ECONOMIC NOTES

23rd Government Stock Tender

Government Stock Tender No. 23 was held on 17 October 1985. As was the case in the previous three tenders a total of $300 million of stock was offered for sale, comprising two maturities (October 1991 and August 1993) of $150 million each. Valid bids in the tender amounted to $1,177 million, up on the $865 million received in Stock Tender No. 22, but similar to the totals recorded in each of the previous two tenders. The 1991 maturity was particularly heavily subscribed, with bids totalling more than five times the amount on offer, while bids on the longer 1993 maturity were slightly more than twice the amount on offer.

The weighted average yields for the 1991 and 1993 stocks were 19.96 per cent and 19.55 per cent respectively, with the average rate on the 1993 stock around 0.75 percentage points higher than that for the same stock in the previous tender. Although no direct comparison can be made for the shorter stock with the previous tender (due to the switch from a March to an October maturity) the average rate for the 1991 stock was around 0.3 percentage points below secondary market rates ruling just prior to the tender.

24th Government Stock Tender

Government Stock Tender No. 24 was held on 14 November 1985. A total of $300 million of stock was offered for sale, comprising $200 million of October 1991 stock and $100 million of August 1993 stock. Valid bids received totalled $869 million, which was down on the total of $1,177 million received in the previous tender, also for $300 million. However, bids received were still well in excess of the amount of stock on offer, with bids on the 1991 maturity about two and a half times greater than the amount on offer and bids on the 1993 maturity almost four times greater.

The weighted average yields on successful bids were 17.8 per cent for the 1991 stock and 17.2 per cent for the 1993 stock. The average yields were lower than those in the previous tender by 2.2 per cent and 2.4 per cent respectively, which was in line with developments in secondary market rates.

See Table E1 for the results of this and other Government stock tenders.

Treasury Bill Tender and Open Market Operations

During early October liquidity injections and withdrawals were approximately equal but by 10–11 October withdrawals had exceeded injections and a total of $158 million of discounting occurred on these two days. On 14–15 October public sector injections due principally to social welfare benefits, public service pay, and interest on government stock raised settlement cash levels to about $220 million. These injections were offset in late October by tax flows to government. The bank strike on 29 October to 1 November delayed the processing of government transactions and so the usual end-of-month sales tax withdrawals impacted predominantly in early November.

A total of $446 million of Treasury bills were sold by tender during October. Of these $112.5 million were October maturities, $110 million were November maturities, $151 million were December maturities and $72.5 million were March maturities. The sale of these maturities reflected the Bank's desire to match Treasury bill maturities with forecast liquidity withdrawals from the system.

The Reserve Bank conducted open market operations on three occasions in October in response to the high levels of cash held by the settling institutions at the time. On 18 October the Bank sold $50 million of Treasury bills maturing on 31 October. On 23 October the Bank sold $30 million of Treasury bills maturing on 29 November and on 24 October $50 million of Treasury bills maturing on 28 November were sold.

The settlement of Stock Tender 22 was completed on 18 October. As has been the pattern in recent tenders, a large portion of settlements occurred over the final days of the settlement period. Stock Tender 23 settlements of $73 million occurred in October.

Primary liquidity which began the month at $1,572 million increased during the first week of October but then declined to reach $1,544 million on 11 October. Strong public sector injections on 14 and 15 October increased primary liquidity to $1,816 million. Net injections continued during the following week (16–22 October) and primary liquidity reached $1,848 million on 22 October before falling to $1,576 million on 31 October as a result of late month tax withdrawals.

Treasury Bill Tenders and Open Market Operations

Treasury Bill Tenders:

Tender	Amount Offered $m	Term	Amount Sold $m	Weighted Average Rate %
36	35	161 days	35	24.68
37	75	21 days	112.5	22.417
	50	49 days	50	23.740
	75	154 days	37.5	25.492
38	60	42 days	60	22.5
	40	56 days	40	23.104
39	Nil			
40	75	42 days	36	22.001
	50	56 days	75	22.429

Open Market Operations:

	Amount Offered $m	Term	Amount Sold $m	Amount Purchased $m
18 October Treasury Bill	50	13 days	50	—
23 October Treasury Bill	30	37 days	30	—
24 October Treasury Bill	50	35 days	50	—

New Banks Policy Announced:

Finance Minister Roger Douglas announced on 11 November 1985 that more existing institutions would be able to call themselves 'banks' in the future, and new institutions would be able to set up as banks.

He said present law required a special Act of Parliament before any company could be incorporated as a bank. This law had become an impediment to the sensible development of financial institutions.

"It is in part the reason why only four trading banks operate in New Zealand, though we have many other institutions which carry out some banking functions.

The proposed change recognises firstly that there has been very rapid development in the finance sector, as more and more 'non-bank' institutions develop increasingly 'bank-like' roles.

Their development has already blurred the traditional boundary line between banks and other financial institutions. To that extent, we are merely recognising what has already happened in New Zealand.

In a freer environment, these institutions obviously have the capacity to grow further and serve their customers better, with many major new developments like electronic funds transfer now on the way.

It is not appropriate to place artificial limits on what they can offer customers, or what they can call themselves," he said.

"Secondly, the Government sees no reason why new banks should continue to be excluded from the financial system, confining growth in numbers to 'non-bank' finance companies, merchant banks and so on.

