RESERVE BANK
OF NEW ZEALAND
TE PŪTEA MATUA

ANNUAL REPORT

BUILDING A STRONG FINANCIAL FRAMEWORK 2012–2013

Reserve Bank of New Zealand Annual Report and Financial Statements for the financial year ended 30 June 2013, prepared pursuant to section 163 of the Reserve Bank of New Zealand Act 1989, published September 2013. ISSN 0110 7070

ANNUAL REPORT
2012–2013

GOVERNOR'S STATEMENT

In many respects the outlook for the New Zealand economy is positive. The economy is currently growing faster than nearly all of the advanced economies and growth is expected to accelerate as construction activity in Canterbury and Auckland gather momentum, and provide further stimulus to the manufacturing sector. The unemployment rate should decline and approach 5 percent, and consumer price inflation is likely to increase towards the midpoint of the 1 to 3 percent target range. These summary indications, however, disguise the nature and complexity of the adjustments taking place in New Zealand.

Our economy is buffeted by a range of domestic and international factors. Some are driven by natural events, like the $40 billion (in current prices) rebuild in Canterbury, and the decline in agricultural production and spending associated with the recent drought. Some result from international conditions, like the 20 percent decline and subsequent recovery seen in our export commodity prices over the past two years, or the spill-over effects of the monetary and liquidity policies of major central banks that increase the upwards pressure on our exchange rate. Other pressures, such as the rapid house price inflation in Auckland and Christchurch, are driven by supply shortages, pent-up demand and the lowest mortgage rates in 50 years. And others, such as the Government's fiscal consolidation, represent major adjustments in domestic economic policy.

At the same time, our businesses face challenges in adjusting to powerful long-term structural changes that are global in nature. These include changing poles of global growth and international trade; the relative decline in the international price of information technologies and manufactured goods; and the rising international demand for highly skilled labour.

Just as firms and households develop strategies to adjust to the wide range of forces that hit our economy, the Reserve Bank also needs to respond to them in meeting its goals of price stability and financial stability.

A major challenge for the economy will be whether it can successfully redirect the resources necessary to rebuild New Zealand's second biggest city, including meeting its residential housing needs, and also meet the housing shortages in Auckland. The Bank will closely monitor this shift and strive to ensure that the relative price increases needed to redirect resources to these ends do not spill over into generalised inflation pressures, and threaten the Bank's price stability objectives. This is one reason why reducing the Government's demand for resources through fiscal consolidation is so important.

The two most significant challenges facing the Bank at present are the overvalued New Zealand dollar and overvalued housing market. The former is creating difficult headwinds for New Zealand's export and import substitution industries, although it has benefited purchasers of imported goods and services, and contributed significantly to the current low levels of inflation.

New Zealand's house prices, in comparison to household disposable income and rents, are high by international standards. Household indebtedness, relative to GDP, is currently rising from already high levels. The rapid increase in house prices in some regions, especially Auckland and Christchurch are of concern for several reasons, not least the increasing risks they present to financial stability and the wider economy.

The Global Financial Crisis demonstrated that economic and financial risks can build up for several reasons, even though an economy might be growing close to its potential, and be experiencing sound fiscal policy and price stability. Our main concern is that rapidly increasing house prices increase the likelihood and the potential impact of a significant and disruptive fall in house prices at some point in the future – particularly in a market that is already widely considered to be over-valued.

In May 2013, the Minister of Finance and the Bank signed a *Memorandum of Understanding* (see page 25) outlining the purpose of macro-prudential policy, the range of policy instruments, and governance arrangements relating to their possible deployment. The macro-prudential policy framework seeks to build additional resilience in the domestic financial system during periods of rapid credit growth, rising leverage, or abundant liquidity. The instruments can also help to dampen growth in asset prices that pose risks to financial stability.

Since balance date, we have announced the introduction of one such macro-prudential tool, speed limits on high loan-to-value ratio lending, with an implementation date of 1 October 2013. These are designed to help slow the rate of housing-related credit growth and house price inflation, thereby reducing the risk of a substantial downward correction in house prices that would damage the financial sector and the broader economy.

This *Annual Report* reports on the work we have undertaken to ensure that the Bank's strategies, policies, and tools are attuned to the challenges facing the New Zealand economy and financial system. The Board of Directors' assessment of the Bank's performance during the year is published inside this *Annual Report*.

During the year, we also adopted 10 Strategic Priorities over the next three years to enhance our capacity to respond to this challenging environment. Detailed in our Statement of Intent 2013-16, these priorities are designed to continue to strengthen the Bank's performance; develop a more integrated Bank approach to the Bank's policy; and improve infrastructure and reduce enterprise risk. In summary, they are:

CONTINUING TO STRENGTHEN THE BANK'S PERFORMANCE

- We are strengthening the support for *decision making* in the Bank by establishing a committee comprising the four Governors to assist the Governor in all major monetary, regulatory and financial policy decisions that fall under the Bank's responsibilities.
- The Bank will continue to *improve its performance culture* by enhancing the quality of management through well-defined core competencies, greater emphasis on developing leadership and managerial skills, and rewarding strong managerial performance.
- We are proactively *communicating on a broader front* to enhance understanding of the Bank's policy choices, explaining the Bank's functions and roles, and what it can and cannot be expected to do.

DEVELOPING A MORE INTEGRATED APPROACH TO THE BANK'S POLICY

- A *new Macro-Financial Department* has been established, overseeing the stability of New Zealand's macro-financial system, and to design and implement macro-prudential instruments.
- We have developed a *Macro-Prudential Policy framework,* and proceeded to develop macro-prudential tools. This work is led by the Macro-Financial Committee and the new Macro-financial department, with contributions from the Economics, Financial markets and Prudential supervision departments.
- We are expanding our research to enhance our *understanding of the interface between monetary and macro-prudential policy*.
- We continue to implement a sound and comprehensive *prudential regulatory regim*e, through initiatives including Open Bank Resolution, licensing insurance companies, licensing and reviewing non-bank deposit takers, reviewing the legislative framework for the payments and settlement system regulation, and progressing the operation of the anti-money laundering regime.

IMPROVING INFRASTRUCTURE AND REDUCING ENTERPRISE RISK

- The Bank will further *develop its operational systems* to ensure a more robust operating environment, and develop new products and instruments.
- *Business continuity resilience* will continue to be tested and enhanced, including a comprehensive business continuity exercise relating to a significant regional event.
- Finally, the Bank is re-examining the *Currency, Property and Security* operations in light of a changing environment.

I am very grateful for the support and wise counsel I have received from the retiring Chair, Dr Arthur Grimes, and the Board of Directors. Arthur has been an outstanding Chair of the Board. My thanks also to Dr Chris Eichbaum, who made a substantial contribution to the Board, and whose term as a Director ended at the end of July 2013.

I wish to thank my colleagues in the Bank for their hard work, creativity, and dedication to improving New Zealand's economic prospects, and continuing to fit the organisation for the next decade. I endorse the Board's assessment of the high quality of their work. I am particularly grateful for the leadership and guidance demonstrated by my fellow Governors and other members of the Bank's senior management team.

Graeme Wheeler
Governor
21 AUGUST 2013

RESERVE BANK OF NEW ZEALAND

BOARD OF DIRECTORS' REPORT FOR THE YEAR ENDED 30 JUNE 2013

THIS REPORT IS MADE PURSUANT TO SECTION 53A OF THE RESERVE BANK OF NEW ZEALAND ACT 1989.

The Bank's Board of Directors is responsible for keeping the performance of the Bank and of the Governor under constant review across all Bank functions. The Reserve Bank of New Zealand Act 1989 (the Act) sets out the Bank's functions and powers. The Governor, who is the Bank's Chief Executive, is responsible for decisions with respect to the Bank's functions. The Board has a major role to play in the appointment of the Governor and Deputy Governors, and in ensuring that the Governor and the Bank carry out their mandated functions and powers to a high standard.

The Board met nine times in the year to 30 June 2013. Six of those meetings were held in Wellington, one in Auckland, one in Queenstown and one in Whangarei. Holding meetings outside of Wellington enables the Board to discuss economic developments with local business people and other leaders, and receive their feedback.

The Board regularly receives briefing materials from Bank staff. These materials are of extremely high quality both in terms of their depth and their breadth of coverage. Materials received include papers prepared especially for the Board, plus the full range of materials prepared for each OCR decision which the Board sees after the decision is made public. This enables the Board to assess the ongoing quality of the analytical frameworks, forecasting and advice operating within the Bank. Input is also received from a range of external sources, such as the IMF and OECD, focusing particularly on monetary policy and financial stability issues within New Zealand.

Following each *Monetary Policy Statement* and *Financial Stability Report*, directors consider whether these documents comply with the requirements of section 15 and section 165A of the Act respectively. In each case over the past year, the Board determined that the requirements of the Act were met.

The Board provides advice to the Governor during the preparation of the Bank's *Statement of Intent* and its *Annual Report*, and on the Bank's broader areas of responsibility. The Board has an Audit Committee comprising three non-executive directors. The Committee receives detailed materials on the Bank's financial and risk position and proposed disclosures in its financial statements, and monitors external and internal audit processes. It reviews the Bank's performance in these areas, and provides advice to the Governor.

NEW GOVERNOR

Dr Alan Bollard completed his second five-year term as Governor on 25 September 2012. His term as Governor was noteworthy in terms of the pressures that he had to face – international commodity and asset price booms, followed by the Global Financial Crisis and the Canterbury earthquakes. His leadership of the Bank in coping with these pressures was outstanding and he left the Bank in a strong position to keep performing its statutory functions. The Board wishes him well in his new role as Executive Director of the APEC Secretariat.

The Board recommended the appointment of Mr Graeme Wheeler to succeed Dr Bollard as Governor, and this recommendation was accepted by the Minister of Finance. Mr Wheeler previously worked for the New Zealand Treasury, the New Zealand delegation to the OECD, and for the World Bank, where he held the roles of Treasurer and Managing Director, Operations. We were delighted to be able to appoint someone of Mr Wheeler's experience and standing as Governor.

We are also fortunate to have a Deputy Governor of the calibre of Mr Grant Spencer and to have been able to appoint a second Deputy Governor, Mr Geoff Bascand, who was formerly Government Statistician. In addition, Dr John McDermott is Assistant Governor (and Chief Economist) of the Bank. Together, the four Governors form a governing committee that makes decisions about all economic and financial policy aspects of the Bank's activities. Accountability for decisions remains with the Governor, as specified in the Act, but practically, the decision-making within the Bank is a team effort. The Board is satisfied that the processes used to make statutory decisions, such as those associated with the *Monetary Policy Statement* and the *Financial Stability Report*, reflect high quality research and internal debate in the development of advice to the Governor consistent with sound management practice and the accountabilities set out in the Act.

MONETARY POLICY

The Act specifies (section 8) that: *The primary function of the Bank is to formulate and implement monetary policy directed to the economic objective of achieving and maintaining stability in the general level of prices.* A new Policy Targets Agreement (PTA) is signed when a Governor begins a new term. The PTA has to be consistent with the primary function specified in section 8.

The new PTA retains the previous inflation target of achieving future CPI inflation outcomes between 1 and 3 percent "on average over the medium term". It adds to this requirement that the Bank should "focus on keeping future average inflation near the 2 percent target midpoint". The new PTA also requires the Bank to monitor asset prices within its broader monitoring of a range of inflation measures, and requires the Bank to have regard to "the efficiency and soundness of the financial system" when implementing monetary policy. This latter requirement complements the existing requirement that the Bank "seek to avoid unnecessary instability in output, interest rates and the exchange rate" in pursuing its price stability objective.

For each of the four quarters to June 2013, CPI inflation has come in slightly below the lower boundary of the 1 to 3 percent target range, ranging between 0.7 percent and 0.9 percent per annum. Over the medium term – which we have normally interpreted as a three-year timeframe – inflation has remained well within the target range, averaging 2.3 percent over the three years to June 2013 (or approximately 1.6 percent, excluding the effects of the GST rise in

2010). The Bank's standard measure of annual 'underlying inflation' (the 'sectoral factoral model', which strips out volatile price movements) has remained within the 1 to 3 percent range in every quarter for the past three years. Most measures of inflation expectations (from one to four years' ahead) are currently clustered around 2 percent, the mid-point of the inflation target. Thus the Board considers that the Bank has met its core requirement in the PTA in relation to the inflation target.

In line with the new PTA, the Bank has introduced extra monitoring of asset prices in its *Monetary Policy Statements*. Furthermore, its preparation for the potential implementation of macro-prudential tools (discussed further below) is consistent with the requirement to implement monetary policy having regard to the efficiency and soundness of the financial system.

Volatility of interest rates remains low, with the OCR having been held steady at 2.5 percent since March 2011. Short-term wholesale and retail interest rates have also exhibited considerable stability over this period. Longer-term rates have been more volatile, primarily reflecting international volatility. GDP growth has also been broadly stable in recent years with the annual rate of GDP growth being between 0.7 percent and 3.2 percent each quarter (excluding one quarter) since December 2009. Over the three years to March 2013, GDP growth averaged 2.0 percent compared with the OECD average growth rate of 1.7 percent. Internationally, exchange rates have been volatile since the onset of the Global Financial Crisis but, in relative terms, New Zealand's exchange rate has shown only moderate volatility. Using Bank for International Settlements monthly real exchange rate data for the decade to June 2013, New Zealand ranks 29th of the 60 listed countries in terms of exchange rate volatility.[1] Developed countries that have had a more volatile real exchange rate than New Zealand over the past decade (on this measure) include: Iceland, Korea, United Kingdom, Australia, Japan, Singapore, Canada, United States and Switzerland.

In the Board's view, the recent stability in interest rates, the stable and moderately strong GDP performance of New Zealand relative to other developed countries, and the comparative stability in New Zealand's real exchange rate – all coupled with the maintenance of low inflation – indicate that monetary policy is being operated within the requirements set out in the PTA.

FINANCIAL STABILITY

The Bank has voiced concerns about the potential for asset price instability within New Zealand. In particular, it has articulated concerns about resurgent house price inflation, notably in Christchurch (following the earthquakes) and in Auckland, the latter reflecting supply shortages in the face of a growing population. The Board has supported the Bank investigating the potential use of macro-prudential tools to address such concerns since at least the Supplementary Stabilisation Instruments review conducted by the Bank and the Treasury in 2006. The Bank has previously implemented a Core Funding Ratio (CFR), which is available to be used as a macro-prudential tool from its current level of 75 percent set in January 2013. It has also implemented the Basel III bank capital adequacy regime which, amongst other things, enables the Bank to impose a counter-cyclical capital buffer on banks. The Board supports these developments.

In May, the Bank signed a Memorandum of Understanding with the Minister of Finance on Macro-Prudential Policy and it has consulted widely on a range of possible macro-prudential instruments. Following these consultations, the Bank assessed the proposed objectives, instruments and decision-making framework and the potential costs of using macro-prudential instruments. Regulatory assessments such as these are an important component of the process for introducing new policy instruments.

The Bank released a paper summarising its final position on these matters in May 2013. Included amongst the potential macro-prudential instruments discussed by the Bank are various forms of loan-to-value ratio (LVR) restrictions. By the end of the financial year, the Bank had not announced the adoption of any form of LVR restriction, but it has consulted closely with banks with regard to the systems that they would have to have in place to be able to implement such ratios if required. As the Bank has made clear, any implementation of an LVR restriction (or other new macro-prudential instrument) will have to be accompanied by clear objectives and be subject to ongoing review as to their effectiveness and/or side effects. Issues of disintermediation, which may occur if the instruments are used on a prolonged basis, will have to be monitored particularly closely. The Board, as well as the Bank itself, will play an important role in monitoring the effectiveness, and effects, of such instruments if they are introduced.

Implementation of the Basel III regime (tailored to fit New Zealand circumstances) has also led to modifications to micro-prudential policies, including to minimum capital ratios for banks. Recently, the Bank adjusted upwards the risk weights which larger banks (that use internal risk models) use in relation to their high LVR loans. The Bank has also moved to ensure that all systemically important banks have in place the systems required to make Open Bank Resolution (OBR) operational if it were ever needed. OBR is a policy that the Board has long supported and we are pleased to see that it is now able to be implemented if required. Whether the size of any *de minimis* threshold under such a scheme should be preannounced, and, if so, at what level, will be the subject of further analysis.

The Bank has also been busy implementing new regimes required by recent legislation with regard to the licensing and monitoring of insurance companies and implementing aspects of AML/CFT (anti-money laundering / countering financing of terrorism). These new regimes have placed a significant workload on the Bank and have required it to develop and acquire a broader range of expertise. At the same time, the Bank is leading a review of the NBDT (non-bank deposit-taker) regime.

1. As measured by the coefficient of variation (standard deviation divided by the mean).

Overall, the Board is comfortable with the Bank's processes in relation to the wide range of developments that are taking place with respect to financial stability. The Bank has a large work programme with regard to both macro-prudential and micro-prudential policies in order to broaden its available tools and responses, reflecting the stresses that the past few years have revealed within the international financial sector.

OTHER FUNCTIONS

One of the defining roles of a central bank is the provision of currency (banknotes and coins). The Bank has an enviable record in maintaining a high quality currency with minimal counterfeiting of notes. However, advances in technology mean that the Bank has to look continually at upgrading the security features embedded within banknotes. The Board supports the Bank's programme to introduce a new series of banknotes, and is confident that the process is proceeding according to plan.

The Reserve Bank plays a central role in operating payments and settlements systems within New Zealand through ESAS and NZClear. NZClear, which during the year became a designated securities settlement system, enables settlement of trades in financial instruments with legal certainty. ESAS enables banks and other financial institutions to have legal certainty when settling transactions between themselves and is an important component of the Bank's financial stability and efficiency role.

RESOURCES

The five-year funding agreement that began in July 2010 incorporated net expenditure (for items covered by the funding agreement) of $52.7 million for the Bank over the 2012-13 year. Net operating expenses (on this definition) came in well below this figure at $48.3 million. Expenditure rose by $1.3 million relative to the prior year, reflecting the growth of the Bank's statutory functions, such as AML/CFT and the licensing of insurance companies. The ability of the Bank to expand its roles while remaining within its funding envelope reflects strong financial controls and planning within the organisation.

Over the past year, the Bank has looked to extend its internal risk management practices. Enhancements have been made to the internal audit function where extra granularity has been introduced to internal risk ratings. We have also supported the Bank's move to adopt a benchmark foreign reserves portfolio that will enhance accountability for the management of the Bank's foreign reserves. The Bank continues to upgrade its business continuity capability, a feature that the Board considers essential for the stability of the financial system and the broader economy.

The Bank reported an annual profit of $308 million for the financial year ended 30 June 2013. As noted in past *Annual Reports*, the Bank holds an unhedged foreign exchange exposure. The unhedged position enables the Bank to intervene more effectively were there to be circumstances in which confidence wanes in the New Zealand economy, at a time when the exchange rate is falling. The Board is comfortable with the Bank maintaining this unhedged position as required to fulfil its policy functions. This year, a slight fall in the exchange rate led to a positive contribution to profit from foreign exchange gains, but we acknowledge that negative outcomes, as occurred in the two immediately prior years, are also possible.

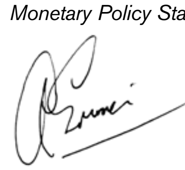
Each year, the Bank reviews its required equity, using risk models similar to those used by commercial banks. Following this review, the Board recommended to the Minister of Finance that the Bank pay a dividend to the Crown of $175 million, and this recommendation was accepted.

FINAL COMMENTS

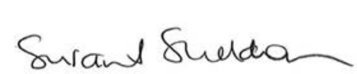
The new Governor, Graeme Wheeler, is now well established in his role. He has maintained momentum both in terms of the Bank's policy developments and its internal process improvements. With other senior staff at the Bank, he has increased the organisation's interactions with business and the general public through a strengthened programme of speeches to a wide variety of audiences.

The Governor draws on a considerable depth of experience amongst the Bank's senior leadership and across staff as a whole. The Bank has a tradition of training and developing its staff, and the quality of the staff shows in the way that the Bank has been able to deal with the many substantive issues it has had to face in the past six years. The Board thanks all staff for their dedicated contribution both to the Bank and to the efficiency and soundness of the country's financial system more broadly.

Board membership has been stable over the year. Dr Chris Eichbaum's term finishes in July 2013. He did not seek reappointment to the Board. We take this opportunity to thank Dr Eichbaum for his contribution to the Board over the past five years, including as lead reviewer within the Board of the *Financial Stability Reports*. Dr Rod Carr joined the Board as a Director in July 2012. Dr Carr had previously been on the staff and Board of the Bank as Deputy Governor, and then as Acting Governor in 2002. Following the announcement that Dr Grimes would stand down from the role in September 2013, the Board elected Dr Carr to become Chair, effective from 19 September. Sue Sheldon remains Deputy Chair and a member of the Audit Committee, Keith Taylor remains Chair of the Audit Committee, Kerrin Vautier remains a member of the Audit Committee, and Neil Quigley retains the role as lead reviewer within the Board of the *Monetary Policy Statements*.



Arthur Grimes
Chair
19 AUGUST 2013



Sue Sheldon
Deputy Chair
19 AUGUST 2013

WHAT WE DO

GOVERNANCE

The Reserve Bank of New Zealand is the nation's central bank. A Crown agency wholly owned by the New Zealand government, the Bank exercises powers across the financial sector that are derived from several pieces of legislation:

- the **Reserve Bank of New Zealand Act 1989**, which specifies the Bank's functions and duties;
- the **Insurance (Prudential Supervision) Act 2010**, which provides the Bank's powers to license and impose prudential standards on insurers;
- the **Anti-Money Laundering and Countering Financing of Terrorism Act 2009**, which confers powers on the Bank to detect and deter money laundering and the financing of terrorism.

These Acts can be viewed electronically on the *New Zealand Legislation website*. Regulations made under these Acts can be viewed on the same site. Powers conferred under these Acts are detailed in our *Briefing to the Incoming Minister 2011*, pages 39-42, [www.rbnz.govt.nz/about_us/what_we_do/briefings/4663879.pdf].

Pursuant to the Reserve Bank of New Zealand Act 1989, the Bank exercises its authority subject to:

- the **Policy Targets Agreement (PTA)**, a written contract between the Minister of Finance and the Governor detailing the monetary policy outcomes that the Bank is required to achieve (RBNZ Act 1989 s9);
- the **Bank's Funding Agreement**, a five-yearly agreement between the Governor and the Minister of Finance that specifies how much of the Bank's income can be retained by the Bank to meet its operating costs (RBNZ Act 1989 ss159-161);
- the ***Statement of Intent***, an annual three-year statement provided to the Minister of Finance covering the Bank's operating environment, functions, objectives and strategies for the three years, and projected income and expenditure for the first financial year (RBNZ Act 1989 ss162A-162E); and
- the ***Annual Report***, an annual accountability document, including presentation of financial statements (RBNZ Act 1989 ss163-165).

The Act provides considerable day-to-day operational autonomy to the Bank, an important role for the Minister of Finance in some key decisions, and a robust accountability structure in which the Bank's Board, the Minister, and Parliament all have formal roles. The Bank's activities are scrutinised by Parliament's Finance and Expenditure Select Committee. Typically, hearings are held covering the quarterly *MPS*s, the six-monthly *FSRs* and the Bank's annual financial performance. For a description of how the Bank's performance is monitored, see the Bank's *Statement of Intent 2012-2015*, pages 33-34.

THE MINISTER

The Minister of Finance has responsibility for: negotiating and agreeing the monetary policy target with the Governor; agreeing on changes to the scope of the supervisory regime; approval of any decision to place a failing bank into statutory management or to give directions to a registered bank; and approval of Orders-in-Council in relation to bank, non-bank deposit taker (NBDT) and insurance regulation. The Minister can also direct the Bank to intervene in the foreign exchange market or to impose, for a limited period, an alternative monetary policy target. In these cases, transparent procedures are set out in the Act.

BOARD OF DIRECTORS

Section 53 of the Act specifies the duties of the Board, among other things, as being to:

a. keep under constant review the performance of the Bank in carrying out—
   i. its primary function [monetary policy]; and
   ii. its functions relating to promoting the maintenance of a sound and efficient financial system; and
   iii. its other functions under this Act or any other enactment:
b. keep under constant review the performance of the Governor in discharging the responsibilities of that office:
c. keep under constant review the performance of the Governor in ensuring that the Bank achieves the policy targets agreed to with the Minister [the Policy Targets Agreement]:
d. determine whether policy statements made pursuant to section 15 [*Monetary Policy Statements*] are consistent with the Bank's primary function and the policy targets agreed to with the Minister:
e. keep under constant review the use of the Bank's resources.

Section 53 also specifies that the Board may provide advice to the Governor on any matter relating to the performance of the Bank's functions and the exercise of its powers.

The Board's Audit Committee reviews the Bank's financial statements and internal and external audit activity. Each year, the Board writes an assessment of the Bank's and the Governor's performance, which is provided as advice to the Minister of Finance and made public later in the Bank's *Annual Report*.

The Board makes recommendations to the Minister on the appointment or reappointment of the Governor. The Minister can only appoint a Governor recommended by the Board. The Board can recommend to the Minister that the Governor be dismissed if the Board believes that the Governor's performance or conduct has been inadequate or inappropriate. The Board appoints the Deputy Governors on the Governor's recommendation.

The Board typically meets nine times a year, with provision for additional meetings. In the 2012–13 year, the Board had seven non-executive directors (see details on page 11). Board members are appointed for five-year terms and are eligible for reappointment.

Two Board vacancies have arisen and appointments announced since balance date, following the decisions by Dr Grimes to step down after serving just over 11 years, and Dr Eichbaum not to seek another term. The incoming Directors are Mr Jonathan Ross (commenced 12 August 2013) and Ms Bridget Liddell (commencing 1 October 2013).

CONFLICTS OF INTEREST

The Bank maintains policies and practices to avoid or manage conflicts of interest among all Bank personnel, including Governors and directors. The policy requires that all personnel act honestly and impartially, and in no circumstances reveal or make private use of confidential, market-sensitive information. The policy states that personnel must avoid situations where their integrity might be questioned, and that their best protection is full disclosure of any potential conflicts.

Governors and departmental managers are required to provide the Bank with quarterly updates as to their personal interests, so that any potential conflict of interest is recorded. If any other personnel have a particular concern, they can also record their interests in the same way.

Personnel must not be involved, directly or indirectly, in regular trading in wholesale financial markets in which the Bank has, or might have, a significant influence. Bank personnel cannot own or control shares in entities (or their parent companies) that the Bank regulates, or use inside information to benefit when depositing or withdrawing funds from financial institutions, or purchasing or selling bonds or shares, or when changing between fixed and floating rates for a loan. It is unacceptable to use inside information, whether to avoid losses or to make gains.

Under sections 56 and 61 of the Reserve Bank Act, the Minister must have regard to the likelihood of any conflict of interest in appointing a director to the Board, and directors must disclose their interests in any contract with the Bank. On appointment to the Board, directors sign a declaration that they will observe confidentiality in relation to the affairs of the Bank and will not make use of any confidential information they may acquire regarding Bank operations. They also provide lists of their other directorships and major interests to enable the Governor to determine whether any Board papers should be withheld from them.

FINANCIAL DISCLOSURE OF THE GOVERNOR

As the Bank has extensive and expanding responsibilities, and in the interests of promoting sound organisational governance and transparency, there is merit in reporting the Governor's financial disclosure. This will be reported in each *Annual Report* and any changes made during the previous 12 months will be highlighted.

GOVERNOR'S FINANCIAL DISCLOSURE AS AT 24 AUGUST 2013[2]

1. Marketable Securities, Real Estate, Rights, Proprietary and Other Interests, Business and Other Assets owned during 2012-13 and valued above NZD10,000.

   Real Estate:[3]

   - Family home, Wellington
   - Section, Coromandel Peninsula
   - Section, Coromandel Peninsula
   - Holiday home, Coromandel Peninsula.

   Deposits and Marketable Securities:

   - Deposit at Bank-Fund Staff Federal Credit Union (Washington DC)
   - Deposit at Westpac Bank
   - KiwiSaver Employee and Employer Contribution.

2. Sources of Non-Bank Income over NZD5,000 during 2012-13 (other than from listed investments)

   - World Bank Group Pension.

3. Liabilities over NZD50,000 owed during 2012-13

   - Mortgage with Westpac Bank.

4. Trading in foreign currency or in financial instruments

   - None.

5. Positions held outside the Bank

   - None.

2. All assets and liabilities are jointly owned with spouse.
3. Purchased prior to joining the Reserve Bank.

FINANCIAL MANAGEMENT OVERVIEW

Foreign reserves management, New Zealand dollar liquidity management and currency operations materially affect the size and structure of the Bank's balance sheet, as well as its financial performance. The nature and extent of the Bank's principal financial activities are described in more detail in the financial statements on pages 41-87.

The Bank's financial performance is also influenced by: changes in both foreign exchange rates and interest rates; the extent of available funds in the form of equity; and currency in circulation.[4]

The Bank's reported net income will fluctuate from year to year, primarily because the Bank's unhedged foreign currency reserves will generate profits and losses as foreign exchange rates change.

FUNDING OF THE BANK'S OPERATIONS

The Bank's main source of income is the return on the substantial investments the Bank holds, which are funded by the issue of currency and by the Bank's equity.

Under the Act, the Minister of Finance and the Governor are required to enter into a funding agreement to specify the amount of the Bank's income that may be used to meet expenses in each financial year. Capital expenditure is funded by the Bank, with depreciation of fixed assets included in annual operating expenses.

The current Funding Agreement, signed by the Governor and the Minister of Finance in 2010, covers the five-year period ending 30 June 2015. The agreement provides for $47.8 million in the first year (2010–11) increasing to $56.4 million in year five (2014–15).

ANNUAL DISTRIBUTIONS PAID BY THE BANK

The Act requires the Bank to publish in its *Statement of Intent* a 'statement of dividend principles'. The Bank's statement of dividend principles is shown here.

STATEMENT OF DIVIDEND PRINCIPLES

The Bank should maintain sufficient equity for the financial risks associated with performing its functions. Equity in excess of that required to cover those risks will be distributed to the Crown.

In general, unrealised gains should be retained by the Bank until they are realised in New Zealand dollars. However, the Bank may recommend the distribution of unrealised gains where the Bank believes that the probability of the gain being realised is high.

Each year, the Bank makes a recommendation to the Minister of Finance of the amount to be paid as a dividend. The Minister decides how much should be paid having regard for the recommendation of the Bank, the views of the Board of the Bank and any other relevant matters.

4. No interest is paid on currency in circulation. When notes and coins are issued to a registered bank, the registered bank will pay for the currency that is issued by paying funds to the Reserve Bank from that bank's exchange settlement account with the Reserve Bank. The Reserve Bank invests the proceeds it receives, and the earnings on those investments are known as 'seigniorage'.

