

Annual Performance Statement for 2017/18

I, as the accountable authority of the Reserve Bank of Australia, present the annual performance statement of the Reserve Bank for the 2017/18 reporting period, prepared under paragraph 39(1)(a) of the *Public Governance, Performance and Accountability Act 2013* (PGPA Act). In my opinion, this annual performance statement accurately presents the performance of the Reserve Bank in the reporting period and complies with subsection 39(2) of the PGPA Act.

Philip Lowe
Governor, Reserve Bank of Australia
23 August 2018

Introduction

This performance statement outlines the key purposes of the Reserve Bank as set out in the 2017/18 corporate plan and provides the results of the measurement and assessment of the Bank's performance in achieving those purposes for the year ended 30 June 2018. Where necessary, additional context is provided, including an analysis of the significant factors that have contributed to the performance of the Bank in achieving its purposes in 2017/18.

As noted elsewhere in this annual report, the Reserve Bank of Australia is Australia's central bank and it conducts central banking business. The Bank has two boards, the Reserve Bank Board and the Payments System Board. The Reserve Bank Board is responsible for the Bank's monetary and banking policy and the Bank's policy on all other matters, except for payments system policy, for which the Payments System Board is responsible.

Monetary Policy

Purpose

It is the duty of the Reserve Bank Board to ensure that the monetary and banking policy of the Bank is directed to the greatest advantage of the people of Australia and that the powers of the Bank are exercised in a way that, in the Board's opinion, will best contribute to:

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

In support of the above duties, the most recent *Statement on the Conduct of Monetary Policy* agreed by the Treasurer and the Governor, dated 19 September 2016, confirms the Bank's continuing commitment to keeping consumer price inflation between 2 and 3 per cent, on average, over time, consistent with its duties under the *Reserve Bank Act 1959*. Ensuring low and stable inflation preserves the value of money and facilitates strong and sustainable growth in the economy over the longer term.

Reserve Bank of Australia – Performance Summary 2017/18

Corporate Plan Purpose ^(a)	Performance objectives	Summary Performance Measures	Results
Monetary policy	Achieve inflation target	Consumer price inflation maintained between 2–3 per cent, on average, over the medium term	Consumer price inflation is forecast to be between 2 and 3 per cent over much of the forecast period; see the Bank's quarterly <i>Statement on Monetary Policy</i> for details. Consumer price inflation has averaged around 2½ per cent over the inflation-targeting period, although it has been below 2 per cent recently
	Financial stability	Support overall financial stability	<p>A stable financial system that is able to support the economy. The Bank assesses a range of economic and financial data to help gauge the soundness of the financial system and identify potential vulnerabilities, and communicates this assessment, primarily in the Bank's half-yearly <i>Financial Stability Review</i></p> <p>Work with the Council of Financial Regulators (CFR) agencies to identify and appropriately address evolving systemic risks</p>
Financial market operations	Achieve cash rate target	Overnight cash rate equal to the target each business day	Overnight cash rate was equal to the target each business day
	Manage reserves to portfolio benchmarks	Portfolio managed within small deviations around the asset and duration benchmarks	Deviations from the reserve portfolio benchmark were small and in line with pre-defined limits
	Intervene in foreign exchange market as appropriate	Publish data and explanations of any interventions	No foreign exchange market intervention was conducted
Payments and infrastructure	Support competition and efficiency in the payments system and financial system stability	Maintain and improve where possible the efficiency and competitiveness of the payments system, consistent with financial system stability. Monitor and publish information on the effect of new card standards. Complete new statistical collection system for retail payments	New interchange and surcharging standards are now fully implemented and well understood (see <i>Payments System Board Annual Report 2018</i> for further details). The Bank has been actively encouraging the provision of least-cost routing functionality to merchants. The Bank's retail payments statistical collection was revamped and a new reporting system was introduced
	Stability in the provision of financial market infrastructure (FMI) services	Stability of FMI service provision. Assess Reserve Bank Information and Transfer System (RITS) and licensed clearing and settlement facilities against relevant standards and take action where required to ensure standards are met	Assessments of RITS and all licensed clearing and settlement facilities have been completed and published. Where necessary, the Bank has set and monitored the response to regulatory priorities

