

# Annual Performance Statement for 2019/20

I, as the accountable authority of the Reserve Bank of Australia, present the annual performance statement of the Reserve Bank for 2019/20, prepared under paragraph 39(1)(a) of the *Public Governance, Performance and Accountability Act 2013* (PGPA Act). In my opinion, this annual performance statement accurately presents the performance of the Reserve Bank and complies with subsection 39(2) of the PGPA Act.

Philip Lowe  
Governor, Reserve Bank of Australia  
7 September 2020

## Introduction

This performance statement outlines the key purposes of the Reserve Bank as set out in the 2019/20 corporate plan and provides the results of the measurement and assessment of the Bank's performance in achieving those purposes. Where necessary, additional context is provided, including an analysis of the significant factors that have contributed to the performance of the Bank in 2019/20.

## Reserve Bank of Australia – Performance Summary 2019/20

Corporate Plan Purpose	Performance Objectives	Summary Performance Measures	Results
<b>Monetary policy</b>	<p>Conduct monetary policy in a way that will best contribute to:</p> <ul style="list-style-type: none"> <li>the stability of the currency</li> <li>the maintenance of full employment</li> <li>the economic prosperity and welfare of the people of Australia</li> </ul>	<p>Flexible medium-term inflation target to achieve consumer price inflation of between 2 and 3 per cent, on average, over time</p> <p>Foster sustainable growth in the economy</p>	<p>Consumer price inflation has averaged around 2½ per cent over the inflation-targeting period. Over the past five years, however, headline inflation has mostly been between 1¼ and 2¼ per cent, while measures of underlying inflation have mostly ranged between 1½ and 2 per cent. Headline inflation briefly turned negative in mid 2020 owing to the effect of declining oil prices and the temporary introduction of free childcare. Headline inflation is forecast to rebound to 3 per cent by mid 2021 before declining back to 1 to 1½ per cent in 2022</p> <p>Growth in the economy had averaged around 2½ per cent over the five years prior to the pandemic, and the unemployment rate had declined from around 6¼ per cent around mid 2015 to be around 5¼ per cent in early 2020. Prior to the COVID-19 outbreak, growth in the economy was a little below average, at 2¼ per cent over 2019, but was recovering. Over the first half of 2020, the spread of COVID-19 infections in Australia resulted in a sharp contraction in GDP of around 7 per cent; the unemployment rate rose to 7½ per cent in July 2020</p> <p>See the Bank's quarterly <i>Statement on Monetary Policy</i> for details</p>
<b>Financial stability</b>	Support overall financial stability	<p>A stable financial system that is able to support the economy</p> <p>Work with the Council of Financial Regulators (CFR) agencies to identify and appropriately address evolving systemic risks</p>	<p>The financial system has been able to help buffer the economy from the severe effects of the COVID-19 pandemic by allowing affected households and businesses to defer their repayment obligations, and by continuing to supply credit to support economic activity. Financial institutions have been able to do this because their financial resilience improved significantly over the past decade, in particular from mandated increases in capital and liquidity management enhancements. The supply of credit has also been supported by the package of monetary policy measures announced by the Bank in March 2020 and various other initiatives by governments and financial regulators</p> <p>The Bank intensified its contact with the other CFR agencies during the pandemic to support a coordinated response. In addition, the CFR issued statements that outlined its discussions and provided a collective assessment of the Australian financial system</p>

## Reserve Bank of Australia – Performance Summary 2019/20

Corporate Plan Purpose	Performance Objectives	Summary Performance Measures	Results
<b>Financial stability (continued)</b>	Support overall financial stability (continued)	Assess and communicate risks to financial stability, including through the Bank's half-yearly <i>Financial Stability Review</i>	The Bank has continued to assess financial stability risks. This has been enhanced by extending the Bank's stress-testing and scenario analysis to assess more explicitly household and business sector vulnerabilities, as well as those in the banking sector. The Bank communicates its assessments of these and other risks through the half-yearly <i>Financial Stability Review</i> , <i>Bulletin</i> articles and speeches
<b>Financial Market operations</b>	Achieve cash rate target	Overnight cash rate consistent with the target each business day	The overnight cash rate was equal to the target on all business days until late March 2020. Since then, the cash rate drifted somewhat below the target as a result of the significant increase in liquidity in the financial system owing to the Bank's package of policy measures in response to the COVID-19 pandemic. This was an expected result of the policy package and consistent with the aim of reducing funding costs in the Australian economy
	Manage reserves to portfolio benchmarks	Portfolio managed within small deviations around the asset and duration benchmarks	Deviations from the benchmarks were small and in line with pre-defined tolerances
	Intervene in foreign exchange market as appropriate	Publish data and explanations of any interventions	No foreign exchange market intervention was conducted
<b>Payments and infrastructure</b>	Support competition and efficiency in the payments system and financial system stability	Maximise the competitiveness of the payments market, subject to maintaining financial system stability. Policy work focusing on the strategic priorities identified by the Payments System Board	In 2019/20, the Bank: <ul style="list-style-type: none"> <li>• promoted competition in the market for card payment services through least-cost routing and transparency in merchant pricing</li> <li>• promoted the uptake of fast payments using the New Payments Platform (NPP)</li> <li>• participated in international initiatives to enhance the efficiency and competitiveness of cross-border payments</li> </ul>
		Monitor the outcomes for consumers and businesses following past reviews of the regulatory framework for card payments	In 2019/20, the Bank focused on: <ul style="list-style-type: none"> <li>• the provision of least-cost routing functionality to merchants</li> <li>• understanding differences in payment costs across merchants and card schemes</li> <li>• the operation of the surcharging framework</li> <li>• the implications for merchants and consumers of the rise of 'buy now, pay later' services</li> <li>• undertaking its three-yearly Consumer Payments Survey to better understand changes in payments behaviour</li> </ul>

