

1939.

NEW ZEALAND.

RESERVE BANK OF NEW ZEALAND.

ANNUAL REPORT OF THE BOARD OF DIRECTORS AND STATEMENT OF ACCOUNTS FOR THE YEAR
ENDED THE 31st MARCH, 1939.*Presented to both Houses of the General Assembly pursuant to Section 20 of the Reserve Bank of New Zealand Amendment Act, 1936.*

ANNUAL REPORT.

To the Hon. the MINISTER OF FINANCE:

THE Board of Directors reports as follows on the operations of the Reserve Bank during the financial year ended the 31st March, 1939.

After making such provision as the Board thinks proper for depreciation in assets, superannuation and retiring-allowances for the staff and other purposes deemed to be advisable in the circumstances, the net profit for the year totalled £250,285 10s. 4d. This amount has since been paid to the Consolidated Fund in conformity with the requirements of the Reserve Bank of New Zealand Amendment Act, 1936, no request having been made for any payment in advance in accordance with the provisions of section 11 of the Finance Act, 1934.

Despite an increase of approximately 20 per cent. in expenses—occasioned mainly by larger supplies of bank-notes and additions to the staff and to office accommodation consequent upon the expansion of the note-issue and the introduction of exchange control, as well as by normal increases in salaries—the profit again showed a substantial advance on the amount realized in previous years.

The principal factors responsible for the larger profit were:—

- (i) An increase in the return from advances to the State;
- (ii) Additions to the total holding of investments; and
- (iii) Heavier sales of sterling.

As has been pointed out in previous reports, however, whilst net sales of sterling yield an immediate exchange profit, they do so at the expense of the future earning-power of the Bank's sterling assets.

The yield on British Treasury Bills, in which the main part of the Bank's sterling reserve is invested, continued at a low rate, the average yield obtained by the Bank from that source once more being not much in excess of one-half of one per centum per annum.

The principal changes in the balance-sheet, in comparison with the figures at the close of the previous year, were as under:—

LIABILITIES.

Bank-notes.

As in the previous year, the total of notes outstanding (consisting of the combined holdings of the public and the trading banks) was consistently higher than on the corresponding dates of the previous year. The amount outstanding at the end of the year (£15,246,970 10s.) exceeded the figure at the 31st March, 1938, by £1,693,424.

The effective note-circulation—that is, notes held by the public—increased from £9,536,178 on the 28th March, 1938, to £11,175,725 on the 27th March, 1939.

This increase is a continuation of the expansion movement which was noticed last year, and was in a measure to be expected in view of the further increase in the national wages bill and in the rise in retail prices which took place.

Demand Liabilities.

(a) *State*.—The total of the balances under this heading declined by £1,751,448 8s. 2d. during the year. The cash resources of the various Government Departments were naturally reduced to a low level as the State was heavily indebted to the Bank at the end of the year, whereas there were no such advances—apart from those to the Primary Products Marketing Department—outstanding at the beginning of the year.

(b) *Banks*.—The increase of £2,872,339 10s. 1d. in these balances was due in the main to the expenditure by the Government of sums advanced by the Reserve Bank after the suspension of the Bank's obligation to sell sterling. Until that time the increase in the trading-banks' deposits resulting from accommodation granted to the State was offset by purchases of sterling to meet the requirements of their customers. A further factor offsetting the increases in these balances was the expansion of the circulation of Reserve Bank notes.

During the whole of the year the banks maintained balances in excess of their statutory obligations. The aggregate of the minimum balances on the 31st March, 1939, was £3,526,186, their free balances thus amounting at that date to £4,823,927.

The powers conferred by section 23 of the Reserve Bank of New Zealand Amendment Act, 1936, were not used to raise the percentage of the minimum balances.

ASSETS.

Sterling Exchange.

