

**Private Sector Credit, Policy and  
Enforcement: 1978-1982**

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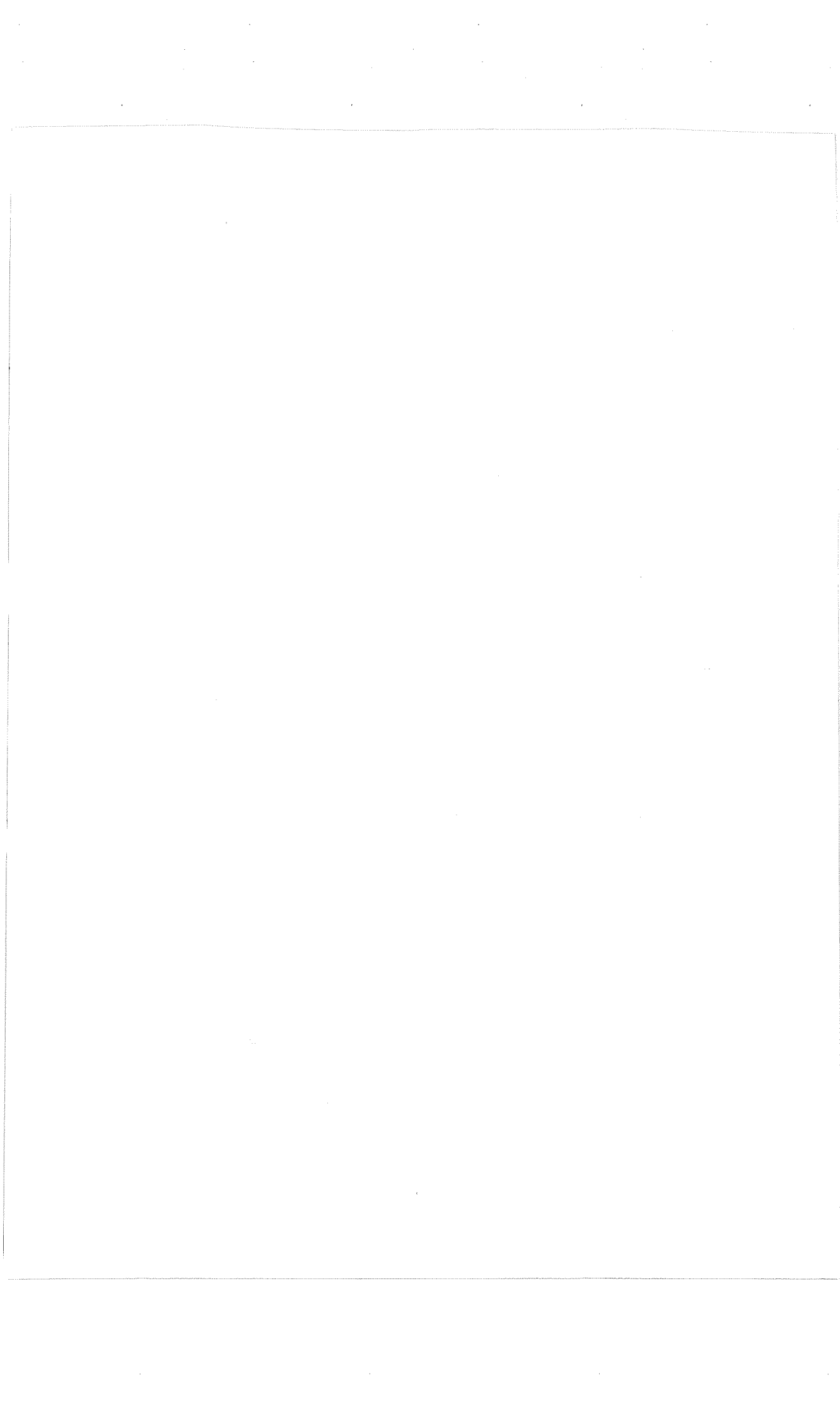
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## PRIVATE SECTOR CREDIT, POLICY AND ENFORCEMENT: 1978-1982

Anthony Leddin\*

### *Introduction*

This paper is concerned with examining certain aspects of the Central Bank's quantitative credit guidelines over the period 1978 to 1982. The sectoral or personal lending guidelines are not considered in this paper. The approach is to consider first the policy aspects to the guidelines and in particular the relationship between the guideline and the external reserve objective. Secondly, the issue of neutralization of interest rates is discussed and some evidence is presented on this matter. Finally, the paper examines how Central Bank enforcement may act as an indicator of the existence and timing of credit rationing and concludes by demonstrating how policy and enforcement combined to cause a reduction in the Associated Banks' relative lending share.

