

What the Depreciation of the Dollar Means for the Palouse

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Why Listen to This Guy?

- ▶ Ph.D. 2008 University of Minnesota
- ▶ *Dissertation*: State Export Behavior & Policy
- ▶ Research interest: Regional development through exportation
 - Information barriers to trade
 - Costs to begin exporting
 - Export promotion policy
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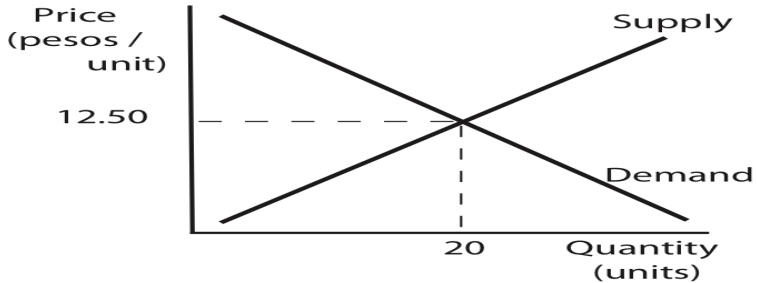


Introduction to Currency Exchange

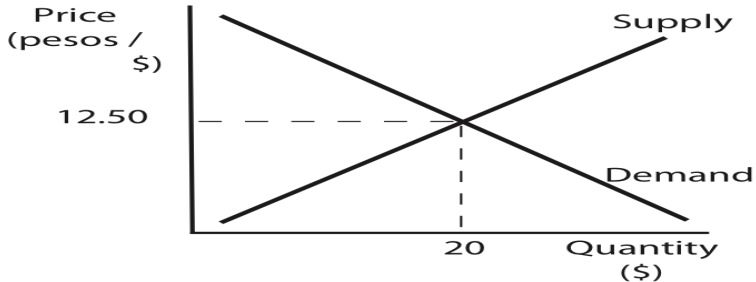
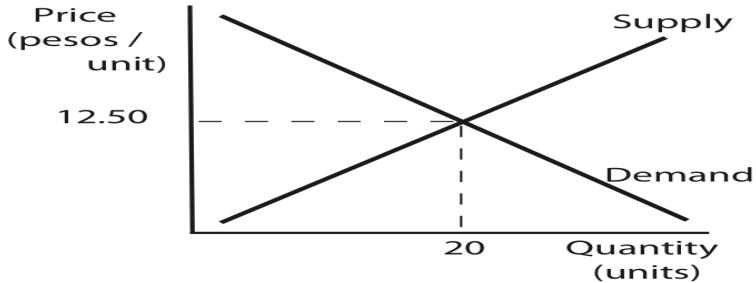
- ▶ Purchases of foreign goods and assets involves two trades
 - Buy foreign good or asset with foreign currency:
Foreign goods market
 - Buy foreign currency with domestic currency:
Exchange rate market
- ▶ *Effective* price can change in two places instead of one
- ▶ Theory of exchange rates & international trade
- ▶ Data on recent exchange rate trends
- ▶ What does this mean for U.S., WA, and the Palouse?



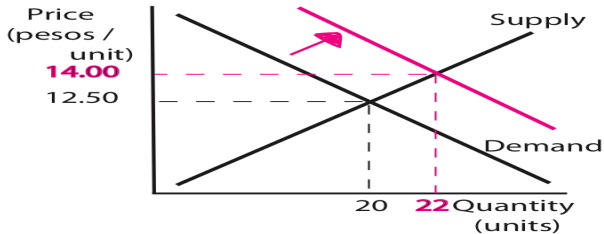
Market for Goods



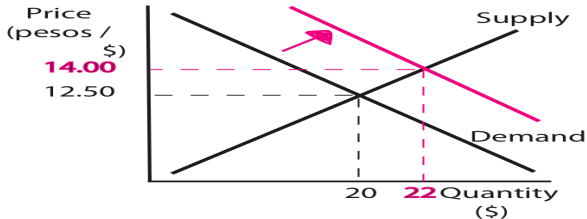
Market for Foreign Currency



Foreign Currency Price Changes



Takes more pesos to buy one unit: price increase or each peso buys less units



Takes more pesos to buy one \$: price increase or each peso buys less dollars



Appreciation vs. Depreciation

- ▶ **Appreciation** is when each unit of domestic currency buys **more** foreign currency than before
 - This means price of foreign currency **decreases**
 - Strong currency
- ▶ **Depreciation** is when each unit of domestic currency buys **less** foreign currency than before
 - This means price of foreign currency **increases**
 - Weak currency
- ▶ Widespread belief that currency “strength” associated with nationalism
- ▶ In reality, exchange rate changes help some Americans & hurt others



An Example

- ▶ A cheeseburger costs 100 pesos in Mexico. Exchange rate is 10 pesos. It costs \$10 for an imported cheeseburger (No transportation costs, taxes, or fees)
- ▶ Now cheeseburger still costs 100 pesos But exchange rate = 20 pesos.
- ▶ What is U.S. price to import a cheeseburger now? **\$5**
Has the peso appreciated? **No, depreciated**
Has the dollar appreciated? **Yes**
- ▶ Conversely, if a hotdog cost \$8 in the U.S., Mexicans used to pay 80 pesos, but now they pay 160 pesos!



