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

**MICHAEL J. PRELL  
DIRECTOR  
DIVISION OF RESEARCH AND STATISTICS**

**May 8, 1990**

**To: Federal Open Market Committee**

**From: Michael J. Prell**

A handwritten signature in dark ink, appearing to be "MJP", written over the printed name "Michael J. Prell".

Attached is a copy of a report prepared by the Reserve Bank staff on trends in the U.S. trade position as perceived by businessmen in their districts.

**Enclosure**

## PRESENT TRENDS IN THE TRADE SECTOR

### National Summary

Some firms in the United States report slower growth of foreign demand for their products in recent months, but many report no change in growth of exports and a few report stronger growth. There is also a wide divergence of views as to how rapidly exports are likely to grow during the year ahead. U.S. producers continue to face intense competition from imports, but most have not seen increased competition during recent months. Reports do not suggest that a sizeable shift from domestic to foreign suppliers, or vice versa, is underway.

#### Exports

Some companies in each region of the country report that growth of their exports has slowed in recent months, but many have experienced no slowdown and a few report a pickup in export growth. Most companies expect their export sales to grow fairly strongly during the coming year -- frequently at a stronger rate than domestic sales. Roughly half of the firms contacted expect unchanged or stronger growth of exports than during recent years; half expect weaker growth. Very few firms expect their export sales to fall.

While the most striking characteristic of comments on present trends in exports is their diversity, there are consistent responses across Districts on four points: (1) growth of aggregate demand in foreign markets is generally more important in determining the growth of exports in the short run than are exchange rate movements; (2) recent movements in exchange rates are likely to have a bigger effect on export sales to Japan than on sales to other countries; (3) the short-run outlook for exports to Brazil is not bright because of that country's internal economic and political problems; and (4) economic and

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political changes in Eastern Europe are likely to yield export opportunities for U.S. companies, but not quickly.

In explaining why exports change, most producers cite product-specific factors, such as technological change or new product introductions, and market-specific factors, such as income growth or changes in trade barriers. Many firms also cite more extensive marketing efforts. Fewer cite recent exchange rate movements.

Firms that export to Europe tend to emphasize the importance of income growth abroad, and of procurement policies of foreign governments. Companies that export to Latin America tend to focus on changes in trade barriers, buyers' difficulties in obtaining credit, and weak aggregate demand.

Many firms noted that recent exchange rate changes have not been large enough to have a major effect on their exports. Nonetheless, a sizable minority of companies does say that recent appreciation of the dollar eventually will slow growth of their exports; that expectation is more often mentioned by firms that sell in Japan and other Asian countries.

Most exporters report intense price competition from foreign producers, but few indicate that there has been much change in the past few months. A few cite increased competition from Japan and other Asian countries. On the other hand, a few firms indicate that competition from Europe has diminished.

Many exporting firms report that they have held dollar prices constant and maintained profit margins without suffering an appreciable drop in export sales. Some of these companies express concern that further appreciation of the dollar will hurt their exports. Other U.S. exporters report that they have held foreign currency prices constant and accepted shrinking profit margins during recent months. A fair number of these firms indicate that further appreciation of the

dollar, especially against the Japanese yen, will force them to raise foreign currency prices for their goods.

#### **Imports**

While noting that competition from imports is intense, most U.S. firms report that they have seen little change in price competition from imports during recent months. A number of firms commented that Japanese companies with whom they compete in the U.S. market have not cut dollar prices in response to recent depreciation of the yen, but instead have fattened profit margins. A sizeable minority of firms does report increased competition from imports, however, on both price and non-price terms. That perception seems particularly prevalent among producers of "low tech" consumer goods such as textiles, apparel, and furniture.

Despite the perceived rise in import competition, there are few reports of appreciable increases in the quantity of imports. While there are some reports of increased imports of raw materials, intermediate goods, and capital equipment, there also are reports of increasing exports of such items.

#### **Domestic Prices**

There is substantial agreement that domestic prices have been held down by import competition. A fairly large number of firms report that they have been unable to raise prices, or to raise them as much as they would like, because of competition from imports. A few firms indicate that they have had to roll back price increases.

#### **Domestic vs. Foreign Suppliers**

Based on respondents' comments, no major change in sources of supply is underway. Some U.S. firms report shifting from domestic to foreign suppliers, occasionally because appreciation of the dollar has made foreign supplies

cheaper. Other firms report shifting from foreign to domestic suppliers. A few, but not many, contacts indicate that they have shifted their purchases from goods produced abroad to goods produced at foreign-owned facilities in the U.S. Companies cite quality, reliability, and availability of goods as reasons for choosing or changing suppliers far more often than they cite recent exchange rate movements.

#### **Relocation of Production Facilities**

Among firms that commented on factors influencing decisions to relocate production facilities, a large majority indicated that they believed that the dollar's depreciation through 1987 played a role in the growth of foreign-owned production facilities in the U.S., but few thought it was the dominant factor. Instead, companies generally indicated that decisions to relocate plants are made for long-term reasons and are based on factors such as gaining proximity to growing markets, reducing transportation, labor and energy costs, and avoiding tariffs and trade barriers. Few of those who commented thought that the dollar's recent appreciation was large enough to make much difference in such decisions.

#### **Suppliers to Foreign-owned Firms**

Those respondents who commented on the issue believed that foreign-owned firms in the U.S. rely more heavily on imported inputs than do U.S. companies, but offered little direct evidence on this point. Only a small number of U.S. firms report having attempted to become suppliers to transplant or other foreign-owned production facilities; some report success, others failure, but they agree that establishing such relationships is difficult.

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FIRST DISTRICT - BOSTON

SPECIAL THEME REPORT

During 1989 exports grew faster than total sales at most First District firms contacted, with export gains ranging from 5 to 35 percent over 1988 levels. Half the respondents expect these export trends to continue in 1990; the remainder foresee slower growth. Because demand for many First District exports is not very price sensitive, contacts stress aggregate demand and foreign government procurement policies in explaining export behavior. Nevertheless, exchange rate developments are said to be important for some products. On the import side, most respondents view foreign competition as restraining U.S. prices; several contacts recently abandoned planned price increases because of rising competition from abroad. Among firms discussing sourcing, shifts offshore outnumber shifts to domestic suppliers. Over the long term, First District manufacturers expect foreign markets to continue to gain importance. They intend to pursue export and overseas investment opportunities regardless of exchange rate developments.

Exports

The importance of exports to First District manufacturing contacts varied from slight to over half of total sales. (Firms with modest exports often have substantial overseas affiliates.) Nevertheless, almost all firms reported that direct exports had grown as a share of sales during the last two years, with export gains ranging from 5 to 35 percent during 1989. Exports of aircraft, power systems and products embodying unique technology experienced strongest growth. Even in Japan, products with little foreign competition have made significant headway, with two firms reporting sales increases of 20 percent or more.

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Just over half of the respondents expect recent export trends to continue (or, in one case, to accelerate) in 1990; however, the remainder foresee slower growth. Some foreign markets are viewed as weaker than others. Economic activity is reported to be flat in the United Kingdom and slowing in Japan and Korea. In Latin America, only Mexico is seen as a promising market in the near term. Respondents have mixed views about continental Europe. Some point to a capital spending boom, but others report declines in export orders. Most contacts see Eastern Europe as a potential market for consumer and capital goods in two to three years. One contact has already established a joint venture in the Soviet Union, while another will shortly open a facility there.

Explanations for recent and expected export performance varied by region and product line. Many First District firms export technically sophisticated products with limited foreign competition and limited price sensitivity. For example, sales of aerospace and defense-related products are largely determined by GDP growth and government procurement policies, and not by exchange rate developments. For some industrial and most consumer products, however, exchange rates are believed to be important.

Firms exporting to Europe tended to emphasize GDP growth and national procurement and industrial policies as key determinants of U.S. export growth. In Latin America, restrictive trade practices and weak aggregate demand are said to be curbing U.S. exports. Companies selling to Japan and the Far East mentioned the foreign exchange value of the yen and the special ties between Japanese firms and their suppliers in addition to aggregate demand. A third of the respondents also attributed part of their export growth to improvements in their own marketing efforts.

