Annual Performance Statement

I, as the accountable authority of the Reserve Bank of Australia, present the annual performance statement of the Reserve Bank for the 2020/21 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

10 September 2021

Introduction

This performance statement outlines the key objectives of the Reserve Bank as set out in the 2020/21 corporate plan and provides an assessment of the Bank's performance in achieving those objectives. Where necessary, additional context is provided, including an analysis of significant factors that have contributed to the outcomes.

Reserve Bank of Australia – Performance Summary 2020/21

Key objectives	Key activities	Performance measures and targets	Results
Price stability and full employment	Conduct monetary policy in a way that will best contribute to: · stability of the currency · maintenance of full employment · economic prosperity and welfare of the people of Australia.	Flexible medium-term inflation target to achieve consumer price inflation of between 2 and 3 per cent, on average, over time. Foster sustainable growth in the economy.	Consumer price inflation averaged around 1¾ per cent over five years prior to the COVID-19 pandemic. Movements in consumer prices over the past year have been dominated by the effect of responses to the pandemic. Headline inflation has been volatile, and was briefly negative in mid 2020 due to the effect of declining fuel prices and a number of government price freezes, rebates and subsidies. Headline inflation rose to 3¾ per cent over the year to June 2021 as these temporary policy measures were unwound and fuel prices returned to around pre-pandemic levels. GDP growth was strong over 2020/21. GDP increased to be above its pre-pandemic level by early 2021 as the economy rapidly recovered from the COVID-19 downturn. The unemployment rate was around 5 per cent in mid 2021 – similar to its pre-pandemic level and well below the peak of 7½ per cent in mid 2020. Growth in the economy had averaged 2½ per cent over the five years prior to the pandemic. See the Bank's quarterly *Statement on Monetary Policy* for details.
	Achieve cash rate consistent with the Board's objectives.	Keep the cash rate within the interest rate corridor around the cash rate target each business day.	The cash rate was within the interest rate corridor around the cash rate target each business day.
	Achieve three-year Australian Government bond yield target.	Three-year Australian Government bond yield consistent with the target at the close of each business day.	The three-year Australian Government bond yield has remained consistent with the target. See below and the Bank's quarterly *Statement on Monetary Policy*.
	Provide low-cost term funding to the banking system.	Provide the Reserve Bank's Term Funding Facility (TFF).	The Bank provided $188 billion in low-cost funding to the banking system through the TFF.
	Provide adequate liquidity to the financial system.	Use daily open market operations to ensure financial institutions have access to sufficient liquidity.	Since mid 2020 daily market operations have been significantly below pre-pandemic levels, reflecting the increase in banking system liquidity and substitution towards longer-term TFF funding.

Key objectives	Key activities	Performance measures and targets	Results
	Support the smooth functioning of government bond markets.	Purchase government securities if required to support the smooth functioning of government bond markets as reflected in various measures of liquidity, including bid-offer spreads.	The Bank purchased government securities as required to support the smooth function of government bond markets, including by bringing forward bond purchases under the bond purchase program in early March to assist with market functioning at that time.
	Manage reserves to portfolio benchmarks.	Manage reserves portfolio to within small deviations around benchmarks for interest rate and currency risk.	Deviations from the benchmarks were in line with pre-defined tolerances.
	Intervene in foreign exchange market as appropriate.	Publish data and explanations of any intervention.	No foreign exchange market intervention was conducted.
The stability of the financial system	Support overall financial stability.	A stable financial system that is able to support the economy.	The financial system and the household and business sectors have remained resilient, and are well placed for the recovery phase from the effects of the COVID-19 pandemic. Banks' healthy capital and liquidity positions following earlier reforms has allowed them to support the economy through the pandemic, including by offering loan repayment deferrals and, as demand for credit has picked up, new lending. The Bank's ongoing monetary policy measures (including the cash rate target and expansion and extension of the TFF) continued to support credit flows, as well as confidence in the wider financial system. Loan repayment deferrals and public support measures have proved effective in bridging the worst of the pandemic-related disruptions, with few signs of stress arising from the progressive withdrawal of many measures during the year. While accommodative financial conditions could present risks if they are accompanied by excessive risk-taking by lenders or borrowers, lending standards remain sound overall and CFR agencies are positioned to respond to a deterioration in the risk outlook.
		Work with the Council of Financial Regulators (CFR) agencies and international bodies to identify and appropriately address evolving systemic risks.	The CFR continued to closely monitor and assess the effects of the pandemic on the financial system and the broader economy, including the unwinding of support measures. The CFR issued statements that outlined its discussions and assessments, as well as areas of focus.

Key objectives	Key activities	Performance measures and targets	Results
		Assess and communicate risks to financial stability, including through the Bank's half-yearly *Financial Stability Review*.	The Bank continued to assess financial stability risks. The Bank is using existing and new datasets to identify and assess emerging risks in the banking, household and business sectors. The Bank communicates its assessments of these and other risks through the half-yearly *Financial Stability Review*, *Bulletin* articles and speeches. The Bank included, from October 2020, a new succinct presentation of the key risks identified in the *Financial Stability Review*.
A secure, stable and efficient payments system	Support competition and efficiency in the payments system and financial system stability.	Monitor the outcomes for consumers and businesses following past reviews of the regulatory framework for card payments. Undertake policy work focusing on the strategic priorities identified by the Payments System Board (including promoting competition and reliable, secure, efficient and low-cost electronic payment services, as well as keeping abreast of new technologies and platforms in payments) and on any issues of competition, efficiency or risk identified in liaison with stakeholders.	In 2020/21, the Bank focused on · the provision of least-cost routing functionality to merchants · understanding differences in payment costs across merchants and how to strengthen competition in acquiring services · policy issues associated with the rise of 'buy now, pay later' services and large technology companies in payments · work in support of the G20 roadmap on enhancing cross-border payments · research on the case for, and implications of, issuing central bank digital currencies (see also below).
		Recommence work on the comprehensive Review of Retail Payments Regulation, which was placed on hold in March 2020 due to the COVID-19 pandemic. Monitor and enforce compliance with the Bank's card payments regulations.	The Bank published a consultation paper with preliminary conclusions (and associated draft standards) from the Review of Retail Payments Regulation in May. The Payments System Board is expected to reach final conclusions on the Review in the second half of 2021.
		Undertake research and work with industry on policy issues relating to both legacy and emerging payment methods, including work to support the ongoing provision of cash services, work exploring the wind-down of the cheques system, and research on the possible issuance of central bank digital currency (CBDC).	In 2020/21, the Bank focused on: · analysing policy issues associated with the emergence of digital wallets and 'buy now, pay later' services · analysing trends in cash demand and changes in access to cash services and cash acceptance · overseeing industry efforts to wind-down the cheques system · research on the case for, and implications of, issuing CBDC (see also below).

