QUARTERLY REVIEW OF MONETARY CONDITIONS AND POLICY

INTRODUCTION

During the March 1984 quarter there were increasing indications of a recovery in economic activity having taken place. While this improvement can be partly attributed to a modest rise in real disposable incomes during 1983, probably the major factor has been the sharp turnaround in domestic monetary conditions over the second half of 1983, when a build-up in real money balances coincided with significant reductions in nominal interest rate levels.

This article sketches the main developments in monetary conditions and Government monetary policy during the March 1984 quarter. It outlines changes which have been implemented in recent months in the reserve ratio requirements of a number of institutional groups. The article also examines the underlying rates of deposit and lending growth of the major institutional groups.

For details of monetary conditions and policy during 1983 readers are referred to the quarterly review which appears on p. 78 of the March 1984 *Bulletin* and to those located in volume 46 of the *Bulletin* (1983) on pages 174, 332 and 559 (ff).

The March 1984 quarter saw some slowdown in the growth of the main monetary aggregates compared with the rapid increases over the previous six months. Preliminary estimates of the monetary aggregates as at the end of March show the narrow money supply (M1) to have fallen by around 2.6 per cent over the March quarter compared with respective increases of 8 and 5.4 per cent in the September and December quarters 1983.[1] Meanwhile the more broadly defined money supply and selected liquid assets of the public (M3) is estimated to have risen by 3 per cent over the March quarter following an increase of 4 per cent in the December quarter 1983 and of 5 per cent in the preceding three month period. The annual rates of growth in M1 and M3 at the end of March were 8.2 per cent and 11.6 per cent respectively, a little down on their levels in December. Given the decline in the rate of inflation over the same period (to 3.5 per cent) these growth rates are well in excess of increases in both prices and nominal incomes, and represent a build-up in real money balances.

The strong pick-up in lending by domestic financial institutions which emerged as a major influence on the growth in the money supply in the December quarter is estimated to have continued in the early part of 1984, though at a slower rate. Estimates for the March quarter suggest that private sector credit growth was 3.5 per cent, following an exceptionally rapid increase of 8.4 per cent over the December quarter. This expansion in the March quarter contributes to an estimated annual growth for the year ending March 1984 of 16.7 per cent, compared with an annual increase of 14.3 per cent in December and annual increases of less than 5 per cent in the earlier quarters of 1983. Underlying the expansion in credit since mid – 1983 has been a recovery in trading banks' reserve assets and a pick-up in the demand for credit in response to falling nominal interest rates and increased economic activity. As was the case in the December quarter, the major contributors to this growth appear to have been the trading banks and finance companies. In addition, savings banks' lending has recently displayed firm growth — the monthly increase in their loans outstanding in the first three months of 1984 has averaged 1.5 per cent compared with 1.1 per cent in the December quarter.

Underlying the movement in reserve assets over the last few quarters has been the injections into the financial system from the Government. Although the 1983/84 fiscal deficit of $2,983.9 million was less than budgeted for, it remained a major contributor to the monetary expansion. Not only did it add to deposit growth and monetary aggregates directly but it provided the reserve base through which the financial institutions could further expand their lending activity.

The influence on monetary growth and domestic liquidity during the March quarter from the external accounts was fairly modest. Over the period an increase in import payments which continued a trend evident since the third quarter of 1983, was partly offset by a seasonal increase in export receipts, resulting in a deficit on the current account of $152 million (compared with that of $610 million registered in the December quarter 1983). Meanwhile a small net private capital inflow of $71 million was recorded for the March quarter, representing a marked slowdown from the substantial inflows in the corresponding quarter of 1983. The overall impact for the first three months of 1984 was a net withdrawal of just over $82 million.

