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Photography by Stephen A'Court.

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## Editor's note

This issue of the Reserve Bank *Bulletin* contains four articles touching on various aspects of the Reserve Bank's financial stability and financial markets responsibilities.

Rural lending represents a much larger proportion of bank lending in New Zealand than in most other advanced economies. Kevin Hoskin and Ian Harrison outline how the Reserve Bank has gone about setting new minimum requirements for how much capital has to be held against rural lending by the four large banks accredited to use their own risk models under the Basle II regime. An extensive process involving modelling, and consultation with affected parties, has taken place over the last couple of years, to help ensure that the risk weights used for rural exposures adequately capture the relative risks of rural lending. Events of the last few years have reminded both borrowers and lenders that rural lending can be quite risky. The finalised rural capital requirements will, on average, require these banks to hold slightly less capital against rural exposures than was the case under the Basle I regime that was in place until the end of 2007. The impact on banks' rural lending margins seems likely to be small.

In a complementary article, David Hargreaves and Gina Williamson report on a "stress test" the Reserve Bank has undertaken to help understand the implications for banks of severe adverse shocks in the dairy industry (lending to dairy farmers makes up the bulk of total rural debt). Using detailed data obtained from banks, they test the impact of a variety of severe shocks (to land prices, to the payout, to interest rates). Sustained multi-year downturns in the payout and in farm land prices pose the largest risks to lenders.

In various parts of the Reserve Bank Act, the Reserve Bank is required to promote, or have regard to, not only the soundness of the financial system, but also the efficiency of the system. Chris Hunt and Chris Bloor report on some developing work about how to think about the efficiency of the financial system, and how these statutory provisions should influence the Reserve Bank's analysis and policy development. They also report some interesting preliminary cross-country results on rates of return in banking. Those data appear to suggest unusually high rates of return are earned in New Zealand, although more work is required to reach a definitive understanding of what these data mean.

Finally, Aidan Yao and Enzo Cassino review the range of extraordinary measures the Reserve Bank took during the international financial crisis of 2007 to 2009 to help manage domestic liquidity conditions and to avoid the risk of a more severe domestic credit crunch. International stresses quickly spilled over into domestic markets, and the vulnerability of the short-term wholesale foreign funding that banks had relied on heightened New Zealand's exposure to the stresses, even though the credit quality of the Australian banks was not in question through this period. Formal statistical tests help illustrate the announcement effects of the various measures, although the authors note that a variety of factors, including the pre-emptive nature of several of the announcements, means that the overall impact was much larger than the effects that can be captured using these formal techniques.

Michael Reddell  
For the Editorial Committee

