PRESS STATEMENT:

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AN EXPLANATION OF BANK POLICY

In the last few months there have been notices in the Press that large sums of money have been called into what are called "Special Accounts" by the Reserve Bank.

It is important that the average person should understand what is involved in this and what the Bank is trying to do, because if there is misunderstanding of Government or of Reserve Bank financial policy it can give rise to uneasiness.

To explain this let me go back a while in history. Originally all banks were independent. They carried their own reserves in their own vaults. Banks made money by getting deposits from people and then making loans to other people who required money for certain reasons. They were able to make money and lend it at moderately low rates of interest because all banks worked on the assumption that not all the people who had deposited money at any one time would want to draw it out at the same time.

Normally this worked quite safely, but every now and again a rumour, based on imagination or perhaps on fact, would begin and people would think that a bank in some town was in difficulties and was going to fail, and therefore one morning when it opened all the people who had deposited money would be lined up outside it waiting to draw their money out. Although the bank might be quite sound in the long term it would not be able to do this all at once because of the money it had advanced by way of loan to other customers. This was in the days when banks were independent family businesses and each branch was independent without contacts or associations with other branches.

Then, in efforts to overcome this, some banks formed groups or associations, and if there was what was called a "run" on one bank, other banks would come to its aid so that any creditors could get their money when they wanted it. This still created strains within the banking system.

In addition, Governments found that the rate of lending of the banks seemed to run in a sort of cycle. This was not because of any concerted policy but was largely because of economic forces which, when they were uncontrolled, seemed to operate in a haphazard fashion. In other words, in times of confidence and expansion all the banks would lend a lot of money and there would be what today might be called an uncontrolled boom, except that this doesn't happen these days — or at least not to the same extent. People or businesses or companies would over-reach themselves, and ultimately confidence would be broken. Banks would then revert from a policy of over-free lending to one of great stringency and rigidity. Even with the association of several banks forming groups or chains in such circumstances it was not unusual for banks to fail, because with the break in confidence you would find many people trying to draw their money out at once.

To prevent this sort of thing happening, by accident in Great Britain and by law in most other countries, Central Banks came to be formed. Central Banks have a specific job to try to maintain an even and sensible credit policy for the major trading banks. At the same time if any one trading bank gets into difficulties in any way, the Central Bank has a duty and an obligation to advance to it whatever funds are needed to prevent a crisis. Since the days of Central Banks, bank failures have become unknown.
This is not the only function of Central Banks. In times of slack demand, in times of unused resources, when there are people wanting jobs who can't get jobs, the Central Bank or Reserve Bank, as it is called in Australia, has an obligation to encourage the trading banks to lend more money to make advances to people so that activity and employment and production can be stimulated. Alternatively, if there looks like being a shortage of labour, if our resources are being strained because of inadequate supplies of materials, the Reserve Bank has an obligation to try to restrain the lending policy of the trading banks so that the pressure on resources can be eased to a certain extent. It is clear that this is a most important function.

The Central Bank — the Reserve Bank — is not the only weapon to achieve this. The Government, in its budget policy and in its taxation policy, also has powerful weapons which are directed towards a steady but rapid rate of development. But budgets are introduced once a year, and the bank can alter its policy and its attitude as circumstances alter during the year, thus it is a more flexible weapon in maintaining a balanced economy.

All banks must have reserves in their tills and in their vaults to meet withdrawals that may be demanded, to meet cheque payments between Banks. These reserves, the liquid assets of the banks, are made up of cash, the money we keep in our pockets, and Government assets of one kind or another — Government bonds or Special bonds.

There is an agreed minimum below which these reserves must not fall. Every trading bank in Australia must have enough liquid assets to cover at least 18% of its deposits. The fact is that at the moment the banks have got about 30% of their deposits covered by liquid assets, so there is still tremendous scope within the banking system for further lending. This is despite the calls by the Reserve Bank into Special Deposits.

The funds held by the Reserve Bank in Special Deposits are additional to this reserve ratio which the banks hold in their own coffers. They would be available to assist any Bank that got into trouble because of some peculiarities of the trading system, but primarily they are used to try to regulate the lending rate of the trading banks. When the banks are flush with funds, when there is a high level of employment with pressure on resources, the Reserve Bank will increase the amount which it calls into Special Deposits. If there was any unemployment, if there were resources lying idle, it would release funds from Special Deposits.

The level of activity in Australia is running very high at the moment and export prices have been particularly good. This brings additional funds into the banking system.

The Reserve Bank has clearly been concerned that these funds should not be used to increase the rate of lending at this time because there is already some pressure and shortage of resources in Australia, and if much more money was advanced it would tend to push up the price of goods and services. Therefore, the Reserve Bank has called fairly large sums of money into Special Accounts in the last several weeks, and this has really done little more than isolate for the time being the additional funds coming to Australia from buoyant export prices. The banks as a whole are in a more liquid position, that is they are more able to lend money to customers now than they were twelve months ago, despite these calls by the Reserve Bank into Special Accounts.

What the Reserve Bank has done should be regarded as a prudent precautionary action to prevent undue lending by banks which could, if unregulated, lead to a renewed inflation. This has been widely recognised in the financial and political world, because nobody in these groups has attacked the Reserve Bank for what it has done.