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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

December 13, 1960

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Recent Changes In Australian Banking

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Major changes were introduced to the Australian banking system during 1960. In January 1960, the Commonwealth Bank, which for several decades had combined central, commercial, and industrial development banking, ceased to exist. Its central banking functions were transferred to the Reserve Bank of Australia; the commercial and industrial development activities were separated from the Central Bank. At the same time, there were some fundamental changes in the method by which trading bank reserves were controlled. Under the Special Accounts, which had been introduced about twenty years ago, the Central Bank made monthly calls for cash deposits from each individual commercial bank; this arrangement was replaced by a system of required reserves called Statuatory Reserve Deposits, applied uniformly to all banks as a per cent of outstanding deposits. Changes in these deposit ratios now require a public announcement by the Central Bank.

The decision to separate central and commercial banking was the outcome of an extended political controversy. At the same time, there have also been other major changes in Australian banking arrangements which grew out of attempts by the Australian authorities to enhance the effectiveness and flexibility of monetary instruments as tools of economic stabilization. These technical and policy changes, which are reviewed in this paper, include the shift from special to uniform reserve requirements, attempts to construct a short-term money market, and the introduction of more flexibility in interest rates on Treasury securities.

Organization of the Central Bank

Prior to the establishment of the Reserve Bank of Australia, in January 1960, the Commonwealth Bank of Australia carried out all central bank functions. In addition, it was also responsible for commercial and development banking functions. Under the Banking Act of 1959, the central bank functions were separated from the other functions.

The Reserve Bank of Australia was established as the Central Bank on January 12, 1960. A Reserve Bank Board was placed in charge of central banking policies. According to the Reserve Bank Act of 1959, it is the Bank's responsibility to take any steps necessary to assure: (a) a stable currency, (b) the maintenance of full employment, and (c) the economic prosperity and welfare of the people of Australia. In the event of a difference of opinion between the Bank and the Ministry of Finance regarding appropriate policy, the Governor-General may order appropriate Bank policy.

The Reserve Bank Board consists of the Governor, Deputy Governor, Secretary to the Department of the Treasury, and seven members appointed by the Governor-General. Of these seven, at least five are to represent the private sector of the economy, and are appointed for a period of five years. The members chosen from the Bank or the Public Service of the Commonwealth remain in office at the pleasure of the Governor-General.

Special Accounts and other reserve requirements

The Australian authorities have relied primarily upon reserve requirements as the major instruments of monetary control. They have utilized two types of reserve requirements: (1) a cash reserve in the Central Bank, and (2) a secondary reserve consisting of a minimum holding of specified liquid assets. The method of determining the levels of cash reserves held in the Bank was recently altered from the system of Special Accounts to Statuatory Reserve Deposits.

The Special Account system permitted the Central Bank to call upon trading banks1/ to make cash deposits to the Central Bank, bearing an interest return equivalent to the discount on the Treasury bill (seven-eighths per cent at the end of 1959). These deposits were determined not as a percentage of bank deposits, but were related to the increase in each trading bank's assets over the level of a base month. Until 1953, the Central Bank was able to call the entire monthly increase. Since that time, however, the Bank was permitted to call a maximum of 75 per cent of the increase in any month. Calls were made by the Central Bank each month; no public announcement of the amounts called was required. While the Bank could, if it saw fit, discriminate between banks because of their different liquidity practices or for other reasons, it has never done so, largely for political reasons; it was easier to defend a policy of uniform treatment to all banks.2/

In accordance with the Reserve Bank Act of 1959, the system of Special Accounts was replaced by the Statuatory Reserve Deposits. Accordingly, the trading banks are now required to maintain a deposit in the Reserve Bank of Australia, equivalent to a percentage of total deposits. The percentage is determined by the Reserve Bank. The Bank may alter the Statuatory Reserve Deposit ratio upon one day's notice, if the ratio is not to exceed 25 per cent of deposits. However, 45 days' advance notice is required to raise the ratio above 25 per cent; it can be effective for only 6 months and extended for only three months. Extentions require 45 days' advance notice before the end of each period. Interest is paid on the reserve deposits at a rate determined by the Reserve Bank and approved by the Treasurer; at the moment, it is seventh-eighths per cent.

When the Statuatory Reserve Deposit Accounts were established, on January 14, 1960, the ratio was set at 16.5 per cent of deposits, which was approximately the percentage which the Special Account balances bore to deposits immediately before the changeover. Effective February 10 the rate was increased to 17.5 per cent.

