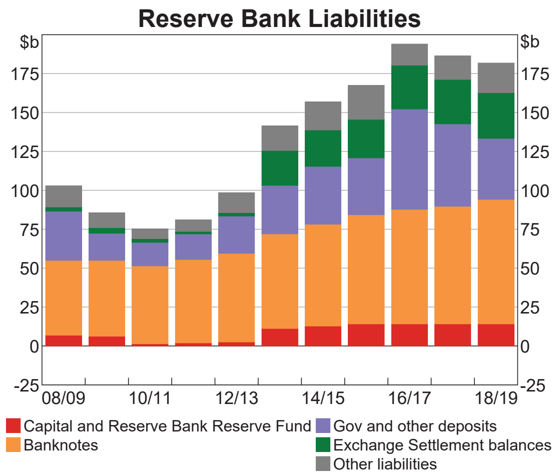
Operations in Financial Markets

The Reserve Bank operates in domestic and international financial markets in order to achieve its policy objectives. These operations include implementing the monetary policy decisions of the Reserve Bank Board, facilitating the smooth functioning of the payments system, managing the nation's foreign exchange reserve assets and providing banking services to clients (mainly the Australian Government and foreign central banks).

Balance Sheet

Over the past year, the Reserve Bank's balance sheet decreased by $5 billion and ended the 2018/19 financial year at $182 billion. The decrease in liabilities owed mainly to a decrease in deposits held by the Australian Government with the Bank. These deposits are used by the government to manage the timing of its receipts and outlays and can vary considerably over the course of a year. On the asset side of the balance sheet, the decrease in liabilities was matched by a decrease in foreign exchange swaps and repurchase agreements (repos).[1]

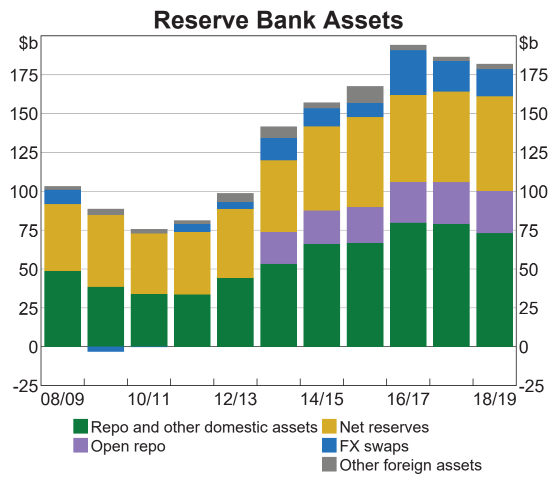


Source: RBA

Domestic Market Operations

Monetary policy implementation

The Reserve Bank Board's operational target for monetary policy is the cash rate – the rate at which banks borrow and lend to each other on an overnight, unsecured basis. The Board adjusted the cash rate target once during 2018/19, from 1.50 per cent to 1.25 per cent in June 2019. The cash rate was reduced by a further 25 basis points to 1.00 per cent in July 2019. The daily liquidity



Source: RBA

1 A repo involves an agreement to buy and then later sell securities; this is economically similar to a secured loan, with the difference between the purchase and sale price representing the interest earned on the transaction.

management operations of the Reserve Bank were conducted so as to ensure that the cash rate was consistent with the target set by the Board.

The funds traded in the cash market are the balances held by financial institutions in their Exchange Settlement Accounts (ESAs) at the Reserve Bank. These accounts are held by around 100 financial institutions and are used to settle payment obligations between these institutions. The aggregate level of Exchange Settlement (ES) balances changes as a result of payments made or received by customers of the Bank (principally the Australian Government) and ESA holders. The Bank also undertakes transactions on its own behalf to affect ES balances available to financial institutions. This includes undertaking repos collateralised with eligible securities, buying or selling government securities on an outright basis, or using foreign exchange swaps involving Australian dollars. The Bank conducts these transactions with a view to maintaining the aggregate level of ES balances consistent with demand at the cash rate target.

The bulk of ES balances arise from 'open repos'. These are repos contracted without a maturity date with the Reserve Bank by financial institutions to meet their liquidity needs outside of normal banking hours. As these balances are remunerated at the cash rate target and are held to facilitate the effective operation of the payments system, they have no implications for the implementation of monetary policy. At the end of June 2019, these balances were around $27 billion.

