

Annual Performance Statement for 2016/17

I, as the accountable authority of the Reserve Bank of Australia, present the annual performance statement of the Reserve Bank for the 2016/17 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
16 August 2017

Introduction

This performance statement outlines the key purposes of the Reserve Bank as set out in the 2016/17 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 2017. 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 2016/17.

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

Under the *Reserve Bank Act 1959*, 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 *Statement on the Conduct of Monetary Policy* agreed by the Treasurer and the Governor confirms the Bank's continuing commitment to keeping consumer price inflation between 2 and 3 per cent, on average, consistent with its duties under the Reserve Bank Act.

Reserve Bank of Australia – Performance Summary 2016/17

Corporate Plan Purpose ^(a)	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
Financial stability		
Support overall financial stability	Stability of the financial system as it performs its function of supporting the economy	The financial system was assessed as remaining stable on the basis of a range of economic and financial data in 2016/17, although domestic vulnerabilities related to household debt and the housing market more generally have increased; see the Bank's semiannual <i>Financial Stability Review</i> for details. The Bank continued to work with the Council of Financial Regulators to identify and address evolving systemic risks
Financial market operations		
Achieve cash rate target	Overnight cash rate equal to target	The overnight cash rate was equal to target on all business days in 2016/17
Manage reserves to portfolio benchmarks	Portfolio managed within small deviations around the asset and duration benchmarks	Deviations from benchmark were small and in line with pre-defined limits
Payments & infrastructure		
Promote competition and efficiency in the payments system	Effect of new card standards	New standards are well understood and have resulted in declines in some surcharges (see <i>Payments System Board Annual Report 2017</i> for further detail)
Stability in the provision of financial market infrastructure (FMI) services	Assessment of Reserve Bank Information and Transfer System (RITS) and licensed clearing and settlement facilities against relevant standards	All entities were assessed as meeting relevant standards
	Contribute actively to international policy work on central counterparty resilience and FMI crisis management	The Bank continues to actively participate in this work
	Adapt domestic regulatory standards in response to international developments	Ongoing review; no change was required in 2016/17
RITS operational reliability	RITS availability of at least 99.95 per cent during core hours	RITS availability was 99.99 per cent during core hours in 2016/17
RITS cyber security	Cyber resilience of RITS	The Bank's ongoing program of cyber resilience work helped underpin the reliable operation of RITS in 2016/17

Reserve Bank of Australia – Performance Summary 2016/17

Corporate Plan Purpose ^(a)	Summary Performance Measures	Results
Banking		
Maintain transactional banking competitiveness	Minimum required 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 2016/17
Progress on projects to deliver convenient, secure, reliable and cost-effective banking services to customers	Progress on renovating the Bank's banking applications and systems	<p>In 2016/17, the Bank completed, as planned, the renovation of key components of the systems that process bulk electronic payments and the final components of systems that collect payments for government</p> <p>Work continued on replacing the Bank's core account maintenance system, and remains on track for completion in late 2018 as planned.</p> <p>Work on the Bank's capability to participate in the New Payments Platform proceeded as planned in step with the payments industry's schedule</p>
Banknotes		
Maintain public confidence in banknotes by:	Surveyed perceptions of Australian banknotes	The 2017 survey results showed heightened awareness of banknote security features and risk of counterfeiting
Meeting banknote demand	99.5 per cent of banknote orders from commercial banks fulfilled by the Bank on the day requested	100 per cent of orders were fulfilled on the day requested in 2016/17
Increasing security of Australian banknotes	Issuance under Next Generation Banknote program	The new \$5 banknote was released on 1 September 2016 as planned and achieved wide acceptance and distribution.
	Counterfeiting rates	The counterfeiting rate in Australia remained low by international standards at 17 parts per million in 2016/17
Ensuring high-quality banknotes	Reserve Bank banknote production orders to be met by Note Printing Australia	All orders were met in full, on time and to the required quality standard in 2016/17
	Quality of banknotes in circulation	The quality in circulation increased by 5 per cent in 2016/17
Financial position & capital		
Maintain sufficient level of capital	Balance of the Reserve Bank Reserve Fund maintained in line with the Reserve Bank Board's policy	Achieved. See the section below on 'Financial Position and Capital' for details of changes to the framework for the Bank's capital during 2016/17

(a) See the Reserve Bank of Australia Corporate Plan 2016/17
Source: RBA

Ensuring low and stable inflation preserves the value of money and facilitates strong and sustainable growth in the economy over the longer term. Low inflation assists businesses and households in making sound investment decisions and underpins the creation of jobs, protects the savings of Australians and preserves the purchasing power of money. The *Statement on the Conduct of Monetary Policy* also recognises the importance of financial stability for a stable macroeconomic environment. Following the appointment of Philip Lowe as Governor of the Reserve Bank with effect from 18 September 2016, the *Statement on the Conduct of Monetary Policy* was revised to further clarify that it is appropriate for the Reserve Bank Board to take account of financial stability considerations in setting monetary policy. This revision has not affected how the Bank's performance in relation to monetary policy has been assessed, as set out below.

