Moving to a Competitive Dollar: Modeling the Impact on the US Economy

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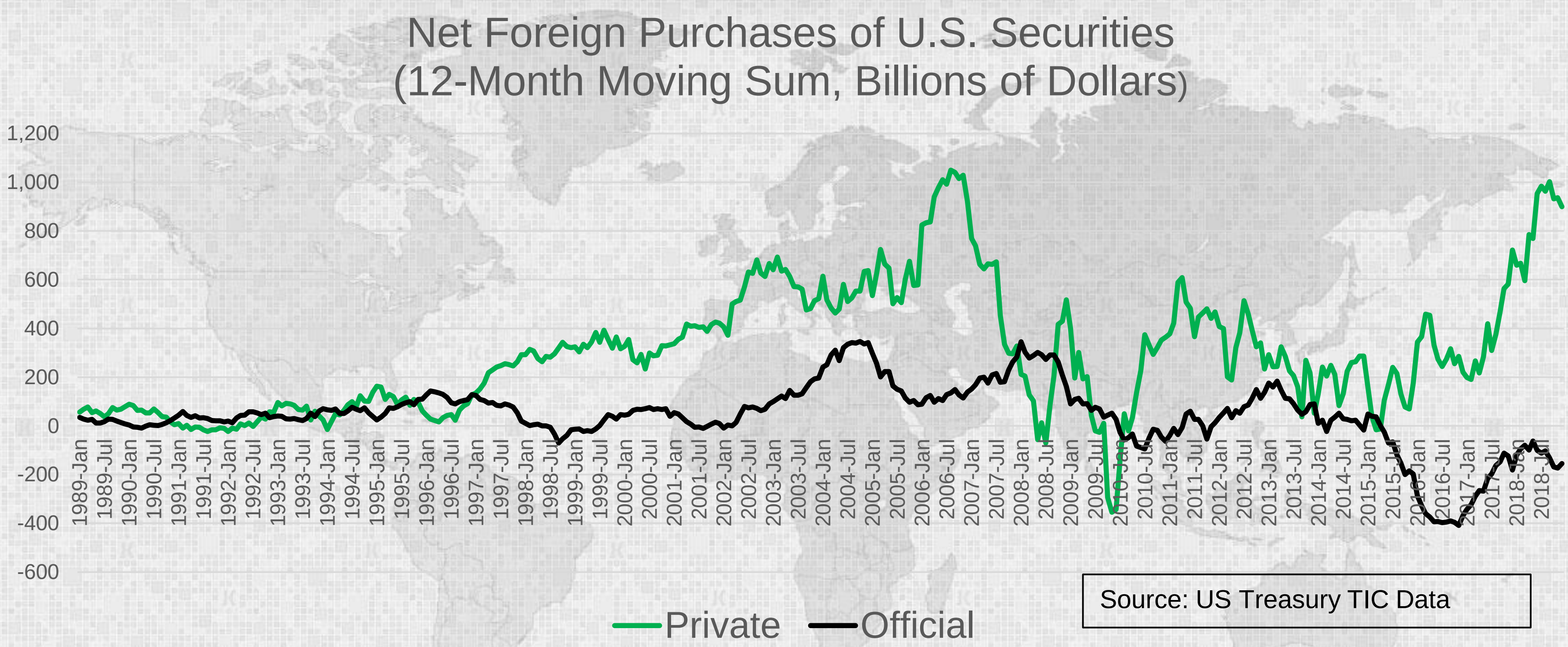
Summary

- Capital inflows from surplus nations drive overvalued dollar
- Overvalued dollar drives US trade deficit ($621 Billion for 2018) and loss of competitiveness
- Adjusting dollar value by 27% balances US trade in six years
- Delivers massive economic benefits:
    - Job creation: 6.7M over baseline growth
    - GDP: 4.8% or $968B over baseline
    - Job quality improvements: job growth concentrated in goods producing industries
    - Agricultural prices and world trade increase

Net Foreign Purchases of U.S. Securities



Net Foreign Purchases of U.S. Securities continue to increase putting upward pressure on the dollar.

Capital Inflows Put Upward Pressure on the USD Which Drives the US Trade Deficit

- Surplus country (Asia/Eurozone) policies:
  - Intentional export surpluses
  - Consumption suppressed
  - Excess savings generated
- Key transmission mechanism:
  - Capital moves from surplus to deficit countries
  - Dollar appreciates to uncompetitive levels
  - US trade deficit widens
- US absorbs most global capital surpluses
  - Result: loss of competitiveness, industrial decline

