

## Five Year Financial Summary

<i>Financial Position as at</i>	1995 June (\$m)	1996 June (\$m)	1997 June (\$m)	1998 June (\$m)	1999 June (\$m)
<b>Assets:</b>					
Foreign Currency Financial <sup>1</sup>	4,002	4,474	5,255	6,353	5,885
Local Currency Financial	3,545	3,915	4,029	4,413	5,321
Other Assets	65	66	62	61	60
<b>Total Assets</b>	<b>7,612</b>	<b>8,455</b>	<b>9,346</b>	<b>10,827</b>	<b>11,266</b>
<b>Liabilities and Equity:</b>					
Foreign Currency Financial	4,002	4,473	5,254	6,350	5,879
Local Currency Financial	1,571	1,818	1,880	2,176	2,926
Currency in Circulation	1,516	1,599	1,665	1,733	1,885
Other Liabilities	142	174	151	164	171
Equity	381	391	396	404	405
<b>Total Liabilities and Equity</b>	<b>7,612</b>	<b>8,455</b>	<b>9,346</b>	<b>10,827</b>	<b>11,266</b>

<i>Consolidated Income and Expenditure<sup>2</sup> Financial Year Ending</i>	1995 June (\$m)	1996 June (\$m)	1997 June (\$m)	1998 June (\$m)	1999 June (\$m)	2000 June Budget (\$m)
Net Investment Income	159.1	171.7	170.4	187.4	186.1	171.2
Other Income	10.4	34.4	10.7	10.7	11.7	12.9
<b>Total Income</b>	<b>169.5</b>	<b>206.1</b>	<b>181.1</b>	<b>198.1</b>	<b>197.8</b>	<b>184.1</b>
Operating Expenses	39.7	38.6	37.8	37.0	44.2	43.0
Tax for Current Year	0.6	0.8	0.9	0.8	0.6	0.3
<b>Surplus for Appropriation</b>	<b>129.2</b>	<b>166.8</b>	<b>142.5</b>	<b>160.3</b>	<b>153.0</b>	<b>140.8</b>
Transfers to Equity	22.8	5.3	6.4	8.4	2.2	3.1
Payment to Government	106.4	161.4	136.0	151.9	150.8	137.7

<i>Cost of Services<sup>3</sup></i> <i>Financial Year Ending</i>	1995 June (\$m)	1996 June (\$m)	1997 June (\$m)	1998 June (\$m)	1999 June (\$m)	2000 June Budget (\$m)
Monetary Policy Formulation	6.2	6.5	6.1	6.7	7.2	7.4
Market Operations	3.0	2.9	2.8	2.8	2.8	2.9
Financial System Oversight	3.2	3.2	2.8	2.8	2.7	3.1
Currency Operations	17.6	16.7	15.8	14.0	19.6	18.0
Foreign Reserves Management	3.8	3.5	3.7	3.7	4.0	3.6
Banking Services	0.3	0.4	0.8	0.8	1.1	1.2
Overseas Investment Commission Secretariat	0.6	0.6	0.7	0.9	0.7	0.6
Other Outputs	0.5	0.5	0.7	0.6	1.3	1.0
<b>Total for Functions within Funding Agreement</b>	<b>35.1</b>	<b>34.3</b>	<b>33.4</b>	<b>32.3</b>	<b>39.4</b>	<b>37.8</b>
Registry Services <sup>4</sup>	5.2	4.9	5.5	5.7	5.9	5.8
Less Intercompany Transactions	-	(0.2)	0.2	0.2	0.4	0.3
<b>Total Expenditure</b>	<b>40.3</b>	<b>39.4</b>	<b>38.7</b>	<b>37.8</b>	<b>44.9</b>	<b>43.3</b>

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

<sup>4</sup> Includes tax payable.



## 1999/2000 Budget Information

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

The 1999/2000 budget has been prepared using April 1999 interest rates. No allowance has been made for future changes in interest and exchange rates.

### **Budget Assumptions**

The major assumptions underlying the preparation of the 1999/2000 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 1999/2000 will be similar to the 1998/1999 levels.

## Budgeted Cost of Services

The Bank has budgeted to provide the following functions in 1999/2000.

Function	Operating Income	Operating Income	Operating Expenses	Operating Expenses	Operating Surplus (Deficit)	Operating Surplus (Deficit)
	Budget 2000 \$000	Actual 1999 \$000	Budget 2000 \$000	Actual 1999 \$000	Budget 2000 \$000	Actual 1999 \$000
<i>For the year ended 30 June</i>						
Monetary Policy Formulation	41	26	7,366	7,230	(7,325)	(7,204)
Market Operations	8,421	17,667	2,941	2,761	5,480	14,906
Financial System Oversight	5	8	3,072	2,695	(3,067)	(2,687)
Currency Operations	155,642	145,517	17,960	19,636	137,682	125,881
Foreign Reserves Management <sup>5</sup>	13,505	26,952	3,606	3,955	9,899	22,997
Banking Services	1,590	1,853	1,212	1,102	378	751
Overseas Investment Commission Secretariat	711	764	643	723	68	41
Other Outputs	-	231	1,011	1,252	(1,011)	(1,021)
<b>Total for Functions within Funding Agreement</b>	<b>179,915</b>	<b>193,018</b>	<b>37,811</b>	<b>39,354</b>	<b>142,104</b>	<b>153,664</b>
Registry Services	6,465	7,175	5,770	5,868	695	1,307
Less Intercompany Transactions <sup>6</sup>	2,245	2,362	245	362	2,000	2,000
<b>Total for Bank</b>	<b>184,135</b>	<b>197,831</b>	<b>43,336</b>	<b>44,860</b>	<b>140,799</b>	<b>152,971</b>

<sup>5</sup> The 1998/1999 actual operating income for Foreign Reserves Management includes \$8,900,000 arising from the Bank's role as holder of International Monetary Fund Special Drawing Rights (SDR). During 1998/1999, the SDR assets and liabilities (and associated income streams) were transferred to the Treasury. Hence, the 1999/2000 budgeted income for Foreign Reserves Management has declined.

<sup>6</sup> Intercompany transactions for 1999/2000 includes a budgeted \$2,000,000 dividend from the Registry Services function to other Bank functions. Other intercompany transactions are mainly for the purchase of Registry Services by other Bank functions.

## Consolidated Budgeted Statement of Financial Performance

<i>For the year ended 30 June</i>	<b>Budget 2000 \$000</b>	<b>Actual 1999 \$000</b>
Operating Income:		
Net Investment Income	171,263	186,114
Other Income	12,872	11,717
<b>Total Operating Income</b>	<b>184,135</b>	<b>197,831</b>
Operating Expenses:		
Personnel	19,624	21,391
Asset Management	6,379	6,041
New Currency Issued	8,159	8,323
Administration	1,789	1,602
Other	7,042	6,858
<b>Total Operating Expenses</b>	<b>42,993</b>	<b>44,215</b>
<b>Operating Surplus</b>	<b>141,142</b>	<b>153,616</b>
Taxation	343	645
<b>Surplus Available for Appropriation</b>	<b>140,799</b>	<b>152,971</b>

19 August 1999

**MANAGEMENT STATEMENT**

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

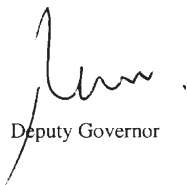
1. We have been responsible for the preparation of the annual financial statements and for the judgements used in them.
2. We have been responsible for establishing and maintaining a system of internal controls designed to provide reasonable assurance as to the integrity and reliability of the Bank's financial reporting.
3. In our opinion, the annual financial statements for the year ended 30 June 1999 fairly reflect the financial position and operations of the Bank.



Governor



Deputy Chief Executive



Deputy 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 41 to 79. The financial statements provide information about the past financial performance of the Reserve Bank of New Zealand and group and its financial position as at 30 June 1999. This information is stated in accordance with the accounting policies set out on pages 41 to 45.

### Governors' responsibilities

The Governors are responsible for the preparation of financial statements which give a true and fair view of the financial position of the Reserve Bank of New Zealand and group as at 30 June 1999 and the results of its operations and cash flows for the year ended on that date.

### 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.

### Basis 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 judgements 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 New Zealand Auditing Standards. 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 obtain 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 41 to 79:
  - comply with generally accepted accounting practice; and
  - give a true and fair view of the financial position of the Reserve Bank of New Zealand and group as at 30 June 1999 and the results of its operations and cash flows for the year ended on that date.

Our audit was completed on 19 August 1999 and our unqualified opinion is expressed as at that date.

Wellington



# Reserve Bank of New Zealand

## 1998/1999 Financial Statements

### 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 1999. 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".

#### (a) Basis of Consolidation

The Reserve Bank accounts for its Registry Services function through 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 30. Parent financial statements are not produced because the difference between the parent and group accounts is not material.

#### (b) 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 financial 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:

	1999	1998
Euro	0.5138	-
German marks	-	0.9265
Japanese yen	64.05	72.11
United States dollars	0.5310	0.5125

#### (c) Financial Assets and Liabilities

The Bank presents financial assets and financial liabilities, and the associated income and expense streams, by distinguishing between foreign currency and local currency activities. Foreign currency activities mainly arise from the Bank's Foreign Reserves Management function. Local currency activities mainly reflect the assets and liabilities associated with monetary policy implementation, investment of the proceeds of issuing circulating currency and banking activities.

The separate reporting of these activities is considered to provide a better presentation of the Bank's financial position, financial performance and risk profile. The Bank considers that the combined reporting of foreign and local currency activities would weaken the informational value of the financial statements.

