

As New Zealand's central bank, we will do everything in our power to build national and international confidence in the stability and integrity of New Zealand's money and monetary system.

We will do that by:

- operating monetary policy so as to maintain price stability;
- promoting the maintenance of a sound and efficient financial system; and
- meeting the currency needs of the public.

We will critically review our performance regularly and will aim to ensure that we use tax-payers' resources efficiently and effectively.

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Foreword



This *Annual Plan* covers the Reserve Bank of New Zealand's 1998/99 financial year, from 1 July 1998 to 30 June 1999.

As the Reserve Bank's activities affect all New Zealanders, it is important to communicate our intentions. The aim of the *Annual Plan* is to provide information on the functions the Bank will perform in the year ahead and the resources required to carry out those functions.

While this Plan is primarily concerned with what we do, we think how we do things is also very important. Accordingly, we have set out *Our Commitment to New Zealanders* and *Our Values* on the inside covers of this document as a guide to the principles that govern our work.

For most of the Reserve Bank's activities, the planned outputs are similar from year to year, and in this respect the next year is no exception. There are, however, a number of significant initiatives planned in the year ahead as the Bank continues to search for better ways of carrying out its activities. These are set out in the section entitled *The Bank's Functions*.

The *Annual Plan* also provides an assurance to the public of New Zealand that the Reserve Bank's stewardship of resources is sound and that the expertise required to carry out its functions is maintained. The Bank's key resource is its staff. The continuing success of the Bank in meeting the goals set for it by government depends not on one individual but upon a great many people. We must, and do, attract and retain staff of the very highest calibre. The Bank places considerable emphasis on maintaining and improving its intellectual capital and in the year ahead our efforts will be no less.

The present Reserve Bank of New Zealand Act has been in place for nearly nine years now and is well established. During that period the Bank has been through significant structural change and has achieved considerable reductions in its operating costs. A challenge before us now is to maintain the productive performance of previous years while continuing to do our work to a very high standard.

Donald T. Brash
Governor

The Reserve Bank of New Zealand

THE BANK AND ITS FUNCTIONS

The Reserve Bank of New Zealand is New Zealand's central bank and, as such, it provides banking services to the Government and commercial banks.

The Reserve Bank has three main goals. These are to:

- operate monetary policy to maintain price stability;
- promote the maintenance of a sound and efficient financial system;
- meet the currency needs of the public.

Under its own statute (Reserve Bank of New Zealand Act 1989), the Reserve Bank is required to independently manage monetary policy to maintain overall price stability. Price stability is defined in a separate agreement with the Government as inflation of between 0 and 3 percent annually. Price stability contributes to New Zealand's overall economic success by protecting the value of people's incomes and savings, and by encouraging investment in the nation's productive capacity.

To achieve the goals set above, the Reserve Bank performs nine key functions. The role and description of each function are set out in the section *The Bank's Functions*.

ORGANISATION STRUCTURE

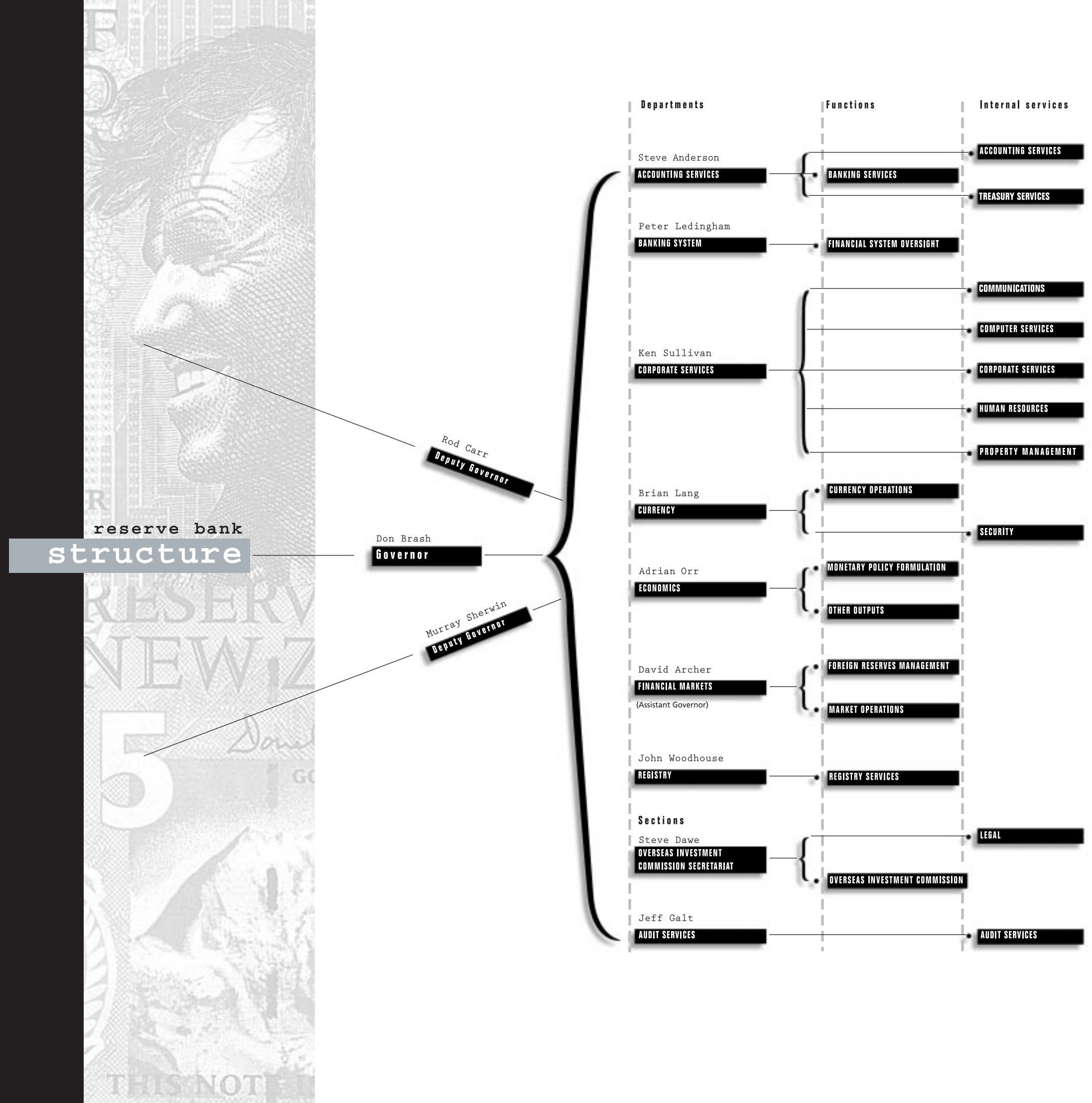
The structure of the Reserve Bank and its relationship to the Bank's functions are shown in the diagram opposite.