The sterling exchange eligible as a reserve for notes in circulation and other demand liabilities decreased during the year by the equivalent of £(N.Z.)11,872,002 9s. 5d. This decrease was due mainly to the fact that the Bank's sales of sterling to the trading banks greatly exceeded the surplus available from the proceeds of the sale of dairy-produce in London after providing for the Government's sterling requirements; in addition, there were considerable sales of sterling to the public prior to the suspension, on the 7th December, 1938, of the Bank's obligation to give sterling in exchange for its notes in accordance with section 16, subsection (1), of the Reserve Bank of New Zealand Act, 1933.

Advances.

To the State or State Undertakings :—

- (i) *Primary Products Marketing Department*: The total under this heading, which includes the overdrafts on the Dairy Industry Account and on the Internal Marketing Account, was £2,034,612 17s. 9d. higher on the 31st March, 1939, than a year previously. Further particulars of the operations on these accounts are given below.
- (ii) *Other Purposes*: Of the total amount of £12,225,000 advanced under this heading, £5,600,000 was on account of the Government housing programme, and the rest was for general purposes. All these advances were provided against the issue of Treasury bills to the Bank.

Investments.

The increase of £1,266,379 19s. 2d. is accounted for in part by the fact that the total of investments at the 31st March, 1938, was temporarily reduced by allowing certain State Departments to take over some of the Bank's securities for a short time, thus employing their surplus cash balances.

ADVANCES TO THE PRIMARY PRODUCTS MARKETING DEPARTMENT.

Particulars of the accommodation granted to the State in the two accounts operated by the Primary Products Marketing Department are shown in the following tables :—

(a) Dairy Industry Account.

Date.	Amounts advanced.	Repayments.			Balance of Advance outstanding at End of Month.
		In London.	In New Zealand.	Total.	
(000 omitted.)					
1938.	£(N.Z.)	£(N.Z.)	£(N.Z.)	£(N.Z.)	£(N.Z.)
April	1,388	2,644	17	2,661	3,872
May	2,380	2,414	45	2,459	3,793
June	1,476	1,543	35	1,578	3,691
July	2,186	2,222	17	2,239	3,638
August	1,517	1,772	25	1,797	3,358
September	1,746	1,335	22	1,357	3,747
October	1,927	1,827	23	1,850	3,824
November	2,308	1,393	27	1,420	4,712
December	2,861	1,968	81	2,049	5,524
1939.					
January	2,682	2,154	33	2,187	6,019
February	2,515	1,868	52	1,920	6,614
March	2,516	1,913	294	2,207	6,923
	25,502	23,053	671	23,724	..

The repayments during the month of March included the sum of £276,850 8s. 5d. transferred from the Consolidated Fund in repayment of the deficit incurred in respect of the operation of the account for the year ended the 31st July, 1937.

Valuing the stocks of butter and cheese on hand at the 31st March, 1939, at the then current market prices, and allowing for the cost of realization, the Dairy Industry Account showed an estimated deficit of approximately £1,000,000 at that date. Since then, however, prices of dairy-produce in London have fallen still further, and there appears to be every prospect of a substantial increase in the deficit by the end of the current production year (31st July).

To the extent that such deficits exist they represent the creation of credit beyond the equivalent of commodities produced, and the Board considers it important that the inflationary tendency of such accommodation should not be overlooked.

(b) Internal Marketing Account.

Date.	Advances.	Receipts.	Balance.
(000 omitted.)			
1938.	£(N.Z.)	£(N.Z.)	£(N.Z.)
April	97	96	57
May	157	113	101
June	284	155	230
July	175	195	210
August	164	200	174
September	303	333	144
October	245	182	207
November	173	189	191
December	188	172	207
1939.			
January	129	137	199
February	156	141	214
March	268	169	313
	2,339	2,082	..

MANAGEMENT OF THE PUBLIC DEBT.

No new public issues or offers of conversion were made during the year.

STATE ADVANCES CORPORATION.

The list of applications for the 3½ per cent. guaranteed stock or debentures (Series "B") due 1st June, 1944, remained open during the whole of the year.

DISCOUNT RATE.

The minimum rate at which the Bank is prepared to discount or rediscount bills was raised from 2 per cent. to 4 per cent. as from the 19th November, 1938, following on the heavy drain on the Bank's sterling resources which had occurred.