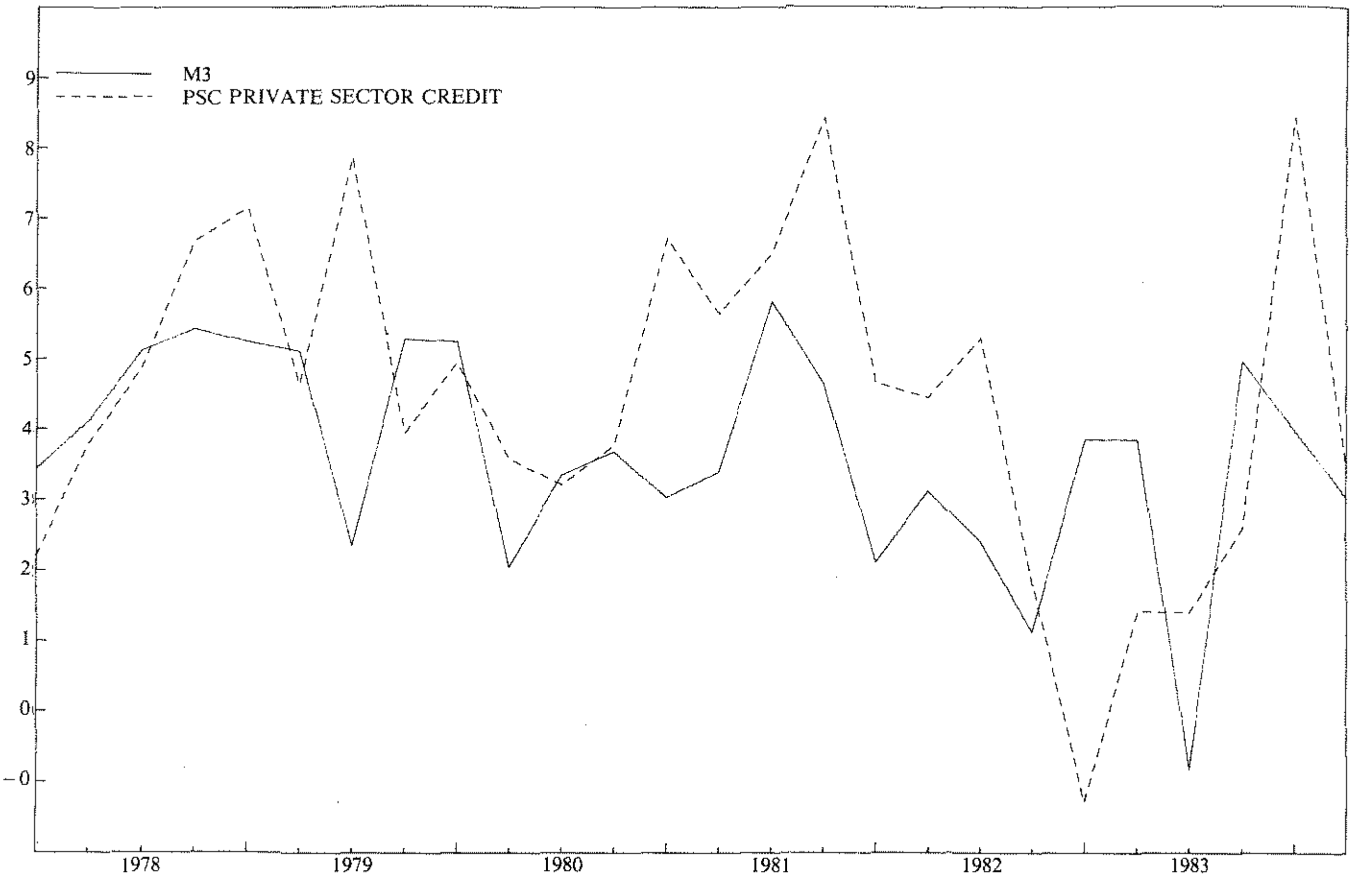
Another significant influence on monetary developments over the period was public debt policy. While the Government has been concerned that an expansion in monetary and credit growth rates that could jeopardise the current low rate of inflation should not be permitted, it has also been committed to achieving a reduction in interest rates. As a consequence, its public debt programme over the March quarter was not sufficient to offset the easing in liquidity that stemmed principally from the fiscal deficit.

On the retail side only Inflation Adjusted Savings Bonds (IASBs) remained on the market at the end of the quarter, with the second issue of Kiwi Savings Stock being withdrawn on 9 February. In the six months this issue was on the market it attracted only $125 million (net of redemptions) of which only a net $12 million had been raised in the March quarter. The issue was withdrawn by the Government in order to facilitate a general decline in interest rates.

