Two sides of the coin: Pros & Cons of the Falling Dollar

BY TONI LAPP, SENIOR WRITER

Sales are so strong for industrial products made at Clay & Bailey Manufacturing Co. in Kansas City, Mo., that the company is adding workers to meet the demand. Why? The depreciating dollar is making their products more competitive against foreign-made products. Meanwhile, the company president is concerned over the cost of imported raw materials—up sharply, due in part to the falling dollar.

Such is the world of currency exchange, producing winners and losers, sometimes within the same company. Clay & Bailey's mixed results reflect many other firms' experience, says Bill Keeton, assistant vice president and economist at of the Federal Reserve Bank of Kansas City, who has spoken on the issue.

"The weak dollar is having a positive effect on exports, but a negative effect due to the higher cost of raw materials," he said.

In the world of foreign exchange, the terms "strong" and "weak" get tossed around a lot. A strengthening dollar means its value is rising in relation to other currencies. A weakening dollar means it is losing value against other currencies.

Over the last three years the dollar has fallen about 35 percent against the

European Union's euro and 24 percent against the Japanese yen.

While it may seem counterintuitive to wish for a weak dollar, some U.S. firms are reaping benefits.

A recent manufacturing survey conducted by the Bank speaks to the beneficial effects. The instrument shows the district's year-over-year export index has edged up recently, and the six-month-ahead index has increased even more, suggesting that the lower dollar is having some positive impact on manufacturing exports.

But manufacturing is not the only sector feeling an effect—good or bad.

"It impacts a lot of industries—from shipping, to agriculture, to the manufacture of actual products," says Mary Pyle, managing director of the Greater Kansas City Chamber of Commerce World Trade Center.

"The weak dollar is having a positive effect on exports but a negative effect on raw materials."

Grain traders in Kansas City credit the dollar with creating a more favorable market for U.S. wheat exporters. A liquor-store retailer blames the dollar for sending the price of French wine soaring. A Colorado ski resort attributes a boom in foreign visitors to the dollar.

The impact of the dollar's fall on businesses in the Tenth Federal Reserve District has been keenly felt by some firms, while others have little noticed it at all.

"Manufacturing is considered to be one of the sectors most exposed to changes in exchange rates," says Keeton.

Nebraska-based Behlen Manufacturing is a prime example. Its products, fabricated metal storage containers and sheet-metal joining presses, are in demand in developing countries. Lyle Burbach, president of Behlen's International and Diversified Products Division, estimates that exports have risen 30 percent over the last three years.

"It's been helpful for us," he says of the plummeting dollar. "It's spurred exports."

Put simply: "We are winning more contracts."

Because Behlen's products are sold in dollars, the manufacturer is at a competitive advantage over European firms whose goods are sold in euros, says Burbach.

And what of the "desirability" of a strong dollar?

"When the dollar peaked in the 1990s, it dampened our exports," says Burbach.

The flip side

Not all Tenth District manufacturers are beaming about the falling dollar.

Kawasaki's U.S. plant should realize a boom, right? Not so, says Shin-ichi Tamba, president of Kawasaki Motors Manufacturing Corp., U.S.A. in Lincoln, Nebraska. Kawasaki is spending more for inputs, says Tamba.

"We are going to spend about 5 percent to 10 percent more than before because of downsized dollars," he laments. Kawasaki imports parts such as electrical control units and shock absorbers. And because the United States is the leading market for the all-terrain vehicles and jet skis produced at the Lincoln, Neb., plant, exports are not increasing dramatically.

The extent to which a fall in the dollar increases the cost of imports is known as "pass-through." Foreign manufacturers usually pay their workers and suppliers in foreign currency, so when the dollar falls, they charge higher dollar prices to their U.S. customers to cover their costs. Sometimes, though, foreign companies refrain from raising their dollar prices the full amount to avoid losing business.

more expensive U.S. product made at Clay & Bailey. Now the French product is not such a good buy, reflected in the sales ratio: 10 percent for the French product versus 90 percent for the domestic product. “It’s to the point where the French are grumbling,” said Borst.

A conventional estimate is that import prices rise by half the amount of a fall in the exchange rate, though some economists have found evidence of smaller pass-through during the last decade.

Some analysts have claimed that the use of imported inputs has increased greatly in U.S. manufacturing, eliminating the benefit to manufacturers of a fall in the dollar.

