GOVERNOR'S FOREWORD

The period covered by this Report – the financial year 2001/02 – was an eventful one for the world economy, but a relatively trouble-free one for the Australian economy. The world economy experienced very sluggish growth, with the two biggest economies – the United States and Japan – in recession in the first half of the financial year. Into this environment, the events of September 11 added an additional element of uncertainty, and it seemed for a time that conditions might worsen in 2002. In the event a slow and uncertain recovery is occurring, despite further economic shocks in the form of sovereign debt crises (notably in Argentina), and the revelation of serious deficiencies in corporate governance in the United States.

In Australia, the RBA eased monetary policy three times in the second half of 2001 – once before September 11 and twice after it. On all three occasions, the easing was motivated by a desire to pre-empt the effects on Australia of a probable downturn in the world economy in 2002. When it became clear that another year of downturn for the world economy was unlikely, monetary policy was tightened again in the first half of 2002. These tightenings were fully consistent with the RBA's inflation targeting framework as inflation was near the top of the desired range and forecasts pointed to the likelihood that, if nothing was done, it would in time exceed the range. More details on the conduct of monetary policy can be found in the quarterly *Statement on Monetary Policy*, the testimony to the Parliamentary Economics Committee, media releases at the time of changes and in various speeches by myself and the Deputy Governor.

The financial markets area was the part of the RBA to be most directly affected by the events of September 11. First, as recounted in the body of the Report, it faced an immediate challenge in providing sufficient liquidity to the money market when it opened shortly after the event. This it was able to achieve without a hitch, although other markets, including the foreign exchange market, were inevitably affected. Second, the dealing capacity at our New York Office was immediately taken out of action as it was in a building adjacent to the World Trade Center that was damaged by the collapse. The dealers were switched to London and could not re-occupy the building in New York for three months, but operations were successfully carried out in London during that time.

A change to operating procedures in the financial markets area was announced in July to facilitate the introduction of the Continuous Linked Settlement Bank. This involved the introduction of a new intra-day facility for repurchase agreements in bank bills and certificates of deposit. The facility will be available to banks and some other holders of exchange settlement accounts.

Despite the economic weakness in the world economy and the international shocks referred to earlier, financial systems around the world have shown a great deal of resilience. This is particularly true in Australia, although it has to be admitted that our institutions were barely affected by events in Argentina and the US corporate sector. The payments policy area of the RBA was fully occupied during the year with its review of credit card schemes, overseen by the Payments System Board. This involved extensive consultation with the industry, the release of a consultative document in December 2001, and the preparation of a final set of standards and access regime.

With staff numbers appearing to have finally levelled out, after the long fall of the past two decades, a particular area of activity in the past year in the business and support areas of the RBA has been in consolidating our buildings. The Perth and Hobart buildings were sold and the Sydney Head Office is undergoing extensive renovations to free space on six floors for letting to commercial tenants. One of these floors has already been let.

Interaction with the community has not been diminished by any of the recent changes and we still maintain a presence in Sydney, Melbourne (including Craigieburn), Brisbane, Perth, Adelaide, Canberra, London and New York. Our new Regional Offices have been successful in building a network of contacts among businesses, industry groups and State governments across the country. Their first-hand intelligence about local economic conditions is proving to be a valuable input into the Board's deliberations about the economy.

In Head Office, the project begun last year to bring in-house the operation and development of the computer systems support for Australia's real-time gross settlement (RTGS) arrangements moved forward on schedule. While this required a dozen or so additional staff, the importance of the work fully justifies the commitment. The RTGS system is the cornerstone of interbank payments and is vital to controlling risk in the financial system. When this project is completed later in 2002, it will provide a platform to modernise the RTGS system in coming years so that these arrangements in Australia remain at the forefront of international practice.

The banking business remains important, notwithstanding the fall in staff over nearly 20 years. Although the RBA is a relatively small player in Australia's transactional banking market, we fill an important niche in making payments on behalf of the Commonwealth Government, mainly to social welfare recipients. Costs have been greatly reduced and services have been progressively improved over time, to achieve the desired levels of efficiency and reliability. In the past year, new security systems for cheque-clearing and a web-based banking facility have been developed. Overall, the RBA is now a competitive provider of these relatively specialised services, as demonstrated by our success in holding onto most of our major customers when their business has been put to tender.

The centralised facility for note processing and distribution, the National Note Processing Centre (NNPC), was opened in June 2001 at Note Printing Australia (NPA), and the cash handling facility in Sydney was closed. The transfer to banks of ownership of the working stocks of currency was completed in November. These had previously been owned by the RBA but held in pools external to the RBA and operated by armoured car companies. Now that this has been completed, we no longer have any direct role in cash handling or distribution once currency has left the NNPC, nor do we own any currency held outside our own premises. Taken together, these measures have reduced the cost of note distribution and exposed the market for currency notes to greater commercial discipline.

Both NPA and Securency, our joint venture with the Belgian firm UCB, continue to make progress in promoting export sales based on polymer banknote technology. The supply to Mexico of 176 million printed banknotes from NPA, and a large order of polymer substrate from Securency, added another major name to the growing list of export markets for polymer currency.

Despite the smaller number of staff and buildings, the RBA remains as active as ever in many areas of Australia's financial markets and economy. In fact, we believe that we play a bigger role in the Australian economy than in the days when our physical presence was larger. That is testimony to the dedication of our staff in maintaining high standards across the full range of our responsibilities.