## Reserve Bank of Australia – Performance Summary 2019/20

Corporate Plan Purpose	Performance Objectives	Summary Performance Measures	Results	
<b>Payments and infrastructure (continued)</b>	Support competition and efficiency in the payments system and financial system stability (continued)	Commence work on a comprehensive review of the regulatory framework for card payments, focusing on promoting competition and low-cost payments	The Bank commenced a Review of Retail Payments Regulation with the publication of an Issues Paper and the start of a stakeholder consultation period in November 2019. The Review was initially expected to be completed by late 2020, but was put on hold in March 2020 owing to the COVID-19 pandemic and is expected to be completed in 2021	
		Work with industry on plan to modernise payment messaging standards	The Bank completed an industry consultation (jointly with the Australian Payments Council) on the strategy for domestic migration to the ISO 20022 messaging standard in February 2020. The Bank has been participating in the industry-led migration project	
		Work with industry and the Australian Prudential Regulation Authority (APRA) to develop disclosure standards for operational performance	The Bank made progress on work with the industry on an enhanced reporting and disclosure framework for retail payments operational incidents. However, this work was put on hold in March 2020 owing to the COVID-19 pandemic and is expected to be completed in 2021	
	Stability in the provision of financial market infrastructure (FMI) services	Stability of FMI service provision. Assess Reserve Bank Information and Transfer System (RITS) and licensed clearing and settlement facilities (CS) against relevant standards. Establish recommendations and regulatory priorities as appropriate for each high-value payment system and CS facility based on these assessments		Assessments of RITS and all licensed clearing and settlement facilities (other than for CME) have been completed and published. The CME assessment was postponed for 12 months following the reprioritisation of work in response to the COVID-19 pandemic. Where necessary, the Bank has set regulatory priorities for facilities and monitored responses
			Monitor whether additional FMIs should be subject to supervision or oversight by the Bank	The Bank completed its annual review of whether any payment systems other than RITS and CLS should also be subject to ongoing oversight and assessment against the Principles for Financial Market Infrastructures (PFMI), concluding that no other systems should be included
			Develop proposals for enhancements to the FMI regulatory regime, including crisis management powers	The CFR consulted on proposed reforms to enhance the regulatory regime for a range of FMIs. The CFR has prepared advice to the Government on those proposals

## Reserve Bank of Australia – Performance Summary 2019/20

Corporate Plan Purpose	Performance Objectives	Summary Performance Measures	Results
<b>Payments and infrastructure (continued)</b>	Stability in the provision of financial market infrastructure (FMI) services (continued)	Contribute to international policy work on central counterparty resilience and FMI crisis management	Bank staff actively participated in international policy development and implementation on crisis management and the resilience of financial market infrastructures
		Adapt domestic regulatory standards in response to international developments. Support international supervisory cooperation	No change to domestic regulatory standards was required
	RITS operational reliability	RITS availability at 99.95 per cent during core hours	RITS availability was 100 per cent during core hours in 2019/20
		RITS Fast Settlement Service (FSS) availability at 99.995 per cent on a 24/7 basis, with most transactions processed in less than one second	FSS availability was 100 per cent on a 24/7 basis and the processing time for 95 per cent of FSS transactions was 66 milliseconds or less
	RITS cyber security	Ongoing investment and regular reviews and testing to support cyber resilience	The Bank's ongoing program of cyber resilience work helped underpin the reliable operation of RITS in 2019/20. The Bank continued to comply with the requirements of ISO 27001 and SWIFT's mandatory Customer Security Program. The Bank also conducted an industry cyber 'tabletop' exercise during 2019/20. The Australian National Audit Office published a performance audit of the Bank's cyber resilience in July 2019 and concluded that the Bank had effectively managed its cyber security risks
<b>Banking</b>	Ensure central banking services remain fit for purpose	Work with key stakeholders to maintain and improve, where possible, the central banking services provided to the Commonwealth of Australia	The Bank continued to work with the Department of Finance (Finance) on its multi-stage plan to modernise Commonwealth cash management. Phase 1 of the project, to enable Finance to make agency funding payments using the NPP, was completed in March 2020
	Satisfy financial performance benchmarks	Minimum return on capital for transactional banking business equivalent to the yield on 10-year Australian Government Securities plus a margin for risk	The Bank's banking services achieved the minimum required return on capital in 2019/20

## Reserve Bank of Australia – Performance Summary 2019/20

Corporate Plan Purpose	Performance Objectives	Summary Performance Measures	Results
<b>Banking (continued)</b>	Progress on activities to deliver convenient, secure, reliable and cost-effective banking services to customers	Provision of high-quality, cost-effective banking services to government and other official agency customers and, in turn, the public, supported by: <ul style="list-style-type: none"> <li>• replacement of the Bank's core account maintenance system using a modern programming language and architecture</li> <li>• continued development of banking services and systems, including NPP capabilities</li> <li>• delivery of open and secure integration services via Application Programming Interfaces (API) for agencies</li> </ul>	In 2019/20, the Bank: <ul style="list-style-type: none"> <li>• completed the work undertaken to embed and enhance the core banking system in August 2019</li> <li>• continued to work with the industry to develop new NPP capabilities, most notably the Mandated Payment Service</li> <li>• assisted Services Australia to leverage existing NPP and API capability for payment processing and enquiry functionality</li> <li>• supported agency customers as they progressed through the development and implementation of new payment systems</li> </ul>
<b>Banknotes</b>	Maintain the capacity of Australian banknotes to provide a safe, secure and reliable means of payment and store of value, as follows: <ul style="list-style-type: none"> <li>• Meet banknote demand</li> <li>• Increase security of Australian banknotes</li> <li>• Ensure high-quality banknotes</li> </ul>	Maintain or improve public perceptions of Australian banknotes as measured in the Bank's survey <p>More than 95 per cent of banknote orders from commercial banks fulfilled by the Bank within three days of the request</p> <p>Issuance of new \$20 banknote with upgraded security features as part of Next Generation Banknote program</p> <p>Banknote production orders by the Reserve Bank to be met by Note Printing Australia Limited within agreed quality parameters</p> <p>Maintain quality of banknotes in circulation above the minimum quality standard agreed with industry</p>	The counterfeiting rate was 13 parts per million in 2019/20, which is lower than in recent history and relatively low by international standards <p>100 per cent of orders were fulfilled on the day requested in 2019/20. In response to the COVID-19 pandemic, the Bank made available its contingency distribution site in Sydney for a short period in late March and early April in order to meet public demand</p> <p>The new \$20 banknote was released on 9 October 2019 as planned</p> <p>82 per cent of orders were met by Note Printing Australia Limited on time and to the required quality standard in 2019/20. The shortfall was due to an agreed deferral to assist NPA in meeting export orders, and minor delays in the production of banknotes owing to the COVID-19 pandemic</p> <p>The quality of banknotes in circulation remained at a high level in 2019/20, as measured by the Bank's quality standards. The measurement of quality, however, was interrupted by the COVID-19 pandemic from February 2020</p>

## Monetary Policy

### Purpose

It is the duty of the Reserve Bank Board 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 a way that, in the Board's opinion, will best contribute to:

- a. the stability of the currency of Australia
- b. the maintenance of full employment in Australia
- c. the economic prosperity and welfare of the people of Australia.

