

The Australian Money Market (*)

Prior to the 1950s, the means of investing money for short periods in Australia were rather limited. The traditional outlet was the "fixed deposit" accepted by the trading banks for terms of from 3 to 24 months. However, during the 1950s, the rate paid on such deposits had ceased to be competitive with alternative outlets, such as the issue of short-term debenture stock and unsecured notes by hire purchase finance companies. This latter facility began to be offered (soon by other enterprises as well) about 1950, but trustees and public authorities were unable to employ this technique because of legislative restrictions. Hence, a means had to be devised to meet the needs of investors who wanted the security of Government paper but whose funds were unlikely to be available long enough to justify an outright purchase. Also Government securities with only a few months to run were not normally available in large amounts. This need was met by the "buy-back" facilities that certain stock and share brokers in Sydney and Melbourne were prepared to offer their customers. Moreover, by selling securities subject to an agreement to repurchase, as well as the more normal borrowing of funds at short-term, these brokers were able to build up sizeable portfolios. The big disadvantage of this system was the absence of a true lender of last resort, who could assure ultimate liquidity in the event of need. At that stage, stockbrokers for the most part could only fall back on

* The author visited Australia in order to study its money market arrangements on two occasions — in April 1967 and January 1971. Within this context, he desires to express his very considerable appreciation for all the help received both from senior officers and staff of the Reserve Bank of Australia and from dealers and bankers operating in the several markets described in this article. Without their ready assistance, the writing of this article would not have been possible. For particular interpretations of the facts (and any omissions), however, the author alone is responsible.

their facilities with the trading banks,¹ but it was unreasonable to regard these as always and necessarily available.

It was not until February 1959, by which time there already existed a market of quite appreciable size, that the central bank began to provide formal lender of last resort facilities to authorised dealers in the short-term money market. Accreditation as an authorised dealer in the money market was at that time subject to observance of minimum capital requirements, maximum portfolio limits² (and, by implication, a limit on their lines of credit at the central bank), the restriction of money market investments to Commonwealth Government stock with a term not exceeding 3 years, the provision of "margins" (the shareholders' funds of dealing companies had to be such that dealers were able to lodge with the Reserve Bank money market securities whose market value would be equivalent in total to a schedule of margins on Government securities of various maturities), and the daily reporting of their positions. In addition and at all times, dealer companies had to be ready and able to engage in the buying and selling of money market securities. Originally, there were 4 authorised dealer companies (formed by houses that had experience in the buy-back market). By late 1960, the number had increased to 9, which at that time was probably a larger number than the market could comfortably accommodate. There have been no additions since then.

For some time, there remained something of a shortage of securities with a sufficient range of maturity dates to accommodate seasonal variations in liquidity. The dealers could have no interest in Treasury bills with a discount rate of 1 per cent and, at that time, these were held almost entirely by the banks. But the range of available securities was widened to some extent with the issue in November 1959 of 3 months Seasonal Treasury Notes, which were rediscountable at the central bank. These were originally issued fortnightly but latterly on a daily basis during the flush period of the year from about September to March. They had to be redeemed by the end of each financial year (June 30) and no new issue could

¹ There was also a limited amount of dealing between buy-back brokers and the old Commonwealth Bank of Australia (which at that time also acted as the central bank).

² These limits were relaxed progressively until June 1964, when they were removed. The maximum amount of loans that a dealer may now accept is determined by a prescribed gearing ratio to shareholders' funds. The precise gearing is not officially disclosed but it is believed to be in the region of 33 times shareholders' funds. Its main purpose is to ensure that each dealer has a significant financial involvement in his business.

therefore be made after March 31 until the following September. Then, as from July 16, 1962, the Federal Government began to issue in minimum amounts of \$10,000 also at a rate of discount and on a continuous basis 3 months Treasury Notes, which were likewise rediscountable at the Reserve Bank. These replaced Seasonal Treasury Notes. The attraction of the Treasury Note was further enhanced by the introduction of a 26 weeks maturity in July 1967. Its issue price is varied from time to time and has become the barometer of short-term money market rates. As a result of these changes, the Treasury bill disappeared from trading bank balance sheets (about July 1962)³ and they now came to be held entirely by the Reserve Bank itself (as formal recognition of short-term borrowings from the Bank by the Commonwealth Government). After 1959, too, the dealers were able to supplement their supplies of securities by purchases from the Reserve Bank which became a significant source. Since there were no brokerage or similar charges on these transactions, rate competition had full play.

It was on these bases that the market built up its activity. Although the main centres are Sydney and Melbourne (with Sydney tending to become the more important of the two, partly because the Head Office of the Reserve Bank is there), the market in fact also operates in Brisbane, Adelaide, Perth, Hobart, Canberra, Launceston, and Port Moresby. Except for Adelaide (half an hour behind) and Perth (2 hours behind) all are in the same time zone (E.S.T.). Moreover, though most business is transacted in Sydney and Melbourne, dealers cannot ignore developments in other centres. Thus, the Perth and Brisbane markets are quite small, but from time to time big sums can go out or come in.⁴

Of the 9 dealers,⁵ five have their head offices or principal office

³ Treasury bills were no longer bought by the trading banks after Treasury Notes came to be issued. Over the period when Seasonal Treasury Notes were on issue, the trading banks were required to take up an amount of Treasury bills that matched any subscriptions they might make to Seasonal Treasury Notes.

⁴ Both the Treasurer of Western Australia and the Queensland Treasury are substantial users of the money market.

⁵ All-States Discount Limited, Melbourne; A.M.P. Discount Corporation Limited, Canberra, but with its principal office in Sydney; Capel Court Securities Limited, Canberra, with its principal office in Melbourne; Delfin Discount Company Limited, Sydney; First Federation Discount Company Limited, Melbourne; National Discount Corporation Limited, Sydney; Short Term Acceptances Limited, Sydney; Trans City Discount Limited, Sydney; and United Discount Company of Australia Limited, Melbourne.

in Sydney (one of these is registered in Canberra), four are based on Melbourne⁶ (though senior personnel in Sydney may deal direct with the Reserve Bank there). Broadly speaking, there are two main types of houses: there are (1) the money dealers, who trade in money and with the money that they borrow they purchase securities and sit on them; and (2) traders in securities, who regard everything in their portfolio as being available for sale and who are in the market to buy anything on offer — in both cases, at a price (in the latter case, dealers merely use money “to get their securities on the shelf” and the rates they pay are in consequence determined by their need of money with which to carry securities on that particular day;⁷ nevertheless, not all of these are really very active).⁸ Some houses have tried to establish a balance between the two types of business. In the past, it was said that the houses that were originally linked with life offices tended to sit on their portfolio of securities, while those that derived from a stockbroking firm tended to be primarily traders in bonds (though some were not particularly active).⁹ There may once have been some truth in this;¹⁰ latterly, the emphasis on trading has depended much more obviously on the personnel employed by the house concerned. In any event, all houses have been associated with a stockbroker and most have been linked with some other institution such as a life office or merchant bank. In addition, a number of overseas banking interests (although foreign banks have so far been unable to obtain licences in Australia) have acquired participations in merchant banks, or become associated with stockbrokers and, in this way, have developed links with Australian short-term money markets.

