BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

STRICTLY CONFIDENTIAL (FR)
CLASS II - FOMC

TO: Staff

DATE: February 5, 1987

FROM: Rosemary Loney

SUBJECT: Special Reports on the Effects of the Dollar Depreciation

For your information, attached are the individual Reserve Bank theme reports on the effects of the dollar depreciation. A summary of these reports was circulated to the FOMC with the Greenbook on February 4.

Attachments

**FEDERAL RESERVE BANK OF BOSTON**

**MEMORANDUM**

To: Directors of Research

From: Lynn E. Browne

At the request of the Board staff, the theme reports on the dollar depreciation prepared by the Reserve Banks are being distributed to the Directors of Research.

The national summary will be distributed with the Greenbooks on February 4.

FIRST DISTRICT - BOSTON

# The Effects of the Dollar Depreciation:
# Results of a Survey of First District Firms

Most First District respondents can now report some limited effects from the dollar depreciation against the major OECD currencies, but they also stress the impact of U.S. trade with countries whose currencies have not appreciated against the dollar. Accordingly, while a great majority of the manufacturers contacted have experienced an increase in foreign sales, most of those who face import competition feel no less pressure from abroad. Retailers and manufacturers both report mixed experiences with import prices, depending on the type of product and source country. Continuing foreign and domestic competition have generally limited their ability to pass any increases on to their customers, however. Perhaps as a consequence, manufacturers shifting production to less developed countries continue to outnumber those returning production to the United States. While a majority of the respondents do expect the impact of the dollar depreciation to intensify, several expressed concern about the continued erosion of the U.S. manufacturing base.

## Exports

Most of the manufacturers contacted report an increase in exports primarily to Europe or to South Korean, Taiwanese and East European markets previously served by Japanese or German firms. Representatives of the chemicals, fabricated metals and electrical and non-electrical machinery industries noted increases ranging from slight to "very nice" starting last fall. One firm is just now bidding on a major foreign project for the first time since the 1970's and expects to be successful. The only exceptions to this consensus were firms that export very little or serve their foreign markets primarily from foreign subsidiaries.

Import Competition

On the other hand, New England manufacturers facing import competition could report little or no decrease in pressure from abroad. The exceptions were a non-electrical machinery firm which indicated that its competitors had been forced to raise prices in July, and two contacts which cited declines in shoe and textile imports from Europe but not, of course, from Southeast Asia or Brazil. Because the New England textile firms produce specialized product lines, their major competitors are located in Europe; thus, they may have benefited from the dollar depreciation more than their counterparts elsewhere in the country, according to an industry spokesman. The majority of First District firms saw no decrease in import competition, however. They cited the continued flow of goods from countries whose currencies have not appreciated against the dollar (in particular, Canada and Southeast Asian countries) and the ability of some Japanese firms to avoid price increases (on electrical machinery, for instance). Still others complained that the dollar depreciation had increased competition by encouraging foreign firms to undertake direct investment in this country.

Production Shifts

While foreign investors may be shifting production to the United States, First District firms generally are not. Some respondents said that although their European subsidiaries were suffering from the dollar depreciation, it was far too soon to consider such a move. Others referred to the need for a local presence in foreign markets regardless of the foreign exchange value of the dollar. Another pair indicated that they intended to increase production in Brazil and Mexico - in part for export to the United States - because of tax and export incentives available there. By way of exception, one firm had shifted foreign production to the United States, but for technical rather than currency reasons, and another was considering whether it would now be easier to serve its Southeast Asian markets from the United States rather than from its Japanese subsidiary.

Import Prices

Experiences concerning import prices varied considerably by source country. Manufacturers reported some increase in input prices on goods from Japan and Europe but no changes on goods from Southeast Asia and Korea. Excess capacity may also have helped to keep imported semiconductor prices unchanged, one firm suggested. Price increases for European wool were the only ones likely to be passed on to U.S. consumers. Otherwise, manufacturers were close to unanimous in saying they felt compelled to hold the line on their own prices.

First District retailers corroborated the mixed experience with import prices. About half the contacts encountered some increases, generally for hard goods. The firms' reported reactions to these price increases are not likely to benefit U.S. manufacturers very directly, however. Some were shifting from Japanese to Korean sources while others were discontinuing the product entirely since U.S. substitutes are too expensive. One firm specializing in home furnishings reported sizable price increases for imported fine furniture in mid-1986. This firm succeeded in passing the price increases on to consumers after failing to find U.S. manufacturers with the right quality and style. Retailers reporting little or no increase in import prices were generally referring to soft goods and to imports from the developing countries or, in some cases, from Japan. One respondent also cited a fall in the world price of cotton as a contributing factor.

Outlook

Among the First District firms contacted, respondents expecting the impact of the dollar depreciation to intensify outnumbered those who foresaw no change. Two retailers who are currently importing more than they did 18 months ago anticipate suffering more from import price increases than they have heretofore. One firm, which orders up to one year in advance and fixes the dollar price of imports by buying forward cover, was able to sail through 1986 with import prices little changed. Now, however, it expects its import prices to rise considerably more in the 1987 season than they did in 1986. By contrast, another retailer foresees no major increases in the prices of appliances from Korea or Japan; thus, expectations concerning Japanese prices continue to vary from product to product. Manufacturers anticipating that the impact of the dollar depreciation will strengthen tend to focus on the dollar's most recent decline. They expect that the renewed depreciation will increase demand for their products directly or indirectly through their customers in six months or more. Nevertheless, several manufacturers expressed concern about the continued erosion of the U.S. manufacturing base. Two in particular complained that their major U.S. customers have moved so much production offshore that it has become increasingly difficult to sell capital equipment or parts to them.

# Second District - New York
# Theme Report on Responses to Dollar Depreciation
# January 1987

Reported effects of the 1985-1986 depreciation of the dollar varied considerably across industries. In general, however, respondents found depreciation had its largest impact on export sales. Just over half of the 12 manufacturing firms contacted reported moderate to sharp increases in sales abroad. On the import side, only one-third of 16 respondents (12 manufacturing and 4 retail sales firms) said there had been a moderate to strong rise in the price of finished goods imports. A number of other firms reported facing no significant import competition in their product areas or only competition from areas which had not appreciated significantly vis-a-vis the dollar. Half of the 12 manufacturing firms contacted did see some rise in the price of imported intermediate goods although this rise was often fairly modest.

These results show significant improvement from responses received to the dollar depreciation survey conducted in January 1986. At that time only one firm mentioned its export sales had increased, in contrast to seven firms reporting export sales gains in the current survey. In January 1987 several more firms reported increases in finished goods import prices and related gains in their own domestic sales performances. Imported input prices have also risen since last January, although this has as yet led to only limited increases in the prices of domestically-produced finished goods as a consequence.