Key objectives	Key activities	Performance measures and targets	Results
		Review elements of the regulatory framework for e-conveyancing platforms jointly with the CFR, the Australian Competition and Consumer Commission (ACCC) and the Australian Registrars' National Electronic Conveyancing Council, with the aim of identifying enhancements that would promote consumer protection, resilience and competition in the e-conveyancing market.	This Review was completed and recommendations were provided to a meeting of the CFR and ACCC in June.
		Work with the CFR to complete the review of the regulatory framework for stored-value facilities (SVFs) in Australia, including to progress any changes to the framework stemming from the CFR's report provided to the Australian Government in October 2019.	The government accepted the recommendations in the CFR's report and the Bank is now participating in a CFR working group led by the Treasury that is developing a reform package to implement the changes to the regulatory framework for SVFs.
		Work with industry to modernise payment messaging standards via participation in the ISO 20022 migration project.	The Bank has been participating in the industry-led migration project. The planning and design phase is completed, and the project has entered the build phase. Full migration of the Australian high-value payments system is expected by November 2024.
		Work with industry and the Australian Prudential Regulation Authority (APRA) to develop disclosure standards for operational performance.	Reporting and disclosure requirements for retail payments incidents have been developed and institutions are required to disclose the availability of retail payment services from November 2021.
		Work in the Bank's Innovation Lab (including with external partners) to conduct research on the case for, and implications of, CBDC.	A project to develop a proof-of-concept for a wholesale CBDC, in collaboration with a number of external partners, was completed. A public report is forthcoming.
	Oversee the stable provision of financial market infrastructure (FMI) services.	Assess Reserve Bank Information and Transfer System (RITS) and licensed clearing and settlement (CS) facilities against relevant standards. Establish recommendations and regulatory priorities as appropriate for each high-value payment system and CS facility based on these assessments.	The Bank completed and published assessments of RITS and all licensed CS facilities (other than for Chicago Mercantile Exchange Inc (CME)). The CME assessment has moved to a two-yearly cycle, with the Bank's next assessment expected to be published in 2022/23. Where necessary, the Bank has set regulatory priorities for facilities and monitored responses.
		Undertake reviews as appropriate to determine whether additional FMIs should be subject to supervision or oversight by the Bank.	The Bank determined that no payment systems other than RITS and CLS should also be subject to ongoing oversight by the Bank and provided advice to ASIC that several overseas central counterparties do not require an Australian CS facility licence.

Key objectives	Key activities	Performance measures and targets	Results
		Provide proposals for enhancements to the FMI regulatory regime, including crisis management powers, to the Australian Government.	The CFR provided recommendations to the government on reforms to the FMI regulatory regime, which the government accepted.
		Contribute to international policy work on central counterparty resilience and FMI crisis management.	Bank staff actively participated in international policy development and implementation on crisis management and the resilience of FMIs.
		Adapt domestic regulatory standards in response to international developments. Support international supervisory cooperation.	No change to domestic regulatory standards was required. However, the Bank revised the guidance on its supervisory approach to reduce the frequency of broad assessments of systemically important domestic CS facilities in order to conduct more special topic reviews.
	Ensure the operational reliability of RITS.	RITS availability at 99.95 per cent during core hours.	RITS availability was 99.96 per cent during core hours in 2020/21.
		RITS Fast Settlement Service (FSS) availability at 99.995 per cent on a 24/7 basis, with most transactions processed in less than one second.	FSS availability was 99.999 per cent on a 24/7 basis and the processing time for 95 per cent of FSS transactions was 56 milliseconds or less.
		Complete an upgrade of RITS hardware and network infrastructure by end of June 2021.	The multi-year refresh of core RITS network and application infrastructure was completed in 2020/21.
	Ensure the cyber security of RITS.	Ongoing investment and regular reviews and testing to support cyber resilience, including participation in a pilot 'red team' exercise for financial institutions sponsored by the CFR.	The Bank's ongoing program of cyber resilience work helped underpin the reliable operation of RITS in 2020/21. The Bank continued to comply with the requirements of ISO 27001 and SWIFT's mandatory Customer Security Program. The pilot threat intelligence exercise testing the cyber maturity and resilience of institutions is underway in collaboration with the CFR.
		Complete a review of RITS end-point security arrangements and update RITS member security requirements as required.	An external review of the Bank's end-point security standards for RITS members and feeder systems has been completed. A draft set of enhanced RITS member security requirements has been developed and will be released for RITS member comment in the September quarter of 2021.
The delivery of efficient and effective banking services to the Australian Government	Ensure central banking services remain fit for purpose.	Work with key stakeholders to maintain and improve, where possible, the central banking services provided to the Commonwealth.	The Bank continued to work with the Department of Finance and the Australian Office of Financial Management on its Commonwealth cash management initiatives. The term deposit facility was replaced with a cash management account, implemented in November 2020.

Key objectives	Key activities	Performance measures and targets	Results
	Satisfy financial performance benchmarks.	Minimum return on capital for transactional banking business equivalent to the yield on 10-year Australian Government Securities plus a margin for risk.	The Bank's banking services achieved the minimum required return in 2020/21.
	Progress on activities to deliver convenient, secure, reliable and cost-effective banking services to customers.	Provision of high-quality, cost-effective banking services to the Australian Government and other official agency customers and, in turn, the public, supported by: · continued development of banking services and systems, including New Payments Platform (NPP) capabilities · support agency customers as they migrate payments from legacy payment systems to new systems.	The Bank: · continued to work with the industry to develop new NPP capabilities, notably the Mandated Payment Service, and implemented Category Purpose Payments in December 2020 · assisted Services Australia to further leverage existing NPP and API capability for the timely processing and delivery of emergency welfare and disaster recovery payments · supported agency customers as they progressed through the development and implementation of new payment systems · on-boarded new service offerings.
The provision of secure and reliable banknotes	Ensure Australian banknotes provide a safe, secure and reliable means of payment and store of value, as follows:	Maintain or improve public perceptions of Australian banknotes, as measured in the Reserve Bank survey.	In the biannual survey on perceptions of Australian banknotes, 70 per cent of respondents perceived the Next Generation Banknote (NGB) series as sufficiently secure against counterfeiters, compared with 67 per cent in 2019. In addition, 77 per cent of respondents noted they liked the new banknotes, similar to the 2019 results. The counterfeiting rate was 10 counterfeits per million banknotes in circulation in 2020/21, which is lower than in recent history. It is also low by international standards.
	· meet banknote demand	Fulfil more than 95 per cent of banknote orders from commercial banks within three days of request.	One hundred per cent of orders were fulfilled on the day requested in 2020/21. In response to the increased lockdown restrictions in Victoria during the COVID-19 pandemic, the Bank made available its contingency distribution site in Sydney for a short period in late July and early August in order to meet public demand.
	· increase security of Australian banknotes	Complete NGB program with the issuance of a new $100 banknote with upgraded security features.	The new $100 banknote, released on 29 October 2020, was the final denomination to be upgraded as part of the NGB program.

