

**FINANCIAL MARKET LIBERALISATION IN NEW ZEALAND:  
AN OVERVIEW**

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## PREFACE

After its election in July 1984 New Zealand's Labour Government embarked on a programme of accelerated economic liberalisation. Perhaps the most thorough liberalisation has occurred in the financial market. In mid-1984 the financial market was heavily regulated under the Prices and Wages Freeze and other regulations, but just four years later New Zealand's financial market is one of the least regulated in the world. In this Research Paper an overview of some aspects of financial market liberalisation is presented. The Paper complements other recently published papers on the same subject.

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Professor A C Zwart  
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## SUMMARY

The main purpose of this paper is to complement other studies of financial market liberalisation in New Zealand that have been published recently. The paper provides a brief summary of the regulatory environments before and after the election of a Labour Government in 1984. Specific aspects of the effects of liberalisation that are discussed include financial deepening, market concentration, profitability, and market structure. Broadly speaking the conclusions are that, since 1984, financial deepening has occurred, neither market concentration nor profitability have altered very much and some significant changes in market structure have occurred.



## CHAPTER 1

### INTRODUCTION

A distinguishing characteristic of economic policy of the Lange Labour Government, first elected in July 1984 and now almost half-way through its second term of office, has been its persistent drive towards removing artificial impediments to competition in markets. The government has sought to make markets more contestable, but the speed of "deregulation" has not been consistent across all markets. Arguably, the speed of deregulation has been most rapid in the financial market. At the time the Labour Government came into office, New Zealand's financial market was the most highly regulated in the western world, largely as a result of stringent regulations invoked by the Muldoon National Government during the Prices and Wages Freeze of June 1982 to November 1984. In late 1988 New Zealand boasts one of the least regulated financial markets in the world.

A small number of studies of the causes and effects of liberalisation of the New Zealand financial market has been published recently. The most comprehensive is Harper (1986) in which regulatory policy in the decade prior to 1984 was surveyed and the causes and effects of reform were studied within an industrial economics framework. Shorter studies are Harper and Karacaoglu (1987), Mayes and Hunn (1987) and Weston (1988). All three studies were generally confined to microeconomic aspects of the financial market. A review of liberalisation that also considered some macroeconomic factors is Spencer and Carey (1988).

Earlier accounts of the factors that led the Government and its advisers to reject pervasive regulation in favour of liberalisation can be found in Reserve Bank of New Zealand (1984, 1986) and Treasury (1984).

The main purpose of this paper is to complement those studies mentioned above by discussing some particular aspects of change in the market. These aspects are: i) financial deepening (an increase in the value of financial assets held by the public), ii) market concentration, iii) profitability, and iv) market structure as measured by institutional shares of deposits and advances. Broadly speaking the conclusions are that: i) financial deepening occurred after 1984, ii) market concentration has not altered significantly since 1984, iii) profitability has not altered significantly since 1984, and iv) there have been some significant changes in market structure as measured by institutional shares of deposits and advances.

A brief review of financial market regulation prior to and after July 1984 is also provided in Section 2 of this paper.



## CHAPTER 2

### REGULATORY FRAMEWORKS BEFORE AND AFTER JULY 1984

#### 2.1 The Regulatory Framework Prior to July 1984

The major theme in financial market regulation prior to 1984 was the maintenance of control over the activities of groups of financial institutions by creating specific market segments. The main means of segmentation were entry restrictions (that were most stringent in the trading bank and savings bank segments) and direct controls on both prices (such as interest on deposit regulations, mortgage interest rate regulations and the "thirty day rule" that forbade trading banks from paying interest on short term deposits) and on portfolio composition (such as various reserve ratios, regulations on terms of fixed deposits, priority lending guidelines and restrictions on savings institutions' transactions with "commercial" depositors and borrowers). Details of these and other regulatory instruments can be found in Deane, Nicholl and Smith (1983) and case studies of their effects on balance sheet growth of groups of the main deposit-taking institutions appear in Jeyasubramaniam (1981), Nicholl and King (1985) and St Hill (1988, Ch 5).

Most of the direct controls could be manipulated by the Minister of Finance or the Executive Council (Cabinet plus the Governor General) under powers enshrined in the Reserve Bank Amendment Act (1936) and subsequent amendments and various other Acts, including the Economic Stabilisation Act 1948 (repealed in 1987). Consequently, control of monetary aggregates was pursued via direct means and governments made little effort either to promote or use secondary markets in government debt. (In part this could have been because direct controls enabled governments to force "captive" institutions to hold government debt at below-market interest rates - in mid-1984 the captive institutions held around 85 percent of the internal government debt not held by the government itself or by government-owned corporations, but by mid-1988 the same institutions, now freed from statutory requirements to hold government securities, held under 50 percent of the internal debt.)

In the early 1970s it became clear that direct controls were encouraging disintermediation (a transfer of deposits from highly-regulated financial institutions to less-regulated institutions). By severely restricting the activities of trading banks, savings banks and building societies, governments had unwittingly aided the development of new financial instruments. Solicitors' nominee companies were first established in 1969 and facilitated the growth of the private mortgage market. (The first full year for which published data are available is 1976/77: solicitors' nominee companies were the source of finance for nearly 11.5 percent

of all new mortgages by value. This was a larger share than that for trading and savings banks combined, for building societies or for life insurance offices.) Impetus for the growth of this market was given by deposit interest rate regulations imposed on M3 institutions and buoyant demand for loans during the commodity price boom of the early 1970's. At this time the commercial bill market also expanded rapidly: from about \$1 million in bills outstanding at the end of March 1970 to over \$100 million and over \$200 million at the end of March 1973 and March 1975 respectively. Finance companies also experienced very rapid growth in the early 1970's. At the end of March 1970 their share of M3 deposits was around 3.4 percent and by 1973 it was around 5.6 percent. Generally speaking, the finance companies were less regulated than the other M3 institutions and, during the latter half of the period March 1972 to March 1976, they benefitted from a positive margin with respect to other M3 institutions under deposit interest rate regulations: at the end of March 1976 finance companies held 8.3 percent of total M3 deposits.

In March 1976 the Muldoon National Government revoked the deposit interest rate regulations and began relaxing a number of other direct controls. Perhaps the most significant actions by the Government, apart from relaxing most interest rate controls were: i) reducing the minimum term for trading bank transferable certificates of deposit from three months to thirty days in March 1978, and allowing them to fully participate in the commercial bill market a month later; and ii) progressively allowing savings banks to directly compete with other institutions for term deposits. Nicholl (1977) observed that the changes in policy left New Zealand with one of the worlds' least regulated financial markets, although this must be qualified by noting that exchange controls curbed international financial transactions.

