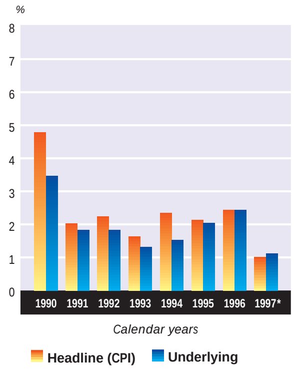
96
97 Year at a glance

- Underlying inflation in the year to September 1996 was 2.3 percent and to December 1996 2.4 percent, both of which were above the 0 to 2 percent inflation target that applied then. Underlying inflation in the year to March 1997 was 2.0 percent and to June 1997 1.5 percent. The Reserve Bank eased monetary conditions substantially as inflationary pressures abated.
- On 10 December 1996 the Policy Targets Agreement (PTA) was amended to set a new inflation target of 0 to 3 percent. The PTA also made explicit that price stability is a means to an end, its value being enhanced sustainable economic performance.
- In June 1997 the Reserve Bank began using a new index, the Monetary Conditions Index, to publicly describe monetary conditions.
- The new regime for bank supervision had its first year of operation, and worked well.
- Three more banks were registered.
- The Reserve Bank released a series of booklets on the impact of monetary policy, and an explanation of the Bank's functions in the Maori language. Use of the Bank's Internet site increased massively.
- An upsurge in bank note forgeries was evident. Total numbers of forgeries remained small, but the trend leaves no room for complacency.
- The Reserve Bank's operating costs, where covered by its Funding Agreement with the Government, were 12.3 percent below the requirements of that Agreement and 2.6 percent below equivalent actual costs the year before.

Inflation

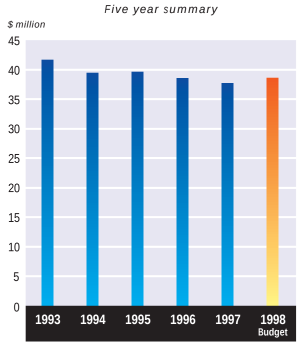
Annual percentage change

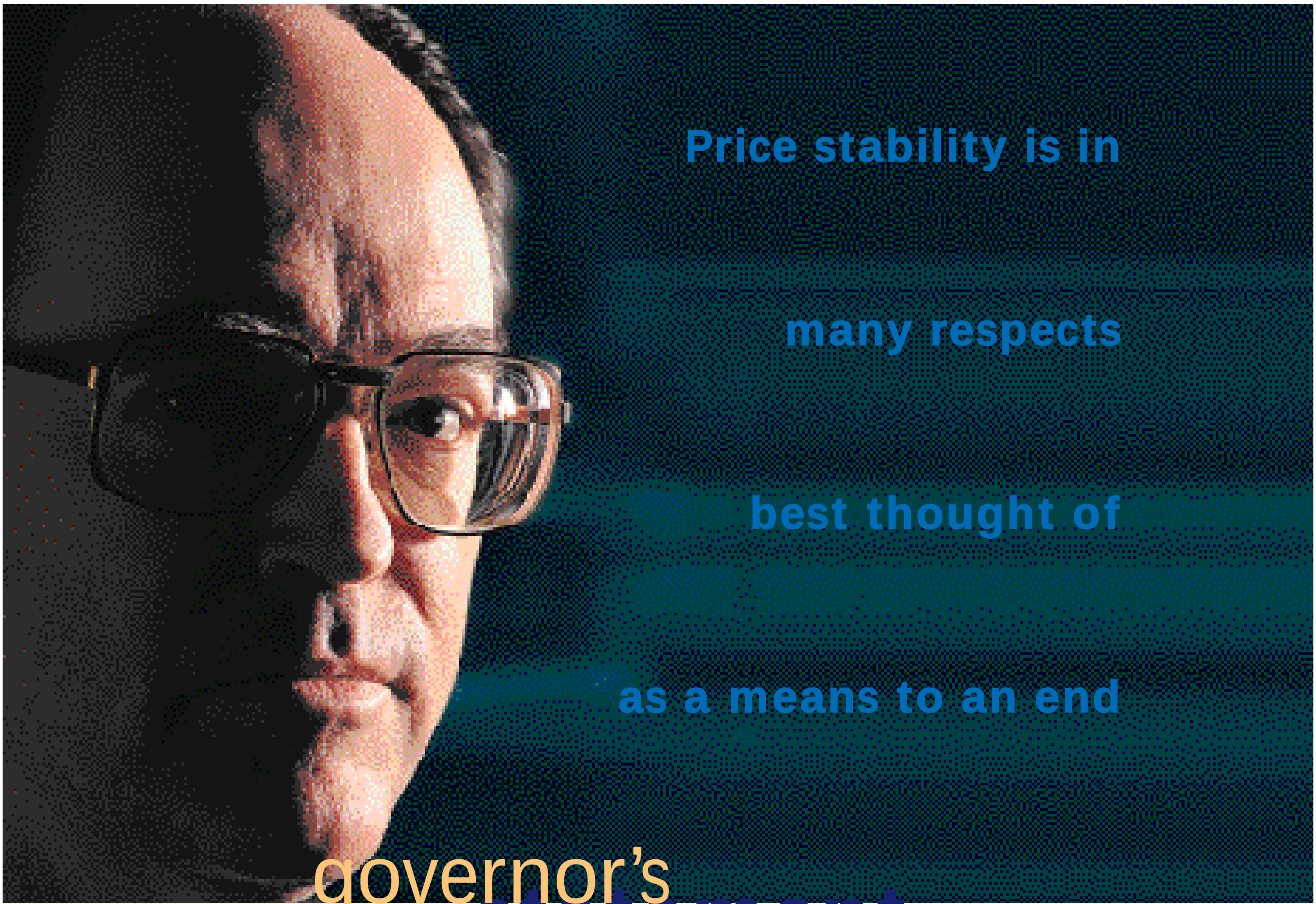


* Projection to December 1997 as at June 1997

Operating expenses

Five year summary





governor's statement

The year to June 1997 was challenging for the Reserve Bank.

In the first half of the year, we kept monetary conditions very firm, to bring underlying inflation back within the then 0 to 2 percent inflation target. Notwithstanding this, and the firm conditions which had prevailed for more than two years previously, underlying inflation was 2.3 percent in the year to September 1996, and 2.4 percent in the year to December 1996. Economic growth to December was stronger than almost all observers expected.

In the second half of 1996/97, inflationary pressures began to abate quite rapidly, as a result of a slowing in economic activity and a fall in the New Zealand dollar prices of imports due to the earlier substantial appreciation of the currency. These were both, in part, a response to the firm monetary conditions of the preceding two years. Underlying inflation in the year to March 1997 was 2.0 percent, and in the year to June 1.5 percent. Most observers expect inflation to fall further over the next 12 months.

As a result of this decline in inflationary pressures, the Bank was able to signal a modest easing in monetary policy in December, and a more substantial easing at the end of June. By the beginning of July, 90 day interest rates were some 3 percent lower than they were at their peak last September, while the trade-weighted measure of the exchange rate was similarly about 4 percent lower than it was at its peak, in March.

In December 1996, following the formation of a Coalition Government, I agreed to a new Policy Targets Agreement. This changed the target for monetary policy from 0 to 2 percent inflation to 0 to 3 percent inflation. While I did not push for a change of this kind, and indeed saw some risk that the change would encourage higher inflationary expectations, I accepted the somewhat wider range.

Certainly, the change has reduced the likelihood of the Bank having to move monetary conditions violently to stay within the narrower target, and, by reducing slightly the risk of having inflation fall outside the target, it has reduced risk to the Bank's reputation.

The Policy Targets Agreement also made explicit for the first time what had previously only been implicit, namely that price stability is in many respects best thought of as a means to an end, "so that monetary policy can make its maximum contribution to sustainable economic growth, employment and development opportunities within the New Zealand economy."

Unlike other models of central bank independence, the New Zealand model reserves to the elected Government the final right to determine the precise target of monetary policy; requires the Government to make that target public; leaves the central bank free of political interference to achieve the target; and holds the Bank's Governor accountable for his performance under that target. In May 1997, the United Kingdom adopted most of the key features of this approach.

Because both interest rates and the exchange rate impact on inflation, especially in our small open economy, the Bank looks at both in assessing the effects of monetary policy. In December, we indicated publicly that, as an approximate guide, we regarded a 1 percentage point movement in 90 day interest rates as having a similar effect on inflation as a 2 percent change in the trade-weighted exchange rate. When we issued our June 1997 *Monetary Policy Statement*, for the first time we expressed our desired monetary conditions in index number form. Although we are by no means the first central bank to communicate in terms of 'monetary conditions', rather than interest rates alone, to my knowledge we are the first to formalise our communications in this way. The new approach helps explain the stance of policy to financial markets and to the wider public. Early indications are that it is working very well.

As in past years, the Bank devoted considerable effort to explaining monetary policy to key opinion-makers and to the wider public. We address our six-monthly *Monetary Policy Statements,* six-monthly *Economic Projections,* and quarterly *Reserve Bank Bulletins* principally to financial markets, business leaders, economists, and the media. As well, we continued a very active speech programme throughout the country and produced a series of brochures, aimed at the general public. Further resources were provided to assist the teaching of economics in schools. Use of our Internet site continued to expand rapidly.