In support of this, the most recent *Statement on the Conduct of Monetary Policy* agreed by the Treasurer and the Governor, dated 19 September 2016, confirms the Bank's continuing commitment to achieving consumer price inflation between 2 and 3 per cent, on average, over time, consistent with its duties under the *Reserve Bank Act 1959*. Achieving the inflation target preserves the value of money and facilitates strong and sustainable growth in the economy over the longer term. This assists businesses and households in making sound investment decisions, underpins the creation of jobs and protects the savings of Australians. The *Statement on the Conduct of Monetary Policy* also recognises the importance of financial stability for a stable macroeconomic environment.

### Results

Assessing the conduct of monetary policy during 2019/20 involves judging whether the policy decisions taken by the Reserve Bank Board, based on the information available at the time, were consistent with achieving the Bank's broad objectives.

Consumer price inflation has averaged around 2½ per cent over the inflation-targeting period. Over the past five years, headline inflation has

mostly been between 1¼ and 2¼ per cent, while measures of underlying inflation have mostly ranged between 1½ and 2 per cent. Headline inflation briefly turned negative in the June quarter 2020 owing to the effect of declining oil prices and the temporary introduction of free childcare.

In 2019, prior to the COVID-19 outbreak, growth in the Australian economy was below trend but had been recovering and was expected to continue to pick up over 2020 and 2021 to be above estimates of trend growth in productive capacity. During 2019, employment growth had been relatively strong, but labour market participation rose by more than would be typically expected and there was ongoing spare capacity in the labour market. Over the first half of 2020, the spread of COVID-19 infections in Australia resulted in a sharp contraction in GDP of around 7 per cent, and by July 2020, the unemployment rate had risen to 7½ per cent. Both GDP and the labour market are expected to improve over 2020/21, but the pace of recovery is expected to be uneven and will remain highly dependent on containment of the virus.

Towards the end of 2019, the Reserve Bank Board reviewed the forecasts and monetary policy decisions it had taken over the previous year, including the reasons behind the forecast errors. GDP growth over 2019 had been weaker than initially expected, partly reflecting lower-than-expected growth in consumption and household disposable income. Weaker-than-expected growth in GDP and slower progress in reducing labour market spare capacity had contributed to consumer price inflation remaining a little below expectations and thus slightly below the Bank's target range. A decline in housing cost inflation to around historical lows and lower inflation in certain administered prices also weighed on inflation.

After leaving the cash rate unchanged since August 2016, the Reserve Bank Board lowered

the cash rate by 75 basis points between June and October 2019, to 0.75 per cent. When the Board lowered the cash rate in October 2019, the forecasts suggested that it was likely that unemployment and inflation outcomes over the following years would remain short of the Bank's goals. The Board judged that lower interest rates would assist in reducing spare capacity in the labour market, which would be required for inflation to return sustainably to the Bank's target.

In early 2020, the Board needed to assess the effects of the COVID-19 outbreak on the economy and the functioning of the financial system. At the time the Board met on 3 March 2020, there was increasing evidence that the virus would cause major economic disruption globally but it was less clear how it would unfold in the Australian context. The Board decided to cut the cash rate by 25 basis points to 0.5 per cent at that meeting.

In response to the economic disruption caused by the spread of COVID-19, and with interest rates already at very low levels, on 19 March 2020 the Bank announced a package of policy measures to help to further lower funding costs across the economy, support the provision of credit, especially to small and medium-sized businesses, ensure that the financial system has plenty of liquidity and ensure the smooth functioning of key financial markets. The measures were introduced as part of a substantial, coordinated and unprecedented policy response by governments and financial regulators. The Bank's policy response included the following elements:

1. a reduction in the cash rate target to 0.25 per cent
2. a target for the yield on the 3-year Australian Government bond of around 0.25 per cent. The Bank commenced a program of buying government bonds in the secondary market as required to achieve this target and to address dislocations in the markets for

Australian Government bonds and the bonds of the state governments

3. expanding the Bank's daily market operations in size and in maturity to ensure financial institutions had plentiful liquidity
4. a Term Funding Facility for the banking system, with particular support for credit to small and medium-sized businesses
5. modifying the interest rate corridor system so that balances held in Exchange Settlement Accounts at the Bank earn 10 basis points, rather than zero.

The Board indicated that it did not plan to increase the cash rate target, or change the target on the 3-year Australian Government bond yield, until the economy was making progress towards full employment and the Board was confident that inflation would be sustainably within the 2–3 per cent target band. The Board's expectation, though, was that the yield target would be removed before the cash rate is increased.

The Governor's statement and the minutes following the monetary policy meetings provide further details of the Reserve Bank Board's assessment of economic developments, the outlook and monetary policy decisions. A brief summary of analysis by the Bank of these issues is provided below. Further details of this analysis are provided in the Bank's quarterly *Statement on Monetary Policy*, the Governor's regular appearances before the House of Representatives Standing Committee on Economics, and speeches by the Governor and other senior Bank officials.

## Analysis

In the second half of 2019, policy decisions were made in the context of significant uncertainty around the global economy, which included slowing growth in Australia's major trading partners and continuing trade and technology disputes. Despite tight labour market conditions



in the major advanced economies, inflation generally remained below central bank targets. Central banks had lowered interest rates in a number of economies to respond to downside risks to their outlooks and subdued inflation.

