Reserve Bank Bulletin

QUARTERLY REVIEW OF MONETARY CONDITIONS

INTRODUCTION

This article examines developments in monetary and liquidity conditions over the December quarter, and outlines the latest round of Government monetary policy measures. The underlying rates of deposit and lending growth of the major institutional groups are also examined, particularly in light of the recent moves to deregulate the financial sector.

For details of monetary conditions and policy in the previous three quarters of 1984 readers are referred to the quarterly reviews which appeared in volume 47 of the *Bulletin* (1984) on pages 239, 403 and 587 (ff).

LIQUIDITY CONDITIONS AND THE DEBT PROGRAMME[1]

At the start of the December quarter liquidity conditions in the financial sector had tightened considerably from the earlier relatively easy position. One indicator is provided by the Reserve Bank's working definition of primary liquidity[2] (trading bank demand deposits at the Reserve Bank, and private sector holdings of government securities with less than six months to maturity) which stood at the rather low level of $492 million, down from the post-election peak of $1,290 million at the end of July. This situation resulted from large sales of government tender stock combined with the continuing OET current account deficit, and was reflected in higher short-term interest rates, with the 90-day commercial bill rate exceeding 17 per cent by the end of September and the call rate peaking, briefly, in excess of 20 per cent. In the first week of October liquidity conditions tightened further and in the week to 12 October the average 90-day bill rate reached 19 per cent, with rates at times in excess of 20 per cent.

In the domestic money markets concern was expressed about liquidity conditions and the likelihood of little or no improvement in light of the already announced stock tendering programme. However, this concern did not adequately take into account the ability of the financial markets to adjust to the new environment. The removal of interest rate regulations had enabled New Zealand financial institutions to compete more effectively in world financial markets, and institutions and brokers were reasonably free to arrange and accept deposits from overseas investors. A combination of relatively high domestic interest rates, comparatively lower overseas interest rates and some feeling in the market that the New Zealand dollar was undervalued, eventually led to significant foreign inflows of funds.

The fiscal deficit for October totalled $534 million, but this injection was almost exactly offset by Government stock tender settlements of $271 million and an external current account deficit of $265 million. The October stock tender sought $200 million. This amount reflected a trade-off between the wish to maintain a reasonably steady tender sales programme and the acknowledgement that market conditions were not conducive to a larger tender. Bids received totalled $450 million, and although the tender was filled there was a marked increase in the weighted average interest rate. A capital inflow of $602 million, in response to the higher rates on both Government and private paper, increased primary liquidity to $936 million and by the end of October the 90-day commercial bill rate had eased back to about 16.5 per cent. In response to the increase in liquidity the Reserve Bank became active in the secondary market for government stock, conducting open market sales of stock in an attempt to absorb more of the liquidity injections. In late October the Bank entered the market selling more than $135 million of relatively short-dated stock, in parcels of around $20 million per

1 All monthly and quarterly growth rates given in this article are seasonally adjusted unless otherwise stated.
2 See discussion on page 588 of the December 1984 *Bulletin* for more details.

day, before withdrawing on 6 November when conditions had firmed sufficiently.

A heavy foreign exchange inflow was again experienced in mid-November ($280 million in the week to 13 November, and $250 million in the week to 27 November) and primary liquidity reached a peak of just over $1,300 million before settling back to $923 million by the end of the month. The 14th tender, held on 15 November, sought $400 million, consistent with the debt programme and the desire to absorb some of the capital inflow. Bids received totalled $1,298.4 million, the highest for any tender up to that time, perhaps reflecting increasing confidence in the operation of the tender system, and some overseas entry into the market. Interest rates were similar to those in the previous tender, and the downward sloping yield curve apparent since the change of Government continued to prevail (see table 2). Almost the entire tender was settled in the first few days of the settlement period, in recognition of the easy liquidity conditions. After debt sales are allowed for, the public sector injection in November was strongly negative. The fiscal deficit was $296 million, but tender settlements totalled $402 million and Reserve Bank open market sales raised another $261 million. The Bank re-entered the market on 22 November seeking $20 million a day, and then on 28 November the Governor of the Bank announced that the size of the daily open market sales would be increased to $40 million. This measure represented an attempt to offset the foreign exchange inflows and maintain firm monetary conditions. Within a week the Bank again withdrew from the market, having raised $295 million since 22 November.