Discussions of competition in third markets focused on Japan. Japanese exporters are gaining market share in Latin America and the Far East in part because they are reportedly willing to incur short-run losses and in part because Japanese foreign aid is said to be tied to Japanese exports. As much of this competition is based on price, exchange rates matter.

Contacts describing their export pricing policies indicated that selling expensive equipment to foreign governments requires putting together an "attractive package" including sales offsets. (The exporter agrees to "offset" part of the export price by buying a specified volume of goods from the importing country.) Another respondent pointed out that it often exports through its foreign subsidiaries; thus, it has only limited ability to lower export prices to maintain foreign sales since the IRS is taking a renewed interest in multinationals' use of non-market transfer prices.

#### Imports

Several contacts perceive an increase in import competition. They cited fabricated metal parts from Korea, auto-related products from Japan, aerospace products from Europe and, increasingly, from Japan, and power and medical systems from Europe. Respondents generally believe that foreign competition contributes to U.S. price stability; one-third indicated that they had recently abandoned planned price increases because of foreign competition.

Roughly half of the respondents mentioned obtaining some inputs from foreign suppliers - in the NICs, Japan, France and the United Kingdom, in particular. Accordingly, some have benefitted from the yen's recent weakness. While one respondent argued that the need for quality and reliability requires stable supplier relationships, several firms have

recently shifted from U.S. to foreign, especially Asian, sources. One cited fluctuating prices and limited supplies of U.S. specialty steel. Another shifted production to a U.K. facility with excess capacity. By contrast, only two firms mentioned shifting production to the United States. In one case the firm had (with the help of the dollar's 1985-87 decline) persuaded foreign suppliers to locate production facilities in this country. This same firm has a U.S. joint venture in which the Japanese partners had expected to export their half of the output. With the dollar's recent strength, these export plans may no longer be viable. Accordingly, this respondent believes that the dollar appreciation may slow foreign direct investment in this country.

Two firms that serve U.S. auto makers report mixed results in obtaining contracts from Japanese transplants. One, a large diversified multinational, has become a "preferred supplier" of parts to the transplants. The other, a small capital goods manufacturer, has had little success. Both companies agree that it is very difficult to break into the special relationship between Japanese firms and their suppliers.

#### Long-Term Outlook

All First District contacts believe that foreign markets will continue to gain importance over the next decade, in part because they expect foreign growth rates to exceed U.S. growth rates for the foreseeable future. Accordingly, most contacts will seek export and foreign investment opportunities regardless of exchange rate developments.



FEDERAL RESERVE BANK  
OF NEW YORK

## OFFICE MEMORANDUM

DATE April 30, 1990

To Mr. Prell

SUBJECT Special Report on Trade

FROM Richard G. Davis

A survey of ten firms in the Second District yielded mixed conclusions about the trade outlook. Most felt there would be some slowdown in exports in 1990, although the recent appreciation of the dollar against the yen was not reported to be a significant factor. Optimism was expressed about sales to the East Asian NICs and Latin America, while exports to Europe were expected to be weak. There was little evidence of an acceleration in imports as only one firm felt it was losing domestic market share to foreign competitors. In particular, the responses indicated that Japanese manufacturers have so far not used the dollar's rise to improve their price competitiveness relative to U.S. firms. There were reports of fairly modest shifts in U.S. purchases away from foreign suppliers. Some firms are bringing production closer to home, to lower transportation costs and limit their exchange rate exposure, but were more inclined to shift operations to Mexico rather than return them to the United States.

### Exports

Export growth was generally expected to fall this year. The responses of the exporting firms surveyed ranged from three (chemicals, electronic equipment, consumer goods) that expected little export growth this year to two firms (pharmaceutical,

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industrial machinery) projecting sales to grow at the same strong rate as last year. The rest expect smaller, but still healthy, increases.

The dollar is not a major factor for those firms having trouble maintaining growth in their export sales. A chemical producer has been suffering from aggressive pricing by a European firm able to take advantage of EC agricultural subsidies of raw alcohol. This firm, though, had some hope that the year might turn out better than expected because of two recent developments. The European manufacturer bought out of a contracted delivery to Japan last month, with speculation that it is was having difficulties coping with the recent strength of its currency. In addition, the U.S. firm's Japanese customers seem to be buying again, after a pause in the first two months of the year, at an exchange rate that was previously thought to be too high to maintain export sales. The electronic equipment manufacturer said it was suffering from inadequate research and development and could not blame its weak position on either the dollar's rise or trade barriers. The consumer goods firm was unsure of the reasons for the slowing, particularly since the weakness has been in sales to Europe where the lower dollar should be of help.

Many respondents expected solid increases in their sales to Asia and Latin America. Only one firm (leisure goods) said it is under pressure to lower prices because of the dollar's rise against the yen. Three other exporters (transportation equipment, industrial machinery, pharmaceutical) were optimistic about sales to Japan, having so far not experienced any unusual price pressures. These firms attribute continued growth to having



successfully gained access to Japanese markets in the last few years. Four firms (industrial machinery, leisure goods, machine tools, pharmaceutical) said they expected very strong demand from other parts of Asia due to favorable exchange rates and rapid economic growth in the region. Latin America was also frequently mentioned (electric equipment, consumer goods, industrial machinery, leisure goods) as a source of growth, in part because of recent reductions in trade barriers. Current problems in Brazil and Argentina have affected the sales of two firms (appliances, consumer goods) but the disruptions are expected to be temporary. The only negative appraisal was from one firm (pharmaceutical) that had decided to devote less resources to the region after being frustrated in attempts to protect its patents.

Almost all of the firms surveyed (consumer goods, electronic equipment, engines, industrial machinery, pharmaceutical, transportation equipment) expected slower sales to Europe, with the fall in the dollar against European currencies not yet having any positive affect. Most, including those with local operations, thought Europe was now their most difficult market because of the strong preferences of European customers for locally produced goods. A manufacturer of transportation equipment reported that getting contracts for a new European project seemed more difficult than usual even though it operates through a European partner. The firm still hopes to succeed as they see no viable European competitor. The engine manufacturer is currently experiencing a significant slowing in sales to Europe, after growing by almost 40 percent last year. It is losing market share to both domestic and foreign competitors, but



attributes this development to market specific factors rather than to protectionism in Europe.

### Imports

There was little evidence of any acceleration in imports as only one firm (chemicals) felt it was losing market share to foreign competitors. Recent currency swings have apparently not altered the relative price of imported goods. In particular, respondents felt that Japanese firms have not used the stronger dollar to improve their price competitiveness in the United States. One respondent (electronic equipment) speculated that the Japanese were hesitant to lower prices for fear of the yen appreciating in the near future.

Two apparel importers reported no drops in prices offered by their Japanese suppliers. For one firm, the yen rate had become increasingly unimportant since it has shifted its purchases from Japan to the East Asian NICs over the past five years. This process is continuing as the firm has recently been buying less from the NICs, due to rising labor costs in those countries, and is now relying more on other locations in Asia such as China. An importer of leisure goods from the NICs has not noticed any unusual price developments. There has been a drop in prices for electronic toys, but this is due to slackening demand rather than from shifting exchange rate values.

There was some evidence of switching to domestic suppliers, with one (electronic equipment) saying it was purchasing more "low-tech" components from U.S. firms to reduce its exchange rate exposure, while another (chemicals) said that



U.S. petrochemical companies have recently become more competitive in their pricing and responsiveness. A retailer said it is buying more U.S. goods, although such purchases are still very small. A contrary trend was reported by a manufacturer of transportation equipment that has started to buy components from Japanese manufacturers after being dissatisfied with the quality of some domestically produced items.

Four firms (consumer goods, leisure goods, appliances, pharmaceutical) reported that they are continuing to move production to Mexico and Puerto Rico to take advantage of lower labor and transportation costs while also limiting their exchange rate exposure. No respondent said it was shifting production back to the U.S. from abroad, although one (appliances) said some of its components are built by Japanese firms which have recently opened operations in the United States.