During 2019, the Australian economy had been navigating a soft patch but was recovering, supported by accommodative monetary policy and the earlier depreciation of the exchange rate. The earlier decline in housing markets had weighed on consumption by more than had been initially anticipated; with the housing market recovering in the second half of the year, consumption growth was expected to pick up over 2020. Mining investment reached a trough in mid 2019, marking the end of the decline that followed the mining boom, and mining investment was expected to pick up over the following few years. Employment growth was reasonable over 2019 and early 2020. The participation rate rose a little to be around its historical high and, as a result, the unemployment rate remained around 5–5¼ per cent. Wages growth remained subdued. Consumer price inflation increased to 2¼ per cent in the March quarter 2020, although underlying inflation pressures remained subdued. Bushfires in the latter part of 2019 and early 2020 had a significant effect on regional communities, and resulted in a modest subtraction from GDP growth.

Over the second half of 2019, the Reserve Bank Board had considered a range of risks to the outlook and their implications for the required stance of monetary policy. For the global economy, the risks for the outlook were generally tilted to the downside. A potential re-escalation in trade tensions and uncertainty about how quickly growth in output in China might pick up in response to stimulus measures were some specific risks that were considered. For

the domestic economy, the risks to the outlook were relatively balanced; however, it was likely that inflation and unemployment outcomes over the following few years would remain short of the Bank's goals. Ongoing spare capacity in the labour market was a particular concern; the potential for wage-setting norms to be anchored at a low level represented one downside risk, but it was also possible that wages growth could pick up faster than expected if labour market spare capacity was eroded faster than assumed.

In 2020, the COVID-19 pandemic dramatically shifted the economic landscape both in Australia and abroad. Measures implemented to contain the spread of the virus resulted in sizeable economic contractions in most economies over the first half of the year; a recovery had commenced in most economies since around May, but a number of economies were also forced to contend with fresh outbreaks of the virus, including Australia. The sharp contraction in activity in the first half of 2020 came at a time when inflation pressures were already subdued globally and in Australia. The shock was accompanied by temporary dysfunction in financial markets and a substantial decline in oil prices.

Following the onset of the pandemic, the outlook for the global economy deteriorated significantly and involved a high degree of uncertainty. The main source of uncertainty related to the evolution of the virus and potential medical advances; a resurgence in new cases had led to a decline in economic activity, partly because of a partial reinstatement of containment measures in some economies, including Australia. On the other hand, many advanced economies were being supported by unprecedented fiscal stimulus and significant monetary stimulus, providing critical support during the recovery. The contraction in the Australian economy over the first half of 2020 was very large by

historical standards, but not quite as large as initially feared. The speed of economic recovery in Australia also remained highly uncertain and would depend to some extent on the speed of global recovery. The recovery would also depend on a range of domestic factors, including the need for measures to contain fresh outbreaks of the virus, as well as the confidence of firms and households to spend and re-hire workers. The Reserve Bank Board also considered that there could be some long-lasting effects from the period of social and economic disruption, including lasting behavioural changes and shifts in business models.

Pressures that have weighed on wage and price inflation over recent years are likely to persist in the period ahead. The necessary containment measures that were introduced to limit the spread of the virus in Australia have added to ongoing spare capacity in the labour market, as seen in the marked rise in unemployment and underemployment rates, and it is uncertain how quickly this spare capacity will decline. Wages growth, which had been unusually slow over recent years, is expected to ease in the near term as a result of some employers introducing wage freezes or pay cuts. Some administered prices have also been increasing at a slower rate than usual over the past year or so as governments have taken steps to contain cost of living pressures, and this will weigh on inflation if it were to continue. Housing-related inflation is currently near historical lows, and the outlook is quite uncertain.

## Financial Stability

### Purpose

The Reserve Bank has a responsibility for fostering overall financial stability in Australia. This stems partly from the Bank's duties to exercise its powers in a way that will best contribute to 'the maintenance of full employment in Australia'

and 'the economic prosperity and welfare of the people of Australia'. Given the serious damage to employment and economic prosperity that can occur in times of financial instability, the Reserve Bank Act has long had an implied mandate to pursue financial stability. This mandate has been made more explicit by successive governments. The Treasurer and the Governor recorded their common understanding of the Bank's longstanding responsibility for financial system stability, as part of the *Statement on the Conduct of Monetary Policy*.

The Bank works with other regulatory bodies to foster financial stability. The Governor chairs the Council of Financial Regulators (CFR) – comprising the Bank, the Australian Prudential Regulation Authority (APRA), the Australian Securities and Investments Commission (ASIC) and the Australian Treasury – whose role is to promote the stability of the Australian financial system and support effective and efficient regulation by Australia's financial regulatory agencies. The Bank's central position in the financial system, and its position as the ultimate provider of liquidity to the system, gives it a key role in financial crisis management, in conjunction with the other members of the CFR.

The Bank's operations in domestic financial markets, discussed in the Financial Market Operations section below, and oversight and operational roles in the payments system, discussed in the Payments and Infrastructure section below, also contribute to the stability of the financial system.

### Results

The Australian financial system remained resilient in the face of the deep economic contraction arising from the COVID-19 pandemic. This resilience has allowed the financial system to continue to perform its function of supporting economic activity. The strength of the financial

system when it entered this period supported this outcome. This was, in part, a result of significant regulatory reforms that took place in response to the global financial crisis. In addition, the Reserve Bank acted quickly to alleviate strains in the financial system as they arose. The Bank's initial responses, announced in mid March, aimed to ensure that Australia's financial markets continued to operate effectively (see the Financial Market Operations section below). They also sought to ensure that credit was available in the economy, including with a new Term Funding Facility (TFF), which provided authorised deposit-taking institutions (ADIs) with access to low-cost funding, particularly for those that increased their lending to small and medium-sized businesses. With these measures, the Bank was fulfilling its mandate to maintain overall financial system stability so that it could support the economy.

With the Governor as Chair of the CFR, the Bank worked closely with the other CFR agencies to coordinate appropriate financial sector policy actions. The Bank's analysis of the economic and financial impact of the pandemic was shared and discussed with the other CFR agencies. The CFR agencies issued several statements to highlight their COVID-19 responses and other key messages. These combined efforts supported APRA and ASIC, the direct regulators of ADIs and most other financial institutions, in performing their supervision of these entities' financial and operational capacity. This also contributed to overall financial stability and the continued provision of credit in the economy.

As part of its routine operations, the Bank works closely with other CFR agencies on crisis preparedness to ensure a coordinated response. This includes processes for managing the resolution of a distressed financial institution. In addition, the CFR and the Trans-Tasman Council on Banking Supervision (TTBC), which

comprises the CFR agencies and their New Zealand counterparts, periodically organise crisis simulation exercises to test the arrangements and amend protocols as required. The most recent TTBC crisis simulation exercise was carried out in September 2019 and focused on crisis management communication arrangements.