The remainder of ES balances, referred to as surplus ES balances, fluctuated between $2 billion and $3 billion in line with demand during 2018/19. ESA holders are not allowed to have a deficit in their account and any surplus balances are remunerated at an interest rate that is 25 basis points below the cash rate target. Therefore, ESA holders typically aim to maintain a small surplus in their accounts. Day-to-day demand for these surplus ES balances can vary for a number of reasons. In particular, at times, some institutions choose to hold ES balances as high-quality liquid assets (HQLA) to comply with prudential requirements. There can also be increased demand for holding liquid balances at the central bank (in the form of ES balances) at certain times of the year.

As well as ensuring that the cash rate remains consistent with the target, the Reserve Bank is responsible for calculating and publishing the cash rate. The Bank calculates the cash rate directly from market transactions, sourcing individual transaction data from the Reserve Bank Information and Transfer System (RITS). In 2018/19, there was an average of 33 cash market transactions each day, with aggregate daily activity in the cash market averaging around $4 billion.

Open market operations

On a day-to-day basis, the Reserve Bank transacts in domestic markets to ensure that the demand and supply for ES balances remains consistent with attaining the cash rate target set by the Reserve Bank Board. Through these open market operations (OMO), ES balances are supplied in order to offset the effect on the availability of ES balances arising from the payment flows between ESA holders and the Bank (discussed above), and to accommodate changes in aggregate demand for ES balances by financial institutions. The Bank publishes the aggregate results of its OMO dealing rounds on market data services and on its website each day.

Most of the Reserve Bank's transactions in the domestic market are repos contracted as part of its regular morning OMO. Repos involve the purchase of high-quality collateral securities where the Bank acquires the securities for a period of time in return for providing cash (i.e.

funds deposited into an ES account). As a result, there is very little risk of the Bank suffering financial loss in its operations. The securities accepted by the Bank include securities issued by the Australian Government, the Australian states and certain approved international sovereign and supranational issuers. Securities issued by authorised deposit-taking institutions (ADIs), such as bank bills and bonds, and residential mortgage-backed securities (RMBS) are also eligible for repo in the Reserve Bank's OMO.

In conducting its operations, the Reserve Bank takes account of its forecasts of the liquidity needs of the financial system, as well as of the pricing of the bids and offers received in the OMO dealing round. In 2018/19, the repo transactions conducted in these operations had an average maturity at origination of around 37 days and a maximum term of around six months. Reflecting the role that repos play in managing system liquidity, the total amount of cash outstanding that was extended by the Bank under repo (the 'repo book') averaged around $60 billion during the financial year. The Bank lent cash under repo to banks, insurance companies, non-bank securities firms and government institutions.

To ensure that unexpected payment flows during the day do not adversely affect the cash rate, the Reserve Bank has the option of undertaking a second round of market operations in the late afternoon. Such additional rounds were announced, on average, four times per month during 2018/19, with around two-thirds of these operations offering to withdraw additional liquidity from the system. Terms for these operations are typically shorter than the morning operations, with a maximum term of around eight days in 2018/19. In the event of unforeseen liquidity developments in the evening, further dealing rounds can be announced if the need arises, although no such operations were conducted in 2018/19.

On 30 August 2018, routine maintenance of the Reserve Bank's fire control systems caused an interruption of power to the Bank's main data centre, temporarily disrupting some payments systems (see the chapter on 'Risk Management' for more detail). Towards the end of that day, the Bank conducted an additional round of dealing to support liquidity and injected $2.4 billion under repo for an overnight term.

The Reserve Bank also uses foreign exchange swaps when managing system liquidity (swapping Australian dollars for foreign currencies increases the supply of ES balances in the same way as a repo transaction).[2] This is necessary because of the limited capacity of the domestic repo market to absorb sizeable fluctuations in the Bank's positions, such as those associated with large maturities of Australian Government Securities (AGS). Reflecting the role of the Bank's foreign exchange swaps in assisting with short-term liquidity management, these swaps have typically been contracted at maturities of around one month.

The Reserve Bank purchases government securities on an outright basis to assist in the management of large AGS maturities. This reflects the Bank's need to mitigate the liquidity impact on the bond's maturity date of the funds that are paid out of the Australian Government's account at the Bank into ESAs (for the credit of the security holder). These purchases for liquidity management purposes are carried out for near-to-maturity securities (usually less than 12 months). They have no implications for the stance of monetary policy. To offset the liquidity effect of AGS maturities, the Bank purchased $4.3 billion of the October 2018 bond and $7.7 billion of the March 2019 bond prior to their

2 While the use of foreign exchange swaps increases the Reserve Bank's holdings of foreign exchange, it has no effect on net foreign reserves, as the increased holdings of foreign exchange are matched with a commitment to sell foreign exchange at a predetermined price and date. For the same reason, the use of swaps has no effect on the exchange rate.

maturity. Given the overall size of these maturities, the Bank also contracted sizeable repos and foreign exchange swaps to offset their impact on ES balances. In recent years, the Australian Office of Financial Management (AOFM) has also been buying back AGS directly in the secondary market prior to the maturity date, but typically ceases to do so around the time that the Bank enters the market to commence its purchases. These buybacks by the AOFM assist the Bank in managing the liquidity impact of a maturity. In preparation for the large AGS maturities scheduled for 2019/20, by the end of June 2019, the Bank had purchased $4.3 billion of the October 2019 bond and $2.6 billion of the April 2020 bond. The Bank's outright holdings of AGS are published monthly on the Bank's website.

