The value of exports was £1,000,000 greater for the year ended January, 1934, than for the year ended January, 1933. Imports were £1,600,000 less, and the favourable trade balance £2,600,000 more. Allowing for overseas interest payments of Government and local bodies to the extent of, say, £9,000,000, this would leave a surplus of £4,000,000. I understand that the surplus is very much greater than this. In my opinion the accumulation of funds in the hands of the Government has been influenced by the following factors :—

(i) An unknown volume of funds was transferred abroad prior to the raising of the rate, in anticipation of a rise. This lowered the datum line above which surplus exchange would be calculated. Much of the money would be returned to New Zealand when the rate was raised.

(ii) Since the rate was raised there have been persistent rumours that the exchange was to come down "shortly." This has led to uncertainty and has—

- (*a*) Discouraged imports :
- (*b*) Encouraged overseas exporters to leave funds in New Zealand on account of goods imported into New Zealand rather than accept payment in London :
- (*c*) Encouraged the transfer of funds to New Zealand in order to make a speculative profit by retransfer when the rate is lowered.

I believe that these factors are operating at the present time in the expectation that the rate will be lowered at the end of the export season.

My conclusion is that the accumulation of funds is due not to the raising of the rate but to the fear that it will be reduced. I am confident that, had it been generally accepted that the exchange would remain at the present level for some years, there would have been little, if any, surplus of exchange accumulated. Certainly it would have been less than £4,000,000, allowing for Government and local-body requirements. If the currency were devalued, imports would increase and the above practices making for an accumulation of exchange funds would cease.

(iii) Although there may be a gradual rise in overseas prices any rapid and considerable rise is extremely unlikely. Hence the shelter of the exchange premium is still likely to be of value to farmers in helping them to bridge the gap between costs and selling-prices.

I conclude that the currency should be devalued at the present level of exchange, at the earliest possible moment,—

- (*a*) Because farmers still require its assistance, and are likely to do so for some time :
- (*b*) Because it would remove uncertainty from the minds of importers, and encourage an increase in imports :
- (*c*) Because it would remove the main causes leading to the accumulation of exchange funds in the hands of the Government :
- (*d*) Because it would relieve the Government of the prospect of loss from the sale of exchange bought at 125 and disposed of at a lower figure.

It should be noted that while the prejudicial effects of a rise in exchange in public revenue were felt at once the beneficial effects by way of increased income-tax and other receipts is not yet fully felt.

14. In view of present conditions, and the prospective outlook for the next few years, what should be the exchange policy of New Zealand?

This question is partially answered in reply to questions 12 and 13.

Having regard to existing and prospective conditions, my opinion as to exchange policy is as follows :—

(1) The Government should immediately declare a new parity of exchange of £125 New Zealand = £100 sterling.

(2) It should announce that this parity will hold for at least two years, save as the result of extraordinary and unforeseen events.

(3) It should be the duty of the central bank to hold the rate between, say, £3 of parity either way—*i.e.*, between £122 New Zealand = £100 sterling and £128 New Zealand = £100 sterling. This proposal is, in reality, a proposal for a parity fluctuating within narrow limits. Any change in the rate during the next two years should require the approval of the Minister of Finance.

(4) In two years the rate might be reviewed in the light of the price situation and the general economic position at the time. It might then be desirable to declare a new parity, but the above margins should be retained.

(5) Since the responsibility for maintaining the rate will rest with the central bank and not with the commercial banks, and since the danger of loss to the commercial banks from a lowering of the rate will be removed by devaluation, the Bank Exchange Indemnity Act might be repealed or at least amended.

My present feeling is that it would be wiser to hold the rate at not less than 125 during the next two years because I do not anticipate that world prices will rise sufficiently during that period to permit of adjustment at a lower rate. The proposal to widen the margin of exchange fluctuation permitted by statute beyond the 30s. either way, originally provided in the Reserve Bank Bill, is made for the following reasons :—

- (*a*) It would provide the central bank with a method of control over imports and exchange funds more elastic and effective than interest-rates :
- (*b*) Occasions might arise when it was desirable to take action affecting the accumulation or reduction of such funds without raising or lowering interest-rates in New Zealand :