QUARTERLY REVIEW OF MONETARY CONDITIONS

INTRODUCTION

The September quarter was a turbulent period for the financial sector, encompassing the pre-election drain on overseas reserves and the subsequent devaluation and rapid foreign exchange inflow. It was also a period in which a wide range of direct controls imposed on the financial system were removed. The events of the period surrounding the election, together with the measures initially taken by the new Government, were fully covered in the extended June quarterly review published in the September 1984 *Bulletin* (Vol. 47) on pages 403–409. A summary of the more recent policy measures, together with a discussion of the general philosophy behind these reforms, is provided in the extract from a speech given by the Governor of the Reserve Bank, Mr S.T. Russell, on 23 October 1984 which is reprinted in the October 1984 *Bulletin* (Vol. 47) on pages 467 and 468.

This article covers developments in monetary and liquidity conditions over the second half of the September quarter, and examines the impact that Government policies, adopted during the quarter, will have on monetary conditions over the remaining months of the year. The article also examines the rates of deposit and lending growth of the major financial institutions in the September quarter.

MONETARY AGGREGATES

The estimates of the monetary and credit aggregates for the September quarter suggest that the growth rates of the main aggregates during the quarter were similar to those experienced earlier in the year. The narrow monetary aggregate M1 is estimated to have grown by 4.6 per cent in July, 1.1 per cent in August, and −2 per cent in September, an average monthly increase of 1.2 per cent following average monthly growth of 0.2 per cent and −0.8 per cent in the March and June quarters respectively.[1] However, the June quarter figure incorporated a fall of 7 per cent over May and June — the period when the 7th Government stock tender was being settled and when there was a large foreign exchange outflow — whereas the July increase was heavily affected by the strong foreign exchange inflows following devaluation. Meanwhile, the more broadly defined money supply and selected liquid assets of the public (M3) is estimated to have risen by 0.8 per cent in July, 2 per cent in August and 2.9 per cent in September, an average monthly increase of 1.9 per cent following average monthly increases of 1.1 per cent in the June quarter and 1 per cent in the March quarter. The annual growth rate of M1 fell from 11.1 per cent in June to 10.8 per cent in September and the annual rate of growth of M3 also fell slightly, from 15.4 per cent to 15.1 per cent.