The Reserve Bank holds a small amount of longer-term semi-government securities (semis) on an outright basis in its domestic portfolio. These are available to be sold as collateral under repo when the Bank conducts operations to drain liquidity from the overnight money market. At the end of 2018/19, the Bank held around $2 billion of semis on an outright basis. These securities are generally purchased as part of the Bank's daily OMO or separately through outright purchase operations.

The Reserve Bank continues to operate a Securities Lending Facility on behalf of the AOFM. The securities available through the facility comprise all Treasury Bonds and Treasury Indexed Bonds currently on issue. The Bank sells these securities under intraday or open repos to RITS members eligible to participate in the Bank's domestic market operations. The Reserve Bank is also willing to lend securities from its outright portfolio under repo in response to enquiries from eligible counterparties.

Standing facilities

Separate from its OMO, the Reserve Bank also provides certain standing facilities, primarily to support the smooth functioning of the payments system. Through these facilities, eligible counterparties transact with the Bank on pre-arranged terms, with liquidity made available via repos. The most frequently used standing facilities are those for the provision of intraday liquidity to ESA holders. The Bank can also extend overnight funding via repo where an ESA holder faces a shortage in ES balances that cannot be borrowed from another financial institution; such funding is extended at an interest rate of 25 basis points above the cash rate target. During 2018/19, these arrangements were used only occasionally for small values, including for testing purposes.

Open repos are provided under the Reserve Bank's standing facilities for ESA holders that have to settle payment obligations outside normal business hours, such as 'direct-entry' payments and transactions through the New Payments Platform (see the chapter on 'Banking and Payment Services' for more detail). At the end of June 2019, 16 financial institutions had open repo positions with the Bank, valued at around $27 billion. To collateralise these open repos, the Bank has permitted the use of certain related-party assets issued by bankruptcy remote vehicles, such as self-securitised RMBS.

Eligible securities

The eligibility of securities for purchase under repo in the Reserve Bank's domestic operations is determined according to specific criteria.[3] To protect against a decline in the value of the collateral securities should the Bank's counterparty not meet its repurchase obligation, the Bank requires the value of the securities to exceed the cash lent by a certain margin. These margins, which are listed on the Bank's website, are considerably higher for securities that are not issued by governments.[4]

3 See <https://www.rba.gov.au/mkt-operations/resources/tech-notes/eligible-securities.html>.

4 See <https://www.rba.gov.au/mkt-operations/resources/tech-notes/margin-ratios.html>.

Participants in the Reserve Bank's market operations tend to be the fixed-income trading desks of banks and securities firms, as well as bank treasuries. Reflecting this, over half of the securities held by the Bank (excluding those under open repo) are government-related obligations, with most of the remainder being bank-issued debt securities and RMBS.

Domestic securities purchased by the Reserve Bank are held in an account that the Bank maintains in Austraclear, the central securities depository operated by the Australian Securities Exchange (ASX). Securities transactions conducted between the Bank and its counterparties are settled in the Austraclear system, mostly on a bilateral basis. The Bank also settles repo transactions contracted in its OMO within ASX Collateral, a collateral management service. During 2018/19, around 36 per cent of the value of securities the Bank purchased under repo was settled within ASX Collateral, up from around 30 per cent in 2017/18. The use of this system reduces the manual processing that would otherwise be required to manage this collateral, including marking it to market and maintaining margins.

Asset-backed securities form a significant share of the collateral securities the Reserve Bank purchases under open repo. Around 95 per cent of the outstanding value of open repos is backed by self-securitised RMBS. Self-securitised RMBS do not have directly observable market prices. As a result, the Bank uses an internal valuation model for self-securitised RMBS based on observed market prices of similarly structured RMBS; this internal model has been reviewed externally.