1996/97 was the first full year of our new disclosure-based approach to banking supervision. We are well pleased with the way in which the new system has worked. There is evidence that the directors of some banks are now more conscious of their responsibilities than previously and that some banks have put better risk-control systems in place. There is still, however, a widespread public perception that registered banks are in some sense riskless, and that bank deposits are guaranteed by the Government or the Reserve Bank. At every opportunity, we make clear that, while the Bank promotes a sound and efficient banking system, we do not guarantee the survival of individual banks, and do not guarantee the repayment of deposits.

During the year, the Bank registered three new banks to operate in New Zealand as branches. In November 1996, Trust Bank New Zealand Limited relinquished its registration following acquisition by Westpac Banking Corporation. A few days after the end of the financial year another registration took place, bringing the total number of registered banks to 19.

It would be nice to be able to report that the real-time gross settlement system (RTGS), under development for several years, became operational during the year, as envisaged in our last *Annual Report*. Unfortunately, as many other countries have found, the technical problems of RTGS are many and varied, and New Zealand still has no RTGS system. At this stage, however, substantial parts of the structure are in place, and we are confident that a system linking all major banks will be functioning shortly. This will play an important part in further reducing risk in the New Zealand financial system.

New Zealand may be unique in not having intervened in its foreign exchange market over the last twelve years (since the New Zealand dollar was floated in early March 1985). The Reserve Bank nevertheless maintains a capacity to intervene in the event of "disorderly market conditions", for which we manage foreign exchange assets and committed credit lines of some NZ$4.5 billion (exactly matched by foreign exchange liabilities to the Treasury, so that the Reserve Bank has no net foreign exchange position). During the year we undertook a full review of the costs and benefits of holding these reserves, recognising however that any conclusion reached would be in the form of a recommendation to the Treasurer, who determines the level of such reserves. We concluded that continuing to hold reserves is warranted, particularly given that the income earned on the assets now very nearly matches the cost of the related liabilities.

Issuing bank notes and coins occupies more Bank staff than any other single function, and the efficiency of that operation continued to be a source of considerable satisfaction. Despite an upsurge in the number of forged notes passed during the year, the total number of such notes was very low in relation to both the total notes on issue and the forgery problem in many other countries. Over the 12 months to 30 June 1997, our processing machines detected 1,100 counterfeit bank notes. We continue to explore ways of reducing this rash of forgeries.

The Bank's registry operation, and the related Austraclear operation, also continued to grow and make a worthwhile contribution to the development of the New Zealand financial market. Austraclear will make a particularly important contribution to the operation of the RTGS system, by providing the core of the "auto-repo" system which is a key component of RTGS.

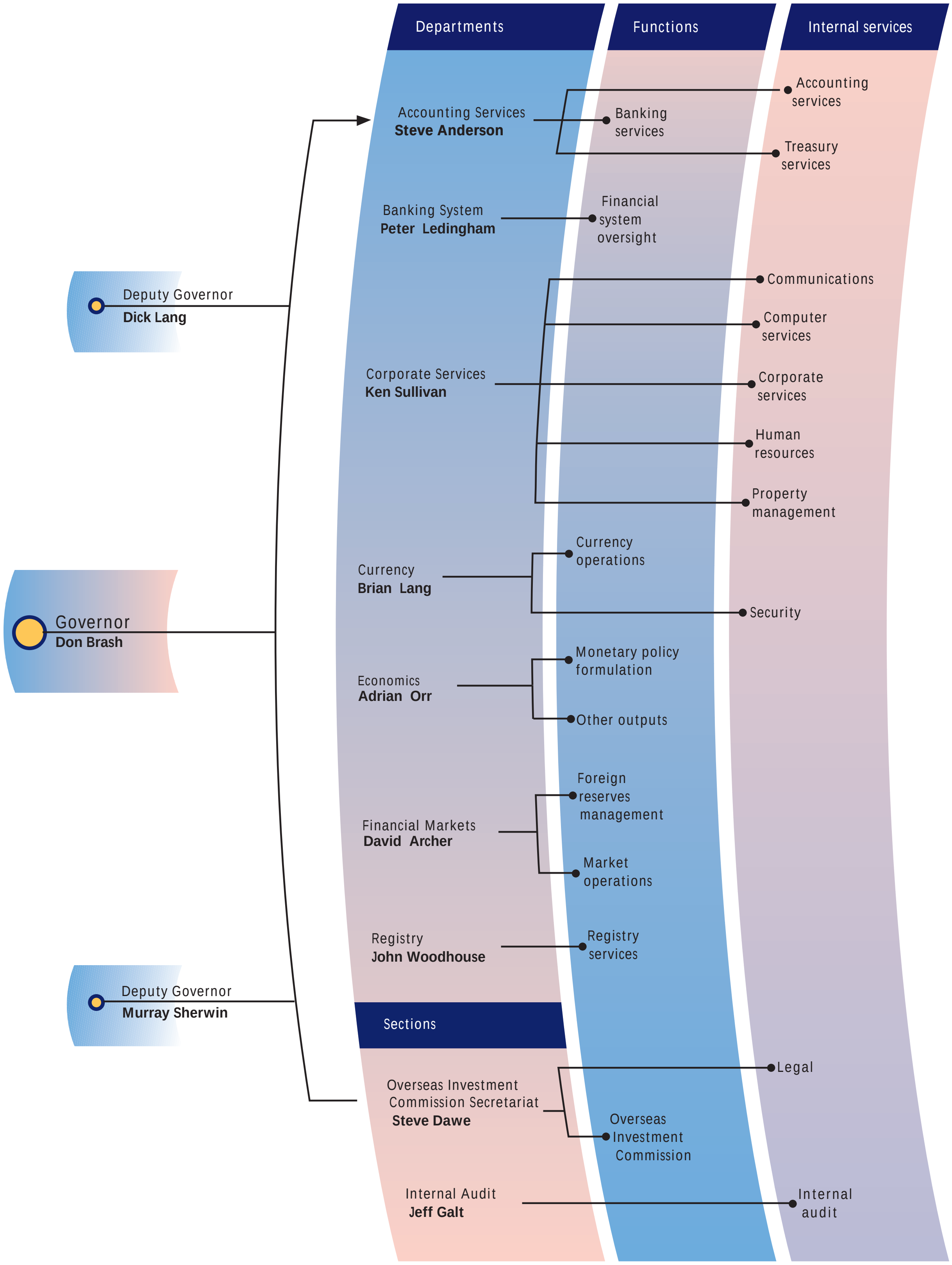
The 1996/97 year was the second under the five-year Funding Agreement signed with Government in mid-1995. That Agreement provided for $38.0 million in operating expenses for the non-commercial functions of the Bank for 1996/97 (our registry and Austraclear functions are not covered by the Agreement), and for the automatic adjustment of that figure in the event that the Bank's inflation target was changed by Government. Because the inflation target was changed in mid-year from 0 to 2 percent to 0 to 3 percent, a change in the mid-point of the target by 0.5 percent implied an adjustment of the Funding Agreement limit of an extra $95,000. In the event, we were able to hold costs subject to the Funding Agreement to just $33.4 million, 2.6 percent below actual costs in 1995/96, 8.0 percent below budgeted expenses for 1996/97, and 12.3 percent below the Funding Agreement limit.

This was a very pleasing outcome, given that the Funding Agreement limit is itself well below the first five-yearly Funding Agreement signed in 1990 ($56.7 million annually). In part the result can be attributed to delays in the start-up of RTGS, the costs of which, even though recoverable from banks, will be a charge against the Funding Agreement. However, in large part, the outcome is a result of a continuing focus on efficiency and effectiveness throughout the Bank.

For that continuing dedication and commitment on the part of all of the Bank's staff, I record my sincere appreciation.

Don Brash
Governor

structure of the reserve bank



Board of Directors

Executive

Governor
Don Brash, (Chief Executive)

Deputy Governors
Dick Lang, (Deputy Chief Executive)
Murray Sherwin

The role of the Board of Directors of the Reserve Bank is different from that of a company. The Board has no involvement in directing Reserve Bank policy, monetary or otherwise, and Board members do not receive market-sensitive information ahead of the markets. The Board's primary function is to monitor the Reserve Bank's performance, reporting to the Treasurer. As well, the Board provides advice to the Governor, typically on the consequences of the Reserve Bank's activities for the commercial community. When required, the Board makes recommendations to the Treasurer on the appointment or reappointment of the Governor, and appoints Deputy Governors on the recommendation of the Governor. These duties, and some others, are carried out by a committee of the non-executive directors, which is chaired by Sir Peter Elworthy and, for these purposes, meets independently of the executive directors. Two other Board committees, audit and registry, meet regularly. The Board as a whole met 11 times during the year in review.

Non-executive

Professor Viv Hall
University professor: Macarthy Professor of Economics and Head of the School of Economics and Finance, Victoria University of Wellington; Trustee, New Zealand Institute of Economic Research (Inc).
(First appointed 1 March 1992 - current term expires 28 February 2002.)

Bill Wilson
Company director: Chairman, FERNZ Corporation Ltd, Fletcher Challenge Ltd, New Zealand Guardian Trust Company Ltd; Director, BOP Fertiliser Ltd.
(First appointed 1 February 1990 - current term expires 31 January 1998.)

Stuart Young
Industrialist: Retired Co-Founder and Chairman of the Interlock Group; Director, Musacus International Ltd.
(First appointed 1 July 1994 - current term expires 30 June 1999.)