All financial assets and liabilities are recognised in the Statement of Financial Position on a trade date basis. This means that purchases and sales of financial assets are recognised from the date at which the purchase or sale is agreed.

### *Foreign Currency Marketable Securities*

Foreign currency marketable securities are valued at quoted market prices. Changes in market value are recognised as an increase or decrease in the value of the Marketable Securities asset in the Statement of Financial Position.

Gains and losses on marketable securities are recognised immediately in the Statement of Financial Performance as Unrealised Price Revaluation Income (where the revaluation gains or losses have not been realised) and as Realised Gains (Losses) from Price Changes where the gains or losses have been realised by selling the security.

### *Foreign Currency Term Liabilities*

Foreign currency term liabilities are reported at market or fair value. The funds from these liabilities are invested in foreign currency marketable securities. Hence, this valuation policy ensures consistency with the policy adopted for the corresponding assets. Market or fair value is imputed by deriving the fair value rate from the relevant market yield curve of similar liabilities and discounting the future cash flows of the liabilities at this rate. Changes in the value of these liabilities are recognised as an increase or decrease in the value of the Term Liabilities in the Statement of Financial Position.

Gains and losses on foreign currency term liabilities are recognised immediately in the Statement of Financial Performance as Unrealised Price Revaluation expenses (where the revaluation gains or losses have not been realised) and as Realised Gains (Losses) from Price Changes where the gains or losses have been realised through repayment of the liability.

### *Repurchase and Reverse-Repurchase Transactions*

Securities sold under agreements to repurchase are retained as Marketable Securities in the Statement of Financial Position. The obligation to repurchase (Securities Sold Under Agreements to Repurchase) is disclosed as a liability. The difference between the sale and repurchase price represents an expense and is amortised over the term of the contract and reported in 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 price and sale price represents income and is amortised over the term of the contract and reported in the Statement of Financial Performance.

Both repurchase and reverse-repurchase transactions are reported at the original transaction value.

### *Securities Lending Programme*

Securities lent out under the securities lending programme are accounted for on the same basis as repurchase and reverse-repurchase transactions.

### *Derivative Instruments*

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

Foreign exchange swap contracts are used as part of hedged foreign exchange transactions for both monetary policy implementation and foreign reserves management. The unrealised foreign exchange gain (loss) on unsettled swap forward transactions are offset by the foreign exchange revaluation on the associated money market instruments. These are both included within the balance of Short-Term Advances. Premiums and discounts relating to the forward contracts are amortised over the term of the contract.

The cross currency interest rate swap is part of a series of hedged transactions that enhance the yield on foreign currency marketable securities. The market value of the principal components of the swap is derived by discounting the future cashflows based on the appropriate market yield curves. Changes in the market value of the principal components are recognised immediately as an increase or decrease in the value of Marketable Securities in the Statement of Financial Position. Gains and losses are recognised immediately in the Statement of Financial Performance as Unrealised Price Revaluation Income (as the gains and losses are not realised). Net interest income on the principal amounts is reported as Interest Income from Marketable Securities. The accrued interest on the principal amounts is reported within the balance of Foreign Currency Accrued Interest.

### *Short Sales of Securities*

A short sale is a sale of a security that we do not own. Securities which are sold short are recorded at quoted market prices and reported as Short Sales within the balance of Marketable Securities. Any gains or losses are recognised immediately in the Statement of Financial Performance on the same basis as foreign currency marketable securities.

### *Unsettled Transactions*

Amounts due from unsettled sales of securities (transactions not yet due for settlement) are reported as assets under the title Receivable from Unsettled Sales of Securities. Amounts payable for unsettled purchases of securities are reported as liabilities under the title Payable for Unsettled Purchases of Securities.

Unsettled transactions are reported at the contract amounts.

### *Investment Portfolio - NZ Government Securities*

The Bank's investment portfolio is accounted for on a yield to maturity basis. This reflects the intention to hold the portfolio until maturity as these assets represent the investment of the proceeds from issuing currency and the Bank's equity. Any premium or discount on purchase is capitalised and amortised over the term of the security.

### *Market Test Activities*

From time to time, the Bank may hold small trading positions in local currency securities as part of market test activities. These are valued at quoted market prices. Changes in market value are recognised as an increase or decrease in the value of Other Local Currency Financial Assets. Gains or losses are recognised immediately in the Statement of Financial Performance as Gain (Loss) from Market Test Activities.

### *Transaction Value*

The following financial assets and liabilities are valued at transaction date value:

- a) local and foreign currency cash;
- b) short-term advances; and
- c) current account deposits.

#### **(d) 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.

#### **(e) 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 redemption, this is also recognised as a contingent liability.

#### (f) Land and Buildings

Land is carried at market value. Property intended for sale is valued at the lower of book value or 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 when the property is intended to be held for the longer term. 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 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.

#### (g) 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 straight line basis over the given terms:

Computer Hardware	4 years
Computer Software	5 years
Plant and Equipment	5 years

Motor vehicles are depreciated on a diminishing value basis at a rate of 26 percent per annum. Other assets are depreciated on a straight line basis over their expected useful lives. Computer software is capitalised when total costs exceed \$100,000.

#### (h) Operating Leases

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

#### (i) 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 as inventory at the cost of acquisition and expensed when issued.

#### (j) Accounts Receivable

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

#### (k) 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.

#### (l) Personnel Expenses

Personnel expenses include the full cost of all staff benefits, including any applicable Fringe Benefit Tax. Salaries and leave accrued at year end are reported as Accrued Employee Entitlements.

#### (m) 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.

#### **(n) 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 of 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.

#### **(o) Cash Flows**

Cash is defined as those items that are convertible to cash within two working days and are used in the day-to-day cash management of the Bank.

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 fixed assets, and loans to staff.

Financing activities are those arising from the issue of circulating currency, 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.

#### **(p) Custodial Activities**

Securities held by the Reserve Bank through a subsidiary company under custodial arrangements are not included in these financial statements (see note 32).

#### **(q) Segmental Reporting**

The Bank presents financial assets and financial liabilities, and the associated income and expense streams, by distinguishing between foreign currency and local currency activities. In addition, the Bank provides operating results by function. The Bank considers that these reporting approaches provide appropriate segmental reporting of the Bank's activities.

#### **(r) Comparative Amounts**

To ensure consistency with the current year, comparative figures have been restated where appropriate. The material change is in Foreign Currency Financial Assets, where \$242,732,000 of Short-Term Advances were re-classified as Cash Balances with Other Central Banks.

#### **(s) Changes in Accounting Policies**

There has been no change in the Reserve Bank's accounting policies for the year ended 30 June 1999.

## Consolidated Statement of Financial Position

<i>As at 30 June</i>	Note	1999 \$000	1998 \$000
<b>Assets:</b>			
<b>Foreign Currency Financial Assets</b>			
Cash Balances with Other Central Banks		381,118	250,513
Marketable Securities	2	3,539,726	4,419,325
Short-Term Advances		-	84,778
Receivable from Unsettled Sales of Securities		41,435	93,031
Securities Purchased Under Agreements to Re-sell		1,860,245	1,431,814
Accrued Interest		62,640	71,610
International Monetary Fund Special Drawing Rights		-	2,172
<b>Total Foreign Currency Financial Assets</b>		<b>5,885,164</b>	<b>6,353,243</b>
<b>Local Currency Financial Assets</b>			
Cash on Hand		78	94
Securities Purchased Under Agreements to Re-sell		3,063,648	1,058,000
Advances to Government		-	1,194,982
Investment Portfolio - NZ Government Securities		2,205,712	2,098,051
Accrued Interest		50,579	61,020
Other Local Currency Financial Assets	3	1,265	547
<b>Total Local Currency Financial Assets</b>		<b>5,321,282</b>	<b>4,412,694</b>
<b>Total Financial Assets</b>		<b>11,206,446</b>	<b>10,765,937</b>
<b>Non-Financial Assets</b>			
Accounts Receivable		2,180	1,952
Inventories	4	7,122	6,330
Deferred Taxation		60	76
Currency and Artwork Collection		767	767
Fixed Assets	5	49,372	52,393
<b>Total Non-Financial Assets</b>		<b>59,501</b>	<b>61,518</b>
<b>Total Assets</b>		<b>11,265,947</b>	<b>10,827,455</b>

	Note	1999 \$000	1998 \$000
<b>Liabilities:</b>			
<b>Foreign Currency Financial Liabilities</b>			
Short-Term Deposits		-	30,509
Payable for Unsettled Purchases of Securities		283,221	22,082
Securities Sold Under Agreements to Repurchase		1,190,600	1,213,666
Term Liabilities		4,313,042	4,601,986
Accrued Interest		91,949	114,516
International Monetary Fund Special Drawing Rights <sup>7</sup>		-	367,070
<b>Total Foreign Currency Financial Liabilities</b>		<b>5,878,812</b>	<b>6,349,829</b>
<b>Local Currency Financial Liabilities</b>			
Government Deposits		2,880,976	956,473
Other Deposits	6	45,169	16,148
Reserve Bank Bills <sup>8</sup>		-	1,203,586
Accrued Interest		408	344
<b>Total Local Currency Financial Liabilities</b>		<b>2,926,553</b>	<b>2,176,551</b>
<b>Total Financial Liabilities</b>		<b>8,805,365</b>	<b>8,526,380</b>
<b>Non-Financial Liabilities</b>			
Currency in Circulation		1,884,816	1,733,306
Provision for Transfer of Surplus	9	150,818	151,890
Other Liabilities	7	20,058	11,637
<b>Total Non-Financial Liabilities</b>		<b>2,055,692</b>	<b>1,896,833</b>
<b>Total Liabilities</b>		<b>10,861,057</b>	<b>10,423,213</b>
<b>Equity</b>	10	<b>404,890</b>	<b>404,242</b>
<b>Total Liabilities and Equity</b>		<b>11,265,947</b>	<b>10,827,455</b>

The above statement is to be read in conjunction with the notes on pages 53 to 79.