Asset-backed securities – particularly self-securitised RMBS – are also the major asset provided as collateral for the Committed Liquidity Facility (CLF) (see below). Given the importance of asset-backed securities to the Reserve Bank's operations, the Bank has mandatory reporting requirements for securitisations to remain eligible for repo. In 2018/19, the Bank received around 4,100 data submissions monthly on around

Australian Dollar Securities Held under Repurchase Agreements[(a)]
30 June

	2016		2017		2018		2019	
	$ billion	per cent of total	$ billion	per cent of total	$ billion	per cent of total	$ billion	per cent of total
AGS	32.8	35	43.8	43	49.9	48	36.5	37
Semis	7.4	8	6.2	6	8.7	8	12.7	13
Supranational	3.4	4	3.5	3	3.6	3	2.8	3
Government guaranteed	0.0	0	0.0	0	0.0	0	0.0	0
ADI issued	16.8	18	12.5	12	8.1	8	12.9	13
Asset-backed securities	31.6	34	35.6	35	32.7	32	33.5	34
– Of which for open repo	27.2	29	33.5	33	32.3	31	32.4	33
Other	0.6	1	0.6	1	0.6	1	0.4	0
Total	92.5	100	102.2	100	103.7	100	98.8	100
– Of which for open repo	29.3	32	35.7	35	34.2	33	34.5	35

(a) Market value of securities before the application of margins; includes securities held under triparty repurchase agreements
Sources: CEIC; RBA

300 asset-backed securities from issuers or their appointed information providers. For eligible RMBS, this covers 1.7 million underlying individual housing loans with a combined balance of around $430 billion, which is around one-quarter of the total value of housing loans in Australia. The required data include key information on the structure of the RMBS and the relationships among counterparties within the RMBS structure; the required data also include anonymised information on each of the residential mortgage loans and the underlying collateral backing the RMBS structures.

Reflecting the Reserve Bank's interest in promoting transparency for investors in asset-backed securities, issuers are also required to make securitisation information available to investors and other permitted users. The data provided to these users are broadly similar to the data provided to the Bank; however, issuers may redact particular fields where the information poses a potential risk to privacy obligations and provide aggregated data instead. The mandatory reporting requirements allow the Bank (and other investors in RMBS) to analyse in detail the underlying risks in asset-backed securities and to price and manage risk for such securities accurately.[5]

Committed Liquidity Facility

Banks subject to the Liquidity Coverage Ratio (LCR) under Basel III prudential standards are required to hold sufficient HQLA (which, in the Australian context, consist of AGS and semis) to meet outflows during a period of stress of 30 days. Given the relatively low levels of government debt outstanding in Australia, there is a shortage of HQLA securities. To address this, the Reserve Bank provides some institutions with a contractual commitment to provide repo funding – the CLF – subject to certain conditions. These conditions include a fee that financial institutions pay on the committed amount. In addition, any bank seeking to use the CLF must have positive net worth. The banks are able to contract these repos using securities eligible in the Bank's domestic market operations. The full terms and conditions of the facility are available on the Bank's website.[6]

The Reserve Bank administers the CLF, while APRA determines which banks have access and the amount available (in aggregate and to each bank). During 2018/19, 15 banks were permitted to access the CLF. The aggregate size of the CLF is the difference between the Australian Prudential Regulation Authority's (APRA's) assessment of banks' overall LCR requirements and the Bank's assessment of the amount of HQLA securities that could reasonably be held by the banking system without unduly affecting market functioning.

In determining the amount of HQLA securities that the banking system can reasonably be expected to hold, the Reserve Bank takes into account factors such as the holdings of other market participants and the impact on the liquidity of HQLA securities in secondary markets. For 2015–19, the Bank assessed that the relevant banks could reasonably hold 25 per cent of the stock of HQLA securities. Over recent years, the volume of HQLA securities has risen and they have become more readily available in bond and repo markets. Given this, the Bank has assessed that the banks can increase their holdings to 30 per cent of the stock. To minimise the effect on market functioning, the increase in the banks' reasonable holdings of HQLA securities will occur at a pace of 1 percentage point per year until 2024, commencing with an increase to 26 per cent in 2020.

5 Analysis of the securitisations data was included in speeches by Christopher Kent, Assistant Governor (Financial Markets), in November 2018 and March 2019. See <https://www.rba.gov.au/speeches/2018/sp-ag-2018-11-26.html> and <https://www.rba.gov.au/speeches/2019/sp-ag-2019-03-19.html>.

6 The CLF legal documentation is available at <https://www.rba.gov.au/mkt-operations/resources/tech-notes/pdf/clf-terms-and-conditions.pdf> and <https://www.rba.gov.au/mkt-operations/resources/tech-notes/clf-operational-notes.html>.

