# The significance of liquid assets other than money and near-money in the South African economy

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### Introduction

The preceding two articles in this issue of the Reserve Bank's *Quarterly Bulletin* have outlined the concepts of the monetary banking sector and of money and near-money in the South African economy, supplied reasons for the revised definitions of these concepts, indicated the nature of the several types of money and near-money comprised by these definitions, and presented an exposition of the way in which immediate "causes" of changes in the total quantity of money and near-money, as it exists in the economy at different moments of time, may be identified and measured by means of a "monetary analysis". At the same time it was recognized that for certain purposes a measurement of money and near-money may not provide an accurate measure of the overall liquidity of private non-financial spending units whose spending decisions are mainly responsible for determining the aggregate volume of private consumption and investment expenditure in the economy. The analyses of the preceding two articles should therefore be supplemented by a survey of "other" financial assets that have liquidity characteristics or are held for purposes that may render them more or less close substitutes for money and near-money in the hands of their holders.

### Nature of "other liquid assets"

Money and near-money have been defined to include coin and bank notes in circulation and short and medium-term deposit liabilities of the monetary banking sector to the private sector. Since "liquidity" is a matter of almost continuous variation and not an exclusive property of a limited range or number of financial assets only, a corresponding definition of "other liquid assets" would be difficult to give. It is nevertheless possible, and for certain purposes desirable, to distinguish certain types of financial assets which, in addition to money and near-money, represent more or less liquid claims on the "financial sector" of the economy and as such should be considered a part of the overall liquid asset holdings of private non-financial spending units. For purposes of this article, the "financial sector" will be held to consist of banking and other deposit-receiving institutions, insurers and pension funds. In addition to assets held with these institutions, private non-financial spending units also hold a variety of liquid assets with the government sector. Notable examples of "liquid assets other than money and near-money", to be discussed in more detail below, accordingly include (i) short and medium-term deposits with banking institutions other than those included in the monetary banking sector, and savings deposits with building societies, (ii) "other" (long-term) deposits with banking institutions and building societies, and building society "shares", and (iii) liquid assets, such as Treasury bills and short-term government stock, with the government sector.[1]

A number of reasons present themselves why significant changes in the aggregate volume of such assets should be of interest to the monetary authorities in assessing overall monetary and credit conditions. Firstly, a significant proportion of these assets themselves possess technical liquidity characteristics (in the sense that they may be monetized fairly rapidly and conveniently and with relatively small risk of loss) that are little different, and may be indistinguishable, from those of certain types of money and near-money as now defined. In other cases, e.g., those involving long-term deposits with monetary banking institutions, the difference may be real but to some extent remains a matter of degree. A fairly substantial amount of these assets was in fact included in near-money under the somewhat different conditions prevailing under the Banking Act of 1942. In several cases the "liquidity" of these assets, either in a technical sense or from the point of view of their holders, may therefore be deemed to be at least equal to that of the less liquid and less actively used types of deposits now included in near-money. As a result, the private sector's reasons

[1] It is not, of course, claimed that these particular groups of assets, together with money and near-money, necessarily present an exhaustive "inventory" of all liquid asset holdings of private non-financial spending units (which for certain purposes might also be made to include, e.g., the cash value of life insurance policies). The above categories of financial assets, next to money and near-money, would nevertheless appear to contain the more obviously liquid and/or quantitatively more important groups of financial assets that are readily available to broad sections of the public and should be included in the total net financial wealth of the private non-financial sector as a whole. The existence of a variety of such assets, as in South Africa, is in itself typical of a relatively advanced economy showing a highly diversified and flexible financial structure.

for holding these assets, as well as the effects of changes in their aggregate volume on actual or planned private spending behaviour, may at times be much the same as those that apply in the case of money and near-money.

