

Governor's Foreword

After a temporary weak spot in the middle of 2003, the world economic recovery resumed in 2003/04. In Australia it was a year of good growth and low inflation as we completed the thirteenth year of the current economic expansion. In late 2003, when it became clear that the world economic recovery was on track, and the Australian economy was speeding up, the Board took the opportunity to move the cash rate back towards a more neutral level in two quarter point rises. Two additional factors at the time affecting the monetary policy decision-making process were the rapid rise in the exchange rate and the credit-driven overheating in house prices. Both of these abated somewhat in the first half of 2004.

The rises in November and December were the first for around eighteen months. The rate at which interest rates have been increased in Australia has thus been quite gradual by earlier standards. Nevertheless, Australia stands out as the only significant OECD economy in which interest rates were not actually lowered at some stage in 2002 and 2003.

The development of monetary policy during the year has been thoroughly explained in the quarterly *Statement on Monetary Policy*, testimony before the House of Representatives Standing Committee on Economics, Finance and Public Administration, media releases accompanying the changes in monetary policy and speeches by senior officers. For this reason, the Annual Report has for some years now concentrated on giving an account of other activities of the RBA during the year, as well as presenting the financial statements. Among the various activities that occurred during the year, the following are worthy of mention:

In its domestic market operations, the Bank again widened the range of securities in which it will deal in order to cope with the shrinking supply of Commonwealth Government securities. As at March 2004, bank bills and certificates of deposit were made eligible for purchase under repo. Although this involves an increase in credit risk, the magnitude is negligible because banks cannot offer their own paper. In addition they must provide overcover of 2 per cent.

The RBA was very active in its foreign exchange operations in 2003/04, but not in the sense of engaging in foreign exchange intervention aimed at influencing the exchange rate. Instead, the main activity was purchasing foreign exchange to replenish reserves and to provide the Australian Government with its needs, which were particularly heavy during the year as it paid out remaining cross-currency swaps. In the first eight months of the financial year, a period when the Australian dollar rose rapidly, the RBA bought \$7 billion of foreign currency for the Government and \$10 billion to replenish its own reserves.

International co-operation at both the global and regional level was again a major part of International Department's work. The major regional initiative is the development of Asian Bond Fund 2. This fund will consist of bonds issued in local currency by Asian governments, and is the logical extension of Asian Bond Fund 1, which was made up of bonds issued in US dollars by the same governments. Both initiatives are aimed at improving bond markets in Asia and giving Asian investors, initially central banks, a wider range of Asian investment opportunities.

The Financial System Group contains two departments – Payments Policy Department and System Stability Department. The former advises the Payments System Board which publishes its own Annual Report. During the year, the court case brought by Visa and MasterCard challenging the reform of credit card schemes in Australia was unsuccessful and costs were awarded to the RBA. In February 2004, the Payments System Board designated a second payment system, namely the Visa debit system. The System Stability Department formerly provided an analysis of the stability of the financial system in this Annual Report. In March 2004, it published a *Financial Stability Review* as a stand-alone document. This will now be a semi-annual publication after tabling before the Council of Financial Regulators, which is chaired by the RBA.

The major development affecting Securrency was the decision by the State Bank of Vietnam to introduce polymer in its note issue. Also, the Bank of Zambia issued two denominations on polymer, the first polymer banknotes issued on the African continent. This, with the very large Vietnamese order, brings to 22 the number of countries which have used polymer for at least some of their note issue, with Chile also having announced its intention to do so in the near future. Note Printing Australia began the printing and assembly of the new Australian passport for the Department of Foreign Affairs and Trade, incorporating a number of new security features.

Work is nearing completion on the Museum of Australian Currency Notes, which will occupy the eastern end of the ground floor of 65 Martin Place. It replaces the existing “ad hoc” display of notes and historical material previously occupying the site, and is expected to open in October 2004.

Staff numbers remained in the eight hundreds for the fourth year in a row, indicating that the level has stabilised after nearly twenty years of falling numbers. An important challenge at present is to establish a consolidated business resumption site in the Sydney region, but well removed from Head Office. This site will be permanently staffed on a revolving basis by staff from a number of departments. It will involve some interesting management and staffing issues, but should contribute significantly, not only to the security of the RBA’s operations, but to the stability of the Australian financial system.