For 2019, APRA assessed banks' overall LCR requirements to be $468 billion and the Reserve Bank assessed the banks' reasonable holdings of HQLA securities to be $225 billion, such that the total size of the CLF was $243 billion. This was $6 billion lower than the total size of the CLF in 2018, largely reflecting lower projected net cash outflows. For 2020, the Bank has assessed that banks can reasonably hold $242 billion of HQLA securities.

Since the CLF was introduced in 2015, the Reserve Bank has charged a CLF fee of 15 basis points per annum on the commitment to each bank. The fee is set so that the banks face similar financial incentives to meet their liquidity requirements through the CLF or by holding HQLA. Following a review, the Bank assessed that the CLF fee should be increased. To minimise the effect on market functioning, the increase will occur in two steps, with the CLF fee rising to 17 basis points on 1 January 2020 and to 20 basis points on 1 January 2021.[7]

Administration of the cash rate

The Reserve Bank is the administrator of the cash rate, which is the operational target for monetary policy. The cash rate is also a significant financial benchmark referenced in overnight indexed swaps and the ASX's 30-day interbank futures contracts. The Bank publishes the *Cash Rate Procedures Manual*, which sets out in more detail the Bank's arrangements for administering the cash rate and the procedures for handling errors and complaints.[8] In 2019, the Bank made amendments to the *Cash Rate Procedures Manual* to clarify that the Bank is not required by the Australian Securities and Investments Commission (ASIC) to be licensed as a benchmark administrator under Australia's benchmarks regulatory regime. The amendments also provided detailed information about the Bank's use of expert judgement when administering the cash rate, business continuity arrangements and procedures for complaints and whistle-blowing.

Foreign Exchange Operations

The Reserve Bank transacts in the foreign exchange market on almost every business day. The majority of these transactions are associated with providing foreign exchange services to the Bank's clients, the most significant of which is the Australian Government.

The Reserve Bank typically purchases the necessary foreign currency in the spot market. During 2018/19, the Bank bought $10 billion in the spot market to facilitate its customer business. However, the Bank retains the option – especially during periods of market stress – to use its existing stock of foreign currency reserves to fund its customer business, subsequently replenishing those reserves when market conditions have stabilised. Using foreign currency reserves in this manner has not been considered necessary since 2008, at which time global financial market functioning was significantly impaired. Similarly, the Bank has not intervened in the foreign exchange market since 2008. During 2018/19, the Bank's assessment was that trading conditions in the market were sufficiently orderly that it was not necessary to support liquidity in the market through its own transactions. The Bank nevertheless retains the discretion to intervene in the foreign exchange market to address any dysfunction and/or a significant misalignment in the value of the Australian dollar. With each Annual Report, intervention data for the year under review are published on the Bank's website.

7 The adjustments made to the CLF were explained in a speech by Christopher Kent, Assistant Governor (Financial Markets), in July 2019, with further details provided in a *Bulletin* article. See <https://www.rba.gov.au/speeches/2019/sp-ag-2019-07-23.html> and <https://www.rba.gov.au/publications/bulletin/2019/sep/the-committed-liquidity-facility.html>.

8 See <https://www.rba.gov.au/mkt-operations/resources/cash-rate-methodology/cash-rate-procedures-manual.html>.

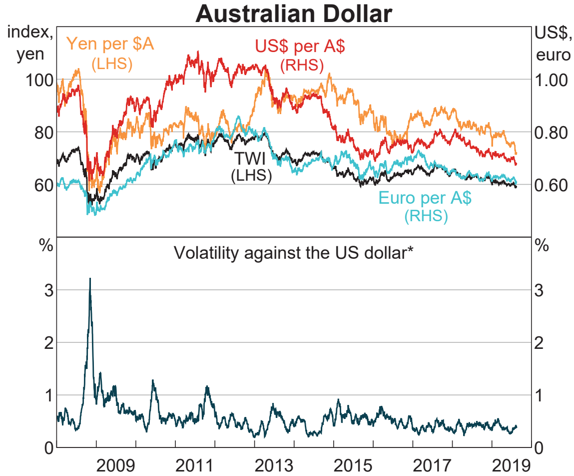
The Reserve Bank also transacts in the foreign exchange market when managing its foreign currency reserves. As discussed below, the relative weightings of foreign currencies in the Bank's portfolio are tightly managed against a benchmark. To maintain the portfolio at these benchmark weights, or to accommodate discrete changes in the weights, the Bank transacts in spot foreign exchange markets. The final settlement of these rebalancing flows may be deferred through the use of foreign exchange swaps, whereby one currency is exchanged for another with a commitment to unwind the exchange at a subsequent date at an agreed (forward) rate. Swaps can also be an efficient way to manage the shorter-term investments within the reserves portfolio. During 2018/19, the Bank generally maintained around $20 billion in swaps for these purposes.