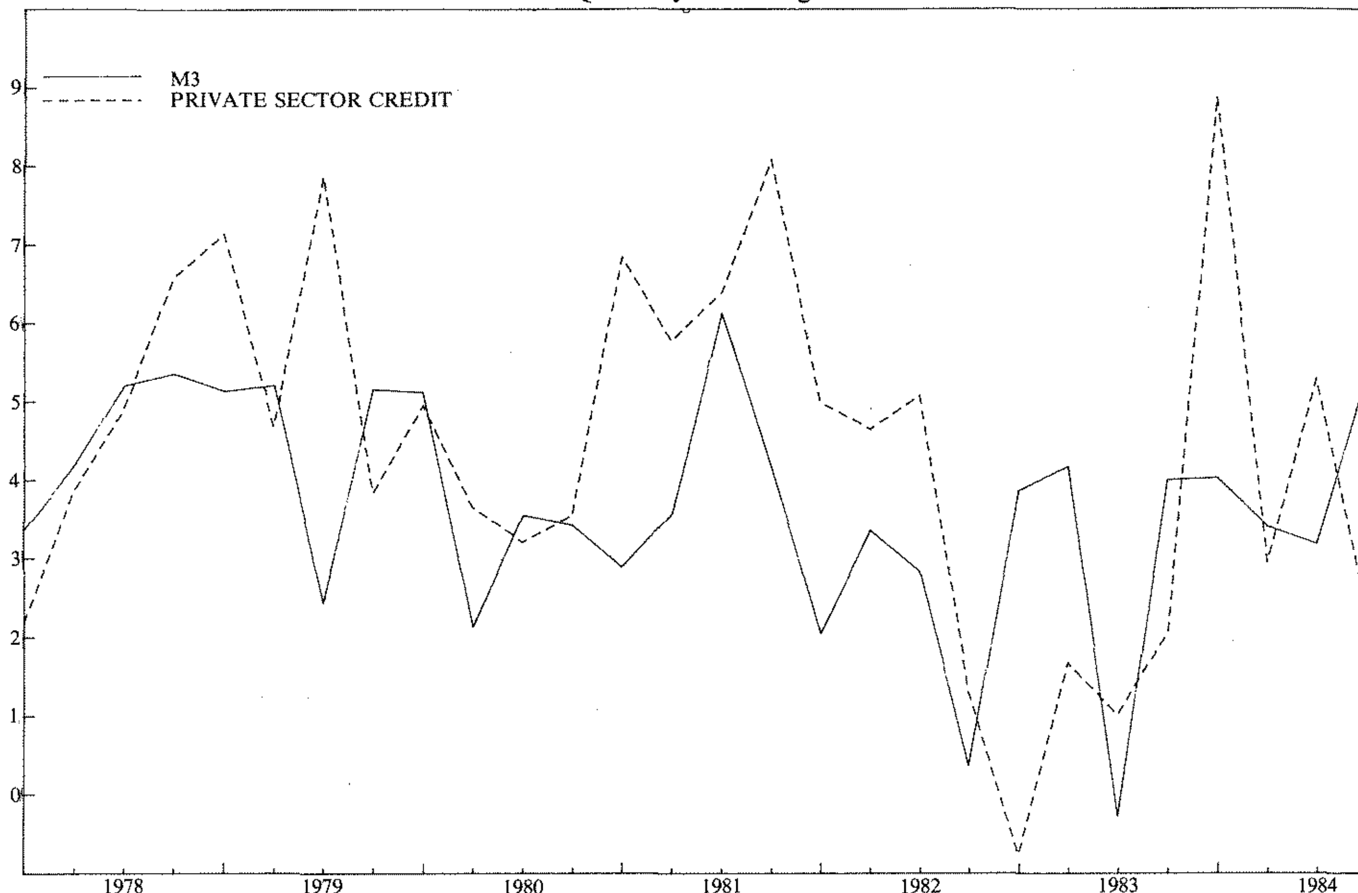
The strong growth in lending to the private sector by domestic financial institutions which emerged in the September quarter of 1983 and continued through the first half of 1984 was somewhat moderated in the September quarter. Following quarterly increases of 2.1 per cent, 8.9 per cent, 3 per cent and 5.3 per cent in the September 1983 — June 1984 quarters respectively, private sector credit grew by 2.4 per cent in the September 1984 quarter made up of monthly increases of 0.2 per cent in July, 0.3 per cent in August and 2.8 per cent in September. The slowdown can be attributed mainly to small increases in the lending of the trading banks and trustee savings banks. Despite the slightly lower monthly growth rates, the annual rate of growth in the year to September remained high at 21 per cent.

Considerable caution needs to be exercised when interpreting movements in the monetary aggregates during the September quarter. Problems exist regarding the treatment of inter-institutional deposits (i.e. deposits of M3 institutions held with other M3 institutions) within the M3 framework. When compiling the M3 aggregate, inter-institutional deposits are netted off the total deposit statistics before arriving at a measure of the public's money supply and selected liquid asset holdings. However, complete figures on these deposits are only available on a quarterly basis and for the months between quarters this total must be estimated. The only consistent inter-institutional figures available on a monthly basis are for trading bank holdings of other banks' TCDs, which increased sharply from $5.6 million in June to $345.7 million in August. Total TCDs on issue also rose rapidly over this period, from around $1,300 million at the end of June to a peak of just over $1,900 million in mid September. It is likely that a large part of these deposits are held by other financial institutions, though not necessarily by institutions which are included in the M3 framework. Thus, in the money supply estimates for the quarter, an allowance was made for an increase in inter-institutional deposits, though given the large magnitudes involved, it may be insufficient. When the September quarter figures are finalised, a clearer picture should emerge on movements in the monetary aggregates over the September quarter.

