

## EARNINGS AND DISTRIBUTION

As a consequence of its responsibilities as the nation's central bank, the RBA holds a large portfolio of financial assets which generates substantial earnings. These earnings, net of costs, are distributed as a dividend to the Commonwealth, subject to any transfer from earnings to augment reserves.

Earnings available for distribution have two sources: underlying earnings, and the valuation gains or losses that are realised when assets are sold in the course of implementing monetary policy or in other portfolio management operations.

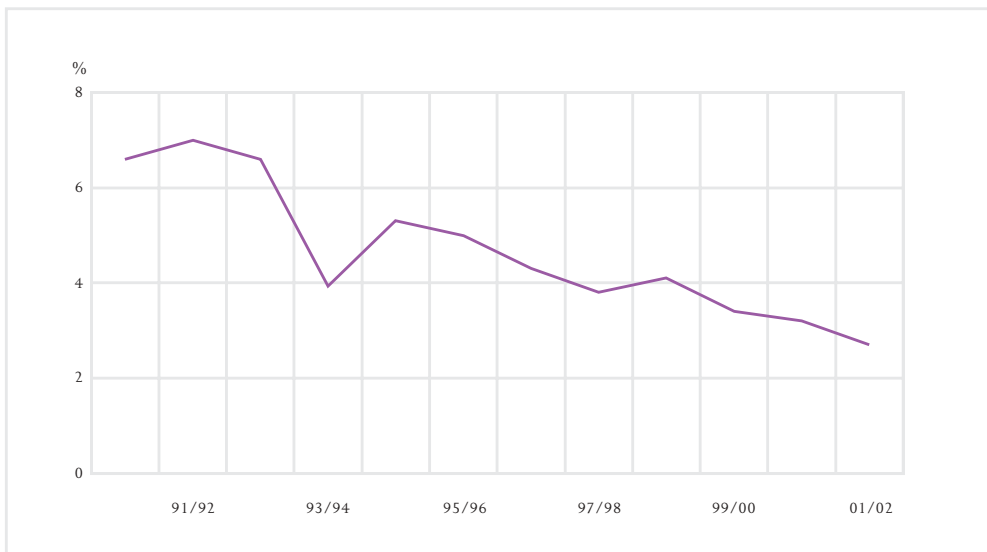
Underlying earnings mainly comprise interest earnings on assets minus interest on liabilities. The moderate sums of other revenue received – such as rent and fee income from providing banking services – add to underlying earnings, while operating costs subtract from them.

Fee and rental income aside, underlying earnings

arise because about two-thirds of the RBA's liabilities are interest-free, while almost all of its assets earn interest. The RBA is the issuer of currency notes in Australia, a liability of some \$31.9 billion on which it pays, for the most part, no interest. Although under new currency distribution arrangements outlined in the chapter on "Business Services", banks are now reimbursed for interest forgone on some of the currency they hold as working balances, this cost is covered since the RBA earns interest from investing the proceeds it receives from banks for these balances. As with the bulk of currency, no interest is paid on capital and reserves of \$9.5 billion.

The size of underlying earnings is largely determined by the interest margin on the portfolio and the size of the portfolio itself. Underlying earnings over the past decade or so have been relatively steady, averaging around \$1.7 billion a year.

GRAPH 22 / RBA'S AVERAGE INTEREST MARGIN



The main reason why these earnings have not tended to increase as the balance sheet has roughly doubled over this period is that the RBA's interest margin has declined, as market interest rates have fallen. The trend in market interest rates has had a much bigger impact on earnings than on interest costs because, as noted, the RBA does not pay interest on a large component of its liabilities.

This trend in the interest margin has been aggravated by an increase in the proportion of liabilities on which the RBA pays interest. This proportion was less than 10 per cent in 1990, whereas the figure is now over 30 per cent. This shift is explained both by the abolition of some liabilities on which the RBA once paid interest at below-market rates – such as Non-Callable Deposits of banks – and because it has also begun to offer deposit facilities which pay a market rate, such as term deposits for the Commonwealth Government.

In 2001/02, the narrowing in the interest margin, as interest rates fell in response to the easing of

monetary policy around the world, saw underlying earnings fall to \$1 400 million, from \$1 629 million in the previous financial year.

The second component of earnings available for distribution from the RBA is the valuation changes that are realised when assets are sold. Valuation gains arise when the price of a security increases due to a decline in interest rates or because the value of the Australian dollar depreciates against the currencies in which the RBA invests. Valuation losses occur when interest rates rise or the Australian dollar appreciates.

