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 continue to increase putting upward pressure on the dollar.

Source: US Treasury TIC Data
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)
• 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

Global Current Account Imbalances

- China
- Other Surplus
- United States
- Japan
- Other Deficit
- Statistical Discrepancy

Sources: IMF WEO, Haver
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

<table>
<thead>
<tr>
<th>CPA Baseline Forecast 2019-2024</th>
<th>Avg. Annual % Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP</td>
<td>1.7%</td>
</tr>
<tr>
<td>Employment</td>
<td>0.24%</td>
</tr>
<tr>
<td>PCE Inflation</td>
<td>2.24%</td>
</tr>
<tr>
<td>Exports</td>
<td>2.73%</td>
</tr>
<tr>
<td>Imports</td>
<td>2.44%</td>
</tr>
</tbody>
</table>
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%

<table>
<thead>
<tr>
<th>USD Value Change</th>
<th>Δ Price of US Exports (%) Paid by Foreign Consumers</th>
<th>Δ Price of Imports (%) Paid by US Consumers</th>
<th>Δ Price of Exports % per year over 4 years</th>
<th>Δ Price of Imports % per year over 4 Years</th>
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</thead>
<tbody>
<tr>
<td>2018 Base</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>10%</td>
<td>-7.0%</td>
<td>3.20%</td>
<td>-1.75%</td>
<td>0.8%</td>
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<tr>
<td>24%</td>
<td>-16.8%</td>
<td>7.68%</td>
<td>-4.200%</td>
<td>1.920%</td>
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<tr>
<td>25%</td>
<td>-17.5%</td>
<td>8.00%</td>
<td>-4.375%</td>
<td>2.000%</td>
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<tr>
<td>26%</td>
<td>-18.2%</td>
<td>8.32%</td>
<td>-4.550%</td>
<td>2.080%</td>
</tr>
<tr>
<td>27%</td>
<td>-18.9%</td>
<td>8.64%</td>
<td>-4.725%</td>
<td>2.160%</td>
</tr>
<tr>
<td>28%</td>
<td>-19.6%</td>
<td>8.96%</td>
<td>-4.900%</td>
<td>2.240%</td>
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</tbody>
</table>

3.2% Import Pass-Through Rate, 7.0% Export Pass-Through Rate***

**Category**

<table>
<thead>
<tr>
<th>Category</th>
<th>Units</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
<th>2024</th>
<th>2025</th>
<th>2026</th>
<th>2027</th>
<th>2028</th>
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</thead>
<tbody>
<tr>
<td>Foreign Export Costs</td>
<td>Percent</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>-4.725</td>
<td>-9.45</td>
<td>-14.175</td>
<td>-18.9</td>
<td>-18.9</td>
<td>-18.9</td>
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<tr>
<td>Foreign Import Costs</td>
<td>Percent</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>2.16</td>
<td>4.32</td>
<td>6.48</td>
<td>8.64</td>
<td>8.64</td>
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</tbody>
</table>

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

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

- 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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