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Editor's Note

In the March 2003 issue of the *Bulletin*, we ran an article on the Financial Sector Assessment Program (FSAP), noting that New Zealand will undergo an FSAP assessment later this year. We noted that this will involve a broad-based assessment of the regulatory framework for the New Zealand financial system and the capacity of the system to withstand economic and financial shocks. In that article, we indicated that the Reserve Bank would be publishing a series of articles on financial system issues in the lead up to, and following, the FSAP. We made a start in the March issue with the article on the New Zealand payment system. This issue of the *Bulletin* makes a further contribution, with two articles relating to the financial system – one on registered banks and banking supervision issues, and one on the non-bank financial institutions.

The first article is our annual review of the banking system. It looks at the financial condition and performance of the registered banks and developments in the banking sector. The article also discusses developments in the Australian banking system, given the importance of Australian banks to the health of the New Zealand banking sector. The analysis shows that both the Australian and New Zealand banking sectors continue to display good health, with strong profitability, low levels of impaired assets, modest exposure concentration and sound capitalisation. The article also provides an update of developments in banking supervision policy, noting the work under way on various policy issues, including local incorporation of banks, possible closer integration of Australian and New Zealand regulatory policy, and the management of banking system distress.

The second article provides an overview of the non-bank financial institutions, including finance companies, building societies, life insurance companies and managed funds. These and other non-bank financial institutions are not subject to supervision by the Reserve Bank and in most cases are not supervised by any other regulatory body. The main reason for this is that, by most measures, these financial institutions do not pose a risk of instability for the financial system as a whole, which is the main rationale for registering and supervising banks. Nonetheless, the non-bank financial institutions play an important role in the financial system and provide a wide range of financial services to households

and businesses. The Reserve Bank therefore keeps an eye on developments in the non-bank financial sector, and takes a particular interest in any developments that could pose risks to the stability of the financial system or that point to significant structural changes in the financial sector. In that context, the articles summarises the main developments in the non-bank financial sector over recent years and comments on some of the financial condition indicators applicable to these entities.

We change tack in the final article by discussing aspects of how we communicate on monetary policy issues. The article notes that the economy, like life in general, is full of uncertainty. The only certainty in forecasting the economy is the certain knowledge that we will be wrong! That is as true for the purpose of monetary policy as it is for any other economic purposes. It is therefore important that, when the Bank communicates on monetary policy issues, it does not create the false impression that our economic forecasts – whether of GDP, interest rates, prices, or anything else – involve precise assessments of particular economic variables. Rather, we need to make it clear that any forecasts are inherently uncertain and that the forecasts we are making are therefore within bounds of probability of actual future outcomes. The article discusses some of the techniques available for communicating the nature of uncertainty in economic forecasts, including the use of graphical techniques for doing so.

Finally, this issue of the *Bulletin* contains a speech that the Governor of the Bank, Alan Bollard, gave earlier this year on the subject of corporate governance in the financial sector. This speech provides another important piece of the jigsaw puzzle that makes up the financial system and discusses a number of elements that relate to corporate governance and risk management in registered banks. In particular, it stresses the vital role that sound corporate governance plays in fostering high quality management of risks in the banking system and the need for policies to reinforce the incentives for sound governance practices in the banks. It draws particular attention to the special governance issues that arise in banks domiciled, or owned by parents domiciled, in another country.

I hope that this issue of the *Bulletin* provides some interesting and informative reading for our readers.

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