Reserve Bank of Australia – Performance Summary 2017/18

Corporate Plan Purpose ^(a)	Performance objectives	Summary Performance Measures	Results
		Contribute to international policy work on central counterparty resilience and FMI crisis management. Adapt domestic regulatory standards in response to international developments. Support international supervisory cooperation	No change to domestic regulatory standards was required
	RITS operational reliability	RITS availability at 99.95 per cent during core hours	RITS availability was 100 per cent during core hours in 2017/18
		Fast Settlement Service (FSS) go-live; FSS availability at 99.995 per cent on a 24/7 basis, with most transactions processed in less than one second	FSS publicly launched on 13 February 2018. Between launch and 30 June, FSS availability was 100 per cent on a 24/7 basis and the median response time was 50 milliseconds
	RITS cyber security	Ongoing investment and regular reviews and testing to support cyber resilience	The Bank's ongoing program of cyber resilience work helped underpin the reliable operation of RITS in 2017/18
Banking	Maintain transactional banking competitiveness	Minimum return on capital equivalent to 10-year Australian Government Security rate plus a margin for risk	The Bank's banking services achieved the minimum required return on capital in 2017/18
	Progress on projects to deliver convenient, secure, reliable and cost-effective banking services to customers	Provision of high-quality, cost-effective banking services to government and other official agency customers and, in turn, the public supported by: <ul style="list-style-type: none"> Continued work on replacing the Bank's core account maintenance system Completion of initial capabilities to participate in the New Payments Platform (NPP) 	In 2017/18, the Bank continued to work on a number of projects to renovate its banking applications and systems. Work is nearing completion, with good progress made on the project to upgrade the Bank's core account maintenance system. Following the public launch of NPP in February 2018, the Bank has processed on behalf of the Australian Government transactions valued at \$179 million

Reserve Bank of Australia – Performance Summary 2017/18

Corporate Plan Purpose ^(a)	Performance objectives	Summary Performance Measures	Results
Banknotes	Maintain public confidence in banknotes as follows:		
	• Meet banknote demand	99.5 per cent of banknote orders from commercial banks fulfilled by the Reserve Bank on the day requested	100 per cent of orders were fulfilled on the day requested in 2017/18
	• Increase security of Australian banknotes	Issuance of new \$10 banknote with upgraded security features as part of Next Generation Banknote program	The new \$10 banknote was released on 20 September 2017 as planned and achieved wide acceptance and distribution
	• Ensure high-quality banknotes	Reserve Bank banknote production orders to be met by Note Printing Australia Limited in full, on time and to required quality standard	All orders were met in full, on time and to the required quality standard in 2017/18
	Maintain quality of banknotes in circulation in excess of a minimum quality standard		The quality of banknotes in circulation was broadly unchanged at a high level in 2017/18

(a) See the Reserve Bank of Australia Corporate Plan 2017/18
Source: RBA

Low inflation assists businesses and households in making sound investment decisions, underpins the creation of jobs and protects the savings of Australians. The *Statement on the Conduct of Monetary Policy* also recognises the importance of financial stability for a stable macroeconomic environment.

Results

Assessing the conduct of monetary policy by the Reserve Bank during 2017/18 involves judging whether the policy decisions taken by the Reserve Bank Board, based on the information available at the time, were consistent with achieving the inflation target of between 2 and 3 per cent, on average, over time to foster sustainable economic growth in Australia. Because there are lags between changes in the cash rate and their effect on the economy, such an assessment needs to give weight to both actual outcomes and the forecasts for inflation,

output and the unemployment rate. These forecasts are published quarterly in the *Statement on Monetary Policy*.

