ECONOMIC NOTES

MONETARY POLICY AND THE PUBLIC DEBT PROGRAMME FOR 1985/86

Finance Minister Roger Douglas announced on 19 March 1985 a Government borrowing programme for the year ahead which strongly indicates a continuation of firm control over monetary policy.

Mr Douglas said the Government intended over the coming year to offset fully the monetary injections into the economy as a result of the fiscal deficit and other public sector activity.

The Government would be monitoring developments in the monetary indicators and real economic activity closely. Some allowance would be made for growth in the liquidity base of financial institutions, provided this was consistent with the Government's objective of a lasting reduction in inflation. He emphasised however that this firm monetary policy stance would imply slower growth in the liquidity base than had often been the case in the past. Financial institutions would need to take this into account when making forward lending commitments, Mr Douglas said.

Early forecasts of the volume of government stock tender sales required, based on current indications about the major influences, suggested about $2,700 million of debt would need to be raised domestically during 1985/86.

About $700 million was intended to be raised in three tenders to be held on 18 April 1985, 16 May 1985, and 13 June 1985. Further announcements on subsequent tender dates and sales volumes would be made when appropriate, Mr Douglas said.

The timing of debt sales through tenders would be geared to the expected pattern of liquidity injections during the year.

In particular, it was intended that the tender programme would be concentrated in the first three quarters of the fiscal year, to allow for the absence of a Compensatory Deposit scheme next March.

Tenders would probably be held monthly, except in the March 1986 quarter, when only one tender was likely to be held.

The average tender sizes would probably be largest in the December quarter, when strong liquidity injections were expected, Mr Douglas said.

BACKGROUND TO STOCK TENDER PROGRAMME

The Governor of the Reserve Bank, Mr Spencer Russell, provided background to the announcement by the Minister of Finance on 19 March 1985 of the stock tender programme for the June 1985 quarter and his indications of the March 1986 year borrowing requirement.

Mr Russell said that the stock tender programme should be analysed in the light of what it was intended to do; namely to contain the growth of the base liquid assets of the financial system (commonly called 'primary liquidity').

The stock tender sales volumes announced by Mr Douglas were based on present forecasts of the main influences on primary liquidity. To the extent that these forecasts changed during the year, Mr Russell noted, the stock tender programme would be adjusted in order that the intended degree of restraint was maintained.

Mr Russell highlighted the particular uncertainty surrounding the influence of repayments of compensatory deposits over the June 1985 quarter. To date the March tax flows appeared to be significantly below forecast levels, suggesting a lower level of compensatory deposit repayments than had been allowed for in the debt programme. It was not clear at this stage what was the cause of the lower than expected tax flow. To the extent that late tax payments were involved, the timing of the main influences on liquidity over the 1985/86 year could alter.

Variations in the timing of influences on liquidity would in part be handled by open market operations, whereas more permanent changes in the main influences on liquidity would of course result in a change to the stock tender programme itself, Mr Russell noted.

It was anticipated that open market operations over the June 1985 quarter would involve offsetting some of the effects of maturing private sector securities recently purchased by the Reserve Bank. "In effect," Mr Russell said, "the withdrawal of liquidity resulting from maturing private securities will probably be spread out over more than one quarter rather than occurring all at once in the June quarter." The exact extent of this spreading operation would depend on the looseness or tightness of money markets at the time, he noted.

"In conclusion," Mr Russell said, "decisionmakers should plan for slow growth in the liquid base of the financial system. Monetary conditions will be consistent with the Government's objective of returning to moderate rates of inflation."

TREASURY BILL TENDERS AND OPEN MARKET OPERATONS

No Treasury bills were offered for sale in the weekly Treasury bill tenders during the first three weeks of March (tenders 6, 7, 8). $70 million of bills were offered for sale in tender 9 on 26 March 1985.

During the first two weeks of March, liquidity conditions were very tight and the Reserve Bank injected a considerable amount of liquidity into the system — around $900 million over 5–13 March. These injections helped to raise primary liquidity levels and to reduce interest rates from their very high levels over the previous two–three weeks.

With much of the liquidity in cash balances and securities with around six months left to maturity, the Reserve Bank subsequently conducted open market operations to supply Treasury bills with maturity dates corresponding to expected periods of cash drains from the banking system. $250 million of bills were sold from portfolio on 15 March, and $50 million on 19 March. A 'switching operation' was undertaken on 18 March, in which some $30 million of six month government stocks were effectively converted into more liquid Treasury bills.

A build-up in cash balances over 20–25 March plus prospective cash injections allowed the Bank to offer $50 million of 28 day bills, and $20 million of 63 day bills in tender 9, on 26 March. The tender was filled, with the bills going at 18.98 per cent for both maturities.

