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CONFIDENTIAL (FR)
CLASS III - FOMC

TO: Federal Open Market Committee

FROM: Nancy M. Steele

Attached are special theme reports on "Effects of Dollar Depreciation" from each Federal Reserve Bank and a summary prepared by the Richmond Bank.

Attachments

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NATIONAL SUMMARY*

SPECIAL REPORT ON THE DEPRECIATION OF THE DOLLAR

Because of the uniformity of their findings, the surveys of the Reserve Banks of the effects of the dollar depreciation can be summarized succinctly. All the summaries of these reports began with a sentence like that from Boston: "First District businesses have seen little, if any, impact from the decline in the value of the dollar, with respect to either input prices or, in the case of manufacturers, their firm's ability to compete in domestic and foreign markets." The explanations for the lack of a significant impact to date are generally similar across Districts. It should perhaps be noted that while these explanations imply that the impact of the dollar depreciation will be delayed, they do not necessarily imply that it will be absent. Several Banks reported that respondents expect an impact in the months ahead.

Five reasons were offered for the absence to date of a significant effect on domestic prices. (The numbers in brackets identify the Districts making a particular comment.)

(1) Long-term contracts have so far prevented import prices from rising [2, 3, 5, 7, 10, 11]. A typical comment was, "The majority of companies contacted, however, have seen no increases in dollar import prices. Many companies attribute this to the prevalence of contracts of up to one year duration [2]." The long lag between purchases abroad and domestic sales was also cited [3, 4].

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*Prepared at the Federal Reserve Bank of Richmond.

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It was also mentioned that many exporters to the United States make long-term commitments in dollars and then hedge these commitments. This hedging was said to have allowed foreign exporters to maintain their dollar prices without eroding their profits [4, 10].

(2) Respondents frequently indicated that the impacts of changes in exchange rates on the domestic prices of imports are smoothed in a way that protects the market share of an import [1, 2, 3, 4, 7, 8, 10]. Importers make a fixed investment in order to establish a share of the U. S. market for their goods. "Current penetration of U. S. markets by foreign goods took many years. Much trial and error was involved in designing and producing goods to American tastes and specifications. Distribution networks and business relationships had to be created [7]." As the foreign exchange value of the dollar changes, the domestic prices of imports are changed only with a lag. In this way, changes in the exchange rate that prove to be transient are not allowed to affect the market share of an import.

(3) Two surveys noted that the nature of business relationships between domestic importers and foreign exporters caused a lag in the impact of exchange rates on domestic import prices [2, 10]. These relationships are costly to establish. Foreign exporters change dollar prices only infrequently because price rises set off a search by domestic importers for alternative, cheaper foreign sources. "The importance of business relationships was also cited as a reason to expect little effect on retail prices in the U. S. One company suggested. . . . It did not plan to change suppliers because of the importance of relationships, but it noted that it might find new suppliers if it had no cooperation in holding down retail prices [2]."

(4) There was also some indication that importers change the domestic price of an import in response to a change in the exchange rate with a lag

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because of the time required to determine whether a particular change in the exchange rate is permanent or transitory [1]. "Finally, some respondents emphasized that . . . the future path of the dollar is still uncertain. In particular, there is skepticism about whether the dollar will stay down relative to the yen [1]."

(5) Special factors have also prevented the dollar depreciation from raising import prices. Weakness of demand and excess capacity domestically in particular sectors have prevented domestic price rises in the affected sectors. Metal fabrication, food processing, chemicals, electronics, and specialty steel were mentioned [2, 4]. The fall in the dollar price of oil was referred to a number of times.

A number of Districts reported that some respondents expected the dollar depreciation to exert an influence on the price of imported goods [2, 3, 4, 5] in the period ahead. A typical comment was "Responses to the 1985 depreciation of the dollar seem generally consistent with historical experience. There has been very little effect on dollar prices of imports or exports so far. In two or three quarters, however, respondents do expect significant price changes. . . . One trade sector contact thought that new contracts would contain significant price increases that would appear sometime next fall [2]."

The minority of respondents that did report price increases on imports mentioned the following: television sets, cameras, consumer electronics, pulp, Japanese semi-conductor chips, wine, and European apparel [2, 5, 6, 7, 11, 12]. The Japanese were occasionally mentioned as the foreign exporters either raising prices or most likely to raise prices [2, 4], although this view was not universal [3, 10].

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Explanations for the failure to date of the dollar depreciation to stimulate exports were varied. Most commonly it was reported that the past appreciation of the dollar had rendered exports of particular items so uncompetitive on world markets that additional dollar depreciation would be required in order for exports to be increased [2, 3, 6, 7, 10, 11]. The constraining effect of shortages of foreign exchange on exports to Latin America were also mentioned [2]. One respondent reported that foreign importers are postponing placing orders in anticipation of a further decline in the value of the dollar [3]. Increases in exports are also reported to be restricted in some markets by foreign quotas [6, 7].

Opinions were mixed regarding the impact of the dollar depreciation on the future course of exports. Respondents in some Districts expected a pickup [1, 2, 3, 5]. For example: "Manufacturers view the decline as a positive development, and most expect an improvement in their competitive positions relative to foreign producers. . . . While they have not experienced any significant sales pickup yet, most manufacturing respondents expect that the decline will eventually have a positive effect. Some see the possibility of a noticeable improvement in spring or summer; others think that the lags may be even longer." Not all Districts, however, anticipated a pickup in exports in the foreseeable future [6, 10].

In a number of Districts, the firms surveyed expected that the demand for imports would remain strong in the near-term future. One reason given was that increased domestic competition has led to more outsourcing by firms. This trend would continue and would lead to additional foreign outsourcing [1, 7]. Also, foreign sources have developed specialized products not immediately available in the United States [4, 9]. It was also stated that even with a considerable dollar depreciation, foreign suppliers would still be cheaper

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than domestic suppliers in many cases [7, 10]. One Bank suggested that foreign government subsidies would maintain U. S. imports [7]. The same Bank felt that the effect of the dollar depreciation in discouraging imports has been offset to a significant extent by a decline in the cost of shipping imports due to worldwide excess capacity in shipping.

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FIRST DISTRICT-BOSTON

First District businesses have seen little, if any, impact from the decline in the value of the dollar, with respect to either input prices or, in the case of manufacturers, their firms' ability to compete in domestic and foreign markets. Manufacturers view the decline as a positive development and most expect an improvement in their competitive position relative to foreign producers. However, they consider the decline to date as rather modest and they expect the improvement to be correspondingly modest and slow in coming.

All the manufacturers contacted said they have seen no significant increases in input prices. While most of these firms rely primarily on domestic suppliers, those that do import also reported that input prices have been stable. One dissenting opinion came from a representative of a local business association, who said that producers are facing rising prices for foreign imports. Several manufacturers noted that the competitive pressures of recent years have forced their firms to engage in more outsourcing and more foreign sourcing; they expect this to continue. Indeed, two retailers reported plans to substantially expand purchases from Asian countries in the coming year despite the decline in the dollar; prices are still very attractive and the quality is good.

Most manufacturing contacts have not seen any change in their competitive position, either in the United States or abroad, resulting from the dollar's decline. The exceptions were a producer of industrial

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supplies that has regained market share lost when the dollar peaked last spring and a high tech company that attributes a turnaround in European sales to the dollar's decline. Even these exceptions are somewhat questionable. The producer of industrial supplies improved its product and entered new markets at the same time as the dollar declined. Other contacts also experienced an upturn in European sales, but attribute this to a strengthening in the European economy rather than changes in exchange rates. One firm reported an undesirable result of the dollar's fall: customers of its Asian subsidiary are asking for lower prices on the grounds that the subsidiary is now paying less for products from the U.S. parent.

