QUARTERLY REVIEW OF MONETARY CONDITIONS AND POLICY

OVERVIEW

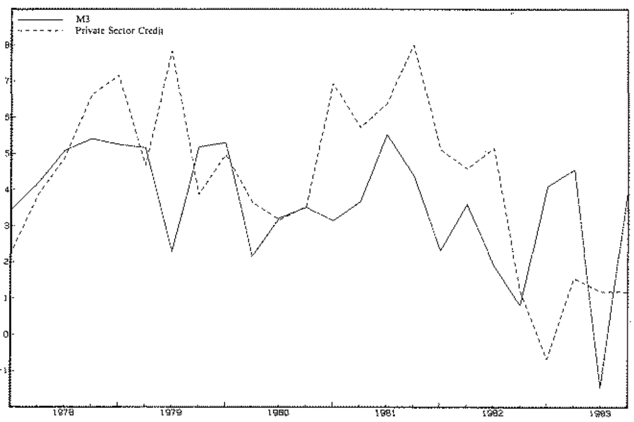
The dominant feature of monetary conditions throughout the September 1983 quarter was strong growth[1] in liquidity. The broadly defined money supply (M3), which fell by 1.4 per cent over the June 1983 quarter, increased by a net 4.1 per cent over the three months ended September. Monthly estimates of the growth rate in M3 suggest that this upswing in liquidity in fact commenced during the month of June 1983. These estimates also indicate an acceleration in the trend in the rate of M3 growth from June onward with successive monthly growth rates of 0.9 per cent (June), 1.1 per cent (July), 1.4 per cent (August) and 1.6 per cent (September).

The fall in the narrowly defined money supply (M1) during the June quarter (−3.9 per cent) was also reversed with that aggregate displaying seasonally adjusted growth over the September quarter of 8.4 per cent. Although M1 is generally more volatile than M3, the movements in these two monetary aggregates taken together indicate that the comparatively tight monetary conditions which were a feature of the June quarter, have now eased considerably.

Superimposed on this picture of an increasingly liquid domestic economy was a relatively slack demand for credit, at least up until the month of September. Private Sector Credit (PSC) over the September quarter grew by an estimated 1.2 per cent. This represented a levelling out of the declining trend evident over the first two quarters of 1983 when growth rates of 1.6 per cent (March) and 1.2 per cent (June) were recorded. The June and September quarterly PSC growth rates were both well below the maximum rate of growth permitted under the quantitative credit guideline, issued to the major lending institutions in April/May 1983, of 1 per cent a month seasonally adjusted, (around 3 per cent per quarter), through the growth in September itself, of 1.3 per cent, indicating that credit growth could be beginning to push the guideline level.

Figure 1 below presents the quarterly percentage change in the M3 and PSC aggregates. This illustrates a continuation during the September 1983 quarter of the pattern of divergent growth trends in these two series which has been evident over the last twelve months.

FIGURE 1
Seasonally Adjusted M3 and PSC
Quarterly % Change



The quarterly PSC aggregate, however, understates a turnaround in the growth rates that occurred in some institutions' lending levels, towards the end of the September quarter. Analysis of the monthly growth rates of the finance companies, for example, for the month of September, reveals a growth rate of 2.6 per cent. For the building societies (which as an institutional group falls outside the present framework used in the compilation of the M3/PSC aggregates) a similar pick-up has occurred.

For the month of September the growth rate in building society lending reached 2.2 per cent,[2] though most of this lending increase took the form of holdings of commercial bills. Total lending by the Trustee Banks grew by 3.2 per cent for the quarter as a whole.[3]

Together these statistics, which show that each of these institutional groups recorded lending growth in excess of the credit growth guideline in September, point to a resurgence in lending growth in spite of the comparatively low PSC growth rate for the quarter as a whole. The increase in trading bank lending growth for the month of October of 2.1 per cent evidences a continuation of this trend into the December quarter.

These developments have prompted the Reserve Bank to warn a number of institutions that tighter public sector security ratio requirements may be imposed in the event of continued excessive lending growth.