### *Policy*

Credit guidelines were first issued in Ireland in 1965. During the period 1965-1977 the Central Bank's credit policy was on the whole passive with the probable exception of the years 1965, 1973 and 1974 when attempts were made to restrain the growth of domestic credit. Table 1 presents the guidelines and the outcomes for the period 1978 to 1982. It is evident from the Table that the first two guidelines were not successful in restricting lending to the private sector whereas the remaining three guidelines were successful in this regard. The first guideline was, in fact, terminated in August 1978 when it became apparent that the guideline would be breached and a six-month guideline was introduced with the intention of moderating credit in the final months of 1978. An interim guideline was introduced from 1979 onwards and, most significantly, foreign currency based lending (FCBL) was allowed exemption from the 1979 and 1980 guidelines.

The basic rationale for the credit guideline is not to control the money supply in the economy but to influence its composition between its domestic and external sources. By this means an external reserve objective can be achieved. This may be illustrated by reference to the following identity which is derived from the consolidated balance sheet of the banking system.

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My thanks to Joe Durkan for comments. The usual disclaimer applies.

**TABLE 1: Private Sector Guidelines 1978-1981**

No.	Period	Guideline %	Outcome %	Foreign Currency Based Lending £m	Excess Lending £m
1	Dec 77 — Dec 78	20	33		320.7
2	Sep 78 — Mar 79	10	14.7		158.1
3	Feb 79 — Feb 80	18	19.3	129.1	46.8
	Interim	10	13.3		
4	Feb 80 — Feb 81	13	13.3	323.6	16.5
	Interim	7	1.3		
5	Feb 81 — Feb 82	15	15.3		15.5
	Interim	8	4.1		

Source: Various Central Bank Bulletins

Notes: 1. Guideline 1: Terminated August 1978

2. Guideline 3: Backdated one month on date of issue

3. Guideline 4: Foreign Currency Base Lending (FCBL) exemption terminated in October 1980

$$1. \quad R + \text{NEALBs} = M^s - (\text{NGL} + \text{BLG} + \text{OTHERS})$$

where R = External Reserves; NEALBs = Net External Assets of the Licensed Banks;  $M^s$  = Money Supply; BLG = Bank Lending to the Government; NGL = Non Government Lending. The 'OTHERS' variable is closely related to the banks' net non monetary assets. The sum of the terms in the bracket is referred to as Domestic Credit (DC).

The money supply is determined by the demand for money which in turn is assumed to be a stable function of a few variables.<sup>1</sup> If the Central Bank's objective is to have no change in the external reserves, then the Central Bank must ensure that the change in DC is in line with the change in the money supply. The NGL variable within the overall DC variable is controlled by the quantitative credit guideline. Thus in setting the guideline the Central Bank must estimate correctly the likely change in each variable in identity 1 and then set the guideline as a residual to achieve a certain external reserve objective.<sup>2</sup> While the ability of monetary policy to achieve growth and employment is severely limited in a small open economy, an expansionary guideline would tend to facilitate growth at the expense of a reduction in the external reserves.<sup>3</sup>

Table 2 presents the data on each of the variables in identity 1 and in particular shows the external reserve outcome associated with the credit guidelines and the other variables in identity 1. It will be observed that the decreases in the external reserves in 1979 and 1981 were offset by increases in 1978 and 1980 so that over the period a marginal increase of £68m was recorded.

With regard to the question of whether the credit guideline achieved the desired external reserve outcome, no precise answer can be given as forecasts for the BLG, NEALBs and the 'other' variables are not published. However, by comparing the available published estimates with the actual outcomes some indication can be given. This approach may also indicate some of the difficulties involved.

<sup>1</sup>See, for example, Laidler (1981).

<sup>2</sup>For an outline of how the Central Bank calculates the guidelines, see Murray (1979).

<sup>3</sup>See, for example, Murray (1980).

