RESERVE
BANK
of
AUSTRALIA

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ANNUAL REPORT 2009

Reserve Bank

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Governor's Foreword

2008/09 was an even more turbulent year for the global financial system than the year before. After a lengthy period of escalating tension, the failure of Lehman Brothers in mid September 2008 was the catalyst for the most serious and widespread financial crisis in generations. Confidence in the soundness of financial institutions and systems was seriously impaired. Share prices fell heavily, and demand for durable goods slumped as households and firms all over the world adopted a much more precautionary attitude both to current spending and to their financial positions.

Governments and central banks of major countries had to resort to extraordinary measures to stabilise financial systems and institutions, including issuing guarantees, taking ownership stakes in key institutions, and greatly expanding programs of asset purchases and lending. In many other countries that were not central to the crisis, spillover effects nonetheless were very significant, and governments and central banks needed to protect system stability by issuing guarantees and providing additional liquidity. Subsequently, as the likely effects on economic activity and inflation became clearer, central banks cut interest rates rapidly and governments announced large-scale discretionary fiscal stimulus programs.

These actions averted a much more serious economic and financial disaster. But the legacy of the excesses of the earlier part of this decade, and of the steps needed to cope with their subsequent unwinding, is likely to be quite persistent. Significant private wealth has been destroyed. Expectations of future income have been correspondingly reduced and the need to save is now higher. Governments of major countries have assumed, one way or another, a significant part of the obligations associated with earlier poor decisions by lenders and investors. Some are issuing very large quantities of debt to fund these obligations, as well as to pay for stimulus programs. As one simple metric, the ratio of gross government debt to GDP for the advanced countries as a group is likely to reach 100 per cent within a year or two. So constraints on economic policy are likely to last, in some countries, for some time.

On this score, as on a number of others, Australia is relatively well positioned. The economy has been significantly affected by the crisis, but has not experienced the sharp contraction seen elsewhere. The financial system remains strong (and privately owned), public finances are in reasonable shape and resort to unconventional monetary measures has not been needed. The exposure to China has proved a boon. It is not surprising that, over recent months, confidence has recovered some ground.

The global events continued to affect the work of the Reserve Bank, across many dimensions. Most obviously, the Reserve Bank Board adjusted monetary policy to suit the economy's changing circumstances, reducing the cash rate on six occasions by a total of 425 basis points, the most active use of the policy instrument for many years. As usual, the rationale for the policy decisions was spelled out in other documents, and so is not discussed further here.

There were many other effects on the Reserve Bank's activities. Throughout the period of financial distress since mid 2007, the Bank has adjusted its financial operations as needed to help markets continue to function. During the past year, particularly during the last few months of 2008 as the crisis intensified, the Bank further expanded its domestic dealing operations, increasing system liquidity, accepting a wider range of collateral and dealing over longer terms. It worked along with the US Federal Reserve and other central banks to facilitate the provision of US dollar funding against appropriate local currency collateral. As a result, the Bank's balance sheet expanded significantly, with assets reaching over $165 billion at the peak, though by the end of the financial year they had fallen back to about $100 billion as usage of the various facilities unwound.

Unusual volatility of the Australian dollar during the worst of the turmoil saw the Reserve Bank undertake intervention transactions, selling foreign currency acquired earlier at a high exchange rate and purchasing Australian dollars at a much lower exchange rate. These transactions realised substantial valuation gains. Subsequently, as the exchange rate has risen, the reserves run down in the intervention episode have been replenished. The dealing, settlements, reserves management and risk management areas all had higher workloads associated with these activities.

The Reserve Bank responded to a surge in demand for banknotes around the time of the global banking crisis, as some depositors withdrew cash from banks. Although this demand was met from the Bank's contingency stocks, Note Printing Australia stepped up production as these stocks fell sharply. As calm was restored this flow abated, but by the end of the financial year currency in the hands of the public, at about $48 billion, was still about $4 billion higher than would have been expected based on trend growth in the economy.

The Banking Department trebled its daily cheque-processing capacity to facilitate the increased volume of cheques associated with government stimulus payments issued by the Australian Tax Office. The Risk Management Unit took responsibility for administration of the Government's wholesale funding guarantee, involving assessment of applications and collection of fees on behalf of the Government, which are now running at an annual rate of about $1 billion.

The Bank's staff responded to increased demands for participation in international efforts to grapple with the crisis, organised under the auspices of the G-20 and the Bank for International Settlements. These demands will continue to grow, as Australia has been asked to take part more fully in bodies such as the Financial Stability Board, the Basel Committee on Banking Supervision and the Committee on Payment and Settlement Systems.

All up, these unusual events added around $5 million (2½ per cent) to the Reserve Bank's cost of operation in the year. Ongoing programs to improve the Bank's capacity to meet its various public policy obligations also continued, with significant upgrades to key systems adding to costs but improving quality and resilience.

The Reserve Bank earned a profit, measured in accordance with Australian equivalents to International Financial Reporting Standards, of over $8.8 billion in 2008/09. This measure includes not only the net interest earnings of $2.2 billion and realised valuation gains of $4.4 billion, but unrealised gains on the portfolio of $2.3 billion, principally owing to the effects of the decline in the Australian dollar on the valuation of foreign assets. Earnings available for distribution to the Australian Government, as determined by the provisions of the *Reserve Bank Act 1959*, are limited to the net interest earnings plus realised valuation gains. This sum, $6.6 billion, was the highest in the Bank's history.

To keep the Reserve Bank's capital commensurate with the size of its balance sheet and the associated risks, and in line with its longstanding policy on capital, the Board recommended to the Treasurer that $577 million be transferred to the Reserve Bank Reserve Fund. The Treasurer agreed to the recommendation, resulting in a dividend to the Australian Government from 2008/09 earnings of almost $6 billion. This is the highest dividend ever paid by the Bank, but it reflects unusual circumstances. It can be expected with a high degree of confidence that future dividends will generally be much smaller. On average, they can be expected to be approximately equal to net interest earnings.

Were there to be a large rise in either the Australian dollar or local and global interest rates (or both), the Reserve Bank would sustain, as on many past occasions, significant valuation losses. It is entirely possible under such conditions that the Bank could record an overall loss, as it did in 2006/07. This reflects the large exposures to interest rate and foreign currency risk that are part and parcel of being a central bank.

The staff of the Reserve Bank have once again exhibited a high level of professionalism and dedication. The Board joins me in thanking them for their tireless efforts, during what has proved to be a formidable year, but a successful one.

In a few months' time, on 14 January 2010, the Reserve Bank will mark 50 years of operation. While the Reserve Bank is the continuing legal entity established as the Commonwealth Bank of Australia in 1911, and technically therefore is nearly 100 years old, it is only since 'separation' in 1960 that it has been purely a central bank. It will be appropriate to commemorate the anniversary, and some suitable events are being planned.

Glenn Stevens

Chairman, Reserve Bank Board
13 August 2009

Functions and Objectives of the Reserve Bank

The Reserve Bank of Australia is Australia's central bank. It is established under the *Reserve Bank Act 1959*, which empowers it to conduct its operations and sets out the objectives of the Bank's monetary policy. Section 10(2) of the *Reserve Bank Act 1959* states:

'It is the duty of the Reserve Bank Board, within the limits of its powers, to ensure that the monetary and banking policy of the Bank is directed to the greatest advantage of the people of Australia and that the powers of the Bank … are exercised in such a manner as, in the opinion of the Reserve Bank Board, will best contribute to:

(a) the stability of the currency of Australia;

(b) the maintenance of full employment in Australia; and

(c) the economic prosperity and welfare of the people of Australia.'

For more than 15 years now, this general mandate has found concrete expression in the form of a medium-term inflation target. Monetary policy aims to keep the rate of consumer price inflation at 2–3 per cent, on average, over the cycle. The fourth *Statement on the Conduct of Monetary Policy*, issued by the Treasurer and the Governor in December 2007 following the election of the current Government, records the common understanding of the Government and the Reserve Bank on key aspects of the monetary policy framework.

In addition to conducting monetary policy, the Reserve Bank also:

- holds Australia's foreign currency reserves;
- operates Australia's main high-value payments system;
- provides banking services to government; and
- designs, produces and issues Australia's banknotes.

The Reserve Bank has not, since 1998, been responsible for prudential supervision of banks. It has, however, a general responsibility, within the limits of its powers, to foster stability in the overall financial system.

The responsibilities of the Reserve Bank for ensuring the stability, efficiency and competitiveness of the payments system arose in 1998 from amendments to the *Reserve Bank Act 1959*. These amendments also established the Payments System Board, which is separate from the Reserve Bank Board and issues its own annual report. The Reserve Bank's main powers in relation to the payments system are set out in the *Payment Systems (Regulation) Act 1998*.

Governance

The Reserve Bank Board

The Reserve Bank Board comprises the Governor (Chairman), Deputy Governor (Deputy Chairman), Secretary to the Treasury and six external members appointed by the Treasurer, a total of nine. There was no change in the composition of the Board during the year; current members are shown here and on page 9 and 10.

The Board meets 11 times a year, on the first Tuesday of each month except in January. Five members form a quorum.

Most meetings are held at the Head Office in Sydney. From time to time, Board meetings are held in other Australian capitals. During the year, the December 2008 meeting was held in Melbourne and the April 2009 meeting in Brisbane.

Board Meetings in 2008/09 – Attendance by Members[a]

Glenn Stevens	11	(11)
Ric Battellino	11	(11)
Ken Henry[b]	9	(11)
John Akehurst	11	(11)
Jillian Broadbent	11	(11)
Roger Corbett	10	(11)
Graham Kraehe	10	(11)
Donald McGauchie	11	(11)
Warwick McKibbin	10	(11)

(a) Figures in brackets show the number of meetings each member was eligible to attend

(b) David Gruen (Executive Director, Macroeconomic Group, Australian Treasury) attended two meeting in place of Ken Henry, as provided in section 22 of the *Reserve Bank Act 1959*

Conduct of Reserve Bank Board Members

On appointment to the Reserve Bank Board, each member is required under the *Reserve Bank Act 1959* to sign a declaration to maintain confidentiality in relation to the affairs of the Board and the Reserve Bank. Further, by law, members must meet the general obligations of directors of statutory authorities, as set out in the *Commonwealth Authorities and Companies Act 1997* (CAC Act). The CAC Act sets standards of conduct for directors and officers of Commonwealth authorities. Directors must:

- discharge their duties with care and diligence;
- act in good faith, and in the best interests of the Reserve Bank;
- not use their position to benefit themselves or any other person, or to cause detriment to the Reserve Bank or any person;
- not use any information obtained by virtue of their position to benefit themselves or any other person, or to cause detriment to the Reserve Bank or any person; and
- declare any material personal interest where a conflict arises with the interests of the Reserve Bank.

Over and above these legislated requirements, members recognise their responsibility for maintaining a reputation for integrity and propriety on the part of the Board and the Reserve Bank in all respects. Members have adopted a Code of Conduct that provides a number of general principles as a guide for their conduct in fulfilling their duties and responsibilities as members of the Board; a copy of the Code is on the Bank's website.

Remuneration and Indemnities

A committee of the non-executive Reserve Bank Board members reviews annually the remuneration of the Governor and Deputy Governor as required by section 24A of the Reserve Bank Act.

Under the provisions of section 27 of the CAC Act and pursuant to a Board resolution on 3 November 1998, members of the Reserve Bank Board have been indemnified against liabilities incurred arising out of the proper discharge of their responsibilities, provided that any such liability does not arise from conduct involving a lack of good faith. This indemnity does not extend to claims by the Reserve Bank itself or any subsidiary of the Bank. A similar indemnity was extended to the members of the Payments System Board, pursuant to a resolution by the Reserve Bank Board on 3 November 1998.

Audit Committee

The objectives of the Audit Committee of the Reserve Bank Board are to:

- ensure a high-quality, independent and effective audit process;
- assist the Governor and the Board in fulfilling their obligations relating to financial reporting, compliance with laws and regulations, internal control and risk assessment, employee conflicts of interest, business ethics and prevention of fraud; and
- enhance contact between management and the Audit Department.

The Committee also acts, at the request of the Board of Note Printing Australia Limited (NPA), as NPA's Audit Committee.

Jillian Broadbent, an external member of the Reserve Bank Board, has chaired the Audit Committee since August 2008. Other members of the Committee are Ric Battellino (Deputy Governor), George Bennett (a company director and former National Executive Chairman of KPMG Peat Marwick) and, from March 2009, Roger Corbett (also an external member of the Reserve Bank Board). The appointment of Mr Corbett brings the size of the Committee equal to that of comparable organisations.

During 2008/09, the Committee met on four occasions. The external members of the Audit Committee also meet, at least annually, with the external auditors in the absence of management. At its July 2009 meeting, the Committee considered the draft financial statements for the year ended 30 June 2009 and agreed that the statements be presented to the Reserve Bank Board with its endorsement.

Reserve Bank Board | August 2009

Glenn Stevens (Chairman)

Governor since 18 September 2006
Present term ends 17 September 2013

Chairman – Payments System Board
Chairman – Council of Financial Regulators

Ric Battellino

Deputy Governor since 14 February 2007
Present term ends 13 February 2012

Member – RBA Audit Committee

Ken Henry AC

Secretary to the Treasury
Member since 27 April 2001

John Akehurst

Member since 31 August 2007
Present term ends 30 August 2012

Director – CSL Limited
Director – Origin Energy Limited
Director – Securency International Pty Ltd
Director – University of Western Australia Business School

Jillian Broadbent AO

Member since 7 May 1998
Present term ends 6 May 2013

Chairman – RBA Audit Committee
Director – Coca-Cola Amatil Limited
Director – Special Broadcasting Service

Roger Corbett AO

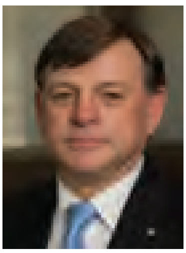
Member since 2 December 2005
Present term ends 1 December 2010

Member – RBA Audit Committee
Chairman – ALH Group Limited
Deputy Chairman – PrimeAg Australia Limited
Director – Fairfax Holdings Limited
Director – Wal-Mart Stores Inc

Graham Kraehe AO

Member since 14 February 2007
Present term ends 13 February 2012

Chairman – BlueScope Steel Limited
Chairman – Brambles Limited
Director – Djerriwarrh Investments Limited
Member – Australasian Council of INSEAD



Donald McGauchie AO

Member since 30 March 2001
Present term ends 29 March 2011

Deputy Chairman – James Hardie Industries NV
Director – Nufarm Limited
Chairman – Australian Wool Testing Authority Ltd

Warwick McKibbin

Member since 31 July 2001
Present term ends 30 July 2011

Executive Director, Centre for Applied Macroeconomic Analysis & Professor of International Economics, College of Business and Economics – Australian National University
Professorial Fellow – Lowy Institute for International Policy
Non-Resident Senior Fellow – The Brookings Institution, USA
President – McKibbin Software Group Inc (USA)
Director – McKibbin Software Group Pty Ltd
Director – EconomicScenarios.com Pty Ltd

Accountability and Communication

Relationship with Government

Section 11 of the *Reserve Bank Act 1959* sets out the relationship between the Government and the Reserve Bank Board. It confers substantial independence on the Board, but balances this with an obligation to inform the Government of its policies ‘from time to time’ and a requirement for Parliamentary accountability. Discussions between the Bank and the Treasurer serve to keep the Government informed.

Reporting Obligations

The Reserve Bank is a Commonwealth authority for the purposes of the *Commonwealth Authorities and Companies Act 1997* (CAC Act) and, for these purposes, the members of the Reserve Bank Board are the directors of the Reserve Bank. As such, they are responsible for the preparation of the annual report. At the meeting of the Board on 4 August 2009, they resolved that the Chairman sign the annual report and financial statements as at 30 June 2009, transmit them in accordance with the requirements of the CAC Act and arrange publication.

The House of Representatives Standing Committee on Economics has, in its Standing Orders, an obligation to review the annual report of the Reserve Bank and the annual report of the Payments System Board. The Committee holds twice-yearly hearings, at which the Bank presents its views on the economy and responds publicly to questions from Committee members. In 2008/09, the Governor and senior officers attended hearings in Melbourne in September 2008 and in Canberra in February 2009. These appearances, and the quarterly *Statement on Monetary Policy* (see below), are important elements of the arrangements embodied in the understandings between the Governor and the Treasurer outlined in the fourth *Statement on the Conduct of Monetary Policy*, which was issued in December 2007 following the election of the current Government.

Photo by Andrew Dawson, House of Representatives

(From left) Deputy Governor Ric Battellino, Governor Glenn Stevens and Assistant Governors Malcolm Edey and Philip Lowe appear before the House Economics Committee in February 2009

During the year, senior staff of the Reserve Bank also provided evidence before Federal Parliamentary committees conducting inquiries into particular matters. These included the Senate Select Committee on State Government Financial Management in July 2008 and the House of Representatives Standing Committee on Economics inquiry into competition in the banking and non-banking sectors in August 2008.

Communication

The Reserve Bank views it as important to ensure a high degree of transparency about its goals, decision-making processes and the analysis and reasons behind policy decisions. Transparency not only facilitates the accountability of an independent central bank in a democracy, it also increases the effectiveness of monetary and other policies by promoting informed decision-making by the community.

Apart from regular communication about monetary policy and decisions of the Reserve Bank Board, which were changed in 2007 in an effort to enhance the Bank's transparency and accountability, the Bank has a longstanding and extensive program of communication.

Reserve Bank Governor Glenn Stevens at James Cook University in June 2009

The most direct form of communication is delivery of speeches. During 2008/09, the Governor, Deputy Governor and senior officers gave around 30 on-the-record speeches on various topics, many of which encompassed aspects of the financial crisis, including its causes, consequences and policy responses. There were numerous updates on the economic conjuncture and medium-term outlook as well as consideration of longer-run economic challenges. There were explanations of developments in the payments system, thinking on macro-prudential issues and the inflation-targeting regime more generally. Audio files of these speeches, along with the Q&A sessions that follow, are now available on the Reserve Bank's website, further enhancing transparency and accountability.

The quarterly *Statement on Monetary Policy* informs the financial markets, media and wider community about the Reserve Bank's thinking on monetary policy and provides a basis for the Parliamentary Committee's questioning of the Bank. These statements provide an analysis of the state of the economy, the outlook for inflation and economic growth, and further explanation of recent decisions on interest rates.

The Reserve Bank *Bulletin* is a monthly record of media releases, speeches, monetary policy minutes and a wide range of statistics. The *Bulletin* also includes articles on various topics, which in the past year included commodity prices, export developments, conditions in the foreign exchange market, household wealth, ATM reforms and banking fees.

The *Financial Stability Review*, published in March and September each year, gives a detailed assessment of the overall condition of Australia's financial system. As well, there is analysis and views on issues of specific interest; in the past year such issues included government guarantees of deposits and wholesale funding, over-the-counter credit derivatives and Australian listed property trusts.

The Reserve Bank disseminates research conducted by the staff in the form of *Research Discussion Papers* (RDPs). While the views expressed in these papers are those of the authors and do not necessarily represent those of the Bank, their publication encourages discussion and comment on economic issues among a broad range of researchers. During 2008/09, 11 RDPs were released on a wide range of topics, including liquidity management, the regulation of payment systems, economic modelling and forecasting, the effects of monetary policy, currency misalignments and the term structure of bond yields. Staff have also had their work accepted in various publications, such as the *Australian Economic Review*, *JASSA*, the *International Journal of Theoretical and Applied Finance*, the *International Statistical Review*, the *Economic Record*, the *Applied Economics Quarterly*, *Applied Economics Letters*, the *Australian Journal of Agricultural and Resource Economics* and the *BIS Quarterly Review.*

Reserve Bank staff present their research at external conferences. In 2008/09, papers were presented at such gatherings as the Workshop of the Asian Research Network for Financial Markets and Institutions, held in Hong Kong; the Conference of Australian Economic History, at the Australian National University; a meeting of the Econometrics Society, in Wellington; the Federal Reserve Bank of Chicago's International Banking Conference; the Norges Bank's Research Conference on Payment Systems; and the Reserve Bank of New Zealand's Workshop on Nowcasting with Model Combination.

The Reserve Bank itself holds regular conferences, bringing together academics, central bankers and other economics practitioners. The 2009 conference, jointly hosted with the Australian National University's Centre for Applied Macroeconomic Analysis, was on 'Inflation in an Era of Relative Price Shocks'. A precursor to this conference was convened in Münster, Germany, in association with the Viessmann European Research Centre and the Westfälische-Wilhelms Universität. A volume of the conference papers and discussions, the 21st in the series, will be published later this year. The Bank issued a call for papers for a Research Workshop to be held later in 2009 focusing on issues relating to financial stability and monetary policy in open economies. This follows a Research Workshop at the end of 2008, which was convened with the assistance of Professor Adrian Pagan (University of New South Wales) and Professor Fabio Canova (Universitat Pompeu Fabra). It featured 12 papers by academics and central bankers from Australia and overseas. The Bank was also host to a number of prominent invited academics through the year, who conducted research on issues relevant to monetary policy and presented seminars during their short visits.

The Reserve Bank publishes information in both electronic and hardcopy formats. Demand for hardcopy publications has been declining as use of its website continues to grow strongly. In 2008/09, the number of page views/downloads of information on the website averaged about 91 500 per day, up by 40 per cent on the previous year. The increase in usage of the website has reflected the increased appetite for economic information stemming from the global financial crisis. In September and October 2008, when the financial crisis intensified, website usage roughly doubled. On 7 October 2008, when the policy interest rate was reduced by 100 basis points, there was a ten-fold increase in visits to the website. Consistent with this increased appetite for economic news, the number of subscribers to the email service for alerts about information published on the website increased to around 15 500 at the end of June 2009, up from 13 500 at the same time the previous year.

Operations in Financial Markets

At the time of last year's annual report, financial markets had been subject to serious dislocation for close to a year, although Australian markets had been less affected than those in other countries. The situation worsened dramatically over September and October 2008, including in Australia, following the failure of Lehman Brothers in the United States. The evolution of the financial crisis has been discussed in detail in the Reserve Bank's quarterly *Statement on Monetary Policy* and semi-annual *Financial Stability Review* over the past year.

In the face of this turbulence, much of the focus of the Reserve Bank's operations over the course of the year has been directed towards ensuring that the financial system in Australia continued to function as smoothly as possible, in addition to its conventional mandate of keeping the cash rate at the target set by the Reserve Bank Board. Most of the Bank's actions in response to the crisis have been conducted within its longstanding framework for market operations. The framework has proven to be sufficiently flexible to enable the Bank to respond promptly and in a targeted manner to market developments.

The actions taken by the Reserve Bank resulted in a large, though temporary, increase in the size of its balance sheet. However, by the end of 2008/09, conditions in financial markets had improved significantly and a number of the short-term measures undertaken by the Bank had been wound down. As a result, the size of the Bank's balance sheet was little changed in net terms over the financial year.

Domestic Market Operations

In Australia, monetary policy is implemented in terms of a target for the cash rate – the interest rate on unsecured overnight loans between banks – determined by the Reserve Bank Board at its monthly monetary policy meeting. Over the past year, the Board has reduced the target on six occasions, bringing the rate down sharply from 7.25 per cent to 3.00 per cent.

While the announcement of a new target rate is sufficient in itself for market participants to move the cash rate to the new target, the Reserve Bank conducts daily open market operations to adjust the level of exchange settlement (ES) balances to ensure the cash rate remains at the target. ES balances are liabilities of the Reserve Bank held by commercial banks and certain other institutions to meet their settlement obligations with each other and the Bank. As such, ES balances provide banks with their most immediate source of liquidity. Payment flows between ES account holders and the Reserve Bank's customers (principally, the Australian Government) have the potential to affect the aggregate volume of ES balances.

Each day, the Reserve Bank must gauge the overall demand for ES balances from the financial system and adjust the supply of funds accordingly so as to keep the cash rate at the target. With the tensions that emerged within global financial markets in mid 2007 intensifying at various times over 2008/09, the Bank judged that a relatively high volume of ES balances was necessary.

Over the past year, ES balances have averaged almost $4 billion, compared with $2.5 billion in 2007/08 and around $750 million in the five years prior to the onset of the financial crisis. These developments are explained in more detail below.

Most of the Reserve Bank's transactions in the open market are contracted as repurchase agreements (repos), whereby the Bank purchases securities with an agreement to resell them to the counterparty at an agreed maturity date. Dealing operations are announced each morning, though the Bank is also willing to conduct an additional round of dealing with the market should conditions require it. In 2008/09, there was one instance in which the Bank conducted a second round of market operations to offset unexpectedly large flows to the government, the first since December 2005.

The Reserve Bank provides a standing facility for ES account holders where banks that experience an unexpected shortfall in their cash position late in the day (typically because of unforeseen payment flows), and are not able to source those funds from the market, are able to borrow from the Reserve Bank on a secured basis at a rate 25 basis points above the cash rate target. Notwithstanding the financial turbulence, throughout the past year, usage of the Bank's standing facility was a little less than in recent years.

Standing Facility for Overnight Repurchase Agreements

	Number of times used	Value ($ million)
2002/03	14	1 673
2003/04	24	2 159
2004/05	11	1 394
2005/06	10	436
2006/07	24	3 589
2007/08	18	4 220
2008/09	15	3 257

Source: RBA

Actions Undertaken During the Financial Turbulence

As noted, the framework used in Australia for implementing monetary policy proved resilient to the financial turmoil and enabled the Reserve Bank to modify its operations quickly to address specific pressures. As pressures within financial markets intensified significantly during September and October 2008 following the intervention by the US authorities to support Fannie Mae, Freddie Mac and AIG and the collapse of Lehman Brothers, the Bank made a number of modifications to its market operations. These included:

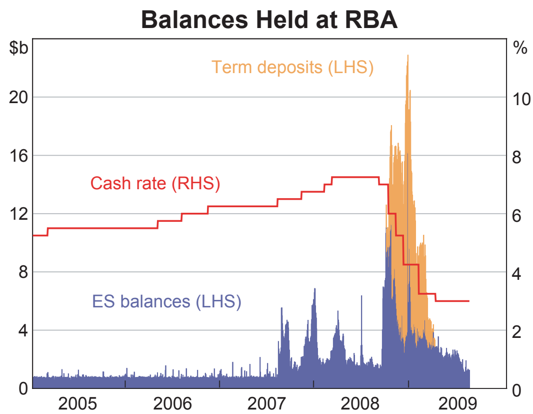
- increasing the supply of ES balances;
- lengthening the term of its repos;
- conducting a larger share of its repos using private securities;
- widening the pool of securities eligible for use in repos;
- introducing a term deposit facility; and
- initiating a swap facility with the US Federal Reserve for institutions to receive US dollar funding.

These developments are discussed in detail below. Reflecting the flexibility of the pre-existing framework, these changes were implemented quickly and smoothly and did not need to be as extensive as those implemented by most other central banks. Notably, because the Reserve Bank already had a wide range of counterparties for its open market operations – including banks, other deposit-taking institutions, securities dealers and other financial institutions – it did not see a need to change the eligibility criteria or implement new facilities to disperse liquidity more widely in the market.

Increasing ES Balances and Introduction of Term Deposit Facility

Prior to the dislocation in financial markets, ES balances were typically around $750 million. As the financial turbulence became more severe, the demand for risk-free liquid assets by private institutions increased. The Reserve Bank accommodated this desire by its counterparties to hold larger cash balances by increasing the supply of ES balances, thereby increasing the size of the Bank's balance sheet. Had it not done so, there would have been upward pressure on the cash rate, raising it above the target set by the Board. As market conditions deteriorated in September 2008, the Bank increased aggregate ES funds sharply, with aggregate balances reaching a peak of $11 billion in October.

To provide the market with an additional risk-free asset and enable the Reserve Bank to undertake a larger volume of term repos, without increasing ES balances to such a level that would put downward pressure on the overnight cash rate, the Bank introduced a term deposit facility in October. Under this facility, institutions could bid to hold short-term deposits at the Bank (usually of one or two weeks duration). These deposits acted to reduce the amount of cash in the market for the life of the deposit. By late December, reflecting both year-end liquidity demands and also to accommodate the Bank's desire to provide liquidity to the market at longer terms, the Bank had around $20 billion outstanding in the form of overnight ES balances or term deposits.



Source: RBA

As market conditions improved during 2009, the Reserve Bank was able to scale back its activities in the market. The reduced demand for longer-term repos reduced the need to drain liquidity from the overnight cash market through term deposits, and the improved market conditions themselves also reduced demand for the term deposit facility. Consequently, in March, the facility was allowed to wind down. ES balances were also progressively reduced to around $2¼ billion by June 2009 as institutions felt comfortable in reducing their level of precautionary cash balances. Notably, throughout this entire period and notwithstanding the large movements in ES balances, the cash rate traded at the target set by the Board on every day in 2008/09.

Deviations from Cash Rate Target

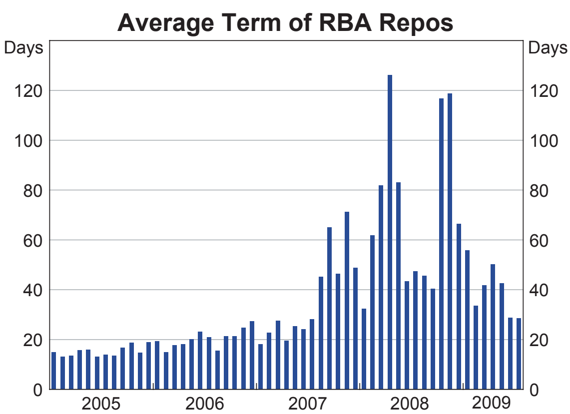
Number of days

	Basis point deviations					
	-2	-1	0	1	2	3
2003/04	0	0	250	5	0	0
2004/05	0	0	253	0	0	0
2005/06	0	0	253	0	0	0
2006/07	0	2	249	0	0	1
2007/08	1	8	244	0	0	0
2008/09	0	0	254	0	0	0

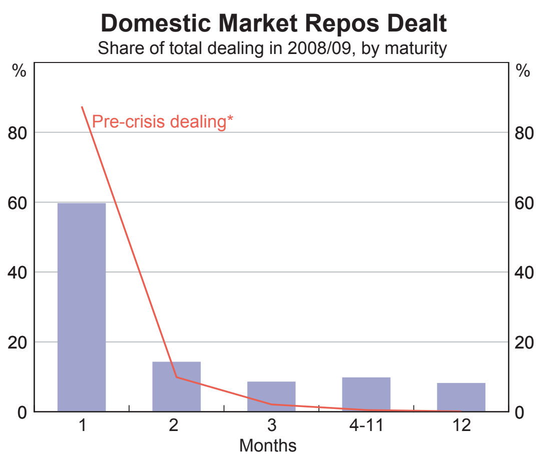
Term of Repurchase Agreements

Prior to the crisis, the longest term the Reserve Bank generally offered for repos was around three months; such repos were offered about once a week. As tensions emerged in financial markets in the second half of 2007, and with greater pressure in longer-term markets, the Bank extended the terms of its dealing, first to regular dealing in three-month repos, then periodically in six-month and one-year repos.

