MONETARY POLICY, 1976 AND BEYOND

I. INTRODUCTION

In March 1976, a number of important monetary policy measures, mainly in relation to the adoption of a flexible interest rate policy, were announced. These measures opened the way for the development of a monetary policy based more on market forces and less on administrative controls. It was considered that this would result in more effective policy and a more soundly based and equitable financial system. This policy direction has been, by and large, maintained in the subsequent four years, with the introduction of a number of further measures aimed at removing the distortions and impediments to competition which had arisen under the previous system of detailed institutional control. Associated with these measures has been the development of institutional arrangements designed to prepare the way for open market operations and to facilitate a more active public debt policy.

The monetary policy measures announced in March 1976 and subsequently have been reported and commented on by the Bank from time to time in a number of places. This article is intended to provide a comprehensive list of the main measures taken over the period since March 1976 in order to provide an overview and single source of reference.[1] In order to put these policy measures into perspective, a brief descriptive list of the controls which remain is also included.

II. MONETARY MEASURES ANNOUNCED ON 2ND MARCH 1976

(a) The Interest on Deposit Regulations were revoked. These had been in force since 1972, and specified the interest rates payable by most deposit accepting institutions other than trading banks and savings banks.

(b) Interest payable on Post Office Savings Bank deposits and the maximum rates permitted on private and trustee savings bank investment account deposits were adjusted upwards as follows:

Deposit Period	*Previous Rate*	*New Rate*
	Percent	Percent
6 months	4.5	5.5
1 year	5.5	6.5
2 years	6.0	7.0
3 years	6.5	8.0

(c) Interest rates on trading banks deposits were decontrolled, except for deposits of $12,000 or less for terms of three years or less. Interest rates on the latter were not to exceed the rates offered by savings bank on investment accounts for comparable periods. This measure was effected by way of a Reserve Bank directive which set out a schedule of maximum permissible interest rates.

(d) The control on trading banks' overdraft interest rates, which had required them to adhere to a maximum average rate of 6 percent, was removed.

(e) Treasury bill and Government stock interest rates were adjusted upwards. The new rates were:

		Percent
Treasury bills:	3 months	4.0
	6 months	4.5
Government stock:	2 years	5.25
	5 years	6.75
	10 years and over	8.0

Previously Treasury bill rates had been 3 and 3.5 percent respectively and Government stock rates had been 5 percent for three years, 5.75 percent for six years and 6.5 percent for eighteen years.

(f) Rates of interest on new issues of local authority stock were raised and the margin over Government stock for terms of ten years or more was increased from 0.25 to 0.5 percent.

Term	*Previous Rate*	*Term*	*New Rate*
	Percent		Percent
1 year	4.75	1–2 years	5.5
3–5 years	5.25–6.0	3–4 years	6.25
		5 years	7.25
6 years	6.25	6 years but less than 10 years	7.75
Over 6 years	6.75	10 years and over	8.5

(g) Trustee and private savings banks' Government security ratios were effectively reduced by two percentage points. The savings banks were requested to apply the funds made available by this ratio reduction to financing new houses (or existing houses, where the vendor intended to purchase a new house).

(h) The Housing Corporation's prime lending rate was increased as was that for the Rural Bank and other Government agencies lending to the farming sector. With respect to both housing and farm finance, the Government announced that it would introduce policies designed to reduce the relative level of involvement by Government agencies in these areas.

III. MONETARY MEASURES ANNOUNCED SINCE 2ND MARCH 1976

(i) *In Relation to Trading Banks*

(a) In late March 1976, the Reserve Bank increased by 1.5 percentage points the rates of interest charged on trading bank borrowings from the Reserve Bank for reserve asset purposes and the Bank indicated that the rates would in the future be adjusted in a more flexible manner than in the past.

(b) In April 1976 an interest rate limitation on trading bank leasing was removed.

1. In an article of this nature it is possible to give only a broad outline of the various policy measures. Readers who have a particular interest in a specific measure are therefore advised to refer to the original policy announcement (major measures have been published in the *Bulletin* at the time of announcement) or to the authorities responsible for the administration of the policy in question. Readers interested in the background to the change in the direction of monetary policy since 1976, and in the experience under that new policy direction, are referred to the articles listed at the end of this article.

(c) In December 1976 a quantitative directive on trading bank lending to other financial institutions, which had been in force since May 1974, was rescinded but such lending continued to be regarded as low priority under a 'qualitative' directive.