While they have not experienced any significant sales pickup as yet, most manufacturing respondents expect that the decline in the dollar will eventually have a positive effect. Some see the possibility of a noticeable improvement in spring or summer; others think the lags may be even longer. Commodity-type products are expected to be affected sooner than products with a large and changing technology content. Firms that face severe foreign competition in the United States, for example, textile and traditional machine tool firms, seem less optimistic about the prospects for improvement than those that compete with foreign producers primarily through exports. One machine tool representative, commenting on Japanese competition in the United States, expects no benefit from the dollar's decline; he argues that the Japanese are rationalizing their industry to cut costs and will go to great lengths to protect market share. Even export-oriented firms expect the sales gains to come from

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Europe rather than from Japan. Contacts see the Japanese market as very difficult to penetrate.

Finally, some respondents emphasized that the dollar has not yet fallen very far, except in comparison with a brief peak, and that the future path of the dollar is still uncertain. In particular, there is skepticism about whether the dollar will stay down relative to the yen. However, all manufacturing contacts view the decline to date as a positive development, if only for the psychological lift it has provided.

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Second District - New York

Theme Report on Responses to Dollar Depreciation

Responses to the 1985 depreciation of the dollar seem generally consistent with historical experience. There has been very little effect on dollar prices of imports or exports so far. In two to three quarters, however, respondents do expect significant price changes. Until now, our respondents have seen virtually no changes in orders or shipments nor do they anticipate changes in the next two quarters. The most prevalent and immediate effect of depreciation has been sizable translation gains in foreign subsidiary profits.

Changes in Dollar Prices of Imports

Import price increases were reported in TV's, cameras, pulp, and European apparel. Only one retailer reported widespread increases in import prices. Further increases in camera prices were expected even without further depreciation. Domestic camera prices were not being raised so that positive effects on domestic output were expected.

The majority of companies contacted, however, have seen no increases in dollar import prices. Many companies attribute this to the prevalence of contracts of up to one year duration. One trade sector contact thought that new contracts would contain significant price increases that would appear sometime next fall.

Weakness of demand or excess capacity was frequently cited as a reason for the absence of import price increases.

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This situation was reported in the metal fabrication, food processing, chemical, and electronics industries. It was not clear whether this weakness meant that non-dollar prices were lowered for all importing countries or just for U.S. importers.

The importance of business relationships was also cited as a reason to expect little effect on retail prices in the U.S. One company suggested that both it and its foreign suppliers would be likely to reduce their profit margins, if necessary, to minimize any increase in retail prices. It did not plan to change suppliers because of the importance of relationships, but it noted that it might find new suppliers if it had no cooperation in holding down retail prices.

Japanese manufacturers were often singled out. One toy importer reported rapid price increases and had switched to suppliers in Hong Kong and Korea where the value of the dollar has been relatively steady. Another firm reported that Japanese fabric manufacturers were already high cost suppliers and he thought they might have difficulty in remaining competitive with other Asian manufacturers. One contact reported that Japanese manufacturers of ball bearings were aggressively reducing yen prices in order to maintain market share in the U.S. He had been told that his Japanese competitors were willing to avoid passing through the effects of dollar depreciation until the exchange rate reached 180 yen per dollar. One manufacturer that imports from his Japanese subsidiary suggested that he was considering bringing the operation back to the U.S. because Japanese sourcing was becoming more costly relative to domestic production.

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Conditions in the apparel industry were varied. One retailer that caters to high-income consumers reported that its European imports are attractive for their quality and uniqueness. Import prices are rising and the increases will be passed on to retail prices. One broad-range national retailer reported that price increases made it worthwhile to shift from European suppliers to Asian suppliers, even though that meant that it had to deal with the "hassles" of quotas on imports of Asian goods. He considered the trade fairs in the next two months to be crucial determinants of price increases for next fall. However, two other major retailers generally had seen no price increases in apparel and they contemplated no changes in suppliers. Only one contact reported any increase in prices from domestic apparel suppliers.

Electronics imports were also discussed separately. TVs, which are imported as parts and assembled in the U.S., had immediately increased in price and this was being passed on to U.S consumers. Assembled VCRs and other electronics were such competitive items, on the other hand, that some contacts reported that dollar prices were still falling and might continue to fall for another six months. Only then might dollar depreciation lead to price increases. Some contacts suggested that the Japanese have a reputation for quality that has allowed them to maintain higher prices without losing market share; however, Japanese firms have lowered yen prices somewhat in recent months. One importer suggested that, if the dollar declines much more, the price margin over other Asian manufacturers may exceed the quality margin and he might shift

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to non-Japanese suppliers. He had already been approached by Hong Kong manufacturers. A major retailer who is already paying higher import prices reported that "cut throat" competition prevented him from passing the increase on to consumers. If the increase became large enough, he would consider changing suppliers.

Effects on U.S Exports

The benefits of dollar depreciation to U.S. exports were less discernible. One manufacturer of heavy equipment reported that he had become so uncompetitive due to past dollar appreciation that a much larger depreciation would be necessary before exports could become feasible. An exporter of sporting equipment to Latin America reported that foreign exchange shortages were as much a limitation as was the level of the dollar. A toy exporter expected sales to Latin America and Europe to return to pre-1985 levels only if there was substantial further depreciation.

Most contacts in the manufacturing sector reported no changes in export orders or shipments or in dollar prices of exports. One group suggested that the time had been too short and the depreciation too limited to have any effect on shipments. One apparel exporter expected shipments to pick up in six months. Export margins for pulp are already increasing and one company expected to increase exports further.

Value of Subsidiary Income Abroad

Several contacts in the manufacturing sector reported that the depreciation of the dollar had immediately increased the dollar value of their earnings from their subsidiaries abroad.

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THIRD DISTRICT - PHILADELPHIA

Manufacturers and retailers in the Third District say that the depreciation of the dollar in foreign exchange markets has not yet had a substantial impact on their business or prices. Minimal increases in the prices of imported inputs are reported by about half of the manufacturers contacted for this report. Prices of domestically produced inputs have been stable. Local manufacturers say that the dollar's decline has not helped them boost foreign sales yet, but that a continued drop could eventually improve their export price competitiveness. Nearly all the manufacturers surveyed report that their foreign competitors in U.S. markets have been maintaining steady prices. Some local manufacturers, especially durable goods makers, expect their overseas competitors to be forced to raise prices in the near future, but cannot say by how much.

Retailers purchased most of the foreign goods they will sell in 1986 last year, before the dollar declined substantially. Thus, the lower dollar has had no effect on their business yet. Purchasing agents will make overseas buying trips this winter and cannot yet say what price developments they may find.

MANUFACTURING

Third District manufacturers who import raw materials and intermediate products do not report widespread increases in the cost of these supplies in the months since the dollar's foreign exchange value has declined. About half of those contacted say they are beginning to notice some price increases, but that

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these have been slight so far. None has been above 5 percent. The limited price hikes that have been noted have been on products imported from a variety of countries; however, no Japanese imports have increased in price. Price developments have been similar in both durable and nondurable goods industries, and for makers of producer and consumer products alike. Thus, the current situation is not broadly changed from a few months ago; however, most companies say they sign long-term contracts (up to a year) for imports, so their import costs lag exchange rate changes.