Management

Each Department is headed by a Chief Manager, who reports directly to the Governors (the Governor and two Deputy Governors). Five Departments – Banking System, Currency, Economics, Financial Markets and Registry – are responsible for most of the Bank's functions. Financial Markets Department Chief Manager, Mr David Archer, also carries the title Assistant Governor. Of the other Departments, Accounting Services contributes directly to a function and provides support services, and Corporate Services provides support services to the other Departments. Two smaller units, Audit Services and the Overseas Investment Commission secretariat, also report directly to the Governors.

The Board

The Board of the Reserve Bank comprises the three Governors and seven non-executive Directors. The Board reviews the Bank's performance and the performance of the Governor in discharging his responsibilities, particularly achievement of the inflation target and the use of resources. Thus the Board differs from most boards in that it is a monitoring body, on behalf of the Treasurer, rather than a decision-making body.



CORPORATE ISSUES

The outputs to be produced under each function in the next financial year vary little from 1998. Our aim is to produce the outputs in a manner which is timely, of appropriate quality and within the limits of our resources. To do this we need to ensure effective accountability arrangements are in place to monitor outputs and performance. The structural mechanisms we have in place to ensure this are set out in the section *Performance Monitoring and Control*.

During the 1998/99 year, aside from carrying out its normal duties, the Reserve Bank specifically intends to:

- further enhance the Forecasting and Policy System model used in the preparation of *Monetary Policy Statements*, policy analysis and research;
- critically review the role of monetary policy throughout the most recent business cycle, to see if the management of monetary policy can be improved in the future;
- implement revised rules for banks' mandatory disclosure of their finances, as part of their registration obligations;
- facilitate drafting and passage of banking law reforms on netting and payments finality and amending legislation to shift Community Trust administration to the Internal Affairs Department;
- introduce the first polymer plastic bank notes around May 1999;
- participate in a review of banking industry cash-handling procedures co-ordinated by the New Zealand Bankers' Association;
- continue research into improving the risk-adjusted performance of our foreign reserves portfolio;
- address the implications for foreign reserves of the January 1999 introduction of the new European currency;
- ensure our systems are not going to be disrupted by the Year 2000 problem;
- host a SEANZA training programme for central bankers, along with meetings of SEANZA Governors and of EMEAP Deputies in November 1998;
- implement any decisions that emerge from the Retention of Women project;
- develop strategies for managing resource and personnel issues in the event of a natural disaster;
- sponsor a Journalists Training Organisation economics course and text book for mid-career journalists; and
- publish a booklet on the implications of price stability for personal savings and investments.

PEOPLE

Our people remain the Bank's key resource. The Bank will continue to adopt policies that ensure we are able to recruit and retain quality staff. Recognising that modern organisations no longer presume to offer employees jobs for life, achieving appropriate levels of staff retention and turnover is of considerable importance.

Ensuring a supply of quality staff requires the right mix of human resource policies and practices, including staff development and remuneration policies. Having just reviewed our remuneration policy and introduced a competency-based approach to performance reviews with an emphasis on staff and management development, we are looking to maintain our standing as an "employer of choice". We face a challenge in retaining women at senior levels and to this end will seek to identify and implement various strategies this year.

BUDGETED OPERATING EXPENDITURE

Our Funding Agreement¹ with the Government provides for operating expenditure in the 1998/99 financial year of \$40.2 million. Our budgeted operating expenditure for the same period (excluding the Registry function, which is self-funding) is \$35.6 million. This is \$4.6 million or 11 percent below the Funding Agreement limit for the period.

The Bank's 1998/99 consolidated budgeted operating expenditure (excluding taxation) is \$40.7 million. This is \$3.7 million, or 10 percent more than our actual consolidated operating expenditure for 1997/98. The bulk of the expected increase in operating expenditure in 1998/99 is due to higher expenditure related to:

- The introduction of polymer bank notes. There will be further expenditure increases in the following year after which currency costs will reduce substantially as a result of the longer life span of polymer notes.
- The real time settlement environment. A large proportion of this increased expenditure will be recovered by charging transaction fees to banks.
- Increased liaison with overseas central banks through the SEANZA and EMEAP programmes.

The proportion of resources consumed by each function is shown in the pie graph above. Our most significant area of expenditure is in Currency Operations, mainly due to the cost of issuing new notes and coins. The most significant expense for most of our functions is personnel costs.

The Reserve Bank has a number of sources of income. With the exception of the Overseas Investment Commission, which is substantially funded from fees, and Registry, which is required to be self-funding, the Bank's income is a consequence of its functions rather than a specific objective. The Bank is quite explicitly not seeking to maximise its income. Indeed, since most of the Bank's income derives from the investment of the funds arising from issuing currency, the simplest way to maximise income would be to increase inflation and, with it, interest rates. This would run directly counter to our primary objective.

The income derived from investing funds arising from issuing currency is referred to as seigniorage, and in 1998/99 is expected to amount to \$130.8 million. Other sources of income are expected to be comparatively minor, and arise essentially from investment of the Reserve Bank's equity in income-earning securities.

In preparing the 1998/99 budget, we have assumed that the Reserve Bank will carry out existing functions and operations and that there are no material changes to the balance sheet.

