

3.4 Earnings, Distribution and Capital

In 2022/23, the Reserve Bank recorded an accounting loss of \$6 billion, mainly due to negative underlying earnings resulting from the higher domestic cash rate and valuation losses from a further rise in bond yields. With the balance in the unrealised profits reserve (UPR) and Reserve Bank Reserve Fund (RBRF) fully depleted from absorbing large losses last year, the accounting loss was added to accumulated losses.

The Bank was in a negative equity position of \$17.7 billion on 30 June 2023, compared with \$12.4 billion a year earlier. The Reserve Bank Board's judgement continues to be that negative equity does not affect the Bank's ability to operate effectively or perform its functions, but that it is important that the Bank's equity is restored over time. This can be achieved through the Bank retaining its profits over the years ahead.

Earnings and distribution

The Reserve Bank's earnings come from two sources:

- underlying earnings, which includes net interest and fee income less operating costs
- valuation gains or losses on its holdings of government bonds and foreign exchange.

The Bank earns interest on most of its assets but, historically, has paid no interest on a large proportion of its liabilities, namely banknotes on issue. With the substantial increase in Exchange Settlement (ES) balances since the COVID-19 pandemic, the Bank's net interest earnings were negative in 2022/23. This reflects that most of the Bank's domestic assets earn fixed interest rates (at the much lower interest rates that prevailed when those assets were acquired), while the Bank's interest-bearing liabilities (mainly ES balances) are paid a floating interest rate linked to the cash rate. This is expected to remain the case for a few more years, and at least until funds loaned under the Term Funding Facility (TFF) are fully repaid in June 2024.

Valuation gains and losses result from movements in exchange rates or changes in the market yields on securities held outright:

- A depreciation of the Australian dollar or a decline in market yields results in valuation gains.
- An appreciation of the Australian dollar or a rise in market yields leads to valuation losses.

These gains and losses are realised only when the underlying asset is sold or matures.

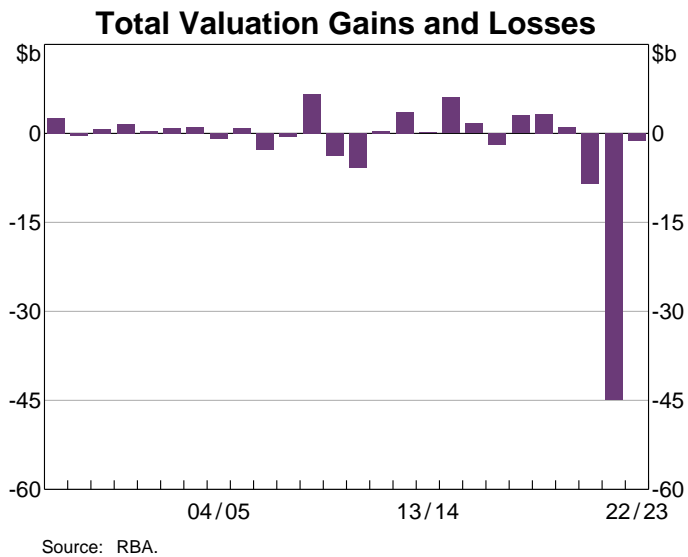
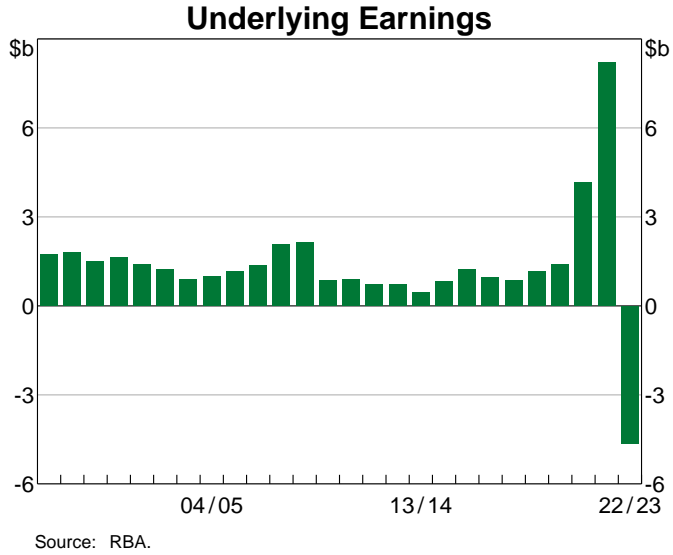
Valuation gains and losses are volatile, as both exchange rates and market interest rates can fluctuate in wide ranges over time.