Removal of direct controls came to an abrupt end in November 1981 when all financial institutions were required to notify proposed increases in lending interest rates to the Reserve Bank prior to their implementation. The Minister of Finance directed the Bank to object to most notifications, effectively imposing a "freeze" on lending rates. This action was a response to rising nominal interest rates (that reflected rising inflation). In June 1982 regulations on deposit interest rates were invoked as part of a Prices and Wages Freeze. These were revoked in November 1983 and replaced almost immediately by mortgage rate regulations. In May 1984 non-mortgage lending rates were regulated and, a month later, deposit interest rate regulations were reinvoked. During 1983 and early 1984 reserve requirements for trading banks, finance companies and building societies were increased. Indeed, the Minister of Finance tried to make it impossible for the trading banks to meet their reserve requirements, by setting the target level of free reserves equal to minus \$50 million in March and April 1984 and minus \$100 million in July 1984.

It is noteworthy that the interventionist fervour of the Minister of Finance during the period November 1981 to July 1984 was quite incongruous when set beside progressive liberalisation that was occurring elsewhere, most notably in the United Kingdom, the United States and Australia.

## 2.2 Causes of Liberalisation After 1984

It is not clear that Sir Robert Muldoon, as Minister of Finance, was always predisposed to direct intervention in the financial market (see, for example, Muldoon, 1985). Certainly his approach between early 1976 and late 1981 indicated that he and the government he led were prepared to ease controls. Furthermore, a "deregulation" sentiment had been building up in the National caucus for some time (see James, 1986, Ch 1). Thus, to some extent, 1981-1984 was an aberration and resulted from financial market policy being hostage to Muldoon's attempt to wring inflation and inflationary expectations out of the economy. At the risk of trivialising policy at that time, it could be said that the basic approach was to temporarily outlaw price and income inflation, supported by restraint on the growth of monetary and credit aggregates (but not by restraint on government deficit spending).

It is now history that in mid-July 1984, after calling an early election (hoping to improve on his Government's slim majority in Parliament), Sir Robert Muldoon suffered a landslide defeat. At least some New Zealanders had rejected "interventionism".

It is also now history that something of a constitutional crisis developed between the date of the election and the time when warrants were issued to ministers in the new government. There had been a sizeable outflow of foreign currency just prior to the election and devaluation became inevitable. The outgoing prime minister ignored the incoming prime minister's advice to devalue. According to David Lange:

"... the first few days of being in government - even before we were sworn in - determined the entire course of this government ... It was a very quick series of decisions, compared with the normal three-year time scale. They were taken between the Monday and the Wednesday of that first week, before we were first sworn in ... By the Wednesday we had ... the devaluation ... (T)here were certain inexorable outcomes. They were that we would float the dollar ... (and that it was) absolutely illogical to carry on with an eastern European-style regulatory structure ..." (National Business Review, 11 July 1986.)

For two versions of the events of those few days see Douglas and Callan (1987, Ch 5) and Muldoon (1985, Ch 12).

The Lange government's approach to controlling inflation was to restrict the rate of growth of monetary and credit aggregates by aggressively marketing government debt. Significant features were the funding of the domestic budget deficit by selling government securities within New Zealand and a reduction in the amount of deficit spending by government. Direct controls on financial institutions therefore had little relevance and many were dispensed with during the first six months of the new government's term. Interest rate regulations were abolished first and, in February 1985, all compulsory reserve ratios were abolished (leaving only the Post Office Savings Bank with a voluntary ratio). On the first business day in March 1985 the New Zealand dollar was "clean" floated (exchange controls had been removed in December 1984). By November 1985 the government had announced plans to remove entry restrictions in commercial banking and since that time it has amended a number of Acts that segmented the financial market.

Despite David Lange's view quoted above, it is hard to believe that the events of the crisis days after the election influenced policy direction, although they almost certainly influenced the speed and sequencing of regulatory reforms. There are a number of reasons for this.

First, it had been clear as far back as the early 1970s that direct controls were encouraging disintermediation. This was a catalyst in the 1976-1981 liberalisation programme. Furthermore, it had been observed overseas that technological advances had forced changes in market structure. For example, Kane (1984) asserted that computer technologies had made it possible for financial institutions to encroach on each others' territories. He noted that the process of financial market liberalisation in America had occurred after the regulatory framework had broken down owing to "structural arbitrage". Structural arbitrage occurred when financial institutions used technological advances to reorganise themselves so as to lighten their regulatory burdens. In the New Zealand context the development of direct credit and debit systems, credit and debit cards and "sweep" accounts could be considered as structural arbitrage. Therefore there had been underlying pressure for a change in the regulatory framework for some time.

Second, as far as monetary control was concerned, government advisers had little faith in direct controls as effective instruments. This was clear from Reserve Bank annual reports, especially those from about 1980 to 1985 and from Treasury (1984) and Reserve Bank of New Zealand (1984 and 1986). The main problem with direct controls appeared to be that they could not reliably influence growth of the balance sheets of financial institutions, possibly because

of the conflict between (macro) monetary policy objectives and (micro) equity objectives. (It appeared that governments wanted to slow down the rate of growth of the monetary aggregates without upsetting market structure). St Hill (1988, Chs 5 and 6) concluded that most direct interventions between 1970 and 1985 had no systematic effects on either: i) the rate of growth of deposits or advances of the major deposit-taking institutions; or ii) market structure in terms of institutional shares of total deposits or advances.

Third, it was clear before the election in 1984 that a Labour government would make less use of direct controls as instruments of monetary policy. Upon election to leadership of the Parliamentary Labour Party in February 1983, David Lange appointed Roger Douglas as his finance spokesperson. Douglas' views on economic policy were by then well-known, after he had published an "alternative Budget" and a book (Douglas, 1980) in which he revealed his attitudes to economic policy. Between early 1983 and the 1984 election Douglas was assertively supported, not only by Mr Lange, but by other caucus members like Geoffrey Palmer, Mike Moore, David Caygill and Richard Prebble (see James, 1986, Chs 8 and 9). Therefore it is hardly surprising that, as Minister of Finance, Roger Douglas set about reforming the regulatory framework (with help from two Associate Ministers, Mr Caygill and Mr Prebble).

### 2.3 The Regulatory Framework After July 1984

The regulatory framework that has evolved since July 1984 has two main features: i) an emphasis on removing artificial segmentation and engendering contestability (Harper and Karacaoglu 1987, call this the "principle of effective competition"); and ii) prudential management via capital requirements and reporting standards.

With respect to the first feature, undoubtedly the most important reform was to open up commercial banking. Any institution can now apply to the Reserve Bank for a licence to call itself a registered bank provided it satisfies the following criteria:

- (a) Issued capital of at least \$30 million, at least \$15 million paid up;
- (b) Main line of business accepting deposits and making loans;
- (c) Expertise in the conduct of banking business and good standing in the financial community;
- (d) A well-spread shareholding or internal controls to prevent undue loan concentration; and

- (e) A willingness to cooperate with the Reserve Bank in all its functions, including prudential management.