We want an efficient system which serves customers as well as possible, and even-hand competition will help to ensure that result."

In future, therefore, institutions would be granted permission to call themselves banks provided that they satisfied the following qualitative criteria:

- issued capital of $30m., with at least $15m. paid up;
- substantial business in deposit/lending functions;
- a well-spread shareholding, or firm internal controls to protect depositors from undue loan concentration or connected lending;
- demonstrable banking expertise, plus willingness and capacity to make a positive contribution to the development of the finance sector;
- good standing in the financial community.

Under legislation to be introduced this year, the Reserve Bank would be given responsibility for granting bank authorisations.

"To obtain maximum benefit from the new policies, there will be no discrimination against the entry of overseas banks. They will be able to operate as either branches or subsidiaries.

It would be illogical to fear the entry of foreign banking organisations, when three of our four established trading banks are overseas owned and play major roles in our financial life.

On the other hand, I have no doubt that we will also see more New Zealand owned operations emerging as banks under the new system," he said.

The Government would not place any artificial limit — other than the qualitative requirements — on the number of institutions able to qualify for bank status, or on the period during which they could apply.

There would be no official limitation on the range of banking activities (apart from foreign exchange dealing) in which the new banks could engage.

"The term 'trading bank' will cease to have any legal meaning in the new system. It will be replaced by the simpler and more general term 'bank'", Mr Douglas said.

Also, the Government would no longer discourage non-banking financial institutions from offering cheque account facilities or becoming involved in the payments/clearing system.

"This does not however imply that they have any automatic right to have their paper accepted by other institutions in the clearing system," he said.

He said no authorisations could be given under these new policies until the proposed legislation became law, but institutions were free to discuss their intentions with the Reserve Bank if they wished.

Principles of Prudential Supervision Outlined by Minister:

Finance Minister Roger Douglas on 11 November 1985 announced that legislation would be introduced in Parliament this year to strengthen Reserve Bank powers of prudential supervision of the banking industry.

Mr Douglas said the legislation would provide the supervisory powers needed by the bank to assist the maintenance of public confidence in the banking system.

"Our objective is to place banks in a position to develop the more diversified services which the economy needs for its future growth, and to achieve maximum economic efficiency in the industry.

In the past in New Zealand, restrictive regulation has prevented the management of the banking industry from taking many decisions and actions which were in the best interests of its customers.

The Government has removed many of those constraints, to ensure that financial institutions have greater ability to manage their businesses sensibly, with improved regard for market requirements.

By removing compulsory ratios, we gave the institutions freedom to invest where they consider it prudent and appropriate, instead of requiring them to invest against the interest of many customers.

The Government has also removed the perils which previously faced the banking industry and its customers from frequent, unpredictable changes of national economic policy.

These moves have opened the way to a stronger, more flexible and dynamic banking industry with greater ability to facilitate the development of the economy, at lower cost to the public.

At the same time, it is important to have a strong system of prudential supervision in place, to give support to public confidence in the soundness of the industry.

This system needs to be capable of managing the demands for supervision both of the traditional banking system and of new banks which enter the system in the future," Mr Douglas said.

"Prudential supervision is not a substitute for the fundamental responsibility on every financial institution to conduct its affairs efficiently and prudently, or for prudence by investors.

That responsibility will remain squarely on the shoulders of the share holders, directors and management of the institutions, where it belongs, and on individual investors to place their money sensibly.

Those are not risks which the taxpayer should be taking, either on behalf of the financial institutions or individual investors. Prudential supervision is not a Government guarantee to either party.

Prudential supervision aims at ensuring the community can have confidence in the ability of the financial system as a whole to fulfil its economic functions.

The concern therefore is for the stability of the system, rather than to offer guarantees to individual institutions or investors against inadequate decision-making on their own part."

Mr Douglas said the Reserve Bank Act would be amended to ensure that the bank received detailed, regular reports and statistics to monitor the position and performance of the key financial institutions.

The Reserve Bank would also consult as necessary with the senior management of banks and other financial institutions on their financial position.

"The Bank should therefore be well-placed to be aware of any risks to a supervised institution which might affect the financial system as a whole", he said.

The essence of the system would be supervision by means of exchange of detailed information and exchange of views, to ensure sensible decision-making — not formal standards or regulatory controls.

"No one can remove from investors the need to think carefully about where to place money, or eliminate an element of risk from the investment process. But we can limit the risk.

The key to risk containment is an environment which allows institution managers to implement sound decisions, supported by a framework of prudential supervision.

The risks under this new system are less than those in our previous highly regulated systems which compelled managers to courses of action against the interests of both the institution and its customers.

If at any time problems arise for some institution which appear to be beyond its ability to solve, the aim would be to encourage its orderly exit from the banking system, by sale or merger for example.

Failures have occurred occasionally in the past, and the possibility of such an occurrence in the future can never be ruled out.

The Reserve Bank will be given powers of last-resort intervention for use in selected rare cases where the failure of an institution may seem inevitable.

Last-resort intervention might include, for example, a change of management, putting in a statutory manager, recapitalisation or similar steps designed to prevent other institutions from becoming affected.

It will not be an object of the legislation to shift the responsibility for the failure, or losses created by it, on to the Government and the taxpayers," Mr Douglas said.