<sup>7</sup> Since New Zealand joined the International Monetary Fund (IMF) in the 1960s, the Reserve Bank of New Zealand has been the agency responsible for holding New Zealand's allocation of IMF Special Drawing Rights (SDRs). New Zealand's allocation of SDR assets represented a liability on the Reserve Bank balance sheet, while holdings of SDRs provided the counterpart asset. During 1998/1999, the SDR assets and liabilities were transferred to the Treasury. SDRs are now directly accounted for on the Crown balance sheet (see note 1.(c) (ii)).

<sup>8</sup> The Bank ceased issuing Reserve Bank bills on 5 February 1999. All Reserve Bank bills and the related Advances to Government were repaid by 9 April 1999 (see note 1.(f) (i)).

## Consolidated Statement of Financial Performance

<i>For the year ended 30 June</i>	Note	Actual 1999 \$000	Budget 1999 \$000	Actual 1998 \$000
<b>Operating Income:</b>				
Income from Financial Assets	17	455,909		633,992
Expenses on Financial Liabilities	18	(268,894)		(457,656)
Net Foreign Exchange Revaluation Gain (Loss)	19	(901)		11,035
Net Investment Income		186,114	158,720	187,371
Other Income	20	11,717	11,425	10,683
<b>Total Operating Income</b>		<b>197,831</b>	<b>170,145</b>	<b>198,054</b>
<b>Operating Expenses:</b>				
Personnel <sup>9</sup>		21,391	19,277	18,435
Asset Management	21	6,041	6,803	6,268
New Currency Issued <sup>10</sup>	23	8,323	6,173	4,214
Administration		1,602	1,776	1,943
Other	22	6,858	6,668	6,140
<b>Total Operating Expenses</b>		<b>44,215</b>	<b>40,697</b>	<b>37,000</b>
<b>Operating Surplus</b>		<b>153,616</b>	<b>129,448</b>	<b>161,054</b>
Taxation	31	645	330	750
<b>Surplus Available for Appropriation</b>	<b>9</b>	<b>152,971</b>	<b>129,118</b>	<b>160,304</b>

The above statement is to be read in conjunction with the notes on pages 53 to 79.

<sup>9</sup> The increase in Personnel expenses in the 1998/1999 year mainly reflects the expense arising from the provision for restructuring the Currency Operations function over the next 12 to 18 months (see note 8).

<sup>10</sup> New Currency Issued expenses were above budget due to a higher than expected demand for the new \$20 polymer bank notes.

## Consolidated Statement of Cost of Services

<i>For the year ended 30 June</i>	Note	Operating Income	Operating Expenses	Operating Surplus (Deficit)	Operating Surplus (Deficit)	Operating Surplus (Deficit)
		Actual 1999 \$000	Actual 1999 \$000	Actual 1999 \$000	Budget 1999 \$000	Actual 1998 \$000
<b>Functions:</b>						
Monetary Policy Formulation		26	7,230	(7,204)	(7,170)	(6,681)
Market Operations		17,667	2,761	14,906	9,599	11,946
Financial System Oversight		8	2,695	(2,687)	(2,713)	(2,765)
Currency Operations	23	145,517	19,636	125,881	118,448	132,453
Foreign Reserves Management		26,952	3,955	22,997	10,554	24,616
Banking Services		1,853	1,102	751	633	123
Overseas Investment Commission Secretariat		764	723	41	32	(279)
Other Outputs		231	1,252	(1,021)	(934)	(629)
<b>Total for Functions within Funding Agreement</b>		<b>193,018</b>	<b>39,354</b>	<b>153,664</b>	<b>128,449</b>	<b>158,784</b>
Registry Services	30	7,175	5,868	1,307	669	1,520
Less Intercompany Transactions <sup>11</sup>		2,362	362	2,000	-	-
<b>Surplus Available for Appropriation</b>		<b>197,831</b>	<b>44,860</b>	<b>152,971</b>	<b>129,118</b>	<b>160,304</b>

The Consolidated 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 53 to 79.

<sup>11</sup> Intercompany transactions include \$2,000,000 dividend paid from the Registry Services function. Other intercompany transactions are mainly for the purchase of Registry Services by other Bank functions.

# Consolidated Statement of Cash Flows

<i>For the year ended 30 June</i>	Note	1999 \$000	1998 \$000
<b>Cash Flows From Operating Activities:</b>			
<b>Source:</b>			
Interest Received - Foreign Currency		190,016	243,753
- Local Currency - Investment Portfolio		162,646	157,396
- Local Currency - Other		109,540	125,170
Fees, Commission and Other Income Received		6,975	16,380
		469,177	542,699
<b>Disbursements:</b>			
Interest Paid - Foreign Currency		218,577	198,406
- Local Currency		70,009	126,916
Payments to Suppliers and Employees		32,569	40,034
Income Tax Paid		693	810
GST Paid (Received)		77	(29)
		321,925	366,137
<b>Net Cash Flow From Operating Activities</b>	24	147,252	176,562
<b>Cash Flows From Investing Activities:</b>			
<b>Source:</b>			
Net Decrease in Foreign Currency Marketable Securities		931,019	116,216
Net Decrease in Other Foreign Currency Financial Assets		118,690	124,312
Net Repayment of Advance to Government		1,194,982	33,646
Net Decrease in Other Local Currency Financial Assets		277	586
Net Increase in Other Foreign Currency Financial Liabilities		199,681	331,148
Sale of Fixed Assets		77	39
		2,444,726	605,947
<b>Disbursements:</b>			
Net Increase in Foreign Currency Securities Purchased under Agreements to Re-sell		428,431	547,240
Net Purchases of NZ Government Securities for Investment Portfolio		116,843	91,990
Purchase of Fixed Assets		1,931	2,837
		547,205	642,067
<b>Net Cash Flow From Investing Activities</b>		1,897,521	(36,120)

	Note	1999 \$000	1998 \$000
<b>Cash Flows From Financing Activities:</b>			
<b>Source:</b>			
Issue of Circulating Currency		11,618,884	11,174,840
Withdrawal of Circulating Currency		11,467,454	11,106,848
Net Issue of Circulating Currency		151,430	67,992
<b>Disbursements:</b>			
Net Repayment of Foreign Currency Term Liabilities		301,738	(107,589)
Transfer of IMF Special Drawing Rights to Treasury		367,070	-
Net Repayment of Reserve Bank Bills		1,213,000	30,000
Payment of Surplus to Government		151,890	136,015
		2,033,698	58,426
<b>Net Cash Flow From Financing Activities</b>		<b>(1,882,268)</b>	<b>9,566</b>
<b>Cash Flow from All Activities</b>		<b>162,505</b>	<b>150,008</b>
Plus Exchange Rate Effect		23,168	328,758
<b>Net Cash Flow from All Activities</b>		<b>185,673</b>	<b>478,766</b>
Opening Cash Balance		3,548,909	3,070,143
<b>Closing Cash Balance</b>	25	<b>3,734,582</b>	<b>3,548,909</b>

The above statement is to be read in conjunction with the notes on pages 53 to 79.

Cash is defined in the Statement of Cash Flows as those items that could be liquidated in two working days and are used in the day-to-day cash management of the Bank. This definition includes local currency securities purchased under agreements to re-sell and a substantial portion of the Bank's foreign reserves portfolio (see note 2).

Previously, cash was defined as those items that were convertible "at call". The change in definition resulted in an increase in reported cash balances of \$6,638,100,000 (1998 \$4,513,655,000) and an increase in investing cash flows of \$2,124,445,000 (1998 \$526,739,000).

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

For further information on the management of the Bank's liquidity, see Note 16. Liquidity Risk.

## Consolidated Statement of Movements in Equity

<i>For the year ended 30 June</i>	Note	1999 \$000	1998 \$000
Equity at Start of Year		404,242	396,408
Net Surplus for the Year		152,971	160,304
Movement in Properties Revaluation Account	10	(1,505)	(580)
Total Recognised Revenues and Expenses for the Year		151,466	159,724
Provision for Transfer of Surplus to Government	9	(150,818)	(151,890)
Equity at End of Year		404,890	404,242

The above statement is to be read in conjunction with the notes on pages 53 to 79.

# Notes to be read as part of the Consolidated Financial Statements

## 1. 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.

### (a) Foreign Currency Activities

Foreign currency activities result 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 euros. The overall level of these assets is determined by the Treasurer on advice from the Bank.

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. These loans incur interest at market rates. The overall currency composition of the assets and liabilities is determined in consultation with the Treasury. Generally these loans are held to maturity, though from time to time the opportunity to repay early may be taken at the instigation of either the Bank or the Treasury 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.

### (b) Departures from Neutral Positions

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

Decision-making for departures from neutral asset 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 12 to 16.

### (c) Events during 1998/1999

- (i) On 1 January 1999, the new euro currency was launched. This currency replaced a number of European currencies for financial transactions, including the German mark. All the financial assets and liabilities held by the Bank that were denominated in these currencies were redenominated into euro currency during the first week of January 1999.
- (ii) During 1998/1999, the Bank's role as holder of International Monetary Fund Special Drawing Rights (SDRs) was transferred from the Bank to the Treasury. This reflected the increased efficiency of one organisation managing the Crown's net SDR position. The foreign currency assets and liabilities transferred to the Treasury were of equal value.