The movements in the rate since the Bank commenced operations have been as under :—

	Per Cent.
As from 1st August, 1934	4
As from 29th July, 1935	3½
As from 2nd March, 1936	2½
As from 29th June, 1936	2
As from 19th November, 1938	4

EXCHANGE RATE.

The rates at which the Reserve Bank was prepared to pay its notes in sterling, and to issue notes in exchange for sterling or gold, remained unchanged at £125 (N.Z.) and £124 (N.Z.) respectively, for £100 sterling until the statutory obligation to redeem notes in sterling was suspended under powers conferred by section 16 of the Reserve Bank of New Zealand Amendment Act, 1936. The buying-rate for sterling has remained unchanged.

On the 21st October, 1938, the trading banks altered their selling and buying rates for telegraphic transfers of sterling from £124 10s. (N.Z.) and £124 (N.Z.), respectively, to £125 (N.Z.) and £124 10s. (N.Z.) respectively, for £100 sterling; the buying-rate was subsequently reduced to £124 7s. 6d. (N.Z.) on the 4th January, 1939.

EXCHANGE CONTROL.

The introduction of exchange control on the 7th December, 1938, directly concerned the Bank, firstly, by the suspension of the obligation to redeem notes in sterling, and secondly, by the operation of section 10 of the Reserve Bank of New Zealand Amendment Act, 1936, whereby the Bank is charged with the general duty of regulating and controlling the transfer of moneys to or from New Zealand, and the disposal of moneys that are derived from the sale of any New Zealand products and for the time being are held overseas.

The broad lines upon which the control system is being operated are as follows:—

- (1) The Comptroller of Customs notifies the Bank of all export licenses issued under the Export Licenses Regulations 1938.
- (2) The proceeds of exports have to be paid over to the trading banks carrying on business in New Zealand, which act as agents for the Reserve Bank for this purpose, and are held by them at the disposal of the Reserve Bank in accordance with the terms of clauses 11 and 12 of the Export Regulations.
- (3) The trading banks are also requested to account to the Reserve Bank for all exchange received by them overseas in respect of their New Zealand business otherwise than from exports, as such receipts are regarded as a set-off against payments allowed for purposes other than imports.
- (4) The Comptroller of Customs also advises the Bank of all import licenses granted under the Import Control Regulations 1938.
- (5) The trading banks are authorized to use overseas funds held by them on behalf of the Reserve Bank to pay for goods imported under license.
- (6) The trading banks are not authorized to make other disbursements from overseas funds held on behalf of the Reserve Bank except against exchange permits issued by the Bank. (This requirement is relaxed to the extent of normal payments not exceeding £25 each, but all such transactions must subsequently be advised to the Bank.)
- (7) The requirements of the Government for overseas funds, including the debt service, are met by the Reserve Bank out of the proceeds of dairy-produce exported; any surplus remaining after meeting the needs of the Government provides practically the only source from which to cover any excess payments by the trading banks in respect of import licenses and exchange permits over and above their receipts of overseas funds arising from exports or otherwise.

In operating the permit system for transfers the Bank has been guided by your assurance to the effect that one of the objects of exchange control is to enable overseas debts—whether Government, local body, or private—to be met on their due dates.

Owing, however, to the extent to which import licenses had been issued the Reserve Bank was unable to build up its holding of sterling to any appreciable extent during the remainder of the year, the increase from the date of the introduction of the Exchange Regulations to the 31st March, 1939, amounting to only about £(N.Z.)527,000, despite the fact that that period covered a considerable portion of the export season.

TRADING BANKS.

Trading-bank deposits and advances at the end of March, 1939, were approximately at the same level as at the end of March, 1938; but the average of deposits during the year ended March, 1939, was 3 per cent. lower than during the previous year, while advances, on the average, were 10 per cent. higher. Cash holdings increased by £3,500,000, holdings of Government securities by £2,500,000, but net overseas assets fell by (£N.Z.)5,000,000. The unexercised overdraft facilities decreased from £24,750,000 to £23,500,000.