The rapid growth in inter-institutional deposits over the September quarter appears to have been at least partly attributable to the low interest rate available on Treasury bills over this period. Treasury bills have traditionally been the main instrument used by the banking system as a short-term depository for funds which can be readily exchanged for settlement balances at the Reserve Bank. Following the removal of interest rate controls in July, there was a widespread expectation that the Treasury bill yields would be raised in line with other market interest rates (the three month rate on new issue Treasury bills had been set at 7.8 per cent since July 1983). Because of both the low yields and the risk of capital losses if the bill rate was raised, the banks generally sought to avoid holding Treasury bills. They achieved this partly through greater use of inter-bank borrowing and lending to allow more active use of available liquid balances and partly by engaging in sell-back transactions in longer-dated government stock with non-bank institutions, timing the reversal of the deal to match expected liquidity flows. The counterpart to many of these deals was a trading bank term deposit or TCD, thereby inflating total deposit statistics and the monetary aggregates. In response to some of the problems experienced during this period and as a prelude to the introduction of a tender system for Treasury bills, the issue yield on 13 week Treasury bills was raised on 19 October 1984 from 7.8 per cent to 13.5 per cent. At the same time, 26 week bills were reissued at a yield of 14 per cent (26 week bills were previously

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

Figure 1
Seasonally Adjusted M3 and PSC
Quarterly % Change



taken off the market in September 1984).

The moves to deregulate the financial sector are also expected to create some problems for interpreting financial statistics. The initial removal of the Interest on Deposit regulations is likely to have resulted in some re-ordering of market shares in favour of those institutions who were previously subject to the greatest degree of control. In the medium term, the revocation of the directives preventing trading banks from paying interest on cheque account balances or on deposits for terms of less than thirty days (the 30 day rule), and the removal of the limit of 3 per cent on interest paid by savings banks on ordinary accounts are likely to have a significant impact on the monetary aggregates. If the institutions choose to pay interest on these deposits, the relative growth rate of M1 may increase compared with the experience of the last decade when demand deposits generally earned a negative real rate of return. The broader M3 aggregate will only be affected to the extent that the existing M3 institutions gain market share as a result of their greater freedom to compete for deposits across the full range of maturities. The moves which took effect as from 30 August had little noticeable impact in the financial sector during the remainder of the September quarter. However, the POSB and two trustee savings banks have already begun offering interest on cheque accounts and, in line with overseas experience, other institutions can be expected to move in this direction, possibly coupling interest paid on deposits with full-cost recovery on the operation of cheque accounts.

PRIMARY LIQUIDITY

In addition to examining movements in the main money and credit aggregates and interest rate developments, the Reserve Bank also monitors the level of 'primary liquidity' in the financial system when assessing current monetary conditions. Primary liquidity measures the amount of money available to the private sector for the settlement of transactions with the Reserve Bank. It is related to the broader money and credit aggregates, through the effect changes in the level of and rate of return on primary liquidity balances have on financial institutions' ability and willingness to expand their lending.

In practice, the decision on what to include in the definition of primary liquidity tends to be determined largely by current institutional arrangements. The working definition which has been adopted includes trading bank demand deposits with the Reserve Bank, Treasury bills, and ordinary Government stock with less than six months to maturity. This reflects the fact that the Reserve Bank is currently prepared to discount stock with less than six months to maturity on demand (at a margin of 1 per cent above the selling yield). The Bank will also buy longer-dated stock, but at a wider margin, so that the effective cost of such discounting makes it more of a last resort.

Movements in primary liquidity were particularly volatile during the September quarter. At the beginning of the quarter, the level had fallen to a low $345 million.