Towards the end of 2017, the Reserve Bank Board undertook a review of the forecasts and monetary policy decisions it had taken since 2011, including the reasons behind the forecast errors and what the Bank's staff had learnt about the economy as a result. The review concluded that, based on the information available at the time the decisions were made, the Board had struck a reasonable balance in achieving its broad objectives in relation to the inflation target and financial stability considerations over the preceding several years.

Following a period of below-average growth, GDP is likely to have expanded by 2¾ per cent in 2017/18. From there, growth is expected to pick up a little further, to a bit above 3 per cent in subsequent years, as remaining new liquefied natural gas (LNG) production capacity

comes on line. These rates are somewhat above the Reserve Bank's estimate of trend growth in productive capacity, implying that spare capacity is likely to be absorbed over this period. The unemployment rate is therefore expected to decline. Consumer price inflation has averaged around 2½ per cent over the inflation-targeting period, although it has been below 2 per cent recently. Consumer price inflation was 2.1 per cent over the year to the June quarter 2018 and is expected to be above 2 per cent for much of the 2½-year forecast period. However, temporary factors are expected to hold down year-ended inflation in the near term.

After lowering the cash rate by 25 basis points in August 2016, the Reserve Bank Board has left the cash rate unchanged since then. The Board has judged that this has been consistent with achieving sustainable growth in the economy and inflation consistent with the target over the medium term. Over the past two years gradual progress has been made in reducing unemployment and bringing inflation back towards the target range, and further progress is expected over the period ahead. The Board's view has been that holding the cash rate steady at 1½ per cent would assist that progress, with steady monetary policy promoting stability and confidence.

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

support the effectiveness of monetary policy, by improving understanding of monetary policy decisions across the community, and the transparency of monetary policy, which facilitates the Bank's accountability for the performance of its monetary policy responsibilities.

Analysis

On the global economy, the incoming data and the outlook for economic growth improved compared with a year ago. Consistent with this, monetary policy has been tightened in the United States and a few other economies, while further monetary easing is no longer expected in other major advanced economies. However, global interest rates and measures of underlying inflation remain low. Because Australia is a small open economy with a floating exchange rate, shifts in global monetary conditions can affect financial conditions in Australia.

The period of adjustment that has followed the end of the mining investment boom is close to its end. Non-mining investment has picked up and labour market conditions have strengthened. Over the past year, the unemployment rate has declined and inflation has increased a little. Further progress on both these fronts is expected over the period ahead. Internal assessments suggest that the performance of the forecasts presented to the Reserve Bank Board has been a little better than the average of recent years.

Over the past year, the Reserve Bank Board has been considering a range of risks to the outlook and their implications for the policy decision. A significant escalation in trade protectionism or risk aversion could derail the global expansion. On the other hand, growth and inflation in the United States could be higher than expected given the substantial fiscal stimulus that is in train. The Chinese authorities continue to balance the aim of supporting near-term growth with

the more medium-term priorities of containing financial risks and improving environmental outcomes. Domestically, the introduction of further supervisory measures to improve lending standards, together with increased public scrutiny, has helped limit the build-up of risks in household balance sheets. In the context of weak growth in wages and household incomes, however, risks to consumption from this source remain.

Financial Stability

Purpose

The Reserve Bank has a responsibility for fostering overall financial stability in Australia. This stems from the Bank's duties to exercise its powers in a way that will best contribute to 'the maintenance of full employment in Australia' and 'the economic prosperity and welfare of the people of Australia'. Given the serious damage to employment and economic prosperity that can occur in times of financial instability, the Reserve Bank Act has long implied a mandate to pursue financial stability. This mandate has been made more explicit by successive governments. More recently, the Treasurer and the Governor have recorded their common understanding of the Bank's longstanding responsibility for financial system stability, as part of the periodically updated *Statement on the Conduct of Monetary Policy*.

