# MONETARY POLICY MEASURES

*In March 1983, the Minister of Finance, the Right Honourable R. D. Muldoon, announced some significant changes in the Government's monetary policy.*

## BACKGROUND

The immediate purpose of the recently announced policy changes is to restrain the recent rapid growth in the money supply, and reduce the risk of a credit expansion later in the year. During the second and third quarters of 1982, the rate of growth of the main monetary and credit aggregates slowed significantly. Since October, however, there has been a substantial easing of monetary conditions. Seasonally adjusted December quarter growth in M1 was 2.3 per cent (−2.1 per cent in the September quarter), and the growth in M3 was 4.1 per cent, (+0.9 per cent in the September quarter). This strong growth has continued during the first two months of 1983, when M3 growth of 3.2 per cent on a seasonally adjusted basis was recorded.

This marked turnaround in monetary conditions has resulted from two main factors. Firstly, there has been an improvement in the overseas exchange transactions private sector balance due to a flattening in the current account deficit and a rapidly increasing net private capital inflow. Secondly, the tax cuts of October 1982 signalled a shift to a more expansionary fiscal policy which has added to the supply of money. This happened at a time when sales of Inflation Adjusted Savings Bonds and Premium Stock were slowing. Net injections have been increased further by a rapid expansion in Reserve Bank lending to the primary producer boards. Together these factors have produced an unprecedented growth in trading bank reserve assets. For October 1982 reserve asset holdings averaged $855 million, while in February 1983 they averaged $2,295 million. Financial institutions have so far used this inflow of funds to restore their balance sheet positions; the trading banks' lending to deposits ratio, for example, fell from 86 per cent in October 1982 to 73 per cent in February 1983 on a seasonally adjusted basis.

This reduction in lending to deposits ratios has also been assisted by a sharp reduction in credit growth. The seasonally adjusted December quarter change in private sector credit was −1.2 per cent, compared with +1.7 per cent in the September quarter and increases of 4 to 5 per cent per quarter in the three preceding quarters. This slowdown continued during the first two months of 1983, when private sector credit declined by a seasonally adjusted 0.6 per cent, to give a February 1983 year on year increase of only 6.7 per cent. In the preceding year ended February 1982 the increase had been 26.4 per cent.

Initially, the slowdown in credit growth was enforced by the constraints on financial institutions' ability to lend, principally their lending to deposits ratios and liquidity positions which had become very tight in the middle of 1982. However, more recently, it has become clear that as the level of economic activity has fallen away, the demand for credit has eased off. This is reflected in the extent to which bank credit limits are currently being utilised; for most of 1982 the percentage utilisation was around 74 per cent (seasonally adjusted), but by February, 1983 this had fallen back to 70 per cent. The long-run average is about 72 per cent.

Thus, while recent credit growth rates have been very slow, the potential for a renewed and excessive rate of credit expansion, if economic activity were to pick up, has clearly emerged. The Government's concern has been to reduce the potential for excessive growth, given that such a development would be fundamentally inconsistent with its objective of permanently reducing New Zealand's rate of inflation. The policy measures detailed below were designed accordingly.

Some of the measures entailed increasing the rates of interest paid on Government debt instruments. The objective here, as indicated by the Minister, was to make Government investments competitive with private sector investments so as to reduce the growth in the monetary base and contain inflationary pressures from the monetary sector. While the competitiveness of Government instruments was already being promoted by the reductions to market interest rates which had occurred since December 1982 (for example, the weighted average trading bank transferable certificate of deposits (TCD) interest rate fell from 16.5 per cent to 12.5 per cent between the end of December and mid March, and commercial bill selling rates (90 days) fell from around 16.5 per cent to about 14 per cent over the same period), the risks of a credit expansion getting underway were such that it was considered important that the remaining margin should be closed quickly. This has been largely achieved by the Government security interest rate adjustments made, and the full range of Government investments now yield returns at or near market rates.

