Operations in Financial Markets

Balance Sheet

The Reserve Bank's balance sheet is affected by domestic and international transactions undertaken to meet the Bank's policy objectives. These transactions include implementing the Board's monetary policy decisions, facilitating the smooth functioning of the payments system, managing the nation's foreign reserve assets, providing banking services to clients (mainly the Australian Government and its agencies and foreign central banks) and issuing Australia's banknotes.

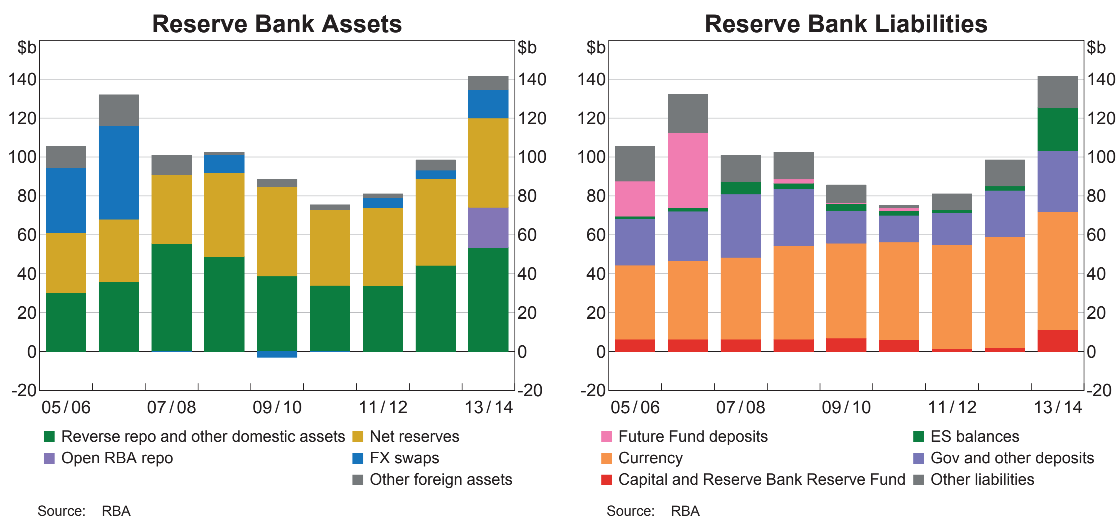
The Reserve Bank's balance sheet grew by around $43 billion over 2013/14 to about $141 billion. The increase was driven by three main factors: an increase in Exchange Settlement (ES) balances held by authorised deposit-taking institutions (ADIs) with the Bank; a rise in balances held by the Australian Government on deposit; and a Commonwealth grant to the Bank.

To facilitate the faster settlement of a number of electronic payments, financial institutions are now holding higher balances with the Reserve Bank in their ES accounts. These balances have increased by around $21 billion following the introduction in November 2013 of new arrangements to ensure that ES account holders have sufficient liquidity buffers to meet their interbank payment obligations and facilitate same-day settlement after normal banking hours (see below). ADIs fund these balances using reverse repurchase agreements with the Bank that do not have a maturity date (known as open repo positions).

Balances held by the Australian Government on deposit with the Reserve Bank increased by around $9 billion over the financial year. These deposits are predominantly used by the government to manage the mismatch in timing between its receipts and outlays and can vary considerably over the course of the year. In May, the government also made an $8.8 billion grant to the Reserve Bank to bolster the Bank's capital position. When the transfer to the Bank occurred, Australian Government deposits declined and funds available for distribution to the government increased.

To ensure that the large withdrawal of liquidity from the financial system implied by the sizeable run-up in government deposits was offset, the Reserve Bank increased its holdings of domestic securities (mainly under repo) and Australian dollar foreign exchange swaps. There was no increase in foreign exchange reserves.

The Reserve Bank has not needed to set aside additional capital against the increase in its balance sheet associated with the larger ES balances and Australian Government deposits as there has been no material effect on the Bank's risk profile. In the case of higher ES balances, the Bank's interest rate risk has not changed, as the interest rates on the additional ES balances and associated open repo positions are identical and reset each day at the cash rate target. The credit risk associated with the repo positions is managed by imposing haircuts on those assets purchased under repo, thereby limiting the Bank's exposure in the event of counterparty default. For Australian Government deposits (a liability of the Bank), the interest rate risk of the associated repo assets is generally limited to no more than six months.