MANAGEMENT STRUCTURE

Governor
Graeme Wheeler

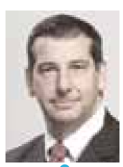
Assistant Governor
Head of Economics
John McDermott

Deputy Governor
Head of Financial Stability
Grant Spencer

Head of
Prudential Supervision
Toby Fiennes

Head of Macro-Financial Stability
Bernard Hodgetts

Head of Financial Markets
Mark Perry



Deputy Governor
Head of Operations
Geoff Bascand

Head of
Risk Assessment & Assurance
Steve Gordon

Head of
Currency, Property and Security
Brian Hayr

Head of
Communications
Board Secretary
Mike Hannah

Head of
Human Resources
Lindsay Jenkin

Chief Information Officer
Tanya Harris

Chief Financial Officer
Mike Wolyncewicz

BOARD OF DIRECTORS

NON-EXECUTIVE

DR ARTHUR GRIMES

Chair Reserve Bank of New Zealand Board of Directors

Economist

Corporate interests
- The Hugo Group Ltd[5] – Chair

Other interests
- Financial Markets Authority – Associate member of the Board
- GT Research & Consulting – Principal
- Motu Economic & Public Policy Research Trust – Senior Fellow
- Postal Network Access Committee – Chair
- Reserve Bank Superannuation Fund – Trustee
- University of Auckland – Adjunct Professor of Economics
- Wellington Jazz and Music Festival Trust – Trustee
- Wellington Jazz Trust – Trustee

First appointed 13 March 2002 – current term expires 12 March 2017. Dr Grimes elected to step down from the Board on 18 September 2013.

SUE SHELDON CNZM

Deputy Chair Reserve Bank of New Zealand Board of Directors

Company Director

Corporate interests
- Chorus Limited – Chairman
- Contact Energy Limited – Director
- FibreTech Holdings Limited – Director
- FibreTech New Zealand Limited – Director
- Freightways Limited – Chairman
- Paymark Limited – Director

Other interests
- Sue Sheldon Advisory Limited
- NZ Global Women – Board member

First appointed 1 May 2009
– current term expires 30 April 2014

DR ROD CARR

Vice-Chancellor, University of Canterbury

Corporate interests
- Lyttelton Port Company Limited – Director
- Canterprise Limited – Director
- Te Tapuae O Rehua Limited – Director

Other interests
- Canterbury Employers' Chamber of Commerce – Director
- Christchurch Earthquake Appeal Trust – Trustee
- National Infrastructure Advisory Board – Chair
- University of Canterbury Trust Funds – Vice-Chancellor
- Christchurch Business Leaders Group – Member
- Future Canterbury Network – Member

First appointed 16 July 2012
– current term expires 15 July 2017

KEITH TAYLOR

Chair Reserve Bank of New Zealand Board of Directors' Audit Committee

Company Director

Corporate interests
- Butland Management Services Limited – Director
  - Group includes: Butland Holdings Ltd, Stratford Properties, Stanway Properties
- Gough Gough & Hamer Limited – Chair[6]
  - Group includes: Gough Gough & Hamer Investments Ltd, Gough Gough & Hamer Properties Ltd, Gough Holdings Ltd, Gough Transport Supplies Ltd, Transport Specialties Ltd, Transport Wholesale Ltd
- Port Marlborough Limited – Director
  - Group includes: Waikawa Marina Trustee Ltd, PMNZ Marina Holdings Ltd, Marlborough Sounds Maritime Pilots Ltd
- Speirs Group Ltd – Chair

Other interests
- Earthquake Commission – Deputy Chairman
- Government Superannuation Fund Authority – Chair
  - Annuitas Management Ltd – Director
- Southern Cross Healthcare – Director
- Takeovers Panel – Member[7]
- NZ Fire Services Superannuation Scheme – Trustee

First appointed 1 July 2009
– current term expires 30 June 2014

DR CHRIS EICHBAUM

University Lecturer

Victoria University of Wellington – Reader in Government, School of Government

First appointed 1 August 2008
– term expired 31 July 2013

KERRIN VAUTIER CMG

Consulting Research Economist

Other interests
- High Court – Lay Member under the Commerce Act
- Auckland City Mission – Chair
- Musica Sacra Trust – Chair[8]

First appointed 9 February 2010
– current term expires 8 February 2015

PROFESSOR NEIL QUIGLEY

Deputy Vice-Chancellor (Research), Victoria University of Wellington

Corporate interests
- Victoria Link Limited – Chair
  - Group includes: iPredict Ltd, Predictions Clearing Ltd, Magritek Ltd, Pacific Nanofibres Ltd, Te Puni Village Ltd, Wetox Ltd

Other interests
- New Zealand Qualifications Authority – Board member
- Adam Art Gallery Funding Trust
- Adam Art Gallery Trust

First appointed 1 February 2010
current term expires 31 January 2015

EXECUTIVE

GRAEME WHEELER

Governor – First appointed 26 September 2012

DR ALAN BOLLARD

Governor – Term expired 25 September 2012

SECRETARIAT

MIKE HANNAH

Board Secretary

5. To 18 April 2013.
6. Chair from 1 April 2013.
7. To 4 April 2013.
8. To 28 February 2013.

STRATEGIC DIRECTION

VISION AND VALUES

The Reserve Bank's vision is to promote a sound and dynamic monetary and financial system. It endeavours to achieve this vision by being a *high-performing small central bank*, with values of:

INTEGRITY – Being professional and exercising sound judgement

INNOVATION – Actively improving what we do

INCLUSION – Working together for a more effective Bank.

OUTCOMES

The Bank contributes to the government's goal of *improving New Zealand's economic performance* by targeting three outcomes. These are designed to foster confidence and stability in New Zealand's financial system by:

- Maintaining stability in the general level of prices
- Maintaining a sound and efficient financial system
- Providing legal tender to meet the currency needs of the public.

To achieve these outcomes, the Bank performs functions covering:

- Monetary policy formulation
- Financial market operations
- Macro-financial stability
- Prudential supervision
- Settlement services
- Currency operations.

These functions, the links between them through the outcomes targeted, and the measures used to evaluate performance are shown in the following tables.

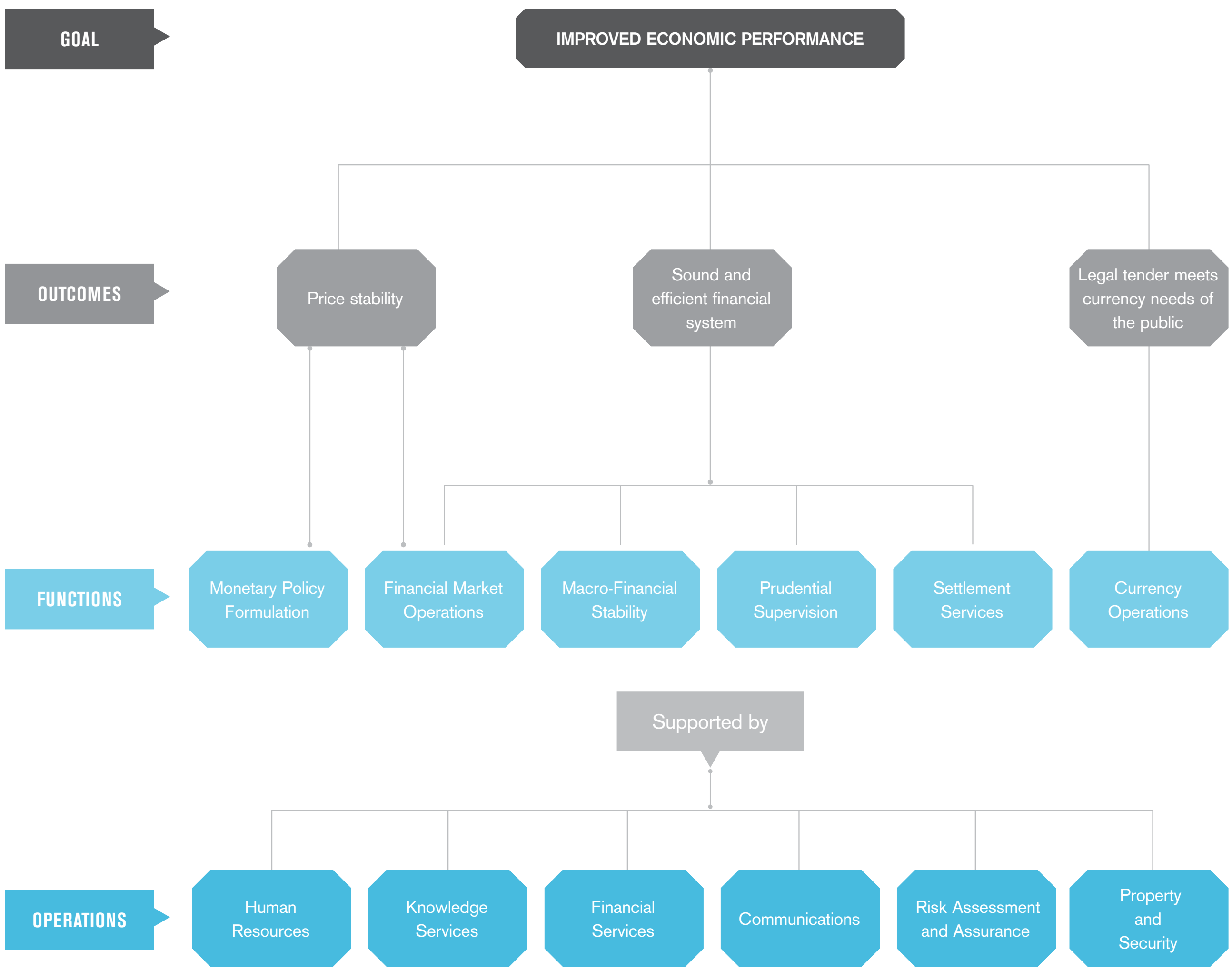
OUR VISION

WE PROMOTE A SOUND AND DYNAMIC MONETARY AND FINANCIAL SYSTEM

WE ENDEAVOUR TO ACHIEVE THIS VISION BY BEING A HIGH-PERFORMING SMALL CENTRAL BANK

RESERVE BANK

GOAL, OUTCOMES, FUNCTIONS AND OPERATIONS



2012-13 GOALS

GOAL, ORGANISATION OUTCOMES, FUNCTIONS, FUNCTIONAL OUTCOMES AND SUCCESS MEASURES

GOAL

ORGANISATION OUTCOMES

FUNCTION / FUNCTIONAL OUTCOMES

IMPROVED ECONOMIC PERFORMANCE

PRICE STABILITY MAINTAINED

MONETARY POLICY FORMULATION

Stability in the general level of prices.

FINANCIAL MARKET OPERATIONS

- Adequate banking system liquidity
- Short-term interest rates consistent with monetary policy
- Confidence in the efficient functioning of New Zealand financial markets
- Foreign reserves available for efficient foreign exchange intervention and crisis management.

SOUND AND EFFICIENT FINANCIAL SYSTEM MAINTAINED

- A sound and efficient financial system that supports the functioning of the economy.
- International and local confidence in New Zealand's financial system

MACRO-FINANCIAL STABILITY

Financial stability, promoted by:

- reducing or managing risks to the financial system arising from extremes in the credit cycle or developments in liquidity conditions and global funding markets;
- analysis and reporting on the soundness and efficiency of the financial system.

PRUDENTIAL SUPERVISION

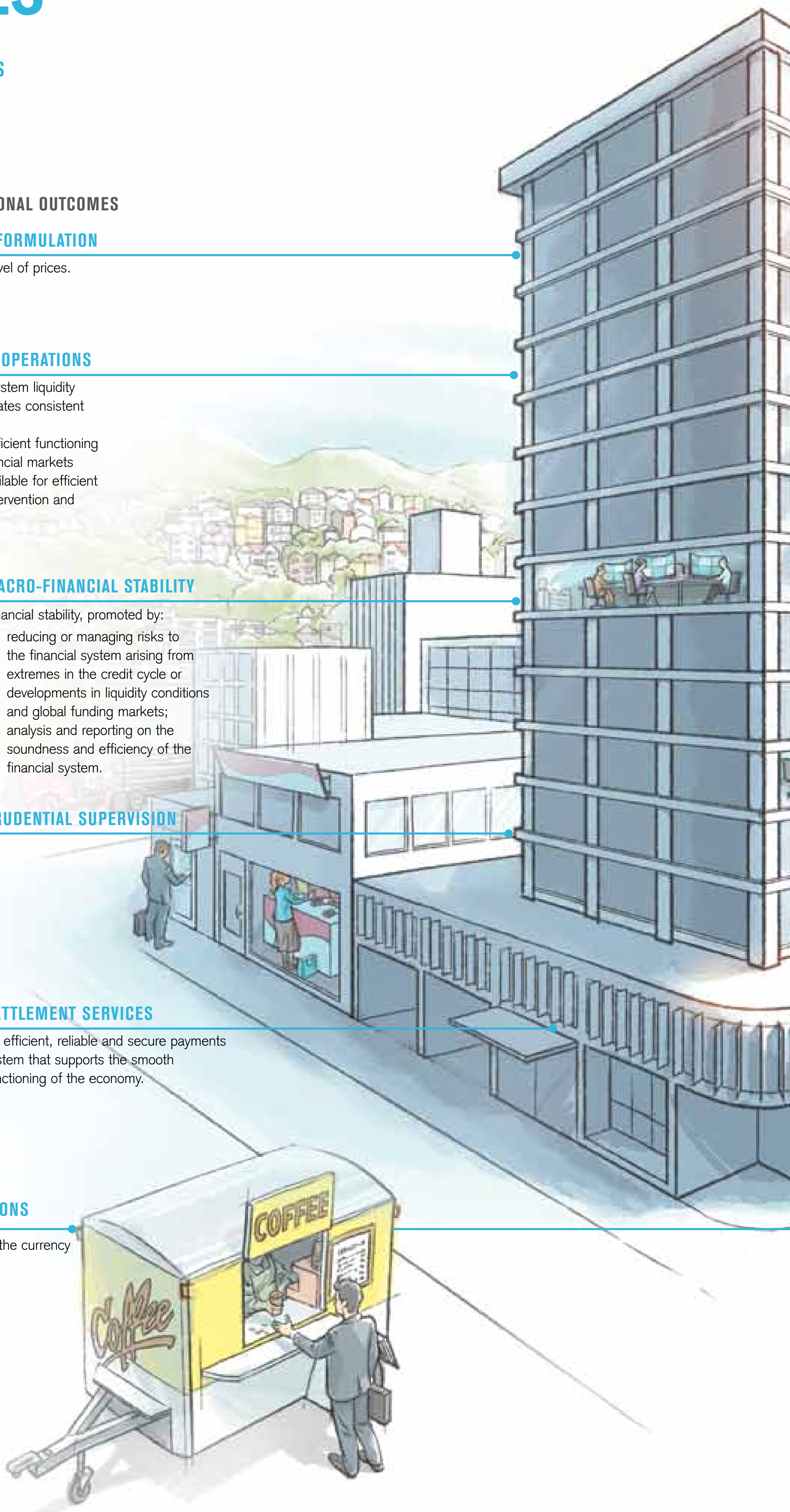
SETTLEMENT SERVICES

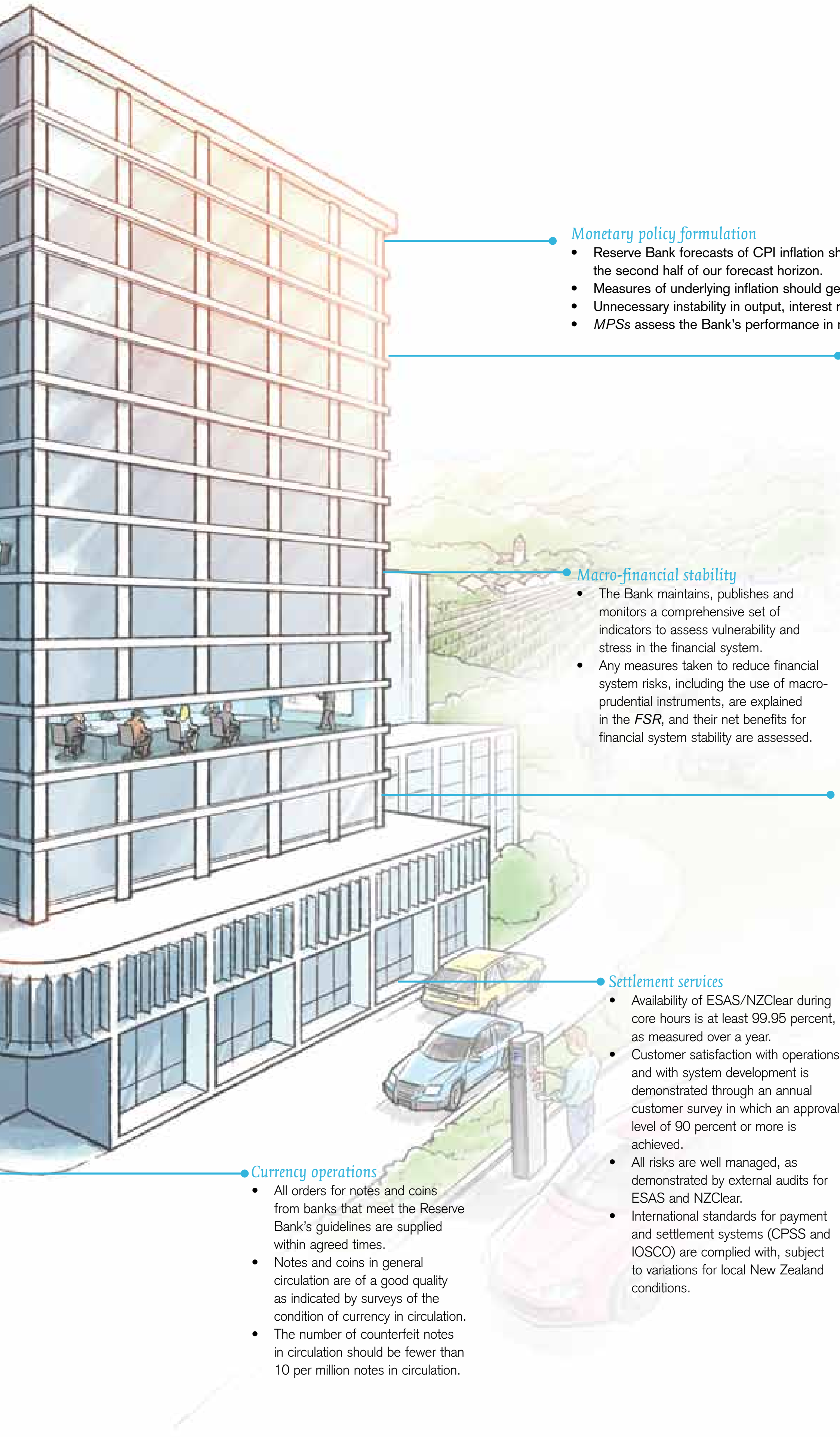
An efficient, reliable and secure payments system that supports the smooth functioning of the economy.

CURRENCY NEEDS OF THE PUBLIC ARE MET

CURRENCY OPERATIONS

Legal tender that meets the currency needs of the public.





SUCCESS MEASURES

Monetary policy formulation

- Reserve Bank forecasts of CPI inflation should be comfortably within the target range in the second half of our forecast horizon.
- Measures of underlying inflation should generally remain within the target range.
- Unnecessary instability in output, interest rates and the exchange rate should be avoided.
- *MPSs* assess the Bank's performance in meeting the objectives of the PTA.

Financial market operations

- Short-term wholesale interest rates are maintained at levels close to the OCR.
- No evidence of payment disruptions due to a shortage of settlement cash in the system, e.g., persistent accessing of the Overnight Reverse Repo Facility.
- Over the medium term, domestic market operations generate a positive return.
- Foreign reserves are maintained at target levels, with liquidity and credit standards met throughout.
- The Foreign Reserves Management portfolio yields a net return that meets or exceeds the benchmark portfolio.
- The foreign exchange open position is managed such that:
  a. the bulk of active foreign exchange purchases (sales) are undertaken around peaks (troughs) in the exchange rate cycle; and
  b. the net return on the non-core open foreign exchange position is positive over the cycle.

Macro-financial stability

- The Bank maintains, publishes and monitors a comprehensive set of indicators to assess vulnerability and stress in the financial system.
- Any measures taken to reduce financial system risks, including the use of macro-prudential instruments, are explained in the *FSR*, and their net benefits for financial system stability are assessed.

Prudential supervision

- The bank, NBDT and insurance regulatory regimes, and in particular the regulatory changes implemented during the year, promote the soundness and efficiency of the financial system in a cost-effective manner, as demonstrated by sound regulatory impact analysis.
- The prudential oversight function for banks, NBDTs, insurance companies and payment systems shows: vigilance in its monitoring activities; it is capable of identifying emerging financial stresses in a timely manner; and it is prepared, where necessary, to effectively resolve institutional failures in conjunction with government.
- The Bank demonstrates a consultative and transparent approach to its policy development, supported by robust analysis that is understood by regulated institutions and stakeholders.
- In its decisions on whether to grant licences to new applicants, the Bank takes a consistent approach within the legislative framework, without successful challenges.
- The *FSRs* provide a comprehensive assessment of the health of the New Zealand financial system.

Settlement services

- Availability of ESAS/NZClear during core hours is at least 99.95 percent, as measured over a year.
- Customer satisfaction with operations and with system development is demonstrated through an annual customer survey in which an approval level of 90 percent or more is achieved.
- All risks are well managed, as demonstrated by external audits for ESAS and NZClear.
- International standards for payment and settlement systems (CPSS and IOSCO) are complied with, subject to variations for local New Zealand conditions.

Currency operations

- All orders for notes and coins from banks that meet the Reserve Bank's guidelines are supplied within agreed times.
- Notes and coins in general circulation are of a good quality as indicated by surveys of the condition of currency in circulation.
- The number of counterfeit notes in circulation should be fewer than 10 per million notes in circulation.

BUSINESS PRIORITIES & OUTCOMES

2012–13

The Bank adopted a number of Business Priorities in addition to its business-as-usual activities:

Priority 1:

MONETARY AND FINANCIAL STABILITY POLICIES

Ensure monetary and financial stability policies are appropriate in light of recent structural changes in the economic and financial environment.

OUTCOME

The Bank undertook substantial theoretical and empirical research so as to better understand the economic and financial environment, following the structural changes wrought by the global financial crisis and Canterbury earthquakes. The implications of this work have fed into internal policy discussions and, where appropriate, been communicated through speeches, the *Monetary Policy Statement (MPS)*, the *Financial Stability Report (FSR)*, and research publications.

The Bank signed a Memorandum of Understanding with the Minister of Finance on macro-prudential policy and operating guidelines. Substantial work was advanced, including consultation with stakeholders, around the possible implementation of loan-to-value restrictions, with the intent of limiting excessive housing price and credit movements that accentuate risks of financial instability.

Priority 2:

OPEN BANK RESOLUTION

All relevant banks to have pre-positioned information technology and operating systems to enable Open Bank Resolution (OBR).

OUTCOME

As at 30 June 2013, all registered banks subject to the Open Bank Resolution policy – that is, all locally incorporated registered banks with retail deposits over one billion dollars – had pre-positioned their information technology and operating systems to enable the operation of the Open Bank Resolution policy. These registered banks are now subject to revised Conditions of Registration that require ongoing compliance with the pre-positioning policy.

Priority 3:

BASEL III

Implementation of the Basel III capital adequacy requirements for banks.

OUTCOME

The Bank finalised its capital adequacy requirements, and locally incorporated registered banks are operating under these new requirements. From 1 January 2013, locally incorporated registered banks must comply with the revised required capital ratios, measured in relation to their risk-weighted assets.

Priority 4:

BANKNOTE UPGRADE

Determination of the detailed specifications for the new series of banknotes.

OUTCOME

The project established to issue the new series of banknotes (Series 7) is tracking to key milestones with detailed design specifications completed.

Priority 5:

RISK MANAGEMENT AND ASSURANCE

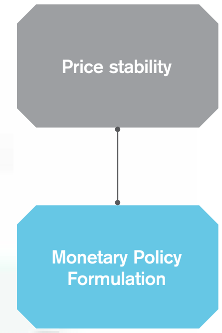
Implementation of a new operating model for risk management and assurance.

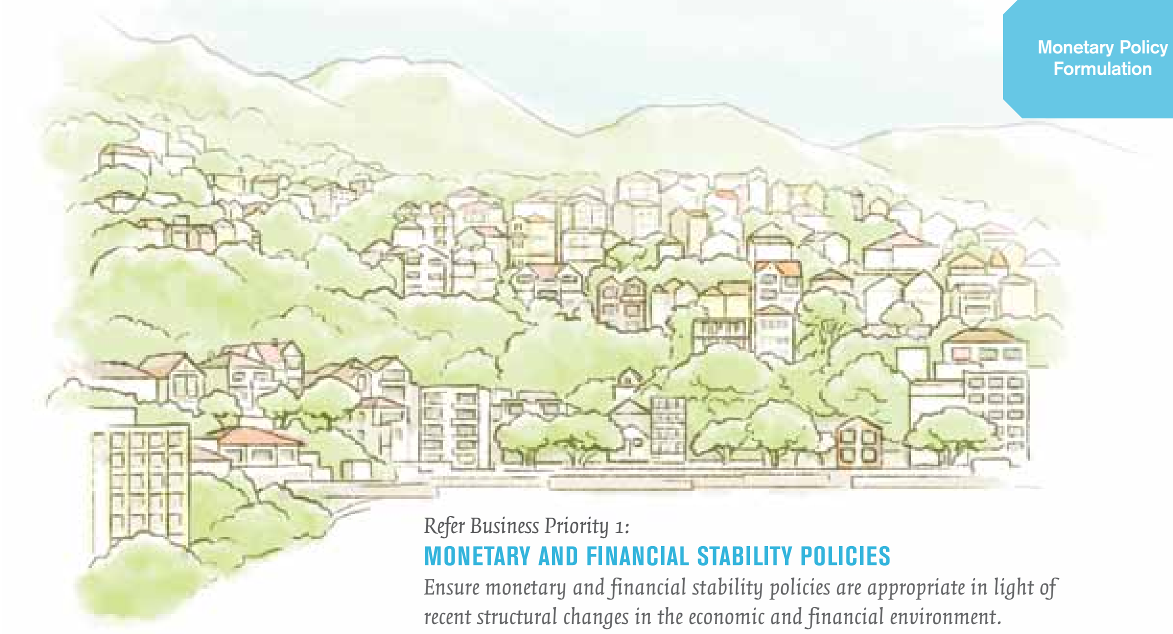
OUTCOME

A new risk and assurance operating model has been adopted across the Bank. For internal audit, the new assurance model is embedded and producing quality audit output. In addition, a new enterprise risk management framework is operational and is providing enhanced capability to identify and manage the Bank's risks.

THE YEAR IN REVIEW

MONETARY POLICY FORMULATION





Refer Business Priority 1:

MONETARY AND FINANCIAL STABILITY POLICIES

Ensure monetary and financial stability policies are appropriate in light of recent structural changes in the economic and financial environment.

ENVIRONMENT

The recovery in global economic activity from the global financial crisis has been slow and mixed across regions. Europe was in financial turmoil a year ago. That has subsided and global market sentiment has been buoyant recently. However, risks remain. Developed economies still face a number of significant challenges, not least the fiscal consolidation required to bring public debt to a more sustainable path.

Australia's economic growth is slowing as the boost from mining investment begins to wane. New Zealand's direct trade exposure to the mining sector is limited. Nonetheless, the outlook for the Australian economy has important implications for New Zealand, through trade, labour flows and the exchange rate.

Against this backdrop, New Zealand has continued to benefit from its close and growing ties with faster-growing economies in the Asia-Pacific region.

New Zealand's economic growth strengthened over the past year, with GDP increasing by 2.4 percent in the year to March 2013. However, growth was uneven over the year and across sectors. Continued fiscal consolidation has dampened private sector demand, with the government working towards a fiscal balance of zero in 2014-15. Conflicting signals on the state of the labour market and on the degree of spare capacity in the economy created challenging conditions for the formulation of monetary policy over the past 12 months. More recently, there are signs that the improvement in economic activity is broadening, reflected in rising business and consumer confidence.

Post-earthquake reconstruction in Canterbury has picked up over the past 12 months, although progress remains slower than expected. The cost of reconstruction is now expected to total $40 billion (in 2013 dollars), approximately $10 billion more than was assumed a year ago. How quickly this rebuild activity will accelerate and how soon the construction sector will reach full capacity remain key issues for the profile of economic growth and inflationary pressures going forward. Although construction cost inflation has increased to 12 percent in Canterbury, to date the spillover to the rest of the country appears limited.

Momentum in the housing market has continued to build, with nationwide house prices increasing by 9 percent in the year to April 2013, and even more sharply in Auckland and Canterbury, where there are supply shortages. Household consumption and nationwide residential construction have picked up. As discussed elsewhere in this document, the Bank is mindful of the potential financial stability risks posed by rapid house price inflation.

Easy monetary conditions globally and New Zealand's relatively favourable growth outlook have contributed to the strength of the New Zealand dollar on a trade-weighted basis. While it has depreciated recently, the dollar remains elevated, dampening tradable inflation and creating challenging conditions for New Zealand's export and import-competing sectors. Many farmers were also affected by drought in early 2013. Lower dairy production in much of the country will be partially offset by higher global dairy prices. However, the effects of the drought on animal condition and breeding stocks are likely to hamper production for some time. As a result, the aggregate effect that the drought will have on national income is yet to be determined.

Given the range of forces hitting the New Zealand economy and the current outlook for inflation, the Bank has stated that it expects to leave the OCR unchanged at 2.5 percent in 2013. The Bank has not changed the OCR since March 2011; indeed, the OCR has been stable to an unprecedented degree for the past four years.

THE OBJECTIVE OF THE MONETARY POLICY FUNCTION IS:

To achieve and maintain stability in the general level of prices. The current Policy Targets Agreement requires that the Bank "keep future CPI inflation outcomes between 1 percent and 3 percent on average over the medium term, with a focus on keeping future average inflation near the 2 percent midpoint". It also requires that: "In pursuing its price stability objective, the Bank shall… have regard to the efficiency and soundness of the financial system, and seek to avoid unnecessary instability in output, interest rates and the exchange rate."

IN OUR 2012–15 *STATEMENT OF INTENT*, WE UNDERTOOK TO DELIVER THE FOLLOWING:

OUTCOME

Stability in the general level of prices.

INITIATIVES AND STRATEGIES

- Explore changes in the environment, and undertake research to develop better tools and analytical frameworks, to improve future monetary and macro-prudential policies.
- Understand the next business cycle in the context of earthquakes, fiscal consolidation and international developments.
- Publish high-quality, credible analysis underpinning monetary policy decisions.
- Develop and publish quality statistics on New Zealand's economy and financial sector that inform decision making and policy advice.
- Develop and implement a modelling and forecasting framework that is robust and flexible.

