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Watch The Dollar In 2014, But Not Because Of Bitcoin

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This is a guest post by Wolfgang Koester, chief executive and co-founder FiREapps, a provider of currency exposure management tools.

Investors, boards, CFOs, and corporate treasurers take heed: in 2014, the U.S. dollar and its impacts will surprise those who are not prepared.

Not because 2014 will be the year a digital currency like Bitcoin kills the banknote (it won't be). And not because the Chinese yuan is taking over the world (it isn't).

The dollar is the currency to watch next year for a less exciting – though no less impactful – reason: the likelihood of it strengthening is much higher than weakening, and that appreciation will hurt multinationals that are not prepared. What makes the challenge greater is that the dollar won't strengthen equally across the board, but will against some currencies that mean quite a bit to corporations.

To understand why, let us take a lesson from recent history.

Lessons learned from impact of yen devaluation

Before he was elected prime minister in 2012, Shinzo Abe promised to revitalize the long-stagnant Japanese economy, in part by "forcing" the Bank of Japan to weaken the value of the yen. Abe was election by a large margin and in December 2012 led the central bank to begin the competitive devaluation that is now regarded as the centerpiece of "Abenomics." By some measures, the policies are working: since Abe's election, the yen has fallen some 25% against the dollar and focused in around the 100 mark.

The yen's fall hit many U.S.-based multinationals hard; among currencies that companies cited as impactful, the yen was the most cited in the first and second quarters of 2013 and the second-most cited in the third quarter. The reason why is twofold:

1. A weaker yen makes the dollar relatively stronger, which makes U.S. exports less competitive than Japanese exports in global markets. Consider, for example, a car manufactured in Japan and a hypothetically identical car manufactured in the U.S. The Japanese car at the end of 2012 cost 1.75 million yen, or $22,000. The American car cost $22,000. At the end of 2013, the same 1.75 million yen Japanese car cost $17,500. In addition to making Japan's exports relatively less expensive, devaluation has been a boon to Japanese companies: for example, in the six months to September 2013, 96% of Toyota's operating profit increase was attributable to the yen's fall.

2. A weak yen can also significantly impact multinational companies that do business in yen. Multinationals with revenue in Japan – companies like Varian Medical Systems, NIKE, Procter & Gamble – get relatively fewer dollars for their yen as the currency depreciates. Indeed, U.S. companies in a range of industries have blamed the yen for eroding revenue. (Those with expenses in Japan, on the other hand, benefit, paying relatively fewer dollars for their yen as the currency depreciates.)

It took three quarters, but bottom line impact from the yen has been so significant, and so sustained, that it has forced companies to finally rethink their currency risk management programs. Investors have told CFOs – and CFOs their Treasurers — "We don't want to go through these kinds of losses again."

The U.S. dollar's impending rise

Not "going through these kinds of losses again" will require a change in the way multinationals approach currency risk management. If those companies that have realized nearly $12 billion in losses in 2013 keep doing what they have done, they will continue to see those kinds of impacts. Where will it come from in 2014? We will see currency volatility from a range of countries – some surprising, some not. But companies will also have to deal with currency movement right here at home: the appreciation of the U.S. dollar.

Why is the dollar likely to rise? Because:

1. With the appointment of Janet Yellen as the new head of the Federal Reserve, there are expectations of a bit more inflationary environment – the kind of environment that would result in rising interest rates and increased attractiveness of the dollar. Furthermore, the Fed is poised to roll back its bond buying as soon as the economy appears healthy enough to grow on its own. While the Fed kicked that can down the road this year, it can't do so forever, and most signs point to the economy being healthy enough sometime in 2014.

2. We are not likely to see a stronger euro. While it appears that Europe is emerging from its deep and long recession, the EU is not out of the woods yet; if the euro strengthens significantly, that could stymie the little momentum the economy has. So the European Central Bank will likely do everything it can to keep the euro down.

3. Weakness in the yen will continue. Prime Minister Shinzo Abe's depreciation of the yen to drive Japanese export competitiveness, in an attempt to kickstart the economy, has worked well in the year since it began. The Bank of Japan has articulated a goal of 2% inflation, well above the current levels below 1%.

Fundamentally, the factors behind a more expensive dollar are less critical to corporations than the impact of the move. Anything that results in dollar appreciation will impact U.S. multinationals, decreasing American export competitiveness and eroding U.S. dollar revenues.

So what is a corporate to do?

A few months ago I shared the screen on a news program with a financial markets commentator who said that companies simply cannot move very quickly or frequently to adjust to underlying exposures and mitigate risk. That was true at one time, but not anymore. Today, many corporations are able to achieve increasingly common benchmarks like limiting the balance sheet impact of currency fluctuations to less than 1 cent of earnings per share.

In 2014, management teams that do not take a more proactive approach to managing the risk of a rising dollar may find themselves explaining to shareholders why currency impacts landed on their bottom line.

Savvy investors and boards take heed: those kinds of impacts are less acceptable than they have ever been and – more importantly – are avoidable.

Wolfgang Koester is the CEO and co-founder of FiREapps, the leader in foreign exchange exposure management solutions that aim to eliminate surprise currency impacts, reduce transaction costs and increase efficiency.