**TABLE 2: External Reserves, Money Supply and Domestic Credit: 1978-1981 (£m)**

Period	Change in External Reserves	Change in Net External Assets of Licensed Banks	Change in Money Supply (M3)	Private Sector Credit Subject to Guideline	Foreign Currency Based Lending	Bank Lending to Government	Other
	R	+ NEALBs =	M <sup>s</sup> -	(PC +	FCBL +	BLG +	Others)
Dec '77 - Dec '78	51.2	4.5	934.5	814		176.9	-112.1
Feb '79 - Feb '80	-262.6	-42.4	678.5	673	129.1	230.3	-48.9
Feb '80 - Feb '81	331.5	-319.4	1,125.1	573.1	323.6	433.7	-217.4
Feb '81 - Feb '82	-50.7	-71.8	953.8	792.3		298.6	-14.6
Dec '78 - Feb '79	-1.4	-41.4					
Change over Period	68.0						

Source: Derived from consolidated balance sheet of banking system  
Various Central Bank Bulletins

Note: (a) Data from January and February 1978 are added to obtain R over period  
(b) External reserves are exclusive of gold revaluations

In 1978, the stated intention was that "... the import cover afforded by the official external reserves is high at present by international standards and ... some reduction can be tolerated".<sup>4</sup> However, a £320.7m breach of the guideline was more than offset by a £348.2m underestimate of the change in the money supply and a £233.1m overestimate of BLG (1978 is the only year a forecast is available for this variable). Thus, contrary to expectations, the expansionary credit guideline was associated with an increase in the external reserves of £51m.

In 1979, the decrease in the reserves of £262.6m would seem to be at odds with the stated objective of having "... little change in the external reserves".<sup>5</sup> The increase in oil prices and the subsequent change in the terms of trade would seem to largely explain the fall in reserves. (The effect of increased prices on the demand for money does not seem to have materialized until 1980.) A contributory factor was that the increase in FCBL was not matched by an equal decrease in NEALBs. This implies that some banks were borrowing abroad and on lending to the private sector while they or their non-resident customers were simultaneously using domestic resources to repay foreign indebtedness. An underestimate of the change in the money supply of £53.7m was almost offset by a £46.8m breach of the guideline. Finally, speculative capital inflows associated with entry into the EMS may have contributed to an increase in the external reserves.

In setting the quantitative credit guideline for 1980 the Central Bank temporarily avoided a decision between the growth and reserve objectives by encouraging the private sector to borrow abroad. Commenting on its reserve objective, the Bank stated that it was "... seeking to avoid introducing a deflationary element into economic policy. The broad approach adopted is that maintenance of reserve adequacy this year would be achieved by external

<sup>4</sup>Q.B. 1, 1978, p. 25.

<sup>5</sup>Q.B. 1, 1979, p. 24.

borrowing by the private as well as the public sector".<sup>6</sup> This was achieved by issuing a restrictive 13% credit guideline which would "... induce some recourse by the private sector to external financing".<sup>7</sup> In the event this approach was particularly successful with the external reserves increasing by £331.5m. It may not, however, have been entirely expected as the money supply was underestimated by a considerable £301.7m. Also, despite the termination of the FCBL exemption in October 1980, this variable was underestimated by approximately £184m. It is noticeable that, unlike 1979, the NEALB's variable moved closely with the FCBL variable.

Finally, in 1981 the intention was that the reserves would be maintained at an 'adequate level' and concern was expressed at the growing level of foreign indebtedness. Little information is available for this period but it is likely that the outcome was relatively more in line with intentions.

The above discussion omits considerations of Government Monetary Financing (GMF) simply because Central Bank estimates are not available for this variable. However, for the three guidelines between February 1979 and February 1982, the Central Bank underestimated the Exchequer Borrowing Requirement (EBR) by £230m, £317m and £383m respectively. Assuming these underestimates reflect underestimates in GMF and allowing for Government Foreign Borrowing (GFB) which adds initially to the external reserves, the unpredictability in government finances clearly contributed to the difficulties in achieving the reserve target.

Overall, the policy stance of the Central Bank would seem to have been towards accommodating the growth objective with perhaps 1981 being the exception. It is noticeable that a decrease of £470.5m in the net external assets of the Licensed Banks combined with an increase of £2,620m in Government Foreign Borrowing led to a £3,022.5m decrease in external finance. Thus, the maintenance of reserve adequacy over the period was largely achieved by increased foreign indebtedness.