**(d) Derivatives**

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

The Bank uses forward foreign exchange swap contracts as part of hedged foreign exchange transactions for both monetary policy implementation and foreign reserves management. The Bank did not have any forward foreign exchange swap transactions at 30 June 1999 (1998 US \$55 million).

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 US dollar fixed rate portfolio.

**(e) Securities Lending Programme**

As part of its foreign reserves 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 own 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 1999, the market value of securities lent out under the programme was US \$400.8 million (1998 US \$389.5 million).

**(f) Local Currency Activities**

Local currency activities arise on two main counts:

(i) Liquidity management operations.

Liquidity management largely involves the Reserve Bank offsetting the daily net flows through Government Deposits by advancing funds to or withdrawing funds from the banking system. Most of this business is undertaken through daily open market operations, but arrangements for handling the residual liquidity flows have changed during the year. Under the Official Cash Rate scheme (OCR) (introduced on 17 March 1999), the Bank advances or withdraws cash at a margin to the OCR. Before the OCR, the Bank sold Reserve Bank bills to the market and undertook to buy these bills from the market when additional liquidity was needed. Proceeds from the sale of Reserve Bank bills were advanced to the government. These were recorded as liabilities (Reserve Bank Bills) and assets (Advances to Government). The Bank ceased issuing Reserve Bank bills on 5 February 1999. All Reserve Bank bills and advances to government were repaid by 9 April 1999.

(ii) 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 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.

**(g) 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 as Marketable Securities in the Bank's Statement of Financial Position. At balance date, securities with a book value of \$1,191 million (1998 \$1,214 million) had been sold to counterparties 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.

**(h) Concentrations of Funding**

The Bank has a concentration of funding from the New Zealand government. The funding for foreign currency assets is provided by foreign currency loans from the Treasury. Funding for local currency assets is from government deposits, bank deposits and the issue of circulating currency.

# Asset Notes

## 2. Marketable Securities

	1999 \$000	1998 \$000
Marketable Securities		
- Liquifiable within two days (considered cash equivalent)	3,215,883	3,212,923
- Liquifiable outside two days (not considered cash equivalent)	719,793	1,158,586
Short Sales	(599,588)	(168,789)
Cross Currency Swap position	203,638	216,605
	3,539,726	4,419,325
Cross Currency Swap position comprises		
- Swap derivative components	(35,531)	596
- Government securities	239,169	216,009

The change in the value of the Cross Currency Swap position is largely offset by changes in the value of the Bank's liabilities. This is consistent with the Bank's risk management practice of matching assets and liabilities.

## 3. Other Local Currency Financial Assets

	1999 \$000	1998 \$000
Receivable From Unsettled Foreign Exchange Transactions	1,000	-
Advances to Staff	174	334
Term Loans	91	213
	1,265	547

## 4. Inventories

	1999 \$000	1998 \$000
Bank Notes for Circulation	4,087	2,880
Coin for Circulation	2,716	3,157
Commemorative Currency	319	290
Office Supplies	-	3
Total Inventories	7,122	6,330

## 5. Fixed Assets

	1999 Historic Cost \$000	1999 Accumulated Depreciation \$000	1999 Book Value \$000	1998 Historic Cost \$000	1998 Accumulated Depreciation \$000	1998 Book Value \$000
Freehold Land			8,080			14,510
Buildings			17,835			25,910
Property Intended for Sale			13,000			-
			38,915			40,420
Computer Hardware	4,538	3,116	1,422	4,583	3,970	613
Plant	5,643	5,343	300	5,627	5,303	324
Office Equipment	6,543	5,481	1,062	7,044	5,391	1,653
Software	7,747	5,266	2,481	7,131	4,568	2,563
Currency Processing Equipment	5,019	3,294	1,725	5,019	2,667	2,352
Motor Vehicles	186	116	70	296	138	158
Building Improvements	5,155	2,660	2,495	4,039	2,004	2,035
Tenancy Inducements	1,659	1,116	543	1,761	1,020	741
Work in Progress	359	-	359	1,534	-	1,534
			10,457			11,973
<b>Total Fixed Assets</b>			<b>49,372</b>			<b>52,393</b>

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The book values for land and buildings are market values based on existing use with the exception of the Wellington specialised basement and ground floors occupied by the Bank, which are valued at adjusted replacement cost. The market value of the Wellington Head Office to a purchaser not requiring the Bank's specialised facilities is \$22,600,000 (1998 \$22,600,000).

	Valuation Date	Registered Valuer	Last Valuation \$000
Auckland Property	June 1998	Jones Lang Wooton Limited	13,000
Wellington Head Office	June 1998	Jones Lang Wooton Limited	24,350
Wellington Carparks	June 1999	Darroch Limited	1,565
			38,915

## Liability and Equity Notes

### 6. Other Deposits

	1999 \$000	1998 \$000
Settlement Bank Deposits	1,141	1,652
Central Bank Deposits	2,030	2,564
Staff Deposits	4,818	7,660
International Monetary Fund Deposits	37,180	4,272
	45,169	16,148

### 7. Other Liabilities

	Note	1999 \$000	1998 \$000
Accounts Payable		14,925	7,024
Accrued Employee Entitlements		2,021	2,540
Other Current Liabilities		401	750
Provision for Restructuring	8	1,466	-
Demonetised Currency		1,245	1,323
		20,058	11,637

Demonetised currency is recognised as a contingent liability (see note 29(c)) except for \$1,245,000 (1998 \$1,323,000), which has been retained to cover future expected redemption.

Pre-decimal currency coin was issued by the Treasury and is included in the Bank's contingent liabilities (see note 29(b)).

### 8. Provision for Restructuring

	1999 \$000	1998 \$000
Balance at Start	-	-
Provision Made	1,466	-
Balance at End	1,466	-

The Bank has made a provision for the restructuring of its currency operations. This has resulted in an increase in personnel expenses for the year ended 30 June 1999. This provision includes payments to currency staff who will become redundant over the next year or so, as the volume of bank note processing diminishes. The decline in bank note processing arises from the introduction of the more durable polymer notes that will enable the Bank to become less directly involved in the circulation of cash in the community. The precise timing of these payments will depend on the pace with which the banks are able to set up alternative distribution systems, but is expected to occur during the next 12 to 18 months.

### 9. 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 the government plus the RBNZ Registry Limited 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 \$846,000 (1998 \$6,894,000) has consequently been transferred to the Bank's Equity. In addition, the RBNZ Registry Limited net surplus of \$1,307,000 (1998 \$1,520,000) 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 (1998 \$2,000,000) in respect of the year ended 30 June 1999.

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.

	1999 \$000	1998 \$000
Allowable Expenditure under Funding Agreement	40,200	39,195
Operating Expenses for Functions Covered by the Funding Agreement	39,354	32,301
<b>Under-expenditure Transferred to Equity</b>	<b>846</b>	<b>6,894</b>
<b>Surplus Available for Appropriation</b>	<b>152,971</b>	<b>160,304</b>
<b>Less Transfers to Equity:</b>		
Under-expenditure under Funding Agreement	846	6,894
RBNZ Registry Limited Surplus	1,307	1,520
<b>Total Transfer to Equity</b>	<b>2,153</b>	<b>8,414</b>
<b>Provision for Transfer of Surplus</b>	<b>150,818</b>	<b>151,890</b>

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## 10. Equity

	1999 \$000	1998 \$000
<b>Retained Earnings</b>		
Opening Balance	395,510	387,096
Add Transfers to Retained Earnings:		
Reserve Bank of New Zealand	846	6,894
RBNZ Registry Limited	1,307	1,520
<b>Closing Balance</b>	<b>397,663</b>	<b>395,510</b>
<b>Properties Revaluation Account</b>		
Opening Balance	8,052	8,632
Decrease in Value of Auckland Property	(1,500)	(645)
Increase (Decrease) in Value of Wellington Property	(5)	65
<b>Closing Balance</b>	<b>6,547</b>	<b>8,052</b>
<b>Collections Revaluation Account</b>		
Closing Balance	680	680
<b>Total Equity</b>	<b>404,890</b>	<b>404,242</b>

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

## 11. Fair Value of Financial Instruments

The fair value of a financial instrument is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arms-length transaction. When a financial instrument is traded in an organised and liquid market that is able to absorb a significant transaction without moving the price against the trader, quoted market values represent fair value.

### (a) Derivatives

The fair value of derivatives is calculated using discounted cash flow models based on current interest rates for the type and maturity of the underlying instrument.

The Bank had no forward foreign exchange swap contracts at 30 June 1999. Hence, there was no unrealised foreign exchange gain (loss) at 30 June 1999 (1998 \$564,000).

The fair value of the derivative components of the cross currency swap at 30 June 1999 was -\$35.5 million (1998 +\$0.6 million). The swap is part of a series of hedged transactions that enhance the yield on the US dollar portfolio. The total value of the Cross Currency Swap position at 30 June 1999 was \$203,638,000 (1998 216,605,000) (see note 2).

### (b) Financial Assets and Liabilities

All other financial assets and liabilities are valued at either quoted market prices or prices derived from market yield curves, as described in the Bank's accounting policies, except as detailed below.

#### *Repurchase and Reverse-Repurchase Agreements*

The reported value of repurchase and reverse-repurchase agreements is considered to approximate their fair value due to the short-term nature of the agreements.