TABLE 1
SUBSCRIPTIONS AND REDEMPTIONS OF RETAIL DEBT INSTRUMENTS: COMPARISON OF JUNE AND SEPTEMBER QUARTERS 1984

	June 1984			*September 1984*		
	Subscriptions	*Redemptions*	*Net*	*Subscriptions*	*Redemptions*	*Net*
Inflation Adjusted Bonds	+ 27.0	− 42.1	− 15.1	+ 52.0	− 29.3	− 22.7
Kiwi Savings Stock I	...	− 21.0	− 21.0	...	− 50.8	− 50.8
Kiwi Savings Stock II	...	− 5.6	− 5.6	...	− 20.9	− 20.9
Our New Zealand Bonds	+ 17.7	...	+ 17.7	+ 50.7	...	+ 50.7
Other Savings Stock	...	− 19.5	− 19.6	...	− 0.9	− 0.9
Total	**+ 44.7**	**− 88.3**	**− 43.6**	**+ 102.7**	**− 101.9**	**+ 0.8**

TABLE 2
NEW ZEALAND GOVERNMENT STOCK SALES BY TENDER

Tender number	Date held	Stock offered	Maturity date	Total amount offered $m	Total bids submitted $m	Over-subscriptions accepted[2] $m	Total successful bids $m	Allotment Yield[3] % p.a.
1.	8/9/83	N.Z. Govt. Stock	15.06.85	80.0	218.6		80.0	8.71
			15.08.87	20.0	80.0		20.0	9.01
2.	13/10/83	N.Z. Govt. Stock	15.10.85	100.0	108.2		100.0	9.52
			15.10.86	75.0	69.8		69.8	9.90
			15.10.89	25.0	37.7		25.0	10.65
3.	17/11/83	N.Z. Govt. Stock	15.10.85	200.0	194.1		76.2	10.64
			15.05.87	150.0	168.5		49.8	10.58
			15.10.91	50.0	96.0		17.0	10.90
4.	15/12/83	N.Z. Govt. Stock	15.12.84	125.0	172.6		125.0	9.89
			15.06.86	100.0	91.9		88.0	11.00
			15.10.91	50.0	24.4		19.9	11.00
		Index Linked[1]	15.03.89	75.0	55.4		30.7	6.00
			15.03.94	50.0	60.8		50.0	6.00
5.	2/2/84	N.Z. Govt. Stock	15.06.85	200.0	61.0		58.5	11.00
			15.01.87	100.0	22.8		18.7	11.00
		Index Linked	15.06.89	100.0	43.9		29.9	6.00
			15.06.92	200.0	225.8	1.0	201.0	6.00
6.	22/3/84	N.Z. Govt. Stock	15.05.86	100.0	86.0		12.6	10.00
		Index Linked	15.06.91	250.0	545.7		222.5	5.30
			15.06.99	50.0	171.2	10.0	60.0	4.59
7.	3/5/84	N.Z. Govt. Stock	15.04.86	100.0	65.6		55.1	10.00
		Index Linked	15.09.87	100.0	137.1		64.8	5.00
			15.09.92	300.0	588.7	60.0	360.0	4.95
			15.09.01	100.0	197.2	20.0	120.0	4.55
8.	7/6/84	N.Z. Govt. Stock	15.04.86	50.0	2.9		0.2	10.00
		Index Linked	15.09.87	100.0	35.0		11.4	5.00
			15.09.93	100.0	117.3		72.0	5.00
9.	27/7/84	N.Z. Govt. Stock	15.06.87	100.0	78.7		68.7	15.00
			15.06.90	100.0	78.2	57.6	15.6	15.50
		Index Linked	15.12.87	150.0	158.0		139.8	5.00
			15.12.91	150.0	212.4	30.0	180.0	5.00
10.	16/8/84	N.Z. Govt. Stock	15.06.86	150.0	157.9		123.9	15.50
			15.11.92	50.0	220.7	7.8	57.8	15.25
		Index Linked	15.06.89	100.0	92.7		73.7	6.00
			15.06.92	100.0	133.2	20.0	120.0	6.00
11.	30/8/84	N.Z. Govt. Stock	15.05.90	100.0	155.6		100.0	15.49
			15.05.94	100.0	226.0		100.0	15.25
		Index Linked	15.06.88	50.0	64.6		50.0	6.00
12.	20/9/84	N.Z. Govt. Stock	15.09.86	80.0	94.0		75.0	15.97
			15.05.90	60.0	138.2		60.0	15.60
			15.05.94	60.0	187.1	5.0	65.0	15.45
13.	18/10/84	N.Z. Govt. Stock	15.10.90	100.0	238.2		100.0	17.40
			15.10.94	100.0	211.6		100.0	16.96