Key objectives	Key activities	Performance measures and targets	Results
	· ensure high-quality banknotes.	Banknote production orders by the Bank to be met by Note Printing Australia Limited (NPA) within agreed quality parameters.	Sixty-six per cent of orders were met by NPA on time and to the required quality standard in 2020/21. The shortfall was due to an agreed deferral to assist NPA in meeting export orders, and minor delays in the production of banknotes due to the COVID-19 pandemic.
		Maintain quality of banknotes in circulation above the minimum quality standard agreed with industry.	The measurement of the quality of banknotes in circulation was interrupted by the COVID-19 pandemic. From the smaller sample of banknotes obtained, quality remains good.

Price stability and full employment

Purpose

It is the duty of the Reserve Bank Board to ensure that the monetary and banking policy of the Reserve 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

(c) the economic prosperity and welfare of the people of Australia.

In support of this, the *Statement on the Conduct of Monetary Policy* agreed by the Treasurer and the Governor confirms the Bank's continuing commitment to achieving consumer price inflation between 2 and 3 per cent, on average, over time, consistent with its duties under the *Reserve Bank Act 1959*. Achieving the inflation target preserves the value of money and facilitates strong and sustainable growth in the economy over the longer term. This assists businesses and households in making sound investment decisions, underpins the creation of jobs and protects the savings of Australians.

Sustaining high employment means not only do more people have jobs, but they also have greater opportunities in life. High rates of unemployment are costly for the economy and hurt our society.

The Bank's operations in domestic financial markets are conducted to implement the monetary policy decisions of the Reserve Bank Board and to ensure that there is sufficient liquidity in the domestic money market every day. These domestic market operations promote the objectives of monetary policy and the stable functioning of the financial system.

The Bank's foreign reserves are held to give the Bank the capacity to intervene in the foreign exchange market, consistent with the objectives of monetary policy. In particular, the foreign reserves enable the Bank to address any apparent dysfunction in the foreign exchange market and/or a significant misalignment in the exchange rate. Such interventions occur rarely.

Results

Assessing the conduct of monetary policy during 2020/21 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 Bank's objectives. The Bank has taken a number of complementary policy actions to support the Australian economy since the onset of the COVID-19 pandemic. The policy response has evolved over this period as information about the extent of the pandemic and its economic impact has unfolded. During 2020/21, the Bank lowered its policy interest rate to near zero, lowered the target for the three-year government bond yield (which was introduced in March 2020), enhanced its forward guidance, commenced a program of purchasing government bonds and provided long-term low-cost funding to the banking system.

Consumer price inflation has averaged around 2½ per cent over the inflation-targeting period. However, in the five years prior to the pandemic, consumer price inflation averaged around 1¾ per cent, which was below the Bank's 2 to 3 per cent target. Headline inflation briefly turned negative in the June quarter of 2020 owing to the effects of declining oil prices and government policy measures to reduce household expenses, such as the temporary introduction of free childcare. Headline inflation then increased to 3¾ per cent over the year to June 2021 as these temporary policy measures were unwound and fuel prices returned to around pre-pandemic levels. Looking through the volatility, measures of underlying inflation were around 1¾ per cent over the year to June 2021. At the time of the August *Statement on Monetary Policy*, headline inflation was forecast to ease to below 2 per cent in 2022 before picking up gradually to be a little above 2 per cent by the end of 2023.

GDP growth was strong over the year to the June quarter of 2021, with GDP returning to its pre-pandemic level by early 2021 as the economy rapidly recovered from the COVID-19 downturn. Employment also rebounded strongly over the past year. The unemployment rate declined to around 5 per cent by mid 2021, which was around its pre-pandemic level and well below the peak of 7½ per cent in mid 2020.

In mid March 2020, in response to the economic disruption caused by the spread of COVID-19, and with interest rates already at very low levels, the Bank announced a package of policy measures to help support the economy. It did this by further lowering funding costs across the economy, supporting the provision of credit (especially to small and medium-sized enterprises (SMEs)), ensuring that the financial system had sufficient liquidity and that key financial markets functioned smoothly. The measures were introduced as part of a substantial, coordinated and unprecedented policy response by governments and financial regulators. The Bank's policy response comprised the following elements:

- a reduction in the cash rate target to 0.25 per cent, or 25 basis points, having already reduced the cash rate to 0.50 per cent at the Board meeting on 3 March 2020
- a target for the yield on the three-year Australian Government bond of around 0.25 per cent, supported by Bank purchases of government bonds in the secondary market as required to achieve this target
- Bank purchases of Australian Government bonds and bonds of the state governments as required to address dislocations in these markets
- expanding the Bank's daily market operations in size and in maturity to ensure financial institutions had plentiful liquidity

- a Term Funding Facility (TFF) for the banking system, under which funds equivalent to 3 per cent of lending could be borrowed from the Bank for three years at 25 basis points (against eligible collateral). Banks could draw down on their allowances up until the end of September 2020. The TFF made additional funding available for banks that increased lending to businesses, to provide an incentive to support lending, particularly to SMEs
- modifying the interest rate corridor system so that balances held in Exchange Settlement Accounts (ESAs) at the Bank earned an interest rate of 10 basis points, instead of zero.

The Reserve Bank Board indicated that it did not plan to increase the cash rate target, or change the target on the three-year Australian Government bond yield, until the economy was making progress towards full employment and the Board was confident that inflation would be sustainably within the 2 to 3 per cent target band.

In September 2020, as the deadline for the drawdown of funding under the TFF approached, the Board decided to expand the TFF to provide additional low-cost funding equivalent to 2 per cent of lending in the banking system. It also decided to extend the drawdown period for this, as well as the additional funding linked to business lending, to June 2021.

In October 2020, the Board adjusted its forward guidance to focus on actual outcomes for inflation, rather than expected outcomes, in guiding its future policy decisions.