The net foreign exchange inflow in the first three weeks of December was in excess of $400 million, and primary liquidity reached a new peak of $1,490 million on 27 December. By the time the details of the 15th tender, held on 13 December, were decided it was apparent that the $1,000 million target for the last four months of 1984, which was announced in August, had become inadequate in light of the responsiveness of capital flows. Accordingly a new tender sales target was released — $1,600 million in the four tenders to the end of March 1985. Consistent with this new target, the 15th tender sought $500 million. Bids received totalled almost $1,400 million, and interest rates were almost unchanged from the previous tender. Again reflecting the relatively easy liquidity conditions, $293 million of the tender was settled on the first settlement day, with another $140 million settled on the following four days. The Reserve Bank also sold $105 million of stock over three days in the week prior to Christmas. Over the whole month $451 million of stock was settled, although this fell short of government injections through the fiscal deficit which totalled $570 million for the month.

Little detailed information is available on the origin or destination of the capital inflow. Some information suggests that Australia and Japan were principal sources. A large proportion of the inflow appears to have been invested through brokers and nominee companies, and the bulk has probably been portfolio investment in domestic financial instruments — TCDs, government stock and the share market, in particular. It is difficult to judge at this stage the extent to which the inflow was a temporary phenomenon resulting from the abrupt transition of policies in New Zealand, or whether it may have represented, at least in part, a more permanent inflow as a result of a more fundamental reappraisal of the attractiveness of New Zealand dollar financial assets.

It is clear that the private capital flows have had the effect of stabilising domestic interest rates, mainly in the case of short-term rates on private paper, but also in the Government stock tenders where the rates in each of the December quarter tenders were remarkably similar, before a further increase in the January tender. The 90-day bill rate fell steadily until late November when it stabilised at around 15.2 — 15.3 per cent for almost two months, and the average TCD rate remained between 15 and 16 percent over the same period, although these rates may have also been underpinned by the then-current Treasury bill yields.

Given the higher overall interest rate structure and the absence of a competitive Government instrument in the retail market, it was perhaps not surprising that redemptions of retail stock exceeded new issue sales by $99.9 million during the December quarter. The issue of Our New Zealand Bonds closed on 2 November having raised a total of $78.7 million in five months. Sales in the December quarter totalled $10.7 million, and $0.4 million was withdrawn. (The bonds first became redeemable in December). At the beginning of December a new retail issue of Kiwi Savings Stock was launched with maturities of 2 and 4 years. The new issue differed significantly from previous Kiwi Stock issues by being negotiable. Also, the stock could not be redeemed before September 1985, and from that date there were substantial penalties on redemption prior to maturity. The returns of 16 per cent on the two year stock and 15.5 per cent on the four year stock proved reasonably attractive with the new issue raising $40.5 million by the end of December.

On 8 November, Inflation Adjusted Savings Bonds (IASBs) were withdrawn from sale, having raised a total of $1,192.1 million since the bonds were first introduced

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

	September 1984			*December 1984*		
	Subscriptions ($m)	*Redemptions ($m)*	*Net ($m)*	*Subscriptions ($m)*	*Redemptions ($m)*	*Net ($m)*
Inflation Adjusted Bonds	+ 52.0	− 29.3	+ 22.7	+ 43.4	− 19.5	+ 23.9
Kiwi Savings Stock I	. . .	− 50.8	− 50.8	. . .	−111.3	−111.3
Kiwi Savings Stock II	. . .	− 21.0	− 21.0	. . .	− 36.3	− 36.3
Kiwi Savings Stock III	. . .	. . .	. . .	+ 40.5	. . .	+ 40.5
Our New Zealand Bonds	+ 50.7	. . .	+ 50.7	+ 10.7	− 0.4	+ 10.3
Other Savings Stock	. . .	− 0.8	− 0.8	. . .	− 27.0	− 27.0
Total	**+ 102.7**	**− 101.9**	**+ 0.8**	**+ 94.6**	**− 194.5**	**+ 99.9**