When the dislocation in term funding markets became extreme in mid September 2008, the Reserve Bank announced that it would offer six-month and one-year maturities every dealing day. This helped improve liquidity in the underlying market for bank paper, since counterparties must use collateral with a term at least as long as that of the repo. The regular offering of long-term repos also provided greater certainty of term funding to financial institutions.



Source: RBA



* Average of dealing from 2003/04 to 2006/07

Source: RBA

As a result of these actions, the average term to maturity of the Reserve Bank's new repos increased from around 20 days in June 2007 to around 120 days at its peak in late 2008. As banks' access to funding has improved over recent months, demand for repos at longer maturities has declined significantly. In response, the Bank's dealing at longer terms has become less frequent, with one-year repos typically offered once a week, rather than daily, and for considerably smaller amounts than at the peak of the turbulence. This has seen the average term to maturity of new repos decline to around 30 days.

Collateral in Repurchase Agreements

In its market operations, the Reserve Bank takes bids separately for repos of government securities and private securities. This enables the Bank to observe the relative pressures in these markets through the bids submitted for the different classes of collateral and respond to those pressures by dealing accordingly in those different classes. With greater tensions evident in the market for private securities, the Bank increased the share of repos collateralised by private securities to around 80 per cent in 2008/09, compared with an average of around 25 per cent prior to the turmoil. These actions improved the liquidity of the market for the private securities, as purchasers of these assets could be confident that liquidity from these instruments would be available from the Bank, even if it were unavailable in the market.

In the first few months of the crisis in the second half of 2007, the Reserve Bank expanded the range of eligible collateral to include a wider range of securities issued by authorised deposit-taking institutions (ADIs) and securities backed by high-quality residential mortgages, thereby making these securities more liquid. The Bank further expanded the range of eligible securities in November 2008 to include all P-1 or AAA-rated assets.

Around the same time, the Reserve Bank relaxed the restriction that prevented banks from using asset-backed securities (ABS) in which a related party was involved in the loan origination or securitisation. Most Australian banks, and a number of building societies and credit unions, have put together securities backed by mortgages on their books to meet the criteria specified by the Bank – 'self-securitised' residential mortgage-backed securities (RMBS). This served to increase significantly the pool of assets that ADIs could use in the Bank's repo operations. By December 2008, the Bank had repos of $45 billion backed by self-securitised RMBS as collateral. Much of this collateral was accepted in the Bank's longer-term repos and in the US dollar term repo facility, and has subsequently matured. As a result, the value of the Bank's repos involving such assets has since declined to a little over $20 billion.

As in all repo operations, the risk involved in accepting these new collateral classes is mitigated by the high quality of the collateral, the initial margin (or 'haircut') applied and the regular marking-to-market of the value of the collateral (see the chapter on 'Risk Management'). The new securities eligible for use in repo operations are in the highest ratings categories (AAA for long-term and P-1 for short-term) and, for self-securitised ABS, additional restrictions are placed on the underlying mortgages to ensure they are of a high quality. Riskier securities also require a higher haircut, with margins up to 10 per cent applied, meaning that the Reserve Bank is protected against larger price falls.

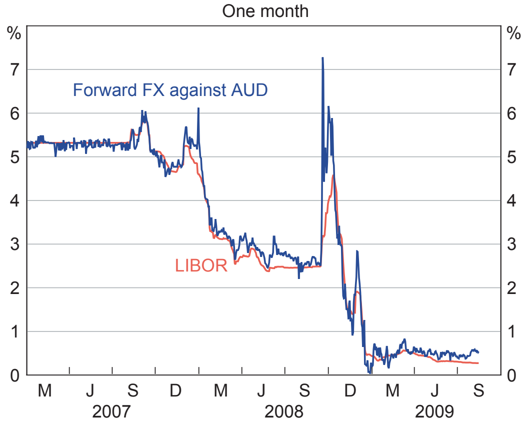
Composition of Repo Book

Collateral type	End June 2009 $ billion	End June 2009 per cent	End December 2008 $ billion	End December 2008 per cent
General Collateral				
– CGS	2.5	6	0.7	½
– Semis	1.2	3	1.2	1
– Supras	0.4	1	0.8	1
– Govt guaranteed ADI paper	0.3	1	0	0
Private Securities				
– ADI paper	11.8	28	42.7	43
– RMBS (self-securitised)	21.2	50	44.7	45
– RMBS (other)	4.9	12	5.2	5
– ABCP	0	0	2.9	3
– Other	0.2	<½	0.6	½
Total	42.3		98.9	

US Dollar Term Repo Facility

From mid 2007, the cost of borrowing US dollars in offshore markets increased sharply compared with the borrowing costs in local US markets. This significantly impaired the operation of the forward foreign exchange market, raising the premium paid on US dollars when swapped against other currencies.[1]

USD Interest Rates
One month



Sources: AFMA; Bloomberg; RBA

To relieve the pressure this created on financial institutions outside the United States, the Federal Reserve entered into currency swaps with other central banks, which then on-lent the US dollars to banks operating in the local markets against the receipt from the counterparty of local currency assets. Initially, in December 2007, these swap facilities were with the European Central Bank and the Swiss National Bank. In September 2008, the Fed extended the arrangement to a number of other central banks, including the

1 *For a discussion of the shortage of US dollars, see McGuire P and G von Peter (2009), 'The US dollar shortage in global banking',* BIS Quarterly Review, *March.*

Reserve Bank, to improve the availability of US dollars in other markets and time zones. The US dollars were provided at a premium to the cost of obtaining US dollars in normal market conditions, to ensure that as conditions improved, counterparties would be inclined to return to the market to obtain funds there rather than become dependent on the facility.

The Reserve Bank auctioned the US dollars obtained under the swap to its regular pool of domestic counterparties at terms of between one and three months. Successful bidders pledged Australian dollar denominated securities under a repo. An additional haircut was required by the Bank to protect against movements in the exchange rate of the Australian dollar against the US dollar. By November 2008, nearly US$27 billion was outstanding in this facility.

As a result of the introduction of the central bank facilities, the premium on US dollars that had been evident in foreign exchange swaps had largely disappeared by early 2009. As market conditions improved over the course of the year and the cost of obtaining US dollars in the market declined, participation at the Reserve Bank's US dollar repo auctions fell such that at its most recent auctions no bids were received. Consequently, since May 2009 the Bank has not seen the need to offer this facility, and the last of the outstanding balances matured in July, though the agreement with the Federal Reserve was extended until February 2010 in line with other participating central banks.

Long-dated Operations

In its regular market operations, the Reserve Bank generally buys securities under repo. However, for many years it has also been willing to purchase Commonwealth Government securities (CGS) and semi-government securities on an outright basis where these securities have less than 18 months to maturity.

The Reserve Bank also maintains a portfolio of longer-dated semi-government securities, which it has purchased in the secondary market in targeted operations. The Bank conducted these longer-dated operations on 10 occasions during 2008/09, purchasing securities totalling $1.5 billion. This was substantially greater than the amounts purchased in earlier years. The additional purchases were predominantly made at times when there was a significant reduction in liquidity in the market for semi-government debt, reflecting the generalised deterioration in markets, the increase in supply of government-guaranteed debt globally and the downgrade to the Queensland Government's credit rating in February 2009. During these periods, the Bank judged that an increase in its portfolio of semi-government securities would be timely and appropriate. As usual, securities were sold from this portfolio at various times through the year for liquidity management purposes. Overall, reflecting the net of these transactions, the Bank's holdings of longer-dated semi-government debt, at around $2 billion, are little changed from a year ago.

Securities Lending

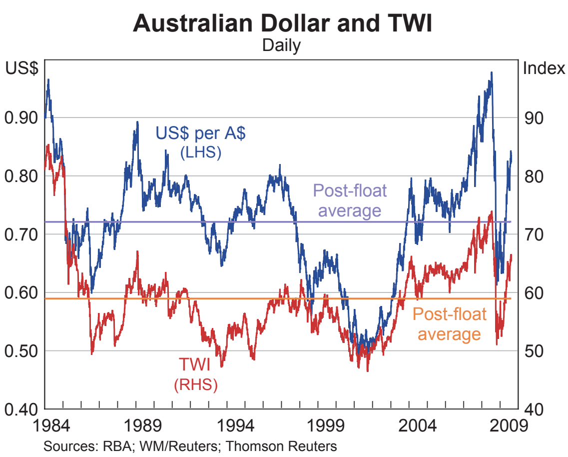
To enhance market liquidity and prevent shortages of particular securities, the Reserve Bank continued its practice of lending securities from its own portfolio. The Bank makes available for loan the CGS and semi-government securities that it holds on an outright basis. These transactions are contracted as sales under repos with the Bank usually purchasing 'general collateral' from the same counterparty in an offsetting trade. During 2008/09, income from securities lending was negligible, amounting to less than $0.1 million.

The Reserve Bank also operates a securities lending facility on behalf of the Australian Office of Financial Management (AOFM). Under this facility, market participants can borrow CGS under repo, selling general collateral in an offsetting reverse repo. As it is designed to be used only when securities are not readily available from the market, the margin between the two repo rates had always been set at 300 basis points. However, as the general collateral rate fell to 3 per cent during 2008/09 (in line with the reduction in the cash rate target), the AOFM narrowed the margin to ensure that repo rates on CGS lent through the facility would remain positive. The margin is now set as the lower of 300 basis points or 25 basis points below the cash rate target.

During 2008/09, the Reserve Bank lent an average of $80 million per day through the AOFM facility, significantly more than in previous years. However, this lending was concentrated in the latter part of 2008. The expansion in CGS issuance in recent months has meant there are fewer occasions in which dealers cannot source securities in the market to complete settlement, and the use of this facility has diminished considerably.

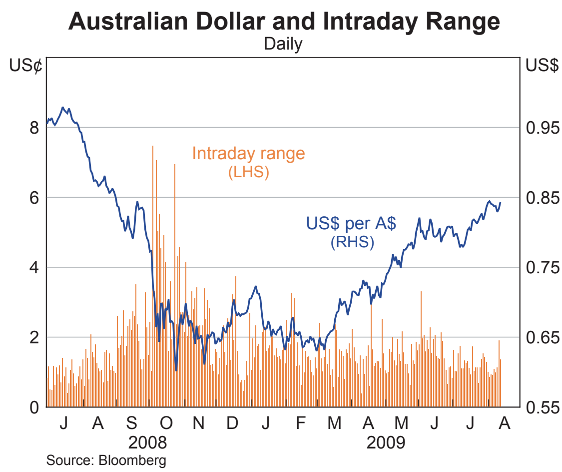
Foreign Exchange Operations

The Reserve Bank undertakes transactions in the foreign exchange market for policy reasons, to manage its portfolio of foreign currency reserves and also on behalf of its clients. Policy transactions include those intended to address disorderly market conditions, commonly known as foreign exchange intervention, as well as those undertaken as part of the Bank's domestic liquidity management. As was the case with the Bank's domestic market operations, the increased severity of the financial crisis had a significant impact on the Bank's foreign exchange operations at different times in 2008/09.



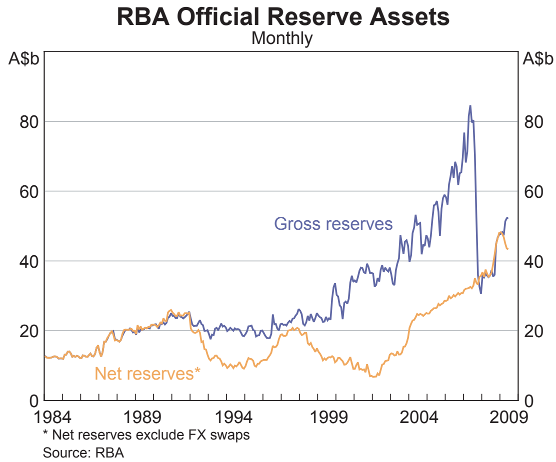
After reaching a post-float high against the US dollar in July 2008, the Australian dollar depreciated sharply over the following few months in response to a marked deterioration in the global economic outlook, a related decline in commodity prices and a sharp reduction in risk appetite by financial institutions and investors as the global financial crisis deepened. The Australian dollar reached a low of US60 cents in late October, a depreciation of almost 40 per cent in just over three months. The Australian dollar depreciated by over 30 per cent on a trade-weighted basis over the same period. This constituted the most rapid depreciation in the Australian dollar since the float.

Despite the size and pace of the adjustment in the exchange rate, conditions in the Australian foreign exchange market held up into September. However, following the collapse of Lehman Brothers on 15 September, conditions deteriorated markedly and, by early October, along with most other markets, the Australian foreign exchange market was experiencing periods of extremely poor liquidity and unprecedented volatility. As funding was severely curtailed, some large leveraged global portfolios collapsed, with a number of trades forced through the market as the portfolios were liquidated. This was coupled with the more general retreat from 'riskier' assets. Moreover, through this period a number of parties used the Australian dollar as a proxy for the retrenchment of investments from other less liquid markets, including emerging market assets. The resultant breakdown in market liquidity led to increased 'gapping' in the exchange rate as there was little desire by market participants to absorb the forced flows. With the market becoming increasingly dysfunctional, the Reserve Bank intervened on a number of occasions in October and November.



These operations were not undertaken to target any particular level of the exchange rate. Indeed, the Reserve Bank regarded the significant depreciation of the Australian dollar from its July peak as consistent with the perceived deterioration in underlying fundamentals at the time. However, by October the breakdown in market conditions itself had become a significant factor in the increasingly rapid depreciation of the exchange rate. The primary objective of the Bank's intervention was to break this dynamic and underpin market liquidity to restore confidence in the price discovery process, thereby ensuring the market continued to function efficiently. In total, the Bank purchased A$3.8 billion through these operations. However, unlike in earlier intervention episodes, the Bank found that the size of individual transactions was generally small, reflecting the extremely poor liquidity in the market. Throughout the period, the market was not characterised by large flows associated with investors seeking to take short positions in the Australian dollar on the belief that it would depreciate further.

Liquidity gradually improved in the market from the beginning of 2009 and, from March, the Australian dollar appreciated steadily in response to signs of stabilisation in financial markets, some better economic news and a related increase in risk appetite. By the end of June, the Australian dollar had reversed more than half of the depreciation that took place in the second half of 2008. The Reserve Bank took the opportunity provided by the rise in the exchange rate to purchase foreign currency, replenishing the reserves drawn down as a result of the intervention. The combination of transactions in foreign currency and the earnings on reserves added $2.4 billion to net foreign currency reserves in 2008/09. The net depreciation of the



Australian dollar over the year resulted in valuation gains of $5.1 billion. As a result, the Australian dollar value of net reserves rose by $7.5 billion to $43.3 billion.

Over the year, the Reserve Bank continued to use foreign exchange swaps to assist in domestic liquidity management. Swaps were used both to withdraw and supply domestic liquidity at different times. As a result, the Bank's forward foreign exchange position (its net obligation to deliver or receive foreign currency in the future) fluctuated through the year. Gross reserves, which include foreign exchange held outright (net reserves) and those held under foreign exchange swaps, ended the year at $52.3 billion.

As noted above, the Reserve Bank also operates in the foreign exchange market on behalf of its clients. The vast majority of these transactions are undertaken for the Bank's largest client, the Australian Government. The Government has a range of foreign currency obligations, the largest of which include defence expenditure, foreign aid and meeting the running costs of its embassies around the world. In the normal course, the Bank purchases foreign currency for the Government from the market as required. However, if the Australian dollar is under significant pressure or disorderly market conditions make price discovery difficult, the Bank may decide to provide foreign currency directly from reserves. In 2008/09, the Bank sold $6.9 billion of foreign currency to the Australian Government. For a short period during the worst of the market turbulence, the Bank did temporarily meet the Government's foreign currency needs from reserves but subsequently offset these transactions in the market as conditions improved.

Reserves Management

The Reserve Bank has responsibility for managing the portfolio of foreign currency assets and gold held on its balance sheet to facilitate policy operations in the foreign exchange and domestic cash markets. The severe market turmoil of the past two years has highlighted the importance of a small open economy such as Australia having access to sufficient reserves of foreign currency. It has also demonstrated the importance of having those reserves invested in high-quality assets and ensuring the reserves are sufficiently liquid to meet policy needs in all market conditions.

In common with most central banks, the Reserve Bank uses a benchmark to guide the investment process and to facilitate risk management. The benchmark represents the best estimate of the Bank's long-run optimal investment allocation given the investment constraints it faces. The Bank has used a formal benchmark for its reserves since the early 1990s and there have been very few changes to it since then. For many years, the benchmark has had a currency and asset allocation of 45 per cent to the United States, 45 per cent to Europe and 10 per cent to Japan.

Investments within those currencies are limited to sovereign debt instruments, investments secured by sovereign or quasi-sovereign debt under repos, and commercial bank deposits. The exposure of the investments within each of the three currencies to changes in interest rates had been set at a weighted average maturity, or duration, of 30 months.

The Benchmark Portfolio

	United States	Europe	Japan
Asset allocation (% of total)	45	45	10
Currency allocation (% of total)	45	45	10
Duration (months)	18	18	18

The financial crisis affected the reserves management process in a number of ways over the year. The need to deploy reserves to fund intervention in the foreign exchange market at a time when a number of markets were dysfunctional meant that it was not practical to attempt to maintain portfolio allocations in line with the benchmark. Accordingly, the requirement that reserves allocations be in line with benchmark allocations was suspended temporarily. Credit and counterparty exposures were kept under constant review. With a number of new sovereign-guaranteed instruments available in the market, the Reserve Bank took the opportunity to invest a portion of foreign currency reserves in AAA-rated government-guaranteed bank debt and US agency debt, which offer a higher return than the sovereign's direct issuance.

In addition, the exceptionally low level of interest rates prevailing in early 2009 led the Reserve Bank to review the interest rate risk of the portfolio. While the benchmark had been designed to be resilient to the typical movement in yields over the cycle, the level of rates observed over the past year has been at the extreme of the range of the outcomes for which the benchmark was designed. Indeed, recent outcomes have on occasion been outside the experience on which the benchmark had been based. Following an analysis of the risk/return possibilities, a decision was taken to reduce the benchmark duration from 30 months to 18 months. The changes to the risk profile of the portfolio are discussed in more detail in the chapter on 'Risk Management'.

Over 2008/09, the return on foreign currency assets, measured in SDRs, was 7.1 per cent, above the average of recent years. The Australian dollar value of the return on reserves was $5.2 billion, nearly $3 billion higher than in the previous financial year. This outcome was due largely to the significant decline in global bond yields, which generated large mark-to-market

Rates of Return in Local Currency by Portfolio
Per cent

	US	Europe	Japan
2002/03	6.6	7.2	1.3
2003/04	0	1.9	0
2004/05	4.1	5.8	1.1
2005/06	1.2	0.1	–0.9
2006/07	5.6	2.2	1.1
2007/08	8.1	4.0	1.7
2008/09	5.2	8.1	1.8

capital gains on the Reserve Bank's holdings of foreign currency sovereign debt. These gains more than offset the reduction in interest earnings arising from the lower level of yields. In addition, the lower average Australian dollar exchange rate in 2008/09 increased the Australian dollar value of foreign earnings by over 15 per cent.

Actual and Benchmark Returns on Total Foreign Currency Portfolio

Rates of return in SDR (per cent)

	Actual	Benchmark	Value of difference (A$ million)
2002/03	6.7	6.4	77
2003/04	0.5	0.3	67
2004/05	4.7	4.5	38
2005/06	1.2	1.0	55
2006/07	3.1	3.0	40
2007/08	6.5	6.2	83
2008/09	7.1	6.7	165

The Reserve Bank maintained its investments in the Asian Bond Funds over the year. The Asian Bond Funds, an initiative of the EMEAP group, are designed to support the development of local bond markets in the region and to provide an additional vehicle for investors to access these markets. The Bank has modest investments in both the US dollar denominated fund, ABF1, and the local currency denominated fund, ABF2. At the end of June 2009, the total allocation of reserves to these funds was $425 million. The return on these investments over 2008/09 was 4.6 per cent, measured in US dollar terms.

The Reserve Bank holds around 80 tonnes of gold as part of its official reserve assets. The gold price was quite volatile through the year but ended the year broadly unchanged in US dollar terms, although it was around 20 per cent higher in Australian dollar terms. The value of the Bank's holdings of gold increased by around $0.5 billion to $3 billion. Income from gold loans, where the Bank lends gold to major gold market participants against collateral, declined further in 2008/09 to just $3.6 million. As was the case last year, gold leasing rates remained at low levels as demand for borrowing gold was negligible. As a result, the Bank took delivery of all but one maturing gold loan in 2008/09, with the amount on loan at the end of the year standing at just 4 tonnes, down from 27 tonnes in June 2008.

The Balance Sheet

The various measures described above saw the Reserve Bank's balance sheet expand substantially over the course of the year, peaking at $166 billion in November. However, with the improvement in market conditions, the demand for many of these facilities has decreased and the balance sheet has declined, such that the size of the Bank's assets and liabilities was little changed over the 12 months to June 2009.

Over the year, there was an increase in currency, which was offset by a decline in deposits. Currency on issue increased sharply in October last year as the turbulence in financial markets resulted in higher demand for banknotes. Some of the increased demand has since unwound, though currency holdings remain somewhat elevated.

Reserve Bank Balance Sheet

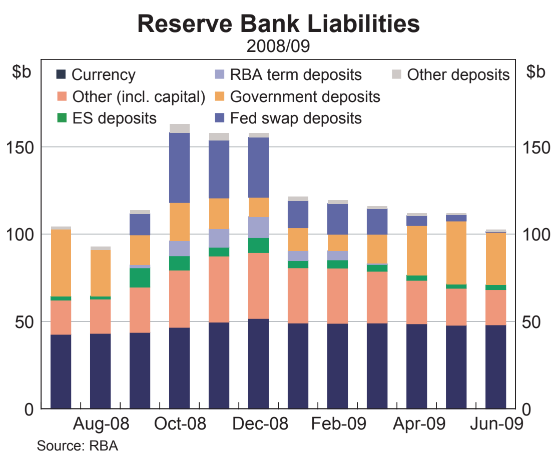
$ billion

	June 2008	December 2008	June 2009
Assets	*101*	*158*	*103*
Foreign	45	54	54
– Net reserves[a]	35	47	43
– FX swaps	0	–2	9
– Other	9	8	1
Domestic	56	70	48
Federal Reserve swap collateral	n.a.	34	0
Liabilities	*101*	*158*	*103*
Deposits	39	34	34
Federal Reserve swap deposit	n.a.	34	0
Currency	42	52	48
Other (including capital)	20	38	20

(a) Excludes Special Drawing Rights and Australia's reserve position at the International Monetary Fund

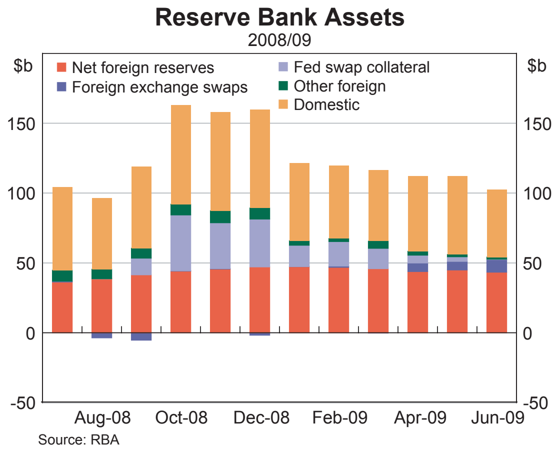
Source: RBA

There was substantial variation in deposits over the course of the year. Much of this reflected the policy decisions taken by the Reserve Bank discussed above. Deposits increased sharply after September, reflecting the increase in ES balances, the introduction of term deposits and the US dollar swap facility, as the Federal Reserve chose to hold the Australian dollars received in these swaps on account at the Bank.



However, as financial markets have improved, Reserve Bank term deposits have fallen back to zero (from a peak of $18.5 billion in December), and the US dollar facility had only $330 million outstanding at the end of June, compared with a peak of $40 billion in November (and has since been completely unwound). Government deposits varied over the year, partly reflecting the normal seasonal influences, but also decreasing as the budget position shifted from surplus to deficit in response to increased expenditure and a sharp decline in revenue, before increasing as a result of increased government debt issuance later in the year.

The composition of assets changed significantly over the year, with an increase in the proportion of foreign assets. After being run down to almost zero last year, the Bank made greater use of foreign exchange swaps in managing its assets. In addition, net reserves rose by $10 billion, reflecting both reserves replenishment and revaluation gains. Following a $20 billion increase over the year to 30 June 2008, domestic securities declined by $6 billion this year, reflecting the increased use of foreign exchange swaps in liquidity management.



Banking and Payments

The Reserve Bank provides a range of banking, registry and payment settlement services to other institutions in the Australian financial system, the Australian Government, and other central banks and international bodies. These include the provision of central banking services to the Australian Government for the core public accounts operated by the Department of Finance and Deregulation, transactional banking services to government agencies, custody, registry and associated services, and the operation of a real-time gross settlement system for Australian dollar high-value payments.

While the majority of services provided fall within the scope of central banks' core activities, some services, such as the transactional banking and registry services provided to Australian Government agencies, do not. Accordingly, these services are provided on a commercial basis in line with the Australian Government's competitive neutrality guidelines.

Banking

The Reserve Bank provides central banking and related services to the Department of Finance and Deregulation (DoFD) on behalf of the Australian Government, the Future Fund, the Australian Office of Financial Management (AOFM), and a number of overseas central banks and other official institutions. It also provides contestable transactional banking services to around 90 government agencies on a commercial basis.

One aspect of the Reserve Bank's central banking activities is the role it plays as core banker to the Australian Government. Among other things, this requires the Bank to manage the consolidation of all Australian Government agency account balances, irrespective of the financial institution that provides transactional services to an Australian Government agency. These balances are then transferred at the end of the operational day into a group of accounts, known as the Official Public Accounts (OPA) Group. This is where the Commonwealth's overnight at-call cash balances are held. The Bank also provides the Government with a term deposit facility for investment of its excess cash reserves, as well as a short-term overdraft facility to cater for occasions where there is an unexpected demand on Commonwealth cash balances. These broad arrangements have been established under an agreement with DoFD.

The AOFM has day-to-day responsibility for ensuring there are sufficient cash balances in the OPA Group and the investment of excess Commonwealth funds in approved investments, including term deposits at the Reserve Bank. The Bank also offers term deposit investment facilities to other government entities, including the Future Fund Board of Guardians.

The Reserve Bank's transactional banking activities relate to the delivery of more traditional day-to-day banking services. The provision of these services is contestable, and the Bank competes against other commercial financial institutions to deliver these services to Australian Government agencies. These agencies can require service features that are common to government but not routinely requested by other users of payment and collection services. Because of its particular focus on the government sector, the Bank is able to provide facilities tailored to their specific requirements. These include features such as extremely high standards of system reliability and availability, purpose-built overnight reporting and the flexibility to react quickly when changes in government policy require consequent changes to systems and processes.

During the course of this financial year, the Australian Government initiated a number of financial stimulus measures in response to the global financial crisis. Centrelink and the Australian Taxation Office were responsible for effecting one-off payments directly to eligible families, pensioners, carers, students, drought-affected farmers and other eligible recipients. As transactional banker to both agencies, the Reserve Bank worked closely with each agency to ensure the smooth delivery of large volumes of payments in a relatively short period of time. The Bank also liaised with financial institutions to ensure they had sufficient information to manage the increase in ATM and branch-related cash demand created by the stimulus payments. Centrelink distributed 5.5 million payments totalling around $8.7 billion in December 2008 and a further 2.8 million payments totalling over $5 billion in March and April 2009. The Australian Taxation Office disbursed around $7.3 billion in April and May 2009 to around 8.4 million recipients.

The delivery of direct entry payments to recipients' accounts is a significant part of the Reserve Bank's transactional banking activities. In 2008/09, approximately 270 million payments totalling $285 billion were delivered through this payment stream by the Bank. During the course of this year, the Bank worked with the industry to develop a solution to replace the dated bilateral communication infrastructure that supports the exchange of direct entry and other low-value payments between payment service providers in Australia. The existing bilateral communication links will be replaced by newer communication networks that will allow payments system participants to use a single network connection to exchange payment messages with all other network members. The Bank expects to be able to test the exchange of files across this new infrastructure in coming months. Its broader work to support this initiative is described further in the section on Settlement Services.

During the past year, the Reserve Bank has provided assistance to government agencies that are considering new payment options, or making more effective use of those currently available, to meet their developing business requirements. Some of these include more timely and robust arrangements for the delivery of financial assistance in response to natural disasters.

Bushfire and flood relief payments facilitated by the Reserve Bank in February 2009

Others include the use of EFTPOS transactions to deliver cost and process improvements to agencies that have a requirement to complete within-day payments to their clients.

The Reserve Bank also provides its government agency customers with access to a number of bill collection services, including BPAY©, over-the-counter, phone and internet-based collections, as well as card-based collection services. Increasingly, government agencies are looking to broaden the number of channels through which debts to government can be collected, especially in the sphere of electronic collection. Cost and process efficiencies, as well as greater flexibility for debtors, are the key drivers. The Bank has continued its focus on expanding its range of service delivery options to meet this demand.

Earnings after tax in 2008/09 for the Reserve Bank's transactional banking services were $3.5 million, compared with $2.3 million the previous year.

Registry

The Reserve Bank provides registry services to the Australian Government, under an agreement with the AOFM, and a number of official foreign institutions that have Australian dollar debt programs. In common with other registry operators, the services provided to clients include registration of new issuance, ongoing maintenance of ownership records, distribution of interest payments and redemption of securities at maturity.

The Reserve Bank also provides a small-investor facility that enables retail investors to buy or sell CGS. As a result of the global financial crisis, there was increased interest and activity in this facility this financial year. Information relating to the small-investor facility, including indicative buying/selling prices, is available on the Bank's website.