**Effects on U.S. Exports**

Significant export sales gains in value terms - on the order of 15 percent or greater - were reported in the chemicals, paper, and toy industries. The export sales gain in chemicals, which was about 40 percent in volume terms, was attributed to a strong world market for chemicals, a fall in chemicals prices due to the oil price decline, and dollar depreciation. For paper, both export price and export volume reportedly rose at double digit rates. (It was noted that this led to a rise in production but not in employment.) These increases were attributed directly to dollar depreciation. For toys, sales were up extremely strongly to Japan but up over 15 percent to other Asian countries as well. This was attributed directly to yen appreciation.

More moderate export sales gains were reported by four other intermediate supplies and consumer goods industries: ball bearings, metal containers, photographic supplies, and meat products. Most of the sales gains were in exports to Europe, although there was also a reported gain in sales to the Caribbean and Central America (where U.S. producers apparently increased market share at the expense of foreign export competition). Gains were mostly in volume terms with some modest price increases.

Two other consumer products producers and all three capital goods producers contacted reported no increase in export sales. Weak market conditions were mentioned as a major inhibiting factor by a sporting goods producer who exports to

Latin America. Foreign sales of a computer manufacturer were largely met from local production abroad. Producers of food products, electrical machinery, and telecommunications goods said dollar depreciation had simply not boosted export sales.

## Effects on Finished Goods Import Prices and Domestic Sales

The effect of dollar depreciation on the prices of finished imported products which compete with U.S. goods and on the domestic sales of U.S. producers has so far been modest. Only two respondents spoke of import prices increasing over 15 percent. These price increases, however, applied to goods facing either no or limited U.S. competition - 35 mm cameras and designer fashions. Three other respondents reported more moderate import price increases: ball bearings, meat products, and candy and liquor. Of these products, only ball bearings is a product area not subject to significant brand name recognition. The ball bearings producer noted, however, that Japanese competitors had not raised prices.

Of the five respondents who stated there had been a negligible rise in competing import prices, two (computers and photographic film) mentioned in particular that Japanese prices had not risen. The computer respondent, along with a producer of electrical machinery, also noted that import prices were held down by significant import competition coming from other Asian countries whose currencies had not appreciated significantly vis-a-vis the dollar. The other two respondents seeing no import price rise were a producer of food products and a regional department store. The department store stated that imports from Europe and Japan were actually increasing. Six other respondents (chemicals, sporting goods, metal containers, paper, specialized paper, and a chain department store) reported either no significant imports in their product areas or imports coming only from countries which had not appreciated vis-a-vis the dollar.

The limited extent of the rise in prices of finished goods imports is reflected in the fact that only one respondent (ball bearings) reported a noticeable rise in domestic production. Prices of competing domestic goods, similarly, did not rise due to dollar depreciation. The two retailers who did report some rise in import prices basically passed this rise on to their customers.

## Effect on Imported Intermediate Goods Prices

Six manufacturers reported that the prices of imported intermediate goods had risen. This group included producers of telecommunications equipment, electrical machinery, and specialized paper, all of whom said prices were up 10 percent or more, as well as producers of computers, metal containers, and food products, who experienced more modest price increases. Substantial price rises were reported for inputs purchased from both European and Japanese suppliers. Where price increases were above 10 percent, the respondents reported switching suppliers to U.S. and Canadian firms. Respondents who saw more modest increases in imported input prices mentioned East Asian suppliers as a market factor holding prices down. Since these East Asian countries have not raised input prices, they have continued to maintain their U.S. market share. Long-term suppliers contracts and capital equipment specifications were also mentioned as factors limiting input source switching by two respondents.

U.S. intermediate goods producers, with the exception of paper mills, had generally not raised prices in response to the foreign price rises according to the survey respondents. One firm did expect this to change when contracts came up for renewal. Only the respondent purchasing from paper mills had raised his output prices in response to the rise in input costs.

Three other respondents using imported inputs saw no direct price effect on these goods from dollar depreciation. The major inputs of these respondents (producers of photographic film and chemicals) were silver and oil derivatives. The third respondent, a meat products producer, purchased inputs from Canada and Australia.

## The Outlook for 1987

Of the seven firms who commented on the outlook for 1987, three expected improvement while four did not foresee any significant change. Of those expecting improvement, only one (a photographic film producer) had reported no substantial impact from dollar depreciation as yet. The other two firms were a producer of toys, who expected even further export sales gains on top of an already strong export sales increase in

1986, and a producer of metal containers, who expected further export sales gains over a moderate increase in 1986.

The four respondents expecting no significant change in 1987 due to recent dollar depreciation were producers of chemicals, computers, electrical machinery, and telecommunications equipment. The chemicals producer expected 1987 exports to remain at their already strong 1986 level. The other three producers had seen no beneficial gain from dollar depreciation as yet and did not expect to see such a gain in the coming year. Reasons given for this pessimism included import competition from areas which had not appreciated vis-a-vis the dollar, concessional aid given by foreign governments to their own producers, and a general feeling that the recent depreciation would not be a help.

# THIRD DISTRICT - PHILADELPHIA

Manufacturers and retailers in the Third District say that the decline in the dollar's foreign exchange value over the past 18-24 months has had a noticeable effect on prices of imported goods. Industrial companies report rising prices for imported inputs, and they are attempting to find lower-cost substitutes. With respect to imported products that compete with their own goods, manufacturers say that the trend of falling import prices that started in the early 1980s has come to a halt and, for many items, has been reversed. Local manufacturers have implemented some moderate price increases in domestic markets and these have usually been matched by foreign competitors. Nevertheless, price competition by foreign firms is still strong for many products. Local manufacturers have gained sales in overseas markets, but increases have been moderate.

Retailers report increased costs for foreign goods. However, they also say demand for imported goods remains strong, and they have been able to recoup much of their higher costs through increased selling prices. Switching to U.S. goods is not straightforward, according to store buyers, as many products are made with both U.S. and foreign components or labor, and domestic sources are as likely to supply such mixed-origin goods as are foreign sources.

Importers report that the lower dollar has not substantially affected the volume of business they do. However, recent implementation of protectionist measures has hampered some local importers, and they fear further restraints on their ability to operate.

MANUFACTURING-PRODUCTION

U.S. manufacturers who import materials or parts say the dollar's depreciation has raised the cost of these inputs for them, but foreign companies remain important sources of supply. Domestic input prices have not risen appreciably.

Imported input costs. Third District manufacturers who import materials and components say that prices for these inputs have risen in the past year. This is especially true for items imported from Japan, the increases for which have been large enough to prompt a search for substitutes. Manufacturers are responding to the higher cost of Japanese inputs in several ways. Some are shifting to domestic suppliers, and some are making required components in-house. In a number of cases, however, the cheapest alternative is still an import, but from another country. Asian countries, especially South Korea and Taiwan, are becoming more important low-cost sources. Eastern European countries are also mentioned as growing sources of supply at competitive prices. In addition, foreign countries whose currencies are pegged to the dollar have maintained or increased their U.S. sales. The extent to which manufacturers have been able to change their sources of supply has been limited by the costs of establishing trade arrangements with new suppliers, including contracting and retooling costs.

American-made input costs. Despite general reports of higher prices for imported inputs, few of the local manufacturers contacted said that domestic suppliers were charging more for materials or parts, and the increases that are reported are not large.