The slowdown in the rate of PSC growth over most of the September quarter may in part be attributable to the emergence of positive (real) lending interest rates on the domestic market, brought about by successive quarterly reductions in the Consumers' Price Index (CPI). Equally, however, this may be attributed to the uncertainty surrounding growth prospects in the domestic economy which, in turn, served to dampen business confidence.

In large measure, the growth in M3 is attributable to the impact of the fiscal deficit on the financial sector, improvement in the external accounts in July and August compared with the deterioration that occurred over the period June to December 1982, and the absence of an active debt sales policy by the Government over the first two months of the quarter. Total sales of the Government's retail debt instruments over the September quarter were markedly lower than in the preceding quarter. This is highlighted by the table below which provides a comparison of sales and redemptions of the various retail instruments available in those two quarters.

1 All growth rates given in this article are seasonally adjusted unless otherwise stated.

2 & 3 Building Society monthly advances and deposits and trustee bank lending display no seasonally stable pattern. These growth rates and references elsewhere in the text are therefore those actually recorded.

SUBSCRIPTIONS AND REDEMPTIONS OF RETAIL DEBT INSTRUMENTS: COMPARISON OF JUNE AND SEPTEMBER 1983 QUARTERS

	June			*September*		
	Subscriptions	*Redemptions*	*Net*	*Subscriptions*	*Redemptions*	*Net*
Inflation Adj. Bonds	+ 35.1	− 46.3	− 11.2	+ 12.7	− 68.2	− 55.5
Kiwi Savings Stock I	+ 1309.8	− 233.0	+ 1157.8	+ 14.3[3]	− 225.8	− 211.5
Kiwi Savings Stock II	...[1]	...	...	+ 92.6	− 10.0	+ 82.6
Other Savings Stock[2]	—	− 11.9	− 11.9	—	− 3.7	− 3.7
Total:	+ 1425.9	− 291.2	+ 1134.7	+ 119.6	− 307.7	− 188.1

NOTES:
1 The first issue of Kiwi Savings Stock was taken off the market on 16 June 1983. The second issue of Kiwi Savings Stock was launched on 5 September and at the time of writing was still available.
2 Including Premium Stock.
3 Kiwi Stock I applications received, but not processed until the September quarter.

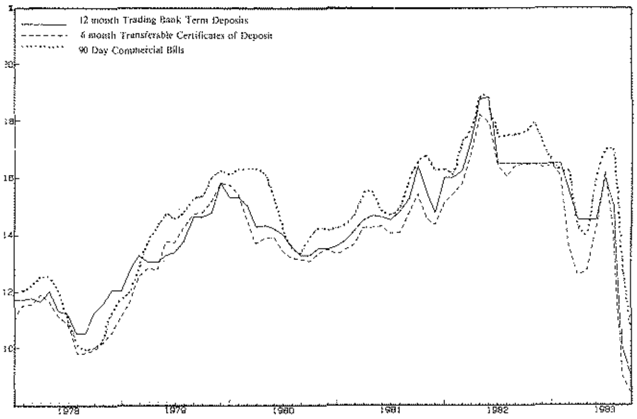
Briefly, during the June quarter total sales, net of redemptions, amounted to $1,134.7 million, which was almost entirely due to the large volume of sales (net $1,157.8 million) of the first issue of Kiwi Stock. During the September quarter the position was reversed with total sales falling short of redemptions by $188.1 million.

In contrast to the first issue of Kiwi Stock, which was pitched at rates slightly above those ruling in the market at the time, the second Kiwi Stock issue was launched with rates of interest set at a level broadly in line with the then ruling rates in the market place. The main reason for delaying the introduction of Kiwi Stock II was the Government's concern that sufficient time be allowed for deposit rates across the board to adjust to the reduction in the inflation rate that had occurred. Kiwi Stock II offered an interest rate of 10 per cent per annum, reducible to 8.5 per cent per annum on stock redeemed within twelve months of the issue date. Repayment provisions specify seven working days' notice.