TABLE 2
NEW ZEALAND GOVERNMENT STOCK SALES BY TENDER

Tender number	Date held	Stock offered	Maturity date	Total amount offered $m	Total bids submitted $m	Over-subscriptions accepted [1] $m	Total successful bids $m	Allotment Yield [2] % p.a.
7.	3/5/84	N.Z. Govt. Stock	15.04.86	100.0	65.6		55.1	10.00
		Index Linked	15.09.87	100.0	137.1		64.8	5.00
			15.09.92	300.0	588.7	60.0	360.0	4.95
			15.09.01	100.0	197.2	20.0	120.0	4.55
8.	7/6/84	N.Z. Govt. Stock	15.04.86	50.0	2.9		0.2	10.00
		Index Linked	15.09.87	100.0	35.0		11.4	5.00
			15.09.93	100.0	117.3		72.0	5.00
9.	27/7/84	N.Z. Govt. Stock	15.06.87	100.0	78.7		68.7	15.00
			15.06.90	100.0	78.2	57.6	15.6	15.50
		Index Linked	15.12.87	150.0	158.0		139.8	5.00
			15.12.91	150.0	212.4	30.0	180.0	5.00
10.	16/8/84	N.Z. Govt. Stock	15.06.86	150.0	157.9		123.9	15.50
			15.11.92	50.0	220.7	7.8	57.8	15.25
		Index Linked	15.06.89	100.0	92.7		73.7	6.00
			15.06.92	100.0	133.2	20.0	120.0	6.00
11.	30/8/84	N.Z. Govt. Stock	15.05.90	100.0	155.6		100.0	15.49
			15.05.94	100.0	226.0		100.0	15.25
		Index Linked	15.06.88	50.0	64.6		50.0	6.00
12.	20/9/84	N.Z. Govt. Stock	15.09.86	80.0	94.0		75.0	15.97
			15.05.90	60.0	138.2		60.0	15.60
			15.05.94	60.0	187.1	5.0	65.0	15.45
13.	18/10/84	N.Z. Govt. Stock	15.10.90	100.0	238.2		100.0	17.40
			15.10.94	100.0	211.6		100.0	16.96
14.	15/11/84	N.Z. Govt. Stock	15.11.87	100.0	259.0		100.0	17.36
			15.05.90	150.0	489.3		150.0	17.05
			15.05.92	150.0	550.1		150.0	16.95
15.	13/12/84	N.Z. Govt. Stock	15.11.87	150.0	383.4		150.0	17.31
			15.05.90	200.0	530.2		200.0	17.04
			15.10.94	150.0	485.2		150.0	16.85
16.	17/1/85	N.Z. Govt. Stock	15.03.87	150.0	385.3		150.0	17.91
			15.03.90	150.0	471.1		150.0	17.46
			15.10.94	100.0	460.5		100.0	17.09

Note:
[1] As from the fifth tender over-subscriptions of up to 20% of the amount offered in any maturity may be accepted subject to the overall amount accepted not exceeding the amount of stock offered in the tender (this facility was announced on 2 February, 1984 and was covered on page 18 of the January/February *Bulletin* (Vol 47)).
[2] The figures for tender 12 and following are the weighted average yield under the yield bid system. In tenders 7-11 stock was allotted on a uniform yield basis.

in 1977/78. In the final six weeks $43.4 million of IASBs were sold, and over the whole quarter $19.5 million of stock was redeemed, compared with $29.3 million in the September quarter.

Redemptions of both of the first two Kiwi Stock issues increased markedly in the December quarter, totalling $147.6 million compared with $71.8 million in the September quarter and $26.6 million in the June quarter. The increase in redemptions can be attributed to the higher interest rate structure in the market, and evidence of increased competition for the small saver's dollar.

MONETARY AGGREGATES AND REINTERMEDIATION

The estimates of the monetary and credit aggregates for the December quarter indicate that the growth rates have continued at around the levels experienced earlier in the year.

