

A photograph of a man in a dark suit, white shirt, and red patterned tie, speaking into a microphone at a podium. The background is a soft, out-of-focus blue.

Governor's Foreword

International developments were again a source of concern and uncertainty in 2014/15. The global economy recorded growth, but fell a little short of forecasts from a year earlier. Financial conditions continued to be remarkably accommodative, as major jurisdictions ran extraordinary monetary policy settings in an effort to support demand in their respective economies. Short-term interest rates remained at or near zero and, in some countries, rates on deposits at the central bank fell into negative territory. Long-term interest rates early in 2015 reached the lowest levels ever recorded and in some European countries were negative for terms as long as 10 years. Although the Federal Reserve completed its 'quantitative easing' program some time ago, central bank balance sheets in Japan and Europe are still expanding significantly.

The Chinese economy has slowed, affecting demand for natural resources. This has affected Australia's terms of trade, which have also been driven lower by an increasing supply of commodities, including from Australia. Financial markets returned to more normal levels of volatility as they contemplated, among other things, the events in Greece and the rise and crash of a Chinese equity market bubble.

These were absorbed without widespread spillovers, though it is apparent that financial markets have less underlying liquidity than was the case in earlier periods. Over the year ahead, there will, no doubt, be further news for markets to absorb – not least the approach of higher US interest rates.

The Australian economy recorded moderate growth in 2014/15. As in the world economy as a whole, the growth was a little disappointing, leaving unemployment relatively unchanged at a higher-than-desirable rate. Inflation remained low and, abstracting from the temporary effects of falling energy prices, was consistent with the medium-term target. After a lengthy period of stability in policy settings, the Reserve Bank Board adjusted the cash rate twice during 2014/15, taking it to 2 per cent, the lowest recorded on a sustained basis since the 1950s.

The Reserve Bank continued the build-up of several major projects during 2014/15. As has been noted in previous annual reports, these projects are resulting in a very significant, but largely temporary, increase in costs, with most of the likely outlays still in the future as work to deliver key projects gathers further momentum. These costs are mainly, though not entirely, in the IT area, as the projects

are very technology intensive. Preparations to introduce a series of banknotes with upgraded security features, overhauling the technology architecture that supports banking services to the government, building the Bank's contribution to the New Payments Platform and upgrading the capacity to assess the quality of collateral that may be presented to the Bank at various points of its market operations are all driven by the Bank's Charter obligations. The Bank's staff numbers are commensurately rising, with the IT Department by far the largest in size, employing most additional staff on limited-term contracts.

The cost of running the Reserve Bank's existing operations rose by a little more than 1 per cent in 2014/15. The additional costs from the projects added a further 3.4 per cent. As the full effect of the project workload comes through, total outlays will rise, reaching a peak during 2015/16.

The Reserve Bank's net profit in 2014/15 amounted to \$6.9 billion, a significant rise from the previous year (abstracting from proceeds of the one-off grant received from the Australian Government in that year). As explained in the chapter on 'Earnings and Distribution', the fall in the exchange rate has resulted in substantial valuation gains. Part of these were realised as the Bank's portfolio of foreign reserves turned over, while the unrealised gains are set aside against the risk of future losses or will be realised as relevant assets are sold. Underlying earnings remain low because of low yields on the Bank's portfolio but, at \$832 million, were higher than in the previous year as the Bank's balance sheet expanded and ADIs began paying fees associated with the Committed Liquidity Facility from the beginning of 2015. The full-year effect of these fees will further boost underlying earnings in 2015/16.

Adding the realised valuation gains to underlying earnings results in earnings available for distribution as per the *Reserve Bank Act 1959* of about \$3.5 billion. The Treasurer decided, after consulting the Board, that a sum of about \$1.6 billion from distributable earnings be placed to the credit of the Reserve Bank Reserve Fund, effectively the Bank's capital. Accordingly, this reserve stood at \$12.7 billion at balance date, a strong position given the risks on the Bank's balance sheet. The remainder of distributable earnings, a sum of about \$1.9 billion, will be paid as a dividend to the Commonwealth.

As always, the Reserve Bank's management and staff have performed to a very high standard, under challenging conditions. This was very clearly in evidence during the terrible events at the Lindt Café, adjacent to the Head Office building, in December 2014. The Bank's building was locked down for some hours and was not available the following day, requiring the Business Resumption Site to be used for all the Bank's routine operations. The security and operational areas of the Bank responded admirably to these events, despite sharing the profound sense of loss evident so widely in the community, and all the Bank's normal operations were able to continue without interruption. The Reserve Bank Board and I, personally, record our admiration and appreciation for the skills and dedication of all our people.



Glenn Stevens
Governor and Chair, Reserve Bank Board
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