The Government has placed no restriction on the number of licences it will issue nor is there any time limit on applications. There are now fifteen registered banks including the four trading banks that existed in 1984.

Another important reform was opening up the payments system to potential competition. This occurred when the Reserve Bank became willing to open settlement accounts for any institution (although at this time the trading banks and Post Bank and three newly-registered banks are the only institutions with settlement accounts).

The prudential management system has not yet been finalised but characteristics that are now well established include:

- (a) A reliance on reporting to the Reserve Bank as a means of early warning of solvency or liquidity problems;
- (b) A determination to manage financial institution failure rather than prevent it (in this regard the Government has withdrawn lender of last resort facilities from trading banks and is withdrawing deposit guarantees from trustee banks and Post Bank);
- (c) A determination to adopt capital adequacy standards along similar lines to those recommended by the Bank for International Settlements; and
- (d) Acceptance of Reserve Bank responsibility for maintaining liquidity of the financial system as a whole.

(See for example, Reserve Bank of New Zealand, 1987a and 1987b).

With respect to monetary policy, direct controls have been replaced by open market operations as the main policy instrument. This has brought New Zealand into line with practice in many other western economies.

## CHAPTER 3

### EFFECTS OF LIBERALISATION

#### 3.1 Introduction

In this section some effects of financial market liberalisation are considered. First, some evidence is presented that suggests that financial deepening has occurred since 1984. This could contribute to future economic growth. Second, the effects of liberalisation on market structure, as revealed by concentration ratios, are discussed. It appears that there have not been any significant changes in overall market concentration since 1984. Nor have there been significant changes in profitability. Third, the effects of liberalisation on market structure, as revealed by changes in institutional shares of deposits and advances are discussed. It is clear that there have been some fairly substantial shifts in market structure measured on these bases.

#### 3.2 Financial Deepening

Financial deepening is a term used to describe the increasing importance of financial assets, such as bank deposits, in an economy over time. Financial deepening is part of the process of evolution of financial institutions, services and instruments as an economy develops. This evolutionary process is usually referred to as financial development.

Systematic studies of relationships between financial development and economic development were first published in Goldsmith (1955) and Gurley and Shaw (1955). Since that time it has become widely acknowledged that increasing sophistication in financial markets enhances prospects for economic development. A commonly used indicator of the depth of the financial market is the ratio of a monetary aggregate to gross domestic product (or change in a monetary aggregate to change in gross domestic product). Some indicators of financial deepening in New Zealand are set out in Table 1. Data for M1 and M3 are averages for each financial year and data for changes in M1 and M3 are March differences. It is clear from the M3 ratios that, from 1984/85 to 1987/88 financial deepening occurred. Also, the ratio of the change in M1 to change in Gross Domestic Product rose substantially in 1985/86 and again in 1987/88. On the whole, Table 1 indicates rapid deepening of the financial market.

It might be argued that at least some of the apparent deepening was the result of the public transferring deposits from non-traditional financial institutions back to the traditional financial institutions where they were

Table 1: Financial Deepening in New Zealand, 1981/82 to 1987/88

Year	M1/GDPx100	M3/GDPx100	$\Delta$ M1/ $\Delta$ GDPx100	$\Delta$ M3/ $\Delta$ GDPx100
1981/82	9.8	54.7	8.8	44.5
1982/83	9.3	59.7	3.8	62.6
1983/84	9.3	56.6	7.8	78.3
1984/85	8.8	60.2	2.0	115.8
1985/86	8.5	65.7	12.0	117.0
1986/87	8.6	66.2	10.1	67.1
1987/88(3)	11.8	72.1	50.1	150.8

Notes:

- (1) M1 comprises notes and coin in the hands of the public and transactions balances (cheque or call deposits) with registered banks, savings institutions and financial corporations.
- (2) M3 comprises M1 plus other funds (mainly term deposits) with registered banks, savings institutions and financial corporations.
- (3) There is a sharp discontinuity in the M1 series in April 1987 when EFTPOS balances were included for the first time.

originally held (reintermediation) after interest rate regulations were lifted in 1984. Although this is a possibility, it should be emphasised that the definitions of money now used in New Zealand are much wider than the earlier ones and embrace both the more traditional institutions such as commercial and savings banks and other institutions such as finance companies and merchant/investment banks.

Some impressions of the degree of reintermediation can be gained from Table 2 in which data on sources of finance of registered mortgages are presented. It is evident from this table that: i) the proportions of mortgages and their value sourced from producer enterprises and solicitors' nominee companies and government all fell after 1983/84 and it appears that the proportions sourced from the "other" category also fell; and ii) the proportions of mortgages and their value sourced from trading banks, trustee banks, building societies and other financial intermediaries generally rose after 1983/84. This evidence implies that some reintermediation occurred after 1983/84 but of course, data in the table only record part of the flow of lending and do not capture any behaviour on the funding side of intermediation (see Section 3.4 for some evidence on the funding side). Some of the adjustment in sources of finance for mortgages undoubtedly reflects removal of compulsory reserve ratios in February 1985.

Table 2: Sources of Finance of Mortgages Registered, 1981/82 to 1987/88

Year	Trading Banks				Trustee Banks				Building Societies				Other Financial Intermediaries			
	Number	Share of Total %	Amount \$m	Share of Total %	Number	Share of Total %	Amount \$m	Share of Total %	Number	Share of Total %	Amount \$m	Share of Total %	Number	Share of Total %	Amount \$m	Share of Total %
1981/82	51,257	25.6	80.7	2.3	21,594	10.8	371.7	10.5	12,760	6.4	259.3	7.3	20,431	10.2	658.4	18.6
1982/83	34,821	21.0	37.9	1.1	13,875	8.4	132.7	3.7	10,110	6.1	227.9	6.4	27,219	12.8	768.2	21.6
1983/84	37,979	21.2	43.6	1.1	16,798	9.4	90.5	2.3	9,862	5.5	243.6	6.1	22,832	12.7	957.9	23.9
1984/85	38,247	20.6	57.1	1.3	18,937	10.2	101.9	2.4	12,423	6.7	308.7	7.2	20,160	10.9	950.6	22.1
1985/86	38,757	20.8	76.7	1.4	14,789	7.9	97.6	1.8	9,652	5.2	320.4	5.8	25,244	13.6	1,546.5	27.9
1986/87	54,900	27.8	93.8	1.5	21,179	10.7	181.9	2.9	14,816	7.5	640.6	10.1	24,574	12.5	1,822.6	28.8
1987/88(1)	27,828	23.5	110.3	2.4	13,678	11.6	157.9	3.4	9,499	8.0	383.2	8.2	16,721	14.1	1,877.5	40.2

Table 2 (cont'd)

