

Briefing on the Reserve Bank of New Zealand

November 2008

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Introductory note

This paper has been prepared to brief the incoming Minister of Finance on the role and functions of the Reserve Bank of New Zealand. It highlights the key issues the Bank is facing, and the important roles played by the Minister, the Governor, and the Board of Directors.

The *Briefing* has the following structure:

- The Executive Summary sets out the key issues contained in the briefing paper.
- Section 1 provides an overview of the current global and domestic financial and economic environment, and the Reserve Bank's roles.
- Section 2 described the objectives, issues and strategies relating to each of the Bank's functions.
- Section 3 outlines the Bank's functions, governance, and structure.

Executive summary

- The Reserve Bank of New Zealand is a 'full service' central bank, well placed to be fully informed and to engage in the economic and financial system.
- New Zealand's financial system has been weathering extreme disorder in international financial markets, leading to a global 'credit crunch' that is dampening the economic outlook.
- The New Zealand economy has contracted over 2008 following a sustained period of growth. We expect the economy to grow only slowly over the next few quarters before gaining more momentum toward the end of 2009.
- We expect to see inflation pressures dissipate further, although price trends for some non-tradeables inflation remain of concern.
- Should the outlook for inflation evolve as projected we would expect to lower the OCR further. We will be monitoring and assessing economic and financial developments and prospects closely when determining the precise timing and extent of OCR reductions over the coming months.
- Markets have become more risk averse and illiquid, New Zealand banks' access to and cost of offshore funding has been affected.
- We have widened the eligible collateral New Zealand banks can use to access liquidity from the Reserve Bank.
- We are currently consulting with the registered banks on proposed new standards for the management of their funding and liquidity.
- The Government has introduced a temporary opt-in retail deposit guarantee scheme to give assurance to New Zealanders that their deposits are safe; and a temporary opt-in guarantee scheme covering the wholesale debt of investment-grade New Zealand financial institutions to facilitate the banks' re-entry to offshore wholesale debt markets.
- We are reviewing the longer-term impact of these schemes on prudential supervision policies.
- Implementation of non-bank deposit taker regulation is continuing.
- Insurance prudential supervision legislation is expected to be introduced.

Key Issues

The following issues are covered in more detail in the following pages.

Function	Issues
Monetary policy formulation	<ul style="list-style-type: none"> • Maintaining price stability in an environment of global financial turmoil, cost shocks, persistent underlying inflation, and an economic downturn. • Dealing with asset price cycles. • The relationship between the wider government policy framework and the cyclicity of the economy. • Finding supplementary tools to support the OCR.
Domestic market operations Foreign reserves management	<ul style="list-style-type: none"> • Market volatility, illiquidity, impaired access to credit markets. • Ensuring the financial system has adequate liquidity.
Prudential supervision	<ul style="list-style-type: none"> • Higher funding costs and liquidity pressures for banks. • Putting in place a liquidity policy for banks. • Longer-term impacts of Government guarantee schemes on prudential supervision policies. • Continuing implementation and communication of non-bank deposit taker regulation. • Introducing insurance prudential supervision legislation. • The impact of the introduction of Settlement Systems, Futures and Emissions Unit Bill.
Currency	<ul style="list-style-type: none"> • Improving the monitoring of trends in the use of currency. • Holding sufficient cash reserves for emergencies. • Ensuring counterfeit threat to notes and coins is minimised.
Depository and settlement services	<ul style="list-style-type: none"> • Progressing projects on soundness and efficiency of payments system. • Continuing to deliver system enhancements to improve the range of services. • Facilitating the inter-operability between ESAS/Austraclear and other providers' payment and settlement systems. • The Minister of Commerce is reviewing New Zealand's approach to clearing and settlement.