QUARTERLY REVIEW OF MONETARY CONDITIONS AND POLICY

INTRODUCTION

The December 1983 quarter saw a continuation of the strong monetary growth which had emerged during the September quarter. Liquidity conditions remained easy. A major contributing factor to the growth in the money supply was a rapid acceleration in lending by domestic financial institutions. Government policy actions which continued to influence financial sector developments, included the effects of the large fiscal deficit, action to reduce interest rates, a reluctance to accept the upper interest yields bid for Government stock offered in the tenders, and tightening ratio policy on some financial institutions.

This article first sketches the main developments in monetary conditions during the December quarter and then examines in more detail the underlying rates of deposit and lending growth of the major institutional groups. The text lists chronologically various monetary policy initiatives relating to the overall financial sector and to individual institutional groups. For details of the monetary policy environment that existed prior to the December quarter, readers are referred to the 'Economic Chronology 1983' which appears on page 11 January/February 1984 *Bulletin* and to the quarterly reviews of monetary conditions and policy during 1983 which appeared in Volume 46 of the *Bulletin* pages 174, 332, 559.

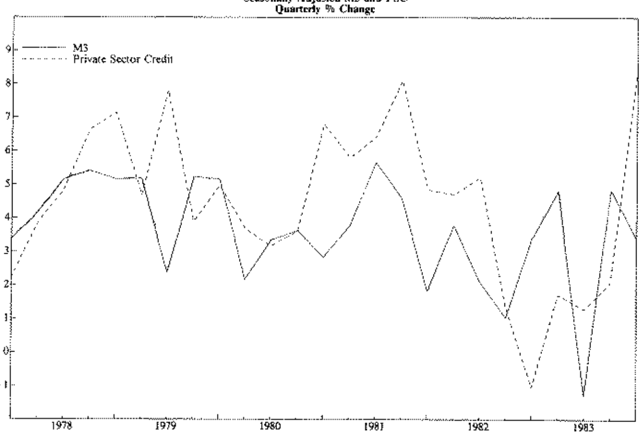
Both the narrow money supply (M1) and the more broadly defined money supply and selected liquid asset series (M3) showed strong growth during the December 1983 quarter, though the respective increases were not quite as marked as those recorded in the September quarter. M1 is estimated to have increased by 5.8 per cent in the December quarter[1], following the very sharp 8 per cent rise recorded over the September quarter. The M3 aggregate showed a similar pattern, rising by an estimated 3.4 per cent over the December quarter, which was down a little on the 4.9 per cent increase recorded in the previous quarter.

The rapid growth in the monetary aggregates over the last six months of 1983 has seen the annual growth rate for M1 rise from 1.2 per cent for the year ended June 1983 to an estimated 15.5 per cent for the December 1983 calendar year. The comparable annual growth rates for M3 were 8.2 per cent for June and 12.2 per cent for December. These rates are far in excess of the growth in incomes (whether measured in real or nominal terms).

However, the dominant feature of developments in the financial sector over the December quarter was the re-emergence of private sector credit as a major influence behind growth in the money supply. Lending by most financial institutions had slowed considerably over late 1982 and the first half of 1983, initially reflecting tightening of lending policies by the institutions themselves, but more recently attributable primarily to a general lack of demand for credit across the economy. This situation has turned around very rapidly since September 1983, with credit demand responding to the falling nominal interest rates and also reflecting the emergence of a pick-up in economic confidence and activity. Supported by the recovery in reserve levels during the September quarter, most financial institutions moved to accommodate this demand with the result that the private sector credit (PSC) aggregate (comprising the lending of selected major financial institutions), is estimated to have grown by 8.4 per cent during the December quarter. This compared with a total combined increase over the preceding four quarters of only 4.1 per cent, and confirms that a significant easing of credit conditions occurred over a comparatively short space of time in late 1983.

Figure one below presents the quarterly percentage changes in the M3 and PSC aggregates. This illustrates the strong growth recorded in both aggregates in the December 1983 quarter, after a period for some 12–15 months during which the two aggregates followed quite divergent growth paths.