The Bank's April 2020 *Financial Stability Review* focused on the stability of the financial system given the onset of the COVID-19 pandemic. It noted that, while the pandemic had caused significant strains in the global financial system, the Australian financial system was well placed to manage them. In particular, the banking system was well capitalised and had significant liquid assets, and substantial financial buffers were available to be drawn down if required to support the economy. It also highlighted that regulatory authorities were working closely together to reduce the economic damage caused by the pandemic and that, partly as a result of the strong starting position of Australia's banking system, the nation's financial system has the ability to absorb, rather than amplify, the effects of the pandemic.

Towards the end of 2019/20, financial markets and broader financial sector conditions settled. This followed the measures put in place to ease strains in financial markets and ensure the supply of credit, a substantial fiscal response, and the easing of restrictions that had helped to contain COVID-19 across most parts of Australia. Credit continued to be supplied to households and businesses, and interest rates on outstanding housing loans declined. Banks facilitated the deferral of loan repayments for over 10 per cent of households and around 20 per cent of small and medium-sized businesses.

In 2019/20, the Bank continued to review other potential sources of risks to the financial system, including climate change, and especially those

that could be exacerbated during the pandemic. For example, with many staff working from home and from different locations during the crisis, financial institutions faced increased operational risks, including IT and cyber risks. The Bank remained alert to these risks, including via its supervision and oversight of financial market infrastructures (discussed in the Payments and Infrastructure section below).

As discussed in the October 2019 *Financial Stability Review*, the level of household debt is a longstanding risk for the Australian financial system. The financial resilience of households and businesses during the pandemic has been a key focus of the Bank. The pressures affecting households' finances included the loss of employment and income, while many businesses have experienced significant disruption to their operations from measures to control COVID-19. None of these risks, on their own, appears likely to be the source of significant financial instability in the near term, given the substantial policy response, the overall resilience of households, businesses and banks, and the financial system more generally.

The Bank is a member of several international regulatory bodies, and continued to contribute to their work on financial stability in 2019/20. Like their domestic counterparts, these groups quickly reprioritised their work programs to address the unprecedented challenges posed by the pandemic. They sought to assess the pandemic's financial implications across markets and financial entities, determine how the pandemic may affect existing global vulnerabilities or give rise to new ones, and to share information on domestic developments and policy measures implemented. In addition, these bodies deferred the implementation of certain global regulatory reforms so as to allow firms to focus resources on responding to the pandemic. The Governor and other senior executives participated in these

discussions, for example through the G20, several Financial Stability Board bodies (the Plenary, Steering Committee and Standing Committee on Assessment of Vulnerabilities), and the Basel Committee on Banking Supervision (BCBS). Other Bank staff participated as members of various committees and working groups. For further information, see the chapter on 'International Financial Cooperation' in this annual report.

## Analysis

Several factors supported the performance of the financial system in 2019/20, notwithstanding the sizeable shock caused by the pandemic. Fundamentally, the Australian financial system was resilient prior to the COVID-19 crisis and therefore was well placed to deal with it. In particular, the domestic banks had large capital and liquidity buffers. The financial system was in this strong position partly because over the past decade APRA has worked with financial institutions to boost their capital and to reduce their liquidity risks. Australia's financial institutions were also profitable and had low levels of problem loans.

The improvement in lending standards seen over recent years, reflecting in large part regulatory actions by APRA and ASIC, has contributed to the resilience of lenders to risk. This also enhanced the resilience of households and businesses seeking credit, so that they too were generally better placed to withstand the financial stress brought on by the pandemic and the steps required to contain its spread. More generally, the broader operating environment also benefited from the regulators' actions, such as waiving some regulatory requirements on lenders, and lenders in turn supporting their borrowers. Indeed, the strong cooperative actions of lenders, retailers and households complemented government support measures and regulatory actions, which underpinned confidence and helped maintain stability in the overall financial system.

The central role of the CFR was an important element of an effective response by the Reserve Bank and other financial regulators to the pandemic during 2019/20. While it does not have formal powers, the strong cooperative culture embodied in the CFR helped Australia's financial regulators work together effectively. Contact across the four agencies intensified at both senior executive and working levels, allowing for better informed and coordinated responses. This coordination also enabled a comprehensive and consistent message to be delivered to the public about the risks posed by the pandemic, the effects on the financial system and the approach of regulators – including through the Bank's *Financial Stability Review*.

The analysis conducted by the Bank on the financial system helped to inform the Bank's executive and the Reserve Bank Board, other CFR members and the government as they formulated their response to the COVID-19 pandemic. In turn, the Bank's close monitoring of developments benefited from having access to a wide range of supervisory data on financial institutions. This included the modernised 'Economic and Financial Statistics' (EFS) collection, which is compiled by APRA on behalf of the Australian Bureau of Statistics (ABS) and the Bank. The EFS allows trends in broad aggregates related to ADIs and other financial institutions to be assessed. The Bank also drew upon its detailed knowledge of household and business balance sheets, to assess their resilience and to identify areas of potential vulnerability. This benefited from access to data from the ABS, the Bank's securitisation dataset, and data from a range of other data providers. The Bank's stress-testing model has provided important insights into the capacity of the banking system to withstand a downturn, and supported APRA's own stress-testing work. In addition, legislative changes in

2018, that expanded the coverage of financial firms reporting data to APRA, have enabled the Bank to better understand potential vulnerabilities at lenders that are not prudentially regulated. The Bank also extended its modelling capacity by establishing new stress-testing frameworks to analyse more directly both household and non-financial business sector risks.

## Financial Market Operations

### Purpose

The Reserve Bank has a sizeable balance sheet, which will continue to be managed through financial market operations in support of the Bank's policy objectives.

The Bank's operations in domestic financial markets are conducted to ensure that the cash rate is consistent with the target set by the Reserve Bank Board and that there is sufficient liquidity in the domestic money market on a daily basis. This promotes the objectives of monetary policy as described in the Monetary Policy section above and the stable functioning of the financial system, in particular the payments system.