MANUFACTURING-SALES

The falling dollar has boosted American manufacturers' sales abroad, to a degree, and has reduced the price advantage of foreign goods in American markets. However, most manufacturers say they expect little further change in the underlying competitive situation, and have no plans to significantly expand capacity as a result of business stemming from exchange rate movements.

American sales abroad. Local manufacturers have gained foreign sales in the past year, but most contacts describe these increases as having only a modest impact on their overall business, either because the increases are relatively small, or because exports account for only a small portion of their sales. Several firms said they acquired or established overseas facilities when the dollar was higher, and they no longer supply foreign customers from their U.S. operations. Other factors cited as limiting the increase in U.S. exports are the costs of changing international trade arrangements, and the growing presence of Asian countries (other than Japan) in world markets. Several local manufacturers said their costs have risen so that the falling dollar has allowed them only to maintain, rather than reduce, foreign prices. They cite increased expenses for pensions, occupational safety, environmental protection, and product liability insurance.

Domestic sales. Third District manufacturers report that prices of imports that compete with their own products have either moved up or halted their downward trend in the past year. When local companies have raised prices in recent months, the increases generally have been matched by foreign competitors. However, foreign companies appear to be targeting some product markets for penetration, and they continue to reduce prices on selected goods.

DISTRIBUTION

Retailers say price increases for the foreign goods they buy have become more common during the past year. This has squeezed selling margins somewhat, but most retailers have been able to raise prices in response to higher costs of goods. Merchants note little consumer resistance to higher prices for imported goods.

Retailers say it is difficult to distinguish the effect of exchange rate movements from other cost factors in wholesale prices because many goods have both domestic and foreign inputs. Moreover, both overseas and domestic suppliers distribute goods of mixed origin. Thus, there is not always a clear distinction between "foreign" and "U.S." goods.

Importers say their business has not been hampered appreciably by the lower dollar. However, increased protectionist measures are raising concerns. In particular, quotas have restrained trade opportunities, and importers fear that further protectionist measures could severely reduce their business.

FOURTH DISTRICT - CLEVELAND

SPECIAL THEME REPORT
ON EFFECTS OF DECLINING DOLLAR
January 28, 1987

Prices of Imported Inputs

The effect of the devaluation of the U.S. dollar on the price of inputs to producers in the Fourth District reportedly depends upon the relationship between purchaser and seller. Everyone who was contacted indicated that their companies are seeking long-term relationships with suppliers in order to manage them more effectively. In identifying the factors that are important in maintaining these relationships, everyone felt that quality, delivery, and technical support were important. Price was rated as least important. Therefore, a number of respondents indicated that they would continue to purchase from foreign suppliers even if prices do go up.

One machine tool manufacturer, which competes directly with Japanese companies, reported that the Japanese have not raised prices appreciably. However, they expect that prices will increase in the near term as inventories imported over the past two years are depleted. An instruments producer reported that the dollar devaluation has deterred French and German producers from additional penetration of the U.S. market.

Steel prices have increased in recent weeks, but most attribute this to the situation with USX and not with foreign suppliers. However, the increased prices initiated by domestic suppliers have cushioned the effect of the dollar depreciation for foreign suppliers.

## Prices of Finished Goods

Local retailers reported that the prices of many imported items are beginning to increase as foreign producers are no longer able to absorb lower profit margins.

However, the magnitude of the price increases depends upon the substitutability between goods. A local car dealer reported that prices of "top-of-the-line" imported luxury cars, which have very little competition from domestically-produced models, have risen dramatically. The lower-end imported economy cars, on the other hand, have not increased much at all, primarily due to stronger competition from similar domestically-produced models and automobiles made in countries that have not seen their currency appreciate significantly vis a vis the dollar.

The same variation in price increases holds true for other consumer goods. Prices of consumer electronics have increased to some extent but not as much as expected. This sluggish price response has been due primarily to competition between East Asian countries and not between domestic and foreign producers. The simple reason is that a very small proportion of these goods are produced domestically. As with automobiles, local retailers report larger price increases for goods with brand names recognized for quality than for lower-end products.

## Domestic Suppliers

The importance of quality over price has reportedly influenced the relationship between the dollar depreciation and domestic production. One food-processing firm that purchases heavy equipment from European producers stated that the quality of equipment is their primary concern and that price is only secondary. Thus, this individual sees the sluggish response of increased domestic production to the dollar devaluation resulting from a strong commitment to a specific type of foreign-produced machinery and the perception that the quality of domestically-produced equipment has deteriorated. A company that supplies parts to major automobile manufacturers agreed that quality is of utmost concern to its customers. Reportedly, this firm has gone to considerable efforts to cut costs while maintaining quality.

There is some evidence, however, that the dollar depreciation has prompted greater domestic production. A manufacturer of heavy machinery reported that they are beginning to move some of their European manufacturing back to the U.S. An automobile manufacturer predicted that they would be exporting a greater number of cars to Europe because of the dollar situation. Another domestic manufacturer stated that quotation activity seems to be picking up from foreign customers.

In addition, two foreign automobile manufacturers are establishing production facilities in the Fourth District. Although their investment plans were conceived before the recent dollar depreciation, these plans may have resulted in part from anticipation of such an event.

## Domestic Producers' Sales and Prices

Comments from domestic producers and retailers about price changes were mixed. Three major department store chains reported that they did not expect prices of domestically-produced goods to increase significantly due to import price increases. On the other hand, purchasing agents, primarily from manufacturers, reported that prices from both domestic and foreign suppliers have increased.

# FIFTH DISTRICT - RICHMOND
# SPECIAL THEME REPORT
# ON EFFECTS OF DOLLAR DEPRECIATION
# JANUARY 27, 1987

## Summary

Most manufacturers and retailers report that their business activities have been affected in one way or another by foreign price developments this past year. In manufacturing, the majority of firms have seen the prices of imported materials rise, and several have shifted to different suppliers. In retailing, many firms are shifting to domestic suppliers because of increases in the prices of imported goods. A larger proportion of retailers than manufacturers expect that dollar depreciation will have significant effects on prices and sales in 1987.

## Manufacturing

On the input side, higher prices for imported materials are reported by 63 percent of the manufacturing firms that were asked to compare such prices with year earlier levels. Ten percent report that foreign input prices are lower than a year ago. Domestic suppliers of those same inputs have held prices steady during 1986, according to 86 percent of the respondents.

Thirty-six percent of the manufacturers are shifting to substitute inputs because of these price increases; 18 percent are shifting to domestic suppliers. In the textile industry, half of the respondents report shifts to domestic suppliers because of increased input costs. Some apparel firms, however, report a shift to offshore production and to suppliers in newly industrialized countries.

The foreign countries whose producers are named most often as having increased prices are Japan, West Germany, the United Kingdom, and Taiwan, in that order. Textile and apparel firms note price increases on competing goods produced in Japan, Hong Kong, Korea, and Taiwan. Electronic equipment manufacturers say that Japan and West Germany have shown a greater tendency to increase prices of products that compete with U. S. manufactured goods. Nearly 80 percent of the respondents indicate that the pricing behavior of these countries has not changed recently.