### *Liquidity*

The literature on the monetary approach to the balance of payments (MAB) asserts that a balance of payments disequilibrium reflects money market disequilibrium and that an adjustment mechanism exists whereby changes in the monetary base will tend to rectify imbalances in the external account. If in a fixed exchange rate system the Central Bank can neutralize the effect of changes in the external reserves on the monetary base, then the adjustment process is broken and monetary base control of the money supply may be feasible in the short run.

Neutralization is, however, not possible except under certain conditions. (One important condition is the existence of imperfect substitution between foreign and domestic financial assets in investors' portfolios.<sup>8</sup>) But controls such as exchange controls and quantitative credit guidelines, which are not usually discussed in this context, significantly increase regulation in the money markets and consequently should increase the degree of independence the

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<sup>6</sup>Q.B. 1, 1980, p. 13.

<sup>7</sup>Q.B. 1, 1980, p. 13.

<sup>8</sup>See, for example, M. Obstfeld (1982).

**TABLE 3: Central Bank Balance Sheet — Change over Period (£m)**

	Assets					Liabilities				
	1978	1979	1980	1981		1978	1979	1980	1981	
External Reserves (R)	51.0	-262.7	331.5	-50.7	Currency (Cu)	89.7	96.3	94.8	68.8	
Central Bank Lending to Licensed Banks (CC <sub>B</sub> )	44.1	69.5	-176.5	47.7	Licensed Banks Reserves (RE)	119.7	-58.6	211.5	-63.1	
Central Bank Lending to Government (CC <sub>G</sub> )	-3.8	74.3	144.7	51.6	Government Deposits (G.D.)	-103.3	-173.2	-48.8	-26.4	
Other	-6.9	20.8	37.7	19.4	Other	-21.7	37.4	79.9	88.7	
	84.4	-98.1	337.4	68.0		84.4	-98.1	337.4	68.0	

Source: Various Central Bank Bulletins

- Notes:
1. 1978 is from December to December. Remaining years are from February to February
  2. CC<sub>B</sub> = Exchequer Bills rediscounted for banks + ACIBs + secured advances to banks + short term credit facility
  3. CC<sub>G</sub> = Exchequer Bills + Irish Government Securities + Exchequer overdraft facility
  4. RE includes statutory deposits
  5. External Reserves are exclusive of gold revaluations
  6. CC<sub>B</sub> does not include foreign currency swaps, data for which is not available

Central Bank has in monetary policy. In particular, since credit guidelines control lending to the private sector and exchange controls can be expected to modify capital flows through the external account, the Central Bank can use additional instruments to influence liquidity and hence interest rates in the economy. Instruments such as Central Bank credit to the Licensed Banks ( $CC_B$  is defined in Table 3 to include the rediscounting of Exchequer bills, secured advances and the short term credit facility<sup>9</sup>), changes in the primary reserve ratios and the discount rate can be used to remove or inject liquidity into the system and therefore enable the implementation of a type of stabilization policy in interest rates. This is a major advantage from using credit guidelines in that the disadvantages of flexible interest rates such as the implications for Exchequer financing, industrial investment, inflation and expectations are avoided. However, as is demonstrated below, the Central Bank can also neutralize interest rates in the short run by accepting a lower level of external reserves and a lower primary reserve ratio.

Table 3 shows a categorization of the Central Bank balance sheet which emphasises the  $CC_B$  variable. The generally inverse relationship between the external reserve changes and  $CC_B$  is evident. Also it is noticeable that the Licensed Banks recorded a lower reserve base in 1979 and 1981 despite increases in lending.

Table 4 gives quarterly figures for  $CC_B$ . The 1978 figures would suggest a form of stabilization policy in interest rates. If the first three quarters of 1979 are compared with the remaining quarter in 1979 plus the four quarters in 1980 the data again suggests a stabilization policy in interest rates. However, in October 1979 the Central Bank reduced the primary and secondary reserve ratios for the Associated Banks and decreased the primary but increased the secondary ratio for the Non-Associated Banks. These changes combined with a £118m increase in the external reserves in the fourth quarter of 1979 largely explain the reduction of £252m in  $CC_B$  in this fourth quarter. Moreover, the repayment of  $CC_B$  in 1980 reflects an increase in the external reserves which in turn is largely explained by banks borrowing abroad under the foreign currency based lending exemption.