As discussed above, the Reserve Bank also makes use of foreign exchange swaps in its domestic market operations. Swapping Australian dollars for foreign currencies does not affect the exchange rate, but alters the supply of ES balances in the same way as the Bank's repo transactions. Throughout the year, the amount of foreign currency held under swaps against Australian dollars can vary significantly. In 2018/19, the amount held by the Bank ranged between $3 billion and around $25 billion.

Foreign currency swaps executed by the Reserve Bank are generally for no more than three months' duration. The resulting forward foreign exchange positions with each of the Bank's counterparties are marked to market daily and collateral is held against net exposures. The terms under which collateral is exchanged are defined in two-way credit support annexes to the International Swaps and Derivatives Association Master Agreements that the Bank has executed with each of its counterparties (see the chapter on 'Risk Management' for more detail).

The Reserve Bank's activities in the foreign exchange market are conducted in a manner consistent with the principles of the FX Global Code. A 'Statement of Commitment to the FX Global Code' has been signed on behalf of the Bank.[9] Further, the Bank only transacts in the foreign exchange market with counterparties that have also signalled their adherence to the code by signing such statements.

Australian Dollar



* Daily absolute percentage change, 22-day rolling average
Sources: RBA; Refinitiv

Reserves management

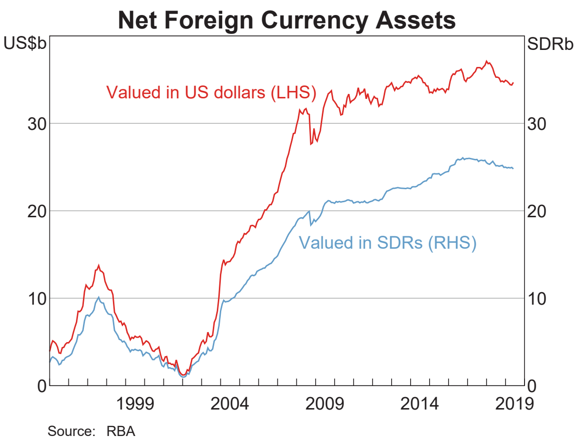
Australia's official reserve assets include foreign currency assets, gold, Special Drawing Rights (SDRs – an international reserve asset created by the International Monetary Fund (IMF)) and Australia's reserve position in the IMF. At 30 June 2019, these assets totalled $77.5 billion. All components of official reserve assets are owned and managed by the Reserve Bank, with the exception of Australia's reserve position in the IMF, which is an asset of the Australian Government.

Official reserve assets are held by the Reserve Bank to facilitate various policy operations, including in the foreign exchange market (described above) and to assist the Australian Government in meeting its commitments to the IMF (discussed below). The Bank's capacity to undertake such operations

9 For the Reserve Bank's Statement of Commitment, see <https://www.rba.gov.au/mkt-operations/pdf/statement-of-commitment-to-fx-global-code.pdf>.

is best measured by its foreign currency assets net of any forward commitments (such as foreign currency the Bank has obtained from short-term swaps against the Australian dollar). As at 30 June 2019, these net foreign currency assets were SDR24.8 billion or US$34.7 billion. (In Australian dollar terms, net foreign currency assets totalled $49.4 billion, an increase of $1.2 billion since 30 June 2018, reflecting valuation effects.) The amount held represents the level assessed as necessary to meet policy requirements.

To ensure a strong balance sheet, the Reserve Bank holds capital against certain risks arising from its reserve assets (see the chapter on 'Earnings, Distribution and Capital' for more detail). These assets can expose the Bank to market, liquidity and credit risk, which the Bank seeks to mitigate where possible, such as by holding a diversified portfolio and investing only in assets of high credit quality and appropriate liquidity (see the chapter on 'Risk Management' for more detail).



Foreign Assets
30 June 2019

	A$m
Official Reserve Assets	77,470
Foreign Currency	64,910
Gold	4,440
SDRs	6,170
Reserve Position in the IMF	1,950
Other Foreign Currency Assets	–53
Net Forward Commitments	–14,694
Foreign currency	–15,412
Gold loans	718
Net Foreign Reserves	62,723
Memo item:	
Net Foreign Currency Assets	49,445

Source: RBA

The composition of the Reserve Bank's net foreign currency assets is managed against an internally constructed benchmark that reflects the Bank's need to maintain effective intervention capacity. Subject to this constraint, and the Bank's overall risk tolerance, the benchmark is assessed to be the combination of foreign currencies and foreign currency assets that maximises the Bank's expected returns over the long run. The structure of the benchmark is reviewed periodically and in response to significant changes in market conditions.