The dollar's decline has resulted in increases in both domestic and foreign sales, according to 15 percent of the responding manufacturers. Thirty-three percent of the textile and apparel firms report increases in exports. Producers of transportation equipment also report increases in foreign orders. Only 6 percent of the responding firms say that they have increased employment because of the decline in the dollar. Most manufacturers indicate that their sales and orders have strengthened in the U.S. The greatest increases in foreign sales and orders have come from Asia, Europe, and Latin America. The fabricated metal industry is experiencing some increases in sales and orders from the Orient, while one furniture manufacturer indicates more sales and orders from Asia.

Nearly half of the respondents do not expect dollar depreciation to have much effect on prices, sales, and orders in 1987. About 25 percent expect the effects of the dollar depreciation to intensify in 1987 and the remainder expect the effects to be moderate.

Three-fourths of manufacturers that sell in foreign markets say they set their prices in dollars.

A final note in manufacturing comes from a furniture firm: "The dollar decline hasn't had the effect the Fed said it would. We are worse off now in terms of off-shore competition than we were a year ago. Imports of furniture from Taiwan, South Korea, and Singapore have increased 40 percent. Their prices haven't changed at all. Only in the case of Italy do we see any diminution of import competition."

Retail

Nearly three-fourths of the retailers indicate higher prices of imported goods at year end 1986 as compared with prices a year earlier. Twenty-four percent report prices unchanged. Domestic suppliers of similar goods have raised prices over the same period, according to 62 percent of the respondents.

Forty-two percent of retailers expect that the effects of dollar depreciation on prices will intensify in 1987, while 42 percent expect the effects to be moderate. The remainder of the respondents expect that dollar depreciation will have little effect on prices in 1987.

Thirty-eight percent of the retail respondents indicate that they are shifting to domestic suppliers as a result of increased costs of imported goods. Other retailers are responding to import price increases by reducing employment and other costs. One furniture retailer emphasized that domestic goods are better than imported goods and that U.S. manufacturers do not take as long to deliver.

Retailer responses to the question on the effect of changes in the cost of goods on profit margins are distributed equally among those who indicate increased margins, those who indicate no change, and those who indicate decreased margins.

Retailers say that Japan has show the greatest tendency to increase prices. West Germany, France, and Taiwan are the other countries most often named, in that order, for raising prices. Half of the retailers say that the pricing behavior of these countries has changed recently. Building material retailers cite the Canadian tariff on lumber as the reason for recent price increases.

## SIXTH DISTRICT - ATLANTA

The recent depreciation of the dollar in foreign exchange markets has prompted mixed responses from southeastern businessmen. Many of those surveyed have seen substantial increases in the prices of imported inputs, but few were changing business behavior because of the decreasing value of the dollar overseas. Most respondents seemed to be watching the yen if they were watching a currency at all. The overall impression gathered from our survey is that, while businesses are more aware of the dollar's depreciation than they were last year, they are not more responsive than at the last survey.

Revenue and Costs: Manufacturing. Manufacturers of electronic equipment, chemicals, and other business goods were contacted in our survey. Imported inputs do not account for a large share of costs of the surveyed manufacturers. Over half reported no imported inputs, and the rest report that between 5 and 10 percent of costs are from imports. An electronics firm reports that the price of Japanese components has risen sharply, raising their costs. The firm also notes that the declining dollar has not helped exports significantly. Another firm pointed out that it imports a large number of aircraft parts from Canada. Because the U.S. dollar has not depreciated relative to the Canadian dollar, the firm's costs have not been affected. Exports account for about 20 percent of revenues, but most firms indicate that the fall in the dollar has not helped much. They also do not expect further declines to change matters much.

Revenue and Costs: Trade and Distribution. Our survey covered a variety of firms importing and exporting goods like auto parts, food, electronic equipment, furniture, and clothing at the retail as well as wholesale level.

Imports and exports are slightly larger shares of costs and revenues in trade than in manufacturing. Trade and distribution firms have noticed more improvement in exports, but several firms pointed out that exchange rate movements were not a key factor affecting profitability. Imported items were becoming more expensive across the board, especially goods from Japan and western Europe.

Business Response. None of the manufacturing or trade and distribution companies were currently increasing inventories of foreign goods in anticipation of a further drop in the dollar; none had plans to increase production or employment as a response to increased demand here or abroad. An apparel importer stated that if the dollar continues to decline, the firm may increase inventories of imported clothing before the dollar falls much further. An aircraft manufacturer thought that employment might improve if export demand picks up. No firm indicated that it was considering shifting production overseas to avoid increasing costs of imported inputs.

Because many of the firms interviewed were small, they viewed themselves as price-takers in competitive markets. Perhaps because imports do not account for a major portion of their costs, even large movements in exchange rates will not affect their costs substantially. Two firms were trying to increase their market share domestically, but most took prices of foreign inputs as given and charged whatever the competition was charging to domestic customers. Few companies expected that a further decline in the dollar would have much impact on their industries. One marketing firm thought it would see some change in its business only if the dollar fell another 10-15 percent and stayed low for 2 to 3 years. The same firm also noted that the Japanese seemed eager to maintain market share by cutting prices in yen; other foreign suppliers maintained prices in their own currencies.

In general, the recent decline of the dollar has not caused any consistent changes in pattern of behavior of the firms surveyed. Some have absorbed increased import costs; others have passed them along. Several companies have cited other factors as being more important to their business than exchange rate considerations. They include income growth in foreign countries and technological changes abroad. Poor income growth in less developed countries has hurt the exports of several firms. Others point out that import demand is price inelastic or that long-term contracts with suppliers have shielded them from exchange rate fluctuations. If the declining dollar is to have much effect on southeastern business, this effect is not expected until later in the year.

January 27, 1987



SEVENTH DISTRICT--CHICAGO

Theme Report on the Effect of the
Decline in the Exchange Value of the Dollar
(as requested in Mike Prell's letter of 12-23-86)

Sources of Information. To gather current information for this report our economists talked to over 25 informed people in a wide variety of sectors. Respondents represented basic steel, aluminum, copper, steel strapping, motor vehicles, auto parts, diesel engines, construction equipment, pumps, small gasoline engines, household appliances, home video apparatus, electronic components, plumbing fixtures, construction, gypsum board, cement, petroleum, commercial airlines, commercial aircraft, and general merchandise retailing. We also spoke to the directors of the purchasing managers associations of both Chicago and Milwaukee. On a continuing basis we follow local press reports, trade journals, and corporate statements, which are useful for assessing the general picture. It should be noted that in some cases, for example automobiles and steel, it is difficult to separate clearly the effects of the lower dollar from the effects of negotiated agreements to slow imports.

Summary. The reduced exchange value of the dollar relative to foreign currencies worked to improve the competitive positions of many District companies in 1986. This trend is expected to gather strength in 1987.