The specific measures introduced include a new advertising campaign for Inflation Adjusted Savings Bonds; the introduction of an attractive new instrument, Kiwi Savings Stock, which pays 15 per cent interest per annum, reduced to 13 per cent per annum on stock redeemed within 12 months; and increased yields on Treasury bills and Government securities, of up to 1.5 percentage points. Additionally, the Minister warned all financial institutions that unwarranted credit growth would result in further immediate policy action. As a signal of his willingness to move in this way, the Government security investment requirement for finance companies was increased from 18 per cent to 20 per cent. (The ratio system for finance companies had been strengthened by new Finance Company Regulations passed in February).

It was also announced during the month that two further significant policy developments were under consideration. They were public debt sales by tender, and the liberalisation of the foreign exchange market. These measures are aimed at improving the effectiveness of monetary policy and the efficiency of the financial system in the medium to longer term.

The liberalisation of the foreign exchange market will take the form of authorisations to deal in foreign exchange being granted to suitably qualified organisations in addition to those currently held by the trading banks (and some other organisations on a limited basis). The Reserve Bank is now able to consider applications for additional authorisations.

The tendering of public debt instruments, on the other hand, is still at the exploratory stage, and the Minister, in announcing the proposal, was not specific on the nature or timing of any developments in this area. Rather, he has instructed officials to commence detailed investigations and to consult with likely market participants on how a tendering system could be implemented. The Reserve Bank and the Treasury will accordingly be contacting those organisations currently actively involved in the Government securities market and have also encouraged any other organisations which may be affected by or who have an interest in the proposal to make submissions to the Reserve Bank.

## PRESS STATEMENTS

Reprinted below are the press statements released by the Minister of Finance at the time of the announcement of the recent monetary policy changes. The first is essentially technical in nature and outlines changes to the method of calculating the public sector security requirement applying to finance companies. This is followed by the press statement announcing the introduction of Kiwi Savings Stock, and the revised yield curve for Treasury Bills and Government Securities. The third press statement outlines the increase in the finance companies' public sector security ratio, while the final two contain the Minister's announcements on tendering public debt and on the liberalisation of the foreign exchange market.

### 1 Press Statement, 24 February 1983

*Finance Companies (Investment) Regulations 1983*

The Minister of Finance (Right Hon. R. D. Muldoon) today announced the introduction of the Finance Companies (Investment) Regulations 1983, which replace the Finance Companies (Investment) Regulations (No. 2) 1969.

The general effect of the Regulations remains that of requiring finance companies to hold Government Stock in accordance with a prescribed ratio. However, there are a number of differences between the old and new Regulations.

Mr Muldoon said that the most important difference was the change to calculating the ratio as a simple percentage of 'investments'. Under the old Regulations the ratio was calculated as a percentage of 'borrowings' with some exemption allowed according to the debt equity ratio of each company. This had tended to penalise companies borrowing for a purpose unrelated to their financing activities and to give an advantage to companies (usually trading companies offering financial services) having a low debt equity ratio.

The definition of a finance company now includes any company, association or person engaged in both 'borrowing' and 'investing' unless:

(i) its investments do not exceed $100,000; or

(ii) its investments do not exceed $2 million and these investments then represent less than 25 per cent of its total assets; or

(iii) in the case of an individual his investments do not exceed $2 million.

Special provision is no longer made for related companies. However, loans made by a finance company to its holding company or subsidiary will be exempt from ratio requirements in order to avoid applying ratios to transactions which are essentially 'internal' to a group of companies. Loans made to or deposits made with another finance company are also exempted from ratio requirements in order to avoid a double ratio effect. The definition of 'borrowing' has been widened to include borrowing by way of bank overdraft.

In future finance companies will be required to make monthly rather than quarterly returns to the Reserve Bank. The Government Stock holdings will also have to be adjusted monthly. This will allow more effective policing of the Regulations and increase the flow of information from the financial sector to the Reserve Bank.

