates as a central bank, predominantly in one geographical area.

Note 18 Financial instruments

Australian Accounting Standard AAS 33 – Presentation & Disclosure of Financial Instruments – requires disclosure of information relating to: both recognised and unrecognised financial instruments; their significance and performance; accounting policy terms & conditions; net fair values; and risk information.

A ***financial instrument*** is defined as any contract that gives rise to both a financial asset of one entity and a financial liability or equity instrument of another entity. The identifiable financial instruments for the Bank are its domestic government securities, its foreign government securities, bank deposits, interest rate futures, foreign currency swap contracts, gold loans, notes on issue and deposit liabilities.

Net fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction, and is usually determined by the quoted market price net of transaction costs. All of the Bank's recognised financial instruments are carried at current market value which approximates net fair value.

Financial risk of financial instruments embodies price risk (currency risk and interest rate risk); credit risk; liquidity risk; and cash flow risk. AAS 33 requires disclosure on interest rate risk and credit risk.

The interest rate risk and credit risk tables are based on the Bank's settled portfolio as reported in the Bank's balance sheet.

Interest rate risk

Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates. The following table shows the Bank's balance sheet restated in compliance with AAS 33.

Note 18 *(continued)*

Interest rate risk
As at 30 June 1999

	Balance sheet total $M	Floating interest rate $M	Repricing period $M 0 to 3 months	3 to 12 months	1 to 5 years	Over 5 years	Not bearing interest $M	Weighted average rate %
Assets								
Gold								
Gold loans	1 008	–	380	539	89	–	–	1.8
Gold holdings	5	–	–	–	–	–	5	n/a
Sub-total	**1 013**							
Foreign exchange								
Securities sold under repurchase agreements	3 396	–	–	189	1 776	1 431	–	4.0
Securities purchased under repurchase agreements	7 384	–	7 384	–	–	–	–	4.4
Deposits and other securities	14 450	137	7 816	1 782	2 011	2 170	534	2.6
Accrued interest foreign exchange	140	–	–	–	–	–	140	n/a
Sub-total	**25 370**							
Domestic government securities								
Securities sold under repurchase agreements	662	–	–	81	459	122	–	5.1
Securities purchased under repurchase agreements	11 656	–	10 155	1 501	–	–	–	4.7
Other securities	9 091	–	3 424	1 818	2 296	1 553	–	5.0
Accrued interest domestic government securities	224	–	–	–	–	–	224	n/a
Sub-total	**21 633**							
Loans, advances and bills discounted	76	57	–	–	–	–	19	3.3
Property, plant & equipment	265	–	–	–	–	–	265	n/a
Cash and liquid assets	587	–	–	–	–	–	587	n/a
Other assets	129	–	–	–	–	–	129	n/a
Total assets	**49 073**	194	29 159	5 910	6 631	5 276	1 903	3.8
Liabilities								
Australian notes on issue	23 552	–	–	–	–	–	23 552	n/a
Deposits	10 383	10 193	–	–	–	–	190	2.2
Profit distribution	3 676	–	–	–	–	–	3 676	n/a
Other	4 225	–	4 104	–	–	–	121	4.0
Total liabilities	**41 836**	10 193	4 104	–	–	–	27 539	0.9
Capital and reserves	7 237	–	–	–	–	–	–	n/a
Total balance sheet	**49 073**							
Off balance sheet items								
Interest rate futures*	(26)	–	(7)	–	(1)	(18)	–	n/a

Note 18 *(continued)*

Interest rate risk

As at 30 June 1998

	Balance sheet total $M	Floating interest rate $M	Repricing period $M 0 to 3 months	3 to 12 months	1 to 5 years	Over 5 years	Not bearing interest $M	Weighted average rate %
Total assets	47 310	78	28 120	6 644	5 874	5 105	1 489	4.6
Total liabilities	37 481	11 073	1 887	–	–	–	24 521	1.0
Capital and reserves	9 829	–	–	–	–	–	–	n/a
Total balance sheet	47 310							
Off balance sheet items	(1 864)	–	(877)	–	–	(987)	–	n/a

Other liabilities includes amounts outstanding under sale repurchase agreements.

All recognised financial instruments are shown at net fair value.