PERFORMANCE MONITORING AND CONTROL

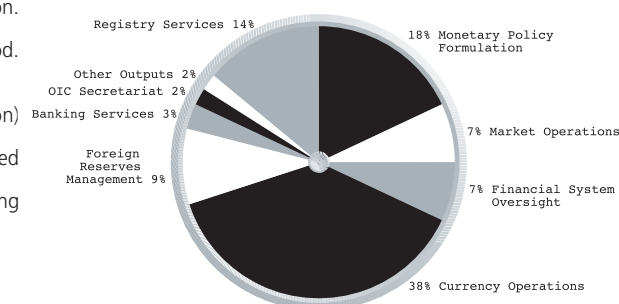
To ensure that the highest standards are maintained, we will continue to subject our work to rigorous internal peer review, management review, external review and Board review. The Reserve Bank's policies and their implementation are intended to be as transparent as possible in order to encourage public scrutiny.

The Reserve Bank's procedures and practices will continue to be monitored by our Audit Services group, external auditors and, in the case of the currency function, which has ISO 9002 accreditation, Bureau Veritas Quality International.

Total Quality Management and benchmarking initiatives will be continually reviewed as the Reserve Bank continues to seek improvement in the efficiency and effectiveness of its outputs.

¹Refer to Appendix 2.

Budgeted Operating Expenses by Function 1999



COMMUNICATIONS

The Reserve Bank takes external communications seriously, believing that public understanding of the Bank's activities is fundamental to the Bank's success. In particular, the effectiveness of monetary policy is significantly influenced by public perceptions of the Bank's commitment to delivering price stability. Furthermore, the Reserve Bank has statutory independence and has a responsibility to provide the public with information on its activities and performance. A substantial challenge for the Reserve Bank over the 1998/99 year will be adapting its external communications to deal with the context of an economy facing the effects of the Asian economic crisis.

A major element of the Reserve Bank's external communications programme is the quarterly release of the *Monetary Policy Statement*. In August and November 1998, March and May 1999, *Monetary Policy Statements* will lay out how the Reserve Bank expects inflation to evolve and the Bank's likely stance in ensuring price stability.

One of the communications highlights in the coming year will be a publication entitled *Profiting from Price Stability*. It aims to advise people how to make the most of New Zealand's low inflation environment in terms of investing their savings.

Over the next two years the Reserve Bank will introduce polymer versions of the entire range of New Zealand's bank notes. This changeover from paper to polymer currency will require a substantial public education initiative and will mean a new edition of the popular Reserve Bank booklet *Explaining Currency*.

The Reserve Bank is committed to investing in education to promote a broader understanding of economic issues. This year the Reserve Bank is sponsoring the preparation of a text book for mid-career journalists, aimed at improving the economic understanding of news media financial reporters.

The Reserve Bank's Internet site will continue to be enhanced. For thousands of people world-wide, the Website has become their main source of information about the Reserve Bank.

The Reserve Bank's public speaking programme, primarily by the Governors, will continue. Almost all of these engagements will be off-the-record, and they remain important for building understanding of the Reserve Bank's activities. This is especially so among key audiences, such as the business community and those concerned for the perceived social costs of achieving and maintaining price stability. From time to time, on-the-record speeches will be given and will be circulated to the media and relevant audiences.

The Bank's Functions

The following describes the activities carried out by the Bank under each of its nine functions. Under each function are included:

- a brief outline of the **function** and its purpose;
- a brief **description** of the function, including its outputs and, where appropriate, its basis in legislation;
- **key initiatives** for each function over the coming year;
- **key performance indicators** for each output; and
- **budgeted expenditure** for the 1998/99 year.

Our various outputs share many common features. Much of our work involves preparing reports and formulating policy. The quality-related performance criteria for these types of outputs are that reports and advice should be concise, of a high technical standard, understandable by the intended audience, rigorous and relevant.

Many outputs are produced as required, and not to a predetermined timetable. Deadlines for these are set on a case-by-case basis.

This Plan primarily covers those outputs reaching external audiences. Staff also contribute to the Bank's work by producing material and services for internal use. Generally, these items are not listed in this *Plan* as outputs. However all internal and service activities are included in the plans of the sections where they are carried out.

Information about the Reserve Bank's recent performance can be found in our *1998 Annual Report*.



A 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.

DESCRIPTION

The Reserve Bank's primary function is to conduct monetary policy to maintain price stability, as directed in section 8 of the Reserve Bank of New Zealand Act 1989 (the Act). The intent of the monetary policy provisions in the Act is to give the Bank a clear and unambiguous objective – price stability – and to provide the Bank with the authority to pursue that outcome.

The Governor of the Bank is accountable for the Bank's actions in pursuit of price stability. The current Policy Targets Agreement (PTA), signed by the Treasurer and the Governor on 15 December 1997², in accordance with section 9 of the Act, defines the operational target to be 12-monthly increases in the All Groups Consumers Price Index excluding Credit Services (CPIX) of between 0 and 3 percent. The PTA notes that "the Treasurer and the Governor may agree to use an alternative index of consumer price inflation following the implementation of the changes to the calculation of consumer prices proposed by the Government Statistician to take effect during 1999."

Policy Framework

The PTA recognises that unusual events may lead to inflation outcomes, as measured by the CPIX, outside the target range. Such events may include, for example, major movements in the prices of commodities traded in world markets, material changes to indirect taxes, significant government policy changes that directly affect prices, or a significant natural disaster affecting a major part of the economy. When such events arise, the PTA requires the Bank to react in a manner which prevents general inflationary pressures emerging. Having been set the target by the Government, the Bank has independence in policy formulation and is accountable for its judgements and actions in implementation. There are no hard and fast rules connecting monetary policy actions and outcomes. We must always make judgements regarding how best to achieve the target. The Act requires us to publicly articulate the nature of those judgements and their rationale. This transparency in policy formulation, coupled with policy independence, is important in enhancing the credibility of policy and, ultimately, its effectiveness in maintaining price stability.

Economic Forecasting

The Reserve Bank's inflation projections are a central ingredient in the setting of monetary policy. Policy formulation involves assessing whether current monetary conditions are likely to produce inflation outcomes in the middle part of the 0 to 3 percent inflation target range around one to two years ahead. Our approach lays considerable emphasis on reliable projections of inflation, and a sound understanding of the way changes in monetary policy settings affect future inflation developments. Considerable resources are focused on reviewing and improving our projection methodology and performance.

