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THE PRICE OF THE YEN: DOES IT MATTER?

by

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Introduction

Can a higher price of yen actually affect the quality of life in South Dakota? Will a cheaper dollar somehow impact the welfare of a South Dakota rancher or farmer? While the magnitude of effect may be different for different people, the answer to both questions is "Yes." Currently, a more expensive yen has stimulated car sales of US auto producers, which in turn creates ripples of spending throughout the US, some of which wash up on South Dakota shores. This essay will look at the basics of currency markets.

A foreign exchange market exists where two currencies are priced in terms of each other. In the US / Japan currency market, when the yen is equivalent to, say, 1 cent US, the dollar is worth 100 yen. The price of the yen in dollars is the mirror image (or reciprocal) of the dollar priced in yen.

Most economies maintain a managed, floating exchange rate between their currency and those of trading partners. The price of a currency is generally free to bob up and down with the forces of supply and demand. However, if a nation's currency becomes severely over or undervalued, its central bank is likely to intervene in foreign exchange markets, selling or buying the currency to stabilize its price. Nonetheless, a central bank is limited in the degree to which it can influence the value of a currency.

Weaker Dollar, Stronger Yen

In the short run, the price of a currency (in terms of other monies) is
(Continued on page 2)



SLAUGHTER CATTLE OUTLOOK

by

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The 5-market slaughter steer price averaged almost \$83.00 in March, 1993. Summer and Fall prices generally were below \$75, averaging about \$10 below the March high. This year the March price for the same 5 markets was only \$75. April prices consistently have been \$5-7 below last year. A price decline into the Summer similar to last year would put prices well below \$70. Is that possible? A quick look at history and then at factors expected to affect the price for fed cattle should help answer that question.

History

Since 1988, fed cattle prices in mid-April always have been higher than those in mid-June. In 1988, the difference was only 25¢ while in 1991, the difference was \$7.00. For the remaining 4 years since 1988, June's price was between \$1 and \$4 below the April price. While none of the declines were as much as the \$8 decline between March and June, the \$12 decline between March and July, or the \$15 decline between March and October of last year, there is strong historical evidence that fed steer prices in the Spring are higher than they are in the Summer.

If one were to use the last 5-year price trend as a guide, a decline in prices of \$5 from Spring to Summer would not be surprising. That would mean prices in the \$70 area. A more likely scenario would put prices this Summer and Fall in the low \$70's, maybe averaging in the \$72-73 area. Only slight recovery into the Fall is expected. Historical averages would mean a \$3-4 price increase, or a Fall price in the \$74-76 area.

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determined by market forces. An American importer of electronic goods from Japan is affected by two relevant prices: (1) the price of the electronic goods in yen and (2) the price of the yen in dollars. Conversely, a Japanese importer of US soybeans will want to know (1) the price of soybeans in dollars and (2) the price of the dollar in yen.

If the dollar weakens against the yen, the yen has become more expensive in terms of the dollar. Or, in terms of yen, the dollar has become less expensive. Here, the price of the yen might rise to \$.0105 - while the price of the dollar would fall to 1 / .0105 or 95 yen. A weaker dollar hurts the US importer, as a set quantity of yen is now more expensive - effectively hiking the cost of Japanese electronic goods. On the other hand, the weaker dollar makes US soybeans cheaper to Japanese importers, stimulating US exports of soybeans.

How one views changing currency prices depends on the direction of change and whether one is buying or selling abroad. In the same economy, one firm's nightmare may be another's bonanza.

Japan's Trade Surplus

For as many years as the US has run a persistent trade deficit, Japan has enjoyed a trade surplus. Japan's ongoing surplus can be attributed to a number of different factors: industrial, cultural, governmental, and the value of the yen.

Japan is a high-tech economy, replacing its plant and equipment more frequently than other nations, ensuring that more efficient technologies are embodied in new machines. A more efficient capital stock allows output per Japanese worker to be relatively high (but not as high as for US manufacturing workers). Thus, Japan is able to produce a surplus of high quality products.

The fact that Japanese workers tend to save at a much higher rate than the US labor force (by a factor of 2-3 times) reduces Japanese per capita consumption and mandates that Japan export a larger percentage of her ever-growing output. Consumption in Japan is further discouraged by favorable tax rates on savings income, compared to much higher

tax rates on other earnings (up to 60% on incremental income). Finally, household debt (and hence spending) is discouraged in Japan by the non-deductibility of such items as interest on mortgages.

Policies that retard Japanese consumption reduce the demand for imports while encouraging exports. The organization of Japanese industry into keiretsu also reduces imports by favoring domestic over foreign suppliers. A keiretsu consists of a number of producers of final goods in diverse industries, plus supplier firms, a trading company, and a large bank. Trading companies are very reluctant to import cheaper inputs when the product can be supplied from within the family-like keiretsu.

The Japanese government, through its policies, also encourages the trade surplus. Agencies such as MITI (Ministry of International Trade and Industry) and Japan's Export-Import Bank encourage exporters through loans, favorable interest rates, and tax incentives. Alternately, restrictive Japanese policy toward imports also adds to the trade surplus. While formal barriers such as tariffs and quotas are not particularly prominent, non-tariff barriers such as import inspection procedures, quality control restrictions, and licensing requirements effectively limit imports.

