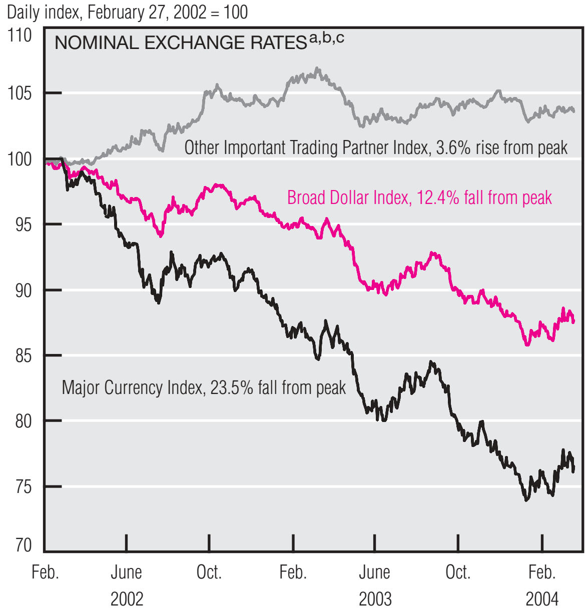
Dollar Depreciation and Inflation



Import Price Changes since the Dollar's Peak

	Percent change from February 2002
Import prices	
All items	8.4
Food, feed, and beverages	12.4
Industrial supplies and materials	37.3
Capital goods	–2.5
Automotive vehicles and parts	1.6
Consumer goods less autos	0.1
Petroleum and petroleum products	73.5
Nonpetroleum products	3.2
CPI	4.7
Broad Dollar Index[a,b]	–12.7

Export Price Changes since the Dollar's Peak

	Percent change from February 2002
Export prices	
All items	4.7
Food, feed, and beverages	25.9
Industrial supplies and materials	16.4
Capital goods	–1.8
Automotive vehicles and parts	1.3
Consumer goods less autos	0.7
Agricultural commodities	26.1
Nonagricultural commodities	3.1
CPI	4.7
Broad Dollar Index[a,b]	–12.7

a. The Broad Dollar Index measures dollar movements against the 26 currencies of our most important trading partners. The Major Currency Index measures dollar movements against 17 currencies of the large developed countries. The Other Important Trading Partner Index measures dollar movements against 19 emerging-market currencies. All three are constructed on a trade-weighted basis.

b. Small differences in measuring the change in the Broad Dollar Index occur because the first figure above records daily observations, whereas the tables record monthly averages.

c. Data through March 19, 2004.

SOURCES: U.S. Department of Labor, Bureau of Labor Statistics; and Board of Governors of the Federal Reserve System, "Foreign Exchange Rates," *Federal Reserve Statistical Releases*, H.10.

Since its most recent peak on February 27, 2002, the dollar has depreciated more than 12% on a trade-weighted average basis against the currencies of our major trading partners. Surprisingly, this hefty depreciation has had relatively little impact on the prices of most traded goods in the U.S.

When the dollar depreciates in foreign exchange markets, the dollar prices of foreign goods will rise, and foreign-currency prices of U.S. goods will fall. As a consequence, worldwide demand will tilt away from foreign-made goods and toward U.S. products. The dollar prices of traded goods in the U.S.—imports and exports—should rise.

The extent of these price changes, however, often depends heavily on the pricing strategies of large multinational firms. These firms, particularly those producing goods with fairly unique characteristics, can often adjust their profit margins, thereby affecting the degree to which exchange rate changes pass through to the final product prices. On the other hand, foreign producers often price standardized commodities, like oil or wheat, in dollars rather than their local currencies. When the dollar depreciates, these producers may raise prices to recoup their purchasing power.

Research suggests that over the past decade or so, firms have reduced the proportion of exchange rate changes that pass through into final prices. The degree of pass-through could change, however, if the dollar continues to fall or if expectations about overall inflation rise.