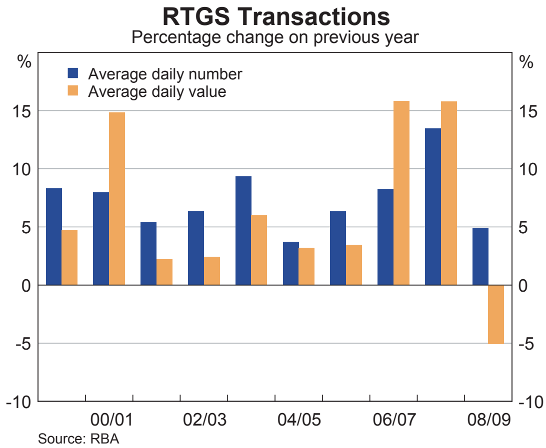
Notwithstanding the Australian Government's recent increased debt issuance activities, the level of transactional activity in the Reserve Bank's registry remains quite low as a result of wholesale financial market participants settling their CGS trades electronically in Austraclear. Earnings after tax for the CGS registry business in 2008/09 were $0.1 million, the same as the previous year.

Settlement Services

The Reserve Bank Information and Transfer System (RITS) provides the Australian financial system with a real-time interbank payment and settlement service. It is accessed by around 60 institutions approved by the Bank to operate an Exchange Settlement Account (ESA).

Payments between these institutions are settled in RITS across respective ESAs. About 90 per cent of these payments, by value, are settled on a real-time gross settlement (RTGS) basis, including time-critical customer payments, all wholesale debt and money market transactions and Australian dollar legs of foreign exchange transactions. The latter includes Australian dollar trades involved in continuous linked settlement (CLS), for which net amounts are paid to CLS Bank each day.

Following strong growth in the previous two financial years, the average daily value of RTGS transactions fell by 5.0 per cent in 2008/09, to $184 billion. This is the first financial year in which values settled have fallen since the introduction of RTGS in June 1998. The decline



is likely to be associated with a fall in foreign exchange settlements. The average daily number of transactions rose modestly, by 4.9 per cent in the year, to around 32 000. The highest daily value of transactions during 2008/09 was $289 billion, on 28 November 2008, well down from the peak of $312 billion recorded in 2007/08.

RITS also settles batches of netted interbank payments. One batch is a dedicated multilateral settlement at around 9.00 am, mainly for payments arising from cheque, direct entry and retail card transactions that are cleared overnight prior to interbank settlement across RITS. A batch settlement facility in RITS also allows approved parties to submit batches of netted interbank payments to RITS at any time during the business day. This facility is used once each day by the Australian Securities Exchange for settlement of payments arising from equity transactions.

The Reserve Bank invests significant financial and staff resources to ensure that RITS meets the exceptionally high standards of availability and resilience appropriate to its critical role in the financial system. As part of an ongoing RITS evolution program, an upgrade of the core RITS hardware, operating system and database was completed in February 2009. This major upgrade provided improvements in capacity and resilience while also placing RITS on a better footing for system support and maintenance. It followed an extensive project to replace the user interface and security regime between 2005 and 2008.

Future improvements to RITS business functionality include an additional liquidity optimisation feature, a targeted bilateral offset, and facilities for same-day exchange and settlement of files for low-value payments. These developments are described below.

The targeted bilateral offset is planned to be implemented in the September quarter 2009 and will allow two RITS members to offset selected transactions, for example those on behalf of the same client. This will reduce the amount of liquidity required for those transactions and assist in the management of client credit positions.

The Reserve Bank plans to use its significant public policy investment in RITS to assist the industry to make major improvements in the infrastructure for low-value payments (such as cheques and direct entry) and the timeliness of settlement of these payments.

Currently, institutions use low-speed bilateral network connections to exchange clearing information on customers' low-value payment transactions. As noted above, the respective positions of each institution in each clearing are collated each night and settled across RITS in a batch, at around 9.00 am on the business day following exchange.

The Reserve Bank and the industry are now working together to enhance some aspects of these arrangements significantly. In particular, the Bank is very supportive of industry initiatives to replace the ageing bilateral links with a modern 'network cloud', described as a Community of Interest Network (COIN), or by making more use of SWIFT. The Bank believes that migration to new network arrangements will bring significant benefits to Australia, including easier access to low-value payments systems for new entrants. In other projects, the Bank and industry are also exploring ways to move the settlement of low-value files (particularly those for direct entry) onto the same day as exchange. This will reduce remaining settlement risk associated with the current deferred settlement arrangements, and may in some cases also allow faster customer access to funds.

To facilitate the same-day settlement of files of low-value payments, the Reserve Bank will make a number of changes to RITS over the next year. Some broader work is also necessary to support the proposed upgrading of network connections. Since these will provide RITS members with the option of providing settlement instructions to RITS by means of SWIFT or via the COIN 'network cloud', the Bank is building a Settlement Interconnector to link RITS to any agreed industry networks for the exchange of low-value payments. The Bank is targeting availability of these facilities by around the middle of 2010.

Using the Settlement Interconnector infrastructure, the Reserve Bank is also developing a 'clearing connector', a facility that will allow participant institutions to exchange clearing files across their preferred network (SWIFT or industry network) rather than having them need to use both. This will enable participants, on their initiative, to send all clearing files to the connector for on-forwarding to their various exchange partners. The Bank is planning for this facility to be available by the end of 2009.

Settlement services are also provided for banknote lodgements and withdrawals by commercial banks and for high-value transactions undertaken by the Reserve Bank and its customers, including the Australian Government and overseas central banks and official institutions. At the end of June 2009, 35 central banks and official institutions overseas were using the settlement and safe custody services provided by the Bank to settle their Australian dollar transactions.

Currency

The Reserve Bank is responsible for the production and issuance of new banknotes and the destruction of unfit banknotes. The ultimate goal is to ensure public confidence in the currency, such that banknotes continue to be an effective payment mechanism and a secure store of wealth. This confidence is maintained by:

- making sure there are always enough banknotes available to meet the public's demand;
- maintaining a high quality of banknotes in circulation; and
- conducting research to ensure that the currency remains secure against counterfeiting.

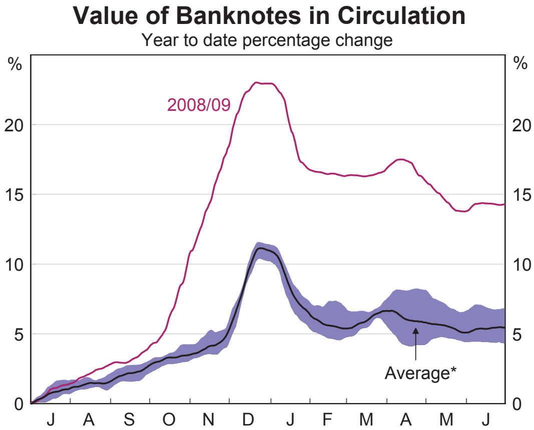
Note Issue Department is responsible for ensuring the supply of quality banknotes and researching security features to be incorporated on banknotes. The Assistant Governor (Currency) also chairs the Boards of Note Printing Australia Limited (NPA), the wholly owned subsidiary that prints Australia's banknotes, and Securency International Pty Ltd, the joint venture company that produces the polymer substrate used for Australia's banknotes.

Note Issue

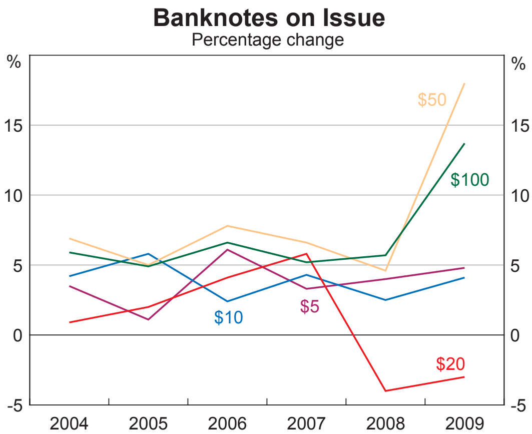
Banknotes on Issue

The Reserve Bank ensures that there are always sufficient banknotes available to meet anticipated demand from the Australian public. This demand is highly seasonal; it increases sharply in the weeks before Christmas and Easter to accommodate holiday demand, and falls away in the weeks that follow each of these holiday periods. Over time, demand for currency has been rising at an annual increase of around 5 per cent. In late 2008, however, several factors led to a significantly sharper increase in demand. Specifically:

- Developments in global financial markets reduced the public's financial risk appetite. One manifestation of this was that public demand for currency increased as households made large cash withdrawals from financial institutions.
- The sharp depreciation of the Australian dollar encouraged a range of individuals to convert their foreign currency holdings into Australian dollars. These individuals included tourists, expatriates and families of students studying in Australia.
- The Australian Government announced a stimulus package, including direct payments to households, which boosted demand for cash when these payments were made in December.
- In response to these developments, commercial banks increased their precautionary holdings of banknotes to ensure that they would be able to manage possible cash withdrawals at short notice.



* Shaded area represents the range for the four years ended June 2008
Source: RBA



Source: RBA

The combined effect of these factors was to boost the value of banknotes in circulation by 19 per cent in the three months to December, several times larger than the typical seasonal rise. Although the public's demand for banknotes has since eased, the value of banknotes in circulation remains around 14 per cent higher than at the start of the financial year, well above the average growth rate experienced in recent years.

The increased demand for currency in late 2008 saw currency in circulation as a proportion of nominal GDP rise by 0.3 per cent to 4 per cent. Over the past two decades, the growth in the value of banknotes in circulation has largely matched the nominal growth of the economy, which is broadly in line with the experience in many other developed countries.

Demand was particularly strong for $50 and $100 banknotes. The value of these banknotes on issue rose by 18 per cent and 14 per cent respectively over the past year. This represents the highest annual growth rate for these denominations since 2002, when new cash distribution arrangements were introduced. At the same time, there was a decline in the number of $20 banknotes in circulation. This shift has largely been driven by an increased preference for the $50 banknote in ATMs.

Value of Banknotes on Issue

$ million

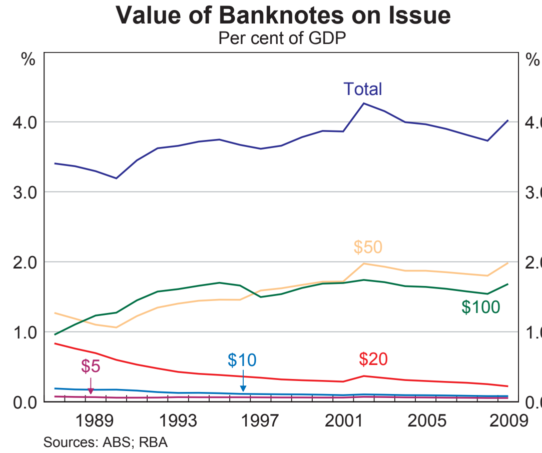
At end June	$5	$10	$20	$50	$100	Total[(a)]	Total (percentage change)
2004	533	791	2 533	15 941	14 224	34 022	5.7
2005	539	837	2 584	16 740	14 924	35 624	4.7
2006	572	857	2 690	18 044	15 903	38 066	6.9
2007	591	894	2 846	19 228	16 730	40 289	5.8
2008	614	917	2 732	20 111	17 690	42 064	4.4
2009	644	954	2 651	23 721	20 117	48 087	14.3

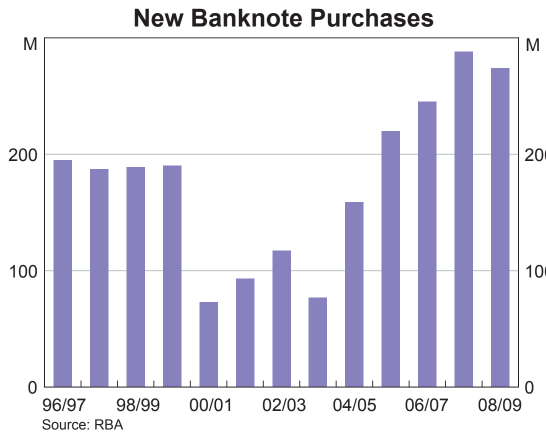
(a) Includes $1 and $2 banknotes remaining on issue

As at end June 2009, there were 1 billion banknotes in circulation worth $48.1 billion. This is equivalent to 47 banknotes worth $2 200 for every Australian.

New Banknote Purchases

The Reserve Bank held a sufficient stock of $5 and $10 banknotes to meet public demand, and therefore did not need to print these denominations during the year. In the case of higher denominations, the amount held in stock was not sufficient and during the year the Bank purchased 98 million $20 banknotes, 130 million $50 banknotes and 46 million $100 banknotes from NPA.





Distribution

In addition to the stocks of banknotes maintained by the Reserve Bank, the commercial banks also maintain a surplus stock of banknotes in approved cash centres located throughout Australia. These stocks ensure there are sufficient banknotes to meet their customers' day-to-day currency requirements. Commercial banks are encouraged to replenish these stocks by dealing directly with each other, but have the option of sourcing additional banknotes from the Reserve Bank's National Note Processing and Distribution Centre, located within NPA in Victoria. The importance of maintaining these surplus stocks of banknotes to accommodate movements in public demand was highlighted in late 2008 when demand for banknotes increased sharply.

Banknote Quality

In order to maintain a high quality of banknotes in circulation, the Reserve Bank regularly issues new banknotes and withdraws unfit banknotes. These activities maintain the functionality of banknotes for handling by the public and for processing through the various banknote accepting and dispensing machines that are increasingly present in the community. High-quality banknotes also assist the public's ability to detect counterfeits.

The commercial banks and armoured car companies play an important role in achieving this quality objective. The Reserve Bank provides incentives for banks and armoured car companies to sort unfit banknotes from their contingency holdings and for investment in banknote sorting machines.

The Reserve Bank monitors banknote quality by periodically sampling the banknotes held by the commercial banks and armoured car companies. Since the introduction of the note quality scheme in 2006, the quality of these banknotes has improved appreciably. The proportion of banknotes rated as high quality has increased from 78 per cent in 2006 to 85 per cent in June 2009. Banknotes deemed to be unfit by the commercial banks and armoured car companies are returned to the Reserve Bank's banknote processing centre in Victoria and destroyed.

Some banknotes become damaged in circulation beyond the normal levels of wear and tear and become unsuitable for processing through high-speed sorting equipment. The Reserve Bank has a policy of paying value for severely damaged banknotes that can be authenticated as genuine Australian banknotes. This includes banknotes significantly damaged or contaminated as a result of natural disasters, such as the floods in southern Queensland and the Victorian bushfires.

Although commercial banks can assess damaged banknotes and pay the assessed value for them, all damaged banknotes are returned to the Reserve Bank for final assessment and destruction. Under this policy, most damaged banknotes receive full value, including ATM dye-stained banknotes submitted by commercial banks. However, where a large piece of a banknote is missing, only the appropriate partial value is paid. During 2008/09, the Bank assessed around 25 000 damaged banknote claims, and paid out around $8.1 million.

Counterfeiting in Australia

In line with its objective of maintaining confidence in Australia's banknotes, the Reserve Bank monitors the incidence of Australian counterfeits passed. By international standards, counterfeiting in Australia continues to be quite low. Specifically, around 7 700 counterfeits, mainly of poor quality, were passed in Australia in 2008/09. These counterfeits had a nominal face value of approximately $423 000. This equates to around seven counterfeits passed per million genuine banknotes in circulation, which is similar to the previous year. The average rate of counterfeits passed per million banknotes in circulation in other developed countries that have publicly available statistics has been around 100 in the past two years.

As has been the case for a number of years, the $50 banknote continued to be the most commonly counterfeited denomination, comprising approximately 80 per cent of the number of counterfeits passed in 2008/09.

Counterfeit Banknotes in Australia
2008/09

	$5	$10	$20	$50	$100	Total
Number	48	166	208	6 136	1 104	7 662
Nominal value ($)	240	1 660	4 160	306 800	110 400	423 260
Parts per million	0.4	1.7	1.4	13.0	5.7	7.4

Importantly, there is no evidence of 'professional' counterfeiting in Australia, with the vast majority of counterfeits being printed on paper and only a crude attempt made to simulate the clear window and its printed image. These counterfeits are easily detected by visual inspection and feel.

Notwithstanding the low level of counterfeiting activity, the Reserve Bank takes all counterfeiting incidents seriously, and is actively engaged in improving the protection of Australia's banknotes. This includes:

- an ongoing research and development program into improving the security of Australia's banknotes;
- working with law enforcement agencies in Australia and overseas to monitor and combat emerging counterfeiting trends; and
- the establishment of a dedicated counterfeit examination laboratory to assist the Australian Federal Police (AFP) with the administration and handling of counterfeits.

The Reserve Bank is continuing to work with the AFP to develop new counterfeit processing procedures, with the aim of gaining deeper insights into counterfeiting trends and the techniques used by counterfeiters. It is hoped that this additional information could be used to assist law enforcement agencies with counterfeit-related investigations.

Banknote Research and Development

The Reserve Bank continues to conduct research and development into features designed to enhance the security of polymer banknotes. A number of the Bank's research initiatives are conducted jointly with a range of third parties, including private companies, universities and research institutions. The Bank's research and development group also works closely with a number of overseas central banks to discuss and explore issues, ideas and solutions related to banknote authentication and counterfeit deterrence. The Bank is a member of the Central Bank Counterfeit Deterrence Group, an association of central banks and printing authorities that works towards developing strategic responses to counterfeiting threats worldwide.

Numismatics

Following a review of the results of the annual auctions of numismatic banknotes held in 2007 and 2008, the Reserve Bank has examined a number of alternative models for numismatic sales in an attempt to refine the arrangements further. In future, numismatic banknotes will be made available by the Bank for a specific period during each year at fixed prices. Details of the new sales facility will be announced in the second half of 2009.

Note Printing Australia

Note Printing Australia is a wholly owned subsidiary of the Reserve Bank, located in Victoria, which produces Australian banknotes and operates the National Note Processing and Distribution Centre under contract to the Bank. NPA also produces Australian passports for the Department of Foreign Affairs and Trade, banknotes for a small number of other countries in the Asia-Pacific region and banknote security products for a number of overseas banknote producers.

NPA operates with a charter from the Reserve Bank, under which its primary focus is to produce Australian banknotes efficiently and to a high level of quality. NPA's operations are overseen by a board of directors appointed by the Bank. The board at present comprises four Reserve Bank executives: Bob Rankin, Assistant Governor (Currency) as Chairman; Keith Hall, Assistant Governor (Banking and Payments); Darryl Ross, Chief Financial Officer;

and Lindsay Boulton, Head of Risk Management. During the year, Les Austin and Richard Warburton AO retired from the Board. The company's chief executive is Bernhard Imbach, who has occupied the position since early 2008.

In support of the company's focus on quality and efficiency, a major investment program is under way. When completed in early 2010, this program will have ensured that key equipment and systems at NPA represent the best current practices in the banknote industry.

In 2008/09, NPA produced 403 million banknotes, comprising 275 million for Australia and 128 million for other countries, including Brunei, Malaysia and Papua New Guinea. NPA also produced 2.1 million passports during the year. Most passports produced this year were of the new series, launched by the Department of Foreign Affairs and Trade in May 2009.

NPA earned a profit after tax of $6.1 million in 2008/09, broadly in line with the previous year. The financial accounts for NPA are consolidated with those of the Reserve Bank.

Securency

Securency is a joint venture between the Reserve Bank and Innovia Films, a major manufacturer of polypropylene films based in the United Kingdom. Securency produces high-security substrate for banknotes and other security documents by applying proprietary coatings and features to specialised films manufactured by Innovia. The principal product of the company is Guardian®, the substrate for use in banknote printing.

Securency has a board comprising eight voting directors, four appointed by each of the Reserve Bank and Innovia, with the Managing Director, Myles Curtis, as a non-voting director. The directors appointed by the Bank are Bob Rankin (Chairman), John Akehurst (a member of the Reserve Bank Board), Les Austin and Darryl Ross. Securency's headquarters are in Victoria.

Securency produces Guardian® substrate at plants in Victoria and in Queretaro, Mexico. The latter is owned by Securency Mexico, S.A. DE C.V., a joint venture between Securency and Banco de Mexico, the Mexican central bank. The Mexican plant commenced operations in December 2008, and provides capacity to supply the growing demand for Guardian® in Latin America as well as contingent support for the plant in Victoria.

During 2008/09, Securency produced Guardian® substrate for banknotes in the following countries: Australia, Brunei, Chile, Guatemala, Honduras, Hong Kong, Malaysia, Mexico, Nigeria, Papua New Guinea, Romania, Singapore and Vietnam. Several countries, including Chile, Guatemala, Honduras and Nigeria, have issued Guardian®-based banknotes for the first time or announced conversion of additional denominations to Guardian® during the year.

Securency has a strong commitment to research and development, ensuring that the company can continue to offer innovative and effective solutions to demands for security features in banknote substrate. In keeping with this commitment, the company has invested in a new centre for research and development (located in Victoria adjacent to the production plant) to accommodate the research staff and facilities. The new centre also provides a platform for future collaborative work with third parties to enhance research into banknote security in the future. The centre was opened in July 2009.

Securency earned a profit after tax of $7.9 million in 2008 on sales of $120 million, most of which were for export. The Reserve Bank equity accounts for its investment in Securency.

Late in the financial year, a series of media articles appeared in a Melbourne newspaper, *The Age*, alleging impropriety related to Securency's international sales and marketing activities, in particular its use of agents as its representatives in developing countries.

The Board of Securency has measures in place designed to ensure the maintenance of high standards of integrity in the company's operations and has ensured that the company has strict and unambiguous protocols in place governing the use of agents. The effectiveness of the company's implementation of these measures has been regularly audited and these audits have found no evidence of non-compliance. The allegations were therefore treated very seriously, and when they were first raised the Board of Securency promptly requested an independent investigation by the AFP. This investigation began immediately and the Board has ensured that all possible assistance has been given to the AFP.

The Board of Securency also engaged an external accounting practice to undertake a thorough independent review of the company's policies and practices in relation to the use of agents, to ensure that they remain at best practice. At the AFP's request, Securency delayed the start of this review until the AFP had completed its initial assessment of the allegations. The review, which is now in progress, is expected to take several months to complete.

The Board of Securency has kept the Reserve Bank and its other shareholder informed of its actions and decisions. The measures it has taken have the full support of the Reserve Bank and the other shareholder.

International Financial Co-operation

The global financial crisis has increased the need for closer international co-operation, as both developed and emerging economies have sought to mitigate the effects of the turmoil in financial markets and the resulting downturn in economic activity. Over the past year, various international fora have been addressing problems in the regulation, oversight and structure of the global financial system highlighted by the crisis, as well as the more immediate issue of measures intended to foster recovery in the global economy. In many cases, this has led to an increase in the workload of the international groups in which the Reserve Bank is involved. Since late 2008, the G-20 has taken a lead role in prioritising and co-ordinating the work of the major international organisations and has sought to provide the political impetus needed for significant progress in implementing reform.

Group of Twenty (G-20)

In November 2008, the first G-20 Leaders' Meeting was held in Washington DC, attended by heads of state or government. This meeting took place during a period of significant disruption in financial markets. The leaders outlined a plan of significant reforms to the financial sector, which focused on strengthening transparency and accountability, enhancing sound regulation and promoting integrity in financial markets. They also sought closer international co-operation and reform of the international financial institutions.

This plan has shaped the recent work of the G-20, and has been overseen by regular meetings of the G-20 finance ministers and central bank governors and their deputies. In late 2008, four working groups were established to pursue the leaders' reform plan in conjunction with the major international bodies that were undertaking much of the detailed work on the specific action items. The Australian Treasury co-chaired the working group on reforming the IMF, while the Reserve Bank was most actively involved in the working group on reinforcing international co-operation and promoting market integrity, which made recommendations concerning such issues as supervision of major cross-border financial institutions, cross-border crisis management, and protection against market manipulation and fraud. The other two working groups focused on enhancing sound regulation and strengthening transparency, and reforming the World Bank and other multilateral development banks. The Reserve Bank, Treasury, APRA and ASIC have been pursuing the implementation of the G-20 financial reform plan in Australia, although, in many cases, Australian institutions and practices were already consistent with the recommendations.

At their April meeting in London, the G-20 leaders committed to providing the stimulus needed to underpin global recovery, while ensuring consistency with long-term fiscal sustainability and price stability, and to continue to pursue regulatory reform of the financial sector. This included the transformation of the Financial Stability Forum into the Financial Stability Board (see below), and agreement to extend regulation and oversight to all systemically important institutions, instruments and markets. To respond to a potential increase in calls on IMF resources, the G-20 leaders committed to trebling the resources of the IMF to US$750 billion and to support at least US$100 billion of additional lending by multilateral development banks. The G-20 is now preparing for a third meeting of its leaders later this year.

During the year, the G-20 published a report by a Study Group on Global Credit Market Disruptions, led by the Reserve Bank. The G-20 also held workshops involving private sector and academic experts; one was on the 'Economic and Financial Implications of Climate Change', held in Sydney and jointly hosted by Australia and the United Kingdom, and the other on the 'Causes of the Crisis: Key Lessons?'

Financial Stability Forum (FSF)/Financial Stability Board (FSB)

The Financial Stability Forum was established in 1999 in the aftermath of the Asian financial crisis to promote international financial stability, improve the functioning of financial markets and reduce the tendency for financial shocks to spread. Its membership comprised national authorities from the G7 countries, central bank representatives from a number of other countries, including Australia, as well as international organisations such as the IMF, the Bank for International Settlements and the Basel Committee on Banking Supervision.

Since the onset of the financial crisis in 2007, the FSF had done a significant amount of work to address the underlying causes of the financial crisis, which it outlined in its April 2008 *Report on Enhancing Market and Institutional Resilience.* It subsequently followed up with its members on the implementation of the recommendations it made. This work was done in consultation with other international bodies, particularly the G-20.

As part of this process, FSF working groups examined issues related to procyclicality and its relationship with bank capital, provisioning, valuation and leverage, as well as best practices in executive compensation. Senior Reserve Bank staff participated in the Working Group on Valuation and Leverage (see more details below), while senior APRA staff were members of the executive compensation and provisioning working groups. As part of this work, the FSF has:

- put forward a number of proposals to strengthen the Basel II regulatory framework, which includes increasing the risk-weights for resecuritised assets, as well as improving the quality of banks' capital with an increased emphasis on ordinary equity, rather than hybrid equity;
- investigated the feasibility of using macro-prudential indicators to reduce excess procyclicality in the financial system;
- sought to establish supervisory colleges for around 30 systemically important global banks;
- proposed principles on co-operation on cross-border crisis management; and
- recommended greater convergence of arrangements for deposit insurance.

Coinciding with the G-20 Leaders' Meeting in April 2009, the FSF announced that it would be re-established as the Financial Stability Board with broader representation and a stronger mandate for financial stability. In addition to the original FSF members, the FSB now includes representation from the remaining G-20 countries plus Spain and the European Commission.

In the process, Australia gained a second seat, which has been filled by the Australian Treasury. The mandate of the FSB has been broadened to include monitoring market developments, advising on the implications for regulatory policy, setting guidelines, providing support for supervisory colleges and working with the IMF on early warning exercises. The first plenary meeting of the FSB was attended by the Governor in Basel in June 2009.

Under the FSB, there are four permanent committees, which, in most cases, have the same objectives as the existing groups that met under the auspices of the FSF. The Governor will represent the Bank on the Steering Committee of the FSF and on the vulnerabilities assessment group.

As a requirement of its membership of the FSB, the Reserve Bank, in conjunction with APRA, ASIC and Treasury, has been actively involved in making sure that Australia's system of financial regulation remains world's best practice and in compliance with the international standards.

Bank for International Settlements (BIS)

The BIS and its associated committees have been extensively involved in the international response to the global crisis, and have continued to play an important role in bringing together high-level officials from central banks to exchange information about the current economic and financial environment.

The Governor or Deputy Governor attended the regular bi-monthly meetings of the BIS governors, which discussed the evolution of the financial crisis, the vulnerabilities revealed in the financial sector and their effect on the real economy. Discussion focused on particular challenges faced by central banks during the financial crisis, including the provision of liquidity to the financial system, the need by some countries to respond to insolvent or failing institutions and the adoption of unconventional monetary policy by some countries. The Governor also participated in the Asian Consultative Council, which focuses on financial and monetary developments in Asia and provides direction for the work of the BIS in Asia.

The Assistant Governor (Financial Markets) represents the Reserve Bank on two BIS committees – the Committee on the Global Financial System (CGFS) and the Markets Committee. The CGFS discusses vulnerabilities in the global financial system and structural developments in financial markets, while the Markets Committee focuses on the short-run implications of current events for the functioning of financial markets. Over 2008/09, the CGFS published reports on: the role and valuation of leverage on procyclicality (jointly with the FSF); capital flows to emerging markets; ratings on structured finance products; central bank operations in times of a financial crisis; the effect of leveraged finance; and the effects of private equity and leveraged buyouts on incentives and corporate structures.

The Reserve Bank has been represented on a number of CGFS working groups over the past financial year. The Assistant Governor (Financial Markets) co-chaired a working group that investigated the impact of the crisis on cross-border funding and lending strategies of international banks. He also participated in a group that examined the liquidity provision by central banks, which, *inter alia*, provided the underpinnings of the swap lines established among central banks over the past year, and a group that assessed the options available to central banks in conducting unconventional monetary policy. The Head of Financial Stability Department participated in the joint CGFS/FSF Working Group on Valuation and Leverage in Procyclicality. This group, in combination with the Working Groups on Bank Capital and Provisioning, examined the forces that contribute to procyclicality in the financial system, suggested options to mitigate it and contributed to the publication of a report by the FSF in April 2009 on *Recommendations for Addressing Procyclicality in the Financial System*. A senior manager from the Financial Markets Group participated in a CGFS working group that reviewed the effectiveness of statistics available for understanding credit risk transfer markets and participated in the Review Group for the BIS/ECB/IMF Handbook on Securities Statistics, which is a subgroup of the Working Group on Securities Databases. Finally, the Bank also contributed to the CGFS collation of information on financial sector rescue plans, which will, in turn, enable work to be undertaken to assess their effectiveness.

The Assistant Governor (Financial System) will represent the Reserve Bank on the Basel Committee on Banking Supervision (BCBS), following the expansion of its membership in April to include all representatives from the G-20 countries as well as Hong Kong SAR and Singapore. As the architect of the Basel II framework, the BCBS has worked intensively over the past year on strengthening guidance on liquidity risk management and supervision, fair value practices, stress-testing principles and other aspects of financial sector regulation. The Head of Payments Policy Department will represent the Bank on the recently expanded Committee on Payment and Settlement Systems (CPSS). The CPSS provides a forum for central banks to monitor and analyse developments in domestic payment, clearing and settlement systems as well as in cross-border and multi-currency settlement schemes. Its recent work has focused on interdependencies between payment and settlement systems and clearing and settlement of over-the-counter (OTC) derivatives. It has also started work with the International Organization of Securities Commissions on a review of the standards applying to risk management in central counterparties.

A number of senior officials from the Reserve Bank were seconded to the BIS during the year, at both its Basel headquarters and at its Asian representative office in Hong Kong, and a number participated in various conferences organised by the BIS.