In November 2020, the Board decided on a further package of measures to support the economy, given the assessment that Australia was facing a prolonged period of high unemployment and inflation was unlikely to return sustainably to the target range of 2 to 3 per cent for at least three years. The measures comprised:

- a reduction in the cash rate target, the three-year yield target and the interest rate on new drawings under the TFF to 10 basis points, from the previous rate of 25 basis points
- a reduction in the interest rate on Exchange Settlement (ES) balances to zero, from the previous rate of 10 basis points
- the introduction of a program of government bond purchases, focusing on the five to 10-year segment of the yield curve. The Bank committed to purchasing $100 billion of government bonds over the following six months in the secondary market, purchasing bonds issued by the Australian Government (AGS) as well as by the Australian states and territories (semis).

Towards the end of 2020, the Reserve Bank Board reviewed the forecasts and monetary policy decisions it had taken over the previous year, including the reasons behind forecast errors. Economic growth had been well below what had been expected in the November 2019 forecasts, owing to the extraordinary economic contraction following the onset of the COVID-19 pandemic. While a global pandemic was a known risk, its timing could not be predicted.

In February 2021, to provide further support to the recovery in the Australian economy, the Board announced that it would purchase an additional $100 billion of government bonds, after the first program of $100 billion was completed in mid April.

The Bank's operations in domestic markets met their performance targets in 2020/21:

- the cash rate was within the interest rate corridor around the cash rate target each business day
- the three-year Australian Government bond yield was consistent with the target other than for brief periods[1]
- the Reserve Bank provided $188 billion in low-cost, three-year term funding to the banking system through the TFF before it closed to new drawdowns at the end of June 2021
- the Bank used daily market operations and maintained sufficient liquidity for financial institutions to access
- the Bank purchased government securities as required to support the smooth functioning of government bond markets.

These actions promoted the objectives of monetary policy and the stable functioning of the financial system by contributing to: very low funding costs; a banking system with high liquidity; very low bond yields; an Australian dollar exchange rate lower than would otherwise have been the case; and stronger household and business balance sheets. Conditions in the foreign exchange remained orderly and the Bank did not need to intervene.

In July 2021, with the economic recovery in Australia stronger than earlier expected and forecast to continue, the Board announced that it would:

- retain the April 2024 bond as the bond for the yield target and retain the target of 10 basis points
- continue to purchase government bonds after the completion of the current bond purchase program in early September, at the rate of $4 billion a week until at least mid November 2021
- maintain the cash rate target at 10 basis points and the interest rate on ES balances of zero per cent.

In September 2021, the Board announced that it would purchase bonds at the rate of $4 billion a week until at least February 2022. This decision was in response to the delay in the economic recovery and the increased uncertainty associated with the outbreak of the Delta variant. GDP was expected to decline materially in the September quarter of 2021 and the unemployment rate was expected to move higher in the period ahead. But this setback to the economic expansion was expected to be temporary, with the Delta outbreak expected to delay, but not derail, the recovery.

The Board remains committed to maintaining highly supportive monetary conditions to support a return to full employment in Australia and inflation consistent with the target. It will not increase the cash rate until actual inflation is sustainably within the 2 to 3 per cent target range.

The Governor's statement and the minutes following each monetary policy meeting of the Reserve Bank Board provide further details of the Board's assessment of economic developments, the outlook and monetary policy decisions. A brief summary of analysis by the Bank of these issues is provided below. Further details of this analysis are provided in the 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.

[1] The three-year bond yield declined below the target rate of 25 basis points in the period between mid September and early November, with the yield reflecting market participants' expectations of a further easing in the target rate (which was announced after the November Board meeting). The three-year bond yield was below the target of 10 basis points for a brief period in mid June 2021, reflecting prevailing market pressures at the time.

Analysis

On average, consumer price inflation was below the Bank's target in the five years prior to the COVID-19 pandemic. Low inflation had also become the norm internationally during this period, with many advanced economies recording average inflation outcomes below 2 per cent. Several factors have contributed to low inflation in Australia and internationally. Many countries experienced a prolonged period of spare capacity in the labour market. In Australia, the unemployment rate was relatively low by historical standards, but the unemployment rate that would typically generate meaningful upward pressure on wages growth is likely to have been lower than it was in the past. Underemployment, measured as workers who are willing and able to work additional hours, may have also contributed to subdued upward pressure on wages growth in Australia over this time. Additionally, globalisation and advances in technology affected the level of prices in many countries for much of the past decade. This occurred through increased competition for a wide range of goods and services and reductions in the cost of production.

The COVID-19 pandemic dramatically shifted the economic landscape both in Australia and abroad. Measures implemented to contain the spread of the virus resulted in very large economic contractions in most economies over the first half 2020. The sharp contraction in activity came at a time when inflation pressures were already subdued. The outlook for the global economy deteriorated significantly and involved a high degree of uncertainty. The main source of uncertainty related to the evolution of the virus and potential medical advances.

A global recovery commenced in the second half of 2020 and continued in the first half of 2021. Progress with vaccinations, additional fiscal policy support in many economies and ongoing accommodative monetary policy supported the recovery. Even so, the outlook has remained highly uncertain and is expected to be uneven for some time. The economic recovery in many countries, including Australia, has been disrupted by a resurgence in COVID-19 cases, which has prompted renewed restrictions on activity in many countries with lower vaccine coverage. GDP remains well below its pre-pandemic trajectory in most economies. Consumer price inflation pressures have risen, partly reflecting pressures related to rapid economic reopening, bottlenecks in supply chains and other pandemic-related factors. Further out, inflation in advanced economies will hinge on how quickly the spare capacity in labour markets is absorbed.

The contraction in the Australian economy over the first half of 2020 was very large by historical standards, though not quite as large as initially feared. The trajectory of economic recovery in Australia remained highly uncertain throughout the second half of 2020, given the possibility of fresh outbreaks of the virus and uncertainty around the willingness of households to spend and firms to rehire workers. However, the recovery in the domestic economy was much stronger than the Bank had expected in mid 2020. Relatively favourable outcomes in containing the virus meant restrictions on activity were less disruptive than earlier feared. Another factor was the very significant fiscal policy support in Australia. The level of output rebounded to be above its pre-pandemic level by the March quarter of 2021, although this was still some way below the pre-pandemic trajectory for the economy.