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Third District - Philadelphia

Summary

Businesses contacted for the special theme report on trends in the trade sector generally note that exports continue to grow at a good pace and report that the dollar's recent appreciation has had little effect on exports to date. Firms typically attribute recent changes in their export sales to non-price factors in particular markets rather than to movements in the dollar's exchange rate vis a vis particular currencies; that is true for firms whose exports have fallen as well as those whose exports have grown. Some firms note that they have begun selling to new markets abroad during the past year or two. They cite strong demand in those markets as a more important factor than the level of exchange rates. Many companies express concern that further appreciation of the dollar would depress exports; that is particularly true among firms that export to Japan.

Exporters generally expect continued strong growth of sales in Asian and Pacific countries, and also in Western Europe; they generally cite robust economies and strong demand. There is concern that further appreciation of the dollar against the yen would force U.S. firms to raise prices in the Japanese market and result in a quick loss of market share to Japanese firms. Those who sell in Latin America are generally not optimistic about the prospects for exports during the coming year; companies cite both political and economic instability in that region. Third District firms do not expect any substantial export sales to Eastern Europe during the next year or two.

Companies typically report strong price competition, both in the U.S. and abroad, from foreign producers. They indicate that competition from foreign

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firms has not intensified during recent months, however, and that they have not seen a change in their suppliers' pricing behavior. That is true of producers of intermediate goods and also of firms that manufacture final goods.

Almost all of the contacted companies say that quality and reliability are more important than price in choosing suppliers. Virtually all of the companies deal solely or primarily with suppliers in the U.S. There has been little if any change in suppliers of inputs during the past year, even among those firms that consider price of paramount importance.

### Exports and Exchange Rates

Firms in the Third District generally report healthy growth of exports and indicate that the dollar's recent appreciation has had little effect to date. One large manufacturer reports especially good growth in exports to Asian and Pacific countries. Other firms report strong growth of exports to Western Europe. Some exporters report slowing sales to particular markets, including Brazil, Canada, and China. Companies generally say that recent increases as well as declines in export sales have been caused primarily by changes in local market factors, and not by exchange rate movements. Companies cite factors such as income growth, interest rates, political disruptions, and changes in trade restrictions.

Firms generally expect recent trends in their exports to continue during the coming year. They expect continued strong growth in sales in Asia and Pacific countries. There is, however, substantial concern that further depreciation of the yen against the dollar would force U.S. firms to raise prices in Japan and thus hurt sales in that market. Firms also expect continued strong growth in exports to Western Europe, citing strong economic growth. They do not

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seem worried about a "fortress Europe." Companies expect little growth in exports to Latin America because of political and economic instability in some of the region's major countries. Firms see little chance of new export opportunities arising in Eastern Europe during the coming year or two, although some are hopeful that such opportunities will arise eventually.

One banker involved in trade financing noted his frustration in trying to get small and medium-sized U.S. firms interested in investigating export markets. He noted that the dollar's earlier depreciation had made little difference to these companies; they did not try to expand through foreign sales.

Pricing and Foreign Competition

Firms in the Third District indicate that they have not changed export pricing in response to the dollar's recent appreciation. Most exports are priced in dollars; for those contracts there has been no change in margins because of the dollar's strength. Some exports to Japan are invoiced in yen; for those contracts profit margins have shrunk. Those companies that compete either in the U.S. or in third markets with firms from Japan or the newly industrialized countries report intense price competition, but no change in recent months.

Most of the contacted firms say that exports are a relatively small part of their total sales; they price in U.S. dollars and they have not changed their export pricing. A larger firm indicates that it sometimes invoices in foreign currency; that is most often the case when dealing with Japanese distributors. While that firm has not yet raised its yen prices in response to depreciation of the yen, it may be forced to do so later this year, especially if the yen depreciates further. That firm expressed concern that sales in Japan would suffer not only because of higher prices, but also because the firm's Japanese

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distributor would reduce spending on advertising and promotion.

Some firms in the Third District note that they are under continuing pricing pressure from imports, but indicate that nothing has changed in recent months. Several firms volunteered that they have seen no recent changes in their domestic suppliers' pricing, either.

#### Domestic versus Foreign Suppliers

Few respondents indicated that they had made any changes in suppliers during the past year or two. Those who had made changes cited quality and reliability problems, including political disruptions, far more frequently than exchange rates. One manufacturer of specialized capital equipment has increased purchases of supplies from foreign firms recently, as prices abroad have declined relative to those in the U.S.

Most firms said that quality and reliability continue to be more important than price or location in choosing suppliers. Some companies note that they obtain supplies from the cheapest source, but indicated no recent changes in supplier relationships.

A banker noted that many small and medium-sized firms in the U.S. are still seeking to shift from foreign suppliers to domestic sources in response to the 1986-87 depreciation of the dollar, but have not been able to do so because of "lack of domestic availability." For such firms, the dollar's recent appreciation has not been large enough to offset the effect of its earlier depreciation.

#### Exchange Rates and the Location of Production

None of the firms contacted in the Third District reported shifting the location of its production during the last several years. One large manufacturer

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noted that it had expanded into several new foreign markets during the past year, citing earlier exchange rate changes. Those new markets were supplied from the company's U.S. production facilities. The same firm noted that it had begun supplying European markets from its U.S. production facilities somewhat earlier; in that case the firm cited its inability to supply the rapid growth in European demand from its European production facilities.

Several respondents noted difficulty in establishing relationships as suppliers to newly established transplant facilities in the U.S. One firm reported frustrations in trying to sell to U.S. manufacturing facilities established by Japanese auto companies, in particular. Another firm noted no such difficulties; it cited foreign acquisitions of existing firms or plants in the U.S. and commented that they tend to keep existing supplier relationships with U.S. firms. No respondent indicated that recent exchange rate movements had affected the ease or difficulty of establishing supplier relationships.

**FEDERAL RESERVE BANK**  
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April 30, 1990

Mr. Michael J. Prell  
Director  
Division of Research and  
Statistics  
Board of Governors of the  
Federal Reserve System  
21st and Constitution Ave., N.W.  
Washington, D. C. 20551

Re: Export Survey

Dear Mike:

Multinational companies headquartered in this District, all of which have operating plants or joint ventures throughout most of the world, report little slowdown in export sales so far this year. They expect, however, slow export growth rates as the year progresses because of a reduced pace of activity abroad and the lagged effects of dollar appreciation, especially relative to Japan. Other manufacturing companies that are trade-sensitive generally anticipate continued growth in exports this year. Brazil is the export market with greatest uncertainty that could dampen U.S. exports this year. Neither multinational companies nor the other respondents note intensifying foreign competition in the U.S., although one respondent heavily involved with trade in Japan expects that foreign-owned plants in the U. S. will force closures of many small manufacturers over the next few years.

Multinationals. In general, multinational firms contacted have about 20% to 50% of their total sales dependent on international sales, but only a small share originates with exports. Most have extensive operations throughout Western Europe, South America, and Asia. Several stated that their exports consist of specialty products, and that standard-type products are typically produced in plants located close to markets abroad. Also, multinational firms export to countries in which they have no operating plants. Decisions to locate plants overseas are made for long-term considerations, such as

of trade restrictions, while exchange rate changes are not a particularly important consideration.

**Exports.** Several multinational firms noted no particular slowdown in exports in recent months, although some anticipate a slowdown later this year, especially because of the dollar's appreciation relative to the yen. An automotive parts producer pointed out, however, that the effects of the dollar appreciation may be less than expected because Japanese auto producers strive to use American-produced products in order to achieve their domestic-content goals for new cars. A glass and coatings producer reported continued strong demand in Western Europe for most products, but flat glass prices have been declining because of excess capacity abroad.

Exchange rate changes apparently have not had much effect on exports so far this year. Some firms indicated that they initially attempt to pass-through some of the currency rate changes because markets abroad are strong enough to absorb higher prices, while others commented that a higher price is not the crucial factor in sales of specialty products where the U.S. producer has a reputation for a high-quality product. For "standard" products, firms will absorb the higher cost if there are alternative products available. An office machinery producer commented that although their costs of parts and sub-assemblies have risen in recent months, changes in exchange rates of 10% to 15% are "swamped" by rapid improvement in technology.

Several firms expressed considerable uncertainty over exports to Brazil or earnings from their plants located there because of the hyper-inflation and policies taken to deal with that problem. One producer believes their plant that produces for domestic Brazilian consumption will be idled shortly.

