MEMORANDUM FOR	Minister of Finance
COPIED TO	
FROM	Reserve Bank
DATE	23/02/2004
SUBJECT	THE RBA APPROACH TO INTERVENTION
FOR YOUR	Information

The Reserve Bank of New Zealand is scheduled to brief the Minister more fully on the range of intervention options and their relative merits on March 4, 2004. This memorandum should thus be considered partial background information to note.

The Reserve Bank of Australia's intervention objectives and technique

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Intervention instruments and the structure of the RBA's balance sheet

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Communication Strategy

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Intervention amounts and the cycle in reserves

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Decision making and governance

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Some issues associated with applying the RBA approach to New Zealand

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The RBNZ plays no part in the management of the Crown's FX needs

The Bank does not transact any of the Crown's foreign exchange business. Government agencies transact either directly with commercial banks or with the NZDMO who deals with the banks. Thus the Bank has no control of the FX operations of other areas of the Crown [ ]. The Bank's own FX activities are extremely modest and revolve around the management of the profits and losses that emanate from the foreign reserves operation or from reserves management's discretionary trading activities.

The institutional set-up of the RBNZ differs from the RBA

They key elements here are the nature of the RBNZ Act and the Policy Targets Agreement and the Governance arrangements surrounding the management of foreign reserves.

Reserves Governance Issues

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Further the currency composition of reserves, in so far as the mix between foreign currency and New Zealand dollar assets is concerned, is also decided by the Minister of Finance. The Governor of the Reserve Bank has only a limited scope to take major strategic decisions on foreign reserves without the Minister's direct consent. The situations when the Governor does have scope to alter the currency composition of reserves are reserved for crisis situations and even then, the understanding is that the Minister's consent will be sought as soon as practical.

For the Bank to operate a more active intervention approach, changes to the nature of the delegated authority the Minister has in place would need to be made to allow the Governor sufficient room to materially change the level and currency composition of reserves without needing to explicitly ask the permission of the Minister.

The RBNZ Act and the PTA

Another issue relates to the objectives of intervention. [ ]. In New Zealand, the Act combined with the PTA place a division between the Minister and the implementation of monetary policy. Intervention with monetary policy goals in mind (e.g. to affect the mix of monetary conditions) could not occur without a clear understanding between the Minister of Finance and the Governor.

[ ]. Intervention on the instructions of the Minister potentially could run counter to the objectives of monetary policy resulting in the Governor seeking a renegotiation of the PTA.

There are a couple of options that could be explored to effectively operationalise a new intervention approach. One way might be to change the nature of the delegated authority from the Minister to the Governor on the management of the reserves. A second approach would be for all intervention to occur independently of the Minister of Finance and thus independently of our foreign reserves. The Bank would build up a second portfolio of foreign currency assets, the size of which would vary according to the exchange rate cycle.

The Reserve Bank is scheduled to brief the Minister of Finance more fully on the range of intervention objectives and their relative merits on Marc 4, 2004. This memorandum should thus be treated only as partial background information to note.