TODAY'S DEVELOPMENTS – TOMORROW'S OPPORTUNITIES

by
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Last year, I spoke on the subject of Liquidity Management – a topic on which I must by now have earned a reputation of the Club Bore. Even to those who have been having a few problems in that area over the last week or two – none of whom is among those present here this evening, of course! 50% overnight money, indeed!

Today, I want to sketch in a somewhat wider compass; to identify where we are in relation to our objectives. And then to suggest where we might be going, rightly or wrongly. I won't bore you with those stories about not starting from here if we want to reach the village of Middle Wallop but, even if we are wrong, it is still possible to go to Paradise by way of Golders Green or by a brief visit to that equivalent establishment on the Lane Cove River.

To look, very briefly, at the history of the market's development over the last quarter century let me remind you: –

a) First, how it started out as an attempt to meet the demands of those having large sums of money, and wishing to earn interest on them, by creating a deposit facility payment interest on call money. And how this grew, through the Inter-company market, the buy-back market, the authorised dealers and then the merchant banks.

b) Secondly, how the availability of a pool of deposit funds provided a base from which to borrow in a regular and dependable way. And how this grew, through the inter-company market, the commercial bill companies and then the merchant banks.

c) Thirdly, how the cash movements steadily gave way to the buying and selling of pieces of paper, evidencing indebtedness and providing a negotiable security.

d) Fourthly, how the banking system reacted to all this, forming different subsidiary operations in savings banks, finance companies, property companies and merchant banks, to protect its deposit base. And how it has succeeded to the point where its share of the deposit base through all its activities is largely unchanged from what it was in 1955.

The last twenty five years have seen an unlocking of a previously rigid system of cash movements, creating a much more fluid system of constantly changing arrangement, but still contained within much the same bounds.

To examine whether we have actually achieved anything worthwhile, in all this, is an exercise – certainly in this gathering – to be approached with some care, if not without prejudice.

The Holy Grail of money marketeers is to achieve a situation where no single arrangement need last more than a single day and where, to differentiate between cash and pieces of paper convertible instantly into cash, is to make a distinction without a difference. A parallel might be drawn by the more venturesome between the relationship of an old pound note, for which you could get gold; and many short securities nowadays, for which you can get cash. The process must be capable of instantaneous achievement to sustain credibility.

At the same time, the marketeers are trying to eliminate the distinction between making a loan and buying a security – an area of obfuscation which has tested the ingenuity of Stamp Duties Commissioners and lawyers alike over recent years. Not least in the area of bills of exchange, where the purchaser of the bill is held variously to be making a loan or to be buying a security, depending on the semantics of, perhaps, the securities clerk settling the transaction.

Indeed, I myself was once accused of mendaciousness by an official of the official family for denying any real difference between buying a bond and making a loan to the Commonwealth. He insisted I knew perfectly well what the difference was; I insisted equally that it was my job to eliminate the difference, in the public interest. Fortunately, Frank Crean came to our rescue by making us brothers in arms when he publicly condemned the practice of marketeers "shuffling second-hand pieces of paper backwards and forwards".

However, the conversion of large areas of the borrowing and lending markets *away* from unsecured deposits with, and secured loans from, the banking system *to* the purchase and sale of negotiable instruments has had several profound effects which are worth examining to decide whether we are on the right course.

In the first place, it has given the principals in the market much greater freedom of choice in the management of their short-term surpluses and deficits. Instead of simply dealing with their banks, they now have a large number of intermediaries – some might say much too large a number – competing to service them. So the balance of power has shifted away from the intermediaries (including the banks) to the principals actually generating the economic activity – and that, as Messrs. Sellars and Yeatman would have it, is a Good Thing.

It is, of course, a wholsale market, not a retail one, so that these new facilities are available only to the larger organisations. The little people, whether individuals or small business, have not experienced the same benefits, although the awareness of cash management appears to have spread through the community as evidenced in the growth of building societies and credit unions.