Prospects for exports or plant location in Eastern Europe are looked upon with some caution. A tire producer believes that Western European producers have closer ties than American producers. An auto parts producers that has a joint venture in Poland reported difficulties because major assumptions underlying that investment decision have not proved valid. A specialty chemical producer is bullish over prospects in Eastern Europe because there are very few suppliers of their product.

**Imports.** Multinational firms generally report no significant changes in imports or in market shares of their competitors in recent months. A common reason offered is that demand in most markets abroad is strong and little capacity is available for expanding export markets. A domestic tire producer commented that all major world tire producers are now producing in the U. S., largely the result of recent acquisitions, so that imports of tires are not as large as they have been. Although price competition remains intense, a consumer goods producers reports relying on product differentiation to maintain its domestic sales.

A domestic steel producer reports that exports have been stronger and imports less than they expected so far this year, but they expect a declining trend in exports and a rising trend in imports over the course of the year, partly because of changes in exchange rates. The less than expected volume of imports is attributed to weak domestic prices for steel and strong demand for steel in Europe.

Other Trade-Sensitive Producers. Most of these producers of consumer and producer goods report little or no slowdown in export growth so far this year. They expect increases in a 5% to 10% range from last year, with several at the upper end of that range. Price competition remains intense, and is increasing from the foreign-owned plants that have recently located in this District.

Exports. Only one of the producers, a manufacturer of pianos, reported that exports this year will decline from last because of the depreciation of the yen. They see little prospect for improvement in their exports until the dollar declines.

All other respondents report no slowing in overall growth, and all expect a strong growth rate in their exports again this year. A producer of medical equipment expects their exports to increase 5% to 10% this year from last, with strong growth especially in Canada. The eight capital goods producers contacted, including four machine tool builders, were generally optimistic over export prospects this year, partly because of sizable backlogs, but also because of well established markets in Western Europe and Canada. They do not expect much business in Latin America and other Third World nations. A few will attempt to exploit opportunities in Eastern Europe.

Several expressed little concern or loss of export business because of exchange rate changes so far this year. They asserted that their product is more sensitive to quality rather than to price considerations.

Imports. Respondents generally have not experienced a significant increase in competition, although they report competition was already intense. One domestic producer remarked on the potential advantages of shifting purchases among his foreign suppliers because of the yen depreciation.

Import competition, especially for machine tools and automotive parts, is fierce. Machine cutting tool imports so far this year have been well above a year earlier. Moreover, several foreign-owned auto parts plants that are now located in the Kentucky-Ohio area not only serve Toyota and Honda plants but also are soliciting business from Big Three auto producers. A trade consultant reported strong growth in exports to Korea, especially for high-tech equipment that was previously purchased from Japan. He expects that U. S. imports from Korea will decrease this year because of heavy domestic demand in Korea. Taiwan is expected to cut its purchases from the U. S., and shift purchases to Eastern European nations. The foreign-owned plants

recently located in this District are expected to intensify competition in industrial markets to the point where many small business firms will be forced to close or to seek joint ventures with foreign producers.

Sincerely,

A handwritten signature in black ink, appearing to read "Mark Sniderman". The signature is fluid and cursive, with the first name "Mark" being more prominent and the last name "Sniderman" following in a similar style.

Mark Sniderman  
Vice President and  
Associate Director of Research

V-1

## FIFTH DISTRICT-RICHMOND

### Overview

Imports of manufactured goods rose and exports slowed somewhat in recent weeks according to our survey of Fifth District producers.<sup>1</sup> New export orders held up well, however, and few manufacturers expect declines in the months ahead. Slower general growth in foreign demand was cited as the main reason for the poorer recent performance in exports, while stiffer price competition was considered an important factor stimulating increased imports. Most manufacturers indicated that the decline in the dollar from 1985 to 1987 continued to encourage foreign firms to establish factories in the United States.

### Changes in Export Sales

More than half of our respondents said their sales to some foreign countries have slowed recently. About 30 percent of the respondents indicated sales slowed the most in Japan and Europe while a few others cited the Middle East and Canada.

### Factors Affecting Exports

Somewhat slower growth in world demand has evidently been the main development affecting the exports of District producers. Most of the surveyed manufacturers pointed to this factor. About 30 percent of the respondents, however, including most manufacturers of textiles and nonelectrical machinery, believed that movements in exchange rates had had a greater effect than the general growth in demand on their exports, and about

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<sup>1</sup>The information in this report is based on 80 responses from a special mail survey of manufacturers.

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15 percent thought that restrictive trade policies abroad were the main factor.

A clear majority of manufacturers expect new orders for exports to remain at current levels over the next 6 months. About 30 percent indicated that their prospects for increasing exports to Latin America were good. Most do not expect the movement toward free markets in Eastern Europe to affect their sales over the next year, but almost half anticipate increased sales and few expect declines in sales in the next two years because of these developments.

Forty percent of the manufacturers we surveyed reported that in markets other than the United States and Japan, their Japanese and other Asian competitors had intensified price competition more recently than their European competitors. One-third of the District's producers reduced prices and 40 percent accepted smaller profit margins in order to maintain foreign sales. All of the exporting textile firms reported cutting prices and squeezing profits.

#### Price and Nonprice Import Competition

About two-thirds of our respondents indicated that their competition from imported products increased in U.S. markets in recent weeks. Virtually all respondents indicated that price competition was an important factor in this regard while a few reported increased nonprice competition. Price competition appeared to be a more important factor among manufacturers of textiles, apparel, and furniture than among other manufacturers. Half of the respondents, particularly textile and apparel producers, indicated that the prices they charge in domestic markets were held down by import competition. About a third of the respondents observed that Taiwan, Korea,

and Japan showed a greater tendency to reduce prices, and about 20 percent of the respondents also placed Hong Kong in this category.

#### Inputs

Slightly over half of the manufacturers reported that they recently shifted from domestic to foreign suppliers, while slightly less than half switched the other way. Most indicated they changed suppliers because of price factors. One textile producer, however, said he switched to foreign suppliers because of a reduction in the capacity of domestic suppliers. About one-fourth of the respondents attributed declines in the prices of imported inputs to movements in exchange rates.

#### Foreign-Owned Plants in the United States

Three-fourths of the respondents believed the decline in the dollar from 1985 to 1987 encouraged foreign firms to establish factories in the United States. The majority thought this impetus had not diminished as a result of recent exchange rate movements.

One manufacturer of automotive cable assemblies said Japanese automobile makers do not use U.S. materials in their U.S.-produced cars.

**FEDERAL RESERVE BANK OF ATLANTA**

**OFFICE CORRESPONDENCE**

**May 1, 1990**

**TO: Michael Prell**  
**FROM: Sheila Tschinkel**  
**SUBJECT: Special Theme Report**

General Comments and Overview: This memo is in response to your request for a "special theme" report to gain insight into prospects for our foreign trade sector. We surveyed businesses throughout the Southeast ranging from natural resource processors to retailers. Primary products are the most important exports from the Southeast. In large part southeastern companies that engage in export activities do so at the margin; indeed, many have just recently begun to market their products abroad. As a result, many responses to our inquiries reflect the limited experience to date in international trade. Respondents did not discuss timing of changes in a uniform way, consequently time periods reported in this memo varied and are specified.

In general, respondents indicated that the exchange rate movements since the beginning of March have had no substantive impact on the growth of their exports. Most of our contacts indicated that their profit margins and not final sale prices are being impacted by exchange rate movements this year. Nonprice factors such as long standing trade relationships, dependable distribution systems, trade agreements and quality of products were mentioned often as more important to maintaining growth in exports

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than are exchange rate movements of the magnitude we have seen in 1990.

On the import side, our contacts report that foreign costs are so low that small exchange rate changes have little or no impact on competitive pressures. This is especially the case for apparel and related textiles. They indicate basically no change in import competition this year and they gave no indication that exchange rate movements have altered the plans of foreign firms to invest in the U.S.