**TABLE 4: Central Bank Credit to the Licensed Banks (£m)**

	Q1	Q2	Q3	Q4
1978	34.8	115.7	-61.0	-45.4
1979	128.1	177.0	16.8	-252.4
1980	-57.2	-61.8	-65.0	7.5

*Note:* For 1978, Quarters are from December to March and for 1979 and 1980, from February to May.

*Source:* Central Bank Bulletins

This reduction of indebtedness and the injection of liquidity via the foreign currency exemption effectively amounts to a neutralization of interest rates. The implications are that, firstly, the external reserves are at a lower level since

<sup>9</sup>The  $CC_B$  variable does not include foreign currency swaps which is an important short run liquidity instrument. No data are available on this variable.



if interest rates had been allowed to increase, capital inflows would have occurred. Referring to the year 1979, Murray (1980) comments: "... there was a conscious decision to take action to prevent (interest) rates going even higher, in recognition of the burden this would have placed on the economy; it was, however, at the cost of a larger fall than we would have liked in the external reserves".<sup>10</sup> Secondly, the primary reserve ratio is lower and private sector credit is likely to be higher than if the authorities had not intervened. Finally, the lower interest rates have implications for income distribution and the allocation of resources. (An intensification of credit rationing, for example.) This latter point is also true for any stabilization policy in interest rates.

A similar situation emerged in 1981 as the Central Bank extended £47.7m in credit to the banks and reduced the primary reserve ratio from 12% in February 1981 to 10% in January 1982. In addition, most categories of banks had a shortfall in their secondary reserve ratio. As in 1979, the reserve base was also lower at the end of the period.

There is a floor, set by the need to maintain prudent primary reserve ratios, to this type of interest neutralization. However, over the period, the data indicate that interest rates have not been increased to the extent called for by a policy to achieve external balance and that the broad thrust of policy has been to accommodate the credit guidelines.

#### *Enforcement*

It is informative to examine Central Bank enforcement of the credit guidelines over the period as this may indicate the existence and timing of credit rationing. Also it is important because, as is demonstrated at the end of this section, policy and enforcement combined to change the Associated and Non-Associated Banks' relative lending base and therefore their relative long-run profits.

Assuming credit rationing exists, the main incentive to breach a credit guideline is the extra profit that can be earned on excess lending. It requires two distinct measures to remove this incentive. Firstly, it is necessary to impose a special deposit measure which requires a bank to place on deposit with the Central Bank an amount equivalent to the excess lending. The interest paid on this deposit is calculated so that an immediate loss is incurred on excess lending. Secondly, because a bank's lending base is increased by excess lending, which in turn is used to calculate next period's guideline, the bank increases its (long run) profit. To remove this incentive it is necessary to make an appropriate deduction from the bank's permitted growth of credit so that the bank returns to the correct lending base at the end of the period. These two enforcement measures — special deposits and market base deductions — are consistent and sufficient to obtain compliance with the guideline. It was not, however, until the end of 1981 that the Central Bank implemented both measures.

In 1978, a 50% capital inflow requirement and a temporary penal rediscount policy used in June proved ineffective and, given the demand for credit, as a consequence the credit guideline was abandoned after nine months.

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<sup>10</sup>Murray (1980), p. 117.

For the second six-month guideline, a special deposit requirement was introduced along with a penal rediscount policy and the 50% capital inflow requirement. Ironically, the data indicate that those banks liable for special deposits (mainly the Associated Banks) were also responsible for the 4.7% breach of the guideline and that those banks who faced essentially the same enforcement measures as in the previous unsuccessful guideline actually complied with the guideline. Perhaps the reason why the special deposit measure did not moderate Associated Bank lending lies in the ambiguous criterion on which it was based. The deposits were non interest bearing, but the extent of the overlending and the length of time to the end of the period would determine the effect on excess lending profit. No measure was introduced to remove the long-run profit incentive. The special deposits which were reinforced by a progressively penal rediscount policy were not sufficient to act as a deterrent.

The year 1979 gives an opportunity to examine the relationship between enforcement and credit rationing. It is useful to refer to the following data in Table 5 for non-government lending (NGL) which, although it includes foreign currency based lending exempt from the guideline, can still be used to illustrate the main points.