Meanwhile new subscriptions of IASBs continued to fall away during the March quarter. In late February, in an endeavour to increase the instrument's attractiveness, the terms and conditions of new and existing IASBs were improved (for details refer to p. 85 of the March 1984 *Bulletin*). While in subsequent months the level of subscriptions increased slightly (particularly in April when sales of over $7 million were recorded) the level of redemptions has been such that a net withdrawal has still been occurring. Overall, although the levels of redemptions of all other retail stocks during the first quarter of 1984 were down on

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



those in the three months ended December, total retail debt sales fell short of redemptions for the third successive quarter, implying an additional net injection of funds to the financial system. (Table 1 provides details of these retail debt transactions). Moreover, in the month of April the net effect of subscriptions and redemptions was a further injection into the monetary base of $16.5 million.

Turning to wholesale market debt operations, two government security tenders were held in the March quarter. In the first, held 2 February, the bids received indicated a lower level of market support than had been the case previously. For an offering of $600 million, bids received amounted to only $353.4 million, and of these $44.8 million were rejected because their yields were considered by the Government to be too high. In the next tender, held on 22 March, market support was stronger —$802.9 million of bids were submitted for the $400 million stock offered. However, on this occasion bids to the value of only $295.1 million were allotted stock; $104.9 million of bids which might otherwise have been accepted being rejected because the yields bid were excessive in relation to those considered acceptable to the Government.

The outcome of the next tender, held on 3 May, was, however, considerably more successful in that virtually the total amount offered — $600 million — was sold at rates at or below those set at previous tenders. Moreover the tender was generally well covered, with a total of $959 million of bids being submitted. This can probably be attributed to the more liquid conditions prevailing at the time (a reflection of developments over the March quarter), to the increasing market interest in index linked stock which formed the main part of the offering, and in part to the prospective increases in the government security holding requirements of financial institutions. However, there are some indications that the tender was more successful than had been expected by the market, and that this, along with some contributing factors (in particular the tight ratio position experienced by trading banks over May and to a less certain extent attempts to fund increased government securities requirements faced by finance companies), has led to significant pressures on short-term deposit interest rates. Table 2 summarises the results of tenders to date.

With regard to interest rate developments more generally, the rise in short-term deposit rates noted above has not as yet interrupted the overall downward trend in longer-term deposit interest rates and lending interest rates, although secondary market yields for government securities show early signs of firming. Unless longer-term rates similarly start rising again, it is probably safe to conclude that the market views the factors leading to pressure on short-term rates to be temporary in nature.

The downward trend in longer-term rates is most clearly demonstrated by movements in rates associated with loans secured by mortgages over real property. These, since November, have been subject to regulations limiting the interest payable on new and reviewed first mortgages to 11 per cent and subsequent mortgages to 14 per cent. The average rates for new mortgages registered in February (which would have been arranged in earlier months) fell to 12.61 per cent (or 13.98 per cent excluding Government lending institutions) compared with 14.17 per cent (16.01 per cent) three months earlier. Although the speed with which individual institutions have reviewed mortgage rates has varied (with some claims that the requirement

TABLE 1
SUBSCRIPTIONS AND REDEMPTIONS OF RETAIL DEBT INSTRUMENTS: COMPARISON OF DECEMBER QUARTER 1983 AND MARCH QUARTER 1984

	December 1983			March 1984		
	Subscriptions	Redemptions	Net	Subscriptions	Redemptions	Net
Inflation Adjusted Bonds	+ 7.4	− 52.9	− 45.5	+ 5.6	− 55.0	− 49.4
Kiwi Savings Stock I	. . .	− 22.2	− 22.2	. . .	− 15.4	− 15.4
Kiwi Savings Stock II	+ 159.4	− 122.2	+ 37.2	+ 16.6	− 7.0	+ 9.6
Other Savings Stock	. . .	− 85.7	− 85.7	. . .	− 0.6	− 0.6
Total	+ 166.8	− 283.0	− 116.2	+ 22.0	− 78.0	− 55.8

TABLE 2
NEW ZEALAND GOVERNMENT STOCK SALES BY TENDER

Tender number	Stock offered	Maturity date	Total amount offered $m	Total bids submitted $m	Over-subscriptions accepted[2] $m	Total successful bids $m	Allotment[3] Yield % p.a.
1.	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.	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.	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.	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.	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.	N.Z. Govt. Stock	15.05.86	100.0	80.0		12.6	10.0
	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.	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