The necessary containment measures that were introduced to limit the spread of the virus in Australia added to spare capacity in the labour market during 2020, as seen in the marked rise in unemployment and underemployment rates in the middle of the year. It was highly uncertain how quickly this spare capacity would decline. As with activity, the improvement in the labour market was much faster than expected, with the unemployment rate declining to its pre-pandemic rate of around 5 per cent in mid 2021.

Recent outbreaks of the Delta variant in parts of Australia, and the resulting lockdowns, have introduced a high degree of uncertainty to the outlook for the second half of 2021. Activity will contract in the September quarter and job losses are expected. Towards the end of this year, the economic recovery is expected to resume as restrictions ease, as it has from previous lockdowns. While the Delta variant is likely to require a more measured reopening of the economy in affected areas than in the past, the Australian economy entered this challenging period in a strong position and fiscal policy is directly supporting households and businesses in the affected areas.

Wages growth, which had been unusually slow prior to the pandemic, was still around record low levels in mid 2021 – in part as a result of some private sector employers introducing wage freezes or pay cuts in the initial phase of the pandemic, as well as public sector wages caps. Measures of underlying consumer price inflation have also remained subdued and, unlike measures of economic activity, wages and underlying inflation outcomes have been broadly as forecast over the course of 2020/21.

The Reserve Bank Board has remained flexible and has adjusted monetary policy settings on a number of occasions to support the economy through the pandemic and the recovery. Actions included: lowering the targets for the cash rate and the three-year government bond yield; lowering the cost of the TFF and increasing and extending the facility; and introducing a bond purchase program in November 2020 to lower bond yields (and risk-free rates) and the exchange rate relative to where they would otherwise have been in the absence of the program. These actions have supported the economic recovery. The policy measures are designed to assist the recovery transition into strong and durable economic growth, with low unemployment and faster growth in wages than observed in recent years. Over time, this will help achieve the inflation target.

The Bank has also remained flexible in the course of achieving its operational targets in the changing environment and has successfully implemented the policy measures as directed by the Board. This included responding on a number of occasions to market conditions to achieve the three-year yield target, through market actions or communication. As banking sector liquidity increased as a result of the bond purchases and the TFF, demand for liquidity through the Bank's regular market operations declined.

The stability of the financial system

Purpose

The Reserve Bank has a responsibility for fostering overall financial stability in Australia. Given the serious damage to employment and economic prosperity that can occur in times of financial instability, the Bank has long had an implied mandate to pursue financial stability. The Treasurer and the Governor recorded their common understanding of the Bank's longstanding responsibility for financial system stability as part of the *Statement on the Conduct of Monetary Policy*.

The Bank works with other regulatory bodies to foster financial stability. The Governor chairs the Council of Financial Regulators (CFR), which brings together the Reserve Bank, the Australian Prudential Regulation Authority (APRA), the Australian Securities and Investments Commission (ASIC) and the Australian Treasury. The CFR is a non-statutory body whose role is to promote the stability of the Australian financial system and support effective and efficient regulation by the financial regulatory agencies. The CFR draws on the expertise of other non-member government agencies where appropriate, and meets jointly with the Australian Competition and Consumer Commission (ACCC), AUSTRAC and the Australian Taxation Office at least annually to discuss broader financial sector policy. 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

Australia's financial system remained resilient in the face of the severe shock triggered by the COVID-19 pandemic and has continued to play an important role in supporting the broader economy. With financial markets more settled by the start of 2021, the focus was primarily on assessing the effects of the deep economic contraction on households and businesses, and in turn the interdependencies between those sectors and the financial system. The financial system had entered the pandemic in a strong position following a period of reform in response to the Global Financial Crisis (GFC). This strength, coupled with broad policy measures, including the Reserve Bank's policy actions, to assist the availability of low-cost funding, meant the financial system was well placed to support the household and business sectors through the disruptions caused by the pandemic. In particular, banks were able to offer loan repayment deferrals (which peaked at around 9 per cent of housing and small business loans) and to manage some deterioration in loan quality as deferrals expired and some government support measures were progressively unwound through the course of the year. In addition, the superannuation industry accommodated households' withdrawals of $36 billion of funds through the early access to superannuation scheme.

The combination of financial sector and public sector support, along with relative success in controlling the spread of the virus in Australia in 2020/21, meant that households and businesses had sound, and in many cases improved, financial positions in mid 2021 (prior to the delta outbreak). Household saving and the liquidity of businesses both increased. Business insolvencies were suppressed for a period of time by a moratorium, and changes to the insolvency regime made insolvency processes more efficient for smaller businesses, reducing the likely effect on creditors. Importantly, while banks' asset quality deteriorated a little, this was mild relative to earlier expectations, and banks had previously increased their provisions to absorb future defaults. In many cases, banks have been able to release some of those provisions.

The Reserve Bank's pursuit of financial stability over 2020/21 was again in close coordination with the other agencies on the CFR, which has provided a highly effective forum for discussing and assessing developments, potential risks and policy actions. The CFR increased the frequency of meetings during the early stages of the pandemic, given the rapid pace of developments and heightened need for policy coordination. The increased tempo extended into early 2020/21, but, with more settled conditions, meetings later reverted to their typical quarterly cycle. The Bank also worked jointly with APRA on banks' recovery and resolution planning, and as part of this, communicating the Bank's requirements for the potential provision of Exceptional Liquidity Assistance (ELA).

Strong focus areas for the CFR during the year involved assessing the effects of the unwinding of support measures on households and businesses, along with credit conditions for small businesses. More recently, the CFR has been closely monitoring developments in household borrowing, lending standards and the housing market, given the extended period of highly accommodative policy settings. While there have been some signs of increased risk-taking, lending standards overall have remained sound. Risks could also build if growth in household borrowing substantially outpaced growth in income. The CFR agencies discussed potential policy options to address these risks.

The CFR's quarterly media statements have become an important communication tool, with the CFR able to present its assessment of financial system developments and draw attention to areas where the financial sector can contribute to financial stability.

The Bank continued to contribute to financial stability through its own public communication, especially its *Financial Stability Review*. The Reviews issued in October 2020 and April 2021 presented to financial sector participants and the wider public the Bank's views about the ongoing effects of the pandemic on banks, households and businesses. The focus of the *Financial Stability Review* evolved with the health, economic and financial circumstances during the year. In the October 2020 Review, the Bank discussed the potential negative effects on the financial system if the pandemic induced a severe economic contraction. However, it also highlighted the fact that households and businesses had been cushioned by support measures and that Australian businesses generally had low levels of debt going into the crisis. Equally, banks had high capital levels, were profitable and most of their loans were well-secured. By the time of the April 2021 Review, it was clear that the economy had fared better than earlier expected. Risks to the financial system had diminished and, as a consequence, the sector was well placed to continue to support a recovery. Nonetheless, the Bank stressed that income levels had not recovered for some borrowers, which increased the likelihood that they would exhaust their financial buffers and ultimately default. A rise in global and domestic asset prices, underpinned by low interest rates, would be a risk to financial stability if accompanied by rapid growth in debt and weaker lending standards.