A similar inquiry a year ago produced generally negative replies. At that time, it was stated that the dollar had not declined enough, that adjustment processes were lengthy, and that labor costs were often much lower abroad. Also, trade restrictions and foreign government subsidies prevented the lower dollar from having as great an effect as might be expected, other things equal. Reference also was made to the fact that market participants would have to view the decline in the dollar as long lasting to have a significant effect, and that foreign producers were willing to absorb the impact of the cheaper dollar by squeezing their profit margins. All of these factors tending to dampen the effect of the decline in the dollar are still present, but they are less powerful than a year ago. In the past year, the dollar has declined substantially further against the Japanese yen and leading European currencies. But it has remained relatively stable, or has strengthened, relative to many other currencies. Adjustment processes, for example the expiration of long-term contracts, have been taking place. Many foreign producers have exhausted their capacity to reduce profit margins. Prices have increased on imports of finished products and components, such as apparel, autos, and certain hydraulics. Domestic producers have been able to raise prices on paperboard and chemicals, exports of which have increased. Other domestic producers have been content to hold dollar prices abroad while increasing profitability through larger volume. Overall, the effect of the lower dollar in accelerating inflation is expected by our respondents to be significant, but not dangerous.

While this report is generally positive, in contrast to our report of January 1986, there is scant hope that the nation's trade balance will improve sharply in 1987. Two important sectors, (1) exports of corn and soybeans, and (2) imports of oil, will not be much affected by the value of the dollar. Large trade deficits in motor vehicles, steel, and nonferrous metals will not shrink significantly. Finally, markets for such capital goods as construction equipment, machine tools, and equipment for processing remain depressed, worldwide, and will not soon return to the high levels reached in 1981. This is partly because of the poor financial positions of the LDCs, particularly Latin America and the Middle East, which had been large buyers.

Labor Cost. Despite "concessions" by leading unions, domestic hourly labor rates may still be 10 times the rate prevailing in Mexico or the Far East. Productivity and quality may be as good or better in these nations, mainly because of the absence of restrictive work rules. These enormous labor cost differentials are unlikely to be offset by any probable declines in the value of the dollar. And the dollar has not declined relative to currencies of most of these low-wage countries.

U.S.-Owned. Many U.S. producers of such products as phamaceuticals and electronics supply foreign demand from their foreign plants, particularly in the EEC. The lower dollar benefits these companies by raising their profits in foreign currencies when converted to dollars.

Foreign and Domestic Sources. Markets for most types of machinery remain depressed, regardless of the value of the dollar. In many cases, U.S. producers have closed domestic plants in recent years in order to "outsource" components and finished products at lower prices abroad. New decisions to outsource abroad are still being made. However, there are a growing number of reports of U.S. companies "repatriating" production of machinery and components. While more foreign companies are making "inquiries" and getting "quotes" in the U.S., more and more firm orders were placed as 1986 drew to a close, and this trend is expected to continue in 1987. Changing the source for specific manufactured products (as opposed to "generic" products) may take one to three years, depending on complexity. Once established, such relationships are likely to be maintained through substantial fluctuations in exchange rates.

Japan. Most discussions of foreign trade turn to emphasis on Japan. No other country sends us so many different items, frequently of excellent quality, both for consumers and business. The Japanese have raised many selling prices in the U.S. in the past year, but not nearly as much as would be indicated by the rise in the yen. It is believed that formerly large profit margins of Japanese exporters have been sharply reduced, or replaced by losses, and that the Japanese will have to raise prices substantially further. As new contracts are negotiated, this trend will be increasingly evident. In some cases, e.g. autos, steel, construction equipment, and electronics, it is believed the Japanese have been losing money. This may be a way to retain market share, until their U.S. production facilities are able to handle demand. (A number of respondents insisted that market share means more to the Japanese then profits, at least in the short term.)

Steel. Imports accounted for almost one-fourth of U.S. steel consumption in 1986, despite efforts to enforce lower quotas. More steel has been coming from countries such as Brazil, Canada, and Korea where currencies have not risen relative to the dollar. Other steel exporters have circumvented restrictions by arranging shipments through third countries. The heavy influx of steel imports in recent years has reflected worldwide overcapacity, combined with foreign government subsidization of steel exports. The cost of these subsidies has been extravagant. Now programs are underway to "rationalize" steel industries in all major producing countries by closing less efficient plants and drastically reducing capacity. This will help to strengthen the domestic steel industry which has already undergone substantial rationalization.

Motor Vehicles. The leading Japanese car and light truck producers have, or are building, assembly plants in the Midwest. Moreover, they are implementing plans to produce a growing share of their components here, and to buy more steel from U.S. mills. This trend has been accelerated by the lower dollar. Industry experts believe the Japanese have been losing money on vehicles shipped here from Japan, despite sharp increases in prices in the past year. Some think the number of vehicles imported from Japan has peaked, and will decline, as their production in the U.S. increases.

Auto Crash Parts. In recent years, a growing volume of auto repair parts have been coming from abroad, mainly Canada, Korea, and Taiwan. These currencies have changed little relative to the dollar. Average prices for parts have declined, and are still declining. Domestic producers, including the Big Three, have reduced their prices on parts to prevent further loss of market share to imports. Replacement parts from the Far East have been judged equal in quality to domestic parts--in some cases superior--according to a well-informed source.

Paperboard. The clearest case of improvement for domestic manufacturing resulting from the lower dollar is paperboard. Exports of linerboard, the principal component of cardboard boxes, have been rising steadily since 1985. Exports are expected to rise a further 7% in 1987, and exceed 15% of domestic output. Sales abroad have increased at the expense of producers in Scandinavia, Australia, Brazil, and South Africa. Prices of paperboard have increased about 8% from the trough, and are rising further in early 1987. (They have not yet regained their peak.) The industry is operating close to capacity with a big assist from higher exports.

Chemicals. Many chemicals are traded fairly freely on world markets. Exports of soda ash are up substantially because of the lower dollar, as are a number of specialty chemicals, e.g. colloids and agricultural chemicals. Prices are firm. Further gains in exports and prices are expected in 1987.

Cement. In 1986, 18% of portland cement consumed in the U.S. was imported, up from 7% in 1973, the previous peak year for total consumption. Some 80% of cement imports are brought in by domestic companies. Foreigners now own 53 percent of the domestic industry, up from 2% in 1973. Imports are from countries such as Spain, Korea, Canada, and Mexico. Except for Spain, these currencies have not risen relative to the dollar. Cement prices have been stable to weak, despite record usage. Imports are expected to maintain, or expand, market share in 1987.

Commercial Aircraft. Commuter-type aircraft are now largely imported and this situation is not likely to change because of large cost differentials. Large commercial aircraft production, worldwide, is dominated by Boeing and McDonnell-Douglas. Helped by the lower dollar, these two companies probably would completely control world markets were it not for heavy government subsidies provided for AirBus by the French-led consortium.