RESERVE BANK ECONOMIC FORECASTS

Background

For over a decade the Economic Department of the Reserve Bank has been producing regular forecasts of New Zealand economic conditions for up to two years ahead. Until last year the forecasts were not circulated widely but, in response to requests received under the Official Information Act, the Bank decided to release a summary table of forecasts of key statistics (the forecasts are produced usually four times a year at about quarterly intervals). From time to time the range of statistics released may vary or a release be delayed depending on, for instance, whether any forthcoming policy changes as yet unannounced have been incorporated into the forecasts.

The forecasts are produced using an econometric model of the New Zealand economy, developed in the Economic Department of the Bank over many years. As with any forecasting technique there is a significant degree of judgmental input from the forecasters. As well, there are the prior assumptions or forecasts of variables not determined by the model. These include policy variables such as tax rates and government expenditure, and external price and volume assumptions. They also include assumptions as to average wage settlements over the forecast period.

Most of the difference over time between actual outcomes and the paths forecast by the model can be attributed to changes which make the prior assumptions

SUMMARY OF FORECASTS

(annual percentage changes of annual totals or averages)

March Years	*1983*	*1984*	*Forecasts 1985*	*Forecasts 1986*
REAL EXPENDITURES ON GDP				
Consumption	-0.7	2.5	3.2	-1.2
Gross Fixed Capital Formation	5.4	1.0	8.0	-4.5
Final Domestic Expenditure	0.8	2.2	4.3	-2.0
Stockbuilding[1]	-0.8	-0.3	2.8	-2.1
Gross National Expenditure[2]	-0.7	0.3	7.1	-4.1
Exports of Goods and Services	0.9	10.0	6.5	5.4
Imports of Goods and Services	0.9	-0.4	12.8	-7.4
Expenditure on GDP[3]	-0.8	3.7P	4.5/5.5	0.0/1.0
PERSONAL INCOME				
Personal Income	12.0	3.8	11.6	13.3
Less Income Tax	13.9	1.4	9.3	24.9
Personal Disposable Income	11.0	4.2	12.4	9.4
Consumer Price Index (average)	15.3	5.1	8.5	12.4
Real Personal Disposable Income	-4.1	-0.9	3.9	-2.8
GOVERNMENT BUDGET TRANSACTIONS				
Expenditure	13.2	12.4	8.0	13.5
Receipts	16.1	6.5	10.5	19.7
Balance Before Borrowing ($m.)	-2158	-3101	-2630	-1880
EXTERNAL SECTOR TRANSACTIONS[4,5]				
Current Receipts	11.3	17.4	30.3	12.0
Current Payments	4.3	17.6	33.4	1.5
Current Account Balance ($m.)	-1347	-1623	-2530	-970
EXTERNAL TRADE PRICES[5]				
Export Price Index	5.8	6.5	22.5	6.7
Import Price Index	9.7	5.5	26.0	6.8
Terms of Trade — % change	-3.6	0.9	-2.8	-0.1
PRICES				
Consumer Price Index[6]	12.6	3.5	13.0	10.0
EMPLOYMENT (full-time)[6]	-2.3	0.7	3.0	1.0

P Provisional
1 Percentage point contribution to growth in GDP
2 Includes a statistical discrepancy
3 Unofficial series. Differs from the Statistics Department's index of real GDP which measures increments in production.
4 SNA basis
5 June years.
6 March quarter to March quarter

Notes
(1) These predictions are not adopted as official Reserve Bank forecasts by the Bank's Governors and Board. They are used extensively within the Bank however, to complement other available information.
(2) The above forecasts are based on a no policy change assumption — no allowance is made for possible government policy reactions to the developments portrayed and to the extent that such policy reactions occur, some or all of the predictions may be altered.
(3) The forecasts contain a degree of judgmental input arising from first, the necessary process of adopting a structure for the econometric model of the New Zealand economy, and secondly from forecasters' assumptions (exogenous variables) and adjustments.

Source: Reserve Bank of New Zealand

no longer fully appropriate. These changes can include amendments to government policy and international economic developments.

Given the structure of the inter-related mathematical set of equations modelling the New Zealand economy that are used to generate the predictions, the forecasts can be regarded as representing one set of views of how the economy will track in the short term — the views of the people who built and use the model.

