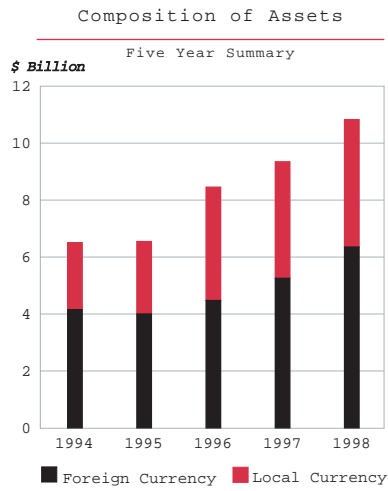
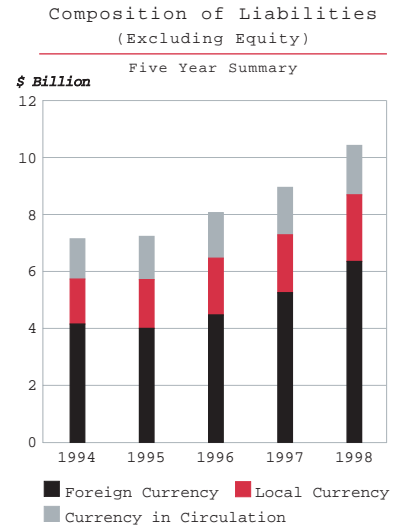




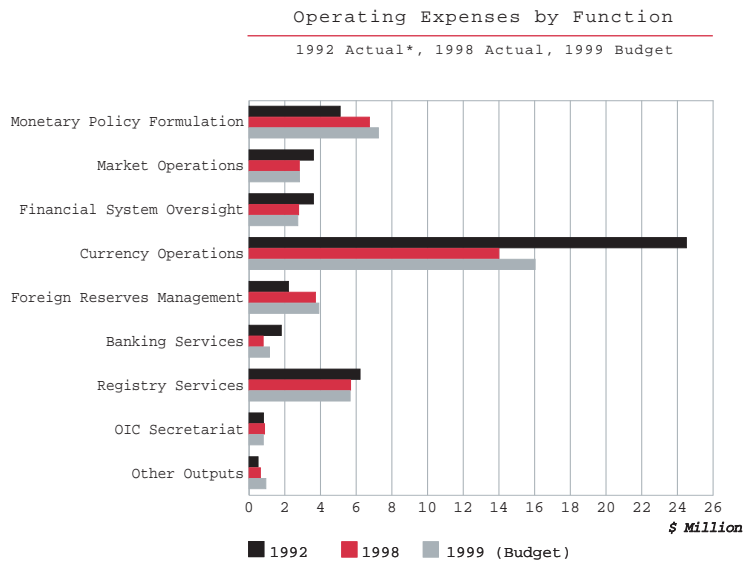
Graph 4



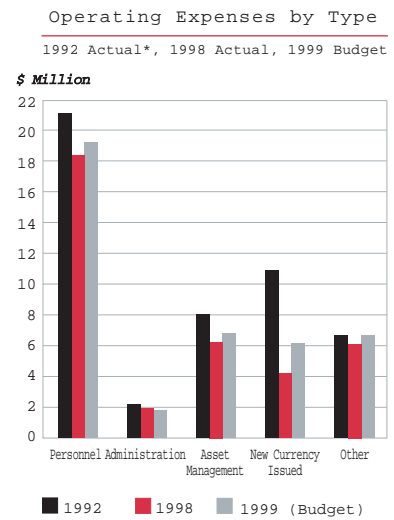
Graph 5



Graph 6



Graph 7



\* 1992 is used in these graphs as a benchmark, given that in the early 1990s the Reserve Bank underwent a substantial restructuring that resulted in savings and new priorities.

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The Reserve Bank's outputs are classified according to the major functions of the Bank. Details of functions and performance criteria are contained in the 1999 *Annual Plan*. Definitions of each output are provided below, in italics, and where necessary further explanation is provided to enhance the reader's understanding.

#### Monetary Policy Formulation

*Formulating and publicly presenting an ongoing monetary policy strategy to enable the Bank to maintain price stability, in the most efficient manner possible.*

#### Market Operations

*Trading, liaising with and monitoring financial markets, for effective implementation of monetary policy, and maintenance of the Bank's capacity to intervene in financial markets in support of the orderly and competitive functioning of financial markets.*

As part of monetary policy implementation, the Reserve Bank issues Reserve Bank bills (a financial liability). The proceeds from the issue of Reserve Bank bills are advanced to the Government (a financial asset) and earn interest. The asset and liability closely match in terms of value<sup>1</sup> and similarly the interest income and interest expense flows approximately net off<sup>2</sup>.

#### Financial System Oversight

*Registering and supervising banks, promoting the efficiency and soundness of the New Zealand financial system and avoiding significant damage to the financial system that could arise from a bank failure or other financial system distress.*

#### Currency Operations

*To maintain the supply and integrity of legal tender currency in order to facilitate cash transactions in the community.*

Registered banks pay the Reserve Bank the face value of the currency being issued to them. These funds are invested in Government securities, which are included in local currency financial assets on the Reserve Bank's balance sheet to offset the currency in circulation liability. Currency in circulation is a non-interest-bearing liability. However, the Government securities portfolio asset is interest-bearing. This income directly associated with the issue of currency is referred to as seigniorage and provides the Bank with its main source of income.

#### Foreign Reserves Management

*Maintaining the capability to counter circumstances of severe erosion of liquidity in our foreign exchange market and maintaining the Bank's foreign reserves at a level and in a form suitable for foreign exchange market intervention.*

The Crown has advanced foreign currency funds to the Reserve Bank. The Bank has invested these funds in foreign currency assets that are held as foreign reserves. These assets and liabilities are closely matched by currency, duration, and value. As a result the Bank limits its exposure to interest and exchange rate movements in these overseas markets.

#### Banking Services

*Providing banking services to the Government, settlement banks and appropriate overseas institutions to meet their banking needs and to facilitate effective implementation of monetary policy.*

#### Overseas Investment Commission Secretariat

*Providing the secretariat of the Overseas Investment Commission. The Commission administers New Zealand's legislative controls on major inward foreign investment.*

#### Registry Services

*Providing high quality depository, registry and settlement services to the securities market, in order to contribute to an efficient and sound financial sector.*

The Bank's registry services are provided by a wholly-owned subsidiary company, RBNZ Registry Limited, which is required, under the Reserve Bank of New Zealand Act 1989, to be self-funding.

#### Other Outputs

*Producing other outputs which cannot be classified under our main functions. These include sundry economic policy advice and overseas representation and liaison that relates to the general purposes of the Bank rather than to a particular function.*

<sup>1</sup> See *Advances to Government* in note 1, *Financial Assets*, and *Reserve Bank Bills* in note 4, *Financial Liabilities*, in the notes to the financial statements.

<sup>2</sup> See *Advances to Government* in note 10, *Income from Financial Assets*, and *Reserve Bank Bills* in note 11, *Expenses on Financial Liabilities*, in the notes to the financial statements.

Financial Position as at:	1994 June (\$m)	1995 June (\$m)	1996 June (\$m)	1997 June (\$m)	1998 June (\$m)
<b>Assets:</b>					
Foreign Currency Financial	4,154	4,002	4,474	5,255	6,353
Local Currency Financial	3,278	3,545	3,915	4,029	4,413
Other Assets	76	65	66	62	61
<b>Total</b>	<b>7,508</b>	<b>7,612</b>	<b>8,455</b>	<b>9,346</b>	<b>10,827</b>
<b>Liabilities and Equity:</b>					
Foreign Currency Financial	4,153	4,002	4,473	5,254	6,350
Local Currency Financial	1,460	1,571	1,818	1,880	2,176
Currency in Circulation	1,413	1,516	1,599	1,665	1,733
Other	118	142	174	151	164
Equity	364	381	391	396	404
<b>Total</b>	<b>7,508</b>	<b>7,612</b>	<b>8,455</b>	<b>9,346</b>	<b>10,827</b>

Consolidated Income and Expenditure <sup>3</sup> Financial Year Ending:	1994 June (\$m)	1995 June (\$m)	1996 June (\$m)	1997 June (\$m)	1998 June Actual (\$m)	1999 June Budget (\$m)
Net Investment Income	131.6	159.1	171.7	170.4	187.4	158.7
Other Income	11.0	10.4	34.4	10.7	10.7	11.4
<b>Total Income</b>	<b>142.6</b>	<b>169.5</b>	<b>206.1</b>	<b>181.1</b>	<b>198.1</b>	<b>170.1</b>
Operating Expenses	39.5	39.7	38.6	37.8	37.0	40.7
Tax for Current Year	0.5	0.6	0.8	0.9	0.8	0.3
Surplus for Appropriation	102.6	129.2	166.8	142.5	160.3	129.1
Transfers to Equity	23.2	22.8	5.3	6.4	8.4	4.6
Payment to Government	79.3	106.4	161.4	136.0	151.9	124.5

<sup>3</sup> Figures in this section have been rounded. Totals have not been adjusted for rounding error.