(d) The 1977 Budget introduced a scheme providing a 100 percent guarantee to qualifying trading bank lending on export transactions. This scheme is administered by the Export Guarantee Office.

(e) In late 1977 trading banks were given approval to introduce negotiable certificates of deposit, and a long-standing prohibition on trading banks investing in local authorities' securities was removed.

(f) A compensatory deposit scheme was introduced in March 1978, under which the Reserve Bank re-deposits with the trading banks much of the net flow of funds to Government during periods of seasonally low liquidity brought about by income tax payments in March and September of each year. These deposits are gradually repaid by the banks over the subsequent two and a half months thus spreading the tax generated liquidity troughs over a longer period than before.

(g) The minimum term and amount for trading bank transferable certificates of deposit were reduced to 30 days and $12,000 respectively as from 31st March 1978. They had previously been 6 months and $25,000.

(h) The trading banks were permitted to operate fully in the commercial bill market as from 1st April 1978. They had previously been excluded from this market.

(i) In 1979, trading banks were permitted to issue credit cards.

(j) New arrangements were introduced in July 1980 for trading bank borrowing from the Reserve Bank for reserve asset purposes and, as from August 1980, the trading banks' reserve asset requirement has been specified in terms of a single ratio covering both demand and time deposits. Previously separate ratios had been applied to the different types of deposit.[2]

(ii) *In Relation to Savings Banks*

(a) Since March 1976, the Government security investment requirements of the trustee and private savings banks have been progressively reduced from the equivalent of 47 percent and 64 percent of deposits to the current levels (December 1980) of 38 percent and 54 percent respectively. Frequently the ratio reductions have been accompanied by a request that the funds made available be lent for housing purposes.

(b) In September 1976, a new deposit instrument called the Housing Bond was introduced for trustee savings banks and the Post Office Savings Bank. This type of deposit is subject to a comparatively low government security ratio of 15 percent.

(c) In late 1976, the home and farm ownership savings schemes operated through the Post Office Savings Bank, the trustee savings banks and certain building societies were extended. In 1977, a fishing vessel ownership account savings scheme, along similar lines to the amended farm ownership account scheme, was introduced.

(d) In June 1977, the Post Office Savings Bank introduced a personal housing loans (second mortgage) scheme. This scheme is in addition to the personal loans scheme introduced in 1973, although the two schemes have now been combined for funding purposes. The proportion of POSB funds available for personal and housing loans has been progressively increased over the years, and in August 1977 the maximum terms for some POSB second mortgages were extended.

(e) In July 1977 savings banks were given the freedom to set their own term deposit rates and structure, although in the case of the trustee savings banks the Reserve Bank's concurrence for rate changes was still needed. Similarly the Post Office Savings Bank had to submit proposed interest rate alterations to the Treasury. The previous restriction on trading banks' rates for term deposits of $12,000 and under was removed with the proviso that the banks were not to pay to customers eligible to bank with their savings bank subsidiary rates in excess of the maximum paid by their savings bank subsidiaries. This proviso was subsequently removed in September 1980.

(f) In February 1978, the total amount that the trading and trustee savings banks could lend by way of personal loans was increased from the equivalent of 1 percent of savings banks' deposits (in the case of trading banks, the deposit of each bank's savings bank subsidiary) to 2 percent of deposits. In March 1979, a set of formal conditions relating to the terms and repayment requirements for trustee savings banks and trading banks personal loans were removed; and in April 1980, the forementioned 2 percent of deposits limit was abolished.

(g) The Minister of Finance, in February 1978, urged the trustee and private savings banks to provide housing finance of a type more suitable to many borrowers in inflationary times, namely 'low start' mortgages. At the same time it was announced that the Housing Corporation would make available 'low start' mortgages. As from August 1978, the savings banks have been given a direct incentive to do likewise, in the form of a deduction from their deposit liabilities of the amount of outstanding 'low start' mortgages when determining their government security investment obligations.

(h) In October 1978 arrangements allowing the private savings banks to phase out their holdings of special government stock bearing 3.75 percent interest were introduced. Previously the private savings banks had been required to hold this special stock as backing to their ordinary deposit accounts.

(i) The POSB was given approval in August 1979 to introduce a wider range of term deposit accounts.

(j) Following on from the introduction of cheque account facilities in late 1974, the trustee and Post Office savings banks were authorised in late 1979 to make loans by way of overdrafts. However, overdraft lending was to be encompassed within the respective limits on personal lending applicable to each institution.