Source: RBA

Source: RBA

Domestic Market Operations

Management of system liquidity

The Reserve Bank Board's operational target for monetary policy is the cash rate – the rate at which banks borrow from and lend to each other on an overnight, unsecured basis. Since August 2013, the Board has maintained the cash rate target at 2.5 per cent.

To assess whether the target has been achieved, the Reserve Bank collects data from ES account holders on their unsecured borrowing and lending in the overnight interbank market. The Bank publishes these data each day on the total volume of transactions in the cash market and the weighted-average rate at which those transactions were executed. Aggregate activity within the cash market averaged around $5 billion each business day during the year in review. The weighted-average cash rate was equal to the Board's target on all days. In 2013, the Bank changed its methodology for measuring the cash rate. A sample of the largest market participants on their unsecured borrowing and lending in the overnight interbank market was replaced by a survey of all ES account holders. Prior to this change, the Bank had still been capturing around 85 per cent of market activity in the unsecured interbank overnight market.

To implement the cash rate target, the Reserve Bank operates in financial markets to maintain an appropriate level of ES balances, which are liabilities of the Bank used by financial institutions to settle their payment obligations with each other and the Bank. Of the 152 financial institutions that are members of the Reserve Bank Information and Transfer System (RITS), around 55 per cent hold ES accounts.

The Reserve Bank transacts in financial markets each day to influence the cash rate in the unsecured interbank market. The supply of ES balances is altered by payments between ES account holders (mainly financial institutions) and the Bank (including its customers, principally the Australian Government). To offset these, the Bank can buy or sell government securities, undertake transactions in the repo market or use foreign exchange swaps.

The Reserve Bank announces its dealing intentions each morning at 9.30 am. Those RITS members wanting to participate in the Bank's open market operations have a 15-minute window in which to approach the Bank. The results of the Bank's first round of open market operations are announced shortly after 9.45 am. To ensure that unforeseen payments do not adversely affect the Bank's ability to implement monetary policy, the Bank has the option of undertaking additional rounds of market operations late in the afternoon.

The shift to same-day settlement of direct entry (DE) payments in November 2013 has resulted in some changes to the Reserve Bank's operations. This reflects the increased uncertainty around the exact timing of payment flows across Government accounts related to the much faster settlement of these payments. Prior to November 2013, DE transactions were batched and settled the following morning. Since then, these payments have been settled through several intraday batches, with some of these batches occurring when the interbank cash market is closed (see also the chapter on 'Banking and Payments').

Given the size and uncertainty surrounding the value of DE payments made after the close of the interbank market, participants in the DE payments exchange are required to hold higher minimum ES balances. These balances act as a buffer, ensuring that ADIs hold sufficient liquidity to complete their payments after the close of the cash market. The 10 ADIs that are participants in the DE payments exchange increased their ES balances by around $20 billion in aggregate during the year, establishing open repo positions with the Reserve Bank by a corresponding amount. In net terms, there is no interest cost to holding an open repo position matched by ES balances; open repos accrue interest at the cash rate target, and to the extent that an ES account holder has matching funds in its ES account, the institution also earns interest at the cash rate target. An allowance is made for variations in ES balances arising from DE payments that settle during the evening. Minimum required open repo positions are reviewed annually by the Bank and seek to provide a buffer above the largest payment obligations that have arisen in recent times.

The size of the open repo positions, and their ES balance counterpart, has no implications for the interpretation of the stance of monetary policy in Australia. While required local currency-denominated central bank reserves are used as an instrument for monetary policy in other countries, their purpose in Australia is purely to meet liquidity requirements for the smooth functioning of the payments system. Although the aggregate amount of ES balances has increased substantially from the previous financial year, the system's liquidity buffer – that is, ES balances at the Reserve Bank, which earn an interest rate 25 basis points below the cash rate – has been maintained around $1 billion, in line with the average in the previous year.

The introduction of the Fast Settlement Service (FSS) in 2016 is expected to provide near-instantaneous settlement of certain retail payments across the entire day, including on weekends (see also the chapter on 'Banking and Payments'). From a liquidity management viewpoint, this change will be accommodated within the open repo framework.