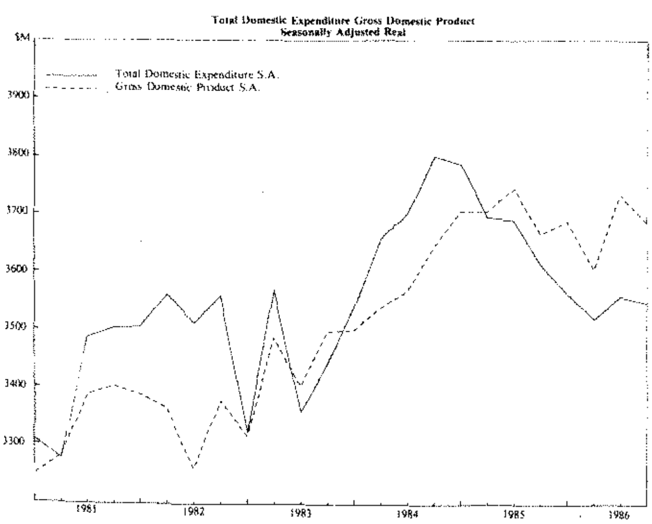
The forecasts are used within the Bank to supplement and complement other information. They are not officially adopted by the Bank's Governors or Board and therefore they should not be regarded as formal Reserve Bank forecasts.

Nevertheless, it is felt that the forecasts may be of interest and value to those involved in economic decision making in both the public and private sectors, since they provide a further source of reference for use in considering possible economic developments. The forecasts are generally compiled on an assumption of no change in economic policies.

March 1985 Forecasts

These forecasts update those released last November and incorporate the Government's recent policy measures, namely the move to a floating exchange rate regime and the further deregulation of the financial system. The forecasts are similar to the previous set in that they describe the current growth cycle as having peaked late in the 1984/85 year, with lower rates of economic growth expected over the rest of the forecast period. The peak level of growth is, however, higher than that previously forecast. The higher base level of economic activity that this implies for 1984/85 contributes to a lower growth rate for 1985/86.

It now appears that real GDP growth for 1984/85 will be in the 4.5 to 5.5 per cent range, slightly stronger than was previously forecast. From the accompanying table it can be seen that all the expenditure components, excepting the external sector, contribute to this growth.



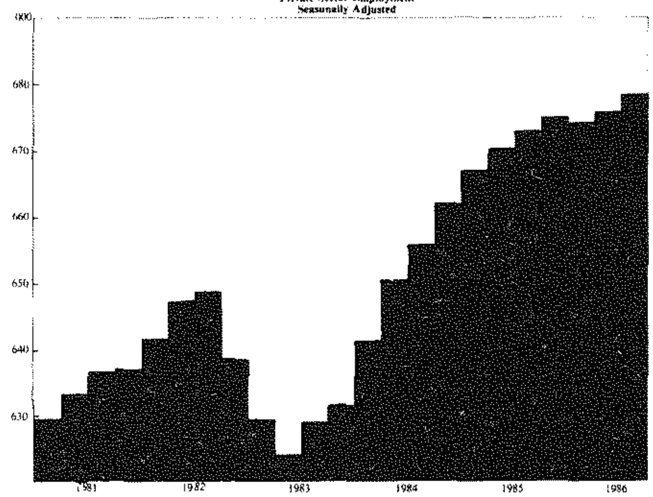
In 1985/86 real GDP growth of only 0 to 1 per cent is expected. In response to static household real disposable incomes and real money balances, and the higher level of interest rates that has been evident since late 1984, real consumption and investment expenditures are expected to contract throughout the forecast period. As a result, real gross national expenditure is expected to fall by about 4 per cent over 1985/86. Offsetting this fall, the recent growth in export volumes is expected to continue while import volumes should turn down quite sharply from their current peak, in response to lower domestic expenditures and the higher relative price of imports. The net external sector surplus which arises more than offsets the contraction in domestic expenditures and should generate slight positive growth.

The current account deficit on an SNA basis is forecast to be around $2,500 million for the year ended June 1985. In response to the external sector trends noted above, it is expected to improve significantly to around $970 million for the June 1986 year.

Full time employment as at March 1985 is forecast to be about 3 per cent above the March 1984 level. It is forecast to continue to rise, but by only a further 1 per cent by the end of the March 1986 year.

Annual consumer price growth is expected to be about 13 per cent by the end of March 1985 and to peak at between 14 and 15 per cent by the end of June 1985. Thereafter, the annual growth rate is expected to decline, reaching about 10 per cent for the March 1986 year.

Real personal disposable incomes are forecast to rise by around 4 per cent for the 1984/85 year but to fall by around 3 per cent for the 1985/86 year. Aggregate nominal personal incomes are forecast to rise by 12 per cent and 13 per cent over 1984/85 and 1985/86 respectively but these rises are offset by increases in personal direct tax collections, and by an average movement in the CPI of 8.5 per cent over 1984/85, and 12.5 per cent in 1985/86.



AUTHORISED FOREIGN EXCHANGE DEALERS

Prior to August 1983, the Reserve Bank and the trading banks were the only institutions authorised to undertake full foreign exchange dealing activities while the Post Office, two trustee savings banks and two travel agents had some limited authority.