(k) In April 1980 the requirement for trustee savings banks to obtain the consent of the Reserve Bank to

2. For the details on these amendments to the reserve asset ratio system, readers are referred to the article entitled the *Reserve Asset Ratio System* which appears in the October 1980 *Bulletin*.

changes in the interest rates they offer on deposits was removed.

(l) In September 1980, the private savings banks were added to the list of savings institutions authorised to offer farm and fishing vessel ownership accounts.

(iii) *General*

(a) Treasury bill and government stock interest rates have been varied on a number of occasions in line with market interest rates. They are now significantly above rates ruling in March 1976. A comparison of rates is set out below:

	Rates as at Dec. 1980		*Rates as at Mar. 1976*
	Percent		Percent
Treasury bills:			
3 months	11.25		4.0
6 months	11.5		4.5
Government stock:			
1 year	11.5	1 year	. .
2 years	12.0	2 years	5.25
6 years	13.3	5 years	6.75
10 years	. .	10 years and over	8.0

Rates of return on new issues of local authority stock have also been raised significantly since March 1976.

	Rates as at Nov. 1980		*Rates as at Mar. 1976*
	Percent		Percent
1–2 years	12.0	1–2 years	5.5
3–5 years	12.5	3–4 years	6.5
		5 years	7.25
6–8 years	13.5	6 years but less than 10 years	7.75
9 years & over	13.0	10 years & over	8.5

(b) As from 2nd February 1976, importers of certain goods (representing about 5 percent of New Zealand's overall imports) were required to lodge an amount equivalent to one-third of the current domestic value of goods imported as non-interest bearing deposits with the Reserve Bank for a period of six months. This scheme, which was designed as a deterrent to 'speculative importing', was initially intended to run for one year, but it was twice extended for six months before it was withdrawn with effect from 3rd February 1978.

(c) In 1976, there were some significant developments with regard to farm income stabilisation, with wool income and meat income stabilisation schemes being introduced in July and October respectively. Both these schemes are designed to trim incomes in buoyant years and return the funds to the industry when realisations fall. In April 1977 the tax benefits associated with the Farm Income Equalisation scheme, which had been operating for a number of years, were supplemented by interest on deposits at the rate of 3 percent per annum.

(d) The National Provident Fund, in June 1976, was permitted to accept deposits (over $12,000) direct from the public, so as to enable it to provide, through its Local Authorities Investment Pool, a greater amount of finance for local authorities' capital works programmes. In December 1976 the interest rates were increased and the deposits were made negotiable in an attempt to make deposits with the National Provident Fund more attractive. However, with other deposit accepting institutions offering increasingly competitive terms, only a limited amount was raised, and the Fund has not continued to seek public deposits.

(e) The 1977 Budget contained three schemes whereby interest earned on certain mortgages would be either exempt from income tax or eligible for a tax rebate. The first related to farm mortgages and provided for half the interest earned by retiring farmers from money left on mortgage in farms to be exempt from income tax. The other two schemes related to housing mortgages, and were designed to encourage direct private lending for housing and to encourage older people to vacate family homes and shift to more suitable smaller accommodation.

(f) In August 1977 the Government introduced a scheme whereby the Housing Corporation would be able to assist home-owners who were unable to refinance short-term mortgages on their homes. This facility is still available, but the number of applications for assistance and the number of approvals are now significantly reduced compared with when the scheme was introduced.

(g) In November 1977 Inflation Adjusted Savings Bonds were first made available. These have a five year term although certain groups (persons over 60 years of age or those buying their first home, first farm or first commercial fishing boat) can redeem them on one month's notice. On redemption a non-taxable adjustment equal to the movement in the Consumers' Price Index is allowed. In addition the bonds earn interest at the rate of 2 percent per annum, which is taxable. There is a limit on the amount which can be subscribed for these bonds. Originally this was set at $5,000 per bond holder (with no more than $1,000 annually), but in November 1979 this was raised to $10,000 (with no more than $5,000 annually).

(h) The maximum interest rate which moneylenders, as defined in the Moneylenders Act, can charge without being subject to the restrictive provisions of the Act, was raised from 10 percent to 15 percent in July 1977.

(i) In April 1978 the Reserve Bank relaxed the rules governing the operations of the official money market dealers. The changes comprised:
- — lifting the restrictions on how much trading banks can place on deposit with official dealers;
- — allowing investment of a certain proportion of their funds in government stock with over five years to maturity;
- — allowing up to 5 percent of their portfolio to be held in commercial bills bearing the name of a company whose securities qualify as trustee investments or of a trading bank.