Sir Peter Elworthy
Agriculturalist: Chairman, Alan Duff Charitable Foundation, Opihi (S.C.) River Development Company Ltd, Port of Timaru Ltd, Primary Industry Consultants Board, The Power Company Ltd; Director, New Zealand Rural Property Trust, BP New Zealand Ltd, Pacific Beef Ltd, Sky City Ltd, Stanfield Oaks Ltd, Trans Tasman Properties Ltd; Trustee, Lincoln University Foundation, New Zealand Institute of Economic Research (Inc), Waitangi Foundation; Patron, Croydon Aviation Heritage Trust, South Canterbury Conservation Trust.
(First appointed 1 September 1985 - current term expires 31 January 1999.)

non executive

Gil Simpson
Computer programmer: Chief Executive Officer, Aoraki Corporation Ltd; member, New Zealand Business Roundtable, Foreign Direct Investment Advisory Group, Minister for Information Technology's Advisory Group; board member, Genesis Research and Development Corporation Limited; joint venture partner in Canterbury Technology Park; Chairman, Christchurch City Mission Special Gifts Campaign.
(First appointed 9 June 1997 - current term expires 8 June 2002.)

Alison Paterson
Chartered accountant: consultant, Beattie Rickman; Chairman, Waitemata Health Ltd; Director, Health Waikato Ltd, Wrightson Ltd; Trustee, Donny Charitable Trust, Health Waikato Charitable Trust, Wrightson Retirement Plan.
(First appointed 1 February 1995 - current term expires 31 January 2000.)

Lindsay Fergusson
Company director: Chairman, AIT Foundation, America's Cup Village Ltd; Deputy Chairman, Business in the Community Ltd, Northern Regional Health Authority; Director, Auckland Regional Chamber of Commerce and Industry, Tauranga Civic Holdings Ltd, Terabyte Interactive Ltd; Councillor, Auckland Institute of Technology.
(First appointed 1 December 1988 - current term expires 31 January 2000.)

statement of service performance

In its *Annual Plan,* the Reserve Bank sets out the functions it will perform in the year ahead. This section of the *Annual Report* complements the *Annual Plan 1997,* by citing those functions (in italics) and then describing the Reserve Bank's performance in the year completed.

The Reserve Bank's Monetary Policy Committee (below) assesses inflationary pressures, in part based on direct contact with business made by staff in the field, such as former Chief Manager Economics Department David Mayes at a manufacturing plant in Wainuiomata (above).

a Monetary policy formulation

Formulating and publicly presenting an ongoing monetary policy strategy to enable the Bank to maintain price stability, in the most efficient manner possible.

The policy framework

As defined in the Reserve Bank of New Zealand Act 1989, the Reserve Bank's primary function is to conduct monetary policy so as to maintain price stability. A Policy Targets Agreement (PTA), signed by the Governor and the Minister of Finance (or the Treasurer,[1] were it to be renegotiated in the future), provides a specific and numerical definition of price stability. The Reserve Bank has operational independence when implementing monetary policy, but is accountable to the Treasurer for its performance in meeting the inflation target specified in the PTA.

The current PTA was signed on 10 December 1996, when the new Coalition Government was formed. It includes two changes from previous agreements. First, the definition of price stability was amended from annual increases in underlying inflation between 0 and 2 percent to between 0 and 3 percent. Secondly, Clause 1 was extended, to make clear that monetary policy is directed at achieving price stability: "... so that monetary policy can make its maximum contribution to sustainable economic growth, employment and development opportunities within the New Zealand economy."

All other aspects of the previous PTA were carried over.

Box 1

The new macroeconomic model

In June 1997, the Reserve Bank implemented a new macroeconomic modelling system, called the Forecasting and Policy System (FPS), which provides a substantial input into the Bank's regular economic projections and assists in the investigation of issues relevant to monetary policy.

FPS is a simplified representation of how the New Zealand economy operates. FPS describes how people balance consumption and savings decisions; how businesses decide their levels of output, capital accumulation and employment levels; and New Zealand's overall borrowing and trading in international markets. The spending, taxing and borrowing decisions of the Government are also included, as are the monetary policy actions of the Reserve Bank. All these factors in combination affect inflation.

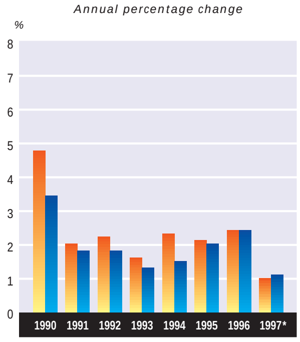
The Reserve Bank has had many macroeconomic models in the past, but FPS is significantly new, and puts the Reserve Bank at the leading edge of this kind of work. Its particular value is that if further substantial structural changes occur to the New Zealand economy (e.g. sharp shifts in public policy), FPS can factor in those changes, whereas a more traditional model might have to be rebuilt. As a result, FPS is a considerable advance for Reserve Bank policy making.

The value of FPS is that it imposes a specific discipline on the Bank's decision making. A well-designed model forces the user to look at the "big picture", and keep track of subtle but important linkages that otherwise can get overlooked. That said, a model should not be used mechanically or in isolation. This system includes a clear role for judgement by our analysts to enhance model-based projections, given the complexity of economic behaviour across society as a whole.

The definition of price stability was amended

Inflation

Annual percentage change



* Projection to December 1997 as at June 1997

Figure 1

The inflation record

During the period reported on, underlying inflation[2] peaked in the year to December 1996 at 2.4 percent. Since then, underlying inflation has fallen to 1.5 percent for the year to June 1997.

This inflation profile reflects the economic cycle of recent years. Economic growth was strong in 1993 and 1994. From 1994 onwards, firmer monetary conditions were required to prevent strong demand taking inflation even further above the 2 percent upper limit that applied then.

1 *The position of Treasurer was created at the time of the formation of the Coalition Government, and is in addition to that of Minister of Finance. In the allocation of portfolio responsibilities, the Reserve Bank falls under the Treasurer.*

2 *"Underlying" inflation is Consumers Price Index (CPI) inflation minus specific caveats described in the PTA.*

By late 1996, when the inflation target was widened to 0 to 3 percent, monetary policy had achieved the required degree of restraint on inflation, and monetary policy accommodated some easing in monetary conditions. Then, in the Reserve Bank's June 1997 *Monetary Policy Statement,* we projected further declines in underlying inflation to a little under 1 percent in 1998, and we therefore sanctioned a more significant easing in monetary conditions.

The increase in inflation to levels above the then 0 to 2 percent target in 1995 and 1996 was a major test of the price stability objective legislated in the Reserve Bank Act. We judge that the framework established by the Act survived that test admirably.

Between the March quarters of 1993 and 1997, the economy grew by over 16 percent, whereas underlying inflation over the same period rose by about 7 percent, or on average by about 1.8 percent per annum. This was a marked change from New Zealand's previous experience, when growth cycles typically saw much stronger surges in inflation. We now know that the economy can grow and at the same time enjoy low inflation. Indeed, our emerging track record of price stability is contributing to long-term improvement in New Zealand's economic and social well-being.

The economy can grow and at the same time enjoy low inflation

Inflation in the non-tradable sector

In 1996/97, the Reserve Bank took a particular interest in areas of public policy which impact on inflation. This reflected the sharp difference between inflation in the tradable and non-tradable sectors of the economy during the period[3]. The Bank commissioned research into the inflationary effects of the way the Resource Management Act is being administered, primarily in the Auckland area. We also reviewed policy proposals from the exporting and farming sectors for making the non-tradable sector more responsive to monetary policy in terms of price setting.

Communications

The Reserve Bank places particular importance on clear external communications about monetary policy. Good public knowledge of our objective and methods can contribute considerably to the achievement of those objectives, particularly in relation to price-setting behaviour.

The Reserve Bank's main forms of communication in relation to this function are *Monetary Policy Statements, Economic Projections, Reserve Bank Bulletins,* research and discussion papers, speeches, informal gatherings, and contributions to seminars and meetings. In 1996/97, we published booklets entitled *The impact of monetary policy on farming, The impact of monetary policy on exporters* and *The impact of monetary policy on people.*

Monetary policy formulation

Operating expenses

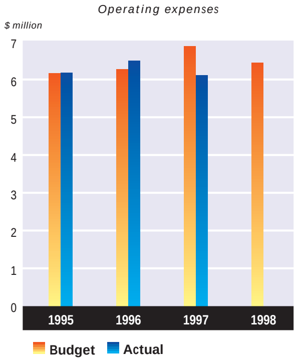


Figure **2**

Table 1

Financial results (monetary policy formulation)

(For the year ended 30 June 1997)	*Actual $000*	*Budget $000*	*Variance $000*
Operating income	77	79	(2)
Operating expenses	6,086	6,855	769
Operating surplus (deficit)	(6,009)	(6,776)	767

3 The tradable sector of the economy includes those activities which involve exports, imports or competition with imports, all being affected by the exchange rate. The non-tradable sector includes those parts of the economy not affected by the exchange rate.

b Market operations

Trading and interacting with financial markets to provide a stable liquidity base and information ... for efficient monetary policy implementation, and to maintain the capacity for intervention in financial markets. In the process, we provide cash and debt management services for the Crown.

Left to right:
In the Bank's dealing room, Monetary Policy Implementation Manager Michael Reddell, Financial Markets Department Chief Manager David Archer, Monetary Policy Implementation officer Christine Bruce.