Manufacturers generally report that the prices they pay for domestically produced inputs have been stable in recent months. According to manufacturers who can choose between foreign and U.S. suppliers, American companies have usually matched price cuts by their foreign competitors in the past. Nevertheless, none of the companies contacted were willing to speculate on how their domestic suppliers would react to price increases by foreign suppliers.

With respect to the export market, the general opinion of Third District manufacturers is that a continued decline in the dollar would benefit them somewhat in the future; but most believe they will not be sufficiently competitive on prices overseas until the dollar's appreciation of the last several years is more completely retraced. For example, a producer of computerized industrial controls who exports to Germany said he would not be able to regain his former market share in that country until the dollar fell to 2.2 Deutsche marks or less. And, a producer of auto parts for the after-market said his foreign customers are giving him smaller and more frequent orders in anticipation of further depreciation of the dollar.

Third District manufacturers contacted for this report were unanimous that the prices of foreign products competing with their own have not increased in recent months, and that they have kept their own prices in check as well.

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Contacts in the producers' durables industry attribute this to the fact that many of these products are now at least partially manufactured in the U.S. Therefore, the effect of the weaker dollar on the prices of such "foreign" goods has been offset to some degree. Most manufacturers believe that their foreign competitors are likely to raise prices in the future, however, but none feel confident in forecasting when or by how much. Makers of durable goods are more certain than others that foreign price increases are imminent. For example, one such manufacturer was told by buyers in his industry that Japanese suppliers would raise prices if the dollar remained below ¥200 for a significant period. Makers of consumer nondurables (e.g., clothing, food products) do not foresee higher prices for competing imported products. They believe foreign producers will absorb the revenue reduction associated with the weaker dollar in order to maintain market share. Domestic manufacturers say U.S. price supports for inputs they use, along with import restrictions on these commodities, raise the cost of their raw materials above world prices and give foreign producers this pricing flexibility.

RETAIL

Large Third District retailers have been unaffected by the dollar's recent drop because the imported products they sold in 1985, and will be selling during the first two-thirds of 1986, were purchased before much of the decline in the dollar took place. In the next few weeks retail purchasing agents will begin making their overseas buying trips for fall merchandise, bhave no indications at this time as to how much higher this year's prices will be. However, they say they are not committed to buying foreign products and may not renew contracts with all foreign suppliers if the weaker dollar gives American producers a price advantage or results in a smaller gap between foreign and domestic prices.

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Retailers say that regardless of what happens to the foreign exchange value of the dollar in coming months, the prices of some imported products are unlikely to be raised. One contact noted that a large portion of imported apparel comes from countries whose currencies are pegged to the U.S. dollar and are thus unaffected by variations in its value. And, although retailers are exposed to price changes in electronics resulting from the stronger Japanese Yen, competition among companies in this industry has maintained downward pressure on the prices of these goods.

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FOURTH DISTRICT - CLEVELAND

SPECIAL THEME REPORT
ON EFFECTS OF DOLLAR DEPRECIATION

Imported Inputs.

Fourth District firms contacted report no price increases for imported inputs, but suggest several reasons for the apparent lack of response to dollar depreciation. Weak markets were cited by a specialty steel producer as the reason for continuing declines in prices for steel alloying materials, and by a tire producer for continuing declines in prices for natural rubber. Another firm reported that many commodities are imported from Canada and Latin American nations, countries against whose currencies the U.S. dollar has depreciated little if at all. Oil is a major input for chemicals producers, but it is priced in dollars and not affected by depreciation. A major steel producer reported that the low level of steel capacity utilization here and abroad has kept imported and domestic steel prices from rising and will continue to do so, at least for the next few months.

Imported Finished Goods.

A major retailer reported that most imported goods merchandised during the Christmas selling season had been ordered early enough in 1985 that there had been little effect from dollar depreciation. Consequently, the price impact was near zero. Goods ordered later in the year and arriving early in 1986 will start showing price increases. So far, domestic

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suppliers have not increased prices because they want larger market shares. This retailer and others will fully pass through to customers all price increases on imported goods.

The three major U.S. auto producers were contacted. They reported that Japanese auto makers earn 85% of their profit in the United States so it is important to them to maintain their margins. About half of the production cost of Japanese cars is for dollar-denominated inputs, so costs do not rise by the same percentage as that by which the yen appreciates. Moreover, Japanese auto producers had hedged the yen through the end of March 1986, and that is supporting their yen profits, so they have less need to raise dollar prices. Japanese auto producers have raised their dollar prices again, by 2% to 4%. U.S. retailers of Japanese cars have absorbed some of the increase by narrowing their profit margins because quotas are less binding than in the past. Domestic U.S. car producers will not raise prices just because the Japanese do.

Another firm commented that for products where dollar-priced oil is a major input, foreign producers' costs have fallen in their own currencies and so dollar prices are less likely to rise.

Shifting to Domestic Suppliers.

A major producer of auto parts reported that unless the yen per dollar exchange rate were to fall below 180 or 170, and were expected to stay there a long time, it will be cheaper for the firm to continue obtaining many auto parts from its joint ventures in Japan than to switch to North American production.

A major retailer reported that it may take another 10% to 20% dollar depreciation before there will be much shifting of orders to domestic suppliers.

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Differences Among Countries.

A major retailer reported that European suppliers have much fatter profit margins than Japanese suppliers. They seem to be absorbing much more of the dollar depreciation than are Japanese suppliers.

A major producer in the capital goods industry reported that, prior to last September, Japanese producers of semi-conductor chips absorbed the changes in the yen-dollar rate and didn't raise prices. That narrowed their profit margins so much that, since September, those producers have raised the dollar prices of chips "point for point" with changes in the yen-dollar rate. In contrast, there have been no dollar price increases on machine tools imported from Germany. Another contact commented that responses to dollar depreciation are more dependent on a company's cost, profit margin, and competitive situations than on its country of residence.

Domestic Producers' Sales and Prices.

Eight major manufacturing firms commented on this issue. None had implemented price increases that could be attributed to dollar depreciation. Two reported an increase in sales because of dollar depreciation, and six reported no increase, nor even additional inquiries.

Expectations for Sales and Prices.

A major retailer expects price increases to be seen soon at the retail level but expects it will take all of 1986 for the full price effects to be seen from the dollar depreciation that occurred in 1985.

Manufacturing firms contacted were evenly divided between those who expect to maintain their current prices even if imported substitute goods rise in price and those who would raise prices, but by less than imported

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goods prices rise. None of the firms contacted would fully match import price increases. One firm noted that it would raise prices on items for which its capacity utilization is satisfactory and would not raise prices on items for which it has too much idle capacity.

Of U.S. manufacturers that export, one reported it would raise its own dollar prices for exports by the full amount of any additional dollar depreciation, two would raise prices by less than the full amount of additional depreciation, and three firms would not raise their prices at all. One noted that its price decisions would differ among products and would be based on whether its capacity utilization was satisfactory.

Seven of eight firms contacted expect their foreign competitors who export to the United States to pass through only part of the depreciation in the form of higher dollar prices; only one firm expected its foreign competitors to absorb all of the depreciation by narrowing its margins. None expected the full amount of depreciation to be fully passed through into higher dollar prices.