#### *Unsettled Transactions*

The reported value of unsettled sales and purchases is considered to approximate their fair value due to the very short-term until settlement occurs.

#### *Investment Portfolio - NZ Government Securities*

The Bank's holdings of NZ government securities have a fair value of \$2,298,421,000 (1998 \$2,187,366,000). This has been calculated by discounting the current holdings of NZ government securities at 30 June 1999 market rates.

#### *Short-Term Advances and Current Account Deposits*

The carrying values of the above instruments are considered to approximate their fair value as they are short-term in nature or are receivable on demand.

### (c) Currency in Circulation

The fair value of currency in circulation is considered to be its face value as reported in the accounts.

# Risk Management Notes

## 12. Risk Management

In its financial activities, the Bank is subject to interest rate, credit, foreign currency, liquidity and operating risk. The policies for managing interest rate, credit, foreign currency and liquidity risk are outlined in notes 13 to 16. A Risk Management Committee comprised of senior management is responsible for advising the Governor on the monitoring and management of all risks to which the Bank is exposed.

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.

Operating risk 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.

A separate Risk Unit maintains the Bank's financial risk management framework. This is outlined in notes 13 to 16. The Risk Unit and Accounting Services Department are responsible for the daily monitoring of the Bank's financial risk exposures.

The Risk Assessment and Assurance Department (which includes 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 and frequency of audits conducted. All Bank departments are subject to review and audit.

An Audit Committee, comprised of three 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.

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## 13. Interest Rate Risk

Interest rate risk is the risk of loss arising from changes in interest rates.

### *Foreign Currency Interest Rate Risk*

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 high rated bank and corporate instruments, but liquidity considerations require that most investments are in United States, Japanese and German domestic government instruments. The Bank accepts the associated spread risk as inevitable, but seeks to closely limit additional (mainly duration-related) interest rate mismatches. As at 30 June 1999, the calculated potential annual income variance inherent in the neutral asset/liability structure was approximately plus or minus \$53 million (1998 plus or minus \$40 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 potential daily income variance from most movements in market interest rates. The Funds at Risk limits are set to constrain daily income variance to remain under 3 basis points on 19 out of 20 days. Given the Funds at Risk positions on 30 June 1999, the likely (19 days out of 20 probability) loss from any adverse interest rate movements would have been less than plus or minus \$0.2 million (1998 plus or minus \$0.4 million).

Secondly, 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 income variance from interest rate risk arising from these strategies was plus or minus \$0.7 million as at 30 June 1999 (1998 plus or minus \$0.6 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. Separate stop-loss limits of \$2 million in any calendar month are applied to both discretionary and strategic departures from the neutral position. Therefore, in the worst case, the maximum total loss before stop-loss limits would be triggered is \$4 million in any calendar month.

Funds at Risk limits for the foreign currency asset portfolios, actual Funds at Risk as at 30 June 1999, and the peak Funds at Risk values over the period were:

Funds at Risk	United States Dollar Portfolio Basis Points	Euro Portfolio Basis Points	Japanese Yen Portfolio Basis Points	1999 Total Basis Points	1998 Total Basis Points
Limit	3.00	2.50	2.50		
As at 30 June 1999	0.32	0.42	0.72	0.46	0.78
Peak Over Period	1.92	2.47	2.44	1.79	1.20

#### *Local Currency Interest Rate Risk*

Interest rate risk on the Investment Portfolio - New Zealand Government Securities 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; and
- (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 interest rate 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.

Assets and liabilities will mature or re-price within the following periods:

<i>As at 30 June 1999</i>	Weighted Average Interest Rate	1999 Total \$000	Non- Interest Sensitive \$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>Foreign Currency Financial Assets</b>								
Cash Balances with Other Central Banks	4.78%	381,118	-	381,118	-	-	-	-
Marketable Securities	3.50%	3,539,726	-	394,681	468,652	386,448	896,552	1,393,393
Short-Term Advances	-	-	-	-	-	-	-	-
Receivable from Unsettled Sales of Securities	0%	41,435	-	41,435	-	-	-	-
Securities Purchased Under Agreements to Re-sell	1.48%	1,860,245	-	1,860,245	-	-	-	-
Accrued Interest	0%	62,640	-	62,640	-	-	-	-
International Monetary Fund Special Drawing Rights	-	-	-	-	-	-	-	-
<b>Total Foreign Currency Financial Assets</b>	<b>2.88%</b>	<b>5,885,164</b>	<b>-</b>	<b>2,740,119</b>	<b>468,652</b>	<b>386,448</b>	<b>896,552</b>	<b>1,393,393</b>
<b>Foreign Currency Financial Liabilities</b>								
Short-Term Deposits	-	-	-	-	-	-	-	-
Payable for Unsettled Purchases of Securities	0%	283,221	-	283,221	-	-	-	-
Securities Sold Under Agreements to Repurchase	1.03%	1,190,600	-	1,190,600	-	-	-	-
Term Liabilities	3.44%	4,313,042	-	1,135,374	283,878	702,425	773,688	1,417,677
Accrued Interest	0%	91,949	-	91,949	-	-	-	-
International Monetary Fund Special Drawing Rights	-	-	-	-	-	-	-	-
<b>Total Foreign Currency Financial Liabilities</b>	<b>2.73%</b>	<b>5,878,812</b>	<b>-</b>	<b>2,701,144</b>	<b>283,878</b>	<b>702,425</b>	<b>773,688</b>	<b>1,417,677</b>
<b>Foreign Currency Interest Rate Sensitivity Gap</b>		<b>6,352</b>	<b>-</b>	<b>38,975</b>	<b>184,774</b>	<b>(315,977)</b>	<b>122,864</b>	<b>(24,284)</b>
<b>Local Currency Financial Assets</b>								
Cash on Hand	0.14%	78	-	78	-	-	-	-
Securities Purchased Under Agreements to Re-sell	4.49%	3,063,648	-	3,063,648	-	-	-	-
Advances to Government	-	-	-	-	-	-	-	-
Investment Portfolio - NZ Government Securities	7.58%	2,205,712	-	-	446,758	503,304	452,163	803,487
Accrued Interest	0%	50,579	-	50,579	-	-	-	-
Other Local Currency Financial Assets	1.25%	1,265	-	1,000	86	37	142	-
<b>Non-Financial Assets</b>	<b>0%</b>	<b>59,501</b>	<b>59,501</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Total Local Currency Assets</b>	<b>5.66%</b>	<b>5,380,783</b>	<b>59,501</b>	<b>3,115,305</b>	<b>446,844</b>	<b>503,341</b>	<b>452,305</b>	<b>803,487</b>
<b>Local Currency Financial Liabilities</b>								
Government Deposits	4.50%	2,880,976	-	2,880,976	-	-	-	-
Other Deposits	0.57%	45,169	-	45,169	-	-	-	-
Reserve Bank Bills	-	-	-	-	-	-	-	-
Accrued Interest	0%	408	-	408	-	-	-	-
<b>Non-Financial Liabilities</b>	<b>0%</b>	<b>2,055,692</b>	<b>2,055,692</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Equity</b>	<b>0%</b>	<b>404,890</b>	<b>404,890</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Total Local Currency Liabilities and Equity</b>	<b>2.41%</b>	<b>5,387,135</b>	<b>2,460,582</b>	<b>2,926,553</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Local Currency Interest Rate Sensitivity Gap</b>		<b>(6,352)</b>	<b>(2,401,081)</b>	<b>188,752</b>	<b>446,844</b>	<b>503,341</b>	<b>452,305</b>	<b>803,487</b>
<b>Total Interest Rate Sensitivity Gap</b>								
<b>All Currencies</b>		<b>-</b>	<b>(2,401,081)</b>	<b>227,727</b>	<b>631,618</b>	<b>187,364</b>	<b>575,169</b>	<b>779,203</b>
New Zealand		(6,352)	(2,401,081)	188,752	446,844	503,341	452,305	803,487
United States		3,219	-	165,812	(57,626)	(189,670)	71,039	13,664
Euro		1,400	-	(215,286)	242,400	(126,307)	88,285	12,308
Japan		1,500	-	88,216	-	-	(36,460)	(50,256)
Other		233	-	233	-	-	-	-

Comparative figures as at 30 June 1998 were:

