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Exploiting Exportation: Why Foreign Exchange Rates Matter

"In a time when millions of Americans are out of work, boosting our exports is a short-term imperative. Our exports support millions of American jobs."
—President Barack Obama[1]

Strong growth in the sales of goods and services to foreign buyers (exports) has greatly helped the U.S. economy over the past several quarters: One-third of the reported growth in gross domestic product in 2009:Q4 was credited to exports.[2] Although the potential for export growth to alleviate unemployment is clear, measuring by how much requires understanding how exchange rates influence trade.

Exchange rates state the price of one country's money in terms of units of another country's money. Suppose that I am interested in buying a German car. The manufacturer likely accepts only euros for payment, which means that I must first exchange my dollars for euros in a foreign exchange market. The exchange rate sets how many dollars I need to "pay" for each euro, and in turn, is determined by the supply and demand for euros.

Trade (imports and exports) is influenced by exchange rates because consumers care only about the price of goods in their home currency. An appreciation of the euro relative to the dollar affects me because a German car will cost more dollars as a result. Meanwhile, a German businessman interested in buying American steel will find that the same quantity of steel costs fewer euros. All else equal, a depreciation of the dollar against the euro increases orders for American steel in Germany while decreasing sales of German cars in America.[3] American manufacturers enjoy increased demand for their products, which benefits labor should they hire more workers to meet that demand. Economics stresses, however, that there is no free lunch. American consumers, thanks to more expensive foreign goods, see their purchasing power decrease, particularly hurting lower-income households.

Recent attention to our exchange rate with China is rooted in this connection between exchange rates and trade. President Obama's emphasis on China moving "to a more market-oriented exchange rate"[4] is based on the argument that, through direct foreign exchange intervention, China has held the value of its currency 25 to 40 percent[5] below the free market price. All else equal, this contributes to our large trade deficit with China by increasing the international competitiveness of Chinese exports while simultaneously curbing Chinese demand for our exports. Caution, however, is required in interpreting the extent to which China's possibly undervalued currency may be affecting U.S. exports. Complex causal relationships link the imports and exports of our trading partners, and exchange rates between the dollar and all other major currencies will shape the ultimate success of the United States in growing its exports.

—By Brett Fawley, Research Analyst

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[1] Remarks at the Export-Import Bank's Annual Conference, March 11, 2010.

[2] See "Can the United States Double Exports in Five Years?" in Recent Articles and Further Reading.

[3] An important assumption here is that the domestic price of the goods has not changed. If the dollar loses 50 percent of its value against the euro, but prices in the United States double, then the price of American steel (in euros) has not changed. For this reason it is important to distinguish between real and nominal exchange rates.

[4] See note 1.

[5] Wong, Edward and Lander, Mark. "China Rejects U.S. Complaints on Its Currency." *New York Times*, February 4, 2010; www.nytimes.com/2010/02/05/world/asia/05diplo.html.

Recent Articles and Further Reading on Exchange Rates

"Can the United States Double Exports in Five Years?" by Uri Dadush and Shimelse Ali, Carnegie Endowment for International Peace, *International Economic Bulletin*, February 17, 2010.

This article discusses whether President Obama's goal of doubling exports in the next five years is achievable in light of exchange rate expectations.

"The Chinese Exchange Rate and U.S. Manufacturing Employment," statement by Douglas Holtz-Eakin, director, Congressional Budget Office, *CBO Testimony*, October 30, 2003.

This report provides a balanced discussion of the impact of China's exchange rate on the United States. The report was published before a Chinese reevaluation of its currency in 2005 in response to pressure from the Bush administration.

"The Story of Foreign Trade and Exchange," by Cedric Fan, Federal Reserve Bank of New York Public Affairs Department, 1998.

This comic book–style pamphlet explains the basic principles underlying foreign trade and exchange and is geared toward a middle and high school audience.

Free Data Sources and Reports

Data: Exchange Rates
Description: Historical exchange rates between the United States and numerous other countries at daily, monthly, and annual frequencies. Also includes exchange rates between the United States and a trade-weighted bundle of currencies.
Published by: Federal Reserve Bank of St. Louis
Location: http://research.stlouisfed.org/fred2/categories/15

Data: Foreign Exchange Intervention
Description: Daily series of currency transactions conducted by the central banks of multiple countries, including the United States.
Published by: Federal Reserve Bank of St. Louis
Location: http://research.stlouisfed.org/fred2/categories/32145

Data: Trade Activity
Description: Data covering export-related jobs, the number of U.S. companies exporting, and the effect of foreign investment on exports. Also links to the Exporter Database, which describes the export activities of small- and medium-sized enterprises.
Published by: U.S. Department of Commerce, Office of Trade and Industry Information
Location: http://ita.doc.gov/td/industry/otea/OTII/OTII-index.html

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