Another feature that became less common as the market developed was the tendency of market houses to borrow moneys

⁶ Again, one of these has its registered office in Canberra (this was a common device for minimising stamp duty).

⁷ They also tend to be the largest users of lender of last resort facilities, since the cost of money tends to be secondary to their trading activities.

⁸ Most of the really active trading in Government bonds is concentrated in the hands of 4 or 5 dealers.

⁹ Although they would belong to the same financial group as the stockbroking house, in their day to day business they operated with full autonomy, dealing freely with any broker — “profit was the only consideration”.

¹⁰ An alternative explanation of the early emphasis on money books rather than on security trading was that it was attributable in part to dealers acquiring expertise and moving cautiously and in part to the fact that the emphasis was at that stage on building up portfolios, which could later be used for trading; also dealers benefited from the capital growth associated with the declining interest rates of the early 1960s.

from a limited range of clients, when relationships were often on a somewhat personal basis and the rates paid did not always fluctuate to the same extent as the market — they tended to be in line with the market but were less flexible.¹¹ On the other hand, houses that from the first were primarily dependent on bank money were more impersonal in their relationships and paid more competitive rates.

So far as ownership of the dealing houses is concerned, the main change in recent years has been a tendency for the equity of share-broking firms in these companies to decline and for an increasing capital interest to be held by life offices and overseas banking houses. The overseas interests are in every case indirect and have been the result of London and New York banking houses acquiring a stake in local financial intermediaries with shareholdings in authorised dealers. Capital — rather than expertise — has probably been the main contribution made by these overseas banking houses to the development of the authorised dealer companies.

The mechanics of the market are quite simple. Most of the dealings are initiated by telephone. If it is a lending operation, the client will inform the dealer of the amount of money he wishes to lend and the term that suits him. The dealer quotes a rate of interest for the proposed loan. If agreement is reached,¹² the dealer will then send a messenger to the client to pick up from him a bank cheque for the amount of the loan — in the case of Commonwealth Government securities, in exchange for safe custody certificates issued by the Reserve Bank,¹³ though other forms of security may also apply.¹⁴

¹¹ Also, at this stage, the dealer may have felt obliged to accept money from a regular client whatever the circumstances. Where relationships were less personal, a house could always say it was full up and decline the money.

¹² Although transactions are usually arranged on the telephone and agreement as to amount and rate is reached verbally, the dealer would subsequently confirm the transaction in writing. All transactions between banks and authorised dealers also go through the Reserve Bank, with which both maintain accounts.

¹³ Authorised dealers also give marked transfer and acceptance forms, if requested to do so. This is an arrangement that in Australia facilitates market transactions in Commonwealth Government Inscribed Stock. Conventional practice is that on presentation of a transfer and acceptance form, properly executed by the transferor, the relevant amount of series of stock is "stopped" in the Registry ledger and the transfer form marked accordingly. Such a "stop" nominally lapses at the end of a 14 day period, but may be renewed.

¹⁴ E.g. commercial bills may be held against the loan, under a certificate that specifies the State in which the bill has been drawn and is due to be paid. Dealers frequently avoid the physical transfer of bills over State borders as further stamp duty has to be paid, if they are negotiated before maturity in another State. Hence, such bills tend to stay in

The certificates state that the Reserve Bank holds on behalf of the dealer certain specified Commonwealth Government securities — they represent securities and are now issued for any required denomination.¹⁵ The use of a bank cheque as the basis of a loan is in accordance with official policy; from a dealer's point of view insistence on a bank cheque ensures that payment is undoubted; it also prevents a lender's cheque "floating" between the making of the loan and the debiting of the cheque to his account, while resort to the safe custody system obviates the risks involved in handling large amounts of bearer bonds or transfers of stock as security for loans; it also facilitates the handling of market transactions. This service, for which a fee is charged, is provided by the Reserve Bank at all its Australian branches (except Darwin).

In the case of withdrawals — the calling of loans — the dealer may be advised on the preceding afternoon (though this is infrequent); usually, a loan is called by 11.00 a.m. on the morning of the day when funds are required. When payment is effected, a cheque in his favour will be delivered to the client in exchange for the security. Incoming money (money that comes into the hands of potential lenders during the day) may be placed up to (say) 2.45 p.m.¹⁶ (In Sydney, very large amounts are lent to the market each day between 2.15 and 2.45 p.m.).¹⁷

Not all money will be placed at call (though short loans will usually be at call, with a little at 7 days or 14 days). "Fixed" money (and some dealers prefer a book based on fixed money; it depends on the dealer) is fairly well spread from 7 up to 30 days and may amount to about 20 per cent of the total. Buy-backs are still used to some extent as a means of financing (also of providing a facility) in

one State and are used as collateral for loans in that State, provided lenders will accept them. It is up to the lender to ensure that he has full cover for his loan and, if he is to be prepared to accept bills in the security cover, he must have an up-to-date knowledge of bill markets.

¹⁵ These arrangements go back to 1965, when the Reserve Bank began to issue safe custody certificates that could circulate throughout the market. Previously, the Bank issued safe custody receipts in the names of individual lenders, which was much less convenient.

¹⁶ The large trading banks would reckon to have the day's money out by 9.30 a.m. During the day, they would then buy or sell any or all of a range of securities depending on the course of the market and their own liquidity requirements (e.g. Treasury Notes, short Government bonds or commercial bills), though sales might not in fact be value in nor purchases be value out to the bank concerned until the following day.

¹⁷ On days when banks are open to 5.00 p.m. (e.g. Fridays), a good deal of business is done even later.

the official market, but they are not now as important in this part of the market.¹⁸

Obviously, if customers wish to withdraw their funds, dealers will have to find the cash to repay these loans. The simplest solution is to seek out new funds to replace those that are being withdrawn. To ensure sufficient access to funds, dealers must be prepared to offer competitive rates of interest and, to this end, they may have to vary their interest rates on several occasions during the course of a single day. They will also be concerned to know what rates their competitors are paying. In the final analysis, if they cannot raise the money in any other way (and do not wish to borrow from the Reserve Bank), they will have to sell from their own portfolio. Hence the need to safeguard their liquidity and to hold a proportion of Treasury Notes or other short-dated securities.

