

The



Dilemma



The falling dollar has made American goods more attractive to consumers abroad, but not everyone is happy about the currency's slide

BY BETTY JOYCE NASH
AND JENNIFER WANG

China is famous for its exports, but this nation of 1.3 billion people is also one of the world's biggest importers. Thanks to the falling dollar, it may become even more so. In 2004, China bought machinery from firms in Maryland and Virginia. China also bought wood from North Carolina — lots of it. China bought organic chemicals from South Carolina and plastic from West Virginia. And China isn't the only country buying U.S. goods — the dollar is making U.S. prices look good these days.

After cresting in 2002, the dollar has retreated to exchange rates not seen since the mid-1990s. Overall, the weakened dollar helped lift Fifth District exports during 2004 by 13.5 percent, with \$53.2 billion worth of goods being sent overseas. Manufacturers of chemicals, machinery, plastic, and vehicles have seen the biggest gains. Wood exports also grew, while apparel and woven fabric exports dropped off.

But does the falling dollar portend trouble if the United States must keep borrowing from foreign investors to finance its consumer and government spending? Or will the depreciation enhance U.S. competitiveness and help keep economic growth strong?

exported \$18 billion worth of goods in 2004, 11.3 percent more than 2003. "The weaker dollar's having a huge impact on our business worldwide," says Peter Cunningham, director of the International Trade Division at the North Carolina Department of Commerce.

The Tar Heel state exported 50 percent more pharmaceutical products in 2004 than it did in 2003, but it also exported almost 22 percent more cotton and yarn. And \$5.4 million of the cotton and yarn exported went to China, an increase of 36 percent to that country. Knit apparel, however, dropped by nearly 19 percent, a trend that many think will continue. Likewise, South Carolina sent 63 percent more cotton and yarn abroad last year, with China being its second best customer.

Strong cotton and yarn sales fuel overseas apparel shops, says Donald Brasher, president of Global Trade Information Services, based in Columbia, S.C. North Carolina is the No. 1 exporter of cotton yarn, and with the removal of textile quotas, China will produce even more apparel for export. That may be bad news for what's left of the Fifth District apparel sector. But China is going to need cotton — lots of it. "We might be sending more yarn to China or we may be just sending more raw cotton," Brasher notes.

Will China buy another traditional Fifth District manufactured product — furniture? Perhaps. In 2004, North Carolina exported about 23 percent more furniture and bedding to China than the previous year.

North Carolina exported about \$253 million in furniture and bedding in 2004, about 3 percent more than 2003, according to Global Trade Information Services. Most furniture companies have not embraced the

Going Abroad State Merchandise Export Totals

State	Exports 2003	Exports 2004	% change
District of Columbia	809,220	1,164,327	44
Maryland	4,940,631	5,746,142	16
North Carolina	16,198,733	18,114,767	12
South Carolina	11,772,894	13,375,890	14
Virginia	10,852,981	11,630,744	7
West Virginia	2,379,808	3,261,683	37
Fifth District	46,954,267	53,293,553	14
United States	723,743,177	817,935,849	13

NOTE: Figures are in thousands of dollars
SOURCE: Department of Commerce

Falling Dollar, Rising Exports

Economists are debating the long-term implications, but the falling dollar's impact in 2004 was favorable for many U.S. firms. North Carolina

ILLUSTRATION: GETTY IMAGES AND JERRY COX

export strategy but are being urged to expand to international markets because of the falling dollar. North Carolina's biggest furniture customers in 2004 were Canada and Australia.

"I use this example: A \$500 sofa two years ago would have cost 560 euros, today it's about 400 euros," says Jeremy Ruff of the North Carolina Department of Commerce's Furniture Trade Office. "Just the difference in the exchange rate is pretty dramatic."

For exporters, the effect of the declining dollar is easy to understand: A depreciated dollar makes U.S. goods more affordable. And more foreign tourists travel in the United States because their money goes further. One dollar was worth .76 euros in March, so a \$5 lunch cost 3.81 euros for German tourists in Washington, D.C.