FIGURE 1
Seasonally Adjusted M3 and PSC
Quarterly % Change



The rise in PSC during the December quarter was only one factor, though an important one, behind the growth in the monetary aggregates. The large fiscal deficit, which had underpinned M3 growth throughout the previous three quarters, also continued to provide a substantial monetary injection into the financial system. This both adds to deposit growth and the monetary aggregates directly, and also provides the financial institutions with additional reserves on the basis of which they can further expand their lending activities.

The Government's concerns over the level of interest rates resulted in a public debt programme over this period that was not sufficiently active to offset the impact of the fiscal deficit on the reserves of the financial institutions. Though two retail debt instruments, Inflation Adjusted Savings Bonds and Kiwi Savings Stock II, remained on the market throughout the December quarter, neither offered a sufficient return to investors to attract funds in the amounts required to restrict the growth in reserves.

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1 All growth rates given in this article are seasonally adjusted unless otherwise stated. This means that these growth rates are the period-to-period changes in the particular series under consideration which have had the underlying seasonal component of the changes removed. For this analysis the Reserve Bank of New Zealand uses the US Bureau of Census, X – 11 Seasonal Adjustment Programme.

As can be seen from table 1, total retail debt sales fell short of redemptions for the second quarter in a row, implying an additional net injection of funds into the monetary system. New subscriptions of Inflation Bonds have fallen away steadily throughout the course of 1983 with only $7.4 million being taken in the December 1983 quarter, compared with $55.4 million over the December 1982 quarter. A corresponding increase in the rate of redemptions occurred in the same period, with $52.9 million redeemed in the December 1983 quarter compared with only $16.0 million for the December 1982 quarter. These trends reflect the declining rate of return on this instrument as a result of the currently low rate of inflation. The second issue of Kiwi Savings Stock also proved much less attractive than the first. Net subscriptions over the December 1983 quarter only just covered the level of redemptions of Kiwi Stock I.

The Government continued to operate the tender system for selling ordinary Government stock during this period, with three tenders being held over the December quarter. Table 2 summarises the results of the tenders held to date, beginning with the first tender on 8 September 1983. The primary objective of moving to a tender system for selling Government stock was to free the Government from the task of setting the price at which the stock is sold, thereby enabling it to determine the level of debt sales required for monetary policy purposes while leaving the interest rates to be determined by the market.

As the table indicates, total bids received exceeded the amount on offer in each of the first three tenders. However, in the third tender, a large number of bids which would otherwise have been successful were rejected by the Government because the yields bid were considered excessive. Accepted bids totalled only $143 million, compared with the $459 million of bids received

TABLE 1

COMPETITIVE TENDER RESULTS

Tender	Stock Type	Maturities	$(Million) value: of Stock Offered	$(Million) value: of Bids Received	$(Million) value: of Bids Accepted	Weighted Average % of Accepted Bids/Allotted Yield[3]
1		15.06.85	80	218.6	80.0	8.71
		15.08.87	20	80.0	20.0	9.01
2		15.10.85	100	108.2	100.0	9.52
		15.10.86	75	69.8	69.8	9.90
		15.10.89	25	37.7	25.0	10.65
3		15.10.85	200	194.1	76.2	10.64
		15.05.87	150	168.5	49.8	10.58
		15.10.91	50	96.0	17.0	10.90
4	Standard	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	Standard	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	201.0[2]	6.00

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'.

[2] As from the fifth tender subscriptions of up to 20% 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 is covered on page 18 of the January/February *Bulletin*).

[3] At the same time as Index-limited 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 will be issued at a uniform yield equal to the *highest* yield accepted in the tender. This system was first operated in the fourth tender.

TABLE 2

SUBSCRIPTIONS AND REDEMPTIONS OF RETAIL DEBT INSTRUMENTS: COMPARISON OF SEPTEMBER AND DECEMBER QUARTER 1983

	September: Subscriptions	September: Redemptions	September: Net	December: Subscriptions	December: Redemptions	December: Net
Inflation Adjusted Bonds	+ 12.7	− 68.2	− 55.5	+ 7.4	− 52.9	− 45.5
Kiwi Savings Stock I	+ 14.3	−225.8	−211.5	. . .	− 22.2	− 22.2
Kiwi Savings Stock II	+ 92.6	− 10.0	+ 82.6	+159.4	−122.2	+ 37.2
Other Savings Stock	—	− 3.7	− 3.7	—	− 85.7	− 85.7
Total	**+119.6**	**−307.7**	**−188.1**	**+166.8**	**−283.0**	**−116.2**

