The Impact of the Dollar on the U.S. Consumer

BY DANIEL E. WAGNER

Recently, there has been much attention in the financial press to the "falling dollar." The average U.S. person may be confused by the falling dollar because a U.S. dollar is still worth one dollar in U.S. currency. The reference to the falling dollar refers to the value of the U.S. dollar as compared to a foreign currency. Basically, the dollar would fall against a foreign currency if it now costs $2.00 U.S. dollars to buy the same basket of goods that previously cost $1.50 U.S. dollars in another country.

The relationship between the U.S. dollar and a foreign currency is affected by several factors. One factor that has a large impact on the value of the dollar is whether the U.S. has a trade deficit with a foreign country. In general, a large U.S. trade deficit will often lead to a declining dollar against the relevant currency.

The U.S. dollar has an economic relationship with every other foreign currency except for currencies that are pegged to the dollar. For example, the Chinese yuan has a direct relationship with the U.S dollar. Therefore, the "falling dollar" does not have an immediate impact on the price of Chinese goods. Specifically, the U.S. dollar's relationships with the euro and the yen are of primary significance.

We are currently in a period where the value of the U.S. dollar has declined versus the yen and the euro. This decline has several direct results. First, it now has become increasingly expensive for U.S. tourists to travel to Europe. Conversely, the United States has become a prime vacation destination for Europeans because of the falling dollar.

A falling dollar also increases the costs of certain foreign goods for U.S. consumers. For example, the decline in the U.S. dollar versus the yen could lead to higher prices for Japanese cars and electronic equipment. However, foreign manufacturers may reduce their profit margins to keep rising prices from scaring off U.S. consumers.

Large U.S. global companies usually benefit from a falling dollar. For example, many large corporations such as Coca-Cola, Procter & Gamble and IBM have huge foreign divisions. The profitability of these divisions often increases when the U.S. dollar falls.

Similar to many other economic patterns, the dollar will rise and fall versus foreign currencies over time. One day, the popular press will once again be writing stories about how the strong U.S. dollar is causing an influx of U.S. tourists to Europe.

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