Responding to your specific questions:

1. & 2. Our contacts have experienced no slowing in the growth of their export sales with one exception. A manufacturer of home furnishing fabrics stated that the decline of the yen against the dollar has resulted in declining orders over the last few weeks. On the other hand, a producer of measuring instruments and industrial pumps said that his export orders from Europe have improved since early March. Exporters of primary products such as coal, kaolin, and poultry indicate that growth in exports has been little changed over the last year or two. Our contacts basically expect the growth rate of export sales to remain largely unchanged from the rate experienced last year.

Exchange rate movements during the last couple of months are said to have had little impact on exports from the Southeast and are not expected to change by so much that they would have any impact on exports during the remainder of the year. Nonexchange rate factors are said to dominate these businesses' export

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activity. Bilateral trade agreements, the ability of developing countries to obtain hard currencies, longstanding trade relationships, continued growth in foreign demand, the quality of U.S. products, and the reliability of U.S. supplies were all mentioned as factors more important to export growth than changes in exchange rates of the magnitude seen this year. A wood pulp exporter credits increasing exports to having a diversified base of customers and a record of reliability established over several years. A fertilizer processor states that exchange rate movements are fairly important to his overseas sales. His markets are mainly in developing countries which are strapped for hard currencies. In trade with these countries, bilateral trade agreements have been important influences on exports also. China and India are currently the company's major source of export growth, as they are in the process of rebuilding their agricultural sectors.

3. Generally, our contacts have not reported much if any slowing in sales in particular foreign markets, and they do not anticipate any differential changes for the rest of the year. Exports to Eastern Europe are not expected to increase until political conditions stabilize and Eastern Europe can acquire hard currencies. There was no consensus on how long this might take.

Further recovery of exports to Latin America is also expected to depend on the ability of those countries to acquire hard currencies or gain access to trade financing. Our contacts believe that the long-run prospects of exports to Latin America are good three to four years out; however, for this year they are not as

optimistic and expect some slowing, particularly for countries with large international debts.

4. Japan does not appear to have become generally more competitive in third markets than have other countries this year. Only during the last month or two in West Germany did the Japanese become more competitive against American producers according to a manufacturer of industrial pumps and tools. He attributes this to the recent appreciation of the dollar against the yen. Several wood and pulp producers expect that Canadian and Scandinavian firms will become increasingly price competitive in world markets during the next two to three years. Colombian and Venezuelan coal producers are also expected to be increasingly competitive in the next few years because they produce at lower costs than U.S. suppliers.

5. Exporters in our District indicate that for the past few months they have been letting profit margins shrink so they can maintain prices denominated in foreign currencies. They cite increased competition from lower-cost producers as well as the recent appreciation of the dollar versus the yen as reasons for their shrinking profit margins.

6. In general, most businesses we contacted feel no increased competition from imported products in the last year or so. The only exception is the apparel industry, where a number of contacts report that very low cost producers in Taiwan, Korea, and China continue to displace domestic production. No let up is expected.

Cost advantages for apparel producers in NIEs are so great

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that small exchange rate movements are not an important factor for apparel and related textile producers.

Import quotas, quality inspection requirements, and tariffs are several nonprice factors that continue to insulate our regional food processors from import competition. Our contacts report that their prices have been relatively steady. They have seen no noticeable change in price competition from imports this year and do not expect much change for the rest of the year.

7. Over the past year, most firms reported no shifting between domestic and foreign suppliers of inputs. Respondents have not observed price changes for imports either for final goods or for manufacturing inputs in recent weeks. Quality concerns rather than price prompted one discount hardware and home supply firm to reduce imports from Taiwan in favor of domestically produced products. Taiwan's growing practice of procuring goods from China to fill export orders has reportedly resulted in increasing incidences of inferior quality.

8. The textile and apparel producers say that most of their competition is from Pacific rim countries like Taiwan and Korea, but they do not indicate that any particular country has become more competitive relative to the rest in the past year. They single out China as a continued major competitor because of its government's practice of fixing prices at levels necessary to maintain market share. Our contacts believe that Eastern European countries could become serious competitors in textiles and apparel

because their work force is technically skilled but earns relatively low wages.

9. The dollar's decline through 1987 was a significant factor in the relocation of Japanese-owned auto plants and related parts production plants to the Southeast. Although market softness has cut auto sales and production in 1990, there are no indications that recent fluctuations in exchange rates have triggered any changes in investments of foreign firms in the Southeast.

10. We found no evidence that U.S. firms have recently shifted from suppliers located abroad to foreign-owned firms located in the United States. Foreign-owned auto manufacturers in the Southeast depend more heavily on imported supplies than do domestic manufacturers but local procurement has been trending upward over time.

VII-1

SEVENTH DISTRICT--CHICAGO

Summary. Export activity in the District appears to be mixed, with most contacts attributing little of the change in export sales or import purchases directly to the recent strengthening in the exchange value of the dollar. Several manufacturers stated that exports went to their own production facilities overseas and were insulated from dollar swings. Several producers, however, did express concern over the effects of the higher dollar on their cash flow, as they absorbed the rise in the dollar rather than pass it on in higher prices. With respect to decisions to purchase imported materials, several contacts stated that quality of product and reliability of delivery still outweigh cost differentials that are attributable to recent dollar movements. Higher costs of capital were cited as more serious concerns than dollar movements by those contacts who were attempting to expand or modernize their domestic plants. Several contacts mentioned that foreign competition was intensifying in domestic markets as a result of strategies by foreign producers to increase market share rather than to take advantage of recent dollar gains by increasing their profit margin. At the retail level, however, several contacts stated that sales promotions on some imported goods were stimulating import sales at the expense of domestic substitutes.

Export-related Activity. Export activity in the District has been mixed. Several contacts reported that export sales were doing better than expected since the beginning of the year. Export volume, according to a producer of packaging material, improved dramatically since the beginning of the year. An economist for the steel industry stated that exports so far this year have been below year-ago levels, but have been improving from the latter part of last year. An analyst for the auto industry noted gains in exports to Japan that were linked in part to joint agreements with Japanese producers. A supplier of basic building materials, however, stated that export growth has been slower than expected in recent months because of excess capacity world-wide. Several contacts reported that export sales of intermediate goods to affiliates have been slowing because growth in demand for the final product has been weakening.

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## VII-2

Most contacts with export sales expressed the view that factors other than the dollar have been most important in determining their ability to expand exports in recent months. A producer of agricultural equipment stated that their manufacturing facilities were specialized worldwide, often with a product being made in the same country as their major competitor. In addition, agricultural prices were cited as more important in determining their sales than dollar movements. A large electronics manufacturer reported that most of their production facilities were located close to their customers and business was conducted in local currencies. A small electronics firm stated that export sales were up considerably because of improved distribution and new product lines. Several contacts from different industries noted that a major portion of their export sales was with affiliates under long-term agreements, which insulated their sales from dollar movements.

Several contacts, however, did express some concern over the indirect developments associated with a rising dollar, citing higher cost of capital and weaker cash flow. Several contacts from the paper industry noted they have experienced little trouble competing anywhere in the world (including the Pacific Rim). However, newly added capacity along with the dollar's rise has put downward pressure on prices, which has squeezed profit margins. Several manufacturers with production limited to domestic facilities cited concern over weakening cash flow as prices of their exports were lowered to offset dollar gains. So far, they have been able to maintain their share in their export markets. A large chemical producer reported some problems selling to Japan and its surrounding area, which might be dollar related. However, the firm was still very competitive in Europe. A producer of heavy construction equipment expressed concern that recent increases in the dollar had "wiped out" efficiency gains achieved over the last five years through modernization and was worried about its competitive position if the dollar continues to rise.

Import-related Activity. On the import side, most District contacts reported no change in purchasing patterns as a result of recent dollar gains. A large chemical producer stated that foreign suppliers of raw materials were generally chosen on the basis of "best quality" available.

## VII-3

Recent movements in the dollar were not sufficient to offset the importance of that quality. A producer of industrial and construction equipment noted that only two or three foreign suppliers could meet their quality standards. As a result, changes in the dollar were much less important than establishing stable ties to these suppliers. An economist for a heavy equipment producer mentioned that one foreign supplier of parts had become very aggressive in asking for price increases for new contracts. The dollar may be only a partial factor, according to this source, because the supplier's European market was so good that the supplier may have simply become less interested in selling to the U.S. market. A small producer of wire products stated that the cost of recently purchased capital equipment from Europe turned out to be less expensive than expected because of the dollar's rise, but no additional purchases would be made simply on the basis of exchange rate savings. An analyst of the machine tool industry attributed weak orders in that industry to domestic market conditions and regarded product quality and payment term differences between domestic and foreign machine tool producers as more important factors than dollar changes in the growth of imported machine tools.

