

Fin-Ed Centre



FINANCIAL EDUCATION AND RESEARCH CENTRE

Understanding your financial world

The Central Bank

Most countries have a central bank, which has two roles in the economy. The Federal Reserve Bank of America (known as the Fed) is the central bank of the US, the Bank of England is the UK's central bank and the Reserve Bank of Australia is the Australian central bank. New Zealand's central bank is the Reserve Bank of New Zealand (RBNZ).

Role of the Reserve Bank of New Zealand

The RBNZ's functions are defined by the Reserve Bank of New Zealand Act 1989, which give it a wide range of statutory powers and functions designed to help maintain financial stability and efficiency. The roles of the RBNZ are:

1. Oversee New Zealand's monetary system and ensure that banks and other financial institutions operate stably and efficiently
2. Act as the government's banker and as its an agent to carry out monetary policy.

Although the RBNZ is an agent of the government, it is **independent** of the government. That means the RBNZ, and not the government, decides on matters like interest rates. It uses interest rates to achieve its primary role; price stability. In other words, the RBNZ's main objective is controlling inflation and it does this through **monetary policy**.

Note issuance

The Reserve Bank has the sole right to issue New Zealand's bank notes and coins (currency). It controls the design and production of currency and issues the notes and coins to **registered banks**. The Reserve Bank also withdraws damaged or unusable currency.

Banker to banks and government

The Reserve Bank is the banker to all of New Zealand's registered banks. In the same way as people make payment to each other through their bank, registered banks make payments to each other through **settlement accounts** that they hold at the Reserve Bank. Similarly, the RBNZ also provides some banking services to the government.

Financial system supervision

The Reserve Bank sets the criteria for institutions wanting to be a bank in New Zealand and registers those that it believes have met the criteria. The criteria are designed to protect the

financial system as a whole. Registered banks are then monitored by the Reserve Bank and if the Reserve Bank thinks that they are in financial trouble, and could put the whole financial system at risk, it has statutory powers to intervene.

Foreign reserves

The RBNZ holds and manages New Zealand's foreign exchange reserves. Although New Zealand has a floating exchange rate that is set by the market, the government can intervene on the exchange rate by directing the Reserve Bank to buy or sell New Zealand dollars (reduce or increase the foreign exchange reserves) to smooth out peaks and troughs in the exchange rate.

The importance of price stability

Price stability is important because it protects the value of people's income and savings. It also means that people can enter into business deals knowing that the prices set in a contract will mean essentially the same thing throughout its term.

(Sloman and de Boer, 2009, p.287)