The Bank also drew attention to non-pandemic related risks affecting the financial system – in particular, climate change and cyber attacks. Climate change presents an ongoing challenge for the financial system, by exposing it to risks that will rise over time and, if not addressed, could become considerable. The Bank is working with APRA and other CFR agencies to better understand these risks, including by contributing to APRA's assessment of the vulnerability of Australia's five largest banks to the financial risks stemming from climate change. Regarding cyber attacks, there were increasing examples of operational disruptions in financial market infrastructures (FMIs) over the past financial year. These were areas of particular concern for the Bank given its supervisory and oversight responsibilities for FMIs (see 'A secure, stable and efficient payments system' below).

As economic and financial conditions improved in major economies (with reduced COVID-19 case numbers and vaccine rollouts), the G20, the Financial Stability Board (FSB) and other international regulatory bodies shifted their efforts from crisis response to supporting the recovery while adjusting policy settings. The Bank is a member of the G20, the FSB and several other international regulatory bodies, and during 2020/21 contributed to their pandemic-related work. The latter entailed several elements. One has been an assessment by the FSB of the major market turmoil at the beginning of the pandemic. Another was to assess whether to extend, amend and, eventually, end support measures (such as loan repayment deferrals and restrictions on bank dividend distributions), and how to do so without jeopardising the recovery or the supply of credit to the economy. More recently, the FSB has examined preliminary lessons from the pandemic, with an emphasis on identifying aspects of the G20's financial regulatory reforms following the GFC that may warrant further consideration at the international level. The Bank's involvement in these global bodies is often at the level of the Governor and other senior executives, with other Bank staff members participating in several other international working groups. For further information, see chapter on 'International Financial Cooperation'.

Analysis

The resilience of the financial system allowed it to support the economy during the pandemic. This resilience was supported by reforms following the GFC that required banks to hold more capital and liquid assets, which meant banks were easily able to meet the demand for credit during the pandemic. The improvement in lending standards in Australia for property from the mid 2010s helped to ensure borrowers were better placed to weather the economic shock over the previous year. Households and businesses were generally in a strong financial position at the onset of the pandemic, and this resilience has continued.

Unprecedented levels of support by the public and private sectors complemented this underlying resilience. Such support aided household and business balance sheets, and wider confidence in the community, thereby helping to maintain financial stability.

As direct powers over financial institutions rest with other agencies, the CFR is an important channel for meeting the Bank's financial stability mandate. Throughout 2020/21, the CFR helped members form more complete assessments of developments and policy issues and to coordinate policy responses.

The Bank's analytical contribution to the CFR, and in external communications such as the *Financial Stability Review*, is based on detailed research and analysis. The Bank strives to improve these continually, so as to better understand trends and, in particular, distributions within those aggregate trends. Ongoing access to APRA's supervisory data has been critical to monitoring and understanding the impact of the pandemic on Australian banks, and on their levels of capital, liquidity and non-performing loans. Through its close collaboration with APRA, the Bank was able to receive, process and analyse new APRA collections of banking data (the 'crisis collections') on loan repayment deferrals, provisions, liquidity and capital.

Another way the Bank assessed the financial health of banks during the year was through stress tests. The Bank's 'top-down' stress test model uses balance sheet data for selected banks (supplemented with other data such as the Bank's dataset of securitised mortgages). A key advantage of top-down stress testing models is that they can be used quickly and efficiently to consider banks' capital position under a range of scenarios, which has been especially useful given the rapidly changing conditions over the past year. The results of the Bank's stress tests were reported in the October 2020 *Financial Stability Review* and indicated that, even in a prolonged recession, banks' capital levels would remain above minimum requirements. The Bank also continued to develop its ability to stress test the household and business sectors, taking advantage of a growing body of microdata, with the results published in the *Financial Stability Review*. The Bank continues to improve its data sources and data management. Better data management is enabling greater automation, as well as new techniques in data visualisation and analysis.

A secure, stable and efficient payments system

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 Bank's policymaking role, it is the duty of the Payments System Board to ensure that the Reserve Bank's payments system policy is directed to the greatest advantage of the people of Australia, and 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

(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 Reserve 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 and securities settlement facilities, which are key components of the infrastructure that supports financial markets. The Bank's payments policy area also acts as overseer of Australia's high-value payment system, the Reserve Bank Information and Transfer System (RITS).

The Bank's operational role in the payments system is effected through its ownership and management of RITS (including the Fast Settlement Service (FSS)), 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.

Results

The Reserve Bank has continued to monitor the effects of its policy and regulatory settings on competition and efficiency in the payments system. In 2020/21, the Bank continued work on its comprehensive Review of Retail Payments Regulation, which started in late 2019. A consultation paper with preliminary conclusions (and associated draft standards) was published in May 2021 and, after incorporating feedback from the consultation, the Bank is expecting to complete the Review in the second half of 2021.

As part of the Review, the Bank has proposed a number of policy measures aimed at keeping downward pressure on merchant payment costs and promoting competition between card schemes. The Bank is continuing to encourage the provision of least-cost routing (LCR) functionality, whereby merchants can choose to route transactions on dual-network debit cards to the lowest cost-processing network. While all of the major acquirers are now offering some form of LCR functionality, the Bank is proposing that all entities that provide card acceptance services to merchants offer and promote LCR in the card-present (in-person) environment. In addition, the Bank has proposed a set of principles aimed at encouraging the development of LCR functionality in the online environment, which has become feasible now that eftpos' online transaction capability has been developed. To support the viability of LCR, the Bank has also proposed a policy framework to encourage the continued issuance of dual-network debit cards, including an expectation that the major banks (at least) will continue to issue them.

As part of the Review, the Bank has also reviewed its card payments interchange fee and surcharging framework, which helps keep merchant payment costs down. The Bank has proposed some minor changes to the interchange requirements, which will have the effect of lowering the effective interchange rate for lower-value debit transactions. The Bank has also been pursuing a number of measures aimed at improving the transparency of payment costs to merchants and strengthening competition in the provision of acquiring services to smaller merchants.