The Reserve Bank works with other regulatory bodies in Australia to foster financial stability. The Governor chairs the Council of Financial Regulators (CFR) – comprising the Reserve Bank, the Australian Prudential Regulation Authority (APRA), the Australian Securities and Investments Commission (ASIC) and the Australian Treasury – whose role is to contribute to the efficiency and effectiveness of regulation and the stability of the financial system. The Bank's central position in the financial system, and its position as the ultimate provider of liquidity to the system, gives

it a key role in financial crisis management, in conjunction with the other members of the CFR.

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

Results

The ultimate measure of performance in financial stability policy remains the stability of the financial system itself as it performs its function of supporting the economy. The Reserve Bank assesses a range of economic and financial data to help gauge the soundness of the financial system and potential vulnerabilities. During 2017/18, the Reserve Bank assessed that the resilience of the Australian financial system increased a little further. The financial system continued to facilitate economic activity and financial market infrastructures continued to function effectively, as noted in the Bank's *Financial Stability Review* in October 2017 and April 2018. However, there were a number of potential domestic sources of systemic risk and shocks to financial stability that might come from abroad. Domestic vulnerabilities related to household debt and the housing market more generally continued to be a focus during the past year, as well as risks related to commercial property lending. Tighter lending standards by banks and other authorised deposit-taking institutions, in part induced by regulatory actions by APRA and ASIC, have assisted in enhancing resilience to potential risks; none of the domestic risks on their own appears to be enough to be a direct source of significant domestic financial instability in the near term.

The Reserve Bank uses its powers, influence and public communications to ensure as far

as possible that the Australian financial system remains stable and that financial stability risks and how they can be addressed are well understood across the community. During 2017/18, the Bank highlighted the key issues and risks for the Australian financial system in its *Financial Stability Review*, as well as in several public speeches.

The Bank contributed to work with other CFR agencies on a range of issues during the year, including: developments and risks in the housing and mortgage markets; crisis management and resolution preparedness; financial technology ('fintech'); shadow banking activity; and the financial risks of climate change.

In 2017/18, the Reserve Bank also contributed to work undertaken in relation to financial stability under the auspices of various international regulatory bodies, including the Financial Stability Board (FSB), the Basel Committee on Banking Supervision and the Trans-Tasman Council on Banking Supervision. The Governor participated as a member of the FSB Plenary (the decision-making body of the FSB), Steering Committee and Standing Committee on Assessment of Vulnerabilities, and served as Co-Chair of the FSB Regional Consultative Group for Asia. Other Bank staff participated as members of various committees and working groups. For further information, see the chapter on 'International Financial Cooperation' in this annual report.

Analysis

Financial stability in Australia has been assisted by the sustained strong financial performance of the domestic banking system. Australian banks have improved their resilience to future financial and economic shocks by increasing their capital and liquidity ratios over recent years. They have also taken steps to improve the quality of lending and raise lending standards, especially in relation to their mortgage business. As noted above, the Reserve Bank, together with other CFR agencies,

has been closely monitoring developments in residential mortgage lending and household balance sheets. Both APRA and ASIC have taken measures to address risks in this area. As risks have moderated from elevated levels, APRA has removed the temporary benchmark on investor lending growth for banking institutions that have been able to provide an assurance on the strength of their lending standards. However, the CFR agencies would consider further measures in the future should circumstances change. In the period ahead, the Bank and other CFR agencies will also carefully consider the implications for the resilience of the financial sector arising from findings and recommendations of the final report of the Productivity Commission's review of competition in the financial system, as well as the outcomes of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. Further relevant analysis by the Reserve Bank is provided in the *Financial Stability Review* and speeches by the Governor and other senior Bank officials.

Financial Market Operations

Purpose

The Reserve Bank has a sizeable balance sheet, which will continue to be managed through financial market operations in support of the Bank's policy and other objectives over the period of the 2017/18 corporate plan.¹

The Bank's operations in domestic financial markets are conducted to ensure that the cash rate trades at the target and that there is sufficient liquidity in the domestic money market on a daily basis. This promotes the objectives of monetary policy as described in the 'Monetary Policy' section of this performance statement

¹ Section 8 of the Reserve Bank Corporate Plan 2017/18 covers the Bank's management of its financial position and capital.

and the stable functioning of the financial system, in particular the payments system.

