August 2019

The Currency Shift that Really Matters to Agriculture

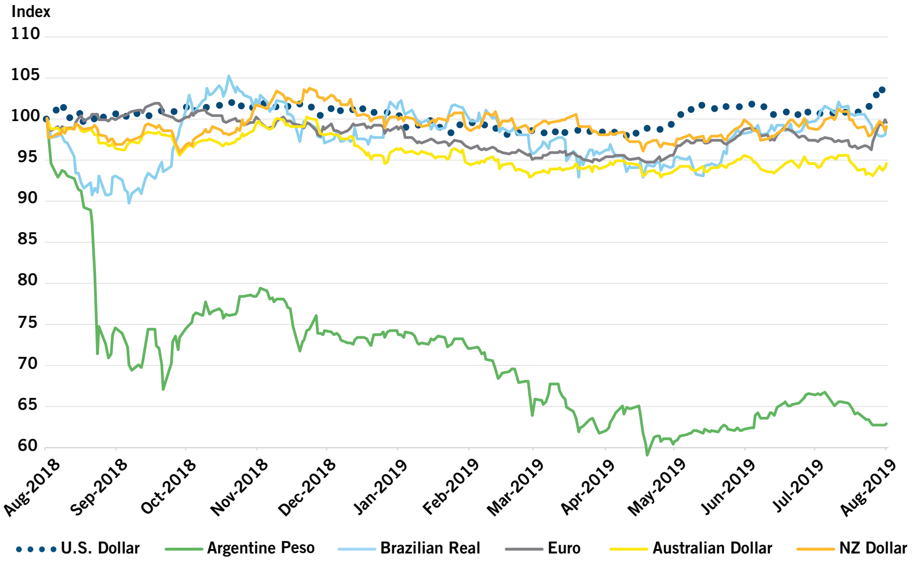
By Dan Kowalski
Vice President, Knowledge Exchange

Currencies have been all the buzz of late. China's decision to reduce support for the yuan in early August sent markets into a tailspin and triggered some central banks in Asia and Oceania to cut interest rates. Markets and policy makers feared that a currency war was suddenly afoot, and China's devaluation could stoke a destabilizing race to the bottom in global currencies and interest rates.

For those involved in U.S. agriculture, this move was meaningful – but not nearly as meaningful as the relative movement of currencies for countries that compete with the U.S. for agricultural export markets in China. After all, U.S. products may become more expensive in China if the yuan declines versus the dollar, but it matters only if China has alternative markets from which to source similar products at a lower price.

Many other factors affect the competitiveness of U.S. agricultural exports to China right now, including tariffs and Beijing's recent decision to halt all purchases of U.S. agricultural goods. Currency movements have compounded those effects. Since summer 2018, when the U.S.-China trade dispute kicked into full gear, the U.S. dollar and our competitors' currencies have diverged against the Chinese yuan *(Exhibit 1).*

EXHIBIT 1: Currency Movements Relative to the Chinese Yuan



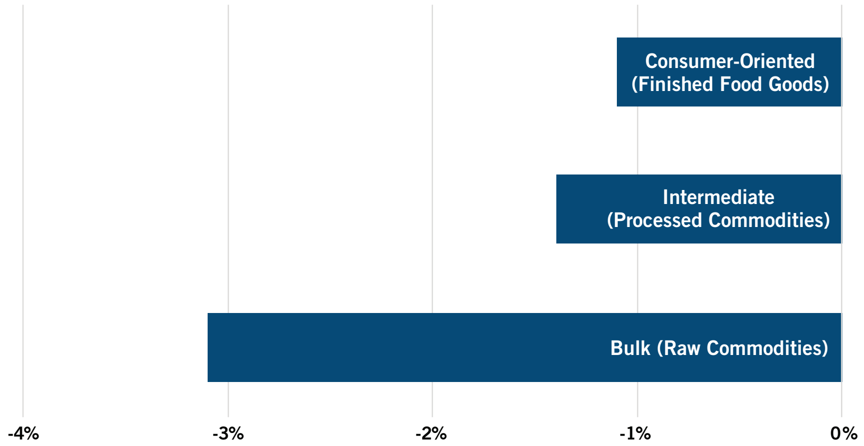
Source: Bloomberg

Over the past year, the U.S. dollar has risen a little more than 3% against the yuan, the New Zealand dollar has been flat, and others have dropped: the Australian dollar by 6%, the Euro and the Brazilian real both by 1%, and the Argentine peso by 36%.

A study from the USDA tells us that for every 1% gain in the U.S. dollar, our bulk agricultural exports lose roughly 3% of their value *(Exhibit 2)*. So the 12-month impact of a rising dollar (vs. the yuan) has been about a 10% hit to the value of bulk ag exports like soybeans or almonds. Adding in the impact of competitors' depreciating currencies against the yuan, and the relative impact is substantively larger.

The currency situation is unlikely to reverse in 2019. China's economy is weakening, as is much of the rest of the world, including Europe. And several central banks are poised to cut interest rates further in coming months. When the world economy slows and markets become shaky, global investors rush into U.S. assets to find a safe haven. All three of these factors support the strength of the dollar, making it less likely for U.S. ag exporters to catch a currency break soon.

EXHIBIT 2: Effect of 1% Increase in Value of U.S. Dollar on U.S. Agricultural Export Values



Source: Global Macroeconomic Development Drive Downturn in U.S. Agricultural Exports, USDA July 2016

References

Cooke, B., G. Nigatu, K. Heerman, M. Landes, and R. Seeley. (2016). Global Macroeconomic Developments Drive Downturn in U.S. Agricultural Exports. U.S. Department of Agriculture, Economic Research Service, AES-94, July.