Several domestic producers in direct competition with imported products cited special factors for recent changes in the growth of import sales. An economist for the cement industry noted that most of the industry's imports come from Canada or Mexico, and a dumping suit has recently been brought against Mexico. Cement imports from Europe peaked in 1987 and have been declining because of rising freight costs and strengthening demand for cement in the European market. A contact in the steel industry reported that it is still too early to know what the effect of the rising dollar on steel imports is going to be. However, much of the Japanese steel now being imported is going into the auto industry, particularly the transplants. Joint ventures with Japanese auto producers to make high performance steels in domestic plants have recently been established that will help domestic producers replace Japanese steel on a progressive basis over the next year regardless of dollar movements.

Retail-related Activity. The higher dollar has had some impact at the retail level, both through retailers purchasing more imported final goods and through direct competition between

VII-4

foreign and domestic auto dealerships. An analyst for a major discount chain stated that their contracts with foreign suppliers typically are written six months in advance of delivery, so that recent rises in the dollar will not effect their sales for some time. In addition, contracts typically are not rewritten unless the dollar's value changes more than 5 percent, which eliminated from consideration most of the countries from which they order. Taiwan and Korea, however, were cited by one retailer as becoming more aggressive in competing for the retailer's orders, even though the dollar has changed little against these currencies. As a result, some orders were being shifted away from domestic producers.

An economist for the auto industry stated that the rise in the dollar was allowing import car dealers to offer better sales incentives than six months ago. That added competitiveness has kept pressure on domestic auto dealers and producers to retain sales incentive programs in order to expand sales and reduce their inventories. A recent study estimated that Michigan would loss another 170,000 jobs in its auto industry (roughly one quarter of the state's auto-related jobs) because of intensifying worldwide competition. However, that job loss was attributed to many long-term factors, rather than to recent movements in the dollar.

VIII-1

EIGHTH DISTRICT - ST. LOUIS

Special Theme Report - Trade Sector

Summary

Recent trends in export activity in the Eighth District are mixed. For example, District exports of metal products and equipment are generally flat or are declining, with no expectations of a pickup in the remainder of the year; lumber, coal and poultry exports, on the other hand, are expanding. Specific factors in individual industries and products appear to account for most of the recent shifts in exports; however, the recent rise in the U.S. dollar against the yen has reduced some exports and is expected to dampen them in 1990. Most contacts believe export opportunities in Eastern Europe are limited this year, but could prove significant in the long run. Decisions by U.S. firms to locate their production facilities abroad have been propelled more by lower labor and energy costs than by exchange rate changes. The intensity of import competition in the United States varies considerably by industry.

Exports and Export Competition

Primary and fabricated metals manufacturers report generally flat to declining exports in 1990, compared with 1989. One contact, who reported moderate export growth so far this year, expects a sharp slowdown in the second half of 1990. Several contacts indicated that exports of homogeneous metal products were sensitive to exchange rate changes and that the falling yen has allowed Japanese producers to regain a competitive position in the world market. One manufacturer of brass products indicated that increases in the value of the deutsche mark since the mid 1980s had eased German

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## VIII-2

competition in the U.S. market but, in the short run, the growth rates of firms using brass are generally more important than exchange rates in determining brass trade.

Exports of electrical, cutting tool and printing equipment have ranged from slightly weaker to down significantly in early 1990, relative to 1989. One electrical equipment manufacturer reported that new export orders have dropped about 20 percent. Several factors have contributed to the slowdown, including sluggish growth and hyperinflation in South America. In contrast to the other equipment and machinery manufacturers contacted, one producer of soft-drink-dispensing equipment has experienced export growth in the Pacific Rim, but noted that the low value of the yen could jeopardize efforts to enter the Japanese market. This producer's Japanese distributors want price guarantees in yen. Most of these equipment and machinery manufacturers see Eastern Europe as a potential export market, but believe that a lack of hard currency will prevent these countries from being significant equipment importers for the next several years.

Contacts in other industries, such as rubber, chemical and plastic manufacturing, report mixed export activity. One tire manufacturer has noticed no significant change in exports or export competition recently. Plastic exports to markets in which U.S. firms compete with Japanese firms are facing extreme price pressure from the falling yen and are not expected to expand for the remainder of the year. Agricultural chemical exports, however, are expected to increase in the second half of 1990.

Providers of export financing report mixed results, depending on industry and country of destination. One banker indicated that export letters of credit were up 40 percent in the first quarter relative to 1989, largely because of rising exports of capital goods and medical equipment. Another

## VIII-3

banker reported no growth in export financing in the first quarter. Two contacts indicated that the lag between order placement, when prices are usually set, and shipment of goods was largely responsible for relatively recent stable exports to Japan. Bankers also indicate the falling value of the yen has hurt earth-moving equipment sales by U.S. firms, and slower economic growth in Korea has slowed exports to that nation. Exports to Mexico, including nonferrous metals, printing equipment and petroleum cracking equipment, however, are expanding rapidly because of changes in Mexico's foreign investment laws and the privatization of industry.

Coal exports are expanding at a 6 percent annual rate in 1990, relative to 1989. A build-up in foreign inventories was suggested as one possible reason for the increased coal exports. Contacts were divided over whether coal exports would rise in the short run from changing political conditions in Eastern Europe, but agreed that long-run export potential exists.

Forest product exports are also up slightly thus far in 1990. While plywood exports are flat, lumber exports are up as much as 10 percent over a year ago. Exports of logs, lumber and/or veneer to Romania, Yugoslavia, East Germany, the Soviet Union and Spain have increased, while exports to Japan are falling. Contacts cited relatively high Japanese inventories as the most significant factor accounting for declining exports to Japan. Increased housing demand in East Bloc countries, strong economic growth in Spain and a tax on Indonesian hardwood lumber exports all have contributed to increased hardwood lumber exports from the United States. Finally, poultry exports are considerably better in the first part of 1990 than they were in 1989. The growth in exports has stemmed from increased exports of chicken parts to the Soviet Union and Romania.

### Production Abroad

One electrical equipment manufacturer indicated that lower labor costs were more important than exchange-rate fluctuations in the decision to shift some production to Mexico, Venezuela and Canada. Relatively high U.S. energy costs, which will likely escalate when clean air legislation is enacted, have eliminated new aluminum plant building in the States. New plants are being or will soon be built in Quebec, Iceland and Brazil, where energy costs are lower and legislation less restrictive. Exchange-rate changes were not a major factor in the decisions to shift new aluminum production overseas.

### Import Competition and Imports

Over the past few years, decisions in unfair trade cases against firms in Europe, the Far East and South America have eased foreign competition in the United States for domestic producers of some aluminum and brass products. In recent years, some foreign steel producers found they could sell their products for better prices elsewhere, and thus import competition for U.S. steel sales has also been limited. Of two equipment manufacturers that reported import competition from Europeans in the U.S. market, one stated that exchange-rate fluctuations were more important than quality, while the other reported the opposite. Domestic prices of some equipment have been held down by import competition. Although Japan is a major competitor in the U.S. tire market, exchange-rate fluctuations are of little consequence, according to a manufacturer, as Japanese firms are willing to sacrifice profit margins to keep their market share. One firm that imports components from Korea reported no recent changes in price, while another importer continued to buy Japanese equipment because it remained relatively cheap and was of higher quality. In addition, the importer received better service from the Japanese exporter. An importer of Taiwanese plywood reported no changes in this market.

Federal Reserve Bank of Minneapolis

April 30, 1990

Special Report  
on  
"Trends in Exports and Imports in the Ninth District"

We contacted firms from a diverse group of industries in the Ninth District to assess recent developments and prospects for imports and exports. For the most part there has been a slight slowing of exports recently but expectations for continued growth prevail. The assessments of the relative importance of exchange rates versus other factors for export performance are quite mixed. Almost all firms contacted are optimistic about increasing exports to Eastern Europe, but not in the short-term. Finally, there was not much evidence given for large changes in competition with foreigners, or for domestic firms shifting between foreign and domestic suppliers and between foreign and U.S.-based foreign suppliers.