1/ State banks were exempt for constitutional reasons.
2/ H. W. Arndt, The Australian Trading Banks, pages 164-180.

In addition to cash reserves, the trading banks are also obligated to hold certain liquid assets (cash and Treasury bills) and Government securities in their own vaults. The level of these holdings, which is determined as a ratio to deposits, is called the Liquid Asset and Government Security ratio (hereafter called the LGS ratio).

The minimum LGS ratio is established by voluntary agreement between the Central Bank and the private banks. By permitting the private banks to earn higher interest on holdings of certain types of Government securities, the LGS ratio provides higher earnings for the banks, a market for low cost Treasury financing through Treasury bills (seven-eighths per cent per annum), and a market for Government bonds.

The LGS ratio was first introduced in 1953 when the Central Bank decided not to continue to control credit by calls to Special Accounts; instead, the authorities decided to use changes in Special Accounts as a signal to the trading banks to restrict lending. The Commonwealth Bank proceeded to reduce its reserve holdings and the private banks proceeded to expand their holdings of liquid assets and Government securities. By March 1953, the average LGS ratio of the banks rose to 37.5 per cent from 19 per cent the year before. The ratio of the Special Accounts to deposits during this period fell from 35 per cent to 18 per cent. In return, the trading banks agreed to maintain a yearly average LGS ratio of 25 per cent.

There were several disadvantages in this technique which resulted ultimately in its failure. First, it required the banks to maintain a yearly average LGS ratio, thus permitting maximum flexibility at any particular moment of time. It was therefore possible for a bank to overlend in any one period in anticipation of holding back in a later period. Secondly, the ratio was based solely upon voluntary agreement. The agreement called for a 25 per cent annual ratio, but the average LGS ratio was 23.4 per cent in fiscal year 1953/54, 18.2 per cent in 1954/55; and 17.7 per cent in 1955/56.

In 1956/57, following the failure of this policy, the Bank re-established the earlier technique of control through Special Accounts, but attained agreement with the trading banks that a minimum LGS ratio of 14 per cent would be maintained. The new agreement provided for a daily ratio rather than a yearly average. Therefore, any deviation from it may be corrected before the situation gets out of hand. Furthermore, this new level was set at 14 per cent, the approximate minimum level that most of the leading banks have adhered to by custom. The temptation to go below this level, therefore, is considerably less than at 25 per cent.

Market for Government securities

Almost half of the outstanding Government securities are held by the general public while the remainder is held by the banking system.

Holdings of Treasury bills and Government bonds by private banks are used to meet their reserve and liquidity requirements. The Central Bank stands ready to deal directly with the private banks if they wish to buy or sell. The general public, on the other hand, deals through brokers on the Australian stock exchanges.

The trading banks and the savings banks together held approximately 37 per cent of outstanding Government securities as of June 30, 1960 (see Table 1). The trading banks hold securities to meet their LGS requirements. The savings banks are required by law to hold 60 per cent of their assets in Government bonds (federal and local) and 10 per cent in cash or Treasury bills.

Table 1

Distribution of Australian Government Securities
(In millions of pounds)

	Holdings as of June 30, 1960	Per cent
Reserve Bank	470.5	16.0
All check paying banks	273.8	9.3
Savings banks	799.3	27.2
Money market	81.0	2.8
Other non-Government holdings	1,310.2	44.7
Total	2,934.8	100.0
Less Treasury bills	201.0	
Government bonds	2,733.8	

Source: Reserve Bank of Australia, Statistical Bulletin, Financial Supplement, September 1960.

The general public held about 47 per cent of outstanding Government bonds at end-June 1960. Of this a small portion, £81 million, was held by the money market. The portfolio of the money market is determined jointly by the dealers and the Bank. The general public may buy or sell through brokers on the Australian stock exchange. However, the market is spotty and the Bank feels responsible to buy or sell to avoid severe fluctuations in interest rates and thus assure a continued and expanding market for Government bonds.

