

Manufacturing in America: The Uneasy rider

The world's toughest motorbike-maker meets a grisly opponent—the dollar

The Economist, May 9th 2015

HAIRY male bikers are hard to spot at the Harley-Davidson dealership in Tribeca, a fashionable part of Manhattan. Half the floorspace is devoted to women's clothes and a café selling delicate pastries. For Harley traditionalists the only consolations are the chrome and leather two-wheelers, and a tattooed attendant who says she moonlights at a heavy-metal bar.

Harley-Davidson used to be the Republican Party of the vehicle industry. Perhaps two-thirds of its customers in America are grizzled white guys. But unlike the GOP it has worked to broaden its appeal, as have the dealers who sell its products in Tribeca and elsewhere. As well as touring bikes big enough to fit a Jacuzzi on, it now offers zippier models that are easier to ride if you are female—and easier to afford if you are young. So-called sports and street bikes made up a fifth of volumes in 2014. Sales in India, China and Vietnam are booming.

A finer example of an American manufacturer adapting and taking on the world is hard to find. Harley was roaring until last summer. But then it hit something harder and faster than a 1690cc Fat Boy: the dollar. The greenback has soared by 18% since July against a trade-weighted basket of currencies. Currency gyrations affect firms in three ways: by changing the rate at which foreign sales are translated into dollars, by creating financial mismatches and by altering the behaviour of competitors. The impact can be deep, as Harley shows.

Start with the translation impact. In the quarter to March, Harley's sales, in dollars, fell by 3% compared with a year earlier. Had currencies remained flat, sales would have been unchanged. Almost all big American manufacturing firms are in the same boat, although the degree of pain varies according to the size of their foreign arms and the currencies they operate in (see chart). For big American firms overall, as measured by the S&P 500 index, sales fell by 2-3% in the first quarter, the worst decline since the financial crisis in 2009, according to Factset, an analysis firm. The dollar explains much of the slowdown.

Financial mismatches are even more of a headache. The largest American manufacturers have put much of their production closer to their global customers, partly so that their costs and sales are in the same currencies. For example, Emerson, an industrial conglomerate, incurs about 85% of its costs in the same region as the related goods are sold in. But midsized and smaller firms often manufacture mostly in America, even as they sell some of their output abroad. As the dollar rises their costs will stay constant but their sales will fall, squeezing margins. Harley makes most of its bikes in Wisconsin, Missouri and Pennsylvania, whereas a third of its sales are generated abroad. It expects its gross margin to drop in the coming quarter. The foreign business barely broke even in 2014. It may make a loss this year.

The least predictable consequence of big currency moves is how they change the behaviour of competitors. Harley's rivals are mostly European and Japanese firms, which typically manufacture in their home countries. That means they are enjoying soaring revenues and expanding margins thanks to the dollar. Some have decided to blow these new profits by starting a price war in America, with prices dropping by up to 25%. Harley expects to lose market share at home as a result.

What is the right response to all this? Typically, investors want firms to react instantly. In Harley's case the expedient approach would be to cut prices to keep market share. It owns a financing arm and that could water down its lending rules so as to subsidise buyers. As a sop to shareholders, Harley could slash its research-and-development budget and other investment, and launch a much bigger share buy-back programme. Excluding the finance arm, it has no net debt on its balance-sheet.

Harley's new boss, Matt Levatich, accords this approach about the same degree of respect that a Hell's Angel does an Italian scooter. The battle against short-term thinking is something "we will fight every day." Instead he plans to keep on investing, hold prices steady, and weather the storm. Harley's brand and decent record will mean Wall Street grants him some slack. But if a new era of dollar strength has

just begun, then eventually Harley will have to think about shifting production abroad—as will other American manufacturers.