

TREASURY EXECUTIVE MINUTE

Minute No. 11/2303

6 September 2011

Deputy Prime Minister and Treasurer

RESERVE BANK OF AUSTRALIA 2011 ANNUAL REPORT

Section 22

Recommendation: That you:

- Section 22

Noted

- provide in principle agreement that future profits be used to replenish the Reserve Bank Reserve Fund (RBRF) before any dividends are paid, Section 22

Agreed

- Section 22

Signed

Signature:

201
...../2011

KEY POINTS

- Section 22
- Section 22
- The RBA recorded an accounting loss of around \$4.9 billion in 2010-11, following a \$2.9 billion loss in 2009-10. As a result, no dividend will be paid to the Government in 2011-12, Section 22
 - The loss is primarily driven by unrealised valuation losses on the RBA's foreign reserve holdings resulting from an appreciation of 16 per cent in the exchange rate during the year.
 - Section 22

Section 22

– Section 22

- As previously advised, the loss will be absorbed by the RBRF which will bring the balance of the RBRF significantly below the RBA Board's target level of 10 per cent of the RBA's assets at risk.
 - Governor Stevens wrote to you on 19 July (letter attached) seeking your agreement that profits in future years be transferred to the RBRF to restore its balance to the policy target before any dividend is paid to the Commonwealth Government.

• Section 22

- This approach is consistent with our previous advice to you Section 22
Section 47E

- Section 22

Manager
Monetary and Fiscal Policy unit.

Contact Officer:

Ext:

ADDITIONAL INFORMATION

RBA Dividend and Underlying Earnings

- The Earnings and Distribution chapter of the Annual Report notes that the RBA recorded an accounting loss of \$4,889 million in 2010-11, its second consecutive yearly loss. Underlying earnings from interest receipts were \$897 million in 2010-11, which is low by historical standards, owing to global interest rates remaining low.
 - Realised valuation losses of \$1,135 million were recorded, primarily from the RBA rebalancing its foreign exchange portfolio.
 - Unrealised valuation losses of \$4,651 million were recorded, reflecting an appreciation of 16 per cent in a measure of the exchange rate weighted by the composition of Australia's international reserves.
- The Annual Report states that the net accounting loss was completely absorbed by the RBRF, since no unrealised gains are available in the Unrealised Profit reserve. Consequently, the RBA will not pay a dividend to the Government in 2011-12.
- The Annual Report notes that while the transfer from the RBRF in 2010-11 has reduced the balance in the RBRF to well below that which the Reserve Bank Board regards as desirable, the Reserve Bank Board will seek to replenish this reserve from earnings in future years.
 - Such transfers to the RBRF will need your approval. Your agreement to this approach was formally requested by Governor Stevens in a letter to you dated 19 July 2011.
- Overall, the loss reflects the fact that as a central bank, the RBA holds foreign currency risk through its foreign exchange holdings. As it holds financial assets for policy purposes, it has very limited scope to manage foreign exchange risk and interest rate risk.
 - Accordingly, the RBA incurs valuation losses on its assets when either the exchange rate appreciates or yields on securities rise. Following the substantial gains in 2008-09, when the exchange rate depreciated, the RBA has incurred valuation losses in 2009-10 and 2010-11 as the exchange rate appreciated.

- Section 22

-

-

Suggested talking points*RBA Accounting Loss*

- The accounting loss recorded by the RBA mainly reflects a valuation adjustment on its foreign currency reserves.
 - When the Australian dollar rises, the value of the RBA's foreign currency reserves falls with the value of its assets denominated in foreign currencies. Accounting standards require this to be recognised as a loss whether the loss is realised or not.
 - Abstracting from unrealised valuation losses, the RBA would have recorded a loss of only \$238 million.
- The accounting loss and its associated impact on the RBA's dividend payments is consistent with that already factored into 2011-12 Budget estimates.

• Section 22

•

•

•

•

ATTACHMENT B

Section 22 p6, 7, 8, 9, 10, 11