(j) In August 1978, the Minister of Finance announced a private sector credit growth guideline. Financial institutions were advised that the overall level of loans outstanding in the months ahead should not

exceed the previous year's level by more than 10 - 15 percent.

(k) Also in August 1978 there was an important further development in monetary policy when the Minister of Finance announced that a more active secondary market in government securities would be encouraged so that in future open market operations could be utilised as an additional instrument of monetary policy.

A number of moves have been taken to further this aim, including:

— recognition by the Reserve Bank of 'specialised dealers in government securities'. In return for actively participating in the market for official securities these dealers were given direct access to the Reserve Bank's portfolio;
— conducting advertising campaigns to increase the public's awareness of government securities as an investment;

(l) A new form of Government security, Government Savings Stock, was introduced in October 1978. It had the following features:

— a five year maturity but with provision for prior redemption at any time on one month's notice;
— an interest rate of 11 percent per annum except that where stock is redeemed within 1 year of the issue closing the interest rate is reduced to 8 percent;
— a maximum holding of $250,000 by any one stockholder.

There have been two subsequent issues of this type of security. The latest (November 1979) carried a five year interest rate of 11.5 percent.

(m) In December 1978 bearer Treasury bills became available. Registered Treasury bills had been available since 1969 and the issue of bearer bills was a further move designed to make government securities an attractive and competitive investment. Despite some initial enthusiasm these bearer bills were not popular, and they are no longer offered.

(n) In March 1979 there was an easing of conditions and limits on Housing Corporation loans, particularly with respect to the purchase of existing houses. Previously, the Corporation's lending policy had been strongly biased against existing houses. The interest rates charged by the Housing Corporation and Rural Bank were increased in 1979, and the 1980 Budget gave the Rural Bank a degree of flexibility in setting lending rates (within a prescribed band).

(o) In May 1979, the Securities Commission was established. One of the functions of the Commission is to ensure that all those raising money from the public provide adequate information to enable depositors to make informed decisions. In carrying out this function the Commission will obviously not remove the risks associated with financial investment, but it should enable investors to better assess the risks, and in this regard, depositor protection should be enhanced.

(p) A guideline of 8 - 12 percent growth in private sector credit for the year to March 1980 was set in April 1979. This guideline replaced that announced in August 1978, but was not itself replaced or renewed on its expiry in March 1980.

(q) From 1st April 1979 an across-the-board tax exemption of $200 income from interest and dividends was introduced as a replacement for the previous general exemption of $100 on interest income, the $200 additional exemption for interest income derived from savings banks, building societies and mortgages covered by the Housing Corporation's mortgage guarantee scheme and the dividend rebate applicable to persons with an income of less than $8,000.

(r) A new flexible exchange rate system was introduced in June 1979 along with a liberalisation of the forward exchange system.[3]

(s) A Credit Contracts Bill is currently before the House of Representatives. The objectives of the bill, which when enacted will replace the Moneylenders Act, are:

(i) to prevent oppressive credit contracts and conduct;
(ii) to ensure that all the terms of credit contracts are disclosed to debtors before they become irrevocably committed to them;
(iii) to ensure that the cost of credit is disclosed on a uniform basis in order to prevent deception and encourage competition; and
(iv) to prevent misleading credit advertisements.

The provisions of the bill will have wider application than the Moneylenders Act, but generally, they are less onerous.

(t) In November 1980 'tap' sales of Government stock were introduced. Under this new marketing method, stock is available for cash subscription (for amounts of $10,000 and over) on a more or less continual basis. However, during the period that each stock is on issue, there will be changes in yield on account of the shortening time to maturity and/or discretionary policy changes. Previously each cash issue was kept open for only a limited period, and the minimum subscription was only $100. The new minimum subscription means that ordinary Government stock is being marketed mainly in the 'wholesale market', with small savers being catered for with other instruments such as inflation adjusted savings bonds and savings stock. The stocks on issue will be changed from time to time.

IV. REMAINING CONTROLS AND SELECTIVE POLICIES

This section lists the various controls and other non-market measures which still remain in force.

(a) The reserve asset ratio system applied to the trading banks remains an important means by which the level of trading bank lending is regulated.