AND OUR PERFORMANCE WOULD BE MEASURED BY:

KEY PERFORMANCE INDICATORS

- Reserve Bank forecasts of CPI inflation should be comfortably within the target range in the second half of our forecast horizon.
- Measures of underlying inflation should generally remain within the target range.
- Unnecessary instability in output, interest rates and the exchange rate should be avoided.
- *MPS*s assess the Bank's performance in meeting the objectives of the PTA.

HOW WE PERFORMED – INITIATIVES AND STRATEGIES

Monetary policy formulation has focused on ensuring price stability, while avoiding undue volatility in output, interest rates and the exchange rate. To assist in this, the Bank has devoted considerable attention to understanding the structural and cyclical economic consequences of the Canterbury earthquakes, fiscal consolidation, developments in credit and asset prices, and international developments.

As the Christchurch rebuild has progressed, the Bank has gathered data and met regularly with interested parties to help improve its understanding of the likely economic impact of the magnitude and profile of the reconstruction. The Bank has also been investigating potential resource constraints on the rebuild process, and inflationary consequences. This information is incorporated into regular internal policy discussions and has been communicated externally via speeches and publications (primarily the quarterly *MPS*).

In forming its judgement of the current economic environment, the Bank used its contacts with other central banks and international institutions to gain further insight into developments in the international environment. This has been supplemented domestically by the regular quarterly meetings with businesses across the country.

The Bank's research programme has concentrated on understanding how economic relationships may have evolved. It aims to improve the analytical frameworks underpinning monetary and macro-prudential policies. The results to date have been presented to conferences both domestically and internationally. In addition, the Bank hosted a workshop on the stability and efficiency of financial systems in December 2012. Published research papers over the past year include: measuring the stance of monetary policy when nominal interest rates are at the zero lower bound; empirical analysis of drought impacts in New Zealand; assessing the macroeconomic effects of a stable funding requirement; and investigation of financial frictions in small open economies.

To help inform policy advice about exchange rate issues, the Bank and the New Zealand Treasury hosted an exchange rate policy forum on 26 March 2013. The forum explored current knowledge about the behaviour of the exchange rate and its impact on the economy. Participants included public sector research economists and policy advisers, several private sector economists, representatives of business and industry, and Australian academics and public sector officials.

The forum explored the roles of global factors and relative economic performance as important determinants of the exchange rate, across the different monetary and exchange rate regimes that New Zealand has adopted over the past several decades. Other themes included the trade-offs incurred with different approaches to managing exchange rate fluctuations and their consequences. A number of papers have been published in the the Bank's *Bulletin*.

Over the past 18 months, the Bank developed a new forecasting model. The new model, the New Zealand Structural Inflation Model (NZSIM), has been successfully implemented and was used as the main economic model for the economic projections in the June 2013 *MPS*.

This year, the Bank has expanded the range of data it collects and has made significant improvements to the presentation of data on the Bank's website.

HOW WE PERFORMED – KEY PERFORMANCE INDICATORS

The *MPS* is the full accountability and assessment document for our monetary policy key performance indicators. The Bank's judgement of economic conditions and of the level of inflationary pressure within the economy is set out in the *MPS*, which is published every three months.

The OCR has remained at the historically low level of 2.5 percent since early 2011. Despite accommodative monetary policy, lower-than-expected headline inflation over the past 12 months has tended to surprise both the Bank and private sector forecasters. Much of these surprises can be accounted for by the impact of the stronger-than-expected New Zealand dollar on tradable goods prices. Tradables inflation has also been dampened by pronounced decreases in the prices of imported items, such as food and fuel. Increased competition for mobile and broadband services has helped pull non-tradables inflation lower.

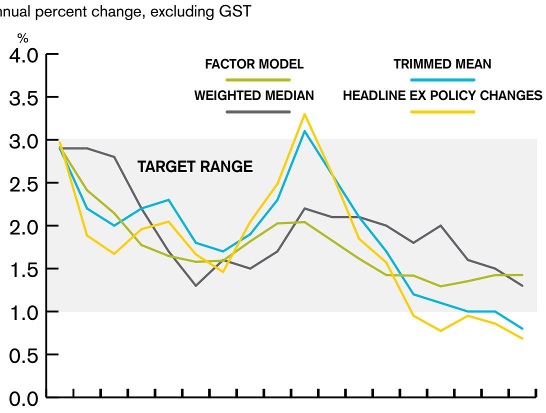
However, even accounting for these factors, headline CPI inflation has been subdued. Measures of underlying inflation have lingered in the lower part of the Bank's target range for some time. Inflation expectations have also declined, to be very near the 2 percent midpoint.

The impulse from the Canterbury rebuild and rising house prices and construction activity more generally are expected to boost economic activity over the medium term. As this creates pressure on available resources in the economy, CPI inflation is forecast to increase towards 2 percent over the projection.

However, the outlook for monetary policy has been finely balanced over the past year. Monetary policy settings needed to balance the low starting point for inflation, and the impact of the high exchange rate and weak labour market, against increasing signs that output and inflationary pressures would pick up over the medium term. Because of policy lags, any efforts to offset weakness in near-term inflation may have had an only limited effect on near-term conditions. Furthermore, an easing in monetary policy may have exacerbated the medium-term inflationary pressures that had been, and continue to be, anticipated.

CORE INFLATION MEASURES

Annual percent change, excluding GST



GRAPH 1

THE NEW POLICY TARGETS AGREEMENT

The Policy Targets Agreement (PTA) between the Minister of Finance and the Governor of the Reserve Bank sets operational targets for the conduct of monetary policy, consistent with the Bank's primary goal of achieving and maintaining stability in the general level of prices.

A new PTA took effect in September 2012. It retains an overall focus on price stability indicated by a CPI inflation target. There are three additions to the previous agreement.

- Clause 2a now requires the Bank to monitor "asset prices" among the price indicators it regularly examines.
- Added to the existing target of "future CPI inflation outcomes between 1 percent and 3 percent on average over the medium term", clause 2b now requires the Bank to have "a focus on keeping future average inflation near the 2 percent target midpoint".
- Clause 4b requires the Bank to have regard to "the efficiency and soundness of the financial system" in pursuing price stability.

Through its history the PTA has required the Bank to monitor a range of prices while targeting inflation as measured by the CPI. The *Monetary Policy Statement* (*MPS*) regularly reports the Bank's analysis of movements in a range of price measures, including asset prices. The new reference in clause 2a reinforces this focus.

The added focus on keeping future average inflation near the target's 2 percent midpoint is intended to help anchor inflation expectations around that level. Well-anchored expectations reduce the risk of inflation persistently deviating from target, and reduce the need to adjust the OCR in response to economic shocks.

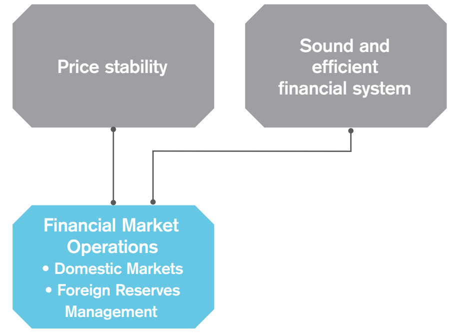
The requirement to "have regard to the efficiency and soundness of the financial system" incorporates language from the Act. Experience over the past decade illustrates the powerful influence asset and credit market conditions can have on the wider economy, including output losses and deflationary pressure when asset prices collapse and credit provision is disrupted.

The PTA continues to reflect the view that monetary policy's best contribution to long-run economic growth comes through ensuring low and stable inflation, and supporting financial stability. Under the flexible approach to inflation targeting in New Zealand, monetary policy focuses on keeping inflation expectations anchored, and doing so in a way that does not contribute to excessive economic volatility. The latest amendments to the PTA are evolutions of the approach, consistent with those objectives.

BOX 1

THE YEAR IN REVIEW

FINANCIAL MARKET OPERATIONS



ENVIRONMENT

Global financial market conditions proved more stable in 2012-13. While this allowed the Bank to review its market operations, the Bank faced challenges to its management of currency and interest rate risk from increased quantitative easing in the US and Japan as well as occasional liquidity shortages in the New Zealand dollar.

THE OBJECTIVE OF THE FINANCIAL MARKETS FUNCTION IS:

To support the implementation of monetary policy; to assist in the efficient functioning of the New Zealand financial system; to manage official foreign reserves; to implement the Bank's foreign exchange market intervention policy; to manage the Crown's financial liquidity; and to maintain crisis intervention capability.

IN OUR 2012–15 *STATEMENT OF INTENT*, WE UNDERTOOK TO DELIVER THE FOLLOWING:

OUTCOME

- Adequate banking system liquidity; short-term interest rates consistent with monetary policy; confidence in the efficient functioning of New Zealand financial markets.
- Foreign reserves available for efficient foreign exchange intervention and crisis management.

INITIATIVES AND STRATEGIES

- During 2012-13, the Bank is reviewing access to and the operation of its domestic markets facilities, to ensure they meet its policy objectives and the needs of the financial system in the new Basel III environment.
- The Bank is implementing a new foreign reserves asset allocation and management approach, including independent performance benchmarks for the foreign reserves portfolio.
- The Bank has established a market operations office in Auckland for both business-as-usual and business continuity purposes.

AND OUR PERFORMANCE WOULD BE MEASURED BY:

KEY PERFORMANCE INDICATORS

- Short-term wholesale interest rates are maintained at levels close to the OCR.
- No evidence of payment disruptions due to a shortage of settlement cash in the system, e.g., persistent accessing of the Overnight Reverse Repo Facility.
- Over the medium term, domestic market operations generate a positive return.
- Foreign reserves are maintained at target levels, with liquidity and credit standards met throughout.
- The Foreign Reserves Management portfolio yields a net return that meets or exceeds the benchmark portfolio.
- The foreign exchange open position is managed such that:
  a. the bulk of active foreign exchange purchases (sales) are undertaken around peaks (troughs) in the exchange rate cycle; and
  b. the net return on the non-core open foreign exchange position is positive over the cycle.

HOW WE PERFORMED – INITIATIVES AND STRATEGIES

The Financial Markets department reviewed its operating environment during the year and identified a programme of improvements that will update system architecture, reduce enterprise and reputational risk, and enable the Bank to better respond to global regulatory initiatives.

A new benchmarking framework for the Bank's foreign reserves management was implemented. This framework operationalises the Bank's strategic asset allocation preferences, which are motivated by the need to diversify reserves in light of the experience during the global financial crisis, while maintaining the highest credit quality and a liquid portfolio.

The department will now focus on performance measurement, stress testing and alternative investment scenarios, as global market conditions continue to evolve and the Bank examines further opportunities to optimise the mix of risk, liquidity and financial return.

The Bank has entered into updated Credit Support Annex agreements with its major banking counterparties. This will enable efficient two-way transfer of collateral that is posted against derivative contracts in order to reduce counterparty credit risk. The Bank has also requested proposals from financial institutions to provide central clearing services that could meet its future trading and investment needs in a rapidly evolving global regulatory environment. Additionally, the Bank has identified treasury and financial system enhancements that will significantly improve end-of-day processes and system resilience, and enable development of further products and instruments to meet future business requirements.

HOW WE PERFORMED – KEY PERFORMANCE INDICATORS

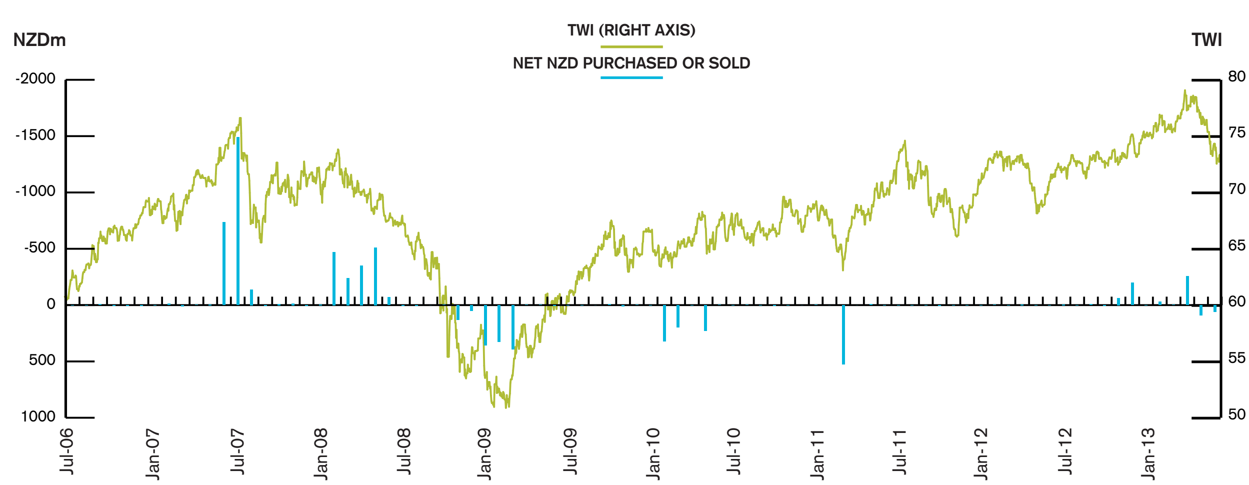
DOMESTIC MARKETS

The Domestic Markets team aims to maintain short-term wholesale interest rates at levels close to the OCR. While a return to stability in global financial markets was reflected in the New Zealand market, local wholesale interest rates traded away from the OCR rate due to a lack of liquidity at times.

This lack of liquidity, coupled with the ongoing over-supply of US dollars (due to quantitative easing in the US), saw volatile short-term rates in the foreign exchange forward market, with rates trading at a slightly higher-than-normal margin to the OCR. Conversely, the local interbank cash market had an over-supply of cash and generally traded at or slightly below the OCR.

Trading in this market increased as a result of increased payment system activity, related to the introduction of Settlement Before Interchange (SBI), and the market's difficulties in absorbing high volumes of US dollars through the foreign exchange forward market.

TWI v NET NZD PURCHASED OR SOLD



GRAPH 2

To close this divergence between the interest rate implied in the foreign exchange forwards and the OCR, the Bank's Domestic Markets team proactively injected cash into the banking system via foreign exchange forwards and then withdrew some or all of the cash via repo. The daily settlement cash level between banks averaged $7.2 billion during the financial year, the same amount as in the previous two financial years.

Domestic Markets managed the liquidity implications of the largest bond maturity to date, $10.0 billion on 15 April 2013. The largest previous bond maturity totalled $7.6 billion.

Domestic Markets made a positive return on its operations over the 2012–13 financial year, recording a profit of $7.3 million before operating expenses.

FOREIGN RESERVES MANAGEMENT

Following the transition to the new foreign reserves allocations in March 2013, assets are held in government bonds, government bills and cash in six currencies with a targeted duration for bills at three months, and for government bonds at two years. This revised asset allocation continues to meet our KPI of maintaining reserves above our minimum holding of SDR 4.4 billion, while ensuring the credit quality of assets is no lower than A-.

To complete the framework, the Bank has developed risk and performance reporting. Table 1 outlines the Bank's current strategic asset allocation.

CURRENT STRATEGIC ASSET ALLOCATION

SAA	Bills *	Bonds **
USD	36.5%	7.5%
EUR	12.5%	5.0%
JPY	8.5%	6.5%
GBP	7.0%	2.1%
CAD	6.5%	3.5%
AUD	0.0%	4.4%

TABLE 1

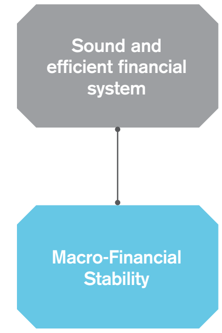
* Bills target duration is three months
** Bonds target duration is two years

Ongoing monetary policy stimulus by the world's major central banks continues to be a challenge to investment returns, as global yields remain near record low levels. Despite this, the net return from holding foreign reserves was positive in 2012-13, through a combination of revaluation gains to the Bank's unhedged foreign exchange position and valuation gains to the long-term financial instruments used to fund foreign reserves. Under the new benchmarking framework, core asset returns have also been positive for the year to date.

The Bank's unhedged foreign exchange position was increased from the latter part of 2012 as the exchange rate moved further from fair value, eventually reaching a new post-float high on a TWI basis in April 2013 of 79.67. The unhedged position grew to a maximum size of SDR 1.5 billion against our long-term benchmark level of SDR 1.0 billion, before returning to an unhedged position of SDR 1.36 billion by 30 June 2013.

THE YEAR IN REVIEW

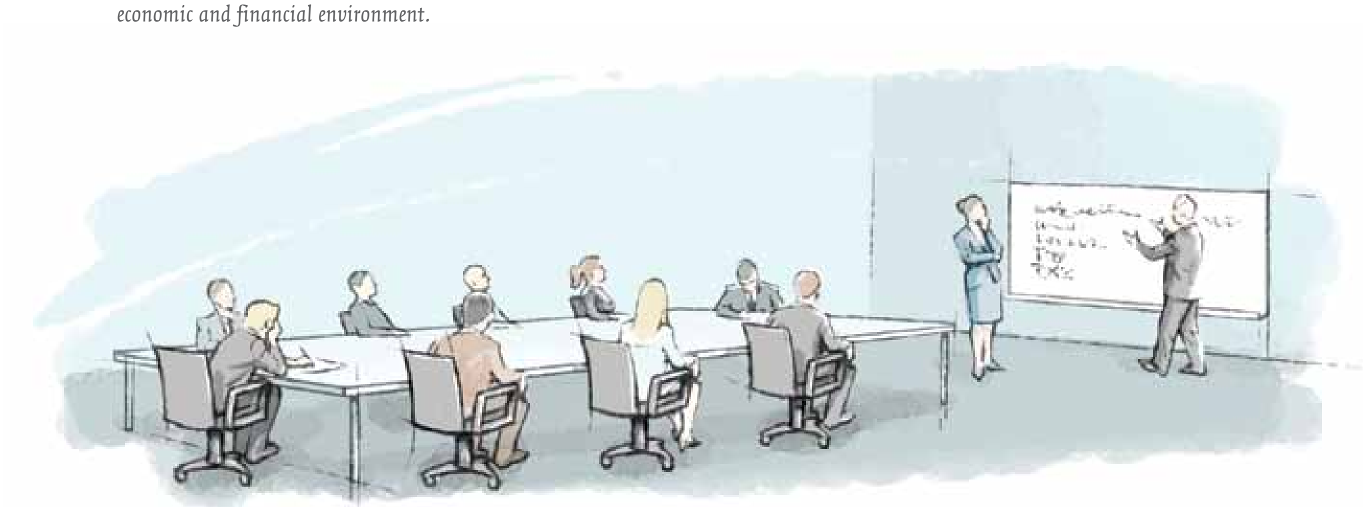
MACRO-FINANCIAL STABILITY



Refer Business Priority 1:

MONETARY AND FINANCIAL STABILITY POLICIES

Ensure monetary and financial stability policies are appropriate in light of recent structural changes in the economic and financial environment.



ENVIRONMENT

The benefits of macro-prudential policy instruments come from reducing the risks to the financial system that can arise from unsustainable credit and asset price growth, and rising household or business sector leverage. As many countries have experienced in recent years, boom-bust cycles in credit and asset prices can be extremely destabilising for banking systems and can create large economic costs. They can also pose a significant fiscal burden for the government.

While New Zealand was fortunate not to have experienced the major upheaval in its core financial system seen in some countries, macro-prudential policy represents an important step in reducing the financial system's vulnerability to any such instability in the future. New Zealand's net financial liabilities remain high relative to GDP, reflecting a sustained period of current account deficits, financed by borrowing primarily through the banking system.

Macro-prudential policy places more demands for accurate and timely statistical data that meet international standards, while being sensitive to the reporting burden on business.

The key policy issues for macro-financial stability include: high leverage in the household sector and parts of the farming sector; increasing risks to financial stability arising from developments in private sector credit and the housing market; assessing when best to operationalise macro-prudential policies and the costs and benefits of doing so. The Bank is also examining how macro-prudential policy might support and interact with monetary policy.

THE OBJECTIVE OF THE MACRO-FINANCIAL POLICY FUNCTION IS:

To promote a sound and efficient financial system that facilitates the effective performance of the economy; where possible, to reduce or manage risks to the financial system arising from extremes in the credit cycle or developments in liquidity conditions and global funding markets; to analyse and report on the soundness and efficiency of the financial system.

IN OUR 2012–15 *STATEMENT OF INTENT*, WE UNDERTOOK TO DELIVER THE FOLLOWING:

OUTCOME

- A sound and efficient financial system that supports the functioning of the economy.
- International and local confidence in New Zealand's financial system.

INITIATIVES AND STRATEGIES

- Continue to develop the implementation framework for macro-prudential policy tools in New Zealand, including a system of indicators of financial risks and imbalances to support decision making in this area.
- Monitor bank funding conditions and assess any implications for Reserve Bank policies.
- Assess the implications of changes in household and business sector behaviour and financial sector operating conditions for the conduct and interaction of monetary and financial stability policies.

AND OUR PERFORMANCE WOULD BE MEASURED BY:

KEY PERFORMANCE INDICATORS

- The Bank maintains, publishes and monitors a comprehensive set of indicators to assess vulnerability and stress in the financial system.
- Any measures taken to reduce financial system risks, including the use of macro-prudential instruments, are explained in the *FSR*, and their net benefits for financial system stability are assessed.

HOW WE PERFORMED – INITIATIVES AND STRATEGIES

In May, the Bank signed a Memorandum of Understanding on Macro-Prudential Policy with the Minister of Finance. The Memorandum provides governance arrangements for the use of macro-prudential tools, such as restrictions on high loan-to-value (LVR) lending or a countercyclical capital buffer.

The signing of the Memorandum was preceded by a high-level public consultation on macro-prudential policy, which provided useful feedback on the design of the framework. This was followed by a further consultation on a proposed framework for the implementation of LVR restrictions. The Bank has already consulted on the countercyclical capital buffer, which could in principle be applied at any date after 1 January 2014.

The Bank continues to monitor credit and asset markets and has been expressing concern (in speeches and the *FSR*) about rising house prices, which already appear elevated on a number of measures, increasing the risks to both borrowers and the financial system that could arise from adverse economic conditions. Housing market turnover has been rising towards the levels seen prior to the global financial crisis, spurring increased borrowing from the banking system (graph 3).

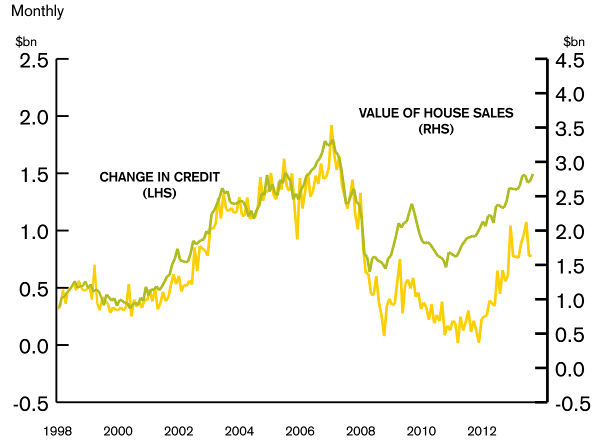
The Bank has established a new Macro-financial department, which will design and implement macro-prudential policies as appropriate. The department is also responsible for the preparation of the *FSRs* and associated policy advice. The Bank's Statistics unit, which collects and disseminates financial statistics, is also part of the new department.

HOW WE PERFORMED – KEY PERFORMANCE INDICATORS

Our *FSRs*, which are required under the Reserve Bank Act, assess the performance of New Zealand's financial institutions and payments systems, the risks and vulnerabilities facing the financial system, and the measures we are taking to help promote its soundness and efficiency.

Recent *FSRs* have emphasised our concerns about the sustainability of the recent housing market developments. We have also monitored the international wholesale funding markets, which many New Zealand banks utilise to fund a significant (though much reduced over the past five years) portion of their lending. Conditions in these markets have improved considerably over the year, leading to an improvement in domestic credit availability. Our *FSRs* have also reported on a range of prudential and macro-prudential policy initiatives, including most of the developments covered under the Prudential Supervision function.

HOUSE SALES AND CHANGES IN MORTGAGE CREDIT
Monthly



GRAPH 3

MACRO-PRUDENTIAL POLICY – MEMORANDUM OF UNDERSTANDING

In May 2013, a Memorandum of Understanding was signed between the Bank and the Minister of Finance, which sets out the key objectives, instruments and responsibilities under the new macro-prudential policy framework.

The Memorandum describes the objective of macro-prudential policy as increasing the resilience of the domestic financial system and countering instability in the domestic financial system arising from credit, asset price or liquidity shocks.

"The instruments of macro-prudential policy are designed to provide additional buffers to the financial system (e.g. through changes in capital, lending and liquidity requirements) that vary with the macro-credit cycle. They may also help dampen extremes in the credit cycle and capital market flows.

As such, these instruments can play a useful secondary role in stabilising the macro economy."

Four instruments are listed in the Memorandum as being potentially useful for addressing financial stability risks in New Zealand (see table 2 to the right). Any further instruments would be developed by the Bank in consultation with the Treasury.

The Memorandum establishes that the Bank has decision-making responsibility for macro-prudential policy implementation but must consult with the Minister and Treasury prior to the deployment of any instrument. The Bank has also undertaken to keep the public informed on macro-prudential policy through speeches and publications, with the main accountability document being our six-monthly *FSR*.

BOX 2

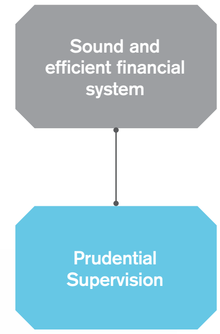
MACRO-PRUDENTIAL INSTRUMENTS

Counter-cyclical capital buffer (CCB)	The CCB is part of the Basel III framework. It requires an additional capital overlay to be applied, normally of up to 2.5 percent of risk-weighted assets. Higher capital holdings would increase the resilience of bank balance sheets to credit losses. The CCB might also moderate the credit cycle via upward pressure on bank funding costs. Banks would be given up to 12 months to raise the extra capital.
Adjustments to the minimum core funding ratio (CFR)	Adjustments to the CFR would vary the proportion of stable funding (retail deposits and long-term market funding) required relative to a bank's total lending. A CFR tightening would increase the resilience of banks to liquidity shocks. It could also lean against the credit cycle by increasing bank funding costs. Banks would be given up to six months' notice in which to meet an increase in the CFR.
Sectoral capital requirements (SCR)	Sectoral capital requirements are akin to the CCB and would require banks to hold extra capital against lending to a particular sector. An SCR would provide an additional cushion against credit losses in the relevant sector and could reduce the relative attractiveness of lending to that sector. Banks would be given up to three months' notice in which to raise the extra capital.
Restrictions on high loan-to-value ratio (LVR) residential mortgage lending.	Restrictions would generally take the form of 'speed limits' restricting the share of new bank lending that has a high LVR. Such restrictions would reduce the incremental risk in bank mortgage portfolios and would also have a direct effect on the supply of new bank credit, thus helping to moderate housing market pressures. Banks would be given at least two weeks' notice of any LVR restriction.

TABLE 2

THE YEAR IN REVIEW

PRUDENTIAL SUPERVISION



Refer Business Priority 2:

OPEN BANK RESOLUTION

All relevant banks to have pre-positioned IT and operating systems to enable Open Bank Resolution (OBR).

Refer Business Priority 3:

BASEL III

Implementation of the Basel III capital adequacy requirements for banks.

ENVIRONMENT

The New Zealand banking system has maintained the increase in profitability that occurred after 2009, aided by broad economic recovery, lower impaired asset expenses and higher net interest margins. This has enabled the banking system to increase the level of capital available to absorb future losses. Banks have also reduced their reliance on short-term wholesale funding, which is more subject to flight in times of stress. The Bank increased the regulatory minimum core funding ratio from 70 percent to 75 percent from 1 January 2013.

The NBDT sector has continued to reduce. In December 2012, Heartland Building Society became a registered bank, trimming the NBDT sector by one third in assets. Further consolidation of the NBDT sector looks possible once the Non-bank Deposit Takers Bill is passed by Parliament and NBDTs are subject to a new licensing regime.

The Canterbury earthquakes have continued to be a key focus for the insurance sector, predominantly around settling claims. New property insurance has become more available as firms have relaxed underwriting constraints imposed in the immediate aftermath of the earthquakes, although costs have risen. At the time of writing, the second phase of licensing, introduced by the Insurance (Prudential Supervision) Act 2010, is well under way with a September 2013 deadline for every continuing insurer to have a full licence.

New Zealand's financial market infrastructures have continued to operate effectively over the past year. In response to the major disruption to retail payments in April 2012, Payments NZ Limited has taken steps to better manage, if not avoid, similar incidents in the future. This event was the result of disruption to the exchange of payments between banks via SWIFT (the international communications services provider).

THE OBJECTIVE OF THE PRUDENTIAL SUPERVISION FUNCTION IS:

To register and supervise banks, license and supervise insurers, regulate non-bank deposit takers, oversee payment and settlement systems, and undertake policy development in all these areas. The Bank takes these actions to promote a sound and efficient financial system, and to limit damage to the system that could arise from institutional failure or other financial system distress. Actions will be relevant to New Zealand, with a cost-effective balance between regulatory requirements and self- and market discipline.

IN OUR 2012–15 *STATEMENT OF INTENT*, WE UNDERTOOK TO DELIVER THE FOLLOWING:

OUTCOME

- A sound and efficient financial system in New Zealand.
- International and local confidence in New Zealand's financial system.

INITIATIVES AND STRATEGIES

- Enhance the Bank's monitoring of risks to bank balance sheets and profitability.
- Ensure all relevant banks have pre-positioned IT and operating systems to enable Open Bank Resolution.
- Continue to monitor funding market conditions with a view to raise the Core Funding Ratio to 75 percent on 1 January 2013.
- Continue implementing regulations for the non-bank deposit taker sector, and review the effectiveness of these by the end of the financial year.
- Initiate the licensing process for non-bank deposit takers (assuming enactment of the Non-Bank Deposit Takers Bill in 2012).
- Finalise the Bank's Basel III capital adequacy standards and oversee the implementation of these standards by locally incorporated New Zealand banks.
- Further refine our crisis preparedness, focusing on coordination with other, particularly trans-Tasman, financial regulators.
- Monitor the financial soundness of all insurers as they move from provisional to full licensing by September 2013, and Canterbury earthquake claims develop and are settled.
- Develop and implement the AML/CFT supervisory regime.