<i>Cost of Services<sup>4</sup></i> <i>Financial Year Ending:</i>	<i>1994</i> <i>June</i>	<i>1995</i> <i>June</i>	<i>1996</i> <i>June</i>	<i>1997</i> <i>June</i>	<i>1998</i> <i>June</i> <i>Actual</i> <i>(\$m)</i>	<i>1999</i> <i>June</i> <i>Budget</i> <i>(\$m)</i>
	<i>(\$m)</i>	<i>(\$m)</i>	<i>(\$m)</i>	<i>(\$m)</i>		
Monetary Policy Formulation	5.6	6.2	6.5	6.1	6.7	7.2
Market Operations	3.0	3.0	2.9	2.8	2.8	2.8
Financial System Oversight	3.7	3.2	3.2	2.8	2.8	2.7
Currency Operations	17.0	17.6	16.7	15.8	14.0	16.0
Foreign Reserves Management	3.2	3.8	3.5	3.7	3.7	3.9
Banking Services	0.8	0.3	0.4	0.8	0.8	1.1
Overseas Investment Commission Secretariat	0.5	0.6	0.6	0.7	0.9	0.8
Other Outputs	0.6	0.5	0.5	0.7	0.6	0.9
<b>Total for Functions within Funding Agreement</b>	<b>34.5</b>	<b>35.1</b>	<b>34.3</b>	<b>33.4</b>	<b>32.3</b>	<b>35.6</b>
Registry Services <sup>5</sup>	5.5	5.2	4.9	5.5	5.7	5.7
Less Intercompany Transactions	-	-	(0.2)	0.2	0.2	0.2
<b>Total Expenditure on Functions</b>	<b>40.0</b>	<b>40.3</b>	<b>39.4</b>	<b>38.7</b>	<b>37.8</b>	<b>41.0</b>

The Reserve Bank's budget has been prepared for a 12 month period and is consistent with the Bank's accounting policies.

The 1999 budget has been prepared using April 1998 interest rates. No allowance has been made for future changes in interest and exchange rates.

#### Assumptions

The major assumptions underlying the preparation of the 1999 budget are that:

1. The Bank performs the functions prescribed in the Reserve Bank of New Zealand Act 1989, and existing functions not directly specified in the legislation.
2. The levels of activity in the Foreign Reserves Management and Market Operations functions in 1998/99 will be similar to the 1997/98 levels.

The Statement of Cost of Services shows the total cost of providing each function, including internal transfers between functions. It includes fees charged by the Registry Services function to other functions, which are netted off against Registry income in the Consolidated Statement of Financial Performance.

<sup>4</sup> Figures in this section have been rounded. Totals have not been adjusted for rounding error.

<sup>5</sup> Includes tax payable.

## Budgeted Cost of Services

The Bank has budgeted to provide the following functions in 1999. Details of functions and performance criteria are contained in the 1999 Annual Plan.

Function	Operating Income	Operating Income	Operating Expenses	Operating Expenses	Operating Surplus (Deficit)	Operating Surplus (Deficit)
	Budget 1999 \$000	Actual 1998 \$000	Budget 1999 \$000	Actual 1998 \$000	Budget 1999 \$000	Actual 1998 \$000
<i>For the year ended 30 June 1999</i>						
Monetary Policy Formulation	73	57	7,243	6,738	(7,170)	(6,681)
Market Operations	12,418	14,756	2,819	2,810	9,599	11,946
Financial System Oversight	12	7	2,725	2,772	(2,713)	(2,765)
Currency Operations	134,472	146,444	16,024	13,991	118,448	132,453
Foreign Reserves Management	14,458	28,329	3,904	3,713	10,554	24,616
Banking Services	1,773	908	1,140	785	633	123
Overseas Investment Commission Secretariat	824	583	792	862	32	(279)
Other Outputs	1	1	935	630	(934)	(629)
<b>Total for Functions within Funding Agreement</b>	<b>164,031</b>	<b>191,085</b>	<b>35,582</b>	<b>32,301</b>	<b>128,449</b>	<b>158,784</b>
Registry Services	6,329 <sup>6</sup>	7,203 <sup>6</sup>	5,660 <sup>7</sup>	5,683 <sup>7</sup>	669	1,520
Less Intercompany Transactions	215	234	215	234	-	-
<b>Total for Bank</b>	<b>170,145</b>	<b>198,054</b>	<b>41,027</b>	<b>37,750</b>	<b>129,118</b>	<b>160,304</b>

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## Consolidated Budgeted Statement of Financial Performance

*For the year ended 30 June 1999*

	Budget 1999 \$000	Actual 1998 \$000
<i>For the year ended 30 June 1999</i>		
<b>Operating Income:</b>		
Net Investment Income	158,720	187,371
Other Income	11,425	10,683
<b>Total Operating Income</b>	<b>170,145</b>	<b>198,054</b>
<b>Operating Expenses:</b>		
Personnel	19,277	18,435
Asset Management	6,803	6,268
New Currency Issued	6,173	4,214
Administration	1,776	1,943
Other	6,668	6,140
<b>Total Operating Expenses</b>	<b>40,697</b>	<b>37,000</b>
<b>Operating Surplus</b>	<b>129,448</b>	<b>161,054</b>
Taxation	330	750
<b>Surplus Available for Appropriation</b>	<b>129,118</b>	<b>160,304</b>

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<sup>6</sup> Includes Austraclear fees and ESAS recoverable income, which are netted off against related Bank expenses in the Consolidated Budgeted Statement of Financial Performance.

<sup>7</sup> Includes tax payable.

### Accounting Policies

These are the consolidated financial statements of the Reserve Bank of New Zealand, a body corporate under the Reserve Bank of New Zealand Act 1989. These statements apply to the financial year ended 30 June 1998. They have been prepared in accordance with part VI of the Reserve Bank of New Zealand Act 1989. Unless otherwise stated, the measurement base is historic cost.

In these financial statements the Reserve Bank of New Zealand is also referred to as the "Reserve Bank" or the "Bank".

### Basis of Consolidation

The Reserve Bank accounts for its Registry Services function via a wholly-owned subsidiary company (RBNZ Registry Limited). The consolidated financial statements include this subsidiary company. The purchase method of consolidation is used. All material inter-company balances and transactions have been eliminated. (Separate financial statements for RBNZ Registry Limited appear in note 27.) Parent financial statements are not produced because the difference between the parent and group accounts is not material.

### Foreign Currency Conversions

Transactions in foreign currencies have been translated to New Zealand currency using exchange rates applying on the settlement dates of transactions. Foreign currency financial assets and liabilities have been translated to New Zealand currency using mid-market exchange rates applying at balance date. The following New Zealand dollar closing exchange rates for major currencies were used to convert foreign currency assets and liabilities to New Zealand dollars for reporting purposes.

	1998	1997
United States dollars	0.5125	0.6778
German marks	0.9265	1.1777
Japanese yen	72.1100	77.4400

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### Financial Assets and Liabilities

Except as noted below, foreign currency financial assets and liabilities, along with local currency financial assets held for trading purposes, are recorded at market value. Changes in market value, whether due to exchange rate movements, interest rate movements or other factors, are recognised immediately in the Consolidated Statement of Financial Performance.

Local currency financial assets held for investment purposes, and local currency financial liabilities, are recorded on a yield to maturity basis. Any premium or discount amortisation is recognised in the Consolidated Statement of Financial Performance.

Certain foreign currency and local currency financial assets and liabilities are recorded at face value. These are:

- Short-term deposits, repurchase and reverse-repurchase agreements and advances that are not realisable prior to maturity.
- Current account deposits and advances through the daily float tender.
- Assets and liabilities denominated in Special Drawing Rights.

Financial assets and liabilities are recognised in the Statement of Financial Position on a trade-date basis. Unsettled sales of securities are reported as assets under the title Forward Sales of Securities and unsettled security purchases are reported as liabilities under the title Forward Purchases of Securities. Income and expense recognition on forward transactions is recognised from trade date.

Where derivative instruments have been used to change the characteristics of specifically identified underlying financial instruments, recognition in the Statement of Financial Position and Statement of Financial Performance is on the basis of the combined characteristics of both the derivative and the underlying instrument.

Securities sold under agreements to repurchase are recorded in the assets in the Statement of Financial Position. A liability (Securities Sold under Agreements to Repurchase) recognising the obligation to repurchase is also disclosed. The difference between the sale and repurchase price represents interest expense and is recognised within the Statement of Financial Performance. Securities held under reverse-repurchase agreements are recorded as an asset (Securities Purchased under Agreements to Re-sell). The difference between the purchase and sale price represents interest income and is recognised in the Statement of Financial Performance.

### Currency in Circulation

Currency issued by the Reserve Bank represents a claim on the Bank in favour of the holder. The liability for currency in circulation is recorded at face value in the Statement of Financial Position.

### Commemorative and Demonetised Currency

The Reserve Bank has a liability for the face value of commemorative currency. However, it is most unlikely that significant amounts of commemorative currency will be returned for redemption. The face value of commemorative currency is therefore recognised as a contingent liability.

The Bank has a liability for the face value of demonetised currency still in circulation. Except for a portion retained in the Statement of Financial Position to cover expected future repatriations, this is also recognised as a contingent liability.

### Land and Buildings

Land is carried at market value. Buildings are valued at market value except for the specialised basements and ground floors occupied by the Reserve Bank, which are valued at adjusted replacement cost. Surpluses of book value over historic cost for this class of asset are recorded in the Properties Revaluation Account. Where the book value of this class of asset falls below historic cost, previous individual asset revaluations are reversed and the remaining balance is charged as an expense in the financial year it occurs. Independent valuations of this class of asset are obtained triennially. Because of this policy of regular valuation, buildings are not depreciated.