Construction Equipment. Demand for construction equipment, particularly the heavy types, has been depressed worldwide and is not likely to improve soon. Exports have increased slightly recently as a result of the lower dollar. Prices, quoted in U.S. dollars, are about at 1981 levels. Komatsu, the big Japanese producer, is said to have raised list prices 20-25% in the U.S. But market studies by competitors indicate that actual transaction prices for Komatsu machines have not increased at all.

Household Appliances. U.S. manufacturers of major household appliances have been surprised by inquiries recently from foreign buyers, mainly European, who are thinking of procuring appliances here. (The products would be made to foreign specifications.) The increase in inquiries is believed to be a result of the low value of the dollar. Only about 2 to 3% of U.S. appliance output is exported. A few years ago appliance manufacturers were concerned about foreign producers entering our markets.

Apparel. A large share of apparel and footwear sold in American stores is imported. The great bulk of these imports come from countries such as China, Taiwan, and Korea whose currencies have not increased relative to the dollar. However, export restrictions agreed to last year by several leading apparel exporters immediately led to price boosts because of restrictions on supply. These increases will be increasingly evident in 1987.

Air Travel. The decline in the dollar, along with terrorism fears, is credited with reducing U.S. tourism to Europe last year, while increasing European travel to the U.S. Data on passport issuance indicate that these trends will continue in 1987.

Other Types of Exports Helped by the Lower Dollar. Foreign sales of a number of products have benefitted from the lower dollar in addition to those mentioned above. These include electronic components, industrial gears, marine drives, small gasoline engines, pumps, stoves, food additives, construction equipment, freight handling equipment, plumbing fixtures, and quality men's shoes. The amount of improvement ranges from slight to substantial. In most cases, further gains are expected in 1987.

# Exchange Rate Changes and Their Effect on Local Businesses: Results from a Survey of Firms in the Eighth District

## Summary

Essentially the same twenty-five firms contacted in January 1986 were surveyed during the week of January 12-16, 1987 regarding the effects of continued exchange rate depreciation on their businesses. Most respondents generally anticipate prices and volumes of imports and exports to remain near current levels. Respondents again are classified as firms either in manufacturing or trade. Manufacturers are those firms whose goods compete with foreign goods primarily in U.S. markets; this category also includes domestic suppliers of raw inputs. Firms classified in the trade sector are those respondents who sell finished goods purchased from domestic or foreign suppliers.

The conclusions of this year's survey are largely unchanged from those of last year. Most firms have felt little impact from the dollar's depreciation. Moreover, they do not anticipate a significant impact in the future as they perceive individual market factors to be more important than the value of the dollar in determining the pricing policies of domestic producers. In particular, persistent overcapacity was mentioned by a number of respondents as a major factor restraining price increases. Many respondents also claimed that the value of the dollar has had little

impact because many foreign suppliers are from countries where the dollar has not depreciated. Finally, it was noted that suppliers from countries where the dollar has fallen have not been able to raise prices appreciably. Their price changes have been restrained not only by strong competition from domestic sources but also from other foreign sources where the dollar has not depreciated against the local currency. This pattern was noted both in the manufacturing and trade sectors.

## Effects on the Manufacturing Sector

The declining value of the dollar has had little effect on domestic manufacturer's input prices, product prices or market share. Respondents from the oil, steel, chemical, aluminum and coal industries indicated that excess production capacity has been a far more important factor than the value of the dollar in determining pricing policy. Moreover, they stated that since most of the world's coal and oil supplies are traded in U.S. dollars, there has been little if any effect on prices, sales or orders from exchange rate changes. The negotiating season for new, one year coal contracts will be completed in April. Due to cargo and ocean freight scheduling lags, any price increases in these contracts will be delayed by another 3-4 months.

Six firms responded that, although some foreign suppliers had attempted to raise their prices in response to the fall of the dollar, they were unsuccessful because of the competitive pressures of the specific markets. For example, one respondent in the steel industry indicated that Japanese suppliers of machinery attempted to raise prices but were unable to do so because of domestic competitors. Moreover, because import prices are still very competitive, domestic prices have been generally stable in order to maintain market share. A respondent in the casting business noted that while some foreign suppliers had raised prices, domestic suppliers did not follow suit; the higher foreign prices still were competitive enough to maintain price pressure on domestic suppliers.

Producers of electrical appliances and beer, however, have seen some foreign price increases. The increases have been slight and generally have not permitted domestic firms to increase their prices. Thus, the impacts on exports or share of the domestic market have been minimal. German and Japanese producers still appear to be cutting profit margins to maintain market share.

Domestic producers generally have seen little change in the prices of imported inputs. In several cases, including a maker of uniforms and an electrical equipment manufacturer, the inputs are purchased from areas where the dollar has not declined substantially against the local currency, primarily Taiwan, South Korea, and Hong Kong. Therefore, there is no pressure to raise prices of domestic products.

## Effects on the Trade Sector

Local retail and wholesale trade sectors generally reported that the decline in the exchange value of the dollar has had little impact on their operations. A common response was that the supply and demand characteristics of individual markets dwarfed any influences that might be present from changes in the value of the dollar.

A major importer of shoes, however, has seen some change in prices due to the depreciation of the dollar, although the impact varies by country. Prices of shoes and boots from Italy rose approximately 20 percent during 1986, with the price movement associated with the decline of the U.S. dollar against the lira. This action has prompted a shift to suppliers in Brazil and the Far East (Korea, Taiwan and Hong Kong) where contracts are negotiated in U.S. dollars and where prices have risen only slightly. Domestic prices for their products have increased slightly (approximately 5 percent) but no difference in the quantity demanded has been noted.

A distributor of domestically-produced construction equipment reported that list prices of competing Japanese imports have risen substantially but actual transaction prices have not changed.

# NINTH DISTRICT - MINNEAPOLIS

## Special Theme Report:
## Domestic Impact of the Dollar's Decline

A telephone survey of Ninth District manufacturers and retailers seems to indicate that, over the past year, the declining dollar has not had much impact on the cost of many imports, with some exceptions. The effect of the dollar's decline on U.S. exports has varied according to the goods produced. Of the district exporters contacted, many expect any helpful effects of the dollar's decline to be delayed for at least a few months.

### Imports

In general, Ninth District manufacturers have noticed very few appreciable increases in import prices that can be attributed to the dollar's decline. One maker of air pollution devices has shifted some of its buying from imported inputs to domestic substitutes because higher freight charges have made some imports uncompetitive. But a packaging producer says the only price changes experienced at his firm have been due to supply and demand. A manufacturer of office automation equipment has seen no price increases for its imported inputs, but it expects to see some increases later. One multinational corporation has consistently used domestic materials in its U.S. operations, despite its many factories abroad.

There are signs that some imported input prices may increase in the future. For instance, West German and Finnish paper producers are currently losing money on their exports to the United States, and they still are not maintaining their market share. As a result, they may have to raise their prices soon.

District retailers who import finished goods report mixed experiences due to the dollar's decline. A buyer for a department store says prices of exclusive European fashions have accelerated over the last six months; however, more pedestrian goods from Korea are still cheaper to import. This department store absorbs part of any price increase. A large, general merchandise discounter, however, does not credit the dollar's decline for price increases during the last six months. This discounter also absorbs part or all of any increase.