The Reserve Bank's foreign reserves are held to give the Bank the capacity to intervene in the foreign exchange market. In particular, they enable the Bank to address any apparent dysfunction in that market and/or a significant misalignment in the value of the currency, consistent with the objectives of monetary policy. Regular transactions in the foreign exchange market are conducted to manage these reserves, to provide foreign exchange services to the Bank's clients (the largest of which is the Australian Government) and to assist in liquidity management in domestic markets.²

Results

The Reserve Bank's operations in financial markets support its monetary policy objectives through ensuring that the operational target in the domestic money market is met; this target (the cash rate target) is a decision of the Reserve Bank Board. When supplying liquidity to the domestic money market, the Bank seeks to ensure that the overnight cash rate is maintained at the prevailing cash rate target each day. The Bank collects information on each participant's activity in the money market and publishes the resulting measure of the overnight cash rate daily. The cash rate was equal to the target every day during 2017/18.

The Reserve Bank manages its foreign reserves portfolio relative to a benchmark. During 2017/18, the portfolio was managed so that any deviations around the benchmarks for exchange rate and interest rate risk were small and in line with pre-defined limits.

The Reserve Bank did not intervene in foreign exchange markets during 2017/18.

Analysis

The Reserve Bank's financial markets operations continue to be influenced by the diverging monetary policy trends among the major central banks, as well as the regulatory regimes that apply to financial markets in which the Bank transacts and/or the counterparties with which it deals, both domestically and internationally. During 2017/18, the Bank continued to monitor and, where necessary adjust to, the environment where market functioning and structure are evolving significantly following a period of substantial regulatory reform and unusually low interest rates.

Payments and Infrastructure

Purpose

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

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

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

In addition, it is the Payments System Board's duty to ensure that the powers and functions of the Bank under Part 7.3 of the

² The Banking section of this performance statement discusses the Bank's responsibility to act as banker for the Commonwealth.

Corporations Act 2001 are exercised in a way that, in the Board's opinion, will best contribute to the overall stability of the financial system. These powers and functions relate to the supervision of central counterparties (CCPs) and securities settlement facilities, which are key components of the central infrastructure that supports financial markets. The Bank's payments policy area also acts as overseer of Australia's high-value payment system, RITS, which is another key part of Australia's financial market infrastructure.

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

The Bank's work in these areas supports its other work, discussed in the 'Financial Stability' section of this performance statement, directed towards fostering overall financial stability.

Results

As is discussed further in the *Payments System Board Annual Report 2018*, the Reserve Bank's new interchange standards became fully effective from July 2017. As a result of the schemes modifying their interchange fee schedules to ensure compliance with the new standards, interchange payments on many transactions have fallen, particularly for transactions at smaller merchants that previously faced higher interchange rates. The reduction in interchange payments will be reflected in lower merchant service fees for many merchants. Interchange-like payments in the American Express companion card system are now also subject to equivalent regulation to that applying to the Mastercard and Visa credit card systems, helping ensure

competitive neutrality and broadening the effect of the reforms.

After taking effect for large merchants in September 2016, the Reserve Bank's new surcharging framework became effective for all remaining merchants in September 2017, helping prevent excessive surcharging. To assist merchants' surcharging decisions, acquirers and payment facilitators were required from June 2017 to provide their merchants with easy-to-understand information on the cost of acceptance for each designated card scheme.

The Reserve Bank successfully encouraged industry progress on providing merchants with the ability to route contactless dual-network debit card transactions to their lowest-cost processing network, known as least-cost routing (LCR). Some small acquirers are now offering LCR functionality to their merchants, and the four major banks have committed to do so within the next year. LCR is aimed at increasing competitive pressure in the debit card market, and thereby holding down payment costs in the economy.

The Reserve Bank revamped its retail payments statistical collection to ensure its ongoing relevance and to minimise industry reporting burden. This was launched alongside a more efficient and secure data reporting system.