**TABLE 5: Non-Government Lending (NGL) Monthly % change 1979/1980**

	Base £m	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb
NGL	3,571.1	6.2	1.0	2.1	3.6	-0.1	0.3	4.7	0	0.9	1.3	-0.9	2.0

The guideline was initially enforced by a special deposit requirement and was backdated by one month to February 1979. The Associated Banks had increased lending by 8.3% during March compared to a 0.5% increase by the Non-Associated Banks and their lending capacity for the remainder of the period was therefore reduced. Redebiting of interest in March would partly explain this large increase in Associated Banks' lending. As the NGL data indicate, lending moderated in April and May but began to accelerate again in June.

At this point the Central Bank introduced additional enforcement measures to curtail lending. Given the increasing indebtedness to the Central Bank, the penalty on rediscounting was to be increased. The special deposit criterion was redefined to explicitly account for profits earned on excess lending. The interest paid on special deposits or, equivalently, the interest on a tranche of bank deposits would be varied so that the "cost to a bank of either measure would outweigh any profit on the corresponding amount of excess lending".<sup>11</sup> Moreover, nine banks were required to place special deposits with the Central Bank at "rates substantially below those which the bank normally pays on deposits".<sup>12</sup> As reflected in the NGL Table, credit expansion now moderated in July and August but the interim guideline was breached by 4.6% by the

<sup>11</sup>Q.B. 2, 1979, p. 21.

<sup>12</sup>Q.B. 3, 1979, p. 18.

Associated Banks and their indebtedness to the Central Bank increased to £375m, reflecting falls in the external reserves.

Credit continued to increase in September and the Central Bank reiterated its intention to require special deposits and warned that "any such excess might be taken into consideration in the application to a particular bank of monetary policy for 1980".<sup>13</sup> This was the first indication that the market base incentive would be removed. Credit expansion now moderated with virtually no change in NGL in October and November.

By the end of the third quarter, the Associated Banks had already exceeded the guideline for the year and their indebtedness to the Central Bank had increased to £437m, reflecting the continued fall in the external reserves. As discussed in the section on liquidity, the changes in the required reserves in October 1979 significantly contributed to reducing this indebtedness. In the final quarter, as the data below in Table 6 indicates, the Associated Banks decreased their lending to bring their cumulative increase within the guideline limits. The Non-Associated Banks, on the other hand, were much more consistent in lending over the period.

**TABLE 6: Private Sector Credit, Subject to the Guideline  
Quarterly % Change 1979/1980**

	Q1	Q2	Q3	Q4	Year
Associated Banks	11.9	3.7	3.4	-0.9	17.5
Non-Associated Banks	4.7	6.2	5.7	4.0	22.4

Source: Central Bank Bulletins

Although the Non-Associated Banks and foreign currency based lending may have acted as alternative sources of finance, the data indicate that the Associated Banks conducted non price credit rationing in the fourth quarter of 1979/'80.

Moreover, an examination of the Associated Banks' analysis of advances table in this quarter shows that the non prime borrowers experienced large decreases in lending.<sup>14</sup> Lending to the non prime, Financial, Total Personal, Housing and Other personal lending categories all decreased, by 10.1, 4.7, 7.6 and 0.8 percentage points respectively,<sup>15</sup> whereas lending to the prime sectors such as Manufacturing, Building and Construction and the 'Others' categories increased by 8, 3 and 13.4 percentage points respectively. This may indicate differential effects from credit rationing. In general, the Central Bank enforcement efforts over the period suggest that credit rationing did exist and the neutralization of interest rates (as discussed in the previous section on Liquidity) would have intensified the extent of this rationing.

There is some evidence that rationing was continued into the 1980/81 period. As the data below in Tables 7 and 8 show, the banks made full use of

<sup>13</sup>Q.B. 3, 1979, p. 19.

<sup>14</sup>See Browne and O'Connell (1979).

<sup>15</sup>Total Personal lending equals lending to the Housing and Other personal sectors. The analysis is complicated by the existence of sectoral guidelines on lending to the Financial and Other personal categories. Lending to Housing is not subject to a sectoral guideline.

the foreign currency lending exemption while pursuing conservative domestic lending policies. It is noticeable that lending bases were only maximized in the final quarter.