Note:
[1] On 2 December 1983, the Minister of Finance announced debits of a new 'Index-Linked' Government Stock — details of this stock were provided on page 565 of the December *Bulletin*.
[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 not exceeding the amount of stock offered in the tender (this facility was announced on 2 February, 1984 and is covered on page 18 of the January/February *Bulletin*).
[3] At the same time as Index-linked stock was announced, the allotment system for successful bids under the tender system was also changed from the yield bid to a uniform yield basis. This means that all stock of any one maturity is issued at a uniform yield equal to the *highest* yield accepted in the tender. This system was first operated in the fourth tender figures prior to that are presented as a weighted average.

to bring rates down to the regulation level has resulted in reviews being delayed), it is expected that these statistics will show further downward adjustments in the coming months as lower rates now being approved are registered. Furthermore preliminary indications from trading bank data show that average overdraft rates have fallen by nearly 1.5 per cent and term loan interest rates by around 1 per cent over the six months to March 1984.

On the other hand, both wholesale and retail deposit rates increased in late January and early February. This continued a trend which had become apparent in the last quarter of 1983 and probably reflected in particular increased competition for funds as demand for credit increased. It also prompted Government warnings of the likelihood of further regulations if the strong upward movement continued. Subsequently, some drop in carded rates was recorded. Commercial bill (90 day) rates dropped from around 14.75 per cent to just under 13 per cent in mid-February and rates on retail deposits at major institutions fell to 10 or 11 per cent by mid-March. However, pressures in the wholesale market re-emerged in March. Liquidity conditions tightened following the March tax payment period and increased consumer buying prior to the end of the price freeze probably also encouraged increased competition for funds in financial markets. By mid-March rates on 90 day commercial bills had moved back up to 15 per cent. Short-term wholesale rates subsequently fell in April with the bill rate getting down to around 11 per cent. However, the re-emergence of short-term liquidity pressures in May has forced them up again, with rates well in excess of 15 per cent being quoted towards the end of the month.

Despite the declines in long-term rates which have occurred, the Government made it clear in early May that it was still dissatisfied with the level of interest rates relative to the current rate of inflation. In conjunction with the announcement that new ratio moves were being taken against finance companies to stem their lending growth, the Minister of Finance made it clear that further controls over lending interest rates, would be imposed if any unacceptable interest rate movements were to occur. (Regulations currently in force are described on p. 84 of the March 1984 *Bulletin*).

THE CREDIT GROWTH GUIDELINE AND RESERVE RATIO REQUIREMENTS

The Government's concern in recent months to restrain growth in monetary and credit aggregates and thereby avoid demand pressures on prices has been reflected in the use of the credit growth guideline as a major instrument of monetary policy. This guideline was formally communicated to a number of financial institutions in early 1983, essentially as a precise and firm statement of the Government's monetary policy objectives and implied that a strict control of lending would be required. This reflected concern that any underlying surge in lending growth should be curbed at the outset, given that on past experience, growth becomes very difficult to contain if allowed to persist for longer than a few months. Essentially the guideline advised that lending by each institutional group should grow by no more than one per cent per month.

Nevertheless, since late 1983 the lending growth of virtually every institutional group (with the exception of the private savings banks) has been either close to or in excess of the guideline rate of growth.

In response to such growth, and in an effort to induce institutions to take steps to slow their lending, the Government moved to tighten ratio policy against those groups whose credit expansion had breached the guideline. Specifically the public sector security ratio applied to building societies was raised on 16 December 1983 from 16 per cent to 19 per cent, effective from 9 February 1984, while that for the finance companies was raised twice. On the first occasion, an increase from 20 per cent to 25 per cent was announced on 16 December to take effect from the end of February and this was followed by a further increase of 5 per cent announced on 27 January to take effect from the end of March. More recently action has been taken against the finance companies with an amendment on 7 May 1984 of the Finance Companies (Investment) Regulations 1983. As from the beginning of June 1984 those companies whose investments have grown by more than one per cent per month since December 1983 will be required to hold additional government stock equal to 100 per cent of that excess. This marginal ratio will apply in addition to the current across-the-board ratio of 30 per cent. It is intended to be a short-term measure only and will expire on 31 December 1984.