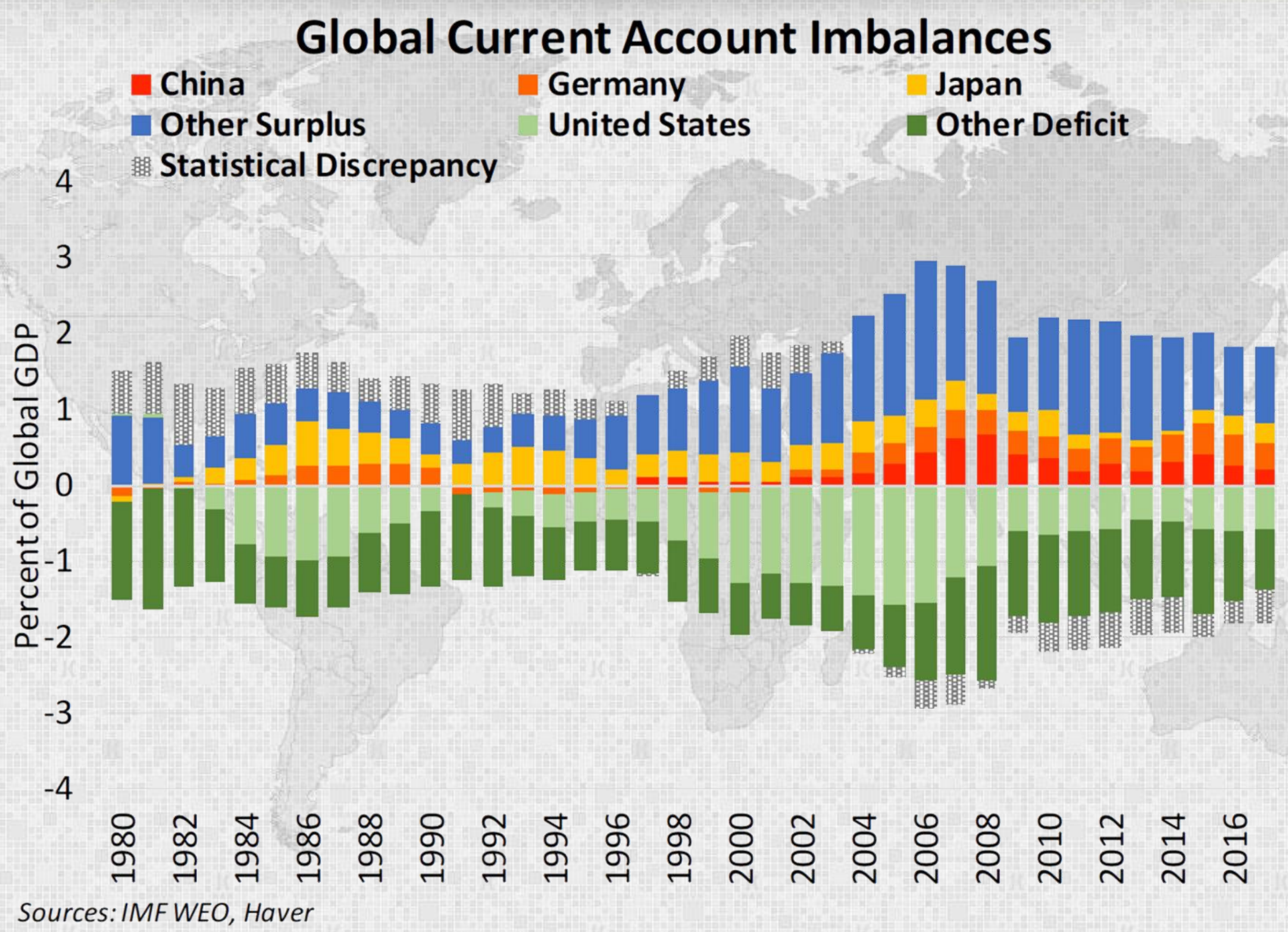
Global savings glut widely accepted by leading economists:

- *"the saving flowing out of the developing world has been directed into dollar-denominated assets such as US Treasuries. The effects…have been felt on US interest rates and the dollar."* ***(Ben Bernanke, 2005)***
- *"a world plagued with excess savings...in which the excess saving in one country has strong negative externalities on its trading partner via current account surpluses."* ***(Larry Summers et al., 2015)***
- *"the world's unwanted savings pour into the US due to the dollar's role as the world's primary reserve and safe-haven currency."* ***(Michael Pettis & Ken Austin, 2018)***

US Trade Deficit

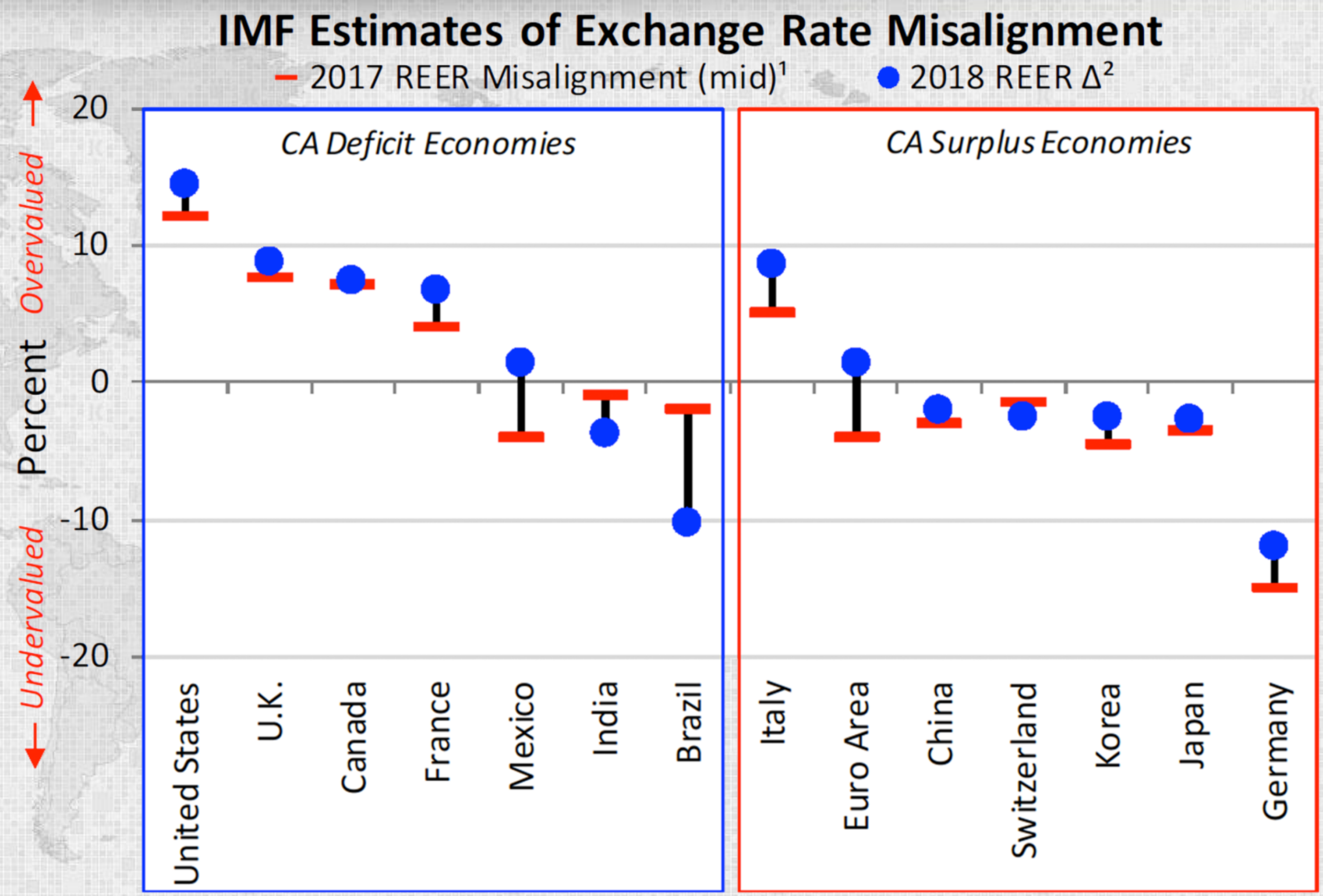
- The Commerce Department said on Wednesday March 6, the US trade deficit surged to a 10-year high in 2018 of **$621 Billion**