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FIFTH DISTRICT - RICHMOND

SPECIAL THEME REPORT
THE DECLINING VALUE OF THE DOLLAR
JANUARY 29, 1986

The effect of the declining value of the dollar on Fifth District businesses has so far been fairly limited. The large majority of businesses surveyed stated that they had seen very little change due to the decline. Many respondents said it was too early to measure the change because many contracts written before the decline were still in force. A few respondents, however, noted significant changes in the prices of imported goods, and one large industrial company indicated that its competitive position had improved significantly in overseas markets.

The manufacturers contacted provided varied information about the prices of imported inputs. A furniture manufacturer noted no increased prices for metal parts produced in Ireland or Italy. Metal products manufacturers have experienced little change in the prices of imported raw materials and no change in the prices of imported equipment. Most textile industry manufacturers said they have made no significant purchases of imported materials recently. One large textile firm was in the process of purchasing new capital equipment and had received higher price quotes from all of its foreign suppliers (Japanese prices up 8% to 13%; Swiss prices up 22%; German prices up 6% to 8%).

The decline in the value of the dollar has led no responding manufacturers to shift purchases to domestic suppliers of raw materials or equipment. Because of the respondents' lack of interest in domestic suppliers, no substantive information was available concerning the price response of domestic competitors of foreign suppliers.

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Firms that actively import finished goods said they have seen some price increases due to the decline of the dollar. The strength of this effect has been strongly dependent on the product's country of origin and the type of product. Respondents representing department store chains maintained that while Japan and other Asian countries have raised prices very little on most products, European and British producers of clothing have raised prices considerably. One respondent said that while clothing manufacturers located in the Orient have raised prices by no more than 5%, those in Europe have increased prices by 20%-25%. She said this factor has led wholesalers of clothing to increase orders going to the Orient but not those going to domestic firms. A hardware importer has found few, if any, price increases explainable by the fall in the value of the dollar. Most of his imported goods are also purchased in East Asia. A large electronics importer noted significant (3% to 12%) increases in the price quotes received since January 1 on products produced in Japan. He also stated that domestic producers of television sets have increased prices in response. He noted that so far his firm has not had to pay these higher prices because the higher prices have not been uniformly imposed by all suppliers.

Respondents had no plans to enlarge the percentage of finished goods orders going to domestic producers and were therefore not seeking new bids from domestic suppliers.

Respondents explained their lack of interest in shifting purchases of production inputs or finished goods to domestic suppliers in several ways. Most pointed out that import price increases have been fairly small, so there has been little incentive to date to change to domestic producers. Also, many contracts written before the value of the dollar had fallen significantly were

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still in effect. A large proportion of the respondents indicated that the products they needed were not available from domestic suppliers.

While most domestic producers said they thought the decline of the dollar should eventually be helpful in increasing sales, both here and abroad, only a few claimed any significant effect thus far. Among the metals firms contacted, one experienced improved sales in the United States due to increased foreign prices, and one had "fewer lost orders" from overseas purchasers. In neither of these cases was the effect strong. Most of the firms in the textile industry reported no increased sales, though several have received more inquiries. One fiber producer, however, had strong enough growth in sales and prices abroad to warrant planning the start up of a new production facility in February, and a large diversified chemical manufacturer reported that the dollar's decline had significantly improved its competitive position in overseas markets, especially in the United Kingdom.

Many of the manufacturers contacted expressed a vague expectation of future sales increases due to the dollar's depreciation, but no one made strong statements supporting the hope of growing sales. Several importers expected import prices to increase more in the near future, but none were planning to shift to domestic suppliers to a significant extent.

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SIXTH DISTRICT - ATLANTA

It is somewhat premature to discern generalized effects from the dollar's substantial depreciation on foreign exchange markets that occurred during 1985, judging by the results of our survey of southeastern manufacturers, wholesalers, and retailers. The trade sector has begun to experience some increase in prices for imported merchandise, but the degree varies substantially according to the imports' country of origin. Manufacturers in regionally important industries tend to rely heavily on local resources, and their costs have hence been less influenced by the dollar's decline than those in the trade sector. Export-oriented manufacturers report some favorable effects on sales abroad but not enough to warrant increasing payrolls or capacity yet.

In general, our poll adduced only scant evidence that the dollar's depreciation has or will soon have an appreciable impact on U.S. price or production levels. Still, the absence of substitutes for certain products could put upward pressures on the cost structures of some businesses.

Prices and Costs in the Manufacturing Sector. According to representatives from the regionally important textile, apparel, food, lumber, and chemical industries, price increases for imported inputs have been minimal. This sanguine picture of minor price increases must be qualified, though. Most industrial firms contacted rely only minimally on imported supplies. One that does, a large textile and apparel producer, reports substantial price increases for technically sophisticated equipment not available domestically. As yet, higher input costs have not affected overall production costs or final prices for this respondent, however. Similarly, a large beverage producer for whom imported inputs costs have begun to rise has not raised its prices largely because higher revenues, enhanced by its improved exports, have improved profits.

Prices and Costs in the Trade Sector. Our survey of a variety of southeastern wholesalers and retailers in a variety of fields, ranging from specialized product lines

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such as shoes, alcoholic beverages, and household durables to general merchandisers, indicates that import prices have been rising slightly. Most of the affected items were nondurable consumer goods.

The majority of these retailers and wholesalers are more dependent on foreign imports than the manufacturers we surveyed. However, most are smaller and tend to buy through jobbers rather than directly from foreign suppliers. Consequently, many are uncertain as to the extent to which such price increases were related to the dollar's depreciation as opposed to other factors. Moreover, as several manufacturers also remarked, the extent of price increases depends largely on the country from which certain products are imported. Many developing countries have experienced much less exchange-rate appreciation. Hong Kong, Spain, and certain other countries whose curriences have appreciated apparently are holding their prices down rather than passing through the effects of foreign-exchange rate changes to U.S. buyers. This competition in turn may be dampening price hikes by more advanced economies such as Japan.

Most domestic rivals of foreign suppliers are not responding to the increase in import prices by raising their charges. Nonetheless, respondents in the trade sector report that their cost structures are beginning to rise, largely because many imports, such as German crystal and kitchen cabinets and French wines, do not have ready American substitutes.

Effect on Domestic Firms. Only the chemical, paper, lumber, and one of the textile and apparel firms report that the dollar's decline has had an effect on their domestic and foreign sales. Generally, these export-oriented companies are raising prices on products for which competition is somewhat less keen and attempting to build or rebuild market share in other, more competitive product lines. Despite their expanded sales, these firms are reluctant to expand employment or capacity until they are more certain that the underlying conditions will be sustained. However, the chemical firm, which has transferred half its operations offshore since the dollar began appreciating in

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1980, indicated that it would restore domestic production if the dollar continues to fall to a more competitive level.

Manufacturers who are more import-sensitive than export-oriented are not observing symmetrical results in their domestic markets. Only one textile and apparel maker notes that imports have begun to slow. Firms that are more dependent on imported inputs—primarily in the trade sector--are fairly evenly divided between those with unaffected sales and those with lower sales as a consequence of price increases emanating from the dollar's decline.

Future Expectations. Retailers and wholesalers are also divided as to their outlook for the dollar's effect on price and sales levels in the next two quarters. Only a few prepared for the rise in their costs by building inventories early; most have no plans to do so at this point, largely because they do not foresee substantial changes in the foreign-exchange value of the dollar in the coming 6 months. Even those who fear import prices will continue to increase, depressing their sales, do not expect to alter their employment levels signficantly, suggesting that they expect future change to be limited. Most manufacturers polled also expect the dollar's foreign exchange value to have little effect on prices, sales, and orders in the coming six months. Accordingly, they have not begun to build inventories of imports in anticipation of future price rises.