Year	Producer Enterprises			Solicitors' Nominee Companies				Government			Other					
	Number	Share of Total %	Amount \$m	Share of Total %	Number	Share of Total %	Amount \$m	Share of Total %	Number	Share of Total %	Amount \$m	Share of Total %	Number	Share of Total %	Amount \$m	Share of Total %
1981/82	7,300	3.6	210.2	5.9	22,843	11.4	513.8	14.5	39,918	19.9	812.0	22.9	24,265	12.1	639.9	18.0
1982/83	6,445	3.9	248.9	7.0	24,338	14.7	591.8	16.6	31,568	19.0	831.3	23.3	23,623	14.2	724.8	20.3
1983/84	6,324	3.5	231.7	5.8	27,105	15.1	738.3	18.4	35,485	19.8	987.0	24.6	22,737	12.7	721.9	18.0
1984/85	6,462	3.5	295.4	6.9	30,126	16.2	772.4	18.0	34,903	18.8	1,040.1	24.2	24,543	13.2	766.4	17.9
1985/86	5,611	3.0	284.2	5.1	25,282	13.6	845.6	15.3	46,840	25.1	1,590.5	28.7	20,122	10.8	772.3	14.0
1986/87	5,714	2.9	317.6	5.0	21,350	10.8	911.4	14.4	37,851	19.2	1,271.1	20.1	16,870	8.6	1,091.1(2)	17.2
1987/88(1)	3,654	3.1	197.9	4.2	11,752	9.9	558.7	12.0	26,592	22.4	745.2	15.9	8,753	7.4	643.5	13.7

Number	TOTAL Amount(\$m)
200,418	3,546
165,999	3,564
179,122	4,015
185,801	4,293
186,297	5,535
197,254	6,330
118,474	4,675

## Notes:

(1) Seven months to October 1987.

(2) There were some very large mortgages raised overseas in this year.

Source: Department of Statistics, Monthly Abstract of Statistics, various.

### 3.3 Market Concentration

Harper and Karacaoglu (1987) noted an apparent lack of concern on the part of policy makers about the possibility of increased concentration in a deregulated financial services industry. They suggested that this was explained by the fact that policy makers were more concerned with contestability than with ensuring that a large number of firms existed. Indeed, as Harper and Karacaoglu pointed out, this was explicitly stated in Reserve Bank of New Zealand (1986, p105). Nevertheless it is still instructive to study data on market concentration.

The most comprehensive data on financial market concentration can be found in Department of Statistics (1985) and relate to 1983/84. Unfortunately, this publication is the first and latest so cannot be used in the present analysis. For the purposes of this paper, concentration data have been prepared using Francis, Allison, Simes and Company (1984, 1985) and KPMG Peat Marwick (1986, 1988), hereafter referred to as FAS and PM. The reason for using two sources was that FAS ceased publication in 1985 and PM commenced in 1986.

The two most commonly used measures of market concentration are the N-firm concentration ratio, which is the percentage market share of the largest N firms in the market, and the Herfindahl-Hirschman index, which is the sum of squared market shares for all sellers in the industry. For discussion of these indices and their limitations see Scherer (1980). Concentration data based on total tangible assets (of surveyed institutions) were computed using FAS and PM and are set out in Table 3. It should be noted that the concentration data for 1985 are different for FAS and PM. The main reason is that FAS is based on balance sheets as at 31 March of each year or the closest balance date to 31 March each year, whereas PM is based on balance dates falling in each calendar year. Also, the PM survey covers fewer institutions (60 in PM, 1986) compared to FAS (75 in FAS, 1985).

The impression conveyed by data in Table 3 is that concentration has not altered much overall given the institutions surveyed (see row "Table Aggregate"). However, opening up commercial banking has obviously had a significant impact on concentration in that sector. It will be interesting to see what happens to concentration in this sector over the next few years.

It is not clear why opening up the financial sector to potential competition has not reduced concentration. High concentration in a contestable market is often indicative of economies of scale, but in financial markets this is probably not the case. The evidence from (mainly United States) empirical research on scale economies indicates that there are no significant scale economies in banking, after a relatively small minimum efficient scale is reached (see, for example, surveys by Benston, 1972; Gilbert, 1984; and

Table 3: Concentration Ratios in the Financial Market

Year	1984(1)		1985(1)		1985(2)		1987(2)	
Class of Institution	Four-Firm(5)	Herf(6)	Four-Firm(5)	Herf(6)	Four-Firm(5)	Herf(6)	Four-Firm(5)	Herf(6)
Trading Banks	100	0.347	100	0.360	100	0.289	100	0.314
Other Registered Banks (3)							76	0.241
All Registered Banks							76	0.195
Private Savings Banks (4)	100	0.271	100	0.280	100	0.378	100(7)	0.502(7)
Trustee Banks	68	0.180	68	0.170	68	0.170	71	0.210
All Savings Banks	68	0.183	69	0.187	69	0.182	76	0.212
Finance Companies, Merchant and Investment Banks	35	0.050	23	0.041	36	0.059	44	0.082
Building Societies	89	0.280	90	0.300	100	0.410	100	0.615
TABLE AGGREGATE	50	0.088	51	0.100	53	0.084	48	0.080

Notes:

- (1) Francis, Allison, Symes and Company. Based on data as at 31 March or closest balance date to 31 March.
- (2) KPMG Peat Marwick. Based on data as at balance dates during each calendar year.
- (3) Registered banks came into being on 1 April 1987.
- (4) By 1987 two private savings banks had been absorbed by their parent trading banks.
- (5) Four-firm concentration ratio based on share of total tangible assets of the institutions surveyed.
- (6) Herfindahl-Hirschman index computed as sum of squared market shares of all institutions surveyed.
- (7) Two banks only.

Sources: Francis, Allison, Simes and Company (1984, 1985).  
KPMG Peat Marwick (1986, 1988).

Greenbaum, 1967). Therefore, economies of scale are unlikely to be the cause of concentration. However, it has recently been noted by Edwards (1986) and Federal Reserve Bank of New York (1986) in the United States and by Harper (1986) in New Zealand, that economies of scope are substantial in the financial services industry. (Economies of scope arise when a single firm can produce a given level of output of multiple products in joint production at lower average total cost than a combination of individual firms each producing a single product.) If this is true, then removing the sources of artificial segmentation of the financial market could be expected to result in increased concentration over time.

The existence of economies of scope does not mean that concentration is necessarily something to be welcomed. There is a substantial body of empirical research in the United States that suggests that concentration is associated with lack of competition (see Heggstad, 1979), although it should be acknowledged that most of these studies applied to regulated (that is, largely non-contestable) markets. It is not possible to include detailed consideration of changes in the degree of competition since 1984 in this paper. However, the studies by Harper (1986) and Spencer and Carey (1988) make it clear that there is a bigger range of financial products available now.