One consequence of the new arrangements is that they largely remove the need for an ES account holder to contract intraday repos with the Reserve Bank, because the higher balance held in their ES account allows them to meet intraday liquidity needs. The Bank also allows other ADIs that operate ES accounts to contract open repos, not only those participating in the direct entry exchanges. Provided any drawings on the ES accounts are repaid same-day there is no cost to using the facility in this way. As at 30 June 2014, 12 institutions had an open repo position with the RBA as part of these arrangements. Since the introduction of the new arrangements in November 2013, intraday repos outstanding have averaged around $3 billion, compared with an average of $12 billion in the 12 months prior to the change.

As a result of the increased uncertainty around the timing of payments, the Reserve Bank has also introduced a routine second round of dealing at 5.15 pm. The additional operations are designed to address any large imbalances in the cash market that are the result of an unforeseen change in the magnitude of payments and which affect system liquidity or the timing of such payments. These operations are designed to ensure that aggregate ES balances remain at a level consistent with the achievement of the cash rate target. There have been 46 such dealing rounds since November 2013, with a roughly even split between operations to inject and withdraw liquidity.

Additional Rounds of Open Market Operations under Same-day Settlement
November 2013 to June 2014

Operation	Number	Average size offered	Coverage ratio	Average size dealt	Average number of counterparties	Spread to OIS[(a)]
		$ million		$ million		Basis points
Cash injection	20	540	1.0	440	2	–4
Cash withdrawal	26	420	0.6	210	1	10

(a) Overnight index swap rate
Source: RBA

The new arrangements preserve the corridor framework for the implementation of monetary policy by providing an incentive for ES account holders to participate in the interbank cash market, lend surplus balances or borrow to cover any shortfall. ES balances in excess of the open repo position earn 25 basis points less than the cash rate target and any shortfall between ES balances and the open repo position is charged a 25 basis points margin, with an allowance being made for variations in ES balances arising from DE transactions during the evening.

ES account holders are not permitted to overdraw their accounts, although the Reserve Bank remains willing to advance funds overnight against eligible securities to account holders at an interest rate 25 basis points above the cash rate target. In general, this occurs only when banks have to meet unforeseen payments late in the day and are unable to source funds elsewhere. During 2013/14, overnight repos at an interest rate 25 basis points above the cash rate target were undertaken by ES account holders on six separate occasions, mostly for small amounts.

The Australian Prudential Regulation Authority (APRA) will implement the Basel III liquidity standard in Australia from January 2015. The standard requires ADIs subject to the liquidity coverage ratio (LCR ADIs) to hold sufficient high-quality liquid assets (HQLA) to meet outflows during a 30-day period of stress. Given that there is a shortage of HQLA in Australia for LCR ADIs to be able to satisfy the LCR, the Bank will introduce a committed liquidity facility (CLF) in 2015. Under this facility, LCR ADIs will pay a fee of 15 basis points per annum to obtain a commitment from the Bank to provide funding through its repo facilities up to an amount approved by APRA for the purpose of the LCR. LCR ADIs will be able to contract these repos using eligible securities (including self-securitisations). In January 2014, APRA announced the results of a trial exercise to determine the size of individual CLF requirements. Based on this exercise, the total size of all CLF amounts was estimated to be around $280 billion. APRA will determine the CLF amounts applicable in 2015 towards the end of 2014.

Management of domestic assets

Over the past year, the Bank's holdings of domestic assets have increased as the counterpart to higher government deposits and the establishment of open repo positions. The domestic assets are either purchased outright or held under repo.

Most of the Reserve Bank's transactions in the domestic market are contracted as repos. Under reverse repos, the Bank is willing to purchase both government-related debt securities and certain private debt securities. In many respects, the transaction is similar to a secured loan, with the difference between the purchase and repurchase prices representing the interest earned on the transaction. To protect against a decline in the value of these securities should the Bank's counterparty not be able to meet its repurchase obligation, the Bank requires that the value of the security exceeds the cash lent by a certain margin. These margins, which are listed on the Bank's website (www.rba.gov.au/mkt-operations/resources/tech-notes/eligible-securities.html), are considerably higher for private securities than for government-related securities.