Implementing monetary policy

Implementing monetary policy involves:

- Providing clear and consistent signals about the Reserve Bank's policy intentions in regard to monetary conditions; and
- Managing banking system liquidity to provide a stable backdrop for signalling to occur. We also, when necessary, adjust conditions to keep financial market prices consistent with the intended stance of monetary policy.

During the period in review, the Reserve Bank modified the way it signals its policy intentions. In June 1997, the Bank explicitly stated its desired monetary conditions in index form, the so-called Monetary Conditions Index (MCI). The MCI uses a 2:1 ratio to create an approximate index that describes the combined effect of interest rates and the exchange rate on the economy and, by that, inflation.

During 1996/97, the Reserve Bank considered adopting a cash interest-rate based system for implementing monetary policy, which would have involved borrowing or lending on demand to keep overnight interest rates within a targeted range. After consultations with the financial markets, we decided not to make this change.

To manage the liquidity of the banking system, we forecast daily cash flows between the Reserve Bank and the banks which hold accounts with us. These forecasts are the basis for daily open market operations. We aim to forecast flows to within $20 million on 80 percent of days. This happened on 76 percent of days in 1996/97, compared with 86 percent in 1995/96.

Open market operations, float tenders, Reserve Bank bill tenders, and discounting of Reserve Bank bills were routinely undertaken throughout the year. In addition, we conducted regular tenders for government securities on behalf of the Treasury.

During the year, extra resources were devoted to enhancing the analytical and research outputs of this function. Our goal is to enrich our understanding of market dynamics and prices, and to stay abreast of leading-edge international thinking on the best ways to implement monetary policy.

Trading helps our understanding of market dynamics

Maintaining foreign exchange intervention capacity

The Reserve Bank's activity in the foreign exchange market changed markedly during the year. The elimination of the Crown's net foreign currency debt ended foreign exchange business previously generated by Crown debt repayments. Our presence in the market is now limited to small positions that we initiate. This trading helps our understanding of market dynamics, maintains links with market participants, and ensures that systems and procedures are in place should the Bank need to intervene in the foreign exchange market. These positions are not intended to influence the exchange rate, and we are sceptical of claims that foreign exchange market intervention can have any enduring impact on the exchange rate.

Market operations

Operating expenses

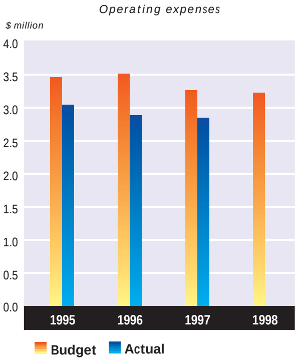


Figure 3

Table 2

Financial results (market operations)

(For the year ended 30 June 1997)	*Actual $000*	*Budget $000*	*Variance $000*
Net operating income	2,224	2,124	100
Operating expenses	2,836	3,253	417
Operating expenses surplus (deficit)	(612)	(1,129)	517
Allocated functional income	14,220	15,676	(1,456)
Net operating surplus (deficit)	13,608	14,547	(939)

C Financial system oversight

Advising on the New Zealand financial system, principally as it relates to banks; registering and supervising banks; identifying financial system risks and being prepared to deal with financial system stress if it arises. The overriding purposes of these activities are to encourage financial system soundness and efficiency, and to reduce the damage that could arise from a bank failure or other financial system distress.

Registration and supervision of banks

The new public disclosure regime for bank supervision is working well. The new system was first implemented in January 1996. It requires each registered bank to publish quarterly a wide range of financial and prudential information, with more extensive disclosures at the time of each bank's six-month and annual balance dates. From June 1996, the new regime was extended to encompass disclosure of banks' exposure to potential risks caused by market changes. Guidance was provided to banks on the new requirements.

The new disclosure regime is intended:

- to strengthen incentives for bank managers and directors to monitor and manage risks effectively;
- to enhance market disciplines on banks to behave prudently; and
- to reduce any perception that the Government will rescue a bank in the event of that bank's failure.

We have been encouraged by progress so far.

Banking System Department
Chief Manager Peter Ledingham

Throughout 1996/97 the soundness and efficiency of the banking system as a whole was kept under scrutiny. Individual banks were also monitored for compliance with disclosure requirements and conditions of registration. We maintained liaison with banks on both technical and policy issues. Regular consultations were conducted to keep the Reserve Bank in touch with strategic and financial trends in the banking industry.

Throughout the period the sector overall was robust and resilient. Banks' profitability remained sound, with average post-tax annual returns on assets of around 1 percent. The overall asset quality of banks continued to improve and capital ratios remained well above minimum requirements. No banks failed.

During the 1996/97 year, three major overseas banking groups were registered as branch banks in New Zealand, these being Bank of Tokyo-Mitsubishi (Australia) Limited, Deutsche Bank AG, and Banque Nationale de Paris. A New Zealand-incorporated bank, Trust Bank New Zealand Limited, was removed from the bank register as a result of its take-over by Westpac Banking Corporation. Shortly after the end of the financial year, Kookmin Bank (of South Korea) was also registered, bringing the total number of registered banks to 19.

The overall asset quality of banks continued to improve

Key policy initiatives

The Bank reviewed the impact of the bank disclosure regime to identify desirable refinements. These will be implemented in 1997/98. Another policy issue addressed was bank registration criteria. We concluded that no major changes were necessary.

International agencies, including the IMF and the Basle Committee on Banking Supervision, have sought to strengthen banking supervision world-wide, particularly in emerging countries. In response, we commented on the Basle Committee's proposal for "core principles" for bank supervision, and sought to ensure that any international arrangements encompass New Zealand's emphasis on disclosure and market disciplines.

Work continued on issues and potential responses associated with events that could lead to widespread disruption of the financial system. During 1997/98 we intend to complete a crisis management plan.

Progress in implementing a real-time gross settlement system (RTGS) for large-value inter-bank transactions has been slower than expected, with several technical and legal issues causing delays. The Reserve Bank and the industry are working towards commencement in late 1997 and the Bank has been testing software. Amending legislation to enforce netting arrangements between counter-parties in an insolvency situation, and to promote greater certainty of payment finality, has been discussed with interested parties, and recommendations will be made to the Government shortly.

Financial system oversight

Operating expenses

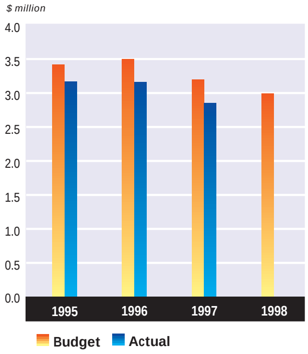


Figure 4

Table 3

Financial results (financial system oversight)

(For the year ended 30 June 1997)	*Actual $000*	*Budget $000*	*Variance $000*
Operating income	15	27	(12)
Operating expenses	2,847	3,189	342
Operating surplus (deficit)	(2,832)	(3,162)	330

Currency Department Chief Manager Brian Lang

d Currency operations

Supplying New Zealand with its currency, maintaining the physical quality of currency in circulation and ensuring counterfeits are detected, in order to facilitate cash transactions in the community.

Supply of currency

The total value of currency in circulation at 30 June 1997 was $1.74 billion, compared with $1.68 billion a year earlier[4]. This was an increase of 3.6 percent, down from growth rates of between 5 and 7 percent in recent years. We think this was partly attributable to slower growth of the domestic economy, as well as the very widespread use of EFTPOS facilities.

Bank note processing

During the 12 months to 30 June 1997, the Reserve Bank processed 513 million bank notes at our Auckland, Wellington and Christchurch sites, compared with 498 million the previous year. The Bank's key performance measures all exceeded planned levels throughout. Specifically:

- we averaged 29,441 bank notes per hour through our seven currency processing machines, compared with 28,567 during the previous year and a benchmark of 28,000 notes per hour;

4 The difference between the totals shown here and the amount shown under "Currency in circulation" in the Statement of financial position (page 40) relates to $87.7 million of coin issued by the Treasury prior to 1989, which remains in circulation but which we treat as a contingent liability (see note 29(b), "Contingent liabilities" (page 66).

- on average, currency processing machines were operational for 98.2 percent of each working day, compared to our plan requiring 95 percent availability; and
- on most occasions bank notes were processed within our benchmark of six working days of receipt.

The cost of processing bank notes continued to decline. The unit cost of reissuing bank notes for circulation was 1.90 cents per bank note compared with 1.93 cents in 1995/96 and 2.04 cents in 1994/95.

We continued to encourage currency handlers from commercial banks and security companies to visit our processing sites to see how we operate. As a result, efficiency gains were made, including bar-coding for bank note repatriation data. After discussions with the banks and security companies, we decided not to establish agency facilities to process bank notes outside the main metropolitan areas.

The Reserve Bank's new PC-based computer system for recording currency transactions and balances successfully went "live" on 1 November 1996. More recently, we joined the Austraclear system and, as a result, currency issue settlements with the banks are now done electronically.