However, those who have already experienced some market changes foresee ongoing increases in their prices, sales, and inventories, but not in their payrolls. Several respondents, including representatives of the chemical, paper, food, and fabricated metals industries as well as one wholesaler, believe that the dollar must fall further, from 15 to 40 percent, to have a signficant impact on their respective industry's ability to compete with foreign competition. Other factors that respondents noted as having equal or greater potential weight than further dollar declines were reasonable economic growth abroad and changes in quotas and tariff structures.

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SEVENTH DISTRICT--CHICAGO

Theme Report on the Effect of the Decline in the Exchange Value of the Dollar

Summary. Respondents report little evidence that the decline in the exchange value of the dollar since February 1985 has significantly affected prices, orders or sales. Improvements in demand often can be explained by increased activity or other factors. Partly this is because of delayed responses related to contractual arrangements and changes in distribution networks. However, the problem of restoring equilibrium is more deeply seated than mere lags in adjustments. Much lower labor costs and improved technology abroad continue to encourage foreign sourcing. Trade barriers and government-sponsored industries elsewhere in the world militate against U.S. companies. Other nations seeking additional foreign exchange find the U.S. the one, large "free market" open to them. Some of the decline in the dollar has been offset by foreign exporters' ability to reduce profit margins. Another offset has been the sharp decline in ocean freight rates. In short, a substantial further decline in the dollar will be required to correct the deficit in the balance of trade.

General. Current penetration of U.S. markets by foreign goods took many years. Much trial and error was involved in designing and producing goods to American tastes and specifications. Distribution networks and business relationships had to be created. These networks will not be dismantled because of the decline in the dollar that has occurred to date. Similarly, domestic productive facilities, distribution, networks, and business relationships have tended to shrink and atrophy, at least in cases (e.g. industrial fasteners) where foreign penetration has become deep.

The U.S. represents 30-40 percent of the world market for many basic materials and finished products. Also, the U.S. is the only important "free" market. Abroad, enterprises are often owned or controlled and financed by their respective governments. In their efforts to maintain or increase generation of foreign exchange, these countries look to the U.S. as the prime outlet

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for surplus output. This is particularly important for basic materials such as steel, nonferrous metals, and cement. The situation is not readily affected by adjustments in exchange rates.

Labor Costs. Respondents state that the dollar would have to fall substantially further and market participants would have to be convinced that the dollar will stay down to bring "equilibrium" to the import-export picture. Labor costs are substantially higher here, especially in comparison with Latin America and much of the Far East--Korea, Taiwan, China etc. "Equilibrium levels" for the dollar relative to the yen and the mark seem elusive. Six months ago current levels for these currencies would have appeared to be sufficient to restore a reasonable balance. Now, it is common to cite rates for the dollar 10-20 percent lower than recent quotations.

Budgeting. Some respondents mentioned that they had just completed time-consuming budgeting processes for 1986 and that management's attention has not been focused on exchange rate developments. Planning decisions will now relate more closely to such factors as changes in the dollar and oil prices.

Trade Barriers. U.S. companies which sell abroad and face import competition at home emphasize that the effect of declines in the dollar are limited because of restrictions on imports in countries that produce competitive products. For example, the Common Market recently excluded imports of excavators, either from the U.S. or Japan, and it may extend the ban to lift trucks. Most U.S. sales to Japan are contingent on a variety of special conditions that hamper competition.

Foreign Profits. A number of respondents with production facilities in Europe report higher profit margins on sales by these divisions as a result of the lower dollar. This may take the form of higher reported earnings, as converted into dollars, and may encourage realization of these higher earnings by repatriation.

Freight Rates. Many reports mentioned the decline in ocean freight rates as an important

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offset to the decline in the dollar. Trans-ocean freight rates are down 40-75 percent from peak levels, both from Europe and Asia, because of the huge excess of shipping capacity. Both bulk materials and containerized freight move at much lower rates. Affected are motor vehicles and components, steel, cement, building stone (mainly from Italy), and even sand and gravel (from the U.K.) Freight charges often are crucial in decisions to import products available from domestic suppliers.

Some Markets Not Affected. Several respondents--e.g. pharmaceuticals, construction and agricultural equipment, electronics etc.--say that their foreign markets are largely or exclusively supplied from facilities owned abroad. As a result, the decline in the value of the dollar has no affect on sales, but may help profit margins. Other firms are supplying goods and services--e.g. franchise foods, auto repair etc.--that have no effective, direct foreign competition. Success of these divisions is not significantly affected by adjustments in exchange rates. Finally, some respondents point out that competitive imports are coming from nations whose currencies have not risen relative to the dollar.

Foreign Sourcing. Sourcing of finished products and components abroad has not been significantly affected by the lower dollar. U.S. companies have great flexibility to procure specified goods throughout the world, seeking the lowest cost configuration. These decisions involved extensive planning and commitments that will not be quickly reversed. In some cases, domestic facilities have been closed or scaled down and domestic producers are not physically capable of responding to market changes in the short run. Moves by U.S. manufacturers to increase foreign sourcing of finished products and components in the past year have emphasized contracts to purchase these items from foreign producers. Many firms have been disposing of direct investments abroad because of heavy costs incurred and ill-feelings engendered when employment had to be reduced or establishments closed.

Grain. A major exporter of grains and grain products reports a moderate pick-up in demand

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from Europe in the past several months. However, the change is so slight that it could be attributed to the general improvement in activity observed in these nations. Moreover, the rise in demand is _much_ less than would have been projected if the extent of the decline in the dollar relative to other major currencies had been accurately predicted. No adequate explanation is available.

Steel. Steel prices have strengthened somewhat recently, but not as much as would be indicated by the 20 percent decline in the dollar since last February. This decline may have had some effect in boosting orders to U.S. steel producers, but this is hard to separate from the influence of the Administration's efforts to tighten import restraints, and the completion of inventory adjustments.

Nonferrous Metals. Prices of copper, aluminum, and various other nonferrous metals have increased in recent months. World prices for most metals are determined on the London Metal Exchange. The U.S. accounts for 30-40 percent of the consumption of these metals and the decline in the dollar tends to cause these prices to rise in terms of dollars. However, demand also has been affected by the end of inventory reduction programs, which have caused some users to increase orders. U.S. nonferrous metals producers have not been successful in getting import restrictions, and foreign producers are still seeking to raise foreign exchange by selling to the U.S. As a result, the lower dollar is not likely to cause U.S. production to rise substantially.

Cement. Imports of cement apparently peaked last March, after an unprecedented rise to over 10 percent of the U.S. market. Much of this tonnage is brought in by domestic companies. The decline in the dollar probably has marginally affected imports from the U.K., France, and Japan. However, of the major suppliers to the U.S.--Canada, Mexico, Spain, and Venezuela--only Spain's currency has risen relative to the dollar. A sharp drop in freight rates, to about 25 percent of earlier levels, had encouraged the rise in imports to early 1985. Freight rates are not likely to fall further. The lower dollar should hold down further increases in cement

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imports.