Secondly, to the extent that such assets represent deposit or similar liabilities of private banking or financial institutions that are not included in the monetary banking sector, an increase in their volume represents an increase in the credit creating potential of the institutions concerned. On being relent, the cash or deposits involved usually return to private holders, thereby restoring the private non-financial sector's holdings of money and near-money to its original level while actually increasing this sector's holdings of "liquid assets" by an amount roughly equal to that of the original deposit.[2] In this context, it should be remembered that the power of non-banking sector institutions to increase their deposit liabilities and lending potential (e.g., by offering a somewhat higher level of deposit interest rates than is being offered elsewhere) *may* but certainly *need* not mean a decline in the deposit liabilities of, or in the amount of credit being supplied by, institutions in the monetary banking sector.[3] Being able to add to the overall availability of credit and thereby to sustain an increase in aggregate spending (the effects of which will show up statistically in an increase in the velocity of circulation of money), these institutions may therefore occasionally add to inflationary pressures or counteract deflationary tendencies induced by a restriction of credit elsewhere. Although a presumption exists that the institutions concerned may in fact be doing no more than to channel "true savings" into various forms of financing investment, this is not necessarily the case, either because the funds being shifted represent "old" rather than current savings (i.e., represent "idle" balances being activated) or because the deposit liabilities of the recipient institutions themselves (as in the case of savings deposits with building societies) strongly resemble money or near-money and have come to be used as such. As special conditions may occasionally tend to encourage this type of deposit shift beyond its normal rate, the aggregate volume of the liabilities of these institutions deserves to be kept under regular review.[4]

Thirdly, not only may an increase in "other liquid assets" with banking institutions and other financial institutions outside the monetary banking sector bring about some increase in the overall availability of credit, but, similar to the effects of a redistribution of deposits within the banking sector, it may also have effects on the *direction* of the stream of lending. This is, of course, particularly clear in the case of the building societies whose success or otherwise in attracting deposits or increasing their "share" liabilities in competition with other deposit-receiving institutions may have significant effects on the cost and availability of mortgage credit.

Finally, as a significant proportion of private sector holdings of "other liquid assets" with institutions outside the monetary banking sector consists of assets which more or less closely resemble money and near-money and have come to be used as such by certain broad sections of the public, and as the aggregate volume of these assets is relatively large, a measure of "return flow" may also apply to these institutions. As a group, therefore, these institutions may to some extent also enjoy the power of a multiple creation of credit on the basis of any given original increase in their liabilities, although the "credit multiplier" in their case is, no doubt, much smaller than that which applies in the case of the monetary banking sector.

In summary of the above, it may be restated that any significant change in the volume or composition of "other liquid assets" held by the private non-financial sector should be of interest to the monetary authorities to the extent that (i) "other liquid assets" themselves may closely resemble money and near-money, or as a part of their general usefulness may serve as fairly close substitutes therefor; (ii) an increase in "other liquid assets" with private financial institutions not included in the monetary banking sector may mean increased overall availability of credit; and (iii) the lending activities of these institutions may have effects

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[2]It is, of course, possible that the lending activities of the institutions concerned will by themselves set up pressures making for a reduction in money and near-money (e.g., by increasing imports and causing a balance of payments deficit, or by necessitating a restrictive monetary or fiscal policy).

[3]When a demand deposit is shifted from a commercial bank to some other banking or financial institution, the deposit liabilities of all commercial banks as a group will generally tend to remain unchanged (due to the virtually automatic "return flow" which applies to all commercial banks collectively). In view of the restrictions placed on the repayment of fixed and notice deposits before due date imposed by the new banking legislation in South Africa, most deposit shifts presumably involve demand deposits, the great majority of which are in fact held with commercial banks.

[4]It will be observed that the processes described in this paragraph are the same as those that applied in the case of deposit shifts between commercial banks and "other monetary banking institutions" (including the merchant banks) before the Banks Act of 1965 imposed identical reserve requirements on both. Under present conditions and assuming all banking institutions in the banking sector to be "fully loaned up", a shift of demand deposits between institutions in the monetary banking sector, provided that such deposits reappear as short-term liabilities of the recipient institutions, amounts to a redistribution of lending power rather than to an increase therein. As was pointed out above, this is not the case where demand deposits are shifted from commercial banks to institutions outside the banking sector, in which case aggregate lending power will generally tend to be increased. In assessing the extent to which deposit shifts from banking sector institutions to institutions outside the banking sector are likely to occur in practice, it should be remembered that institutions outside the banking sector comprise all building societies. Apart from being able to "increase their own indebtedness without reducing the liquidity of their creditors to any significant extent" (by attracting deposits which are on equal footing with near-money), building societies as a group can normally also expect to receive a share of the public's current savings.