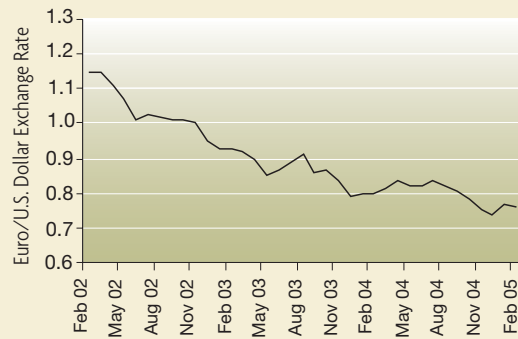
Linda Yelton, manager of international research at the Travel Industry Association of America, notes that travel to the United States from Europe, the United Kingdom, and Asia increased last year. In total, overseas travel to the United States rose by 14 percent over 2003.

Fifth District companies are benefiting from increased international tourism indirectly as well as directly. In February, Goodrich Corp. of Charlotte, N.C., announced a contract worth \$6 billion over 20 years with airplane maker Airbus of France.

How Low Can You Go?

The dollar may be falling but it hasn't tumbled enough to suit Cliff Waldman, an international economist for the trade group Manufacturers Alliance. He thinks the dollar needs to keep dropping to close the ever-widening trade deficit, which reached almost 6 percent of gross domestic product in

The Dollar's Slide Against the Euro



SOURCE: Bloomberg

late 2004. Waldman notes that the growth in demand for U.S. exports has moderated as economic activity in certain key countries has weakened, namely Germany and Japan.

"In terms of what we really need to see the dollar do, it has not gone back to the levels where we needed it to be competitive," Waldman says. He points out that in the early 1990s, the dollar appreciated more than 70 percent from 1992 to February of 2002, and almost 40 percent of that occurred from 1995 to 2002. Since then, the dollar has declined roughly 40 percent against the euro, but considerably less against a larger basket of currencies.

Likewise, Michael Walden, an economist at North Carolina State University, sees no threat in the declining dollar. He believes the dollar was overvalued prior to its recent decline.

"We're at a level commensurate with where we were in the mid-1990s. It's going to have a positive impact on our economy," he says. "It's an automatic stabilizer, if one is worried about the trade deficit. It stimulates exports and makes imports more expensive, eventually."

America's Savings Rate

The capital flowing into the nation from abroad has financed consumer and government spending, reflecting

the lack of domestic savings, one piece of the dollar puzzle. If foreign investment falls, the United States could be stuck paying higher interest rates.

Federal Reserve Board Governor Edward Gramlich recently focused on savings in a speech, concluding: "In the short run, output growth is healthy and inflation rates are stable. Investment shares are reasonable, but that is largely

because the United States is borrowing such a huge amount from world capital markets. The key question is whether this borrowing is sustainable. However sustainable it is, the United States would seem well-advised to minimize risks by raising its own national saving to finance its own investment. That would stabilize investment in the short run and increase profitability in the long run."

Walden notes that personal savings calculations don't capture capital appreciation in such things as homes or 401(k) plans. Also, one "could argue that education and research are investments," and compared to other countries, the United States spends a high share of its national product on those things.

While the falling dollar has benefited American exporters, the effect on some domestic manufacturers and consumers has been quite different.

"Relative prices of all internationally traded goods increase with dollar depreciation. U.S. producers of these goods gain, but all U.S. buyers are harmed," says Thomas Grennes, a colleague of Walden's at N.C. State. "For example, U.S. producers of steel gain from more expensive imported steel, but U.S. makers of automobiles and all users of steel are harmed because their costs increase." **RF**

READINGS

Bivens, Josh. "The Benefits of the Dollar's Decline." Economic Policy Institute Briefing Paper no. 140, July 24, 2003.

Gramlich, Edward. "The Importance of Raising National Savings." Remarks Delivered at Dickinson College, March 2, 2005.

Obstfeld, Maurice, and Kenneth Rogoff. "The Unsustainable U.S. Current Account Position Revisited." National Bureau of Economic Research Working Paper no. 10869, October 2004.

"The Disappearing Dollar." *The Economist*, December 4, 2004, p. 9

Visit www.richmondfed.org for links to relevant sites.