Some insights can be gained by considering the answers to specific questions. In terms of real trends in exports, about two-thirds of the group have experienced no recent slowing of exports; and of those who have, most said it has been moderate. Almost all of the respondents, though, expect exports next year to grow about the same or faster. The perceptions of the relative importance of exchange rates, aggregate demand and restrictive trade practices on exports are a completely mixed bag.

Most of the firms have not experienced significantly slower growth in sales in specific markets, although a few mentioned some slight slowing in Western Europe. Nearly all of the firms are optimistic about future prospects in Eastern Europe, although many expect these to take at least several years to develop. Most of the firms do not do much business with Latin America: of those who do there was a mixture of opinions.

In terms of foreign competition in third markets, about three quarters of the respondents feel competition has been keener with Asian nations than with those in other areas. Nonetheless, few have cut their prices or profit margins to keep sales up. In terms of competing domestically against the imports of foreigners, about half of the

firms surveyed perceive greater competition. Of those who do, nearly all feel that price competition has been important but they also mentioned foreign demand, new product innovations and a wide assortment of other industry-specific nonprice factors. Not many firms have held down their prices because of import competition.

In terms of domestic firms shifting suppliers there is scant evidence that domestic firms have been shifting either to foreign suppliers or to foreign-owned suppliers in the U.S. There is moderate evidence that the prices of imported inputs have fallen. Few firms think that the decline in the dollar in 1987 has been much of a factor in determining relocation of foreign production to the U.S. There is also little evidence that foreign firms in the U.S. depend more heavily on foreign inputs compared to their domestic counterparts.

X-1

TENTH DISTRICT - KANSAS CITY  
Special Theme Report  
April 27, 1990

Tenth District manufacturers are optimistic about both their short-run and long-run abilities to compete in world markets, despite recent increases in the value of the dollar. Manufacturers intend to be selective, however, in choosing the international markets in which they will compete.

About one-fourth of the manufacturers surveyed in the Tenth District reported slower growth in their export sales in recent months. But more than half reported no change, and a few reported definite improvement. Moreover, most manufacturers have positive expectations, with more than half expecting some increase in sales in coming months.

Demand growth abroad and exchange rate changes were rated about equally important as determinants of recent and expected performance in export sales. While several respondents reported that foreign demand was the most important factor for their exports, almost as many respondents ranked movements in exchange rates as the major factor for their exports. Several respondents gave equal weight to demand growth and exchange rate movements. Other factors affecting price competitiveness of U.S. products in world markets received little mention. A number of respondents complained of restrictive trade practices in various foreign markets but considered such practices only a minor effect on export sales.

Only a few manufacturers reported that sales were changing more noticeably in some foreign markets than in others. Where such responses occurred, actual and expected increases in Asia were most evident.

Most respondents have considered the impact of developments in eastern

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Europe on their sales. Slightly more than half believe the potential is good for increased sales, although sales efforts have barely begun. About one-fourth of the respondents expect developments in eastern Europe to have little or no effect on their sales. One firm believes its products are too sophisticated for the area's current stage of development in transportation and health care delivery systems. Another firm believes its major competitors--Swedish and West German firms--are better positioned to take advantage of opportunities in eastern Europe. But the remaining one-fourth of the respondent firms are considerably more optimistic. One firm, which already sells to the Soviet Union and East Germany, expects increased sales. A maker of farm irrigation systems views East Germany as an especially favorable market. A maker of small electrical home appliances sees no short-run effect on its sales but expects good opportunities in five to ten years as consumer goods markets develop. A light aircraft manufacturer expects increased sales, first in western Europe as travel into eastern Europe expands, and then in eastern Europe in five or six years as sales opportunities emerge there.

Virtually no firms speak favorably of increasing sales opportunities in Latin America. Respondents mention a number of difficulties in the area--inflation, currency controls, political instability, bad credit--that restrain their desire to expand there. A light aircraft manufacturer with significant sales to Latin America in the past expects those sales to lessen, while sales to Pacific Rim and southeast Asian countries increase.

Intensity of price competition with Japanese firms varies according to industry and markets served. Two firms are more competitive with the Japanese than they were two or three years ago. But other firms report the opposite.

X-3

For example, one firm finds its sales efforts in Europe being strongly met by the Japanese, while another is engaged in a fierce price battle with a Japanese competitor.

Few firms find price competition as intense with European firms, although there are exceptions. One capital goods maker and one consumer products firm report very aggressive price competition from European firms. Besides competition from Japan and Europe, little intensification of competition was noted.

About half of the firms queried have accepted lower prices and profit margins in order to maintain their foreign sales. Some respondents identified fierce head-to-head competition or the desire to enter new markets as the reason for accepting lower prices and profit margins. Other firms cited the desire to retain market share as the reason for absorbing some of the effects from a higher dollar in profit margins.

Increased import competition in the U.S. market was noted by slightly more than half of the responding firms. While price competition is the major factor, product competition is also important in some cases due to the quality and reputation of the imports. Several respondents believe foreign government subsidies are important in bolstering import sales in the United States. Most respondents believe domestic prices are being held down by import competition, but they generally believe the impact is slight. Import competition for respondent firms comes mainly from Japan and Europe (particularly Sweden, West Germany, Great Britain, and France). One specialized transportation equipment manufacturer has lost market share due to imports from Finland, Canada, and Brazil.

Very few respondent firms are shifting from domestic to foreign

X-4

suppliers. A few firms have shifted either because of lower prices or better quality of the imported goods.

About two-thirds of those responding thought the decline in the value of the dollar through 1987 was quite important in bringing foreign-owned production facilities to the United States. Few respondents believe that more recent exchange rate movements have much affected such relocations. Respondent firms have not shifted away from suppliers with overseas production facilities to foreign-owned suppliers with domestic facilities. Two-thirds of the respondents believe that foreign-owned firms operating in the United States depend more heavily on imported supplies than on domestically produced supplies.

XI-1

ELEVENTH DISTRICT--DALLAS

While fluctuations in foreign exchange rates were perceived as important influences upon trade in the District, many respondents felt that other factors were at least as important. Most firms said their exports had risen or were unchanged in the last few months, while a smaller majority said that competition from imports had not increased. Nevertheless, with regard both to exports and imports, there was great variance in the experiences of individual firms. Although some general patterns may be seen from surveys of import and export activity in the District, a number of important determinants of changes in merchandise trade are industry specific.

Exports

Most firms said that their exports had either increased or were unchanged in the last several months and, despite a good deal of uncertainty, their expectations were generally positive. Firms that reported declines were concentrated in the chemical and paper industries and these firms expressed some concern about future sales.

The major factors affecting both recent and expected export performance vary considerably among industries. A number of respondents noted the value of the dollar as having a long-run impact on their foreign sales, but most of these firms said that recent exchange rate movements had not yet affected their orders. In cases where respondents affirmed that exchange rate fluctuations had affected their sales, they tended to stress the dollar/yen rate, and usually had little to say about movements in the dollar against

XI-2

other currencies. These firms noted that movements in the dollar/yen rate resulted in acute price competition and were squeezing their profits.

Even with regard to Japanese trade, however, firms had difficulty separating the impact of exchange rate movements from other demand-related factors. For example, in addition to citing dollar/yen rate fluctuations as leading to lower orders, a paper firm noted that its sales to Japan had weakened because of what appeared to be inventory adjustments by its purchasers. A telecommunications firm said that, in the Japanese market, price competition is tough but that it had not been worsening.

Particularly among steel and chemical firms, expansion of productive capacity abroad was also cited as having made foreign price competition tougher. In steel, growth in Japanese capacity was noted as particularly significant. In chemicals, expansions in Middle Eastern capacity received mention. On the other hand, a large fabricated metals firm noted that its export sales had risen considerably because it sold products used in the construction of Middle Eastern petrochemical plants.