Global Savings Glut:
US Absorbs Global Surpluses



Exchange Rates Do Not Always Move to Alleviate Imbalances

- In major deficit countries, India and Brazil being the exception, currencies are not moving to alleviate imbalances.
- With the exception of Switzerland, major surplus countries currencies are moving to alleviate the surplus



Source: IMF via US Treasury

Open Investment Policy
Makes US the Leading Deficit Nation

- Open investment policy versus exchange rate management
- Global reserve status
- Investment/safe harbor currency
- International payments in dollars
- Tax free investment benefits for foreigners
- Perceived “Sound” Monetary Policy and Independent Central Bank (The Fed)

The Model

Baseline Projection

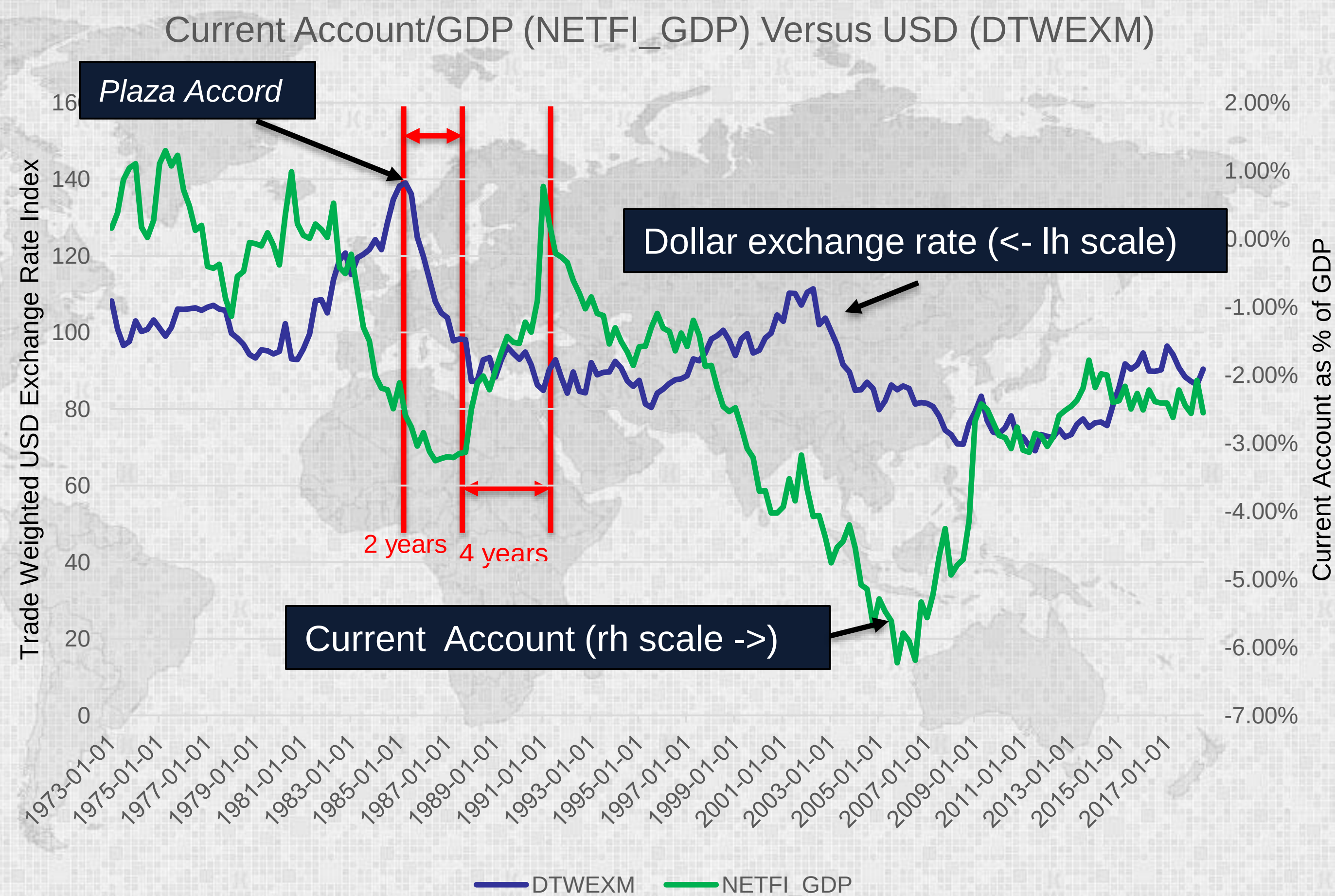
- CPA Economic Model:
  - Utilizes REMI economic model
  - Incorporates Congressional Budget Office economic forecast of August 2018 to create “CPA Baseline Forecast”
  - Six year forecast: 2019 to 2024