The narrow monetary aggregate M1 is estimated to have grown by 1.8 per cent in October, −0.5 per cent in November and 6.9 per cent in December, an average monthly growth rate of 2.7 per cent. This follows average monthly growth of 1.3 per cent in the September quarter. The estimated December M1 monthly growth rate is the highest for a number of years. However, this can be largely explained by an unusually strong public demand for notes over the Christmas period and by a change in the trading bank reporting day associated with the Christmas holiday period (so that banks reported before Christmas rather than after Christmas as is usually the case). The annual growth of M1 increased from 6.2 per cent in September to 11.5 per cent in December (but, again, this growth rate is distorted by the timing change). Meanwhile, the more broadly defined money supply and selected liquid assets of the public (M3) is estimated to have increased by 2 per cent in October, 1 per cent in November and 1.1 per cent in December, an average monthly growth rate of 1.4 per cent, compared with 2.1 per cent in the September quarter and 1 per cent in the June quarter. However, the distortion affecting M1 may also account for up to half of the growth in M3 during December. The annual growth rate of M3 has remained almost unchanged, rising from 17.7 per cent in September to 18.1 per cent in December.

A very large gap has opened up in recent months between the annual growth rates of M1 and M3. In the year to April 1984, M1 and the fixed deposit component of M3 both grew by around 17 per cent, but in the year to November M1 grew by 4 per cent and fixed deposits by 29.5 per cent. While M1 grew more slowly than M3 during much of the 1970s, the relative growth of fixed deposits has been particularly rapid in recent months. In part this gap may reflect the inter-institutional deposits problem discussed in the previous quarterly review, but it must also reflect the rapid increase in interest rates on

term deposits. Most M1 deposits (i.e. trading banks' and savings banks' cheque accounts) still pay no interest and have therefore become increasingly less attractive.

Lending to the private sector by the M3 institutions continued at a moderately strong pace during the December quarter, with monthly growth rates of 1.1 per cent in October, 1.1 per cent in November, and 1.8 per cent in December, giving a monthly average rate of 1.3 per cent, compared with 1.2 per cent in the September quarter and 1.7 per cent in the June quarter. Given the extremely rapid growth in the December quarter of 1983 it was not surprising that the annual growth rate fell from the September 1984 peak of 21.4 per cent to 17.3 per cent in December 1984. However, the current monthly growth rates mean that the annual growth rate could remain high for some time to come.

It is necessary to allow for the impact of the new deregulated environment when interpreting the monetary and credit aggregates. The general move away from regulation is likely to enable the central institutional groups to boost their share of business as 'reintermediation' takes place. Since many of these groups are included in M3, the growth in these institutions' share of total business will be reflected in more rapid growth rates of the money and credit aggregates.

A second aspect of post-regulation adjustment is the changing market shares of the institutional groups within the aggregates. Such changes should reflect the differential impact on various institutional groups of the web of regulations which grew up over the years. The marginal ratio system which was briefly applied to finance companies was a prime example of a measure which could have stunted the growth of a particular institutional group. The ban on savings banks paying more than 3 per cent on ordinary accounts or offering interest on cheque accounts, and the corresponding '30 day rule' for trading banks, are two more examples of institutional group specific regulation. The deposit and lending rate regulations also probably affected the relative competitiveness of various institutional groups. At this stage, it is too soon to observe any clear change in market shares in the post-regulation environment although early statistics indicate that the trend decline in the trading banks' market share (including or excluding their savings bank subsidiaries) has been halted.

The third aspect of recent developments in the monetary aggregates is the changing role of the retail instruments which have played a major part in the debt programme since 1978. One feature of these instruments (the Savings Stocks, Premium Stocks, the three Kiwi Savings Stocks and Our New Zealand Bonds) was that, with the exception of the current Kiwi Stock issue they all either restricted the size of individual holdings or barred financial institutions from holding the stocks. The effect of these restrictions was to ensure that almost all retail stocks were held outside the M3 sector, with sales of the stocks directly reducing the money supply. For most of the holders these retail stocks were fairly liquid so that, although the monetary aggregates were constrained and the institutions' ability to expand credit was reduced, potential private sector spending power was not necessarily reduced to the same extent. However, since November 1984, a reduced role has been accorded to retail instruments, and the debt sales programme has been pursued to a greater extent through tender sales of ordinary government stock, with unrestricted institutional holdings.