In addition, the reserve asset ratio policy applied to trading banks was tightened over the first three months of 1984, through both an increase in the penal borrowing interest margin (the effective cost to the banks should they need to borrow from the Reserve Bank to meet their ratio requirement) and successive reductions in the free reserves margin. A minus $50 million free reserve margin was set for the months of March and April this being the first time that a negative margin had been used since the current ratio system was introduced in 1973.

The level of the free reserves margin is an indicator of the stance of reserve asset ratio policy. The use of a significantly positive margin indicates that the ratio policy is unlikely to be a significant constraint on banks' lending behaviour. This is because most of the likely variability in reserve flows can be accommodated without having to borrow from the Reserve Bank. With a relatively small positive margin, say $50 to $100 million, the magnitude of the monthly fluctuations in reserves is such that a shortfall in reserve assets, and a consequent need to borrow at penal rates from the Reserve Bank, may occur. In this light, the moves over the first few months of 1984 to a zero and subsequently a negative free reserves margin, by significantly increasing the chances that the banks would have to borrow, indicated considerable dissatisfaction on the part of the authorities with trading banks' lending policies.

In the event reserve assets rose by more than had been allowed for when the January and February ratios had been set, so that the actual free reserves margin for those two months were respectively $65 million and $72 million. However, a smaller increase in reserve assets than had been expected occurred in March, reflecting in particular a lower than expected level of compensatory deposits being placed with the banks to cover the March tax flow. This resulted from a somewhat unusual pattern of Government expenditure and revenues in the month of March. Overall a shortfall of $256 million in reserve asset holdings below the March requirement was experienced and resulted in penal borrowing of that magnitude being required of the trading banks in the following month. Such penal borrowing was the first for some time and certainly the most significant since the reserve asset ratio scheme was introduced.

The free reserves margin was subsequently raised to positive $50 million for May. This followed a lower increase in trading bank lending to just under 1 per cent (after allowance for the effect of seasonal trading bank lending to the Dairy Board) in March and an even smaller increase, of under 0.5 per cent, in April, combined with a substantial reduction in February and March in the level of new and increased credit limits being granted. However, the banks were warned that any upswing in lending growth beyond the guideline over May would lead to an immediate reversal of this easing in ratio policy.

FINANCIAL INSTITUTIONS AND MARKETS

Trading Banks

After an average monthly increase of over 2.5 per cent in the last quarter of 1983 and growth of similar magnitude in the month of February 1984, the rate of increase in trading bank lending (after adjusting for seasonal lending to the Dairy Board) eased to less than one per cent in March and April 1984. Nevertheless the annual increase of 13.1 per cent recorded for April was well up on the 3.2 per cent registered over the April 1983 year. (Refer figure 2).

The strong expansion in trading bank total credit limits which had become apparent in the latter part of the September quarter 1983 and which had continued through to January and February 1984 slowed significantly in March, with the first monthly decrease for over a year. Following a broadly similar pattern, trading bank new and increased credit limits, after averaging growth of around 7 per cent per month in the 6 months ended January 1984, in the subsequent two months recorded declines of 17.1 per cent and 15.3 per cent respectively (these figures are calculated on a two month moving average basis). Against this background the percentage utilisation of credit limits, after falling to a 10 year low of 65.1 per cent in October 1983, returned to just over 69 per cent by March 1984, close to its rate of a year earlier. (Refer figure 3).