International Monetary Fund (IMF)

The financial crisis has increased the pressure for further reform of the IMF, including greater representation of emerging market economies and stronger governance. It has also resulted in the IMF reviewing its surveillance activities so as to be better placed to identify and respond to future episodes. The G-20 has asked the IMF to undertake some work in response to the financial crisis, including research on the causes of the crisis, analysis of its likely effects and policy advice to mitigate the most adverse of these.

The Reserve Bank works with the Australian Treasury to provide regular briefing to Australia's Constituency Office at the IMF on the issues being considered by the IMF Executive Board and in the governance of the IMF. In order to contribute further to the capacity of the Constituency Office, the Bank has provided an advisor to work at the office who has expertise in the areas of capital markets and financial systems. The Bank also provides support to other IMF activities – the Assistant Governor (Banking and Payments) is participating in the IMF's Financial Sector

Assessment Program in Indonesia and has also been involved in technical assistance programs on stress-testing capabilities in Indonesia and Malaysia.

The IMF conducts an annual review of member countries' economic situation and policies, known as an Article IV Consultation. The 2008 report for Australia was published by the IMF in September 2008. As input to the 2009 report, a mission team from the IMF visited Australia in June and, as is customary, spoke with the Bank's Governor and Assistant Governors. The report was published in August.

Executives' Meeting of East Asia-Pacific Central Banks (EMEAP)

The Executives' Meeting of East Asia-Pacific Central Banks is an important regional forum, in which the Reserve Bank is extensively involved. It brings together representatives from 11 countries in the East Asia-Pacific region – China, Hong Kong SAR, Indonesia, Japan, Korea, Malaysia, New Zealand, Philippines, Singapore, Thailand and Australia – to discuss monetary and financial stability, seek ways to foster closer co-operation, and exchange information and expertise on issues of common interest. The Bank participates in EMEAP at a number of levels from the Governor down.

Glenn Stevens met with Chief Executive Joseph Yam from the Hong Kong Monetary Authority and Governor Masaaki Shirakawa from the Bank of Japan at the 14th EMEAP Governors' Meeting, held in Hong Kong in July 2009

As with other international groups, the focus of discussion in the past year has been the effects of the global financial crisis and how the represented economies should be responding. The financial crisis has affected most of the represented economies in very different ways from the large developed economies, and differences in the structure of financial sectors in the region have called for some differences in response. At the deputy governor level, a dedicated Monetary and Financial Stability Committee (MFSC) has focused on the implications of the financial crisis for the region's financial sectors. This committee met twice during the past year and has also held teleconferences on several occasions to exchange information during periods of acute uncertainty in financial markets.

Three working groups report to the deputies and support the surveillance work of the MFSC: the Working Group on Financial Markets; the Working Group on Banking Supervision; and the Working Group on Payment Settlement and Systems. In addition to their regular work program, these working groups have reviewed the recommendations made by the FSF and G-20 and have discussed their implications for the EMEAP region. Each year, one meeting and one workshop are held for IT Directors. The most recent workshop was hosted by the Reserve Bank in Sydney.

EMEAP is involved in the establishment and ongoing oversight of Asian Bond Fund 1, a US dollar denominated Asian bond fund, and Asian Bond Fund 2, comprising eight local currency indexed bond funds, and a Pan Asia Index Bond Fund (PAIF). Until recently, the PAIF was listed only in Singapore; however, in June 2009, it was cross-listed on the Tokyo Stock Exchange, which should increase its attractiveness as an investment for domestic Japanese investors.

Government Partnership Fund (GPF)

In 2008/09, the Reserve Bank continued its program with Bank Indonesia (BI), under the Australian Government's Government Partnership Fund, which has been running for the past four years. This program is designed to share skills and knowledge between Australian and Indonesian public-sector institutions.

The core focus of the Reserve Bank's program with BI was originally centred on building capacity in the areas of monetary policy, financial markets and financial stability. However, over time, the activities have broadened to cover all aspects of central banking, including note issue, auditing and human resources. In 2008/09, the program involved 32 staff exchanges between the Bank and BI, with the visits ranging between a few days and a few weeks. This brings the number of exchanges between the two institutions to just over 100 since the inception of the program.

Among the visits by Reserve Bank staff to BI, in July 2008 a senior manager from the Bank conducted the second of a series of workshops on money market operations to support the reforms enacted by BI in this area. Several officers from the Bank's financial markets area held a workshop on reserves management and portfolio investment strategies. Visits by BI officers to the Bank related to a wide variety of activities, including central bank communication, regional economic analysis, the payments system and risk management. One of the new developments of the program was the production of a training DVD on cash processing and distribution in English and Bahasa Indonesian for use throughout BI. As a result of the program, the relationship between the two organisations has strengthened considerably.

South Pacific Central Bank Co-operation

In December 2008, the Reserve Bank hosted the annual meeting of the South Pacific Central Bank Governors. This meeting brings together the central bank governors of those countries within the Pacific region that have their own currencies – Fiji, New Zealand, Papua New Guinea, Samoa, Solomon Islands, Tonga, Vanuatu and Australia – to discuss economic issues of particular interest to small island economies. Representatives from the IMF's Pacific Financial Technical Assistance Centre also contributed to the meeting. The main issues discussed at the meeting in Sydney focused on recent economic developments, notably the effects of the global financial crisis on the Pacific region, the significant changes in food and fuel prices and the implications for policy-makers. Longer-term issues relating to the principles of central bank communication and the payments system were also discussed.

South Pacific Central Bank Governors' Meeting 1. Siosi Mafi, Governor of the National Reserve Bank of Tonga **2.** Odo Tevi, Governor of the Reserve Bank of Vanuatu **3.** Glenn Stevens with Tommy Scanlan, Governor of the Central Bank of Samoa **4.** Denton Rarawa, Governor of the Central Bank of Solomon Islands **5.** The meeting in session **6.** Alex Heath, International Department, and Matt Davies, incoming Co-ordinator of the Pacific Financial Technical Assistance Centre **7.** Don Abel, Assistant Governor and Head of Operations, Reserve Bank of New Zealand, and James Holloway, Economic Analysis Department **8.** Meeting organiser Brett Winton, International Department **9.** Wilson Kamit, Governor of the Bank of Papua New Guinea, and Tommy Scanlan **10.** 'Ungatea Latu, National Reserve Bank of Tonga

The Reserve Bank continued to foster closer ties with the South Pacific countries through an exchange of staff. A Reserve Bank staff member was seconded to the Reserve Bank of Vanuatu, while a delegation from the Bank of Papua New Guinea visited Sydney to discuss the Bank's foreign exchange trading platform. Several senior officers from the National Reserve Bank of Tonga also participated in management courses conducted for Reserve Bank staff.

Bilateral Relations and Co-operation

As in previous years, the Reserve Bank continued to receive a number of visitors from overseas. Predominantly from foreign central banks, the visits covered the full range of the Bank's activities, and included delegations from Chile, Kenya, Korea, Mozambique and the Philippines.

A second senior officer from the Reserve Bank of India (RBI) visited the Bank for three months under the auspices of an ongoing exchange initiative entered into during 2007/08. To date, one officer of the Reserve Bank has undertaken a placement at RBI's head office in Mumbai.

The Reserve Bank in the Community

Activities of the State Offices

In addition to its Head Office located in Sydney, the Reserve Bank has offices in Melbourne, Brisbane, Adelaide and Perth.[1] These State Offices play an important role in the Bank's business liaison program and form a key component of the Bank's communication with members of the public, business, government and academia in their respective States.

Since 2001, the Reserve Bank has devoted significant resources to systematically building relationships across a broad cross-section of the business community, with a view to gaining first-hand insights into conditions in different industries and regions within the national economy. The staff involved in the business liaison program have built up a pool of over 1 500 regular contacts around the country, with staff in the State Offices playing a critical part. The information obtained is reported in detail to Head Office and incorporated into the material prepared for monthly Board meetings and in the quarterly *Statement on Monetary Policy*. In this way, information obtained from liaison is used as a complement to standard sources, such as data from the Australian Bureau of Statistics and business surveys, in forming the Bank's assessments of the economy. This information has proved particularly informative over the past year.

Staff in the State Offices also play a role in the Bank's efforts to keep the public informed of its evolving views on the economy. They interact with a broad cross-section of the community, regularly giving presentations on economic developments to business groups, community organisations and educational institutions, in both State capitals and regional centres. They also facilitate visits by senior staff from Head Office's Economic Group each quarter to brief groups of liaison contacts about the main themes following the release of the *Statement on Monetary Policy*.

Liaison with Small Businesses

The Reserve Bank continues to convene its Small Business Advisory Panel, which meets annually to discuss issues relating to the provision of finance and the broader economic environment for small businesses. Membership of the Panel is drawn from a wide range of industries across the country. The Panel represents a valuable source of information on the financial and economic conditions faced by small businesses.

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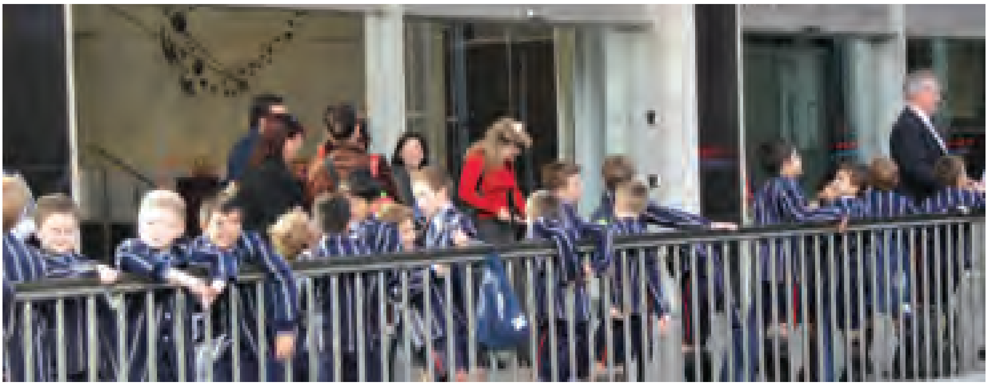
1 *The Victorian Office covers Tasmania, the South Australian Office covers the Northern Territory and staff in Head Office cover the Australian Capital Territory.*

Museum of Australian Currency Notes

The Reserve Bank's museum exhibits the story of Australia's currency notes against the background of the nation's broader history. It commences with the types of money used before Federation, ranging from a rum bottle used in early colonial days to Australia's first gold coins. Visitors can then view the various notes produced since the first Australian note series in 1913–1915. The final stage of the museum focuses on Australia's polymer currency notes, including information on their design, security features and potential for recycling. When viewing the original notes, visitors can observe the evolution of Australian identity as expressed through currency notes, learn about the men and women represented on the notes and the artwork used in their design. The notes are presented alongside displays of key episodes in Australian history captured in archival film, photographs and documents.

Over 11 000 people visited the museum in 2008/09, including more than 1 000 visitors on Australia Day 2009. The museum remains popular with school groups. Many of these groups receive a short presentation on the role of the Reserve Bank or, in the case of senior economics students, a talk on the Australian economy. This year, for the first time, presentations were extended to primary school students, who received a talk on the role of money and the special features of Australian banknotes. Most of the information in the museum is on the Bank's website, where visitors can also take a virtual tour of the museum. Around 250 000 people visited the museum online in the past year, with around half of these being from other countries.

The Currency Museum on Australia Day 1, 2, 3 While some visitors waved flags, others wore them **4, 5.** The momentum from the crowds in Martin Place and Macquarie Street carried on into the museum **6.** Elements of banknotes are highlighted in the museum pamphlet



Year 2 students from The King's Grammar School outside the Reserve Bank before their talk on Australian banknotes

Assistance for Research and Education

The Reserve Bank sponsors Australian and international economic research in areas that are closely aligned with its primary responsibilities. This sponsorship includes financial support for conferences, workshops, data gathering, journals and special research projects, and encompasses areas of study such as macroeconomics, econometrics and finance.

In 2008/09 the Reserve Bank continued its longstanding contribution towards the cost of a monthly survey of inflation expectations undertaken by the Melbourne Institute of Applied Economic and Social Research at the University of Melbourne, and a quarterly survey of union inflation and wage expectations undertaken by the Workplace Research Centre at the University of Sydney.

The Reserve Bank continued to provide financial support for the *International Journal of Central Banking*, the primary objectives of which are to disseminate first-class policy-relevant and applied research on central banking and to promote communication among researchers inside and outside central banks. The Bank continued its support of the International Accounting Standards Committee Foundation, with the second of three pledges following completion in 2005 of the initial five-year support plan. It also maintained its longstanding practice of contributing to the Group of Thirty's program of research and publications in the area of international finance.

Financial assistance to Australian universities each year includes contributions towards the costs of their organising conferences in economics and closely related fields. In 2008/09, these conferences included the 21st Conference for PhD Students in Economics and Business, held at the Australian National University; the Economic Society of Australia's 37th Conference of Economists, held on the Gold Coast; a Conference on Behavioural Macroeconomics, held at the Reserve Bank's Coombs Centre, organised by the Centre for Applied Macroeconomic Analysis at the Australian National University; the 14th Melbourne Money and Finance Conference; the 14th Australasian Macroeconomic Workshop, held at Deakin University; the Australasian Meeting of the Econometric Society, held in Wellington, New Zealand; the University of New South Wales 21st Australasian Finance and Banking Conference; the Financial Integrity Research Network PhD Tutorial, held at the University of Technology, Sydney; and the 4th Annual Workshop in

Macroeconomic Dynamics, held at the National University of Singapore. The Bank is also assisting a research project on real-time forecasting, convened by Professor Shaun Vahey of the University of Melbourne.

The Reserve Bank sponsors an annual essay competition for undergraduate students across Australia, organised jointly with the University of New South Wales Economics Society, in order to engage and support students of economics. In 2008 the theme of the competition was 'Housing Costs and Affordability in Australia'. Amy Wagner (University of Queensland) wrote the winning essay, the runner up was Louise Burns (Curtin University), and the best essay from a first-year student was written by Rhea Thrift (University of Newcastle). These students were presented with their prizes by the Governor at a ceremony in October. For the 2009 competition, students have been invited to submit an essay on the theme of 'Policy Responses to the Global Financial Crisis'.

In conjunction with APRA, the Reserve Bank has continued sponsorship of the Brian Gray Scholarship Program, initiated in 2002 in memory of a former senior officer of the Bank and APRA. Four scholarships were awarded under this program in 2009, one for PhD study on whether trust law provides an appropriate foundation for governing superannuation, at the University of New South Wales, and three for honours year studies: at the University of Queensland, modelling the behaviour of interbank markets under asymmetric information; at Macquarie University, on a multi-model inference for determining insurance reserve levels; and at the University of New South Wales, on the analysis of pricing and risk management aspects of products that insure against longevity risk.

The Reserve Bank has a rich archive of documents relating to banking activities and bank buildings in Australia over an extended period, pre-dating the existence of the Bank. The Bank was formerly the government printer for materials other than currency notes and the archives contain, among other things, a historical collection of Australian stamps, vouchers and posters. Many of these records are of interest to researchers. Over the past year, the Bank hosted visits by researchers, including prominent academics, heritage architects, curators and postgraduate students. It also dealt with numerous written requests from researchers requiring Bank staff to assess archival records and provided access to the archives by members of the public making specific enquiries. Work continued over the year on preparation of a further volume of the history of the Bank, covering the period 1975–2000.

Charitable Activities

During the year the Reserve Bank made its seventh annual contribution of $50 000 to the Financial Markets Foundation for Children, of which the Governor is Chairman. Along with several other Australian financial institutions, the Bank has committed to support the Foundation to this extent for a further three years. In July 2009, in its fourth public event to raise funds, the Governor addressed the Anika Foundation, which was established in 2005 to support research into adolescent depression and suicide.

The Reserve Bank's corporate philanthropy program involves two major initiatives: dollar-matching staff payroll deductions to the staff's Reserve Bank Benevolent Fund; and donating the value of leave days given up by staff to work for charitable organisations under a Volunteer

Day Program. The Bank's contributions under both initiatives in 2008/09 totalled $49 500. The Bank also facilitates staff salary sacrificing under a Workplace Giving Program.

Following the Victorian bushfires in February 2009, the Reserve Bank Benevolent Fund arranged a collection from staff. This resulted in $24 000 being donated to the relief fund, which was dollar-matched by the Bank on a one-off basis.

Reserve Bank staff interacted with the community in a number of volunteering capacities in the past year, including the Cancer Council's Daffodil Day and Biggest Morning Tea fundraisers, the National Breast Cancer Foundation's Pink Ribbon Day, the Jeans for Genes Day annual fundraiser for the Children's Medical Research Institute, and the Christmas food collection for the Salvation Army's Streetlevel Mission.

Management of the Reserve Bank

Operating Costs

During the year, the Reserve Bank was required to undertake a range of new or additional activities in response to the global financial crisis. These included: establishing arrangements to administer the Government Guarantee Scheme for Large Deposits and Wholesale Funding on behalf of the Australian Treasury; additional new banknotes to meet increased demand for cash; increased staffing to monitor developments in global financial markets, including the international policy response; higher transaction costs associated with more active operations, especially in domestic markets; and additional costs associated with the issuance and processing of cheques for the Government's stimulus payments. Some of these involved additional staff and new investment in systems and equipment. Others pushed up costs by reducing the amount of leave taken and increasing overtime, while the significant depreciation of the Australian dollar increased the cost of overseas operations. These direct and indirect costs flowing from the financial crisis added substantially to the Bank's running costs for the year. Of course, the financial crisis also added to the Bank's revenues, as outlined in the chapter on 'Earnings and Distribution'.

More generally, the rise in the Reserve Bank's costs also reflected a restructuring of its activities in relation to currency printing, issue and distribution, to strengthen the governance of operations at Note Printing Australia (NPA) and Securency and ensure the integrity of the Australian banknote issue. The ongoing program of enhancing the functionality, resilience and security of IT systems continued. Key systems developed further in 2008/09 were the platform for the interbank payments system (RITS), the Bank's trading system and the transactional banking system. These IT systems are pivotal to ensuring the continuity of the Bank's operations, which are of systemic importance.

In total, operating costs in 2008/09 were $215.4 million, an increase of about 9.7 per cent from the previous year.

Operating Costs(a)
$ million

	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09
Staff costs	67.7	73.9	77.8	85.5	91.4	101.0	110.2	119.1	132.6
Other costs	54.1	58.4	62.7	58.6	68.8	73.1	74.7	77.2	82.8
Underlying operating costs	121.8	132.3	140.5	144.1	160.2	174.1	184.9	196.3	215.4
Cost of redundancies	2.6	3.4	2.6	0.2	0.2	0.2	0.2	0.2	2.0

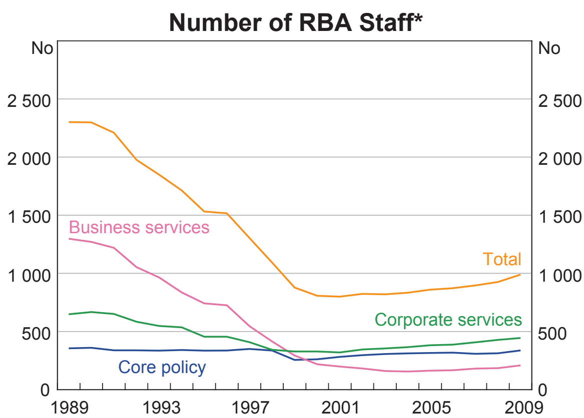
(a) Costs associated with the ongoing operation of the Reserve Bank, excluding NPA

More than half of the Reserve Bank's operating costs arise from the conduct of its responsibilities for monetary and payments system policies, including operations in financial markets; about a quarter are associated with providing banking and settlement services, including the real-time interbank settlement system and transactional banking services for the Australian Government; and about 16 per cent of operating costs arise from issuing banknotes.

Expenditure on staff represents the Reserve Bank's largest cost, accounting for around 60 per cent of total operating costs including remuneration, on-costs and other related costs for training, recruitment and the like. Redundancy payments are also made from time to time when work practices are redesigned to meet changing business requirements or to improve the efficiency of operations; in 2008/09, these payments amounted to $2.0 million.

Our People

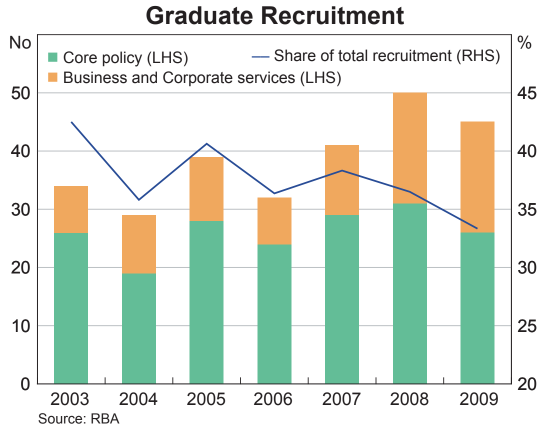
Reflecting additional activities, the Reserve Bank took on more staff during the year. As at the end of June 2009, the total number of employees at the Bank was 989, an increase of 63, or 6.8 per cent, from the previous year. The direct impact of the global financial crisis on staff numbers was felt mainly in new positions created to administer the Government's Guarantee Scheme. The indirect effects were felt more widely. These included changes in work programs as new challenges have arisen; higher payment settlement volumes and peak loads; and increased banking activity associated with the Government's economic stimulus payments and variations to systems as a result of the Bank's changing collateral requirements. The restructure of the Currency Group resulted in a transfer of some banknote research and development functions and staff from NPA, which also added to staff numbers in 2008/09. In addition to research and development activities, this group now has greater responsibility for the administration and examination of counterfeit banknotes, activities that were previously handled by the Australian Federal Police. New staff were also added to support the Bank's information services.



* As at 30 June, excluding NPA
Source: RBA

Most of the increase in staff numbers was concentrated in Head Office. Fifty-eight staff, or just under 6 per cent of the Bank's workforce, are now working at the Bank's business resumption site, reflecting the Bank's ongoing focus on risk management and contingency planning.

The Reserve Bank continues to recruit a large number of graduates. Forty-five joined the Bank's Graduate Development Program this year, compared with 50 last year. The trend to a higher representation of recruits from fields other than economics and finance continues, with areas such as law, accounting and information technology well represented. Increasingly, these graduates are working in the Bank's business and corporate services areas. Graduates account for around one-third of the Bank's annual recruitment. This share has fallen slightly over the past few years as the number of people hired on fixed-term contracts to work on Bank projects has increased. The Bank sources graduates primarily from across Australia in the interests of recruiting the best talent. The Bank eased its citizenship requirements for employment to allow more flexibility in engaging employees from overseas with specialist knowledge and experience. Where a position requires a security clearance, however, the incumbent must still be an Australian citizen.



The Reserve Bank also employs around 15 to 20 staff each year under its traineeship scheme. The scheme is designed to assist those without qualifications to enter the workforce, with formal training (and accreditation) forming part of the program.

Staff turnover in 2008/09, at around 9 per cent, was smaller than in previous years, partly reflecting the weaker labour market conditions generally. Turnover remains low by industry standards.

The Reserve Bank strives to offer a total reward package that attracts and engages high-calibre employees. The majority of staff are employed on individual contracts, which provide flexibility in remuneration based on performance and market relativities. The Bank also negotiated a Workplace Agreement with the Finance Sector Union, which runs for two years from December 2008. Staff, on average, received a salary increase of 4 per cent in 2008/09, with scope for a modest additional payment in recognition of good performance.

Part of the reward structure is the opportunity to engage in continuous professional development with Reserve Bank support. Forty-eight staff received financial support for further study during the year, including four who commenced full-time post-graduate study at overseas universities. Other training is provided by on-the-job experience, formal training courses and, for a limited number of staff, attachments to other organisations. Over the past year, for example, the Bank has had staff on secondment with APRA, the Australian Securities Exchange, the IMF, the Reserve Bank of Vanuatu and the BIS. At the same time, the Bank has hosted secondees from the Bank of England and the Reserve Bank of India.

Facilities

The Reserve Bank owns premises in locations where there is a business need to do so, including its Head Office building in Sydney, office buildings in Melbourne and Canberra, the note printing facility north of Melbourne and the business resumption site in outer Sydney. In addition to the buildings it owns, the Bank leases accommodation for the State Offices in Adelaide, Brisbane and Perth, where demands for space are quite small. The Bank's Representative Offices in London and New York also occupy leased premises.

The value of premises assets in Australia, which is appraised annually by external valuers, decreased by a net amount of $28 million to $337 million in 2008/09, reflecting the widespread softening of the Australian commercial property market. Surplus accommodation in premises owned by the Reserve Bank is leased to external tenants; gross income from these leases amounted to $7.5 million in 2008/09.

During the year, the Reserve Bank continued to strengthen the resilience of facilities supporting critical operations. At its Head Office, this involved establishing an IT operations centre to monitor the performance of the Bank's key systems and accommodation to support the Bank's role in the Government Guarantee Scheme. In Victoria, the electrical power supply and other critical building services were upgraded to meet the expected future operational demands of NPA.

Environmental Management

The Reserve Bank continues to develop initiatives to reduce costs and promote sustainable practices in its operations. During the year, building services were upgraded, leading to improvements in energy and water efficiency. These steps included the upgrade of the air-conditioning plant at NPA and the improvement in building services controls at Head Office. The Bank also continues to measure the impact of environmental initiatives, with the following results in 2008/09:

- a reduction in consumption of electricity of 0.3 per cent;
- an increase in the consumption of gas of 1.6 per cent;
- a reduction in consumption of paper of 3 per cent, with three-quarters of paper now 50/50 recycled, more than double the proportion the previous year; and
- the Bank's fuel efficiency is well within the Commonwealth's green guidelines for vehicle fleets.

Waste recycling was extended to all of the Reserve Bank's facilities during the year. About 60 per cent of waste from the Bank's mainstream activities was recycled in 2008/09. New technology for recycling water used in the printing process at NPA has reduced water use by about 90 per cent to 3 000 litres per day.

Consultancies

The Reserve Bank employs outside contractors or professional service providers to carry out specific tasks where necessary, and also, from time to time, uses consultants. In 2008/09, the following two consultancies were undertaken.

Consultancies[a]
2008/09

Consultant	Project	Cost ($)[b]	Purpose
Deloitte Touche Tohmatsu	Peer review of Audit Department	41 070	Assessment of audit process and compliance with standards
Open Link International Pty Ltd	Upgrade of trading system	21 600	Pre-upgrade quality assurance review and report

(a) Costing $10 000 or more
(b) Excluding GST

Risk Management

Objectives and Governance Structure

The Reserve Bank manages a range of financial and operational risks in carrying out its responsibilities as a central bank. The principal objective is not to eliminate risk – which is not always possible or comes at excessive cost – but rather to contain risk to a level that is consistent with the Bank effectively achieving its policy and operating objectives.

The Reserve Bank's risk management framework involves identifying and assessing risks as well as implementing and reviewing the effectiveness of controls. This framework is applied to all non-policy risks irrespective of whether they arise through one of the Bank's existing activities or through a new activity implemented to achieve a specific policy objective. Underpinning the framework is the principle that risk management is an integral part of each line manager's job. As such, the prime responsibility for controlling and mitigating risks on a day-to-day basis rests with managers of the various business areas within the organisation. More generally, management also promotes an active risk management culture that emphasises the careful analysis and control of risk as a vital and integral part of all business processes within the Bank.

Oversight of the Reserve Bank's arrangements for risk management rests with the Risk Management Committee. This is a senior committee responsible for ensuring that all of the non-policy risks facing the organisation are properly assessed and managed. It is chaired by the Deputy Governor and comprises the Assistant Governors for Banking and Payments, Corporate Services, Currency and Financial Markets; the Chief Financial Officer; the Heads of Audit and Risk Management; and the General Counsel and Deputy Secretary. It meets every three months, or more often if needed, and keeps the Bank's Executive Committee and the Board's Audit Committee advised of its activities. The Risk Management Committee is assisted in carrying out its responsibilities by the Risk Management Unit (RMU), whose main role is to help business areas of the Bank manage their risk environment within a broadly consistent framework across the organisation. Among the Unit's principal activities is monitoring risk and compliance with trading limits on the foreign and domestic asset portfolios.

Arrangements for managing risk are also supported by the Audit Department, which complements – but remains separate from – the work of the RMU. In addition to providing assurance that the Reserve Bank's risk management policy is effective, the Audit Department has a separate, independent brief to test the adequacy of procedures and controls at all levels of the Bank. The Audit Department has a direct reporting line to the Board's Audit Committee.

Similar to many other central banks, the Reserve Bank made a number of changes to its operations over the past year in response to global credit and financial market developments. Most of these involved adjustments to the Bank's operations in domestic financial markets and resulted in changes to the composition of the Bank's balance sheet. The Bank also took on new tasks – in particular, administration of the Government's Guarantee Scheme for Large Deposits and Wholesale Funding, which was put in place to assist financial institutions in maintaining access to funding markets. These changes typically involve some risks, which reflect the nature of the instruments used, the size of the transactions undertaken or simply because the tasks are new and involve unfamiliar systems and processes. The risks were assessed in a manner consistent with the Bank's risk management framework and, where appropriate, controls were put in place to ensure that they are managed to a level that is acceptable to the Bank in carrying out its responsibilities.

The sections below describe the various risks and associated management practices in more detail.

Portfolio Risks

The most significant risks the Reserve Bank faces in terms of potential financial impact flow directly from its operations in financial markets and the assets it holds to support these operations. The main risks are exchange rate risk, interest rate risk and credit risk. These are managed by the Financial Markets Group within a set of conservative parameters. The strict control framework has kept the Bank's exposure to generally low levels during the turbulent conditions that have characterised financial markets over the past 18 months.

As noted above, the RMU is responsible for monitoring risks and day-to-day compliance with the control framework. Compliance reports, together with reports on portfolio performance and risk, are provided daily to the Assistant Governor (Financial Markets), the Head of Risk Management and other senior staff.

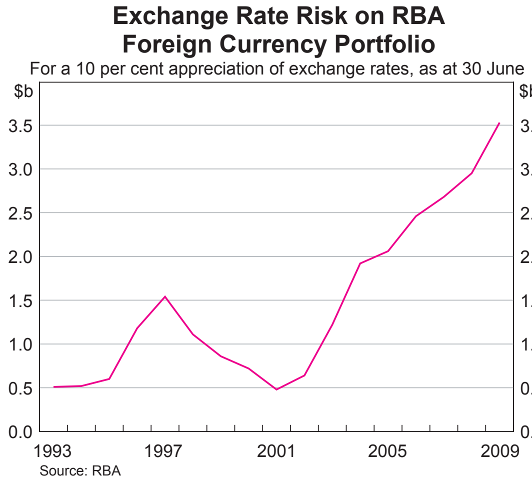
Exchange Rate Risk

The Reserve Bank maintains a portfolio of foreign currency assets as holder of Australia's official reserves. The value of these assets changes with movements in the Australian dollar and can vary quite markedly during periods of substantial volatility in the exchange rate. The sharp depreciation of the Australian dollar between the end of July and late October 2008, for example, resulted in the value of the Bank's foreign currency assets rising by around 40 per cent in Australian dollar terms, while the appreciation since the beginning of 2009 reduced the magnitude of the rise to around 20 per cent.