In 2022/23, the Bank's accounting loss of \$6 billion comprised the following:

- underlying earnings of -\$4.6 billion (compared with \$8.2 billion in 2021/22); as noted above, this net expense is because the Bank currently pays a higher interest rate on ES balances than it earns on its portfolio of assets

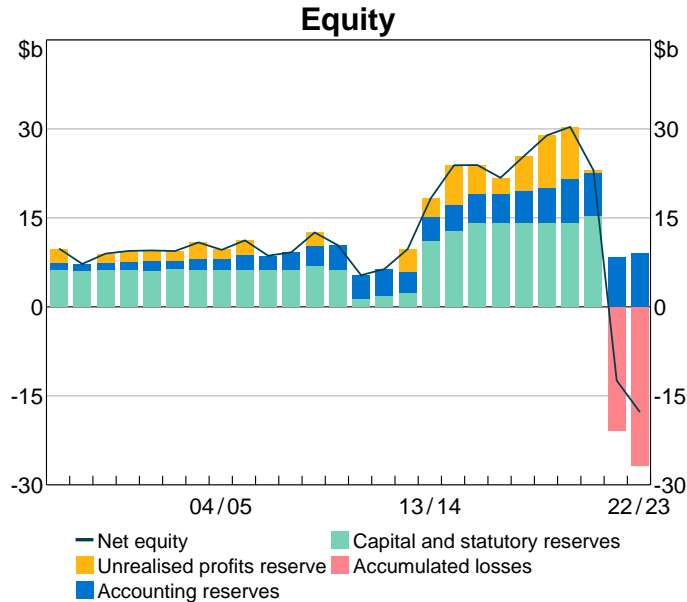
- unrealised valuation losses of \$1.8 billion, mainly reflecting that a rise in bond yields in Australia and abroad was only partially offset by the depreciation of the Australian dollar over the year
- realised valuation gains of \$0.4 billion.

With the balance in the UPR and RBRF fully depleted from absorbing large losses last year, the 2022/23 accounting loss was added to accumulated losses on the Bank’s balance sheet.



Capital and reserves

The Reserve Bank was in a negative equity position of \$17.7 billion as at 30 June 2023, as accumulated losses on its balance sheet exceeded the combined balance of its other reserves. The Reserve Bank Board's judgement remains that negative equity does not affect the Bank's ability to operate effectively or perform its functions, but that it is important that the Bank's equity is restored over time.



Source: RBA.

For several years, the Board has maintained a formal framework for determining the target balance in the RBRF, which is essentially the Bank's capital. Capital was assigned to market risk arising from the Bank's portfolio of foreign and domestic securities. A small amount of capital was also assigned to credit risk arising from the very small exposures to commercial banks that are not collateralised. The target RBRF balance is not a minimum level of capital, but rather a benchmark for the Board to consider when providing advice to the Treasurer regarding the Bank's capital and dividends. As at 30 June 2023, the RBRF target was \$23.2 billion, compared with an actual balance of nil (and accumulated losses recorded elsewhere on the balance sheet of \$26.8 billion).