The most visible output of monetary policy formulation is the stance taken, as reflected in the settings of the various policy instruments that we employ. In terms of the Bank's management framework, Monetary Policy Formulation includes the research and analysis which supports the advice on the appropriate stance of policy provided to the Governor by our specialist staff, as well as the Governor's decisions on the stance. The output Market Operations covers the transactions and actions that serve to implement the desired stance.

² Refer to Appendix 1.

Communications

We make a wide range of information available to inform the public about our actions and policies, and the reasoning that supports these. Successfully communicating the intended stance of monetary policy to people whose decisions determine economic outcomes is an integral part of good policy. Increased knowledge of, and certainty about, our commitment to the price stability target help shape individuals' and organisations' decisions in ways that support achievement of price stability. We therefore communicate through a wide variety of channels. The most important of these is the three-monthly *Monetary Policy Statement*, but our *Bulletins*, research and discussion papers, speeches, presentations, and meetings with interested groups are also all part of the process.

KEY INITIATIVES FOR 1998/99

- Issue four *Monetary Policy Statements* carrying at least one of the following themes in each: policy implementation, policy formulation, policy framework, long-term outlook, and international. Publish four *Bulletins*, with a key theme running through each issue.
- Finalise the technical documentation for the Forecasting and Policy System (FPS). Enhance the projection environment by improvements related to the interaction of FPS and data spreadsheets, as well as ongoing improvements to the short-term dynamics and calibration of FPS.
- Install new data collection methodology for the survey of financial institutions for the compilation of the money and credit aggregates.

PERFORMANCE INDICATORS

Policy Target

- Maintain price stability as defined in the Policy Targets Agreement.

Policy Framework

- Research focused on improving the Bank's understanding of issues related to inflation forecasting.

Economic Forecasting

- Inflation forecasts to be the most accurate among those assessed by the New Zealand Institute of Economic Research.
- Advice and analysis to be timely, relevant, honest, understandable, and founded on rigorous research and evidence.
- Statistics to meet users' defined needs and contain no processing errors.

Communications

- Communication of the Bank's analysis and decisions to improve understanding across target groups.

BUDGETED OPERATING EXPENDITURE

Budgeted operating expenditure for 1998/99 is \$7.24 million, which is an increase of 7 percent (\$0.51 million) over actual expenditure for 1997/98. This increase is largely due to an increase in personnel expenses as a result of a small increase in staff numbers.

B 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 support of the orderly and competitive functioning of financial markets.

DESCRIPTION

Our main outputs under this function are as follows.

Crown Cash and Debt Management

We undertake liquidity management on behalf of the Crown. This keeps banking system liquidity at the end of each day in line with the monetary policy target for settlement banks' cash balances. We also conduct regular government domestic debt tenders and provide advice on the frequency and structure of domestic debt issuance.

Monetary Policy Implementation – Operations

Monetary policy is implemented by adjusting the settlement cash target and, more usually, by issuing public statements that state the Reserve Bank's view of inflation and by that infer potential cash target adjustments. We issue and discount Reserve Bank bills to support and enforce the cash target.

Provision of Intra-day Liquidity

To facilitate the real-time gross settlement of high value financial transactions, we engage in intra-day securities repurchase transactions with approved settlement account holders. We buy acceptable securities to add cash to settlement accounts during the day, and then re-sell those same securities at the same price at the end of the same day. This mechanism maintains a clear separation between monetary policy and intra-day liquidity issues.

Monetary Policy Implementation – Policy and Analysis

Under this output, issues related to the monetary policy implementation framework, financial markets and liquidity management are addressed.

KEY INITIATIVES FOR 1998/99

- a) Review the conditions under which liquidity is provided to facilitate real-time settlement, including the types of securities accepted by the Reserve Bank for intra-day repurchase transactions, and the continuing need for the clear distinction between inter-day and intra-day liquidity management arrangements.
- b) Review the skills required for dealing in financial markets and develop a strategy to ensure that the appropriate skill set is maintained.

PERFORMANCE INDICATORS**Crown Cash and Debt Management**

- Forecasts accurate to within \$20 million on four days out of five.
- Operations conducted without material error.
- Advice seen as relevant and rigorous by the Treasury.

Monetary Policy Implementation – Operations

- All operations concluded within pre-determined times and without material error.

Provision of Intra-day Liquidity

- Monetary conditions not affected by intra-day liquidity arrangements

Monetary Policy Implementation – Policy and Analysis

- Policy advice to be pertinent, timely and informed.
- Analysis to be robust and rigorous and add noticeably to our understanding and approach.
- Reports to be concise and readable.

BUDGETED OPERATING EXPENDITURE

Budgeted operating expenditure for 1998/99 is \$2.82 million, largely unchanged from actual expenditure for 1997/98.

C FINANCIAL SYSTEM OVERSIGHT

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

DESCRIPTION

The Reserve Bank has a statutory role to register and supervise banks. We carry out this role in a way which encourages individual banks to conduct their business in a prudent manner, and ensures that bank directors, managers and shareholders remain responsible for maintaining the soundness of their institutions, while endeavouring to avoid imposing excessive administrative burdens on them. In addition, we seek to minimise any perception that the Government underwrites the prudential soundness of individual banks or that banks are in any way guaranteed by the Crown. Our responsibility is not to provide a 'safety net' for insolvent institutions, nor to shelter depositors from losses, but is to help limit the risk of a bank failure creating more widespread disruption to the financial system. We also advise the Government and work with a variety of interested groups on such matters as payments system and banking law reform. Our main outputs are as follows.

Registering and Supervising Banks

Applications for bank registration are assessed against policy standards, which are aimed at promoting competition and efficiency as well as the integrity and stability of the banking system. Following registration, we regularly monitor compliance of individual banks with their conditions of registration and public financial disclosure requirements, evaluate their financial and prudential performance, and keep ourselves informed on broader developments in the financial system.

Formulating Banking Supervision Policy

Policies are kept under continual review to ensure relevance and consistency with the overall supervision approach and to enhance the effectiveness of market disciplines. We monitor supervision policy initiatives and financial sector developments internationally to assess the policy implications for New Zealand.