In the three months to December, private sector holdings of all Government securities increased by around $2,350 million, of which more than half was taken up by M3 institutions. Given the relative thinness of the secondary market in small parcels of government securities and the absence of early redemption or non-penal discount facilities, it is to be expected that the larger holders (in particular the financial institutions) will dominate the take-up of government stock. However, although this may mean that the impact of debt sales on the money supply and on institutions' reserves is less, this does not necessarily threaten monetary stability. Since the Government is paying market interest rates the institutions will be willing long-term lenders to the Government. Most importantly, Government stock cannot be used to finance an expansion in lending to the private sector so long as the Reserve Bank is unwilling to discount stock — present Reserve Bank policy is to discount only stock with less than six months remaining to maturity, and then only at some penalty. Thus, to the extent that M3 institutions have increased their lending to the Government, overall monetary and credit conditions will have been tighter than the monetary data alone have indicated.

[The change in emphasis of the debt programme will be examined in greater detail in a forthcoming *Bulletin* article.]

OTHER POLICY DEVELOPMENTS

The process of deregulation and structural change continued during the December quarter, particularly in the areas of overseas investment, exchange control and liquidity management.

Decisions announced during the quarter included the removal of restrictions on the term and interest rate applying to overseas borrowing by New Zealand companies; permitting overseas-owned companies operating in New Zealand to raise funds in the New Zealand capital markets; the removal of restrictions on New Zealand financial institutions' borrowing overseas (subject to the exposure limits specified for foreign exchange dealers); and the easing of the exchange control regulations to permit New Zealand residents to purchase foreign currency for investment purposes. This last change effectively implies the elimination of exchange control for all practical purposes — the requirements which remain are for technical and statistical reasons only. These measures are all intended to improve the efficiency of financial markets by removing administrative impediments which no longer served any useful purpose and encouraging greater competition. With interest rates in New Zealand now market determined, the exchange rate at a more realistic level, greater emphasis being given to adopting a consistent monetary and fiscal policy stance, and a higher level of overseas reserves, such regulations were no longer necessary for economic stability.

On 21 December details of the liquidity management package were announced. Liquidity management is a phrase used to cover the institutional and policy framework in which flows to and from the reserves of financial institutions are managed. It was announced that from 24 December the Reserve Bank was withdrawing the automatic 'discount' facility for government stock with more than six months to maturity. The change in policy was designed to support the monetary policy impact of selling long-dated stock through the tenders. It should also encourage institutions to better match maturities with known commitments and stimulate the secondary market in government securities. The Reserve Bank remains willing to discount

government securities with less than six months to maturity at a rate (currently) 1 per cent above the assessed market rate.

The second aspect of the package was that the Government would adopt the tendering system for selling Treasury bills (the first tender was held on 29 January 1985). The main perceived advantage in shifting to tendering is similar to that for stock tendering — that the Government could determine the quantity of bills it wished to sell based on short term financing requirements and expected liquidity developments, and then sell the desired quantity at minimum cost through a competitive tender. The move to tendering Treasury bills places greater onus on the authorities to forecast accurately official sector injections to liquidity — and thus this component of the demand for Treasury bills. To this end, the Bank has initiated a major effort to improve its information gathering. In addition, however, more frequent open market operations will be necessary, at least in the short-term, to allow for any remaining deficiencies in the information available, and to ensure that interest rate stability is not unduly jeopardised. The tendering system for selling short-term government instruments has operated successfully in a number of developed countries and it should also work well in New Zealand once the system has settled down. To facilitate the changeover, the 'tap' issue of Treasury bills and access to the Bank's portfolio of bills and short-dated stock were withdrawn on 25 January.

