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*Themed issue: Liquidity and the  
New Zealand financial system*

## Contents

Editor's note	3
<b>Articles</b>	
Evolution of the Reserve Bank's liquidity facilities <i>Ian Nield</i>	5
The global financial crisis and its transmission to New Zealand – an external balance sheet analysis <i>Paul Bedford</i>	18
The Reserve Bank's payment system oversight role applied to settlement risk in the retail payment system <i>Phoebe Chan and Stuart Irvine</i>	29
New legislation for regulation of non-bank deposit takers <i>Noemi Javier</i>	40
Results from our recent survey of <i>Bulletin</i> readers <i>Victoria Zhang and Tim Ng</i>	47
<b>For the record</b>	
Discussion papers	49
News releases	51
Publications	61
Articles in recent issues of the Reserve Bank of New Zealand <i>Bulletin</i>	63

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## Editor's note

This edition of the Reserve Bank *Bulletin* is built around the theme of liquidity and New Zealand's financial markets. 'Liquidity' in a general sense relates to the ability for payments and other financial transactions to occur without hindrance, disruption or surprise. In some contexts it means the ready availability of cash and credit; in others, well-functioning financial markets. In all cases, the desired state of liquidity conditions is such that the financial system can support economic activity in a manner that is, for most people, largely invisible.

Such conditions do not currently prevail in New Zealand or in much of the rest of the world. In recent months the Reserve Bank and other central banks around the world, and governments as well, have undertaken extraordinary action to shield the financial system and global economy from the effects of extremely disrupted liquidity and credit conditions. Various, central banks have injected large volumes of cash into their local banking systems, or made it more readily available, and have cut official interest rates dramatically. Supervisory authorities have closed down distressed or problematic institutions, or facilitated their merger with stronger institutions. Governments have removed impaired and illiquid assets from weakened financial institutions, or injected capital into them; introduced or extended guarantees of wholesale bank liabilities and retail deposits; and announced major new fiscal stimulus packages.

The articles in this edition put these actions into a broader context. Our first article, by Ian Nield, discusses the evolution of the Reserve Bank's liquidity management arrangements over the past few years. This evolution includes the measures introduced this year as the global financial system turmoil deepened. As a result of changes to the arrangements and our thinking over this time, the arrangements and New Zealand liquidity conditions are now more robust and adaptable to a variety of stresses, including those of the type we currently face.

Paul Bedford explores in our second article how instability in the international financial system spread far beyond its original source, including to New Zealand. The article discusses the impact of the global developments on the domestic financial system. The impact is modulated by the scale, composition and maturity structure of the international

assets and liabilities that comprise New Zealand's external accounts. The article highlights the role of the international liabilities – a substantial part of which are due to local banks' offshore funding operations – and how they are intermediated.

In our third article, Phoebe Chan and Stuart Irvine look at settlement risk in the retail payment system. The existence of settlement risk is one reason why banks need to ensure they have adequate liquidity resources at all times. The current typical pattern of payment flows through the New Zealand retail payment system includes a proportion of very high value payments. Although these payments are very low in number, they significantly increase banks' exposures to each other at the time that their retail payment obligations must be settled. The article discusses a proposal from the New Zealand Bankers' Association to address settlement risk in the retail payment system in light of the Reserve Bank's payment system oversight and financial stability objectives.

Noemi Javier explains in our fourth article the new regulatory framework for non-bank deposit takers introduced with the amendments to Reserve Bank of New Zealand Act in September 2008. Under the new legislation, the Reserve Bank becomes the sector's prudential regulator. Non-bank deposit takers will be required to comply with prudential standards set by the Reserve Bank, including credit rating, capital and liquidity requirements, and restrictions on related-party exposures.

Finally, Victoria Zhang and I provide a note summarising the results of our August 2008 survey of *Bulletin* readers. Thanks again to all respondents for taking the time to return the survey. We received useful suggestions on the *Bulletin's* content and style, which we will take on board. In particular, I am glad to announce that from the September 2009 issue, the Reserve Bank will provide printed copies of the *Bulletin* free of charge.

I hope you enjoy the range of articles in this edition. Best wishes for the holiday season.

Tim Ng  
Editor

 **RESERVE  
BANK**  
**MUSEUM**

The Reserve Bank Museum celebrates and records New Zealand's economic and banking heritage.

Displays range from timelines and interactive exhibits to comprehensive display panels outlining both the Reserve Bank's history and role, and how the New Zealand economic system has developed.

Artefacts include the only working example in New Zealand of the MONIAC hydro-mechanical econometric computer developed by New Zealand economist and inventor Bill Phillips in the late 1940s.

In early 2008, the museum received its 10,000th visitor.

The museum is open 9.30 a.m.–4.00 p.m. weekdays. It is closed weekends, public holidays, and for special events. Please call to confirm opening hours.

Reserve Bank Museum  
2 The Terrace  
Wellington  
New Zealand  
ph 04-471-3682  
museum@rbnz.govt.nz  
<http://www.rbnz.govt.nz/about/museum/2766074.html>



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