If the Reserve Bank is to be approached, this must be done by 2.30 p.m. on the day the loan is required (except on Fridays when it is 4.00 p.m.). These loans are made against the lodgment of Commonwealth Government and Public Authority¹⁹ securities (formerly, the range extended to all securities dealt in on the official market and included bank-accepted commercial bills; this was changed — see below — in April 1969). Lending is for a minimum period of 7 days²⁰ and, although not published, the rate charged is in the nature of a penalty. There is no limit on the amount any dealer may borrow, so long as he has acceptable security. The market in fact goes in regularly,²¹ though the use made by the dealers of last resort borrowing from the Reserve Bank does vary from time to time. Thus, in 1967-68, in general dealers had less recourse to last resort loans than in 1966-67, but the use made by dealers of such borrowing during 1968-69 was greater than in the previous year. Again, in

¹⁸ Buy-backs are used most frequently in the State of Victoria where the Government has not yet followed the other States in making short-term money market loans a trustee security.

¹⁹ In the case of Public Authority securities, provided a dealer can give a charge over the securities acceptable to the Reserve Bank.

²⁰ And a maximum of 30 days. There is provision for re-negotiation beyond 30 days, but the interest rate may then be changed.

²¹ This may be due to the dealer's inability to sell securities quickly and in some volume, or he may expect funds to be available in a week or so, in which case the dealer may not wish to "shorten his book" temporarily knowing that he will only have to repurchase later.

1970-71, there was less recourse to last resort facilities than in the previous year.²²

During the course of a day, there will be a number of occasions on which a dealer may require overdraft accommodation (cp. the situation in Canada).²³ For example, a dealer may arrange new deposits early in the morning but not receive the bank cheques until the afternoon. Meanwhile, he may have to repay money to other clients. Hence, the dealer is often faced with a situation in which he has to issue cheques for amounts called before new money is received. In order to resolve this problem, the Reserve Bank stands ready to allow the dealer a "daylight overdraft" to a limited amount, subject to the rule that the dealer's account must be in credit by the end of each day, even if the dealer has to borrow formally from the Reserve Bank to achieve this.²⁴

The securities dealt in by the official market have steadily expanded with the years, but the emphasis in their portfolios has to be on the short end because the bulk of the dealers' liabilities are either at call or fixed for short terms, the proximate objective being to earn interest at rates above what they have to pay. A proportion of their funds will therefore be invested in liquid securities, but they also deal in bonds which are much less liquid and subject to higher risks of capital loss.²⁵ In Australia, at the very short end, dealers now hold Treasury Notes (already described) and, from many points of view, they represent an ideal investment for the official market.²⁶

²² See *Annual Reports* of the Reserve Bank of Australia. The use of the last resort facilities has declined relatively, since the facilities were first extended to dealers. In the early years, the securities available to dealers were not well suited in maturity pattern for meeting liquidity needs. Dealers (and others) are now able to rely mainly on Treasury Notes and near-maturing bonds for liquidity. But the last resort facility, to the extent of course that a dealer has eligible securities against which he can borrow from the central bank, remains the ultimate guarantee of an authorised dealer's liquidity.

²³ See "The Canadian Money Market Experiment" in this *Review*, March 1958 and in J. S. G. WILSON, *Monetary Policy and the Development of Money Markets* (London, 1966), pp. 281-4.

²⁴ In fact, "daylight overdrafts" may be arranged within limits in both money and securities. These overdrafts are subject to strict supervision but do not attract interest charges. At the same time, although no specific charge is made for "daylight overdrafts", a general fee is paid each quarter by the authorised dealers to the Reserve Bank as a contribution towards the costs of services and facilities provided.

²⁵ Indeed, after 1959 and until about March 1971, rates on money market securities moved significantly upwards and as a result quite substantial capital losses had to be absorbed by the market.

²⁶ Nevertheless, for a true market to develop for these securities, it is argued that the authorities should cease to issue them to all comers at any time of the day. Otherwise,

For the rest, the bulk of the dealers' holdings has consisted of other Commonwealth Government securities with maturities of no more than 3 years (this tended to remain true even after the modifications of April 1969, described below). From a liquidity point of view, even other short-dated Commonwealth Government securities are likely to be somewhat less satisfactory to the dealers than Treasury Notes, but the rate of earnings is likely to be higher. They may be either short-dated securities issued usually 4 times a year by the Commonwealth Government or originally longer dated series which through the effluxion of time have reached a remaining maturity of less than 3 years. Until regular Treasury Note issues began to be made after July 1962, short-term money market dealers were compelled to rely extensively on the then existing types of Commonwealth Government securities and they still hold large amounts of these in their portfolios (though the bulk of the buy-back transactions in them now takes place in the "unofficial" market). Holdings of Treasury Notes by the authorised dealers have continued to be much less important²⁷ than their holdings of other Commonwealth Government securities — they also fluctuate quite markedly from time to time (from virtually nothing to — say — \$150 million). On the other hand, holdings of other Commonwealth Government securities, though there are some fluctuations, have grown steadily over the years — with a low of \$202.6 million in February 1963 to a high of \$934 million in June 1972.²⁸

Dealers will have to pay competitive rates for short-term money and, if funds are needed to replace calls, they will also consider the alternatives of last resort borrowing and the cost of a sale and subsequent repurchase of securities. But, over the longer run, what they will be prepared to pay on funds lent to them must bear some relationship to what they can earn with the money borrowed. If interest rates move against them, they may for a period have to face a running loss. In addition, at all times, dealers run the risk that market fluctuations in the prices of securities may involve them in capital losses. The risk is obviously greater with the longer-term securities, since if one wishes to liquidate one must sell — it is not possible to wait for maturity. The rates paid by the dealer must take

the dealers are not given a chance to meet the demand from their portfolios. "To form a true market there must be a limitation on supply as well as demand".

²⁷ But they are very important in absorbing "within season" increases in liquidity.

