

If the year 1914 is taken as the base the increase up to the end of 1918 amounted to 214 per cent. The percentage increase in the volume of money in circulation is lower than this figure, as part of the note issue replaced gold coins which before the war were in circulation and which since the war have gradually been withdrawn. The bulk of the business of New Zealand, however, is effected not by cash—i.e., coin or notes—but by means of bank deposits subject to cheque. Bank deposits (including the figures for the Post Office and private savings-banks, but excluding the interest-bearing deposits of trading banks) increased considerably, as shown by the following table:—

Table showing the Yearly Totals of Deposits, together with a Series of Index Numbers on the Figures for the Year 1910, which are equated to 1000.

Year.	Amount in Thousands. £	Index Number.	Year.	Amount in Thousands. £	Index Number.
1910 ..	30,109	1000	1915 ..	44,285	1471
1911 ..	33,443	1111	1916 ..	52,771	1753
1912 ..	33,299	1106	1917 ..	61,067	2028
1913 ..	34,092	1132	1918 ..	67,990	2258
1914 ..	37,836	1257			

If 1914 is taken as the base the increase in deposit currency up to the end of 1918 amounted to 80 per cent.

Thus, concurrently with a decrease in the volume of business on the one hand amounting to 9.2 per cent., there was on the other hand an increase in note-circulation amounting to 214 per cent., and an increase in deposits subject to cheque of 80 per cent., and these changes in the relationship that exists between volume of business and currency (in its widest sense) found expression in a general rise in prices.

The statistics on which the figures are based have been compiled by the Government Statistician at the request of the Board, and are shown in Appendix C.

Rise in Prices.

As the expansion of the currency—including in this term not only monetary currency proper but bank deposits subject to cheque and their respective velocities of circulation—has in the Board's opinion been the most important factor in raising the general level of prices, we propose to trace the processes of inflation that have undoubtedly taken place during the war period.

From the above table it will be seen that the note currency increased by 214 per cent., and deposit currency by 80 per cent., and these increases were brought about mainly through the machinery of banking and credit. This requires a little explanation. The amount standing to the credit of depositors in banks constitutes the rights of those depositors to consume goods and services, and these rights may be termed *general purchasing-power* which may be exercised at any time by the depositors. Banks, however, relying on the improbability of these rights being exercised to any great extent at one time, conduct a profitable business by transferring them temporarily to others against merchandise and other security, keeping a small reserve in legal tender currency for the satisfaction of those depositors who may desire it. Depositors draw on their accounts by cheque—that is, they exercise their rights to general purchasing-power continually from day to day—but the persons to whom they transfer these rights usually retransfer them to the same or some other bank. In business parlance cheques drawn on a bank are usually paid in by the holders to the credit of their accounts in the same or some other bank without the use of coin or other legal tender currency.

The claims of depositors may thus be satisfied to practically any extent and used as purchasing-power for a multitude of transactions, provided they do not take the form of demands for currency, without obliging the banks as a whole to reduce their loans or investments. Subject to the same proviso the banks may create fresh rights in favour of borrowers to an extent limited only by the amount of security which may be offered and their own discretion. The cheques drawn on a bank in virtue of these loans will be paid in by the holders to their accounts in the same and other banks, and the only change in the aggregate position of the banks will be an enlargement of their loans on the one side, balanced by the enlargement of their deposits on the other.

The probability that currency will be demanded is always present, and for this reason banks, under normal conditions, work with a constant eye to the necessity of keeping their small reserve of currency up to the ratio of their deposits which they consider compatible with safety. This consideration operates in normal times as a check on the undue expansion of loans, which must lead to diminution of the ratio of reserve of currency to deposits, either by a fall in the former or a rise in the latter.

In normal times the only legal tender currency is gold. The amount of loans is therefore more or less strictly limited by the amount of gold available.

But immediately on the outbreak of the war the Banking Amendment Act, 1914, was passed. This Act gave power to the Governor-General in Council by Proclamation to declare bank-notes payable on demand legal tender on condition that the Governor-General in Council was satisfied—

- (a) In the case of a bank having its head office situated in New Zealand, that as between the bank and its creditors the assets of the bank exceeded its liabilities by at least the amount of its paid-up capital;
- (b) In the case of a bank having its office situated outside New Zealand, that as between the bank and its creditors the assets of the bank within New Zealand exceeded its liabilities.