The stock outstanding of cash lent through the Bank's open market operations has ranged between $22 billion and $53 billion over the financial year. With the stock of repos outstanding in the domestic market generally around $100 billion, the Reserve Bank's operations have, at times, accounted for a significant portion of the market. The most active users of repos tend to be the fixed-income trading desks of banks and securities firms seeking to finance their inventories of Commonwealth Government Securities (CGS) and semi-government securities (semis). Reflecting this, around 70 per cent of the securities held by the Bank (excluding those under open repo) are government obligations. The average term of reverse repos contracted via open market operations over the past year was around one month, slightly longer than in recent years.

Australian Dollar Securities Held under Repurchase Agreements

	June 2012		June 2013		June 2014	
	$ billion	Per cent of total	$ billion	Per cent of total	$ billion	Per cent of total
CGS	8.5	35	15.5	42	17.6	25
Semis	8.6	35	9.4	30	15.5	22
Supras	0.6	2	1.4	4	3.3	5
Government guaranteed	0.3	1	0.2	1	0.0	0
ADI issued	5.6	23	8.0	19	8.8	12
RMBS	0.8	3	0.6	4	25.1	35
Other	0.0	0	0.0	0	0.6	1
Total	24.4	100	35.2	100	70.9	100

Source: RBA

Securities that are eligible in the Reserve Bank's open market operations are also eligible for open repo positions. In addition, the Bank has permitted the use of certain related-party assets issued by bankruptcy remote vehicles, such as self-securitised residential mortgage-backed securities (RMBS), as security against open repo positions for participants in the DE payments exchange. Around 90 per cent of the outstanding amount of open repos is backed by these self-securitised assets.

Self-securitised RMBS used in open repos do not have observable market prices as they are retained in full by the originating institutions and are therefore not traded. As a result, the Reserve Bank makes an internal estimate of their prices to determine their value. The Bank has developed an internal valuation model for self-securitised RMBS, which estimates certain key parameters of the securities and uses these, together with observed market prices of public RMBS, to infer prices for self-securitised RMBS. In May 2014, the Bank engaged an external consultant to conduct an independent review of its pricing model and the Bank's overall framework, including the use of margins. The high-level assessment indicated that the Bank's pricing model and overall framework was fit for purpose, while indicating a number of possible minor improvements.

With asset-backed securities becoming an increasing share of assets held under repo, as a result of the change in the payments arrangements described above, as well as the potential use of self-securitised RMBS as collateral for the CLF, the Reserve Bank has introduced new eligibility requirements for securitisations used in repurchase agreements with the Bank. New information, which will be required to be reported to the Bank for RMBS, commercial mortgage-backed securities and other asset-backed securities, includes transaction-related data as well as information on the underlying assets. The information will allow the Bank to value securitised assets more precisely and better assess and manage risk. This will likely result in more granularity

of the adjustments that the Bank makes to manage its credit risk. Reflecting the Bank's interest in promoting increased transparency in asset-backed securities, the information will also be made available to members of the public with a legitimate interest, although some information will be aggregated or redacted to protect borrower privacy. The Bank is working with an external contractor selected via an open tender process to develop the Securitisation System to collect, validate and store the securitisation data submitted to the Bank. The reporting requirements have been developed in consultation with market participants, and the Bank will continue to communicate with these participants throughout the implementation process to facilitate a smooth transition to the new reporting requirements in 2015.

Domestic securities purchased by the Reserve Bank are held in an account that the Bank maintains in Austraclear, the securities depository of the Australian Securities Exchange (ASX). In April 2013, the Bank agreed to become a Foundation Customer of ASX Collateral, a collateral management service that allows the ASX to act as tri-party agent to the Bank's repos. As agent, the ASX is responsible for ensuring that securities delivered to the Bank's Austraclear account are appropriately valued and meet the Bank's eligibility requirements. Tri-party arrangements can make it more efficient for those with a large number of small-denomination holdings to fund their securities via repo. As agent, the ASX also offers optimisation tools that can determine the most efficient allocation of securities against each exposure that a user is managing. The Bank settled its first tri-party repo in early 2014. Bank counterparties continue to have the option of using existing arrangements, which involve confirming each individual security and its value bilaterally with the Reserve Bank prior to settlement.