and the $400 million sought by the Government. In the fourth tender total bids again exceeded the value of stock offered but the spread of bids over the different maturities was such that the bids lodged did not fully cover the amount of stock offered in every maturity. In addition, 8 per cent of bids (by value) were again rejected due to excessive yields, and total successful bids amounted to $314 million (compared with the $400 million on offer). The results from the fifth tender (held on 2 February 1984) indicated a much lower level of market support than was the case for previous tenders. Of the $600 million of stock offered, total bids received amounted to only $353.4 million with only one maturity over-subscribed. Bids rejected due to excessive yields amounted to some 13 per cent of the total.

The only case in which bids received covered the amounts on offer in the fifth tender was for the 8 year index-linked stock. Index-linked stock was first made available in the fourth tender and is essentially similar in nature to conventional stock except that the return is automatically linked to the rate of inflation. This effectively removes the element of uncertainty over the future inflation rate from the bidding and enables participants to bid in terms of the real interest rate only. It was thought that such an instrument would be particularly suited to institutions investing in longer-term maturities where uncertainty over the path of inflation a number of years ahead may reduce demand for a conventional stock or cause the nominal return sought to be higher than would be the case if the future inflation rate was known with greater certainty. Details of the index-linked stock were provided on page 565 of the December *Bulletin*.

It is apparent that there has now been a quite substantial shortfall of debt sales through the tender system to date relative to the total amount put on offer. Of the $1,700 million sought in the first five tenders, only $1,060 million has been sold, despite the relatively favourable market reception of the new indexed stock. This primarily reflects the Government's overriding concern that interest rates should be reduced to a level more in line with the current low rate of inflation. As long as the Government continues to place a limit on the yield at which new issue stock is sold through the tenders, there is a risk that the level of funds attracted will not be sufficient to maintain firm monetary conditions.

A further influence on monetary growth and domestic liquidity during the December quarter was the external accounts. Some deterioration in the OET current account became apparent over this period with the overall deficit being almost double that for the September quarter ($610 million compared with $326 million in the previous three months). However, this was partly offset by the turnaround from a small outflow to a net private capital inflow over the same period. The result was a net withdrawal through the foreign accounts of similar magnitude to that recorded in the September quarter.

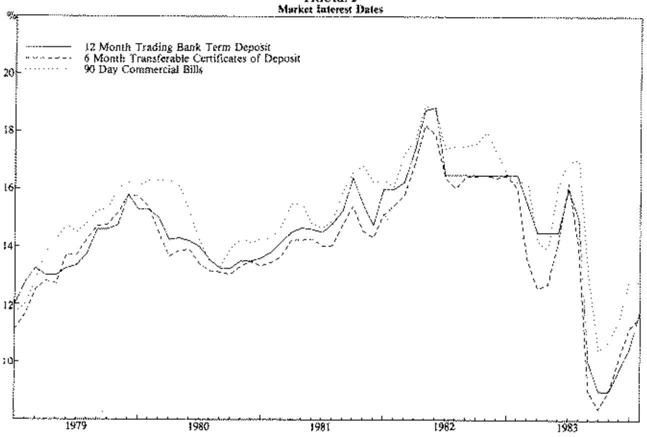
The monthly increases in credit granted by many of the groups of financial institutions since September were well in excess of the maximum rate of growth permitted under the quantitative credit guideline issued to the major lending institutions in April/May 1983, of 1 per cent a month seasonally adjusted (or around 3 per cent a quarter). The trading banks and finance companies were primarily responsible for the large credit expansion over this period, while of the other major institutional lenders, only the trustee savings banks (TSBs) and the private savings banks (PSBs), whose lending base has been steadily contracting for the last 2–3 years, exhibited lending growth within the guideline. In response to these increases the Government moved primarily by tightening ratio policy for those institutional groups who had exceeded the credit guideline. The specific measures which have been taken to date in this regard are discussed later under the individual institutional headings.