Crisis Management

We maintain an ability to act swiftly and effectively to minimise disruption to the financial system in the event of financial distress or a crisis affecting registered banks, while minimising financial risk to the Crown.

Reviewing and Administering Bank Legislation

In consultation with relevant external parties, we promote law reform initiatives where the Bank considers that the achievement of system efficiency or soundness can be materially improved.

Advice on Issues Related to the Efficiency and Soundness of the Financial System

We work towards implementation of payments system reforms and, where relevant to the Bank's objectives, we provide advice to external parties (e.g. ministers and government departments) on such issues as business and securities law, electronic cash, money laundering, and the strengthening of financial reporting standards for financial institutions.

Information About Financial System Oversight

We use speeches, seminars, pamphlets and articles to convey clearly and accurately our role in financial system oversight.

KEY INITIATIVES FOR 1998/99

- a) Promulgate and implement by October 1998 revised disclosure Orders in Council following the review and industry consultations carried out in 1997/98.
- b) Monitor international developments in supervision, in Australia in particular, and strengthen relationships with other supervisory authorities.
- c) Facilitate drafting and passage of banking law reforms on netting and payments finality and amending legislation to shift Community Trust administration to the Internal Affairs Department.
- d) Review and finalise the options for responding to a bank in distress.
- e) Review the risk characteristics of the payments system and its ability to cope with natural disasters or operational disruptions.
- f) Monitor the banking industry's progress in dealing with the Year 2000 issue.
- g) Improve public understanding of the information disclosed by banks and seek to improve the quality of the external analysis of and reporting on bank disclosure statements.

PERFORMANCE INDICATORS**Registering and Supervising Banks**

- Bank application evaluations and supervision monitoring to be carried out to agreed standards within designated deadlines, using accurate and relevant technical analysis.
- Reserve Bank to be respected as informed, professional and competent by the banking industry.
- Conditions capable of affecting the efficiency and soundness of the financial system to be identified accurately and in time for the Bank to make informed and considered decisions about its response.

Policy-Related Outputs

- Policy advice must be recognised by recipients as rigorous, timely, relevant and readable.

BUDGETED OPERATING EXPENDITURE

Budgeted operating expenditure for 1998/99 is \$2.73 million. This is 2 percent (\$0.05 million) under actual expenditure for 1997/98.

D CURRENCY OPERATIONS

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

DESCRIPTION

The Reserve Bank has sole rights to issue bank notes and coin under section 25 of the Reserve Bank of New Zealand Act 1989. Every effort is made to promote confidence in the currency. The Bank does this by using design features in bank notes which ensure that our currency is difficult to counterfeit and by maintaining the physical quality of the notes in circulation. Our outputs and the activities associated with them are as follows.

Providing Circulating Currency

Currency is issued, on demand, to banks. Bank notes withdrawn from circulation are either reissued (if they meet authenticity and fitness benchmarks) or destroyed.

Providing Currency to Collectors

We also issue currency from time to time for collectors. Special issues designed for collecting are legal tender but are not generally circulated.

KEY INITIATIVES FOR 1998/99

- a) Introduce into circulation the first polymer bank notes, with new security features, towards the end of the 1998/99 financial year.
- b) Participate in a strategic review of cash handling procedures in the banking industry co-ordinated by the New Zealand Bankers' Association.
- c) Trial new process initiatives that improve the efficiency and security of our note processing operations.
- d) Implement any changes resulting from the strategic and operational review of our collectors' currency operations.

PERFORMANCE INDICATORS**Providing Circulating Currency**

- Currency issued on demand to banks.
- Currency to meet predetermined re-issuable note fitness standards.
- All bank notes received to be processed within six working days (seven working days during seasonal peaks).
- ISO 9002 accreditation to be maintained.

Providing Currency to Collectors

- Internationally accepted standards to be met for the production and packaging of the currency.
- Products received by collectors within four weeks of receipt of orders.

BUDGETED OPERATING EXPENDITURE

The total budget for 1998/99 is \$16.02 million, which is 15 percent (\$2.03 million) above actual expenditure for 1997/98. The increase is due to one time costs associated with the introduction of polymer bank notes.

E 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.

DESCRIPTION

The Bank maintains a foreign exchange market intervention capability of around \$4.5 billion, a level determined by the Treasurer. Most of this takes the form of foreign reserves, which are funded by foreign currency loans from the Treasury, with the balance in the form of credit lines. Investments comprise high quality, marketable instruments in the major markets. Financial risks are constrained within prudent limits by the close monitoring and management of foreign exchange, interest rate, liquidity, and credit exposures. Our main outputs are as follows.

Managing Foreign Reserves

The major activities associated with this output are active management of the asset portfolios, maintaining credit lines, maintaining the benchmark portfolios, managing the loans from the Treasury, reporting on performance and developing and maintaining dealing relationships. Settling of transactions and accounting is also a significant part of our work on this output. To ensure risks are well managed, we routinely monitor exposures, performance and systems. We also undertake related research and project work on issues relevant to foreign reserves management.

Foreign Reserves Management Advice

Advice is provided to the Treasurer on the level and composition of reserves.

Information About Foreign Reserves

Information on foreign reserves is provided as required in response to external enquiries, including responses to Parliamentary questions and letters to the Treasurer and Minister of Finance.

KEY INITIATIVES FOR 1998/99

- a) Implement a new portfolio management, settlement and accounting system by the end of December 1998.
- b) Review and update the risk management framework and adapt this to fit the new portfolio management system and the Bank's risk/return preferences.
- c) Investigate, and implement where appropriate, new trading strategies that improve the Bank's risk/return position.
- d) Ensure operational and risk implications of the January 1999 introduction of the European currency (Euro) are recognised, addressed and implemented.
- e) Develop the capability to use futures by the end of June 1999.

PERFORMANCE INDICATORS**Managing Foreign Reserves**

- Maintain an intervention capacity within the range determined by the Treasurer.
- Observe internally-determined risk limits.
- Exceed the return on benchmark portfolios.