The Bank's foreign reserves are held to give the Bank the capacity to intervene in the foreign exchange market. In particular, the foreign reserves enable the Bank to address any apparent dysfunction in the foreign exchange market and/or a significant misalignment in the exchange rate, consistent with the objectives of monetary policy. Such interventions occur rarely. Regular transactions in the foreign exchange market are, however, conducted to manage these reserves, to assist in liquidity management in domestic markets and to provide foreign exchange services to the Bank's clients (the largest of which is the Australian Government; see the Banking section below).

## Results

The cash rate was equal to the target on all business days until late March 2020. At that time, the Reserve Bank introduced a package of policy measures in response to the COVID-19 restrictions (see the Monetary Policy section above). These measures resulted in higher system liquidity and, as expected, led to the cash rate, which reflects overnight interbank lending rates, drifting a little below the target. The lower cash rate was consistent with the aim of the package of reducing funding costs in the Australian economy.

The Bank manages its foreign reserves portfolio to a benchmark. During 2019/20, the portfolio was managed so that any deviations around the benchmark for exchange rate and interest rate risk were small and in line with pre-defined tolerances.

The Reserve Bank did not intervene in the foreign exchange market during 2019/20.

## Analysis

The cash rate is the rate at which banks borrow from and lend to each other on an overnight, unsecured basis. The Reserve Bank operates a corridor system around the cash rate target. Under this system, the balances that banks hold with the Bank overnight in Exchange Settlement (ES) Accounts earn an interest rate set at a margin below the cash rate target (the floor of the corridor). And at the top of the corridor, when a bank needs to borrow from the Bank overnight, it is charged an interest rate set at a margin above the cash rate target. In this corridor system, banks have no incentive to borrow in the cash market at a rate higher than the top of the corridor (as they could borrow more cheaply from the Bank) nor lend at a rate below the floor of the corridor (as they could earn more by holding ES balances with the Bank).

Until the package of policy measures implemented in mid March 2020, the Bank altered the volume of ES balances so as to keep the cash rate as close as possible to the prevailing cash rate target each day. Following the package of policy measures, the volume of ES balances has increased substantially. As a result, and as expected, the cash rate has drifted below the cash rate target, but remained above the floor of the corridor. This is consistent with the aim of the Bank's policy package of ensuring that funding costs in the Australian economy are very low.

As part of the policy package, the floor of the corridor was increased relative to the cash rate target. This adjustment was made because of the very large increase in ES balances resulting from the package of policy measures. In the absence of this change, the ES balances held by banks with the Bank would have earned a zero interest rate, which would have increased the costs to the banking system, working against the aim of the package.

The package of policy measures has been working broadly as expected. It has helped to ease financial market conditions and improve functioning in government bond markets, which serve as important pricing benchmarks for many financial assets. The policy measures have reduced Australian banks' funding costs and encouraged a reduction in housing and business interest rates, which have all reached historic lows. Lenders have also taken steps to ease loan repayment burdens for households and businesses whose incomes have been affected by the COVID-19 disruptions. Since April 2020, there has been less demand for liquidity in the Bank's daily open market operations, given the large amount of liquidity that has been provided through the package of policy measures and as financial conditions have stabilised. The Bank did not purchase bonds from early May through to the end of June 2020, with

the target for the 3-year Australian government bond yield achieved over that period and market functioning returning to more normal levels.

The COVID-19 pandemic led to episodes of heightened volatility and illiquidity in foreign exchange markets, including for the Australian dollar. This was most apparent in March 2020. The Bank's assessment was that the impairment in market functioning at this time was sufficiently short-lived that it was not necessary to support liquidity for Australian dollars by intervening in the foreign exchange market.

US dollar funding pressures emerged within global financial markets following the outbreak of COVID-19. A temporary US\$60 billion swap line with the US Federal Reserve was established in March 2020, allowing the Bank to exchange Australian dollars for US dollars. The Bank made the US dollars available to Australian market participants through repos against Australian dollar-denominated securities. Usage of the swap line was modest as local market participants were able to continue meeting any US dollar funding needs in the market.

## Payments and Infrastructure

### Purpose

There are several distinct aspects to the Reserve Bank's role in the payments system, including those of policymaker, overseer and supervisor, and owner and operator of key national payments infrastructure.

In relation to the policymaking role, it is the duty of the Payments System Board to ensure that the Reserve Bank's payments system policy is directed to the greatest advantage of the people of Australia, and to ensure that the powers of the Bank under the *Payment Systems (Regulation) Act 1998* and the *Payment Systems and Netting Act 1998* are exercised in a way that, in the Board's opinion, will best contribute to:

- a. controlling risk in the financial system
- b. promoting the efficiency of the payments system
- c. promoting competition in the market for payment services, consistent with the overall stability of the financial system.

In addition, it is the Payments System Board's duty to ensure that the powers and functions of the Reserve Bank under Part 7.3 of the *Corporations Act 2001* are exercised in a way that, in the Board's opinion, will best contribute to the overall stability of the financial system. These powers and functions relate to the supervision of central counterparties and securities settlement facilities, which are key components of the central infrastructure that supports financial markets. The Bank's payments policy area also acts as overseer of Australia's high-value payment system, the Reserve Bank Information and Transfer System (RITS).

The Bank's operational role in the payments system is effected through its ownership and management of RITS (including the Fast Settlement Service (FSS)), which is used by banks and other approved institutions to settle their payment obligations efficiently on a real-time, gross settlement basis. This ensures that there is no build-up of settlement obligations associated with high-value transactions and thereby promotes the stability of Australia's financial system.

The Bank's work in these areas supports its other work directed towards fostering overall financial stability (see the Financial Stability section above).

### Results

Developments in the Australian payments system and the Bank's recent policy activities are discussed further in the *Payments System Board Annual Report 2020*.

The Reserve Bank has continued to monitor the impact of its card regulatory requirements on competition and efficiency in the payments system. In November 2019, the Bank launched a comprehensive Review of Retail Payments Regulation with the publication of an Issues Paper. It was originally anticipated that the Review would be completed by late 2020, but it was put on hold in March in order to reduce the demands on industry stakeholders during the COVID-19 pandemic, and is expected to be completed in 2021.