### 3.4 Profitability

As far as profitability is concerned, it appears that most institutions have achieved some healthy profit performances since 1984. Some data on after-tax operating profits are set out in Table 4. How much the profits arise because of concentration is not clear. Profits during the prices and wages freeze were quite high because deposit interest rate regulations brought down the average cost of deposits sooner than mortgage interest regulations brought down the average return on loans (mainly because interest rates on loan agreements were reviewed infrequently and the mortgage interest rate regulations applied immediately to new mortgages but only upon review to existing mortgages). Generally, profit increases were smaller in 1985 and 1986 than in 1984 but picked up again substantially in 1987. The latter result might be a reflection of the fact that, as interest rates on funding for financial institutions fell during 1987, reductions in interest rates on existing loans were lagged (by virtue of review clauses in loan agreements).

In terms of after tax profit, expressed as a percentage of total tangible assets, there were no significant increases between 1984 and 1987 although there was a large increase in finance company profitability between 1986 and 1987. It is noteworthy however, that compared with commercial banks in Australia, the United States and much of

Table 4: After-Tax Profits of Financial Institutions, 1984 to 1987(1)

1984(2)	Profit \$m	Increase in Profit Over Previous Year %
<b>Trading Banks</b>		
Best Performer	53.8	132.1
Worst Performer	19.7	-6.6
Sector	166.0 <u>1.1</u>	68.9
<b>Savings Banks</b>		
Best Performer	7.4	74.8
Worst Performer	0.2	-31.1
Sector	32.2 <u>0.5</u>	14.2
<b>Finance Companies</b>		
Best Performer	9.8	112.0 (3)
Worst Performer	0.2	-46.1
Sector	52.0 <u>1.2</u>	41.7
<b>Merchant and Investment Banks</b>		
Best Performer	4.9	320.8
Worst Performer	0.3	-40.7
Sector	22.2 <u>1.1</u>	69.5
<b>Building Societies</b>		
Best Performer	4.5	n.a.
Worst Performer	0.4	n.a.
Sector	16.4 <u>1.3</u>	n.a.
<b>1985</b>		
<b>Trading Banks</b>		
Best Performer	78.2	39.1
Worst Performer	22.7	-4.0
Sector	222.9 <u>1.0</u>	23.4
<b>Savings Banks</b>		
Best Performer	9.3	94.1
Worst Performer	0.4	-49.7
Sector	36.4 <u>0.5</u>	23.4
<b>Finance Companies</b>		
Best Performer	13.7	356.4
Worst Performer	0.2	-94.1
Sector	62.0 <u>1.0</u>	-18.8

1985 cont'd

Merchant and Investment Banks		
Best Performer	6.5	(4)
Worst Performer	-1.6	(5)
Sector	29.3 <u>0.8</u>	17.8
Building Societies		
Best Performer	5.9	37.9
Worst Performer	0.5	-45.0
Sector	13.9 <u>1.0</u>	-15.2

1986

Trading Banks		
Best Performer	84.3	59.0
Worst Performer	36.1	-29.4
Sector	239.7 <u>1.1</u>	12.4
Savings Banks		
Best Performer	10.7	150.8
Worst Performer	-14.2	(6)
Sector	18.4 <u>0.5</u>	49.4
Finance Companies		
Best Performer	8.9	(7)
Worst Performer	-4.0	(8)
Sector	43.4 <u>0.8</u>	17.9
Merchant and Investment Banks		
Best Performer	31.8	(9)
Worst Performer	-4.5	(10)
Sector	115.9 <u>1.4</u>	93.1
Building Societies		
Best Performer	11.2	86.7
Worst Performer	0.1	-40.4
Sector	23.4 <u>1.2</u>	44

1987

Trading Banks		
Best Performer	125.8	44.8
Worst Performer	36.4	0.8
Sector	314.0 <u>1.1</u>	29.6
Other Registered Banks		
Best Performer	45.2	688.8
Worst Performer	-1.6	(11)
Sector	102.1 <u>1.1</u>	84.0
Other Savings Institutions		
Best Performer	25.8	(12)
Worst Performer	0.3	-38.8
Sector	69.3 <u>0.7</u>	94.1

1987 cont'd

Finance Companies		
Best Performer	15.5	(13)
Worst Performer	-1.6	-62.6
Sector	66.5 <u>1.4</u>	52.5
Merchant and Investment Banks		
Best Performer	33.5	(14)
Worst Performer	-1.5	(15)
Sector	134.0 <u>1.6</u>	89.0

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Notes:

Underlined figures are operating profit after tax expressed as a percentage of total tangible assets.

n.a. = not available

- (1) The surveys upon which data in this table are based were not consistent in coverage of firms between years. Consequently, the table should be considered as indicative only.
- (2) Based on Francis, Allison, Simes and Company (1985).
- (3) Approximate only.
- (4) A loss of \$0.2m became a profit of \$1.0m.
- (5) A profit of \$1.9m became a loss of \$1.6m.
- (6) A profit of \$5.6m became a loss of \$14.2m.
- (7) A loss of \$11.3m became a profit of \$5.3m.
- (8) A profit of \$9.4m became a loss of \$4.0m.
- (9) A loss of \$0.3m became a profit of \$2.1m.
- (10) A profit of \$1.9m became a loss of \$4.5m.
- (11) A profit of \$2.5m became a loss of \$1.6m.
- (12) A loss of \$0.2m became a profit of \$5.0m.
- (13) A loss of \$4.2m became a profit of \$4.2m.
- (14) A loss of \$0.3m became a profit of \$7.6m.
- (15) A profit of \$1.3m became a loss of \$1.5m.

Source: KPMG Peat Marwick, 1986, 1987, 1988.

continental Western Europe, returns on total assets of the trading banks are quite high (see Walsh, 1983). Using Peat Marwick data for Australia in 1987, after tax profit expressed as a percentage of total tangible assets was about 0.7 for trading banks, 0.5 for savings institutions, 0.7 for finance companies and also 0.7 for merchant and investment banks. Thus New Zealand financial institutions appear to have been considerably more profitable than their Australian counterparts in 1987.

The profit results set out in Table 4 are broadly consistent with those of the 1986-87 Enterprise Survey (Department of Statistics, 1988). For the banking (trading banks and savings banks) industry profitability, as measured by the ratio of pre-tax net profit to total income, was 12.7 percent. This compares with 13.5 percent in 1985/86 and 12.0 percent in 1982/83.

Finally, the effects of the sharemarket "crash" in late 1987 have not been reflected in data in Table 4. However a number of smaller finance and contributory mortgage companies have been placed in receivership during 1988.

Some annual reports for 1988 have been published and the general impression is that most financial institutions are still recording relatively high profitability. There is also indirect evidence that profitability is being maintained. In Table 5 markups of groups of financial institutions are set out. For registered banks (the four trading banks and eleven other licenced commercial banks) the markup on average cost of funds in June 1988 was 30 percent; for savings institutions (mainly trust banks and building societies) it was 62 percent; and for financial corporations (mainly finance companies and merchant and investment banks) it was 28 percent. Markups of the savings institutions and financial corporations were higher in June 1988 than they were a year earlier (there are no 1987 data available for registered banks).

