

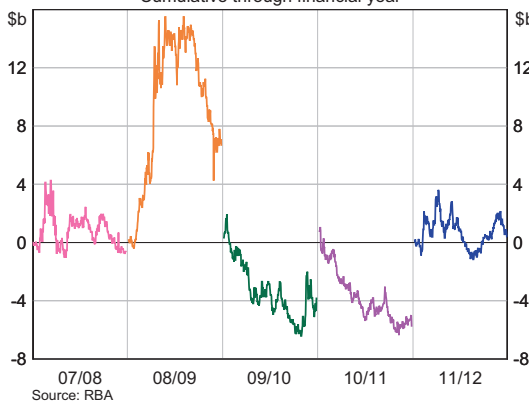
Earnings and Distribution

The Reserve Bank's balance sheet is largely made up of financial assets, primarily used for the purpose of conducting operations in financial markets in pursuit of monetary policy objectives. These assets include Australia's foreign exchange reserves as well as domestic securities used to carry out liquidity management operations. The counterpart liabilities to these assets are banknotes on issue, deposits of the Australian Government and other customers, as well as capital and reserves. While the Bank's balance sheet fluctuates in size, total assets averaged around \$80 billion in 2011/12. The management of these assets is discussed in the chapter on 'Operations in Financial Markets' and a discussion of the associated risks is in the chapter on 'Risk Management'.

The Bank's earnings come from two sources: underlying earnings (mainly net interest) and valuation gains or losses. Underlying earnings arise because the Bank does not pay interest on a large proportion of its liabilities, particularly banknotes in circulation and capital and reserves. In contrast, almost all of its assets earn interest. Valuation gains or losses result from the fluctuation in the value of the Bank's assets with changes in exchange rates and yields on securities. An appreciation of the Australian dollar exchange rate or a rise in interest rates reduces the value of the Bank's securities, resulting in valuation losses. Conversely, a depreciation of the Australian dollar or a decline in market yields has the opposite effect and results in valuation gains. These valuation gains and losses are realised only when the Bank sells the underlying asset; until then they remain unrealised.

Valuation gains and losses are volatile, as market interest rates and the exchange rate can fluctuate across wide ranges over time. The Reserve Bank, however, has limited discretion to manage these foreign exchange and interest rate risks since, as noted, its financial assets are mainly held for policy purposes. Consequently, if the exchange rate appreciates significantly, as it did in the previous two financial years, large valuation losses are inevitable. The potential for such volatility to result in accounting losses is heightened when interest rates around the world (and therefore underlying earnings) are extremely low, as at present. The movements in the exchange rate for the Australian dollar were around a flatter path in 2011/12, with smaller valuation effects than in the preceding two years, when the exchange rate appreciated noticeably.

Valuation Gains and Losses
Cumulative through financial year



Reserves-weighted Exchange Rate*
30 June 2009 = 100



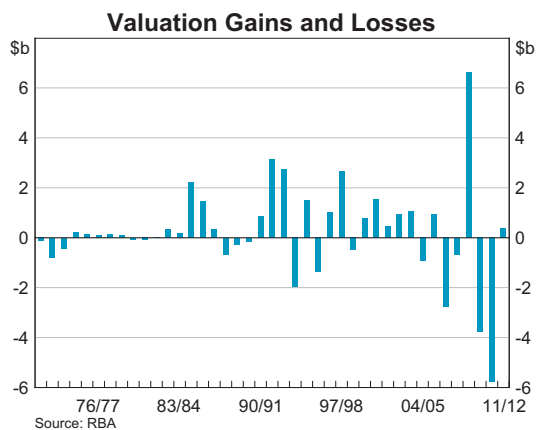
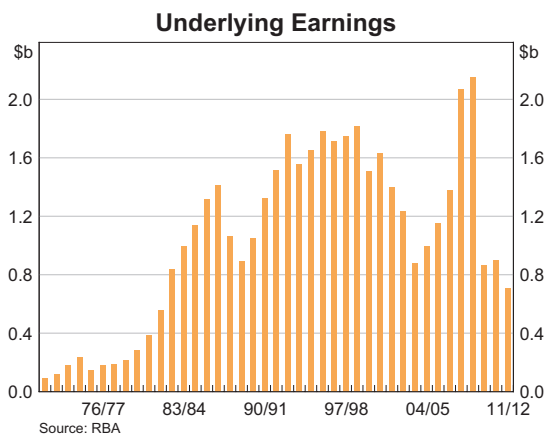
The distribution of the Reserve Bank's earnings is determined by section 30 of the *Reserve Bank Act 1959*. Underlying earnings and realised gains and losses are available for distribution in terms of the Act.

Unrealised gains are not available for distribution, but are transferred to an unrealised profits reserve where they are retained to absorb future valuation losses or until the relevant assets are sold and the gains realised. This feature of the legislative framework reflects sound central banking practice, as it prevents the distribution of unrealised gains, which would reduce the Reserve Bank's capacity to absorb any future valuation losses. Unrealised losses are, in the first instance, also transferred to this reserve, to be offset against unrealised gains accumulated from previous years. If unrealised losses exceed previously accumulated unrealised gains, as occurred in the previous two financial years, the amount by which they do so is initially offset against other sources of income, namely underlying earnings and realised gains, with any remaining losses absorbed by the Reserve Bank Reserve Fund (RBRF), the Bank's permanent general reserve.