CPA Baseline Forecast 2019-2024	
	Avg. Annual % Change
Real GDP	1.7%
Employment	0.24%
PCE Inflation	2.24%
Exports	2.73%
Imports	2.44%

History Shows Dollar Impacts Deficit With 2-4 Year Lag

Lessons from Plaza Accord of 1985

- Immediate drop in USD exchange rate
- 2 year lag for current account impact
- 4 more years to achieve balance
- 6 years total



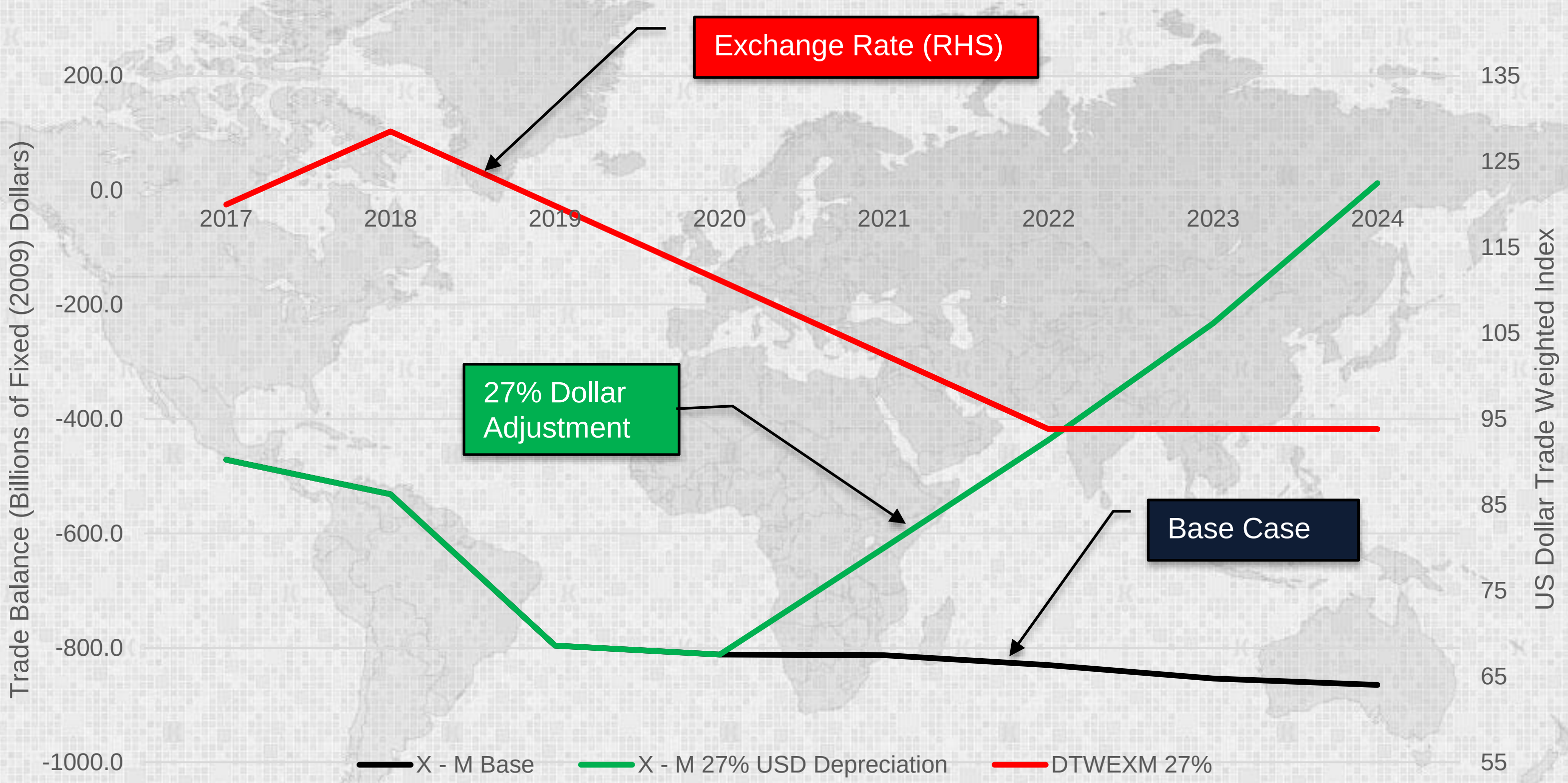
Dollar Value Changes Impact Exports More Than Imports

- Export prices more sensitive to dollar value
  - Dollar value decline of 10% -> export price fall of 7%
  - Dollar value decline of 10% -> import price increase of 3.2%

3.2% Import Pass-Through Rate, 7.0% Export Pass-Through Rate***				
USD Value Change	Δ Price of US Exports (%) Paid by Foreign Consumers	Δ Price of Imports (%) Paid by US Consumers	Δ Price of Exports % per year over 4 years	Δ Price of Imports % per year over 4 Years
2018 Base				
10%	-7.0%	3.20%	-1.75%	0.8%
24%	-16.8%	7.68%	-4.200%	1.920%
25%	-17.5%	8.00%	-4.375%	2.000%
26%	-18.2%	8.32%	-4.550%	2.080%
27%	-18.9%	8.64%	-4.725%	2.160%
28%	-19.6%	8.96%	-4.900%	2.240%
***Current Issues in Economics and Finance, Volume 13, Number 5 – June 2007: Federal Reserve Bank of New York				