The level of exchange rate risk on the portfolio is also determined by the size of the foreign portfolio, in foreign currency terms. This has been the principal cause of an increase in the Reserve Bank's exchange rate risk over the past 10 years. There was, however, little net change in the size of the Bank's foreign currency assets over 2008/09.

To control some of its exchange rate risk, the Reserve Bank spreads its holdings of foreign currency assets across a small number of highly liquid currencies – 45 per cent is held in US dollars, 45 per cent in euros and 10 per cent in yen. In the normal course of events, the portfolio is rebalanced to these shares each day. This involves buying and selling small quantities of foreign currency, usually in response to changes in market rates or transactions that the Bank undertakes for other purposes.

While the Reserve Bank typically maintains the 45-45-10 allocation fairly closely, rebalancing the foreign currency portfolio each day may not be practical in certain market conditions. For this reason, the Bank has on occasion chosen not to rebalance the portfolio, allowing the currency allocation to vary over a wider range than is usually tolerated. Consistent with this, the daily rebalancing of the currency allocation was suspended when the Bank intervened to provide liquidity to the Australian dollar market last year, but was re-activated over the first half of 2009 as market conditions improved, (see the chapter on 'Operations in Financial Markets' for more details).



Overall, the exchange rate risk on the portfolio rose over the year owing to the increase in the value of the portfolio in Australian dollar terms. As discussed above, there was little net change in risk from movement in the size of the portfolio, in US dollar terms. At the current level of reserves, the potential valuation loss from a 10 per cent appreciation of the Australian dollar (on a weighted average basis against the three currencies in the portfolio) would result in valuation losses of around $3.5 billion.

Interest Rate Risk

The Reserve Bank's financial assets are mainly domestic and foreign fixed-income securities. The value of these assets is subject to movements in domestic and foreign market yields. Since the income stream from these securities is fixed, a rise in market yields results in a fall in their value. Securities that have a longer maturity (or duration) contain a greater degree of interest rate risk, as cashflows further in the future are more sensitive to discounting than those in the near term.

The majority of the Reserve Bank's financial assets are invested in highly rated domestic securities, which are held for policy-related purposes. Action taken by the Bank to deal with turbulence in local financial markets resulted in a significant increase in holdings of domestic securities during the first half of 2008/09 (see the chapter on 'Operations in Financial Markets' for more details). This was unwound over the second half of the year, however, as market conditions improved. At the end of June 2009, total holdings of domestic securities were $47 billion, around $8 billion lower than a year earlier.

While the increase in size of the domestic portfolio affects the level of interest rate risk facing the Reserve Bank, the overall level of risk in the portfolio is fairly small. This is because a significant portion of the Bank's domestic securities is held under repurchase agreements (repos) with short terms to maturity. Over the course of the financial year, the average term to maturity of the Bank's domestic repos rose. The move was largely concentrated in the first half of the year as the Bank responded in its market operations to an increase in demand for longer-term funding from banks and other financial institutions. Even so, the increase in the term to maturity was not large in absolute terms. At its peak, the average term to maturity of the Bank's holdings of repos was around 150 days, compared with around 65 days at the start of the financial year. Demand for longer-term funding eased somewhat in the second half of the year as the market settled. The average term to maturity had declined to around 90 days by the end of June 2009.

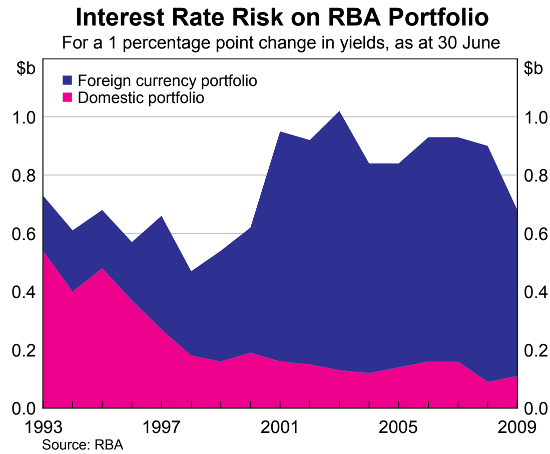
Outright holdings of securities represent only a small proportion of the domestic portfolio. Purchases of short-dated securities, which are typically undertaken as part of the Reserve Bank's daily market operations, increased over the year. However, as for repos, the interest rate risk on these securities is very low and, as a result, these purchases had little effect on the overall level of price risk. Interest rate risk on outright holdings of long-dated securities is, by comparison, much higher. The Bank's holdings of these securities are, however, historically low and their overall contribution to risk within the Bank's domestic portfolio is correspondingly low.

Because of the unique nature of its liabilities, the Reserve Bank has little exposure to interest rate movements on its balance sheet obligations. The principal liability is notes on issue, which carry no interest cost to the Bank. The most significant of the other liabilities are deposits held by the Australian Government and government agencies and settlement balances held by authorised deposit-taking institutions (ADIs). These deposits have short maturities that broadly match those of the domestic assets, particularly those held as repos. Interest paid on these deposits reflects domestic short-term rates, which, in turn, offsets the interest rate exposure of domestic assets. In September 2008, the Bank introduced a term deposit facility for ADIs, designed to assist institutions in managing settlement balances at the height of the market turmoil. These deposits were offered through to March this year. A rate slightly below the cash rate was paid on them.

In contrast to the domestic asset portfolio, the interest rate risk on the foreign portfolio is managed relative to a benchmark that is specified in terms of portfolio duration. The different approaches for the two portfolios reflect different portfolio objectives. While the domestic portfolio is held solely for domestic policy purposes, the Reserve Bank's foreign currency assets are held to provide capacity for intervention in the foreign exchange market. As these operations are typically infrequent, the Bank has scope to invest in foreign assets that earn a market-based return, subject to high degrees of security and liquidity.

For some time, the benchmark for the foreign portfolio has been set at 30 months for each of the three currency portfolios (US dollars, euros and yen). This duration has generally been consistent with the Reserve Bank's long-term risk and return preferences, given the objectives of the foreign currency portfolio. However, in response to developments in asset markets over the past year, which saw interest rates and bond yields reach historically low levels over the first half of 2009, the Bank decided in April to reduce the benchmark duration for all three foreign portfolios to 18 months, thereby reducing the overall level of interest rate risk in the portfolio. This is the first change in benchmark duration since the mid 1990s. The move to the lower duration target was effected gradually to avoid disrupting relevant markets.

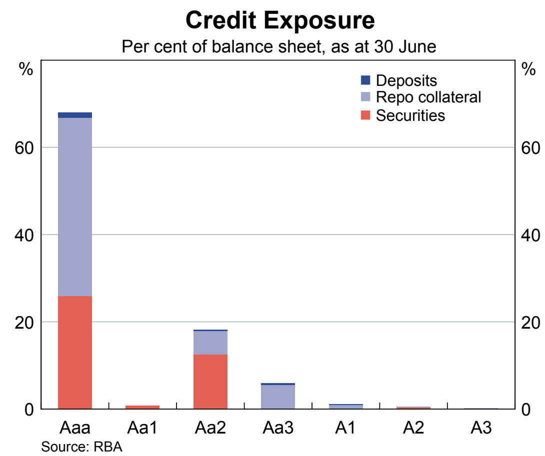
Looking at the domestic and foreign assets together, the interest rate risk on the Reserve Bank's assets declined over the year; the Bank would record a valuation loss of about $700 million if interest rates in Australia and abroad rose uniformly by 1 percentage point across the yield curve, compared with $900 million last year.



Credit Risk

Credit risk is the potential for financial loss arising from the default of a debtor or issuer. The Reserve Bank manages its credit exposure to a low level by applying a set of strict criteria to potential investments. These primarily involve dealing with highly rated counterparties and in highly rated assets. During the year two factors affected the Bank's approach to managing credit risk: the rating downgrades to a number of the Bank's counterparties and the Bank's actions to deal with financial market developments, which resulted in some changes to the composition of its assets. The Bank's credit risk framework accommodated these developments so that its exposure to credit risk remained low.

The Reserve Bank holds only highly rated securities to minimise exposure to credit risk. For the domestic portfolio, the securities held outright include those issued by the Australian Government or by State and Territory government borrowing authorities. As discussed above, a large portion of the domestic portfolio consists of securities held under repo. Although credit risk inherent to repos is generally limited, there is a residual credit exposure related to the quality of collateral and its market value when the repo matures – the Bank would face a potential loss if a counterparty failed to repurchase securities sold under repo and the market value of the securities was less than the value of the initial cash consideration. The Bank manages this by applying an appropriate margin (or 'haircut') to the collateral and maintaining a high credit standard for securities it is prepared to accept under repo.



The Reserve Bank requires that the initial cash position of repos be over-collateralised. It also requires that the collateral be revalued each day and that counterparties supply additional securities once the market value of the collateral falls below a required amount. The degree of over-collateralisation is generally set at 2 per cent for government-backed securities and securities regarded as 'general collateral', but as high as 10 per cent for some long-dated privately issued securities. The degree of collateralisation is monitored daily by the RMU and advice is given to the Bank's front-office dealers when a margin call is required to maintain the degree of over-cover.

The degree of over-cover required by the Reserve Bank was higher for transactions under the US dollar term repo facility, which was set up in late 2008 to ease pressure in offshore markets for US dollars. (This facility is discussed in detail in the chapter on 'Operations in Financial Markets'.) Counterparties to these transactions are required to post the usual margin for Australian dollar-denominated collateral, plus an additional 10 percentage points. The additional margin is to cover a greater level of default risk arising from the fact that, while the collateral is denominated in Australian dollars, the cash leg of the transaction is in a different currency. No operations in US dollar term repos have been conducted since May, reflecting improved conditions in the market for US dollars.

Over the past 10 years or so, the Reserve Bank has gradually expanded the range of highly rated securities that it will accept as collateral beyond government securities, which are the securities traditionally used by central banks in market operations. In general, the expansion has been prompted by the evolving nature of Australian debt markets and, more recently, by the need to ensure that markets did not become dysfunctional during the turmoil in financial markets. During 2008/09, the range was expanded further to include government-guaranteed securities issued by ADIs, corporate bonds, asset-backed securities and commercial paper. Consistent with the Bank's strict credit requirements for collateral, these securities are accepted by the Bank only if they have a long-term rating of Aaa or a short-term rating of P-1.

While the Reserve Bank does not generally accept as collateral securities that counterparties have issued themselves or by a party to which they are related, this restriction was relaxed during the year for offers of residential mortgage-backed securities (RMBS) and asset-backed commercial paper (ABCP). The overall impact on credit risk resulting from this change was small, as the security would continue to be collateralised by the underlying assets in the event of a default by the counterparty. Furthermore, under the Bank's requirements for this type of collateral, the majority of the underlying mortgages are insurable, 'full-doc' loans. The condition of the asset pool underlying the securities is also monitored by the RMU.

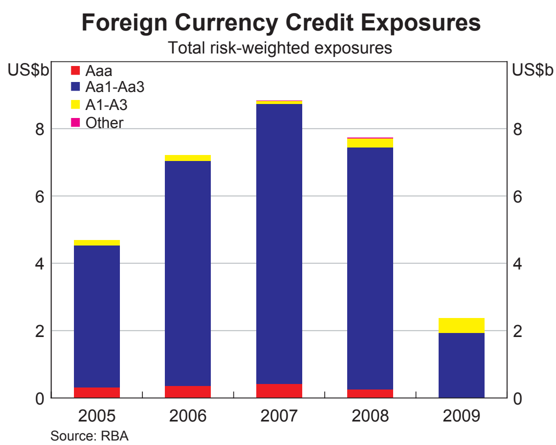
The impact of these changes over the past year altered the composition of the securities that the Reserve Bank holds under repo. Holdings of RMBS now comprise around 60 per cent of the total collateral pool. They have largely replaced bank bills and certificates of deposit as the largest asset class in the portfolio. Though the overall credit quality of the Bank's portfolio was already very high, the generally higher credit rating of RMBS increased this credit quality.

The Reserve Bank's counterparties for domestic operations include banks and non-bank financial institutions. The Bank does not explicitly assign a minimum credit rating to counterparties, as the operations are conducted for policy purposes. Instead, the risk is managed by dealing only with members of the Reserve Bank Information and Transfer System (RITS). Maintaining a high credit quality for collateral and imposing a suitable haircut on transactions are other measures used to manage counterparty credit risk on domestic operations.

Similar to its domestic portfolio, the Reserve Bank confines most of its holdings of foreign assets to highly rated securities. Outright holdings are concentrated in liquid fixed-income assets issued by the national governments of the United States, Germany, France, Netherlands and Japan. The foreign asset portfolio also maintains a modest holding of securities issued by certain Aaa-rated supranational institutions. Following action in a number of countries to underpin key financial institutions during the market turmoil, the range of securities that the Bank can hold outright was expanded during the year to include select government-guaranteed securities and securities issued by US agencies, providing greater scope for holding high-quality assets in the portfolio. Purchases of government-guaranteed securities are subject to a set of strict criteria, including clear evidence that the guarantee is unconditional and irrevocable, and that both the guarantor and the issuer have a high credit rating.

For operational reasons, the Reserve Bank also holds a small portion of the foreign portfolio in cash, which is invested in commercial bank deposits and repos. These assets expose the bank to credit risk because of the possibility of counterparty default. The risk is managed through a combination of measures that, in effect, limit the level of exposure to a counterparty based on their capital base and long-term credit rating and on the type of investment undertaken. The minimum counterparty rating for bank deposits is Aa3, while for foreign exchange and repos the minimum rating is A3 and Baa1, respectively, reflecting the generally lower level of risk for these products. Overlaying this framework is a limit on the share of the foreign portfolio that can be held in commercial bank deposits. Over the course of the financial year, this limit was lowered from 20 per cent to 10 per cent. The reduction in holdings of bank deposits was largely effected by switching into repos as the deposits matured, minimising the overall liquidity impact on cash markets.

With most of the Reserve Bank's foreign assets held in highly rated securities, the reduction in the overall share of assets held in deposits contributed to a significant reduction in credit exposure on the Bank's foreign portfolio over the year. There was also little material change in the overall credit quality of the Bank's assets, which, reflecting the Bank's conservative risk framework, remained high. The majority are rated Aa3 or higher.



Operational Risks

The Reserve Bank faces operational risks that can arise from inadequate or failed internal processes and systems or from external events. These risks are similar to those faced by other financial institutions. They range from the possibility that access to key financial infrastructure might be lost, to the possibility that services might not be delivered to the required standard because processes have not been followed. The Bank also faces security risks, both IT and physical, because its IT systems are critical to its operations, and because of the value of the physical assets it holds.

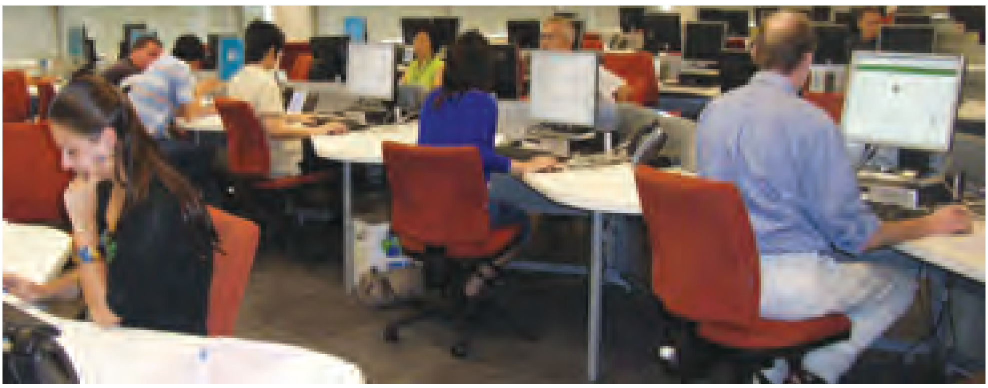
A significant risk facing any financial institution is that its staff may engage in fraud or undertake unauthorised transactions, exposing the institution to significant financial loss or reputational damage. The Reserve Bank has a number of measures in place to manage this risk. These include having a clear decision-making hierarchy, with the staff involved in all financial dealing having limits to their authority to take risks or pass value, and controls over computer access at both the user and administrator levels. These arrangements are further enhanced by independent front, middle and back office functions, where staff who initiate trades, those who settle them, and those who monitor and report on exposures and compliance with trading and investment guidelines are physically separate and have separate reporting lines within the organisation. Separation of duties is strictly enforced.

The Reserve Bank's Code of Conduct for employees sets out the standard of integrity and propriety that is expected of staff in carrying out their duties. This is supported by the Bank's Fraud Control Policy and related arrangements, which enable staff to report suspicious behaviour anonymously. Staff are periodically reminded of these arrangements and the Fraud Control Policy is reviewed regularly to ensure that it remains up to date.

Operational risks arise in the Financial Markets Group from the large number of transactions undertaken each day and because dealing arrangements are altered from time to time. Around 70 000 transactions were undertaken in 2008/09, generating average daily settlement flows of around $40 billion. These figures are lower than the corresponding figures for the previous financial year, with much of the decrease reflecting a general lengthening of the maturity of transactions undertaken in domestic market operations during the year. The risks associated with this volume of transactions are managed by ensuring that systems and processes, including change management processes, are efficient and robust. Consistent with this, the Reserve Bank completed an upgrade of its financial markets trading system and supporting computer hardware over 2008/09. The upgrade was carried out under standard guidelines for project management, with rigorous testing of software, hardware and links to management systems occurring before the upgraded system went into production in April.

Continuity of services to clients and market participants, and high availability of systems, are key considerations because interruptions could have potentially widespread or systemic consequences. The Reserve Bank is the main banker for a number of government agencies, including the Australian Taxation Office, Medicare Australia and Centrelink. On average, the Bank processes around 285 million transactions each year on behalf of these customers, though the number was around 9 million higher in 2008/09 partly because of the extra processing of payments made under the Australian Government's stimulus packages. The Bank also provides real-time interbank payment and settlement services through RITS, which typically involves processing about 32 000 payment instructions per day, for an average total value of $184 billion. To ensure that RITS can continue to handle significant volumes in an efficient manner, the Bank commenced a program in 2003 to modernise the system's technical architecture and functionality. The latest stage of this work, which involved upgrading core system hardware, the operating system and database, was completed in February.

The Reserve Bank has back-up capacity to ensure that its critical operations can be maintained if access to facilities or IT systems at its Head Office is lost. Some 60 staff are based permanently at the Bank's business recovery site to ensure that the key payments, markets and banking services can be restored quickly if the Head Office is unexpectedly disrupted. In the event of a prolonged outage, this site has capacity for nearly 230 staff. Business areas within the Bank regularly test their back-up arrangements at the site – some 30 tests were undertaken over the course of 2008/09. In addition, a large-scale test, involving staff from most of the Bank's departments, as well as external service providers, is conducted at the site twice a year.



Staff at the Bank's business recovery site during a business resumption test in March 2009

In response to concerns about the possibility of a pandemic of H1N1, the Reserve Bank reviewed its arrangements for managing a widespread outbreak of influenza. Such an event raises quite different business continuity challenges, since the risk is that staff, rather than facilities and/or systems, become unavailable.

Notwithstanding strong controls, and a culture in which staff manage risk carefully, operational or other failures occur from time to time, which can have an adverse financial or reputational impact on the Reserve Bank. Such incidents are reported in a timely way to the Risk Management Committee, which monitors the reports to identify areas where the control framework can be strengthened.

Government Guarantee Scheme

As mentioned above, one of the new tasks taken on by the Reserve Bank over the past year has been administration of the Guarantee Scheme for Large Deposits and Wholesale Funding on behalf of the Australian Treasury. Under the scheme, which commenced operations in late November 2008, ADIs in Australia may seek a guarantee from the Government for deposit balances in excess of $1 million and certain wholesale funding liabilities. A fee based on the institution's credit rating is charged on the outstanding guaranteed liabilities.

The Reserve Bank's role in administering the scheme involves processing applications from ADIs, issuing guarantee certificates to successful applicants, processing and reporting monthly fee payments, monitoring guaranteed liabilities, and maintaining a website with relevant information about the scheme and the liabilities that have been guaranteed.

Administration of the scheme does not present any financial risk to the Reserve Bank – the liability to cover all claims under the scheme rests with the Australian Government. However, there would have been potential financial disruption and risk to the Bank's reputation if the scheme had been poorly administered. Accordingly, considerable resources were devoted to setting up and operating the administrative systems for the scheme. Around 550 certificates of guarantee have been issued since the scheme commenced in November, with ADIs paying almost $480 million in fees to the Australian Government. The cost of administering the scheme in 2008/09 came to about $250 000.

In late March, the Government announced a similar scheme to guarantee State and Territory borrowing. This scheme – which commenced operation in late July – is also administered by the Reserve Bank.

Earnings and Distribution

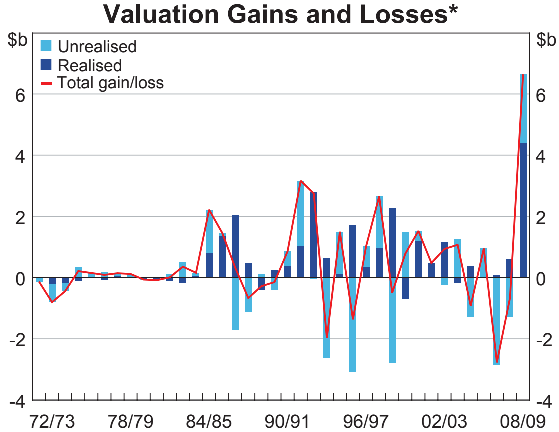
The Reserve Bank holds assets primarily to conduct operations in financial markets in pursuit of its central banking objectives. These operations centre on implementing monetary policy in Australia, supporting the Bank's role in the foreign exchange market and in managing Australia's international reserves. Although these activities are carried out for policy purposes, they are profitable in most years.

The Reserve Bank's profits have two components – underlying earnings and valuation gains (or losses) – that reflect the structure of its balance sheet and its operations. Underlying earnings are determined by interest earnings on financial assets held as Australia's foreign exchange reserves or as the portfolio of domestic securities that underpins daily liquidity management operations. Total assets stood at $103 billion at end-June 2009. While these assets earn market rates of interest, no interest is paid on a significant proportion of the Bank's liabilities, namely banknotes and capital and reserves. Net interest receipts are augmented by relatively small sums from fees the Bank earns from the banking and payments services it provides and from rental income. Operating costs reduce underlying earnings.

As the Reserve Bank's financial assets are mainly held as securities, valuation gains and losses can also be large. The value of this portfolio of assets is sensitive to movements both in market interest rates and exchange rates: a fall in market yields causes prices of securities to rise and, therefore, results in valuation gains; a rise in yields leads to valuation losses. Likewise, a depreciation of the exchange rate results in valuation gains as foreign securities are worth more in terms of Australian dollars at the lower exchange rate; an exchange rate appreciation results in valuation losses. The Bank is constrained in managing the market risks associated with fluctuations in asset values, since, as noted, these assets are held in support of central banking activities. Consequently, the impact on the Bank's profits of movements in the exchange rate and market yields can be large and volatile.

The extent to which gains are realised depends on the operations the Reserve Bank undertakes in financial markets. Gains and losses are realised only when the Bank sells assets; they otherwise remain unrealised. The fall in the exchange rate and in bond yields around the world late in 2008 saw the Bank record large valuation gains, contrasting with the valuation losses of the preceding couple of years when the exchange rate had

Valuation Gains and Losses*



* On investments
Source: RBA

appreciated. These valuation gains were realised to a significant extent because the Bank sold foreign exchange as the value of Australian dollar moved towards its low point around October, and on the sale of foreign securities at lower yields than they had been purchased.

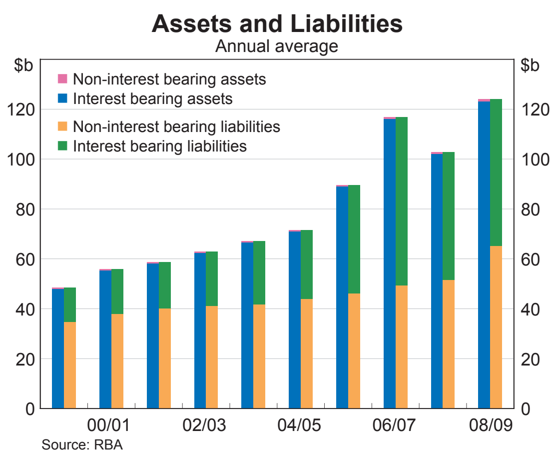
The measures the Reserve Bank adopted in response to the global financial crisis resulted in a large, but mostly temporary, expansion in the balance sheet and increased earnings slightly in 2008/09. The term deposit facility for domestic financial institutions was required for a relatively short period and was in any case associated with only a thin interest margin; the US dollar swap facility established with the Federal Reserve had, by design, no effect on profits; and the expanded range of acceptable collateral eligible for domestic operations had no impact either on balance sheet footings or on earnings; the main impact on earnings came from extending the term of the Bank's domestic repurchase agreements. The small effect on profits of these innovations was, of course, incidental, as these steps were intended exclusively to support the Bank's policy objectives. Discussion of management of the Bank's balance sheet, and of these new facilities, is contained in the chapter on 'Operations in Financial Markets'.

The Reserve Bank reports accounting profit as earnings from all sources – underlying earnings, and realised and unrealised gains – in accordance with Australian equivalents to International Financial Reporting Standards (AIFRS). The distribution of profits – essentially determination of the dividend payable to the Australian Government, the Bank's owner – is governed by section 30 of the *Reserve Bank Act 1959*. In effect, this legislation determines that underlying earnings and realised gains are to be made available for distribution; unrealised gains are retained and transferred to the Unrealised Profits Reserve. These provisions also determine the process for approving transfers to the Reserve Bank Reserve Fund, the Bank's permanent reserve of capital. After consultation with the Board, the Treasurer has approved such a transfer from earnings in 2008/09.

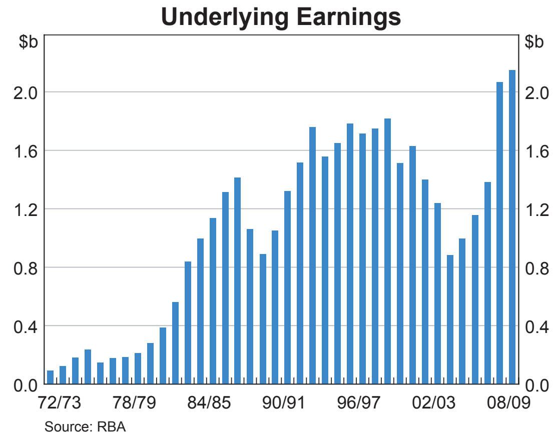
Earnings Available for Distribution

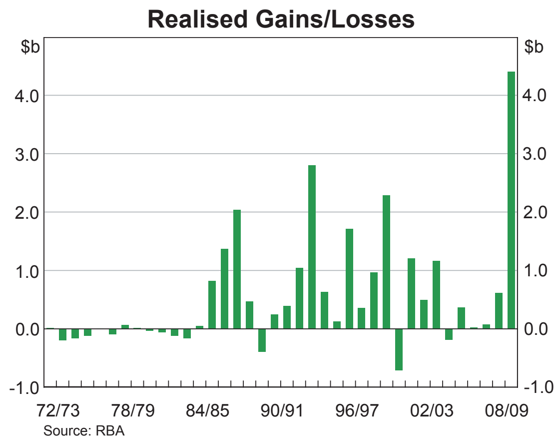
Underlying earnings amounted to $2 150 million in 2008/09, about $80 million more than the previous year. While interest rates on the Reserve Bank's investments declined over the course of 2008/09 in line with policy and market interest rates around the world, net interest income was boosted by a rise in the average level of its interest-earning assets, funded by interest-free liabilities, in particular notes on issue and capital (including reserves). The lower exchange rate in 2008/09 than in the previous year also boosted the Australian-dollar value of interest earnings on foreign securities.

Gains of $4 404 million were realised in 2008/09, resulting from sales of foreign exchange and securities as the exchange rate and interest rates were, on the whole, lower during the year. In particular:



- Gains on foreign exchange amounted to $2 943 million from sales of foreign currency associated with operations to manage international reserves and intervene in the foreign exchange market. Large unrealised gains recorded in the middle of the financial year were partly unwound as the exchange rate rose later in 2008/09.
- Gains of $1 355 million were realised on the sale of foreign securities acquired when market yields were higher as the Bank sold lines of stock of diminishing liquidity to re-invest in benchmark bonds in the normal course of managing the foreign portfolio. Gains were also realised in transactions to re-align the portfolio of international reserves to the shortened benchmark position.
- Gains of $106 million were realised on the sale of domestic securities.





Taking account of underlying earnings and realised gains, earnings available for distribution in 2008/09, at $6 554 million, were larger than in any previous year and $5 151 million higher than the equivalent figure in 2007/08. In addition, total unrealised valuation gains of $2 252 million were transferred to the Unrealised Profits Reserve.

Components of Earnings Available for Distribution

$ million

	Underlying earnings	Realised gains and losses	Unrealised losses charged to other sources of income	Earnings available for distribution
1986/87	1 412	2 035	–	3 447
1987/88	1 062	464	–	1 526
1988/89	891	–494	–80	417
1989/90	1 049	245	–199	1 095
1990/91	1 322	391	–	1 713
1991/92	1 516	1 038	–	2 554
1992/93	1 760	2 803	–	4 563
1993/94	1 556	628	–676	1 508
1994/95	1 649	123	–	1 772
1995/96	1 784	1 712	–1 010	2 486
1996/97	1 715	1 990	–	3 705
1997/98	1 750	1 524	–	3 274
1998/99	1 816	2 284	–424	3 676
1999/00	1 511	–708	–	803
2000/01	1 629	1 205	–	2 834
2001/02	1 400	489	–	1 889
2002/03	1 238	1 159	–	2 397
2003/04	882	–188	–	694
2004/05	997	366	–	1 363
2005/06	1 156	21	–	1 177
2006/07	1 381	75	–371	1 085
2007/08	2 068	614	–1 279	1 403
2008/09	2 150	4 404	–	6 554

Reserves and Dividend

As with other financial institutions, it is desirable for central banks to hold capital to provide capacity to absorb losses. The Reserve Bank Reserve Fund (RBRF) is established by the Reserve Bank Act as a permanent general reserve. Balances in this reserve are regarded as being available to cover extraordinary losses from a range of risks, especially from exceptionally large falls in the market value of the Reserve Bank's assets that cannot be absorbed by its other resources. In other words, the RBRF is essentially the Bank's capital and it has been funded over time by transfers from earnings available for distribution. Under section 30 of the Reserve Bank Act, transfers to the RBRF from distributable earnings are determined by the Treasurer, after consultation with the Board.