**TABLE 7: Sector Credit, Subject to the Guideline  
Cumulative % Change 1980/1981**

	Q1	Q2	Q3	Q4
Associated Banks	2.4	-0.5	5.1	12.7
Non-Associated Banks	1.6	4.0	8.1	14.3

**TABLE 8: Foreign Currency Based Lending, Exempt from the Guideline  
Quarterly Change 1980/1981 (£m)**

	Q1	Q2	Q3	Q4	Year
Associated Banks	5.5	32.4	13.3	35.1	86.3
Non-Associated Banks	78.4	29.6	9.4	119.9	237.3

Source: Central Bank Bulletins

The Central Bank's approach was to issue a restrictive credit guideline in order to encourage the Licensed Banks to borrow abroad and this approach obviously succeeded. It also indicated the Central Bank's confidence in its ability to enforce the guideline. However, the enforcement measures consisting of a special deposit requirement were less forceful than in the previous period given the reduction in indebtedness to the Central Bank. In the event, no additional measures were required as at no stage were the guidelines likely to be breached. The above data indicate a conservatism in lending and this could be interpreted as an over-reaction to the experiences in 1979. On this the Central Bank comments: "The surge in the extension of credit toward the end of the . . . year may have owed something to the scope for increased lending within the guideline; this, in turn, may have been attributable partly to the pursuit by the banks of conservative lending policies earlier in the year in order to avoid the danger of breaching the guideline".<sup>16</sup> If this were the case, an intertemporal reallocation of resources occurred which would have been only partly alleviated by the FCBL exemption.

Finally, in 1981 the Central Bank was again obliged to enforce the credit guideline. All Licensed Banks were within the guideline at the interim stage but in the third quarter the Associated Banks increased lending by 7.1% to bring their cumulative increase to 14.6%. The Central Bank reiterated its intention to call for special deposits and, in addition, warned that "any excess (lending) . . . would be taken into consideration in the application of monetary policy in the next credit policy year".<sup>17</sup>

In the final quarter, the Associated Banks reduced the rate of increase in lending to 1.6% to give an overall increase of 16.3%. In contrast, there was a marked acceleration in Non-Associated Bank lending in the fourth quarter when a 9.2% increase was recorded. A very marginal increase in the earlier

<sup>16</sup>Q.B. 1, 1981, pp. 23, 24.

<sup>17</sup>Q.B. 4, 1981, p. 19.

part of the year, however, brought the Non-Associated Banks' cumulative increase to only 14.8%.

The overall breach of the guideline was considered marginal by the Central Bank and no calls were made for special deposits. However, for banks which exceeded the guideline "a corresponding deduction was made from the growth of credit permitted in 1982".<sup>18</sup> The 14% credit guideline for 1982/83 will not therefore be standard across Licensed Banks.

An examination of the analysis of advances table for the Associated Banks again indicates a reduction in lending to the Total Personal sector in the final quarter although there was a marginal increase in lending to the Financial sector. Other prime categories such as Agriculture, Services and Manufacturing all recorded relatively large percentage increases in lending. Thus, there is again evidence of a movement away from non prime borrowers when rationing is necessary. Unlike 1979, no personal lending guidelines were issued in this period. With regard to the Non-Associated Banks, the increase in lending in the final quarter was largely to the Service, Manufacturing and Agricultural categories, which may suggest an excess demand for credit and therefore the existence of credit rationing.

#### *Licensed Banks' Lending Base*

Table 9 shows the various bank categories share of total lending over the period. It will be observed that the Associated Banks initially increased their share of total lending from 59.9% in December 1977 to 63.5% in March 1979 and that by February 1982 their share was reduced to 58%. Since the amount of lending largely dictates a bank's profitability, Table 9 is an indication of relative profitability between the bank categories. These shifts in lending can be largely explained by Central Bank credit policy and by how the guidelines were enforced.