The fall in deposit interest rates across the market as a whole is illustrated by Figure 2 below which plots monthly data showing recent movements in the interest rates offered on three market instruments:

1. 12 month trading bank term deposit rates (maximum for month).
2. 6 month transferable certificates of deposit (TCDs) (average for month).
3. 90 day commercial bill rate (maximum for month).

FIGURE 2
Market Interest Rates



The general easing of liquidity across the financial sector as a whole was largely attributable to the significant decline in the deposit rates shown. This of course, contrasts with the experience over the June quarter when short term (up to 12 months) deposit interest rates were forced upward. Another factor which contributed to the recent fall in deposit rates was the Government's expectation (communicated to the market during the September quarter) that both lending and deposit rates should be reduced in line with the fall in the inflation rate. More recently, deposit rates have begun to rise again, in response to increased competition for short-term funds.

Lending rates offered by the major financial institutions have also fallen, but to a lesser degree and at a somewhat slower pace than the reductions in deposit rates. The slower response on the lending side flows from the fact that financial institutions are to some extent tied to the previous higher rates they were paying on term deposits and, as a result, their average cost of funds will fall only gradually as these deposits mature. From a cash management point of view, it is generally more difficult for a financial institution to lower its lending rates at the margin, as borrowers may tend to repay existing debt and to refinance at the new lower rates. This notwithstanding, the major lending institutions announced downward revisions in their interest rates on new loans and most indicated their intention to bring rates on existing loans into line with those for new loans over time as review clauses allowed.

As an indication of the sort of reduction in interest rates expected by the Government, the Minister of Finance announced, on 27 July 1983, that the yields on Treasury Bills had been revised downward to between 7 and 8 per cent (previously 12–12.5 per cent). Also, at the same time, the Government withdrew Government stock tap sales from the market in anticipation of the first tender of Government stock which was held on 8 September 1983.

Tendering of Government stock was prompted by official concern that, with the 'tap' system of selling stock, only in retrospect could the Government assess progress towards its debt sales objectives. Under a tender system the Government is better able to determine the level of debt sales consistent with monetary policy objectives at the time, provided that it is willing to accept the market-determined rates of interest at which the stock is sold.

$100 million of stock was offered in the first tender in three maturities — all of which were heavily over subscribed. Because of the large amount of Government

COMPETITIVE TENDER RESULTS

Tender	Maturities	$ (Million) Value of Stock Offered	$ (Million) Value of Bids Received	$ (Million) Value of Bids Accepted	Weighted Average % of Accepted Bids
1	15.06.85	80	218.6	80.0	8.706
	15.08.87	20	80.0	20.0	9.005
2	15.10.85	100	108.2	100.0	9.524
	15.10.86	75	69.8	69.8	9.902
	15.10.89	25	37.7	25.0	10.646
3	15.10.85	200	194.1	76.2	10.644
	15.05.87	150	168.5	49.8	10.584
	15.10.91	50	96.0	17.0	10.901

Note: 5 per cent of the total stock offered in each of the maturities was reserved for non-competitive tender bids, at the weighted average yields of the successful competitive bids.

stock that matured around the tender date ($36 million) and the fact that settlement under the tender scheme may be spread over 28 days from the tender date, the resulting net flow to the Government by the end of the September quarter was in the order of $50 million.

Total bids received for the second tender (held in mid October) were slightly in excess of the total stock tendered ($200 million). However, the distribution of the bids was less even than in the first tender, with the middle maturity (3-year stock) being under-subscribed. The reduced participation in the second tender has been attributed to a sharp tightening of liquidity in the banking system during the week of the tender. A consequential effect of this was that yields bid were generally higher than the first tender results.

The third stock tender was held on 17 November. Again, while total bids received exceeded the tendered amount ($400 million), there was an unevenness in the distribution of bids among the maturities offered with the 2 year stock being under-subscribed. In addition, the Government considered that a large number of the bids received were out of line with current inflationary trends. This disparity caused 69 per cent of the bids received to be rejected. Successful bids totalled $143 million.

The results of the three tenders are summarised in the table above.