The ratio level will be set at 18 per cent under the new Regulations. It is estimated that this will leave finance companies' aggregate holdings of Government Stock at about their current level.

Mr Muldoon stated that the overall effect of the new Regulations would be to make the ratio system more effective, more equitable and easier to police, thus allowing more efficient use of monetary policy through ratio changes.

### 2 Press Statement, 16 March 1983

*Monetary Policy Measures*

The Minister of Finance, the Right Hon. R. D. Muldoon, today announced monetary policy measures designed to maintain firm monetary and credit conditions in the coming months. The Minister said that there had been a very rapid build-up of liquidity in recent months. He was determined that this should not result in unwarranted expansion of credit because this would undermine the Government's strategy to combat inflation.

The specific measures announced were the introduction of a new government savings stock instrument, to be known as Kiwi Savings Stock and changes in the yields on Treasury Bills and ordinary government securities. Kiwi Savings Stock will be available from Monday, 21 March 1983, and replaces New Zealand Government Premium Stock, which will be withdrawn on 18 March 1983. The Treasury Bill and ordinary government stock yield changes will take effect immediately.

The main terms of the new Kiwi Stock instrument are that it will attract 15 per cent interest per annum, paid quarterly, and will be redeemable (after four weeks from purchase date) on seven working days' notice, subject to the interest rate being adjusted to 13 per cent per annum on any stock redeemed within 12 months of purchase date. The instrument will have no fixed maturity date, although the Minister of Finance may repay at any time four years after the date of the Prospectus. All New Zealand domiciled investors, except for financial institutions as defined in Section 2 of the Reserve Bank of New Zealand Act 1964, will be eligible to invest in this stock, and there will be no maximum on the amount which may be held by eligible investors. Application forms for Kiwi Savings Stock will be available from Post Offices, trading or savings banks, members of the Stock Exchange, solicitors and accountants in public practice, specialised dealers in government securities or direct from the Reserve Bank of New Zealand.

The new Treasury Bill and ordinary government security yields are set out below:

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|---|---|---|---|
| 13 week Treasury Bill | | .. | 12.0% |
| 26 week Treasury Bill | | .. | 12.5% |
| Government security yields | 1 year | | 13.0% |
| | 2 years | | 13.65% |
| | 3 years | | 14.0% |
| | 4 years | | 14.0% |
| | 5 years | | 14.0% |
| | 6 years | | 14.0% |

The new selling prices will be announced by the Reserve Bank, and the appropriate determinations have been made to enable investors to subscribe to these issues without contravening the Financial Services Regulations (No. 2) 1982. A review of local authority interest rates will be made at an early date.

The Minister noted that the full range of government investments — Inflation Adjusted Savings Bonds, Kiwi Savings Stock, Treasury Bills and ordinary government securities — were now competitive with private sector investments. He singled out Kiwi Savings Stock in particular as being attractive enough to appeal to every section of the public — giving an unexcelled combination of regular quarterly interest, security and availability of capital.

Mr Muldoon, in commenting on these changes, said that it was important at the present time for government investments to be made competitive with private sector investments if inflationary pressures from the monetary sector were to be contained. "The fall in private sector interest rates during recent weeks has contributed to this objective, and the measures announced today are designed to hasten the closing of the remaining margin" he said. He did not expect these moves to adversely affect business investment plans and business confidence. Private sector interest rates would not be forced back up to any significant extent, given the prospect of a continuing fall in the inflation rate. "While there might be a temporary halt to the downward movements in interest rates that have been occurring, the measures announced today will contribute substantially to holding the reduction in the inflation rate that is being achieved under the 'freeze', and ultimately to a permanent reduction in interest rates. These are the factors on which business confidence finally rests," Mr Muldoon concluded.