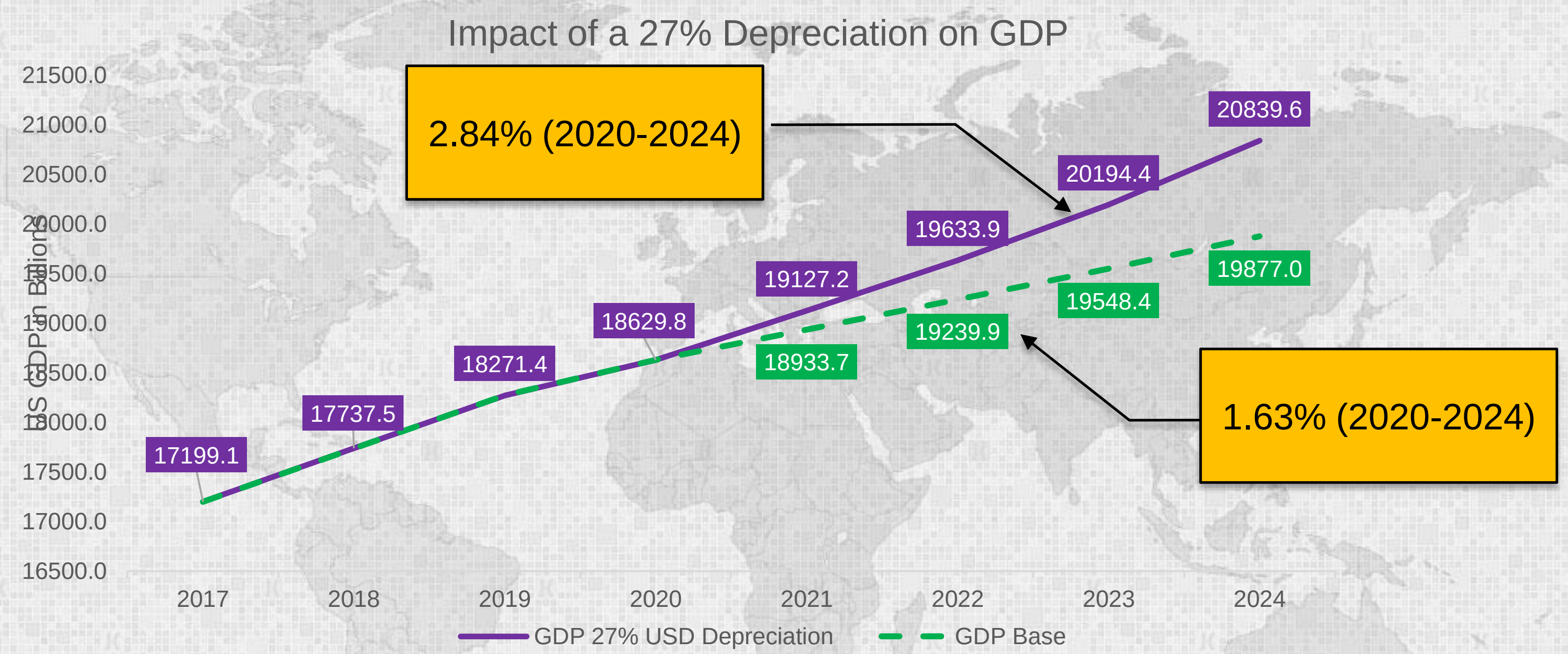
Policy Variable Inputs													
Category	Units	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
Foreign Export Costs	Percent	0	0	0	0	-4.725	-9.45	-14.175	-18.9	-18.9	-18.9	-18.9	-18.9
Foreign Import Costs	Percent	0	0	0	0	2.16	4.32	6.48	8.64	8.64	8.64	8.64	8.64

Competitive Dollar Narrows Trade Deficit
27% Gets To Balance by 2024



The Domestic Economy Results

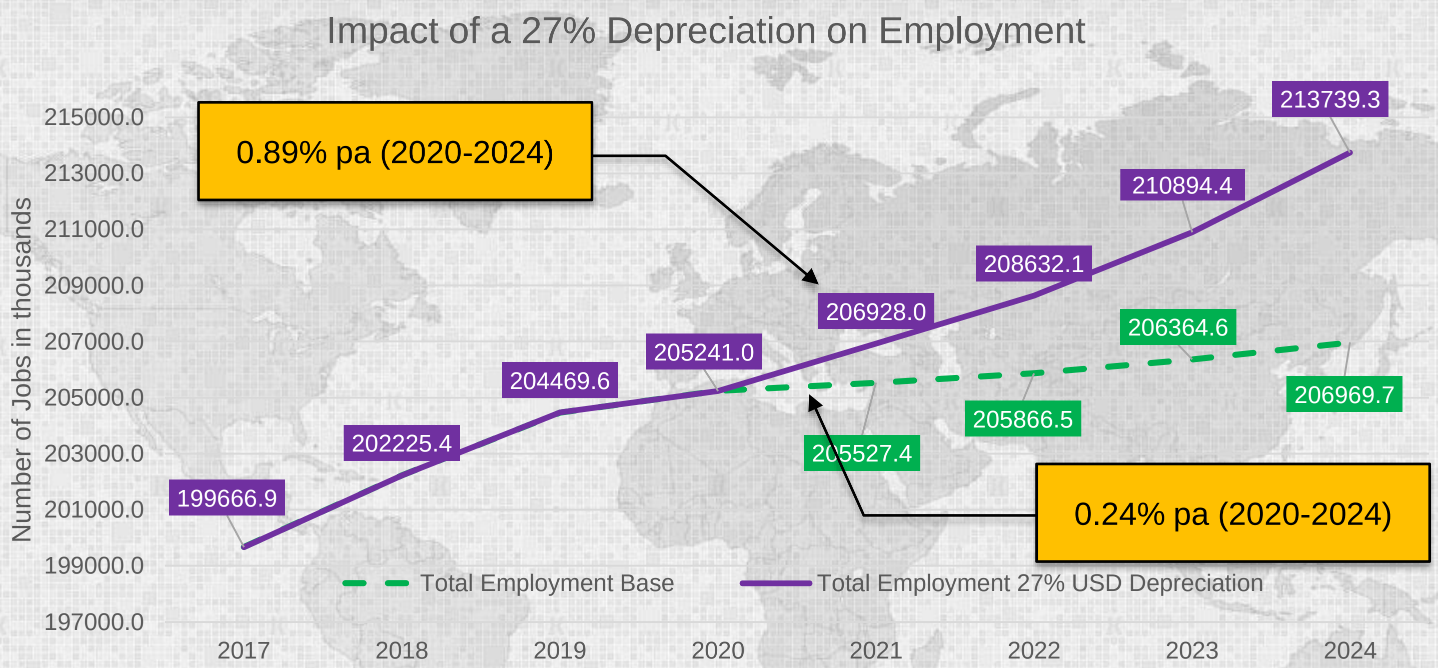
Higher Growth Rate in GDP Makes Economy Nearly $1 Trillion Larger by 2024