And, in so far as it is a wholesale market, where market disciplines are the key to survival, it is no place for the squeamish or for the advocates of the socialisation of investment. Those who show performance and strength in the market will move ahead of the others; borrowing more cheaply and earning higher rates of interest on their funds.

An essential feature of the market is its mobility and its liquidity – the ability to obtain cash instantly, even though the security purchased may have some time to run. Clearly, the longer the term of the security, the more the element of risk and the higher should be the return, though this is not always the case. Unfortunately! Clearly some pieces of paper are more readily negotiable than others and some element of earning needs to be foregone to ensure adequate liquidity. This is an area which is still not entirely grasped by those who are often too eager to earn an extra one per cent, if only for part of the year. But, through the development of the market, funds are now able to be put to very good use without impeding liquidity by having them locked up in fixed term investments or deposits.

So, in this respect also, there are improvements for the funds manager – but there are also dangers if he is too greedy.

From the government viewpoint, new horizons have opened up in debt management, open market operations, money supply management and influencing the liquidity of the system. With the recent introduction of the tap system for issuing Commonwealth Bonds and the tender system for Treasury Notes, the Government has given itself much wider scope for achieving its monetary aggregate objectives. There is, of course, much experimentation going on with the new mechanisms and the Reserve Bank is clearly having a lot of fun, judging by the peals of laughter echoing down from the top of Martin Place – and not always, I understand, from hysteria.

Reverting to the question of competition, the extent of that competition in the market has become focussed in the last few years in an outright struggle between the Government and the banks for the lenders' dollars. A struggle which was hopelessly lost by the Government between 1965 and 1980 but which, with the new tap and tender systems, can be reversed.

In simple terms, the Government believes that it should be able to issue its bonds like any industrial company issues debentures and, at the right rate, people will buy them. But they forget that the banks will always be prepared to pay just a little bit more – interest being a tax-deductible expense – until such time as the economy winds down and nobody wants to borrow at any price. In addition to that, there is a question of reciprocity: if you lend your cash to a bank, it may reciprocate by giving you an overdraft when you next need it. Whereas, buying bonds does not necessarily encourage the purchaser subsequently to expect a loan from the Treasury. So the banks have been winning hands down, and the Authorities' ability to achieve their objectives has been restricted.

You may observe, correctly, that recent issues of semi-government debentures and of Savings Bonds give the lie to my thesis, since the public has shown very strong support for these at recently announced higher rates. That is so, but it has been the general public, in the retail market, that has been switching its dollars from the savings banks and building societies into those other investments. The wholesale market of professional investors has been largely unmoved. To affect that market, the government has got to introduce some incentive, probably linked to the concept of liquidity and through the tender system of Treasury Notes, to win back the professional investor.

Much of all this you will observe in discussions before the Campbell Committee. And after. Many submissions to that Committee have come from intermediaries seeking to further their own roles and secure their deposit bases, and this is disappointing, not to say unconstructive. The roles and market shares of the intermediaries are relatively unimportant compared with the efficiency and financial stability of the principals in the market, and they should look more to the ultimate goals, as should the principals.

Concurrently with these major changes in the structure of the money markets, there occurred, over the past decade, great instability in prices and in exchange rates. In their attempts to satisfy their customers' needs, the practitioners in the capital market have devised a range of practices designed to protect lenders – and sometimes borrowers – from the ravages of inflation and exchange losses.

The investment or currency hedge, variable interest rate loans, rollover loans with currency options, futures markets, options markets and so on, are all devices to give the benefits of long term investment to essentially very short situations. That may be acceptable if the aberration is temporary. But we have convinced ourselves for nearly a decade now that international world instability and inflation are purely temporary phenomena. The longer it takes to cure them, the more people will forget what a stable financial and investment market is like and the more they will accept, as normal practices, things which are symptoms of abnormality.