on the direction of the stream of lending, while (iv) to the extent that such "other liquid assets" are both relatively large in volume and widely held, the "return flow" and the power of multiple credit creation based thereon may be not insignificant.

**The nature of liquidity**

Any "inventory" of the liquid asset holdings of the private sector must necessarily be based on some notion of what constitutes the liquidity of an asset. As a first approach to this matter, three types of criteria readily suggest themselves. Technically, an asset will rank as liquid to the extent that it may be monetized rapidly, conveniently, *en masse* and without risk of significant loss. Secondly, an asset may be deemed to possess liquidity or "moneyness" only to the extent that such an asset is actually used as readily available spending power by its holders. This requirement would introduce some minimum average value of velocity of circulation or rate of turnover as an extra criterion. Finally, financial assets may be deemed to be liquid to the extent that their possession exercises qualitatively similar effects on their holders' willingness to spend as would possession of the same amount of money on some narrow definition thereof.

It will be clear that in terms of any of these criteria (which in the case of any particular asset need not be satisfied simultaneously or to the same extent) the liquidity of assets must necessarily be a matter of degree. In addition, the liquidity of any particular asset may tend to vary with economic conditions generally, the "state of confidence", monetary and financial policy, and conditions of monetary stringency or ease, making its liquidity in some sense dependent on liquidity conditions in the economy in general. For these reasons no outer line of demarcation that might be drawn to separate the liquid asset holdings of private spending units from the rest of their assets need either be universally and permanently valid or be preferable to others. Moreover, any measurement of *liquid asset holdings* of the private non-financial sector may be merely representative of the *liquidity* of private spending units in a more general and subjective sense, which may also take into account factors such as the cost and availability of credit, future income prospects and the subjective burden (or "negative liquidity") of debt already incurred and will allow for the sentiments and judgements of lenders and borrowers generally.

The degree of liquidity in the latter sense, while probably important from the point of view of analyzing private spending behaviour, obviously cannot be determined directly. It will nevertheless be clear that *within* the total of financial assets held by the private non-financial sector various lines of demarcation may be drawn to distinguish concepts of private sector liquidity which, while more comprehensive than money and near-money as now defined, are nevertheless consistent and statistically measurable. The concept of money and near-money may accordingly be supplemented usefully, depending on the purposes for which such measurements are to be used, by taking into account one or more of the several categories or types of "other liquid assets" that were indicated above and are discussed in more detail below.

**Outline of "other liquid assets"**

For purposes of this article, "other liquid assets in the hands of the private non-financial sector" comprise (a) short and medium-term deposits with private banking or financial institutions outside the monetary banking sector, (b) longer-term deposits with private banks or financial institutions, and (c) liquid assets held with the government sector.

(a) *Short and medium-term deposits with non-monetary banking institutions and building societies*

In terms of their purely technical liquidity characteristics only, this category should include the following deposits and similar claims:

(i) demand deposits with banking institutions outside the monetary banking sector;
(ii) other short-term, savings and other medium-term deposits with such banking institutions;
(iii) savings deposits with building societies; and
(iv) a proportion of fixed deposits with building societies.