The large markup of savings institutions can be partly explained by the fact that some 30 percent of their deposits pay less than 10 percent per year interest; for registered banks the proportion is 15 percent; and for financial corporations the proportion is only one percent. Also, savings institutions have slightly higher operating expenses than other financial institutions because they have extensive retail branch networks and smaller average deposit balances.

Table 5: Markups of Financial Institutions, June 1988

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Registered banks	
Weighted av. cost of funds	13.2 percent
Weighted av. return on loans	17.1 percent
Difference	3.9
Markup	30 percent
Savings institutions	
Weighted av. cost of funds	10.7 percent
Weighted av. return on loans	17.3 percent
Difference	6.6
Markup	62 percent
Financial corporations	
Weighted av. cost of funds	15.1 percent
Weighted av. return on loans	19.3 percent
Difference	4.2
Markup	28 percent
At June 1987 markups were:	
Registered banks	?
Savings institutions	48 percent
Financial corporations	26 percent

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Source: Based on data in Reserve Bank Bulletin, Vol 51, No 3, Tables D1, D2 and I5, adjusted for author's estimates of foreign interest rates.

### 3.5 Institutional Shares of Deposits and Advances

The degree of concentration of financial institutions is one dimension of market structure: a further dimension is the composition of deposits and advances outstanding in the market. In this section, some observations on the consequences of liberalisation for the composition of deposits and advances outstanding are made.

The first observations relate to the distribution of deposits, broadly defined to include notes and coin, commercial bills, government stock and accumulated funds of life insurance offices. Relevant data are set out in Table 6. For comparison purposes data for 1970, 1984 and 1987 are presented. The most significant change in the composition of deposits occurred in the trading bank segment between 1984 and 1987: the trading bank share increased by 13.4 percentage points to almost 42 percent of total deposits. Indeed, the trading banks were the only institutions to record an increase in share between 1984 and 1987, apart from commercial bills. Therefore, it would appear that trading banks gained most from any reintermediation that occurred after mid-1984. It is noteworthy that the finance companies' share remained static between 1984 and 1987 after growing by 10.1 percent between 1970 and 1984. It is possible that removal of interest rate regulations in 1984 enabled trading banks to rapidly expand, but the fact is that the trading banks' share of deposits also grew between 1970 and 1984, albeit at a slower rate.

A problem with the data in Table 6 is that they do not cover the first year of operation of the new registered banks. Unfortunately, owing to changes in Reserve Bank definitions of monetary aggregates and deletion of certain tables from the Bank's quarterly statistical bulletin, it is not possible to update Table 6 to 1988. However it is possible to make some assessment of the effects of registered banks by referring to Table 7. Data in this table conform with the Reserve Bank's new definitions of monetary aggregates.

It appears from Table 7 that the advent of registered banks has had some effect on the composition of M3 funding between 1987 and 1988. The share of their "other funds" out of total M3 has increased significantly from about 41 percent to 53 percent. Another significant change in composition was that savings institutions' other funds fell from 34.1 percent in 1981 to 19.2 percent in 1988. This rather dramatic result might partly reflect the fact that deregulation of the activities of trustee banks and building societies lagged behind that of some other market segments (for example, the Trustee Bank Amendment Act was not passed until mid-1988 and did not come into effect until 1 October). Also, private savings banks are now included with registered banks for statistical purposes.

Table 6: Distribution of Deposits, Selected Years(1)

As at 31 March (2)		1970			1984			Change in		1987			Change in
Type of Deposit		Amount	Share	Rank	Amount	Share	Rank	Share 1970-84	Amount	Share	Rank	Share 1984-87	
		\$m	%		\$m	%		% points	\$m	%		% points	
Notes and Coin		169	3.7	8	652	2.4	10	-1.3	868	2.1	9	-0.3	
Trading Banks	- demand	595)	12.9)		2,420)	8.9)		-4.0)	3,737)				
	- fixed	203)	4.4)	17.3	5,208)	19.2)	28.2	14.8)	13,367)	17,104	41.7	+13.5	
Private Savings Banks	- demand	166)	3.6)		373)	1.4)		-2.2)	257)				
	- fixed	161)	3.5)	7.1	397)	1.5)	2.8	-2.0)	179)	436	1.1	-1.7	
Trustee Banks	- demand	312)	6.8)		810)	3.0)		-3.8)	973)				
	- fixed	120)	2.6)	9.4	2,206)	8.2)	11.1	5.6)	3,052)	4,025	9.8	-1.3	
Post Office Savings Bank	- demand	647)	14.0)		974)	3.6)		-10.4)	850)				
	- fixed	276)	6.0)	20.0	1,417)	5.2)	8.8	-0.8)	1,385)	2,235	5.5	-3.3	
Finance Companies	- demand	22)	0.5)		543)	2.0)		1.5)	1,217)				
	- fixed	77)	1.7)	2.1	2,764)	10.2)	12.2	8.5)	3,789)	5,006	12.2	3	
Building Societies	- demand	101)	2.2)		565)	2.1)		-0.1)	692)				
	- fixed	102)	2.2)	4.4	763)	2.8)	4.9	0.6)	1,300)	1,992	4.9	6	
Stock and Station Agents	- demand	48)	1.0)		84)	0.3)		-0.7)	73)				
	- fixed	18)	0.4)	1.5	89)	0.3)	0.6	-0.1)	135)	208	0.5	11	
Official Money Market (net)	- demand	38)	0.8)		51)	0.2)		-0.6)	(6)				
	- fixed	10)	0.2)	1.0	7)	(5)	0.2	-0.2)	(6)				
Commercial Bill Market (net)		1 (4)	(5)	13	768	2.8	9	2.8	1,368	3.3	7	+0.5	
Life Insurance Offices		1,219	26.5	1	5,325	19.7	2	-6.8	6,417	15.7	2	-4.0	
Central Government Stock (3)		143	3.1	9	1,561	5.8	6	2.7	1,249	3.0	8	-2.8	
Local Authority Stock (3)		180	3.9	7	81	0.3	12	-3.6	72	0.2	12	-0.1	
TOTAL		4,608	100.0		27,058	100.0		-	40,980	100.0		-	
of which: demand		2,098	45.5		7,240	26.8		-18.7	10,035	24.5		-2.3	
fixed		2,510	54.5		19,818	73.2		18.7	30,945	75.5		+2.3	

## Notes:

- (1) Wherever possible double counting has been avoided by using data that have been adjusted for deposits which institutions hold with each other.
- (2) Or closest balance date to 31 March.
- (3) Excludes holdings by government and private sector entities and by financial institutions.
- (4) Author's estimate.
- (5) Not significant.
- (6) Official short term money market ceased to exist in 1986.