Restoring the Bank's equity can be achieved by the Bank retaining its profits over the years ahead (see below). The Board has communicated its strong expectation to the Australian Government that future distributable earnings would be applied, in full, to offsetting the accumulated losses and restoring the balance of the RBRF to the Board's target. In response, the Treasurer has endorsed the Board's general approach to restoring the equity position over time, while noting any retention of earnings remains at the discretion of the Treasurer in terms of the *Reserve Bank Act 1959*.

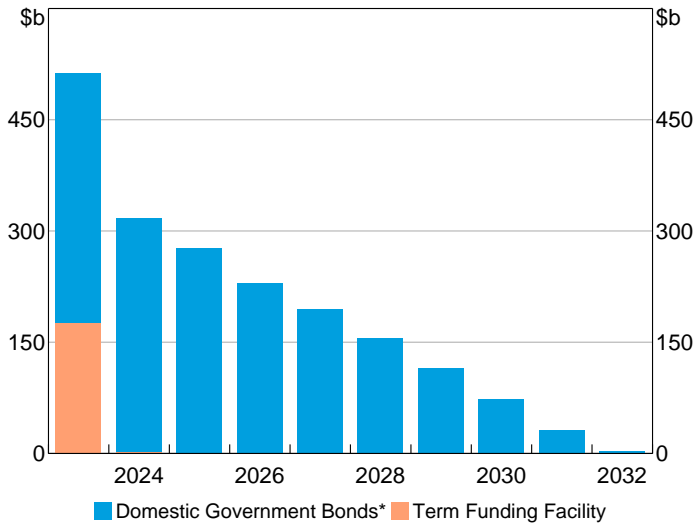
Restoring the Bank's equity

Most of the Bank's domestic bonds are now carried on the balance sheet at a discount to their face value, so that capital gains are expected to be realised as these bonds mature. This will add to the Bank's distributable earnings in future periods. Nevertheless, the Bank's future earnings remain highly uncertain, due to the mismatch between the fixed returns on most of its assets and the variable rate paid on a large portion of its liabilities, notably ES balances. This is especially so in the next financial year, before the bonds purchased to support the three-year yield target mature and funds lent under the TFF are repaid.

Below are four scenarios to illustrate how the Bank’s future earnings and net equity position could vary with different assumed policy rate paths. For all scenarios, the cash rate is projected to evolve in line with the market expectations to June 2024 (using overnight index swap rates in late-June 2023), with the margin between the cash rate target and the ES rate assumed constant at its current level of 10 basis points. The projections beyond 2024 assume the ES rate converges to either 1½ per cent, 2½ per cent, 3½ per cent or 4½ per cent.

Domestic Fixed Interest Assets

As at 30 June

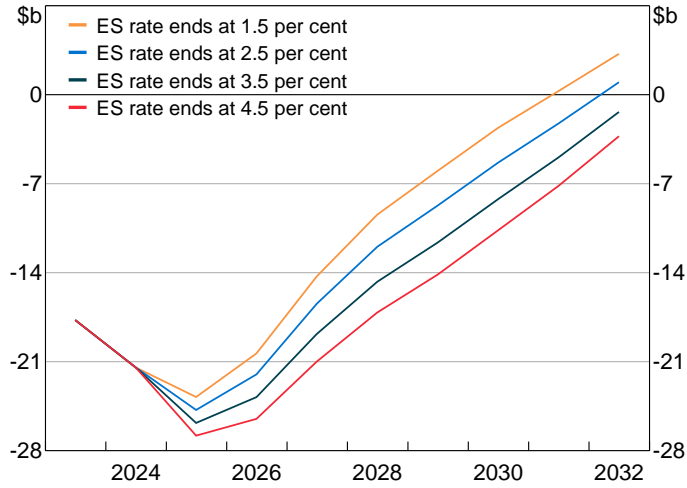


* Total face value held, assuming all domestic government bonds are held to maturity.

Source: RBA.

Projections of Net Equity*

As at 30 June



* Assuming future distributable earnings will first be applied to offsetting accumulated losses and then to restoring the RBRF to target. In accordance with the Reserve Bank Act, such transfers are to be formally determined by the Treasurer each year.