Note:
[1] On 2 December 1983, the Minister of Finance announced details of a new 'Index-Linked' Government Stock — details of this stock were provided on page 565 of the December *Bulletin* (Vol. 46).
[2] As from the fifth tender over-subscriptions of up to 20% of the amount offered in any maturity may be accepted subject to the overall amount accepted not exceeding the amount of stock offered in the tender (this facility was announced on 2 February, 1984 and was covered on page 18 of the January/February *Bulletin* (Vol 47)).
[3] The figures for tenders 1-3 and 12-13 are the weighted average yield under the yield bid system. In tenders 4-11 stock was allotted on a uniform yield basis.

The continued foreign exchange outflow saw primary liquidity drop further and some $256 million of longer-dated stock had to be discounted at the Reserve Bank. By the end of July, however, primary liquidity had risen sharply to $1,290 million in response to the very strong foreign exchange inflow following the devaluation. Government policy was initially aimed at absorbing this excess liquidity by selling longer-dated stock through the tenders. In the first five stock tenders held after the election, a total of $1,470 million was raised. This debt programme, combined with a steady foreign exchange outflow, saw the level of liquidity fall to $542 million by the end of August and to $442 million by the end of September.

In interpreting the degree of primary liquidity in the system caution should be exercised when looking only at figures for the last working day. The New Zealand monthly liquidity cycle typically reaches a minimum at the end of each month, and the level of liquidity can fall by up to $350 million over the last week. Nevertheless, the end of month figures over the September quarter are indicative of the very substantial tightening in liquidity which occurred over the September quarter and into early October.

In mid-August the Government announced that over the remaining four tenders of 1984 it proposed to raise $1,000 million. The target was aimed both at absorbing the then forecast liquidity injections, and also encouraging a more rapid adjustment in the balance of payments. It was also announced that, in line with the desire to move to a more even pattern of tender amounts, the Reserve Bank intended to conduct more active trading operations in the secondary market for government and private paper to smooth out seasonal liquidity fluctuations. The Bank considers that tendering government stock should be directed to the medium term objective of financing the on-going Government deficit while open market operations and sales of shorter-dated instruments such as Treasury bills should be used to take account of seasonal fluctuations in liquidity around the medium term path. It believes that reasonable stability in tender sizes will give the market a better indication as to the overall size of the Government's debt sales target, and increase the informational content of any significant changes in tender amounts.

In addition to the measures already mentioned above there were two other significant decisions announced in late August.

On 31 August it was announced that the 1 per cent per month credit guideline would be lifted immediately. The guideline had gradually been applied to the main institutional groups since July 1982. Over the last year of the previous government it had been used as the trigger level for ratio tightening. With the move towards a more active public debt programme as the principal tool of monetary policy, there was no longer a need for restrictions which concentrate on developments within particular institutional groups.

The second major measure was the announcement by the Governor of the Reserve Bank that as from the end of September the special status accorded to the four Official Short Term Money Market dealers would be withdrawn. This move involved, in particular, the removal of the lender of last resort facility which had been available to these institutions since their inception in 1962. The Official Money Market was originally established at a time when facilities for placing call or short-term deposits were extremely limited. That situation has changed over the years and, particularly with the abolition of the 30-day rule, the special status given to these dealers is no longer necessary for the continued development of the short-term money market.