The Board reviews the adequacy of capital against the market risk associated with the Reserve Bank's financial assets, after taking account of the extent to which these risks are hedged by liabilities. In considering the position over 2008/09, the Board concluded that a transfer to the RBRF would be consistent with its longstanding policy in relation to this fund; the transfer does not reflect any heightened concern about the credit quality either of the Bank's assets or the expanded range of collateral it holds. The Treasurer agreed that a sum of $577 million would be placed to the credit of the RBRF from earnings available for distribution in 2008/09, lifting the balance in this reserve to $6 863 million.

The balance of distributable earnings after any transfer to the RBRF is payable as a dividend to the Australian Government. Accordingly, the dividend payable in 2009/10 amounts to $5 977 million. This dividend is usually paid early in the financial year following the year in which profits are earned. As on numerous past occasions, the Treasurer has decided to defer part of the dividend payable until 2010/11. In particular, a total of $5 227 million was paid to the Australian Government in August 2009 and a further sum of $750 million will be paid in 2010/11. Details are shown in the table below.

Reserve Bank Payments to Government

$ million

			Payments to the Australian Government				
	Earnings available for distribution	Transfers to reserves	Balance available from current year's profit	Interim payment from current year's profit	Payment from previous year's profit	Payment delayed from previous year	Total payment
1990/91	1 713	210	1 503	400	275	–	675
1991/92	2 554	200	2 354	400	1 103	–	1 503
1992/93	4 563	750	3 813	600	1 954	–	2 554
1993/94	1 508	–	1 508	–	3 213	–	3 213
1994/95	1 772	–	1 772	200	1 508	–	1 708
1995/96	2 486	150	2 336	200	1 572	–	1 772
1996/97	3 705	2 005	1 700	–	2 136	–	2 136
1997/98	3 274	548	2 726	–	1 700	–	1 700
1998/99	3 676	–	3 676	–	2 726	–	2 726
1999/00	803	–	803	–	3 000	–	3 000
2000/01	2 834	–	2 834	–	803	676	1 479
2001/02	1 889	–	1 889	–	2 834	–	2 834
2002/03	2 397	133	2 264	–	1 889	–	1 889
2003/04	694	–	694	–	1 300	–	1 300
2004/05	1 363	–	1 363	–	374	964	1 338
2005/06	1 177	–	1 177	–	1 063	320	1 383
2006/07	1 085	–	1 085	–	1 177	300	1 477
2007/08	1 403	–	1 403	–	1 085	–	1 085
2008/09	6 554	577	5 977	–	1 403	–	1 403
2009/10	–	–	–	–	5 227	–	5 227
2010/11	–	–	–	–	–	750	–

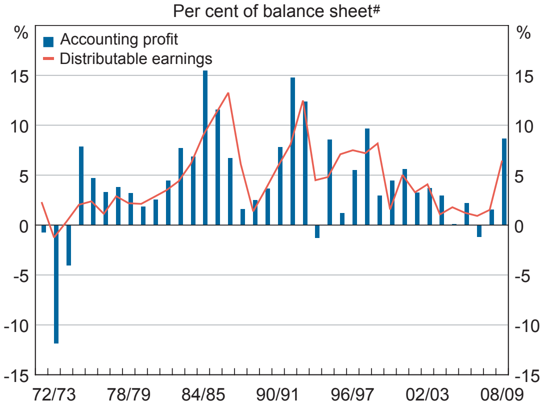
In addition to the RBRF, the Reserve Bank maintains a number of other financial reserves. As noted, unrealised gains are transferred to the Unrealised Profits Reserve, to absorb future valuation losses or to be realised when relevant assets are sold. In 2008/09, unrealised gains of $2 252 million were transferred to this reserve. The approach, determined by legislation, in which the Bank retains unrealised gains is based on sound central banking practice, since distribution of such gains would erode the capacity to cope with subsequent unrealised losses, which, in the case of the Reserve Bank, are unavoidable in some years for the reasons explained above.

In addition to items that affect the Reserve Bank's profit and loss account, revaluation gains and losses on non-traded assets – such as gold holdings, shares in the BIS and property, plant and equipment – are reflected in asset revaluation reserves. The balance of these reserves represents the difference between the market value of these assets and the cost at which they were acquired. The balance in these reserves at 30 June 2009 stood at $3 308 million, an increase of $501 million, mainly reflecting an increase in the Australian dollar value of the Bank's holdings of gold, offset to a small extent by a fall in the value of its properties.

Accounting Profits

The Reserve Bank's financial statements (and accompanying Notes to the Accounts) are prepared in accordance with AIFRS, consistent with the Finance Minister's Orders issued under the *Commonwealth Authorities and Companies Act 1997*. Under these standards, accounting profit, as noted, is measured as profit from all sources, including unrealised gains and losses.

Accounting profit in 2008/09 was $8 806 million, compared with an accounting profit of $1 430 million the previous year.



* Accounting profit is estimated prior to 1998
\# Excludes sell repos
Source: RBA

Statutory Obligations

Equal Employment Opportunity

The Reserve Bank is required under the *Equal Employment Opportunity (Commonwealth Authorities) Act 1987* to report to the Australian Parliament each year on its equity and diversity program. The *Equity and Diversity Annual Report 2008* was tabled on 12 September 2008. The Bank seeks to ensure that all staff are treated with dignity and respect in the workplace and experience equal opportunity throughout their careers.

During the year, the Reserve Bank finalised its new two-year Diversity Plan. The plan, which is the eighth in the series, sets out diversity initiatives that the Bank will support over the near term. The initiatives include gaining an understanding of the issues related to work/life balance that are important to staff, improving the accessibility of the Bank's information systems and building facilities for staff and the community, and understanding the needs of a maturing workforce. Other equity and diversity initiatives undertaken in 2008/09 included an extensive study of gender at the Bank, a review of the effectiveness of the Bank's trainee scheme and the trialling of a mentoring program for indigenous Australians. The Equity and Diversity Policy Committee was also revamped to better reflect the interests of staff and the Bank. Full details of the Bank's program will be included in the Bank's *Equity and Diversity Annual Report 2009*, which is scheduled to be tabled in the Australian Parliament later this year.

Health and Safety, Compensation and Rehabilitation

As required in terms of section 74 of the *Occupational Health and Safety Act 1991* and the conditions of its licence as a Licensed Authority under the *Safety, Rehabilitation and Compensation Act 1988*, the Reserve Bank reports each year on matters of health and safety, workers' compensation and rehabilitation as they affect the Bank. The Bank is committed to the safety, health and wellbeing of its employees, contractors and visitors.

The focus of the Reserve Bank's activities in this area in 2008/09 was on prevention and continuous improvement. This included initiatives to improve the capacity of staff at the Bank's business resumption site and the newly acquired banknote research and development area at Note Printing Australia to manage occupational health and safety matters effectively. During the year there were 47 incidents, which resulted in 10 claims for workers' compensation. The claims largely related to lunch-time sporting injuries. This compared with an annual average of 65 incidents and 17 claims over the previous three years.

Following consultation with staff, the Reserve Bank's Health & Safety Committee, Comcare and the Finance Sector Union, the Bank also implemented its new Health & Safety Management Arrangements (HSMAs). These provide a framework for the Bank and its staff to work co-operatively to promote and develop measures to ensure employees' health, safety and welfare at work. The HSMAs will operate initially for a term of two years but are subject to review after

12 months. Three additional Health & Safety Representatives were appointed to the Health & Safety Committee to ensure a wider coverage of designated workgroups.

The Reserve Bank's strong track record in all aspects of occupational health and safety, compliance with the relevant legislation and the Bank's Conditions of Licence was confirmed by external audits. The Safety, Rehabilitation and Compensation Commission confirmed the Bank's highest possible rating for its prevention, claims management and rehabilitation practices during the year.

Freedom of Information

Section 8 Statement

Organisation and functions: The Reserve Bank of Australia is Australia's central bank. It was established by Commonwealth legislation in 1911. Its functions, powers and responsibilities are specified in the *Reserve Bank Act 1959*, the *Banking Act 1959*, the *Commonwealth Authorities and Companies Act 1997*, the *Payment Systems (Regulation) Act 1998*, the *Payment Systems and Netting Act 1998*, the *Corporations Act 2001* and the *Financial Services Reform Act 2001*, and in Regulations made under those Acts. An overview of the structure of the Reserve Bank is provided in the organisational chart, which appears on pages 122–123.

Categories of documents: The Reserve Bank publishes speeches, reports, articles, occasional papers, conference volumes, information booklets, minutes of the monetary policy meetings of the Reserve Bank Board, media releases, statistical data and various other documents. These are available on the Reserve Bank's website (www.rba.gov.au), which also provides other information about the Bank. The Bank publishes a monthly *Bulletin,* which includes speeches, reports, media releases, statistical data and other items. Other documents are held in the form of working notes and files covering policy and operational matters, statistical data, personnel, premises and general administration.

The right of access to documents in the possession of Australian Government agencies in terms of the *Freedom of Information Act 1982* (FOI Act) applies to the Reserve Bank. However, the Bank is an exempt agency under the FOI Act in respect of documents concerning banking operations (including individual open market operations and foreign exchange dealings) and exchange control matters.

Facilities for access and Freedom of Information procedures: Enquiries under the FOI Act, including requests for access to documents, should be directed to the Secretary of the Reserve Bank. Applications should be accompanied by the application fee (currently $30). Facilities to inspect documents to which access has been granted are available.

Section 93 Statement

Thirteen requests for access to documents under the FOI Act were received in 2008/09. Access was granted in part in response to seven requests, while access was denied in response to two requests. No relevant documents were found in response to three requests. One request, which was received towards the end of the financial year, had not been finalised at the end of June 2009. Processing of two requests that were outstanding at the end of the 2007/08 financial year was finalised; in one case, full access to the documents requested was granted and, in the other case, partial access to relevant documents was provided.

The estimated number of staff hours spent dealing with all aspects of FOI requests in 2008/09 was around 280 hours. The total cost to the Reserve Bank of administering the FOI Act in 2008/09 is estimated to have been about $70 300. Application fees of $390 were collected; additional charges of around $1 600 were levied.

Financial Statements

For the year ended 30 June 2009

Directors' Statement

In the opinion of the directors, the financial statements for the year ended 30 June 2009 give a true and fair view of the matters required by the Finance Minister's Orders 2008–2009 made under the *Commonwealth Authorities and Companies Act 1997*. These statements have been prepared from properly maintained financial records and are signed in accordance with a resolution of the directors.

Glenn Stevens

Chairman, Reserve Bank Board
13 August 2009

BALANCE SHEET As at 30 June 2009
Reserve Bank of Australia and Controlled Entities

	Note	2009 $M	2008 $M
ASSETS			
Cash and cash equivalents	6	772	862
Australian dollar securities	1(b), 16	47 125	54 702
Foreign exchange	1(b), 16	51 156	42 505
Gold	1(c), 16	2 957	2 509
Property, plant and equipment	1(d), 8	443	456
Loans, advances and other	7	513	438
Total Assets		102 966	101 472
LIABILITIES			
Deposits	1(b), 9	34 266	39 006
Distribution payable to Australian Government	1(f), 3	5 977	1 403
Other	10	2 093	9 786
Australian notes on issue	1(b), 16	48 087	42 064
Total Liabilities		90 423	92 259
Net Assets		12 543	9 213
Capital and Reserves			
Reserves:			
Unrealised profits reserves	1(e), 5	2 332	80
Asset revaluation reserves	1(e), 5	3 308	2 807
Reserve Bank Reserve Fund	1(e), 5	6 863	6 286
Capital	1(e)	40	40
Total Capital and Reserves		12 543	9 213

INCOME STATEMENT For the year ended 30 June 2009
Reserve Bank of Australia and Controlled Entities

	Note	2009 $M	2008 $M
INCOME			
Interest revenue	2	4 401	5 204
Net gains/(losses) on securities and foreign exchange	2	6 640	(665)
Dividend revenue	2	5	4
Fees and commissions	2	21	18
Other revenue	2	70	82
Total Income		11 137	4 643
EXPENSES			
Interest expense	2	2 040	2 940
General administrative expenses	2	250	231
Other expenses	2	41	42
Total Expenses		2 331	3 213
Net Profit		8 806	1 430

STATEMENT OF DISTRIBUTION For the year ended 30 June 2009
Reserve Bank of Australia and Controlled Entities

	Note	2009 $M	2008 $M
NET PROFIT		8 806	1 430
Transfer (to)/from unrealised profits reserves	5	(2 252)	(27)
Earnings available for distribution		6 554	1 403
Distributed as follows:			
Reserve Bank Reserve Fund	5	577	–
Payable to the Australian Government	3	5 977	1 403
		6 554	1 403

STATEMENT OF CHANGES IN CAPITAL AND RESERVES

For the year ended 30 June 2009

Reserve Bank of Australia and Controlled Entities

	Note	2009 $M	2008 $M
Opening balance of Capital and Reserves		9 213	8 618
Plus:			
Net Profit	2	8 806	1 430
Gain/(loss) on revaluation of gold	5	475	513
Gain/(loss) on revaluation of shares in international financial institutions	5	49	17
Gain/(loss) on revaluation of properties	5	(23)	38
Total revaluation gains/(losses)		501	568
Total income and expenses		9 307	1 998
Less:			
Transfer to the distribution payable to Australian Government	3	(5 977)	(1 403)
Closing balance of Capital and Reserves		12 543	9 213

CASH FLOW STATEMENT For the year ended 30 June 2009
Reserve Bank of Australia and Controlled Entities

This statement meets the requirements of AASB 107 – *Cash Flow Statements* and the Finance Minister's Orders 2008–2009. In the RBA's view, due to the nature of central banking activities, this statement does not shed additional light on the RBA's financial results. For the purpose of this statement, cash includes the notes and coin held at the Reserve Bank and overnight settlements balances due from other banks.

	2009 Inflow/ (outflow) $M	2008 Inflow/ (outflow) $M
Cash flows from operating activities		
Interest received on investments	4 040	4 972
Interest received on loans, advances, and on net overnight settlements balances	38	62
Loan management reimbursement	1	–
Banking service fees received	20	17
Dividends received	5	4
Rents received	9	8
Net payments for and proceeds from investments	(1 824)	24 082
Interest paid on deposit liabilities	(1 784)	(2 329)
Interest paid on currency note holdings of banks	(167)	(199)
Staff costs (including redundancy)	(142)	(120)
Property, plant and equipment	(37)	(34)
Other	(32)	(5)
Net cash provided by operating activities	127	26 458
Cash flows from investment activities		
Net expenditure on property, plant and equipment	(34)	(23)
Net cash used in investing activities	(34)	(23)
Cash flows from financing activities		
Profit payment to Australian Government	(1 403)	(1 085)
Net movement in deposit liabilities	(4 740)	(26 824)
Net movement in loans and advances	2	8
Net movement in notes on issue	6 023	1 775
Other	(65)	(33)
Net cash provided by financing activities	(183)	(26 159)
Net increase/(decrease) in cash	(90)	276
Cash at beginning of financial year	862	586
Cash at end of financial year	772	862

CASH FLOW STATEMENT (CONTINUED) For the year ended 30 June 2009
Reserve Bank of Australia and Controlled Entities

Reconciliation of cash	Note	2009 $M	2008 $M
Cash		29	9
Overnight settlements systems	6	743	853
		772	862

Reconciliation of net cash provided by operating activities to Net Profits in terms of the *Reserve Bank Act 1959*	Note	2009 $M	2008 $M
Net Profit		8 806	1 430
Increase/(decrease) in interest payable		(39)	14
Net loss/(gain) on overseas investments	2	(1 469)	(506)
Net loss/(gain) on Australian dollar securities	2	(142)	34
Net loss/(gain) on foreign currency	2	(5 029)	1 137
Decrease/(increase) in income accrued on investments		(190)	238
Depreciation of property	8	9	9
Depreciation of plant and equipment	8	14	13
Net payments for and proceeds from investments		(1 824)	24 082
Other		(9)	7
Net cash provided by operating activities		127	26 458

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS 30 June 2009
Reserve Bank of Australia and Controlled Entities

Note 1 SUMMARY OF ACCOUNTING POLICIES

The Reserve Bank of Australia (RBA) reports its financial statements in accordance with the *Reserve Bank Act 1959* and the *Commonwealth Authorities and Companies (CAC) Act 1997*. These financial statements for the year ended 30 June 2009 have been prepared under Australian equivalents to International Financial Reporting Standards (AIFRS), other accounting standards and accounting interpretations issued by the Australian Accounting Standards Board, in accordance with the Finance Minister's Orders (FMOs) 2008–2009, which are issued pursuant to the *CAC Act 1997*. These financial statements comply fully with International Financial Reporting Standards. The RBA has not sought any exemptions from the requirements of the FMOs in 2008/09.

These financial statements and attached notes are a general purpose financial report prepared in accordance with relevant AIFRS. Elections as to the accounting treatment under AIFRS made by the RBA are noted appropriately. All amounts are expressed in Australian dollars unless another currency is indicated. The RBA is classified as a for-profit public-sector entity for purposes of financial disclosure. Fair values are used for the RBA's major assets, including domestic and foreign marketable securities, gold and foreign currency, as well as for properties, plant and equipment. Revenue and expenses are brought to account on an accrual basis. All revenues, expenses and profits of the RBA are from ordinary activities.

(a) Consolidation and joint venture

The financial statements show information for the economic entity only; this reflects the consolidated results for the parent entity, the Reserve Bank of Australia, and its wholly-owned subsidiary, Note Printing Australia Limited (NPA). The results of the parent entity do not differ materially from the economic entity and have therefore not been separately disclosed. Note Printing Australia Limited was incorporated as a wholly-owned subsidiary of the RBA on 1 July 1998, with an initial capital of $20 000 000. The RBA provided NPA with additional capital of $15.0 million in July 2008 and a further $25.0 million of capital in July 2009. Note Printing Australia Limited's total assets, liabilities and capital as at 30 June 2009 were $103.0 million, $22.6 million and $80.4 million respectively ($82.6 million, $22.6 million and $60.0 million as at 30 June 2008).

The assets, liabilities and results of Note Printing Australia Limited have been consolidated with the parent entity accounts in accordance with AASB 127 – *Consolidated and Separate Financial Statements*. All internal transactions and balances have been eliminated on consolidation.

The RBA equity accounts for its investment in Securency International Pty Ltd in accordance with AASB 131 – *Interests in Joint Ventures*. The RBA's investment in Securency International Pty Ltd is included in Note 7.

(b) Financial instruments

A *financial instrument* is defined as any contract that gives rise to both a financial asset of one entity and a financial liability or equity instrument of another entity. The RBA's financial instruments are its Australian dollar securities, foreign government securities, bank deposits, interest rate futures, foreign currency swap contracts, gold loans, cash and cash equivalents, notes on issue, deposit liabilities and its shareholding in the Bank for International Settlements. The RBA accounts for its financial instruments in accordance with AASB 139 – *Financial Instruments: Recognition and Measurement* and reports these instruments under AASB 7 – *Financial Instruments: Disclosures*.

The RBA brings its foreign and domestic securities transactions and foreign exchange transactions to account on a trade date basis; that is, it recognises the effects of purchases and sales of these securities in the Income Statement and the Balance Sheet on the date these transactions are arranged (not when the transactions are settled). Bank deposits and repurchase agreements are brought to account on settlement date.

Australian dollar securities

The RBA holds Commonwealth Treasury Fixed Coupon Bonds and Treasury Capital Indexed Bonds, and securities issued by the central borrowing authorities of State and Territory Governments. It also holds under repurchase agreements: bank bills, certificates of deposit and debt securities of authorised deposit taking institutions licensed in Australia; Australian dollar denominated securities issued by foreign governments, foreign government agencies that have an explicit government guarantee (or equivalent support) and by certain highly-rated supranational organisations; and selected Australian dollar domestic residential and commercial mortgage-backed securities, asset-backed commercial paper and corporate securities. Domestic securities, except those held under buy repurchase agreements, are classified under AASB 139 as 'at fair value through profit or loss', as they are held for purposes of conducting monetary policy and may be sold or lent, typically for short terms, under repurchase agreements. In accordance with this standard, the securities are valued at market bid prices on balance date; realised and unrealised gains or losses are taken to profit. Only realised gains are available for distribution in accordance with the *Reserve Bank Act 1959* (Note 1 (f)). Interest earned on the securities is accrued over the term of the security and included as revenue in the Income Statement.

Commonwealth Treasury Fixed Coupon Bonds and fixed income securities issued by the central borrowing authorities of State and Territory Governments are coupon securities; the interest is received biannually at the coupon rate and the principal is received at maturity. Treasury Capital Indexed Bonds are coupon securities with the nominal value of the security indexed in line with movements in the Consumer Price Index each quarter until maturity; interest is paid quarterly.

Foreign exchange

Foreign exchange holdings are invested mainly in securities (issued by the governments of the United States, Germany, France and Japan) and bank deposits (with highly-rated international banks, central banks and international agencies). The RBA engages in interest rate futures and foreign currency swaps.

Assets and liabilities denominated in foreign currency are converted to Australian dollar equivalents at the relevant market bid or offer exchange rate ruling on balance date in accordance with AASB 121 – *The Effects of Changes in Foreign Exchange Rates*. Realised and unrealised gains or losses on foreign currency are taken to profit, but only realised gains are available for distribution in accordance with the *Reserve Bank Act 1959* (Note 1 (f)). Interest revenue and revaluation gains and losses on foreign currency assets and interest expense on foreign currency liabilities are converted to Australian dollars using the relevant market exchange rate on the date they are accrued or recognised, in accordance with AASB 121.

Foreign government securities

Foreign government securities comprise coupon and discount securities. Coupon securities have biannual or annual interest payments depending on the currency and type of security; the principal of these securities is received at maturity. Interest earned on discount securities is the difference between the actual purchase cost and the face value of the security; this is amortised over the term of the securities. The face value is received at maturity. Foreign securities, except those held under buy repurchase agreements, are classified under AASB 139 as 'at fair value through profit or loss', as they are held for trading. In accordance with this standard, the securities are valued at market bid prices on balance date; realised and unrealised gains or losses are taken to profit. Only realised gains are available for distribution in accordance with the *Reserve Bank Act 1959* (Note 1 (f)). Interest earned on securities is accrued over the term of the security as revenue in the Income Statement.

Foreign bank deposits

The RBA invests part of its foreign currency reserves in deposits with highly-rated international banks; it also maintains working accounts in foreign currencies. Deposits are classified as 'loans and receivables' under AASB 139 and recorded at their face value, which is equivalent to their amortised cost using the effective interest method. Interest is accrued over the term of deposits and is received periodically or at maturity. Interest accrued but not paid is included in Accrued Interest (Note 16).

Foreign currency swaps

The RBA uses foreign currency swaps with market counterparties to assist daily domestic liquidity management and to manage its balance sheet holdings. A foreign currency swap is the simultaneous purchase and sale of one currency against another currency for specified maturities. The cash flows are the same as borrowing one currency for a certain period, and lending another currency for the same period. The pricing of the swap must therefore reflect the interest rates applicable to these money market transactions. Interest rates are implicit in the swap contract but interest itself is not paid or received.

Foreign exchange holdings contracted for sale beyond 30 June 2009 (including those under swap contracts) have been valued at market exchange rates (Note 16).

In September 2008, the RBA established a foreign exchange swap facility with the US Federal Reserve (the Fed) to address pressures in US dollar short-term funding in the Asian time zone. Under these swaps, the Fed provides US dollar liquidity to the RBA in exchange for Australian dollars. The US dollars are, in turn, made available by the RBA to market participants under repurchase agreements, in exchange for Australian dollar collateral. The Australian dollars provided to the Fed under the swap are held on deposit with the RBA. On maturity, these swaps are unwound at the same exchange rate as the currencies were exchanged in the first leg. This facility increases the RBA's balance sheet, but has no effect on its net profits (see Note 16). The establishment and use of this facility is discussed in the Annual Report in the chapter on *Operations in Financial Markets*.

Interest rate futures

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

Interest rate futures positions are classified under AASB 139 as 'at fair value through profit or loss'. In accordance with this standard, futures positions are marked to market on balance date at the relevant bid or offer price and valuation gains and losses taken to profit. Only realised gains are available for distribution in accordance with the *Reserve Bank Act 1959* (Note 1 (f)).

Bank for International Settlements

Under AASB 139 the RBA's shareholding in the Bank for International Settlements (BIS) is classified as 'available for sale' for accounting purposes. The shareholding is valued at fair value and revaluation gains and losses are transferred directly to the revaluation reserve for shares in international financial institutions (Note 5). The fair value is estimated on the basis of BIS' net asset value, less a discount of 30 per cent. Dividends are recognised as revenue in the Income Statement when declared.

Repurchase agreements

In the course of its financial market operations, the RBA engages in repurchase agreements involving foreign and Australian dollar marketable securities.

Securities sold and contracted for purchase under sell repurchase agreements are classified under AASB 139 as 'at fair value through profit or loss', as they are held for trading, and reported on the Balance Sheet within the relevant investment portfolio. The counterpart obligation to repurchase the securities is reported in Other Liabilities (Note 10) at amortised cost; the difference between the sale and purchase price is accrued over the term of the agreement and recognised as interest expense.

Securities purchased and contracted for sale under buy repurchase agreements are classified under AASB 139 as 'loans and receivables' and valued at amortised cost. The difference between the purchase and sale price is accrued over the term of the agreement and recognised as interest revenue.

Deposit liabilities

Deposits include deposits at call and term deposits. Deposits are classified as financial liabilities under AASB 139. Deposit balances are shown at their amortised cost, which is equivalent to their face value. Interest is accrued over the term of deposits and is paid periodically or at maturity. Interest accrued but not paid is included in Other Liabilities (Note 10). Details of deposits are included in Note 9.

Australian notes on issue

Notes on issue are recorded at face value. Prior to 2005/06, the RBA periodically adjusted its liability for note series that had ceased to be issued, to reflect the likelihood that the remaining notes on issue from these series would not be presented for redemption because they were judged to have been destroyed or were otherwise unavailable for presentation. Under this policy, notes totaling $133 million were written down and the gains included in accounting profits. As these notes were written down prior to 1 January 2005, the RBA has not had to re-recognise under AIFRS the liability for these notes. If the written-down notes are subsequently presented, the RBA will reinstate the liability for them and charge an expense against profits. In 2008/09, notes with a face value of $280 000 which had previously been written down were presented to the RBA and re-recognised as a liability ($214 000 in 2007/08); a corresponding expense was charged against profits.

In 2001/02, the RBA began to pay interest on working balances of currency notes held by banks under revised cash distribution arrangements. Interest is paid on balances up to certain limits.

(c) Gold

Gold holdings (including gold on loan to other institutions) are valued at the Australian dollar equivalent of the 3pm fix in the London gold market on balance date. Revaluation gains and losses on gold are transferred to the gold revaluation reserve. The RBA lends gold to financial institutions participating in the gold market. As outlined in Note 1(b), gold loans are a financial instrument and the RBA accounts for them in accordance with AASB 139 and reports these loans under AASB 7.

(d) Property, plant and equipment

Formal valuations of all the RBA's Australian properties are conducted annually; overseas properties are formally valued on a triennial basis. Australian properties are valued by an independent valuer; overseas properties are valued by local independent valuers. The most recent independent valuation of overseas properties was at 30 June 2007. In accordance with AASB 116 – *Property, Plant and Equipment*, properties are recognised at fair value, which reflects observable prices and is based on the assumption that assets would be exchanged between knowledgeable, willing parties at arm's length. Reflecting the specialised nature of the respective assets, the value of the Craigieburn property has been determined on the basis of vacant possession, while the RBA's business resumption site in outer metropolitan Sydney is valued at depreciated replacement cost. Valuation gains (and losses) are transferred to (from) the Property Revaluation Reserve. The latest valuations have been incorporated in the accounts. Annual depreciation is based on fair values and assessments of the useful remaining life of the relevant asset, determined by the independent valuer.

Plant and equipment is recognised on a fair value basis; valuation gains and losses are treated in accordance with AASB 116. Plant and equipment is valued by independent valuers on a triennial basis. The most recent independent valuation was on 30 June 2008. Annual depreciation is based on fair values and the RBA's assessments of the useful remaining life of individual assets. Computer software and other intangible assets are accounted for in accordance with AASB 138 – *Intangible Assets*. Intangibles are recognised at cost less accumulated amortisation, which is calculated on the basis of the estimated useful life of the relevant assets. Amortisation expense for intangibles is included in Other Expenses in Note 2.

The range of useful lives used for each class of newly-purchased assets is:

	Years
Buildings	20–50
Fitout and furniture	5–13
Computer equipment	
– hardware	3–5
– software	3–5
Office equipment	4–5
Motor vehicles	5
Plant	4–20

Details of annual net expenditure, revaluation adjustments and depreciation of buildings, and plant and equipment are included in Note 8; details of computer software and other intangibles are included in Note 7.

(e) Capital and Reserves

The capital of the Reserve Bank was established by the *Reserve Bank Act 1959*.

The Reserve Bank maintains the Reserve Bank Reserve Fund (RBRF), a general reserve, to provide for events which are contingent and non-foreseeable, including covering losses from exceptionally large falls in the market value of its holdings of domestic and foreign securities that cannot be absorbed by its other resources. This reserve also provides for other risks to which the RBA is exposed, including fraud and operational risk. The RBRF has been funded over the years by transfers from earnings available for distribution and is, in all respects, essentially capital. The Reserve Bank Board assesses the adequacy of the balance of the RBRF each year. In line with Section 30 of the *Reserve Bank Act 1959*, the Treasurer, after consultation with the Board, determines any amounts to be credited to the RBRF from earnings available for distribution (refer Note 1(f)).

The Bank also holds a number of other reserves which form part of its equity.

Unrealised gains and losses on foreign exchange, foreign securities and Australian dollar securities are recognised in profit from ordinary activities. Until such gains or losses are realised, however, they are not available for distribution to the Australian Government; such amounts are reflected in the Reserve for Unrealised Profits on Investments. If unrealised losses exceed the balance held in the Unrealised Profits Reserve they are, to the extent that these unrealised losses exceed this balance, charged against other sources of income, consistent with the *Reserve Bank Act 1959* and accounting practice.