Besides developments in the card payments market, the Bank has also been examining the introduction of new electronic payment services in the Australian market and any policy issues they raise. A particular focus during 2020/21 has been on the emergence of 'buy now, pay later' services and digital wallets, where the Bank has been considering a number of competition and efficiency issues. The Bank has been continuing to closely monitor changes in the use of cash as a payment mechanism and the availability of cash withdrawal and deposit services. This work is focused on ensuring that Australians who wish to continue using cash are able to access it easily.

The Bank has continued to pursue a research agenda focused on exploring the case for, and implications of, issuing a central bank digital currency (CBDC). In 2020/21, the Bank completed a project in collaboration with a number of external partners to develop a proof-of-concept for a wholesale CBDC; a report on the project is forthcoming.

In May 2021, the Australian Government announced that it would introduce reforms to the regulation of FMIs. The aim of the reforms is to ensure that the Australian financial system is supported by resilient, efficient and stable FMIs. The reforms include enhancements to the licensing regimes for clearing and settlement (CS) facilities and stronger supervision and enforcement powers for ASIC and the Reserve Bank. The reforms also include crisis management powers over Australian CS facilities. The CFR commenced a consultation on the proposed reforms in November 2019 and provided advice to the government in July 2020 recommending a package of reforms, which was accepted.

The Bank published annual assessments of each of the licensed CS facilities (with the exception of the Chicago Mercantile Exchange Inc (CME)) as part of its ongoing oversight of these facilities. Assessments were published for the ASX CS facilities in October 2020 and for LCH Limited's SwapClear service in December 2020. In these assessments, the Bank judged that the entities had conducted their affairs in a way that causes or promotes overall stability in the Australian financial system, and had made progress against regulatory priorities set by the Bank. The Bank also set out a series of regulatory priorities for each of the facilities for the subsequent year. The CME assessment has moved to a two-yearly cycle, taking into account the entity's profile in Australia, with the Bank's next assessment expected to be published in 2022/23. In June 2021, the Bank published its annual assessment of RITS against the Principles for Financial Market Infrastructures, concluding that RITS observed all relevant principles other than the principles on participant-default rules and procedures and on operational risk, which were assessed to be broadly observed by RITS.

In support of the Bank's oversight approach and its policy framework, Bank staff also participated in international policy development on crisis management and resilience of FMIs and monitoring the implementation of international standards. No change was required to domestic regulatory standards in 2020/21 as a result of international developments. However, in February 2021, the Bank revised its guidance on its supervisory approach for systemically important domestic CS facilities. The Bank's approach will be to undertake a few deep-dive reviews on specific issues each year as part of its assessment of these facilities against the Financial Stability Standards and to conduct a joint assessment with ASIC against the Principles for Financial Market Infrastructures every five years.

As the owner and operator of RITS, the 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. For RITS, the system availability target is 99.95 per cent during core system hours; for FSS, the system availability target is 99.995 per cent on a 24/7 basis. In 2020/21, both systems achieved their targets, with RITS and FSS availability at 99.96 and 99.999 per cent respectively. FSS met its target to complete settlement of most transactions in less than one second, with 95 per cent of FSS transactions processed in 56 milliseconds or less.

A multi-year refresh of core network and application infrastructure of RITS and related systems was completed in 2020/21, ensuring that RITS continues to meet the needs of the payments industry. These upgrades aim to enhance the security, resiliency and functionality of RITS – for example, by enabling higher throughputs and site failover mechanisms in the event operations at an active site are disrupted. Other continual improvement programs involve upgrades aimed at meeting member requirements, streamlining billing procedures, managing potential cyber risks and improving software patch management.

In line with promoting the efficiency of the payments system, the Bank continues to be actively involved in the industry-led migration to the ISO 20022 standard as both an operator and participant of related payments infrastructure. With the project moving to the build phase in the second quarter 2021, the Bank remains on schedule and continues to liaise with the payments industry in relation to message formats and internal system builds. The migration project is governed by an industry steering committee comprising senior industry representatives, including one from the Bank. In the spirit of harmonised messaging standards, the Bank is also in the early stages of migrating legacy messages used by some batch administrators as well as the RITS Automated Information Facility (AIF) to the ISO 20022 standard. The AIF is a proprietary tool enabling RITS members to automate ESA credit and liquidity management in RITS within their own systems and to receive overnight account statements. To minimise the disruption of migration to members, the new message standards will be introduced in phases, including an industry-agreed coexistence phase.

The Bank is committed to ensuring that RITS is well protected from cyber attacks and has an ongoing program of work to maintain high levels of cyber resilience. In July 2020, the Bank's payment settlement systems were recertified under the ISO 27001 standard for Information Security Management and, in December 2020, the Bank completed its independently assessed compliance attestation to the SWIFT Customer Security Controls Framework, with full compliance to all mandatory controls. An independent risk assessment of the Bank's end-point security standards for RITS members and feeder systems was completed in December 2020. The current RITS member security requirements are in the process of being updated in line with the review's recommendations. During 2020/21, the Bank also participated in various working groups promoting industry coordination in managing cyber risks and related contingency measures.

The Bank continued to focus on working with industry participants to achieve outcomes that are in the public interest, with regulatory activity contemplated only when an appropriate industry response was not forthcoming. The Bank conducted its annual assessment under the Australian Government's Regulator Performance Framework, which was published in February 2021.[2]

Developments in the Australian payments system and the Bank's recent policy activities are discussed further in the *Payments System Board Annual Report 2021*.

Analysis

The Reserve Bank's work in the payments area in 2020/21 occurred in an environment that was continuing to change rapidly. There has been a continued shift in consumer payments away from the use of cash and cheques and towards cards and other electronic means of payment, which has accelerated in response to the COVID-19 pandemic. There has been rapid technological change and innovation, with new payment products and services being adopted, and the entry of new players into the payments system. These changes can improve the convenience and security of payments to end users, but can bring particular risks and competitive issues into sharper focus.

New technologies also have the potential to transform payment services and the operations of FMIs. The long-term decline in the use of cash for transactions has highlighted the importance of maintaining secure, resilient and competitive electronic payment services. The security environment for payments and FMIs has been evolving, with the growing digitisation of payments raising various types of fraud, scams and cyber risks that need to be managed in order to support confidence in the community. Bank staff liaise actively with the private sector to better understand trends in these areas and their implications, and have participated in a range of domestic and international working groups with other regulators.