Household Appliances. Exports of certain household appliances are expected to increase because of the decline in the dollar, but there is no clear evidence that this has occurred to date. Prices of imported electronics have strengthened slightly. This may reflect the decline in the dollar, but also an inventory correction last year. Small refrigerators are virtually all imported, as well as 60 percent of microwave ovens. Imports of air conditioners have been increasing. The decline in the dollar already accomplished is expected at least to slow any increase in appliance imports, and to increase exports somewhat.

Oil. Trade in petroleum and products has not been much affected by the decline in the dollar. The decline in the dollar should have boosted prices of oil denominated in dollars, but forces leading to the recent drop in oil prices have overwhelmed this effect. Equipment used in oil/gas development and production, and in refineries, is mainly produced domestically.

From mid-1983 through February 1985, world oil prices were relatively stable. However, because world oil prices are denominated in dollars, and the value of the dollar was rising relative to other currencies in this period, the effective cost of oil was rising for most oil importing nations. The recent sharp drop in oil prices, coupled with the lower value of the dollar relative to currencies of major oil importing nations, has resulted in a substantial lowering of the cost of an important resource. Recent developments are expected to help these nations--Japan and much of western Europe--and therefore expand markets for some U.S. exports.

Chemicals. In the case of petrochemicals, U.S. exporters are facing added competition from new plants built abroad, particularly in OPEC nations. Natural gas feedstock for some of these plants is, in effect, free because the gas otherwise would be flared. A heavy volume of petrochemical production overhangs world markets, and is likely to grow rather than decline.

Fibers. Production of man-made fibers and textiles is said to be gradually "moving abroad" because of a combination of factors, especially lower costs of raw materials and labor, but also

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because modern technology can be readily transferred and exploited in developing nations of Asia.

Cardboard. Demand for linerboard (raw material of cardboard boxes) from U.S. plants is up about 2-3 percent, reflecting both increased final demand and the end of an inventory correction. Demand is up from Europe and Asia also, but mainly because of increased activity rather than the decline in the dollar. The implied decline in export prices of U.S. linerboard producers has been offset by higher dollar prices reflecting stronger domestic demand. There has not been a rise in the U.S. share of the world market. However, export backlogs, normally 30-35 days, have moved past 60 days and may go to 90. Most of this move has occurred since last September.

Most of the export backlog is for Southeast Asia, not for products used there, but to contain products to be exported to the U.S. (In short, many foreign products come to us in boxes made from U.S.-made linerboard.) Producers of these products expect to continue to expand shipments to the U.S., despite the decline in the dollar. Imports of linerboard into the U.S. are negligible. However, the rise in the dollar in 1980-85 encouraged expansion of linerboard capacity abroad--e.g. Brazil, Italy, and Asia. These nations will attempt tp keep these linerboard plants operating in competition with exports from U.S. plants.

Capital Goods. Most producers of capital goods located in the District have seen no evidence of an improvement in demand as a result of the lower dollar. Komatsu announced price increases in the U.S. of 5-10 percent, but these have not been reflected in transaction prices. In this and other cases, foreign producers are ready and able to absorb the effect of the lower dollar by reducing gross margins.

Commercial Aircraft. Leading aircraft producers, i.e. Boeing and Douglas, have dominant positions in world markets. Their only serious competition is Airbus (a multi-national). There is no prospect that this will change because of the enormous R&D costs of developing new engines, airframes, and related electronic and mechanical components. However, our leading aircraft

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producers are backlogged well into 1987, with domestic and foreign commercial business and defense orders, at least for those models in demand.

General Merchandise Retailing. A leading retailer has seen little evidence that the decline in the dollar has increased prices or changed channels of supply. Price increases have occurred for electronics, but this followed a drastic inventory correction in 1985. Prices of VCRs from Japan have increased somewhat. In most categories where imports compete with U.S. goods, foreign suppliers have cut margins while keeping prices about stable. Overall, it appears that the dollar must fall further, and stay down, to reduce the penetration of U.S. retail markets by foreign products. Some long-term contracts provide for splitting of losses resulting from dollar depreciation.

Air Travel. The boom in trans-Atlantic air travel has given way to a level trend, although capacity has increased and favorable fares are offered in a highly competitive market. It is believed that the lower value of the dollar has been partly responsible for ending the boom, but fear of terrorist attacks also is a factor discouraging travel.

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Eighth District Special Theme Report:

Exchange Rates and Their Effects on Local Businesses

Summary

Of the twenty-five District businesses contacted, fifteen perceived that imported goods affect their industries either as inputs or as final goods that compete directly with products they sell. The respondents are divided into two general classifications for this report: manufacturing and trade. Respondents from the manufacturing sector produce goods that are sold in competition with foreign products in domestic markets, and in some cases, export markets. Domestic suppliers of raw material inputs also are included in this classification. The trade sector includes respondents engaged in the sale of finished products purchased from domestic or foreign suppliers.

The manufacturing sector generally reported little or no increase in the price of foreign goods in response to the fall in the value of the dollar. Moreover, no differences in pricing were reported with respect to the origin of the imported goods. Most felt that imports continue to exert downward pressure on the price of their own products and on the price of domestic inputs. Few expect upward movement in import prices in the next six months; several, however, anticipate some price adjustment over the longer run.

Respondents from the trade sector reported a noticeable increase in the price of imported goods corresponding roughly to areas where the dollar has depreciated most sharply. Most have attempted to hold prices constant in an effort to gain market share from foreign competitors. Some have shifted their acquisition patterns to lower priced suppliers.

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Effects on Domestic Manufacturing

Financial officials of eight manufacturers indicated that the depreciation of the dollar generally had little effect on their operations. Of the two respondents importing substantial amounts of inputs, one has experienced no increase in prices while the other, a chemicals producer, reported that input prices rose marginally. Despite the price increase, this respondent felt that imports still compete aggressively for the U.S. market, preventing domestic suppliers from increasing their prices.

All eight of the manufacturers produce intermediate or finished goods that compete with imports. Only one respondent, a maker of packaging material, felt that the decline in the exchange rate was responsible for an increase in the price of competing imports. In this industry, U.S. suppliers increased their share of the domestic market slightly and boosted export sales as they held prices constant.

Only one respondent in the manufacturing sector, a producer of aluminum, expects better sales in response to higher prices of competing imports. He felt that prices of imports would rise only slightly, however, as foreign producers attempt to maintain their market shares. Although the other manufacturers anticipated no changes over the next six months, several predicted a rise in import prices over the longer run and increased sales by domestic manufacturers. A representative of a major chemical producer expects to see slightly higher import prices in the third quarter of 1986 and anticipates correspondingly higher levels of exports of his company's products. Several respondents plan to hold prices constant in order to maintain market shares unless the prices of competing imports increase dramatically.

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Effects on the Trade Sector

Local retail and wholesale trade sectors generally have reported higher import prices due to the decline in the value of the dollar. While one respondent sees his industry benefiting from prices more competitive with imported finished goods, others are experiencing rising costs for foreign inputs. Others of those surveyed indicate little or no effect on their operations while some respondents feel it is too early to form an opinion.

A spokesman for a distributor of piping and related products conveyed that, while there has been some upward price movement, primarily from the Pacific rim countries, it is considered insignificant. The respondent concluded that the foreign pricing policy thus far has been to hold prices constant regardless of the movement in the value of the dollar. He anticipates prices for imported finished goods to appreciate 2-3 percent in the coming year, due to both the depreciation of the dollar and fears of protectionist measures.