**TABLE 9: Banks' Share of Total Lending: 1978-1981 (%)**

	Dec 1977	Sep 1978	Feb 1979	Mar 1979	Feb 1980	Feb 1981	Feb 1982
Associated Banks	59.9	62.0	61.8	63.5	60.1	57.7	58.0
Non-Associated Banks	40.1	38.0	38.2	36.5	39.9	42.3	42.0
of which:							
North American	8.0	6.3	6.5	6.2	6.7	8.2	8.2
Merchant	11.9	12.0	12.1	11.4	12.1	12.3	12.3
Industrial	15.4	15.5	15.7	15.2	15.1	14.3	14.1
Other	4.8	14.1	4.0	3.7	5.9	7.4	7.3
All Licensed Banks	100	100	100	100	100	100	100
Base £m	2538.7	3195.8	3418.7	3665.0	4281.9	5178.7	5989.2

*Source:* Compiled from data given in various Central Bank Bulletins

*Note:* Certain banks in the 'other' category were allowed exemptions from the guidelines. No information is available on these exemptions.

Between December 1977 and September 1978 (the termination date of the first guideline) the Associated Banks increased lending share by 2% due to

<sup>18</sup>Q.B. 1, 1982, p. 27.

greater excess lending relative to the Non-Associated Banks. As already stated, the guideline in this period was not effectively enforced and the Associated Banks had increased lending by 30.3% by September 1978 compared to the Non-Associated Banks' 19.3%. For the second guideline period (September 1978 to March 1979) the Associated Banks increased their share by a further 1.5% for the same reason. On this occasion the relative figures are 17.5% increase in lending for the Associated Banks compared to the Non-Associated Banks lending exactly the stipulated 10%. Between February 1979 and February 1980 (the third guideline period) the Associated Banks' share of lending was reduced by 3.4% due to a number of factors. Firstly, the guideline was backdated by one month and this reduced the lending share by 1.7%. (The Associated Banks increased lending by £179.5m in March relative to the Non-Associated Banks' £6.6m.) Secondly, the Associated Banks did not perfectly maximize their lending base over the period (a 0.4% deficiency) compared to the Non-Associated Banks' excess lending of 4.4%. Thirdly, the Non-Associated Banks had greater FCBL relative to the Associated Banks (£86.3m as compared to £48.7m). These combined to reduce the Associated Banks' lending share by 3.4%.

For the fourth guideline period, the Associated Banks' share continued to fall as they failed to perfectly maximize their lending base by 0.3% compared to the Non-Associated Banks breaching the guideline by 1.3%. As in the previous period, the Non-Associated Banks also had greater FCBL (£237.3m) relative to the Associated Banks (£86.3m). For these reasons the Associated Banks' lending share was eroded by a further 2.4%.

The Associated Banks regained 0.3% of the lending market in the final guideline period by having excess lending relative to the Non-Associated Banks but the stated intention of the Central Bank to impose market base deductions may remove this gain. The Non-Associated Banks did not in fact maximize their lending base in this period and were clearly more concerned to reduce their net external liabilities.

No attempt is made here to account for the effect of the special deposit measures on profits. The data in Table 4 is therefore an indicator of long-term profits. Also it cannot be demonstrated what the relative shares would have been in the absence of credit guidelines. However, with the introduction of market base deductions in 1981 and the increasing concern of the Central Bank for external indebtedness, shifts in the lending base are not likely to be so pronounced in the future.

### *Conclusion*

The compliance by the Licensed Banks to the credit guidelines indicates the close degree of control the Central Bank can exert on private sector credit. This control in turn should facilitate the attainment of an external reserve objective but, as the data in this paper suggest, variables such as the EBR, the money supply and exogenous shocks to the system may have led to the external reserve outcomes not being entirely in accord with the Central Bank's intentions. An important aspect of policy over the period was the FCBL exemption which effectively allowed a reprieve from an overly restrictive monetary policy.

A major advantage of credit guidelines is that interest rates are not required to regulate the demand for credit. Given exchange controls, this allows scope for the Central Bank to conduct a type of stabilization policy in interest rates. The evidence in this paper suggests that interest rates were more stable and lower than if the Central Bank had not intervened. This has several advantages in terms of exchequer financing, industrial investment and the EMS obligation but there are also disadvantages in that the external reserves are lower and there are income and resource allocation effects.

An examination of Central Bank enforcement suggested that credit rationing did exist but although no evidence was presented on the extent of this rationing, some evidence was given on the differential effects. Finally, the paper showed how policy and enforcement combined to reduce the Associated Banks' relative lending share by £120m since 1978 and £330m since March 1979.

A more complete evaluation of credit guidelines will require more evidence on the above issues but this is likely to be forthcoming as credit guidelines are certain to remain an integral part of monetary policy in Ireland in the foreseeable future.

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