Despite the relatively high level of liquidity in the financial system during the December quarter, deposit interest rates generally trended upwards. This was in sharp contrast to the quite substantial declines recorded across-the-board in the previous quarter, following the Government's indication to the market that both lending and deposit interest rates should be reduced in line with the fall in the inflation rate. Figure 2 illustrates the increases in interest rates offered on three market instruments:

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

The rise in deposit rates recorded during the December quarter may have been partly a reflection of an increased level of competition for funds resulting from the general pick up in the demand for credit. In addition, the Government had returned to the market in early September, with both the second issue of Kiwi Stock and with tender sales of ordinary stock (Government tap stock sales had previously been withdrawn in late July). However, as can be seen from figure 2, deposit rates as at the end of the quarter were still well below the levels reached in June 1983, and well below the maximum permissable levels specified under the Interest on Deposit Regulations 1983. These regulations were revoked on 10 November 1983.

FIGURE 2
Market Interest Dates



At the same time however, new regulations were introduced to control the lending interest rates charged on loans secured by mortgages over real property. These regulations, which were subsequently amended on 7 December 1983, limited the interest rates payable on first mortgages over real property to 11 per cent and on second mortgages to 14 per cent (details of these regulations were set out in the December 1983 *Bulletin*, page 564). This measure reflected dissatisfaction on the part of the Government with the speed at which lending interest rates, in the housing area in particular, were being reduced.

To summarise, as was the case during the September quarter, the large fiscal deficit, a relatively small net

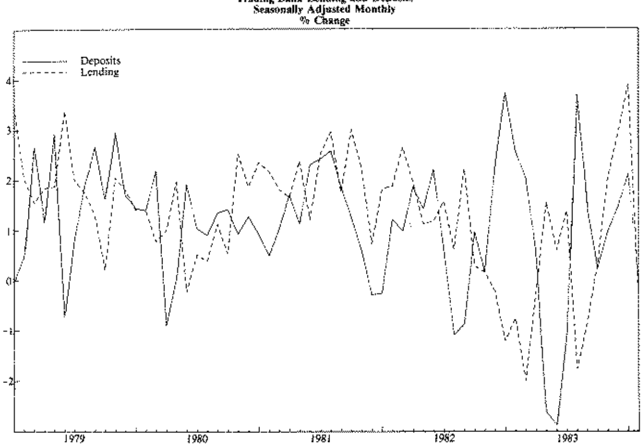
OET outflow, and the absence of a vigorous public debt policy combined during the December quarter to provide a significant build-up in domestic liquidity. In addition, there was a resurgence in the demand for credit across most sectors of the economy and lending by the major financial institutions accelerated rapidly. Lending interest rates continued to show some decline over the quarter, particularly those applying to mortgage lending. However, interest rates offered on both retail and wholesale deposits firmed slightly over the same period following the sharp declines recorded in the September quarter.

FINANCIAL INSTITUTIONS AND MARKETS

Trading Banks

Generally speaking, the trends displayed by trading bank deposits and lending over the December quarter were similar to the growth rates of M3 and PSC aggregates. These are presented in figure 3.

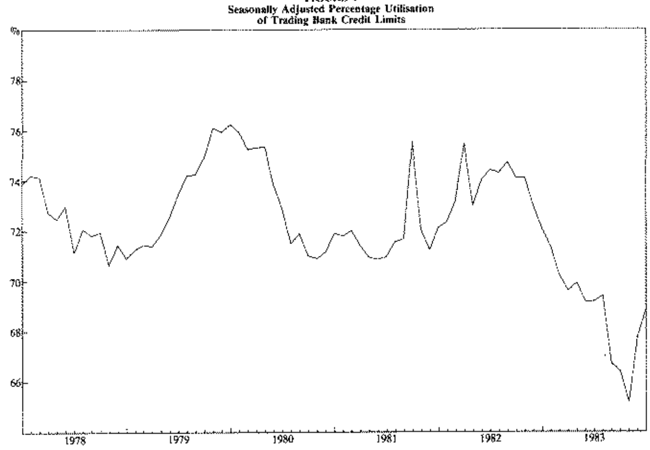
FIGURE 3
Trading Bank Lending and Deposits
Seasonally Adjusted Monthly
% Change



Trading bank deposit growth had been strong during the September quarter, recording a net increase of 5.4 per cent, though this was primarily concentrated in the first two months. The rate of increase accelerated again during the December 1983 quarter, with monthly growth rates of 0.9, 1.5 and 2.1 per cent being recorded over October, November and December respectively. Trading bank lending also followed an upward trend, recording increases of 1.8, 2.9 and 3.9 per cent over the successive months of the quarter. As a consequence of these movements, the lending to deposit ratio (excluding compensatory deposits), increased from 75.1 per cent in September to 78.3 per cent in December. (The average lending to deposit ratio over the last five years has been about 76.2 per cent).