(b) A system of public sector and other specific investment requirements is applied to most other financial institutions (see the table set out on pages 322 and 323 of this Bulletin). These ratios in general terms serve three purposes:

— to regulate the level of private sector lending,
— to ensure that depositors' funds are backed by secure and appropriately liquid investments; and
— to assist in financing the Government's deficit.

This system of ratio requirements over recent years has been rationalised insofar as the wide

3. For further details on the new spot and forward exchange rate systems see the Reserve Bank *Bulletin* of August 1979.

disparity among the ratios for different institutions which previously existed has been narrowed, though significant differences still exist. While it would not be appropriate for all institutions to have the same ratio, because different institutional groups have different liability structures, it is nevertheless necessary that a degree of uniformity prevail if effective and equitable competition among institutions is desired.

(c) The trading banks are asked to observe some qualitative lending guidelines which, inter alia, direct that housing and export orientated business should be given high priority and personal lending, imports and the services sector should receive low priority. Finance companies at times have been asked to observe similar priorities in their lending.

(d) The only private sector interest rates still directly controlled are those on savings and trading banks' demand deposits. Trading banks may not pay interest on deposits for less than 30 days and savings banks can pay only 3 percent on call deposits.

(e) The trading banks are the only financial institutions authorised to buy and sell foreign exchange to and from the public. There is a minor exception in the case of one travel company.

(f) Short term money market dealers, to qualify as an official dealer, must meet certain conditions including:
— a paid up capital of not less than $100,000 and deposits not to exceed 35 times shareholders' funds.
— individual deposits to be not less than $20,000.

Official dealers have both minimum Government security investment requirements and restrictions on the range of investments to which the balance of their portfolio can be applied, and on the extent to which they can invest in the various alternatives.

(g) There remain a number of controls over the avenues available for investment of funds by financial institutions.
— In addition to Government and local authority securities and deposits with a trading bank or the Post Office Savings Bank, private savings banks are restricted to lending by way of mortgages over property or advances to industry, the latter including the purchase of equity shares.
— Similarly trustee savings banks are restricted to investments in Government and local authority securities, mortgages and personal loans.
— The Post Office Savings Bank invests most of its funds in Government and public corporation securities. In addition it is permitted to invest in personal loans and up to 30 percent of the growth in total deposits in housing mortgages.
— Building societies are restricted almost solely to investments in mortgages. Controls on the size of such mortgages and on the investment of funds not immediately required for mortgage advances set out in their act. Special advances, those made to companies or to individuals of over a specified amount, are limited to 10 percent of total advances made by way of mortgage. Surplus funds may only be invested with a trading bank, in public sector securities, with an official short term money market dealer, or as advances to society employees.

(h) Hire-purchase transactions continue to be subject to restrictions. Over the years these have been tightened and relaxed in accordance with changing economic circumstances. In the period since March 1976, the overall effect of these changes has been a relaxation of restrictions, but not in all areas. The following table sets out the restrictions as at February 1976 and November 1980.

	Minimum Deposit Percent		*Maximum Period of Credit*	
Description of Goods	*Feb. 1976*	*Nov. 1980*	*Feb. 1976*	*Nov. 1980*
New cars	60	60	12 mths	12 mths
New light trucks	60	†	12 mths	†
Second hand motor cars	60	60	18 mths	18 mths
Second hand light trucks	60	†	18 mths	†
Motor cycles — new	60	60	12 mths	18 mths
— used	60	33⅓	12 mths	24 mths
Other consumer goods	10	†	30 mths	†

† No longer subject to restrictions.

(i) Cash ratios are prescribed for the trustee and private savings banks. These are over and above their Government security investment requirement.

(j) Both private and trustee savings banks are precluded from operating deposit accounts for trade or business purposes although they are permitted to lend for such purposes.

(k) The Financial Services Regulations 1979, made pursuant to the Economic Stabilisation Act 1948, require all financial institutions to notify the Reserve Bank of any increases in charges for the financial services they provide, including increases in interest rates on lending.

(l) While a high degree of competition is clearly evident in the domestic financial market, the Exchange Control Regulations 1978 and the Overseas Investment Regulations 1974 preclude an active competitive involvement in the international financial market. Even though the controls are primarily designed to prevent capital outflows, capital inflows are not exempt from regulation.

(m) Certain financial institutions receive a favoured tax status. Building societies are exempt from tax, except for income derived from the renting of land and buildings. Life insurance offices (provided they meet certain conditions) are eligible for a concessional tax rate equivalent to two-thirds of the rate which would normally be applied.

