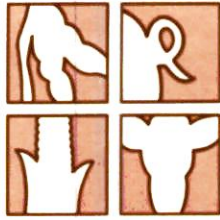




Cooperative  
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# WEEKLY OUTLOOK

Department of Agricultural Economics  
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March 13, 1985

## EFFECT OF THE STRONG DOLLAR

LAST WEEK WE OUTLINED A FEW OF THE FACTORS that have led to the strength of the U.S. dollar in recent years. This week we look at one of the major effects of the strong dollar and prospects for change in the value of the dollar.

The high value of the dollar in relation to major foreign currencies is cited as one of the main causes of the recent increases in the U.S. trade deficit. The U.S. has a normal (sometimes called "structural") deficit in merchandise trade that is offset by a surplus in exports of services. But the recent rapid increase in trade deficits is of some concern.

The trade balance was \$-26.3 billion in 1980-81 (October-September year). By 1983-84 that balance was about \$-106 billion. The current account balance is the difference between exports and imports of merchandise and services, minus net transfer payments made to foreign residents. That balance was still slightly positive in 1981, declined to \$-42 billion in calendar year 1983, and to \$-110 billion in 1984. The current account deficit was partially offset by a capital account surplus of almost \$90 billion. That is, about \$90 billion more investment capital flowed into the U.S. than went out.

The strong dollar is not the only source of the recent increase in trade deficits. Two other factors are important--the loss of exports to those countries with serious debt problems and the more rapid economic growth in the U.S. compared to other industrialized countries. Over the past year, however, the strong dollar has been the major factor contributing to the trade deficit.

The agricultural trade balance remains positive, but declined from \$26.6 billion in 1980-81 to \$19.1 billion in 1983-84. Declines in exports to western Europe have been especially large.

U.S. corn exports declined from a record 2.4 billion bushels in 1979-80 to less than 1.9 billion in 1983-84. Soybean exports declined from 929 million bushels in 1981-82 to 740 million in 1983-84. Shipments of corn and soybean protein to the European Community each declined by 40 percent from 1981-82 to 1983-84.

The strong dollar has contributed to the decline in agricultural exports, but probably is not the major factor. Increased grain and oilseed production in other

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parts of the world coupled with the economic slowdown of the early 1980s have been major factors in the declines.

What Next? There is no way to satisfactorily answer the question about exchange rate movements over the next few months. However, the large trade deficits strongly suggest that the dollar is currently overvalued relative to the other major currencies. Some downward correction would be expected as a result of the imbalance, just as upward correction resulted from the extremely weak dollar of 1979 and 1980. A correction back to the low levels of that period would not be expected because of the increased level of productivity in the U.S. economy.

While the trade deficit will put pressure on the dollar, a significant decline in the value of the dollar may not occur until real interest rates decline. As pointed out last week, a number of factors have led to the increase in real interest rates. We believe that interest rates are not likely to decline significantly until federal budget deficits are corrected.

While almost everyone agrees that the dollar is overvalued, major uncertainty exists as to the timing and magnitude of the dollar's possible decline.

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