AND OUR PERFORMANCE WOULD BE MEASURED BY:

KEY PERFORMANCE INDICATORS

- The bank, non-bank deposit taker and insurance regulatory regimes, and in particular the regulatory changes implemented during the year, promote the soundness and efficiency of the financial system in a cost-effective manner, as demonstrated by sound regulatory impact analysis.
- The prudential oversight function for banks, non-bank deposit takers, insurance companies and payment systems shows: vigilance in its monitoring activities; it is capable of identifying emerging financial stresses in a timely manner; and it is prepared, where necessary, to effectively resolve institutional failures in conjunction with government.
- The Bank demonstrates a consultative and transparent approach to its policy development, supported by robust analysis that is understood by regulated institutions and stakeholders.
- In its decisions on whether to grant licences to new applicants, the Bank takes a consistent approach within the legislative framework, without successful challenges.
- The *FSRs* provide a comprehensive assessment of the health of the New Zealand financial system.

HOW WE PERFORMED – INITIATIVES AND STRATEGIES

The Bank has continued to enhance its monitoring of risks to bank balance sheets and profitability. This is enabled by the collection of prudential data that allows analysis of banks' own risk reporting, complementing publicly disclosed information, and enables more frequent and timely assessment of the condition of individual banks and of the sector.

The Bank released a consultation paper aimed at improving the quality of data used in policy and decision making, enhancing the efficiency of the Bank's data collection, and reducing the overall reporting load placed on registered banks. The Bank has also increased the frequency and breadth of its prudential engagement with registered banks this year.

As at 30 June 2013, all registered banks subject to the Open Bank Resolution policy – that is, all locally incorporated registered banks with retail deposits over one billion dollars – had pre-positioned their IT and operating systems to enable the operation of the Open Bank Resolution policy. These registered banks are now subject to revised Conditions of Registration that require ongoing compliance with the pre-positioning policy.

The Non-bank Deposit Takers Bill has passed through Select Committee and is expected to pass into law in 2013. The Bank is required to complete a review of the regime by September 2013, and has been undertaking that review in 2013, which includes extensive stakeholder consultation.

Although the Non-bank Deposit Takers Bill is still before Parliament, the Bank has designed licensing processes and procedures that will be available when it is enacted.

Locally incorporated registered banks are now operating under new capital adequacy requirements, which the Bank finalised during the year. From 1 January 2013, the following minimum capital ratios, measured in relation to risk-weighted assets, applied:

- A Common Equity Tier 1 capital ratio of 4.5 percent;
- A Tier 1 capital ratio of 6 percent;
- A total capital ratio of 8 percent.

From 1 January 2014, a bank that does not maintain a common equity buffer (known as the 'conservation buffer') of 2.5 percentage points above these minimum ratios will face restrictions on the distributions it can make.

The Bank implemented stage one of a review of bank capital adequacy requirements for residential mortgage loans, with the new requirements taking effect from 30 September 2013. On 8 May 2013, the Bank announced it would increase the capital adequacy requirements for high LVR residential mortgage loans of the large banks that are permitted to use internal models to calculate capital adequacy levels. The Bank considers this is necessary to give sufficient weight to the systemic risk that such loans present.

The Bank has continued its engagement with both New Zealand and Australian financial authorities to advance arrangements for managing a trans-Tasman banking crisis.

Monitoring of insurers has commenced, using information required by licence conditions. Information such as solvency returns has helped inform full licensing decisions, including the quantification of additional capital requirements in some cases.

The Bank developed procedures, processes and templates that will be used from 30 June 2013 in the execution of the Anti-Money Laundering and Countering Financing of Terrorism (AML/CFT) supervisory programme. The Bank worked closely with the other AML/CFT supervisors in the lead-up to the commencement of supervision to ensure that approaches to supervision are broadly consistent.

HOW WE PERFORMED – KEY PERFORMANCE INDICATORS

The *FSRs* provide a comprehensive assessment of the health of the New Zealand financial system.

Regulatory changes for the bank, NBDT and insurance regulatory regimes were implemented during the year in a manner that promotes the soundness and efficiency of the financial system in a cost-effective manner. The regulatory regimes mitigate risk within each sector, while minimising compliance costs. The Bank has a rigorous approach for each of its regulatory regimes, including regulatory impact assessments. An example of this is the regulatory impact assessment of Basel III capital requirements in New Zealand, where the cost-benefit analysis showed that moving to Basel III capital ratios was justified, while ensuring the cost of compliance was not unduly burdensome.

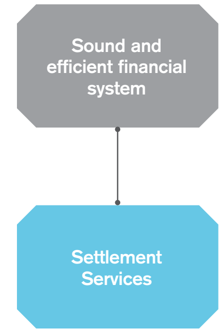
The Bank continues to exercise prudential oversight of banks, NBDTs, insurance companies and payment systems to provide early warning of emerging financial stresses. It has maintained a high degree of active engagement with New Zealand's financial institutions, payments systems and stakeholders throughout the year. The Bank continues to emphasise the importance of a consultative and transparent approach to its supervision – as illustrated on our website – in order to encourage wide acceptance of a robust framework of rules.

The Bank has also had significant engagement with stakeholders in policy development in relation to its Prudential Supervision function.

The Bank has designed licensing processes and procedures for the NBDT and insurance sectors that are consistent across legislative frameworks and ensure that any challenges are unlikely to be successful. While the Non-bank Deposit Takers Bill is still before Parliament, the implementation of the Insurance (Prudential Supervision) Act 2010 continued on track with 64 full licences issued as at 30 June 2013, and 41 full licence assessments by the Bank significantly progressed and to be completed by September 2013.

THE YEAR IN REVIEW

SETTLEMENT SERVICES



THE SETTLEMENT SYSTEM

The Bank provides specialised financial services, mainly to financial institutions. These services comprise operation of the Exchange Settlement Account System (ESAS) and operation of the NZClear securities settlement system.

Most major financial institutions have a New Zealand dollar cash account with the Bank. These are known as exchange settlement accounts, and those financial institutions use those accounts, which comprise the ESAS system, to make payments to each other in real time.

ESAS is a designated payment system under the Reserve Bank Act. Once a payment has been processed in ESAS, it cannot be reversed. This provides certainty to the recipients of those payments, which is important since typically $25 billion or more is paid through this system each day.

One of the account holders in ESAS is Continuous Linked Settlement Bank (CLS). CLS is an international institution that processes the majority of foreign exchange payments made in major economies. By making payments through CLS, financial institutions can achieve simultaneous settlement of both legs of foreign exchange transactions.

When the CLS service is used, it eliminates settlement risk for foreign exchange transactions – the risk that one party makes a payment to purchase or sell one currency, but the other party fails to meet its obligation to pay the other currency.

NZClear allows buyers and sellers of securities to settle transactions efficiently and securely. The system provides for buyers of New Zealand dollar-denominated equities and bonds to receive those securities at the same time as payment of cash is made for those purchases. Each transaction is settled individually – there is no netting of obligations.

NZClear also allows financial institutions to make payments of cash to each other. Once a settlement is effected in NZClear, the NZClear Rules provide that the settlement may not be reversed.

The Bank administers securities on behalf of members of the NZClear system, with a value totalling more than $167 billion, and each day settlements with a value totalling more than $7 billion are made by members of NZClear. ESAS and NZClear, together with CLS, provide certainty to financial institutions in processing their high-value transactions. This is particularly important during periods of financial instability.

BOX 3

THE OBJECTIVE OF THE SETTLEMENT SERVICES FUNCTION IS:

To ensure that payments system infrastructure services support the functioning of the economy, are provided efficiently and reliably, and meet international standards.

IN OUR 2012–15 *STATEMENT OF INTENT*, WE UNDERTOOK TO DELIVER THE FOLLOWING:

OUTCOME

An efficient, reliable and secure payments system that supports the smooth functioning of the economy.

INITIATIVES AND STRATEGIES

- Continue to enhance NZClear and ESAS as agreed with industry, including replacement of the hardware.
- Working together with industry participants to improve the operation of New Zealand's clearing and settlement infrastructure.

AND OUR PERFORMANCE WOULD BE MEASURED BY:

KEY PERFORMANCE INDICATORS

- Availability of ESAS/NZClear during core hours is at least 99.95 percent, as measured over a year.
- Customer satisfaction with operations and with system development is demonstrated through an annual customer survey in which an approval level of 90 percent or more is achieved.
- All risks are well managed, as demonstrated by external audits for ESAS and NZClear.
- International standards for payment and settlement systems (CPSS and IOSCO)[9] are complied with, subject to variations for local New Zealand conditions.

HOW WE PERFORMED – INITIATIVES AND STRATEGIES

On 4 October 2012, NZClear became a designated settlement system under the Reserve Bank Act. Designation provides statutory backing to the NZClear Rules and provides additional legal certainty to settlements effected through NZClear.

We installed replacement hardware for the payment systems. With this hardware upgrade, the ESAS and NZClear systems are more resilient because there are multiple physical system environments to ensure continuous service in the event of a major system failure, natural disaster or other disruption to processing.

9. Committee on Payment and Settlement Systems; and the International Organisation of Securities Commissions.

Significant work has been put into negotiating contractual relationships with the vendor that provides software support and development services for NZClear and ESAS. The objective is to ensure that the highest quality of services is provided. Costs will increase and members have been advised of new tariffs that will be applied.

HOW WE PERFORMED – KEY PERFORMANCE INDICATORS

Tables 3–5 set out key statistics for the operation of ESAS and NZClear. Since the introduction of Settlement Before Interchange (SBI) in early 2012, the number of transactions passing through ESAS each day has increased, although the daily average value of all transactions passing through ESAS has continued to decline. This decline is consistent with similar trends in other countries' main settlement systems.

Transaction volumes passing through NZClear have increased markedly, reflecting higher volumes of equities traded across the New Zealand stock exchange during the year. The system was available to users 99.85 percent of core hours, which was under the target of 99.95 percent. Approximately one-third of system down-time for the year related to one incident in April 2013, when connectivity for internet users was lost. The balance of down-time arose from issues that, individually, were resolved after a brief period and generally related to elements of the system (rather than the entire system) being unavailable. A thorough post-incident follow-up process occurs after each incident to ensure the root cause is understood and actions, such as systems or process changes, are agreed and implemented. In the annual customer survey, users of ESAS and NZClear have continued to report very high levels of satisfaction. In 2013, the satisfaction rating was 100 percent (2012: 100 percent).

On the Auditor-General's behalf, PricewaterhouseCoopers undertakes reviews of the NZClear system. Under the NZClear Rules, the external auditor performs an audit of the internal controls for NZClear once each year, and each quarter PricewaterhouseCoopers performs a review of the Bank's securities reconciliation processes for NZClear. Also once each year, the auditor performs an external audit of the internal controls for ESAS. All external audit reports are reviewed by the Bank's Audit Committee. All opinions expressed by PricewaterhouseCoopers were unmodified. Improvements designed to enhance the management of risk associated with operating these systems are made on a regular basis. The Bank is in the process of completing a self-assessment of compliance with new international standards for payments and settlements systems. This will be published on the Bank's website once it has been completed.

KEY ESAS STATISTICS	2009	2010	2011	2012	2013
Average daily transaction volumes	7,156	6,929	7,383	8,518	**9,411**
Average daily transaction values	$36.8bn	$28.6bn	$26.6bn	$25.1bn	**$24.7bn**

TABLE 3

KEY NZCLEAR STATISTICS	2009	2010	2011	2012	2013
Average daily transaction volumes	973	899	854	963	**1,029**
Average daily transaction values	$6.8bn	$7.0bn	$7.6bn	$8.9bn	**$7.9bn**

TABLE 4

KEY ESAS-NZCLEAR STATISTICS	2009	2010	2011	2012	2013
ESAS-NZClear System availability during core hours	99.77%	99.93%	99.91%	99.94%	**99.85%**

TABLE 5

THE YEAR IN REVIEW

CURRENCY

Legal tender meets currency needs of the public

Currency Operations

Refer Business Priority 4:

BANKNOTE UPGRADE

Determination of the detailed specifications for the new series of banknotes.

CURRENCY OPERATIONS

The Bank meets the currency needs of the public by arranging the procurement, secure storage and issue of New Zealand banknotes and coins, as well as maintaining the quality, and verifying the authenticity, of currency in circulation.

Cash remains an important means of undertaking transactions in New Zealand. The value of currency in circulation grew by 5.3 percent to $4.61 billion in the year to 30 June 2013. Over the 10 years to June 2013, currency in the hands of the public rose by 75.3 percent.

THE OBJECTIVE OF THE CURRENCY FUNCTION IS:

To meet the currency needs of the public by ensuring, as the sole issuer of currency, the supply and integrity of banknotes and coins.

IN OUR 2012–15 *STATEMENT OF INTENT*, WE UNDERTOOK TO DELIVER THE FOLLOWING:

OUTCOMES

- Legal tender that meets the currency needs of the public.

INITIATIVES AND STRATEGIES

- Further develop and fully utilise the new Currency Management System for the efficient and secure management of currency operations.
- Continue planning for the development of a new banknote series.
- Review and implement any changes to the levels and location of contingency currency reserves.

AND OUR PERFORMANCE WOULD BE MEASURED BY:

KEY PERFORMANCE INDICATORS

- All orders for notes and coins from banks that meet the Reserve Bank's guidelines are supplied within agreed times.
- Notes and coins in general circulation are of a good quality as indicated by surveys of the condition of currency in circulation.
- The number of counterfeit notes in circulation should be fewer than 10 per million notes in circulation.

HOW WE PERFORMED – INITIATIVES AND STRATEGIES

The Bank's recently installed Currency Management System has delivered more detailed management reporting and process mapping, which will be used to identify process improvements and prepare the site for the increased volumes of notes expected after the release of the new banknote series.

The project established to issue the new series of banknotes (Series 7) is tracking to key milestones with detailed technical and design specifications completed. The process for procurement of the banknotes is being progressed. The Bank continues to liaise with key stakeholders to ensure that respective planning timelines can be accommodated.

The Bank evaluated several options for the levels and location of reserves to strengthen its capability to deliver cash in the event of a significant disaster.

HOW WE PERFORMED – KEY PERFORMANCE INDICATORS

During 2012-13, the Bank received 1179 orders for currency for a total value of $1,895 million. The Bank met all these orders on schedule and in the denominations requested.

While there were no quality surveys undertaken in 2012, prior to the issue of the new Series 7 banknotes the Bank scheduled for September 2013 a nationwide survey of notes in circulation to provide a baseline for note quality using international benchmarks.

The number of counterfeit banknotes in New Zealand remains low by international standards. In the 2012-13 year, there were 141 counterfeits found in circulation by the Bank, cash-in-transit companies, banks and the Police. This represented 0.7 counterfeits per million notes in circulation. This was well below the upper limit of 10 specified in the key performance indicator.

THE YEAR IN REVIEW

OPERATIONS

OPERATIONS

- Human Resources
- Knowledge Services
- Financial Services
- Communications
- Risk Assessment and Assurance
- Property and Security

OPERATIONS

HUMAN RESOURCES

Management development is a high priority for the Bank and forms a critical part of the Bank's long-term strategy to strengthen its capability and performance. The Bank has developed a comprehensive set of management competencies that will be used as the foundation for future leadership development programmes and for individual manager development. A strong focus on the performance and development of staff in the Bank is a priority for managers, and compensation for managers is differentiated by their management performance.

During the year, managers attend individually targeted developmental training, while potential leaders participate in programmes aimed at preparing them for management roles. All staff have the opportunity to attend relevant training and undertake assignments or projects to develop and enhance their skills and experience.

The Bank has introduced a mentoring programme for early-in-career women to enhance their development with the long-term prospect of increasing the number of women in leadership roles at the Bank.

A focus on strategy and ongoing improvements to internal department structures has resulted in more focused teams and clearer links to Bank objectives for individuals.

REMUNERATION

STAFF

The Bank spent $30 million on personnel in 2012-13. This included all forms of remuneration, direct expenditure on training, and redundancy payments. Table 7 shows the number of staff who received over $100,000 in total remuneration[11], in bands of $10,000.

REMUNERATION IN 2012-13

TOTAL REMUNERATION	Staff numbers 2013
100,000 to 109,999	25
110,000 to 119,999	17
120,000 to 129,999	20
130,000 to 139,999	3
140,000 to 149,999	8
150,000 to 159,999	8
160,000 to 169,999	4
170,000 to 179,999	7
180,000 to 189,999	5
190,000 to 199,999	5
220,000 to 229,999	5
240,000 to 249,999	2
260,000 to 269,999	2
270,000 to 279,999	1
290,000 to 299,999	1
300,000 to 309,999	1
340,000 to 349,999	1
420,000 to 429,999	1
470,000 to 479,999	1
Total staff receiving $100,000 or more	**117**

TABLE 7

HUMAN RESOURCE STATISTICS[10]	2008	2009	2010	2011	2012	2013
Total staff at 30 June (FTE)	223	237	243	250	250	**258**
Average years of service at 30 June	7.6	7.6	7.9	8.0	8.8	**8.3**
Annual staff turnover	17.4%	9.3%	12.5%	12.4%	13.7%	**15.1%**

TABLE 6

10. Increased staff numbers in 2008–11 were due to the Bank's expanded Prudential Supervision function. The 2011 increase relates mostly to the establishment of the Bank's Auckland office.
11. Total remuneration includes the annual cost to the Bank of all elements of contracted remuneration (salaries, any benefits provided, fringe benefit tax, superannuation), plus any bonuses or redundancy payments. The information in table 7 sets out the amount unconditionally earned during the financial year. The remuneration of the Governor is set by the Minister of Finance after receiving a recommendation by the Board's non-executive directors, who also determine the remuneration of the Deputy Governors. The Bank's remuneration policy is to pay all staff on the basis of performance on the job, while having regard to prevailing market conditions based on salary surveys and assessments made by an independent remuneration consultant.

NON-EXECUTIVE DIRECTORS' REMUNERATION

Non-executive directors' remuneration consists of directors' fees. All remuneration paid to non-executive directors is included in the following table. There are no fees paid to the Governor, who is an executive director of the Bank.

Current fees for Board members are as follows:

- The Chair is paid $51,000.
- The Deputy Chair is paid $31,875.
- Non-executive directors are paid base fees of $25,500.

The Board is also entitled to pay additional fees at its discretion from a pool of $20,000 approved by the Minister. The current payments are as follows:

- $6000 to the Chair of the Audit Committee
- $2000 each to two directors who serve on the Audit Committee
- $6000 to one director who provides an assessment of the *MPS*
- $2000 to one director who provides an assessment of the *FSR*.

FEES PAID NON-EXECUTIVE DIRECTORS	2012 $	2013 $
A Grimes (Chair)	51,000	**51,000**
R Carr	0	**24,461**
C Eichbaum	27,500	**27,500**
H Fletcher	35,690	**0**
N Quigley	31,500	**31,500**
S Sheldon (Deputy Chair)	27,870	**33,875**
K Taylor	27,730	**31,500**
K Vautier	27,500	**27,500**
TOTAL	228,790	**227,336**

TABLE 8

On 16 July 2012, Dr Rod Carr replaced Hugh Fletcher, whose term expired on 9 June 2012.

KNOWLEDGE SERVICES

Over the past year, the Knowledge Services Group has focused on providing a modern technology platform, high levels of uninterrupted service, functionality, and access to a broad range of relevant information sources.

This work has included an update of our office technology and internal network, and enhancing resiliency, connectivity and disaster recovery arrangements between the Auckland and Wellington offices. The Bank's website was refreshed to better meet user needs. The Programme Management Office was reviewed to strengthen project management capabilities within the Bank, and consistency across all projects.

Over the year, a number of our information management services have been reviewed to ensure the accuracy, timeliness and completeness of information that is key to fulfilling the Bank's goals.

The Knowledge Services Group has also provided information technology and project management support for the Foreign Reserves Management Benchmarking project (see page 21).

INTERNAL FINANCIAL SERVICES

In early 2013, the Bank changed the reporting from the Bank's core treasury system to implement the new benchmarking of performance of the Bank's foreign reserves management function.

The Bank continued to enhance its financial management information system, substantially completing the development of a forecasting facility for reporting to the Crown that will come into effect in the third quarter of calendar 2013.

From 1 July 2014, the Bank will be required to adopt a new financial reporting regime. As a Public Benefit Entity, the Bank will be required to apply Public Benefit Entities International Public Sector Accounting Standards (PBE IPSAS) rather than New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS). Preliminary evaluation of the new standards indicates that, at the time the changes take effect, the impact of this change in the Bank's financial reporting will be immaterial. However, PBE IPSAS and NZ IFRS are expected to diverge over time and the gap between these standards could become significant.

The Bank is of the view that NZ IFRS rather than PBE IPSAS results in financial reporting of the Bank's business that better meets users' needs. Despite submissions made by the Bank to the External Reporting Board (XRB), the XRB has determined that all Public Benefit Entities (including the Bank) must apply PBE IPSAS from 1 July 2014.

COMMUNICATIONS

Following a review during the year, the Bank has adopted a strategy to broaden its communications to build understanding of, and support for, its roles, policy decisions, decision-making framework, governance and tools. This involves a larger programme of on-the-record speeches and stakeholder engagements, and making use of videos, traditional mainstream media as well as interactive web, social and emerging media.

Through this programme, the Bank seeks to explain its roles and what it can and cannot be expected to do across its functions.

In line with this strategy, in 2012-13 the Bank delivered 15 on-the-record speeches, 11 in the second half-year alone, compared with 10 such speeches in 2011-12. A total of 60 news releases were published in 2012-13 (40 in 2011-12). The Bank maintained an extensive off-the-record speech programme, as in previous years.

RISK ASSESSMENT AND ASSURANCE

Refer Business Priority 5:

RISK MANAGEMENT AND ASSURANCE

Implementation of a new operating model for risk management and assurance.

During 2012-13, the Bank adopted a new operating model for risk management and assurance. This was one of the Bank's business priorities for the year and has led to broad enhancement across the risk and assurance function.

A refreshed internal audit plan for 2012–13 was developed at the outset of the year to provide comprehensive coverage of risk management of the Bank's control environment. This was undertaken as planned and any material issues arising were reported to the appropriate level of management.

During the year, enhanced enterprise risk management practices were embedded across the Bank. This has increased our capability to identify and manage risk in a proactive, coordinated, prioritised and cost-effective manner.

The Bank continues to make extensive use of services provided by in-house legal counsel in support of all its functions. At year end, a continuous improvement review was being completed to ensure the high-quality legal advice and services that the Bank accesses continue to adapt to the future needs of the Bank.

PROPERTY / SECURITY

The Bank maintains its own building in Wellington, and leases a small office in Auckland that provides business continuity services. The Bank also manages security operations to ensure it has secure and appropriate accommodation at both sites.

Projects undertaken during the year included the upgrading of the Bank's passenger and goods lift control system, boiler renovations, and updating of floors. The Bank continues to seek improvements in building energy and security.

INTERNATIONAL ACTIVITIES

The Reserve Bank regularly engages with a wide range of international organisations, central banks, prudential regulators and other foreign organisations in order to further the work of the Bank.

The Bank continues its engagement with EMEAP (Executive Meeting of East Asia Pacific) central banks and monetary authorities. The Bank for International Settlements (BIS) continues to be an active partner for liaison across macro-prudential, micro-prudential, monetary policy and other central banking issues globally, with a range of activities specific to the Asia-Pacific region and focused on the concerns of small open economies like New Zealand's. The Bank learns from these engagements, and also promotes New Zealand's interests through a number of direct relationships, including interaction with the IMF constituency office and secondment of Bank staff to the IMF, BIS and other relevant organisations. The Reserve Bank also maintains formal and informal relationships across the global central banking and regulatory communities.

In the South Pacific area, the Bank plays a significant role through its involvement with the South Pacific Governors' annual meeting and collaboration with PFTAC (Pacific Financial and Technical Assistance Centre). This year, our work with the South Pacific has focused on determining the feasibility of sharing the Bank's statistical survey management system with Pacific central banks. We have been working closely with the Central Bank of the Solomon Islands on a deployment of the system that will begin in August 2013 and run for three months.

OUR FINANCIAL STATEMENTS

AN OVERVIEW

KEY FINANCIAL STATISTICS FOR 2012–13 ARE:

	2013 $m	2012 $m
Net profit[12]	**308**	118
Net operating expenses[13]	**48.3**	47.0
Dividend payment to government	**175**	160
Total equity[14]	**2,572**	2,602
Total assets	**24,082**	26,744
Foreign reserves intervention capacity	**9,097**	8,920

TABLE 9

12. After accounting revaluations due to changes in foreign exchange and interest rates.
13. Net operating expenses stated in this table exclude actuarial gains and losses on the Bank's defined benefit superannuation scheme. Actuarial gains and losses are not included in net operating expenses subject to the Funding Agreement.
14. After provision has been made for dividend payment.

NET PROFIT

KEY COMMENTS

- Net profit was $308 million in 2013.
- Net interest (underlying) income was lower than in 2012 because interest rates in New Zealand and overseas were lower.
- Foreign exchange gains were a result of lower foreign exchange rates for the New Zealand dollar at the end of June 2013 on holdings of unhedged foreign reserves.
- Reported gains from changes in the market value of financial instruments were due to lower interest rates both in New Zealand and overseas.

BACKGROUND

The Bank, like other central banks, has a balance sheet structure and resulting financial performance that reflect its statutory functions and decisions about how these functions are carried out. The Bank's balance sheet is managed to efficiently meet the Bank's policy objectives rather than to maximise profit.

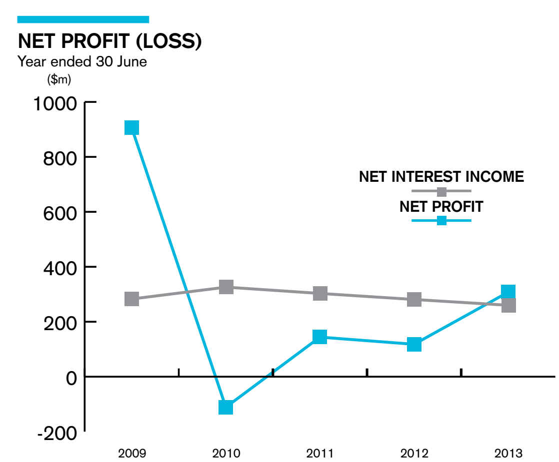
The Bank has an underlying income stream from interest it receives from holdings of New Zealand government bonds and foreign reserve assets, which are funded by the Bank's issuance of notes and coins and its equity.

Financial performance also reflects changes in both global and domestic interest rates and changes in foreign exchange rates. Central banks that, like the Reserve Bank, have an unhedged foreign exchange position can expect more volatile earnings. Therefore, as previously signalled, the Bank's reported profit can be expected to vary considerably from year to year.

During the past year, the Bank implemented a new performance benchmark for its holdings of foreign reserve assets and changed the composition of its holdings. Most foreign assets comprise securities issued by sovereign governments, quasi-government entities and supranational entities, all of which have investment-grade credit ratings. The average duration of foreign reserve assets moved from 0.4 years to 0.7 years, which represents a modest increase in interest rate risk. However, as these securities are liquid, they are able to be disposed of quickly should circumstances require.

Income	2013 $m	2012 $m
Net interest income	**260**	280
Foreign exchange gains (losses)	**29**	(38)
Gains (losses) from changes in the market value of financial instruments	**65**	(73)
Other investment income	**2**	2
Net investment income	**356**	171
Other operating income	**9**	8
Total income	**365**	179
Total operating expenses	**57**	61
Net profit	**308**	118

TABLE 10



NET OPERATING EXPENSES

KEY COMMENTS

- Total operating expenses (excluding actuarial gains and losses on the Bank's defined benefit superannuation scheme) were $57.1 million, an increase of $2.1 million from 2012.
- Net operating expenses (being operating expenses less income such as rentals and fees charged for providing payment system services) were $48.3 million, $4.4 million below the level provided for in the Funding Agreement for the 2013 year. Aggregate spending for the three years to June 2013 was $8.6 million less than the amount provided in the Funding Agreement for that period.
- Other operating expenses were higher than in 2012 due to investment in technology and professional services costs. These higher costs were offset in part by lower custody expenses for financial assets.
- Technology costs related to improvements in system resilience and security. Professional service costs related to the policy development programme and implementation of insurance licensing.
- Lower asset custody expenses resulted from the Bank holding more cash and fewer securities than normal due to market conditions.

Net operating expenses in relation to the Funding Agreement	2013 $m	2012 $m
Staff expenses	**29.6**	28.4
Net currency-issued expenses	**5.6**	5.2
Asset management expenses	**6.2**	6.4
Other operating expenses	**15.7**	15.0
Total operating expenses excluding actuarial loss (gain) on defined benefit superannuation scheme	**57.1**	55.0
Income from operations	**8.8**	8.0
Net operating expenses	**48.3**	47.0
Net operating expenses specified in the Funding Agreement	**52.7**	50.2
Funding Agreement under-expenditure	**4.4**	**3.2**

TABLE 11

DIVIDEND PAYMENT TO GOVERNMENT

KEY COMMENTS

- The dividend payment to government for the 2013 financial year will be $175 million.
- Realised earnings of $100 million were retained to ensure the Bank holds sufficient equity for the risks it manages in performing its functions.

BACKGROUND

The dividend has been determined in accordance with the dividend principles on page 9.

The dividend is not directly related to net profit, due to the timing of the realisation of revaluation gains and losses arising from changes in foreign exchange rates and interest rates.

An unusually large dividend was paid in 2009 when substantial foreign exchange gains were realised. Since that time, the Bank's earnings available for distribution have been lower, mainly due to lower interest rates feeding through to lower interest earnings, and also because of the overall appreciation of the New Zealand dollar, which results in reported losses on foreign exchange.

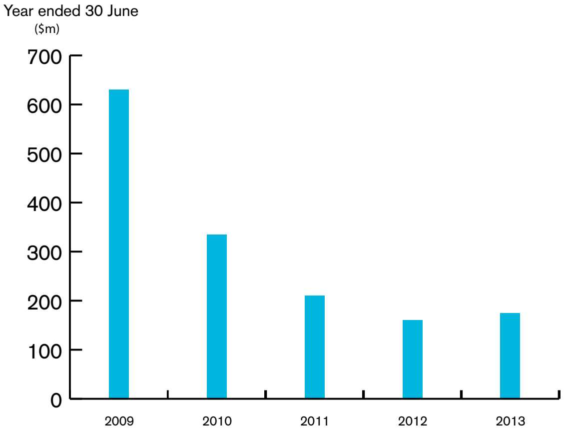
The 2013 dividend is lower than reported net profit because net profit includes unrealised gains from changes in foreign exchange and interest rates and also because the Bank retained a portion of its realised earnings in order to increase its equity. During the year, the Bank reviewed the model used to quantify its financial risks and to determine its required level of equity. In addition to updating the capital modelling methodology, the revised model takes into account data observations generated during the global financial crisis. As a result, the Bank has determined that its revised assessment of financial risk warrants a slightly higher level of equity and this recommendation was accepted by the Board and Minister. The higher equity level has been achieved by retaining $100 million of realised earnings and distributing $175 million of realised earnings.

In general, the Bank will distribute gains from changes in foreign exchange rates and interest rates only once they have been realised.