## 3 Press Statement, 24 March 1983

### *Finance Company Government Security Investment Requirement*

The Minister of Finance announced today that the Government security ratio requirement applying to finance companies will be increased by 2 per cent, from 18 per cent to 20 per cent of 'investments', from 1 May 1983.

Mr Muldoon said that ratio increases had only been applied to finance companies at this stage because their lending growth during the last year had been much faster than that recorded by other institutions and because the finance company ratio is presently a comparatively low one. This move should, however, be viewed by financial institutions as a warning that lending growth must be restrained. "The Government will be keeping a very close watch on the lending behaviour of all institutions throughout this year," he said. "We are ready to act quickly and severely if lending growth should increase unduly".

"The continued success of the fight against inflation depends on restraint in money and credit growth. The strategy to combat inflation is working and we are determined to ensure that it is not undermined by unwarranted increases in credit. That is the warning I am giving to financial institutions."

## 4 Press Statement, 25 March 1983

### *Tendering of Public Debt*

In a further monetary policy statement today, the Minister of Finance announced that the Government is investigating the feasibility of selling Government securities by auction, or tender.

Current arrangements are that the Government fixes interest rates for its Government security issues, and the private sector then decides how much it wishes to purchase at those rates. Under a tender system, the Government would fix the quantity of securities to be issued in a given period, and market participants would effectively determine the interest rates required to achieve that level of sales.

"The system could give us a better chance of achieving our monetary objectives than the present arrangements, under which it is difficult to predict accurately the amount of stock which will be sold. Under a tendering system the risk of substantial overselling or underselling of securities would be avoided" said Mr Muldoon.

He said that no firm commitment to proceed has yet been made, but that he has asked officials from the Reserve Bank and Treasury to commence detailed investigations, and to consult extensively with likely market participants on how such a system could be implemented. He noted that the proposal has no implications for securities such as Kiwi Stock or Inflation Adjusted Savings Bonds, which will continue to be sold as at present.

"If the results of the investigations and consultations are satisfactory, we would be thinking of implementing the tender system in a few months' time," said Mr Muldoon. "I expect that the private sector will welcome this initiative — it has benefits for them as well as for the Government — but there are a lot of technical questions to look at before we can be sure that tendering can be successfully introduced."

## 5 Press Statement, 2 April 1983

### *Foreign Exchange Dealing*

The Minister of Finance announced today that the Government is prepared to allow further suitably qualified institutions to act as foreign exchange dealers. At present, the Reserve Bank and the trading banks are the only institutions authorised to undertake the full range of foreign exchange dealings. The Post Office and two travel agencies have some limited authority, and this is soon to be shared by trustee savings banks.

Mr Muldoon said that the Government wished to encourage the further development of competition and expertise in the field of foreign exchange operations to assist New Zealand's international traders. The action taken by the Reserve Bank in late January to close down the unofficial market in foreign exchange that had developed alongside the authorised dealers, had been necessary to curb unofficial foreign exchange dealing arrangements that did not have approval under the Exchange Control Regulations. With this element of competition now excluded from the market the Government believed that the appropriate way to stimulate competition was to extend new foreign exchange dealing authorities to suitably qualified applicants, in addition to those currently held by the trading banks and the more limited foreign exchange dealers. The liberalisation of the foreign exchange market would help to meet some concerns recently expressed by exporters in the context of a review of export assistance.

The Minister stated that there was no predetermined number of authorisations that would be granted initially, but he indicated that approval to operate in this area would be conditional upon the compliance of the applicant with fairly tight criteria as regards capital adequacy, financial standing, proven management and expertise, as well as otherwise substantiating a capability to provide the proposed service. He emphasised that, having regard to the risk factor associated with this type of operation, any failure to maintain these minimum criteria at all times could result in the withdrawal of the institution's foreign exchange dealing authorisation.

Mr Muldoon said that suitably qualified institutions which wish to be considered for an approval to operate in this area, should submit their application to the Reserve Bank of New Zealand.