Although the cost of imports has not totally eliminated its gains from increasing sales, Clay & Bailey Manufacturing Co. certainly counts both positives and negatives of the falling dollar.

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The manufacturer of construction castings saw a double-digit sales increase in 2004, says company President Ron Borst. But costs have increased faster. This is partly due to rising worldwide demand, but the fact that the dollar has slid 33 percent against the Brazilian currency over the past two years surely has contributed. Borst says raw materials such as iron from Brazil increased from \$180 a ton to \$560 a ton in 14 months.

But all things considered, Clay & Bailey is better off as a result of the dollar’s depreciation, says Borst. He need only look at his customers’ orders as of late. To complement his offerings of plumbing hardware, he distributes a French product; about 40 percent of customers once opted for that product over the higher-quality, more expensive U.S. product made at Clay & Bailey.

Beyond the plant

Manufacturing is not the only industry suffering the woes of pass-through.

“French wines have gone through the roof because of the euro,” says Ralph Bondon, owner of Berbiglia Wine & Spirits in Kansas City, Mo. He has adjusted to the changing economy: He is buying less high-end French wine—bottles now selling in the \$400 range—with the assumption that consumers won’t have the appetite for it that they did a few years ago. He is now concentrating on buying the many midpriced wines that offer good value, he says.

A sector that’s feeling a positive impact is tourism. Domestic tourism, that is.

“You definitely heard a lot more British accents on the chairlifts,” said Kelly Ladyga, spokeswoman for Vail Resorts. “Our domestic guests even commented on it.”

Vail has capitalized on the weakening dollar by ramping up overseas marketing, not just in Europe and Mexico, but also to Australia, in an effort to woo skiers who in the past may have headed for the Canadian Rockies. Americans too, previously lured by favorable exchange rates, have found it more economical to stay home, says Ladyga.

However, the Tenth District in general does not rely heavily on travel expenditures by international visitors; Rocky Mountain ski resorts are the exception to the rule. Overall, foreign visitors are much less important to tourism in the district than to the nation, says Keeton.

Homegrown advantage

One sector that is more important to the Tenth District than to the rest of the nation is agriculture.

Witness the sale of Midwestern grain.

"There's no question that a cheaper dollar helps to trade at higher prices," says Randall Stone, trader with FCStone LLC. The price of hard red winter wheat worldwide is set at the Board of Trade in Kansas City, Mo. World prices are based on U.S. currency. As the dollar falls in value, U.S. commodities become cheaper overseas and U.S. exports rise. This reduces domestic supplies, which has the effect of keeping domestic commodity prices relatively high.

"If the dollar rallies, we'd have to drop our price in order to compete," says Stone.

Because so many factors affect the price grain sells at, wheat farmers are little aware of the effect of the dollar, said Stone. Or at least American wheat farmers. Foreign farmers will more likely have a surplus at the end of the season because of the low dollar.

"It's going to have a mixed impact on U.S. agriculture," says Jason Henderson, senior economist with the Federal Reserve Bank of Kansas City's Center for the Study of Rural America. "Mainly because it hasn't fallen uniformly."

A large part of the U.S. agriculture exports go to China and other Asian countries, says Henderson, and China keeps its currency pegged to the dollar.

And in some cases, the effects of the fluctuating dollar are offset by other factors. For instance, the price of grain is affected by weather conditions, political events, world supply and demand, and myriad other variables. And in the beef industry, which otherwise may have been able to capitalize on the currency's condition, producers are not reaping any benefits because the mad cow scare has caused countries such as Japan to ban import of U.S. beef.

Nevertheless, economists predict an opening for firms in the Tenth District to expand their business overseas.

"It gives them an opportunity," says Keeton of U.S. manufacturers. "Maybe some markets that may not have been open to them before, will be open now."

District businesses are taking note. Borst of Clay & Bailey Manufacturing went to Mexico in 2004 in an attempt to attract new distributors for his product. Recognizing the importance of the global economy to the region, organizations such as Kansas City's World Trade Center lead trade missions overseas. This summer the WTC will lead a tour to China.

Meanwhile, manufacturers such as Borst will continue to celebrate the low dollar.

His only wish? "I would like to see the whole world go to devalued currency."

COMMENTS/QUESTIONS are welcome and should be sent to teneditors@kc.frb.org.

Net Percentage of Tenth District Manufacturers

reporting increased export orders from the year before

Percent reporting increases minus percent reporting decreases