Development of a short-term money market

The beginning of the short-term money market in Australia dates back to incidents early in the 1950's, when short-term funds were required for specific business operations and instruments were created to meet these needs. Notable among these was the offering of short-term debentures by hire-purchase houses in the early 1950's to meet their cash needs. Even more successful issues were offered several years later when several borrowers joined in one short-term issue which was underwritten by a leading brokerage house. Moreover, some brokerage houses introduced the "buy-back" system whereby Government bonds, for lack of a short-term instrument, were sold short-term with the understanding that they would be repurchased on a given date at an agreed upon price. The difference between buying and selling prices represents the interest payment for the short-term loan.3/

The absence of trading in Government short-term securities and the rather wide spread in maturity dates of long-term bonds hindered the development of the market. Non-Government short-term paper, and even the "buy-back" arrangements with regard to Government long-term bonds contained an element of risk for the lender. The lender might lose all or be "locked in" with a long-term bond because of the failure of a broker to live up to the "buy-back" agreement. However, in spite of these shortcomings, some brokers in the short-term market had established portfolios of up to £10 million or £15 million prior to February 1959.

In February 1959, as a move to encourage a broader market the Central Bank became lender of last resort for the authorized money market dealers. The Bank selected dealers and established a maximum portfolio and a line of credit for each dealer. As lender of last resort, the Bank rediscounts; the rate is determined at the time of rediscounting and is not announced in advance. At the beginning, it was set at 3-3/4 per cent, the upper borrowing rate which the brokers were then paying for loans. From the beginning of official recognition, the relationship between brokers and the Bank was a close one, with the Bank influencing policy, interest rates, and portfolios.

Total holdings of funds by authorized dealers increased considerably over the year as new sources of funds became available. Authorized dealers increased their holdings from £33.5 million in March 1959 to £78.1 million in July 1960; their holdings of Commonwealth Government securities increased from £53.5 million in July 1959 to £80.9 million one year later. Bank loans to the money market have increased since March 1959, but nonbank sources have provided increasing proportions of the market's funds. While the banks supplied 63 per cent of the funds in early 1959, they provided only 30 per cent by mid-1960.

3/ C. T. Looker, "How the Market Works" from "Australia's Evolving Money Market," The Banker, London, June 1960, pages 385-391.

Introduction of Seasonal Notes

Marketable short-term Seasonal Treasury Notes, with flexible interest rates, were first issued in November 1959, to absorb some of the increase in bank reserves during a period of seasonal high liquidity. This operation was made possible by the earlier development of the money market and represents the first attempt at controlling bank reserves through open market operations. The issue was a success but it fell short of achieving its purpose to the extent that trading banks were able to switch from Treasury bills to Seasonal Notes to meet their minimum LGS ratio requirements. However, the new instrument was welcomed by the money market and will be used again this year to reduce banks' liquid assets in the November-March period of high seasonal liquidity.

The issuance of the Seasonal Treasury Notes a year ago was probably the first attempt at open market operations in Australia designed to iron out seasonal fluctuations in liquidity. Unlike the Treasury bill, which was available only to banks, the Seasonal Notes were marketable 3-month bills with the discount determined by the market forces. These bills were issued weekly; through March they were rolled over as they matured. All Seasonal Notes matured by the end of June 1960.

The Seasonal Note issue was successful, with total bills outstanding at £43.6 million in March 1960; however, there was some switching by the trading banks from lower interest rate Treasury bills to higher interest rate Seasonal Notes when these Notes were declared eligible as LGS assets. To this extent, the Notes failed to reduce bank liquidity. While the general public did hold the major part of the issue, by March the trading banks held £14.5 million, about 33 per cent of the Notes outstanding, and they reduced their Treasury bill holdings by £10.4 million.

More flexible interest rates

While the Australian authorities have, in the past, considered it their responsibility to maintain relatively constant yields on Government securities to assure a market, they have permitted some flexibility, especially in the shorter-term rates, over the recent past. The introduction of the Seasonal Treasury Notes last November with the rate determined by the market forces was an example of new flexibility. More recently, the authorities have also permitted a rise in bank lending and deposit rates. Short-term Government bonds have also been permitted to rise some in recent months, but there was virtually no change in the long-term yields.

The Governor of the Reserve Bank noted in his statement to the Radcliffe Committee[4] that the Central Bank is a regular buyer of Government bonds on the market to assure ready marketability for sellers. He stated further that they buy and sell to offset pressures from the general public. As a result of this policy over the last year, the 15-year bond yield has increased only 7 basis points in spite of considerable

4/ Committee on the Working of the Monetary System, Volume V, Memoranda of Evidence submitted by Representatives of overseas Central Banks, The Governor of the Bank of Australia, page 247.

tightening in the money markets. However, the authorities have permitted a rise of 40 basis points in the 2-year bond. Short-term rates on the money market, which are approved by the authorities, rose as much as 1 per cent for call- and fixed-period loans.