²⁸ Reserve Bank of Australia *Statistical Bulletins*.

such risks into account; other considerations include an allowance for overhead costs and their expectations of profit. In determining rates, a special difficulty that faces Australian dealers (and this is similar to the situation in Canada) is the fact that the market is Commonwealth-wide. Although most of the business is transacted in Sydney and Melbourne, dealers cannot ignore completely developments in other centres (e.g. in Perth, where money may on occasion go in or come out in substantial amounts). Also, there is the matter of time differences, though Perth does try to accommodate this by attempting to get their transactions through by 2.30 p.m. (local time), so that staff can get away earlier in the Eastern States. (Perth is usually allowed to operate up to 3.00 p.m. local time, i.e. 5.00 p.m. E.S.T.). It is perhaps rather fortunate that 7 out of the 9 centres of business are in the same time zone and Adelaide only half an hour behind. But the fact that the market is separated geographically places a high premium on efficient communications both within and between centres. These are probably adequate, though they could doubtless still be improved. Dealers' offices in Sydney and Melbourne have direct lines to the Reserve Bank (and the Reserve Bank itself has a direct line between Sydney and Melbourne). STD telephone services operate between all capital cities and a number of country centres; full Telex services are also available.

In addition to Commonwealth Government securities, the official houses also deal in commercial bills. In 1964, the Reserve Bank of Australia conducted an enquiry into the scope for an Australian market in commercial bills and, from March 22, 1965, authorised dealers were permitted to trade in commercial bills that had been accepted or endorsed by an authorised bank and with no more than 120 days to run to maturity. The dealers were further permitted to hold a small proportion of their portfolios in bank bills and (until April 1969) the Reserve Bank stood prepared to extend lender of last resort facilities to dealers against the security of such bills. (They are also dealt in in the unofficial market, where a number of new companies was formed for that purpose; being in the unofficial market such houses do not have lender of last resort facilities at the Reserve Bank, though they can — and do — sell assets to official dealers). Since 1965, a secondary market in commercial bills has developed. One reason for this has been the activity of the merchant banks. At the same time, it should be remembered that no acceptance credits in the true sense are granted by the merchant banks in

Australia, since those merchant banks that have first-class status consist of the various international commercial banking consortia (associated with major Australian trading banks), with whose local shareholders there may be some reluctance to compete; for the rest, very few of the remaining merchant banks have as yet achieved the status necessary to have paper bearing their names widely dealt in. The usual procedure is for a bill to be drawn by a merchant bank that will in fact buy the bill; it then attempts to discount it to outside investors. Occasionally, the bills are offered to the official market dealers but because the latter are restricted in this respect the merchant banks hold far more of the non-bank paper and the marketing of non-bank paper is carried out mainly by them, though some of them merely hold the paper against borrowed money while others tend to offer all paper purchased. Because these bills are relatively liquid, the merchant bank is able to offer its client a revolving facility for well over 12 months and without jeopardising its own liquidity. In certain circumstances, to improve the marketability of the bill, the merchant bank may arrange for a trading bank to endorse bills held in portfolio, which can then be rediscounted at the "prime bank bill rate". The holdings of authorised dealers tend to reach a peak about the beginning of each financial year (July) and fall to a low point about the following February. On the basis of average weekly holdings, the high to date is \$50 million in August 1969. More is probably held in the unofficial market.

Then, in March 1969, approval was given for the Australian trading banks to issue marketable Certificates of Deposit.²⁹ These could be issued in amounts of \$50,000 or over for terms ranging from 3 months to 2 years, though yields are subject to a maximum rate that is varied from time to time. Subject to the maximum rate of interest, banks were free to determine the rates they would offer from time to time for individual issues in various maturities. The

²⁹ In addition, the Australian Resources Development Bank (which commenced business in March 1968) had offered (in 1968 and 1969) transferable certificates of deposit (which were marketable, registered, non-bearer securities) in multiples of \$100 with a minimum of \$100. These were really medium-term deposits and were first issued in April 1968 for 6, 8 and 10 year currencies at rates of interest related to their term. The ARDB also accepts 4 and 5 year term deposits with a minimum of \$10,000 and, since March 1969, it has been permitted to make limited issues of CDs, subject to the same minimum denomination (\$50,000) and maximum yield conditions as the trading banks. These are in addition to its longer-term transferable certificates of deposit offered previously and the "transferable deposits" it now issues (for terms of up to 10 years).

authorised money market dealers were permitted to deal in these CDs and to hold a limited amount in this form. No bank would be permitted to buy back its own Certificates. Although the amounts held fluctuate a good deal, the authorised dealers have from time to time had up to \$40 million of bank CDs in their portfolios.

Subsequently, in February 1972, the trading banks were permitted to fix their own rates for fixed deposits of \$50,000 or more for periods of from one month to 4 years (subject to a maximum rate of 6.5 per cent set by the Reserve Bank). Thus, with the abolition of "carded rates" in this sector of the market a new element of deposit competition had been introduced. But, whereas banks could be expected in the longer run to be aggressive takers of funds in this category, initially they found themselves very liquid and the full effects of these changes may therefore take some time to emerge. Nevertheless, having been given freedom (within limits) to compete at market rates, one would expect the banks to develop perhaps to quite an important extent both as takers and lenders of funds in the money markets. Just how successful the banks will be in generating their own new business and in attracting depositors away from the money market proper remains to be seen, but — with corporate treasurers and finance managers becoming increasingly sophisticated — the banks are clearly well placed to take advantage of their freedom to compete with the established money market operators.

So far nothing specific has been said about the relative importance of the several groups of lenders in the official or authorised money market. In the early years (and up to, say, 1965), the trading banks were the most substantial lenders. Even today, they remain consistent lenders, though the funds they have out in the market may fluctuate quite significantly.³⁰ After 1965, non-financial companies (in the manufacturing and commercial sectors)³¹ tended to take over the lead (as company treasurers became increasingly sophisticated and banks switched, especially in January, February

³⁰ Partly due to the seasonal pattern of liquidity over which the banks have no control, fluctuations in their funds with the market are largely involuntary. The funds which the major trading banks have out in the official market are not classed by the Reserve Bank as part of their LGS assets (liquids and Government securities), which banks are expected to maintain at or above a given percentage of their deposits. (As from April 1962, 18 per cent). Because of this, bank loans to the money market tend to run down first during the period of seasonal drain on bank funds (between April and July).

³¹ At certain times, too, mining companies have been important.

and March, into Treasury Notes as a liquid asset); other important lenders are local and semi-Government authorities³² and State Governments. The most important of the remainder are savings banks³³ and life offices. Small amounts are also lent by marketing boards and trustee companies, superannuation, pension and provident funds, and by hire purchase finance companies.³⁴ All of these have funds from time to time that are surplus to immediate requirements and for a variety of reasons — advance provision for dividends, capital expenditure, or taxation; impending overseas remittances to parent companies; liquidation of fixed assets and redemption of maturing bonds; even the time-lag of a few days each month between receipt of debtors' accounts and payments to creditors. In 1970 and 1971, the trading banks (on the basis of quarterly dates) lent no more than \$260 million and sometimes considerably less, while other sources provided up to \$640 million. During 1972, weekly figures for the latter exceeded \$800 million.