Unrealised gains and losses on the surplus of the staff superannuation funds are also recognised in the Income Statement in accordance with the 'corridor' approach under AASB 119 – *Employee Benefits*. These amounts are reflected in the Reserve for Unrealised Profits on Superannuation (refer Note 1(h)).

Balances of asset revaluation reserves in the balance sheet reflect differences between the fair value of a number of the RBA's assets, mainly non-traded assets (gold; property, plant and equipment; and shares in international financial institutions), and their cost. These unrealised gains are transferred directly to the relevant reserve and are not included in accounting profits. The unrealised gains on these assets are not distributable until the gains are realised through the sale of the relevant asset.

The *Earnings and Distribution* chapter in this Annual Report provides additional information on the RBA's capital and reserves.

(f) Profits

Profits of the RBA are dealt with in the following terms by Section 30 of the *Reserve Bank Act 1959*:

(1) Subject to subsection (2), the net profits of the Bank in each year shall be dealt with as follows:

  (a) such amount as the Treasurer, after consultation with the Reserve Bank Board, determines is to be set aside for contingencies; and

  (b) such amount as the Treasurer, after consultation with the Reserve Bank Board, determines shall be placed to the credit of the Reserve Bank Reserve Fund; and

  (c) the remainder shall be paid to the Commonwealth.

(2) If the net profit of the Bank for a year is calculated on a basis that requires the inclusion of unrealised gains on assets during the year, the amount to which subsection (1) applies is to be worked out as follows:

  (a) deduct from the net profit an amount equal to the total of all amounts of unrealised gains included in the net profit; and

  (b) if an asset in respect of which unrealised gains were included in the net profit for a previous year or years is realised during the year – add to the amount remaining after applying paragraph (a) the total amount of those unrealised gains.

(g) Provisions

The RBA maintains provisions for accrued annual leave in accordance with AASB 119 – *Employee Benefits*, calculated on salaries expected to prevail when leave is anticipated to be taken and including associated payroll tax. The RBA also maintains provisions for long service leave and post-employment benefits, in the form of health insurance and housing assistance, and associated fringe benefits tax; these provisions are made on a present value basis consistent with AASB 119. In addition, the RBA makes provision for future workers' compensation claims in respect of incidents which have occurred before balance date.

(h) Superannuation funds

The RBA includes in its balance sheet an asset representing the surpluses in its defined benefit superannuation funds. Actuarial gains and losses are included in the asset in accordance with the 'corridor' approach under AASB 119 – *Employee Benefits*. The counterpart to the superannuation asset is the Reserve for Unrealised Profits on Superannuation. Actuarial gains and losses in excess of 10 per cent of the greater of the funds' assets or its defined benefit obligations are charged or credited to income in subsequent years over the expected average remaining working life of members. Details of the superannuation funds and superannuation expenses are included in Note 14.

(i) Rounding

Amounts in the financial statements are rounded to the nearest million dollars unless otherwise stated.

	Note	2009 $M	2008 $M

Note 2 NET PROFITS

	Note	2009 $M	2008 $M
Interest revenue			
Overseas investments	1(b), 4	1 266	2 042
Australian dollar securities	1(b), 4	3 093	3 092
Overnight settlements	4	37	61
Gold loans	1(c), 4	4	8
Loans, advances and other	4	1	1
		4 401	5 204
Net gains/(losses) on securities and foreign exchange			
Overseas investments	1(b)	1 469	506
Australian dollar securities	1(b)	142	(34)
Foreign currency	1(b)	5 029	(1 137)
		6 640	(665)
Dividend revenue			
Earnings on shares in Bank for International Settlements	1(b)	5	4
Fees and commissions			
Banking services fees received		21	18
Other revenue			
Reimbursement by Australian Government for loan management and registry expenses		1	–
Rental of Bank premises		9	8
Sales of note and security products		34	41
Superannuation revenue	1(h), 14	–	8
Other		26	25
		70	82
Total		11 137	4 643
Less:			
Interest expense			
Deposit liabilities	1(b), 4	1 744	2 342
Currency note holdings of banks	1(b), 4	167	199
Repurchase agreements	1(b), 4	129	399
		2 040	2 940
General administrative expenses			
Staff costs		149	141
Superannuation costs	1(h), 14	4	–
Special redundancy/retirement payments		3	–
Depreciation of property	1(d), 8	9	9
Depreciation of plant and equipment	1(d), 8	14	13
Premises and equipment	1(d)	37	34

	Note	2009 $M	2008 $M
Note 2 (CONTINUED)			
Materials used in note and security products		20	21
Travel		4	3
Consultants' fees, legal fees and payments to contractors		2	2
Other		8	8
		250	231
Other expenses			
Agency business reimbursement		3	2
Subsidiary income tax		3	3
Cash distribution expenses		4	5
Other		31	32
		41	42
Total		2 331	3 213
Net Profit		8 806	1 430

Staff costs in 2008/09 include an expense of $9.0 million associated with the increase in the balance of the provision for post-employment benefits (in 2007/08 there was an expense of $12.8 million) (refer Note 10). Post-employment health care costs of $9.6 million are included in Staff Costs ($13.5 million in 2007/08).

The RBA's aggregate research and development expenditure recognised as an expense in 2008/09 was $0.5 million ($0.6 million in 2007/08); this is included in Other Expenses.

Note 3 DISTRIBUTION PAYABLE TO AUSTRALIAN GOVERNMENT

Section 30 of the *Reserve Bank Act 1959* requires that the net profits of the Reserve Bank of Australia, less amounts set aside for contingencies or placed in the RBRF as determined by the Treasurer after consultation with the Board, shall be paid to the Australian Government (see Note 1(f)). Also under Section 30, unrealised profits are not available for distribution and are transferred to the Unrealised Profits Reserve where they remain available to absorb future valuation losses or are realised when relevant assets are sold. Unrealised losses are, in the first instance, absorbed within the Unrealised Profits Reserve; if such losses exceed the balance in this reserve, the amount by which the losses exceed this balance is charged against other sources of income.

	2009 $M	2008 $M
Opening balance	1 403	1 085
Distribution to Australian Government	(1 403)	(1 085)
Transfer from Statement of Distribution	5 977	1 403
As at 30 June	5 977	1 403

An amount of $1 403 million from earnings in 2007/08 was paid to the Australian Government in August 2008. A dividend of $5 977 million from 2008/09, representing earnings available for distribution of $6 554 million less a transfer of $577 million to the RBRF, will be distributed to the Australian Government: $5 227 million will be paid in August 2009; and the balance of $750 million will be paid in August 2010.

	Average balance	Interest	Average annual interest rate
	$M	$M	%

Note 4 INTEREST REVENUE AND INTEREST EXPENSE

Analysis for the year ended 30 June 2009

	Average balance $M	Interest $M	Average annual interest rate %
Interest revenue			
Overseas investments	62 220	1 266	2.0
Australian dollar securities	55 096	3 093	5.6
Overnight settlements	827	37	4.5
Gold loans	615	4	0.6
Loans, advances and other	27	1	4.3
	118 785	4 401	3.7
Interest expense			
Banks' Exchange Settlement balances	3 818	179	4.7
Term deposits of domestic financial institutions	3 759	172	4.6
Deposits from governments	21 680	1 059	4.9
Deposits from overseas institutions	16 158	327	2.0
Currency note holdings of banks	3 836	167	4.3
Overseas repurchase agreements	5 981	51	0.8
Domestic repurchase agreements	1 598	78	4.9
Other deposits	160	7	4.4
	56 990	2 040	3.6
Analysis for the year ended 30 June 2008			
Interest revenue total	99 213	5 204	5.2
Interest expense total	50 904	2 940	5.8

During 2008/09 the Bank provided domestic financial institutions with a term deposit facility to assist liquidity management. As there were no term deposit balances at 30 June 2009, this facility does not appear in Note 9.

Interest revenue for 2008/09 includes $3 353 million calculated using the effective interest method for financial assets not at fair value through profit and loss ($4 190 million in 2007/08). Interest expense for 2008/09 includes $2 040 million calculated using the effective interest method for financial liabilities not at fair value through profit and loss ($2 940 million in 2007/08).

	2009 $M	2008 $M

Note 5 CAPITAL AND RESERVES

Changes in the RBA's Capital and Reserves are shown below.

	2009 $M	2008 $M
Asset revaluation reserves		
Gold (Note 1(c))		
Opening balance	2 355	1 842
Net revaluation adjustments	475	513
Transfer (to)/from Statement of Distribution	–	–
As at 30 June	2 830	2 355
Shares in international financial institutions (Notes 1(b), 7)		
Opening balance	226	209
Net revaluation adjustments	49	17
As at 30 June	275	226
Bank properties, plant and equipment (Notes 1(d), 8)		
Opening balance	226	188
Net revaluation adjustments	(23)	38
Transfers (to)/from Statement of Distribution	–	–
As at 30 June	203	226
Total asset revaluation reserves (Note 1(e))		
Opening balance	2 807	2 239
Net revaluation adjustments	501	568
Transfers (to)/from Statement of Distribution	–	–
As at 30 June	3 308	2 807
Unrealised profits reserves		
Reserve for unrealised profits on investments (Note 1(e))		
Opening balance	–	–
Net transfers (to)/from Statement of Distribution	2 237	–
As at 30 June	2 237	–
Reserve for unrealised profits on superannuation (Note 1(h))		
Opening balance	80	53
Net transfers (to)/from Statement of Distribution	15	27
As at 30 June	95	80
Total unrealised profits reserves		
Opening balance	80	53
Net transfers (to)/from Statement of Distribution	2 252	27
As at 30 June	2 332	80
Reserve Bank Reserve Fund (Note 1(e))		
Opening balance	6 286	6 286
Transfers (to)/from Statement of Distribution	577	–
As at 30 June	6 863	6 286
Capital		
Opening and closing balance	40	40

Note 6 CASH AND CASH EQUIVALENTS

This includes net amounts of $743 million owed to the RBA for overnight clearances of financial transactions through the clearing houses; an amount of $853 million was owed to the RBA at 30 June 2008.

	Note	2009 $M	2008 $M
Note 7 LOANS, ADVANCES AND OTHER ASSETS			
Shareholding in Bank for International Settlements	1(b)	318	269
Superannuation asset	1(h), 14	95	80
Officers' Home Advances		8	10
Investment in Securency	1(a)	44	35
Computer software and intangibles	1(d)	7	5
Other		41	39
As at 30 June		513	438

The Reserve Bank of Australia has a 50 per cent share in Securency International Pty Ltd (formerly Securency Pty Ltd), which is incorporated in Victoria, Australia, and whose principal activity is the marketing and manufacture of polymer substrate. The capital of Securency International (Securency) as at 30 June 2009 was $36.5 million. The carrying value of the RBA's investment in Securency as at 30 June 2009 was $43.5 million ($35.1 million at 30 June 2008). Securency has a 31 December balance date. The RBA's share of Securency's profit before income tax in 2008/09 was $11.9 million ($8.8 million in 2007/08); its share of Securency's income tax expense in 2008/09 was $3.5 million ($2.8 million in 2007/08). Securency's current and non-current assets as at 30 June 2009 were $74.4 million and $90.0 million respectively ($61.5 million and $80.9 million as at 30 June 2008). Current and non-current liabilities on 30 June 2009 were $50.7 million and $25.8 million ($22.5 million and $38.2 million on 30 June 2008). Securency's revenue and expenses for 2008/09 were $132.9 million and $109.2 million ($103.2 million and $85.6 million in 2007/08). The RBA provides facilities to Securency under operating leases. In 2005/06, the RBA also provided a finance lease to Securency for $5.6 million in relation to the construction of a new building on the Bank's land at Craigieburn. The finance lease was fully drawn down during 2006/07. The lease was provided on commercial terms and at arm's length; it has a term of 10 years. The balance of the lease receivable as at 30 June 2009 was $3.9 million ($4.3 million as at 30 June 2008).

During 2008/09, the RBA acquired $0.7 million of computer software and intangibles ($0.3 million in 2007/08) and amortised $1.7 million ($1.8 million in 2007/08). At 30 June 2009 the gross book value of the RBA's computer software and intangibles amounted to $14.1 million and accumulated amortisation on these assets was $6.9 million ($11.1 million and $5.7 million respectively at 30 June 2008). The RBA had contractual commitments of $1.4 million as at 30 June 2009 for the acquisition of computer software and intangibles ($0.7 million at 30 June 2008).

As at 30 June 2009, other assets included receivables of $20.3 million, all of which are current (at 30 June 2008 other assets included receivables of $24.4 million, all of which were current).

	Land	Buildings	Plant and Equipment	Total
	$M	$M	$M	$M

Note 8 PROPERTY, PLANT AND EQUIPMENT

	Land $M	Buildings $M	Plant and Equipment $M	Total $M
Gross Book Value as at 30 June 2008	132	246	85	463
Accumulated depreciation	–	–	(7)	(7)
Net Book Value	132	246	78	456
Additions	–	3	32	35
Depreciation expense	–	(9)	(14)	(23)
Net revaluation increment/(decrement)	(11)	(12)	–	(23)
Disposals	–	–	(2)	(2)
Net additions to net book value	(11)	(18)	16	(13)
Gross Book Value as at 30 June 2009	121	229	114	464
Accumulated depreciation	–	(1)	(20)	(21)
Net Book Value	121	228	94	443

The net book value of buildings as at 30 June 2009 includes expenditure of $1.6 million on work in progress which has been capitalised in the carrying amount of these assets ($1.2 million as at 30 June 2008). Additions include expenditure of $19.2 million on work in progress that was capitalised during 2008/09 ($8.2 million in 2007/08). As at 30 June 2009, the RBA had contractual commitments of $30.3 million to acquire buildings, plant and equipment ($4.0 million at 30 June 2008).

Note 9 DEPOSITS

	2009 $M	2008 $M
Banks' Exchange Settlement balances	2 582	6 359
Australian Government	30 160	30 979
State Governments	8	3
Foreign governments, foreign institutions and international organisations	1 502	1 651
Other depositors	14	14
As at 30 June	34 266	39 006

	2009 $M	2008 $M
Note 10 OTHER LIABILITIES		
Provisions (Note 1(g))		
Provision for accrued annual leave	13	12
Provision for long service leave	27	24
Provision for post-employment benefits	78	69
Provision for workers' compensation	–	–
	118	105
Other		
Amounts outstanding under repurchase agreements (contract price) (Note 1(b))	1 501	9 125
Interest accrued on deposits	30	69
Other	444	487
	1 975	9 681
Total Other Liabilities as at 30 June	2 093	9 786

The provision for workers' compensation at 30 June 2009 was $441 000 ($329 000 at 30 June 2008). During 2008/09, annual leave of $8.1 million was accrued by staff, while $7.3 million of accrued leave was used. Staff accrued and used long service leave of $3.8 million and $2.4 million respectively in 2008/09; the provision for long service leave also increased by $2.7 million due to the decrease in the interest rate used to discount future cash flows. The RBA provided an additional $6.6 million for post-retirement benefits in 2008/09; a decrease in the discount rate increased the provision by $3.6 million, while benefits of $1.5 million were paid out of the provision. The balance of the provision for post-employment benefits will change if assumptions regarding the length of staff service, the longevity of retired staff, future movements in medical costs or the discount rate vary. At 30 June 2009, $6.1 million of the provision for accrued annual leave was due within 12 months ($5.6 million at 30 June 2008); $2.7 million of the provision for long service was due within 12 months ($2.2 million at 30 June 2008); and $2.6 million of the provision for post-employment benefits was due within 12 months ($2.3 million at 30 June 2008).

Note 11 CONTINGENT LIABILITIES AND OTHER ITEMS NOT INCLUDED IN THE BALANCE SHEET

The RBA has a contingent liability, amounting to $68.8 million at 30 June 2009 ($60.9 million at 30 June 2008), in respect of the uncalled portion of its shares held in the Bank for International Settlements.

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

The RBA carries its own insurance risks except where external insurance cover is considered to be more cost-effective or required by legislation.

Note 12 KEY MANAGEMENT PERSONNEL

AASB 124 – *Related Party Disclosures* requires disclosure of information relating to aggregate compensation of key management personnel. The key management personnel of the RBA are members of the RBA Board, members of the Payments System Board and senior staff who have responsibility for planning, directing and controlling the activities of the RBA; this group comprises 21 in total (22 in 2007/08), including the Governor and Deputy Governor, 7 non-executive RBA Board members, 6 non-executive Payments System Board members and 6 senior staff. Fees of the non-executive members of the Reserve Bank Board and the Payments Systems Board are determined by the Remuneration Tribunal. The Reserve Bank Board determines the terms and conditions on which the Governor and Deputy Governor hold office in accordance with Section 24A of the *Reserve Bank Act 1959*. The Remuneration Committee (comprising three non-executive directors) reviews annually these terms and conditions and, consistent with the Act, makes recommendations to the Board about the remuneration of the Governor and Deputy Governor. The Governor determines, in consultation with the Remuneration Committee, the remuneration of other key executives.

The remuneration of the RBA's key management personnel was as follows:

	2009 $	2008 $
Short-term employee benefits	4 513 477	3 618 564
Post-employment benefits	861 621	668 114
Other long-term benefits	332 707	144 990
Share based payments	–	–
Termination benefits	–	–
Total Compensation	5 707 805	4 431 668

Short-term benefits include cash salary and, in the case of staff, annual leave, motor vehicle benefits, car parking, health benefits and the fringe benefits tax paid or payable on these benefits. Post-employment benefits include superannuation benefits and, in the case of staff, health benefits. Other long-term benefits include long service leave. The components of remuneration are reported on an accruals basis.

As at 30 June 2009 and 30 June 2008 there were no loans by the RBA to key management personnel.

There were no other related party transactions with Board members; transactions with director-related entities which occurred in the normal course of the RBA's operations were conducted on terms no more favourable than similar transactions with other employees or customers. In addition, $36,976 ($97 354 in 2007/08) was paid for non-executive members of the Board of NPA Limited who are not employees of the RBA or members of the Bank Board.

Note 13 REMUNERATION OF AUDITOR

Fees paid or payable to the statutory auditor (Auditor-General of the Commonwealth of Australia) for audit services (excluding GST) totalled $326 000 in 2008/09 ($315 000 in 2007/08); this includes audit services in relation to the RBA's subsidiary Note Printing Australia. These fees are included in Consultants' Fees, Legal Fees and Payments to Contractors in Note 2.

Note 14 SUPERANNUATION FUNDS

Two superannuation funds are operated pursuant to the *Reserve Bank Act 1959*: the Reserve Bank of Australia Officers' Superannuation Fund (OSF) and the Reserve Bank of Australia UK Pension Scheme. A small part of the assets of the OSF is held by the RBA as nominee for the trustees of the OSF; such assets are not included in the RBA's financial statements. Payment of these superannuation funds' current and future benefits is funded by member and RBA contributions and the funds' existing asset bases. The RBA's superannuation expense for 2008/09 (income for 2007/08) in relation to the OSF and the UK Pension Scheme is included in accounting profits and shown in Note 2. Administration and other operational costs (eg salaries, overheads, legal costs and valuation fees) incurred by the RBA for superannuation arrangements are also included in Note 2. There were no other related-party transactions between the RBA and the funds during 2008/09.

The OSF is a hybrid fund. Most members receive a Bank-funded defined benefit in accordance with the rules of the fund; other member benefits include unitised defined contribution accumulation balances, which comprise the RBA's productivity and superannuation guarantee contributions and members' personal contributions, plus earnings on these contributions. The OSF is classified as a single-employer plan for the purposes of AASB 119 – *Employee Benefits*. The UK Pension Scheme is a defined benefit scheme.

Funding valuation

Full independent actuarial valuations of the OSF and UK Pension Scheme are conducted every three years to determine funding for these schemes. The most recent funding valuation of the OSF was at 30 June 2008 and for the UK Pension Scheme at 30 June 2007. At the most recent valuations, the actuaries indicated that, on the basis of accrued benefits, both funds were in surplus and that the funds were in a satisfactory financial position. The most recent triennial review of the OSF took account of asset price movements to 12 January 2009. The next triennial funding valuation for the OSF for 30 June 2011 will be undertaken in 2011/12.

The OSF triennial funding valuation as at 30 June 2008 was based on the Attained Age Funding method, consistent with the accounting standard for superannuation funds, AAS 25 – *Financial Reporting by Superannuation Plans*. Under this standard, the accrued benefits of the OSF were determined as the value of the future benefits payable to members (allowing for future salary increases), discounted using the expected rate of return on the assets held to fund these benefits. At the time of the triennial review, the surplus of the OSF on this measure was $175 million, as the assets of the OSF of $897 million exceeded the accrued benefits of $722 million. Subsequent to the triennial review, the OSF surplus measured on the basis of AAS 25 as at 30 June 2009 amounted to $34 million (assets of $777 million less accrued benefits of $743 million).

Consistent with the Actuary's funding recommendation, the RBA maintained its contribution rate to the OSF at 18.3 per cent of salaries in 2008/09. The Bank will review its contribution rate annually from 2010, as recommended by the Actuary. The main financial assumptions in the triennial valuation were that the annual post-tax rate of return on assets for benefits of active members was 7.0 per cent, that for assets for current pensions was 7.5 per cent (pre-tax), with annual salary increases of 4.0 per cent and annual pension increases of 3.5 per cent.

The triennial funding valuation for the UK Pension Scheme was based on the Attained Age method. The surplus of the UK Pension Scheme as at 30 June 2009, measured in accordance with AAS 25, was $1 million (assets of $20 million compared with accrued benefits of $19 million).

Accounting valuation

For financial statement purposes, the financial positions of the superannuation schemes are valued in accordance with AASB 119. Under AASB 119, accrued benefits are determined by discounting future benefits payable to current fund members at the yield on government bonds of similar maturity on the reporting date. The approach under AASB 119, in contrast with the results of the Actuaries' triennial valuations noted above, does not take into account that the assets held by the superannuation schemes to fund future benefits have generally earned a higher rate of return on average than government bonds.

The principal actuarial assumptions for the AASB 119 valuation used in the case of the OSF were a discount rate of 5.7 per cent (6.54 per cent in 2007/08), future salary increases of 3.5 per cent (4.0 per cent in 2007/08), future pension increases of 3.50 per cent (3.75 per cent in 2007/08) and an assumed return on plan assets of 8.6 per cent (8.7 per cent in 2007/08). The actual return on plan assets of the OSF for 2008/09 was –13.7 per cent (–3.3 per cent in 2007/08). The assumptions used for the UK Pension Scheme were a discount rate of 6.4 per cent (6.3 per cent in 2007/08), future salary increases of 5.25 per cent (5.90 per cent in 2007/08), future pension increases of 3.25 per cent (3.90 per cent in 2007/08) and an assumed return on plan assets of 4.25 per cent (4.90 per cent in 2007/08). The actual return on plan assets of the UK Pension Scheme for 2008/09 was –1.1 per cent (14.0 per cent in 2007/08). The expected overall rates of returns are based on the actuaries' models of returns for major asset classes and reflect the historic rates of return and volatility for each class and correlations across asset classes.

Details of the funds are as shown on the following pages. In the case of the OSF, these details relate only to the defined benefit component of the fund; defined contribution accumulation balances, on which the Bank has no actuarial risk, are excluded. This has no effect on the measurement of the surpluses in the OSF. At 30 June 2009 accumulation balances in the OSF totalled $125.8 million ($144.4 million as at 30 June 2008).

Asset Distribution as at 30 June	**OSF**		**UK Pension Scheme**	
(% of fund assets)	**2009**	**2008**	**2009**	**2008**
Cash and short-term securities	6.2	6.3	–	–
Fixed interest securities	6.0	4.4	–	–
Indexed securities	2.5	3.1	95.1	94.3
Domestic shares	37.0	36.9	4.9	5.7
Foreign shares	4.1	4.7	–	–
Property				
Direct	5.3	5.2	–	–
Indirect	18.7	21.3	–	–
Private equity and alternative investments	20.2	18.1	–	–
Total	100	100	100	100

Note 14 (CONTINUED)

	OSF		UK Scheme		Total	
	2009 $M	2008 $M	2009 $M	2008 $M	2009 $M	2008 $M
Opening balances:						
Net market value of assets	755	796	22	23	777	819
Accrued benefits	(679)	(631)	(16)	(17)	(695)	(648)
Surplus/(deficit)	76	165	6	5	82	171
Actuarial (gains)/losses not included in balance sheet under Corridor	–	(117)	(3)	(2)	(3)	(118)
Exchange rate (gains)/losses	–	–	1	–	1	–
Opening superannuation asset	76	49	4	4	80	53
Change in net market value of assets	(103)	(41)	(1)	(1)	(104)	(42)
Change in accrued benefits	(149)	(49)	2	2	(148)	(47)
Change in asset cap	–	–	(3)	–	(3)	–
Change in actuarial (gains)/losses not included in balance sheet under Corridor	272	117	(1)	(2)	271	115
Exchange rate (gains)/losses	–	–	(1)	1	(1)	1
Total change in superannuation asset	20	27	(4)	–	16	27
Closing balances:						
Net market value of assets	652	755	20	22	672	777
Accrued benefits	(829)	(679)	(14)	(16)	(843)	(695)
Surplus/(deficit)	(177)	76	7	6	(170)	82
Effect of asset cap	–	–	(3)	–	(3)	–
Actuarial (gains)/losses not included in balance sheet under Corridor	272	–	(4)	(3)	268	(3)
Exchange rate (gains)/losses	–	–	–	1	–	1
Closing superannuation asset	95	76	–	4	95	80
Actuarially assumed return on plan assets	63	63	1	1	64	64
Benefit payments	(30)	(27)	(1)	(1)	(31)	(29)
Actuarial gains/(losses) on assets	(150)	(90)	(1)	2	(151)	(88)
Contributions from RBA to defined benefit schemes	17	16	–	–	17	16
Contributions tax	(2)	(2)	–	–	(2)	(2)
Exchange rate gains/(losses)	–	–	–	(3)	–	(3)
Change in net market value of assets	(103)	(41)	(1)	(1)	(104)	(42)
Current service cost	(21)	(19)	–	–	(21)	(20)
Interest cost	(39)	(36)	(1)	(1)	(40)	(37)
Benefit payments	30	27	1	1	31	29
Contributions tax	2	2	–	–	2	2
Experience adjustments on benefits	(54)	(20)	–	–	(54)	(20)
Effects of changes in benefit actuarial assumptions	(68)	(3)	2	–	(66)	(4)
Exchange rate gains/(losses)	–	–	–	2	–	2
Change in accrued benefits	(149)	(49)	2	2	(148)	(47)

Note 14 (CONTINUED)	OSF		UK Scheme		Total	
	2009 $M	2008 $M	2009 $M	2008 $M	2009 $M	2008 $M
Actuarial (gains)/losses on assets	150	90	1	(2)	151	88
Experience adjustments on benefits	54	20	–	–	54	20
Effects of changes in benefit actuarial assumptions	68	3	(2)	–	66	4
Amortisation of actuarial gains/(losses)	–	3	–	–	–	3
Change in actuarial losses not included in balance sheet under Corridor	272	117	(1)	(2)	271	115
Superannuation expense/(income) included in Income Statement						
Current service cost	21	19	–	–	21	20
Interest cost	39	36	1	1	40	37
Assumed return on plan assets	(63)	(63)	(1)	(1)	(64)	(64)
Amortisation of actuarial (gains)/ losses under Corridor	–	(3)	–	–	–	(3)
Effect of asset cap	–	–	3	–	3	–
Productivity and superannuation guarantee contributions	3	3	–	–	3	3
Total superannuation expense/ (income)	–	(8)	3	–	3	(8)

The components of this table may not add due to rounding.

The surplus of the funds and experience adjustments on plan assets and accrued benefits (under AASB 119) as at 30 June for the current reporting period and previous four reporting periods are:

	2009 $M	2008 $M	2007 $M	2006 $M	2005 $M
OSF					
Closing balances:					
Net market value of assets	652	755	796	672	614
Accrued benefits	(829)	(679)	(631)	(650)	(607)
Surplus/(deficit)	(177)	76	165	22	7
Experience adjustments on assets	(150)	(90)	95	40	38
Experience adjustments on benefits	(54)	(20)	7	(11)	(11)
UK Scheme					
Closing balances:					
Net market value of assets	20	22	23	24	23
Accrued benefits	(14)	(16)	(17)	(20)	(19)
Surplus	7	6	5	4	4
Experience adjustments on assets	(1)	2	–	–	1
Experience adjustments on benefits	–	–	–	–	–

The components of this table may not add due to rounding.

Note 15 SEGMENT REPORTING

The RBA's primary function as a central bank is the implementation of monetary policy in one geographical area, Australia. Over 95 per cent of the RBA's assets (and a similar proportion of revenues) are managed for that purpose by the Financial Markets Group. Additional information on the make-up of the RBA's financial assets is provided in Note 16.

Note 16 FINANCIAL INSTRUMENTS AND RISK

As the central bank of Australia, the RBA is responsible for implementing monetary policy and managing Australia's foreign reserve assets. As a consequence, the RBA holds a range of financial assets, including Australian dollar securities, foreign government securities, bank deposits, interest rate futures contracts, foreign currency swaps, gold loans, cash and cash equivalents. The RBA also holds a shareholding in the Bank for International Settlements. As to financial liabilities, the RBA issues Australia's banknotes and offers deposit facilities to its customers, mainly the Australian Government, and eligible financial institutions. Accordingly, the main financial claims on the RBA are currency notes on issue as well as deposit liabilities. The RBA also provides banking services to its customers, and operates Australia's high-value payments and inter-bank settlement systems. These payment and settlements occur through accounts held on the RBA's balance sheet.

AASB 7 – *Financial Instruments: Disclosures* requires disclosure of information relating to financial instruments; their significance and performance; terms and conditions; fair values; risk exposures and risk management.

Financial Risk

The RBA is exposed to a range of financial risks reflecting its policy and operational responsibilities. These risks include market risk, credit risk and liquidity risk. The chapters on the Reserve Bank's *Operations in Financial Markets* and *Risk Management* provide additional information on the RBA's management of these financial risks.

Market Risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises: foreign exchange risk; interest rate risk; and other price risk.

Foreign exchange risk

Foreign exchange risk is the risk that the fair value or cash flows of foreign currency assets and liabilities will fluctuate because of movements in exchange rates. Foreign exchange risk arises from the RBA's foreign currency assets, which are held to support its operations in the foreign exchange market. The value of these assets, measured in Australian dollars, varies with movements in the value of the Australian dollar exchange rate against the currencies in which the assets are invested. An appreciation in the exchange rate results in valuation losses, while a depreciation leads to valuation gains. The overall level of foreign currency exposure is determined by policy considerations and cannot otherwise be managed to reduce foreign exchange risk. The RBA's net foreign currency exposure as at 30 June 2009 was $39.3 billion ($33.0 billion as at 30 June 2008). Within the overall exposure and to a limited extent, foreign currency risk can be reduced by holding assets across a diversified portfolio of currencies. The RBA holds foreign reserves in three currencies – the US dollar, the Euro and the Yen – because the markets for these currencies are typically liquid and suitable for investing foreign exchange reserves. (See *Concentration of foreign exchange* below.)