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### Other Fixed Assets

Other Fixed Assets are carried at cost, less depreciation. The following assets held by the Reserve Bank of New Zealand are depreciated on a diminishing value basis at the given rates:

Plant, Equipment and Vehicles	30 percent per annum
Computer Hardware	50 percent per annum

Other assets are depreciated on a straight line basis over their expected useful lives. Computer software is capitalised only when total costs exceed \$150,000 and is depreciated on a straight line basis over three years.

Assets held by RBNZ Registry Limited are depreciated on a straight line basis at 20 percent per annum with the exception of computer hardware upgrades, which are depreciated at 33 percent per annum.

### Operating Leases

Lease rentals payable on operating leases are recognised in the Statement of Financial Performance over the term of the lease.

### Inventories

Inventories are carried at the lower of cost or realisable value. Cost is determined on a weighted average basis. Unissued currency stocks are recorded in inventory accounts at the cost of acquisition and expensed when issued.

### Accounts Receivable

Accounts Receivable are carried at expected realisable value after making due allowance for doubtful debts.

**C o n s o l i d a t e d   S t a t e m e n t  
o f   F i n a n c i a l   P o s i t i o n**

**Currency and Artwork Collections and Archives**

Items held in the Reserve Bank's currency and artwork collections and archives that have a material commercial value are valued at estimated market values. Nominal values have been placed on items with no material commercial value. Collections are not depreciated. Additions are held at cost until subsequent revaluations.

**Personnel Expenses**

Personnel expenses include the full cost of all staff benefits, including any applicable Fringe Benefit Tax. Accumulated staff benefits and entitlements are accrued.

**Taxation**

Only RBNZ Registry Limited is liable for income tax.

The taxation charged against profit includes both current and deferred taxation calculated under the comprehensive method.

Deferred taxation arises from items of income and expenditure being included in taxation computations in periods different from those in which they are recorded in the financial statements.

**Cash Flows**

Cash is defined as those items that are currently convertible "at call".

Investing activities include the cash movements, including realised gains and losses, in the Reserve Bank's financial asset portfolios. Also included are cash flows arising from movements in IMF Special Drawing Rights, fixed assets, and loans to staff.

Financing activities are those arising from the issue of circulating currency, the issue of Reserve Bank bills, borrowing from the Treasury, and payment of the net operating surplus to the Crown.

Operating activities include income and expenditure cash flows not included as investing or financing activities.

Cash movements in portfolios have been presented net as this is considered to provide a fairer presentation of the Bank's operations.

**Custodial Activities**

Securities held by the Reserve Bank through a subsidiary company under custodial arrangements are not included in these financial statements.

**Comparative Amounts**

To ensure consistency with the current year, comparative figures have been restated where appropriate.

**Changes in Accounting Policies**

There has been no change in the Reserve Bank's accounting policies for the year ended 30 June 1998.

<i>As at 30 June 1998</i>	<i>Note</i>	1998 \$000	1997 \$000
<b>Assets:</b>			
Financial Assets	1,7,8,9	10,765,937	9,283,232
Accounts Receivable		1,952	3,302
Inventories	2	6,330	5,450
Deferred Taxation	28	76	93
Currency & Artwork Collection		767	767
Fixed Assets	3	52,393	53,321
<b>Total Assets</b>		<b>10,827,455</b>	<b>9,346,165</b>
<b>Liabilities:</b>			
Financial Liabilities	4	8,526,380	7,133,402
Currency in Circulation		1,733,306	1,665,238
Provision for Transfer of Surplus	15	151,890	136,015
Accounts Payable		7,024	10,836
Accrued Employee Entitlements		2,540	2,461
Other Current Liabilities		750	406
Demonetised Currency	5	1,323	1,399
<b>Total Liabilities</b>		<b>10,423,213</b>	<b>8,949,757</b>
<b>Equity</b>	6,15	<b>404,242</b>	<b>396,408</b>
<b>Total Liabilities and Equity</b>		<b>10,827,455</b>	<b>9,346,165</b>

The above statement is to be read in conjunction with the notes on pages 47 to 69.

Consolidated Statement  
of Movements in Equity

For the year ended 30 June 1998		1998	1997
	Note	\$000	\$000
<b>Equity at Start of Year</b>		396,408	391,475
Net Surplus for the Year		160,304	142,450
Movement in Retained Earnings	6	-	798
Movement in Properties Revaluation Account	6	(580)	(2,300)
<b>Total Recognised Revenues and Expenses for the Year</b>		159,724	140,948
Provision for Transfer of Surplus to Government	15	(151,890)	(136,015)
<b>Equity at End of Year</b>		404,242	396,408

The above statement is to be read in conjunction with the notes on pages 47 to 69.

Consolidated Statement  
of Financial Performance

For the year ended 30 June 1998		Actual	Budget	Actual
	Note	1998	1998	1997
		\$000	\$000	\$000
<b>Operating Income:</b>				
Income from Financial Assets	10	633,992		565,710
Expenses on Financial Liabilities	11	(457,656)		(396,855)
Net Foreign Exchange Revaluation Gain (Loss)	12	11,035		1,559
<b>Net Investment Income</b>		187,371	164,157	170,414
Other Income	13	10,683	10,228	10,662
<b>Total Operating Income</b>		198,054	174,385	181,076
<b>Operating Expenses:</b>				
Personnel		18,435	18,126	17,669
Asset Management		6,268	6,648	6,451
New Currency Issued	16	4,214	5,429	5,459
Administration		1,943	2,031	1,884
Other	14	6,140	6,457	6,295
<b>Total Operating Expenses</b>		37,000	38,691	37,758
<b>Operating Surplus</b>		161,054	135,694	143,318
Taxation	28	750	600	868
<b>Surplus Available for Appropriation</b>	15	160,304	135,094	142,450

The above statement is to be read in conjunction with the notes on pages 47 to 69.

Statement of Cost of Services

Consolidated Statement of Cash Flows

	Note	Operating	Operating	Operating	Operating	Operating
		Income	Expenses	Surplus	Surplus	Surplus
		Actual	Actual	(Deficit)	(Deficit)	(Deficit)
		1998	1998	Actual	Budget	Actual
		\$000	\$000	1998	1998	1997
				\$000	\$000	\$000
<i>For the year ended 30 June 1998</i>						
<b>Functions:</b>						
Monetary Policy Formulation		57	6,738	(6,681)	(6,349)	(6,009)
Market Operations	17	14,756	2,810	11,946	9,935	13,608
Financial System Oversight		7	2,772	(2,765)	(2,979)	(2,832)
Currency Operations	16,17	146,444	13,991	132,453	122,472	126,098
Foreign Reserves Management	17	28,329	3,713	24,616	11,959	10,993
Banking Services	17	908	785	123	(416)	(352)
Overseas Investment Commission Secretariat		583	862	(279)	(21)	(116)
Other Outputs		1	630	(629)	(724)	(695)
<b>Total for Functions within Funding Agreement</b>		<b>191,085</b>	<b>32,301</b>	<b>158,784</b>	<b>133,877</b>	<b>140,695</b>
Registry Services	27	7,203	5,683	1,520	1,217	1,755
Less Intercompany Transactions		234	234	-	-	-
<b>Surplus Available for Appropriation</b>		<b>198,054</b>	<b>37,750</b>	<b>160,304</b>	<b>135,094</b>	<b>142,450</b>

The Statement of Cost of Services shows the total cost of providing each function, including internal transfers between functions.

The above statement is to be read in conjunction with the notes on pages 47 to 69.

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	Note	1998	1997
		\$000	\$000
<i>For the year ended 30 June 1998</i>			
<b>Cash Flows From Operating Activities:</b>			
<b>Source:</b>			
Interest received		526,319	504,795
Fees, Commission and Other Income Received		16,380	10,859
		<b>542,699</b>	<b>515,654</b>
<b>Disbursements:</b>			
Interest Paid		325,322	352,854
Payments to Suppliers and Employees		40,005	42,449
Net Income Tax Paid		810	755
		<b>366,137</b>	<b>396,058</b>
<b>Net Cash Flow From Operating Activities</b>	18	<b>176,562</b>	<b>119,596</b>
<b>Cash Flows from Investing Activities:</b>			
<b>Disbursements:</b>			
Net Increase in Domestic Investments		366,758	111,990
Net Increase in Foreign Investments		193,303	17,899
Net Increase in Fixed Assets		2,798	2,626
		<b>562,859</b>	<b>132,515</b>
<b>Net Cash Flow From Investing Activities</b>		<b>(562,859)</b>	<b>(132,515)</b>
<b>Cash Flows from Financing Activities:</b>			
<b>Source:</b>			
Net Issue of Circulating Currency		67,992	66,437
Net Issue of Foreign Currency Deposits		107,589	5,051
		<b>175,581</b>	<b>71,488</b>
<b>Disbursements:</b>			
Net Repayment of Reserve Bank Bills		30,000	16,000
Payment of Surplus to Government		136,015	161,432
		<b>166,015</b>	<b>177,432</b>

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Consolidated Statement  
of Cash Flows (Continued)

Notes to be Read as Part of the  
Consolidated Financial Statements

For the year ended 30 June 1998	Note	1998 \$000	1997 \$000
<b>Net Cash Flow From Financing Activities</b>		9,566	(105,944)
<b>Cash Flow from All Activities</b>		(376,731)	(118,863)
Exchange Rate Effect		52,190	2,977
<b>Net Cash Flow From All Activities</b>		(324,541)	(115,886)
Opening Cash Balance		(640,205)	(524,319)
Closing Cash Balance	19	(964,746)	(640,205)
<b>Increase (Decrease) In Cash Balance</b>		(324,541)	(115,886)

The movement in the closing cash balance mainly reflects the movement in the balance of Government deposits with the Reserve Bank.