Foreign Reserves Management Advice

- Produce the regular annual review required by the Treasurer by the end of May 1999.

Information About Foreign Reserves

- Meet enquirers' needs clearly and concisely and meet external deadlines.

BUDGETED OPERATING EXPENDITURE

Budgeted operating expenditure for 1998/99 is \$3.90 million, which is an increase of 5 percent (\$0.19 million) over actual expenditure for 1997/98. The increase is largely due to an increase in personnel and computer expenses.

F 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.

DESCRIPTION

Banking Services' client base reflects the traditional role of central banks, and international conventions and protocols. The power to conduct banking operations is set out in sections 32, 34 and 39(a) of the Reserve Bank of New Zealand Act 1989. Our outputs are as follows.

Inter-bank Settlement

Most registered banks hold exchange settlement accounts with the Reserve Bank on the Exchange Settlement Account System (ESAS). These accounts are used for the settlement of obligations between the various registered banks and with the Reserve Bank in a real time settlement environment. The Reserve Bank administers the ESAS autorepo function, which provides the ESAS system with intra-day liquidity. ESAS accounts are required to be maintained in credit at all times.

Providing Customer Banking Services

Private sector banking services are used by the Government for its daily transaction requirements. At the close of business each day, balances in the Government's private sector bank accounts are transferred to the Crown's account at the Reserve Bank. In addition to settlement and central government banking functions, we maintain accounts for overseas central banks and international monetary and banking organisations.

PERFORMANCE INDICATORS**Inter-bank Settlement**

- Settlement banks to be satisfied with the operation of the ESAS system.

Providing Customer Banking Services

- Customer enquiries to be dealt with confidentially, courteously and promptly.
- Processing deadlines to be met with complete accuracy.

BUDGETED OPERATING EXPENDITURE

Budgeted operating expenditure for 1998/99 is \$1.14 million, which is an increase of 45 percent (\$0.36 million) over actual expenditure for 1997/98. The increase is due to higher expenses related to the move to a real time settlement environment and represents the cost associated with a significant reduction in the risks faced by banks in dealing with each other. These costs will be recovered by charging transaction fees to banks.

G 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.

DESCRIPTION

The provision of an efficient registry and transfer system for financial instruments assists the functioning of financial markets and is consistent with our objective to promote financial system efficiency and soundness. Section 35 of the the Reserve Bank of New Zealand Act 1989 empowers the Bank to provide securities registry services. Because the Act requires Registry to be self-funding, and for reasons of transparency, Registry Services are accounted for separately through a subsidiary company, RBNZ Registry Limited. Our main outputs are as follows.

Registry Services

We provide registration of securities and act as paying agent on behalf of the New Zealand Government, many local authorities, and other corporate clients.

Austraclear

We operate a securities clearing and settlement service (the Austraclear New Zealand System) covering a wide range of instruments, which allows securities to be immobilised and ownership to be transferred electronically on a delivery-against-payment real-time basis.

Exchange Settlement Account System

We also operate the Exchange Settlement Account System (ESAS), which is the real-time inter-bank processing facility as described in the Banking Services function.

Agency Services

We provide agency services for Cedel, Euroclear and the Hong Kong Monetary Authority (HKMA), which allow non-resident investors to hold New Zealand domestic securities using systems with which they are already familiar.

KEY INITIATIVES FOR 1998/99

- Implement improvements to the external communications network for Austraclear New Zealand members.
- Review software requirements for both the Registry and Austraclear New Zealand systems.
- Enhance the quality of our services.
- Participate in the development of depositories in the Asia/Pacific region.
- Ensure our systems are capable of handling all data in the year 2000 and beyond.

PERFORMANCE INDICATORS

- All work to be undertaken in an accurate and timely manner.
- New issues to be registered within one day for wholesale/corporate investors, or three days for retail investors.
- Systems to be available to subscribers without interruption.

BUDGETED OPERATING INCOME AND EXPENDITURE

For 1998/99, budgeted operating expenditure is \$5.66 million (includes estimated tax payable). This is largely unchanged from actual expenditure for 1997/98. Budgeted income is expected to be \$6.33 million, which is 12.1 percent less than actual income for 1997/98. Reduced income is primarily due to a reduction in fees charged.

H OVERSEAS INVESTMENT COMMISSION SECRETARIAT

Providing the secretariat of the Overseas Investment Commission.

DESCRIPTION

The Overseas Investment Commission (OIC) is an independent statutory body which administers the Government's foreign investment policies. Under the Overseas Investment Act 1973, the Reserve Bank provides and funds the Commission Secretariat. The Commission's key outputs are as follows.

Processing Investment Applications

All applications made under the Overseas Investment Regulations 1995 are considered by the Commission. The Commission determines appropriate applications under a delegation from the Treasurer and the Minister of Lands, while other applications are forwarded with recommendations to the Ministers for their consideration.

Monitoring Overseas Investment in New Zealand

The Commission's statutory functions include monitoring overseas investment in New Zealand and monitoring compliance with any conditions of consents granted.

KEY INITIATIVES FOR 1998/99

- a) Introduce new procedures to implement the Overseas Investment Amendment Act 1998.
- b) Complete the development and make operational the OIC database processing system.

PERFORMANCE INDICATORS**Processing Investment Applications**

- Applications to be considered against legal requirements and in terms of Government criteria.
- Respond to delegated applications within ten working days of receiving full information.
- Respond to applications requiring Ministerial decisions within 25 working days of receiving full information.

Monitoring Overseas Investment in New Zealand

- All material breaches of conditions to be detected and reported to Ministers.

BUDGETED OPERATING EXPENDITURE

For 1998/99 the Commission's budgeted operating expenditure is \$0.79 million. This is 8 percent (\$0.07 million) lower than actual expenditure for 1997/98.

I OTHER OUTPUTS

Producing other outputs which cannot be classified under our main functions.

DESCRIPTION

The Reserve Bank produces other outputs not classified under the Bank's main functions, where appropriate and not in conflict with our main functions. Outputs under this function are as follows.