As one would expect, the official market has grown considerably over the years. It really began to move ahead after the Reserve Bank removed the limitation on the volume of outstandings that the market was able to accept. This was in June 1964, when this arrangement was replaced by a gearing limit. It was true that the limit on outstandings had been increased gradually from under \$100 million to \$360 million and that the volume of outstandings had grown from under \$40 million in February 1959 to a disclosed peak of \$360 million in October and November 1964. The growth of operations was held back during 1965 by the low levels of liquidity in the economy, but recovered in the latter part of that year. As a

³² Many of these authorities have fairly steady expenditure commitments throughout the year, but their receipts (from rates and borrowings) are relatively "lumpy"; hence at various times they have large amounts of surplus funds available for investment.

³³ For the most part, funds temporarily surplus to a savings bank's minimum liquidity requirements. (Subject to minor exceptions, each savings bank is required to hold at least 60 per cent — this was changed from 65 to 60 per cent at end-October 1970 — of its depositors' funds in cash on hand in Australia; deposits with the Reserve Bank; deposits with, and loans to, other banks; Commonwealth or State securities; securities issued or guaranteed by a Commonwealth or State authority; or loans to authorised dealers in the short-term money market upon the security of securities issued by the Commonwealth. The 60 per cent must include a total of at least 10 per cent in deposits with the Reserve Bank, Treasury bills, and Treasury Notes).

³⁴ See Reserve Bank of Australia, *Statistical Bulletin*, published monthly, though the relevant Table appears quarterly.

result, outstandings reached a new peak in the early months of 1966 and continued to move upwards with the \$500 million mark being exceeded for the first time in the early months of 1967 and \$1,000 million in March 1972.

There is also a pattern of fluctuations in outstandings over the course of the year. But the factors that determine this pattern are somewhat complex. Thus, it is affected by the regular monthly payments from the Commonwealth to the States by way of financial assistance grants, advances against State loan programmes, and advances for State roads expenditure.³⁵ These are super-imposed on other factors such as the rundown of savings bank cash in December, the large inflow of tax payments to the Commonwealth Treasury accounts in the June quarter and the substantial net outflow from these accounts due to tax refunds in the September quarter and early in the December quarter. In addition, certain payments made by the Reserve Bank Rural Credits Department for marketing of primary produce tend to reach a peak in March or early April.

It is now appropriate to turn to the "unofficial" market. There is less homogeneity here but for the most part business is conducted by four main groups of houses — stockbrokers³⁶ (some are associated within the same group with an authorised dealer); a separate subsidiary within the same group (virtually sharing the same management as an associated authorised house);³⁷ finance companies, which raise much of their finance by issuing debentures and unsecured notes and which themselves often have a highly diversified business, of which unofficial money market transactions are only a part; and the merchant banks (referred to above).

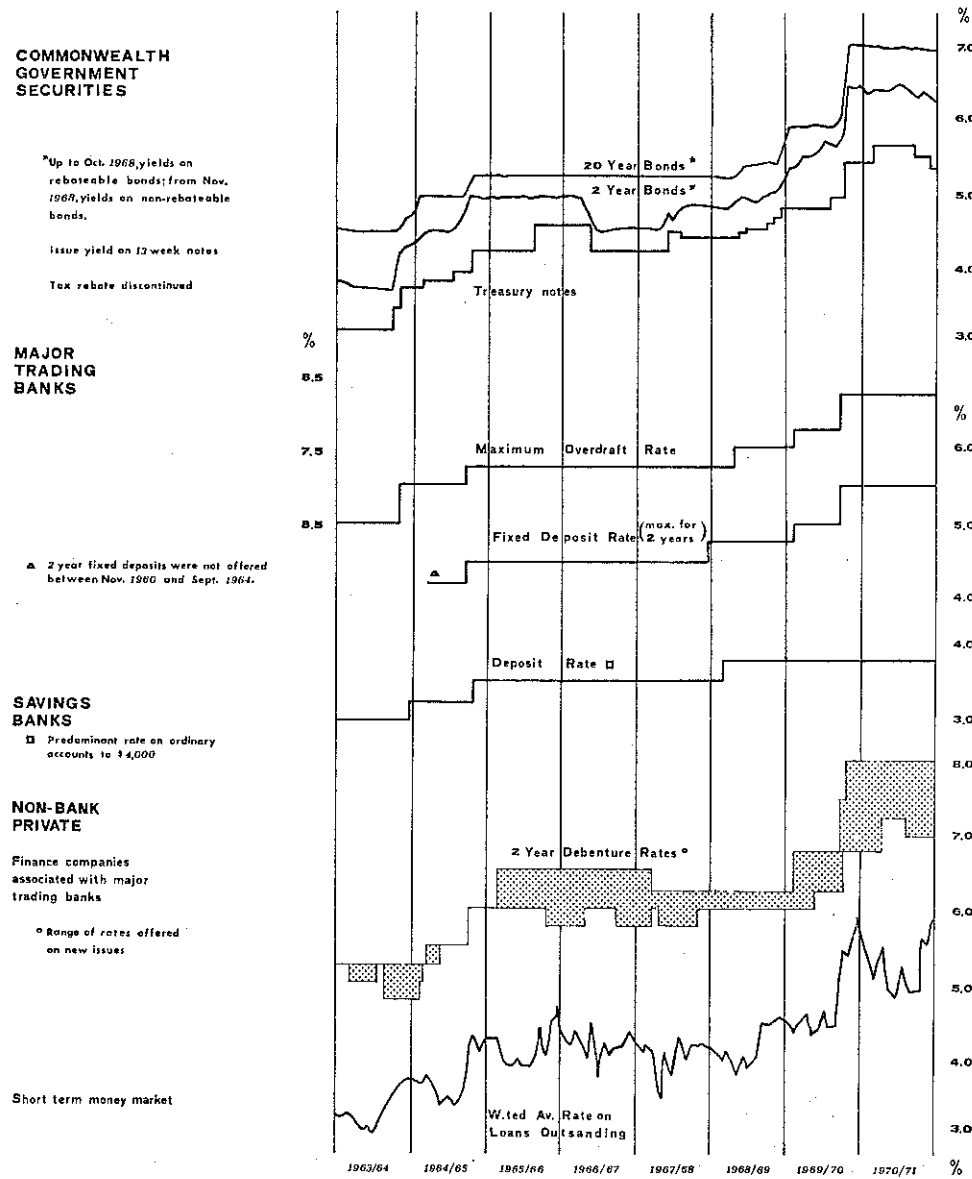
Some of the business done by the "unofficial" market is really a projection of the buy-back facilities that were originally offered prior to the establishment of the official market in February 1959 by

³⁵ The financial assistance grants and Commonwealth Aid Roads grants are made on the 15th of the month or on the first working day thereafter and the advances against State loan programmes are made upon request from the States on, or soon after, the first day of the month.

