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Photography by Stephen A'Court.

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## Editor's note

In this edition of the Reserve Bank *Bulletin* we present four articles that cover macro-financial stability, procyclicality of the financial system, global trade and the management of the Reserve Bank's balance sheet.

In our lead article, Deputy Governor Grant Spencer explains the Reserve Bank's philosophy regarding macro-financial stability. The article places the Reserve Bank's macro-financial stability function within the international context and reviews the appropriate policy framework in light of the global financial crisis. Internationally, attention is turning towards new macro-prudential instruments that might enhance the stability of the financial system. New Zealand is also considering the potential of new macro-prudential tools which could be implemented by the Reserve Bank under its existing prudential policy powers. The article notes that changes to both micro- and macro-prudential policies will need to be carefully managed.

Our second article by Rebecca Craigie and Anella Munro examines procyclicality in New Zealand's financial system. In this context, procyclicality refers to the extent to which the structure of the financial system might amplify the tendency of the economy to experience business cycles. For example, during expansions, house prices often rise, increasing households' net worth and collateral. This increases households' ability to borrow and further fuel an expanding economy. The article concludes there are many ways that the financial system might amplify the cycle in the economy. Proposed changes to the regulatory framework suggest scope to reduce financial sector amplification, but implementation will have to be closely watched.

In our third article, Phil Briggs and David Gillmore make an input-output table to examine global trade linkages and how these trade linkages matter for New Zealand. They find that New Zealand is dependent on Australia and the broad emerging-Asia region. In turn, many countries are heavily influenced by output in the US and Euro area and more so than might be thought by a simple examination of bilateral trade data.

Our fourth article is by Kelly Eckhold. His article outlines the nature and rationale for the significant changes in the structure and management of the Reserve Bank's balance sheet that have occurred over the past five years. In particular, the Reserve Bank no longer fully hedges its foreign reserves against movements in the NZD exchange rate. Furthermore, the Reserve Bank's asset and liability management approach has changed to an integrated model where liabilities are treated as fungible across the Bank's various functions, allowing funds raised in one business area to be used in another. The Bank's experience during the global financial crisis suggests the changes to the management of our balance sheet have been effective in supporting the Bank's functions at a time of system stress.

Kirdan Lees

Editor