Off balance sheet items are shown at nominal market value (difference from net fair value is negligible).

All Financial Instruments are shown at their repricing period.

Repricing period is equivalent to maturity period except for some holdings of domestic government securities (which appear in the 0 to 3 months category):

Approximately $1.8 billion has a maturity period of 1-5 years

* Interest rate futures reflect short positions in interest rate contracts traded in foreign futures exchanges to manage interest rate risk on Official Reserve Assets.

Credit risk

Credit risk in relation to a financial instrument is the risk that a third party (customer, bank or other counterparty) will not meet its obligations (or be permitted to meet them) in accordance with agreed terms.

The Bank's maximum exposure to credit risk in relation to each class of recognised financial assets, other than derivatives (off balance sheet items) is the carrying amount of those assets as indicated in the balance sheet. The Bank's exposures are all to highly rated counterparties and its credit risk is very low.

As part of an IMF support package during 1997/98 and 1998/99 the Bank undertook a series of foreign currency swaps with the Bank of Thailand. The Bank provided United States dollars, receiving Thai Baht in exchange. The amount outstanding on the swaps at 30 June 1999 was the equivalent of $1.3 billion Australian dollars ($1.2 billion at 30 June 1998), on which the Bank is earning a yield of 4.82% (5.33% in 1998). The swaps represent 2.6% of the Bank's total Assets as at 30 June 1999 (2.5% at 30 June 1998).

The Bank's maximum credit risk exposure in relation to off-balance sheet items is:

1. ***Foreign exchange swaps*** – As at 30 June 1999 the Bank was under contract to purchase $10.7 billion of foreign currency and sell $22.9 billion of foreign currency. As of that date there was an unrealised net gain of $119.5 million on these swap positions. The credit risk exposure of these contracts is the cost of re-establishing the contract in the market in the event of the failure of the counterparty to fulfil their obligations.

2. ***Interest rate futures*** – As at 30 June 1999 about 0.14% of the Bank's foreign currency reserves (excluding gold) were hedged through interest rate futures contracts. The amount of credit risk on these contracts is approximately $0.1 million ($9.3 million at 30 June 1998). As at 30 June 1999 there was an unrealised gain on those contracts of $0.2 million ($1.4 million at 30 June 1998).

Note 18 *(continued)*

Concentration of credit risk

The Bank operates to minimise its credit risk exposure through comprehensive risk management policy guidelines. The following table indicates the concentration of credit risk in the Bank's investment portfolio. See Note 1(c) Foreign Exchange.

Credit risk table

Security type	Risk rating of security issuer*	Risk rating of counterparties*	% of total asset portfolio as at 30/6/99	% of total asset portfolio as at 30/6/98
Domestic government securities				
Holdings of Commonwealth Government securities	AAA	n/a	18.9	24.2
Securities sold under repurchase agreements	AAA	AAA	0.0	0.2
	AAA	AA	1.4	0.5
	AAA	other	0.0	0.3
Securities held under repurchase agreements	AAA	AAA	0.0	3.6
	AAA	AA	19.0	10.0
	AAA	other	1.5	2.7
	AA	AAA	0.0	0.1
	AA	AA	3.3	2.1
	AA	other	0.1	0.7
	other	other	0.0	0.2
Foreign investments				
Holdings of securities	AAA	n/a	21.4	18.1
Securities sold under repurchase agreements	AAA	AA	4.6	2.6
	AAA	other	2.3	0.5
Securities held under repurchase agreements	AAA	AA	11.2	13.4
	AAA	other	3.8	9.5
Deposits	n/a	AAA	1.4	0.6
	n/a	AA	4.0	4.2
	n/a	other	2.9	2.5
Gold loans	n/a	AAA	0.2	0.3
	n/a	AA	1.3	0.7
	n/a	other	0.6	1.4
Other			2.1	1.6
			100%	100%

* Standard & Poor's equivalent ratings

Note 19 Cash flow statement

The following cash flow statement appears as a matter of record to meet the requirements of AAS 28; in the Bank's view, it does not shed any additional light on the Bank's financial results. For the purpose of this statement, cash includes the notes and coin held at the Reserve Bank and overnight settlements system account balances with other banks.