In addition to the sharp increase in actual lending, the banks also permitted the rapid expansion in their credit limits which had become apparent over the latter part of the September quarter to continue during the December quarter. Total credit limits rose by 6 per cent over the last three months of 1983, with the percentage utilisation of these limits standing at 68.8 per cent by end December (illustrated in figure 4). This represented a slight increase from the ten-year low of 65.1 per cent which was recorded in October, but was still well below the average utilisation level over the last five years of 72.2 per cent. Such a low utilisation level implies

FIGURE 4
Seasonally Adjusted Percentage Utilisation
of Trading Bank Credit Limits



significant exposure on the part of the banks to a rapid expansion in their lending at a time when the demand for credit is picking up.

The monthly increases in trading bank lending outlined above were well in excess of the one per cent credit guideline. In response, the free reserves margin aimed at when setting the trading bank reserve asset ratio was reduced from $100 million (a level indicative of a neutral policy stance and which had been used in setting the monthly ratios throughout 1983), initially to $50 million for the January 1984 ratio and subsequently to zero for the February ratio once actual lending figures for December had become available. As an additional measure to support this tightening in ratio policy, the penal borrowing interest margin, which is the effective cost to the banks should they need to borrow from the Reserve Bank to meet their ratio requirement, was increased in January from a minimum of 4 to a minimum of 7 percentage points. Trading bank lending subsequently showed a slight decline of 0.3 per cent in January while total credit limits continued to grow in that month, although at a much reduced rate (0.5 per cent). However, figures available during February indicated that bank lending was again increasing at a rate well in excess of the guideline and in response, the free reserves margin was further cut for the March ratio to negative $50 million [this measure is described in more detail elsewhere in this issue of the *Bulletin*].

The actual reserve asset ratio set for March, on the basis of this estimated negative $50 million free reserves margin, was 32 per cent. This represented a continuation of the sharp fluctuations in the ratio requirements over the past two years. The requirement dropped as low as 10 per cent in October and November 1982. It had been increased to 31 per cent by April 1983, was then lowered in two steps to 16 per cent in June, before being gradually raised again over the latter half of 1983 and early 1984. Actual changes in ratio policy, represented by adjustments to the estimated free reserves margin, account for only a small part of these movements (say around 0.5 percentage points for each $50 million adjustment in the estimated margin based on the current level of deposits) and indeed there were no changes in ratio policy between October 1982 and December 1983. By far the major reason for the month-to-month movements in the ratio is technical adjustments for fluctuations in the level of bank reserves, which have been substantial in recent years and reflect the kinds of primary liquidity influences discussed in the earlier part of this article. Stemming from the large fiscal deficit and a relatively favourable external position, average trading bank reserves rose from $855 million in October 1982 to $2,548 million in April 1983. Primarily reflecting the impact of Kiwi Stock I they fell sharply to $1,536 million over the latter part of the June 1983 quarter. However, in the absence of an active public debt policy, they have since grown strongly again and by mid-February 1984, stood at over $2,750 million, an all time record.

Finance Companies

The large finance companies[2] experienced a continuation of the strong deposit growth in the December quarter which had been evident in the September quarter. Successive monthly increases over the December quarter were 2.1, 2.2, and 4.7 per cent. This sustained growth resulted from both the underlying liquidity injections into the financial system over this period and also an aggressive stance adopted by the finance companies in attracting deposits. Finance company lending also rose rapidly during the December quarter with successive monthly increases of 2.8, 3.4, and 3.9 per cent. In addition to the effect of declining interest rates, other reasons for this increase may have been a pick-up in demand for consumer durables in anticipation of the end of the price freeze and also the Government's decision of 8 September 1983 to remove the minimum deposit requirements on motor vehicle hire purchase agreements.