This balance will fluctuate in line with the seasonal liquidity influences of the Government. These seasonal liquidity influences are not controlled by the Reserve Bank.

The above statement is to be read in conjunction with the notes on pages 47 to 69.

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**1. Financial Assets**

(a) Financial Assets comprise:

	1998 \$000	1997 \$000
<b>Foreign Currency Assets:</b>		
Cash Balances with Other Central Banks	7,781	8,628
Short-Term Advances	327,510	418,062
Forward Sales of Securities	93,031	194,878
Securities Purchased under Agreements to Re-sell	1,431,814	1,217,368
Marketable Securities	4,588,114	3,786,036
Short Sales of Securities	(168,789)	(422,095)
Accrued Interest	71,610	51,611
International Monetary Fund Special Drawing Rights	2,172	197
	6,353,243	5,254,685
<b>Local Currency Assets:</b>		
Cash on Hand	94	770
Advances to Government <sup>8</sup>	1,194,982	1,228,628
Securities Purchased under Agreements to Re-sell	1,058,000	749,000
NZ Government Securities - Investment Portfolio <sup>9</sup>	2,098,051	1,991,134
Accrued Interest	61,020	57,882
Advances to Staff	334	748
Term Loans	213	385
	4,412,694	4,028,547
<b>Total Financial Assets</b>	10,765,937	9,283,232

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<sup>8</sup> Represents the re-investment of the proceeds from the issue of Reserve Bank bills, see note 1(b) v) (a).

<sup>9</sup> The investment portfolio is held to support the liability for currency in circulation and the Bank's net equity.

## (b) Nature and extent of activities

The Reserve Bank's role as a central bank determines the nature and extent of its activities with respect to financial instruments. This role is defined by the Reserve Bank of New Zealand Act 1989.

### i) Foreign Currency Activities

Foreign activity results mainly from the Reserve Bank's holdings of foreign currency assets under its foreign reserves management function. These assets are held in various currencies. The majority are denominated in United States dollars, Japanese yen and German marks.

The overall level of these assets is determined by the Treasurer on advice from the Bank. The Bank also maintains a standby credit facility (US \$100 million) to augment the amount of foreign currency that can be accessed.

The financial instruments held within these foreign currency portfolios consist mainly of sovereign securities, securities held under reverse-repurchase transactions or balances held with other central banks, commercial banks and settlement institutions. Liquidity and credit risk are key criteria in determining the type of instruments held.

The funding for these assets is provided by foreign currency loans from the Treasury and to a lesser extent by Special Drawing Rights issued by the International Monetary Fund. The overall currency composition of the assets and liabilities is determined in consultation with the main providers of funding. Generally these loans are held to maturity, though from time to time the opportunity to repay early may be taken where this is expected to reduce the cost of funding.

Subject to liquidity and credit risk constraints being satisfied, the Bank defines benchmark portfolios that represent a "neutral" asset structure in terms of market risk relative to the funding structure. The neutral position is established to minimise the Bank's exposure to foreign currency risk and interest rate risk arising from changes in the yield curve. In general, liquidity and credit risk constraints dictate that the return on the neutral asset structure will be less than the cost of funding.

The Reserve Bank also holds, from time to time, foreign currency assets and liabilities that arise from the implementation of domestic monetary policy. Any foreign currency exposures related to domestic monetary policy implementation activity are fully hedged through the use of foreign currency swaps.

The Bank also participates in the foreign exchange dealing markets on its own account and to meet the foreign currency needs of public sector customers.

### ii) Departures from Neutral Positions

Departures of the asset portfolio structure from the neutral structure are undertaken where there is an expected increase in returns, within defined risk boundaries. Exposures are also incurred by way of investment in short sold assets, again for expected return enhancement within defined risk boundaries.

Decision-making for departures from neutral positions typically involves delegated discretion to specialist staff or trading strategies pre-agreed with the Bank's senior management.

For further information on the risk management policies relating to financial instruments see notes 7 to 9.

### iii) Derivatives

The Bank's involvement in derivatives comprises forward foreign exchange transactions and a cross currency interest rate swap.

The Bank uses foreign exchange swap contracts as part of hedged foreign exchange transactions for both monetary policy implementation and foreign reserves management. The unrealised foreign exchange gain on unsettled swap forward legs are offset by the foreign exchange revaluation on the associated money market instruments. These are both included within the balance of Short-Term Advances. As at 30 June 1998 the unrealised foreign exchange gain on unsettled swap forward legs (exchanging principal of US \$55 million) was \$564,000 (1997 nil).

In November 1997 the Bank entered into a cross currency interest rate swap (exchanging principal of US \$110 million) as part of a series of hedged transactions to enhance the yield on the USD fixed rate portfolio. As at 30 June 1998 the fair value of the swap was \$2.6 million, of which \$0.6 million is included within the balance of Marketable Securities, and \$2 million within the balance of Accrued Interest.

### iv) Securities Lending Programme

As part of its foreign operations, the Reserve Bank participates in a securities lending programme managed by The Chase Manhattan Bank. Under the programme The Chase Manhattan Bank lends out securities owned by the Bank in exchange for cash or alternative securities. The range of financial assets that can be acquired under the programme is constrained by guidelines compatible with those that apply to the Bank's foreign currency asset portfolios.

The total market value of securities which have been made available to participate in this programme is limited to US \$700 million. As at 30 June 1998 the market value of securities lent out under the programme was US \$389.5 million (1997 US \$437 million).

### v) Local Currency Activities

Local currency activities arise on two main counts:

#### (a) Liquidity management operations.

Liquidity management involves the Reserve Bank compensating for daily net flows through the Crown Settlement Account by advancing or withdrawing funds from the banking system. The Bank issues Reserve Bank bills as part of its liquidity management operations. The funds received from the issue of these bills are on-lent to the Government on an unsecured basis.

#### (b) Holding assets representing the investment of the Reserve Bank's net equity and supporting the liability for currency in circulation.

This investment portfolio comprises holdings of benchmark issues of New Zealand Government bonds. The Bank's policy is to hold these investments until maturity.

From time to time the Bank may also hold small trading positions in Crown or registered bank securities as part of market test activities.

## (c) Restrictions on Title to Assets

As part of the active management of its foreign currency operations, the Reserve Bank enters into security repurchase transactions. The securities sold by the Bank under repurchase agreements continue to be recorded in the Bank's Statement of Financial Position. At balance date securities with a fair value of \$1,214 million (1997 \$1,106 million) had been sold to counter-parties under repurchase agreements. These transactions are also recognised as a liability for Securities Sold under Agreements to Repurchase in the Bank's Statement of Financial Position.

The Bank also purchases securities under reverse-repurchase agreements in both its foreign currency and local currency operations. These transactions are recognised as Securities Purchased under Agreements to Re-sell in the Bank's Statement of Financial Position.

## (d) Fair Value (Market Value) of Financial Assets

The carrying value (the value reported in the accounts) of financial assets represents their fair value with the exception of New Zealand Government Securities - Investment Portfolio, which has a fair value of \$2,187,366,000 (1997 \$2,210,755,000).

## 2. Inventories

	1998 \$000	1997 \$000
Bank Notes for Circulation	2,880	1,693
Coin for Circulation	3,157	3,475
Commemorative Currency	290	277
Office Supplies	3	5
<b>Total Inventories</b>	<b>6,330</b>	<b>5,450</b>

## 3. Fixed Assets

	1998 Historic Cost \$000	1998 Accumulated Depreciation \$000	1998 Book Value \$000	1997 Historic Cost \$000	1997 Accumulated Depreciation \$000	1997 Book Value \$000
Freehold Land			14,510			15,610
Buildings			25,910			25,390
			40,420			41,000
Computer Hardware	4,583	3,970	613	4,305	3,629	676
Plant	5,627	5,303	324	5,640	5,176	464
Office Equipment	7,044	5,391	1,653	6,543	4,970	1,573
Software	7,131	4,568	2,563	5,408	4,106	1,302
Currency Processing Equipment	5,019	2,667	2,352	5,019	2,039	2,980
Motor Vehicles	296	138	158	319	121	198
Building Improvements	4,039	2,004	2,035	4,216	1,718	2,498
Tenancy Inducements	1,761	1,020	741	2,088	1,108	980
Work in Progress	1,534	-	1,534	1,650	-	1,650
			11,973			12,321
<b>Total Fixed Assets</b>			<b>52,393</b>			<b>53,321</b>

The book values for land and buildings are market values based on existing use provided by Jones Lang Wootton Limited, registered valuers, with the exception of the specialised basement and ground floors occupied by the Bank, which are valued at adjusted replacement cost. The market value of the buildings, to a purchaser not requiring the Bank's specialised facilities, is \$21,800,000 (1997 \$20,470,000).

June 1998 Valuation  
\$000

Auckland Property	14,500
Wellington Property	25,920
	<u>40,420</u>

## 4. Financial Liabilities

### (a) Financial Liabilities comprise:

	1998 \$000	1997 \$000
<b>Foreign Currency Liabilities:</b>		
Short-Term Deposits	30,509	-
Forward Purchases of Securities	22,082	269,119
Securities Sold under Agreements to Repurchase	1,213,666	1,106,071
Term Liabilities	4,601,986	3,526,123
Accrued Interest	114,516	62,508
International Monetary Fund Special Drawing Rights	367,070	289,832
	<u>6,349,829</u>	<u>5,253,653</u>
<b>Local Currency Liabilities:</b>		
Government Deposits	956,473	608,104
Settlement Bank Deposits	1,652	1,397
Central Bank Deposits	2,564	9,598
Staff Deposits	7,660	6,160
International Monetary Fund Deposits	4,272	18,348
Reserve Bank Bills	1,203,586	1,235,909
Accrued Interest	344	233
	<u>2,176,551</u>	<u>1,879,749</u>
<b>Total Financial Liabilities</b>	<b>8,526,380</b>	<b>7,133,402</b>

### (b) Nature and Extent of Activities

Term liabilities comprise loans from the Treasury. These loans incur interest at market rates.