<i>As at 30 June 1998</i>	Weighted Average Interest Rate	1998 Total \$000	Non- Interest Sensitive \$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>Foreign Currency Financial Assets</b>								
Cash Balances with Other Central Banks	5.80%	250,513	-	250,513	-	-	-	-
Marketable Securities	4.03%	4,419,325	-	752,140	307,897	729,249	1,154,747	1,475,292
Short-Term Advances	5.21%	84,778	-	84,778	-	-	-	-
Receivable from Unsettled Sales of Securities	0%	93,031	-	93,031	-	-	-	-
Securities Purchased Under Agreements to Re-sell	1.76%	1,431,814	-	1,431,814	-	-	-	-
Accrued Interest	0%	71,610	-	71,610	-	-	-	-
International Monetary Fund Special Drawing Rights	4.28%	2,172	-	2,172	-	-	-	-
<b>Total Foreign Currency Financial Assets</b>	<b>3.51%</b>	<b>6,353,243</b>	<b>-</b>	<b>2,686,058</b>	<b>307,897</b>	<b>729,249</b>	<b>1,154,747</b>	<b>1,475,292</b>
<b>Foreign Currency Financial Liabilities</b>								
Short-Term Deposits	0.55%	30,509	-	30,509	-	-	-	-
Payable for Unsettled Purchases of Securities	0%	22,082	-	22,082	-	-	-	-
Securities Sold Under Agreements to Repurchase	0.28%	1,213,666	-	1,213,666	-	-	-	-
Term Liabilities	4.05%	4,601,986	-	821,566	156,877	726,609	1,457,054	1,439,880
Accrued Interest	0%	114,516	-	114,516	-	-	-	-
International Monetary Fund Special Drawing Rights	4.28%	367,070	-	367,070	-	-	-	-
<b>Total Foreign Currency Financial Liabilities</b>	<b>3.24%</b>	<b>6,349,829</b>	<b>-</b>	<b>2,569,409</b>	<b>156,877</b>	<b>726,609</b>	<b>1,457,054</b>	<b>1,439,880</b>
<b>Foreign Currency Interest Rate Sensitivity Gap</b>		<b>3,414</b>	<b>-</b>	<b>116,649</b>	<b>151,020</b>	<b>2,640</b>	<b>(302,307)</b>	<b>35,412</b>
<b>Local Currency Financial Assets</b>								
Cash on Hand	0%	94	-	94	-	-	-	-
Securities Purchased Under Agreements to Re-sell	8.83%	1,058,000	-	1,058,000	-	-	-	-
Advances to Government	8.74%	1,194,982	-	1,194,982	-	-	-	-
Investment Portfolio - NZ Government Securities	7.85%	2,098,051	-	149,962	-	441,951	659,599	846,539
Accrued Interest	0%	61,020	-	61,020	-	-	-	-
<b>Other Local Currency Financial Assets</b>	<b>6.32%</b>	<b>547</b>	<b>-</b>	<b>94</b>	<b>56</b>	<b>107</b>	<b>255</b>	<b>35</b>
<b>Non-Financial Assets</b>	<b>0%</b>	<b>61,518</b>	<b>61,518</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Total Local Currency Assets</b>	<b>8.10%</b>	<b>4,474,212</b>	<b>61,518</b>	<b>2,464,152</b>	<b>56</b>	<b>442,058</b>	<b>659,854</b>	<b>846,574</b>
<b>Local Currency Financial Liabilities</b>								
Government Deposits	8.40%	956,473	-	956,473	-	-	-	-
Other Deposits	4.33%	16,148	-	16,148	-	-	-	-
Reserve Bank Bills	8.74%	1,203,586	-	1,203,586	-	-	-	-
Accrued Interest	0%	344	-	344	-	-	-	-
<b>Non-Financial Liabilities</b>	<b>0%</b>	<b>1,896,833</b>	<b>1,896,833</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Equity</b>	<b>0%</b>	<b>404,242</b>	<b>404,242</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Total Local Currency Liabilities and Equity</b>	<b>4.15%</b>	<b>4,477,626</b>	<b>2,301,075</b>	<b>2,176,551</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Local Currency Interest Rate Sensitivity Gap</b>		<b>(3,414)</b>	<b>(2,239,557)</b>	<b>287,601</b>	<b>56</b>	<b>442,058</b>	<b>659,854</b>	<b>846,574</b>
<b>Total Interest Rate Sensitivity Gap</b>		<b>-</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>
<b>All Currencies</b>		<b>-</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		(3,414)	(2,239,557)	287,601	56	442,058	659,854	846,574
United States		163,182	-	34,960	-	187,402	(98,982)	39,802
Germany		69,241	-	219,897	142,351	(164,927)	(105,383)	(22,697)
Japan		53,173	-	143,974	8,669	(19,835)	(97,942)	18,307
Other		(282,182)	-	(282,182)	-	-	-	-

## 14. Credit Risk

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

### (a) Credit Risk Management

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 local 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, 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 to the counterparty from whom securities are purchased under reverse-repurchase agreements are monitored but are not subject to formal limits. The Bank usually only accepts New Zealand government paper in its inter-day liquidity management operations. However, as part of the year 2000 contingency plan, the Bank has advised financial market participants that it will accept (two name) bank paper in open market operations and overnight reverse-repurchase transactions from around the start of December until mid January 2000.

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

### (b) Concentrations of Credit Exposure

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

	1999 \$000	1998 \$000
New Zealand Government	5,286,108	4,406,003
Other Sovereign Issuers (excluding New Zealand Government)	5,237,006	5,335,114
Supranational Financial Institutions	182,197	250,572
Foreign Banks	436,705	578,348
Other	64,430	195,900
<b>Total Financial Assets</b>	<b>11,206,446</b>	<b>10,765,937</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 to the transaction. Using this approach would result in credit exposures of \$1.86 billion (1998 \$1.43 billion) being reported against securities trading firms and \$3.06 billion (1998 \$1.06 billion) reported against New Zealand banks instead of against Other Sovereign Issuers and the New Zealand Government respectively.

The Bank's maximum credit risk exposure in relation to derivatives is the cost of re-establishing the derivative contracts in the market in the event of the failure of the counterparty to fulfil their obligations. This cost is the fair value of the derivatives as reported in Note 11. Fair Value of Financial Instruments.

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:

	1999 \$000	1998 \$000
New Zealand	5,286,357	4,406,341
USA	2,140,192	2,353,916
Japan	1,745,722	1,723,654
Germany	1,659,993	1,685,226
Supranational Financial Institutions	182,197	250,572
Other	191,985	346,228
<b>Total Financial Assets</b>	<b>11,206,446</b>	<b>10,765,937</b>

(c) *Credit Exposure by Credit Rating*

The following table presents the Bank's financial assets based on Standard and Poor's credit rating of the issuer. AAA is the highest quality rating possible and indicates the entity has an extremely strong capacity to pay interest and principal. AA is a high grade rating indicating a very strong capacity and A is an upper medium grade indicating a strong capacity. BBB is the lowest investment grade rating indicating a medium capacity to pay interest and principal. Ratings lower than AAA can be modified by + or - signs to indicate relative standing within the major categories. N/R indicates the entity has not been rated by Standard and Poor's.

	Credit Rating	1999 \$000	% of 1999 financial assets	1998 \$000	% of 1998 financial assets
<b>Foreign Currency Financial Assets</b>					
Cash Balances with Other Central Banks	AAA	380,953	3.4%	250,326	2.3%
	AA+	165	0%	187	0%
Marketable Securities	AAA	3,196,488	28.5%	3,877,292	36.0%
	AA+	63,793	0.6%	221,354	2.1%
	AA	81,820	0.7%	219,368	2.0%
	AA-	197,625	1.8%	101,311	0.9%
Short-Term Advances	AA+	-	-	84,778	0.8%
Receivable from Unsettled Sales of Securities	AAA	41,435	0.4%	93,031	0.9%
Securities Purchased Under Agreements to Re-sell	AAA	1,860,245	16.6%	760,162	7.1%
	AA	-	-	381,470	3.5%
	N/R	-	-	290,182	2.7%
Accrued Interest	Various	62,640	0.5%	71,610	0.7%
International Monetary Fund Special Drawing Rights	AAA	-	-	2,172	0%
		5,885,164	52.5%	6,353,243	59.0%
<b>Local Currency Financial Assets</b>					
Cash on Hand	AA	78	0%	94	0%
Advances to Government	AA+	-	-	1,194,982	11.1%
Securities Purchased Under Agreements to Re-sell	AA+	3,063,648	27.3%	1,058,000	9.8%
Investment Portfolio - NZ Government Securities	AA+	2,205,712	19.7%	2,098,051	19.5%
Accrued Interest	Various	50,579	0.5%	61,020	0.6%
Other Local Currency Financial Assets	AA	1,000	0%	-	-
	N/R	265	0%	547	0%
		5,321,282	47.5%	4,412,694	41.0%
<b>Total Financial Assets</b>		<b>11,206,446</b>	<b>100.0%</b>	<b>10,765,937</b>	<b>100.0%</b>

(d) *Credit Exposure by Counterparty*

The table below shows the number of issuers where the Bank's credit exposures<sup>12</sup> equalled or exceeded 10% of equity for:

- End-of-year actual credit exposures.
- Peak end-of-day credit exposure (on the basis of limits).
- Peak local currency intra-day credit exposures (on the basis of limits). These exposures arise through intra-day reverse-repurchase agreements entered into with settlement account holders under the Real-Time Gross Settlement system.

% of equity	End-of-year 1999	End-of-year 1998	Peak end-of-day 1999	Peak end-of-day 1998	Peak local currency intra-day 1999	Peak local currency intra-day 1998
10% to 19.9%	7	6	28	31	21	23
20% to 29.9%	1	5	1	1	1	1
30% to 39.9%	-	1	16	14	1	1
40% to 49.9%	-	-	2	6	10	14
50% to 59.9%	-	-	-	-	-	-
60% to 69.9%	-	-	19	17	-	-
70% to 79.9%	-	-	1	-	-	-
80% to 89.9%	-	-	-	1	-	-
90% to 99.9%	-	-	16	30	-	-
100% to 109.9%	-	-	-	-	-	-
110% to 119.9%	-	-	3	2	-	-
120% to 129.9%	-	-	3	2	-	-
140% to 149.9%	-	-	2	-	-	-
150% to 159.9%	-	-	-	1	-	-
160% to 169.9%	-	-	-	-	-	-
190% to 199.9%	-	-	9	9	-	-
200% to 209.9%	-	-	-	-	-	-
240% to 249.9%	-	-	1	-	-	-
310% to 319.9%	-	1	-	-	-	-
320% to 329.9%	-	-	-	-	-	-
350% to 359.9%	1	-	-	-	-	-
420% to 429.9%	-	1	-	-	-	-
430% to 439.9%	1	-	-	-	-	-
490% to 499.9%	1	-	2	2	-	-
510% to 519.9%	-	1	-	-	-	-
590% to 599.9%	-	-	-	1	-	-
610% to 619.9%	-	-	1	-	-	-
740% to 749.9%	-	-	1	-	-	-
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 highly-rated sovereign issuers.