The introduction of contingency measures at the onset of the COVID-19 pandemic ensured there was minimal disruption to the settlement services provided through RITS and related systems. These measures included work-from-home arrangements for the majority of staff, changes to staff resourcing, and critical personnel operating at physically isolated sites. The Bank also engaged external members and operators to understand whether they were well prepared to manage the pandemic situation and ensure the smooth settlement of payment obligations. As a result of the measures taken by both the Bank and RITS members, operational risk throughout the pandemic period appears to have been well managed, thereby supporting Australia's financial system in a period of considerable uncertainty.

[2] See RBA (2021), '2019-2020 Assessment under the Regulator Performance Framework', February. Available at <https://www.rba.gov.au/payments-and-infrastructure/regulator-performance-framework/pdf/2019-20-assessment-under-the-regulator-performance-framework.pdf>.

The delivery of efficient and effective banking services to the Australian Government

Purpose

Insofar as the Commonwealth of Australia requires it to do so, the Reserve Bank must act as banker for the Commonwealth. The Reserve Bank's banking services fall into two categories: those services provided in its capacity as the central bank; and those transactional banking services it provides to Australian Government agencies. 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. The banking services offered to the Australian Government and other central banks include payments and collections, as well as general account maintenance and reporting services.

Results

In providing banking services to Australian Government agencies, the Reserve Bank must cost and price these services separately from its other activities. In addition, the return on providing these services must achieve a minimum rate of return on capital over the medium term. At present, this measure is equivalent to the 10-year yield on Australian Government Securities plus a margin for risk, and is the Bank's principal measure of financial performance for the transactional banking business. In 2020/21, the Bank met its target rate of return. Pro forma accounts for the transactional banking business can be viewed in the chapter on 'Banking and Payment Services'.

As the provider of the Commonwealth's Official Public Account, the Bank works closely with both the Department of Finance and the Australian Office of Financial Management (AOFM) to ensure the services associated with management of this account remain fit for purpose. Work between the Bank and the Department of Finance to modernise Commonwealth cash management continued in 2020/21, with new AOFM cash management arrangements commencing in November 2020. Under the new arrangements, the AOFM has transitioned from the use of a term deposit facility to a cash management account. This change will provide the government with greater flexibly and operational efficiency in the management of funds.

During 2020/21, the Bank's upgraded banking systems and New Payments Platform (NPP) capabilities facilitated the processing of a larger-than-usual volume of payments. This included a number of emergency flood relief payments and COVID-19 stimulus payments on top of normal business activities. In particular, a significant volume of emergency flood relief payments were made on weekends using NPP, where previously payments had primarily been made during business hours, Monday to Friday. In addition, the Bank has continued to participate in the ongoing industry work to further develop NPP services, particularly a new payment mandate service, known as PayTo.

Analysis

The COVID-19 pandemic required the Bank to shift its service delivery focus from a number of ongoing payment initiatives towards the urgent processing and delivery of support and stimulus payments to the Australian public. This comprised a range of stimulus payments to businesses and consumers affected by the pandemic and included a record number of Australian Government payments distributed in a single day in July 2020. This was achieved during a period of changed working conditions, with the majority of the Bank's staff working remotely at the time.

As a consequence of the focus on stimulus delivery and the other related effects of the pandemic, there were some minor delays in progress with new payment initiatives during the first half of the reporting period. However, work on these initiatives, including new customer use cases for NPP, recommenced through the second half of the period.

During 2020/21, the Reserve Bank continued to ensure it remained in a position to respond appropriately to the Australian Government's needs with convenient, secure, reliable and cost-effective central banking and transactional banking services.

The provision of secure and reliable 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 the capacity of Australian banknotes to provide a safe, secure and reliable means of payment and store of value. The Bank works with its wholly owned subsidiary, Note Printing Australia Limited (NPA), to design and produce banknotes. NPA also produces banknotes for other countries and Australia's passports. 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 trends in cash usage and counterfeiting, and conducts research into banknote security technology.

Results

The Reserve Bank aims to fulfil 95 per cent of banknote orders received from the major commercial banks within three days of the request; during 2020/21, 100 per cent of orders were fulfilled on the day requested. The Bank activated its contingency arrangements for three weeks in July/August 2020 with the short-term use of the Sydney site for banknote distribution. This opening was in response to heightened demand for banknotes in the face of domestic transport restrictions associated with the COVID-19 pandemic, and the Bank's intent to ensure there was adequate supply of banknotes across the country and to support the private sector in moving cash to locations where it was needed.

The Bank's key initiative to enhance banknote security has been the release of the new banknote series with upgraded security features. Work on the Next Generation Banknote (NGB) program concluded in 2020/21, with the new $100 banknote entering circulation on 29 October 2020.

The Bank continued to monitor Australian banknote counterfeiting rates, which remained low by international standards. The estimated counterfeiting rate was 10 counterfeits per million banknotes in circulation in 2020/21, down from a peak of around 30 counterfeits per million banknotes in 2014/15. The Bank also continued to monitor international developments in counterfeiting, including through engagement with other central banks and international organisations.

In October 2020, the Bank conducted a survey on perceptions, usage and behaviour related to Australia's banknotes. The results show that public perceptions of Australian banknotes have remained favourable, with 70 per cent of respondents perceiving the NGB series to be sufficiently secure against counterfeiters, up from 67 per cent in 2019. In addition, 77 per cent of respondents noted that they liked the new banknotes, largely unchanged from the 2019 results.

Measurement of the quality of banknotes in circulation was interrupted by the COVID-19 pandemic. The Bank was unable to collect banknote samples from around the country between February 2020 and January 2021. However, banknote samples collected since then suggest the quality of Australian banknotes remains high.

NPA met 66 per cent of the Bank's orders for new series banknotes to the required quality standard and as per the initial annual delivery schedule. The shortfall of 34 per cent was the result of a deferral, as agreed by the Bank, to assist NPA in meeting new export orders, as well as minor production delays owing to the pandemic. These banknotes will be delivered as part of the 2021/22 order. This shortfall in the banknote order did not compromise the Bank's ability to meet public demand or jeopardise its target contingency stock of banknotes.

Analysis

While the proportion of payments made using banknotes is declining relative to electronic payments, the value of banknotes on issue increased notably over 2020/21. This increase was driven in part by ongoing demand for high-denomination banknotes associated with the COVID-19 pandemic, which is likely to reflect the importance of cash as a store of value in times of uncertainty and dislocation. The Reserve Bank has continued to meet demand for banknotes by ensuring orders are fulfilled, including by temporarily making available its contingency distribution site in Sydney in late July and early August 2020. The release of the new series of banknotes with upgraded security features has supported public confidence in banknotes. Australia's level of counterfeiting remains low by international standards.