The Bank issues Reserve Bank bills as part of its liquidity management operations. The Bank provides banking services to the Crown and banks.

For further information on the nature and extent of activities and risk management policies relating to financial instruments, see notes 7 to 9.

**(c) Fair Value (Market Value) of Financial Liabilities**

The fair value (market value) of local currency and foreign currency financial liabilities is the value reported in the accounts.

**(d) Concentrations of Funding**

The funding for foreign currency assets is provided by foreign currency loans from the Treasury, and to a lesser extent by Special Drawing Rights issued by the International Monetary Fund. Funding for local currency assets is from Government deposits, the issue of Reserve Bank bills, and the issue of circulating currency.

**5. Demonetised Currency**

Demonetised currency is recognised as a contingent liability (see note 23(c)) except for \$1,323,000 (1997 \$1,399,000), which has been retained to cover future expected repatriations.

Pre-decimal-currency coin was issued by the Treasury and is included in the Bank's contingent liabilities (see note 23(b)).

**6. Equity**

	1998 \$000	1997 \$000
<b>Retained Earnings</b>		
Opening Balance	387,096	379,863
<b>Add Transfers to Retained Earnings:</b>		
Reserve Bank of New Zealand	6,894	4,680
RBNZ Registry Limited	1,520	1,755
Transfer from Properties Revaluation Account	-	798
Closing Balance	395,510	387,096
<b>Properties Revaluation Account</b>		
Opening Balance	8,632	10,932
Disposal of Wellington Vacant Land	-	(2,300)
Decrease in Value of Auckland Property	(645)	-
Increase in Value of Wellington Property	65	-
Closing Balance	8,052	8,632
<b>Collections Revaluation Account</b>		
Currency Collection	572	572
Artwork Collection	107	107
Archives	1	1
Closing Balance	680	680
<b>Total Equity</b>	404,242	396,408

The Properties Revaluation Account recognises the surplus of book value over cost of the Bank's properties in Auckland and Wellington.

**7. Interest Rate Risk**

Interest rate risk is the risk of loss arising from changes in interest rates. Because the Bank's foreign currency assets are funded by foreign currency liabilities whose interest rate characteristics cannot be exactly replicated, even "neutral" asset portfolios involve interest rate risk. The interest rate characteristics of the liabilities are similar to those of Euro instruments, but liquidity considerations require that most investments are in sovereign instruments. The Bank accepts the associated spread risk as inevitable, but seeks through optimisation methods to closely limit additional (mainly duration-related) interest rate mismatches. As at 30 June 1998, the calculated potential annual income variance inherent in the neutral asset structure was around \$40.1 million (1997 \$30 million) at a 95% probability. Recent annual variances have been substantially smaller.

Interest rate risk arising from departures from the neutral position is managed in three ways (and monitored daily). Discretionary positions adopted by specialist staff are controlled by "Funds at Risk" limits. Funds at Risk measures the probability of potential daily loss from most elements of an adverse movement in market interest rates. The Funds at Risk limits are set to constrain daily profits or losses to remain under 3 basis points on 19 out of 20 days. Given the Funds at Risk positions on 30 June 1998, the likely (19 days out of 20 probability) loss from any adverse interest rate movements would have been less than \$0.4 million (1997 \$0.1 million).

Interest rate risk arising from trading strategies or positions pre-agreed with the Bank's senior management are constrained by limits on position size. The scale of interest rate risk arising from these strategies was \$0.6 million as at 30 June 1998 (1997 \$0.7 million) at the same probability as used for Funds at Risk.

Thirdly, stop-loss limits are set for the various departures from the neutral position. Maximum total losses before stop-loss limits apply are \$4 million.

Funds at Risk limits for the foreign currency asset portfolios, actual Funds at Risk as at 30 June 1998 and the peak Funds at Risk values over the period were:

Funds at Risk	United States Portfolio Basis Points	German Portfolio Basis points	Japanese Portfolio Basis Points	1998 Total Basis Points	1997 Total Basis Points
Limit	3.00	2.50	2.50		
As at 30 June 1998	0.38	1.32	0.78	0.78	0.15
Peak over period	1.40	2.00	1.70	1.20	1.47

Interest rate risk on the domestic (New Zealand Government securities) portfolio is not actively managed as a matter of policy. This decision recognises two factors:

- (a) That active risk management could require the Bank to carry out transactions that may seem in conflict with the Bank's monetary policy stance.
- (b) That the investment portfolio held by the Bank is exactly matched by liabilities held by the Crown, so from a consolidated Crown position the risk is eliminated.

The Reserve Bank's exposure to interest rate risk that arises from liquidity management operations is minimal due to the very short-term nature of the exposures created and because the exposures are offset by other interest-bearing assets and liabilities.

The Bank's exposure to interest rate risk in relation to the investment portfolio of Government securities is potentially greater. Because it is the Bank's policy to hold these investments until or near to maturity, this exposure to interim unrealised interest rate risk does not result in the Bank incurring any material actual realised gains or losses.

Financial assets and financial liabilities will mature or re-price within the following periods:

As at 30 June 1998	Weighted Average Interest Rate	1998 Total \$000	6 Months or less \$000	6 to 12 Months \$000	1 to 2 Years \$000	2 to 5 Years \$000	Over 5 Years \$000
<b>Financial Assets:</b>							
Current Accounts and Advances	8.09%	1,530,368	1,530,368	-	-	-	-
Securities	5.07%	9,100,221	3,484,948	307,897	1,171,199	1,814,346	2,321,831
Other Financial Assets	0.09%	135,348	134,896	56	107	254	35
<b>Total Financial Assets</b>		<b>10,765,937</b>	<b>5,150,212</b>	<b>307,953</b>	<b>1,171,306</b>	<b>1,814,600</b>	<b>2,321,866</b>
<b>Financial Liabilities:</b>							
Deposits	8.10%	1,003,130	1,003,130	-	-	-	-
Short-Term Liabilities	4.56%	2,690,746	2,690,746	-	-	-	-
Long-Term Liabilities	3.99%	4,717,643	937,225	156,877	726,608	1,457,053	1,439,880
Other Financial Liabilities	0%	114,861	114,861	-	-	-	-
<b>Total Financial Liabilities</b>		<b>8,526,380</b>	<b>4,745,962</b>	<b>156,877</b>	<b>726,608</b>	<b>1,457,053</b>	<b>1,439,880</b>
<b>Total Interest Rate Sensitivity Gap All Currencies</b>							
		<b>2,239,557</b>	<b>404,250</b>	<b>151,076</b>	<b>444,698</b>	<b>357,547</b>	<b>881,986</b>
New Zealand		2,236,143	287,600	57	442,057	659,854	846,575
United States		163,182	34,960	-	187,402	(98,982)	39,802
German		69,241	219,898	142,350	(164,926)	(105,383)	(22,698)
Japan		53,173	143,974	8,669	(19,835)	(97,942)	18,307
SDR and Other		(282,182)	(282,182)	-	-	-	-

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Comparative figures as at 30 June 1997 were:

	Weighted Average Interest Rate	1997 Total \$000	6 Months or less \$000	6 to 12 Months \$000	1 to 2 Years \$000	2 to 5 Years \$000	Over 5 Years \$000
<b>Financial Assets:</b>							
Current Accounts and Advances	6.21%	1,656,088	1,656,088	-	-	-	-
Securities	5.51%	7,516,321	3,084,549	68,379	452,139	1,954,487	1,956,767
Other Financial Assets	0.08%	110,823	110,823	-	-	-	-
<b>Total Financial Assets</b>		<b>9,283,232</b>	<b>4,851,460</b>	<b>68,379</b>	<b>452,139</b>	<b>1,954,487</b>	<b>1,956,767</b>
<b>Financial Liabilities:</b>							
Deposits	7.77%	643,607	643,607	-	-	-	-
Short-Term Liabilities	5.07%	2,611,099	2,611,099	-	-	-	-
Long-Term Liabilities	4.63%	3,815,955	1,337,009	-	234,103	1,064,144	1,180,699
Other Financial Liabilities	0%	62,741	62,741	-	-	-	-
<b>Total Financial Liabilities</b>		<b>7,133,402</b>	<b>4,654,456</b>	<b>-</b>	<b>234,103</b>	<b>1,064,144</b>	<b>1,180,699</b>
<b>Total Interest Rate Sensitivity Gap All Currencies</b>							
		<b>2,149,830</b>	<b>197,004</b>	<b>68,379</b>	<b>218,036</b>	<b>890,343</b>	<b>776,068</b>
New Zealand		2,148,800	307,726	-	149,492	1,099,881	591,701
United States		122,693	64,472	68,379	(135,960)	82,026	43,776
German		53,749	28,721	-	196,173	(231,391)	60,246
Japan		49,895	21,392	-	8,331	(60,173)	80,345
SDR and Other		(225,307)	(225,307)	-	-	-	-

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## 8. Credit Exposure

Credit risk is the risk of loss arising from a counterparty/issuer to a financial contract failing to discharge its obligations.