The Bank's standards for card payment interchange fees and surcharging have been helping to contain payment costs for merchants. Average merchant fees for debit and credit card payments have declined further over the past year. To help merchants control their payment costs and promote competition between schemes, the Bank has continued to encourage the provision of least-cost routing functionality, whereby merchants can choose to route contactless transactions on dual-network debit cards to the lowest-cost processing network. While all of the major acquirers are now offering some form of least-cost routing functionality, the Bank has been encouraging acquirers to make it widely available and improve awareness of it among their entire merchant customer base. As part of the Review, the Bank has also been exploring other policy options to strengthen competition in the market for acquiring services, including measures to enhance transparency of merchant pricing and make it easier for merchants to get a better deal.

The Bank has been monitoring the response of NPP Australia Limited (NPPA) and its participants to the recommendations on New Payments Platform (NPP) access and functionality contained in the Bank's report with the Australian Competition and Consumer Commission (ACCC)

published in June 2019. NPPA has responded to all of the recommendations, including introducing some changes to its participation requirements and governance arrangements and publishing a roadmap of future NPP functionality that its participants have agreed to develop. The Bank has been encouraging financial institutions to complete the roll-out of their NPP services and to work collaboratively on the development of the new capabilities outlined in the NPP roadmap.

The Bank has been working with the industry to improve the efficiency and security of the Australian payments system by migrating to the data-rich International Organization for Standardization (ISO) 20022 payments messaging standard that is increasingly being adopted overseas. Together with the Australian Payments Council, the Bank undertook an industry consultation on the domestic migration approach and published the Conclusions Paper in February. This set out the agreed project scope, migration strategy, governance arrangements and timeline for the domestic migration. The industry-led migration project has commenced and is governed by a steering committee comprised of senior industry representatives, including one from the Bank.

As part of its efforts to improve the operational reliability of retail payments, the Bank began work with the industry and APRA to develop a set of standard operational performance statistics to be disclosed by individual financial institutions and reported to the Bank. The work was originally expected to be completed by late 2020, but was temporarily postponed in March 2020 in order to reduce the burden on industry stakeholders during the COVID-19 pandemic. The initiative is expected to be completed in 2021.

In November 2019, the CFR issued a consultation paper on a package of proposed reforms to the regulatory regime for financial market



infrastructures (FMIs). The proposals related to the licensing and supervision of clearing and settlement (CS) facilities, market operators, derivative trade repositories and benchmark administrators, as well as a resolution regime for CS facilities. Following consultation, the CFR prepared advice to Government on those proposals.

The Bank published annual assessments of each of the licensed CS facilities (with the exception of the Chicago Mercantile Exchange Inc. (CME)) as part of its ongoing oversight of these facilities. Assessments were published for the ASX CS facilities in September 2019 and for LCH Limited's SwapClear service in December 2019. In these assessments, the Bank judged that all the entities had conducted their affairs in a way that causes or promotes overall stability in the Australian financial system, or had made progress against regulatory priorities set by the Bank. The Bank also set out a series of regulatory priorities for each of the facilities for the subsequent year. As a result of the reprioritisation of work in response to COVID-19, the CME assessment was postponed by 12 months, taking into account the entity's profile in Australia. In June 2020, the Bank published its annual assessment of RITS against the *Principles for Financial Market Infrastructures*, concluding that RITS observed all relevant principles other than Operational Risk, which was assessed to be broadly observed by RITS.

In support of the Bank's oversight approach and of its policy framework, Bank staff also participated in international policy development on crisis management and resilience of FMIs and monitoring the implementation of international standards. No change was required to domestic regulatory standards in 2019/20 as a result of international developments.

As the owner and operator of RITS, the Bank seeks to ensure that this system operates with

extremely high levels of reliability and security, while also adapting to the needs of a 24/7 payments world. For RITS, the system availability target is 99.95 per cent during core system hours, while for the Fast Settlement Service (FSS), the system availability target is 99.995 per cent on a 24/7 basis. In 2019/20, both systems achieved their targets, with RITS and FSS availability both at 100 per cent. FSS met its target to complete settlement of most transactions in less than one second, with 95 per cent of FSS transactions processed in 66 milliseconds or less.

The Bank is committed to ensuring that RITS is well protected from cyber attack and has an ongoing program of work to maintain high levels of cyber resilience. In July 2019, the Bank's payment settlement systems were recertified under the ISO 27001 standard for Information Security Management and, in September 2019, the Bank completed its independently assessed compliance attestation to the SWIFT Customer Security Controls Framework with full compliance to all mandatory controls. The Australian National Audit Office published a performance audit of the Bank's cyber resilience in July 2019 and concluded that the Bank had effectively managed its cyber security risks. In late 2019, the Bank conducted a cyber 'tabletop' exercise with a range of industry participants to rehearse existing contingency procedures, with a focus on communication and collaboration arrangements in the event of an attack on participants' payments systems. The Bank has also engaged an external vendor to conduct a risk assessment of the external connections to RITS and recommend enhancements to current security requirements.

## Analysis

The Reserve Bank's work in the payments area in 2019/20 occurred in an environment of continued shifts in consumer payments away from the use

of cash and cheques and towards cards and other electronic means of payment. There has been rapid technological change and innovation, with new payment products and services being adopted, which can improve the convenience and security of payments to end users, but also bring particular risks and competitive issues into sharper focus. Innovation has also supported the entry of new players into the payments system, with implications for efficiency and competition. The long-term decline in the use of cash for transactions, has highlighted the importance of maintaining secure, resilient and competitive electronic payment services. The security environment for payments has also been evolving, with the growing digitisation of payments raising various types of fraud, scams and cyber risks that need to be managed in order to support confidence in payments.

The Bank's work in the payments area in 2019/20 was heavily affected by the COVID-19 pandemic. In order to reduce the demands on industry stakeholders at a time when they were focused on dealing with the impact of COVID-19, the Bank put on hold its Review of Retail Payments Regulation and the work on developing a new reporting and disclosure framework for retail operational incidents.

The Bank also took steps to reduce potential operational risk associated with the altered operational environment for itself, RITS members and major feeder systems. As the majority of the Bank's staff transitioned to working-from-home arrangements, a small number of personnel occupying critical roles remained on site at each of the Bank's two operating centres to support RITS operations and the Bank's back office settlement operations. Additional personnel were trained and certified to fill critical roles in the event a large number of Bank staff were infected with or exposed to the virus. The Bank also communicated with RITS members and

major RITS feeder systems to advise them of the Bank's arrangements and noting RITS member obligations for continuing their own effective operations. Despite the potential risks associated with the changed working arrangements and heightened settlement activity in March 2020, both RITS and FSS continued to operate smoothly throughout the pandemic.