Since the election there has been a greater reliance on public debt policy to influence domestic liquidity conditions. The effects of this to date have been tighter liquidity conditions in wholesale money markets rather than significantly slower growth in the monetary aggregates.

The 11th Government stock tender held on 30 August had sought $250 million and with bids received totalling $446.2 million the tender was easily filled. $200 million of conventional stock was sold at rates of 15.25–15.49 per cent, and $50 million of index-linked stock was sold at 6 per cent. In this tender interest was particularly strong in the longer term (May 1994) stock, with $226 million of bids received for the $100 million of stock on offer.

The 12th tender held on 20 September sought $200 million, all in conventional stock, reflecting a reduced level of market interest in indexed instruments once higher rates were accepted in the conventional stock tenders. Bids received totalled $419.3 million, again with the strongest interest being in the longest conventional stock (May 1994). For the 12th tender the yield-bid allotment method was re-introduced, making it somewhat difficult to compare rates with those in earlier tenders. However, rates tended to be somewhat higher overall (the weighted averages being in the range 15.45 per cent to 15.97 per cent) and the interest rate on the September 1986 stock was held below 16 per cent only by accepting over-subscriptions for the 1994 stock.

Settlement of the 12th tender coincided with the already strong liquidity drain at the end of September. Short-term interest rates rose rapidly to 19 — 20 per cent and by the last day of the quarter the call rate was around 21 — 22 per cent, with some deals being made at up to 25 per cent. High call rates for a few days are the market's way of dealing with tight periods and should not be of major concern to the policy-maker. However, over late September the entire private sector yield curve moved substantially upwards, although this was most marked for terms of less than six months. This quickly led to a substantial inflow of funds from overseas as foreign investors took advantage of the attractive rates available on wholesale market instruments in New Zealand. Given the relative ease with which major domestic financial institutions can arrange such inflows, and the growing interest in the New Zealand economy evident amongst the international financial community, such private capital flows are likely to play a more active role in dampening short-term interest rate movements in the future.

In the 13th tender held on 18 October the Government again sought to raise $200 million in six and ten year conventional stocks. Bids received totalled $450 million. Although the tender was filled there was a substantial increase in the weighted average interest rates, to 17.4 per cent on the six year stock and 16.96 per cent on the ten year stock. The higher interest rates reflect the size of the Government's financing requirement and possibly a greater degree of uncertainty in the market following the tight liquidity conditions earlier in the month.

On the retail side of the public debt programme, the September quarter was one in which subscriptions only just managed to exceed redemptions. Total retail stocks

outstanding rose by only a net $0.8 million over the quarter. The two retail issues on the market during the quarter were Inflation Adjusted Savings Bonds (IASBs) and Our New Zealand Bonds. IASB subscriptions picked up markedly in the September quarter, totalling $52 million compared to $27 million in the June quarter, and $5.6 million in the March quarter. Redemptions of $29.3 million were also down on the $42.1 million in the June quarter. The greater success of IASBs can probably be attributed to the increase in the expected rate of inflation for the forthcoming year following the easing of price controls and devaluation. Our New Zealand Bonds have continued to sell at only a moderate rate despite the indexed yield available: $50.7 million over the September quarter compared to $17.7 million in June, the first month of issue. The issue was originally scheduled to close at the end of August, but an extension was announced in late August and the issue finally closed on 2 November. Rising private sector interest rates following the removal of controls were probably the major contributing factor behind the increase in redemptions of the two Kiwi Savings Stock issues, from $26.6 million in the June quarter to $71.7 million in the September quarter.

The interest rate developments in the period immediately surrounding the devaluation were fully covered in the June *Quarterly Review* which was contained in the September 1984 *Bulletin* (Vol. 47) on pages 403-409. Since mid-August interest rates on both private and government securities have tended to rise. The overall increase has been evident on both short and long-term securities, although with the relatively severe short-term liquidity pressures around the end of September, short rates have tended to rise rather more rapidly. Another feature of the yield curve is that interest rates have generally been somewhat higher for securities of six months to two years to maturity, than for longer stock. This yield curve would appear to result from a widespread expectation that the new Government's fiscal and monetary policies are consistent with bringing inflation more permanently under control at a lower level, once the full inflationary effects of the devaluation and budget measures have impacted over the next year.