Realised gains on the RBA's assets amounted to \$489 million in 2001/02, compared with \$1 205 million in 2000/01. Realised foreign exchange gains were \$496 million, \$247 million lower than in 2000/01 because the Australian dollar exchange rate appreciated for much of the year and the RBA's sales of foreign exchange, including those undertaken on behalf of the Government, were largely covered rather than being met out of portfolio. This reduced the potential for profit from these

#### Sources of Earnings Available for Distribution (\$ million)

	Underlying earnings	Realised gains and losses	Earnings available for distribution
1985/86	1 292	1 371	2 663
1986/87	1 412	2 035	3 447
1987/88	1 508	18	1 526
1988/89	971	-554*	417
1989/90	1 248	-153*	1 095
1990/91	1 322	391	1 713
1991/92	1 516	1 038	2 554
1992/93	1 760	2 803	4 563
1993/94	1 556	-48*	1 508
1994/95	1 649	123	1 772
1995/96	1 784	702*	2 486
1996/97	1 715	1 990	3 705
1997/98	1 750	1 524	3 274
1998/99	1 816	1 860*	3 676
1999/2000	1 511	-708	803
2000/01	1 629	1 205	2 834
2001/02	1 400	489	1 889

\* Includes unrealised losses in excess of previous years' unrealised gains held in reserves

foreign exchange sales. Realised gains on sales of foreign securities were \$53 million in 2001/02, down from \$558 million last year. Lower realised gains on foreign securities reflected a steadier level of market interest rates in major countries than had been the case in the previous year.

Profits for 2001/02 that are available for distribution amount to \$1 889 million.

### ACCOUNTING PROFITS

The RBA calculates its accounting profit according to generally accepted accounting principles, under which all valuation gains or losses – whether realised or unrealised – are included in profit and loss. Movements in interest and exchange rates during 2001/02 saw the RBA record an overall valuation gain of \$468 million. Combined with underlying earnings of \$1 400 million, this yields an accounting profit of \$1 868 million (compared with \$3 149 million in 2000/01).

### RESERVES

As with other financial institutions, the RBA maintains reserves which are available to absorb losses that might arise in the course of its operations. Under the *Reserve Bank Act*, and consistent with best practice for central banks, unrealised gains are not available to be paid to the Commonwealth Government but are transferred to the Unrealised Profits Reserve. Balances in this reserve remain available to absorb future unrealised losses that might arise from unanticipated adverse movements in interest or exchange rates, or they are realised when relevant assets are sold. In 2001/02, the balance in the Unrealised Profits Reserve declined slightly, to a level of \$1 798 million on 30 June 2002.

The RBA also maintains asset revaluation reserves, with the value in these reserves reflecting the amount by which the market value of the RBA's holdings of

gold and property exceed the price at which they were purchased. The amounts in these reserves stood at \$1 520 million at 30 June 2002.

Although balances in the Unrealised Profits Reserve and asset revaluation reserves vary with market prices, the RBA also has a major “permanent” reserve, the Reserve Bank Reserve Fund (RBRF), which has been funded out of past profits and, accordingly, can be viewed as akin to capital. The RBRF is available to cover potential losses from a range of risks, including market risk and other events, such as fraud and operational risks, to which most financial institutions are exposed. At 30 June 2002, the balance of the RBRF stood at \$6 152 million, more than 10 per cent of the RBA's total assets.

The *Reserve Bank Act* provides for the Treasurer to determine, after consultation with the Reserve Bank Board, the amount, if any, to be credited to the RBRF from earnings available for distribution. The balance of distributable earnings is payable to the Commonwealth Government after any such transfers. Since the Board viewed the balance in the RBRF as satisfactory at the end of the financial year, it did not seek a transfer from profits to this reserve. Consequently, all of the earnings available for distribution from 2001/02 will be paid as a dividend to the Commonwealth.

The practice in recent years has been for the RBA to pay the Commonwealth's dividend early in the financial year following that in which it was earned. The exception was in 1998/99, when the Treasurer decided to defer the receipt of some of that year's profits, spreading the dividend over the following two years. The RBA has not made an interim payment from its current year's earnings since 1995/96.

**Reserve Bank Payments to Government (\$ million)**

	Earnings Available for Distribution	Transfers to Reserves	Payments to the Commonwealth				Total Payment
			Balance Available from Current Year's Profit	Interim Payment from Current Year's Profit	Payment from Previous Year's Profits	Payment Delayed from Earlier Years	
1990/91	1 713	210	1 503	400	275	—	675
1991/92	2 554	200	2 354	400	1 103	—	1 503
1992/93	4 563	750	3 813	600	1 954	—	2 554
1993/94	1 508	—	1 508	—	3 213	—	3 213
1994/95	1 772	—	1 772	200	1 508	—	1 708
1995/96	2 486	150	2 336	200	1 572	—	1 772
1996/97	3 705	2 005	1 700	—	2 136	—	2 136
1997/98	3 274	548	2 726	—	1 700	—	1 700
1998/99	3 676	—	3 676	—	2 726	—	2 726
1999/2000	803	—	803	—	3 000	—	3 000
2000/01	2 834	—	2 834	—	803	676	1 479
2001/02	1 889	—	1 889	—	2 834	—	2 834
2002/03	—	—	—	—	1 889	—	1 889

The RBA's financial statements for 2001/02 are presented in the following pages.