Figure 2
Trading Bank Lending and Deposits
Seasonally Adjusted Monthly
% Change

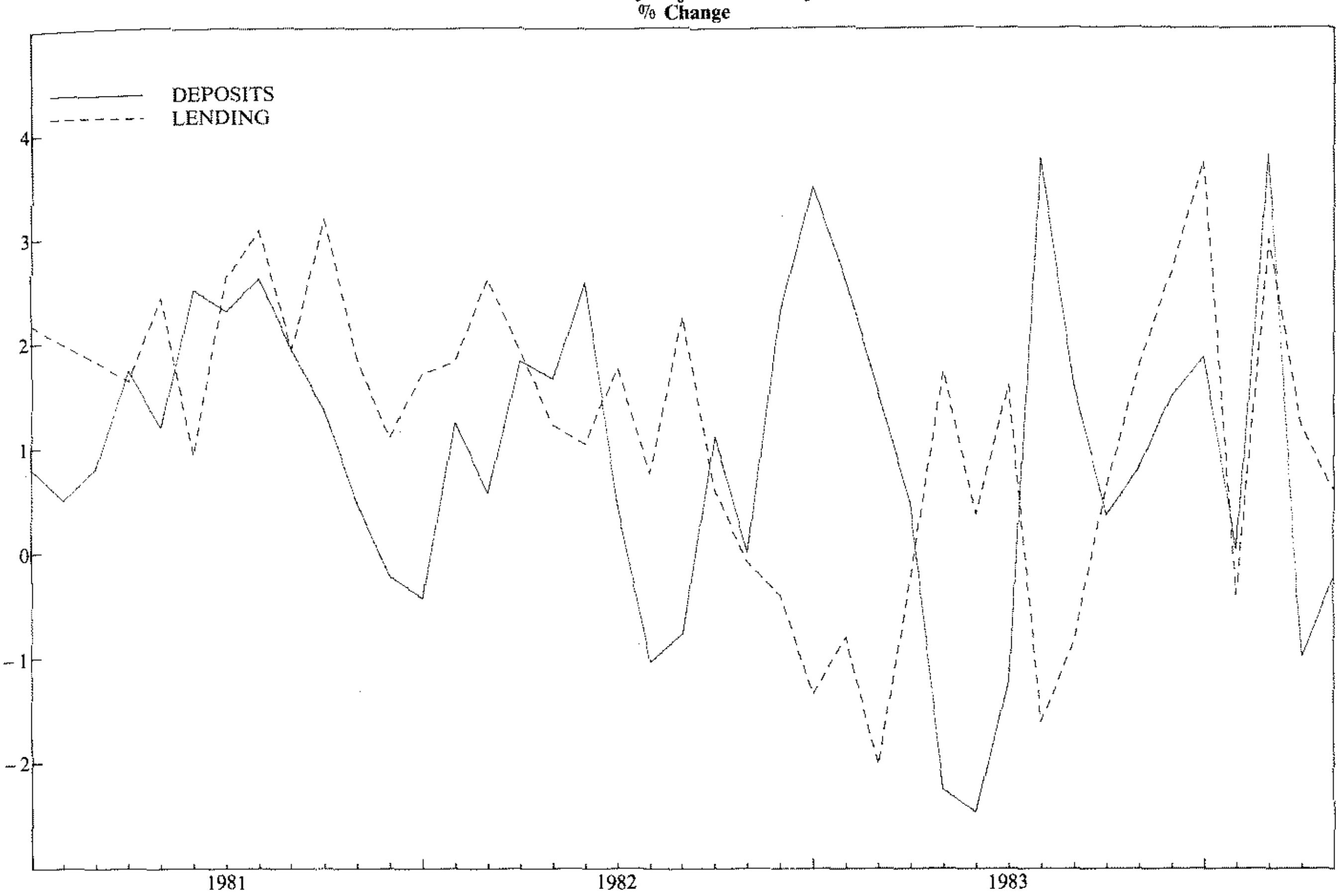
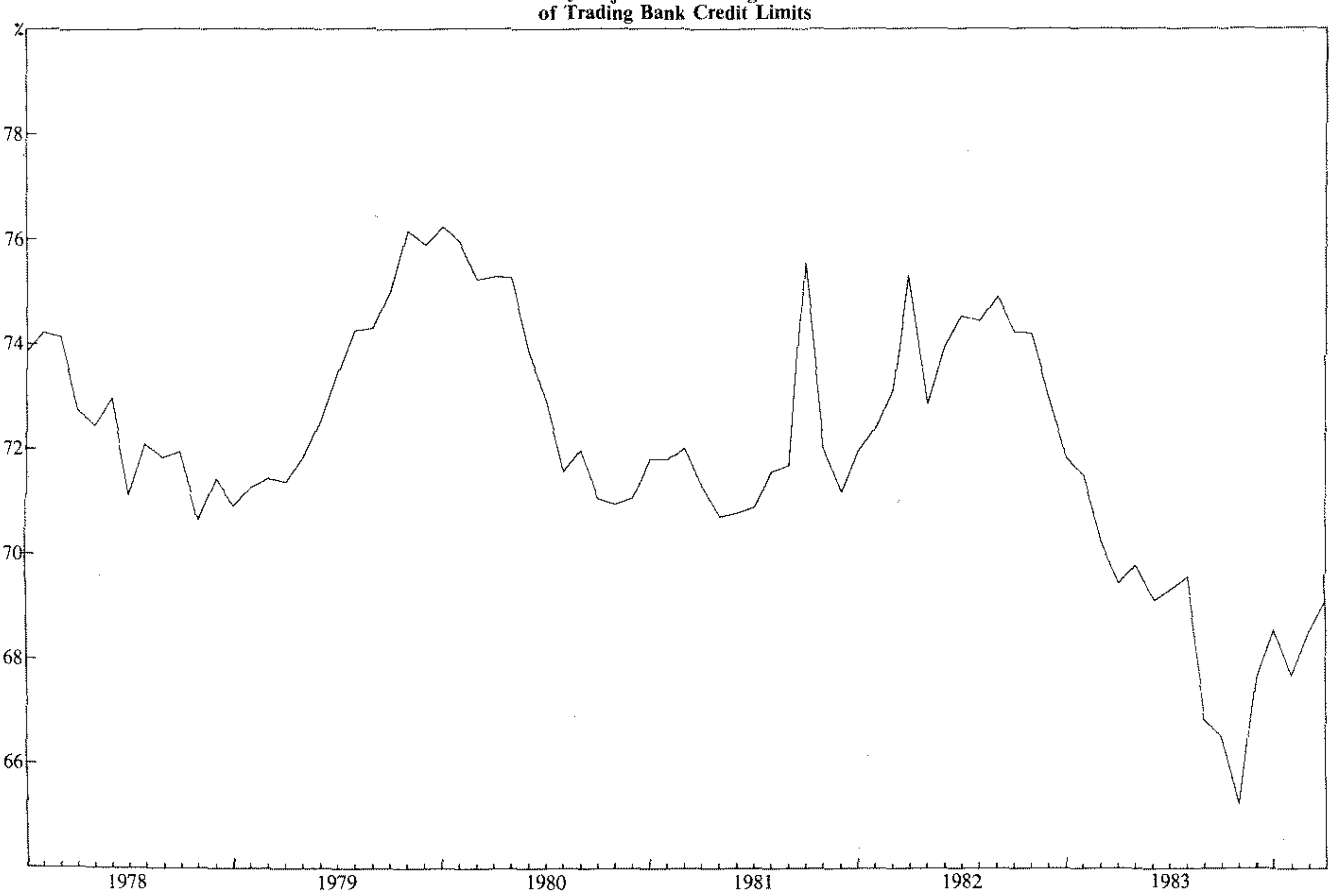