Earnings

In accordance with Australian Accounting Standards (AAS), the Reserve Bank reports accounting profit as earnings from all sources, including realised and unrealised valuation gains and losses. In the 12 months to 30 June 2012 the Bank recorded an accounting profit of \$1 076 million, compared with a loss of \$4 889 million in the previous financial year. The accounting profit in 2011/12 comprised:

- underlying earnings of \$710 million, lower than in the previous financial year mainly due to the falls in interest rates in Australia and overseas. In nominal terms, underlying earnings are at their lowest level since before the float of the Australian dollar, reflecting the extremely low level of interest rates around the world
- realised valuation gains of \$405 million, primarily arising from the sale of foreign securities as overseas market yields fell over the course of the year. The Reserve Bank realised valuation gains of \$37 million on domestic securities. Notwithstanding the volatility in currencies, gains of \$59 million were realised from foreign exchange sold at favourable exchange rates in the course of managing international reserves and conducting business for customers
- unrealised valuation losses of \$39 million, partly resulting from the appreciation of the Australian dollar against the euro, which more than offset unrealised gains on foreign and domestic securities and foreign exchange gains from the depreciation of the Australian dollar against the US dollar and yen.



As there were no unrealised gains from earlier years held in the Reserve for Unrealised Profits on Investments, the unrealised loss on investments was charged against other sources of income to determine earnings available for distribution in terms of the Reserve Bank Act. Earnings available for distribution – the sum of underlying earnings and realised gains less unrealised losses on investments – amounted to \$1 096 million in 2011/12.

The composition and distribution of the accounting profit in 2011/12, and of historical profits and losses, are summarised in the table on page 64.

Reserves and Dividend

The RBRF is established by the Reserve Bank Act and has been funded over the years by transfers from earnings available for distribution. Under the Reserve Bank Act, sums may be credited to the RBRF from earnings available for distribution as determined by the Treasurer, after consulting the Board. The balance of distributable earnings after any such transfer is payable as a dividend to the Australian Government. The RBRF is essentially the Bank's capital, with its primary purpose being to provide the capacity to absorb losses when it is necessary to do so. The RBRF was substantially depleted in 2009/10 and 2010/11 as it absorbed accounting losses.

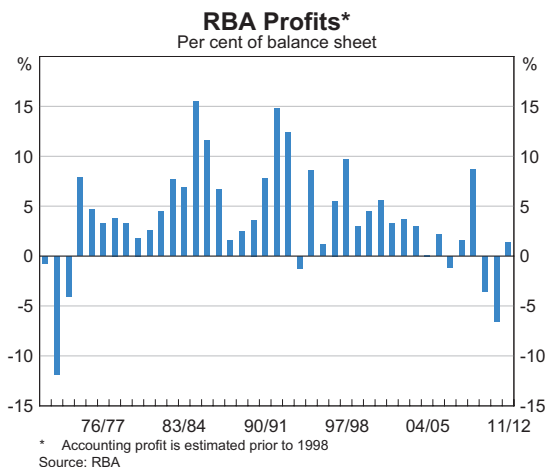
The Board reviews the adequacy of the RBRF against the market risks held on the Bank's balance sheet. With the substantial depletion of the RBRF in previous financial years, the Board will seek to replenish this reserve over time to a level more appropriate to the risks faced by the Bank. After consultation with the Board, the Deputy Prime Minister and Treasurer has determined that a sum of \$596 million be placed to the credit of the RBRF from earnings available for distribution in 2011/12 and a sum of \$500 million will be paid as a dividend to the Australian Government. The transfer to the RBRF will increase the balance of this reserve to \$1 913 million. The purpose of this transfer is to start to replenish the Bank's capital following recent losses, i.e. it does not reflect any heightened concern about the credit quality of either the Bank's assets or the expanded range of collateral it holds. The dividend is usually paid early in the financial year following the year in which profits are earned.

In addition to the RBRF, the Reserve Bank maintains a number of other financial reserves. As noted, unrealised gains are transferred to the Unrealised Profits Reserve to absorb future valuation losses or to be realised, and distributed, when the relevant assets are sold. Since this reserve was fully exhausted by the large valuation losses of the past two financial years, the unrealised loss on investments of \$19 million recorded in 2011/12 will be charged against other income; the balance of this reserve remains nil.

Asset revaluation reserves are held for non-traded assets such as gold holdings, property, plant and equipment. Balances in these reserves represent the difference between the market value of these non-traded assets and the cost at which they were acquired. The total balance in these reserves stood at \$4 375 million on 30 June 2012, \$454 million higher than a year earlier. This mainly reflects the increase in the Australian dollar value of the Reserve Bank's gold holdings.

The balance of the RBRF plus asset revaluation reserves stood at 7.8 per cent of total assets on 30 June 2012.

The Reserve Bank's financial statements (and accompanying Notes to the Accounts) for the 2011/12 financial year were prepared in accordance with AAS, consistent with the Finance Minister's Orders issued under the *Commonwealth Authorities and Companies Act 1997*.



Composition and Distribution of Reserve Bank Profits

\$ million

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

(a) Excludes gains or losses realised from the sale of fixed assets that had been held in asset revaluation reserves
Source: RBA