Source: RBA.

Details of the composition and distribution of the Reserve Bank’s profits are presented in the table below. ↗

Composition and Distribution of Reserve Bank Profits

\$ million

Financial Year	Composition of profits ^(a)				Distribution of profits					
	Underlying earnings	Realised gains or losses ^{(-)(b)}	Unrealised gains or losses ⁽⁻⁾	Accounting profit or loss ⁽⁻⁾	Unrealised profits reserves	Transfer to/from ⁽⁻⁾	Asset revaluation reserves	Reserve Bank Reserve Fund	Dividend payable	Accumulated losses
1997/98	1,750	966	1,687	4,403	1,687	-	-558	548	2,726	-
1998/99	1,816	2,283	-2,773	1,326	-2,349	-	-1	-	3,676	-
1999/00	1,511	-708	1,489	2,292	1,489	-	-	-	803	-
2000/01	1,629	1,200	320	3,149	320	-5	-	-	2,834	-
2001/02	1,400	479	-11	1,868	-11	-10	-	-	1,889	-
2002/03	1,238	1,157	-222	2,173	-222	-2	133	2,264	-	-
2003/04	882	-188	1,261	1,955	1,261	-	-	694	-	-
2004/05	997	366	-1,289	74	-1,289	-	-	1,363	-	-
2005/06	1,156	4	933	2,093	933	-17	-	1,177	-	-
2006/07	1,381	72	-2,846	-1,393	-2,475	-3	-	1,085	-	-
2007/08	2,068	614	-1,252	1,430	27	-	-	1,403	-	-
2008/09	2,150	4,404	2,252	8,806	2,252	-	577	5,977	-	-
2009/10	866	-128	-3,666	-2,928	-2,248	-	-680	-	-	-
2010/11	897	-1,135	-4,651	-4,889	-23	-	-4,866	-	-	-
2011/12	710	405	-39	1,076	-20	-	596	500	-	-
2012/13	723	-135	3,725	4,313	3,725	-	588	-	-	-
2013/14	9,242 ^(c)	790	-640	9,392	-640	-3	8,800	1,235	-	-
2014/15	832	2,622	3,434	6,888	3,434	-	1,570	1,884	-	-
2015/16	1,223	3,389	-1,729	2,883	-1,729	-	1,390	3,222	-	-
2016/17	960	322	-2,179	-897	-2,179	-4	-	1,286	-	-

Financial Year	Composition of profits ^(a)				Distribution of profits				
	Underlying earnings	Realised gains or losses (-) ^(b)	Unrealised gains or losses (-)	Accounting profit or loss (-)	Unrealised profits reserves	Transfer to/from(-)	Reserve Bank Reserve Fund	Dividend payable	Accumulated losses
2017/18	845	-176	3,178	3,847	3,178	-	-	669	-
2018/19	1,167	412	2,970	4,549	2,970	-106	-	1,685	-
2019/20	1,399	1,168	-79	2,488	-79	-	-	2,567	-
2020/21	4,157	-240	-8,249	-4,332	-8,249	-1	1,247	2,671	-
2021/22	8,198	-353	-44,545	-36,700	-502	4	-15,366	-	-20,836
2022/23	-4,631	448	-1,769	-5,952	-	-	-	-	-5,952

(a) As originally published.

(b) Excludes gains or losses realised from the sale of fixed assets that had been held in asset revaluation reserves.

(c) Includes the Commonwealth grant of \$8,800 million.
Source: RBA.



Governor Philip Lowe (fourth from left) and Emma Costello, Chief Financial Officer (right), sign the Reserve Bank's Financial Statements in the presence of the Auditor-General for Australia Grant Hehir (third from left), Bola Oyetunji, Group Executive Director, Financial Statements Audit Services Group, Australian National Audit Office (second from left) and Anthony Dickman, Reserve Bank Secretary (left)