POST OFFICE SAVINGS-BANK.

Sums deposited in the Post Office Savings-bank for the year ended March, 1939, were 7·8 per cent. less, and withdrawals were 16·8 per cent. greater than for the previous year; withdrawals for the year ended March, 1939, showing an excess of £(N.Z.)4,200,000 over deposits, as against excess deposits of £(N.Z.)3,400,000 during the year ended March, 1938.

OVERSEAS FUNDS: RESERVE BANK AND TRADING BANKS.

The combined net overseas assets of the whole banking system in respect of New Zealand business declined by £(N.Z.)17,293,000 during the year, as shown by the following comparison of the figures for the last Mondays in March, 1938, and March, 1939, respectively:—

Date.	Reserve Bank.	Trading Banks.	Total.
(Expressed in New Zealand Currency.)			
(000 omitted.)			
	£	£	£
28th March, 1938 ..	16,930	9,635	26,565
27th March, 1939 ..	4,626	4,646	9,272
Decrease ..	12,304	4,989	17,293

It is estimated that the normal requirements for Government and local-body debt service overseas, and for the net adverse balance of other transactions of a purely financial character (including travellers' requirements), amount to nearly £(N.Z.)12,000,000 annually; but, as revealed by the external trade statistics given later in this report, the surplus of exports over imports for the year ended the 31st March, 1939, had fallen to £3,459,000 only. Moreover, owing to the state of the market for New Zealand local-body loans in London, it became necessary to repay several of those sterling loans which fell due during the year.

Thus, whilst the decline in the favourable balance of external trade appears to have accounted for about one-half of the shrinkage in the net overseas funds, it is evident that there was an abnormal net overflow of capital after allowing for the local-body debt repayments.

In view of the relationship between internal credit expansion and demand for overseas funds, the connection between the total increase of more than £14,000,000 in the accommodation granted by the Reserve Bank to the Government and the loss of overseas funds which occurred during the year is significant.

TRADE, BUSINESS, AND PRICES.

External Trade.

During the year ended the 31st March, 1939, there was a fall of £(N.Z.)7,100,000 in export values. With the exception of the year 1935, when export values declined by £(N.Z.)1,100,000, this was the first fall in the annual value of exports since 1932, as is shown by the following table:—

Value of Exports. (000 omitted.)

Year ended 31st March,	£(N.Z.)
1932	33,943
1933	37,510
1934	46,043
1935	44,918
1936	49,676
1937	60,235
1938	65,008
1939	57,867

The decrease in total export values for 1938–39 as compared with 1937–38 was due mainly to a fall in wool prices, the 814,000 bales exported during 1938–39 being valued at £(N.Z.)11,900,000 as compared with £(N.Z.)16,000,000 for the 821,000 bales exported during the previous year. Exports of butter also declined in value and quantity, this decrease being due to a considerable fall in butterfat-production caused largely by unfavourable seasonal conditions. The principal changes in quantities and values of exports are shown in the following table:—

	Year ended 31st March.				Percentage Change 1939 over 1938.		
	1938.		1939.		Quantity.	Value.	
	Quantity.	Value.	Quantity.	Value.			
(000 omitted.)							
Wool	821 bales	£ 16,012	814 bales	£ 11,946	—0·7	—25·4	
Meat—							
Lamb	2,753 cwt.	9,489	2,674 cwt.	9,186	—2·9	—3·2	
Mutton	925 „	1,812	1,015 „	1,910	+9·7	+5·4	
Beef	922 „	1,393	979 „	1,724	+6·2	+23·8	
Pork	583 „	1,800	542 „	1,791	—7·2	—0·5	
Dairy-produce—							
Butter	3,006 „	18,027	2,444 „	15,887	—18·7	—11·9	
Cheese	1,624 „	5,615	1,647 „	6,152	+1·4	+9·6	
Other	..	10,860	..	9,271	..	—14·6	
Total	..	65,008	..	57,867	..	—11·0	

The progressive increase in the annual value of imports since 1932 and the extent of the fall during the past year are indicated in the following table:—

Value of Imports. (000 omitted.)