Results

Assessing the conduct of monetary policy by the Reserve Bank during 2016/17 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, 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 2016, 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 misses 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.

GDP growth in 2016/17 is likely to have been lower than expected one year ago. This is partly attributable to the temporary effect of unseasonably bad weather. However, as outlined in the August 2017 *Statement on Monetary Policy*, the economy is expected to grow by 2½–3½ per cent over 2017/18, with growth expected to remain a bit above potential throughout the rest of the forecast period. Consumer price inflation is expected to be between 2 and 3 per cent over much of the 2½ year forecast period. This is consistent with the medium-term inflation target. Consumer price inflation has averaged around 2½ per cent over the inflation-targeting period, which commenced in the early 1990s.

Since lowering the cash rate by 25 basis points in August 2016, the Reserve Bank Board has left the cash rate unchanged. The Board judged that this was consistent with achieving sustainable growth in the economy and inflation consistent with the target over the medium term. Within the context of a medium-term inflation target, it is appropriate that the Board pays attention to the resilience of the economy to future shocks. In light of this, the Board has been carefully monitoring developments in the labour market and growth in household debt, which may affect the economy's susceptibility to future shocks.

Analysis

On the global economy, the incoming data and the outlook for economic growth have improved compared with a year ago. Consistent with this, monetary policy has been tightened in the United States while expectations of further

monetary easing in other advanced economies have diminished. However, global interest rates remain extremely low, measures of underlying inflation are generally subdued and potential growth is lower than in previous decades. Because Australia is a small open economy with a floating exchange rate, the environment of highly accommodative global monetary conditions has some effect on the way monetary policy is conducted in Australia.

Internal assessments suggest that the performance of the forecasts presented to the Reserve Bank Board has not been noticeably different from earlier years. The period of adjustment that has followed the end of the mining investment boom appears to be well advanced, as had been forecast, and non-mining activity has continued to pick up. Confidence has increased in the expectation that inflation will increase gradually over the period ahead, although this will depend on ongoing improvements in the labour market leading to a pick-up in wage growth.

Over the past year, the Reserve Bank Board has been considering the balance between achieving a more rapid pick-up in inflation than currently anticipated and the effect of lower interest rates on the resilience of households, given the increase in household debt. These deliberations have been supported by analytical work presented to the Board by Bank staff. The introduction of further regulatory measures to improve lending standards in 2017 is expected to mitigate some of the risks that have been building in household balance sheets. However, supporting spending in the economy today while avoiding creating vulnerabilities in household balance sheets, which could amplify the effects of future shocks, is difficult and complex.

The quarterly *Statement on Monetary Policy* provides further analysis by the Reserve Bank of the

developments in the international and domestic economy and financial markets relevant to monetary policy, as do speeches by the Governor and other senior Bank officials and the monthly statements and minutes following the monetary policy meetings of the Reserve Bank Board.

Financial Stability

Purpose

Given the serious damage to employment and economic prosperity that can result from financial instability, the Reserve Bank Act has long implied a mandate to pursue financial stability. This goal has been made more explicit by successive governments. Most recently, the Treasurer and the Governor 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 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.

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. As noted in the October 2016 and April 2017 issues of the Bank's half-yearly *Financial Stability Review*, 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 and ongoing concerns associated with economic challenges in regions with large exposures to the resources sector. Tighter lending standards by authorised deposit-taking institutions, in part induced by regulatory actions by APRA and ASIC, have assisted in enhancing resilience to potential risks, and none of the domestic risks on their own appears to be enough to be a direct source of 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. During 2016/17, the Bank highlighted the key issues and risks for the Australian financial system in its *Financial Stability Review*, as well as in various public speeches. The Bank contributed to work with other CFR agencies during the year in the areas of: developments and risks in the housing and mortgage markets; financial technology (fintech); Australia's shadow banking sector; and crisis management preparedness.