Table 2

Selected Interest Rates in Australia, July 1959 to September 1960

	Short-term money market		Longer-term yields	
	Maximum on call loans	Maximum for fixed periods	2-yr. bond	15-yr. bond
1959 - July	3.14	3.50	3.90	4.90
Dec.	3.00	3.25	3.96	4.92
1960 - Mar.	3.19	3.38	4.14	4.93
July	3.75	3.75	4.26	4.97
Sept.	4.50	4.50	4.30	4.97

Source: Monthly Review of Business Statistics, Commonwealth Statistician.

The introduction of the Seasonal Treasury Notes in November 1959, also represent a departure from the fixed interest rate policy. Unlike the Treasury bills, the Notes were sold on the market with the purpose of absorbing the excess bank liquidity, and the interest rate was permitted to fluctuate as necessary to accomplish their objective.

In November 1960, the authorities increased the bank lending rates from 5-1/2 to 6 per cent, and deposit rates from 2-1/4 per cent to 4 per cent for 3 to 6 months and from 2.75 per cent to 4-1/2 per cent for over 6 months. However, these steps were taken long after other rates in the private sector had risen substantially; mortgage rates rose gradually from 7.1 per cent in June 1959 to 8 per cent in June 1960.

The additional flexibility in interest rate policy over the last year has increased the ability of the Australian authorities to control monetary expansion. However, the rising long-term rates in the private sector combined with the Bank's concern for maintaining constant long-term rates on Government bonds continues to be a threat to stability.

December 13, 1960

Expansion and Restraint in Australia 1959 and 1960

Edwin A. Anderson

The high level of exports during the second half of 1959, combined with import restrictions, brought about a substantial increase in Australia's official reserves and made it possible for the monetary authorities to continue with expansionary financial measures during 1959. Beginning early in 1960, however, official reserves underwent one of the sharpest declines in recent history. Between the end of May and the end of October 1960, reserves fell from £461.9 million[1/] to £349.2 million.

Throughout 1960, the Australian authorities have attempted to bring under control the domestic business expansion and, since mid-1960, to check the sharp losses in official reserves. To this end, they introduced a series of monetary and fiscal restraints in early 1960. In addition, they also intervened for the first time in basic wage decisions, to restrain further increases. Moreover, as an anti-inflationary measure, they announced the virtual abolition of import restrictions in February. The decision to liberalize imports differs markedly from the control of imports which was relied upon as a major tool of economic policy before 1957; however, the rapid rise in imports has led to a sharp reduction in official foreign exchange reserves.

Because of continued reserve losses, the Commonwealth Treasurer announced on November 15, 1960, further measures designed to halt the decline in reserves, but he stated that import restrictions would not be reimposed. The new measures included: (a) increased interest rates on bank loans and deposits; (b) more selective use of bank loans to avoid financing speculation and imports; (c) higher purchase taxes on automobiles; and (d) measures to discourage borrowing from nonbank financial institutions.

Major expansionary forces

The Australian authorities introduced financial measures in mid-1959 designed to encourage business expansion. The proposed budget for the fiscal year 1959-60 (July to June) showed a 6 per cent increase in expenditures; the deficit increased from £29.5 million in the previous year to £61 million. At the same time, a high degree of bank liquidity made it possible for the private banks to expand bank advances. This expansionary program was based upon two objectives: (1) to offset the decline in income in the export sector; and (2) to reduce the already low level of unemployment.

The concern of the Australian authorities about the loss of income in the export sector stemmed from sharp declines in export prices in the two previous years. The 37 per cent decline in wool prices between mid-1957 and mid-1959 was largely responsible for a decline of 25 per cent in the over-all index of export prices (see Chart). As a result, there was a decline in the value of exports to £810 million in 1957-58 and 1958-59, compared with £979 million in 1956-57.

1/ Pounds in this paper refer to the Australian pound which is the equivalent of $2.25.

The Australian concern about unemployment is difficult to document from the published figures. Between 1957-58 and 1958-59, unemployment declined from 67,000 (2.3 per cent of the labor force) to 65,700 (2.2 per cent of the labor force). However, the authorities have been promoting industrialization, and they have been encouraging immigration to assure a labor force adequate to meet the needs of such expansion. They have tended, therefore, to fully utilize the existing labor force; the high demand for labor has encouraged a continuing inflow of labor from abroad.