Statement of Cash Flows for the financial year ended 30 June 1999

	1999 Inflow/(outflow) $M	1998 Inflow/(outflow) $M
Cash flow from operating activities		
Interest received on investments	2 040	2 449
Interest received on loans, advances, and on net overnight settlements systems	24	29
Loan management reimbursement	2	2
Banking service fees received	28	22
Rents received	7	7
Net payments for and proceeds from sale of investments	(91)	4 435
Interest paid on deposit liabilities	(190)	(276)
Staff costs (including redundancy)	(106)	(130)
IMF Maintenance of Value adjustment	(15)	20
Premises, equipment and stores	(24)	(26)
Other	20	30
Net cash provided by operating activities	1 695	6 562
Cash flows from investment activities		
Net expenditure on property, plant and equipment	11	(1)
Net cash used in investing activities	11	(1)
Cash flows from financing activities		
Profit payment to Commonwealth	(2 726)	(1 700)
Net movement in deposit liabilities	(689)	(8 209)
Net movement in loans and advances	38	11
Net movement in notes on issue	1 920	1 587
Proceeds from gold sales	–	608
Other	(31)	(159)
Net cash provided by financing activities	(1 488)	(7 862)
Net increase/(decrease) in cash	218	(1 301)
Cash at beginning of financial year	369	1 670
Cash at end of financial year	587	369

Note 19 *(continued)*

Reconciliation of cash	**30 June 1999 $M**	**30 June 1998 $M**
Cash	109	85
Overnight settlements system	478	284
	587	369

Reconciliation of net cash provided by operating activities to Net Profits	**1999 $M**	**1998 $M**
Net profit	1 326	4 403
Increase in interest payable	(10)	(28)
Increase in interest receivable	–	1
Net loss/(gain) on overseas investments	106	(105)
Net loss/(gain) on domestic government securities	276	(64)
Net loss/(gain) on foreign currency	108	(2 465)
Increase in income accrued on investments	(6)	347
Depreciation of property	7	7
Depreciation of plant and equipment	7	6
IMF Maintenance of Value adjustment (including accrual to end June)	(15)	34
Net payments for and proceeds from sale of domestic and foreign investments	(91)	4 435
Write-off of Australian notes	(19)	–
Other	6	(9)
Net cash provided by operating activities	1 695	6 562

Directors' Statement

In the opinion of the directors, the financial statements for the year ended 30 June 1999 give a true and fair view of the matters required by the Finance Minister's Orders, contained in Order number 5 of the Commonwealth Authorities and Companies Orders 1998.

IJ Macfarlane
Chairman, Reserve Bank Board
5 August 1999

Auditor-General for Australia

Australian National Audit Office

INDEPENDENT AUDIT REPORT

To the Treasurer

Scope

I have audited the financial statements of the Reserve Bank of Australia (the Bank) for the year ended 30 June 1999. The financial statements include the consolidated financial statements of the economic entity comprising the Bank and the entity it controlled at the year's end or from time to time during the year. The statements comprise

- Balance Sheet;
- Profit and Loss Appropriation Statement;
- Notes to and forming part of the financial statements; and
- Directors Statement.

The members of the Bank's Board are responsible for the preparation and presentation of the financial statements and the information they contain. I have conducted an independent audit of the financial statements in order to express an opinion on them to you, the Treasurer.

The audit has been conducted in accordance with Australian National Audit Office Auditing Standards, which incorporate the Australian Auditing Standards, to provide reasonable assurance as to whether the financial statements are free of material misstatement. Audit procedures included examination, on a test basis, of evidence supporting the amounts and other disclosures in the financial statements, and the evaluation of accounting policies and significant accounting estimates. These procedures have been undertaken to form an opinion whether, in all material respects, the financial statements are presented fairly in accordance with Australian Accounting Standards, other mandatory professional reporting requirements and statutory requirements so as to present a view which is consistent with my understanding of the Bank's and the economic entity's financial position, the results of their operations and their cash flows.

The audit opinion expressed in this report has been formed on the above basis.