Exports

Over 1986, the relative performance of U.S. exports has varied, depending on the product. As a result, some companies have benefited and others have not.

Among the beneficiaries are U.S. paper companies, which have made inroads in some foreign markets, especially with sales of newsprint. A maker of industrial filters has enjoyed increased sales to European customers, but excess capacity has kept it from raising prices in response to the higher demand. A broker for high-tech Minnesota manufacturers exporting to South America and Asia reports that orders for many of his clients' products have increased because of the dollar's decline. And a large, technology-driven manufacturer believes that its market position overseas is more competitive thanks to the decline.

In contrast, numerous other firms haven't yet experienced increased exports attributable to the dollar's decline. Although office automation equipment exported by one manufacturer has sold well in Europe recently, the firm does not attribute the favorable performance to the declining dollar; nor has the firm raised its prices. An exporter of auto racing equipment hasn't seen its foreign sales improve; neither has a maker of electronic instruments and radiant heaters. Even though these firms haven't yet seen a pickup in their exports, most feel that the declines of the last two months may take effect after a few more months.

TENTH DISTRICT - KANSAS CITY
SPECIAL THEME REPORT
January 1987

Overview. A broad range of Tenth District businesses was surveyed, including retailers, manufacturers, and a few other types of firms. Firms contacted were about evenly divided between those experiencing increases in prices of imported inputs and other goods and those experiencing no increases. Domestic competitors in markets for items with rising prices have generally been holding the line on their own prices. Few firms report shifting to domestic suppliers, however, partly because many imports remain less costly, or are of higher quality, than domestic alternatives. The degree of price change has been greatest for Japanese goods. Smaller increases, or no changes, were generally reported for goods from other Asian countries and Latin America.

Tenth District firms report little significant effect on sales or orders due to the decline of the dollar. Almost none of the respondents reported raising their own prices, and few firms have experienced a need to increase employment or capacity. Respondents generally expect only moderate effects of dollar depreciation on prices, sales and orders over the next year or so.

1. Manufacturers contacted were divided about half and half between those experiencing increases in prices of their imported inputs and those experiencing no increases. The price increases were for the following kinds of inputs: metals, including steel, aluminum, chrome, and nickel; machinery repair parts; chemicals used in the production of medicinal drugs; component parts for small appliances; truck tires; and inputs used in the manufacture of rubber products, including yarn, fabric, chemicals and rubber. In most instances, domestic competitors in markets for inputs with rising prices have

been holding the line on their own prices. Domestic products with rising prices include fasteners, bearings, rubber, and chemicals used in production of rubber products. Manufacturers are responding to price increases in several ways: by buying in advance, seeking other sources, negotiating price changes, switching to domestic suppliers who are holding the line on prices, and absorbing cost increases in margins by selectively repricing output. One manufacturer is negotiating long-term contracts with foreign suppliers. A few respondents note that they can do little, because their imported inputs are not produced in the United States. One importer of repair parts for their machinery has no domestic alternative, and is trying to make the parts within the company.

2. Fewer than half of the responding retailers are encountering higher prices for goods ordered or purchased abroad. Specialty stores appear more likely to face rising prices for imports than general merchandisers. Orders placed six months ago for spring items did not reflect rising prices but increases are expected when fall orders are placed in the next couple of months. A firm importing primarily soft goods reports only slightly rising prices. Respondents report that competing domestic suppliers are about evenly divided between those raising prices and those not doing so, in response to price increases on imported merchandise. Retailers' responses to changes in the cost of goods varies. For example, one firm is trying to make foreign suppliers absorb part of the cost increase, while accepting a slight decline in its own margin. Another retailer is raising prices in line with rising goods costs, with no change in its margin.

3. Several manufacturers noted differences from country to country in the degree of price change on imported inputs. Some firms import from just one foreign source and thus have no basis for comparison; a few others reported no difference from one country to another. Japan was singled out as "the worst culprit" in increasing prices, and the Japanese were also described as "aggressively passing on price increases." Some increases were reported on inputs from Germany and Switzerland. Smaller increases, or no changes, were generally reported for Hong Kong, Taiwan, Thailand, and Latin America. There were few indications that this tendency has been changing recently. One firm said that "the Europeans have wanted to raise prices but haven't." Another manufacturer reported that there has been a greater tendency for price increases on inputs from Taiwan within the last three months. A manufacturer that imports only from Japan reported that while one supplier agreed to absorb part of its proposed price increase, another had not. This respondent also noted that their Japanese suppliers recently have become less willing to absorb the costs of the lower dollar. Finally, one firm reported some price decreases on inputs imported from Japan, due to vigorous competition from Korea and Taiwan.

4. Only a small minority of Tenth District respondents report shifting to domestic suppliers in response to changes in import prices. Several respondents, however, couched their replies in terms of "not yet." A number of special reasons were given for not making such a shift: no alternative inputs or substitute products are available domestically; domestic prices remain higher in spite of the dollar's decline, due to lower costs of production abroad; and foreign products remain superior in quality to domestic substitutes, outweighing price changes. One firm noted a further shift to

buying from foreign suppliers, because of price competition between Japan and Taiwan and Korea. Few respondents were aware of domestic suppliers producing more of their output domestically; one respondent noted that the opposite is still true.

5. A substantial majority of the domestic producers contacted report no significant effect on their sales or orders due to the decline of the dollar. A few of these firms expect improvement later this year, however. Sales abroad have improved for a few firms, including one producer of private aircraft. A large grain firm reported making some feedstuff exports for the first time in three years, but noted that these sales were not wholly attributable to the decline of the dollar. Nearly all respondents report that they have not raised their own prices. Some are interested in maintaining or increasing market share; others report that excess capacity and competition are preventing price increases. Most respondents who are exporters said that their export prices are generally set in dollars. Few respondents have seen sales prospects improve enough to lead to actions to expand employment or capacity. Several of those reporting expanded output attribute it to factors other than the decline of the dollar.

6. Respondents generally expect to see only moderately intensified effects of dollar depreciation on prices, sales and orders over the next year or so. Phrases like "no measurable effect," "no significant impact," and "no perceptible change" were commonly used. Surveyed businesses were about evenly divided between those expecting little or no change in sales and orders and those expecting slight to moderate improvement. Respondents were similarly divided between those expecting little or no change in prices and those

expecting higher prices. Several firms report long-term contracts still in force. A pharmaceutical firm expects significant changes after 1988 when contracts run out. A small appliance maker expects a marginal effect on sales and prices this year but major effects over a three-year horizon. One upscale retailer contemplates cessation of purchase of some foreign products as prices continue to rise.