³⁶ The larger stockbrokers used to be important jobbers in Government securities, but this is so no longer. Since they have been allowed to deal in any other assets, the dealers have taken over the major role in both short- and long-dated Commonwealth Government securities. Indeed, there is no need for a jobbing position to be taken at all in long-dated Commonwealth Government securities as long as dealing margins are small enough to entice permanent holders to trade their holdings.

³⁷ This is said to have the advantage of helping to "build bridges".

**SELECTED
INTEREST
RATES**



Reproduced by kind permission of the Reserve Bank of Australia from their *Annual Report, 1970-71*.

**HOLDINGS OF
GOVERNMENT
SECURITIES**

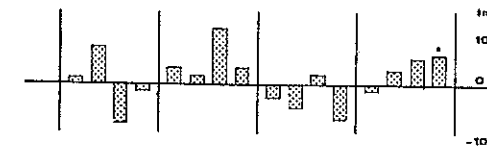
Redeemable in Australia-face value

Quarterly movements

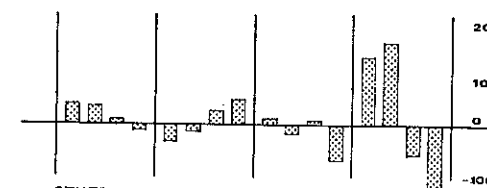
Seasonally adjusted

* Preliminary

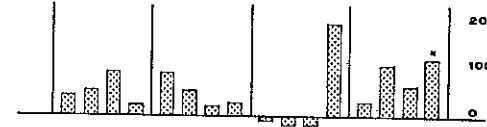
TRADING BANKS



SAVINGS BANKS

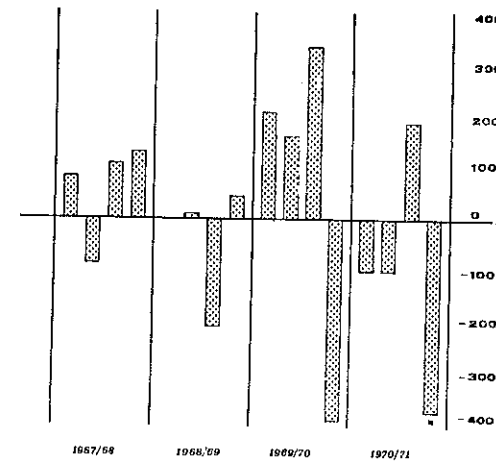


**OTHER NON-OFFICIAL
HOLDERS**



RESERVE BANK

Allows for movement in Commonwealth deposits with Reserve Bank



Reproduced by kind permission of the Reserve Bank of Australia from their *Annual Report, 1970-71*.

certain stock exchange dealers in Sydney and Melbourne to their customers. The big advantages that the unofficial dealers continued to enjoy were the absence of a limit on their portfolios and their ability to operate in Commonwealth Governments with more than 3 years to maturity (also in semi-Government paper), though some unofficial operators have held considerable books in securities with 6 to 12 months of maturity and they in fact also do buy-backs in Commonwealth Governments with maturities of less than 3 years and even in Treasury Notes. This will probably continue to be true despite the modifications of April 1969 (described below), which directly related to the authorised dealers. On the other hand, the unofficial dealers suffered from the major disadvantage that there was no lender of last resort to whom they could refer in the event of difficulty. The buy-backs done by the unofficial dealers may often be at call and be allowed to run on; only sometimes are they done for a definite named period (say, for from 30 to 90 days). The terms will usually be set out in a letter, which sometimes states a rate of interest instead of operating on the basis of the difference between the prices at sale and repurchase. It is not usual for the securities to be transferred physically (this would be too dangerous) and, since no Reserve Bank safe custody certificates are available, dealers resort to a marked transfer. Sometimes, too, buy-backs seem to be done on a very loose basis indeed. There may be no definite arrangement as to price at the beginning of the transaction — just a loose verbal agreement to a buy-back deal, the question of price being left open for 24 hours (or even up to 2 weeks) before becoming firm. In the beginning, the details of the transaction will be noted at each end, but before the actual price is agreed it may be moved a bit either way. From the dealer's point of view, the virtue of the buy-back is that he can carry a larger book than would otherwise have been possible; he can also carry a more varied book. On the other hand, he runs the risk that the prices of the securities sold may change, the buy-back in effect being in the nature of a loan at a fixed rate. It is believed that the buy-back market only represents quite a small part of the total business done in the unofficial market.

Another area in which the unofficial dealer operates, and which is closed to the official houses, is the inter-company market. It is difficult to be precise about its origins, but it certainly goes back to the 1950s, probably encouraged by the credit squeezes of those years

and particularly that of 1958.³⁸ It expanded greatly during the 1960s. Formerly, the loans made were completely unsecured, with much of the money being lent at call.³⁹ Latterly,⁴⁰ with the introduction of the commercial bill, the limits of the market have been less well defined, since a loan by one company to another may now be secured by a commercial bill and yet be defined as coming within the inter-company market. Indeed, inter-company loans, especially when they are at longer-term, may also be secured in other ways either directly by a charge over assets (debenture, mortgage, lien, or bill of sale) or indirectly by irrevocable letter of credit, bank guarantee, parent company guarantee, or even scrip in an industrial company (where a minimum floor cover may be 200 per cent at current market prices; for mining shares minimum floor cover may be 500 per cent — both may be subject to daily adjustment when necessary). Some of the business is done direct between lender and borrower, but much of it goes through brokers,⁴¹ who charge a commission of 1/4 per cent per annum up to \$1 million and 1/8 per cent above this. In some cases, too, finance companies, which borrow money in a variety of ways (including the inter-company market) may also place money from time to time through the inter-company market. The companies operating in this market include most (but not all) of the 20 to 25 blue chip companies in Australia, but there are a lot of other companies besides, some of which are relatively small.⁴²

³⁸ Investment houses in the late 1950s recognised that profitable business could be done by marrying up the widely differing liquidity peaks and needs of companies in different sectors of the economy. This provided the foundation for the inter-company market, but it was the trading banks which unintentionally gave the market its final thrust into orbit. Because of the credit squeeze in 1959-60, they were unable to accommodate some of their more substantial customers and some of the managers of the larger branches began to appreciate the possibilities of "introducing" a customer seeking funds to one known to hold surplus funds at that time. One might add that it was felt likely everything would fall back into place again once the credit squeeze had ended; in fact, a new market gradually built up volume and became established.

