MONETARY POLICY MEASURES

During December 1983 and January 1984 a variety of significant monetary policy measures were announced. A number of these were designed to restrain the growth of credit to within the guideline limits announced earlier in the year, one was designed to improve equity between and consistency of treatment of financial institutions competing in the private market place for business, while another was a modification to the Government Security Tender System.

Finance Company and Building Society Public Sector Security Ratios

On 16 December 1983 the Minister of Finance (Sir Robert Muldoon), announced that the public sector security ratios applying to finance companies and building societies were to be increased. The finance company government security ratio was to rise from 20 per cent to 25 per cent of investments, effective from 29 February 1984. The building society public sector ratio requirement was to rise by 3 percentage points to 19 per cent effective from 9 February 1984, with at least 14 per cent to be held in the form of government securities, compared with 11 per cent previously (the remainder may be held in other public sector securities such as local authority stock).

Sir Robert said that "these ratio increases are in response to the excessive rate of growth of lending by finance companies and building societies over the last few months." Finance company net loans and advances had risen by 2.6 per cent in September, 2 per cent in October and were provisionally estimated to have risen 4.6 per cent in November, all on a seasonally adjusted basis. Building society lending had risen by 2.1 per cent in September and 1.7 per cent in October.

Sir Robert emphasised that these institutions had repeatedly been warned that if their monthly lending growth exceeded 1 per cent on a seasonally adjusted basis then ratio increases would be imposed. "The Government is not prepared to tolerate lending growth rates which put in jeopardy the gains made from the freeze," Sir Robert said, and he added that further ratio increases, and ratio increases on other institutions would follow if the 1 per cent credit guideline was not strictly adhered to in future.

In a further step, on 27 January 1984, Sir Robert announced that the government security ratio on finance companies was to rise by a further 5 percentage points to 30 per cent of investments, effective from 31 March 1984. In explaining the measure, Sir Robert said "the strong lending growth by finance companies over the latter part of 1983 indicates clearly that they have ignored the credit guideline, and their intense competition for deposits at the present time implies that they intend to continue to ignore that guideline. Over 1983, finance company deposits have grown by an estimated 27 per cent, well in excess of the growth rate of M3 which was about 13 per cent. If they think that I will permit that rate of deposit growth to be translated into private sector credit growth then they are very much mistaken. If this second ratio increase does not convince the finance companies that their deposit and lending policies should be rapidly and substantially moderated, additional measures will be taken," Sir Robert concluded.

Trading Banks Reserve Asset Ratio

On 28 December 1983 the Deputy Governor of the Reserve Bank, Dr R.S. Deane, announced that with effect from January 1984 the margin of free reserves aimed at when setting the trading bank reserve asset ratio would be reduced from $100 million to $50 million.

Dr Deane said that this change had been taken in response to the strong increase in trading bank lending which had occurred since September and which showed no sign of abating during December. Despite the credit guideline restricting lending growth to no more than 1 per cent per month seasonally adjusted, trading bank lending rose by 1.9 per cent in October, 2.8 per cent in November and 3.8 per cent in December, all on a seasonally adjusted basis.

A second reduction in the free reserves margin was announced by the Minister of Finance on 27 January 1984. On this occasion, the margin was reduced from $50 million to zero, effective from February 1984. At the time the Minister said "this successive monthly reduction in the ratio margin stresses my determination to see private sector credit growth rates slow down from the excessive growth rates of the last quarter of 1983. I do not intend to allow private sector credit expansion to put in jeopardy the gains made from the freeze. While trading bank lending in January to date seems to have grown much more slowly than in the preceding three months, the combined lending rate in December and January will still be in breach of the guideline. Also, I am alarmed at the way trading bank credit limits grew over the latter half of 1983," the Minister added. "They grew by 11 per cent over that six month period. This ratio measure should indicate to the banks that I will not passively allow the high level of unutilised credit limits that they have created to be turned into actual lending."

The free reserves margin represents the difference between the average level of reserve assets that the banks are required to hold in any one month (as prescribed by the reserve asset ratio which is set in advance each month by the Reserve Bank), and the average holdings expected for the month at the time the ratio is set. In effect, this margin allows an amount for the uncertainty inherent in forecasting month-to-month flows in reserve assets. The reductions in the margin are intended to restrain trading bank lending behaviour since there will be a greater likelihood that the banks' actual reserve asset holdings in any one month will fall below the required level.

In the past the Reserve Bank has taken the view that a free reserves margin of around $100 million is consistent with a neutral policy stance, in that such a margin should imply that there is relatively little chance of the banking system being faced with a reserve asset shortfall. The reductions in the margin should therefore be interpreted as a tightening of monetary policy in order to influence the banks to reduce their lending growth in line with the Government's objectives.

Should a bank suffer a shortfall in reserve assets in any month, it is required to borrow an amount from the Reserve Bank sufficient to make good the shortfall, and to redeposit the borrowed funds at the Bank. Interest rates on both legs of the transaction are set by the

Reserve Bank, at levels designed to impose a penalty on the bank concerned. The extent of the penalty can be altered according to monetary policy considerations — the penalty has recently been increased by reducing the rates paid on these bank deposits with the Reserve Bank by three percentage points, while leaving the borrowing rate unchanged. This amendment took effect from February 1984.

A more complete description of the operation of the reserve asset ratio system is contained in the October 1981 issue of the Bulletin.

Ratio Requirements On Government-owned Financial Institutions

The Governor of the Reserve Bank, Mr D.L. Wilks, announced on 22 December 1983 that the Minister of Finance had agreed that Government-owned financial institutions should be subject to a requirement to hold public sector securities in terms of the Finance Companies (Investment) Regulations 1983 on the same basis as finance companies.

The ratio will apply only to that part of the institutions' lending operations funded by borrowings from the non-Government sector. This measure is designed to place Government-owned financial institutions on an equal footing with private sector institutions in terms of their ability to compete for funds in the market place.

Mr Wilks stated that to permit an orderly adjustment to the new arrangements a phasing in period would be allowed where necessary. The only institution which will have to increase its government security holding in the short-term is the Development Finance Corporation. The Corporation has borrowed extensively from the market but has previously been exempt from a ratio, and accordingly it will be allowed an adjustment period to conform fully to the ratio requirement. Other institutions potentially affected include the Rural Banking and Finance Corporation and the Housing Corporation, but these institutions' government stock holdings are already in excess of any possible immediate requirements, so that no additional holdings are likely to be called for at this stage.

Government Stock Tender — Over-subscriptions

In releasing details of the fifth Government Stock tender to be held on 2 February 1984, the Reserve Bank announced that in this and subsequent tenders, the Reserve Bank will reserve the right to accept over-subscriptions of up to 20 per cent of the amount offered in any individual maturity subject to the total amount accepted in all stocks offered not exceeding the total amount on offer in the tender in question.

PUBLICATIONS

MONETARY POLICY AND THE NEW ZEALAND FINANCIAL SYSTEM

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