Again in response to the excessive increases in finance company lending relative to the credit guideline, the Government announced on 16 December 1983 that the government securities ratio for finance companies would be increased from 20 per cent to 25 per cent from the end of February 1984.[3] Subsequently, on 27 January 1984, the Government imposed a further increase in the finance company ratio from 25 to 30 per cent, to be effective from the end of March 1984.

Building Societies[4]

The rate of growth of actual advances by the building societies increased over the months of the December quarter with increases of 0.4, 0.9, and 2.1 per cent respectively. Though these increases were less than those recorded by the trading banks and finance companies over the same period, they nevertheless represented a significant pick-up from the virtually static level of advances evident throughout the September quarter. In addition to advances for housing, however, investment by the building societies in commercial bills also constitutes a form of lending and the two areas are aggregated for the purpose of monitoring compliance with the credit guideline. Commercial bill holdings were increased nearly three-fold over the September quarter, with the result that in aggregate the building societies exceeded the credit guideline in September when total lending recorded a monthly increase of 2.1 per cent.

As a consequence the Government announced on 16 December 1983 that the building society Public Sector Security Ratio would be increased from 16 per cent to 19 per cent, effective from 9 February 1984, with at least 14 per cent to be held in the form of government securities (11 per cent previously).

During the December quarter as a whole, the overall level of building society investments in commercial bills was unchanged, though significant month-to-month fluctuations occurred. In aggregate total building society lending, including commercial bill investments, is estimated to have risen by 3.4 per cent over the quarter.

Building society deposits grew strongly over the December quarter with growth rates of 3.4, 1.1 and 2.7 per cent being recorded in successive months. This represented a continuation of the substantial pick up in deposit growth recorded since June.

Savings Banks

As an institutional group, the savings banks[5] expanded their lending over the December quarter roughly in line with the rate of increase permitted under the credit growth guideline of 1 per cent per month. Within this category however the level of lending recorded by the private savings banks' (PSBs') continued to decline as increasingly more of their business was channelled through their respective trading bank parents. Of the other savings bank institutions, the trustee savings banks' (TSBs') lending growth rate hovered around 1 per cent per month,[6] while the Post Office Savings Bank (POSB) is estimated to have returned successive growth rates of 4.6, 4.9 and 4.2 per cent over the three months of the quarter.[7]

The very high rates at which the POSB has been expanding its lending reflects partly a differential between the interest rate structure at which the POSB lends and that which generally applies in the market, and also new areas of business, such as the introduction in July of a bankcard facility and the first mortgage lending which the POSB has taken over from the Housing Corporation. When this mortgage lending is excluded, other POSB lending, including POSB bankcard, is estimated to have increased by 18.7 per cent over the January 1984 year. As a consequence the Government moved in February to impose credit growth guideline of 1 per cent per month on the aggregate of POSB second mortgage advances, personal loans and bankcard advances, to bring that institution under the same restrictions as apply to its competitors in the market.

Overall total savings bank deposits displayed similar growth over the December quarter to their aggregated lending performance, recording successive monthly increases of 0.5, 0.9 and 1.1 per cent, respectively. With regard to the components of this expansion, TSB deposit growth per month of 1.5, 0.9 and 2.1 per cent, outstripped that achieved by the POSB of (−0.1, 0.5 and 1.3 per cent). Again, the contraction of the PSBs deposit base continued throughout the December quarter with successive monthly decreases of 0.3, 1.2 and 1.2 per cent.

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2 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.

3 On 1 May 1983 the public sector security ratio for finance companies increased from 18 per cent to 20 per cent.

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

5 The Private (trading bank owned) Savings Banks (PSBs), the Trustee Savings Banks (TSBs) and the Post Office Savings Bank (POSB).

6 Because on a quarterly point observation basis the TSBs lending series displays no stable seasonal pattern, a monthly lending series has been derived using intra point interpolation. This derived series (the basis of the above comments) is seasonally stable.