Several firms cited protectionism in general, and discriminatory treatment of different nations' exports in particular, as creating problems in penetrating some foreign markets. Nevertheless, there was little mention of recent changes in protectionism. A steel firm noted that duties on its products hurt its competitiveness in foreign markets. A paper producer discussed the advantages that the Generalized System of Preferences offers newly industrialized countries in penetrating European Community markets. While U.S. firms are subject to a 9% duty on sales of some products, Brazil can ship duty free.

XI-3

A number of District exporters focus their foreign marketing efforts upon Mexico and most said their sales to this market are increasing. Some firms noted credit problems with their Mexican buyers, however, including purchaser difficulties in getting credit or problems in securing payments from Mexican purchasers. A can company complained that a 15% tariff on can imports impeded its competitiveness in Mexico and noted that Mexican can companies exporting to the United States do not have to pay an import tariff. None of these difficulties were noted as new events, however.

More generally, anticipations of future sales to Latin America are somewhat positive, but chiefly as a long-run phenomenon. An electronics firm, however, expects increasing near-term opportunities for sales to Latin America. Most respondents were less positive about potential Latin American export growth than they were about expansion as a result of events in eastern Europe.

Quite a few firms said they expected the opening of eastern Europe to have positive effects on their foreign demand, but scarcely any had already benefitted from such trade. An oilfield equipment firm mentioned that a major problem in dealing with eastern bloc countries is their lack of hard currency and said that it will be difficult to do much business with them until this situation improves. Some firms felt that the benefits to be derived from eastern Europe would initially be indirect. An electronics firm, for example, expects to sell more electronic components to its western German buyers, who will use them as inputs for products to be sold in eastern Europe.

### Imports

The majority of surveyed firms reported no significant recent increases in domestic competition from foreign sellers, but a fairly large minority of respondents said such competition had lately intensified, and that most of the competition involved price cutting. Although a steel firm representative cited recent increases in domestic competition from Japanese producers, he noted that it was not nearly as acute as it had been during the middle 1980s. Glass and can industry respondents said they faced increased competition from Mexican sellers, despite the high value of the peso. A lumber firm cited greater competition from Canadian producers, while a chemical industry representative said domestic competition from Canadian and Saudi Arabian methanol manufacturers had intensified. Several paper firms reported increased price competition in the United States from Japanese manufacturers.

These claims about increased competition were corroborated by respondents who have increased their purchases from foreign sellers. Several firms that use steel said they had stepped up buying from foreign producers, including steelmakers in Italy and Korea, as well as Japan. A fabricated metals firm noted that the stronger dollar and increased foreign capacity have made foreign steel more competitive. A can company reported that Japanese steel prices were 5% to 8% cheaper than what U.S. firms charged it. An electronics firm mentioned that it was increasing its purchases of inputs made in Mexico.

Conversely, some firms have been cutting back on foreign purchases. One major department store chain said that it was cutting back on imports, while another said that it had shifted towards U.S. sources several years ago. A

large electronics firm said that the share of domestic products it used as inputs was being increased.

Foreign Investment in the United States

Although some respondents believed that the decline in the dollar through 1987 was a factor in the relocation of foreign-owned production facilities to the United States, none believed it was a dominant factor. One firm did say, however, that the level of relocation activity had declined simultaneously with the strengthening of the dollar. A lumber producer noted that it had shifted machinery purchases from suppliers abroad to foreign firms that have located in the United States.

**XII - 1**

**TWELFTH DISTRICT -- SAN FRANCISCO**

**Summary**

Most reports from western business leaders suggest that trade activity has not yet responded appreciably to the increased value of the dollar relative to other currencies. A few exchange rate-related changes in export markets have been reported, but most reported changes in export markets are attributed to industry-specific factors. However, several respondents representing a wide range of industries expect that their exports will ultimately deteriorate if the value of the dollar remains at its current level, although their views of the U.S. trade balance have not changed appreciably in recent months.

**Business Sentiment**

During recent months, there has been little change in western business leaders' expectations about the U.S. trade balance. In April, 44 percent of respondents expected the trade balance to improve during the next year, while 24 percent expected it to deteriorate. These figures are largely unchanged from responses in March 1990 and in April 1989.

**Trade and Services**

A department store retailer reports that the financial problems of some large chains have reduced the amount of clothing imported to the U.S. In recent years, several large retailers opened buying offices in the Far East to buy merchandise directly from producers. Financial problems have led Asian producers to cut off lines of credit for troubled U.S. retailers, and some of the direct-buying offices have been closed. These events, rather than changes in the value of the dollar, have led to reductions in imported clothing, and consequent increased demand at domestic suppliers. This retailer has not noticed any upward price movements yet.

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## XII - 2

Reports on tourist activity indicate that the number of visitors to the U.S. from other countries continues strong. There has been no dropoff in the number of visitors to Hawaii from Japan, and spending by Asian tourists in Hawaii remains high. At Los Angeles International Airport, the number of international passengers has grown by 14 percent during the past year.

### Manufacturing

The rising value of the dollar has not yet affected most western manufacturers. An avionics manufacturer reports strong activity in new orders from abroad, particularly Canada, Germany, and Great Britain. A company that exports copper powders for a variety of metallurgical specialty applications reports that export demand for these products remains strong. A retailer of heavy equipment reports that he has not noticed a significant increase in the number of foreign-made construction machines coming into the country.

In fact, some observers report that exports currently are increasing. A metals manufacturer reports that aluminum scrap prices have escalated in Japan and other parts of Asia, which is stimulating aluminum exports. A western banker reports that he has seen some evidence of increased export activity by businesses in specialized niches such as precision machine tools, scientific instruments, and safety airbags for automobiles. Reports suggest that production at one western steel company is up over last year. One respondent notes that many exporters see eastern Europe, especially Poland, as an attractive market. He notes that strong demand for technology and the present lack of an efficient price system make eastern European firms relatively insensitive to price changes.

However, a few firms have noted more difficulty selling their products abroad. Some California exporters report a slowdown in demand for consumer products in Japan. Others report that Korean producers of television components have begun to undersell U.S. exporters in China (PRC) and Mexico. In addition, while most other reports indicate that the U.S. trade balance is

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not currently deteriorating, many respondents expect exports to fall if exchange rates remain at their current levels.

### Agriculture and Resource-Related Industries

Trade conditions in agriculture and resource-related industries are mixed, but the changes that have occurred generally have been due to factors other than exchange rate changes.

Produce exports are holding up well, and most reports from California indicate continued strong farm export activity. A California vintner expects that wine exports will continue to grow. He thinks that European export activities will be concentrated more heavily on Eastern Europe in coming years, leaving other markets, including the growing Asian market, more accessible to American wines.

Reports are mixed regarding beef exports. A cattle rancher with strong ties to the Japanese market notes that the market there has softened, due to growing inventories and confusion over the outcome of beef liberalization due in 1991. Another rancher cites a positive outlook for exports, citing the Japanese market as well as a new agreement with Korea.

Exports of logs and lumber continue strong, but there are signs of weakening. One forest products firm reports that negotiations with Japanese buyers are much tougher than they were a year ago, and that the Japanese seem to be looking for alternative sources of supply. Most observers expect exports to fall during the next year. Total timber-cutting is being reduced substantially, and there is talk of restricting log exports since American mills are having trouble competing with foreign buyers for the dwindling supply of logs.

In the Pacific Northwest, seafood producers are particularly concerned about the impact of the higher value of the dollar. They export a large proportion of their production, with Japan the biggest customer. Changes in the dollar/yen exchange rate will put pressure directly on prices, and margins will fall since production cannot be adjusted once the year's harvest is complete.

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**Construction and Real Estate**

Western ties with foreign companies continue to become more important in construction and real estate ventures. A southern California developer reports that many second-tier Japanese companies are still heavily in the market, while a banker in Hawaii reports that most of the largest and most established Japanese corporations continue to invest heavily in Hawaii. Many Japanese corporations have been buying Hawaiian construction companies, apparently to establish a base from which to bid on projects on the mainland.

A large western contractor is increasingly teaming up with Japanese vendors, providing construction and engineering services while the Japanese firms provide equipment and financing. The increasingly favorable exchange rate should further enhance the attractiveness of such arrangements to American companies, while the Japanese seem to view an export push as a way to revive their weaker economy.