A local distributor of tractor and construction equipment, who competes primarily with Japanese imports, noted a 5-6 percent price increase since November in the cost of Japanese equipment. Slightly higher domestic sales volume has resulted as the price differential narrowed. He also indicated a decline in "gray market" transactions in which unauthorized dealers purchase identical equipment from European factories and ship and sell to the U.S. at prices 20-40 percent below prices of authorized dealers.

One retailer, whose organization imports finished apparel, noted a significant increase in the cost of Japanese material. Most U.S. firms

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currently are willing to pay the additional cost for the superior quality of the Japanese fabric but are shifting the second step of apparel manufacturing (cutting, making and trimming) to those Asian countries with cheaper labor costs, non-quota restrictions and currencies more closely tied to the dollar. This respondent felt that competing domestic suppliers have increased prices rather than attempting to regain market shares.

Another spokesman for a retail apparel firm also indicated higher import prices from Japanese suppliers of finished goods. To date, price increases from other Asian countries, whose currencies are more closely pegged to the dollar, have not been noted. This respondent concluded that domestic suppliers have maintained current price levels in an attempt to attract sales.

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NINTH DISTRICT - MINNEAPOLIS

Special Theme Report: The Falling Dollar and U.S. Trade

Imports

Firms contacted were all apprehensive about prospective increases in imported good prices. Spokesmen for two high-tech firms, which import precision components from Europe for use in manufacturing high-tech measurement instruments internationally, were worried about a lack of domestically made substitutes for their imported components. In the event of a big price increase, they fear that they would have no alternative but to pay it, although one spokesman indicated that his firm might try to entice an American firm to produce the needed components. Furthermore, a buyer for a department store is anticipating that price increases for imported clothing from Germany and France will finally impact her store this March at a New York buyers' mart. She noted that middlemen will probably have to bear the risk of price increases, because it is difficult for them to obtain firm overseas price committments prior to pricing the goods.

Only a few firms have already suffered significantly from import price increases. An importer of boats made in Switzerland noted that boats costing $50 thousand when ordered rose to $57 thousand when delivered; the difference wiped out his profit. As a result, he sold out his business.

Exports

Responses by area manufacturers were mixed. Some felt that the cheaper dollar was already helping, while others found that either the demand for their products was primarily determined by other factors, or that foreign firms were cutting prices to meet the American competition.

A Vice President of a large, diversified international manufacturer said that the dollar's decline has had a very positive affect on exports, putting them in a more competitive position overseas. Furthermore, their overseas subdivisions will not be under the same pressures to cut prices as their foreign competitors are. Also, the consensus opinion of four North Dakota

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exporters was that retail sales of their products in Europe have been climbing, and the growth rate has accelerated over the last six months, despite price cuts by European competitors.

But not all firms have experienced growth in export sales. A few years ago, a manufacturer of geographic instrumentation sold half of its output overseas. Now it only sells one quarter of its output overseas, with sales to Germany and Switzerland particularly impeded. Their sales to China will probably not increase, because the Chinese are more interested in developing their own import substitutes. Likewise, an exporter of racing car parts to Australia has not seen an increase in its business, which is primarily driven by need rather than price. A Minneapolis manufacturer of machinery and industrial products has only noted a marginal improvement in its export volume, and felt that it is still too early to tell what the eventual impact of the dollar's decline will be. Finally, an economic analyst in North Dakota noted that while there has been some pick up in demand for agricultural exports, U.S. firms aren't allowed to export to Libya, one of the countries desiring farm equipment.

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TENTH DISTRICT--KANSAS CITY
SPECIAL THEME REPORT
January 1986

Overview. A fairly broad range of businesses in the Tenth District was surveyed, including retailers, manufacturers, and a few other types of firms. The most common response was that firms have not been subjected to higher prices for imported goods, nor have competing domestic suppliers generally raised their prices. In any case, even when prices have been adjusted, domestic suppliers are generally described as higher-priced suppliers or uncompetitive with foreign suppliers. Moreover, a number of District firms are protected in the short run by relatively long-run contracts with foreign suppliers. Firms also note that foreign supply relationships are costly to establish and will not be severed quickly. Thus few actual shifts to domestic suppliers were reported.

Very few sales increases were reported by District firms, and none leading to employment increases or capacity expansion. Most respondents expect little effect of the dollar decline on their prices, sales, or orders in the next six months. This view reflects both the firms' buying practices and the view that lack of competitiveness of U.S. suppliers will not be overcome by dollar depreciation.

1. Although some firms report higher prices for imported inputs, the most common response is that import prices have not changed. A few firms even have experienced decreases in import prices despite the depreciation of the dollar. One company reports that its Japanese electronic components have become cheaper recently because of excess capacity in the components industry. Another respondent has observed declines in the price of steel from South America.

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Most firms have not noticed any response by domestic suppliers to the dollar's depreciation. As a result, the price disadvantage of U.S. suppliers is narrowing in those cases where import prices have risen. However, many domestic suppliers remain uncompetitive, and few purchasers actually have shifted from foreign to domestic sources.

2. Most survey respondents have not yet encountered higher prices for imported finished goods. Many retailers negotiate contracts for imported goods from six months to a year in advance. One drug company reports that the dollar's fall has had no impact on its business because of long-term contracts and extensive hedging in the futures markets. In cases where the prices of imported finished goods have increased, the increases generally are passed along to consumers. Most domestic suppliers have not raised their prices in response to the dollar's depreciation.

3. Few respondents have shifted to domestic suppliers in response to rising import prices, although some firms expect that such shifts will be considered eventually. The major reasons for not switching suppliers are long-term contracts, the high initial costs of establishing supply relationships, and--most important--continuing price differentials despite the cheaper dollar. Many firms have not confronted higher import prices because of long-term contracts. Moreover, foreign supply relationships are costly to establish and will not be severed quickly unless the competitive advantages of domestic suppliers are expected to be longlasting. Finally, many firms report that domestic producers remain the higher-cost source despite the decline of the dollar. For example, although one mining firm recently had purchased a hydraulic shovel from a domestic manufacturer because of special reliability

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guarantees, the firm reports that without these guarantees, similar high-quality Japanese machinery would have been attractive because of a 20 percent price advantage. In another example, the president of a major utility notes that his firm purchased Swedish electrical equipment prior to the dollar's decline. If they were considering the same deal now, domestic products would be more competitive, but another 10 percent devaluation would be necessary to equate the costs of the Swedish and American equipment.

4. Since most firms surveyed have been unaffected by exchange rate effects on prices of imported goods, there are few discernible differences in the responses of import prices across countries. Japan is cited as the country that has shown the most price response by those purchasing agents and retailers that report differences. One importer of fabricated metal products noted that Japan was "quick" to change prices in response to changes in the value of the dollar, while India and the United Kingdom were "so-so" and West Germany was "slow." An importer of electronics items and semiconductors reported that suppliers in Hong Kong, Taiwan, and Singapore were holding the line on prices.

5. For most firms surveyed, the decline in the dollar has not yet had a perceptible effect on their sales or orders. For those who do report changes in sales, results are mixed. Some purchasing agents report that sales have decreased further, despite the declining dollar, due to labor cost disadvantages. This is particularly true of semiconductor manufacturers. For those firms whose sales prospects have increased, sufficient idle capacity exists that none have immediate plans to increase employment or expand capacity. It should be noted that nearly all firms surveyed sell to a

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domestic market. One exception is the grain exporting business where the decline in the exchange value of the dollar has brought some interest from buyers abroad but not much increase in sales volume.