7 Final figures on POSB lending are not yet available for the December quarter.

SUMMARY AND OUTLOOK

The initial signs which emerged during the month of September of a reversal in the relatively slack demand for credit throughout the economy were confirmed by a sustained and rapid expansion of lending by all major financial institutions in the December quarter. Given its concern that interest rate levels should be reduced, however, the Government did not step up public debt policy in order to offset the substantial injections into the monetary base which were occurring at the same time, and which were one factor contributing to the credit expansion. In an attempt to constrain the growth in the monetary aggregates, the Government responded primarily by tightening ratio policy against those institutional groups whose lending had exceeded the credit guideline.

The net result is that the reserve base of most financial institutions has expanded considerably, though the ratio increases which have been implemented should limit the extent to which this is permitted to feed through into further monetary expansion through a rise in lending.

Developments over the early part of 1984 to date largely represent a continuation of the trends evident in the December 1983 quarter. Government stock sales in the February tender amounted to only just over half the amount sought, and in response to suggestions that it was holding up deposit rates, the Government moved on 9 February to take Kiwi Stock II off the market, leaving Inflation Bonds as the only remaining retail debt instrument in the meantime. Deposit growth appeared to moderate in January but return to a rapid rate in February. For example, trading bank deposits, which comprise roughly 45 per cent of M3, are estimated to have risen by close to 4 per cent over January and February combined. Trading bank lending is also estimated to be up by approximately 3 per cent for the same period. It was these developments which prompted the Government to further tighten reserve asset ratio policy for March.

In addition to the above trends, deposit interest rates have also initially continued the firming trend which had become evident over the December quarter. Increased competition for deposits, at least partly fuelled by the tightening in ratio policy, saw wholesale short-term deposit rates rise back up to around 15 per cent in early February. However, rates fell sharply again following warnings from the Government of possible further regulation and the removal of Kiwi Stock II. Further reductions in lending interest rates were also announced over this period by several major financial institutions. The financial services and mortgage lending rate regulations due to expire on 29 February, were extended through to 31 August 1984.

The outlook for the first half of 1984 is for a continuation of the large liquidity injections from the fiscal deficit, probably offset to some extent by a deterioration in the external accounts. This together with continuing strength in the demand for credit is likely to result in further increases in the money and credit aggregates which are already increasing at rates well in excess of the current rate of inflation and income growth. Direct measures such as ratio increases may continue to be used to restrict the financial institutions from utilising the liquidity injections to meet the growing demand for credit. However, a return to an active public debt policy will be necessary at some stage if the growth in the monetary aggregates is to be appropriately constrained.

MONETARY POLICY MEASURES

Over the past few weeks the Government has made a number of announcements relevant to monetary policy. Some have been directed at the level of interest rates, while others have been designed to restrain credit growth to within the guideline limits announced last year.

CLOSURE OF KIWI SAVINGS STOCK II

On 9 February 1984, the Minister of Finance, the Right Hon. Sir Robert Muldoon, announced the closure of the second Kiwi Savings Stock issue. This second issue, which had been opened on 5 September 1983, offered an interest rate of 10 per cent per annum, reducible to 8.5 per cent per annum on stock redeemed within twelve months. Though pitched at somewhat lower rates relative to those ruling in the market than had been the case with Kiwi Stock I, the second issue was still initially quite successful and by the end of October had attracted a net $119 million. New subscriptions fell away quite sharply after this however. At the time of its closure, Kiwi Stock II had raised a net $127 million in total, which compared with the net $1,096 million attracted during the period Kiwi Stock I was on the market.

In making the announcement, the Minister pointed to the unsettled market conditions prevailing at the time. Wholesale deposit rates in particular had risen sharply in early February. There was a concern that the presence of Kiwi Stock II may have been inhibiting a general decline in other market interest rates to a level more in line with the current rate of inflation. However, Sir Robert also announced the Government's intention to return to the retail market once rates had settled down again.

RENEWAL OF CONTROLS ON LENDING INTEREST RATES AND THE PRICE OF FINANCIAL SERVICES

Amendments extending the Financial Services Regulations (No. 2) 1983 and Economic Stabilisation (Mortgage Loans) Regulations 1983 to 31 August 1984 were announced by the Acting Minister of Finance, the Hon. John Falloon, on 27 February 1984. The Economic Stabilistion (Mortgage Loans) Regulations 1983, which came into force in November 1983 and require new mortgage lending to be at a maximum of 11 per cent for first mortgages and 14 per cent for second and subsequent mortgages, have been renewed unamended.