As it developed, the Government's policy of not interfering in national wage decisions proved to have major expansionary consequences. Wage increases in 1958-59 accounted for a 2.6 per cent rise in the weekly earnings, with the result that average weekly earnings rose £2.3 million. The basic wage rate, which is set by the Commonwealth Conciliation and Arbitration Commission, was increased another 6 per cent in June 1959. Although the Government has representatives on the Commission, they did not object to the award.

On the monetary side, the authorities took action to increase the liquidity of the trading banks between July 1958 and June 1959. The Central Bank reduced the banks' special required reserves (Special Accounts)2/ from £282 million to £250 million, even though deposits had grown from £1,558 million to £1,613 million. As a result, the ratio of liquid assets and Government securities to total deposits, (hereafter referred to as the LGS ratio), rose from 18.5 per cent to 22.3 per cent. This was considerably above the 14 per cent minimum LGS ratio which the banks had agreed to maintain; consequently, the banks were in possession of adequate funds to expand bank lending further. Since it was the policy of the Central Bank to permit moderate expansion of bank advances, the monetary authorities decided to encourage such expansion by permitting the trading banks to retain the excess reserves then in their possession. However, they decided to call to the Special Accounts any further increases to bank reserves which occurred after July 1, 1959.

Increasing demand pressures

From mid-1959 onwards, the increase in domestic demand accelerated. Between July 1959 and July 1960, the money supply increased by almost 8 per cent as a result of the growth in bank advances. Imports rose sharply; in the spring of 1960, official holdings of foreign exchange began to decline rapidly. There were also significant increases in retail prices during the period, while wages rose and unemployment was reduced to minimum levels.

2/ A detailed discussion of the Special Accounts and other credit-control devices in effect in Australia is found in "Recent Changes in Australian Banking," December 13, 1960.

During the year ending June 1960, imports rose £150 million to £946 million. The growth in imports accelerated in March 1960 following the liberalization of import controls; they reached an annual rate of £1,125 million in the July-September quarter of 1960. However, favorable export developments helped to finance the growth of imports (see Table 1). The wool clip was at a record level and average wool prices rose 9.7 per cent. In addition, private capital inflows increased.

Table 1

Australia: Selected Balance of Payments 1958-59 and 1959-60
(In millions of Australian pounds)

	1958-59	1959-60
Exports	+ 810	+ 936
Imports	- 796	- 946
Trade balance	+ 14	- 10
Net invisibles	- 221	- 233
Current account balance	- 207	- 243
Capital - official	+ 20	+ 31
private	+ 178	+ 208
Reserve change (official & private)	- 9	- 4

In addition to stimulating imports, the rise in domestic demand also brought sharp increases in retail prices. From mid-1959 to end-October (1960), retail prices rose over 8 per cent; from March to September 1960 the increase was over 5 per cent (see Chart).

The labor market also reflected the strains of boom conditions. Registered unemployment, already down to 2.2 per cent of the labor force in mid-1959 was reduced to 1.5 per cent by mid-1960, in spite of a 2.5 per cent expansion in the labor force. During the July - September (1960) period, unemployment was reportedly reduced below 1 per cent, with vacancies exceeding unemployed for the first time in four years.

Measures of restraint

In accordance with its previously stated policy of absorbing any increases in bank reserves, the Central Bank made calls for Special Deposits in October and November. This was the first restrictive action taken by the monetary authorities. These measures were designed to absorb further increases in bank liquidity resulting from the high exports between July and December 1959. Moreover, the authorities issued about £40 million of short-term Seasonal Treasury Notes during this period to absorb some of the seasonal bank liquidity. About 60 per cent of these notes were held by the general public, and bank reserves were therefore reduced by that amount. Despite this temporary security issue and a £35.1 million increase in calls to Special Accounts, the LGS ratio rose from 22.3 per cent on June 30, to 23.9 per cent on December 30 and deposits increased by £128.4 million.