The Reserve Bank continues to operate a Securities Lending Facility on behalf of the Australian Office of Financial Management (AOFM). The securities available through the facility comprise all Treasury Bonds and Treasury Indexed Bonds currently on issue. The Bank sells these securities under open repos to RITS members eligible to participate in the Bank's domestic market operations.

The Reserve Bank holds both CGS and semis on an outright basis in its domestic portfolio. These are used for the Bank's management of system liquidity and are also available to be posted as collateral for repos.

An important influence on the composition of the Reserve Bank's holdings of CGS has been management of the impact of large CGS maturities on system liquidity. This reflects the Bank's need to reduce or offset the large volume of funds that are paid out of the Australian Government's account at the Bank into ES accounts (for the credit of the security holder) on the maturity date. In addition to using reverse repos and foreign exchange (FX) swaps – both contracted to unwind and therefore withdraw liquidity on the same day as the CGS maturity – the Bank makes purchases of CGS ahead of their maturity date. Over the course of 2013/14, the Bank offset the liquidity effects of two large CGS maturities – the $9.3 billion maturity of the December 2013 bond and the $13.3 billion maturity of the June 2014 bond. To do this, the Bank purchased almost $1.6 billion of the December 2013 bond and $3.2 billion of the June 2014 bond in the 12 months preceding each maturity. These sterilisation operations will increase in size in the future as large CGS issues mature. Reflecting these operations, the Bank's holdings of CGS at any point in time are only close-to-maturity issues. The size of these holdings generally increases up to the point of maturity and in aggregate will fluctuate noticeably through time as maturities occur.

At present, the Reserve Bank holds around $3 billion of semis. This is similar to the level of earlier years. These securities are generally purchased as part of the Bank's daily open market operations or separately through occasional outright purchase operations. The latter, which are conducted over Yieldbroker DEBTS, occurred once in 2013/14.

In January 2014, the Reserve Bank closed its small-investor facility when the AOFM outsourced the registry for CGS to a commercial service provider. As a result, over the first half of 2014 the Bank sold a number of small holdings of longer-dated CGS that it held for sale to small investors.

In December 2013, the Bank commenced publishing monthly indicator rates for Australian corporate bond spreads. The decision reflected a lack of publicly available data on bond market conditions faced by non-financial corporations, particularly at longer maturities. The estimation method is described in the December 2013 edition of the *Bulletin*.

Foreign Exchange Operations

The Reserve Bank transacts in the foreign exchange market on most business days, principally to facilitate its customer business. The Australian Government remains the Bank's largest foreign currency customer. Excluding transactions related to International Monetary Fund (IMF) financing, the Bank sold $7.2 billion of foreign currency to the Australian Government during 2013/14, with these sales funded by the Bank purchasing the required foreign currency in the spot market.

It is only in periods where the market for Australian dollars is severely stressed that the Reserve Bank is likely to use its existing stock of foreign currency reserves to fund its normal customer business. In such an instance, these reserves would be subsequently replenished at a time when the Bank judged that market conditions had stabilised. This has not been considered necessary since late 2008, a period when global financial markets were significantly impaired.

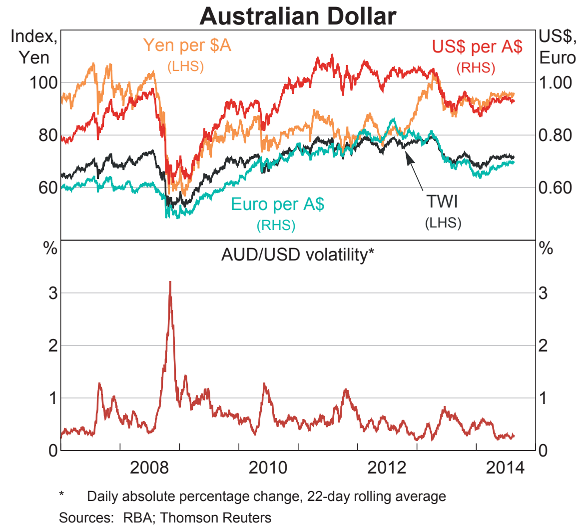
Likewise, not since 2008 has the Reserve Bank transacted in the foreign exchange market to address dislocated trading conditions for the Australian dollar. While Australia has now operated a floating exchange rate regime for more than 30 years, the Bank has always retained the discretion to intervene in the market for Australian dollars to address market dysfunction and/or a significant misalignment in the value of the currency. Over time, the Bank's intervention in the foreign exchange market has become less common as the market has deepened and participants' use of hedging instruments has made them more resilient to episodes of volatility.[1] During the past year, the Australian dollar remained high by historic standards, while trading conditions were generally characterised by low volatility.