One praises the Government for striving to rein in inflation. But as long as it persists in refusing to have a proper margin between its own short securities and long bonds, i.e. a flat yield curve, it will encourage an air of instability in the financial markets, convinced that long-term investments are unsound. For the present, therefore, there is within the short-term money market an admixture of very sound development with a degree of temporarily speculative money looking for a long-term home, and not just in property.

If Australia's development in the 1980's is going to be soundly financed, with the maximum of Australian money, there must be greater incentive for long-term investment. Necessary pre-conditions for this are a sorting out of the real struggle between the banks and the Government, for the lenders' dollar, and greater incentive to long-term investment and saving by the community.

Looking, now, to the future, we have to be careful not to be carried away by euphoria. We have also to see ourselves as others see us, for we are increasingly part of an imploding international market about which we know too little.

I was interested to read in the week-end papers the views on Australia of clairvoyants and futurologists. Heaven forfend that I should join them in their anguish – for they remind me of a story about a renegade uncle of mine in Scotland who is reputed to have said, when asked his views of the New Testament – "that it all happened a very long time ago, and we will just need to hope that it wasn't true". Likewise, I hope their forecasts of earthquakes and diabolical inflation in the 1980's are untrue! They did, however, suggest that Australia will need a fair dose of market forces to prevent it from degenerating into a land of lotus eaters.

There is no question but that we must have in mind that the 1980's may be a turbulent decade, which may prevent us from achieving what we want to. But nonetheless we must set down our objectives and have them constantly in mind.

As far as the financial markets are concerned, their primary objective must be to further the objectives of those organisations promoting Australia's development and economic efficiency, while bringing to bear upon them a high degree of market discipline.

I have tried to describe to you how present market structures are unsoundly distorted because of world inflation and instability. Mainly this derives from an attempt to protect the lenders and investors – those who have the gold. There is a good case to be made for giving less protection to the lender and more incentive and more scope for the borrower. Some of this, at least, bears on the taxation system, where Government will need to re-examine the whole question of Company Taxation.

I was pleased to see that this topic was the subject of a recent seminar before the Campbell Committee. That Committee has a tremendous responsibility to come up with a few answers, but it would be impertinent for me to try to anticipate or pre-empt its recommendations now.

Subsequent speakers in this seminar will describe to you the latest innovations in market practice, whether in new types of instruments, changing legislation and the part the Government has to play both in promoting and monitoring the efficiency of the capital markets. It is no easy task to promote the free enterprise system in a political environment dedicated to the quest of social amelioration as the basis of political power. But I think history will record that Fabian Socialism passed its peak of world influence in 1975, when most social democracies discovered that they simply could not afford it.

Now we must get down to work. The demands on Australian financial markets in the 1980's will be severe, both from resource development and from what we euphemistically refer to as the semi-government area. And the financial markets are already performing well in these areas. Cash-flow lending and management will become all-important, and the short-term money market will play a vital role in financing and in good debt management, as the seminar speakers will demonstrate.

People tell me that we need to borrow most of our funds from overseas to promote our development. I take a somewhat different view in suggesting that, with the Australian saving ratio as high as it is, there is adequate capital available in Australia to keep the workforce fully employed, even on a 60-hour week. Only when the demands of our development are beyond the resources or numbers of our workforce do we need to import our equipment, technology and capital from overseas.

The protected and self-indulgent nature of our social mores tends to make us spend our money on houses and motor-cars of a standard which is the envy of our competitors. But then they buy up and develop our resources which we pretend we cannot afford to do.

The answer, dear Brutus, is in ourselves, whether we are prepared to forego some of our hedonistic existence to protect the heritage for our children.

I very much doubt whether, as a socio-political community, we are prepared to forego *any* of our self-defined privileges. But in the capital and money markets, we have a great opportunity to help in promoting the cause of sound investment for the future. Both for ourselves and for the market and its customers, the eternal truths will prevail and we should batten on them.

We need, and have the capability of promoting, the integrity, efficiency and disciplines of sound, but aggressive, financial management to underpin the future growth and stability of Australia.

I hope that we – and you in the audience – can meet those daunting challenges.