	2013 $m	2012 $m
Equity	**2,572**	2,602
Dividend payment to government	**175**	160

TABLE 12

DIVIDEND PAYMENT TO GOVERNMENT
Year ended 30 June



TOTAL ASSETS

KEY COMMENTS

- Total assets were $24.1 billion at 30 June 2013.
- The reduction in assets in 2013 was due to a decrease in deposits placed with the Bank by the New Zealand government, reflecting a substantial payment made by the government upon the maturity of government stock in April 2013.
- The slight reduction in equity resulted from a mix of retained net profit, the dividend payment to government and a reversal of unrealised revaluation gains on designated financial assets reported directly in equity.

BACKGROUND

The size and composition of the Bank's balance sheet is primarily determined by the public's demand for notes and coin, the level of deposits placed with the Bank by the New Zealand government, the amount of cash held at the Bank to facilitate daily interbank payments, and the amount of foreign reserves the Bank holds to maintain its foreign reserves intervention capacity and the means of funding these reserves.

The Bank holds foreign currency assets that are both liquid and of high credit quality, comprising mainly government and near-government securities.

The Bank has a policy of holding some of its foreign reserves on an unhedged basis. An unhedged foreign exchange position means that the Bank's foreign assets and liabilities are not exactly matched or 'hedged' but allows the Bank to sell foreign currency outright without having to later purchase or borrow foreign currency. This allows the Bank to deliver a more effective response in the event of a crisis affecting the county's foreign exchange market and to lean against more extreme exchange rate movements.

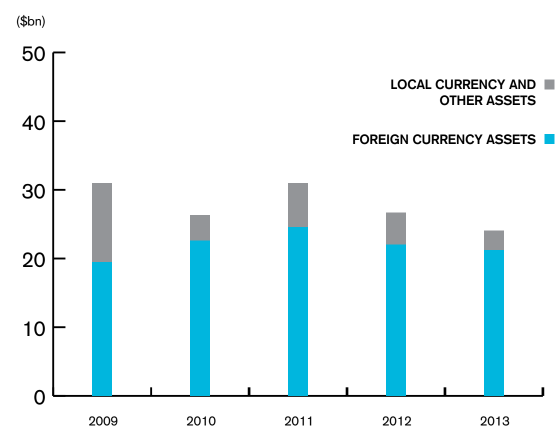
This policy means that changes in exchange rates will have more impact on the Bank's profit than if its foreign reserves were completely hedged. Movements in foreign currency exchange rates might, therefore, result in valuation gains or losses.

The change in reported equity includes the following elements: net profit for the year, deduction of the dividend to be paid for the year and revaluations of certain assets that are recorded directly in equity rather than being included in net profit. Revaluation gains and losses on assets designated by the Bank as "Available for Sale" are reported directly in equity. Assets designated as "Available for Sale" include the Bank's holdings of New Zealand government bonds and its investment in the Bank for International Settlements. Revaluations of the Bank's Wellington building are also recorded directly in equity.

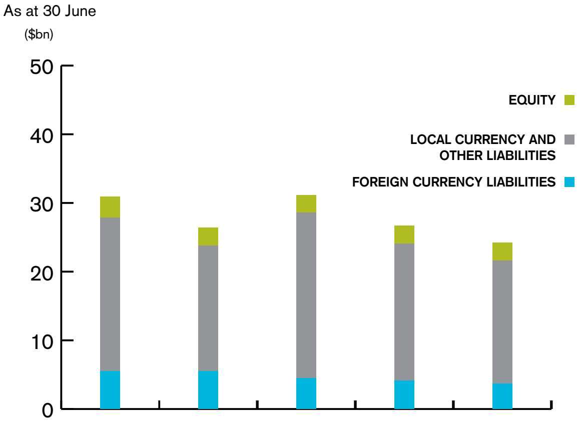
Financial position as at 30 June	2013 $m	2012 $m
Assets:		
Foreign currency financial	**21,163**	21,971
Local currency financial	**2,844**	4,695
Other assets	**75**	78
Total assets	**24,082**	26,744
Liabilities and equity:		
Foreign currency financial	**3,657**	4,129
Local currency financial	**13,058**	15,466
Currency in circulation	**4,609**	4,375
Other liabilities	**186**	172
Equity	**2,572**	2,602
Total liabilities and equity	**24,082**	26,744

TABLE 13

LOCAL AND FOREIGN CURRENCY ASSETS
As at 30 June



LOCAL AND FOREIGN CURRENCY LIABILITIES AND EQUITY
As at 30 June



FOREIGN RESERVES INTERVENTION CAPACITY

KEY COMMENTS

- The Bank continued to hold an unhedged position above its long-term benchmark of SDR[15] 1 billion. At 30 June 2013, the unhedged position was SDR 1.36 billion (equivalent to approximately NZD 2.6 billion).
- Foreign reserves intervention capacity increased slightly to $9.0 billion.

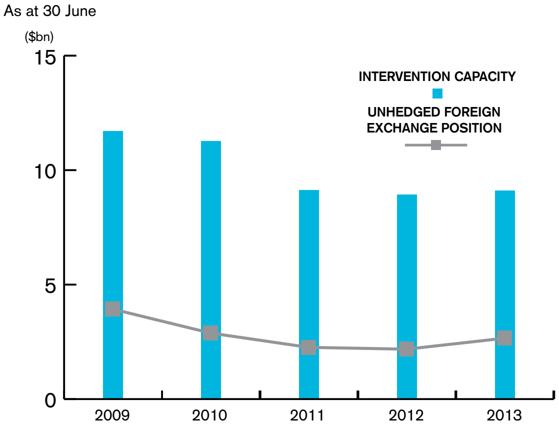
BACKGROUND

The foreign reserves intervention capacity is the measure of the Bank's ability to quickly sell foreign currency and buy New Zealand dollars, should market conditions warrant such an action.

	2013 $m	2012 $m
Foreign reserves intervention capacity	**9,097**	8,920
Unhedged foreign exchange position	**2,625**	2,147

TABLE 14

FOREIGN RESERVES INTERVENTION CAPACITY AND UNHEDGED FOREIGN EXCHANGE POSITION
As at 30 June



15. Special Drawing Right – see Glossary, p88.

MANAGEMENT STATEMENT

RESERVE BANK
OF NEW ZEALAND
TE PŪTEA MATUA

21 August 2013

MANAGEMENT STATEMENT

Pursuant to section 165 of the Reserve Bank of New Zealand Act 1989, we hereby certify that:

1. We have been responsible for the preparation of the annual financial statements and for the judgements used in them.
2. We have been responsible for establishing and maintaining a system of internal controls designed to provide reasonable assurance as to the integrity and reliability of the Bank's financial reporting.
3. In our opinion, the annual financial statements for the year ended 30 June 2013 fairly reflect the financial position and operations of the Bank.

Governor

Deputy Chief Executive

2 The Terrace, Wellington 6011
PO Box 2498, Wellington 6140, New Zealand
Telephone +64 4 472 2029 Fax +64 4 473 8554

AUDIT REPORT

INDEPENDENT AUDITORS' REPORT

to the readers of the Reserve Bank of New Zealand and Group's Financial Statements for the year ended 30 June 2013

The Auditor-General is the auditor of the Reserve Bank of New Zealand and Group (the 'Bank'). The Auditor-General has appointed me, Chris Barber, using the staff and resources of PricewaterhouseCoopers, to carry out the audit of the financial statements of the Bank on her behalf.

We have audited the financial statements of the Bank on pages 46 to 86, that comprise the consolidated statement of financial position as at 30 June 2013, the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year ended on that date and the notes to the financial statements that include accounting policies and other explanatory information.

OPINION

In our opinion the financial statements of the Bank on pages 46 to 86:

- comply with generally accepted accounting practice in New Zealand; and
- fairly reflect the Bank's:
  - financial position as at 30 June 2013; and
  - financial performance and cash flows for the year ended on that date.

Our audit was completed on 21 August 2013. This is the date at which our opinion is expressed.

The basis of our opinion is explained below. In addition, we outline the responsibilities of the Governor and our responsibilities, and we explain our independence.

BASIS OF OPINION

We carried out our audit in accordance with the Auditor-General's Auditing Standards, which incorporate the International Standards on Auditing (New Zealand). Those standards require that we comply with ethical requirements and plan and carry out our audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

Material misstatements are differences or omissions of amounts and disclosures that, in our judgement, are likely to influence readers' overall understanding of the financial statements. If we had found material misstatements that were not corrected, we would have referred to them in our opinion.

An audit involves carrying out procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgement, including our assessment of risks of material misstatement of the financial statements whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the preparation of the Bank's financial statements that fairly reflect the matters to which they relate. We consider internal control in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.

AUDIT REPORT

pwc

An audit also involves evaluating:

- the appropriateness of accounting policies used and whether they have been consistently applied;
- the reasonableness of the significant accounting estimates and judgements made by the Governor;
- the adequacy of all disclosures in the financial statements; and
- the overall presentation of the financial statements.

We did not examine every transaction, nor do we guarantee complete accuracy of the financial statements. Also we did not evaluate the security and controls over the electronic publication of the financial statements.

We have obtained all the information and explanations we have required and we believe we have obtained sufficient and appropriate audit evidence to provide a basis for our audit opinion.

RESPONSIBILITIES OF THE GOVERNOR

The Governor is responsible for preparing financial statements that:

- comply with generally accepted accounting practice in New Zealand; and
- fairly reflect the Bank's financial position, financial performance and cash flows.

The Governor is also responsible for such internal control as he determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. The Governor is also responsible for the publication of the financial statements, whether in printed or electronic form.

The Governor's responsibilities arise from the Reserve Bank of New Zealand Act 1989.

RESPONSIBILITIES OF THE AUDITOR

We are responsible for expressing an independent opinion on the financial statements and reporting that opinion to you based on our audit. Our responsibility arises from section 15 of the Public Audit Act 2001 and section 166 of the Reserve Bank of New Zealand Act 1989.

INDEPENDENCE

When carrying out the audit we followed the independence requirements of the Auditor-General, which incorporate the independence requirements of the External Reporting Board.

In addition to the audit, we have carried out assignments in the areas of systems audits and controls compliance audits which are compatible with those independence requirements. Other than the audit and these assignments, we have no relationship with or interests in the Bank.

Chris Barber

Chris Barber
On behalf of the Auditor-General
Wellington, New Zealand

PricewaterhouseCoopers

PricewaterhouseCoopers

GUIDE TO THE MAIN FUNCTIONS OF THE RESERVE BANK

The Reserve Bank's role is defined by the Reserve Bank of New Zealand Act 1989 (the "Reserve Bank Act").

For the year ended 30 June 2013, the Bank classified its outputs according to its main functions in the ways described below.

MONETARY POLICY FORMULATION:

Developing monetary policy to achieve and maintain price stability in line with the Policy Targets Agreement.

DOMESTIC MARKET OPERATIONS:

Transacting with, monitoring and liaising with financial markets to manage aggregate liquidity in the New Zealand banking system. These actions are for the purpose of implementing monetary policy, facilitating payments and monitoring financial stability.

PRUDENTIAL SUPERVISION:

Registering and supervising banks, licensing and supervising insurers, regulating non-bank deposit takers, overseeing payment systems, and undertaking policy development in all of these areas. These actions are for the purpose of promoting a sound and efficient New Zealand financial system by limiting damage to the financial system that could arise from bank, non-bank deposit taker or insurer failure(s) or other financial system distress. Supervising banks, non-bank deposit takers and life insurers for compliance with their anti-money laundering obligations.

MACRO-FINANCIAL STABILITY:

Analysing and managing financial system risks to promote a sound and efficient system that supports the functioning of the economy.

CURRENCY OPERATIONS:

Maintaining the supply and integrity of legal tender currency to facilitate cash transactions in the community.

FOREIGN RESERVES MANAGEMENT:

Managing the Bank's foreign reserves held to support monetary policy objectives and the maintenance of orderly markets. This includes execution of foreign currency intervention activities.

SETTLEMENT SERVICES:

Providing New Zealand dollar settlement accounts to financial institutions and the New Zealand government and providing securities settlement and depository services, mainly to financial institutions.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 30 June	Note	2013 $M	2012 $M
ASSETS			
Foreign Currency Financial Assets			
Cash Balances		**3,947**	2,785
Securities Purchased under Agreements to Resell		**1,994**	4,566
Marketable Securities	3	**14,033**	12,780
Derivative Financial Assets	4	**1,003**	1,700
Other Foreign Currency Financial Assets	5	**186**	140
Total Foreign Currency Financial Assets		**21,163**	21,971
Local Currency Financial Assets			
Securities Purchased under Agreements to Resell		**25**	1,501
New Zealand Government Securities		**2,818**	3,193
Other Local Currency Financial Assets		**1**	1
Total Local Currency Financial Assets		**2,844**	4,695
Total Financial Assets		**24,007**	26,666
Other Assets	6	**75**	78
Total Assets		**24,082**	26,744
LIABILITIES			
Foreign Currency Financial Liabilities			
Short-term Foreign Currency Financial Liabilities	7	**551**	1,069
Securities Sold under Agreements to Repurchase		**639**	606
Derivative Financial Liabilities	4	**596**	306
Term Liabilities		**1,871**	2,148
Total Foreign Currency Financial Liabilities		**3,657**	4,129
Local Currency Financial Liabilities			
Deposits	8	**12,627**	15,262
Securities Sold under Agreements to Repurchase		**346**	119
Currency in Circulation		**4,609**	4,375
Other Local Currency Financial Liabilities	9	**85**	85
Total Local Currency Financial Liabilities		**17,667**	19,841
Total Financial Liabilities		**21,324**	23,970
Other Liabilities	10	**186**	172
Total Liabilities		**21,510**	24,142
EQUITY	12	**2,572**	2,602
Total Liabilities and Equity		**24,082**	26,744

The above statement is to be read in conjunction with the notes set out on pages 51 to 86 .
Derivative Instruments are used to manage the Bank's exposure to foreign currency risk. The effective foreign currency exposure as at balance date is recorded in Note 19.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Note	Capital $M	Available-for-Sale Reserve $M	Property, Currency and Artwork Collections Revaluation Reserve $M	Retained Earnings $M	Total $M
Equity as at 1 July 2011		1,600	217	47	645	2,509
Net Profit for the Year		-	-	-	118	118
Total Income and Expense Taken to Equity during the Year		-	136	(1)	-	135
Dividend Payable to the New Zealand Government		-	-	-	(160)	(160)
Equity as at 30 June 2012		1,600	353	46	603	2,602
Net Profit for the Year		**-**	**-**	**-**	**308**	**308**
Total Income and Expense Taken to Equity during the Year		**-**	**(163)**	**-**	**-**	**(163)**
Dividend Payable to the New Zealand Government	11	**-**	**-**	**-**	**(175)**	**(175)**
Equity as at 30 June 2013	12	**1,600**	**190**	**46**	**736**	**2,572**

The above statement is to be read in conjunction with the notes set out on pages 51 to 86.

CONSOLIDATED INCOME STATEMENT

For the year ended 30 June	Note	2013 $M	2012 $M
Interest Income		**584**	655
Interest Expense		**324**	375
Net Interest Income	22	**260**	280
Net Gains/(Losses) from Fair Value Changes		**65**	(73)
Net Gains/(Losses) from Foreign Exchange Rate Changes		**29**	(38)
Dividend Income		**2**	2
Total Net Investment Income	22	**356**	171
Other Income		**9**	8
Total Operating Income		**365**	179
Total Operating Expenses	24	**57**	61
Net Profit for the Year		**308**	118

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 30 June	Note	2013 $M	2012 $M
Net Profit for the Year from the Consolidated Income Statement		**308**	118
Items Recognised Directly in the Consolidated Statement of Comprehensive Income			
Movement in Available-for-sale Revaluation Reserve Taken to Equity	12	**(163)**	136
Movement in Property Revaluation Reserve Taken to Equity	12	**-**	(1)
Total Income and Expense Taken to Equity during the Year		**(163)**	135
Total Comprehensive Income for the Year		**145**	253

The above statements are to be read in conjunction with the notes set out on pages 51 to 86.

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 30 June	Note	2013 $M	2012 $M
CASH FLOWS FROM OPERATING ACTIVITIES			
Sources from Income			
Interest Received:			
Foreign Currency:			
Derivatives		**(20)**	(34)
Other		**25**	64
Local Currency:			
Derivatives		**357**	415
Available-for-sale Securities		**173**	195
Other		**62**	32
Dividend		**2**	4
Fees, Commission and Other Income Received		**9**	8
Total Sources of Cash Flows from Income		**608**	684
Disbursements for Expenses			
Interest Paid:			
Foreign Currency		**(3)**	6
Local Currency		**329**	367
Payments to Suppliers and Employees		**51**	48
Total Disbursements of Cash Flows from Expenses		**377**	421
Operating Cash Flows from Income and Expenses		**231**	263
Operating Cash Flows from Changes in Asset and Liability Balances		**890**	155
Net Cash Flows from Operating Activities	25	**1,121**	418
CASH FLOWS FROM INVESTING ACTIVITIES			
Sources			
Maturity of Available-for-sale Securities		**789**	919
Total Sources of Cash Flows from Investing Activities		**789**	919
Disbursements			
Purchases of Available-for-sale Securities		**586**	217
Purchase of Property, Plant and Equipment and Intangible Assets		**4**	4
Total Disbursements of Cash Flows from Investing Activities		**590**	221
Net Cash Flows from Investing Activities		**199**	698

The above statement is to be read in conjunction with the notes set out on pages 51 to 86.

CONSOLIDATED STATEMENT OF CASH FLOWS (CONTINUED)

For the year ended 30 June	Note	2013 $M	2012 $M
CASH FLOWS FROM FINANCING ACTIVITIES			
Sources			
Net Issue of Circulating Currency		**234**	203
Total Sources of Cash Flows from Financing Activities		**234**	203
Disbursements			
Repayment of Foreign Currency Term Liabilities		**325**	321
Dividend Payments to the New Zealand Government		**160**	210
Total Disbursements of Cash Flows from Financing Activities		**485**	531
Net Cash Flows from Financing Activities		**(251)**	(328)
NET CASH FLOWS		**1,069**	788
Plus Foreign Exchange Rate Effect on Cash Balances at the Beginning of the Year		**93**	38
NET CASH FLOWS FROM ALL ACTIVITIES		**1,162**	826
Cash Balances at the Beginning of the Year		**2,785**	1,959
Cash Balances at the End of the Year		**3,947**	2,785

The above statement is to be read in conjunction with the notes set out on pages 51 to 86.

NOTES TO BE READ AS PART OF THE CONSOLIDATED FINANCIAL STATEMENTS

1. STATEMENT OF ACCOUNTING POLICIES

A REPORTING ENTITY AND STATUTORY BASE

These are the consolidated financial statements of the Reserve Bank of New Zealand, a body corporate under the Reserve Bank of New Zealand Act 1989 (the "Reserve Bank Act"). These consolidated financial statements apply to the financial year ended 30 June 2013. They are prepared in accordance with Part VI of the Reserve Bank Act and comply with Generally Accepted Accounting Practice in New Zealand.

In these financial statements, the Reserve Bank of New Zealand is also referred to as the "Reserve Bank" or the "Bank". The Bank's parent entity is the government of New Zealand.

The Governor and Deputy Governor of the Reserve Bank authorised these financial statements for issue on 21 August 2013.

B COMPLIANCE WITH NEW ZEALAND EQUIVALENTS TO INTERNATIONAL FINANCIAL REPORTING STANDARDS

Under NZ IAS 1 *Presentation of Financial Statements,* the Bank is classified as a Public Benefit Entity (PBE). A PBE is a reporting entity whose primary objective is to provide goods and services for community or social benefit and where any equity has been provided with a view to supporting that primary objective rather than for a financial return to equity holders. PBEs are required to comply with requirements under New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS), which differ from corresponding provisions of the equivalent International Financial Reporting Standards (IFRS). For the reasons set out below, while the Bank asserts full compliance with Generally Accepted Accounting Practice in New Zealand and NZ IFRS, it is unable to make an unreserved statement of compliance with IFRS.

The following accounting practice adopted in accordance with the Bank's PBE status has prevented the Bank from asserting full compliance with IFRS.

NZ IAS 2 *Inventories* requires that inventories of currency that are held for distribution be measured at cost. Where that inventory is acquired at no cost, or for nominal consideration, it should be measured at current replacement cost. The corresponding IFRS provision in IAS 2 requires that inventories be measured at the lower of cost and net realisable value.

Inventories of currency on hand include currency repatriated to the Bank at no cost. In accordance with NZ IAS 2, this portion of inventory is measured at the current replacement cost of that inventory at the time of repatriation. At 30 June 2013, the carrying value of inventory was $2.3 million more than that which would have been reported had IAS 2 been applied (2012: $2.6 million more).

C BASIS OF PREPARATION OF FINANCIAL STATEMENTS

Measurement Base

These financial statements have been prepared using the general principles of historical cost accounting, modified by fair value accounting for available-for-sale financial assets, all derivative contracts, financial assets and liabilities that are held at fair value through profit or loss, land and buildings, and currency and artwork collections.

Changes in Accounting Policies

There have been no changes in accounting policies and all accounting policies have been applied consistently by the Bank for all the financial years presented (unless otherwise stated).

Standards and Interpretations Applied with Effect from 1 July 2012

No new accounting standards have been applied since 1 July 2012.

Future Changes to Accounting Standards Applicable to Public Benefit Entities

The External Reporting Board (XRB) has adopted a multi-standards framework for financial reporting. From 1 July 2014, Public Sector PBEs, including the Bank, will be required to apply new accounting standards based on International Public Sector Accounting Standards (IPSAS).

In May 2013, the XRB promulgated new standards that put into operation the new financial reporting framework for PBEs. A full assessment of the impact of the proposed IPSAS-based framework has not been undertaken. The Bank's preliminary assessment is that the new standards will not result in a significant change for the Bank when they come into effect on 1 July 2014.

In light of its decision to adopt a multi-standards approach, the XRB has determined that new IFRS-based accounting standards, or changes to existing IFRS-based accounting standards with a mandatory effective date of 1 January 2012 or later, may be applied by profit-oriented entities only. For example, PBEs are prohibited from applying NZ IFRS 13 *Fair Value Measurement,* which was promulgated in 2011 and which has a mandatory application date for annual periods beginning on or after 1 January 2013.

Basis of Consolidation

These consolidated financial statements are prepared using the acquisition method. All material inter-company balances and transactions are eliminated. Parent financial statements are not produced because the difference between the parent and group is not material.

Trust and Custodial Activities

Assets held for third parties under custodial arrangements and income arising thereon is excluded from these financial statements, as they are not assets or income of the Bank (see Note 32).

Segment Reporting

The Bank's operations comprise a single operating segment for the purposes of NZ IFRS 8 *Operating Segments.* The Bank has significant foreign currency financial liabilities and foreign currency financial assets as part of its Foreign Reserves Management and Domestic Market Operations activities. While the Bank is required by the Reserve Bank Act to report revenue and expenses by reference to the functions carried out by the Bank, these activities do not constitute separate operating segments for the purposes of NZ IFRS 8.

Functional and Presentation Currency

The Bank's financial statements are presented in New Zealand dollars, the Bank's functional and presentation currency. Amounts in the financial statements are rounded to the nearest million dollars unless otherwise stated.

Foreign Currency Conversions

Transactions denominated in foreign currency are translated to New Zealand dollars using exchange rates applied on the trade date of the transaction.

Foreign currency assets and liabilities are translated to New Zealand dollars at the relevant market bid or offer foreign exchange rate as at balance date.

Foreign exchange gains and losses resulting from settlement of foreign currency transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currency are recognised in the Income Statement. Where a gain or loss on a non-monetary item is recognised directly in equity, such as equity investments classified as financial assets that are available for sale, the related exchange gain or loss is also recognised in equity.

D FINANCIAL ASSETS

Classification of Financial Assets

The Bank classifies its financial assets into the following categories: financial assets at fair value through profit or loss, loans and receivables, and available-for-sale financial assets. Bank management determines the classification of its financial assets at initial recognition.

Financial Assets at Fair Value through Profit or Loss

This category has two sub-categories: financial assets designated as fair value through profit or loss at inception and those that are held for trading.

The bulk of the Bank's assets and liabilities are designated as fair value through profit or loss, as compliance with the Bank's investment mandates and performance of the Bank's Foreign Reserves Management and Domestic Market Operations functions are assessed daily on the basis of the fair value of assets and related liabilities funding those assets.

This designation may only be made if the financial asset either contains an embedded derivative or will be managed on a fair value basis in accordance with a documented risk management strategy, or if designating it (and any financial liability) at fair value will reduce an accounting mismatch.

The Bank has active management portfolios, which are classified as held for trading.

Loans and Receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Bank provides goods or services directly to a debtor with no intention of trading the receivable.

Available-for-sale Financial Assets

Available-for-sale financial securities are those non-derivative financial assets that are designated as available for sale or that are not classified as financial assets at fair value through profit or loss, or loans and receivables.

Available-for-sale financial assets include the Bank's holdings of New Zealand government bonds and its shareholding in the Bank for International Settlements. These assets are intended to be held either to maturity or for an indefinite period of time, and in the case of New Zealand government bonds, these may be sold in the course of the Bank's operations. As part of its liquidity management operations, the Bank purchases New Zealand government securities generally up to six months before these securities mature. Government securities purchased for liquidity management operations are classified as financial assets at fair value through profit or loss.

Recognition and Measurement of Financial Assets

Purchases and sales of financial assets are recognised on trade date, the date on which the Bank commits to purchase or sell the asset. Financial assets are recognised initially at fair value. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Bank has transferred substantially all the risks and rewards of ownership.

Loans and receivables are carried at amortised cost less impairment losses.

Available-for-sale financial assets and financial assets through profit or loss are subsequently carried at fair value.

The fair values of quoted investments in active markets are based on current bid prices. In other cases, the Bank establishes fair value by using appropriate valuation techniques.

Realised and unrealised gains and losses arising from changes in the fair value of financial assets at fair value through profit or loss are included in the Income Statement in the year in which they arise. These realised and unrealised gains and losses exclude interest and dividends.

Gains and losses arising from changes in the fair value of available-for-sale financial assets are recognised directly in equity until the financial asset is derecognised or impaired, at which time the cumulative gain or loss previously recognised in equity is recognised in the Income Statement.

Interest income on all assets is calculated using the effective interest method and is recognised in the Income Statement. The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument. The calculation includes all fees paid or received between parties, transaction costs and all other premiums or discounts.

Dividends on available-for-sale equity instruments are recognised in the Income Statement when the right to receive payment is established.

Derivative Financial Instruments

Derivatives are initially recognised in the Statement of Financial Position at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, or valuation techniques, as appropriate. The best evidence of the fair value of a derivative at initial recognition is the transaction price (i.e., the fair value of the consideration given or received).

Derivative transactions, such as foreign currency swaps, and the payment and receipt of different currencies are stated in the Statement of Financial Position at the net of the fair value of receipts less the fair value of payments, both expressed in New Zealand dollars. The net fair value of each derivative contract is determined individually and carried as an asset if the net fair value is positive and as a liability if that value is negative.

The majority of the Bank's assets and liabilities are carried at fair value and managed on a fair value basis. The Bank has not applied the hedge accounting rules of NZ IAS 39 *Financial Instruments: Recognition and Measurement.*

Gains and losses on all derivatives are recognised in the Income Statement.

Securities Purchased under Agreements to Resell

Where the Bank purchases securities under agreements to resell (reverse-repurchase agreements), the Bank records as an asset the consideration receivable from the agreement to resell the security.

The consideration receivable under the agreement to resell is recorded at fair value. Movements in the fair value of reverse-repurchase agreements are reported in the Income Statement.

Securities Lending Programme

The Bank operates a securities lending programme. Where securities are lent, the Bank receives collateral in the form of cash or other securities and the securities continue to be recorded as assets in the Bank's Statement of Financial Position.

The Bank's agent administers the securities lending programme and monitors the securities lending and related collateral against requirements agreed with the Bank.

The Bank records an asset being the market value of the securities lent and a liability for the same amount in respect of the collateral to be returned by the Bank at the conclusion of the loan.

The Bank records income from securities lending as it accrues. Changes in the value of the asset are reflected by a change in the corresponding liability.

Impairment of Financial Assets

For financial assets that are not classified as fair value through profit or loss, the Bank assesses as at each balance date whether there is objective evidence that a financial asset or group of financial assets is impaired. Objective evidence of impairment would include observable data that comes to the attention of the Bank, such as significant financial difficulty of the issuer or counterparty, the disappearance of an active market for the financial asset because of financial difficulties, or a market downgrade in credit rating of the financial asset.

E OTHER ASSETS

Inventories

Inventories of currency on hand are recognised in the Statement of Financial Position at cost. Costs include the cost of bringing inventories to their present location and condition.

For the portion of inventories of currency on hand that relates to currency repatriated to the Bank, this cost is measured at the current replacement cost of producing the currency at the time of repatriation, and is recorded by crediting currency issue expense and increasing the value of inventory recognised in the Statement of Financial Position.

When currency is issued, the value of inventory is reduced and an expense is recorded for currency issuance costs. Currency issuance cost is determined on a first-in, first-out (FIFO) basis.

Property, Plant and Equipment

Land and Buildings

Land and buildings owned by the Bank are classified as Property, Plant and Equipment.

Land is recorded at fair value. Buildings are recorded at depreciated fair value. Surpluses of book value over historical cost for this class of asset are recorded in the Property Revaluation Reserve. Where the book value of this class of asset falls below historical cost, previous revaluations are reversed and any remaining balance is charged as an expense in the financial year it occurs. Buildings are depreciated on a straight-line basis over 40 years.

The Bank obtains an independent valuation of land and buildings every three years. In the years between independent valuations, an annual assessment is made of whether or not there is likely to have been a material change in value. An independent valuation is obtained where a material change has occurred.

Currency and Artwork Collections and Archives

Items held in the Bank's currency and artwork collections and archives that have a material commercial value are independently assessed to determine estimated fair values. Surpluses of book value over historical cost for this class of asset are recorded in the Currency and Artwork Collections and Archives Revaluation Reserve. Nominal values have been placed on items with no material commercial value. Collections are not depreciated. Additions are held at cost until subsequent revaluations.

Other Property, Plant and Equipment

Other property, plant and equipment is carried at cost less depreciation and impairment losses. The following assets held by the Bank are depreciated on a straight-line basis over the following terms:

Computer Hardware	3-5 years
Plant and Equipment	5-10 years
Buildings	40 years
Property Improvements	8 years

Intangible Assets

Intangible assets comprise acquired and internally developed computer software. Intangible assets are stated at cost less accumulated amortisation and impairment losses. Costs include all direct expenses incurred to acquire and bring to use the specific software.

Costs incurred in bringing to use enhancements to an existing software programme are capitalised only if the enhancement will produce additional future economic benefits exceeding costs over more than one year.

Capitalised software development costs are amortised on a straight-line basis over the estimated useful life of the software (three to 10 years). Costs associated with maintaining computer software are recognised as expenses when incurred.