(i) *Demand deposits* – To their holders, demand deposits with "other" banking institutions should obviously be indistinguishable, or almost so, from demand deposits with, e.g., "other monetary banking institutions", which rank as money. As few banking institutions outside the banking sector do in fact accept demand deposits, the amount of these deposits is, however, very small (approximately R3·5 million on the 31st December, 1965) and may represent unclaimed balances and similar liabilities of the institutions concerned rather than demand deposits as such.[5]

(ii) *Other short and medium-term deposits, including savings deposits, with non-monetary banking institutions* – The private sector's holding of these deposits, which in principle compare directly with near-money as now defined, amounted to about R54 million as at 31st December last year. While in itself not impressive, this amount exceeds the contribution to money of the

[5]In this and subsequent sections the amounts of deposits quoted as having been held by the private sector with banking institutions exclude deposits held by the Government and provincial administrations, foreigners and other banking institutions, but may still include amounts held by financial institutions other than banks. They are therefore not fully representative of the deposit holdings of the private *non-financial* sector, data on which are not readily available.

discount houses and is roughly similar to the contributions to money and near-money of the National Finance Corporation and the Land Bank.

(iii) *Savings deposits with building societies* – At the end of last year, total savings deposits with building societies amounted to R265 million, by far the larger part of which was undoubtedly held by individuals. This item therefore also represents by far the largest readily identifiable group of deposits that may be deemed to be on an equal footing with near-money without itself being counted as such. It may be recalled that the Building Societies Act, no. 24 of last year, in an attempt to restore the "true savings" nature of these deposits, imposed an upper limit of R6,000 on the amount that may be held on savings account by a single depositor with any one society and barred limited liability companies from opening such accounts. Their current rate of turnover, which on average appears to exceed 2 per year, nevertheless suggests that a not insignificant and possibly growing section of depositors continues to regard and operate these deposits as quasi-current accounts.

(iv) *Fixed deposits with building societies* – Total fixed deposits with building societies as at the end of last year amounted to R477 million. An important but not readily determinable proportion of these deposits must necessarily have unexpired maturities of less than six months, making them technically comparable to near-money which includes similar deposits held with monetary banking institutions. As little is known at this stage regarding the extent to which such deposits are either renewed or withdrawn as they fall due, they may largely represent "true savings" rather than funds being held in readiness for definite spending plans at some specified future date.

(b) *Longer-term deposits with banking institutions and building societies, and building society shares*

This category includes the following:

(i) *Long-term deposits with banking institutions* – Long-term deposits (i.e. deposits of outstanding maturities or periods of notice of six months or more) held by the private sector with banking institutions at the end of last year amounted to approximately R566 million, about R464 million of which was held with monetary banking institutions (mainly commercial banks and "other" monetary banking institutions). It should be noted that these amounts include deposits of any unexpired maturity from six months up to several years. As in the case of medium-term deposits with banking institutions and fixed deposits with building societies referred to above, the liquidity of these deposits has, of course, been affected by legal restrictions on their repayment before due date, which has strengthened the case for their exclusion from near-money.[6] The liquid asset and prescribed investment requirements of the Banks Act have undoubtedly had the effect of pushing medium-term deposits over the "less than six months" limit, thereby removing them from near-money without substantially changing their nature or the purposes for which they are held. Long-term deposits included in this category have nevertheless recently experienced a notable decline, decreasing by about R160 million or rather more than one-fifth between the ends of March and December, 1965.

(ii) *Fixed deposits with building societies* – Fixed deposits with building societies with outstanding maturities of six months or more also belong in this category.

(iii) *Building society shares* – Building society shares at the end of 1965 amounted to no less than R1,000 million, about 96 per cent of which was held by the private non-financial sector. Although it might be expected that present legal requirements (in terms of which shares cannot be withdrawn without having been held for at least fifteen months plus a three months' period of notice) must have diminished the attractiveness of building society shares as an easily encashable, relatively high-interest earning financial asset, the amount of shares outstanding has in fact continued to rise uninterruptedly since enactment of the Building Societies Act last year.

In general terms, the financial assets enumerated in this section largely represent "true savings". To some extent they nevertheless represent financial assets which under certain conditions (e.g., after having been held for fifteen months or more) may still be monetized within fairly short periods and with relative ease. Their prime function may be to supply a margin of safety for their holders which may exercise a permanent effect on the latter's propensity to spend.

(c) *Liquid assets with the government sector*

This category may be held to include the following:

- (i) certain deposits with the Public Debt Commissioners;
- (ii) tax redemption certificates;
- (iii) Treasury bills; and
- (iv) short-term government stocks and bonds with outstanding maturities of up to three years.