In support of the Payments System Board's responsibility to promote efficiency in the payments system, the Reserve Bank contributed to the industry project to deliver the New Payments Platform (NPP), which was publicly launched in February 2018. The NPP is a major development in Australia's retail payments infrastructure that facilitates real-time, data-rich, easily addressed payments on a 24/7 basis for households, businesses and government entities. To enable the settlement of NPP transactions between financial institutions in real time on a 24/7 basis, the Bank developed the RITS Fast

Settlement Service (FSS). From November 2017, the FSS operated in a 'live testing' mode as part of broader industry testing of NPP-related infrastructure ahead of the NPP's public launch.

The Reserve Bank published annual assessments of each of the licensed clearing and settlement facilities as part of its ongoing oversight of these facilities. Assessments were published of the ASX clearing and settlement facilities (in September 2017), of LCH.Clearnet Limited's SwapClear service (in December 2017) and of Chicago Mercantile Exchange Inc. (in March 2018). In these assessments, the Bank judged that all the entities had met the relevant standards and set out a series of regulatory priorities for the facilities for the subsequent year. The Bank's 2018 assessment of RITS against the *Principles for Financial Market Infrastructures*, which was published in May 2018, concluded that RITS observed all of the relevant principles.

In support of the Reserve Bank's oversight approach and of its policy framework, Bank staff also actively participated in international policy development on crisis management of financial market infrastructures and implementation monitoring related to CCP resilience. No change was required to domestic regulatory standards in 2017/18 as a result of international developments.

As the owner and operator of RITS, the Reserve Bank seeks to ensure that this system operates with extremely high levels of reliability and security, while also adapting to the needs of a 24/7 payments world. A broad range of operational metrics were tracked in real time during 2017/18, including measures of system liquidity, participants' transaction values and volumes, and system throughput and performance. For RITS, the system availability target is 99.95 per cent during core system hours. The Bank achieved this target during 2017/18, with system availability of 100 per cent achieved in core system hours. For FSS, the system

availability target is 99.995 per cent on a 24/7 basis. The Bank met this target during 2017/18, with system availability of 100 per cent from the public launch of the NPP in February 2018 until 30 June 2018.

The Reserve Bank is committed to ensuring that RITS is well protected from cyber attack and has an ongoing program of work to maintain high levels of cyber resilience. The Bank made its first compliance attestation under the new SWIFT Customer Security Controls Framework in December 2017 and, in July 2018, the Bank's payment settlement systems received certification under the International Organization for Standardization (ISO) 27001 Information Security standard.

Analysis

The Reserve Bank's work in the payments area in 2017/18 occurred in an environment that was continuing to change rapidly, with higher expectations of users and the industry concerning the speed of payments and the capacity to combine information with payments. Use of cash and cheques is declining relative to other payment instruments, while use of cards and other electronic forms of payment continues to grow strongly. New technologies, including distributed ledger technologies and other forms of fintech, have the potential to change the payments landscape and the operation of financial market infrastructures significantly. Bank staff liaise actively with the private sector to better understand trends in these areas and have participated in a range of domestic and international working groups with other regulators. An important recent focus for the Bank has been on the implications of crypto-assets and the possible case for the Bank issuing an e-AUD (or digital cash) or providing a new form of central bank liability that could be used to settle a wider range of transactions than those currently settled via exchange settlement accounts.

Banking

Purpose

Insofar as the Commonwealth requires it to do so, the Reserve Bank must act as banker for the Commonwealth. In common with many other central banks, the Bank also provides banking and custody services to a number of overseas central banks and official institutions. These services include payments and collections as well as general account maintenance and reporting.

Results

The Reserve Bank must compete with other organisations to provide banking services to Australian Government agencies. The Bank must cost and price these services separately from its other activities. In addition, the return of providing these services must meet an externally prescribed minimum rate of return on capital over a business cycle. At present, this measure, equivalent to the 10-year Australian Government Security rate plus a margin for risk, is the Bank's principal measure of financial performance for its transactional banking business. In 2017/18, the Bank met the prescribed rate. Pro forma accounts for the transactional banking business are published in a separate chapter of this annual report.