Figure 3
Seasonally Adjusted Percentage Utilisation
of Trading Bank Credit Limits



While the utilisation of credit is still relatively low in historical terms there have been indications, such as those outlined above, that the banks are now exercising firmer credit control and that they will be holding their credit growth over the immediate months. Given the imprecise control banks have over the take-up of overdraft facilities, such restraint is essential if firm control over credit growth is to be maintained.

The overall rate of increase in trading bank total deposits eased slightly in the first quarter of 1984 after growth rates of 5.7 per cent and 4.2 per cent in the September and December quarters 1983. Nil growth in the month of January was followed by an increase of close to 4 per cent in February as banks, partly to meet reserve asset requirements, actively competed for deposits. However, in the subsequent two months total deposits declined by 1 per cent and 0.2 per cent respectively. The resulting ratio of trading bank lending to deposits has in the first four months of 1984 eased upwards to just over 79 per cent, somewhat higher than the average of 76 per cent recorded for the last six months of 1983.

The upward movement in average trading bank reserve assets which began in mid 1983 continued in the first four months of 1984. By the end of April average reserve assets were $2,596 million, almost 70 per cent higher than their level in June 1983, and an all-time record.

SAVINGS BANKS

Total savings bank lending is estimated to have increased by 4.5 per cent in the March quarter 1984, compared with an estimated increase of 3.2 per cent in the preceding quarter. The strongest savings bank lending growth has continued to be Post Office Savings Bank (POSB) lending (although because of its relatively low overall volume of loans outstanding the greatest contributor to total savings bank growth remains the trustee savings bank group). Provisional figures indicate that POSB lending, after excluding that previously provided by the Housing Corporation, grew by 4 per cent in the month of March following respective increases of 2.5 per cent and 1.9 per cent in the preceding two months.

