

The Dollar And Non-Petroleum Import Prices

Had Douglas MacArthur been an economist rather than a general, he might have said, “Old economic statistics du jour never die, they just find another jour.” Our numbers mills in Washington churn out a number of these. For example, the Treasury began its International Capital Statistics report in the late 1970s to track Japanese and OPEC purchases of U.S. Treasuries on the amusing supposition they might stop one day and bankrupt their largest customer. Or, the entire concept of core inflation arose after the first oil shock to say, “See, take away those pesky food and energy prices and inflation’s not so bad, is it?”

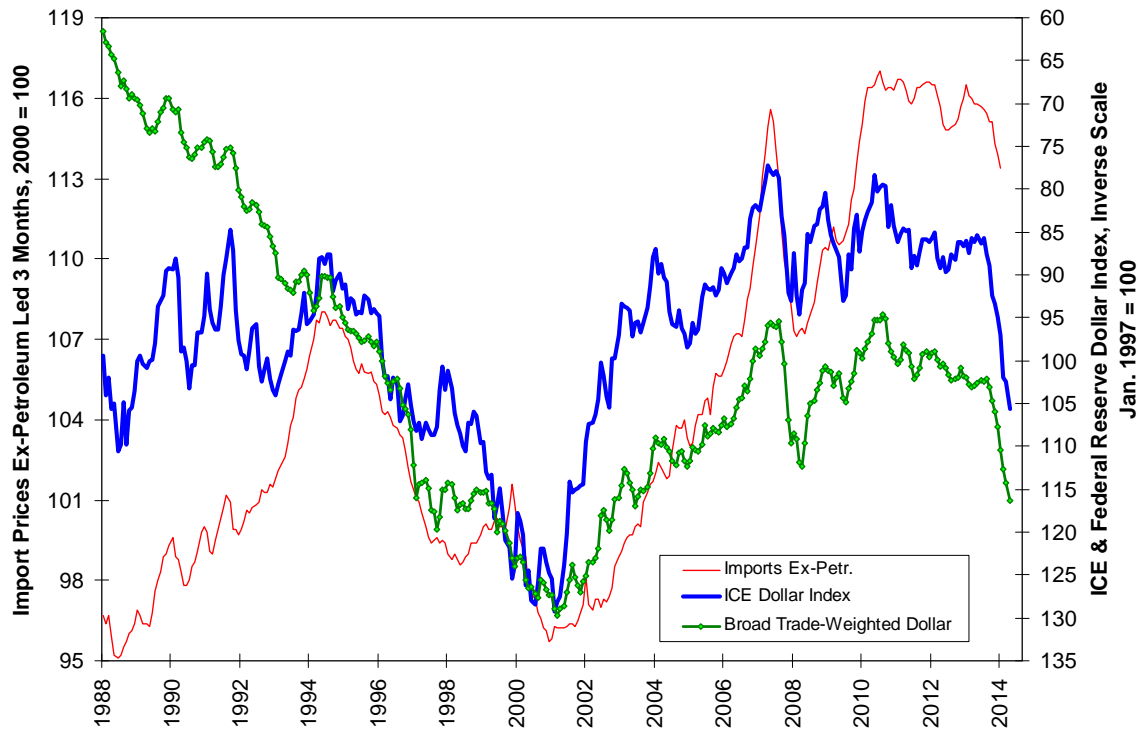
A similar concept exists for something called non-petroleum import prices. We started tracking those in the mid-1980s after the dollar surged and before crude oil prices collapsed to see whether the stronger dollar was putting downward price pressure on U.S. manufactured goods.

The Dollar And Non-Petroleum Import Prices

The index of non-petroleum import prices peaked in September 2011 and has declined 3.08% since then. The Federal Reserve trade-weighted (FRB) and ICE dollar indices hit local minima in July and April 2011 and have gained 22.94% and 34.86%, respectively, since then. These indices had led non-petroleum import prices from the end of 1994 until mid-2011. The December 1994 startdate corresponds to the collapse of the Mexican peso and the pegging of the Chinese yuan at a lower level.

On an individual currency basis, only the EUR and CAD within the ICE dollar index have a demonstrable relationship to their relative import price index levels. As both of these exporters’ trade weights have shrunk relative to China and Mexico, any weakness in their currencies will have a smaller impact going forward than they once did. Neither the CNY nor the MXN have a demonstrable leading relationship to the index of non-petroleum import prices.

Non-Petroleum Import Prices And The Dollar



Relative Import Prices

Let’s switch from absolute to relative price behavior and map non-petroleum import prices relative to the Producer Price index as a function of the FRB index from January 1995 forward.

The data can be divided into three regimes. The first, extending to the May 2003 first war on deflation, was quadratic (blue markers). Relative non-petroleum import prices decreased as a function of the trade-weighted dollar.

The behavior changed between June 2003 and November 2012 (red markers). A number of developments were involved, including QE3 in the U.S. and the engineered downside breakout in the JPY. The relationship inverted in a manner totally contrary to economic theory; relative non-petroleum import prices declined as the trade-weighted dollar weakened.

How was this possible? Exporters to the U.S. continued to compete on the basis of price to gain market share from one another. This battle redounded to the benefit of the U.S. importer and consumer. It also explained why a weaker dollar over this period did not push price levels higher as predicted by classical theory.

The third regime (green markers, last datum highlighted) is showing an increasingly random relationship between the stronger trade-weighted dollar and relative non-petroleum import prices. As the superimposed trend curve suggests, something of a cubic relationship has developed as trade-weighted dollar has advanced over the past year and relative non-petroleum import prices have moved slightly higher. American importers and consumers have not captured the rent of a stronger dollar; that has gone to a combination of exporters and to the U.S. distribution chain. Exporters presumably will be able to wait until any downturn in U.S. demand to start competing for market share on the basis of price discounts. Restated, a stronger dollar alone will not lead to lower prices for non-petroleum imports.

Relative Import Prices Under Different Policy Regimes