The RBA also undertakes foreign currency swaps to assist its daily domestic market operations. These instruments carry no foreign exchange risk since the exchange rates at which both legs of the transaction are settled are agreed at the time the swap is undertaken.

Concentration of foreign exchange

The RBA's net holdings of foreign exchange (excluding its holding of Special Drawing Rights) were distributed as follows as at 30 June:

	% of foreign exchange	
	2009	2008
US dollar	45	45
Euro	45	45
Japanese yen	10	10
Total foreign exchange	100	100

Sensitivity to foreign exchange risk

The sensitivity of the RBA's profit and equity to a movement of +/–10 per cent in the value of the Australian dollar exchange rate as at 30 June is shown below. These figures are generally reflective of the RBA's exposure over the financial year.

	2009 $M	2008 $M
Loss/decrease in equity due to a 10 per cent appreciation in the reserves-weighted value of the A$	–3 577	–2 997
Profit/increase in equity due to a 10 per cent depreciation in the reserves-weighted value of the A$	4 372	3 664

Interest rate risk

Interest rate risk is the risk that the fair value or cash flows of financial instruments will fluctuate because of movements in market interest rates. The RBA's balance sheet is exposed to considerable interest rate risk because most of its assets are financial assets, such as domestic and foreign securities, which have a fixed income stream. The price of such securities increases when market interest rates decline, while the price of a security will fall if market rates rise. Interest rate risk increases with the maturity of a security because the associated income stream is fixed for a longer period.

The interest rate risk table (over page) is based on the RBA's contracted portfolio as reported in the RBA's balance sheet. All financial instruments are shown at their repricing period which is equivalent to the remaining term to maturity. Other liabilities include amounts outstanding under sale repurchase agreements. Interest rate futures reflect the positions in interest rate contracts traded on foreign futures exchanges.

Note 16 (CONTINUED)

Interest rate risk As at 30 June 2009

	Balance sheet total $M	Floating interest rate $M	Repricing period $M				Not bearing interest $M	Weighted average coupon rate %	Weighted average effective rate %
			0 to 3 months	3 to 12 months	1 to 5 years	Over 5 years			
Assets									
Gold loans	149	–	37	74	37	–	1	0.48	0.48
Gold holdings	2 808	–	–	–	–	–	2 808	n/a	n/a
Sub-total	**2 957**								
Foreign exchange									
Balances with central banks	372	370	–	–	–	–	2	0.01	0.01
Securities sold under repurchase agreements	1 393	–	–	–	733	660	–	2.24	2.60
Securities purchased under repurchase agreements	11 374	–	11 374	–	–	–	–	0.26	0.26
Other securities	35 671	216	14 248	7 640	8 375	3 735	1 457	1.44	1.00
Deposits	2 125	28	2 086	–	–	–	11	0.40	0.40
Accrued interest – foreign exchange	221	–	–	–	–	–	221	n/a	n/a
Sub-total	**51 156**								
Australian dollar securities									
Securities sold under repurchase agreements	104	–	–	–	104	–	–	7.13	5.43
Securities purchased under repurchase agreements	42 286	–	21 366	20 920	–	–	–	3.74	3.74
Other securities	4 069	–	1 261	457	909	1 442	–	5.27	4.56
Accrued interest – Australian dollar securities	666	–	–	–	–	–	666	n/a	n/a
Sub-total	**47 125**								
Property, plant & equipment	443	–	–	–	–	–	443	n/a	n/a
Cash and cash equivalents	772	767	–	–	–	–	5	3.00	3.00
Loans and advances	8	8	–	–	–	–	–	2.87	2.87
Other	505	–	–	–	–	–	505	n/a	n/a
Total assets	**102 966**	**1 389**	**50 372**	**29 091**	**10 158**	**5 837**	**6 119**	**2.34**	**2.16**
Liabilities									
Australian notes on issue	48 087	2 770	–	–	–	–	45 317	0.17	0.17
Deposits	34 266	5 907	27 352	–	–	–	1 007	2.96	2.96
Distribution payable to Australian Government	5 977	–	–	–	–	–	5 977	n/a	n/a
Other	2 093	–	1 501	–	–	–	592	(0.01)	(0.01)
Total liabilities	**90 423**	**8 677**	**28 853**	**–**	**–**	**–**	**52 893**	**1.21**	**1.21**
Capital and reserves	12 543								
Total balance sheet	**102 966**								
Off balance sheet items									
Interest rate futures	(484)	–	–	–	–	–	(484)	n/a	n/a

Note 16 (CONTINUED)

Interest rate risk As at 30 June 2008

	Balance sheet total $M	Floating interest rate $M	Repricing period $M 0 to 3 months	3 to 12 months	1 to 5 years	Over 5 years	Not bearing interest $M	Weighted average coupon rate %	Weighted average effective rate %
Assets									
Gold loans	866	–	155	620	62	–	29	1.36	1.36
Gold holdings	1 643	–	–	–	–	–	1 643	n/a	n/a
Sub-total	**2 509**								
Foreign exchange									
Balances with central banks	314	311	–	–	–	–	3	1.70	1.70
Securities sold under repurchase agreements	9 086	–	–	1 700	3 748	3 638	–	3.37	3.10
Securities purchased under repurchase agreements	13 537	–	13 537	–	–	–	–	2.42	2.42
Other securities	14 337	198	1 787	2 473	5 004	4 049	826	3.38	3.72
Deposits	5 008	27	4 980	–	–	–	1	3.41	3.41
Accrued interest – foreign exchange	223	–	–	–	–	–	223	n/a	n/a
Sub-total	**42 505**								
Australian dollar securities									
Securities sold under repurchase agreements	–	–	–	–	–	–	–	–	–
Securities purchased under repurchase agreements	51 451	–	41 392	10 059	–	–	–	7.52	7.52
Other securities	2 777	–	384	–	1 438	955	–	6.33	7.26
Accrued interest –Australian dollar securities	474	–	–	–	–	–	474	n/a	n/a
Sub-total	**54 702**								
Property, plant & equipment	456	–	–	–	–	–	456	n/a	n/a
Cash and cash equivalents	862	853	–	–	–	–	9	7.25	7.25
Loans and advances	10	10	–	–	–	–	–	4.72	4.72
Other	428	–	–	–	–	–	428	n/a	n/a
Total assets	**101 472**	**1 399**	**62 235**	**14 852**	**10 252**	**8 642**	**4 092**	**5.34**	**5.39**
Liabilities									
Australian notes on issue	42 064	2 483	–	–	–	–	39 581	0.43	0.43
Deposits	39 006	8 221	29 406	–	–	–	1 379	7.21	7.21
Distribution payable to Australian Government	1 403	–	–	–	–	–	1 403	n/a	n/a
Other	9 786	–	9 123	–	–	–	663	1.91	1.91
Total liabilities	**92 259**	**10 704**	**38 529**	**–**	**–**	**–**	**43 026**	**3.45**	**3.45**
Capital and reserves	9 213								
Total balance sheet	**101 472**								
Off balance sheet items									
Interest rate futures	99	–	–	–	–	–	99	n/a	n/a

Sensitivity to interest rate risk

The figures below show the effect on the RBA's profit and equity of a movement of +/–1 percentage point in interest rates, given the level, composition and modified duration of the RBA's foreign currency and Australian dollar securities as at 30 June. The valuation effects shown are generally reflective of the RBA's exposure over the financial year.

	2009 $M	2008 $M
Change in profit/equity due to movements of +/–1 percentage point across yield curves:		
Foreign currency securities	–/+591	–/+828
Australian dollar securities	–/+113	–/+86

A rise in interest rates would be associated with a valuation loss; a fall in interest rates would be associated with a valuation gain.

Other price risk

The RBA holds shares as a member of the Bank for International Settlements. This membership is mainly to maintain and develop strong relationships with other central banks which are to Australia's advantage. Shares in the BIS are owned exclusively by its member central banks and monetary authorities. For accounting purposes, the RBA treats BIS shares as 'available for sale' and the fair value of these shares is estimated on the basis of the BIS' net asset value, less a discount of 30 per cent. Accordingly, these shares are revalued to reflect movements in the net asset value of the BIS and in the Australian dollar. The price risk faced on BIS shares is incidental to the general reasons for holding them and is immaterial compared with other market risks faced by the RBA. For this reason, this exposure is not included as part of the RBA's net foreign currency exposure outlined above.

Credit Risk

Credit risk is the potential for financial loss arising from an issuer or counterparty defaulting on its obligations to repay the principal, make interest payments due on an asset, or settle a transaction. For the RBA, credit risk arises from exposure to: the issuers of securities that it holds; banks with which it deposits funds; and counterparties which are yet to settle transactions. The RBA's credit exposure is low compared with that of most commercial financial institutions, as it manages such risks within a highly risk-averse framework. In particular, credit risk is managed by: holding securities issued by a limited number of highly-rated governments, government-guaranteed agencies and supranational organisations; holding government guaranteed issues of certain highly-rated commercial banks and deposits with highly-rated banks, in amounts consistent with the credit ratings and capital positions of these financial institutions; and holding collateral only of low credit risk against buy repurchase agreements and gold loans.

Cash invested under repurchase agreements in overseas markets is secured by collateral in the form of government securities or securities issued by US agencies; the RBA takes and maintains collateral to the value of 102 per cent of the cash invested. Cash invested under domestic buy repurchase agreements is secured by securities issued by Australian governments, Australian banks and various corporate and asset backed securities (see Note 1(b)). The RBA holds collateral to a value of between 102 and 110 per cent of the amount invested according to the risk profile of the collateral held. If the current value of collateral offered by a counterparty to a repo transaction falls by more than 1 percentage point below the initial margin, the counterparty is required to provide additional collateral to restore this margin. Gold loans are secured by Australian dollar securities to 110 per cent of the market value of the gold loaned.

As part of a co-ordinated response by central banks to address pressures in US dollar short-term funding markets, the RBA established a US dollar swap facility in September 2008 with the Fed in which it makes available US dollars to Australian Banks (see Note 1(b)). The US dollars are made available to banks under repurchase agreements with the RBA which are collateralised by Australian dollar securities. This collateral has a market value of up to 120 per cent of the amount of the repurchase agreement, according to the risk profile of the securities offered. The US dollar loans to banks are reported on the RBA's balance sheet as foreign exchange since its claims on these banks are in terms of US dollars. The Australian dollars held by the Fed under the swap are deposited with the RBA, and reported accordingly on the RBA's balance sheet. The A$ securities offered to the RBA by Australian banks as collateral are treated in the same way as collateral held under the RBA's other 'buy' repurchase agreements (see Note 1(b)). The value of US dollars outstanding to banks in Australia under this facility was $0.3 billion at 30 June 2009; the Fed held a counterpart deposit of $0.3 billion with the RBA.

The RBA does not sell or re-pledge securities held as collateral under buy repurchase agreements.

The RBA's maximum exposure to credit risk in relation to each class of recognised financial assets, other than derivatives (off-balance sheet items), is the carrying amount of those assets as indicated in the balance sheet.

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

1. ***Foreign exchange swaps*** – As at 30 June 2009 the RBA was under contract to purchase $2.5 billion of foreign currency ($5.2 billion at 30 June 2008) and sell $12.6 billion of foreign currency ($5.2 billion at 30 June 2008). As of that date there was a net unrealised gain of $773 million on these swap positions included in net profit ($3 million unrealised gain at 30 June 2008). The exposure of these contracts to credit risk is the cost of re-establishing the contract in the market if a counterparty fails to fulfill its obligations.
2. ***Interest rate futures*** – As at 30 June 2009 the amount of credit risk on interest rate futures contracts was approximately $11.3 million ($1.4 million at 30 June 2008). As at 30 June 2009 there was an unrealised loss brought to account on those contracts of $9.2 million ($0.9 million unrealised loss at 30 June 2008).

Concentration of credit risk

As noted, the RBA operates to minimise its credit risk exposure through comprehensive risk management policy guidelines. The table (over page) indicates the concentration of credit risk in the RBA's investment portfolio.

The RBA held no past due or impaired assets at 30 June 2009 or 30 June 2008.

	Risk rating of security/issuer[1]	Risk rating of counterparties[1]	% of total assets	
			2009	2008
Domestic Government Securities				
Holdings – Commonwealth Government securities	AAA	n/a	0.2	0.0
Holdings – Semi Government securities	AAA	n/a	2.1	2.3
	AA	n/a	1.7	0.5
Securities sold under repurchase agreements	AAA	AA	0.1	0.0
Securities held under repurchase agreements	AAA	AA	21.4	7.7
	AAA	A	6.5	0.6
	AAA	BBB	0.6	0.0
	AAA	Other	1.1	0.1
	AA	AA	9.3	36.5
	AA	A	1.4	0.1
	AA	BBB	0.1	0.0
	AA	Other	0.0	0.1
	A	AA	1.0	5.3
	A	A	0.3	0.4
	Other[2]	AA	0.0	0.3
Foreign investments				
Holdings of securities	AAA	n/a	22.1	11.0
	AA	n/a	11.6	2.9
	A	n/a	0.4	0.3
Securities sold under repurchase agreements	AAA	AA	0.3	4.2
	AAA	A	1.0	4.7
	AA	A	0.0	0.1
Securities held under repurchase agreements	AAA	AAA	0.4	0.3
	AAA	AA	6.2	7.8
	AAA	A	4.9	5.2
	AA	A	0.0	0.3
Deposits	n/a	AAA	1.2	0.3
	n/a	AA	0.7	4.7
	n/a	A	0.2	0.0
Other	n/a	AA	0.6	0.0
	n/a	A	0.1	0.0
Gold loans	n/a	AAA	0.1	0.1
	n/a	AA	0.0	0.5
	n/a	A	0.0	0.2
	n/a	BBB	0.0	0.1
Other			4.4	3.4
			100	100

1 Standard & Poor's equivalent ratings

2 This category includes Asset Backed Commercial Paper (ABCP), which does not have a long-term credit rating.

Liquidity Risk

Liquidity risk is the risk that the RBA will encounter difficulty in meeting obligations associated with its financial liabilities. As the ultimate source of liquidity in Australian dollars, the RBA has the powers and operational wherewithal to create liquidity in unlimited amounts in Australian dollars at any time. A small component of the RBA's liabilities is in foreign currencies, namely foreign sale repurchase agreements. All risks associated with these instruments, including liquidity risk, are managed by ensuring the liability is fully hedged.

Liquidity risk is also associated with financial assets to the extent that the RBA may in extraordinary circumstances be forced to sell a financial asset at a price which is less than its fair value. The RBA manages this risk by holding a diversified portfolio of highly liquid domestic and foreign assets.

Fair Value of Financial Instruments

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction, and is usually determined by the quoted market price. The RBA's Australian dollar securities, foreign government securities, interest rate futures, foreign currency swap contracts and its shareholding in the Bank for International Settlements are carried in the balance sheet (and shown in this note) at fair value. The RBA's bank deposits, cash and cash equivalents, notes on issue and deposit liabilities are carried in the balance sheet (and shown in this note) at face value, which is equivalent to their amortised cost using the effective interest method; this approximates fair value.

AASB 7 requires that the fair value of financial assets and liabilities be disclosed according to their accounting classification under AASB 139.

	2009 $M	2008 $M
Assets accounted for under AASB 139		
At fair value through Profit or Loss	41 504	26 446
Loans and receivables	57 725	72 522
Available-for-sale	320	271
Assets accounted for under other standards	3 417	2 233
Total assets as at 30 June	102 966	101 472
Liabilities accounted for under AASB 139		
At fair value through Profit or Loss	409	399
Not at fair value through Profit or Loss	89 890	91 751
Liabilities accounted for under other standards	124	109
Total liabilities as at 30 June	90 423	92 259

Auditor-General for Australia

Australian National
Audit Office

INDEPENDENT AUDITOR'S REPORT

To the Treasurer

Scope

I have audited the accompanying financial statements of the Reserve Bank of Australia (the Bank) and the controlled entities for the year ended 30 June 2009, which comprise: a Directors Statement; Balance Sheet; Income Statement; Statement of Distribution; Statement of Changes in Capital and Reserves; Cash Flow Statement; and Notes to and forming part of the Financial Statements, including a Summary of Accounting Policies.

The Directors' Responsibility for the Financial Statements

The members of the Board are responsible for the preparation and fair presentation of the financial statements in accordance with the Finance Minister's Orders made under the *Commonwealth Authorities and Companies Act 1997*, including the Australian Accounting Standards (which include the Australian Accounting Interpretations). This responsibility includes establishing and maintaining internal controls relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

My responsibility is to express an opinion on the financial statements based on my audit. I conducted my audit in accordance with the Australian National Audit Office Auditing Standards, which incorporate the Australian Auditing Standards. These auditing standards require that I comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Bank's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

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

Independence

In conducting the audit, I have followed the independence requirements of the Australian National Audit Office, which incorporate the requirements of the Australian accounting profession.

<u>Auditor's Opinion</u>

In my opinion, the financial statements of the Reserve Bank of Australia and the controlled entities:

(a) have been prepared in accordance with the Finance Minister's Orders made under the *Commonwealth Authorities and Companies Act 1997,* including the Australian Accounting Standards; and

(b) give a true and fair view of the matters required by the Finance Minister's Orders including the Bank's and the controlled entities financial position as at 30 June 2009 and of their financial performance and cash flows for the year then ended.

Ian McPhee
Auditor-General
Sydney
13 August 2009

Pro Forma Business Accounts

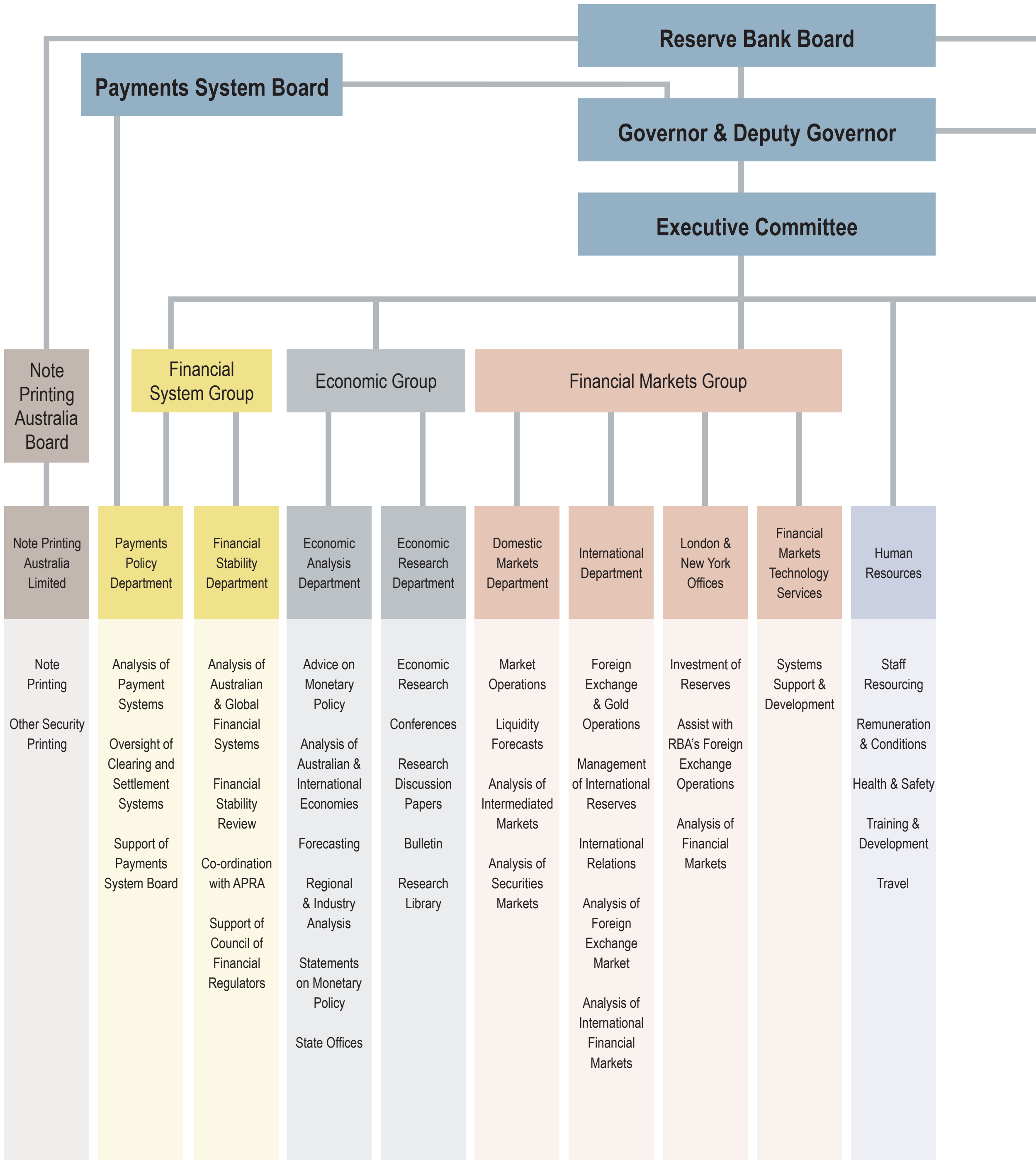
The following sets of accounts for each of the Reserve Bank's contestable businesses have been prepared in accordance with competitive neutrality guidelines. These accounts do not form part of the audited financial statements.

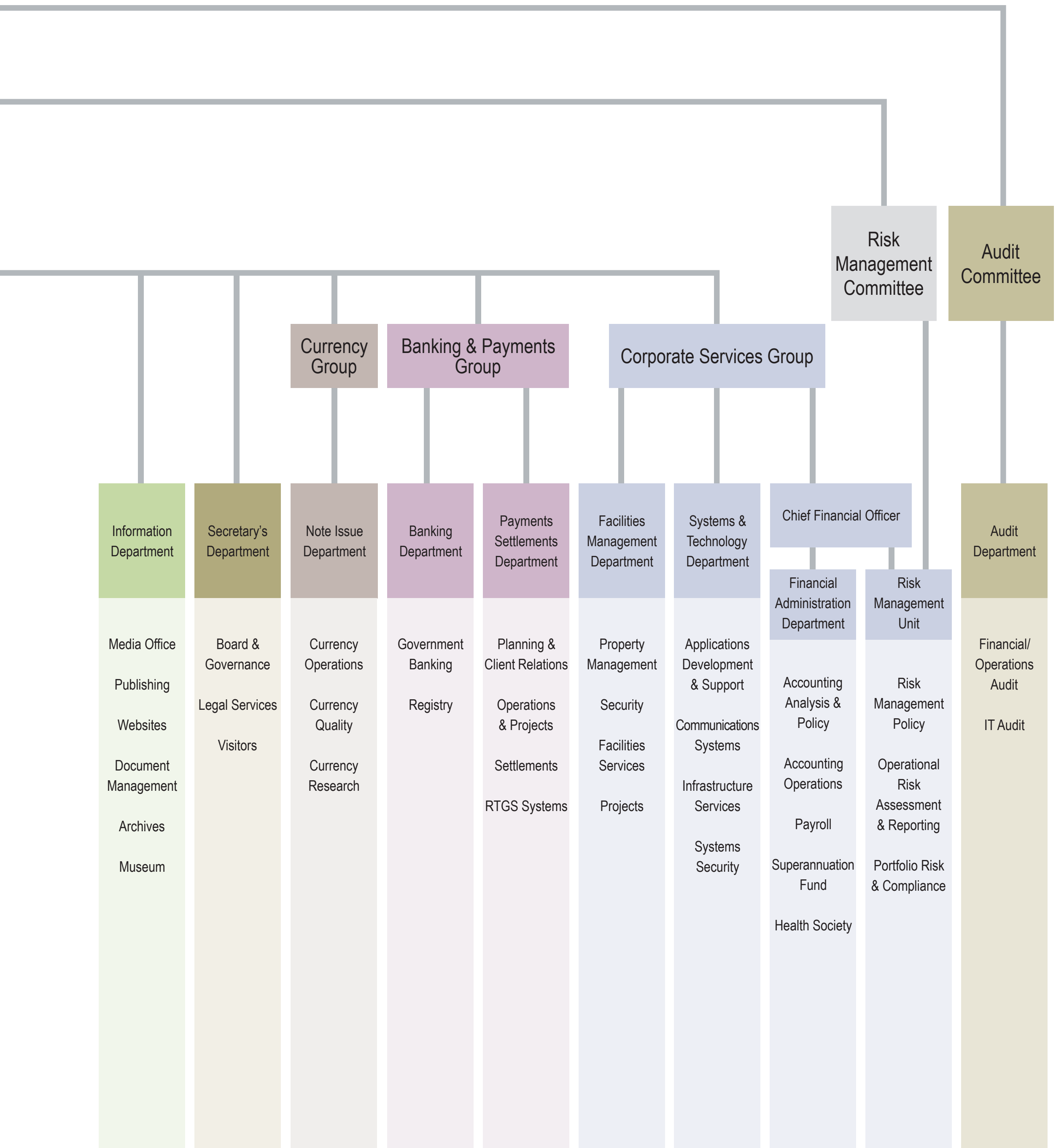
	Transactional Banking		Registry	
	2007/08 $ million	2008/09 $ million	2007/08 $ million	2008/09 $ million
Revenue				
– Service fees	15.5	18.3	0.5	0.5
– Other revenue	6.0	5.0	0.1	0.1
Total	21.5	23.3	0.6	0.6
Expenditure				
– Direct costs	12.8	14.3	0.3	0.3
– Indirect costs	5.3	4.0	0.1	0.1
Total	18.1	18.3	0.4	0.4
Net profit/(loss)	3.4	5.0	0.2	0.2
Net profit/(loss) after taxes[(a)]	2.3	3.5	0.1	0.1
Assets[(b)]				
– Domestic markets investments	409.4	418.0	1.3	1.5
– Other assets	10.1	8.8	0.1	
Total	419.5	426.8	1.4	1.5
Liabilities[(b)]				
– Capital & reserves	25.0	25.0	1.0	1.0
– Deposits	387.9	395.5		
– Other liabilities	6.6	6.3	0.4	0.5
Total	419.5	426.8	1.4	1.5

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

(b) As at 30 June

Organisational Chart | August 2009




Risk Management Committee
Audit Committee
Currency Group
Banking & Payments Group
Corporate Services Group
Information Department
Media Office
Publishing
Websites
Document Management
Archives
Museum
Secretary's Department
Board & Governance
Legal Services
Visitors
Note Issue Department
Currency Operations
Currency Quality
Currency Research
Banking Department
Government Banking
Registry
Payments Settlements Department
Planning & Client Relations
Operations & Projects
Settlements
RTGS Systems
Facilities Management Department
Property Management
Security
Facilities Services
Projects
Systems & Technology Department
Applications Development & Support
Communications Systems
Infrastructure Services
Systems Security
Chief Financial Officer
Financial Administration Department
Accounting Analysis & Policy
Accounting Operations
Payroll
Superannuation Fund
Health Society
Risk Management Unit
Risk Management Policy
Operational Risk Assessment & Reporting
Portfolio Risk & Compliance
Audit Department
Financial/ Operations Audit
IT Audit

Head Office Management | August 2009

Governor:	Glenn Stevens
Deputy Governor:	Ric Battellino

Economic Group

Assistant Governor:	Philip Lowe

Economic Analysis Department

Head:	Tony Richards
Deputy Heads:	James Holloway
	David Orsmond
Head of Regional and Industry Analysis:	Ric Deverell

Economic Research Department

Head:	Christopher Kent

Financial Markets Group

Assistant Governor:	Guy Debelle

Domestic Markets Department

Head:	John Broadbent
Deputy Head:	Jonathan Kearns

International Department

Head:	Chris Ryan
Deputy Heads:	Alexandra Heath
	James Whitelaw

Financial System Group

Assistant Governor:	Malcolm Edey

Financial Stability Department

Head:	Luci Ellis
Deputy Head:	Carl Schwartz

Payments Policy Department

Head:	Michele Bullock
Deputy Head:	John Simon

Banking and Payments Group

Assistant Governor:	Keith Hall

Banking Department

Head:	Greg Johnston

Payments Settlements Department

Head:	Nola McMillan

Currency Group

Assistant Governor:	Bob Rankin

Note Issue Department

Head:	Michael Andersen

Corporate Services Group

Assistant Governor:	Frank Campbell

Financial Administration Department

Chief Financial Officer:	Darryl Ross

Facilities Management Department

Head:	Richard Mayes

Systems & Technology Department

Head:	Michael Hogan

Risk Management Unit

Head:	Lindsay Boulton

Secretary's Department

Secretary:	David Emanuel
Deputy Secretary:	Anthony Dickman

Audit Department

Head:	Paul Apps

Information Department

Head:	Jacqui Dwyer

Human Resources

Head:	Chris Aylmer

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Glossary

ABCP	Asset-backed commercial paper
ABS	Asset-back securities
ADI	Authorised deposit-taking institution
AIFRS	Australian equivalents to International Financial Reporting Standards
AOFM	Australian Office of Financial Management
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
ATM	Automated teller machine
BCBS	Basel Committee on Banking Supervision
BIS	Bank for International Settlements
CAC Act	*Commonwealth Authorities and Companies Act 1997*
CGFS	Committee on the Global Financial System (of the BIS)
CGS	Commonwealth Government securities
CLS	Continuous linked settlement
COIN	Community of Interest Networks
CPSS	Committee on Payment and Settlement Systems (of the BIS)
DoFD	Department of Finance and Deregulation
ECB	European Central Bank
EMEAP	Executives' Meeting of East Asia-Pacific Central Banks
ES	Exchange settlement
ESA	Exchange Settlement Account
FOI	Freedom of Information
FSB	Financial Stability Board
FSF	Financial Stability Forum
G-20	Group of Twenty
G7	Group of Seven
GPF	Government Partnership Fund (with Indonesia)
HSMAs	Health & Safety Management Arrangements
IMF	International Monetary Fund
IT	Information technology
NPA	Note Printing Australia Limited
OPA	Official Public Accounts
OTC	Over the counter (derivatives)
RBA	Reserve Bank of Australia
RBRF	Reserve Bank Reserve Fund
RITS	Reserve Bank Information and Transfer System
RMBS	Residential mortgage-backed securities
RMU	Risk Management Unit
RTGS	Real-time gross settlement
SDR	Special Drawing Right
SWIFT	Society for Worldwide Interbank Financial Telecommunication