It was also announced that as from 1 January the institutions which settle through the Reserve Bank (the trading banks and the POSB) would be paid interest on their demand deposit balances, at a rate of 5 per cent. In the past these institutions (and the Reserve Bank) had held almost all of the Treasury bills on issue. This was due partly to the relatively low returns on Treasury bills in the past which discouraged any other potential holders from taking them up, and also due to the lack, in aggregate, of any alternative instruments in which the settling institutions could invest their liquid reserves. Under the new arrangements, these institutions will no longer have access to Treasury bills on demand, and their cash balances at the Reserve Bank will therefore need to be used as a buffer to a greater extent than in the past. Payment of interest on these balances is in recognition of this fact, and is also intended to facilitate the orderly development of the Treasury bill market under the tender system.

Finally, the compensatory deposits scheme which has operated in each March and September tax period since 1978 is to cease after the March 1985 scheme. The existing scheme tended to be inefficient, and discriminatory between institutions. The recent liquidity management changes will be used to accommodate seasonal fluctuations in liquidity in a more neutral manner, and institutions will be able to organise their cash holdings and Treasury bill maturities to meet expected tax (and other) flows. In addition, the greater freedom to arrange overseas funding and the Bank's open market operations should provide a better environment for institutions to manage their liquidity.

In announcing the liquidity management package the Minister of Finance stated that the main implication of the changes was that in managing their portfolios in future, financial institutions would have to pay much greater attention to the Government's monetary policy stance. Institutions would no longer be able to depend on cheap funding from the Reserve Bank where money and credit growth rates were out of line with the Government's objectives.

[An article which examines and explains more fully the new liquidity management measures will be published in a forthcoming *Bulletin* issue].

FINANCIAL INSTITUTIONS AND MARKETS

Trading Banks

In the final quarter of 1984, the trading banks were free for the first time in many years to compete across the full spectrum of maturities and instruments. The removal of the interest rate controls on lending, deposits and mortgages affected a wide range of institutions but in the medium-term it is probably the abolition of the '30-day rule' (restricting interest on term deposits to deposits of 30 days or more) and the removal of the ban on paying interest on cheque accounts which will prove more important in terms of the overall trading bank share of business. In addition, the trading banks felt the effects and challenges of the new Government's more generalised debt sales approach to monetary control. It is in the light of these changes that the trading bank statistics for the December quarter have to be considered, although with the caution noted earlier that, even in the relatively fluid financial sector, adjustment takes time and any statistical indications of a response to the new environment can probably only be tentative at this stage.

During the December quarter trading bank lending increased by an average of 1 per cent a month, following an increase of only 1.8 per cent over the entire September quarter. However, the December quarter figures should probably not be taken as indicating a sustained increase in the growth of trading bank lending given the very large and unusual flows associated with the foreign exchange crisis at the end of the June quarter. For the six months to the end of September, the average monthly increase in trading bank lending was 1.4 per cent.

In contrast to the relative slow lending growth, which was perhaps a response to the higher overall level of interest rates, credit limits grew more rapidly in the December quarter. The increases in total trading bank credit limits of 2.5 per cent in October, 1.9 per cent in November, and 2.6 per cent in December, followed an average monthly increase of only 1.4 per cent in the September quarter.

Total trading bank deposits were unchanged over the December quarter, after a 13.3 per cent increase during the September quarter. As was noted in the September quarterly review the trading bank deposit figures over that quarter were inflated by inter-institutional activity, at least in part associated with the low Treasury bill rates then offered.

September was the last month when the policy stance for setting the reserve asset ratio was tight. In each of the following four months the free reserves margin was set at a more neutral $100 million. However, this reflected a shift towards a generalised debt policy approach to monetary control rather than a more relaxed monetary stance. Average reserve assets remained at very high levels, particularly during periods of a stronger private capital inflow and reached a peak of more than $3,100 million in late December. Average reserve assets in the December quarter were around $800 million higher than in the corresponding quarter of 1983.

Savings Banks

Total savings bank lending is estimated to have increased by 4.1 per cent in the December quarter, compared with 3.1 per cent in the September quarter. Total savings bank deposits rose by 3.1 per cent, compared with a 0.4 per cent increase in the September quarter.