Japan's Trade Surplus Strengthens the Yen

The strong recent performance of the yen against the dollar can be attributed in part to the trade surplus discussed above. Ironically, that same strong yen should, in the longer run, yield a smaller trade surplus as Japanese goods grow more expensive abroad and exports fall. Under ideal conditions of free currency and trade markets, a strong currency will weaken, then strengthen, fluctuating about a short run equilibrium. Over the longer run, however, exchange rates will reflect relative changes in economic fundamentals among economies.

Japan's trade surplus strengthens the domestic currency because, on the net, demand for the yen will increase, raising the price of the yen in foreign currencies. Consequently, more foreign currency will be supplied in exchange, lowering the yen price of those currencies.

For many years (but not recently) the relatively weak yen made Japan's products attractive abroad. For example, in 1985, the dollar was very strong and the yen weak. The exchange rate was 250 yen to a dollar and Japanese goods were very cheap to US buyers. Accordingly, the US trade deficit began to swell, and central bank action was taken to weaken the powerful dollar in hope of lowering the US trade deficit.

Stronger Yen, Lower Japanese Exports

In recent years, however, the yen has tended to appreciate against world currencies. Economic theory tells us that as a currency strengthens against those of its trading partners, it will begin to export less and import more. In fact, Japan's exports to the US did decline in 1993 during which the dollar/yen rate ranged between 100-110 yen. For example, Japan's share of the US auto market shrank from 35.6% in August 1993 to 28.7% in January 1994. However, Japan's imports also declined and her trade surplus grew to \$130 billion. Japan remains in her most severe recession since the OPEC crises of the 1970's. Typically in recessions, spending declines while spending on luxuries (imports) falls even more. Conversely, as the US economy has expanded, our demand for imports has increased, worsening our trade deficit, particularly the \$60 billion deficit with Japan.

**Stronger Yen, Weaker Yen:
Conflicting Views in Japan**

A strong domestic currency is not necessarily bad for an economy. Its strength implies an underlying confidence in the economy. Also, a strong currency allows offshore acquisitions to be had at bargain rates and encourages corporate expansion abroad. Imported inputs (Japan has almost no natural resources) are also cheaper.

Japan's economic planners have been of two minds with regard to the yen. A strong or even stronger yen will allow Japan to improve her position as the dominant economy in the Far East - allowing her to build an industrial base on the Asian continent, employing cheap labor and avoiding restrictions on exports. Secondly, a strong yen can actually encourage development and export

of high tech, high quality products. The argument goes that competitive disadvantages associated with a strong yen will force Japanese manufacturers to focus on - and dominate - the market for highest value, technologically intensive goods - one largely overlooked by other countries.

The argument for a weaker yen, one advocated by many Japanese exporters, is that Japan's economic planners should stimulate weak domestic consumption (possibly through tax cuts) while opening Japan more to imports. Increased domestic consumption will speed Japan's exit from recession and reduce reliance on export income. This will increase the demand for imports, thereby reducing America's \$60 billion trade deficit with Japan. A smaller trade surplus will eventually weaken the yen and make Japan's exports more affordable abroad.

Prognosis

Forces favoring economic stimulation and a weaker yen will carry the field. Although Premier Hosokawa recently resigned, it is probable that his successor (conceivably Hata, Hosokawa's Foreign Minister) will push equally hard for deregulation, a lowered government presence in economic planning, and consumer welfare.

While the average Japanese citizen enjoys a share of the national income pie roughly equal to ours (approximately \$24,000), it allows only 2/3 of our purchasing power. For years, the Japanese consumer has paid for export subsidization and import restrictions in higher prices and lower consumption levels. The Japanese economy will slowly evolve from an export-led to a more consumer-led configuration. In turn, Japan's imports will rise, while its trade surplus and the US trade deficit (at least with Japan) will fall.

(Murra -- Continued from p.1)

Current Factors

There are several factors which could have a major impact on cattle prices during the rest of 1994. Those factors include the number of cattle on feed, the general demand situation, and the grain market.



Address Correction Requested

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Cattle on Feed: The Cattle on Feed report released on April 25 (for conditions on April 1) was viewed as neutral by the trade. Trade expectations were for a 1-2% increase in the number of cattle on feed, a 4% increase in placements during March, and a 3½% increase in marketings during March. Since the actual inventory was 2% above the April 1, 1993 level, this part of the report was viewed as neutral. The placements figure (unchanged) was viewed as bullish, while the marketing figure (up only 1%) was bearish.

In total, the report supported the contention that supplies will be fully adequate and that prices should remain below \$75. That supports the ideas noted earlier that prices probably already have peaked and that Summer will be lower than Spring prices and maybe even a little below last year.

Demand: Although pork supplies may be below 1993 levels, poultry supplies should more than make up for the difference. That means consumers will have ample supplies of all meat proteins from which to choose. In addition, while beef exports are not expected to drop from 1993 levels, there doesn't appear to be a great expectation for a large increase. In total, a demand picture similar to 1993 is what can be expected. And, that isn't strong enough to give prices a big, if any, boost.

Grain: If 1994 is even close to a normal year in grain production, it will provide encouragement to feeding, not only cattle but also hogs and poultry. Also, a "more normal" grain situation should support feeder cattle prices.

Outlook

Both from an historical view-point and from an analysis of more current factors expected to impact cattle prices, the outlook cannot be described as optimistic. Prices should decline from the current mid-\$70's to the lower \$70's. That is expected to be the price for the Summer. Fall prices should be a little higher, maybe even pushing back close to the mid-\$70's.

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 COMMENTATOR

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