GPO Box 707 CANBERRA ACT 2601
Centenary House 19 National Circuit
BARTON ACT
Phone (02) 6203 7500 Fax (02) 6273 5355
Phone barrep@anao.gov.au

Audit Opinion

In my opinion,

(i) the financial statements have been prepared in accordance with Schedule 2 of the Finance Minister's Orders

(ii) the financial statements give a true and fair view, in accordance with applicable Accounting Standards, other mandatory professional reporting requirements and Schedule 2 of the Finance Minister's Orders, of the financial positions of the Bank and the economic entity as at 30 June 1999 and the results of their operations and their cash flows for the year then ended.

P. J. Barrett
Auditor-General

Sydney

5 August 1999

The Reserve Bank Board and Governance

The Role of the Reserve Bank Board

In announcing its response to the Financial System Inquiry conducted in 1996/97, the Government confirmed that the role of the Reserve Bank will be "..... focused on the objectives of monetary policy, overall financial system stability and regulation of the payments system." (Ministerial Statement by the responsible Minister, the Treasurer, 2 September 1997).

Legislation which was passed in June 1998 to introduce the changes in the regulatory framework of the Australian financial system flowing from this Inquiry did not change the existing charter of the Reserve Bank Board, but did amend its specific responsibilities. Under the amended *Reserve Bank Act 1959,* the Reserve Bank Board is responsible for the Bank's monetary and banking policy, and the Bank's policy on all other matters, other than its payments system policy. The Board "charter" is contained in section 10(2) of the *Reserve Bank Act:*

> "It is the duty of the Reserve Bank Board, within the limits of its powers, to ensure that the monetary and banking policy of the Bank is directed to the greatest advantage of the people of Australia and that the powers of the Bank .... are exercised in such a manner as, in the opinion of the Reserve Bank Board, will best contribute to:
>
> (a) the stability of the currency of Australia;
>
> (b) the maintenance of full employment in Australia; and
>
> (c) the economic prosperity and welfare of the people of Australia."

The Payments System Board is responsible for the Bank's payments system policy and will report separately in its own Annual Report.

Composition of the Reserve Bank Board

The Board comprises the Governor, who is Chairman, the Deputy Governor, the Secretary to the Treasury and six external members, appointed by the Governor-General – a total of nine. Five members form a quorum at a meeting of the Board.

Members of the Board may not be a director, officer or employee of a corporation (other than the Reserve Bank) the business of which is wholly or mainly that of banking.

Meetings of the Reserve Bank Board

The Board meets eleven times each year, on the first Tuesday of each month, except January.

The number of meetings attended by each member in 1998/99 was:

Board members	No of meetings attended
IJ Macfarlane	10
SA Grenville	8
EA Evans*	8
JR Broadbent	10
AR Jackson	10
FP Lowy	10
HM Morgan	10
AR Pagan	9
RFE Warburton	10

* GR Potts attended two meetings and KR Henry attended one meeting in place of EA Evans, in terms of the provisions of section 22 of the *Reserve Bank Act 1959*.

Audit Committee

The primary objectives of the Audit Committee are to:

- assist the Governor and the Board in fulfilling their obligations relating to financial reporting, internal control and compliance with laws, regulations, business ethics and employee conflicts of interest and fraud;
- enhance contact between management and the Audit Department;
- encourage high-quality auditing of the Bank's activities; and
- strengthen audit independence.

The Audit Committee is made up of Stephen Grenville, Deputy Governor (Chairman), a non-executive member of the Board, Jillian Broadbent, and an external appointed member, George Bennett, company director and former National Executive Chairman, KPMG Peat Marwick. During 1998/99, the Committee met on five occasions; all members attended each of these meetings.

Obligations under the *Commonwealth Authorities and Companies (CAC) Act 1997*

The CAC Act is one of three Acts which deal with the financial management, accountability and audit of Commonwealth agencies, authorities and companies. The CAC Act sets standards of conduct for directors and officers of Commonwealth authorities with many of these requirements being modelled on comparable areas of the Corporations Law. The Bank is a Commonwealth authority for the purposes of the CAC Act and, for these purposes, the members of the Reserve Bank Board are the directors of the Bank. As such, they are responsible for the preparation of the Bank's Annual Report and, at the meeting of the Reserve Bank Board on 3 August 1999 they resolved that the Chairman sign the Report, and the Financial Statements as at 30 June 1999, transmit them in accordance with the requirements of the CAC Act and arrange publication.