³⁹ Though it may be for longer periods. Some may be put out at 7 days, or for one month, or right out to 90 days and beyond. It might also be fixed for 12 months, with perhaps the right to break — at one month's notice, or the breaks may be quarterly with the right to a variation of rates. These terms would be formally set out in a letter.

⁴⁰ See Reserve Bank of Australia, *Annual Report, 1969-70*, p. 24.

⁴¹ Usually, stockbrokers, who also do a little money broking. It is also done by small specialised companies (set up as subsidiaries of the merchant banks) and by the merchant banks themselves. The last have tended to make a more realistic charge for their services than do the stockbrokers.

⁴² Latterly, some of the merchant banks in Australia have sought to attract company money as deposits with a view to accommodating the needs of the smaller companies.

Of the companies in the market, some firms are both borrowers and lenders, depending on seasonal factors; in other cases, there are "cross-board" relationships, where men are directors of several companies; and some companies are perpetual borrowers, though they may support this borrowing with an unutilised overdraft limit. Authority for a company to deal in this market may be given by the board of directors; at other times, the decision rests with the company's secretary. Most — if not all — companies in this market have a list of approved borrowers (occasionally, they may take a name off their list; at other times, names may be added); they also apply limits. It is usual for lending companies to keep an eye on a borrowing company's accounts (this may be done for them by a stock-broker), but a lot can happen between one set of accounts and another. Indeed, the arrangements are not without their dangers; loans have at times gone wrong, but not often and, if this happened more frequently, the market might well fold up.

This market has also been under threat from a different quarter. Between April and June 1970, when credit conditions were extremely tight, the commercial bill market reacted immediately by moving its rates up from 5.75 per cent to 9.50 and 10.00 per cent per annum on both bank and non-bank paper. The inter-company market lagged behind and, because of this, inter-company transactions in the narrow sense virtually dried up, the smaller amount of funds now available going into negotiable securities, backed by at least one good name, rather than into what was often a completely unsecured deposit. This experience left its mark and the bill market increased in size, many substantial customers who had hitherto obtained their requirements through the inter-company market (narrowly defined) now turning to bill finance in order to be sure of a supply of funds during tight periods.

When the outside market in commercial bills came into being in the mid-1960s⁴³ (previously, commercial bills had been held within

thereby providing them with readier access to relatively cheap working capital. The merchant banks are in any case important takers of money from the inter-company market and this enables them to hold substantial portfolios of non-bank bills.

⁴³ The market outside the banking system began to expand rapidly with the formation of specialist bill companies such as Bill Acceptance Corporation (established in 1964), Merchant Bills Corporation (1965), and Martin Corporation (1966). Australian United Corporation, which was converted into a public company in 1957, had also been active in the commercial bill market since the mid-1960s.

the banking system), it was hoped that this would compete for funds with the inter-company market and might, at least in part, replace it. As we have seen, this to some extent is what has happened. Not being subject to the requirements of the authorities, the unofficial market had considerable freedom in developing the bill market and several new companies with overseas backing were set up for this purpose (in addition, there were the associated companies of authorised dealers, some development finance companies, and others). In the first place, commercial bill holdings were not restricted to a proportion of their portfolios and the unofficial houses therefore enjoyed unlimited scope in a new market. In the second place, the unofficial dealers could handle a wider range of bills, i.e., they were not confined as was the official market to bills that had been accepted or endorsed by an authorised bank. There were in fact two other categories of paper in which they could do business. First, one large company drew bills which were accepted by their customers (up to specified limits) at rates higher than those that applied to "official" paper.⁴⁴ Other large companies quickly followed.⁴⁵ Second, companies with first-class names (e.g. some of the oil companies) began to issue finance or accommodation paper (rather more like the commercial paper issued in the United States and Canada, but in bill not promissory note form, sometimes backed by a guaranteed line of credit at their bank). These were very obviously a direct substitute for inter-company borrowing and lending, with the advantages that it had the security of a piece of contractual paper to back it up and that it was marketable. Not only was it substitute on the borrowing side but companies could also absorb temporarily surplus funds, and some companies (even large public authorities in the utilities field) bought up trade (and finance) bills as a profitable means of holding their funds.

The big question that remains to be answered is whether the official and unofficial markets will ever become fully integrated. In this context, a big step forward was taken in April 1969, when the Reserve Bank announced a number of modifications to official market procedures, which were calculated to allow dealers more flexibility in their operations and which went a long way towards removing

⁴⁴ But they avoided the bank acceptance charge. Such paper attracted stamp duty. Even so, the relevant finance still cost less than a trading bank overdraft.

⁴⁵ Some of the trade bills that are dealt in relate to quite small companies but the market is only interested in them when at least one name is of "inter-company status".

many of the barriers that previously existed between the official and unofficial parts of the money market. Thus, although the great bulk of the official dealers' funds must continue to be invested in Commonwealth Government securities — and, in future, last resort loans will be granted to authorised dealers only against the security of Government (and, to some extent, Public Authority)⁴⁶ securities — holdings of Commonwealth securities can now be in series maturing within 5 years instead of 3 years as previously; authorised dealers can also now deal in bonds longer than 5 years to maturity and can hold a small amount of these longer-dated securities in their portfolios. Similarly, the maximum term to maturity of bank Certificates of Deposit, which authorised dealers were permitted to hold and deal in was increased from 2 to 5 years. (This enabled the authorised dealers to extend their operations to the Australian Resources Development Bank's transferable CDs,⁴⁷ the first of whose issues — which had an original maturity of 6 years — came within the 5-year range in April 1969). Again, there was no longer a formal limit of 120 days on the term to maturity of bank accepted or endorsed bills, which the authorised dealers could hold or deal in, though it was up to the trading banks to decide whether in fact they wished to accept or endorse bills with maturities longer than 120 days. For the first time, authorised dealers were to be permitted to hold and to deal in non-bank bills, provided they matured within 180 days and another barrier between the official and unofficial markets went down. Furthermore, the authorised dealers might also now deal in any other assets of their choice and could hold a limited amount of these assets in their portfolios. (It seemed likely that in this "free category" dealers would choose to hold mainly fixed interest paper, such as debentures and unsecured notes of blue chip borrowers). In addition, from June 1970, dealers were allowed to hold and deal in Public Authority securities. Maturities of up to 5 years came within their "normal" portfolio (as above), but were to be kept to a relatively small proportion of the total (these were acceptable to the Reserve Bank as security for last resort loans). Any such securities beyond

⁴⁶ Initially, dealers could only hold or deal in Public Authority securities of New South Wales, Victoria, and Queensland. The Reserve Bank did not provide safe custody facilities, but (as indicated) the securities could be used as the basis of last resort loans provided dealers could give an acceptable charge. In relation to the total Government segment of their assets, these holdings were small. Dealers could also hold Public Authority securities in their miscellaneous segment.