Value of currency in circulation

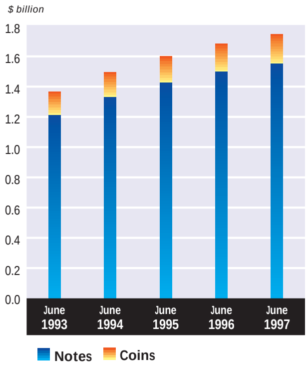


Figure 5

Currency operations

Operating expenses

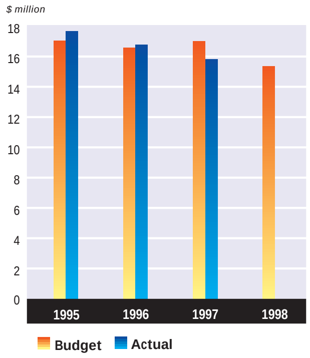


Figure 6

Forgery detection

Over the 12 months to 30 June 1997, the Reserve Bank's processing machines detected 1,100 counterfeit bank notes, compared with 70 during the previous year, with most surfacing in the North Island. In March we produced a brochure *How to spot a counterfeit bank note*, supplied to retailers and banks. We continued to work closely with the Police on tracing sources of counterfeits. We constantly review the security features of our bank notes to ensure they remain difficult to forge.

ISO 9002 accreditation

Standards New Zealand conducted two regular six-monthly audits of our systems and processes over the past year, and confirmed our ISO 9002 accreditation.

Collectors' currency

A joint-venture in support of the World Wide Fund for Nature (WWF) was incorporated with our annual collectors' coin series issue. This series traditionally highlights a New Zealand bird theme and this year featured the Saddleback, which is a threatened species and an appropriate subject for a joint-venture promotion with WWF. Total revenue from collectors' currency sales was $1.7 million. This was a little below budgeted income, reflecting the slower economy, but was still satisfactory. The $5 note sheets (8 notes per sheet) sold out quickly.

Table 4

Financial results (currency operations)

(For the year ended 30 June 1997)	*Actual $000*	*Budget $000*	*Variance $000*
Operating income	141,848	139,350	2,498
Operating expenses	15,750	16,946	1,196
Operating surplus (deficit)	126,098	122,404	3,694

e Foreign reserves management

Maintaining the Bank's foreign reserves and credit lines at a level and in a form suitable for foreign exchange market intervention, in order to have the capability to counter disorderly market conditions.

The Government requires the Reserve Bank to maintain, as an intervention capability, NZ$4.5 billion in foreign reserves and undrawn committed foreign currency credit lines.

Maintaining reserves involves costs and risks, and the benefits are not easily measured. For this reason, during the period under review the Reserve Bank completed a comprehensive review of the role of foreign reserves and the need for an intervention capacity. We concluded that the potential costs to New Zealand of not having foreign reserves outweigh the cost of their retention.

1996/97 was the Reserve Bank's fifth year of using benchmark portfolios to help assess the Bank's performance. Our returns were 0.03 percent better than these benchmark portfolios, which was below our expectations. We have implemented changes to improve future returns.

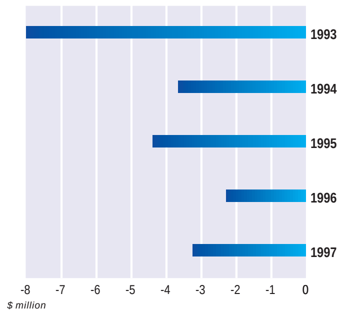
During the year we established a new domestic US dollar custody and securities lending programme with Chase Manhattan Bank. We also signed a new securities lending agreement with Chase Manhattan Bank covering the Bank's securities held by Euroclear.

We have been investigating possible replacements for the current computer system used in portfolio management, settlement and accounting. Good progress has been made and implementation of an alternative is planned for 1998.

Work was initiated on the potential use of futures contracts in our trading operation.

Foreign reserves management operating deficit*

Five year summary



** Excludes allocated functional income*

Figure **7**

Table 5

Financial results (foreign reserves management)

(For the year ended 30 June 1997)	*Actual $000*	*Budget $000*	*Variance $000*
Net operating income	485	(2,097)	2,582
Operating expenses	3,712	3,893	181
Operating surplus (deficit)	(3,227)	(5,990)	2,763
Allocated financial income	14,220	15,676	(1,456)
Net operating surplus (deficit)	10,993	9,686	1,307

Foreign reserves management

Operating expenses

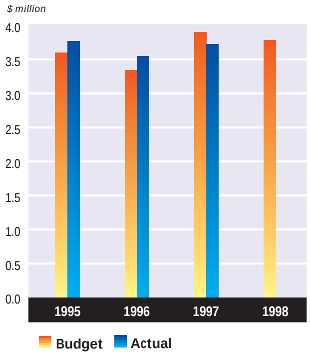


Figure **8**

Financial results

Due primarily to an unbudgeted reimbursement, the net cost for this function in 1996/97 was $3.2 million, compared to a budgeted $6.0 million. The main variances in operating income between budget and actual results were:

- unbudgeted reimbursements of $5.4 million from the International Monetary Fund related to risk-sharing arrangements entered into some years ago;
- gains on active asset management of $1.2 million, against a budgeted gain of $4.2 million; and
- losses on benchmark assets relative to liabilities of $5.8 million, against a budgeted loss of $6.0 million.

f Banking services

Providing banking services to the Government, settlement banks, (and) appropriate overseas institutions ... to meet their banking needs and to facilitate effective implementation of monetary policy.

The primary focus of the banking services function remains the provision of banking services to support the implementation of monetary policy. Account services are provided to banks and to the Government. Banks use these accounts to settle obligations between themselves and to settle transactions with the Reserve Bank. Daily net flows between the Government and the private sector are transferred to the Government's Crown Settlement Account at the Reserve Bank.

We also provide limited banking services to other central banks and international financial institutions. We encourage our customers to use electronic payment systems, which further improve quality and efficiency.

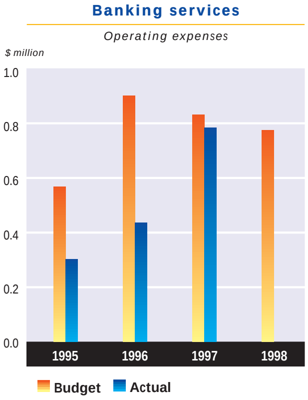


Figure 9

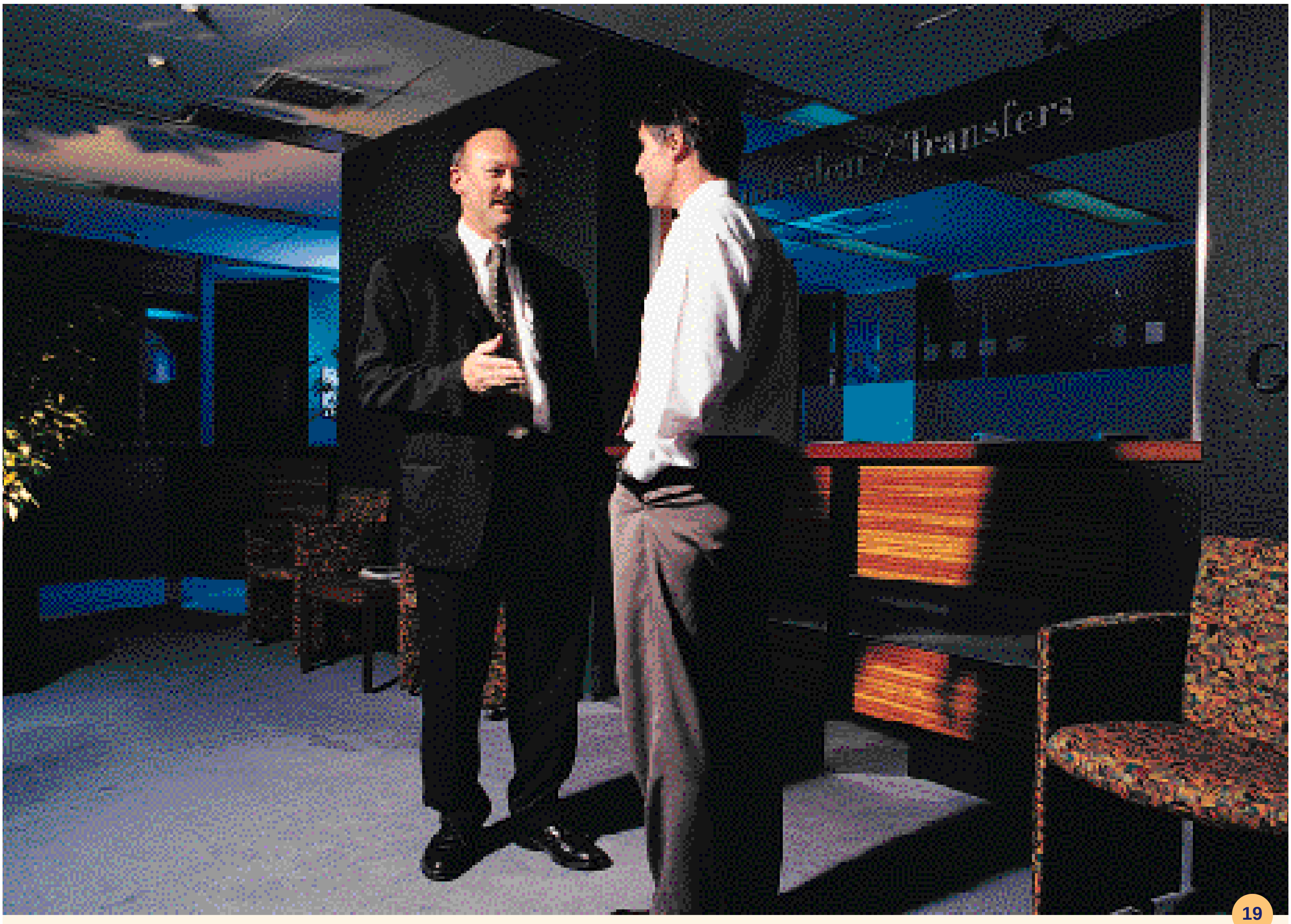
Table 6

Financial results (banking services)

(For the year ended 30 June 1997)	*Actual $000*	*Budget $000*	*Variance $000*
Operating income	431	182	249
Operating expenses	783	830	47
Operating surplus (deficit)	(352)	(648)	296

Financial results

The result for 1996/97 largely reflects delays in the development and implementation of RTGS, as reported on page 14. Depreciation costs were less than budgeted, but offsetting this was greater than expected staff time, and legal and operational costs.



g Registry services

Providing registry and related services on a commercial and competitive basis to financial market participants, in order to contribute to the soundness and efficiency of the financial system.