Credit risk in the foreign currency portfolios is monitored and managed daily. End-of-day exposures are controlled through comprehensive individual counterparty and issuer credit limits. These limits are measured in credit-equivalent terms depending on the nature of the exposure. Exposures to particular classes of counterparty are constrained by aggregate credit limits. Counterparties are allocated to a particular class based mainly on their credit rating. Geographical exposures are controlled by country limits. Limits are updated as necessary when new market information emerges with all limits formally reviewed on an annual basis.

Credit risk in the domestic currency portfolios is also monitored and managed daily. Intra-day and inter-day exposures are controlled through comprehensive individual counterparty and issuer limits. Exposures to the New Zealand Government are not included in this credit framework. Most exposures arise under intra-day reverse-repurchase agreements entered into with settlement account holders

under the real time gross settlement system. Securities that the Bank accepts under intra-day reverse-repurchase agreements include New Zealand Government bonds, Reserve Bank and Treasury bills, and short-term paper issued by registered banks and highly rated corporates. The securities are held in the Bank's name for the duration of the exposure and there is no charge for this intra-day liquidity. The exposures from the counterparty from whom securities are purchased under reverse-repurchase agreements are monitored but are not subject to formal limits. The Bank no longer accepts private paper in its inter-day liquidity management operations.

The maximum loss that the Bank would suffer as a result of a security issuer defaulting is the value reported in the accounts.

The Bank's significant end-of-year concentrations of credit exposure by industry type were as follows:

	1998 \$000	1997 \$000
New Zealand Government	4,406,003	4,027,414
Other Sovereign Issuers (excluding New Zealand Government)	5,335,114	4,275,401
Supranational Financial Institutions	250,572	260,233
Foreign Banks	578,348	681,804
Other	195,900	38,380
<b>Total Financial Assets</b>	<b>10,765,937</b>	<b>9,283,232</b>

Credit exposures arising from securities purchased under agreements to re-sell (reverse-repurchase agreements) are classified according to the issuer of the security for credit exposure concentration purposes. This is consistent with the Bank's view of the substance of the credit exposure and internal risk management purposes. An alternative approach is to classify credit exposures arising from securities purchased under agreements to re-sell according to the counterparty of the transaction. Using this approach would result in credit exposures of \$1.43 billion (1997 \$1.22 billion) being reported against securities trading firms and \$1.06 billion (1997 \$749 million) reported against New Zealand banks instead of against the New Zealand Government and Other Sovereign Issuers respectively.

The Bank's significant end-of-year concentrations of credit exposure by geographical area (based on the entity's country of ownership) were as follows:

	1998 \$000	1997 \$000
New Zealand	4,406,341	4,028,162
USA	2,353,916	2,324,487
Japan	1,723,654	807,349
Germany	1,685,226	1,341,944
Supranational Financial Institutions	250,572	260,233
Other	346,228	521,057
<b>Total Financial Assets</b>	<b>10,765,937</b>	<b>9,283,232</b>

The table below shows the number of counterparties/issuers where the Bank's end-of-year and peak end-of-day credit exposures (on the basis of limits) equals or exceeds 10% of equity:<sup>10</sup>

% of equity	End-of-year 1998	End-of-year 1997	Peak end-of-day 1998	Peak end-of-day 1997
10% to 19.9%	6	12	31	28
20% to 29.9%	5	3	1	27
30% to 30.9%	1	2	14	16
40% to 49.9%	-	-	6	7
50% to 59.9%	-	-	-	6
60% to 69.9%	-	2	17	1
80% to 89.9%	-	-	1	-
90% to 99.9%	-	-	30	-
100% to 109.9%	-	-	-	5
110% to 119.9%	-	1	2	-
120% to 129.9%	-	-	2	2
150% to 159.9%	-	-	1	-
160% to 169.9%	-	1	-	-
190% to 199.9%	-	1	9	-
200% to 209.9%	-	-	-	13
310% to 319.9%	1	-	-	-
320% to 329.9%	-	1	-	-
420% to 429.9%	1	-	-	-
490% to 499.9%	-	-	2	-
510% to 529.9%	1	-	-	-
590% to 599.9%	-	-	1	-
610% to 619.9%	-	-	-	3
770% to 779.9%	-	-	1	-

Peak-end-of-day exposures greater than 100% are to foreign banks, supranational financial institutions and sovereign issuers. End-of-year exposures greater than 100% are to sovereign issuers.

<sup>10</sup> Excludes exposures to the New Zealand Government.



## 9. Foreign Currency Risk

Foreign currency risk is the risk of loss arising from changes in exchange rates. The Reserve Bank is not exposed to any significant foreign currency risk. The assets held in foreign currency portfolios are matched by foreign currency liabilities of approximately equal value. All foreign exchange trading exposures are constrained by low intra-day and overnight position limits and stop-loss limits (monitored on a daily basis). Foreign currency assets and liabilities arising from domestic monetary policy implementation activity are fully hedged using foreign currency swaps.

As at 30 June the Reserve Bank's net exposure to major currencies, including unsettled forward foreign exchange contracts and foreign currency swaps, was:

	Currency of Denomination				1998 Total \$000	1997 Total \$000
	United States Currency \$000	German Currency \$000	Japanese Currency \$000	Other Currencies \$000		
Net currency exposure <sup>11</sup>	2,498	1,128	(199)	(13)	3,414	1,028

These exposures were within approved limits.

## 10. Income from Financial Assets

	1998 \$000	1997 \$000
<b>Income from Foreign Currency Assets:</b>		
Interest Income:		
Current Accounts and Advances	17,451	18,494
Securities Purchased under Agreements to Re-sell	11,517	17,717
Securities Lending	796	400
Marketable Securities	191,828	140,654
International Monetary Fund	8,252	5,344
Unrealised Price Revaluations	51,555	11,273
Realised Gain (Loss) from Price Changes	54,726	59,506
Gain (Loss) from Foreign Exchange Trading	132	44
Other Income	139	86
<b>Total Income from Foreign Currency Assets</b>	<b>336,396</b>	<b>253,518</b>

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## Income from Local Currency Assets:

Interest Income:

NZ Government Securities	161,097	159,892
Advances to Government	99,346	104,318
Government Bank Accounts	851	233
Securities Purchased under Agreements to Re-sell	34,924	46,965
Advances to Staff	55	89
Term Loans	10	16
Other Securities	171	15
Gain (Loss) from Liquidity Management Swaps	1,136	449
Gain (Loss) from Market Test Activities	6	215

## Total Income from Local Currency Assets

## Total Income from Financial Assets

	1998 \$000	1997 \$000
Total Income from Local Currency Assets	297,596	312,192
Total Income from Financial Assets	633,992	565,710

## 11. Expenses on Financial Liabilities

## Expenses on Foreign Currency Liabilities:

Interest Expense:

Securities Sold under Agreements to Repurchase	10,744	6,583
Term Liabilities	225,119	195,523
IMF Special Drawing Rights	14,103	11,307
Unrealised Price Revaluations	48,858	12,104
Realised Gain (Loss) from Price Changes	33,213	28,831
Other Expenses	384	484

## Total Expenses on Foreign Currency Liabilities

## Expenses on Local Currency Liabilities:

Interest Expense:

Deposits	27,150	39,818
Reserve Bank Bills	98,085	102,205

## Total Expenses on Local Currency Liabilities

## Total Expenses on Financial Liabilities

	1998 \$000	1997 \$000
Total Expenses on Foreign Currency Liabilities	332,421	254,832
Total Expenses on Local Currency Liabilities	125,235	142,023
Total Expenses on Financial Liabilities	457,656	396,855

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<sup>11</sup> SDRs have been disaggregated into their composite currencies for net currency exposure.

**12. Net Foreign Exchange Revaluation Gain (Loss)**

	1998 \$000	1997 \$000
Foreign Exchange Revaluations:		
Gain (Loss) on Financial Assets	1,046,179	(163,411)
Gain (Loss) on Financial Liabilities	(1,035,144)	164,970
<b>Net Foreign Exchange Revaluation Gain (Loss)</b>	<b>11,035</b>	<b>1,559</b>

**13. Other Income**

	Actual 1998 \$000	Budget 1998 \$000	Actual 1997 \$000
Fees for Registry Services	6,084	5,482	5859
Sales of Commemorative Currency	1,380	1,492	1725
Rental Income from Properties	1,810	1,914	1881
Registered Bank Fees	3	8	8
Currency Distribution Income	491	445	452
Overseas Investment Commission Fees	581	401	586
Miscellaneous	334	486	151
<b>Total Other Income</b>	<b>10,683</b>	<b>10,228</b>	<b>10,662</b>

**14. Other Operating Expenses**

	Actual 1998 \$000	Budget 1998 \$000	Actual 1997 \$000
Other Professional Fees	1,976	1,924	2,132
Computer Expenses	1,461	1,578	1,474
Information	841	823	818
Operational Travel	549	707	508
Rental	251	249	257
Printing	214	292	277
Agency and Commissions	243	282	164
Audit Fees	214	190	157
Total Non-Executive Directors' Remuneration	88	88	83
Miscellaneous	303	324	425
<b>Total Other Operating Expenses</b>	<b>6,140</b>	<b>6,457</b>	<b>6,295</b>

Other Operating Expenses include \$155,000 (1997 \$161,000) paid to the Bank's auditors for work undertaken outside their capacity as auditors of the Bank.