<sup>12</sup> Excludes exposures to the New Zealand government.

## 15. 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 forward foreign exchange swap contracts and foreign currency swaps, was:

As at 30 June 1999	Currency of Denomination				Total All Currencies \$000
	United States Dollar \$000	Euro \$000	Japanese Yen \$000	Other Currencies \$000	
<b>Foreign Currency Financial Assets</b>					
Cash Balances with Other Central Banks	363,734	357	16,794	233	381,118
Marketable Securities	1,482,458	889,345	1,167,923	-	3,539,726
Short-Term Advances	-	-	-	-	-
Receivable from Unsettled Sales of Securities	-	41,435	-	-	41,435
Securities Purchased Under Agreements to Re-sell	829,965	721,385	308,895	-	1,860,245
Accrued Interest	24,927	26,656	11,057	-	62,640
International Monetary Fund Special Drawing Rights	-	-	-	-	-
<b>Total Foreign Currency Financial Assets</b>	<b>2,701,084</b>	<b>1,679,178</b>	<b>1,504,669</b>	<b>233</b>	<b>5,885,164</b>
<b>Foreign Currency Financial Liabilities</b>					
Short-Term Deposits	-	-	-	-	-
Payable for Unsettled Purchases of Securities	-	283,221	-	-	283,221
Securities Sold Under Agreements to Repurchase	754,830	204,127	231,643	-	1,190,600
Term Liabilities	1,903,804	1,154,599	1,254,639	-	4,313,042
Accrued Interest	39,231	35,831	16,887	-	91,949
International Monetary Fund Special Drawing Rights	-	-	-	-	-
<b>Total Foreign Currency Financial Liabilities</b>	<b>2,697,865</b>	<b>1,677,778</b>	<b>1,503,169</b>	<b>-</b>	<b>5,878,812</b>
Off Balance Sheet Instruments	-	-	-	-	-
<b>Net Currency Exposure</b>	<b>3,219</b>	<b>1,400</b>	<b>1,500</b>	<b>233</b>	<b>6,352</b>

As at 30 June 1998 <sup>13</sup>	Currency of Denomination				Total All Currencies \$000
	United States Dollar \$000	Euro \$000	Japanese Yen \$000	Other Currencies \$000	
<b>Foreign Currency Financial Assets</b>					
Cash Balances with Other Central Banks	247,670	1,882	54	907	250,513
Marketable Securities	1,895,800	1,464,051	1,059,474	-	4,419,325
Short-Term Advances	2,698	-	(2,135)	84,215	84,778
Receivable from Unsettled Sales of Securities	-	-	93,031	-	93,031
Securities Purchased Under Agreements to Re-sell	910,030	140,313	381,471	-	1,431,814
Accrued Interest	29,643	32,380	9,374	213	71,610
International Monetary Fund Special Drawing Rights	950	403	315	504	2,172
<b>Total Foreign Currency Financial Assets</b>	<b>3,086,791</b>	<b>1,639,029</b>	<b>1,541,584</b>	<b>85,839</b>	<b>6,353,243</b>
<b>Foreign Currency Financial Liabilities</b>					
Short-Term Deposits	-	-	30,509	-	30,509
Payable for Unsettled Purchases of Securities	-	-	22,082	-	22,082
Securities Sold Under Agreements to Repurchase	791,849	31,366	390,451	-	1,213,666
Term Liabilities	1,968,773	1,492,365	1,140,848	-	4,601,986
Accrued Interest	52,380	46,139	15,388	609	114,516
International Monetary Fund Special Drawing Rights	160,486	68,031	53,310	85,243	367,070
<b>Total Foreign Currency Financial Liabilities</b>	<b>2,973,488</b>	<b>1,637,901</b>	<b>1,652,588</b>	<b>85,852</b>	<b>6,349,829</b>
Off Balance Sheet Instruments	(110,805)	-	110,805	-	-
<b>Net Currency Exposure</b>	<b>2,498</b>	<b>1,128</b>	<b>(199)</b>	<b>(13)</b>	<b>3,414</b>

## 16. Liquidity Risk

Liquidity risk is the risk that an entity will encounter difficulty in raising funds at short notice to meet commitments associated with financial instruments. Liquidity risk is also the risk that an entity will have to sell a financial asset quickly at much less than its fair value.

### Foreign Currency Activities

Liquidity is a key criterion in determining the composition of the Bank's foreign currency assets. This reflects the potential requirement to liquefy foreign reserves for intervention purposes, should the need arise. Accordingly, there is an array of interacting controls aimed at ensuring quick access to funds. These controls include liquid asset ratios based on the liquidity characteristics of securities held and limits on the minimum and maximum proportion of reserves that may be held in any one currency. These limits are monitored on a daily basis.

The Bank has additional liquidity arrangements for foreign currency assets including:

- Repurchase agreements with other central banks that provide for the Bank to sell securities in exchange for foreign currency, while simultaneously agreeing to repurchase those same securities at a specified later date for an agreed amount. In essence, the arrangement allows the Bank to enhance the liquidity of its foreign reserves portfolio with minimum additional risks.
- Maintaining a standby credit facility (US \$100 million) to augment the amount of foreign currency that can be accessed.

### Local Currency Activities

The Bank is responsible for managing the daily liquidity of the banking system. This includes advancing and withdrawing funds from the banking system in order to smooth out the daily peaks and troughs. The nature of these activities, which mostly involve offsetting the flow of funds from one Bank customer (the Crown) to other Bank customers (settlement banks on behalf of their clients), is such that the Bank is not subject to the liquidity constraints that impact on other organisations.

<sup>13</sup> SDRs have been disaggregated into their composite currencies for net currency exposure, see note 1(c) (ii).

# Consolidated Statement of Financial Performance Notes

## 17. Income from Financial Assets

	1999 \$000	1998 \$000
Income from Foreign Currency Assets		
Interest Income:		
Cash Balances with Other Central Banks	11,811	9,725
Marketable Securities	154,760	191,828
Short-Term Advances	2,130	7,726
Securities Purchased Under Agreements to Re-sell	19,862	11,517
Securities Lending	737	796
International Monetary Fund	8,783	8,252
Total Interest Income	198,083	229,844
Unrealised Price Revaluations	(26,045)	51,555
Realised Gains from Price Changes	34,598	54,726
Gains from Foreign Exchange Trading	191	132
Other Income	(4,202)	139
Total Income from Foreign Currency Assets	202,625	336,396
Income from Local Currency Assets		
Interest Income:		
Securities Purchased Under Agreements to Re-sell	42,544	34,924
Advances to Government	44,837	99,346
Investment Portfolio - NZ Government Securities	164,079	161,097
Government Bank Accounts	1,027	851
Advances to Staff	24	55
Term Loans	5	10
Other Securities	46	171
Total Interest Income	252,562	296,454
Gain from Liquidity Management Swaps	697	1,136
Gain from Market Test Activities	25	6
Total Income from Local Currency Assets	253,284	297,596
Total Income from Financial Assets	455,909	633,992

**18. Expenses on Financial Liabilities**

	1999 \$000	1998 \$000
<b>Expenses on Foreign Currency Liabilities</b>		
Interest Expense:		
Securities Sold Under Agreements to Repurchase	11,132	10,744
Term Liabilities	178,205	225,119
IMF Special Drawing Rights	6,672	14,103
Total Interest Expense	196,009	249,966
Unrealised Price Revaluations	3,238	48,858
Realised (Gain) Loss from Price Changes	(10,206)	33,213
Other Expenses	375	384
<b>Total Expenses on Foreign Currency Liabilities</b>	<b>189,416</b>	<b>332,421</b>
<b>Expenses on Local Currency Liabilities</b>		
Interest Expense:		
Government Deposits	33,326	26,212
Other Deposits	1,950	938
Reserve Bank Bills	44,202	98,085
Total Expenses on Local Currency Liabilities	79,478	125,235
<b>Total Expenses on Financial Liabilities</b>	<b>268,894</b>	<b>457,656</b>

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

	1999 \$000	1998 \$000
<b>Foreign Exchange Revaluations:</b>		
Gain (Loss) on Financial Assets	26,746	1,046,179
Gain (Loss) on Financial Liabilities	(27,647)	(1,035,144)
<b>Net Foreign Exchange Revaluation Gain (Loss)</b>	<b>(901)</b>	<b>11,035</b>

**20. Other Income**

	Actual 1999 \$000	Budget 1999 \$000	Actual 1998 \$000
Fees for Registry Services	6,225	6,114	6,084
Sales of Commemorative Currency	1,539	1,458	1,380
Rental Income from Properties	1,731	1,699	1,810
Registered Bank Fees	5	8	3
Currency Distribution Income	499	488	491
Overseas Investment Commission Fees	763	824	581
Miscellaneous	955	834	334
<b>Total Other Income</b>	<b>11,717</b>	<b>11,425</b>	<b>10,683</b>

## 21. Asset Management Expenses

Asset Management Expenses include depreciation charged against assets of \$3,372,000 (1998 \$3,144,000).