The Reserve Bank's registry provides registration, transfer and payment services for debt securities issued by the Government, local authorities, and other public and private sector issuers.

At 30 June 1997, the Reserve Bank was registrar for securities with a face value of $54.5 billion, compared to $48.0 billion at 30 June 1996. We provided services for just over 38,000 investors, holding over 77,000 separate investments. The total value of payments made to investors on behalf of issuers during the 12 months was $40.8 billion. This compares to $31.2 billion for the previous year.

During the December quarter of 1996, we experienced some operational difficulties, due mainly to an increase in market activity and the loss of some key personnel. This was resolved through a review of our work processes, and the training and recruitment of extra experienced staff. Improvements to our services and better management of risk have resulted.

We also provide the Austraclear New Zealand System, which offers electronic clearing and

Left to right:
Registry Department Chief Manager John Woodhouse and Austraclear Accounts Manager Kevin Jamieson

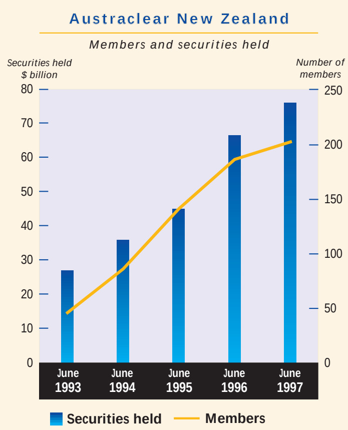


Figure **10**

settlement services for debt and equity securities, and a cash transfer facility. At 30 June 1997, Austraclear had 202 members, including 103 trust memberships; and held securities on their behalf of $76.1 billion, compared to 186 members and $66.5 billion 12 months earlier (see figure 10). Members' securities are held by New Zealand Central Securities Depository Limited, a custodian trustee wholly owned by the Reserve Bank.

We also act as the New Zealand depository for Cedel Bank SA and the Euroclear Operations Centre, which are international securities clearing-and-settlement systems. Securities held for these systems increased 0.1 percent over the past year.

Registry services

Operating income and expenses

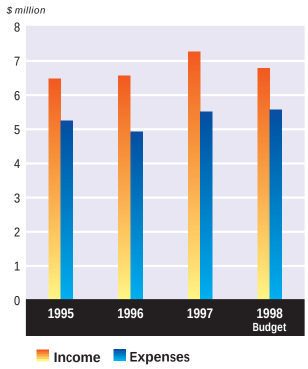


Figure **11**

Table 7

Financial results (registry services)

	Actual	*Budget*	*Variance*
Operating income	7,251	6,126	1,125
Operating expenses including tax	5,496	4,936	(560)
Operating surplus (deficit) after tax	1,755	1,190	565

Financial results

We record all registry services activity through a wholly-owned subsidiary, RBNZ Registry Limited, to enhance the accountability and transparency of this self-funding function.

h Overseas Investment Commission Secretariat

Providing resources for the Secretariat for the Overseas Investment Commission. The Commission administers New Zealand's legislative controls on major inward investment.

The Overseas Investment Commission administers the Government's foreign investment policies. Under the Overseas Investment Act 1973, the Reserve Bank provides the Commission Secretariat and pays for costs not met by application fees. During the year in review, the Government announced changes to New Zealand's foreign investment regime, which are yet to be fully implemented, in part as legislation will be required.

The core work of the Commission is to assess applications from foreign investors who intend making substantial investments in New Zealand. The Commission processed 377 applications involving 283 consents during 1996/97, whereas during 1995/96 441 consents were issued. All but one of the applications determined by the Commission were processed within our 10 working-day target. The Commission's activities are detailed in its six-monthly reports to Parliament.

Overseas Investment Commission Secretariat

Operating expenses

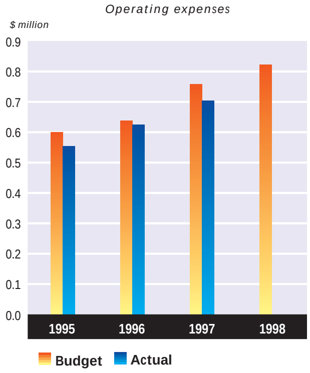


Figure **12**

Table 8

Financial results (Overseas Investment Commission Secretariat)

(For the year ended 30 June 1997)	*Actual $000*	*Budget $000*	*Variance $000*
Operating income	589	767	(178)
Operating expenses	705	758	53
Operating surplus (deficit)	(116)	9	(125)

Other outputs

After the October 1996 general election, the Reserve Bank provided all parliamentarians with a document entitled *Briefing on the Reserve Bank of New Zealand*. This was the equivalent of previous post-election briefing papers, and was a summary of the Reserve Bank's institutional arrangements, functions and activities. Unlike government departments, the Reserve Bank released its briefing paper prior to the Coalition Government being formed. We did this to ensure that those taking part in coalition negotiations had useful information about the role of the Reserve Bank. We changed the title of this document because, as a result of MMP, in future such a paper could be required if a Government changes between elections.

Overseas representation and liaison

The Reserve Bank continued its active involvement in the EMEAP (Executives' Meeting of East Asia and Pacific Central Banks) group[5]. This included participation in three sub-groups, which worked on financial market development, central bank operations and banking supervision.

In November 1996, the Reserve Bank assumed the chair of the SEANZA (South East Asia, New Zealand and Australia) group of central banks[6]. The group's focal point is a residential training course for middle-ranking central bankers held every two years. Planning is in progress for the next course, to be hosted by us in November 1998. We will also assume the chair of the SEANZA forum of bank supervisors in the second half of 1997.

In November 1996 the Reserve Bank assumed the chair of the SEANZA group of central banks

During 1996/97, the Reserve Bank maintained its relationships with major international economic agencies, including the International Monetary Fund, the World Bank, the OECD, and the Bank for International Settlements. We also maintained relationships with overseas central banks, particularly those in the Asia-Pacific region or with monetary policy frameworks similar to our own.

We continued to provide training and advice to some other central banks. Two secondees from the People's Bank of China spent time with us, under a long-standing arrangement. Some of our staff, working through the IMF, took part in missions to some of the former Soviet republics, the People's Republic of China and the Socialist Republic of Vietnam. We provided technical assistance to some South Pacific countries.

Table 9

Financial results (other outputs)

(For the year ended 30 June 1997)	Actual $000	Budget $000	Variance $000
Operating income	1	nil	1
Operating expenses	696	586	(110)
Operating surplus (deficit)	(695)	(586)	(109)

Other outputs

Operating expenses

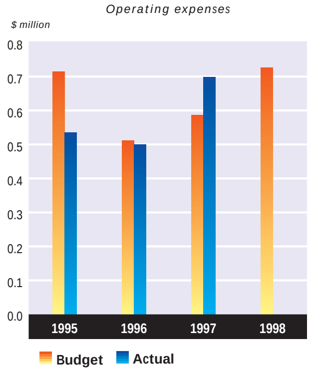


Figure 13

5 The EMEAP group comprises the central banks of Australia, China, Hong Kong, Indonesia, Japan, South Korea, Malaysia, New Zealand, the Philippines, Singapore and Thailand.

6 SEANZA comprises the central banks from Australia, Bangladesh, China, Hong Kong, India, Indonesia, Iran, Japan, South Korea, Malaysia, Nepal, New Zealand, Pakistan, Papua New Guinea, the Philippines, Singapore, Sri Lanka and Thailand.

Left to right:
eputy Governors Murray Sherwin and
Dick Lang, and Governor Don Brash

statement of resource use

How we work

The Reserve Bank's activities are spread over seven departments and two smaller units. Each department or unit is headed by a chief manager or manager, who is responsible to the governors for the quality and cost of outputs. Outputs and their expected costs are set through annual planning and budgeting, and are reviewed regularly throughout the year.

Several changes to the Reserve Bank's senior management team occurred during the year. Adrian Orr was appointed Chief Manager of the Economics Department in June 1997, replacing Dr David Mayes. In line with the Bank's policy of rotating managers throughout different parts of the Bank, in November 1996 Ken Sullivan became Chief Manager of Corporate Services, Steve Anderson became Chief Manager of Accounting Services, and John Woodhouse became Chief Manager of Registry.

A number of internal standing committees and several ad hoc project committees co-ordinate work between departments and provide advice to the Governor. The Governor's Committee, chaired by the Governor and consisting of the Deputy Governors and heads of departments, meets weekly to consider policy and management issues. The Monetary Policy Committee, chaired by Deputy Governor Murray Sherwin, brings together the Governor's principal economic advisers, and co-ordinates monetary policy formulation and implementation. Risk Management, Financial System Oversight, and Planning and Budgeting Committees are chaired by Deputy Governor Dick Lang.