# ELEVENTH DISTRICT--DALLAS

## SPECIAL REPORT ON EFFECTS OF THE DECLINE IN THE EXCHANGE VALUE OF THE DOLLAR

The decline in the exchange value of the dollar has not significantly affected business conditions for most firms contacted in the Eleventh Federal Reserve District. The majority of firms said that they were not directly affected by foreign trade. Of those that are affected, a significant minority of respondents did mention improvement in their export sales or a reduction of foreign competition in domestic markets. This share of respondents was larger than for contacts made last year. Only a few of those affected by foreign trade reported changes in input prices as a result of the dollar's decline. Protectionist measures received a large share of the credit for the reduction of competitive pressures from foreign producers and for such increases in prices of foreign inputs as were reported.

Only a small proportion of those District manufacturers affected by foreign trade reported increases in input prices. Those firms that have experienced price increases in foreign-made inputs have often responded by turning to other sources of supply. These new sources of supply were usually in countries whose currencies have not depreciated against the dollar. Another factor that has reduced the impact of the decline of the dollar on input prices is that petroleum, an important input for the refining and chemicals industry, is denominated in dollars. Among firms that reported increased costs of foreign inputs, only about half were able to pass these higher costs on to purchasers. Intensified local competition, as a result of declines in orders from the construction and energy sectors, were among the factors that prevented prices from being passed on.

Distributors and retailers say that the prices of foreign finished products they buy, and subsequently sell, have increased. Retailers especially noted increased prices for apparel. They attributed a significant portion of the increase to the binding effects of the new multifiber agreement. A scarcity of suitable domestic output is preventing a switch away from foreign-produced goods. When possible, the higher prices of finished goods are being passed on to the final consumer. In contrast, the prices of consumer electronics have not gone up. Continuing technological innovation in consumer electronics has contributed to price stability for such products. Because the dollar has fallen strongly against the yen, but not against some other Asian countries, some Japanese consumer products have become relatively expensive. Accordingly, District retailers have turned to other Asian countries to buy some goods for resale to U.S. consumers.

A fairly clear pattern has emerged regarding country of origin and price increases. Products such as lumber, wood pulp, autos and ceramics from Europe were reported to be significantly more expensive. Japanese automobiles are also more expensive. In no instance did respondents believe that the full impact of the depreciation of the dollar was reflected in the final sales price. Little change was reported in the prices of a host of products from countries whose currency has been relatively stable against the dollar. This group includes countries such as the United Kingdom, Canada, Mexico, South Korea, and Taiwan. A notable exception are lumber and wood products from Canada that have been affected by tariffs or Canadian export taxes.

The response to higher import prices is mixed. Many respondents noted the lack of suitable domestically-produced goods. The appreciation of the dollar during the early 1980s induced changes in the product mix of U.S. manufacturers. These changes have not been reversed in the wake of recent declines in the dollar. Some respondents who once could choose between U.S. and foreign suppliers, now find that some of their domestic suppliers have gone bankrupt or changed their product lines. In a number of cases, however, both retailers and manufacturers are actively seeking domestic producers of goods for which foreign producers have begun to raise prices.

Improvement in exports of manufactured goods was noted. Some respondents reported they were able to raise prices while others increased their sales volumes. The number of respondents that noted improvements in conditions was greater than the number in 1986. The greatest strengthening of exports has been in orders bound for Europe. The debt problem continues to constrain exports to South and Central America. The higher sales were not narrowly based. A number of different types of manufacturers reported gains in export sales.

During last year's survey, few respondents noted improved conditions as already having improved, but many expected benefits from the decline of the dollar to occur during 1986. Less optimism was noted this year, but some still expected to see additional benefits. Most respondents said that they did not expect the current situation to change markedly.

# TWELFTH DISTRICT -- SAN FRANCISCO

In the Twelfth District, the competitive positions of some sectors have improved substantially due to the declining foreign exchange value of the U.S. dollar, but for other sectors the effects so far have been either mixed or nonexistent.

The country of origin and product line determine the extent to which U.S. producers pay higher input prices due to the declining value of the dollar. For the most part, producers and distributors who buy from Japanese or European producers have experienced price increases that are smaller than the changing value of the dollar alone would have brought about. However, the range of experience is wide and some prices have not risen at all, while others have risen in line with the changing values of the yen and mark. Moreover, imports from several countries, including Korea, Taiwan, and Canada, have not been affected because the U.S. dollar has retained its value vis-a-vis these countries' currencies.

Respondents agree that U.S. producers are maintaining dollar prices in order to regain market share. However, in some cases regaining market share may be difficult to do. For example, a forest products company executive reports that although German and Scandinavian equipment now costs 25 percent more than it did before the dollar began its decline, the company will continue to import equipment because its quality is superior to that of U.S.-made equipment. In some other sectors, such as agriculture, most inputs traditionally have been supplied domestically so the value of the dollar has had no effect on costs.

As a result of higher import prices, margins have declined for distributors and manufacturers who import from Japan and Europe. One commonly cited example is Japanese automobiles. Dealers are paying substantially higher prices than they were a year ago, and retail prices reportedly have risen by 10 to 20 percent. Dealer margins are being squeezed, and the higher prices appear to have affected some dealers' overall sales as well. One San Diego dealer of Japanese cars reportedly sold 20 to 25 percent less in 1986 than in 1985.

Some respondents reported that, as Japanese goods have become relatively more expensive, importers are focussing more attention on generating business from low-cost producers in Taiwan and Korea, and less on Japanese products. At the same time, some U.S. manufacturers are putting more energy into selling in Japan, partly because sales prospects have improved as the value of the yen has risen relative to that of the dollar. Firms that have marketed aggressively to Japan have experienced substantial increases in exports during the past year. Respondents agreed that U.S. exporters continue to set prices in dollars.

The impact on U.S. firms' production sites appears to be mixed. Some firms reportedly have increased production in the U.S. and cut back their overseas activities, or have made plans to do so. Others, however, cite reasons why domestic production is unlikely to increase. For some firms, investments are so long term that the dollar would have to remain low for several years before they would change the location of their production facilities. For other firms, the gap in production costs remains so great that little increase in domestic production is expected. This is particularly true for products which are made in countries against whose currencies the value of the dollar has not fallen. One executive noted that many firms have considered shifting production to Mexico and exchange rate considerations have not changed the desirability of doing so.

Export-related increases in production and sales were noted in several sectors. Domestic paper companies have increased production of those paper goods that currently are in strong demand, so plant utilization for these products has increased substantially in the U.S. Employment also has risen, although productivity enhancements have kept employment gains modest. Sales of some agricultural products have strengthened due to increased exports to Japan. Bulk wine grape prices have improved this year, partly because of improved domestic demand attributable largely to wine coolers, but also because the prices of imported wines have increased dramatically and the volume of imports has declined as a result.

In California, foreign investment reportedly has increased. The decreasing value of the dollar may have played a role in decisions to locate in the U.S., but fears of protectionism and the easing of the state's unitary tax law likely were factors as well.

Most respondents agreed that further effects are likely to occur as current contracts expire and new capital investment decisions are made. However, the improvements will not affect those sectors that face soft worldwide demand or continued intense foreign competition, particularly from producers whose currencies have remained strong relative to the dollar.