As the provider of the Commonwealth's Official Public Account (OPA), the Reserve Bank works closely with both the Department of Finance and the Australian Office of Financial Management to ensure the central banking services it provides remain fit for purpose. The Department of Finance and the Bank have initiated a review of the Commonwealth's cash management principles to ensure the ongoing efficiency of cash flows into the OPA.

During 2017/18, the Reserve Bank completed several important banking projects, including the capability to participate in the NPP. Work

on the renovation of banking applications and systems has continued as planned. Key milestones reached during the year included: the completion of the first phase of work to replace the Bank's core account maintenance system; the development of capability to deliver notifications to government agency customers using the Bank's renovated banking applications; and the delivery of the second phase of work on the functionality to process bulk electronic payments, which is currently in its final testing phase. The Bank has also commenced work to implement Application Programming Interfaces (APIs) to expand the Bank's capability to interact securely with agencies.

Analysis

The banking and payments landscape has continued to evolve, particularly in the area of payment services with the public launch of NPP in February 2018. The broader community is embracing new technology and continues to demand real-time digital services. Reflecting this demand, government agencies continue to push ahead with their own initiatives to improve service delivery and achieve productivity gains. Those initiatives that will impact the Reserve Bank include: the Department of Human Services Welfare Payment Infrastructure Transformation (WPIT) project; collections and payments programs for the Australian Taxation Office; and the Department of Finance's project to automate Commonwealth cash management processes using the NPP. During 2017/18, the Bank continued to ensure that it remained in a position to respond appropriately with convenient, secure, reliable and cost-effective services as the provider of both central banking and transactional banking services to the Australian Government.

Banknotes

Purpose

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

Results

Public confidence in Australian banknotes is measured directly by a Reserve Bank survey on perceptions of Australian banknotes conducted every two years. The next survey is scheduled to be conducted in early 2019. Indirectly, 2018 evaluative research results from the Next Generation Banknote communication campaign showed sustained high levels of awareness of the new series of banknotes, with security understood to have been the main reason for the upgrade.

Fulfilment of banknote orders from commercial banks provides an indication that the public's demand for banknotes is being met. The Reserve Bank aims to fulfil 99.5 per cent of banknote orders on the day requested; during 2017/18, 100 per cent of orders were fulfilled on the day requested.

The Reserve Bank's key initiative to enhance banknote security is the release of the new banknote series with upgraded security features. Work on the Next Generation Banknote program continued during 2017/18, with the

new \$10 banknote entering circulation on 20 September 2017 as planned. The Bank implemented a comprehensive communication strategy to assist with public recognition of the new banknotes. The new \$50 banknote is expected to enter circulation in October 2018.

The Reserve Bank continued to monitor Australian banknote counterfeiting rates, which remained low by international standards. The estimated counterfeiting rate remained stable at 16 parts per million in 2017/18, after having risen over the preceding decade or so. The Bank also continued to monitor international developments in counterfeiting. This was assisted by the Bank's engagement with other central banks and international organisations.

NPA met the Reserve Bank's orders for existing and new series banknotes in full, to the required quality standard and as per the agreed delivery schedule.

The quality of banknotes in circulation, as measured by the Reserve Bank in agreement with commercial banks, was broadly unchanged at a high level in 2017/18.

Analysis

While the proportion of payments made using banknotes is declining relative to electronic payments, the number and value of banknotes on issue continues to rise, highlighting their continued importance as a store of value as well as a payment mechanism. The Reserve Bank has continued to meet demand for banknotes by ensuring orders are fulfilled. The release of the new series of banknotes with upgraded security features is expected to maintain public confidence in banknotes. Australia's level of counterfeiting remains low by international standards, although it has tended to increase over time as advances in technology make it easier and cheaper to produce counterfeit banknotes.