Impairment of Non-financial Assets

Non-financial assets are reviewed for indicators of impairment annually. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units).

F FINANCIAL LIABILITIES

Recognition of Financial Liabilities

Financial liabilities are recognised initially at fair value. Except for liabilities classified as financial liabilities at fair value through profit or loss, financial liabilities are subsequently stated at amortised cost.

Financial liabilities are derecognised only when the obligation is discharged, cancelled or expired.

Financial liabilities are recorded on trade date, the date on which the Bank commits to borrow or repay the relevant funds.

Financial Liabilities at Fair Value through Profit or Loss

This category has two sub-categories: financial liabilities held for trading and those designated as fair value through profit or loss at inception. Financial liabilities that are classified as financial liabilities through profit or loss are included in those sub-categories on the same basis as financial assets at fair value through profit or loss (see page 52).

Securities Sold under Agreements to Repurchase

Where the Bank sells securities under agreements to repurchase (repurchase agreements), the security continues to be included as an asset in the Bank's Statement of Financial Position.

The consideration payable under the agreement to repurchase is recorded at fair value. Movements in the fair value of repurchase agreements are reported in the Income Statement.

Short Sales of Marketable Securities

A short sale is a sale of a security that the Bank does not own. Securities that are sold short are recorded at fair value through profit or loss using quoted market offer prices.

Any gains or losses are recognised in the Income Statement.

Currency in Circulation

Currency issued by the Bank represents a claim on the Bank in favour of the holder. The liability for currency in circulation is recorded at face value in the Statement of Financial Position.

Demonetised Currency

The Bank has a liability for the face value of demonetised currency still in circulation. For currency demonetised before 1 July 2004, this is recognised as a contingent liability except for a provision retained in the Statement of Financial Position to cover expected future redemptions. For currency demonetised from 1 July 2004, the Bank records a liability equal to the face value of that currency still in circulation.

Collectors' Currency

The Bank has a liability for the face value of collectors' currency. The face value of collectors' currency issued before 1 July 2004 is recognised as a contingent liability. For collectors' currency issued from 1 July 2004, the Bank records a liability equal to the face value of that currency.

Offsetting of Financial Assets and Financial Liabilities

Financial assets and liabilities are offset and the net amount reported in the Statement of Financial Position when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

G OTHER LIABILITIES

Employee Entitlements

Wages and Salaries, Annual and Sick Leave

Liabilities for wages and salaries, including non-monetary benefits and annual leave, are recognised in Other Liabilities in respect of employees' services and are measured at the amounts expected to be paid when liabilities are settled.

Retirement Gratuity

Retirement gratuities and post-retirement benefits apply to staff members who joined the Bank before 1 October 1991. These gratuities and benefits are recognised in Other Liabilities in respect of employees' services and are measured at the present value of future payments expected to be made in respect of services provided by employees up to balance date. This is calculated by an independent actuary using a discounted cash flow model. Expected future payments are discounted to their net present value using market yields at the reporting date on government bonds with terms that match as closely as possible the estimated timing of future cash flows.

Changes in the value of the liability for retirement gratuities and post-retirement benefits are included in the Income Statement in staff expenses in Operating Expenses.

Superannuation Obligations

Obligations for contributions to defined benefit superannuation schemes are recognised as an expense in the Income Statement as incurred.

A liability is recognised in the Statement of Financial Position where the present value of defined benefit obligations exceeds the fair value of the scheme's assets (as adjusted for unrecognised past-service costs).

An asset is recognised in the Statement of Financial Position where the present value of defined benefit obligations is less than the fair value of the scheme's assets (as adjusted for unrecognised past-service costs). Any net asset recognised in the Statement of Financial Position is limited to the estimated present value of reductions in future employer contributions to the defined benefit scheme.

The present value of the defined benefit obligation is determined by discounting the estimated future cash flows using interest rates of New Zealand government bonds that have terms to maturity approximating the terms of the related superannuation liability. The calculation is performed annually by an independent qualified actuary using the projected unit credit method.

Staff expenses within Operating Expenses in the Income Statement includes the current-service cost, past-service cost, an interest cost and an expected return for the defined benefit superannuation scheme. The actuarial gain or loss on the defined benefit superannuation scheme is included as a separate item within Operating Expenses.

H INCOME AND EXPENSES

Fee Income

Fee income earned from provision of services is recognised as revenue on an accruals basis as the service is provided.

Income and Expenses Allocated to Functions

The Reserve Bank Act requires the Bank to account for revenue and expenses by reference to the functions the Bank performs. Each function receives income and incurs expenses relating directly to the assets and liabilities used exclusively by that function. Earnings from the investment of the Bank's equity are allocated to each function based on the estimated amount of equity required for each function.

Income and expense flows are attached to the notional funding for each function. The Bank operates notional balance sheets to calculate the notional income and expenditure for each of the Bank's functions as though each function operates autonomously. The Bank also has systems in place to allocate operating costs to functions. Operating costs are allocated as closely as possible to reflect their consumption. Direct operating costs are assigned directly to functions. Indirect operating costs are allocated to functions based on predetermined cost drivers and related activity or usage information. These structures enable each function to report more accurately the financial outcome of the services provided.

Income Tax

Section CW38 of the Income Tax Act 2007 exempts the Bank from income tax. Accordingly, no provisions are raised for current or deferred income taxes.

I CASH FLOWS

For the purposes of the Statement of Cash Flows, cash and cash equivalents include balances with other central banks and amounts available at call with other institutions.

Certain cash flows have been netted in order to provide more meaningful disclosure. Netting of cash flows occurs where cash receipts and payments on behalf of customers reflect the activities of the customer rather than the Bank, or where cash receipts or payments are for items in which turnover is quick, amounts are large, and maturities are short.

J SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

The Bank makes estimates and assumptions that affect the reported amounts of assets and liabilities. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Fair Value of Financial Instruments

Financial instruments classified as held for trading or designated at fair value through profit or loss and financial assets classified as available for sale are recognised in the financial statements at fair value. All derivatives are measured and recognised at fair value.

The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Financial instruments are priced either with reference to a quoted market price for that instrument or by using a valuation model. Where the fair value is calculated using financial market pricing models, the methodology used is to calculate the expected cash flows under the terms of each specific contract and then discount these values back to the present value. These models use as their basis independently sourced market parameters including, for example, interest rate yield curves and currency rates. Most market parameters are either observable directly or are implied from instrument prices.

Judgement is applied also in assessing the extent of impairment of financial and other assets.

Superannuation and Post-retirement Obligations

The Bank has obligations under the defined benefit superannuation plan and for certain post-retirement obligations as described on page 55. The carrying amount of these obligations is based upon actuarial valuations, which in turn are dependent upon a series of assumptions. Key valuation assumptions include price inflation, earnings growth, employee retirement dates, and investment returns. Valuations are performed on the basis that the scheme will not be wound up.

Valuation of Land and Buildings

The fair value of the Bank's land and buildings is assessed by an independent registered property valuer. Estimated fair value is arrived at by the valuer, based on a number of assumptions, principally with respect to market rates of rental and market capitalisation rates.

2. NATURE AND EXTENT OF ACTIVITIES

The Reserve Bank's role as a central bank determines the nature and extent of its activities with respect to financial instruments. This role is defined by the Reserve Bank Act.

A LOCAL CURRENCY ACTIVITIES

The Bank provides exchange settlement account facilities to financial institutions and to the New Zealand government. The Bank manages the aggregate level of liquidity held by financial institutions in their exchange settlement accounts.

The financial instruments used to inject funds into the banking system include local currency reverse-repurchase transactions, outright purchases of New Zealand government securities shortly before maturity and foreign currency swaps. The Bank uses its holdings of New Zealand government securities in repurchase transactions and issues Reserve Bank bills to withdraw funds from the banking system for liquidity management purposes.

Balances in exchange settlement accounts are repayable on demand and the Bank pays interest on overnight balances. From time to time, the Bank may also hold small trading positions in New Zealand government securities or registered bank securities as part of market test activities.

The Bank issues notes and coins to registered banks in order to meet the currency needs of the public. When currency is issued to a registered bank, that bank's settlement account is debited with the face value of currency issued.

The Bank also operates the NZClear System. This includes carrying out securities registry and paying agent responsibilities.

B FOREIGN CURRENCY ACTIVITIES

The Bank's foreign currency activities arise mainly from:

- holding foreign currency assets for crisis management purposes;
- the investment of proceeds of foreign currency swaps entered into for managing the aggregate level of liquidity of the New Zealand banking system; and
- the purchase or sale of foreign currency in order to meet monetary policy objectives.

Foreign reserve assets held for crisis management purposes are funded by a combination of foreign currency loans from the Treasury, which are made on arm's length terms, and New Zealand dollar-denominated liabilities, including currency in circulation and deposits placed with the Bank by financial institutions. Cross-currency basis swaps are used to convert New Zealand dollar funding into foreign currency and to manage a significant portion of foreign currency risk. A proportion of foreign currency assets held for crisis management purposes are maintained without hedging their foreign currency risk. The hedged/unhedged position will vary over time as the Bank determines appropriate.

The Bank routinely injects New Zealand dollars into the New Zealand banking system as part of its liquidity management operations. The injection of New Zealand dollars entails the Bank entering into foreign currency swap transactions for a finite term. The swap entails the Bank paying New Zealand dollars to the counterparty and receiving foreign currency for the term of the swap. The foreign currency received from a swap is invested in foreign currency-denominated securities for a term coinciding with the term of the swap. Proceeds received on maturity of the foreign currency investment are used by the Bank to repay the foreign currency at the end of the term of the foreign currency swap transaction and the counterparty repays the New Zealand dollars together with any interest.

Foreign currency purchased or sold when the Bank intervenes in the foreign exchange market to meet monetary policy objectives would usually entail the Bank borrowing or lending New Zealand currency to finance the foreign currency transaction.

Financial instruments held within foreign currency portfolios consist mainly of sovereign securities, securities issued by quasi-government entities or highly-rated supranational institutions, securities held under reverse-repurchase transactions, or balances held with other central banks. Liquidity and credit risk are key criteria in determining the type of instruments held.

The Bank manages the foreign currency exposure arising from certain operating and capital expenditure commitments denominated in foreign currency. The Bank will purchase foreign currency cover for those foreign currency-denominated commitments that will fall due over the following financial year.

For further information on the risk management policies relating to financial instruments, see Notes 14 to 21.

C FOREIGN EXCHANGE DEALING

Section 16 of the Reserve Bank Act provides the Bank with the power to deal in foreign currency for the purpose of carrying out its functions and powers. All dealings in foreign currency assets and liabilities occur under that section, except for transactions that occur at the direction of the Minister of Finance.

Sections 17 and 18 of the Reserve Bank Act provide for the Minister of Finance to direct the Bank to deal in foreign exchange, or for the Minister of Finance to fix the foreign exchange rates for foreign exchange dealing by the Bank. Section 21 of the Reserve Bank Act requires the Bank to either pay any foreign currency exchange gains to the Crown, or to be reimbursed for any foreign exchange losses, as a result of dealing in foreign exchange under sections 17 or 18 of the Reserve Bank Act. For the year ended 30 June 2013, there have been no directions from the Minister under section 17 or 18 and there have been no payments to or from the Crown under section 21 of the Reserve Bank Act (2012: nil).

Under section 24 of the Reserve Bank Act, the Minister, in consultation with the Bank, determines the level or range of foreign reserve assets that must be maintained by the Bank.

D DERIVATIVE FINANCIAL INSTRUMENTS

The Bank's involvement in derivative financial instruments includes primarily foreign currency swaps, bond and interest rate futures, interest rate swaps and cross-currency basis swaps.

Foreign currency swaps are used to manage transactions for foreign exchange for both Domestic Market Operations and Foreign Reserves Management. The arrangements are described in more detail above in (b) Foreign Currency Activities.

Bond and interest rate futures and interest rate swaps are used to enhance expected returns on foreign currency assets and, from time to time, to manage interest rate and foreign exchange risks.

E TITLE TO ASSETS

As part of its foreign currency operations, the Bank enters into security repurchase transactions. These foreign currency securities sold by the Bank under repurchase agreements are recorded as an asset within Marketable Securities in the Bank's Statement of Financial Position. These foreign currency-denominated transactions are also recognised as a liability within Securities Sold under Agreements to Repurchase in the Bank's Statement of Financial Position.

The Bank enters into security repurchase transactions as part of its liquidity management operations and market testing activities. These local currency-denominated securities sold by the Bank under repurchase agreements are recorded as an asset in New Zealand Government Securities in the Bank's Statement of Financial Position.

The Bank also purchases securities under reverse-repurchase agreements in both its foreign currency and local currency operations. These transactions are recognised as Securities Purchased under Agreements to Resell in the Bank's Statement of Financial Position.

The Bank can be required to deliver collateral under swap arrangements. Any collateral delivered by the Bank remains in the Statement of Financial Position.

Note 3 gives details of the collateral taken or provided as at balance date.

FINANCIAL POSITION NOTES

3. ANALYSIS OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

FOREIGN CURRENCY MARKETABLE SECURITIES

Foreign Currency Marketable Securities of $14,033 million (2012: $12,780 million) comprise fixed interest securities issued by foreign governments, foreign near-government entities and supranational organisations. Further details, such as the credit rating and the country in which the issuer is resident, are provided in Note 16 in respect of all financial assets including Foreign Currency Marketable Securities.

ANALYSIS OF FINANCIAL ASSETS AND LIABILITIES BY MEASUREMENT BASIS

Financial assets and financial liabilities are measured on an ongoing basis either at fair value or at amortised cost. The summary of significant accounting policies describes how the classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The following table analyses the financial assets and liabilities in the Statement of Financial Position by class and by category as defined by NZ IAS 39. This year, the Bank has aligned its treatment of Foreign Currency Cash Balances, Short-term Foreign Currency Financial Liabilities and Local Currency Deposits with industry practice. Foreign Currency Cash Balances have been reclassified from the Fair Value through Profit or Loss category to the Loans and Receivables category. Short-term Foreign Currency Financial Liabilities and Local Currency Deposits have been reclassified from the Fair Value through Profit or Loss category to the Liabilities at Amortised Cost category. There is no impact on the carrying value of these balances. These reclassifications have been applied to the comparative information for 30 June 2012.

		Fair Value through Profit or Loss				
As at 30 June 2013	Total $M	Designated upon Initial Recognition $M	Derivatives Deemed Held for Trading $M	Available-for-sale Financial Assets $M	Loans and Receivables $M	Financial Liabilities at Amortised Cost $M
ASSETS						
Foreign Currency Financial Assets						
Cash Balances	3,947	-	-	-	3,947	-
Securities Purchased under Agreements to Resell	1,994	1,994	-	-	-	-
Marketable Securities	14,033	14,033	-	-	-	-
Derivative Financial Assets	1,003	-	1,003	-	-	-
Other Foreign Currency Financial Assets	186	-	-	139	47	-
Total Foreign Currency Financial Assets	21,163	16,027	1,003	139	3,994	-
Local Currency Financial Assets						
Securities Purchased under Agreements to Resell	25	25	-	-	-	-
New Zealand Government Securities	2,818	-	-	2,818	-	-
Other Local Currency Financial Assets	1	-	-	-	1	-
Total Local Currency Financial Assets	2,844	25	-	2,818	1	-
Total Financial Assets	**24,007**	**16,052**	**1,003**	**2,957**	**3,995**	**-**
LIABILITIES						
Foreign Currency Financial Liabilities						
Short-term Foreign Currency Financial Liabilities	551	-	-	-	-	551
Securities Sold under Agreements to Repurchase	639	639	-	-	-	-
Derivative Financial Liabilities	596	-	596	-	-	-
Term Liabilities	1,871	1,871	-	-	-	-
Total Foreign Currency Financial Liabilities	3,657	2,510	596	-	-	551
Local Currency Financial Liabilities						
Deposits	12,627	-	-	-	-	12,627
Securities Sold under Agreements to Repurchase	346	346	-	-	-	-
Currency in Circulation	4,609	-	-	-	-	4,609
Other Local Currency Financial Liabilities	85	-	-	-	-	85
Total Local Currency Financial Liabilities	17,667	346	-	-	-	17,321
Total Financial Liabilities	**21,324**	**2,856**	**596**	**-**	**-**	**17,872**

As at 30 June 2012	Total $M	Fair Value through Profit or Loss: Designated upon Initial Recognition $M	Fair Value through Profit or Loss: Derivatives Deemed Held for Trading $M	Available-for-sale Financial Assets $M	Loans and Receivables $M	Financial Liabilities at Amortised Cost $M
ASSETS						
Foreign Currency Financial Assets						
Cash Balances	2,785	-	-	-	2,785	-
Securities Purchased under Agreements to Resell	4,566	4,566	-	-	-	-
Marketable Securities	12,780	12,780	-	-	-	-
Derivative Financial Assets	1,700	-	1,700	-	-	-
Other Foreign Currency Financial Assets	140	-	-	139	1	-
Total Foreign Currency Financial Assets	21,971	17,346	1,700	139	2,786	-
Local Currency Financial Assets						
Securities Purchased under Agreements to Resell	1,501	1,501	-	-	-	-
New Zealand Government Securities	3,193	-	-	3,193	-	-
Other Local Currency Financial Assets	1	-	-	-	1	-
Total Local Currency Financial Assets	4,695	1,501	-	3,193	1	-
Total Financial Assets	26,666	18,847	1,700	3,332	2,787	-
LIABILITIES						
Foreign Currency Financial Liabilities						
Short-term Foreign Currency Financial Liabilities	1,069	-	-	-	-	1,069
Securities Sold under Agreements to Repurchase	606	606	-	-	-	-
Derivative Financial Liabilities	306	-	306	-	-	-
Term Liabilities	2,148	2,148	-	-	-	-
Total Foreign Currency Financial Liabilities	4,129	2,754	306	-	-	1,069
Local Currency Financial Liabilities						
Deposits	15,262	-	-	-	-	15,262
Securities Sold under Agreements to Repurchase	119	119	-	-	-	-
Currency in Circulation	4,375	-	-	-	-	4,375
Other Local Currency Financial Liabilities	85	-	-	-	-	85
Total Local Currency Financial Liabilities	19,841	119	-	-	-	19,722
Total Financial Liabilities	23,970	2,873	306	-	-	20,791

FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

All financial assets and liabilities are recorded at fair value based on either quoted market prices or prices derived from market yield curves, as described in the Bank's accounting policies, except as detailed below. Refer below for details of the classification by valuation hierarchy of financial assets and financial liabilities carried at fair value.

a Unsettled Transactions

The reported value of unsettled sales and purchases is considered to approximate their fair value due to the very short period between balance date and the settlement date.

b Cash Balances and Short-term Deposits

The carrying value of cash balances and short-term deposits is considered to approximate their fair value, as they are payable on demand.

c Currency in Circulation

Currency in Circulation is reported at its face value, as currency in circulation is payable on demand. NZ IAS 39 requires that the fair value cannot be less than the face value.

DETERMINATION OF FAIR VALUE OF FINANCIAL INSTRUMENTS CARRIED AT FAIR VALUE

Each financial instrument carried at fair value is categorised within the hierarchy based on the lowest-level input that is significant to the fair value measurement of the whole instrument.

Fair values are determined according to the following hierarchy:

a Quoted Market Price

Financial instruments with quoted prices for identical instruments in active markets (level 1).

b Valuation Technique Using Observable Inputs

Financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets, and financial instruments valued using models where all significant inputs are observable (level 2).

The determination of what constitutes 'observable' requires significant judgement by the Bank. The Bank considers observable data to be that market data that is available readily, distributed or updated regularly, reliable and verifiable, not proprietary, and provided by independent sources that are involved actively in the relevant market. Judgement is required to be exercised also in determining appropriate margins to representative forward prices and interest rate yield curves in order to model more accurately the market price of the specific instrument that is being valued.

Where necessary, valuation models include estimated future cash flows and discount rates that are calculated using forward prices and interest rate yield curves. Forward prices and interest rate yield curves are sourced from the relevant published market observable exchange rates and interest rates applicable to the remaining life of the instrument at the valuation date. Also, where necessary, margin adjustments are made to representative prices and interest rate yield curves in order to allow for features of the instrument that would be taken into account in valuing a financial instrument, where those features are not included or priced into representative forward prices and interest rate yield curves.

c Valuation Technique with Significant Non-observable Inputs

Financial instruments valued using models where one or more significant inputs are not observable (level 3).

As at 30 June 2013	Total $M	Valuation Techniques: Quoted Market Price $M	Valuation Techniques: Using Observable Inputs $M	Valuation Techniques: With Significant Non-observable Inputs $M
ASSETS				
Foreign Currency Financial Assets				
Securities Purchased under Agreements to Resell	**1,994**	**-**	**1,994**	**-**
Marketable Securities	**14,033**	**8,355**	**5,678**	**-**
Derivative Financial Assets	**1,003**	**-**	**1,003**	**-**
Other Foreign Currency Financial Assets	**139**	**-**	**-**	**139**
Total Foreign Currency Financial Assets Carried at Fair Value	17,169	8,355	8,675	139
Local Currency Financial Assets				
Securities Purchased under Agreements to Resell	**25**	**-**	**25**	**-**
New Zealand Government Securities	**2,818**	**2,818**	**-**	**-**
Total Local Currency Financial Assets Carried at Fair Value	2,843	2,818	25	-
Total Financial Assets Carried at Fair Value	**20,012**	**11,173**	**8,700**	**139**
LIABILITIES				
Foreign Currency Financial Liabilities				
Securities Sold under Agreements to Repurchase	**639**	**-**	**639**	**-**
Derivative Financial Liabilities	**596**	**-**	**596**	**-**
Term Liabilities	**1,871**	**-**	**1,871**	**-**
Total Foreign Currency Financial Liabilities Carried at Fair Value	3,106	-	3,106	-
Local Currency Financial Liabilities				
Securities Sold under Agreements to Repurchase	**346**	**-**	**346**	**-**
Total Local Currency Financial Liabilities Carried at Fair Value	346	-	346	-
Total Financial Liabilities Carried at Fair Value	**3,452**	**-**	**3,452**	**-**

As at 30 June 2012	Total $M	Valuation Techniques: Quoted Market Price $M	Valuation Techniques: Using Observable Inputs $M	Valuation Techniques: With Significant Non-observable Inputs $M
ASSETS				
Foreign Currency Financial Assets				
Securities Purchased under Agreements to Resell	4,566	-	4,566	-
Marketable Securities	12,780	5,464	7,316	-
Derivative Financial Assets	1,700	-	1,700	-
Other Foreign Currency Financial Assets	139	-	-	139
Total Foreign Currency Financial Assets Carried at Fair Value	19,185	5,464	13,582	139
Local Currency Financial Assets				
Securities Purchased under Agreements to Resell	1,501	-	1,501	-
New Zealand Government Securities	3,193	3,193	-	-
Total Local Currency Financial Assets Carried at Fair Value	4,694	3,193	1,501	-
Total Financial Assets Carried at Fair Value	23,879	8,657	15,083	139
LIABILITIES				
Foreign Currency Financial Liabilities				
Securities Sold under Agreements to Repurchase	606	-	606	-
Derivative Financial Liabilities	306	-	306	-
Term Liabilities	2,148	-	2,148	-
Total Foreign Currency Financial Liabilities Carried at Fair Value	3,060	-	3,060	-
Local Currency Financial Liabilities				
Securities Sold Under Agreements to Repurchase	119	-	119	-
Total Local Currency Financial Liabilities Carried at Fair Value	119	-	119	-
Total Financial Liabilities Carried at Fair Value	3,179	-	3,179	-

ADDITIONAL INFORMATION FOR FINANCIAL INSTRUMENTS CARRIED AT FAIR VALUE WHERE THE VALUATION INCORPORATES NON-OBSERVABLE MARKET DATA

Financial instruments carried at fair value where the valuation incorporates non-observable market data comprise the Bank's shares in the Bank for International Settlements (BIS).

The following table details movements in the level 3 assets. There have been no transfers between level 1 and level 2 assets.

	2013 $M	2012 $M
Opening Balance	**139**	134
New Purchases and Sales	**-**	-
Fair Value Gain Recognised in the Consolidated Statement of Comprehensive Income Recorded in:		
Movement in Available-for-sale Revaluation Reserve taken to Equity	**-**	5
Closing Balance	**139**	139

COLLATERAL PLEDGED

The carrying amount of securities pledged as collateral for liabilities comprising Securities Sold under Agreements to Repurchase was $346 million (2012: $119 million) and the fair value of collateral pledged was $336 million (2012: $117 million). Cash collateral of $nil was provided (2012: $nil).

COLLATERAL RECEIVED

Marketable Securities

The Bank has entered into reverse-repurchase agreements in respect of New Zealand dollar-denominated marketable securities. The principal amount subject to reverse-repurchase agreements for New Zealand dollar-denominated marketable securities was $25 million (2012: $1,501 million) and the fair value of collateral received was $27 million (2012: $1,527 million). The Bank may sell or repledge that collateral even if the counterparty is not in default of its obligations.

The Bank has entered into reverse-repurchase agreements in respect of foreign currency-denominated marketable securities. The principal amount subject to reverse-repurchase agreements for foreign currency-denominated marketable securities was $1,355 million (2012: $3,962 million). The fair value of collateral received was $1,336 million (2012: $4,043 million). The Bank may sell or repledge that collateral even if the counterparty is not in default of its obligations.

Other Collateral Received

In addition, cash collateral received is $551 million (2012: $1,064 million). Cash collateral received is recorded in the Statement of Financial Position in Short-term Deposits within Short-term Foreign Currency Financial Liabilities.

Under the Bank's securities lending programme, the Bank has lent securities with a fair value of $639 million (2012: $606 million). The Bank has accepted securities with a fair value of $654 million (2012: $619 million) as collateral for the securities lent under this programme.

These transactions are conducted under terms that are usual and customary to standard securities borrowing and reverse-repurchase agreements.

Additional Information for Financial Liabilities

The carrying amount as at balance date of financial liabilities designated at fair value through profit or loss, excluding derivatives, was $4 million less (2012: $23 million less) than the contractual amount at maturity.

Interest rates that are used as observable inputs in determining the fair value of financial liabilities will inherently include a component for credit risk. However, given the Bank's status as a sovereign issuer, it is difficult to isolate and accurately measure the change in interest rates and the resulting change in fair value of financial liabilities directly attributable to credit risk.

Collateral has been pledged for all Securities Sold under Agreements to Repurchase. All other liabilities of the Bank are unsecured and rank equally in the event that the Bank ceases to trade.

4. DERIVATIVE FINANCIAL INSTRUMENTS

Refer to page 57 for a description of the Bank's use of foreign exchange swaps and cross-currency basis swaps.

	Carrying Value 2013 $M	**Notional Principal 2013 $M**	Carrying Value 2012 $M	Notional Principal 2012 $M
Interest Rate Futures				
Interest Rate Futures Assets	**-**	**15**	-	4
Interest Rate Futures Liabilities	**-**	**-**	-	-
Net Interest Rate Futures Position	-	15	-	4
As at 30 June 2013, the Bank had 30 open Interest Rate Futures contracts (2012: 20).				
Cross-Currency Basis Swaps				
Cross-Currency Basis Swaps Assets	**936**	**6,761**	1,476	10,632
Cross-Currency Basis Swaps Liabilities	**(258)**	**2,603**	(263)	2,224
Net Cross-Currency Basis Swaps Position	678	9,364	1,213	12,856
Foreign Exchange Swaps				
Foreign Exchange Swaps Assets	**67**	**4,438**	224	5,604
Foreign Exchange Swaps Liabilities	**(338)**	**9,539**	(43)	3,232
Net Foreign Exchange Swaps Position	(271)	13,977	181	8,836
Total Derivative Financial Assets	**1,003**	**11,214**	1,700	16,240
Total Derivative Financial Liabilities	**(596)**	**12,142**	(306)	5,456
Net Derivative Financial Instruments Recognised in the Statement of Financial Position	407	23,356	1,394	21,696

5. OTHER FOREIGN CURRENCY FINANCIAL ASSETS

	2013 $M	2012 $M
Shareholding in the Bank for International Settlements	**139**	139
Receivable for Unsettled Sales of Securities	**47**	1
	186	140

As at 30 June 2013, the Bank owned 3,211 shares (2012: 3,211 shares) issued by the Bank for International Settlements (BIS). This represents approximately 0.6 percent of all shares on issue. The shares have a par value of SDR 5,000 each and are paid up to SDR 1,250 each. The Bank's investment in shares issued by the BIS is valued at fair value, which is determined as being 70 percent of the Bank's interest in the BIS's net asset value.

6. OTHER ASSETS

	2013 $M	2012 $M
Property, Plant and Equipment	**57**	56
Intangible Assets	**5**	6
Inventory	**13**	16
	75	78

7. SHORT-TERM FOREIGN CURRENCY FINANCIAL LIABILITIES

	2013 $M	2012 $M
Payable for Unsettled Purchases of Securities	-	5
Short-term Deposits	551	1,064
	551	1,069

8. DEPOSITS

	2013 $M	2012 $M
New Zealand Government Deposits	4,666	9,095
Settlement Bank Deposits	7,902	6,134
Central Bank Deposits	52	26
International Monetary Fund Deposits	7	7
	12,627	15,262

9. OTHER LOCAL CURRENCY FINANCIAL LIABILITIES

	2013 $M	2012 $M
Accounts Payable	3	3
Demonetised Currency	82	82
	85	85

10. OTHER LIABILITIES

	Note	2013 $M	2012 $M
Dividend Payable to the New Zealand Government	11	175	160
Accrued Salaries and Holiday Pay		2	1
Accrued Retirement Gratuities		2	3
Superannuation Liability	27	7	8
		186	172

No provision is made for non-vesting sick leave, as the pattern of sick leave taken indicates that no additional liability will arise for non-vesting sick leave.

11. PAYMENTS TO THE NEW ZEALAND GOVERNMENT

The Bank has recommended that a statutory dividend of $175 million be paid for the 2012-13 financial year. The Minister has given a direction that a dividend of $175 million (2012: $160 million) be paid. The dividend will be paid in September 2013.

In making dividend determinations, the Minister must have regard to the recommendations of the Bank, the views of the Board of Directors of the Bank and any other relevant matters.

The Bank's *Statement of Intent* includes a statement of the principles in accordance with which the Bank must determine the amount it recommends to the Minister as an annual dividend.

Those principles are:

- The Bank should maintain sufficient equity for the financial risks of performing its functions. Equity in excess of that required to cover those risks will be distributed to the Crown.
- In general, unrealised gains should be retained by the Bank until they are realised in New Zealand dollars. However, the Bank may recommend the distribution of unrealised gains where the Bank believes that the probability of the gain being realised is high.