Economic Policy Advice

This output includes any economic policy advice to the Government which does not fall directly within any of our main functions. This is generally in areas of policy which have a bearing on price-setting behaviour in the economy and thus on inflation, but which are outside the narrow confines of monetary policy. One staff member will represent the Bank on the Steering Group on Saving and Net Worth Statistics in the context of the Todd Committee's recommendations for retirement savings. Also the Bank is one of the sponsors of the New Zealand Institute for the Study of Competition and Regulation. Before undertaking such work, careful consideration is given to the potential for conflict (either direct or indirect through competition for resources) with our main functions.

Overseas Representation and Liaison

This output covers representation and liaison not falling within any of our main functions. Examples include maintaining training relationships and liaison with overseas central banks, and participating in international discussions on economic and financial matters affecting New Zealand. The Reserve Bank represents New Zealand at meetings of the International Monetary Fund, the International Bank for Reconstruction and Development (World Bank), the Organisation for Economic Co-operation and Development and the Bank for International Settlements. Contacts with international financial market participants, other than those related specifically to our main functions, are also addressed under this output.

New Zealand assumes the chair of Asia-Pacific Economic Co-operation (APEC) in January 1999. Economic and financial developments in Asia are likely to take a prominent place on the agenda of the Finance Ministers' and Leaders' meetings. The Bank will provide some support services for New Zealand's APEC role.

The Bank will continue its participation in the Executives' Meeting and working groups for East Asian and Pacific Central Banks (EMEAP) at Governor, deputy and working group levels. This recognises the importance to New Zealand of regional and international economic and financial sector developments. The Bank will also continue to be represented at meetings of the Manila Framework Group, which aids in co-ordinating policy responses and assistance to countries affected by the Asian crisis.

The Bank is currently chair of the South East Asia New Zealand and Australia (SEANZA) group of central banks. In November 1998, the Bank will host the SEANZA Central Bank Training Course and the SEANZA Governors' Symposium. Also, the Bank holds the chair of the SEANZA Banking Supervisors' Forum and will assist in organising a Forum meeting in Sydney in October 1998.

In response to the Asian crisis, the Bank will provide policy advice to the Government and give technical assistance to East Asian central banks.

Demands in these areas have been increasing over the last few years. The framework used for monetary policy in New Zealand continues to gain increased international recognition, and requests to speak about or provide information on it come from many sources. There has also been much interest in our approach to banking supervision, and in addition we increasingly receive requests to provide training or advice to overseas central banks.

Maintaining inflation within a narrow range is difficult, and we shall, therefore, continue to maintain close links with other central banks with similar targets so we can learn from their experience, supplementing and verifying our own analysis. Over the next year, we intend to focus as much of our international liaison and training efforts as possible on the Asia/Pacific region.

BUDGETED OPERATING EXPENDITURE

Budgeted operating expenditure for 1998/99 is \$0.93 million, which is an increase of 48% percent (\$0.30 million) over actual expenditure for 1997/98. The increase is related to SEANZA and EMEAP responsibilities.

P o l i c y T a r g e t s A g r e e m e n t

POLICY TARGETS AGREEMENT

This agreement between the Treasurer and the Governor of the Reserve Bank of New Zealand (the Bank) is made under sections 9(1) and 9(4) of the Reserve Bank of New Zealand Act 1989 (the Act), and shall apply for the balance of the Governor's present term and for his next five year term, expiring on 31 August 2001. It replaces that signed on 10 December 1996.

In terms of section 9 of the Act, the Treasurer and the Governor agree as follows:

1. Price stability

Consistent with section 8 of the Act and with the provisions of this agreement, the Bank shall formulate and implement monetary policy with the intention of maintaining a stable general level of prices, so that monetary policy can make its maximum contribution to sustainable economic growth, employment and development opportunities within the New Zealand economy.

2. Policy target

- a) In pursuing the objective of a stable general level of prices, the Bank shall monitor prices as measured by a range of price indices. The price stability target will be defined in terms of the All Groups Consumers Price Index excluding Credit Services (CPIX), as published by Statistics New Zealand.
- b) For the purpose of this agreement, the policy target shall be 12 monthly increases in the CPIX of between 0 and 3 per cent.
- c) Notwithstanding clause 2(a), the Treasurer and the Governor may agree to use an alternative index of consumer price inflation following the unalteration of the changes to the calculation of consumer prices proposed by the Government Statistician to take effect during 1999.

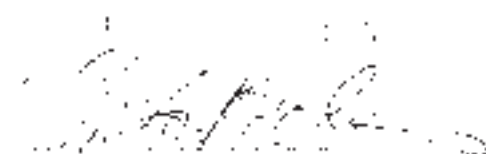
3. Unusual events

- a) There is a range of events that can have a significant temporary impact on inflation as measured by the CPIX, and mask the underlying trend in prices which is the proper focus of monetary policy. These events may even lead to inflation outcomes outside the target range. Such disturbances include, for example, shifts in the aggregate price level as a result of exceptional movements in the prices of commodities traded in world markets, changes in indirect taxes, significant government policy changes that directly affect prices, or a natural disaster affecting a major part of the economy.

- b) When disturbances of the kind described in clause 3(a) arise, the Bank shall react in a manner which prevents general inflationary pressures emerging.

4. Implementation and accountability

- a) The Bank shall constantly and diligently strive to meet the policy target established by this agreement.
- b) It is acknowledged that, on occasions, there will be inflation outcomes outside the target range. On those occasions, or when such occasions are projected, the Bank shall explain in Policy Statements made under section 15 of the Act why such outcomes have occurred, or are projected to occur, and what measures it has taken, or proposes to take, to ensure that inflation comes back within that range.
- c) The Bank shall implement monetary policy in a sustainable, consistent and transparent manner.
- d) The Bank shall be fully accountable for its judgments and actions in implementing monetary policy.