During 2018/19, no changes were made to the currency allocation of the benchmark portfolio. The Reserve Bank maintains the largest allocation to the US dollar at 55 per cent, reflecting the significant liquidity in US dollar currency and asset markets.

Reflecting the generally low level of global interest rates, duration targets have remained short for most of the foreign currency portfolios. Short duration targets reduce the risk of capital losses in the event yields in these currencies increase in the future.

Investments in the benchmark currencies are limited to deposits at official institutions (such as central banks) and debt instruments issued (or guaranteed) by sovereign entities, central banks and supranational agencies. Debt instruments issued by quasi-sovereign entities can also be accepted as collateral under reverse repos.

Sovereign credit exposures are currently limited to the United States, Germany, France, the Netherlands, Canada, Japan, China, the United Kingdom and South Korea.

Benchmark Foreign Currency Portfolio

30 June 2019

	US dollar	Euro	Japanese yen	Canadian dollar	Chinese renminbi	UK pound sterling	South Korean won
Currency allocation (per cent of total)	55	20	5	5	5	5	5
Duration (months)	6	6	<3	6	18	3	18

Source: RBA

At the end of June 2019, the Reserve Bank's holdings of foreign currency included $17.6 billion of foreign currency held from swaps against Australian dollars. Foreign currency obtained in this manner does not comprise part of the benchmark portfolio but reflects domestic liquidity operations. It is invested to ensure that the Bank's forward commitments to sell foreign currency are hedged against currency and interest rate risk.

As has been the case for some years, when the cost of hedging currency risk is taken into account, yields on short-dated Japanese investments have generally exceeded those available in the other currencies in the Reserve Bank's portfolio. Reflecting this, the bulk of the foreign currency the Bank obtains from swaps against Australian dollars is Japanese yen.

For the same reason, the Reserve Bank also swaps other currencies in its foreign exchange reserves portfolio against the yen to enhance returns. As a consequence, while the Bank's exposure to changes in the value of the yen remains small (consistent with the yen's 5 per cent allocation in the benchmark), an additional $20 billion of yen was held at the end of June 2019 as a result of swaps against other foreign currencies in the portfolio.

A small component of the Reserve Bank's net foreign currency reserves sits outside the benchmark framework. These assets encompass investments in a number of Asian debt markets through participation in the Executives' Meeting of East Asia and Pacific Central Banks (EMEAP) Asian Bond Fund Initiative. This initiative was established following the Asian currency crisis in the late 1990s to assist in the development of bond markets in the region. At the end of June 2019, the total allocation of the Bank's reserves to these funds was $707 million and the return on these investments in 2018/19 was 7.8 per cent when measured in SDR terms, largely reflecting interest earnings and capital gains on bond holdings.

Measured in SDRs, the overall return on the Reserve Bank's foreign currency assets over 2018/19 was 2.0 per cent. This return was slightly higher than that in each of the previous three years, reflecting a higher average level of yields on short-term securities and a positive effect of exchange rate valuation changes. The average running yield on the benchmark portfolio increased by 0.5 per cent to 1.5 per cent over 2018/19, largely driven by higher average short-term yields for the US dollar portfolio. Yields remained negative and relatively stable for the euro portfolio.

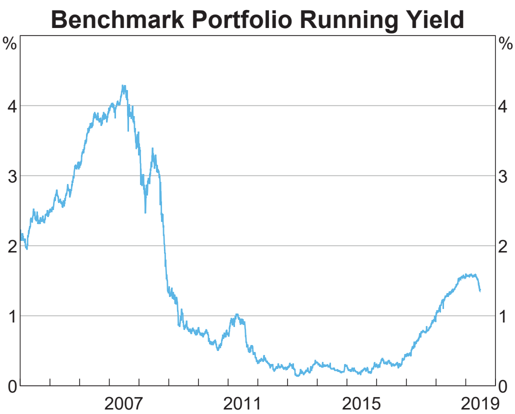
The Reserve Bank's holdings of SDRs at 30 June 2019 amounted to $6.2 billion, $0.6 billion higher than the previous year, mainly owing to the depreciation of the Australian dollar against the SDR. Under voluntary arrangements with the IMF, the Bank is willing to transact in SDRs upon request from other countries or prescribed holders. In these transactions, the Bank will generally either buy or sell SDRs in exchange for foreign currencies (such as euros or US dollars). While such transactions do not alter the level of Australia's reserve assets (only the respective proportions held in SDRs and foreign currency),