There have, however, been some administrative changes in respect of the Financial Services Regulations (No. 2) 1983 which control financial service prices, including interest rates other than where security is over property. Increases in financial service prices other than interest rates and which are no more than the current movement in the Consumers Price Index will now in general be permitted, subject to prior notification to the Reserve Bank. Consideration will not, however, be given to catch-ups in respect of the period of the freeze. Some further allowance may be given where the supplier can show that its specific cost increases are in excess of general price movements and that such increases are a result of factors external to the supplier. Increases over and above those suggested by these guidelines would be considered only where the supplier could prove its business would not be financially viable should the increase be declined.

Changes have also been made to the appeal procedures incorporated in the Regulations. A Financial Services Price Review Authority has been established, consisting of one member of the Commerce Commission, to hear appeals against decisions arising under the Regulations. This new appeal procedure has been modelled on that incorporated in the Department of Trade and Industry's Price Surveillance Scheme and replaces a procedure which required appeals to be heard by a full sitting of the Commission.

TRADING BANK RESERVE ASSET RATIO

On 27 February 1984, the Acting Minister of Finance, the Hon. John Falloon, announced that the reserve asset ratio to be applied to trading banks for March would be determined on the basis of an estimated 'free' reserves margin of minus $50 million, compared with the zero margin aimed at in February. This represented a further tightening of ratio policy and followed evidence that in the first three weeks of February, trading bank lending was continuing to expand at a rate in excess of the 1 per cent per month credit guideline imposed on all groups of major financial institutions in early 1983. Over the four months to January 1984, the rate of growth in bank lending averaged around 2 per cent per month and preliminary February figures showed no change in this trend, with an increase of 2 — 3 per cent in prospect for the month as a whole.

The margin of free reserves aimed at when setting the trading bank reserve asset ratio had already been reduced from $100 million, which is considered to represent a *neutral* policy stance, to $50 million in January and to zero in February, both measures taken in response to the excessive lending growth recorded over the last three months of 1983. Each reduction in the free reserves margin increases the likelihood that the banks' actual reserve asset holdings in any one month will fall below the required level. Should this happen the bank(s) involved are required to borrow from the Reserve Bank to make good the shortfall at a penal interest rate. This penal borrowing charge was also increased recently, effective from February 1984 (see page 17 of the January/February issue of the *Bulletin*). The combined effect of these measures has been to increase both the likelihood and the cost of the banks being required to borrow from the Reserve Bank. The objective is to encourage the banks to contain their lending growth within the credit guideline by increasing the potential cost of exceeding the guideline. (For a more complete description of the operation of the reserve asset ratio system, refer to the October 1981 issue of the *Bulletin*.)

INFLATION ADJUSTED SAVINGS BONDS

More attractive terms and conditions on the issue of Inflation Adjusted Savings Bonds were announced by the Acting Minister of Finance, the Hon. John Falloon, on 28 February 1984. The $20,000 upper limit on individual bond holdings has been removed so that an individual may now invest any amount (provided each investment is for a minimum of $100 with multiples of $50 thereafter).

The inflation premium payable is in future to be calculated from the date of investment until the date of redemption. Previously it had been calculated only until one month before the date of redemption. The new method of calculating the premium applies to all requests for repayment of bonds received by the Reserve Bank after 31 March 1984 (i.e. repayments made from 1 May 1984 onwards).

A minimum inflation adjustment of 1.25 per cent in every quarter will apply from the quarter ending 31 March 1984. Previously, while there was a minimum premium of 5 per cent per annum (compounded quarterly) over the whole life of a bond, very low increases in particular quarters, if offset by high increases in other quarters, could result in a return lower than 5 per cent per annum during the low index periods. For example, quarterly increases in the Consumers Price Index during 1983 of less than 1.25 per cent could have resulted in an inflation premium of less than 5 per cent over 1983 on those bonds which had also been held over earlier years when the inflation rate was in excess of 5 per cent.

These enhancements apply to all Inflation Adjusted Savings Bonds, including those currently held.