Global Trade Advisor — Fall 2008

Global economy will impact exports as much as USD volatility

After a 6-year decline, the U.S. dollar has been appreciating for most of 2008. While this should be of concern to U.S. exporters, which benefit from a weak dollar, the dollar's relative strength may not be the most important factor driving export sales going forward. Equally important will be the strength of the global economy, says Julien Seetharamdoo, Royal Bank of Scotland's London-based senior U.S. economist.

"Exchange rates are important, because a weaker dollar makes U.S. exports more attractive," Seetharamdoo says. "But it's not just about the dollar."

Although aided by the dollar's weakness, strong world demand for U.S. products and services from growing economies has driven the dynamic rise in U.S. exports in recent years, Seetharamdoo says. "That's why a global slowdown is a potential concern for the U.S. export sector."

Impact of USD depreciation

A slowing U.S. economy and resulting sharp interest rate cuts produced a steady depreciation of the USD since early 2002.

One of the best ways to express the value of the dollar is on a trade-weighted basis. Economists calculate the average of all dollar exchange rates using the volume of trade with each trading partner as a weighting method. On this basis, the USD depreciated 37% from January 2002 until March 2008.

During the years of steady USD depreciation, U.S. exports thrived. From 2004 to 2007, for instance, U.S. exports grew at an average annual rate of 9%. And that growth pattern has continued into 2008. In fact, for the first half of this year, U.S. exports were up 20% year-over-year (not adjusting for price effects).

U.S. export growth has been broad-based, benefiting sectors as diverse as agriculture, manufacturing and services, Seetharamdoo says.

"The export sector is one of the few that has done well in the U.S. in recent months, and one of the major reasons why the U.S. has avoided falling into negative growth," he says.

USD changing course?

However, the dollar has begun to strengthen, appreciating on a trade-weighted basis by 8% since March 2008.

The dollar remains weak relative to the long-term average. In September 2008, it was 17% below its trend strength on a trade-weighted basis since 1994. As such, the dollar can be expected to provide some mild support to U.S. exporters for some time yet. However, if the current appreciation trend continues, it eventually will almost certainly put a crimp in U.S. exports.

Of course, forecasting exactly what the dollar will do is difficult, Seetharamdoo says. "We are in volatile times," he says. "Currency will be extremely volatile in the next few months because of the uncertainty of the economy."

U.S. exporters need to be prepared for that volatility and consider hedging strategies to mitigate the potential impact on their businesses, Seetharamdoo advises.

Another threat to exports

Seetharamdoo views a likely global economic slowdown this year and next as potentially just as detrimental to U.S. exports as a strengthening USD.

The economies of emerging markets are holding up reasonably well, he says. However, others are beginning to limp. For instance, the economies of Europe are slowing rather sharply, led by housing market downturns in a number of the eurozone countries, he says.