In the wholesale sector, the 90 day commercial bill rate had dropped to around 15 per cent by mid-August but with the vigorous tender policy stance and a higher OET deficit, the average rate rose to near 17 per cent by the end of September, and to around 19 per cent by early October. Secondary market government security rates rose steadily during the quarter, in line with the rise in new issue rates. For example, stock with less than two years to maturity traded at around 10.9 per cent in the week after the election, but by the end of September the same maturities were trading at 16.1 per cent.

FINANCIAL INSTITUTIONS AND MARKETS

Trading Banks

After growing by 7.1 per cent in the June quarter, trading bank lending rose by only 1.5 per cent in total over the September quarter. The rapid growth rates recorded in May and June, 3.1 per cent and 3.8 per cent respectively, continued in July, with a 2.4 per cent increase in monthly average lending. This growth reflected increased borrowing associated with the large foreign exchange outflow prior to the election. Loans outstanding fell rapidly over the last week in July and the first week of August, so that average lending for August fell by 5 per cent. (By way of comparison if the last week of the month figures are used as for the monetary aggregates, rather than monthly averages, lending fell by 0.2 per cent in July and by 0.1 per cent in August). Despite rapid increases in interest rates across the board in September, lending rose again by 4.3 per cent on average although this may have partly reflected inter-institutional activity associated with the tight liquidity conditions. As was experienced during the June quarter, the growth in lending during the September quarter was mainly in advances and discounts rather than term loans. In the months of July, August and September, the annual growth rates in advances and discounts were respectively 28.5 per cent, 18.5 per cent and 27.2 per cent. By comparison, the annual rates of growth of term loans averaged only 16.6 per cent over the same three months.

Total credit limits grew by 2 per cent in July and by 3.3 per cent in August. This rapid growth of total credit limits over July and August, combined with slow lending growth, led to a reduction in the percentage utilisation of credit limits from 72.2 per cent in June to 67.5 per cent by August. However, in September total credit limits fell by 1.2 per cent, possibly reflecting the tighter liquidity position, and the percentage utilisation rose to 71.5 per cent.

Total trading bank deposits rose by only 2.4 per cent in the June quarter, but in the September quarter they increased by 13.5 per cent, with all of the increase occurring in the months of August and September (average monthly growth rates of 7.2 per cent and 6.1 per cent respectively). Over the quarter, demand deposits increased by only 4.3 per cent while term deposits increased at an average rate of 5.3 per cent per month. However, as already noted, bank deposit figures were inflated over this period by inter-institutional activity. It is also too early to assess what impact the deregulation of interest rates and removal of the 30-day rule may have had on deposit growth of the various financial institutions.

The reserve asset ratio policy stance remained tight in the September quarter. For July the free reserves margin was lowered to −$100 million in response to the upsurge in lending in May and June. The same negative margin was maintained when setting the ratio for August, after lending for July had risen by 2.4 per cent. However, as part of the move away from institution-specific policies and towards a more generalised debt policy approach to monetary control, the free reserves margin was raised initially to zero for September and to $100 million for October.

After the large post-devaluation inflow, reserve assets fell steadily over the remainder of the quarter. Reserve assets reached an all-time record level in late July of almost $3,000 million, and in August average reserve assets peaked at $2,729 million. By the end of the quarter the level of reserve assets was around $2,200 million, about $400 million higher than at the same time in 1983.

Savings Banks

Total savings bank lending is estimated to have increased by 2.9 per cent in the September quarter, compared to 3.5 per cent in the June quarter.