The Reserve Bank also transacts in the foreign exchange market when managing its foreign currency reserves. In late 2013, these operations included the purchase of Chinese renminbi for the first time. A series of foreign exchange transactions were undertaken with the People's Bank of China (against US dollars) to reallocate part of the foreign currency portfolio into renminbi.

To maintain the currency composition of foreign currency reserves at their benchmark weights (discussed below), the Reserve Bank regularly operates in the spot foreign exchange market. The settlement of these rebalancing flows may also be managed through FX swaps (whereby one currency is exchanged for another, with a commitment to unwind the exchange at a subsequent date at an agreed (forward) rate). By themselves, swaps do not alter the Bank's exposure to any currency, but are often used as an efficient way to manage the cash held within the foreign currency reserves portfolio. During 2013/14, swaps transacted for this purpose totalled around US$34 billion.

1 For further details, see Newman V, C Potter and M Wright (2011), 'Foreign Exchange Market Intervention', RBA *Bulletin*, December, pp 67–76. Intervention data are published, with a lag, on the Bank's website at www.rba.gov.au/statistics/tables/xls/a05hist.xls.

As mentioned above, the Reserve Bank is also an active user of FX swaps against Australian dollars. As these transactions alter the supply of ES balances (without affecting the exchange rate), they complement the other operational tools used by the Bank to implement monetary policy. FX swaps are particularly useful at times when the Bank needs to offset large projected changes in aggregate ES balances (such as those associated with government bond maturities) as the swap market is much larger and generally more liquid than the domestic repo market. In 2013/14, turnover in FX swaps undertaken for domestic liquidity management totalled $77.2 billion.

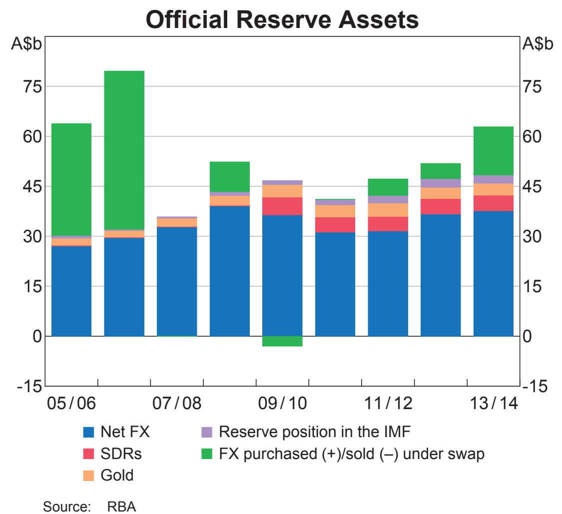


* Daily absolute percentage change, 22-day rolling average
Sources: RBA; Thomson Reuters

All foreign currency swaps executed by the Reserve Bank are for short periods, being generally no more than three months' duration. The risk associated with forward FX positions is mitigated by receiving collateral from (or, where appropriate, posting collateral to) the Bank's counterparties against changes in the market value of these positions. The conditions for such exchanges of collateral are defined in two-way Credit Support Annexes to the ISDA Master Agreements that the Bank has executed with each of its counterparties.

Reserves Management

Australia's official reserve assets encompass foreign currency assets, gold, Special Drawing Rights (SDRs – a liability of the IMF) and Australia's reserve position in the IMF. Reserve assets are held primarily to facilitate policy operations in the FX market (as discussed above). The capacity to undertake such operations is best measured by 'net' reserve assets, with the amount of foreign currency subject to forward commitments (such as foreign currency that the Reserve Bank has obtained in short-term swaps against Australian dollars) excluded.