In early January 1960, with the changeover from the Special Account system to the Statutory Reserve Deposit,[3] the reserve ratio was established at 16.5 per cent, which was the same as the ratio previously in effect under the former system. However, when bank reserves increased further later in January, the Reserve Bank increased the reserve ratio to 17.5 per cent on February 10, 1960. Nevertheless, domestic demand continued to expand. On February 21, 1960, the Prime Minister expressed the Government's concern over the rapid rise in prices and costs. Retail prices had risen about 2 per cent since mid-1959 and wages were up over 4 per cent. He therefore proposed four measures designed to restrain the growing demand and ease the pressure on prices. They were: (1) to have the Reserve Bank act to hold down excessive bank liquidity; (2) to eliminate the budget deficit in the coming fiscal year; (3) to eliminate remaining import restrictions; and (4) to discourage further increases in the basic wage.

The decision by the authorities to intervene in the basic wage case, then before the Commonwealth Conciliation and Arbitration Commission, was their first attempt to influence wage levels. The reason for doing so at that time, according to the Prime Minister, was that the economy had not yet been given time to adjust to wage increases granted in recent months. The Commission therefore rejected the wage request in spite of pressures for higher wages emanating from sharply rising retail prices and declining unemployment.

Some of this pressure for wage increases was eased by the action taken to liberalize import restrictions. The drastic reductions in import controls promised to ease the pressure on prices, first, through increased supplies on the market, and second, through a reduction in the net foreign exchange earnings. On February 23, 1960, the list of imports to be freed of licensing was issued and made effective immediately for all commodities except timber (freed on April 1) and motor vehicles from Canada and the United States (freed on October 1). The entire list represented about 90 per cent of Australia's imports. Moreover, in March 1960, the quotas on the 203 items still subject to licensing, were increased 20 per cent. Sharp rises in imports followed and soon import values reached record levels.

Monetary and fiscal measures were aimed more directly at reducing domestic demand. However, the lag in implementing fiscal measures meant that the appropriate steps could not be introduced before the new fiscal year beginning July 1960. On the monetary side, the authorities took no further steps to increase reserve requirements after the February 10 rise in the bank reserves. However, the Reserve Bank and the trading banks came to an agreement some time during the fiscal year to increase the LGS ratio from 14 to 16 per cent.

3/ See paper cited above for an explanation of this shift.

In August 1960, the Australian authorities took additional steps to curtail the heavy inflow of imports and to control domestic demand pressures. The budget for 1960-61, proposed a surplus of £15 million compared with the £28.9 million deficit realized in the previous year. Moreover, to discourage a continuation of the recent rapid rise in bank advances, the Reserve Bank asked the trading banks to reduce their lending activities, especially their loans for speculative purposes or for use in hire-purchase financing.

Growing pressures on bank liquidity

During recent months there has been growing pressure on trading bank reserves. The banks' average LGS ratio at end-June was 18.8 per cent, the lowest in two years. Earlier the agreed-upon minimum level had been increased from 14 to 16 per cent. As a result, the trading banks were forced to increase their borrowing from the Central Bank to meet loan commitments and maintain adequate reserves. The major factors contributing to the tight market, were the higher reserve ratios established during the year and the contraction due to declining foreign exchange reserves following the upsurge of imports.

By the end of July 1960, the trading banks were borrowing heavily from the Central Bank and their reserves had been reduced close to minimum levels. The trading banks' LGS ratio averaged 18.8 per cent in July; but the average included the high LGS holdings (25.7 per cent) of the State-owned Commonwealth Trading Bank of Australia and the customarily high ratios which a few of the private trading banks maintain. Four of the seven major trading banks were within one per cent of the agreed minimum of 16 per cent (see Table 2). As a result, borrowing from the Central Bank increased £23 million during the June-September period, compared with a rise of only £7.4 million during the six months from end-January to end-July. The borrowing was done largely by the four banks whose LGS ratios are lowest.

Table 2

Australia: Liquid assets of Trading Banks as of July 1960
(In per cent of deposits)

Commonwealth Trading Bank of Australia	25.7
Australia and New Zealand Bank Ltd.	16.3
The Bank of Adelaide	17.6
Bank of New South Wales	18.0
The Commercial Bank of Australia Ltd.	16.8
The Commercial Banking Co. of Sydney, Ltd.	19.4
The English, Scottish and Australian Bank Ltd.	17.8
The National Bank of Australia Ltd.	16.7

Source: Australian Banking Statistics, The Commonwealth Statistician.

The major factor contributing to the recent tightening of bank liquidity was the loss of foreign exchange reserves as the full impact of the import liberalization program took hold. In the May to September (1960) period, imports reached record levels. By the summer of 1960, the wool clip was almost 16 per cent below the 1959-60 volume, and wool prices were declining. Export value began to decline while imports continued to surge upward; these developments led to official foreign exchange losses of about £113 million between beginning June and end-October 1960 (see Chart).