Lending by the Post Office Savings Bank (POSB) continued to grow rapidly over the quarter. However,

FIGURE 2
SEASONALLY ADJUSTED PERCENTAGE UTILISATION
OF TRADING BANK CREDIT LIMITS

FIGURE 3
TRADING BANK LENDING AND DEPOSITS
SEASONALLY ADJUSTED MONTHLY
% CHANGE

when an adjustment is made to exclude lending previously undertaken by the Housing Corporation, POSB lending grew by only 0.6 per cent over the September quarter, compared with 5.3 per cent growth in the June quarter. This slower growth probably resulted from the measures imposed by the POSB in June to restrain its lending to within the credit guideline that was operating at that time.

The lending growth of the trustee savings banks (TSBs) continued to be moderate during the September quarter. Lending grew by 0.8 per cent in July and 1 per cent in August, following increases of 4.4 per cent and 2.5 per cent in the March and June quarters respectively.

Lending by the private savings banks (PSBs) continued to decline over the September quarter. Falls of 0.7 per cent in both July and August and 0.9 per cent in September were similar in magnitude to those recorded in the first six months of 1984. An even more marked downturn occurred in deposits held at the PSBs which fell by 9.3 per cent in the September quarter following quarterly declines of 4.4 per cent in the March quarter and 5.2 per cent in the June quarter. Deposits at both the POSB and the TSBs rose over the quarter, by 2 per cent and 1.6 per cent respectively, although at slower rates than in the preceding quarter. This slower growth was reflected in the annual deposit growth rates which by September had fallen to 10.4 per cent for the POSB, 13.1 per cent for the TSBs and minus 19.9 per cent for the PSBs.

Finance Companies

(Monthly and quarterly growth rates for both finance companies and building societies are not seasonally adjusted.)

Total loans and advances by the large finance companies increased by 4.6 per cent in July, and then fell by 1.3 per cent in August, compared with 2.3 per cent growth over the June quarter. The strong increase in July is likely to have been associated with the high retail sales of consumer durables, most notably motor vehicles and household appliances, following the devaluation. The fall in lending in August 1984 may reflect both a return to more normal lending levels following the post-devaluation surge and some consumer resistance to the rapid increase in finance company lending interest rates which occurred immediately after the removal of the lending interest rate controls. In annual terms lending by the finance companies continued to show strong growth, increasing by 28.2 per cent over the year to August 1984.

After growing by only 2 per cent in the June quarter, total deposits with large finance companies rose by 8.9 per cent over the first two months of the September quarter. The increase was concentrated in August, when deposits grew by 10.2 per cent, with term deposits increasing by 10.8 per cent in August compared with demand deposit growth of 6.6 per cent. The large increase in deposits in August probably resulted from the high interest rates offered by some finance companies in the period following the removal of the Interest on Deposit regulations. A number of companies subsequently lowered their deposit rates.

Building Societies

After increasing by 2.1 per cent over the June quarter, total advances by the building societies rose by 1 per cent in July, 1.3 per cent in August, and 3 per cent in September. Meanwhile, building society deposit growth increased by 2.4 per cent in the September quarter compared with increases of 1.8 per cent and 4.3 per cent in the March and June quarters respectively.

CONCLUSION

The September quarter has been characterised by a major change in the environment within which financial institutions operate. This has involved the removal of controls on interest rates, and a switch in the orientation of Government policy away from attempting to control money and credit growth through direct controls on specific institutional groups and towards the use of more market-based intervention using public debt sales through the Government stock tenders. There has also been large swings in reserves and in lending and deposits associated with the period surrounding the devaluation.

As a result of these developments, movements in the money and credit aggregates over this period have been difficult to interpret. There is some evidence that the aggregates may have been inflated by the large amount of inter-institutional activity undertaken during recent months. The most visible impact of the more active public debt programme has been seen in the wholesale money markets, where primary liquidity has been sharply reduced from the post-devaluation highs and short-term interest rates have risen sharply. However, these trends were reversed to some extent in October as a result of a strong private capital inflow.