**15. Transfers to Retained Earnings and Provision for Transfer of Surplus**

Under section 162 of the Reserve Bank of New Zealand Act 1989, the Bank's surplus, after any transfers to or from Equity, is paid to the Government.

Transfers to or from the Reserve Bank's Equity reflect the difference between actual operating expenses and the level of expenditure specified under the Bank's Funding Agreement with Government plus the RBNZ Registry net surplus. Under-spending by the Bank in relation to the Funding Agreement results in a transfer to Equity. Over-spending by the Bank results in a transfer from Equity. In the current year, under-expenditure by the Bank of \$6,894,000 (1997 \$4,680,000) has consequently been transferred to the Bank's Equity. In addition the RBNZ Registry net surplus of \$1,520,000 (1997 \$1,755,000) forms part of the Bank's consolidated equity.

The Bank's subsidiary, RBNZ Registry Limited, proposes to pay the Bank a dividend of \$2,000,000 (1997 \$1,500,000) in respect of the year ended 30 June 1998.

The Treasurer may authorise additional transfers to Equity. In the current year, no additional transfers have been made and the Bank's consolidated surplus, net of the transfers noted above, has been recorded in the Provision for Transfer of Surplus.

	1998 \$000	1997 \$000
Allowable Expenditure under Funding Agreement	39,195	38,095
Operating Expenses for Functions Covered by the Funding Agreement	32,301	33,415
<b>Under-expenditure Transferred to Equity</b>	<b>6,894</b>	<b>4,680</b>
<b>Surplus Available for Appropriation</b>	<b>160,304</b>	<b>142,450</b>
<b>Less Transfers to Equity:</b>		
Under-expenditure under Funding Agreement	6,894	4,680
RBNZ Registry Limited Surplus	1,520	1,755
<b>Total Transfer to Equity</b>	<b>8,414</b>	<b>6,435</b>
<b>Provision for Transfer of Surplus</b>	<b>151,890</b>	<b>136,015</b>

## 16. Currency Operations

The Reserve Bank owns properties in Auckland and Wellington. The Bank's buildings are primarily designed for secure currency operations, so their operating costs are reported as part of the Currency Operations function.

The buildings also provide office accommodation for other Bank functions. These functions pay market rentals via internal costing systems. Surplus office space is rented on market terms.

As part of the Currency Operations function, the Bank issues commemorative currency. The net income associated with this activity in 1998 was \$359,000 (1997 \$309,000).

Packaging and handling fees are charged to banks for the provision of currency distribution services.

	1998 \$000	1997 \$000
Seigniorage Income	142,731	137,749
Commemorative Currency Sales	1,380	1,725
Rental Income from Properties	1,810	1,881
Packaging and Handling Income	491	452
Other Income	32	41
<b>Operating Income</b>	<b>146,444</b>	<b>141,848</b>
Currency Processing Expenses	10,217	10,814
New Note Issue Expenses	2,179	3,035
New Coin Issue Expenses	1,409	1,681
Commemorative Currency Issue Expenses	626	743
Net Property Management Expenses (Income)	(440)	(523)
<b>Operating Expenses</b>	<b>13,991</b>	<b>15,750</b>

## 17. Income Allocated between Functions

Each function receives income and incurs expenses relating directly to the assets and liabilities used exclusively by that function. Notional balance sheets are calculated for each of the Bank's functions as though each function operated autonomously. Income and expense flows are also attached to the notional funding for each function.

This structure enables each function to more accurately report the financial outcome from the services provided.

The income earned from the assets funded by the Bank's net equity is allocated equally to the Foreign Reserve Management and Market Operations functions as this equity is held primarily to facilitate the conduct of these operations.

## 18. Reconciliation of Operating Cash Flows with Reported Operating Surplus

	1998 \$000	1997 \$000
<b>Reported Operating Surplus</b>	<b>160,304</b>	<b>142,450</b>
<b>Add (Subtract) Non-Cash Items:</b>		
Depreciation	3,144	3,538
Capital Accretion	19,675	10,556
Revaluations	46,675	9,821
Net Change in Foreign Currency Balance <sup>12</sup>	223,129	(156,315)
	292,623	(132,400)
<b>Add (Subtract) Movements in Other Working Capital Items:</b>		
Decrease in Accounts Receivable	1,351	(517)
Decrease in Accounts Payable	(3,389)	(2,780)
Increase in Inventories	(880)	794
Increase in Interest Payable	52,162	(815)
Increase in Interest Receivable	(23,137)	(4,898)
	26,107	(8,216)
Cash Flows from Operating Activities	479,034	1,834
<b>Add (Subtract) Investing and Financing Activity:</b>		
Realised (Gains) Losses	(302,472)	117,762
<b>Net Cash Flow from Operating Activities</b>	<b>176,562</b>	<b>119,596</b>

<sup>12</sup> The net change in foreign currency balance represents the unrealised effect of exchange rate movements on the Bank's foreign currency assets and liabilities. The net effect on the Bank's overall results, after allowing for realised exchange rate gains and losses, is a net gain of \$11,035,000 (1997 \$1,559,000 gain).

## 19. Consolidated Cash Balances

	1998 \$000	1997 \$000
<b>Foreign Currency Assets:</b>		
Current Accounts	7,781	8,611
<b>Local Currency Assets:</b>		
Cash and Bank Account Balances	94	770
	7,875	9,381
<b>Demand Liabilities:</b>		
Government Deposits	956,473	608,104
Settlement Bank Deposits	1,652	1,398
Staff Deposits	7,660	6,178
Other Deposits	6,836	33,906
	972,621	649,586
<b>Closing Cash Balances</b>	<b>(964,746)</b>	<b>(640,205)</b>

## 20. Statement of Commitments

The Reserve Bank's commitments in relation to outstanding forward foreign exchange contracts at balance date were as follows:

	Foreign Exchange Transactions	
	1998 \$000	1997 \$000
The Bank will receive	110,805	-
The Bank will pay	110,805	-

The Bank leases office and storage space in Christchurch, and is committed to pay an annual rental of \$232,595 until 30 June 2000.

The Bank also has commitments towards the replacement of the building management systems in the Auckland and Wellington buildings, totalling \$231,000.

## 21. Free Services

The Reserve Bank of New Zealand Act 1989 empowers the Bank to charge directly for some of its functions.

Some services are provided free of charge. These include services such as providing information to Ministers and Parliament, contributing to policy and briefing papers, providing information to the public, storing official documents securely, and providing information and library facilities to parties such as government departments and economic research organisations.

The Reserve Bank receives some free services from other organisations. In general these relate to the provision of information necessary to perform the Bank's functions.

The Bank liaises closely with other central banks and international agencies. Information and staff training are exchanged free of charge with these institutions.

## 22. Related Parties

In the normal course of its operations the Bank enters into transactions with related parties. Related parties include the Crown, as ultimate owner of the Reserve Bank, various Government departments and Crown entities.

Transactions entered into included:

- banking services;
- short-term advances;
- agency transactions (at no charge);
- foreign exchange transactions; and
- funding from the Treasury and the Earthquake Commission as part of the foreign reserves management operations.

Unless otherwise stated, all transactions take place with reference to market rates.

## 23. Contingent Liabilities

- In terms of a Trust Deed dated 16 May 1980, the Reserve Bank has a contingent liability to maintain the actuarial soundness of the Reserve Bank of New Zealand Staff Superannuation and Provident Fund, following each triennial review of the Fund. On 2 February 1995 the Bank ceased making contributions to the defined benefit division of the Fund on the advice of the Fund's Actuary that such contributions were no longer necessary. The position is re-examined as part of each triennial review.

The Actuary investigated the financial position of the Fund as at 31 March 1998 and reported on 26 July 1998 that, based on the Fund's annual accounts:

- the assets of the Fund would have been sufficient at 31 March 1998 to provide for the benefits payable to or in respect of all members, including existing pensioners, in the event of the Fund being wound up at that time;
  - the assets of the Fund would have been sufficient at 31 March 1998 to provide for benefits to members, including existing pensioners, that are attributable to membership prior to 1 April 1998; and
  - to his knowledge, there have been no circumstances between 31 March 1998 and 30 June 1998 that would cause him to form a different opinion as at 30 June 1998.
- Coin issued by the Treasury prior to July 1989 is not recorded by the Reserve Bank within the total of currency in circulation. The Bank has accepted liability for all coin in the first instance, whether issued by the Treasury or the Bank. However, should coin returned to the Reserve Bank exceed that issued by the Bank, the liability for the excess will revert to the Treasury. The face value of coin issued by the Treasury is \$87,702,000.
  - The Bank has a contingent liability for currency in circulation that has been demonetised but not returned to the Bank.
  - The Bank has a liability for the face value of commemorative currency. However, it is most unlikely that significant amounts of commemorative currency will be returned for redemption at face value. The face value of all commemorative currency issued by the Bank to date is \$6,799,000 (1997 \$6,320,000).

Commemorative coin was issued by the Treasury prior to July 1989. Particular specimens of series issued both before and after 1989 are not generally distinguishable. The Bank has in practice accepted a contingent liability for all commemorative coin, but part of this liability could revert to the Treasury should large quantities of coin be returned.

- The Bank has indemnified the statutory managers of DFC New Zealand Limited against liability arising from the statutory management of DFC New Zealand Limited (which essentially ended on 15 October 1997). However, these indemnities continue and were given under sections 5 and 39 of the Reserve Bank of New Zealand Act 1989, on substantially the same terms as those provided by the Crown in Part V of the Reserve Bank of New Zealand Act 1989.