The following depreciation methods and/or rates have changed from those used in 1998:

	1999 Method	Rate	1998 Method	Rate
Computer Hardware	Straight Line	4 years	Diminishing Value	50%
Computer Software	Straight Line	5 years	Straight Line	3 years
Plant and Equipment	Straight Line	5 years	Diminishing Value	30%
Motor Vehicles	Diminishing Value	26%	Diminishing Value	30%

The Bank considers the new depreciation methods result in a more appropriate allocation of depreciation expenses.

Using the previous methods/rates, the Bank's depreciation expense would have been approximately \$4,528,000 for the 1999 year.

## 22. Other Operating Expenses

	Actual 1999 \$000	Budget 1999 \$000	Actual 1998 \$000
Other Professional Fees	1,722	1,897	1,976
Computer Expenses	1,732	1,636	1,461
Information	940	878	841
Operational Travel	667	632	549
Rental	254	229	251
Printing	306	251	214
Agency and Commissions	293	434	243
Audit Fees	235	232	214
Non-Executive Directors' Remuneration	100	88	88
Miscellaneous	609	391	303
<b>Total Other Operating Expenses</b>	<b>6,858</b>	<b>6,668</b>	<b>6,140</b>

Other Operating Expenses include \$117,000 (1998 \$155,000) paid to the Bank's auditors for work undertaken outside their capacity as auditors of the Bank.

## Other Notes

### 23. 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 to other parties on market terms.

As part of the Currency Operations function, the Bank issues commemorative currency. The net loss for this activity in 1998/1999 was \$44,000 (1998 \$359,000 profit). The 1998/1999 result includes redundancy expenses of \$305,000 arising from providing for restructuring Collectors' Currency Operations during the next financial year (see note 8).

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

	1999 \$000	1998 \$000
Seigniorage	141,705	142,731
Commemorative Currency Sales	1,538	1,380
Rental Income from Properties	1,731	1,810
Packaging and Handling Fees	499	491
Other Income	44	32
<b>Operating Income</b>	<b>145,517</b>	<b>146,444</b>
New Note Issue Expenses	6,180	2,179
New Coin Issue Expenses	1,410	1,409
Commemorative Currency Issue Expenses	733	626
<b>Total Currency Issue Expenses</b>	<b>8,323</b>	<b>4,214</b>
Currency Processing Expenses	11,605	10,217
Net Property Management Expenses (Income)	(292)	(440)
<b>Operating Expenses</b>	<b>19,636</b>	<b>13,991</b>

<b>24. Reconciliation of Operating Cash Flows with Reported Operating Surplus</b>	<b>1999 \$000</b>	<b>1998 \$000</b>
Reported Operating Surplus	152,971	160,304
Add (Subtract) Non-Cash Items:		
Depreciation	3,372	3,144
Capital Accretion	1,557	19,675
Revaluations	29,283	46,675
Net Change in Foreign Currency Balance <sup>14</sup>	(117,280)	223,129
	(83,068)	292,623
Add (Subtract) Movements in Other Working Capital Items:		
Increase in Accounts Receivable	(228)	1,351
Increase in Accounts Payable	8,499	(3,389)
Increase in Inventories	(792)	(880)
Decrease in Interest Payable	(22,503)	52,162
Decrease in Interest Receivable	19,411	(23,137)
Decrease in Deferred Taxation	16	-
	4,403	26,107
Add (Subtract) Investing and Financing Activities:		
Realised (Gains) Losses	72,946	(302,472)
Net Cash Flow from Operating Activities	147,252	176,562

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<b>25. Consolidated Cash Balances</b>	<b>1999 \$000</b>	<b>1998 \$000</b>
Foreign Currency Assets:		
Cash Balances with Other Central Banks	381,118	250,513
Marketable Securities - Liquifiable Within Two Working Days	3,215,883	3,212,923
Local Currency Assets:		
Cash on Hand	78	94
Securities Purchased Under Agreements to Re-sell	3,063,648	1,058,000
	6,660,727	4,521,530
Demand Liabilities:		
Government Deposits	2,880,976	956,473
Settlement Bank Deposits	1,141	1,652
Central Bank Deposits	2,030	2,564
Staff Deposits	4,818	7,660
International Monetary Fund Deposit	37,180	4,272
	2,926,145	972,621
Closing Cash Balances	3,734,582	3,548,909

<sup>14</sup> The net change in the 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 loss of \$901,000 (1998 \$11,035,000 gain).

## 26. 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	
	1999 \$000	1998 \$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.

## 27. 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.

## 28. 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 include:

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

The Bank does not present the values of transactions and outstanding balances with Crown-related parties due to the large volume of transactions and the large number of related parties. Unless otherwise stated, all transactions take place with reference to market rates. Therefore, disclosure of the values of transactions and outstanding balances with Crown entities is not expected to provide useful or material additional information.

## 29. Contingent Liabilities

- (a) 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 1999 and reported on 22 July 1999 that, based on the Fund's annual accounts:

- (i) the assets of the Fund would have been sufficient at 31 March 1999 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;
  - (ii) the assets of the Fund would have been sufficient at 31 March 1999 to provide for benefits to members, including existing pensioners, that are attributable to membership prior to 1 April 1999; and
  - (iii) to their knowledge, there have been no circumstances between 31 March 1999 and 30 June 1999 that would cause them to form a different opinion as at 30 June 1999.
- (b) 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 Bank exceed that issued by the Reserve Bank, the liability for the excess would revert to the Treasury. The face value of coin issued by the Treasury is \$87,702,000.
- (c) The Bank has a contingent liability for currency in circulation that has been demonetised but not returned to the Bank.
- (d) 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 \$7,399,000 (1998 \$6,799,000).

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.

- (e) 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 under Part V of the Reserve Bank of New Zealand Act 1989.

### *Previous Year's Contingent Liabilities*

The above five contingent liabilities were recorded in the Reserve Bank's 1998 *Annual Report*. The only liabilities to arise during the year were:

- (i) demonetised currency with a face value of \$77,918 was returned to the Bank for redemption at face value; and
- (ii) commemorative currency with a face value of \$6,629 was returned to the Bank for redemption at face value.

# RBNZ Registry Limited Notes

## 30. 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.

### (a) RBNZ Registry Limited Statement of Financial Position

<i>As at 30 June</i>	1999 \$000	1998 \$000
<b>Assets:</b>		
Current Assets:		
Bank Accounts	9,939	9,130
Accounts Receivable	1,368	1,288
Prepayments	49	19
Deferred Taxation	60	76
Fixed Assets	586	752
<b>Total Assets</b>	<b>12,002</b>	<b>11,265</b>
<b>Liabilities:</b>		
Current Liabilities:		
Accounts Payable	874	813
Funds held in Trust for Stockholders	638	225
Withholding Tax	4,396	1,561
Funds Received in Advance from Issuers	151	872
Funds Due to the Treasury	514	1,718
Fees Received in Advance	231	194
Goods and Services Tax Payable	24	15
Provision for Dividend	2,000	2,000
<b>Equity:</b>		
Issued Capital	3,000	3,000
Retained Earnings	174	867
<b>Total Liabilities and Equity</b>	<b>12,002</b>	<b>11,265</b>

(b) RBNZ Registry Limited Statement of Financial Performance

<i>For the year ended 30 June</i>	<b>1999 \$000</b>	<b>1998 \$000</b>
<b>Operating Income:</b>		
Fees for Registry Services	6,424	6,171
Interest	544	889
Foreign Exchange Gain	2	18
Other Income	205	125
<b>Total Operating Income</b>	<b>7,175</b>	<b>7,203</b>
<b>Operating Expenses:</b>		
Personnel	2,132	1,881
Administration	1,272	1,253
Computer Expenses	985	910
Asset Management	312	400
Depreciation	341	350
Audit Fees	30	25
Other <sup>15</sup>	151	114
<b>Total Operating Expenses</b>	<b>5,223</b>	<b>4,933</b>
Net Operating Profit Before Tax	1,952	2,270
Taxation	645	750
<b>Net Profit After Tax</b>	<b>1,307</b>	<b>1,520</b>

<sup>15</sup> Other expenses include \$35,000 (1998 \$74,000) paid to RBNZ Registry Limited's auditors for work undertaken outside their capacity as auditors.

(c) *RBNZ Registry Limited Statement of Movements in Equity*

<i>For the year ended 30 June</i>	1999 \$000	1998 \$000
Equity at Start of Year	3,867	4,347
Net Surplus for the Year	1,307	1,520
Less Dividend provided for	2,000	2,000
Equity at End of Year	3,174	3,867

### 31. 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.

<i>For the year ended 30 June</i>	<b>1999 \$000</b>	<b>1998 \$000</b>
<b>Income Tax Expense:</b>		
Net Profit Before Tax	1,952	2,270
Add Back Permanent Difference	3	2
	<b>1,955</b>	<b>2,272</b>
<b>Income Tax Expense at 33%</b>	<b>645</b>	<b>750</b>
<b>Current Tax Charge:</b>		
Tax Effect of Timing Differences	(15)	(7)
<b>Current Tax Charge</b>	<b>630</b>	<b>743</b>
<b>Deferred Taxation:</b>		
Opening Balance	(76)	(93)
Deferred Portion of Current Tax Charge	16	6
1997/98 IRD Tax Assessment Adjustment	-	11
<b>Deferred Taxation Liability (Asset)</b>	<b>(60)</b>	<b>(76)</b>

### 32. 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. With the exception of the local currency securities owned by the Bank and held through NZCSD, 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 1999 was \$83.0 billion (1998 \$84.2 billion).



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