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 Foreign Currency

Price (pesos / unit)
12.50

Quantity (units)
20

Supply
Demand

Price (pesos / $)
12.50

Quantity ($)
20

Supply
Demand
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

![Graph showing the trade weighted currency index from 1990 to 2011. The index rises from 65.0 to 135.0 during this period, with notable peaks and troughs.](image-url)
3 Variables Correlated with Exchange Rate

1. **Relative inflation**: High inflation ⇔ Depreciation
   U.S. has low inflation, but high relative to Can. or Euro.

2. **Relative interest rates**: Low interest ⇔ Depreciation
   Related to relative public debts
   U.S. has low interest relative to Eurozone

3. **Trade**: Deficit ⇔ Depreciation
   U.S. trade deficits not historic, but big

- Randomness: By definition, not correlated, but important, especially if volatile
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

Nominal Exchange Rate
Real Exchange Rate

Australian dollar per U.S. $

Russian Ruble per U.S. $

Nominal Exchange Rate
Real Exchange Rate
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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