Source: RBA

Australia's reserve position in the IMF is an asset of the Australian Government. All other components of Australia's official reserve assets are held on the Reserve Bank's balance sheet, and the Bank is responsible for managing the level and composition of those reserves. As these assets can expose the Bank to various risks (such as market, liquidity and credit risk), the level held represents only the amount assessed to meet expected policy requirements. The Bank also attempts to mitigate risks to its balance sheet where possible, chiefly through holding a diversified portfolio of assets and only investing in assets of high credit quality and appropriate liquidity.

The investment of the Reserve Bank's foreign currency assets is guided by an internally constructed benchmark. This benchmark is judged to be the combination of foreign currencies and foreign currency assets that will maximise the Bank's returns over the long run, subject to the Bank's policy-driven need to maintain the liquidity of the portfolio and its general appetite for risk. The structure of the benchmark is reviewed from time to time to take account of significant changes in market conditions and the Bank's risk tolerance.

During 2013/14, the Reserve Bank reallocated around 3 per cent of its foreign currency benchmark from the US dollar to the Chinese renminbi. This portfolio shift recognised the growing importance of China in the global economy and the broadening financial relationship between Australia and China. From a portfolio perspective, the shift increased the diversification of the Bank's foreign currency investments and is expected to enhance returns over the long run.

Notwithstanding the recent allocation to Chinese renminbi, more than 50 per cent of the benchmark remains in US dollars. Reflecting the current low level of global interest rates, the duration targets for the foreign currency portfolios remain short, mitigating the risk of capital losses when bond yields return to more normal levels.

Benchmark Foreign Currency Portfolio

30 June 2014

	US	Europe	Japan	Canada	China
Asset allocation (per cent of total)	52	35	5	5	3
Duration (months)	6	18	6	6	18

Source: RBA

Investments within the benchmark currencies are limited to deposits at official institutions (such as central banks) and debt instruments issued or guaranteed by sovereigns, supranational agencies and (under reverse repos only) quasi sovereigns. Sovereign credit exposures are currently limited to the United States, Germany, France, the Netherlands, Canada, Japan and China.

Foreign Currency Assets[(a)]

A$ million, 30 June 2014

Currency	Securities held outright	Securities held under reverse repos	Deposits at official institutions[(b)]	Total	Forward FX commitments		Net
					Against AUD	Against other currencies	
US dollar	15 401	1 569	1 649	18 619	–335	1 111	19 395
Euro	8 548	594	6	9 148	–	3 856	13 004
Japanese yen	20 995	–	18	21 013	–14 079	–5 072	1 862
Canadian dollar	1 780	–	7	1 787	–	71	1 858
Chinese yuan	1 034	–	21	1 055	–	–	1 055
Total	**47 759**	**2 163**	**1 700**	**51 623**	**–14 414**	**–35**	**37 174**

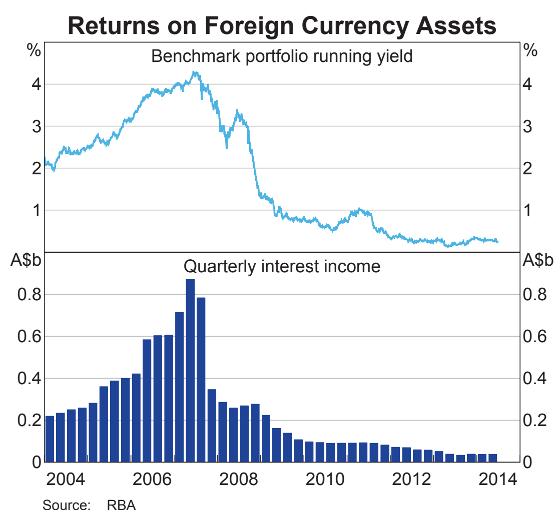
(a) Excludes investments in the Asian Bond Funds
(b) Includes deposits at foreign central banks and the Bank for International Settlements
Source: RBA

The amount of foreign currency reserves held by the Reserve Bank is affected by foreign exchange swaps contracted against Australian dollars. At the end of June 2014, the Bank's gross reserves included $14 billion of foreign currency sourced from such swaps. Foreign currency obtained in this manner does not comprise part of the benchmark portfolio, but is invested to ensure that the Bank's forward commitments to sell foreign currency are fully hedged.