Foreign Currency Assets(a)

A$ million, 30 June 2019

Currency	Securities held outright	Securities lent under repurchase agreements	Deposits at official institutions(b)	Total (gross)	Forward FX commitments(c) Against AUD	Against other currencies	Other	Total (net)
US dollar	9,497	–339	1,298	10,456	159	14,495	1,614	26,724
Euro	2,951	–	3,005	5,957	–21	3,200	487	9,623
Japanese yen	16,531	–	23,830	40,361	–17,737	–20,019	–	2,605
Canadian dollar	533	–	5	539	–	1,946	–	2,484
Chinese renminbi	1,878	–	580	2,458	–	–	–	2,458
UK pound sterling	2,343	–	5	2,348	–2	88	–	2,434
South Korean won	2,323	–	83	2,406	–	–	–	2,406
Total	36,057	–339	28,807	64,525	–17,601	–291	2,101	48,734

(a) Excludes investments in the Asian Bond Fund
(b) Includes deposits at foreign central banks and the Bank for International Settlements
(c) In accordance with IMF guidelines, 'forward commitments' reflect notional values of unsettled spot and forward transactions, converted to Australian dollars at the prevailing forward exchange rate. Other forward commitments largely reflect cash lent under repurchase agreements.
Source: RBA



Source: RBA

the Bank occasionally chooses to replenish foreign currency sold in exchange for SDRs by purchasing additional foreign currency against Australian dollars in the spot market.

Australia's reserve position in the IMF comprises that part of Australia's quota in the IMF that is paid in foreign currency as well as other credit that Australia has extended to the IMF in support of its lending programs. At the end of June 2019, Australia's reserve position in the IMF was $2.0 billion, $0.6 billion larger than a year earlier, mainly reflecting greater provision of foreign currency to the IMF. As noted above, Australia's reserve position in the IMF is not held on the Reserve Bank's balance sheet. However, the Bank will sell to (or purchase from) the Australian Treasury the foreign currency the Treasury needs to complete its transactions with the IMF. In contrast to other foreign exchange transactions with the Australian Government, the Bank will typically draw on (or add to) its foreign currency reserves when providing (or receiving) foreign currency for IMF-related purposes because these transactions do not alter the level of Australia's reserve assets. Nevertheless, as with SDR transactions, on certain occasions the Bank may decide to offset the impact on foreign currency holdings of these IMF transactions by buying or selling foreign currency in exchange for Australian dollars in the spot market.

… overall return on the Reserve Bank's foreign currency assets … was 2.0 per cent … slightly higher than that in each of the previous three years

Gold holdings (including gold on loan) at the end of June 2019 were around 80 tonnes, unchanged from the previous year. Gold prices rose by 18.8 per cent in Australian dollar terms over 2018/19, increasing the value of the Reserve Bank's holdings of gold by around $0.8 billion to $5.2 billion. At $0.9 million, income from gold loans was slightly higher than the previous year as a result of increased lending. The Bank's activities in the gold market are conducted in a manner consistent with the principles of the Global Precious Metals Code, and a 'Statement of Commitment to the Global Precious Metals Code' has been signed on behalf of the Bank.[10] During the year in review, the Bank audited its gold holdings, including that portion stored at the Bank of England.

Bilateral currency swaps

In December 2018 and March 2019, the Reserve Bank renewed bilateral local currency swap agreements with Bank Indonesia and the Bank of Japan. The agreement with Bank Indonesia allows for the exchange of local currencies between the two central banks of up to A$10 billion or IDR100 trillion, while the agreement with the Bank of Japan allows for the exchange of local currencies between the two central banks of up to A$20 billion or JPY1.6 trillion. These agreements are for a further three years and can be extended by mutual consent. The Reserve Bank has similar agreements with the People's Bank of China and the Bank of Korea. The purpose of these agreements is to allow each central bank to support trade settlement in local currencies, particularly in times of market stress, or to support financial stability.

RBA Bilateral Local Currency Swap Agreements[(a)]
June 2019

	Agreement signed/renewed	**Size (A$b)**
People's Bank of China	April 2018	40
Bank of Japan	March 2019	20
Bank Indonesia	December 2018	10
Bank of Korea	February 2017	10

(a) All swap agreements have 3-year terms
Source: RBA

10 For the Reserve Bank's Statement of Commitment, see <https://www.rba.gov.au/mkt-operations/pdf/statement-of-commitment-to-the-global-precious-metals-code-february-2019.pdf>.