(n) Life insurance premiums and superannuation contributions (combined are eligible for a personal income tax exemption of up to $800 per annum (if superannuation contributions are employer subsidised) or $1000 per annum (if superannuation contributions are not employer subsidised). Income derived from interest and dividends is eligible for a general tax exemption of up to $200 per annum, and in addition there are special tax incentives in respect of National Development Bonds and New Zealand Savings Certificates (offered by the Post Office) and private lending in the farm and housing sectors.

(o) The Housing Corporation,the Rural Banking and Finance Corporation and the Maori Affairs and Lands and Survey Departments make housing and farm finance available to qualifying borrowers at concessional rates of interest. Low interest rate overdraft facilities are also extended to some of the statutory primary produce marketing authorities by the Reserve Bank.

(p) As a guideline, merchant banks and finance companies are required to restrict their overseas stand-by facilities to the equivalent of either 100 percent of their shareholders' funds, or 10 percent of their liabilities, including acceptances and guarantees, whichever is the greater.

CONCLUSION

The direction of monetary policy over the last four years has been away from direct controls and official intervention. Financial institutions have been encouraged to compete with each other and to this end they have been given the opportunity to manage their own affairs to a much greater extent, and to develop services more consistent with their customers' needs. It has also been the Government's intention that it lessen its own role as a provider of finance, particularly in the areas of housing and farm finance.

Although the measures introduced over the four years since 1976 have enabled considerable progress to be made towards making public debt policy and Reserve Bank open market operations effective and important monetary policy instruments, these objectives have not yet been fully achieved. The reserve asset ratio scheme applied to trading banks and the public sector investment obligations of most other financial institutions are still relied on to a large extent as the means of implementing monetary policy. Also, certain 'qualitative' directives issued by the Reserve bank to various financial institutions remain extant.

The most visible effect of the new direction to monetary policy has been a rise in nominal interest rates. However, to some extent, this has been more apparent than real. Although the interest rate controls in place up to March 1976 were extensive, they did not, nor could not, embrace all financial intermediaries. Not surprisingly those intermediaries free from control allowed their deposit and lending rates to rise in response to market forces, as evidenced by the fact that rates in the uncontrolled sector — generally 'fringe' institutions — were well above the officially controlled rates, and indeed, often above the general level of rates prevailing today. The significance of this point is reinforced when it is recalled that the 'fringe' institutions during the period of interest rate controls flourished, and competed business away from the controlled sector. With the removal of controls, this disintermediation process has been largely reversed, and a more soundly based financial system has resulted. Also, the authorities now have a greater ability to manage monetary conditions.

There has, however, been an underlying upward trend in nominal interest rates since 1976. This has provided savers with a more equitable return in the face of rising rates of inflation and has correspondingly required borrowers to pay something closer to the real cost of credit.

Higher interest rates, on the other hand, have accentuated some problems. For instance, while interest rates have been allowed to move upwards in recognition of the way in which inflation erodes the real worth of monetary assets and liabilities, for tax purposes interest is still treated as assessable income (subject to a small personal exemption) or deductible expenditure as the case may be. Thus, even when interest rates match the rate of inflation, for an investor or borrower with a 50 percent marginal tax rate, the effective after tax interest rate is only half the rate of inflation.

Also, higher nominal interest rates have distorted the pattern of cash flows associated with debt servicing. With lenders being compensated for the erosion of their capital in the form of a higher rate of interest, interest payments have effectively become, in part, capital repayments. This often causes liquidity problems for borrowers, even when the venture being financed is profitable. Although some measures have been introduced in response to these problems, e.g. the exemption from tax of the inflation adjustment component of the return on inflation adjusted savings bonds, and 'slow start' housing mortgages, they have been very limited in their scope. The ideal solution would be the restoration of price stability, but given the difficulties recently experienced in attaining this objective, it is probably more realistic to approach the problem from the direction of explicitly recognising the effect of inflation on financial contracts.

Finally, there remain some controls which are the remnants of the previous system of interest rate and institutional control. In many cases these now appear to be unnecessary, or are distorting competitive forces, and could well be removed or at least relaxed. In all, while considerable progress has been made toward the objectives stated in the introduction to this article, there is still more to be done if all the serious distortions within the financial system are to be removed, and if monetary policy is to be made fully effective.

—NOTICE—

PROCEEDINGS OF THE THIRD PACIFIC BASIN CENTRAL BANK CONFERENCE ON ECONOMETRIC MODELLING.

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