The Reserve Bank publishes its intended outputs in its *Annual Plan,* and we report on our performance in our *Annual Report.* Performance is monitored by the Bank's Board of Directors on behalf of the Treasurer. Also, the Governor and senior Bank staff typically appear five times a year before Parliament's Finance and Expenditure Committee to answer questions on the Bank's policies and activities.

We work to improve the efficiency and quality of our outputs, and in some areas we have implemented "total quality management" techniques and bench-marking initiatives. The Bank has identified all systems and equipment which could be affected by the year 2000 problem. These are scheduled to be modified or replaced, as required, by December 1998.

Externally we continue to be active in a number of professional organisations where ideas for improving the efficiency and quality of outputs are exchanged.

Public perceptions of the Reserve Bank's commitment to delivering price stability influence actual inflation outcomes

Communications

For the Reserve Bank, communications with the public and the markets are extremely important. This is because:

- public perceptions of the Reserve Bank's commitment to delivering price stability influence actual inflation outcomes (i.e. price setting behaviour);
- in New Zealand, monetary policy is implemented mostly by verbal communication with the markets, as opposed to setting an interest rate; and
- the Reserve Bank's operational independence means at times the Bank must be its own advocate, unlike a government department represented by a Minister of the Crown.

For these reasons, we put a high priority on our external communications, based around the active involvement of the Governors and a three-person media unit.

Each quarter the release of a *Monetary Policy Statement* or *Economic Projection* requires a formal 'lock-up' for the news media. We publish an *Annual Report* and *Annual Plan*, usually in September, and quarterly *Reserve Bank Bulletins.*

The Reserve Bank also maintains a busy public speaking schedule, primarily by the Governor. This is almost always without the media present, to avoid triggering financial market turbulence. During 1996/97 Reserve Bank staff addressed over 100 gatherings. Booklets for non-technical audiences are also prepared.

The Reserve Bank's Internet site now reaches more people than the Bank's written publications

The Reserve Bank's Internet site now reaches more people than the Bank's written publications. Typically the Bank's web site is accessed over 6000 times each week. Most of our public documents are included. The Reserve Bank's web site is at http://www.rbnz.govt.nz.

Education initiatives

In March 1997, The Reserve Bank supplied all secondary schools with a resource called *The PIE Kit* (People, Inflation and Economics), which explains the basic workings of the price system to third and fourth form students. *The PIE Kit* is based around teenagers facing decisions as savers and consumers. This followed on from the successful *Inflation: A Sixth Form Resource*, produced in 1995.

The Reserve Bank contributed to a primary school resource that teaches how money works. Called *Money Matters,* the kit was produced by the New Zealand Bankers' Association, and we provided a booklet called *The Tale of the TT2.* It explains inflation by illustrating how, over 20 years, prices of ice block confectioneries have gone up.

Essay competition

In March 1997 we invited secondary school students around the country to take part in an essay competition on the topic "What's so good about low inflation?"

The winners and their prizes were:

1st	($1000)	Rebecca Redwood	Rangitoto College, Auckland
2nd equal	($500)	Charlotte Pong	St Mary's College, Wellington
2nd equal	($500)	Josh Wilson	Takapuna Grammar School, Auckland
3rd equal	($250)	David Chamberlain	St Peter's School, Cambridge
3rd equal	($250)	Carolyn Enderwick	Sacred Heart Girl's College, Hamilton
3rd equal	($250)	Scott Iggo	Lincoln High School, Canterbury
3rd equal	($250)	Anoushka Reddy	Carmel College, Auckland

$100 winners : Carl Anderson (Pakuranga College); Baden Arthur (Church College of NZ); Chris Berg (Linwood High School); Helen Blazey (Linwood High School); Zubin Chiba (Burnside High School); Jeremy Cranswick (Lindisfarne College); Kylie Dallas (Church College of NZ); Leona Dingle (Tauranga Girls College); Lohit Kalburgi (Mt Albert Grammar School); David Max (Auckland Grammar School).

Prizes to the same dollar value were also given to the winners' schools for the purchase of books or other information resources. The Reserve Bank thanks Professor Viv Hall for judging the finalists. Rebecca Redwood's winning entry is reprinted in box 2 on page 25.

Essay winner Rebecca Redwood and Governor Don Brash at the August 1997 Board cocktail function in Auckland.

Box 2

What's so good about low inflation?

Rebecca Redwood of Rangitoto College

Most people have a nebulous notion that low inflation is good. But what's actually so good about low inflation? To answer this question, it is necessary to say why high inflation, zero inflation and deflation are bad.

Inflation is generally defined as being a rise in the general price level. This means that the average price of goods and services in the economy has increased.

High inflation distorts household spending and saving patterns. When people see prices rising, they are likely to want to buy now, while prices are still within their financial reach. This means that a smaller proportion of household income is directed toward saving. In times of high inflation, real interest rates drop, which means the return upon money invested decreases. The erosion of the value of the principal saved is also of serious concern during times of high inflation. These two factors combine to persuade people to buy now. Borrowing during times of high inflation becomes more attractive because the real value of the amount borrowed decreases over time. This means that the borrower can afford to borrow a higher proportion of the purchase price, so increasing their debt leverage. This "buy now, pay later" mentality which accompanies high inflation is damaging to households.

Households, in periods of sustained inflation, come under pressure to increase incomes to maintain purchasing power. New Zealand's progressive taxation system means that an increase in income can cause a move to a higher tax bracket. A higher proportion of the individual's income will be lost to tax. Tax also affects savings, as it only takes into account the interest earned on savings, not the depreciation that the principal undergoes during periods of high inflation. The individual's real income will therefore fall.

High inflation also impacts negatively upon firms. Costs to the firm generally increase as the costs of inputs increase. Consumers are often resistant to price increases, so profits can be badly affected. When New Zealand's level of inflation is higher than that of our trading partners, our products become less attractive to overseas buyers, so hurting New Zealand firms who produce products for overseas trade. With high inflation, imports become more price competitive and therefore more attractive to the consumer. If this situation continues, a greater proportion of the local market will be supplied from overseas.

Firms are also hurt in other ways by high inflation. The random nature of inflation makes it difficult to plan for the future. Firms, in times of high inflation, like households, may be tempted to take on high levels of debt, relying on the assumption that the book value of the firm will increase in line with inflation, thus improving the debt/equity ratio. This course of action leaves firms vulnerable to changes in the market.

Households and firms suffer in periods of high inflation. High inflation distorts households' patterns of money usage, creating a disincentive to save, and an incentive to spend, and to borrow to spend. High inflation in a country with a progressive taxation system can also cause a decrease in real income. Firms' costs of production increase in times of high inflation, and this usually has a heavy impact upon profits. New Zealand firms producing for the overseas markets are disadvantaged by the inflation differential between us and our trading partners. This same differential makes imports more attractive to local consumers. Firms may make borrowing decisions in times of high inflation that can have disastrous consequences because of the unpredictable nature of inflation.

So, high inflation is bad. But is zero inflation any better? When inflation is zero, the uncertainty that surrounds inflation is removed, so planning for the future becomes easier. However, a moderate level of inflation can be used to smooth pay negotiations. Unions which would not be prepared to take a pay cut may allow their real wages to erode through not having a nominal pay increase. And, assuming that price stability, as represented by zero inflation is desirable, then is it even possible to achieve this inflationary nirvana? To decrease inflation, employment and growth must decrease. The losses that this would cause to the economy in the short and middle run would have to be balanced against the anticipated gains of zero inflation.

Another factor to consider is that many sections of the economy rely on the expectation that inflation exists and will continue. Firms and households who have borrowed expect inflation to reduce the sum they owe, and workers expect inflation-prompted pay increases.

If high inflation and zero inflation are bad, then what about deflation - a general fall in prices? Falling prices can cause consumers to defer purchases until prices drop further, and firms to fear for their future profitability. A deflationary spiral may begin as this postponement of consumption and investment continues to put a downward pressure on prices.

High inflation, zero inflation and deflation are all bad for both firms and households. The only option that does not encapsulate these negatives is low inflation. In a low inflationary situation, households and firms can plan for the future with a reasonable degree of accuracy. Households will neither increase nor defer consumption. Borrowing will not be such an attractive prospect. Saving will be encouraged, as real interest rates will remain at a reasonable level, meaning that people will not risk an erosion of their capital and a resultant loss of purchasing power. The pressure for households to increase income would be lessened, and so would the danger of moving up an income bracket and being forced to stomach a drop in real income.

Firms creating products for export would not be unduly disadvantaged by low inflation, and imports would not be so competitive in the New Zealand market. Investment would be an attractive possibility. Pay negotiations could be smoothed and growth and employment would not have to be dramatically reduced.

What's so good about low inflation? What's bad about it!

(Note that the views expressed in this essay are those of its author and are not necessarily the views of the Reserve Bank.)

Our people

At 30 June 1997, the Reserve Bank employed a total of 303 staff (289.3 full-time equivalent staff). Of these, 35 worked at our Auckland and 15 at our Christchurch branches. Staff levels have remained stable in all departments during the year. Our turnover rate declined from the previous year's peak of 15.0 percent to 10.6 percent (see table 10).

