

borrowing or local borrowing is to be preferred in the future will depend on the circumstances of the particular time when the projects for which borrowing is required are contemplated, as well as on the relative costs of borrowing in New Zealand and abroad.

The effect of overseas borrowing will be different according to whether the sum borrowed is to be spent overseas or in New Zealand. In the former case there is an immediate increase in imports to the extent of the borrowing, but no effect on the London balances or on currency and credit in New Zealand. In the latter case there is an increase in London balances to the amount of the loan. This is credited to the Government's account in New Zealand and increases the ratio of deposits to advances. The expenditure of the loan-money by the Government increases purchasing-power, both directly and indirectly, as indicated under 4 (b). Imports are encouraged to the amount of the increase in the London balances, and the ratio of deposits to advances is again reduced. This tends to a restriction of credit in New Zealand. By contrast with internal borrowing, an overseas loan increases the capacity to import by the amount of the loan. It therefore makes it possible to free the labour which would be required to make such goods for the works for which the loan was raised.

The effect of an internal loan is to divert labour and capital from other uses, unless such labour is idle in the form of unemployed workers and capital in the form of a substantial excess of deposits over advances.

Part of the additional purchasing-power will be expended in imports, which will reduce the London balances. If the ratio of deposits to advances is low and exchange funds are low, there will tend to be a restriction of credit by the banks which will react prejudicially on private industry.

The case for internal borrowing would be strengthened—

- (1) When a surplus of saving was indicated by a substantial excess of deposits over advances :
- (2) When there was an accumulation of exchange funds in London :
- (3) When interest rates in New Zealand were low relative to those overseas :
- (4) When prices were falling and were expected to continue falling.

The case for overseas borrowing would be strengthened—

- (1) When the ratio of advances to deposits was high :
- (2) When overseas interest rates were low relative to those in New Zealand :
- (3) When exchange funds were low :
- (4) When prices were rising and were expected to continue rising, since this would reduce the real burden of overseas loan.

My general opinion would be that, while the above circumstances should influence the decision at any particular time, the policy should be to rely less on overseas borrowing and more on internal borrowing than in the past because—

- (a) Assuming the return to "normal" conditions, it should be easier than in the past to maintain a reasonable standard of living and at the same time engage in capital works out of savings within New Zealand :
- (b) Internal debt is less burdensome than external debt if prices fall :
- (c) Reliance on annual overseas borrowing as a normal policy increases the problem of readjustment if the source of overseas borrowing suddenly dries up.

8. *Has the exchange-rate in the past been governed by the supply of and demand for London funds? Was the exchange-rate ever "free," or was it always "pegged"?*

No. The rate was always "pegged," or "artificial," prior to the crisis. This is demonstrated by the fact that it remained at or near to parity with sterling despite considerable fluctuations in the London balances. The mechanism of control was not fluctuating exchanges, but changes in deposit and overdraft rates.

9. *What determines the rate of interest charged and paid by the banks?*

Interest rates would be affected by a number of factors including—

- (a) Rates offered by the Government and competitive institutions (there is perhaps some doubt as to whether the influence is other than psychological) :
- (b) The ratio of advances to deposits and the state of the London balances :
- (c) The rough practical judgments of bankers as to conditions of demand and supply :
- (d) Rates offered in other countries—e.g., Australia.

I believe that there has been a considerable arbitrary element in interest-rates. During the immediate post-war years, people became accustomed to high rates and for some years interest-rates have been too high. Apart from the influence of (d) above, I see no reason why interest-rates could not have varied about a substantially lower level, provided the Government, the banks, and other financial institutions had co-operated.

10. *If deposits and advances rates were lowered would this tend to promote economic recovery?*

Yes; it would help. Lower deposit rates would force funds into more active use. Lower overdraft rates would reduce costs.

11. (a) *Do banks in New Zealand lend their deposits?* (b) *Is there any fixed relationship between deposits and advances in New Zealand?* (c) *What factors determine an increase in advances?*

(a) Yes.

(b) No.

(c) The demands of traders, manufacturers, farmers, and others for accommodation and the willingness of bankers to grant them having regard to (i) the volume of deposits; (ii) the prospects of the enterprises demanding advances; (iii) the nature of the securities offered.