The House of Representatives Standing Committee on Economics, Finance and Public Administration has, in its Standing Orders, an obligation to review the Annual Report of the Bank. On 8 March 1999, the Committee tabled in the Parliament its interim report on the Annual Report for 1997/98, and on the December 1998 public hearing with the Bank and the associated November 1998 *Semi-Annual Statement on Monetary Policy*.

Indemnities

Under the provisions of section 26 of the CAC Act, and pursuant to a Board resolution on 7 April 1998, members of the Reserve Bank Board have been indemnified against costs they incur in successfully defending themselves in proceedings arising out of the proper discharge of their responsibilities, provided that any such liability does not arise from conduct involving a lack of good faith. This indemnity does not extend to claims by the Bank itself.

Reserve Bank Board

IJ Macfarlane, Chairman
Governor since 18 September 1996
Present term expires 17 September 2003

Chairman – Payments System Board
Board member – Australian Prudential Regulation Authority

SA Grenville
Deputy Governor since 1 December 1996
Present term expires 30 November 2001

EA Evans, AC
Secretary to the Treasury
Member since 10 May 1993

JR Broadbent
Member since 7 May 1998
Present term expires 6 May 2003

Director – Coca Cola Amatil Limited
Director – Woodside Petroleum Limited

AR Jackson, AO
Member since 29 January 1991
Present term expires 28 January 2001

Chairman and Chief Executive – Austrim Limited
Chairman – Australian Trade Commission (Austrade)
Director – Seven Network Limited
Director – Titan Petrochemicals and Polymers Berhad – Malaysia

FP Lowy, AO
Member since 27 June 1995
Present term expires 26 June 2000

Chairman – Westfield Holdings Limited
Director – Daily Mail and General Trust PLC (UK)

HM Morgan, AO
Member since 14 August 1996
Present term expires 28 July 2002

Managing Director and Chief Executive Officer – WMC Limited
Director – Alcoa Inc.

AR Pagan
Member since 29 November 1995
Present term expires 28 November 2000

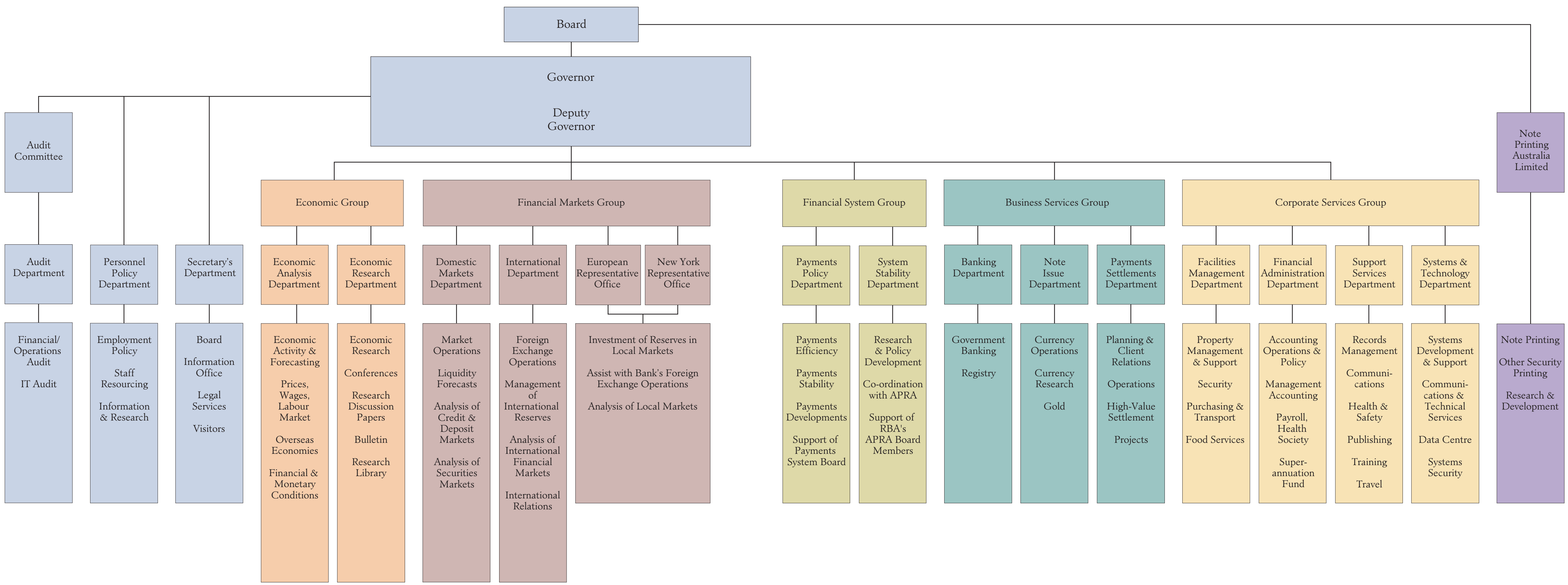
Professor of Economics, Research School of Social Sciences, Australian National University