In 2016/17, the 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. 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 ratios over recent years and are working to maintain prudent lending standards, particularly for 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 and the CFR would consider further measures if necessary. 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 is managed in support of the Bank's policy objectives. Part of the balance sheet is used to ensure that there is sufficient liquidity in the domestic money market on a daily basis. This promotes the stable functioning of the financial system, in particular the payments system, and the objectives of monetary policy. The Bank's regular transactions in the foreign exchange market are conducted to manage Australia's foreign currency reserves, which are held on the balance sheet of the Bank, and also to provide foreign exchange services to the Bank's clients, the largest of which is the Australian Government. On occasion, the

Bank may intervene in the foreign exchange market, consistent with the objectives of monetary policy.

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 2016/17.

The Bank manages its foreign reserves portfolio relative to a benchmark. During 2016/17, 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.

Analysis

The nature of the Reserve Bank's financial markets operations continues 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 2016/17, the Bank continued to monitor, and where necessary adjust to, the environment where regulations are undergoing a period of substantial reform and market functioning and structure are evolving significantly. The historically low level of global interest rates provided challenges for the Bank in managing its holdings of foreign reserves.

Payments and Infrastructure

Purpose

There are several distinct aspects to the Reserve Bank's role in the payments system, involving 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 Payments System 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 *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 Reserve 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 financial institutions to settle their payment obligations on a real-time, gross settlement basis. Extinguishing settlement obligations in a safe and efficient manner 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.

Results

In May 2016, the Payments System Board determined three new standards relating to card payments, which will contribute to a more efficient and competitive payments system. As is discussed further in the *Payments System Board Annual Report 2017*, the new surcharging framework became effective for large merchants on 1 September 2016. A number of merchants, the most prominent being the major domestic airlines, implemented changes to their surcharging policies that resulted in significant falls in surcharges payable on typical airfares. Reflecting significant outreach from the Australian Competition and Consumer Commission and the Reserve Bank, the new framework was well understood. The new interchange standards became fully effective on 1 July 2017.

In support of the Payments System Board's responsibility to promote efficiency in the payments system, the Reserve Bank continues to contribute to the industry project to deliver the New Payments Platform (NPP), which will provide infrastructure that facilitates real-time, data-rich, easily addressed payments on a 24/7 basis for households, businesses and government entities. In 2016/17, the Bank completed the development of the Fast Settlement Service (FSS), which will provide real-time settlement of NPP transactions. This is a major project for the Reserve Bank and the completion of the internal build and test phase has been delivered on time and within

budget. The FSS is now operating in test mode as part of broader industry testing of NPP-related infrastructure. The NPP is expected to commence operations around the end of 2017.

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 2016; of LCH.Clearnet Limited's SwapClear service in December 2016; and of Chicago Mercantile Exchange Inc. in March 2017. 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 2017 assessment of RITS against the *Principles for Financial Market Infrastructures*, which was published in May 2017, 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 and implementation monitoring related to CCP resilience and crisis management of financial market infrastructures. No change was required to domestic regulatory standards in 2016/17 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 2016/17, including measures of system liquidity, participants' transaction values and volumes, and system throughput and performance. The system availability target is 99.95 per cent for RITS during core system hours. The Bank exceeded this target during 2016/17, with system availability of 99.99 per cent achieved in core system hours.

The Reserve Bank is committed to ensuring that RITS is well protected from cyber attack and has an ongoing program of work aimed at ensuring very high levels of cyber resilience. In 2016/17, this work included monitoring of likely threats, penetration testing and enhancements to information technology infrastructure and controls.

Analysis

The Reserve Bank's work in the payments area in 2016/17 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.

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 competes with other organisations to provide banking services to

Australian Government agencies. It must cost and price these services separately from other activities as well as 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 2016/17, the Bank met the prescribed rate. Pro forma accounts for the transactional banking business are published in a separate chapter of this annual report.

During 2016/17, the Reserve Bank achieved progress in implementing several important banking projects, including the renovation of its banking applications and systems and building the capabilities to participate in the NPP. These projects have encountered the usual challenges associated with projects of large size and complexity, mostly around hiring and retaining appropriate staff. These challenges have been effectively handled. Key milestones were reached for the renovation of banking applications and systems, including completion of the work relating to the functionality used to process bulk electronic payments and the systems used to collect payments for the government. The effort to upgrade the Bank's core account maintenance system has commenced following the selection of a suitable provider and is ongoing. Building capability to participate in the NPP proceeded in step with the payments industry's schedule. The project involved working with other financial institutions to meet an industry-set deadline, and managing the usual challenges associated with coordinating with multiple stakeholders, each with their own business pressures and priorities.