- From 2020 to 2024 real GDP grows, on average, 74% faster than the baseline growth rate (2.84% vs. 1.63%)

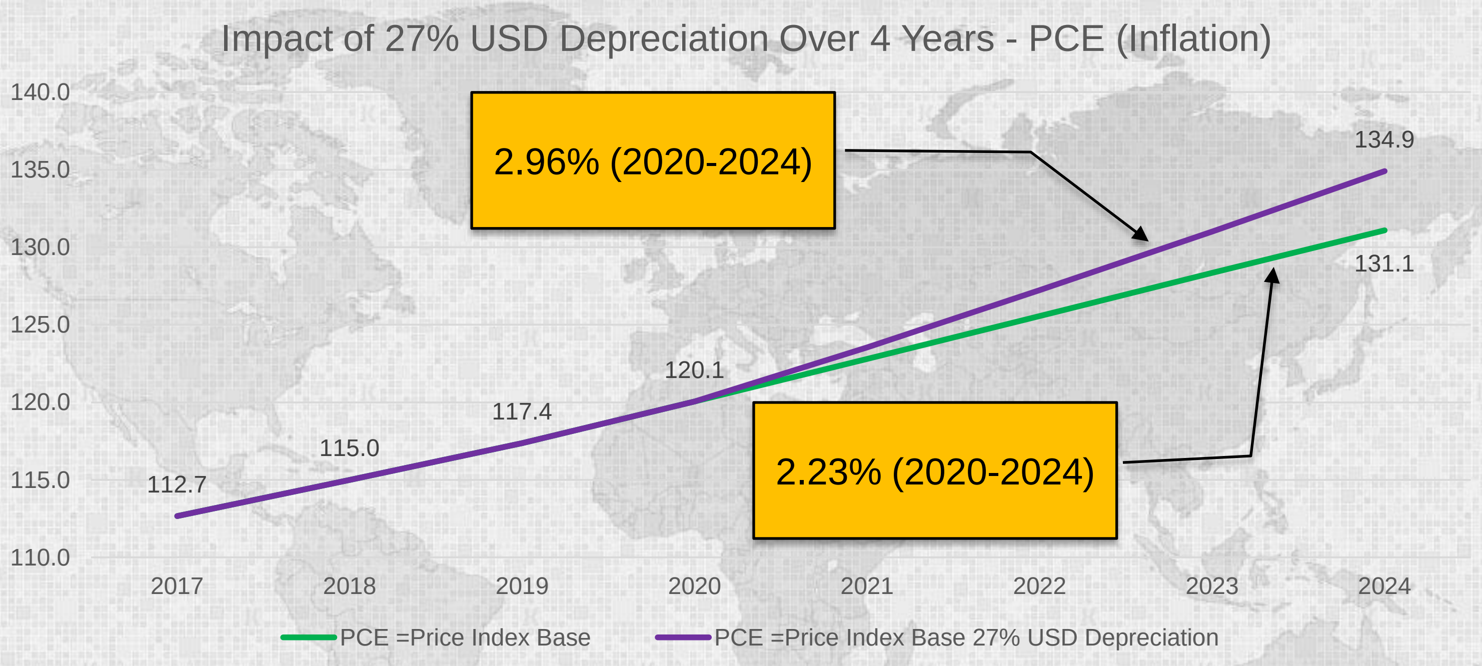
- By the end of 2024, the US economy is $962.2 billion (4.8%) larger than in the baseline (in 2009 dollars)

Depreciation Creates 6.7 Million Additional Jobs



- Average annual employment growth more than triples from 0.24% to 0.89%
- After 6 years (end of 2024) US economy has generated 6.7 million more jobs over the baseline scenario