## Banking

### Purpose

Insofar as the Commonwealth of Australia requires it to do so, the Reserve Bank must act as banker for the Commonwealth. The Bank's banking services fall into two components – services provided in its capacity as the central bank and banking services provided as the transactional banker to the Australian Government and some of its agencies. In common with many other central banks, the Bank also provides banking and custody services to a number of overseas central banks and official institutions. The banking services offered to the Australian Government and other central banks include payments and collections as well as general account maintenance and reporting.

### Results

In providing banking services to Australian Government agencies, the Reserve Bank must cost and price these services separately from its other activities. In addition, the return on providing these services must meet an externally prescribed minimum rate of return on capital over a business cycle. At present, this measure, equivalent to the 10 year yield on Australian Government Securities plus a margin for risk, is the Bank's principal measure of financial performance for its transactional banking business. In 2019/20, the Bank met the prescribed rate. Pro forma accounts for the transactional banking business

are published in the Banking and Payment Services chapter of this annual report.

As the provider of the Commonwealth's Official Public Account, the Bank works closely with both the Department of Finance (Finance) and the Australian Office of Financial Management to ensure the central banking services it provides remain fit for purpose. The Bank continued to work with Finance on its multi-stage plan to modernise Commonwealth cash management. Phase 1 of the project, which was to implement NPP capability for whole-of-government funding payments, was completed in March 2020. This means Government agencies can access their funds in near real-time during business hours and on weekends if required.

During 2019/20, the seven-year project to upgrade the Bank's account maintenance system and banking systems was completed.

The Bank continued to leverage its new Application Programming Interface (API) Gateway implemented in 2018/19, which facilitates fast, secure and automated messaging between the Bank and its customers. Specifically, the Bank assisted Services Australia with leveraging existing API and NPP overlay capabilities to make real-time payments and payment enquiries. In addition, the Bank has continued to participate in the ongoing industry work on further developing NPP services.

The Bank's upgraded banking systems and NPP capabilities enabled the Bank to process a larger volume of payments as part of normal business activities, notably following the Australian bushfires during the summer of 2019/20 and the COVID-19 pandemic.

## Analysis

The banking and payments landscape has continued to evolve, particularly in the area of payment services. The ongoing development of NPP capabilities allows the community to

use this new functionality through the delivery of real-time digital services. Government agencies continue to push ahead with their own initiatives to improve service delivery and achieve productivity gains. Those initiatives that will affect the Bank include: the Services Australia's Welfare Payment Infrastructure Transformation (WPIT) Program; collections and payments programs for the Australian Taxation Office; and Finance's project to modernise Commonwealth cash management. During 2019/20, the Reserve Bank continued to ensure that it remained in a position to respond appropriately with convenient, secure, reliable and cost-effective services as the provider of both central banking and transactional banking services to the Australian Government.

## Banknotes

### Purpose

The Reserve Bank is responsible for the issue, reissue and cancellation of Australian banknotes. Its primary purpose in carrying out this role is to maintain the capacity of Australian banknotes to provide a safe, secure and reliable means of payment and store of value. The Bank works with its wholly owned subsidiary, Note Printing Australia Limited (NPA), to design and produce banknotes. The Bank distributes banknotes to financial institutions, monitors and maintains banknote quality in circulation and withdraws unfit banknotes from circulation. It also monitors and analyses counterfeiting trends and conducts research into banknote security technology.

### Results

The Reserve Bank aims to fulfil 95 per cent of banknote orders received from the major commercial banks within three days of the request; during 2019/20, 100 per cent of orders were fulfilled on the day requested. The Bank

activated its contingency arrangements in March 2020 with the short-term use of the Sydney site for banknote distribution. This opening was in response to heightened demand for banknotes in the face of domestic transport restrictions associated with the COVID-19 pandemic, and the Bank's intent to support the private sector in moving cash to the right places to ensure there was adequate total supply across the country.

The Bank's key initiative to enhance banknote security is the release of the new banknote series with upgraded security features. Work on the Next Generation Banknote program continued during 2019/20, with the new \$20 banknote entering circulation on 9 October 2019 as planned. The Bank implemented a targeted communication strategy to assist with public recognition of the new banknotes. The Bank has been working closely with the cash-handling industry to understand the impact of COVID-19 disruptions on their ability to prepare their machines and be ready for the new \$100 banknote release, which is scheduled to enter circulation in late 2020.

The Bank continued to monitor Australian banknote counterfeiting rates, which remained low by international standards. The estimated counterfeiting rate was 13 parts per million in 2019/20, after having peaked at around 30 parts per million in 2014/15. The Bank also continued to monitor international developments in counterfeiting. This was assisted by engagement with other central banks and international organisations.

NPA met 82 per cent of the Bank's orders for new series banknotes, to the required quality standard and as per the agreed delivery schedule. The shortfall of 18 per cent was the result of an agreed deferral to assist NPA in meeting export orders, and minor delays in the production of \$5,

\$20 and \$100 banknotes owing to the COVID-19 pandemic. These will be delivered in the 2020/21 banknote order. This shortfall in the banknote order did not compromise the Bank's ability to meet public demand or jeopardise its target contingency stock of banknotes.

The quality of banknotes in circulation, as measured by the Bank in agreement with commercial banks, was broadly unchanged at a high level in 2019/20. The measurement of quality, however, was interrupted by the pandemic from February 2020 onwards.

### Analysis

While the proportion of payments made using banknotes is declining relative to electronic payments, the number and value of banknotes on issue continued to rise over 2019/20. This increase was driven in part by a sharp rise in demand associated with the COVID-19 pandemic, which is likely to reflect the importance of cash as a store of value in times of uncertainty and dislocation. The Reserve Bank has continued to meet demand for banknotes by ensuring orders are fulfilled, including by temporarily making available its contingency distribution site in Sydney soon after the onset of the pandemic. The release of the new series of banknotes with upgraded security features is expected to maintain public confidence in banknotes. Australia's level of counterfeiting remains low by international standards.