12. EQUITY

	Note	2013 $M	2012 $M
Capital			
Balance at the Beginning of the Year		**1,600**	1,600
Total Capital		**1,600**	1,600
Retained Earnings			
Balance at the Beginning of the Year		**603**	645
Net Profit for the Year		**308**	118
Dividend Payable to the New Zealand Government	11	**(175)**	(160)
Total Retained Earnings		**736**	603
Available-for-sale Revaluation Reserve			
Balance at the Beginning of the Year		**353**	217
Fair Value Movements during the Year		**(163)**	136
Total Available-for-sale Revaluation Reserve		**190**	353
Property Revaluation Reserve			
Balance at the Beginning of the Year		**41**	42
Fair Value Movements during the Year	6	**-**	(1)
Total Property Revaluation Reserve		**41**	41
Currency and Artwork Collections and Archives Revaluation Reserve			
Balance at the Beginning of the Year		**5**	5
Total Currency and Artwork Collections and Archives Revaluation Reserve		**5**	5
Total Equity		**2,572**	2,602

Retained Earnings comprises:

	2013 $M	2012 $M
Realised Gains not yet Distributed	**780**	749
Changes in the Market Value of Financial Instruments not yet Realised	**34**	(29)
Foreign Exchange Losses not yet Realised in New Zealand Dollars	**(78)**	(117)
Total Retained Earnings	**736**	603

MANAGEMENT OF THE BANK'S CAPITAL

The Bank's capital management framework focuses on the Bank's total equity reported in its financial statements.

The main drivers of reported equity are reported financial results and the Bank's dividend. The dividend is determined annually by the Minister of Finance under the provisions of the Reserve Bank Act and the principles referred to in Note 11.

The Bank's primary capital management objective is to have sufficient capital to carry out effectively its statutory responsibilities. In determining whether the Bank has sufficient capital for those purposes, it assesses the extent of financial risks and the resulting potential for losses arising from its operations. The Bank assesses the appropriate ranges for capital by considering financial risks across the Statement of Financial Position, including the use of statistical models at varying levels of confidence, and supplements that analysis with judgement, where appropriate.

During the year, the Bank reviewed the model used to quantify its financial risks and to determine its required level of equity. In addition to updating the capital modelling methodology, the revised model takes into account data observations generated during the global financial crisis. As a result, the Bank has determined that its revised assessment of financial risk warrants a slightly higher level of equity and this recommendation was accepted by the Board and Minister. The higher equity level has been achieved by retaining $100 million of realised earnings and distributing $175 million of realised earnings.

13. CONCENTRATIONS OF FUNDING

	Total 2013 $M	New Zealand Government $M	New Zealand Public $M	New Zealand Financial Institutions $M	Overseas Financial Institutions $M	Other $M
Financial Liabilities						
Term Liabilities	**1,871**	**1,871**	**-**	**-**	**-**	**-**
Securities Sold under Agreements to Repurchase	**985**	**-**	**-**	**346**	**639**	**-**
Deposits	**12,627**	**4,666**	**-**	**6,457**	**1,463**	**41**
Currency in Circulation	**4,609**	**-**	**4,609**	**-**	**-**	**-**
Other Liabilities	**1,232**	**-**	**82**	**397**	**750**	**3**
Total Financial Liabilities	**21,324**	**6,537**	**4,691**	**7,200**	**2,852**	**44**

	Total 2012 $M	New Zealand Government $M	New Zealand Public $M	New Zealand Financial Institutions $M	Overseas Financial Institutions $M	Other $M
Financial Liabilities						
Term Liabilities	2,148	2,148	-	-	-	-
Securities Sold under Agreements to Repurchase	725	-	-	-	725	-
Deposits	15,262	9,095	-	4,531	1,636	-
Currency in Circulation	4,375	-	4,375	-	-	-
Other Liabilities	1,460	-	82	505	870	3
Total Financial Liabilities	23,970	11,243	4,457	5,036	3,231	3

All figures are stated at carrying values in the Statement of Financial Position.

RISK MANAGEMENT NOTES

14. RISK MANAGEMENT

The Reserve Bank is involved in policy-oriented activities. Therefore, elements of the Bank's risk management framework might differ from the risk management frameworks for most other financial institutions. The main financial risks to which the Bank is exposed include credit risk, foreign currency risk, and interest rate risk on both foreign and local currency assets. In the management of foreign reserves, minimising liquidity risk is a major consideration in order to maintain an effective foreign exchange intervention capability. Policies for managing credit, interest rate, foreign currency, and liquidity risks are outlined in Notes 16 to 20. As for other financial institutions, the nature of the Bank's operations creates exposure to a broad range of enterprise risks, including operational and reputational risks.

The Bank seeks to ensure that strong and effective risk management and control systems are in place for identifying, assessing, monitoring, and managing risk exposures. An Asset and Liability Committee (ALCO), comprising the governors and senior management, is responsible for advising the Governor with respect to all balance sheet-related activities, including the appropriateness of risk-return trade-offs underlying the Bank's strategy. Specialist staff conduct the Bank's local currency, foreign currency reserves management, and foreign exchange-dealing operations in accordance with a clearly defined risk management framework, including delegated authorities and limits set by the Governor. The risk management framework is subject to regular review by ALCO. The overall risk management framework is designed to promote the sound and prudent management of the Bank's risks.

The majority of the Bank's financial risks arise from the Foreign Reserves Management and Domestic Market Operations units of the Bank's Financial Markets department. Within this department, a separate risk management team is responsible for maintaining the Bank's financial risk management framework and operating independent risk reporting systems that monitor and report compliance with various risk limits and policies.

The Risk Assessment and Assurance department (which includes an internal audit unit) is responsible for an enterprise-wide risk management system and reports on internal audit, enterprise-wide risk management and related issues to the governors. A risk-based framework, which evaluates key business risks and internal controls, is used to determine the extent and frequency of internal audits conducted. The risk and assurance frameworks were the subjects of a comprehensive refreshment and enhancement programme of work as part of the Bank's 2012/2013 business priorities. All Bank departments are subject to periodic internal audit review. The Head of Risk Assessment and Assurance and the Manager, Internal Audit have direct and independent access to the Audit Committee of the Board of Directors, comprising three of the Bank's non-executive directors. Summary information on the outcomes of internal audits is reported to the Audit Committee.

The Bank is subject to an annual external audit by the Auditor-General under the Public Audit Act 2001. Auditing arrangements are overseen by the Audit Committee of the Board of Directors, which meets regularly to monitor the financial reporting, risk and audit functions within the Bank. The committee reviews the internal audit function and has direct access to the external auditor. The committee reports to the Board of Directors on its activities. The Board of Directors monitors the Bank's management of risk as part of its role of keeping the Bank's performance and use of resources under constant review.

The Bank self-insures all property, plant and equipment, including the Bank's Wellington building.

15. OPERATIONAL RISK

Operational risk is the risk of loss in both financial and non-financial terms resulting from human error and the failure of internal processes and systems.

The Bank has a broad range of functions spanning policy, financial stability, payments systems and internal corporate support, all of which are exposed to operational risk.

Managing operational risk in the Bank is seen as an integral part of day-to-day operations and management, which includes explicit consideration of both the opportunities and the risks of all business activities. Operational risk management includes Bank-wide corporate policies that describe the standard of conduct required of staff, a number of mandated requirements (e.g., a proactive problem management process whereby problems and incidents are reported and analysed for potential risk management improvements), an active internal audit function, and specific internal control systems designed around the particular characteristics of various Bank activities.

The above policies and procedures for managing operational risk are reinforced by the requirements of section 165 of the Reserve Bank Act. The Reserve Bank Act requires that the financial statements of the Bank include a statement signed by the Governor and Deputy Chief Executive accepting responsibility for, among other things, the establishment and maintenance of a system of effective internal control within the Bank.

16. CREDIT RISK

Credit risk is the risk of loss due to a borrower or counterparty failing to meet their financial obligations in accordance with agreed terms.

Within the Bank, credit risk arises principally through the investment of funds through Foreign Reserves Management and Domestic Market Operations functions. The Bank faces counterparty risk to the extent that derivative contracts are utilised by these two functions as part of normal operations.

A FOREIGN RESERVES MANAGEMENT CREDIT RISK MANAGEMENT

Credit risk for Foreign Reserves Management is monitored and managed daily. Exposures are controlled through comprehensive individual counterparty and issuer credit limits. Individual credit limits are set taking into account the credit of the counterparty or issuer and other factors. Additionally, sovereign and supranational issuers are assigned a higher limit than similarly rated corporates. Individual credit exposures are also aggregated and managed against cumulative limits, such as country exposure limits. The credit risk framework recognises differences in short-term (settlement risk) and longer-term credit risk.

As part of the arrangements for using financial instruments, credit risk is mitigated by receiving collateral. Collateral usually takes the form of cash or government securities. The value of collateral held is required to be within a prescribed range of the value of the exposure to the counterparty. Valuations are updated daily and, as a result, additional collateral may be called for or excess collateral returned to the counterparty.

In measuring compliance with credit limits, actual exposures are calculated on a credit-equivalent basis. In particular, where exposures to counterparties are collateralised by cash or by securities issued by sovereign states, the measure of actual credit exposure is reduced to reflect the collateral held.

B DOMESTIC MARKET OPERATIONS CREDIT RISK MANAGEMENT

The Domestic Market Operations function gives rise to credit risk primarily by transacting foreign currency swaps and reverse-repurchase transactions. The Bank accepts a wide range of pre-approved securities for reverse-repurchase transactions. Acceptable securities include government securities, securities issued by registered banks, highly-rated entities including supranational organisations, local authorities, residential mortgage-backed securities, asset-backed securities, asset-backed commercial paper and securities issued by state-owned enterprises. Where funds are advanced by reverse-repurchase agreements, the amount advanced is subject to specified discounts depending upon the type of security so as to ensure that the value of security held exceeds the amount advanced. The value of security held is monitored daily and calls are made for additional collateral from, or excess collateral is returned to, the counterparty as required.

C CONCENTRATIONS OF CREDIT EXPOSURE

The following table presents the Bank's financial assets based on end-of-year concentrations of credit exposure, classified by the country in which the issuer is resident. For this table, where collateral is held for reverse-repurchase agreements, the exposure measured is that to the issuer of the collateral, as opposed to the counterparty to the reverse-repurchase agreement.

Country in which Issuer is Resident:	Total 2013 $M	Sovereign 2013 $M	Financial Institutions 2013 $M	Total 2012 $M	Sovereign 2012 $M	Financial Institutions 2012 $M
United States	**7,578**	**7,318**	**260**	9,664	9,283	381
New Zealand	**3,250**	**2,818**	**432**	5,289	4,648	641
Supranational	**2,619**	**-**	**2,619**	1,104	-	1,104
Japan	**2,359**	**2,358**	**1**	1,262	1,262	-
Germany	**2,073**	**478**	**1,595**	1,621	285	1,336
France	**1,800**	**1,074**	**726**	2,613	1,416	1,197
Netherlands	**1,216**	**868**	**348**	1,401	167	1,234
Canada	**939**	**915**	**24**	163	125	38
United Kingdom	**900**	**857**	**43**	301	244	57
Australia	**564**	**416**	**148**	1,327	18	1,309
Sweden	**258**	**-**	**258**	752	-	752
Denmark	**210**	**-**	**210**	485	-	485
Asian Bond Funds	**155**	**-**	**155**	149	-	149
Switzerland	**54**	**-**	**54**	42	-	42
Other Non-European	**32**	**-**	**32**	115	-	115
Austria	**-**	**-**	**-**	378	-	378
Total Financial Assets	**24,007**	**17,102**	**6,905**	26,666	17,448	9,218

The following table presents the Bank's financial assets based on end-of-year concentrations of credit exposure, classified by the country in which the counterparty is resident.[16] For this table, any collateral held is not included in determining exposures.

Country in which Counterparty is Resident:	Total 2013 $M	Sovereign 2013 $M	Financial Institutions 2013 $M	Total 2012 $M	Sovereign 2012 $M	Financial Institutions 2012 $M
United States	**5,896**	**5,324**	**572**	5,386	4,719	667
New Zealand	**3,275**	**2,818**	**457**	4,509	3,193	1,316
France	**2,845**	**1,074**	**1,771**	2,933	1,416	1,517
Supranational	**2,619**	**-**	**2,619**	1,059	-	1,059
Japan	**2,359**	**2,358**	**1**	1,265	1,261	4
Germany	**2,073**	**478**	**1,595**	2,002	285	1,717
United Kingdom	**1,375**	**857**	**518**	4,060	244	3,816
Netherlands	**1,191**	**868**	**323**	1,401	167	1,234
Canada	**939**	**915**	**24**	163	125	38
Australia	**564**	**416**	**148**	1,802	18	1,784
Sweden	**258**	**-**	**258**	752	-	752
Denmark	**210**	**-**	**210**	485	-	485
Asian Bond Funds	**155**	**-**	**155**	149	-	149
Other Non-European	**151**	**-**	**151**	115	-	115
Switzerland	**97**	**-**	**97**	207	-	207
Austria	**-**	**-**	**-**	378	-	378
Total Financial Assets	**24,007**	**15,108**	**8,899**	26,666	11,428	15,238

The Bank's maximum credit risk exposure in relation to financial derivatives is the cost of re-establishing the derivative contracts in the market in the event of the failure of the counterparty to fulfil its obligations. This cost is the fair value of the financial derivative assets, as reported in Note 4.

16. The differences between amounts disclosed by issuer and by counterparty relate to Securities Purchased under Agreements to Resell.

D CREDIT EXPOSURE BY CREDIT RATING

The following table presents the Bank's financial assets based on Standard & Poor's credit rating of the issuer. AAA is the highest-quality rating possible and indicates the entity has an extremely strong capacity to pay interest and principal. AA is a high-grade rating, indicating a very strong capacity, and A is an upper-medium grade, indicating a strong capacity to pay interest and principal. BBB is the lowest investment-grade rating, indicating a medium capacity to pay interest and principal. Ratings lower than AAA can be modified by + or - signs to indicate relative standing within the major categories. N/R indicates the entity has not been rated by Standard & Poor's.

For this table, where collateral is held for reverse-repurchase agreements, the credit rating is that for the issuer of the collateral and not the credit rating for the counterparty to the reverse-repurchase agreement.

Country in which Issuer is Resident:	Total 2013 $M	AAA 2013 $M	AA+/- 2013 $M	A+/- 2013 $M	Various 2013 $M	N/R 2013 $M
United States	7,578	-	7,321	254	-	3
New Zealand	3,250	-	3,248	-	-	2
Supranational[17]	2,619	310	-	-	-	2,309
Japan	2,359	-	2,358	-	-	1
Germany	2,073	2,071	-	2	-	-
France	1,800	-	1,740	60	-	-
Netherlands	1,216	1,191	25	-	-	-
Canada	939	915	21	3	-	-
United Kingdom	900	856	-	44	-	-
Australia	564	416	148	-	-	-
Sweden	258	258	-	-	-	-
Denmark	210	210	-	-	-	-
Asian Bond Funds	155	-	-	-	155	-
Switzerland	54	-	-	54	-	-
Other Non-European	32	-	32	-	-	-
Total Financial Assets	24,007	6,227	14,893	417	155	2,315

Country in which Issuer is Resident:	Total 2012 $M	AAA 2012 $M	AA+/- 2012 $M	A+/- 2012 $M	Various 2012 $M	N/R 2012 $M
United States	9,664	-	9,297	366	-	1
New Zealand	5,289	-	5,288	-	-	1
France	2,613	-	2,553	60	-	-
Germany	1,621	1,621	-	-	-	-
Netherlands	1,401	1,387	14	-	-	-
Australia	1,327	657	670	-	-	-
Japan	1,262	-	1,262	-	-	-
Supranational[17]	1,104	287	-	-	-	817
Sweden	752	752	-	-	-	-
Denmark	485	485	-	-	-	-
Austria	378	-	378	-	-	-
United Kingdom	301	245	-	56	-	-
Canada	163	125	38	-	-	-
Asian Bond Funds	149	-	-	-	149	-
Other Non-European	115	-	115	-	-	-
Switzerland	42	-	-	42	-	-
Total Financial Assets	26,666	5,559	19,615	524	149	819

17. Exposures to Supranational that do not have a credit rating are exposures to the Bank for International Settlements.

E CREDIT EXPOSURE BY COUNTERPARTY AS A PERCENTAGE OF BANK'S EQUITY

The following table shows the number of individual counterparties, or groups of closely-related counterparties, where the Bank's credit exposures equalled or exceeded 10 percent of the Bank's equity as at the end of the year. These exposures are measured without taking into account collateral held by the Bank for credit exposures to individual counterparties. Credit exposures are measured taking into account any enforceable rights of set-off.

Percentage of Equity	**End-of-year 2013**	End-of-year 2012
10% to 19.9%	**7**	10
20% to 29.9%	**1**	2
30% to 39.9%	**4**	4
40% to 49.9%	**3**	2
50% to 59.9%	**1**	1
80% to 89.9%	**1**	-
100% to 109.9%	**1**	-
120% to 129.9%	**-**	1
140% to 149.9%	**-**	1
180% to 189.9%	**-**	1
200% to 209.9%	**1**	-

17. MARKET RISK

Market risk is the risk that the fair value of a financial instrument will fluctuate because of changes in market prices and rates. In respect of the Bank, market risk comprises interest rate risk and foreign currency risk.

The Bank uses a range of position size, delta, and stop-loss limits, together with Value at Risk (VaR) for the measurement and management of market risk.

INTEREST RATE RISK AND LIMITS

Interest rate risk is the risk that the fair value of a financial instrument will fluctuate due to changes in interest rates. Interest rate deltas measure the change in fair value of a financial instrument due to a 0.01 percent increase in interest rates. Interest rate delta limits are established for the aggregate balance sheet as well as individual portfolios.

FOREIGN CURRENCY RISK AND LIMITS

Foreign currency risk is the risk that the fair value of financial instruments will fluctuate due to a change in foreign exchange rates. Foreign exchange position limits are established for the aggregate net foreign currency position that may be taken, together with limits for the net exposure to individual foreign currency positions.

VaR AND VaR LIMITS

VaR estimates financial loss potential, based on historical observations of market rate and price movement. The Bank's VaR models test Bank portfolios against various periods of historical data, including the most recently recorded data, and data recorded during stressed market conditions (such as those recorded during 2008). The Bank's primary VaR model captures the potential financial loss over a one-day time horizon, at 99 percent confidence, referencing the most recent 250 days of price data. A 99 percent confidence interval suggests that the Bank may incur losses greater than those predicted by VaR once every 100 trading days, or 2.5 times a year.

VaR limits are utilised for the management of market risk arising from the Bank's actively managed portfolios.

VaR	Foreign Reserves Management Portfolios: Foreign Currency Risk 2013 $M	Foreign Currency Risk 2012 $M	Interest Rate Risk 2013 $M	Interest Rate Risk 2012 $M	Total Market Risk 2013 $M	Total Market Risk 2012 $M
As at 30 June	**26**	28	**5**	10	**27**	32
Peak over the Year	**29**	33	**10**	13	**32**	37
Low over the Year	**21**	25	**5**	10	**22**	29
Average over the Year	**24**	30	**7**	11	**25**	34

Total Market Risk is the sum of Foreign Currency Risk and Interest Rate Risk and also includes a deduction for correlation benefits.

STOP-LOSS LIMITS

Stop-loss limits are set to control losses that may arise in the Bank's actively trading portfolios. Should market risk losses exceed the stop-loss limit, the associated positions are closed down.

SENSITIVITY TO INTEREST RATE RISK AND FOREIGN CURRENCY RISK

The sensitivity of the Bank's financial assets and liabilities to assumed across-the-board changes in interest rates and the exchange rate is shown below.

	Total Gain/(Loss) Impacting Comprehen-sive Income 2013 $M	Gain/(Loss) Reported in the Income Statement 2013 $M	Gain/(Loss) Reported Directly in Equity 2013 $M	Total Gain/(Loss) Impacting Comprehen-sive Income 2012 $M	Gain/(Loss) Reported in the Income Statement 2012 $M	Gain/(Loss) Reported Directly in Equity 2012 $M
Impact of:						
A rise of 10% in the value of the New Zealand dollar	**(238)**	**(225)**	**(13)**	(196)	(183)	(13)
A fall of 10% in the value of the New Zealand dollar	**291**	**276**	**15**	239	223	16
A rise of one percentage point in the local currency yield curve	**(146)**	**(14)**	**(132)**	(135)	(15)	(120)
A fall of one percentage point in the local currency yield curve	**157**	**14**	**143**	144	16	128
A rise of one percentage point in the yield curve for all foreign currencies	**(57)**	**(57)**	**-**	(4)	(4)	-
A fall of one percentage point in the yield curve for all foreign currencies	**63**	**63**	**-**	4	4	-

The Bank's exposures to foreign currency risk and interest rate risk can change materially over time, depending on the Bank's policy objectives and economic conditions.

18. INTEREST RATE RISK

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes to market interest rates.

FOREIGN RESERVES MANAGEMENT INTEREST RATE RISK MANAGEMENT

The Bank holds an open foreign currency position, effectively financing a portion of its foreign currency assets using New Zealand dollar funding. This exposes the Bank to the risk of changes in the relative interest rates between New Zealand and overseas currencies. Interest rate risk also arises as a result of mismatches between the maturity or interest rate resets of assets and liabilities, where the assets and liabilities are denominated in the same currency. The Bank manages interest rate risk through delta limits, which act to cap the amount of interest rate risk the Bank faces.

DOMESTIC MARKET OPERATIONS INTEREST RATE RISK MANAGEMENT

The Bank's exposure to interest rate risk that arises from transacting foreign currency swaps in domestic market operations is constrained through interest rate delta limits and reverse-repurchase transactions in various liquidity facilities.

The average duration of the Bank's holding of New Zealand government securities in its investment portfolio (which excludes outright purchases of government securities for liquidity management purposes) as at 30 June 2013 was 5.1 years (2012: 3.9 years). Interest rate risk on New Zealand government securities is not dynamically managed and it is intended that these securities be held to maturity.

Assets and liabilities will mature or reprice within the following periods:

	Total 2013 $M	Non-interest Sensitive $M	Overnight $M	3 Months or Less $M	Between 3 and 12 Months $M	Between 1 and 2 Years $M	Between 2 and 5 Years $M	Over 5 Years $M
Assets								
Marketable Securities	14,033	-	-	8,836	2,244	1,978	975	-
Securities Purchased under Agreements to Resell	2,019	-	-	2,019	-	-	-	-
New Zealand Government								
Securities	2,818	-	-	298	-	661	710	1,149
Other Financial Assets	5,137	189	3,943	1,005	-	-	-	-
Other Assets	75	75	-	-	-	-	-	-
Total Assets	24,082	264	3,943	12,158	2,244	2,639	1,685	1,149
Liabilities								
Term Liabilities	1,871	-	-	1,871	-	-	-	-
Securities Sold under Agreements to Repurchase	985	-	-	985	-	-	-	-
Deposits	12,627	-	12,627	-	-	-	-	-
Currency in Circulation	4,609	4,609	-	-	-	-	-	-
Other Financial Liabilities	1,232	84	505	636	7	-	-	-
Other Liabilities	186	186	-	-	-	-	-	-
Equity	2,572	2,572	-	-	-	-	-	-
Total Liabilities and Equity	24,082	7,451	13,132	3,492	7	-	-	-
Interest Rate Sensitivity Gap excluding Futures Contracts	-	(7,187)	(9,189)	8,666	2,237	2,639	1,685	1,149
Futures Contracts	15	-	-	10	-	4	-	1
Total Interest Rate Sensitivity Gap	15	(7,187)	(9,189)	8,676	2,237	2,643	1,685	1,150
Interest Rate Sensitivity Gap by Currency[18]:								
New Zealand dollar	(2,611)	(7,768)	(12,628)	15,066	100	661	710	1,248
United States dollar	636	357	1,466	(2,888)	1,005	604	190	(98)
Euro	641	218	870	(1,514)	591	262	214	-
Japanese yen	85	(9)	1,014	(1,559)	-	471	168	-
British pound	390	18	37	(180)	282	233	-	-
Australian dollar	535	(3)	41	121	-	228	148	-
Canadian dollar	237	-	11	(370)	259	184	153	-
Other	102	-	-	-	-	-	102	-
	15	(7,187)	(9,189)	8,676	2,237	2,643	1,685	1,150

18. The Interest Rate Sensitivity Gap by Currency differs from the open foreign currency position by the notional principal on open futures contracts.

	Total 2012 $M	Non-interest Sensitive $M	Overnight $M	3 Months or Less $M	Between 3 and 12 Months $M	Between 1 and 2 Years $M	Between 2 and 5 Years $M	Over 5 Years $M
Assets								
Marketable Securities	12,780	-	-	11,928	703	-	52	97
Securities Purchased under Agreements to Resell	6,067	-	-	6,067	-	-	-	-
New Zealand Government								
Securities	3,193	-	-	-	824	-	685	1,684
Other Financial Assets	4,626	142	2,782	1,702	-	-	-	-
Other Assets	78	78	-	-	-	-	-	-
Total Assets	26,744	220	2,782	19,697	1,527	-	737	1,781
Liabilities								
Term Liabilities	2,148	-	-	2,148	-	-	-	-
Securities Sold under Agreements to Repurchase	725	-	-	725	-	-	-	-
Deposits	15,262	-	15,262	-	-	-	-	-
Currency in Circulation	4,375	4,375	-	-	-	-	-	-
Other Financial Liabilities	1,460	90	1,068	302	-	-	-	-
Other Liabilities	172	172	-	-	-	-	-	-
Equity	2,602	2,602	-	-	-	-	-	-
Total Liabilities and Equity	26,744	7,239	16,330	3,175	-	-	-	-
Interest Rate Sensitivity Gap excluding Futures Contracts	-	(7,019)	(13,548)	16,522	1,527	-	737	1,781
Futures Contracts	4	-	-	-	-	3	-	1
Total Interest Rate Sensitivity Gap	4	(7,019)	(13,548)	16,522	1,527	3	737	1,782

Interest Rate Sensitivity Gap by Currency:

New Zealand dollar	(2,147)	(7,153)	(15,263)	17,076	824	-	685	1,684
United States dollar	549	56	1,475	(1,662)	624	3	52	1
Euro	490	48	168	195	79	-	-	-
Japanese yen	109	15	15	79	-	-	-	-
British pound	318	15	37	266	-	-	-	-
Australian dollar	393	1	18	374	-	-	-	-
Canadian dollar	198	(1)	-	197	-	-	-	-
Other	94	-	-	(3)	-	-	-	97
	4	(7,019)	(13,548)	16,522	1,527	3	737	1,782

19. FOREIGN CURRENCY RISK

Foreign currency risk is the risk of loss arising from changes in exchange rates.

Foreign exchange risk arises from:

- maintenance of a portion of foreign currency reserves on an unhedged basis for crisis management purposes;
- currency intervention to meet monetary policy objectives; and
- active management undertaken in trading portfolios.

The Bank intends to hold some of its reserves on an unhedged basis through most of the exchange rate cycle. The Bank has a policy of maintaining a passive 'benchmark' open foreign exchange position of SDR 1 billion ($NZ 1.937 billion), but can vary the actual open position, and thus the amount of unhedged reserves, around that benchmark level, depending on the behaviour of the exchange rate and foreign exchange markets. This variation might be significant.

For non-trading portfolios, foreign currency risk is managed by way of open position limits, target open-currency composition weights and deviation bands. Additionally, the Bank monitors actual and expected VaR outcomes for these portfolios.

Stop-loss and VaR limits are also used to assist in managing the Bank's trading portfolios, which account for a minor proportion of the Bank's total open foreign exchange position.

As at 30 June 2013, the Bank's net exposure to major currencies, in New Zealand dollar terms, was:

	2013 $M	2012 $M
Australian dollar	**535**	393
British pound	**390**	318
Canadian dollar	**237**	198
Euro	**641**	490
Japanese yen	**85**	109
Swiss francs	**-**	(3)
United States dollar	**631**	545
Various currencies (Asian Bond Fund 2)	**102**	97
Total Net Open Foreign Exchange Position	**2,621**	2,147

At 30 June 2013, the net open foreign exchange position was SDR 1,352 million (2012: SDR 1,130 million). The quantum of the open position varies over time to the level the Bank determines is warranted by its policy objectives and economic conditions. The largest net open foreign exchange position (measured in SDR terms) during the 12 months ended 30 June 2013 was SDR 1,523 million ($NZ 2,672 million) (2012: SDR 1,157 million ($NZ 2,133 million)). The smallest net open foreign exchange position (measured in SDR terms) during the 12 months ended 30 June 2013 was SDR 1,145 million ($NZ 2,165 million) (2012: SDR 1,110 million ($NZ 2,327 million)).

20. LIQUIDITY RISK

Liquidity risk is the risk that the Bank will encounter difficulty in meeting financial obligations associated with financial liabilities that are settled by delivering cash or another financial asset. Liquidity risk also includes the risk that the Bank may have to sell a financial asset quickly at less than its fair value.

The objectives of the Bank's liquidity policy are to:

- ensure all financial obligations are met when due;
- ensure foreign reserves assets held for currency intervention purposes are able to be liquidated in an orderly fashion, within agreed timeframes; and
- ensure the Bank manages the aggregate level of New Zealand dollar liquidity in the New Zealand banking system, so as to, in turn, ensure that interest rates in inter-bank markets are consistent with monetary policy settings, and to facilitate the smooth operation of the inter-bank payment system.

A FOREIGN CURRENCY ACTIVITIES

Liquidity is a key criterion in determining the composition of the Bank's foreign currency assets. This reflects the potential requirement to liquidate foreign reserves for intervention purposes, should the need arise. Accordingly, there is an array of interacting controls aimed at ensuring quick access to funds. These controls include a required composition of portfolios based on the liquidity characteristics of securities, with defined minimum levels, duration, and limits on the minimum and maximum proportion of reserves that may be held in any one currency. Day-to-day foreign currency liquidity is managed through forecasting cash inflows and outflows.

At 30 June 2013, foreign currency assets valued at $18,524 million were classified as being able to be settled within two business days of being liquidated (30 June 2012: $18,736 million).

The Bank also manages refinancing risk on foreign reserves funded from borrowing by applying limits on the amount of borrowing maturing in any 12-month period.

B LOCAL CURRENCY ACTIVITIES

The Bank's management of its own New Zealand dollar liquidity risk is a function of the Bank's management of the daily aggregate liquidity that is available within the New Zealand banking system.

The Bank manages its own New Zealand dollar cash flows by advancing funds to, and withdrawing funds from, the New Zealand banking system. This is achieved through a range of financial transactions, including entering into foreign exchange swap and basis swap transactions and repurchase and reverse-repurchase agreements, and by issuing Reserve Bank bills. As New Zealand's central bank, the Bank is able to create New Zealand dollar liquidity through its daily market operations. Therefore, the Bank is not required to maintain a certain level of liquid assets in order to meet its New Zealand dollar obligations.