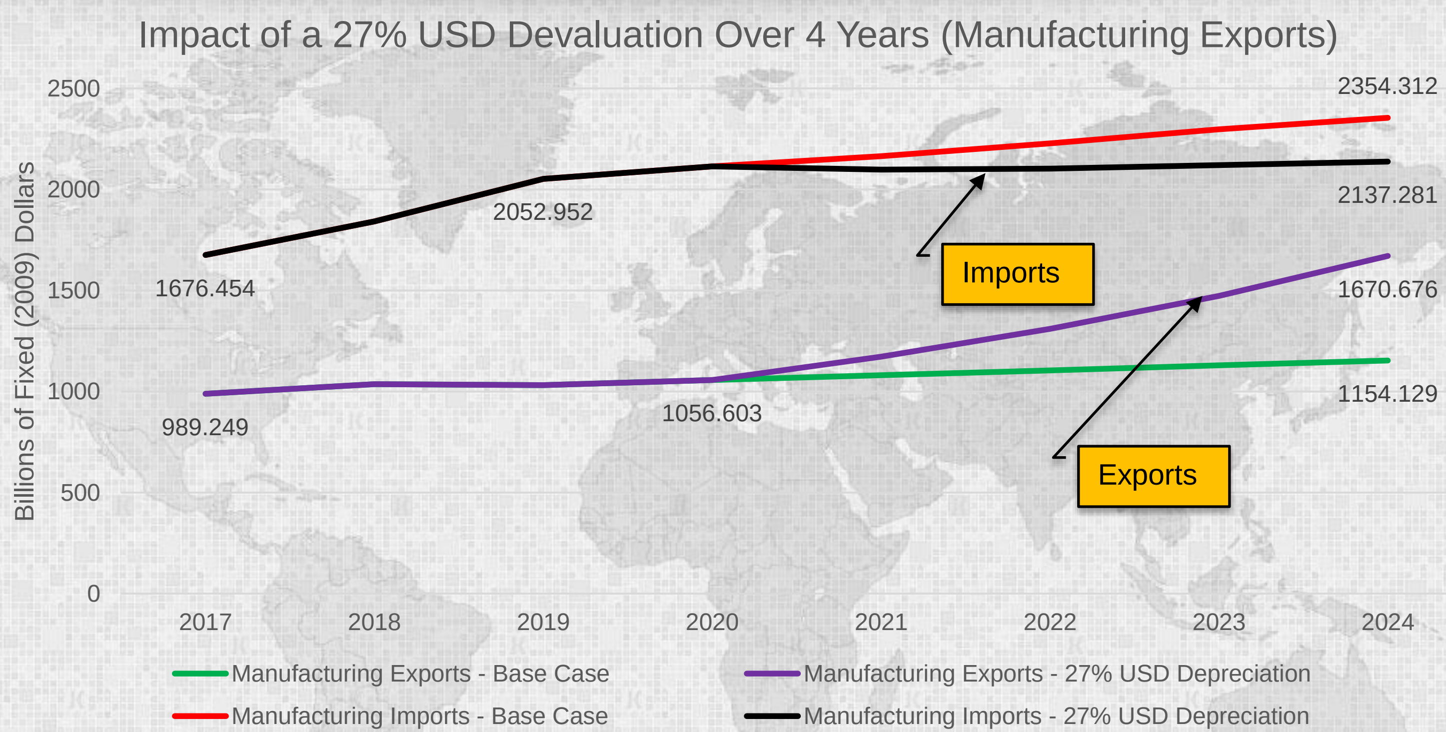
Inflation Increases Only Slightly



- From 2020 to 2024 average inflation rate is 2.96% vs. 2.23% in baseline.

- Competition from domestic producers holds down price increases in imports.

Manufacturing Exports Grow 5X Faster Imports Grow More Slowly



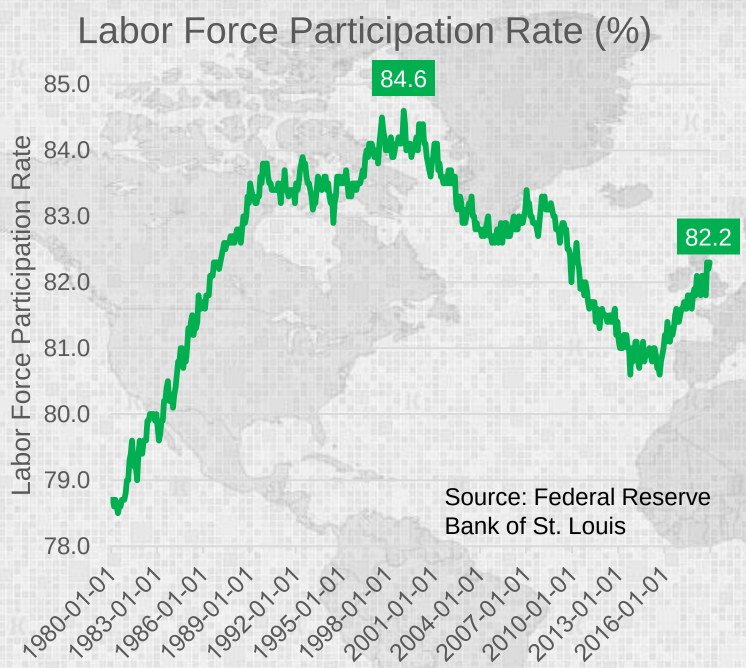
- Annual manufacturing export growth is five times faster: 12.14% vs. 2.23% in base case.
- Annual manufacturing import growth continues, but more slowly: 0.28% versus 2.73% in base case.

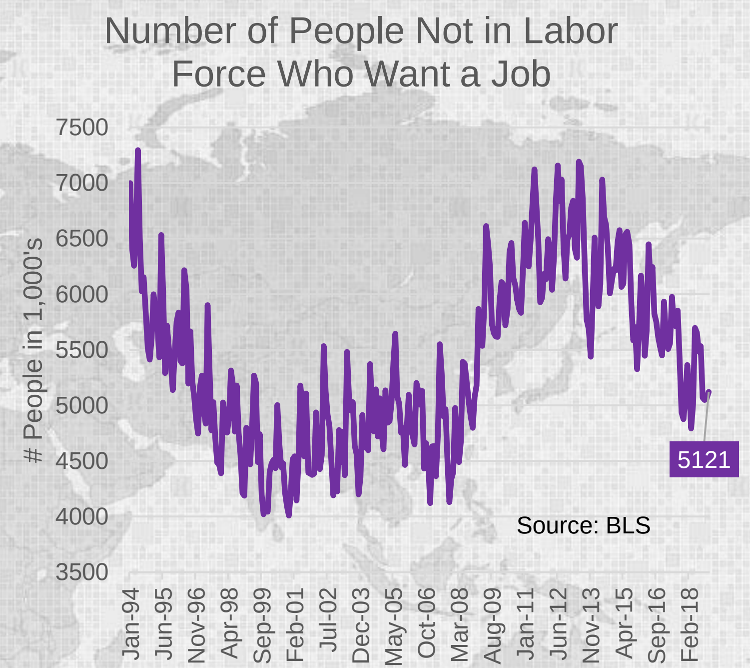
Job Quality Improvements

Growth in Employment Over 2020 – 2024				
	Base Case		27% Dollar Move	
Sector	Base Case pa	Growth in Employment – Base Case (1,000's)	Employment Growth pa	Employment Growth Relative to Base Case 2020-2024 (1,000's)
Natural Resources	0.45%	48.87	2.79%	310.31
Construction	-0.21%	-164.16	0.41%	334.61
Manufacturing	-1.07%	-573.39	1.81%	1,977.23
Retail and Wholesale	-0.03%	-92.01	0.08%	155.21
Transportation and Public Utilities	0.20%	58.7	1.52%	557.98
Finance, Insurance & Real Estate	0.39%	297.02	1.11%	739.61
Services	0.63%	2349.95	1.11%	2,328.18
Government	-0.11%	-165.52	0.18%	366.44