The intention to authorise further suitably qualified institutions to act as foreign exchange dealers was announced in April 1983 and the first nine institutions to be successful in their application for authorisation were named on 5 August 1983. These were Broadbank Corporation Limited, Citicorp Forex Limited, Development Finance Corporation of New Zealand, Indosuez New Zealand Limited, Lombank (NZ) Limited, Marac Corporation Limited, NZI Securities Limited, New Zealand United Corporation Limited and South Pacific Merchant Finance Limited. Seven of these were authorised to commence dealings from 1 September 1983. The remaining two (Lombank New Zealand Limited and Citicorp Forex Limited), received authorisation to commence operations as from 1 January 1984 and 16 January 1984 respectively. Details of these developments were previously described in the August 1983 *Bulletin*, pp. 327–331.

Other moves towards achieving a stronger foreign exchange market have recently been taken. Limits on dealers' foreign currency holdings were removed with the liberalisation of exchange control in December 1984; overseas borrowing by financial institutions has been relaxed; and the 70 per cent overseas ownership limit on financial institutions has also been relaxed, so that up to 100 per cent foreign ownership may be permitted in cases where the Overseas Investment Commission is convinced of the benefits that will result and Reserve Bank prudential requirements are satisfied. Details of these developments will be given in a forthcoming *Bulletin* article.

As at 31 March 1985, a total of 15 authorised dealers were operational, these being:

Bank of New Zealand
ANZ Banking Group (New Zealand) Limited
Westpac Banking Corporation
The National Bank of New Zealand Limited
Barclays New Zealand Limited
Broadbank Corporation Limited
Citicorp Forex Limited
Development Finance Corporation of New Zealand
Hill Samuel New Zealand Limited
Indosuez New Zealand Limited
Marac Corporation Limited
Natwest Lombank (NZ) Limited
NZI Securities Limited
South Pacific Merchant Finance Limited
Wardley New Zealand Limited

A sixteenth institution, Elders Goodman (Merchant Finance) Limited had received the approval of the Minister of Finance, but formal authorisation was awaiting finalisation of certain technical requirements. In addition the Post Office, the trustee savings banks and some travel agents continue to have a limited foreign exchange dealing authority.

Entry to the foreign exchange market is open to prospective dealers able to meet the criteria applied by the Reserve Bank. Equally, the authority can be withdrawn if a dealer fails to maintain satisfactory standards of performance. Authority for the dealers is given under the Exchange Control Regulations. This requires the approval of the Minister of Finance and publication in the New Zealand Gazette. The authority becomes operationally effective on the issue of a formal consent to the dealer by the Reserve Bank, following satisfaction of certain technical requirements. The consents allow the dealer to commence dealing and to offer foreign exchange services, provided they come within the Exchange Control Regulations. Reporting and prudential limits in the form of daylight, overnight and mismatch exposed positions that a dealer may take are also formalised.

FOREIGN BANK ENTRY INTO AUSTRALIA

On 27 February 1985 the Australian Treasurer Paul Keating announced that sixteen new banks had been invited to establish operations in Australia. The successful applicants come from the United States, Canada, United Kingdom, New Zealand, Japan, Federal Republic of Germany, Hong Kong and Singapore. The sixteen banks which have been selected are:

United States

The Bank of America National Trust and Savings Association
Chase Manhattan Bank
Citibank
J.P. Morgan and Company Incorporated
Bankers Trust Corporation.

Canada

The Royal Bank of Canada.

United Kingdom

Barclays Bank PLC
National Westminster Bank PLC
Standard Chartered Bank PLC.

New Zealand

The National Bank of New Zealand Limited

Japan

Bank of Tokyo Limited
Industrial Bank of Japan Limited
The Mitsubishi Bank

Federal Republic of Germany

Deutsche Bank AG

Hong Kong

The Hong Kong and Shanghai Banking Corporation

Singapore

Overseas Chinese Banking Corporation Limited.

The Australian Government has invited the sixteen applicants to proceed with discussions with the Reserve Bank and the Treasury with a view to developing the proposals to a point where a recommendation can be made to the Governor General for the granting of an authority under the Banking Act 1959 to carry out banking business in Australia. It is envisaged that some banks may be able to open for operation around the middle of 1985. Eight of the proposals selected involve Australian equity ranging from 20 to 50 per cent. Of the remainder three have indicated that they are prepared to introduce Australian equity into their institution once they become firmly established.

The banks will spread their headquarters among four cities, Melbourne, Sydney, Adelaide and Perth. They will provide a variety of banking services ranging from comprehensive shop front branch networks covering retail banking, housing, small business and rural financing to specialist operations in the corporate wholesale area.