In recent years, returns on short-dated Japanese investments, taking into account the cost of hedging the currency risk, have been higher than the historically low returns available on the US and euro portfolios. Reflecting this, the Bank has also executed swaps of US dollars and euro against the Japanese yen, helping to raise overall returns on the reserves portfolio. While the Bank's exposure to changes in the value of the yen remains small (consistent with the yen's share of the benchmark), almost half of foreign currency reserves were invested in yen-denominated assets at the end of June 2014.

A small component of the Reserve Bank's net foreign currency reserves sits outside the benchmark framework. This encompasses investments in a number of Asian debt markets through participation in the EMEAP Asian Bond Fund (ABF) Initiative. This initiative was established in the wake of the Asian currency crisis in the late 1990s to assist in the development of bond markets in the region. The Bank has modest holdings in the US dollar-denominated fund (ABF1) and the local currency-denominated fund (ABF2). At the end of June 2014, the total allocation of reserves to these funds was $476 million. The return on these investments over 2013/14 was 0.8 per cent when measured in SDR terms.

The overall return on foreign currency assets over 2013/14 was –0.6 per cent, measured in SDRs, down from the previous year and well below historical norms. This outcome reflected currency valuation effects and the low interest rate environment globally. At the end of June 2014, the running yield on the benchmark portfolio was only 0.2 per cent, compared with over 4 per cent prior to the financial crisis.



The Reserve Bank's holdings of SDRs at 30 June 2014 amounted to $4.7 billion, $0.1 billion lower than a year earlier. Under voluntary arrangements with the IMF, the Reserve Bank is willing to transact in SDRs upon request from other countries or prescribed holders. In these transactions, the Bank will generally either buy or sell SDRs in exchange for foreign currencies (such as euros or US dollars). Such transactions do not alter the level of Australia's reserve assets, only the proportions held in SDRs and foreign currency. In late 2013, to accommodate a larger than normal request to purchase SDRs (equivalent to $320 million), the Bank decided to replenish the foreign currency used in the transaction by selling Australian dollars in the spot market.

Australia's reserve position in the IMF was $2.5 billion at the end of June 2014, $0.2 billion lower than a year earlier. The reserve position comprises that part of Australia's quota in the IMF that was paid in foreign currency as well as other credit that Australia has extended to the IMF in support of the Fund's lending programs. As noted above, this asset is not held on the Reserve Bank's balance sheet. However, the Reserve Bank will sell to (or purchase from) the Australian Treasury the foreign currency the Treasury needs to complete its transactions

with the IMF. Unlike the normal customer business transacted with the Australian Government, the Bank will typically draw on (or add to) its foreign currency reserves when providing foreign currency for this purpose. This is because any change to the Bank's holdings of foreign currency assets will be offset by an equivalent change in Australia's reserve position in the IMF, leaving total official reserve assets unchanged. Nevertheless, as with SDR transactions, on certain occasions the Bank may decide to offset the impact on foreign currency asset holdings of IMF transactions.

Gold holdings at the end of June 2014 were around 80 tonnes, unchanged from the previous year. Gold prices rose by 9 per cent in Australian dollar terms in 2013/14, increasing the value of the Reserve Bank's holdings of gold by around $0.3 billion to $3.6 billion. Activity in the gold lending market remained subdued, with the Bank having only 1 tonne of gold on loan during the year. Income earned on that loan amounted to $0.2 million. During the year in review, the Bank audited its gold holdings, including that portion held in safe custody at the Bank of England.

Bilateral Currency Swap

In February 2014, the Reserve Bank signed a bilateral local currency swap agreement with the Bank of Korea for an initial period of three years. The agreement can be activated by either party and allows for the exchange of local currencies between the two central banks of up to $5 billion. As with the local currency swap agreement signed between the Reserve Bank and the People's Bank of China in 2012, the agreement with the Bank of Korea is designed to promote bilateral trade between the two countries by ensuring that transactions could continue to be settled in local currency during periods of stress.

Governor Glenn Stevens and Bank of Korea Governor Choongsoo Kim shake hands after signing a bilateral local currency swap agreement between the Reserve Bank and the Bank of Korea, Sydney, February 2014