- Manufacturing jobs become larger share of total
- 1.97M manufacturing jobs created from 2020 to 2024, an increase of 10.46%
- In absolute terms, more service sector jobs are created than any other category due to increased economic growth.

Added Workers Come From Labor Force Dropouts and Part-Time Workers

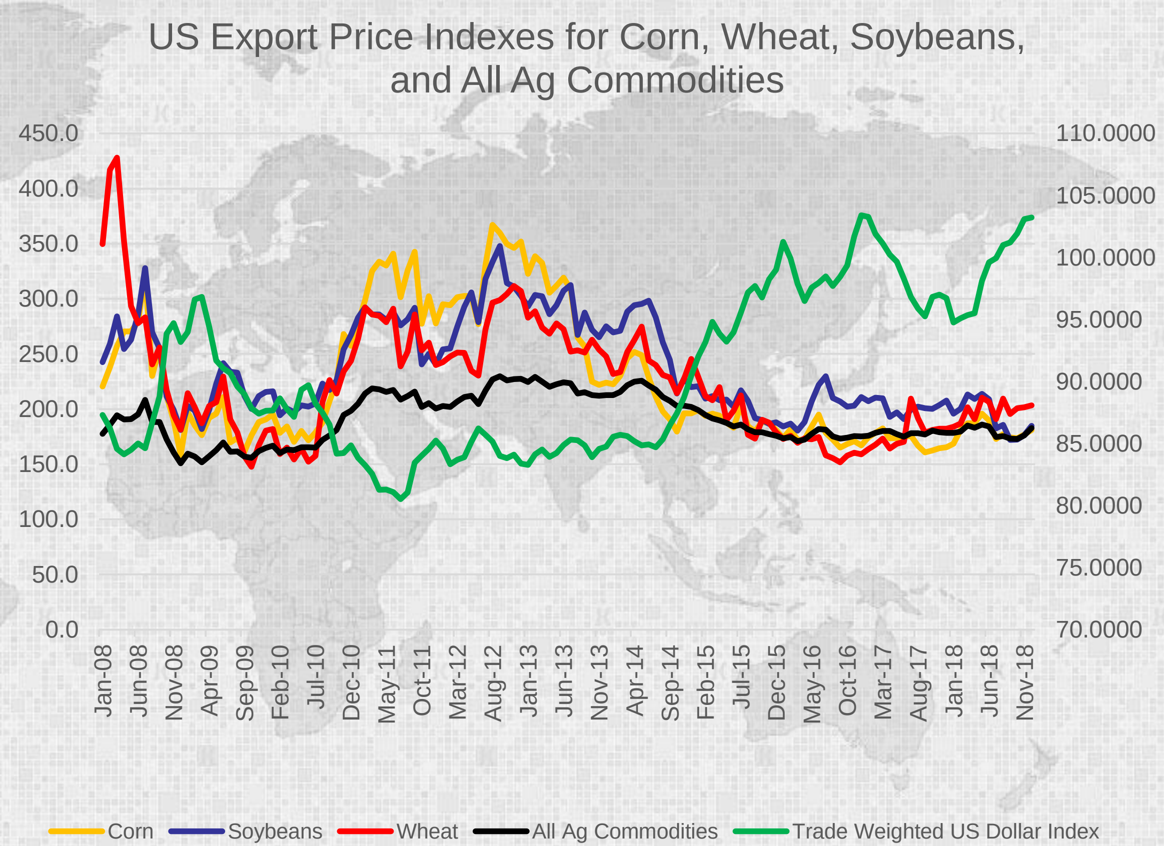




- Labor force participation still 2.4 percentage points below 1998 peak (prime age)
- 5.1M people not in labor force, but say they would “take a job”

Agricultural Benefits From a Competitive Dollar

- Research shows a 1% change in dollar exchange rate leads to 2.5% change in opposite direction in ag. prices
- A 27% decrease in the trade weighted exchange rate would lead to a price rise of 67% in agricultural commodity export prices.



Global Trade Volumes Increase

- Competitive dollar associated with faster growth in world trade
- Historical data shows dollar decline of 1% leads to 0.6% increase in the volume of world trade (Global Trade and the Dollar, Boz, Gopinath, Plagborg-Moller (2017))
- Competitive dollar stimulates world economic growth

Conclusion:
Competitive Dollar Adds $1 Trillion to US GDP

- Capital inflows drive overvalued dollar
- Overvalued dollar drives US trade deficit
- Competitive dollar must be 27% lower to balance trade
- Massive economic benefits
- US production, jobs, incomes on new higher growth path:
  - GDP growth rate increases 74%. US economy 4.8% ($960B) larger by end of 2024
  - Job creation growth rate more than triples adding 6.7M additional jobs
  - Job growth disproportionately benefits goods producing industries
  - Agricultural producers benefit from higher prices
- The results of this simulation can be considered ceilings on the actual (real world) outcome.
  - The Federal Reserve would most likely increase short term interest rates to prevent the economy from overheating.
  - Foreign countries would likely intervene to defend a rise in their currency relative to the US.
    - In lieu of such actions, GDP, employment and the trade balance would lie somewhere below the results shown by our simulation

Thank You

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