21. CASH FLOWS BY REMAINING CONTRACTUAL MATURITIES

The following table sets out the maturity profile of the Bank's financial assets and liabilities. The table discloses the contractual principal receivable or due at the maturity date, together with interest receivable or payable for the period to the maturity date based on interest rates and foreign exchange rates prevailing as at balance date. Financial liabilities payable on demand includes currency in circulation. However, historical experience has shown such balances provide a stable source of long-term funding for the Bank.

Deposits, which are on-demand liabilities, are managed taking into account the Bank's ability to create New Zealand dollar liquidity through its daily market operations. In all other respects, the Bank manages liquidity on a contractual maturity basis, which is consistent with the expected maturities of financial instruments.

The balances in this table do not equate with the balances in the Consolidated Statement of Financial Position, as the table incorporates all cash flows on an undiscounted basis.

Contractual maturities exclude the following assets, which have no fixed maturity dates: Asian Bond Fund 1, Asian Bond Fund 2, and shares in the Bank for International Settlements. The aggregate carrying value of these assets at 30 June 2013 was $294 million (2012: $288 million).

	Total 2013 $M	On Demand $M	3 Months or Less $M	3 to 12 Months $M	1 to 2 Years $M	2 to 5 Years $M	Over 5 Years $M
Foreign Currency Financial Assets							
Cash Balances	3,947	3,947	-	-	-	-	-
Securities Purchased under Agreements to Resell	1,994	-	1,994	-	-	-	-
Marketable Securities	13,923	-	8,851	2,287	1,980	805	-
Other Foreign Currency Financial Assets	47	-	47	-	-	-	-
	19,911	3,947	10,892	2,287	1,980	805	-
Foreign Currency Financial Liabilities							
Short-term Foreign Currency Financial Liabilities	551	551	-	-	-	-	-
Securities Sold under Agreements to Repurchase	639	-	639	-	-	-	-
Term Liabilities	1,891	-	(2)	155	667	1,071	-
	3,081	551	637	155	667	1,071	-
Foreign Currency Derivatives							
Contractual Inflows	6,681	-	5,504	520	148	432	77
Contractual Outflows	(21,571)	-	(14,135)	(1,395)	(863)	(3,180)	(1,998)
	(14,890)	-	(8,631)	(875)	(715)	(2,748)	(1,921)
Foreign Currency Net Gap in Contractual Maturities	1,940	3,396	1,624	1,257	598	(3,014)	(1,921)
Local Currency Financial Assets							
Securities Purchased under Agreements to Resell	25	-	25	-	-	-	-
New Zealand Government Securities	3,386	-	9	127	755	916	1,579
Other Local Currency Financial Assets	1	-	1	-	-	-	-
	3,412	-	35	127	755	916	1,579
Local Currency Financial Liabilities							
Deposits	12,627	12,627	-	-	-	-	-
Securities Sold under Agreements to Repurchase	346	-	346	-	-	-	-
Currency in Circulation	4,609	4,609	-	-	-	-	-
Other Local Currency Financial Liabilities	85	82	3	-	-	-	-
	17,667	17,318	349	-	-	-	-
Local Currency Derivatives							
Contractual Inflows	17,241	-	8,877	1,432	1,024	3,555	2,353
Contractual Outflows	(1,221)	-	(400)	(187)	(117)	(412)	(105)
	16,020	-	8,477	1,245	907	3,143	2,248
Local Currency Net Gap in Contractual Maturities	1,765	(17,318)	8,163	1,372	1,662	4,059	3,827
Total Net Gap in Contractual Maturities	3,705	(13,922)	9,787	2,629	2,260	1,045	1,906

	Total 2012 $M	On Demand $M	3 Months or Less $M	3 to 12 Months $M	1 to 2 Years $M	2 to 5 Years $M	Over 5 Years $M
Foreign Currency Financial Assets							
Cash Balances	2,785	2,785	-	-	-	-	-
Securities Purchased under Agreements to Resell	4,569	-	4,569	-	-	-	-
Marketable Securities	12,643	-	11,940	703	-	-	-
Other Foreign Currency Financial Assets	1	-	1	-	-	-	-
	19,998	2,785	16,510	703	-	-	-
Foreign Currency Financial Liabilities							
Short-term Foreign Currency Financial Liabilities	1,069	1,069	-	-	-	-	-
Securities Sold under Agreements to Repurchase	606	-	606	-	-	-	-
Term Liabilities	2,155	-	-	344	144	747	920
	3,830	1,069	606	344	144	747	920
Foreign Currency Derivatives							
Contractual Inflows	4,764	-	1,831	1,259	1,040	559	75
Contractual Outflows	(19,381)	-	(9,170)	(3,200)	(1,894)	(3,366)	(1,751)
	(14,617)	-	(7,339)	(1,941)	(854)	(2,807)	(1,676)
Foreign Currency Net Gap in Contractual Maturities	1,551	1,716	8,565	(1,582)	(998)	(3,554)	(2,596)
Local Currency Financial Assets							
Securities Purchased under Agreements to Resell	1,501	-	1,501	-	-	-	-
New Zealand Government Securities	3,610	-	8	952	120	903	1,627
Other Local Currency Financial Assets	1	-	1	-	-	-	-
	5,112	-	1,510	952	120	903	1,627
Local Currency Financial Liabilities							
Deposits	15,262	15,262	-	-	-	-	-
Securities Sold under Agreements to Repurchase	119	-	119	-	-	-	-
Currency in Circulation	4,375	4,375	-	-	-	-	-
Other Local Currency Financial Liabilities	85	82	3	-	-	-	-
	19,841	19,719	122	-	-	-	-
Local Currency Derivatives							
Contractual Inflows	17,900	-	7,758	2,511	1,544	3,863	2,224
Contractual Outflows	(1,024)	-	(106)	(97)	(193)	(519)	(109)
	16,876	-	7,652	2,414	1,351	3,344	2,115
Local Currency Net Gap in Contractual Maturities	2,147	(19,719)	9,040	3,366	1,471	4,247	3,742
Total Net Gap in Contractual Maturities	3,698	(18,003)	17,605	1,784	473	693	1,146

CONSOLIDATED INCOME STATEMENT NOTES

22. NET INVESTMENT INCOME

Net Investment Income includes:

	Total 2013 $M	Foreign Currency $M	Local Currency $M	Total 2012 $M	Foreign Currency $M	Local Currency $M
Interest Income						
Cash Balances	5	5	-	5	5	-
Securities Purchased Under Agreements to Resell	12	4	8	27	8	19
Marketable Securities	25	25	-	43	43	-
Derivative Financial Instruments	325	(16)	341	377	(35)	412
New Zealand Government Securities	217	-	217	203	-	203
Total Interest Income	584	18	566	655	21	634
Interest Expense						
Securities Sold Under Agreements to Repurchase	4	-	4	3	-	3
Term Liabilities[19]	(6)	(6)	-	4	4	-
New Zealand Government Deposits	145	-	145	186	-	186
Settlement Bank Deposits	179	-	179	180	-	180
Other	2	2	-	2	1	1
Total Interest Expense	324	(4)	328	375	5	370
Net Interest Income	260	22	238	280	16	264
Net Gains/(Losses) from Fair Value Changes	65	22	43	(73)	(77)	4
Net Gains/(Losses) from Foreign Exchange Rate Changes	29	29	-	(38)	(38)	-
Dividend Income	2	2	-	2	2	-
Total Net Investment Income/(Loss)	356	75	281	171	(97)	268

Interest income from the New Zealand government (including entities controlled by the New Zealand government) comprised 37 percent (2012: 31 percent) of total interest received.

COMPONENTS OF NET INVESTMENT INCOME FROM FINANCIAL INSTRUMENTS

Net Investment Income includes net income/(expense) arising from:

	2013 $M	2012 $M
Financial Assets and Financial Liabilities Classified as Fair Value through Profit or Loss upon Initial Recognition	186	(35)
Derivative Instruments Deemed to be Classified as Held for Trading	325	377
Financial Assets and Financial Liabilities Classified as Held for Trading	1	-
Interest and Dividend Income from Available-for-sale Financial Assets	165	192
Financial Assets Classified as Loans and Receivables	5	5
Financial Liabilities Classified as Financial Liabilities at Amortised Cost	(326)	(368)
Total Net Investment Income	356	171

19. Interest rates on Term Liabilities with the New Zealand government are re-set every quarter, based on market reference rates less a margin agreed at the inception of the loans. During 2013, with market interest rates at very low levels, interest was received by the Bank after the fixed margin was applied.

23. INCOME AND EXPENDITURE BY FUNCTION

The following table sets out operating income and operating expenditure for each of the Bank's main functions.

For the year ended 30 June 2013	Operating Income 2013 $M	Attribution of Earnings on Investments Funded by Equity 2013 $M	Operating Expenses 2013 $M	Net Profit/ (Loss) 2013 $M
FUNCTIONS				
Monetary Policy Formulation	-	-	11	(11)
Domestic Market Operations	8	23	5	26
Prudential Supervision	-	-	12	(12)
Macro-Financial Stability	-	-	4	(4)
Currency Operations	177	1	13	165
Foreign Reserves Management	81	66	6	141
Settlement Services	9	-	6	3
Total for Bank before Earnings on Investments Funded by Equity	275	90	57	308
Earnings not Allocated to Functions:				
Earnings on Investments Funded by Equity	90	(90)	-	-
Total for Bank	365	-	57	308
Income Retained under the Funding Agreement			9	
Net Operating Expenses			48	

For the year ended 30 June 2012	Operating Income 2012 $M	Attribution of Earnings on Investments Funded by Equity 2012 $M	Operating Expenses 2012 $M	Net Profit/ (Loss) 2012 $M
FUNCTIONS				
Monetary Policy Formulation	-	-	12	(12)
Domestic Market Operations	11	24	6	29
Prudential Supervision	-	-	14	(14)
Macro-Financial Stability	-	-	4	(4)
Currency Operations	190	1	12	179
Foreign Reserves Management	(123)	68	8	(63)
Settlement Services	8	-	5	3
Total for Bank before Earnings on Investments Funded by Equity	86	93	61	118
Earnings not Allocated to Functions:				
Earnings on Investments Funded by Equity	93	(93)	-	-
Total for Bank	179	-	61	118
Income Retained under the Funding Agreement			8	
Net Operating Expenses			53	

Operating income for each function includes allocations of notional interest income and expenditure on New Zealand dollar funding provided by (or provided to) the function through internal lending and borrowing. Notional interest rates take into account the estimated term of the funding and the associated external interest earned or incurred. Earnings on equity are not allocated to individual functions. The total operating expenses for each function include internal transfers between functions.

24. OPERATING EXPENSES

	Note	2013 $M	2012 $M
Staff Expenses		**30**	28
Net Currency-issued Expenses		**6**	5
Asset Management Expenses		**6**	7
Other Operating Expenses		**16**	15
Total Operating Expenses excluding Actuarial (Gain)/Loss on Defined Benefit Superannuation Scheme		**58**	55
Actuarial (Gain)/Loss on Defined Benefit Superannuation Scheme	27	**(1)**	6
Total Operating Expenses		**57**	61

	2013 $000	2012 $000
Operating Expenses includes:		
Depreciation of Property, Plant and Equipment	**3,128**	3,154
Amortisation of Intangible Assets	**1,148**	1,286
Impairment Charges for Property, Plant and Equipment	**-**	-
Impairment Charges for Intangible Assets	**-**	-
Bad Debt Expenses	**-**	-
Rental and Lease Expenses	**276**	348
Auditor's Remuneration:		
Statutory Audit	**238**	235
Payment Systems Audits	**69**	122
Advisory Services	**-**	24

The Statutory Audit expense comprises the fee for the audit of the annual financial statements of the Bank.

The Payment Systems Audits expense comprises fees paid for the contractual audits of the NZClear depository system and the Exchange Settlement Account System.

The Advisory Services expense comprises fees for advice on financial reporting and the operation and assessment of payment systems. These advisory services were approved in accordance with the Bank's External Auditor Independence Policy, which requires that prior to engaging the external auditor for any of these services, the advice of the Chair of the Audit Committee must be sought and approval must be given by the Governor.

KEY MANAGEMENT PERSONNEL

Key management personnel comprise the Governor, Deputy Governors and Assistant Governor. Because non-executive Board members are not responsible for decision-making by the Bank, and their statutory role is to monitor the performance of the Bank, they are not considered to be key management personnel as defined in NZ IAS 24 *Related Party Disclosures.* For the year ended 30 June, aggregate compensation paid to key management personnel comprised:

	2013 $000	2012 $000
Salaries, Superannuation Contributions and Other Short-term Benefits	**1,789**	1,710
Total Key Management Personnel Compensation	**1,789**	1,710

This table includes all compensation paid to key management personnel.

OTHER NOTES

25. RECONCILIATION OF NET CASH FLOWS FROM OPERATING ACTIVITIES WITH NET PROFIT FOR THE YEAR

	2013 $M	2012 $M
Net Profit for the Year	**308**	118
Add/(Subtract) Items included in Net Profit relating to cash flows from changes in Operating Assets and Operating Liability Balances, Investing and Financing Activities:		
Foreign Exchange (Gains)/Losses[20]	**(29)**	38
Market Value Changes	**(65)**	73
Add/(Subtract) Non-cash Items:		
Depreciation and Amortisation	**4**	4
Amortisation of Premium/Discount on Financial Instruments	**22**	12
Net Movement in Repatriated Currency Income and Expense	**-**	(1)
	(68)	126
Movements in Other Working Capital Items		
Decrease/(Increase) in Current Assets:		
Movement in Accounts Receivable	**-**	2
Movement in Inventories	**3**	4
Movement in Interest Receivable	**(10)**	6
	(7)	12
Increase/(Decrease) in Current Liabilities:		
Movement in Miscellaneous Liabilities	**(1)**	5
Movement in Interest Payable	**(1)**	2
	(2)	7
Net Movements in Other Working Capital Items	**(9)**	19
Operating Cash Flows from Income and Expenses	**231**	263
Cash Flows from Changes in Operating Assets and Operating Liability Balances	**890**	155
Net Cash Flows from Operating Activities	**1,121**	418

26. STATEMENT OF COMMITMENTS

A PROVISION OF FUNDING TO THE NEW ZEALAND FINANCIAL SYSTEM

As New Zealand's central bank, the Bank is able to create New Zealand dollar liquidity through its liquidity management operations, which include the daily open market operations. The Bank's open market operations include providing New Zealand dollar liquidity facilities to eligible borrowers on terms stipulated by the Bank, including the provision of approved collateral.

B RECIPROCAL FUNDING ARRANGEMENTS WITH FOREIGN CENTRAL BANKS

On 18 April 2011, the People's Bank of China (PBOC) and the Bank established a reciprocal currency arrangement (swap line) to support the settlement of trade transactions between New Zealand and Chinese businesses in circumstances where it might otherwise be difficult to settle obligations in Chinese renminbi (RMB). The swap facility provides for the PBOC and the Bank to enter into foreign exchange swap transactions that have a total value at any point in time of up to RMB 25 billion (NZD 5 billion), with the terms of the foreign exchange swaps to be agreed at the time the swaps are entered into. The swap line is for a term of three years, which may be extended if both parties agree. No drawings have been made under this arrangement in the year ended 30 June 2013 (2012: nil).

The Bank also has a reciprocal arrangement with the Hong Kong Monetary Authority, which allows either party to enter into repurchase agreements with the other to raise up to USD 250 million, secured by US government securities. The existing arrangement expires on 31 March 2014, but may be extended by mutual agreement. No drawings have been made under this arrangement in the year ended 30 June 2013 (2012: nil).

20. Foreign Exchange (Gains)/Losses includes the Foreign Exchange Rate Effect on Cash Balances at the Beginning of the Year in the Consolidated Statement of Cash Flows on pages 49 and 50.

C COMMITMENTS TO THE NEW ZEALAND GOVERNMENT

The Bank has agreed to make foreign currency available to the New Zealand government on arm's length terms so that the government may meet any calls made by the International Monetary Fund (IMF) under two standby loan facilities.

The two standby loan facilities entered into by the government are:

- to provide loans to the IMF up to SDR 624.34 million if the IMF makes a call on the New Zealand government in respect of the government's commitment under the IMF's "New Arrangements to Borrow" facility; and
- to provide loans to the IMF of up to USD 1 billion if the IMF makes a call on the New Zealand government in respect of the government's commitment under the IMF's "2012 Borrowing Arrangements" facility.

During the year ended 30 June 2013, no funds were made available to the government under these arrangements (2012: nil).

27. SUPERANNUATION COMMITMENTS

The Bank has a superannuation fund for staff. The superannuation fund includes both a defined contribution scheme and a defined benefit scheme. Contributions, as specified in the rules of the respective schemes, are made by the Bank as required. Statutory actuarial valuations of the schemes are undertaken every three years, with the last statutory valuation being undertaken as at 31 March 2012. Each year, the actuary provides an assessment of the value of the assets and liabilities of the superannuation fund, with the last valuation performed as at 31 March 2013. There have been no material changes to the fund's financial position between 31 March 2013 and 30 June 2013. Contributions to the defined benefit scheme are at a rate, reviewed annually, sufficient to keep the scheme solvent, based on actuarial assessments. The defined benefit scheme was closed to new members in 1991.

DEFINED BENEFIT SCHEME

The following information is provided in respect of the defined benefit scheme:

As at 31 March	2013 $000	2012 $000
Superannuation Asset/Superannuation Liability Recognised in the Statement of Financial Position		
Present Value of Wholly or Partly Funded Obligations	**41,887**	43,242
Fair Value of Plan Assets	**35,095**	35,645
Present Value of Net Obligations	**6,792**	7,597
Net Liability Recognised in the Statement of Financial Position	**6,792**	7,597

The primary actuarial assumptions used in the above calculations, expressed as weighted averages, are as follows:

	2013 %	2012 %
Discount Rate at the Beginning of the Year	**2.53**	2.92
Expected Rate of Return on Plan Assets at the Beginning of the Year	**4.50**	4.50
Future Salary Increases	**3.50**	3.50
Other Material Actuarial Assumptions - Pension Increases	**2.50**	2.50

28. SUBSIDIARY COMPANY

The Bank has a wholly-owned New Zealand-incorporated subsidiary, New Zealand Central Securities Depository Limited (NZCSD).

NZCSD is a non-trading company, incorporated solely for the purpose of acting as a custodian trustee. It holds assets on behalf of the participants in the NZClear System, as described in Note 32.

29. RELATED PARTIES

In the normal course of its operations, the Bank enters into transactions with related parties. Related parties include the Crown, various government departments, and Crown entities. Unless stated otherwise, all transactions with related parties take place at arm's length.

Transactions entered into include:
- banking services;
- agency transactions (at no charge);
- foreign exchange transactions;
- funding from the Treasury as part of the Foreign Reserves Management operations; and
- purchases of New Zealand government securities.

Material transactions with entities controlled by the Crown and balances with entities controlled by the Crown were:

Year ended 30 June	**2013 $M**	2012 $M
Receipts from and Payments to Entities Controlled by the New Zealand Government		
Receipts of Income from Entities Controlled by the New Zealand Government		
Interest Income	**217**	203
Rental Income	**1**	1
Receipts of a Capital Nature from Entities Controlled by the New Zealand Government		
Receipt of Proceeds on Maturity of New Zealand Government Securities - Available for Sale	**789**	919
Receipt of Proceeds on Maturity of New Zealand Government Securities - Fair Value through Profit or Loss	**4,989**	2,962
Payments of Expenses to Entities Controlled by the New Zealand Government		
Interest Expense	**141**	193
Payments of Capital to Entities Controlled by the New Zealand Government		
Net Decrease/(Increase) in Deposits	**4,317**	3,982
Repayment of Term Liabilities	**325**	322
Payment for Purchase of New Zealand Government Securities	**586**	217

As at 30 June	**2013 $M**	2012 $M
Balances with Entities Controlled by the New Zealand Government		
Assets that Comprise Claims on Entities Controlled by the New Zealand Government		
New Zealand Government Securities	**2,818**	3,193
Securities Purchased under Agreements to Resell	**25**	25
Liabilities that Comprise Claims by Entities Controlled by the New Zealand Government		
Deposits	**4,993**	9,311
Term Liabilities	**1,871**	2,148

In addition, during the year, as part of the Bank's domestic market operations, the Bank entered into securities reverse-repurchase agreements with Crown-owned entities on standard commercial terms. Except as noted above, all amounts advanced under these agreements have been repaid. The table above also includes interest income received by the Bank from this activity.

30. CONTINGENT LIABILITIES

A In terms of a Trust Deed dated 16 May 1980, the Reserve Bank has a contingent liability to maintain the actuarial soundness of the Reserve Bank of New Zealand Staff Superannuation and Provident Fund (the Fund).

The Actuary carried out a review of the financial position of the Fund as at 31 March 2013.

The Fund's Trust Deed provides for the Defined Benefit division of the Fund to be wound up in the event that the Bank is wound up or by resolution of the Bank's directors. In the event that the Fund is wound up, the Fund is required to purchase annuities having values equal to the actuarial value of benefits payable by the Fund. The Actuary reported that, based on current estimates of the cost of annuities, in the event the Defined Benefit division of the Fund is wound up, the purchase cost of annuities would exceed the value of Defined Benefit assets of the Fund. On winding up, the Bank is required by the Trust Deed to make good any shortfall. The Bank considers that the likelihood of the Fund being wound up is remote.

B Five former employees of the Bank who either are, or at one time were, members of the Bank's Defined Benefit superannuation scheme commenced proceedings against the Bank. In February 2012, the Employment Court rejected the plaintiffs' claim and found in favour of the Bank. The Court of Appeal has granted the plaintiffs leave to appeal the decision of the Employment Court. Based on the legal advice received, the likelihood of the appeal being successful is considered to be remote and no provision has been made for any loss that may arise after balance date in respect of this matter. Provision has been made in the financial statements at 30 June 2013 for the estimated legal costs associated with the appeal.

C The Bank has a contingent liability for currency in circulation that has been demonetised but not returned to the Bank, but only to the extent that the Bank has not recognised an actual liability. The total face value of demonetised currency as at 30 June 2013 was $104.5 million (2012: $104.6 million). Of the total face value of demonetised currency, $81.5 million (2012: $81.6 million) is recognised as a liability in the Consolidated Statement of Financial Position.

D The Bank has a liability for the face value of collectors' currency. However, it is most unlikely that significant amounts of collectors' currency will be returned for redemption at face value. The face value of collectors' currency issued before 1 July 2004 and that is not recognised as a liability is $9.8 million (2012: $9.8 million).

E As at 30 June 2013, the Bank had a contingent liability of $23.33 million (SDR 12.04 million) (2012: $22.87 million (SDR 12.04 million)) in respect of uncalled and unpaid capital attached to its shareholding in the Bank for International Settlements.

31. INCOME TAX

Section CW38 of the Income Tax Act 2007 exempts the Bank from income tax. The Bank incurs and meets liabilities for goods and services tax, fringe benefit tax and other withholding tax.

32. CUSTODIAL ACTIVITIES

The Bank operates the NZClear System, which is a securities clearing and settlement system. It holds assets, on behalf of the participants, in the name of New Zealand Central Securities Depository Limited (NZCSD), which it has appointed as custodian trustee in terms of the Trustee Act 1956.

NZCSD is a wholly owned New Zealand-incorporated subsidiary of the Bank, which, in terms of a Deed of Appointment between the Bank and NZCSD, is incorporated solely for the purpose of acting as a custodian trustee. The Bank undertakes to accept liability for all costs and debts of NZCSD as a means of reinforcing that role. NZCSD is a non-trading company, but has legal ownership of securities beneficially owned by members of the NZClear System. With the exception of the local currency securities owned by the Bank and held through NZCSD, the Bank has no beneficial interest in the securities that NZCSD holds, or any management obligations apart from safekeeping or acting as paying agent in certain circumstances.

The total value of securities held by NZCSD as at 30 June 2013 was $167.3 billion (2012: $160.9 billion).

Under the NZClear System Rules, the Bank's and NZCSD's liability to any member of NZClear, arising out of, or in connection with, the system, is limited to direct losses, up to an aggregate of $5 million for any one event.

33. SIGNIFICANT POST-BALANCE DATE EVENTS

There have been no significant post-balance date events.

FIVE-YEAR HISTORICAL FINANCIAL INFORMATION

FIVE-YEAR FINANCIAL POSITION

As at 30 June	Audited 2009 $M	Audited 2010 $M	Audited 2011 $M	Audited 2012 $M	**Audited 2013 $M**
Assets					
Foreign Currency Financial	19,460	22,612	24,647	21,971	**21,163**
Local Currency Financial	11,369	3,658	6,360	4,695	**2,844**
Other Assets	93	87	83	78	**75**
Total Assets	30,922	26,357	31,090	26,744	**24,082**
Liabilities and Equity					
Foreign Currency Financial	5,539	5,533	4,481	4,129	**3,657**
Local Currency Financial	21,777	17,953	23,884	19,841	**17,667**
Other Liabilities	639	297	216	172	**186**
Equity	2,967	2,574	2,509	2,602	**2,572**
Total Liabilities and Equity	30,922	26,357	31,090	26,744	**24,082**

FIVE-YEAR FINANCIAL PERFORMANCE

For the year ended 30 June	Audited 2009 $M	Audited 2010 $M	Audited 2011 $M	Audited 2012 $M	**Audited 2013 $M**
Operating Income					
Net Investment Income	952	(69)	191	171	**356**
Other Income	8	8	8	8	**9**
Total Operating Income/(Expense)	960	(61)	199	179	**365**
Operating Expenses					
Staff Expenses	24	26	27	28	**30**
Currency-issued Expenses	6	4	7	5	**6**
Asset Management Expenses	7	8	7	7	**6**
Other Operating Expenses	13	14	14	15	**16**
Total Operating Expenses excluding Actuarial Loss/(Gain) on Defined Benefit Superannuation Scheme	50	52	55	55	**58**
Actuarial Loss/(Gain) on Defined Benefit Superannuation Scheme	4	(2)	-	6	**(1)**
Total Operating Expenses	54	50	55	61	**57**
Net Profit/(Loss) for the Year	906	(111)	144	118	**308**
Five-year Outcomes under the Funding Agreement					
Actual Net Expenses under the Funding Agreement[21]	45.7	41.2	46.8	47.0	**48.3**
Net Expenditure Specified under the Funding Agreement	43.3	46.9	47.8	50.2	**52.7**
Funding Agreement Under-expenditure/(Over-expenditure)	(2.4)	5.7	1.0	3.2	4.4

FIVE-YEAR DIVIDENDS PAID TO THE NEW ZEALAND GOVERNMENT

For the year ended 30 June	Audited 2009 $M	Audited 2010 $M	Audited 2011 $M	Audited 2012 $M	**Audited 2013 $M**
Dividends Paid to the New Zealand Government	630	335	210	160	**175**

The dividend paid in 2010 includes a voluntary payment to the Crown of $45 million that was made in April 2010.

21. The five-year Funding Agreement that commenced 1 July 2010 excludes actuarial gains and losses from net operating expenses that are subject to the Funding Agreement. Prior to that date, actuarial gains and losses were included in net operating expenses subject to the Funding Agreement.

GLOSSARY

(THE) ACT
The Reserve Bank Act 1989.

AML/CFT
Anti-Money Laundering and Countering the Financing of Terrorism

Under the Anti-Money Laundering and Countering Financing of Terrorism Act 2009, the Reserve Bank is one of three supervisors tasked with ensuring firms comply with new obligations designed to help deter and detect money laundering and terrorist financing.

BASEL III
New global regulatory standards on bank capital adequacy and liquidity, published by the Basel Committee on Banking Supervision in December 2012.

BIS
Bank for International Settlements

An international financial institution based in Switzerland, owned by about 50 central banks and providing a range of financial services to central banks, international financial institutions and governments.

CFR
Core Funding Ratio

The ratio of a registered bank's total core funding to its total loans and advances. Core funding is the sum of all funding with more than one year remaining to maturity, plus varying percentages of shorter-term funding.

CLS
Continuous Linked Settlement

An international system run by CLS Bank International intended to reduce foreign exchange settlement risk (Herstatt risk). CLS does this by ensuring payment of both currencies in a foreign exchange transaction to be made simultaneously and irrevocably.

CPI
Consumers Price Index

The All Groups Consumers Price Index published by Statistics New Zealand. The CPI measures the rate of price change of goods and services purchased by New Zealand households.

CPSS
The Committee on Payment and Settlement Systems

A forum for 25 central banks to monitor and analyse developments in domestic payment, settlement and clearing systems, and cross-border and multicurrency settlement schemes. The Committee also focuses on standard-setting activities.

EMEAP
Executive Meeting of East Asian and Pacific central banks and monetary authorities

A cooperative organisation of central banks and monetary authorities in the East Asia and Pacific region, comprising Australia, China, Hong Kong, Indonesia, Japan, Korea, Malaysia, New Zealand, Philippines, Singapore and Thailand.

ESAS
Exchange Settlement Account System

The Reserve Bank's banking service for certain qualifying institutions that need to make regular high-value payments with each other. All the current account holders are banks.

FSIS
Financial Sector Information System

The Bank's central database for time-series data.

FSR
Financial Stability Report

A six-monthly report assessing the soundness and efficiency of the New Zealand financial system.

IOSCO
International Organisation of Securities Commissions

A worldwide organisation of securities regulators, including the New Zealand Securities Commission.

ISL
Interchange and Settlement Limited

A non-real time switch system that enables the settlement of transactions between banks from the processing of cheques, direct debit, direct credits, automatic payments and EFTPOS.

MPS
Monetary Policy Statement

A quarterly assessment, accompanying an OCR Review, of how the Bank proposes to achieve its monetary policy target (see PTA); how it proposes to formulate and implement monetary policy during the next five years; and how monetary policy has been implemented since the last MPS.

NBDTS
Non-bank deposit takers

Finance companies, building societies and credit unions, which take deposits from the investing public, and which are not registered banks under the Act.

NZCLEAR
A real-time settlement system providing the financial markets with clearing and settlement services for high-value debt securities and equities.

OCR
Official Cash Rate

The interest rate set by the Bank to meet the inflation target specified in the PTA.

PTA
Policy Targets Agreement

A contract, negotiated between the government and the Governor of the Reserve Bank, defining the Bank's price stability target.

SDR
Special Drawing Right

Unit of account of international reserve assets created by the International Monetary Fund (IMF) to supplement the reserves of IMF member countries. Its value is based on a basket of key international currencies.

SBI
Settlement Before Interchange

The process, operated under Payments New Zealand Ltd's rules, by which any two banks prepare and process files containing details of their customers' bilateral transactions. The net value of the transactions is settled by one bank making a payment from its ESAS account to the other bank's ESAS account. Once settled, the file containing details of the customers' transactions is delivered to the destination bank, which will then update its customers' records.

TWI
Trade-Weighted Index

A measure of the value of the New Zealand dollar relative to the currencies of New Zealand's major trading partners.