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The Fourth Year of the War in Foreign Exchange



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FOREIGN EXCHANGE IN 1918

Fluctuations During Year Ended 1st July—Wonderful Way in which Sterling Quotations in New York have been Maintained—Exchange Reflects State of Trade and also Political Outlook

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ON the accompanying chart, prepared by the Union Bank of Canada, Foreign Exchange Department, Montreal and Toronto, will be found the fluctuations of Sterling Cable Transfer in New York, Sterling Cable in Canada and New York Exchange in Canada, for the fourth year of the war, ending June 30th, 1918. The charts have been compiled from the 1st of July to the 30th of June in each following year, as it was in July, 1914, that foreign exchanges first began to show the effects of the anticipated war.

The dotted line shows the course of Sterling Cable in New York, the heavy unbroken line the course of New York Exchange in Canada, and the lighter unbroken line the course of Sterling Cable in Canada, which moves concurrently with the rates of the former two.

Sterling in New York and Canada.

Mention was made in the explanatory article accompanying our 1917 chart of the wonderful achievement of Great Britain in holding Sterling Cable "pegged" at 476 7/16 in New York, and the expectation, since happily realized, of how the advent of the United States to the war would ease her burden. Again the absolute uniformity of the dotted line shows how well the task has been accomplished; as for the past year, in fact since January, 1916, Sterling Cable has not fallen below 476 7/16 in New York.

The stability and world-wide market for the pound sterling have always been synonymous with the financial supremacy of London, so that in this connection it may be of interest to note how the "pegging" of sterling has contributed to the above situation, and the prospects for its retention, in view of the premier creditor position the United States now occupies towards the rest of the world.

At the hearings before the Senate Committee on Banking and Currency in June last, at Washington, it was the practically unanimous opinion of the leading foreign exchange experts, bankers, and importers of the United States, that Great Britain by her action in stabilizing sterling in New York had retained her financial supremacy for any, or all of the following reasons:—

First.—In 1816, by her action in being the first country to place her currency upon a gold basis, Great Britain made the pound sterling the most stable currency in the world, so that her merchants, and the merchants of any other country could make a contract in sterling, without the risk of violent fluctuations; London, therefore, became the clearing house for the world. By restoring the stability of sterling in New York, in 1915, Great Britain retained this enviable position.

Second.—The United States, prior to the "pegging" of sterling in New York was, by reason of her vast exports, practically in control of the world's exchanges, more so as at that time she had not become a belligerent.

It needed only familiarity to place the dollar credit on a desirable, or even more desirable basis than the sterling credit, but Great Britain by stabilizing the market placed, as regards stability, the pound sterling on an equal basis to the

dollar. Consequently, being in possession of the leadership, London was able to retain it.

Third.—Great Britain has always developed the most astute international bankers in the world; she, being in possession of them will, together with her natural advantages, retain her financial supremacy until some other country in possession of equal, if not greater natural advantages, develops as able, or more able international bankers.

Fourth.—By means of stabilizing sterling in New York, Great Britain has been able, indirectly, to finance large obligations, due to the neutrals; the neutral creditor being able to sell his sterling in New York, and with it purchase his own currency. Due to this cause arises the anomalous situation of the neutral exchanges being at heavy premiums in New York, in spite of their unfavorable trade balance with the United States.

Since sterling exchange in Canada follows the course of sterling in New York, and New York funds, a glance at the chart will show its fluctuations, following exactly the trend of New York funds, owing to the "pegging" of sterling in New York.

New York Funds in Canada.

The period shortly prior to, and following the outbreak of war, has witnessed more violent, but not wider fluctuations than have occurred during the year shown on the chart. To account for this it is necessary to revert to the situation of last year. Canada on foreign trade showed a large favorable trade balance, composed chiefly of exports to Great Britain, for which she had furnished credit. Offsetting this, however, was a lesser heavy unfavorable trade balance with the United States, to be settled for on a cash, or short-term credit basis.

In view of the above situation, which this year has become aggravated, the break in New York funds to 15/16 discount on October 23rd last, may appear unwarranted. A review of the trend of the market will show the reasons.

Commencing in July, 1917, the chart shows fluctuations of from 4/ to 9/16 premium, and reactions to 3/16 premium, due chiefly to the grain carried over from the preceding year having been all exported.

From August 1st the chart shows a fairly regular line around 3/16 premium, with a descending tendency, until on September 23rd, par is reached.

From this date until October 23rd, on which date 15/16 discount is registered, a heavy declining trend will be observed, due to loans in the United States for account Great Britain, for the purchase of the Canadian wheat crop.

It is interesting at this date to recall the urgent appeals to the United States to permit the export of gold to Canada, and the final arrangements whereby shipments were to be allowed on condition of being "earmarked" and returned, when needed.

Many comments were made at the time as to the necessity for this arrangement and the so-called "sentimental" response of the market to its announcement. The facts, how-

ever, were, that before the arrangement was made the heaviest selling pressure was over and the final proof that sentiment played no part in the subsequent rise, was the fact it was unnecessary to import gold from United States while New York funds were at a discount.

From November 8th, the date the market again touched par, the chart shows a succession of steady rises, varied by occasional reactions, until April 8th, on which date a new high of 2 per cent. is reached.

Technical and sentimental reasons, due to the efforts of the Canadian government to float loans in the United States, caused between May 1st, and May 8th, a sharp break from $1\frac{3}{4}$ to $\frac{3}{4}$ premium. Sentiment, however, is again short lived, as inside of another week the rate was 1 $\frac{1}{2}$ premium.

After sustaining a further reaction to 1 per cent., the rate steadily climbs, with small reactions, to its new high record of 2 $\frac{15}{32}$ premium on the 27th June, from which date it has reacted to, and hovered around $1\frac{7}{8}$ to 2 per cent. premium.

Relief Measures.

Temporary relief may be obtained this fall by grain shipments, provided they are financed by British or American credits, but permanent rectification of the present undesirable conditions can be had from either, or all of the following:—

1st.—Liquidation of Canada's unfavorable United States trade balance, through the placing of American war orders, and curtailment of unnecessary imports.

2nd.—Securing by Canada of American loans, which at present appears improbable, in view of the present financial burdens of the United States, whose own exchanges with the neutrals needs stabilizing. Our currency is even set at a lesser discount than Great Britain's in the United States.

3rd.—The liquidation, or discounting in the United States of British treasury bills at present held by us in payment of our exports.

4th.—Export of gold which at present is undesirable.

Effect of Allied Victories.

It is evident that the foreign exchanges have now commenced to show the effect of the allied successes. Heretofore, except for a weakening of the Central Powers exchanges on the neutrals, no great response to allied successes can be observed, but on August 10th, Sterling Cable touched 477 $\frac{1}{2}$ in New York, and the neutral exchanges in New York have all shown heavy depreciation; while the Central Powers exchanges on the neutrals have shown great depreciation, all of which are undoubtedly due to the opinion of expert international bankers that the tide has definitely turned in favor of the Allies.