Exchange Rates and International Trade

- ▶ When domestic currency **appreciates** then
 - Imports become **cheaper** for domestic buyers
 - Exports become **more expensive** to foreign buyers
 - Who benefits? U.S. cheeseburger eaters (whether they import or not), Mexican exporters
 - Who loses? U.S. cheeseburger makers, Mexican importers
- ▶ When domestic currency **depreciates** then
 - Imports become more expensive for domestic buyers
 - Exports become cheaper to foreign buyers
- ▶ Absolute exchange rate does **not** matter
Only the **change** in exchange rate matters



Exchange Rate Trends: Biggest Partners

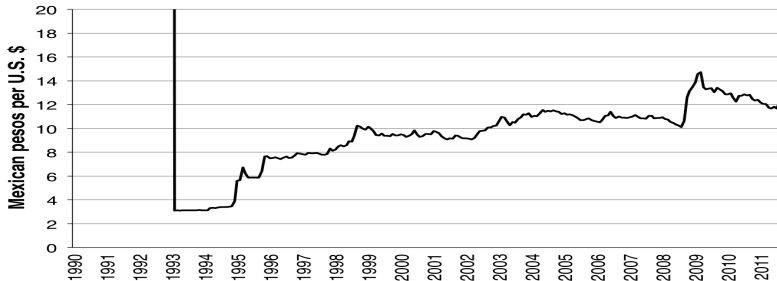
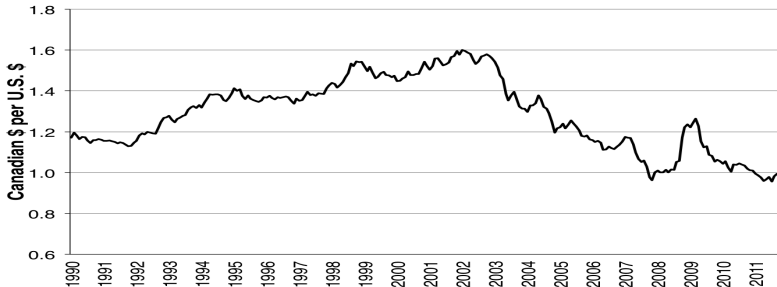


3 Variables Correlated with Exchange Rate

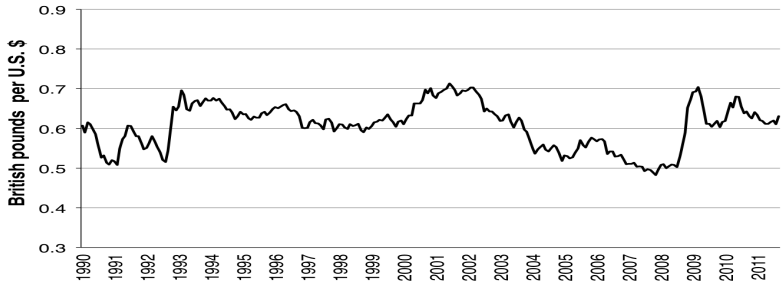
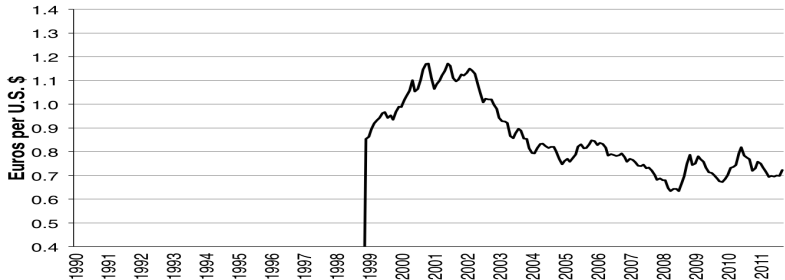
- 1 **Relative inflation:** High inflation \Leftrightarrow Depreciation
U.S. has low inflation, but high relative to Can. or Euro.
 - 2 **Relative interest rates:** Low interest \Leftrightarrow Depreciation
Related to relative public debts
U.S. has low interest relative to Eurozone
 - 3 **Trade:** Deficit \Leftrightarrow Depreciation
U.S. trade deficits not historic, but big
- ▶ Randomness: By definition, not correlated, but important, especially if volatile