Sources: Department of Statistics, Monthly Abstract of Statistics, various.  
Reserve Bank of New Zealand, Bulletin, various.  
Registrar of Building Societies Annual Report various

Table 7: Distribution of Funding of M3 Institutions, Selected Years(1)

As at 31 March (2)	1981	Share of M3	1984	Share of M3	1987	Share of M3	1988	Share of M3
	\$m	%	\$m	%	\$m	%	\$m	%
Notes and Coins (3)	544	4.2	652	3.3	868	2.3	846	1.9
Transaction Account Balances (4)								
Registered Banks	1,930	14.8	2,567	13.0	3,737	9.9	4,998	11.2
Savings Institutions	98	0.7	217	1.1	531	1.4	1,608	3.6
Less Inter-Institutional Transactions Balances and Government Deposits	86	-	142	-	178	-	150	-
M1	2,486		3,289		4,598		7,302	
Other Funds								
Registered Banks	5,522	42.2	7,625	38.5	15,362	40.6	23,534	52.6
Financial Corporations	2,432	18.6	5,196	26.3	13,088	34.6	10,483	23.4
Savings Institutions	4,463	34.1	6,363	32.2	8,351	22.1	8,606	19.2
Less Other Inter-Institutional Funding and Government Deposits	1,831		2,692	-	3,966	-	5,166	-
M3	13,072		19,781		37,793		43,136	

Notes:

- (1) Institutions covered are the Reserve Bank, registered banks, stock and station agents, finance companies, merchant banks, the Rural bank, building societies, PostBank, savings banks, and the Public Service Investment Society.
- (2) Or closest balance date to 31 March. First data available are for 1981.
- (3) Notes and coins on issue from the Reserve Bank minus till money of the registered banks.
- (4) Balances that are subject to chequing or 'EFT-POS' facilities, or in sweep accounts.

Source: Reserve Bank of New Zealand, Bulletin, various issues.

Another interesting observation is that the share of notes and coin in M3 has declined in each of the years included in the table. This probably reflects greater use of electronic funds transfer facilities and is not likely to be a direct result of financial market liberalisation.

Changes in the composition of advances (or "claims") are set out in Tables 8 and 9. In Table 8 data relate to M3 institutions as defined prior to liberalisation. In Table 9 data relate to M3 institutions as they are presently defined. The latter definition includes more types of financial institution than the former (see notes to each table).

It is clear from Table 8 that the share of government in total claims fell substantially between 1970 and 1984. This was more than offset by a rise in the share of the private sector. It is also apparent from the table that trading banks experienced a substantial proportional rise in claims on both government and the private sector. In contrast, savings banks experienced a decline in their claims on government as a proportion of total claims. The change in savings banks' claims on government mainly reflects: (i) steady reduction of the required reserve ratios for private savings banks and trustee banks between 1970 and 1980; and (ii) growth in the trading banks' balance sheets.

The most significant change in the data in Table 8 between 1984 and 1987 was the increase in Reserve Bank holdings of government securities. This was a reflection of the emphasis placed on open market operations after the change of government in 1984.

As at 31 March(2) Claims on:	1970		1984		Change in Share 1970-84 % points	1987		Change in Share 1984-87 % points
	Amount \$m	Share %	Amount \$m	Share %		Amount \$m	Share %	
<b>Government</b>								
Reserve Bank(3)	-63	-	-384	-	-	1,188	3.7	-
Trading banks(4)	32	1.1	2,948	11.2	10.1	3,541	11.0	-0.2
Savings banks(5)	1,504	50.2	3,191	12.1	-38.1	2,623	8.2	-3.9
Coins in circulation	19	0.6	75	0.3	-0.3	83	0.3	0
Other M3 institutions(5)	74	2.5	442	1.7	-0.8	471	1.5	-0.2
<b>Total Government</b>	<b>1,567</b>	<b>52.3</b>	<b>6,272</b>	<b>23.8</b>	<b>-28.5</b>	<b>7,906</b>	<b>24.6</b>	<b>0.8</b>
Marketing and Stabilisation(6)	181	6.0	1,405	5.3	-0.7	-40	-	-
<b>Private Sector</b>								
Trading banks	667	22.2	10,058	38.1	15.9	14,142	44.0	5.9
Savings banks	155	5.2	3,267	12.4	7.2	4,015	12.5	0.1
Other M3 institutions	247	8.2	4,813	18.2	10.0	5,764	17.9	-0.3
<b>Total Private Sector</b>	<b>1,069</b>	<b>35.6</b>	<b>18,137</b>	<b>68.7</b>	<b>33.1</b>	<b>23,922</b>	<b>74.4</b>	<b>5.7</b>
<b>Overseas(7)</b>								
Reserve Bank	98	3.3	319	1.2	-2.1	331	1.0	-0.2
Trading banks	91	3.0	429	1.6	-1.4	397	1.2	-0.4
Other	-5	-	-178	-	-	-353	-	-
<b>Total Overseas</b>	<b>183</b>	<b>6.1</b>	<b>571</b>	<b>2.2</b>	<b>-3.9</b>	<b>375</b>	<b>1.2</b>	<b>-1.0</b>
<b>TOTAL</b>	<b>2,999</b>	<b>100.0</b>	<b>26,385</b>	<b>100.0</b>		<b>32,163</b>	<b>100.0</b>	

Notes:

- (1) Institutions covered are the Reserve Bank, trading banks, savings banks, stock and station agents, finance companies and official short-term money market dealers.
- (2) Or closest balance date to 31 March.
- (3) Reserve Bank holdings of Government securities (at book value) and New Zealand coins plus advances to the State less Government deposits.
- (4) Trading bank holdings of Government securities (at book value) and New Zealand coins less Government deposits.
- (5) Holdings of Government securities (at book value).
- (6) Reserve Bank advances and discounts to marketing organisations plus certain export credits, less marketing deposits and stabilisation deposits at Reserve Bank.
- (7) Overseas claims are defined as foreign assets less all foreign liabilities (excluding shareholders funds). 'Other' represents estimated claims of finance companies.

Source: Reserve Bank of New Zealand, Bulletin, various issues.

In Table 9 data on the distribution of claims based on the current definition of M3 are presented. The data reveal a substantial increase in the share of private sector credit in domestic credit between 1984 and 1988 and a decrease in the share of government credit. The increase in the shares of private sector credit by registered banks is consistent with that for trading banks in Table 8.

It is noteworthy that the increase in the share of private sector credit between 1984 and 1987 in Table 9 is much larger than the increase recorded for the total private sector in Table 8. The difference between the tables is that Table 9 includes more institutions than Table 8.

It is also clear from Table 9 that savings institutions have reduced their holdings of government securities. This reflects removal of compulsory reserve ratios in February 1985 and a reallocation of some savings institutions to the registered banks category.