RFE Warburton
Member since 22 December 1992
Present term expires 21 December 2002

Chairman – David Jones Limited
Chairman – Star City Holdings Limited
Chairman – Goldfields Limited
Director – Caltex Australia Limited
Director – Southcorp Limited
Director – Fernz Corporation Limited (NZ)

Reserve Bank of Australia

End June 1999



Head Office Management

End June 1999

Governor: Ian Macfarlane

Deputy Governor: Stephen Grenville

Economic Group

Assistant Governor: Glenn Stevens

Economic Analysis Department

Head: Malcolm Edey
Deputy Heads: Guy Debelle
Chris Ryan
Jenny Wilkinson

Economic Research Department

Head: David Gruen

Financial Markets Group

Assistant Governor: Ric Battellino

Domestic Markets Department

Head: Frank Campbell
Chief Manager: John Broadbent

International Department

Head: Bob Rankin
Chief Managers: Gordon de Brouwer
Mike Sinclair

Financial System Group

Assistant Governor: John Laker

Payments Policy Department

Head: John Veale
Chief Manager: Michele Bullock

System Stability Department

Head: Philip Lowe

Business Services Group

Assistant Governor: Geoff Board

Banking Department

Head: Wes Maley

Note Issue Department

Head: Les Coventry

Payments Settlements Department

Head: Bill Hands

Corporate Services Group

Assistant Governor: Les Austin

Facilities Management Department

Head: Richard Mayes

Financial Administration Department

Head: Robert Gilfoyle

Support Services Department

Head: Graham Rawstron

Systems & Technology Department

Head: John Wightman

Personnel Policy Department

Head: Keith Hall

Secretary's Department

Secretary: David Emanuel

Audit Department

Head: Clarita Imperial

Reserve Bank of Australia

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Fax: (44 171) 710 3500

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Deputy Chief Representative: Lindsay Boulton
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New York 10006-1404
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Fax: (1 212) 566 8501

Note Printing Australia Limited

Chief Executive: John Leckenby
Hume Highway
Craigieburn 3064
Telephone: (03) 9303 0444
Fax: (03) 9303 0491

Glossary

APEC	Asia-Pacific Economic Cooperation
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
ATMs	Automatic teller machines
BIS	Bank for International Settlements
CAC Act	*Commonwealth Authorities and Companies Act*
CGS	Commonwealth Government securities
CHESS	Clearing House Electronic Subregister System
CSIRO	Commonwealth Scientific and Industrial Research Organisation
DoFA	Department of Finance and Administration
EEO	Equal employment opportunity
EFTPOS	Electronic funds transfer at point of sale
EMEAP	Executive Meeting of East Asia and Pacific central banks
ES	Exchange Settlement (accounts; funds)
GDES	Government Direct Entry System
GDP	Gross domestic product
IBRA	Indonesian Bank Restructuring Agency
IMF	International Monetary Fund
NCDs	Non-callable deposits
NPA	Note Printing Australia
OECD	Organisation for Economic Co-operation and Development
OPA	Official Public Account
RBA	Reserve Bank of Australia
RDPs	Research Discussion Papers
RITS	Reserve Bank Information and Transfer System
RTGS	Real-time gross settlement
SDR	Special Drawing Right

Ritchie Thorburn Design, Sydney.