Table 10

Human resource statistics

	1992/93	*1993/94*	*1994/95*	*1995/96*	*1996/97*
Total staff at year end 30 June (full time equivalent)	321	286	293	290	289
Average years of service at year end	7.8	8.7	8.6	8.6	8.7
Annual staff turnover	11.8%	10.9%	9.6%	15.0%	10.6%
Average sick days per staff member	7.2	7.1	5.3	4.9	5.5

Staff levels have remained stable

Staff training

The Reserve Bank values well-targeted training, and staff secondments to gain experience. Over the past year many Reserve Bank staff received training in relevant technical and management subjects. Support was given to some staff to attend universities and other training courses, and for secondments to and from other central banks, universities and New Zealand financial institutions. Tutorials were held to assist staff identify career development needs and opportunities. The average direct external expenditure on training per staff member over the year was $1,782.

The Reserve Bank actively manages the OOS problem to reduce its effect

Occupational Overuse Syndrome (OOS)

Occupational Overuse Syndrome is an issue for the Reserve Bank. Repetitive machine and process tasks in Currency Department and the high use of computer keyboards throughout the Bank are contributing factors.

The Reserve Bank actively manages the OOS problem to reduce its effect. Early reporting of symptoms, and remedial action and advice provided by the Bank's Occupational Health Nurse, are crucial. All staff are trained in, and frequently reminded about, safe work practices to prevent OOS. Considerable investment is made in the provision and proper use of ergonomically-designed work stations and equipment. Our Occupational Health Nurse works closely with ACC, occupational therapists and physiotherapists to ensure that the Bank's work practices are safe. Training, and massage by a registered therapist, has helped reduce the incidence of OOS in Currency Department.

During the year 16 staff were treated for OOS symptoms. By 30 June 1997, eight cases had been successfully resolved; three staff were receiving treatment, but were able to continue their full duties; four staff were on part-time graduated return-to-work programmes; and one staff member had not returned to work.

Working flexibly

Under the Reserve Bank's teleworking policy, 25 staff made use of computer links away from the Bank. Managers and professional staff regularly use this technology for working and communicating outside normal business hours or during business travel. Where practical, telework links are also used to help staff on parental leave to keep in touch and up-to-date with professional developments, or to assist flexible arrangements upon their return to work.

A survey of work-related stress among employees was undertaken in conjunction with Victoria University, as part of a postgraduate research project. The study showed stress levels within normal ranges and produced useful information on causes of stress. The findings will help us develop better work practices in the future.

Remuneration

The Reserve Bank spent $17.7 million on personnel in 1996/97, including all forms of remuneration, direct expenditure on training, and redundancy payments. Job evaluations of 34 senior positions were reviewed to ensure that comparisons to equivalent levels of market remuneration were accurate and up-to-date. Table 11 reports the number of staff who received over $100,000 in total remuneration[7] in 1996/97.

Telework links are also used to help staff on parental leave

Table 11

Staff receiving $100,000 or more in 1996/97

Total remuneration[7]	*Number of staff*
$100,000 to $109,999	3
$110,000 to $119,999	4
$120,000 to $129,999	1
$130,000 to $139,999	2
$140,000 to $149,999	4
$150,000 to $159,999	2
$160,000 to $169,999	3
$170,000 to $179,999	1
$190,000 to $199,999	1
$230,000 to $239,999	1
$270,000 to $279,999	1
$350,000 to $359,999	1
Total	24

7 *"Total remuneration" includes the annual cost to the Bank of all elements of contracted remuneration packages (salaries, benefits, motor vehicles, fringe benefits tax, superannuation), plus bonuses and redundancy payments.*

Financial resources

Operating expenses

The Reserve Bank's consolidated[8] expenditure for 1996/97 was $37.8 million, which was 6.5 percent under budget. This was $0.8 million, or 2.1 percent, below the previous year's actual expenditure. The Bank was under budget on new currency expenses by $1.1 million because of lower than expected demand. All other categories of expense were within 7 percent of budget.

Funding Agreement

Section 159 of the Reserve Bank of New Zealand Act 1989 requires the Governor to sign a Funding Agreement with the Treasurer, limiting the Reserve Bank's expenditure on non-commercial activities to a specified amount for each year of a five-year period. The intention is to constrain the Reserve Bank's expenditure, whilst ensuring that the Bank has sufficient funds to carry out its responsibilities free from political interference. As a result of the raising of the inflation target to 0 to 3 percent, and clause 4(b) in the Reserve Bank's Funding Agreement, our funding entitlement was increased by an additional 0.25 percent, or $95,000, for the period between January and June 1997.

The Reserve Bank spent $33.4 million on activities covered by the Funding Agreement, 12.3 percent below the $38.1 million applying to the 1996/97 year.

Operating surplus

The Reserve Bank recorded a net consolidated surplus of $142.5 million for the year, against $136.7 million budgeted, and compared to $166.8 million in 1995/96.

The surplus is not, however, a good indicator of our management performance. The Bank deals in financial markets mainly to achieve policy goals, not to maximise its surplus. Also, the Bank's surplus is highly dependent on interest rates levels. Because our principal source of income is interest earned on the financial assets backing currency in circulation[9] and our equity, the Bank's income declines as interest rates decline, and rises as interest rates rise. As such, our operating surplus will vary over time as nominal interest rates move up and down. For these reasons, the level of the Bank's operating expenditure is a better indicator of our stewardship of public resources.

Operating expenses by type

1996 compared with 1997

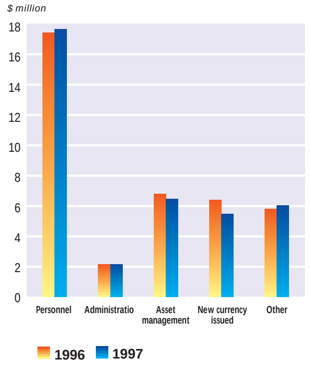


Figure **14**

Operating expenses

Five year summary

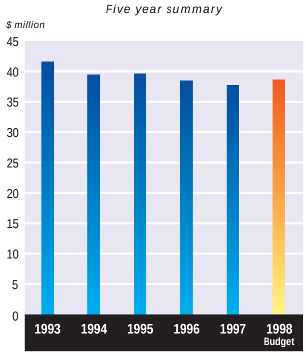


Figure **15**

Change in operating expenses by function

1998 budget compared with 1997 actual

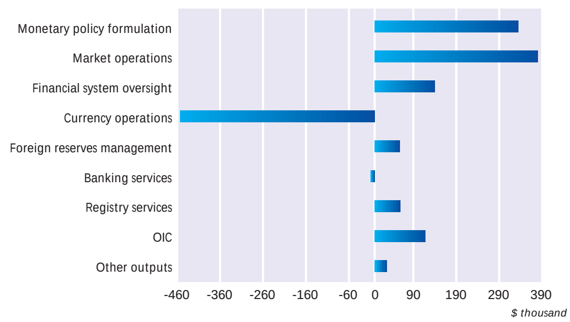


Figure **16**

8 *The Reserve Bank has four activities - foreign exchange dealing, settlement account services, government banking and registry services - that are expected to be self-funding. However, for operational reasons, only the registry services function is excluded from the Bank's Funding Agreement. The other three are subject to the Funding Agreement and an additional requirement for income to cover expenditure in each case. We use the term "consolidated" where the figures include those of the registry services function.*

9 *This is known as seigniorage.*

Payment to Government

The Reserve Bank Act requires the Bank to calculate the amount of its income which exceeds the agreed level of operating expenditure in the current Funding Agreement. This surplus may be added to the Reserve Bank's equity or paid to the Government. The decision rests with the Treasurer, after consultation with the Bank's Board of Directors. The Reserve Bank's surplus this year was $136.0 million, in terms of the Funding Agreement. We expect to pay all of this to the Government.

The Reserve Bank Act also provides that any expenditure savings the Bank makes against Funding Agreement levels may be added to the Bank's equity. Any over-expenditure against Funding Agreement levels must be deducted from equity.

The Reserve Bank's equity

The Reserve Bank's 1996/97 results provided a transfer to equity of $4.7 million, representing under-spending on the Funding Agreement level for the year. Our subsidiary company RBNZ Registry Limited also recorded a surplus of $1.8 million, which forms part of the Bank's consolidated equity. RBNZ Registry Limited expects to pay a dividend of $1.5 million to the Reserve Bank. The Bank's total consolidated equity at 30 June 1997 was $396.4 million.

The Bank's operating expenditure is a better indicator of our stewardship

1998

The Reserve Bank budgeted operating expenditure for 1997/98 is $38.7 million on a consolidated basis. This is 2.5 percent above our 1996/97 spending of $37.8 million (see figure 15).

The Reserve Bank's budgeted operating expenditure for functions covered by the Funding Agreement is $34 million (see figure 16), 13.2 percent below the Funding Agreement level of $39.2 million, and $0.6 million, or 1.8 percent, above actual expenditure in 1996/97. The increase over 1996/97 of actual expenditure primarily reflects increases in operational travel, computer expenses and training.

The future

The Reserve Bank's organisational reforms of recent years produced major gains in the Bank's financial performance, with the benefits accruing to the Crown. We expect future improvements in efficiency, in the medium term, to be relatively small and incremental. These cost savings are expected to be more than offset by the need to increase expenditure on several projects, including the delayed introduction of real-time gross settlement to the payments system and the Bank's hosting of the SEANZA conference in 1997 and the SEANZA staff training course in 1998.