⁴⁷ Since October 1969, known as "Transferable Deposits".

5 year's maturity might be kept in limited amounts within the "free category". Finally, the Reserve Bank decided that from a date to be announced it would withdraw its "margin" requirements⁴⁸ (i.e., the additional amounts of Commonwealth Government securities that had to be provided out of shareholders' funds and held with the Reserve Bank; they were determined by the size and nature of the various assets held by dealers in their portfolios). These requirements were withdrawn as from February 1, 1972.

Following the 1969 modifications, the stage was set for the further development of the Australian money market on an integrated basis with a gradual merger of the official and unofficial aspects of its business. What else might be attempted? No doubt, communications could still be improved, but they are now relatively good even for a country as large as Australia. Secondly, as a means of developing the market, the dialogue between the Reserve Bank and the market must be further encouraged. Both in Sydney and Melbourne, market personnel regularly converse with staff in the Reserve Bank. In addition, the Chief Manager of the Securities Markets Department in the Reserve Bank in Sydney will be in touch with senior men in the market and they with him. Also meetings have been held with dealers usually at quarterly intervals⁴⁹ alternately in Melbourne and Sydney, chaired by the Chief Manager of the Securities Markets Department and attended by the chief executives of the dealing companies and senior officers of the Reserve Bank responsible for the Bank's activities in the bond and money markets. There is also a Council of Dealers; it is at chairman level but is comprised of representatives of only six out of the nine houses and cannot therefore speak for the market as a whole. Nevertheless, and although it only meets occasionally, the current chairman has access both to the Chief Manager of the Securities Markets Department and to the Deputy Governor (or the Governor). The Reserve Bank rightly regards these conversations at their several levels as having an educational value, but they do tend to be rather one way and the central bank's aims might be more quickly realised if the conversations became a true dialogue with the Bank more prepared than at present to discuss the background to policy and its formation, with

⁴⁸ Determination of an appropriate security margin was then to become a matter for negotiation solely between the lender and the dealer.

⁴⁹ Meetings have been held whenever the Reserve Bank or the dealers have sought them.

an increasing emphasis on the market's potentialities as an instrument for the carrying out of the monetary policies of the authorities. On the other hand, a good deal of statistical information is already provided by the Reserve Bank. In addition to the monthly figures published in the *Statistical Bulletin*, there is a daily and weekly press release. Also, and on a confidential basis, the dealers are supplied daily and weekly with a range of information covering the market's activities in money and securities, and the interest rates that have obtained.

Finally, although the Reserve Bank has in recent years shown a greater willingness to be flexible and has traded actively in Treasury Notes, the present author would still wish to see the introduction of a weekly tender of Treasury Notes, as a means of introducing even greater rate flexibility. It is appreciated that Treasury bills are now used in Australia only to finance the Commonwealth Government's net short-term indebtedness to the Reserve Bank, which could just as easily provide overdraft accommodation. Even so, a fixed rate of 1 per cent on Treasury bills in this day and age does look somewhat anachronistic. It is also appreciated that yields on Treasury Notes, the issue of which might be put on a tender basis, are subject to the approval of the Australian Loan Council, of which State representatives are members. These yields are varied from time to time, but the rate on tap issues of Treasury Notes nevertheless tends to lag rather badly behind changes in the market (whether movements be up or down). It is realised that not all the arguments are on the side of the author. The authorities fear to abandon arrangements that over a long period of years enabled them to finance the floating debt at a relatively low level of interest rates (and it must be admitted that the way in which Australian interest rates were over the years largely insulated from the impact of forces operating elsewhere was little short of remarkable).⁵⁰ It was also feared that the issue of Treasury Notes on a tender basis could be expected to result in sharp seasonal fluctuations in rates that could in turn have an effect on other "administered" rates (such as those applying to Certificates of Deposit and other trading bank deposit rates). It is argued, too, that wide fluctuations in interest rates would be undesirable particularly at times immediately prior to the announcement of terms for issues

⁵⁰ This is no longer as true as it was and latterly there has been much evidence of overseas developments exerting an influence on Australian rates.

of public loans by the Commonwealth. Moreover, Australia is a federation and it is difficult to visualise Loan Council approval being given to a system which resulted in sharp fluctuations in rates at the short end of the market, while at the same time attempting to achieve reasonable stability in rates for longer term public borrowings, whether by States or Commonwealth. (In the United Kingdom, this difficulty has been largely avoided by the Treasury issuing longer dated securities to the "Departments" where they have been held until they can be peddled out to the market as and when the authorities judge the circumstances to be opportune. As a result, fluctuations in Treasury bill rates have tended to have a reduced influence on the rates applicable on sales to the public of other Government debt). Also, it is claimed that some of the market houses may not be sufficiently sophisticated to understand what a tender is all about, but if they never start they will never learn.

It is true (as has been mentioned) that the Reserve Bank has attempted to provide a measure of flexibility in the market for short-term debt by trading with the authorised dealers in Treasury Notes. It was thought that this was likely to increase the holdings of dealers and others, since the penalty rate of discount applying when Notes are rediscounted with the Reserve Bank could on occasion be avoided by selling to the Bank. Moreover, the sale of Notes by the Bank might offer more suitable maturities than were available by subscribing to current issues. Nevertheless, and in the long run, the case for a tender is very strong. One can scarcely continue to develop a market, unless rates become fully flexible. Moreover, over the years, rate flexibility is likely to produce cheaper money just as often as dearer money — it will be money obtained at rates that truly reflect current conditions and the flows of money within the market as a whole. It could lead, too, to a much more skilful use of interest rates and of cash availability as weapons of control by the Reserve Bank. In short, sophisticated central banking and an efficient money market based on flexible rates tend to go together. Nor need the Reserve Bank lose control of interest rates; even with a tender the central bank can exercise a strong influence over rates. Much has already been achieved and the 1969 modifications were undoubtedly a further step in the right direction; it would be a pity not to take the ultimate plunge and to introduce a tender.

Hull

J. S. G. WILSON