Analysis

Substantial changes are under way in transactional banking, particularly in the area of payment services. The broader community

is embracing technology and demanding digital services from all providers, including the government, at a rapid pace. During 2016/17, the Reserve Bank continued to ensure that it remained in a position to respond appropriately with convenient, secure, reliable and cost-effective services as the largest provider of 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 the banknotes and arranges for their production through NPA. The Bank distributes the banknotes to financial institutions, monitors and maintains their quality in circulation and withdraws unfit banknotes from circulation. It also monitors and analyses counterfeiting and carries out research into banknote security technology.

Results

The most recent Reserve Bank survey measuring public confidence in Australian banknotes was conducted in early 2017. The 2017 results showed that:

- Nine out of ten people have received a new \$5 banknote.
- The main perceived reason for upgrading Australia's banknotes is security.
- There has been an increase in how often people check their banknotes following the introduction of the new \$5 banknote, with 21 per cent checking banknotes at least regularly compared with 14 per cent in 2014.

- The perceived likelihood of receiving a counterfeit banknote was higher than in previous surveys, with 16 per cent stating they felt it was likely compared with 8 per cent in 2014.

During 2016/17, the Bank continued to monitor indicators that could affect the public's confidence in the supply, security and quality of Australian banknotes in circulation as described below.

Fulfilment of banknote orders by commercial banks provides an indication that the public's demand for banknotes is being met. As an indicator of meeting demand, the Reserve Bank aims to fulfil 99.5 per cent of banknote orders on the day requested; during 2016/17, 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 2016/17, with the new \$5 banknote entering circulation on 1 September 2016 as planned. The Bank implemented a comprehensive communication strategy targeting both businesses and consumers to assist with public recognition of the new banknotes. The new \$10 banknote is on track to enter circulation on 20 September 2017 as planned.

The Reserve Bank continued to monitor Australian banknote counterfeiting rates, which remained low by international standards. The estimated counterfeiting rate remained stable at 17 parts per million in 2016/17, after having risen over the preceding decade or so. The Bank also continued to monitor international developments in counterfeiting. This was aided by the Bank's engagement with overseas 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, increased during 2016/17. This resulted from improvements in sorting processes, particularly for the \$10 denomination. Across all denominations, quality improved by around 5 per cent based on the agreed measure.

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. Australia's level of counterfeiting remains low by international standards, although it has been tending to increase over time as advances in technology make it easier and cheaper to produce counterfeit banknotes.

Financial Position and Capital

Purpose

The Reserve Bank is not a profit-maximising institution. Profits are incidental to its policy outcomes. As noted in the above section on 'Financial Market Operations', the Bank holds assets primarily to conduct operations in financial markets to achieve its central banking policy objectives – specifically, to implement monetary policy, to support the Bank's role in the Australian foreign exchange market and to manage the country's international reserves. Although carried out largely for policy purposes, these activities have been profitable in most years in the past. The Bank seeks to ensure that its retained profits and other capital reserves are sufficient over time to absorb losses to which the Bank may be exposed.

Results

In 2016/17 the Reserve Bank Board reviewed the framework for the Reserve Bank's capital and decided to adopt an approach more reflective of the risks held on the Bank's balance sheet. Accordingly, the previous target for the Reserve Bank Reserve Fund (RBRF), of 15 per cent of assets at risk, was replaced with a target based on assigning capital charges to different classes of assets. These charges reflect an assessment of the respective risks of these assets, mainly foreign exchange and interest rate risk. The charge associated with credit risk is very small, reflecting the quality of assets the Bank holds, the common practice among central banks that capital not be held to cover sovereign and supranational exposures, and the rigorous framework for managing credit risk. The updated capital framework was derived from analysis of the Bank's historical experience and stress tests. Given this revised approach, the Reserve Bank Board assessed the balance in the RBRF, of \$14 119 million, as appropriate for the risks the Bank faces. Accordingly, no transfer was made from profits to the RBRF in 2016/17.

Analysis

With the Reserve Bank's net foreign assets remaining largely unchanged (in foreign currency terms) at a level that is currently considered appropriate, and there being no material change in the Bank's exposures to interest rate risk, no transfer to the RBRF was sought from the Bank's earnings in 2016/17, as noted above. Consistent with section 30 of the Reserve Bank Act, the full sum of earnings available for distribution were therefore payable as a dividend to the Australian Government, the Bank's owner. More detail is provided in the chapter on 'Earnings, Distribution and Capital' in this annual report.