Although the Governor of the Reserve Bank has repeatedly stated that the authorities must maintain a relatively constant interest rate on Government securities if an adequate market is to be assured, yields on shorter-term securities have risen sharply over the last year. The interest return on the 2-year bond in October was 4.35 per cent per annum compared with 3.94 per cent the year before. Moreover, the new issue of Seasonal Treasury Notes is to yield 3.95 per cent compared with 3.05 per cent a year ago.

Recent restrictive measures

On November 15, 1960, the Australian authorities introduced a wide range of additional restrictive measures to bring the loss of reserves under control. These measures can be grouped under three general aims:

(1) To reduce bank credit. Banks were instructed to reduce lending, especially loans for imports, speculative purposes and excessive inventory accumulation, with the intention of reversing the growth in bank lending by March 1961. Higher interest rates are to be applied on bank deposits and bank loans; the new rates went into effect on November 17 following consultations between the Reserve Bank and the trading banks. Deposit rates were raised from 2-1/4 per cent to 4 per cent for three to six months and from 3-1/2 per cent to 4-1/2 per cent for deposits over six months. Average overdraft rates were increased from 5-1/2 per cent to 6 per cent, and the maximum was raised from 6 per cent to 7 per cent. However, preferential borrowing rates are to be offered the export industries.

(2) To reduce consumer spending. The purchase tax on automobiles was raised from 30 to 40 per cent and from a little over 16 per cent to 25 per cent on motor cycles. This industry was responsible for a large part of the increased imports over the last year to meet its production needs. The new tax should also encourage a further expansion in exports of automobiles from Australia.

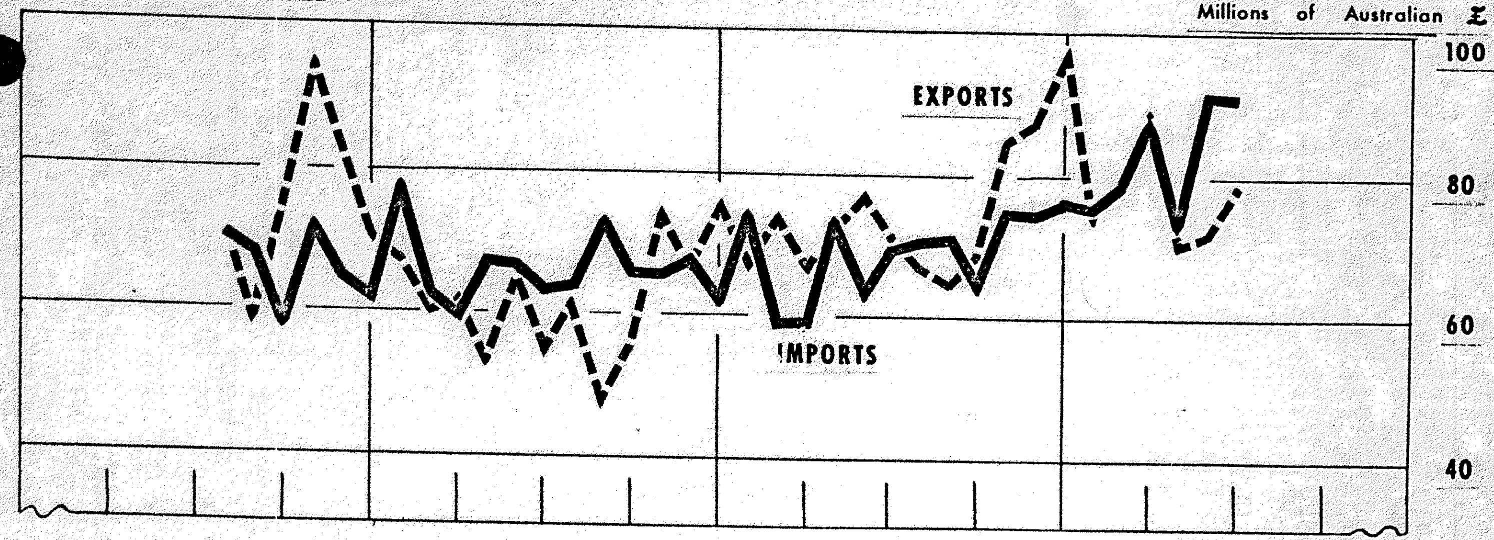
(3) To reduce credit by nonbank lenders. Firms will no longer be able to deduct interest paid on borrowed money against their tax liabilities; as a consequence, they will have to bear the whole cost of funds borrowed from nonbank lenders (frequently at higher rates than are charged for bank loans). This measure is designed to curtail business