Year ended 31st March,	£(N.Z.)
1932	24,760
1933	25,060
1934	26,135
1935	32,568
1936	37,440
1937	47,621
1938	58,065
1939	54,408

A comparison of the yearly values of exports and imports shows that from 1932 to 1937 (inclusive) the average annual excess of exports over imports was approximately £(N.Z.)13,000,000, whereas the excess of exports in 1938 was less than £(N.Z.)7,000,000, and in 1939 was £(N.Z.)3,500,000. The actual amounts are as follows :—

Excess of Exports over Imports.
(000 omitted.)

Year ended 31st March,	£(N.Z.)
1932	9,182
1933	12,451
1934	19,907
1935	12,350
1936	12,236
1937	12,613
1938	6,943
1939	3,459

Business Activity.

Though the upward movement of business activity, which had been a notable characteristic of the previous four years, was checked by the reduction in external trade, there was no evidence of any considerable recession in the general level of activity, as is indicated by a comparison of the figures shown below :—

	Year ended 31st March,		Percentage. Increase or Decrease.
	1938.	1939.	
(£(N.Z.) millions.)			
Trading bank debits (excluding Government) ..	957·2	937·5	— 2·1
Note circulation (weekly average held by public) ..	9·131	10·364	+13·5
Sales tax	3·519	3·572	+ 1·5

Commodity Prices.

The table of price comparisons given below shows that prices generally, and more particularly the export and wholesale groups, were steadier during the year ended 31st March, 1939, than they were during the previous year. The export price index number for March, 1939, was slightly below the level for March, 1938. Wholesale prices, influenced mainly by variations in the prices of locally produced goods, fell slightly from March, 1938, to September, 1938, rose thereafter, and at the end of March, 1939, were about 1½ per cent. higher than they were a year previously. Retail prices have been fairly steady during the greater part of the year, but have shown a rising tendency, more especially since November, and finished the year approximately 3 per cent. higher than at the beginning of the year.

Commodity Price Index Numbers.

	Export.		Wholesale.		Retail.	
	1937-38.	1938-39.	1937-38.	1938-39.	1937-38.	1938-39.
(Base : 1909-13 = 1000.)						
April	1401	1343	1481	1519	1550	1612
May	1463	1389	1502	1514	1566	1620
June	1454	1390	1514	1517	1564	1620
July	1441	1360	1512	1508	1569	1618
August	1451	1329	1525	1513	1579	1622
September	1459	1380	1524	1506	1591	1618
October	1486	1354	1529	1512	1598	1624
November	1563	1377	1564	1518	1613	1624
December	1456	1345	1565	1547	1620	1651
January	1408	1329	1533	1546	1606	1646
February	1351	1342	1528	1540	1606	1652
March	1345	1330	1522	1548	1605	1647

GENERAL REVIEW.

The developments outlined earlier in this report reveal that not only did general business activity and the demand for imports continue at a high level in spite of the reduction in the total value of exports and a considerable net outflow of capital, but that, notwithstanding the expansion of credit represented by the increase of over £14,000,000 in Reserve Bank accommodation to the State (including the increase of £2,300,000 in advances to the Primary Products Marketing Department), commodity prices remained relatively stable throughout the year.

Now that the surplus sterling reserves have been practically exhausted, however, and the Reserve Bank has been relieved of the obligation to pay its notes in sterling, a different situation presents itself.

No longer will it be possible for credit created by the Bank to find an outlet to any appreciable extent in the purchase of goods from overseas (except by using the Bank's statutory reserves for that purpose). Whilst the demand for commodities was being partially satisfied by the utilization of the Dominion's available sterling reserves, the effect of the expansion of credit on internal prices was not very great; but, in existing circumstances, any additional credit expansion would inevitably tend to cause, sooner or later, a general rise in prices, with a consequent diminution in the value of all savings, wages, salaries, and pensions.