In February the Government moved to impose a credit guideline of 1 per cent per month on the aggregate of POSB second mortgage advances, personal loans and Bankcard activity. While the effect of this was not evident in March, provisional estimates for April indicate monthly lending growth to have eased to 1.9 per cent.

The overall expansion in lending by the Trustee Savings Banks (TSBs) during the March quarter of 3.1 per cent (4.6 per cent seasonally adjusted) was the same as that registered in the December quarter. New monthly information on lending provided by the TSBs indicates that in the first two months of 1984 monthly increases of 1.6 per cent, 2.1 per cent (seasonally adjusted) were recorded.[2] In February, the TSBs were warned of possible consequences if their lending for the quarter exceeded the credit growth guideline. The trustee banks advised that they were attempting to adhere to the guideline by keeping the monthly growth in their actual lending to 1 per cent. This they have done over the past two quarters. Meanwhile, Private Savings Banks (PSBs) lending has continued to fall, with successive declines of 0.7 per cent, 1.2 per cent and 0.7 per cent being registered in the first three months of 1984. This decline in lending reflects a similar downturn in the PSBs' deposit share and level of business. (Monthly decreases in PSB deposits of 1 per cent 3.3 per cent and 0.1 per cent occurred in the first three months of 1984).

The growth in deposits of both the POSB and the TSBs averaged 0.8 per cent per month during the first three months of the year, contributing to an overall quarterly increase for the savings banks in total of 1.3 per cent. This increase was somewhat lower than those recorded in both the December (2.5 per cent) and September 1983 quarters (5 per cent).

FINANCE COMPANIES

Figures for lending by large finance companies indicate that in the first three months of 1984 they continued to breach the credit growth guideline, and to a greater extent than the other main institutional groups.[3] Following increases of 2.3 per cent and 2.4 per cent in the months of January and February, total loans and advances grew by a further 1.6 per cent in March. While the estimated increase over the quarter of 6.3 per cent was down on the very high 10 per cent growth recorded in the December quarter, the annual rate of lending growth in the year to March was nevertheless 26.5 per cent. As described earlier, one consequence of this expansion has been the introduction of an additional marginal reserve ratio requirement due to take effect from the beginning of June.

Deposits at large finance companies have also grown steadily over the first months of 1984, giving an estimated increase over the quarter of 8.8 per cent, much the same growth in deposits as in the preceding quarter. This active competition by finance companies for deposits is still seen by the Government as an inhibition to a downward movement in interest rates.

BUILDING SOCIETIES

After registering no change in the month of January 1984, actual advances by the Building Societies increased by 0.7 per cent in February.[4] In March, actual advances grew by 9.7 per cent, but this figure largely represents accrued capitalised interest which is not included for the purpose of monitoring compliance with the credit guideline. When further account is taken of investment by Building Societies in commercial bills (an area in which successive monthly declines of 10.7, 8 and 35 per cent were recorded), it is estimated that total lending as defined by the guideline fell by 0.3 per cent in January but subsequently rose by 0.4 per cent and then 0.5 per cent in February and March. The overall upward movement in lending over the March quarter has thus been somewhat less than the 3.4 per cent growth observed in December. Meanwhile, in contrast to the strong upward movement recorded in the previous two quarters, the growth in building society deposits slowed

2 On a quarterly point observation basis the TSBs lending series displays no stable seasonal pattern. A monthly lending series has therefore been derived using intra point interpolation.

3 From March 1981 the large finance company data collected by the Reserve Bank of New Zealand has been made up of a survey of companies with outstandings in excess of $5 million to that date.

4 Building Society statistics display no stable seasonality. The growth rates given in this text are therefore those actually received.

in the March quarter 1984, increasing over the three months by only an estimated 1.2 per cent.

SUMMARY

Lending by the major financial institutions has continued to expand strongly throughout the early part of 1984 although at a generally slower rate than that observed in the latter stages of 1983. Similarly, the magnitude of growth in deposits at most institutions during the first quarter of 1984 eased in comparison with that in the December and September quarters in 1983.

The response by the Government to these movements has been guided by the dual concern to reduce interest rates and constrain aggregate growth rates. Accordingly, public debt policy was not aggressive in the March quarter although nearly $600 million was obtained in the more recent (May) tender. In an effort to restrain the expansion in credit, attention has been focussed on the credit growth guideline and on ratio policy.