FINANCIAL INSTITUTIONS AND MARKETS

Trading Banks

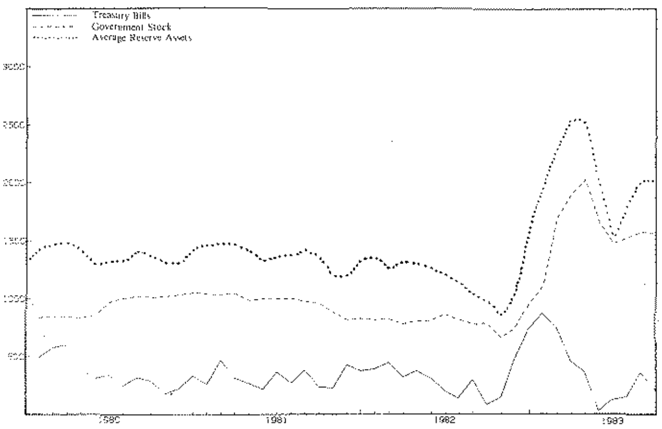
The contrasting patterns of growth displayed by the M3 and PSC aggregates were also recorded in the pattern of the trading banks' monthly percentage growth rates in lending and deposits over the September quarter.

Throughout the September quarter, lending growth per month was below the credit growth guideline although an upward trend in the monthly numbers (from −1.7 per cent (July) to −1.0 per cent (August) and +0.2 per cent (September)) was present. There was strong deposit growth, particularly in the first half of the quarter. Total deposits increased by 3.4 per cent in July, 1.7 per cent in August and 0.3 per cent in September.

The sustained deposit growth contrasts with the loss of deposits the banks experienced during the preceeding quarter when increases in short term deposit rates (see figure 2) were necessary due to the tighter liquidity conditions.

Although trading bank deposits grew during October by 0.7 per cent, suggesting a continuation of the liquidity growth evident from the monetary aggregate figures for the September quarter, reserve assets were unexpectedly flat over the month. This resulted in the average free reserves margin for the month[4] of $20 million — rather lower than the margin of $100 million free reserves margin on which the ratio had been targeted. Over the month as a whole the average reserve asset holdings fell from $2,017 million to $1,812 million. Moreover, it is clear that the banks' overall liquidity position, as indicated by their collective holdings of Treasury Bills, by the end of the September quarter had still not fully recovered from the drain in the June quarter. Figure 3 below, for example, plots recent movements in the trading banks' Government securities (Treasury Bill and Government Stock shown separately) portfolios and their average reserve asset holdings each month.

FIGURE 3
Trading Bank Liquidity
and Average Reserve Asset Holdings



To some extent the banks may attempt to use the easing liquidity in the economy as a whole to bolster their own liquidity positions, which would lessen the expansionary impact of the growth in M3 over the September quarter. Equally however, over the September quarter, all the trading banks allowed a marked build-up in the level of their unutilised loan commitments to occur. [This is borne out by the fall in the percentage utilisation of credit limits which (for the

4 The difference between the banks' required and actual average reserve asset holdings.

banks as a whole), after being reasonably stable at around 69.5 per cent over the first two quarters of 1983, fell to 66.9 per cent in August and further to 66.2 per cent in September]. This movement could affect the ease with which the trading banks can stem a future expansion in lending in the event of significant growth in demand. As already noted, trading bank lending for October grew by 2.1 per cent, seasonally adjusted.

Savings Banks

Both the Post Office Savings Bank (POSB) and the Trustee Savings Banks (TSBs) experienced steady, strong deposit growth during the September quarter (5.6 per cent and 6.6 per cent, respectively). For the POSB, this represents an improvement over the deposit growth in the March quarter (2.7 per cent) and the June quarter (2.5 per cent) and compares with the growth over the September quarter last year of 0.9 per cent. The growth in TSB deposits on a quarterly basis has been marginally higher than that for the POSB, but has followed broadly the same pattern, recording growth rates over the last four quarters of 1.9 per cent (September 1982), 3.8 per cent (December 1982), 5.4 per cent (March 1983), 2 per cent (June 1983). The Private Savings Banks (PSBs), which are owned by the trading banks, on the other hand, continued the contraction in their collective deposit base (a trend which has become established over the last two years or so), falling 2.8 per cent over the September quarter. As an institutional group total savings bank deposits grew by 4.8 per cent in the September quarter. This compares with 4.6 per cent growth last year.