borrowing from hire-purchase (instalment credit) companies and from the sale of convertible notes. In addition, legislation has been proposed to require the life insurance companies to keep 30 per cent of their assets in Government securities. However, the authorities have stated that they will not change the coupon rate on Government bonds at this time.

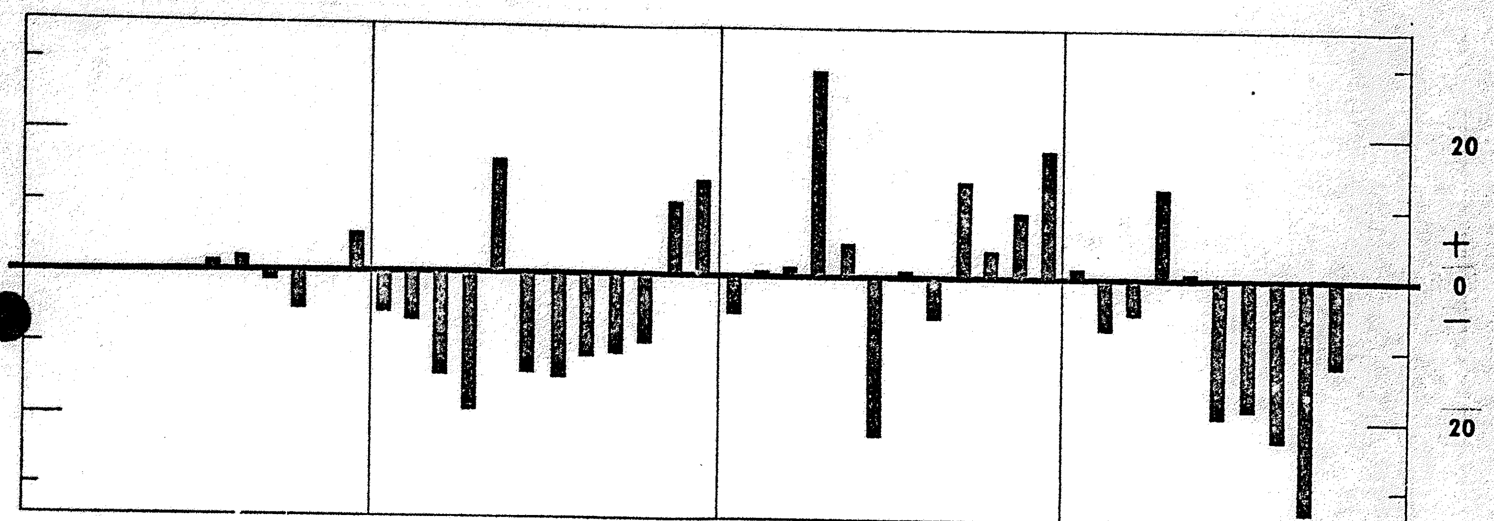
While the above measures will do much to limit demand, they were introduced after earlier measures had already begun to be effective; they may well contribute more to the future control over business expansion than to the immediate problem. Bank reserves had already been reduced to minimum levels as a result of policies established in the last year. The relaxation of import controls resulted in sharp reductions in bank reserves as imports increased. This step and the higher reserve requirements (both Statuatory Reserves and the LGS ratio were raised during the year) resulted in the virtual elimination of excess reserves. By the end of October 1960, just a few weeks before the new restrictions were announced, the trading banks were heavily in debt to the Central Bank and their LGS ratios were close to minimum levels.

The new measures should help to slow down any further expansion and they will improve the degree of control over business expansion in the future. The rise in bank lending and deposit rates, though much delayed, should ease the pressure for bank loans and may encourage further saving. The remaining fiscal measures will probably contribute to holding down total demand over the year; the requirements that insurance companies hold Government securities is designed to eliminate one source of spending previously beyond the direct control of the monetary authorities.

FOREIGN TRADE



CHANGE IN FOREIGN RESERVES



SELECTED PRICE INDICES

Average 3 years ending June 1939