Hon Winston Peters
Treasurer




Donald T Brash
Governor
Reserve Bank of New Zealand

DATED at Wellington, this 15th day of December 1997

F u n d i n g A g r e e m e n t

- 1 This is an Agreement between the Minister of Finance and the Governor of the Reserve Bank pursuant to section 159 of the Reserve Bank Act 1989. It supersedes and replaces the Agreement signed on 17 April 1991.
- 2 It is hereby agreed that the amount of the Bank's income to be applied in meeting the expenditure of the Bank needed to carry out the functions and to exercise the powers specified in section 159 shall be :
- \$38,000,000 for each of the years commencing 1 July 1995 and 1 July 1996,
- \$39,000,000 for the year commencing 1 July 1997, and
- \$40,000,000 for each of the years commencing 1 July 1998 and 1 July 1999[†]
- 3 It is agreed, under section 159 (1) (f), to include within this limit expenditure on foreign exchange dealings, settlement banking and government banking as defined in Part II sections 16, 32 and 34 of the Act.
- 4 It is further agreed that -
- (a) if the policy target for inflation agreed by the Minister and the Governor in terms of section 9 of the Act of 0 to 2 percent per annum is reviewed and a new policy target substituted, the agreed level of Bank expenditure as specified above will be adjusted to reflect any difference between the Bank's new and old path for inflation;
- (b) if there is any material changes in the nature or extent of the work undertaken by the Bank in respect of any of the functions or activities covered by this Agreement, the Minister and Governor will redetermine the levels of expenditure set out in 2 above to reflect such changes;
- (c) this Agreement may be suspended and renegotiated at any time by mutual agreement between the Minister and the Governor but any such renegotiation will require ratification by Parliament.



Minister of Finance

dated... 30 June 1995



Governor of the Reserve Bank

date ... 30 June 1995

Ref #17003

2 The Terrace, PO Box 2498, Wellington
Telephone (NZ) 64-4-472-2029
Fax (NZ) 64-4-473-8554, Telex (NZ) 3368

[†] The 1998/99 Funding Agreement level of \$40.2 million is based on the level of \$40 million adjusted after the December 1996 change in the policy target for inflation to 0 to 3 per cent per annum.

P u b l i c a t i o n s L i s t

The following publications are available on request:

Publications incurring a charge

Financial Statistics*: Published quarterly. Contains economic and financial statistics.

Monetary Policy and the New Zealand Financial System, 3rd edition (1992).

Reserve Bank Bulletin*: Published quarterly. Contains articles on topics relevant to the Bank's work.

Weekly Statistical Release*: Contains economic and financial statistics updating the *Bulletin* tables.

Publications free of charge

Annual Report*

Annual Plan*

Briefing on the Reserve Bank of New Zealand, 1996

Discussion papers*: Issued periodically. See the *Reserve Bank Bulletin* or web site for a current list.

Monetary Policy Statement*: Issued quarterly. Contains a review of relevant economic developments over the last three months, and medium-term forecasts of inflation developments (Charge applies for more than one copy).

Pamphlets*: These include:

- *Explaining currency*
- *How to spot a counterfeit bank note*
- *The impact of monetary policy on exporters*
- *The impact of monetary policy on people*
- *The impact of monetary policy on the economy*
- *Nga mahi a te peke putea matua (Functions of the Reserve Bank)*
- *The Reserve Bank of NZ Act 1989: our accountability to New Zealanders*
- *This is the Reserve Bank*
- *Your bank's disclosure statement: what's in it for you?*

RBNZ Fact Sheets*: These include:

- *What is inflation?*
- *What is the monetary conditions index?*
- *What is the Reserve Bank?*
- *What is the Reserve Bank's cash target?*

The Registry Flyer*: Brief notes on topics of interest to Registry customers and Austraclear members.

Mintage Notes: Advertising brochures showing the latest commemorative currency, issued periodically.

Enquiries should be addressed to: The Knowledge Centre
Reserve Bank of New Zealand
P O Box 2498
Wellington
New Zealand

Phone us at: 64 4 472 2029

Fax us at: 64 4 473 8554

Email us at: knowledge@rbnz.govt.nz

or access our WWW site:

<http://www.rbnz.govt.nz>

* available on our web site.

O U R V A L U E S

- We will undertake all our functions equitably, making every effort to avoid undue economic or social costs.
- We will provide excellent service to both internal and external customers.
- We will seek to establish and maintain professional working relationships with external organisations.
- We will establish and agree clear definitions of the roles and functions of the Reserve Bank in relation to other public sector agencies.
- We will give clear, relevant, informed, impartial, timely advice based on rigorous analysis.
- We will implement our policies credibly and transparently, and will advise and consult with those who can significantly affect the achievement of our objectives.
- We will obtain information on matters relevant to our functions by consulting widely, and will conduct our own analysis of the information.
- We will improve external communication, focusing on clarity, catering for various audiences, and aiming at accurate public perception and understanding of the Bank's role, functions, and policy.
- We will seek to be publicly perceived as credible, stable and respected.
- We will continually assess the cost-effectiveness of all our activities through formal planning, budgeting and monitoring processes.
- We will be environmentally responsible.
- We will minimise threats to our functions from disasters and unplanned events.
- We will be a good employer, and will attract and maintain a high quality, diverse, motivated staff, through:
 - An environment that identifies, encourages and rewards excellent performance, including clearly defined roles and performance objectives, and consistent and fair appraisal and remuneration structures.
 - Transparent appointment procedures.
 - Selecting staff from the widest pool of candidates.
 - Attending to career development and providing appropriate and timely training to allow staff to take advantage of promotion opportunities.
 - Enriching jobs.
 - Providing a healthy, attractive, and comfortable work place.
 - Appropriately using suitable technology and equipment.
 - Inviting new and challenging ideas.
 - Giving all people appropriate authority to do their jobs effectively, and making them responsible for their own work.
 - Operating fair and open disciplinary procedures.
- We will develop and maintain high standards of management skills. Our immediate priorities include encouraging followership, emphasising people management skills as well as technical abilities when appraising managers.
- We will all contribute to building positive team relationships within the Bank.
- We will collectively build a consensus on, and a commitment to, our principal objectives.
- We will consult and communicate clearly, openly, and effectively, at and between all levels and areas of the bank. We will do this through informing, consulting and listening to the relevant people appropriately.
- We will all seek ways to improve the quality of our own work and the Bank's outputs.
- We will act with integrity in all situations.
- We are committed to the application of EEO principles to everything we do.
- We will collectively implement all of the above, and regularly review and report on progress in attaining these goals.