The POSB and TSBs also recorded increases in their lending for the September quarter (3.6 per cent and 3.2 per cent respectively). The PSBs loans outstanding continued to decline falling 4.2 per cent. These results compare with −3.6 per cent (POSB), +3.2 per cent (TSBs) and −0.9 per cent (PSBs) respectively, over the September 1982 quarter. Actual lending for the savings banks as a whole increased 1.2 per cent for the September 1983 quarter.

The growth in POSB and TSB deposits reflects the aggressive marketing stance adopted by each institution in the pursuit of increased deposit share. In this regard Key Accounts (POSB) and Hit Accounts (TSBs) continue to receive considerable support from small savers. The willingness of the POSB to compete more fully in the financial sector is demonstrated by the introduction in July of a bankcard facility.

Finance Companies

After a period of rapid expansion in their deposit base over the first three months of 1983 (averaging 2.5 per cent per month), finance company deposit growth slowed to 1.7 per cent in April and actually went negative in May (−0.7 per cent) and June (−0.6 per cent). In the absence of an active debt sales initiative during the first two months of the September quarter, the rate of finance company deposit growth recovered, peaked at +3.2 per cent in August but is now estimated to have fallen back to around 2 per cent in September.

After peaking at 1.9 per cent in April 1983, the monthly growth in finance company advances fell back and stabilised around 0.6 to 0.7 per cent until the end of August 1983. Up until August 1983, therefore, the trends in finance company lending and deposits were broadly consistent with those of the monetary and credit aggregates in the economy as a whole: strong deposit (liquidity) growth and flat credit (lending) growth. Over the month of September however, total finance company advances grew by 2.6 per cent.

Building Societies

Building Societies experienced strong deposit growth (11 per cent) over the September quarter. This compares with quarterly growth rates for the quarters ended March and June 1983 of 2.7 per cent and 1.7 per cent, respectively. The modest decline in deposit growth in the June quarter over the March quarter is attributable to the general deposit losses arising from tighter liquidity throughout the financial system while the rapid expansion in deposits over the September quarter reflects the improvement in overall liquidity and the aggressiveness with which the societies pursued an increased market share.

Over the same period, there has been a significant change in the application of these deposit funds. For example, after returning a growth rate in total advances of 5.2 per cent in the March 1983 quarter, advances growth as measured by mortgage lending during June and September has been relatively flat (0.3 per cent and 0.5 per cent respectively). Rather than increasing lending for housing, the societies have channelled an increasing proportion of their increased funds into an expanded investment portfolio. In the main this has meant significant increases in their deposits with short term money market dealers and, for the September quarter alone, a nearly three-fold increase in their holdings of commercial bills (from $10.2 million in June to $28.9 million in September).

Acceptance of a commercial bill effectively constitutes an alternative form of lending. For this reason the aggregate of commercial bills plus advances is a more comprehensive indication of building society lending. On this expanded basis an estimated monthly growth in this lending aggregate of around 2.2 per cent for September was recorded.

SUMMARY AND OUTLOOK

After a period of relatively slack demand for credit across all the major financial institutions there was evidence of a pick up in demand in the month of September. A continuation of this trend into the December quarter is also suggested by the trading bank lending figures and other data coming to hand for October and November.

The continuation of these trends will place increasing pressure on the credit growth guideline. In this regard, a number of financial institutions have recently been contacted and warned that upward revisions in public sector security requirements could be imposed if such strong lending growth continues.

The major factors that influenced domestic liquidity during the September quarter were the external and Government accounts and the absence of an active public debt policy for much of the period. Together these contributed to a significant growth in the monetary aggregates and resulted in an easing in monetary conditions generally over the third quarter of 1983. The outlook for the fourth quarter, in spite of some deterioration in the external accounts, is for the strong liquidity injections evident in the September quarter to continue, fuelled primarily by the impact of the fiscal deficit.