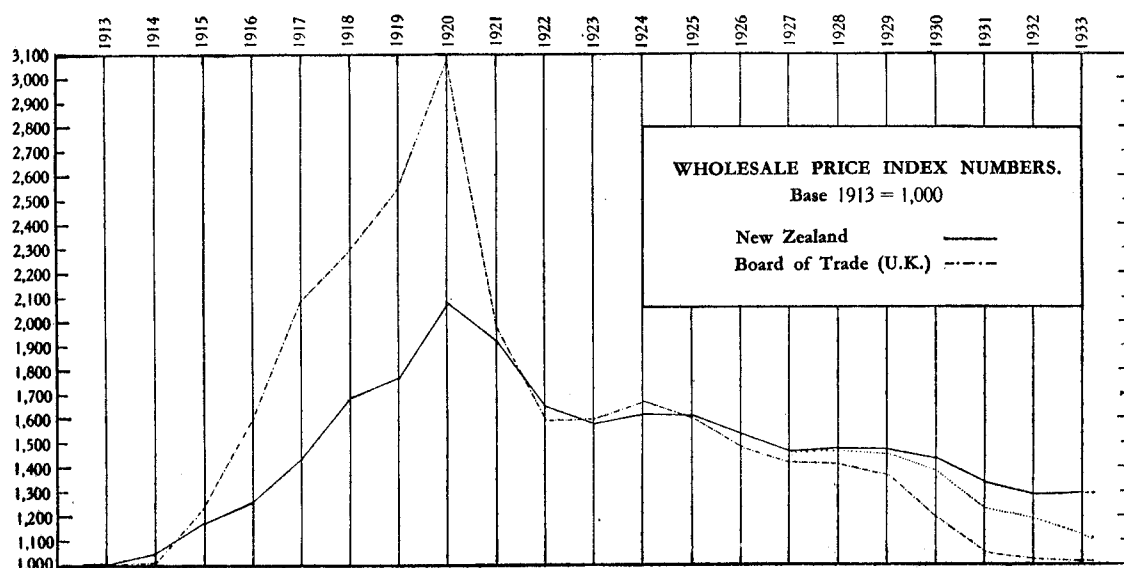


The degree of correlation illustrated by the graph shows unmistakably how the banking figures are affected by receipts and payments overseas. Such difference as there is will be due largely to the fact that the aforesaid receipts and payments are based to some extent on estimates. Furthermore, the banking figures used are the averages for the March quarter, and these obviously will not coincide accurately with the trade for the financial year. To illustrate the same point Professor Tocker, of Canterbury College, in an article published in the *Economic Journal* of December, 1924, demonstrated the close correlation over a period of twenty years between the visible trade balance and the excess of deposits over advances and securities.

On account of our economic circumstances, this domination of our monetary system by our transactions with London would, probably, be practically inevitable in any case, but, in fact, it has been rendered definite and complete by the exchange policy adopted by the banks. Although at the present time there is a marked departure therefrom, this exchange policy consisted of maintaining stable rates of exchange, unaffected by any but very exceptional trade disturbances. For instance, the rates of exchange for telegraphic transfers New Zealand on London stood at 17s. 6d. per cent. for at least ten years prior to 1914, despite marked variation in the trade balance between 1907 and 1911. This exchange policy was the real regulative factor in controlling the volume of credit, and, through credit, the issue of currency in New Zealand. The result was to keep the New Zealand pound at approximate parity with sterling, and in the broad trend our prices fluctuating round about a definite ratio to British prices which, of course, were regulated by gold.

When British prices are down, goods can be purchased more cheaply in Britain and sold more cheaply in New Zealand. Thus New Zealand prices, while not so sensitive as British prices generally, move in sympathy with those of Great Britain. This approximate correlation in the movement of the respective price-levels is best seen at a time of violent fluctuation such as has occurred since 1913. The following graph shows the movements since 1913 in the British Board of Trade index and the New Zealand Government Statistician's wholesale-price index respectively.



WHOLESALE-PRICE INDEX NUMBERS (BASE 1913 = 1000).

The range of commodities used in compiling these two indices is not altogether the same, the main difference being the greater predominance of raw materials in the Board of Trade index.

Even so, it will be seen that, with a slight lag which one would expect under the circumstances, there is a fairly close correlation between the rise and fall in the two price indices. The violent upward swing which occurred between 1918 and 1920 is not so violent in the case of the New Zealand prices, but the peak was probably smoothed out somewhat in the lag, in addition to which it is well known that our internal prices are relatively slow to move. The lines came together again in 1923, and do not diverge very much thereafter. It will be noted, however, that the fall in New Zealand prices since 1929 is not as great as in the case of British prices. The reason for this is the progressive increase in the rate of exchange on London, and the fact that during this period the proportion of Customs duties to value of imports has risen. The effect of these factors upon the New Zealand index has been approximately calculated, and the dotted line also shown in the graph indicates the level to which New Zealand wholesale prices would have fallen but for the factors mentioned. This uniformity in the movement of the price-levels over a period of violent fluctuation, when for the most part both countries were admittedly off the gold standard, is another indication of the monetary system being definitely linked with sterling.

In fact, all the evidence clearly demonstrates that the volume of credit in New Zealand has not been governed through the currency on a gold basis, as was apparently originally intended, but is automatically governed by an exchange fund held by the banks in London, which fund, so long as Great Britain was on the gold standard, was in effect equivalent to a stock of gold held in London. When Great Britain departed from the gold standard, however, we followed automatically, and our exchanges were not directly affected—that is to say, this country possesses a sterling exchange standard.