Lending by the Post Office Savings Bank grew by 2.9 per cent in both October and November and by 2 per cent in December, somewhat slower than the average monthly increase of 3.7 per cent in the September quarter. When lending which was previously undertaken by the Housing Corporation is excluded, POSB lending grew by 0.8 per cent in the September quarter and by 0.6 per cent in the December quarter. Total Post Office deposits rose by 1.9 per cent over the latest quarter, after increasing by 1.4 per cent over the September quarter. However, the decision by the Post Office to pay interest on personal cheque accounts from October appears to have resulted in a substantial increase in these deposits, up 18.6 per cent since August, although cheque account balances still make up only 1.9 per cent of total POSB deposits.

Lending by the trustee savings banks (TSBs) increased more rapidly in the December quarter, growing by 1.3 per cent in October, 1.4 per cent in November and 1.1 per cent in December after an average monthly growth rate of only 0.8 per cent in the September quarter. This level of lending growth was only slightly below the deposit growth rates, 1.2 per cent in October, 1.7 per cent in November, 1.8 per cent in December and an average growth rate in the September quarter of 0.6 per cent.

Private savings bank (PSB) lending continued to fall steadily over the December quarter. The fall of 2 per cent was similar in magnitude to the falls recorded in the first nine months of the year. Total PSB deposits fell by 1.3 per cent over the quarter. However, in October deposits were unchanged and in November, for the first time since early 1982, total PSB deposits increased. This increase reflects the decision by one of the PSBs to increase the interest rate on its ordinary accounts to 10 per cent, following the removal of the old 3 per cent restriction.

Finance Companies

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

For the finance companies covered by the Bank's survey the final quarter of 1984 was one of continuing steady growth and high levels of activity.

Total loans and advances increased by 2 per cent in October and 3.1 per cent in November, slightly higher than the average monthly growth rate in the September quarter of 1.6 per cent, and total growth of 2.3 per cent over the June quarter. However, the annual growth rate of lending has fallen from a peak of 28.3 per cent in the year to July to 23.9 per cent in the year to November.

Similarly, total deposits with large finance companies rose by 2.2 per cent in October and 2.9 per cent in November, slightly slower than the average monthly growth rate in the September quarter, a quarter dominated by the 10.2 per cent increase in August.

Building Societies

Advances by the building societies increased by 0.2 per cent in October, and then fell by 0.3 per cent in November. The static lending level can be attributed, at least in part, to the increase in nominal interest rates experienced in recent months. Meanwhile, after deposits recorded a 2.4 per cent rise in the three months to September they rose by 0.8 per cent and 1.4 per cent in October and November respectively.

CONCLUSION

For some years the New Zealand financial sector has been characterised by long periods of direct intervention and controls. By contrast the philosophy behind the recent policy moves has been to remove impediments to the free working of the market, thus enabling (as far as possible) all institutions to compete on an equal footing; and to operate monetary policy through market-based techniques, which have a generalised impact on all parts of the financial system. As a result the financial sector, both the domestic money markets and the foreign exchange market, is now in a period of major transition. It is recognised that the ultimate effects of these widespread changes, and the benefits which are expected to flow from them, may take some time to become fully apparent.

Some of these benefits will result from greater competition within the domestic financial markets. Greater competition amongst financial institutions should act in the interest of both savers and borrowers by maximising the return to savers whilst minimising the costs to the borrower. Other benefits should result from the abolition of controls. For example, the situation where new projects, however profitable, could not get finance because established borrowers had first claim on resources, should be less common. In the adjustment period it is likely that there will be marked changes in the shares of business done by the various institutional groups, probably in favour of those groups who had previously been most adversely affected by regulations. At the more general macro level the Government has shifted away from inefficient institution-specific monetary control techniques to a generalised debt policy approach centred round the stock tender programme. The return of interest rates to market levels has been an integral part of the new approach. While this has caused significant adjustment difficulties for some borrowers, it should enhance longer-term growth prospects by ensuring that resources flow to those sectors which can make the greatest contribution to economic development. The consistent pursuit of appropriately firm monetary and fiscal policies should also help to restore balance of payments equilibrium, and to restrain inflation — thus leading, in time, to a reduction in nominal interest rate levels as inflationary expectations decline.