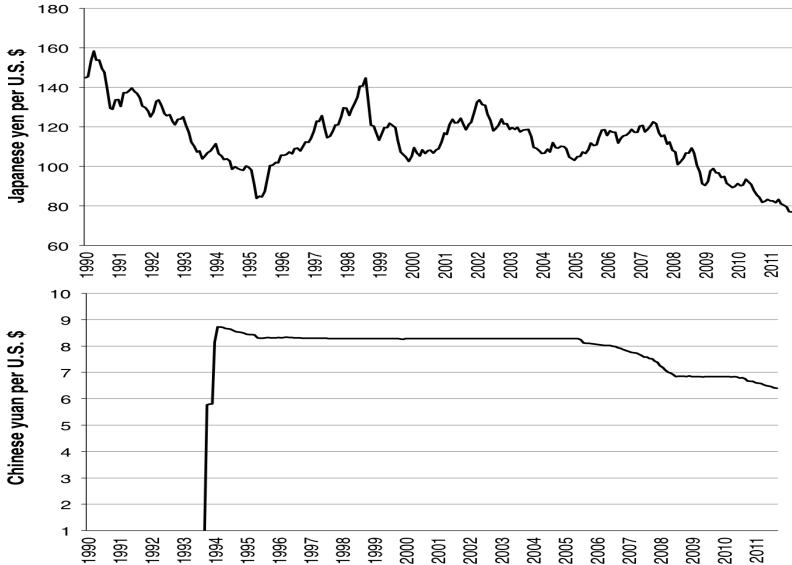
Exchange Rate Trends: North America



Exchange Rate Trends: Europe



Exchange Rate Trends: East Asia



Is the U.S. in decline?

- ▶ Is the U.S. weakening? Or weakening relative to others?
- ▶ Maybe, but I don't think exchange rate information indicates this
- ▶ It does indicate that now is a relatively good time to be a U.S. exporter

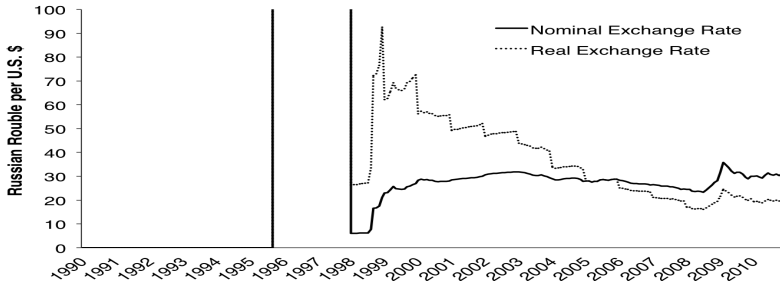
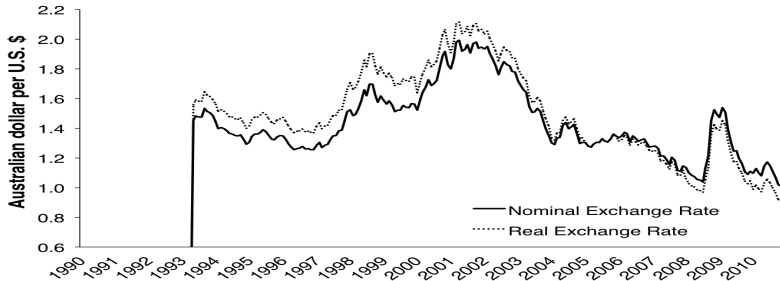


What does this mean for Washington? Palouse?

- ▶ Washington exports more of its shipments than any other state
- ▶ 60+% of WA exports in aerospace industry
Perhaps not a big impact here because contracts are not perfectly competitive
- ▶ Other big exporters: petroleum & coal products; navigational instruments; computer equipment
- ▶ I suspect gains will be “big” for small exporters, but not show up in state-level data
- ▶ What about wheat?



Exchange Rate Trends: Wheat producers



Implications for Exporters

- ▶ After 10 years of a strong currency (favoring importers, consumers), dollar is in a weakening trend benefiting U.S. firms
- ▶ Will it last? - Nobody knows (but people paid to predict)
- ▶ 2008 appreciation due to worldwide recession
Investors sold domestic assets to buy U.S. debt (bonds) requiring dollars



But what about the Euro?

- ▶ **Question:** What will happen with the European debt crises?
- ▶ **Answer:** I don't know.
- ▶ My understanding of plans is that Europeans are hoping exports can save them
- ▶ If decreased government spending does NOT increase consumption and investment, then where else can growth come from?
- ▶ Will ECB manipulate currency (as China does) to spur exports?
That is outside of its mandate for inflation target



Export Assistance Program

- ▶ No cost, confidential, in-depth and long-term export advice
- ▶ Assessment of export readiness
- ▶ Co-development of export plan
- ▶ Guidance through export forms and barriers
- ▶ Small Business Development Center
- ▶ Washington State Department of Agriculture
- ▶ Community & Economic Revitalization Board
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