To complete this discussion it would be useful to briefly comment on some of the effects of the removal of foreign exchange controls that occurred in late 1984. Unfortunately, there are insufficient data available prior to April 1987 that would enable some assessment of the effects on funding and claims of financial institutions of this part of the liberalisation policy. Some of the data that are available are presented in Table 10. Comparing June 1988 to April 1987, there was a small reduction in the proportion of foreign currency funding for registered banks and increases for savings institutions and financial corporations and small increases in the proportion of foreign currency claims for all three groups of institutions. It is possible that larger increases in foreign currency funding and claims occurred in 1985 and 1986 and that some sort of "equilibrium" between foreign and domestic currency balance sheet items has now been established.

Finally, the reduction in claims on marketing and stabilisation schemes reflects the abolition of Reserve Bank funding of various agricultural marketing boards.

Table 9: Distribution of Claims of M3 Institutions, Selected Years(1)

As at 31 March(2)	1981	Share of DC	1984	Share of DC	1987	Share of DC	1988	Share of DC
Gross Claims on:	\$m	%	\$m	%	\$m	%	\$m	%
<b>Private Sector</b>								
Registered Banks	5,148	33.1	7,497	29.5	16,343	36.5	25,906	50.1
Financial Corporations	4,104	26.4	7,916	31.2	15,839	35.3	13,727	26.9
Savings Institutions	2,606	16.7	3,854	15.2	6,787	15.1	8,931	17.5
Reserve Bank	4	n.s.	10	n.s.	20	n.s.	24	n.s.
Less Inter-Institutional Claims	1,124	-	1,657	-	2,817	-	5,238	-
<b>Private Sector Credit</b>	<b>10,738</b>	<b>69.0</b>	<b>17,620</b>	<b>69.4</b>	<b>36,172</b>	<b>80.7</b>	<b>43,350</b>	<b>84.8</b>
Marketing and Stabilisation(3)	600	3.9	1,006	4.0	-40	-	-69	-
<b>Government</b>								
Registered Banks(4)	1,857	11.9	2,819	11.1	3,798	8.5	4,340	8.5
Financial Corporations(5)	301	1.9	859	3.4	1,284	2.9	1,846	1.7
Savings Institutions(5)	2,097	13.5	3,139	12.4	2,346	5.2	1,614	3.2
Reserve Bank(6)	-75	-	-126	-	1,188	2.6	1,928	1.8
Coins in Circulation	45	0.3	62	0.2	83	0.2	97	0.2
<b>Government Credit</b>	<b>4,225</b>	<b>27.1</b>	<b>6,753</b>	<b>26.7</b>	<b>8,699</b>	<b>19.4</b>	<b>7,825</b>	<b>15.3</b>
<b>Domestic Credit(7)</b>	<b>15,563</b>		<b>25,379</b>		<b>44,831</b>		<b>51,106</b>	

Notes:

n.s. = not significant

- (1) Institutions covered are the Reserve Bank, registered banks, stock and station agents, finance companies, merchant banks, the Rural Bank, building societies, PostBank, savings banks, and the Public Service Investment Society.
- (2) Or closest balance date to 31 March. First data available are for 1981.
- (3) Reserve Bank advances and discounts to marketing organisations plus certain export credits, less marketing stabilisation deposits at Reserve Bank.
- (4) Registered Banks' holdings of Government securities (at book value) and New Zealand coins, less Government deposits.
- (5) Holdings of Government securities (at book value).
- (6) Reserve Bank holdings of Government securities (at book value) and New Zealand coins plus advances to the state less Government deposits.
- (7) Domestic credit equals the sum of the claims of 'selected financial institutions' on the three sectors of the domestic economy, Government, marketing and stabilisation, and private sector. Abbreviated as "DC" in column headings.

Source: Reserve Bank of New Zealand, Bulletin, various issues.

Table 10: New Zealand Dollar and Foreign Currency Funding and Claims, 1987 and 1988

As at end of:	Funding		Claims	
	Amount \$m	Share of Total %	Amount \$m	Share of Total %
<b>April 1987</b>				
<b>Registered Banks</b>				
- NZ dollar	19,788	89.4	16,788	89.7
- Foreign currency	2,354	10.6	1,925	10.3
- Total	22,142	100.0	18,713	100.0
<b>Financial Corporations</b>				
- NZ dollar	13,057	73.8	16,556	84.1
- Foreign currency	4,625	26.2	3,132	15.1
- Total	17,682	100.0	19,688	100.0
<b>Savings Institutions</b>				
- NZ dollar	9,002	94.9	7,163	93.0
- Foreign currency	485	5.1	542	7.0
- Total	9,487	100.0	7,705	100.0
<b>June 1988</b>				
<b>Registered Banks</b>				
- NZ dollar	29,491	88.8	26,060	89.8
- Foreign currency	3,729	11.2	2,954	10.2
- Total	33,220	100.0	29,014	100.0
<b>Financial Corporations</b>				
- NZ dollar	9,740	74.3	13,412	89.3
- Foreign currency	3,375	25.3	1,607	10.7
- Total	13,115	100.0	15,019	100.0
<b>Savings Institutions</b>				
- NZ dollar	10,664	95.8	9,307	95.1
- Foreign currency	473	4.2	481	4.9
- Total	11,137	100.0	9,788	100.0

Note: Inter-institutional transactions have not been netted out in this table.

Source: Compiled from Reserve Bank of New Zealand, Bulletin, Vol.51, No.3, 1988, Tables D1 and D2.



## CHAPTER 4

### CONCLUDING COMMENTS

The discussion in this paper has been deliberately selective so as not to cover too much of the ground already covered by other students of financial market deregulation in New Zealand.

In Section 2 it was suggested that, prior to the election in 1984, there were pressures for liberalisation at both the economic and political levels. The events surrounding the Prices and Wages Freeze of 1982 to 1984 and the election in 1984 probably served to increase the speed of regulatory reform.

Already, some effects of deregulation are apparent. Relevant conclusions from Section 3 of this paper include:

- (a) Financial deepening has occurred since 1984;
- (b) Some reintermediation occurred after mid-1984;
- (c) Market concentration in the financial services industry has not altered markedly;
- (d) Profits of financial institutions have generally increased since 1984 but, when expressed as a percentage of total tangible assets, profits have not altered much except for finance companies; and
- (e) There have been some significant changes in institutional shares of deposits and advances.

In conclusion, it is worth emphasising that deregulation in the New Zealand financial services industry has occurred at a very fast speed since 1984. New Zealand now probably has the least regulated financial market in the world. It is only four years since the market was shackled by pervasive direct controls and it is probably safe to say that the effects of liberalisation have by no means worked themselves out yet. Tracking the effects of liberalisation as the market evolves over the next few years will be a fascinating academic challenge.



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