#### 24. Previous Year's Contingent Liabilities

Five contingent liabilities were recorded in the Reserve Bank's 1997 *Annual Report*.

- (a) Reserve Bank of New Zealand Staff Superannuation and Provident Fund. The Fund required no additional payment to maintain its actuarial soundness in the 1998 financial year.
- (b) Coin issued by the Treasury prior to July 1989. No liability arose in the 1998 financial year.
- (c) Demonetised currency issued by the Reserve Bank. Demonetised currency with a face value of \$76,496 was returned to the Bank for redemption at face value during the 1998 financial year.
- (d) Commemorative currency issued by the Reserve Bank. Commemorative currency with a face value of \$716 was returned for redemption at face value in the 1998 financial year.
- (e) Undertakings in connection with the statutory management of DFC New Zealand Limited. No liability arose from these undertakings in the 1998 financial year.

#### 25. Contingent Undertakings

- (a) New Zealand is part of the IMF Designation Plan. Under the Designation Plan, the Bank may be required to purchase SDR currency in exchange for other currencies in the circumstances where the IMF are unable to find voluntary buyers of SDR currency. This process would involve a change in the currency composition of the Bank's reserves. The probability of the Designation Plan being activated is considered to be low.
- (b) The Bank entered into a bilateral repurchase agreement with the Hong Kong Monetary Authority in March 1997. The agreement provides for either party to sell to the other US Government securities in exchange for US dollars, while simultaneously agreeing to repurchase those same securities at a specified later date for an agreed amount. In essence, the arrangement allows each organisation to enhance the liquidity of its foreign reserves portfolio with minimum additional risks.

#### 26. Risk Management

Comprehensive guidelines control the manner in which the Reserve Bank conducts its local currency, foreign currency reserves management, and foreign exchange dealing operations. These guidelines contain specific provisions designed to minimise the risk associated with each operation.

A separate Risk Unit maintains the Bank's risk management framework. The Risk Unit and Accounting Services Department are responsible for the daily monitoring of the Bank's risk exposures. A Risk Management Committee comprised of senior management is responsible for advising the Governor on the monitoring and management of all financial risks that the Bank is exposed to.

Audit Services reports to the Governors and the Audit Committee of the Board of Directors. A risk-based framework which evaluates key business risks and internal controls is used to determine the extent of audits conducted. All Bank departments are subject to review and individual audits are categorised according to risk. Audit frequency is determined according to the risk profile.

An Audit Committee, comprised of four non-executive members of the Board of Directors, monitors the accounting practices and policies and internal control systems of the Bank on behalf of the Board of Directors. The committee also reviews the internal audit function and has direct access to the external auditor.

The policies for managing interest rate risk, credit risk and foreign currency risk are outlined in notes 7 to 9. In addition, the Bank is exposed to operational risk, which is the risk of loss arising from the breakdown of internal controls. These risks are managed as part of the day-to-day running of all business operations.

The nature of the activities of a central bank mean that day-to-day liquidity requirements are not an issue.

#### 27. RBNZ Registry Limited

The Reserve Bank operates registry services through a wholly-owned subsidiary company, RBNZ Registry Limited. The Bank provides various support services to RBNZ Registry Limited and charges for these services at their cost to the Bank.

##### RBNZ Registry Limited Statement of Financial Position

As at 30 June 1998

	1998 \$000	1997 \$000
<b>Assets:</b>		
Current Assets:		
Bank Accounts	9,130	7,078
Accounts Receivable	1,288	1,113
Prepayments	19	33
Fixed Assets	752	1,040
Deferred Tax	76	93
<b>Total Assets</b>	<b>11,265</b>	<b>9,357</b>
<b>Liabilities:</b>		
Current Liabilities:		
Accounts Payable	813	458
Funds Held in Trust for Stockholders	225	476
Withholding Tax	1,561	1,381
Funds Received in Advance from Issuers	872	479
Funds Due to the Treasury	1,718	420
Fees Received in Advance	194	230
Goods and Services Tax Payable (Refundable)	15	44
Provision for Dividend	2,000	1,500
Tax Payable	-	22
<b>Equity:</b>		
Issued Capital	3,000	3,000
Retained Earnings	867	1,347
<b>Total Liabilities and Equity</b>	<b>11,265</b>	<b>9,357</b>

**RBNZ Registry Limited Statement of Movements in Equity***For the year ended 30 June 1998*

	1998 \$000	1997 \$000
<b>Equity at Start of Year</b>	4,347	4,092
Net Surplus for the Year	1,520	1,755
Less Dividend Provided For	2,000	1,500
<b>Equity at End of Year</b>	3,867	4,347

**RBNZ Registry Limited Statement of Financial Performance***For the year ended 30 June 1998*

	1998 \$000	1997 \$000
<b>Operating Income:</b>		
Fees for Registry Services	6,171	5,889
Interest	889	1,126
Foreign Exchange Gain	18	10
Other Income	125	226
<b>Total Operating Income</b>	7,203	7,251
<b>Operating Expenses:</b>		
Personnel	1,881	1,780
Administration	1,253	1,090
Computer Expenses	910	765
Asset Management	400	406
Depreciation	350	345
Audit Fees	25	25
Other <sup>13</sup>	114	217
<b>Total Operating Expenses</b>	4,933	4,628
<b>Net Operating Profit Before Tax</b>	2,270	2,623
Taxation	750	868
<b>Net Profit After Tax</b>	1,520	1,755

**28. Taxation**

Section 180 of the Reserve Bank of New Zealand Act 1989 exempts the Reserve Bank from income tax. The Bank incurs and meets liabilities for goods and services tax and fringe benefit tax.

The Bank's subsidiary company, RBNZ Registry Limited, is liable for income tax. The table below relates only to RBNZ Registry Limited.

	1998 \$000	1997 \$000
<b>Income Tax Expense:</b>		
Net Profit Before Tax	2,270	2,623
Add Back Permanent Difference	2	7
	2,272	2,630
<b>Income Tax Expense at 33%</b>	750	868
<b>Current Tax Charge:</b>		
Tax Effect of Timing Differences	(7)	(20)
<b>Current Tax Charge</b>	743	848
<b>Deferred Taxation:</b>		
Opening Balance	(93)	(113)
Deferred Portion of Current Tax Charge	6	20
96/97 IRD Tax Assessment Adjustment	11	-
<b>Deferred Taxation Liability (Asset)</b>	(76)	(93)

**29. Custodial Activities**

The Reserve Bank of New Zealand operates the Austraclear New Zealand System, which is a securities clearing and settlement system. It holds assets on behalf of the participants in the name of New Zealand Central Securities Depository Limited (NZCSD), which it has appointed as custodian trustee in terms of the Trustee Act 1956.

NZCSD is a wholly-owned subsidiary of the Reserve Bank of New Zealand, which in terms of a Deed of Appointment between the Reserve Bank of New Zealand and NZCSD dated 19 May 1995 is incorporated solely for the purpose of acting as a custodian trustee. The Reserve Bank has no beneficial interest in the securities which it holds, or any management obligations apart from safe keeping.

The total of securities held by NZCSD at 30 June 1998 was \$84.2 billion (1997 \$76.1 billion).

<sup>13</sup> Other expenses include \$74,000 (1997 \$83,000) paid to RBNZ Registry's auditors for work undertaken outside their capacity as auditors of the Bank.

20 August 1998

**MANAGEMENT STATEMENT**

Pursuant to section 165 of the Reserve Bank of New Zealand Act 1989, we hereby certify that:

1. We have been responsible for the preparation of the annual financial statements and for the judgments used in them.
2. We have been responsible for establishing and maintaining a system of internal controls designed to provide reasonable assurance as to the integrity and reliability of the Bank's financial reporting.
3. In our opinion, the annual financial statements for the year ended 30 June 1998 fairly reflect the financial position and operations of the Bank.



Governor



**Audit report**

To the Readers of the Financial Statements of the Reserve Bank of New Zealand

We have audited the financial statements on pages 38 to 69. The financial statements provide information about the past financial performance and financial position of the Reserve Bank of New Zealand and group as at 30 June 1998. This information is stated in accordance with the accounting policies set out on pages 38 to 40.

**Governors' responsibilities**

The Governors are responsible for the preparation of the financial statements as set out in the management statement on page 70.

**Auditors' responsibilities**

It is our responsibility to express an independent opinion on the financial statements presented by the Governors and report our opinion to you.

**Scope of opinion**

An audit includes examining, on a test basis, evidence relevant to the amounts and disclosures in the financial statements. It also includes assessing:

- the significant estimates and judgments made by the Governors in the preparation of the financial statements; and
- whether the accounting policies are appropriate to the Reserve Bank of New Zealand and group circumstances, consistently applied and adequately disclosed.

We conducted our audit in accordance with generally accepted auditing standards in New Zealand. We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatements, whether caused by fraud or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Our firm carries out other assignments for the Reserve Bank of New Zealand and group in the area of taxation advice and special consultancy projects. The firm has no other interest in the Reserve Bank of New Zealand and group.

**Unqualified opinion**

We have obtained all the information and explanations we have required.

**In our opinion:**

- proper accounting records have been kept by the Reserve Bank of New Zealand as far as appears from our examination of those records; and
- the financial statements on pages 38 to 69:
  - comply with generally accepted accounting practice;
  - give a true and fair view of the financial position of the Reserve Bank of New Zealand and group as at 30 June 1998 and the results of their operations and cash flows for the year ended on that date.

Our audit was completed on 20 August 1998 and our unqualified opinion is expressed as at that date.



Wellington