The Board would therefore stress the desirability of the avoidance of further recourse to the Reserve Bank for accommodation and of limiting governmental expenditure to such a sum as can be raised by taxation in addition to what can be borrowed from the public, either in the Dominion or overseas. If such a policy were adopted, and, still further, if steps were taken to reduce the outstanding advances from the Bank, there would be a better prospect of the Bank being able to assist by granting accommodation during relatively unsatisfactory export periods without jeopardizing the financial economy of the Dominion.

STATISTICAL SUMMARY.

As the Bank has published a monthly statistical summary since June, 1938, tables of banking and other statistics are not given so fully in this report as on previous occasions.

STAFF.

The Board wishes to place on record its indebtedness to the staff as a whole for the loyal and efficient way in which the work of the Bank has continued to be performed.

For and on behalf of the Board of Directors,

L. LEFEAUX, Governor.

W. L. WARD, Deputy Governor.

20th June, 1939.

PROFIT AND LOSS ACCOUNT FOR YEAR ENDED 31ST MARCH, 1939.

Dr.	£	s.	d.	Cr.	£	s.	d.
General charges, including salaries, rent, cost of note-issue, and other expenses	108,902	7	6	Balance of profit after making provision for rebate on Treasury bills not yet due, and for sundry liabilities and contingencies	359,187	17	10
Balance, being profit for year	250,285	10	4				
	<u>£359,187</u>	<u>17</u>	<u>10</u>		<u>£359,187</u>	<u>17</u>	<u>10</u>

PROFIT AND LOSS APPROPRIATION ACCOUNT.

Dr.	£	s.	d.	Cr.	£	s.	d.
Payments to New Zealand Government in terms of section 36 of Reserve Bank of New Zealand Act, 1933	195,811	3	7	Balance at 1st April, 1938	195,811	3	7
Balance	250,285	10	4	Balance from Profit and Loss Account	250,285	10	4
	<u>£446,096</u>	<u>13</u>	<u>11</u>		<u>£446,096</u>	<u>13</u>	<u>11</u>

BALANCE-SHEET AS AT 31ST MARCH, 1939.

Liabilities.	£	s.	d.	Assets.	£	s.	d.
General Reserve Fund	1,500,000	0	0	Gold (at face value)	2,801,791	0	0
Bank-notes	15,246,970	10	0	Sterling exchange	4,663,051	6	7
Demand liabilities—				Subsidiary coin	226,271	6	1
(a) State	4,386,770	2	5	Advances—			
(b) Banks	8,350,113	9	3	To the State or State undertakings—			
(c) Other	902,256	19	11	(1) Primary Products Marketing Department	7,235,461	15	2
Liabilities in currencies other than New Zealand currency	26,220	12	4	(2) For other purposes	12,225,000	0	0
Other accounts	304,583	17	7	Investments	3,689,904	19	2
Profit and Loss Appropriation Account	250,285	10	4	Other assets	125,720	14	10
	<u>£30,967,201</u>	<u>1</u>	<u>10</u>	N.B.—Holdings of sterling have been converted into New Zealand currency at the rate of £100 sterling equals £124 (N.Z.).			
					<u>£30,967,201</u>	<u>1</u>	<u>10</u>

W. R. EGGERS, Deputy Chief Accountant.

L. LEFEAUX, Governor.

W. L. WARD, Deputy Governor.

Auditors' Certificate and Report.—We have audited the balance-sheet as at 31st March, 1939, above set forth, and have obtained all the information and explanations we have required.

We have accepted the certificate of the Bank of England as to assets held on account of the Reserve Bank of New Zealand.

In our opinion the balance-sheet is properly drawn up so as to exhibit a true and correct view of the state of the affairs of the Bank as at 31st March, 1939, according to the best of our information and the explanations given to us and as shown by the books of the Bank.

D. G. JOHNSTON }
J. L. GRIFFIN } Public Accountants, Auditors.

Wellington, New Zealand, 24th May, 1939.

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