

FOREIGN PRIVATE DOLLAR HOLDINGS

While there is no evidence that foreign official institutions adjust their gold holdings in accordance with changes in yields, shifts of funds among international money markets by banks and other private investors could lead to changes in foreign gold holdings, over and above the changes that might be associated with a particular payments surplus in deficit on the part of a reserve currency country. For example, a shift of funds might cause a substitution of gold holding (by official institutions) for liquid-dollar holdings (by banks and other private investors). This result would occur if private investors sold dollar exchange for another currency and if neither the commercial banking system nor the central bank of that country added correspondingly to its dollar holdings;⁸ under these conditions, initial acquisition of the dollar exchange by the central bank would be followed by a purchase of gold and (assuming that this transaction added to net foreign purchases from the United States) to a corresponding reduction in the U.S. gold stock.

Since some European central banks traditionally hold their reserves in gold and most others take part of their reserve gains in gold, any large net movement of private funds from the United States to other major financial markets (except Canada) would probably lead to a reduction in the U.S. gold stock, although the extent of the reduction would be strongly influenced by the particular markets to which funds moved. Shifts of funds to or from Canada would be reflected primarily in pressure on the Canadian exchange rate, since the Bank of Canada changes its reserves little and permits transfers of funds to affect the exchange rate.

We shall examine fluctuations in foreign private dollar holdings in order to estimate the extent to which variations in these holdings appear attributable to interest-rate movements or differentials. Analysis of changes in the holdings of different geographical areas would assist in identifying movements that might have been associated with the transfer of funds between the United States and European money markets, but data are available separately only for Canada.

The present study will be limited to examination of fluctuations in aggregate non-Canadian private holdings for two reasons. First, private dollar holdings of European countries probably account for three-fifths of total private holdings (excluding Canada), and these European funds are generally thought to be more likely to be shifted to European money markets than are Canadian funds. Second, the influence of balance-of-payments developments is likely to be much greater in the case of Canada and thus the changes attributable to interest-rate changes much less discernible than for other countries. While developments in the U.S. balance of payments may have an influence on the volume of private, as well as official, dollar holdings of foreign countries, private Canadian dollar holdings appear likely to reflect changes in the Canadian balance of payments much more directly. The Bank of Canada's policy of maintaining its reserves relatively stable has the result that a Canadian payments surplus or deficit leads immediately to a change in Canadian holdings of foreign exchange (almost exclusively U.S. dollars) or in foreign short-term claims on Canada.

To facilitate examination of the fluctuation in non-Canadian holdings, we have computed deviations of the holdings from a straight-line trend fitted to the data by the method of least squares. The results are compared in chart 2 [not printed in Record] both with yields on U.S. Treasury bills and with the yield differential between United States and United Kingdom Treasury bills, after allowing for the cost of covering the foreign-exchange risk. We have also computed a second set of deviations from a trend line adjusted to minimize variations resulting from purely statistical factors. These deviations appear as the dotted line in the chart.⁹

As shown in chart 2 [not printed in Record], both private holdings (measured as deviations from trend) and interest rates have exhibited cyclical fluctuations, with changes in private holdings generally lagging behind those

⁸ Or to holdings of the currency of another country, where the banking system was willing to increase its dollar holdings.

⁹ In the third quarter of 1956 and again in the second quarter of 1957, certain dollar holdings previously reported as privately owned were included with official holdings (see Federal Reserve Bulletin, September 1957, p. 1096). The overstatement of private holdings in published Federal Reserve figures from the end of 1955 to mid-1957 has been corrected by using estimates of the International Monetary Fund. These estimates may be derived from data on U.S. short-term liabilities to foreign official institutions published in "International Financial Statistics," June 1958, p. 242.