At the end of 1965, about R14 million of short-term funds of up to twelve months (including funds at call) were held with the Public Debt Commissioners by the private non-financial sector, being more or less evenly distributed between "individuals and private trusts"

[6]In terms of Section 21 (6) of the Banks Act, fixed and notice deposits may, subject to certain exceptions, be repaid before due date only after having been held for twelve months or more and after expiration of a period of notice of at least thirty days.

and "companies" (including public corporations and the South African Railways). Tax redemption certificates, which are held by individuals only, currently amount to less than R250,000. About R14 million of Treasury bills were held by the private non-financial sector, mostly by companies. Short-term government stocks held by the private non-financial sector amounted to R20 million, R16 million of which was held by companies.

The economic and monetary significance of these assets as an integral part of the liquid asset holdings of the private non-financial sector may be greater than the above figures suggest. Firstly, Treasury bills provide an obvious and occasionally attractive outlet for temporarily idle business funds. As such, the amount thereof held by the private non-financial sector may occasionally be subject to relatively large and rapid fluctuations. Moreover, to the extent that Treasury bills are issued or withdrawn by the government to or from the private non-financial sector direct, they may also, provided that no corresponding changes in government balances with the banking system occur, have effects on the liquid asset holdings of the private sector that are not reflected in the consolidated balance sheet of the monetary banking sector or in the activities and balance sheets of banks and financial institutions generally. As a special feature of both short-term government stock and Treasury bills it may be pointed out that an important part of the liquidity of these assets is derived from their ready marketability as well as from their relatively short currency to redemption.

In addition to the above highly liquid claims on the government, the private non-financial sector at the end of last year also held some R132 million of savings deposits and savings certificates with the Post Office Savings Bank, as well as R106 million of National Savings Certificates and R51 million of Treasury bonds. Little doubt can exist that these assets generally represent "true savings". National Savings Certificates are not repayable within one year from the date of purchase. Treasury bonds are customarily issued with an original maturity of 5 or 7 years; at the moment of writing, no issue is within one year of redemption. As against this, deposits with the Post Office Savings Bank, which are generally subject to 30 days' notice but are withdrawable on demand in small amounts, would appear to be closer to near-money. In view, however, of their low average rate of turnover, which is less than 0·5 per year, they apparently represent a case in which such measure of technical liquidity as they possess is only partly reflected in the view taken of them by their holders.

**Conclusion**

Efforts to define and measure money and near-money are generally at least to some extent based on the assumption that some significant relationship exists between changes in the quantity of money and near-money on one hand and changes in aggregate economic activity on the other. Such a view does not, however, necessarily imply adherence to a quantity theory of money in any strict or mechanistic sense. It may be readily recognized, for example, firstly, that money and near-money as defined make up only a part of the overall liquid asset holdings of the private sector. Secondly, measurable liquid asset holdings themselves may be merely indicative of some even wider and rather more subjective notion of private sector liquidity that may be basic to private spending decisions. Finally, even though increasing liquidity in itself may be an incentive to spend or may facilitate spending, its effects may easily be outweighed by other considerations.

Within this general approach, it is nevertheless important to arrive at some concept of money and near-money, or of money, near-money and other liquid assets, which shows a significant and dependable relationship with current or future levels of the gross national product. For this purpose, more research is obviously still required not only to determine the exact degree of liquidity (including the annual rates of turnover) of a number of financial assets such as those referred to above, but also regarding the purposes for which, and the economic sectors and sub-sectors by which, such assets tend to be held. Their behaviour in various phases of the business cycle, such as the period of rapid expansion experienced by the South African economy between 1962 and 1965, also remains a matter for further attention. Finally, the development of new financial institutions as well as of new instruments of liquidity which may show a high degree of "moneyness" or may acquire "moneyness" at the expense of existing instruments, may necessitate regular review of the various statistical and analytical concepts used, as well as of the legal framework within which South African banks and financial institutions operate.