6. Most of those surveyed do not expect to see effects on prices, sales, and orders over the next six months. For some this is a reflection of their buying practices--long-term contracts with suppliers and positions in futures markets to protect them from exchange rate fluctuations. For others, it reflects a belief that some U.S. businesses will remain uncompetitive with foreign firms despite a further decrease in the exchange value of the dollar (e.g., mining, electronics). Grain exporters would expect to see significant improvements in their overseas markets only if the dollar falls another 20 percent or so.

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ELEVENTH DISTRICT--DALLAS

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

Most District firms and businesses have not seen any evidence of effects from the recent declines in the value of the dollar. A small minority of respondents did note either an easing of foreign competition or an increase in the price of foreign-supplied goods. These effects were not widespread and appear to be concentrated in a few industries. It appears that the full effect of exchange rate movement has not been felt because of long-term contracts covering inputs, existing trade restraints and past efforts of domestic suppliers to insulate themselves from foreign competition by producing speciality products. In addition, raw materials for two important manufacturers in the District, refiners and petrochemical firms, are already priced in dollars, eliminating the possibility of major price movements because of exchange rate changes.

The proportion of District manufacturers that reported price increases in inputs is very small. The lack of a widespread response probably reflects several factors. First, many noted protection from price increases because of long term contracts. Second, the world price of both petroleum and petroleum products is denominated in dollars. The value added by local labor and materials is very small, dampening the effects of exchange rate movements on output price. The result is that refiners, whose largest input is oil, and chemical manufacturers, who rely principally on petroleum products, are largely unaffected by the recent declines of the dollar. Third, some respondents believe that the foreign producers are accepting reduced profits for the time being.

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The most significant response from the recent depreciation of the dollar was noted by retailers. The prices of apparel and fashion items from Europe have risen significantly. The increases are being passed on to customers, although buyer resistance has been stiff.

Surprisingly, the prices of many other imported consumer items have not changed. Respondents noted that they have heard rumors of possible price increases in consumer electronics. These have not yet materialized, although respondents concede that it is difficult to discern price movements because of the continuing rapid pace of innovation. For the more expensive and sophisticated items there is still rapid change of models and prices, making accurate determination of the marginal effects of foreign currency movements difficult. Nevertheless, the prices of many standard items such as small radios and TV's have remained stable. Little change has been noted in the price of apparel imported from Asia. Slower growth of sales during the year has eased the constraints imposed by quotas, and the prices of some imported apparel have actually declined.

Of those manufacturers who noted an increase in input prices, none mentioned seeking domestic suppliers. As yet the price changes have been small relative to the gap between domestic and foreign prices. For retailers, the higher prices have not led to a shift to domestic suppliers. Retailers said that, for many of the imported products they sell, no adequate domestic supplier currently exists.

The results of the contacts did not yield any systematic pattern relating country of origin to price increases. Identifying such changes is difficult because of the lack of a significant response to the decline in the dollar.

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The response of manufacturers regarding their finished products mirrored the answers on questions concerning input prices, although even fewer noticed recent changes. The most frequently cited reasons are that foreign competitors either aren't raising prices or the price increases are too small to affect purchasing or expansion decisions. Another contributing factor to the lack of response is that the domestic manufacturer has specialized and attempted to produce items without perfect substitutes. The specifics of industries also acts to reduce effects. For example, lumber and wood products manufacturers did not report a lessening of domestic competition, because the movement of the Canadian dollar against the U.S. dollar have been relatively slight compared to other currencies.

Some firms that were contacted did note an improvement in foreign sales. Respondents from the lumber and wood products industries said they had seen an immediate increase in foreign prices in the wake of a decline in the dollar. Electronics was an industry where sales gains have been reported. For both industries, regaining lost market share is a more important objective than increasing prices. In neither case was significant additional production or employment expected. Of firms that are capable of competing in international markets, most noted that the relative movements in the exchange rate have been small compared to the overall movement in this decade. The result is that markets they have been shut out of are still not open to them.

Despite the lack of immediate response to the recent declines of the dollar, most individuals contacted were well aware of the possible implications. Even still, a small minority thought that the recent declines of the dollar might bring some change in business conditions in

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the next 6 months. Some respondents did explicitly note that the lagged effect of foreign-exchange movements may force them to be more active in seeking alternative sources of supply in the future.

Recent significant changes in the business conditions faced by some District manufacturers have made it difficult to discern changes from the recent foreign currency movements. The large declines in drilling have led to reduced orders for some firms. Slowing construction is also affecting many businesses.

Most of the major changes in international trade that respondents were able to report occurred because of changes in trade regulations. The sales of paper manufacturers in European markets are being reduced by trade retaliation in response to U.S. barriers to certain steel imports. The Voluntary Restraint Agreements for tubular steel goods are beginning to lesson import competition, which in turn is leading to price stability.

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TWELFTH DISTRICT - SAN FRANCISCO

IMPACT OF THE DEPRECIATION OF THE DOLLAR ON THE WESTERN ECONOMY

Through January the decline in the value of the dollar has had only a modest impact on the economy in the west. In coming months, price increases owing to the decline in the exchange value of the dollar generally are expected to be more apparent. For some products, however, special factors could damp the rise in prices.

With regards to consumer goods, the experience throughout the district suggests that the decline in the dollar generally has not had a perceptible impact on prices. One clear exception is the rise in prices of consumer electronic products, an area in which Japanese producers face limited domestic competition. Sticker prices on Japanese automobiles also have risen, in part due to the depreciation of the dollar. Dealer costs on Japanese cars have risen, and the dealers reportedly are passing the higher costs on to consumers. However, the general sentiment is that price increases on Japanese autos will be restrained due to a number of factors. First, prices may not have adjusted down fully following the lifting of import quotas. Also, Japanese producers apparently are interested in maintaining market shares in the western states, especially California. In addition, there is the longer-run threat of intense competition from Korean and Yugoslavian producers.

The impact of the dollar on the price of material inputs and equipment has been minor up to this point. Some exceptions are certain metals and Japanese produced construction equipment, the price on the latter reportedly rising approximately 7 percent to 10 percent since

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November. The domestic prices for construction inputs such as cement and lumber products in the west have been virtually unaffected by the weakening of the dollar relative to a number of major currencies. This is partly due to competition from countries whose currencies have not strengthened vis-a-vis the dollar; Mexico in the case of cement and Canada in the case of lumber products. Japanese cement suppliers also reportedly are reluctant to raise prices and risk losing market shares to competitors in Korea and Taiwan. In coming months, domestic prices for northwest lumber could be affected by greater Japanese demand owing to the stronger yen. Moreover, there could be feedback effects to domestic lumber prices from pulp and paper products for which domestic producers compete with European as well as Canadian producers. However, a pickup in exports of U.S. pulp and paper products could be stalled by the threat of import restraints on U.S. goods by countries in the EEC.

In the semiconductor industry the weakening of the dollar has led to a firming of domestic prices across a variety of product lines. However, a significant turnaround in prices is not expected, given that within the industry the outlook for both basic semiconductor products and U.S. manufactured electronic products generally remains weak. Domestic prices are expected to be held down in part by a combination of weak worldwide demand and increased efficiency of Japanese producers. Domestic producers also allege that Japanese semiconductor products are being "dumped" in the U.S. market in order to maintain or enhance Japanese share in these products.

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In the agricultural sector, there has not yet been a general recovery in export activity, although some products have apparently benefited from the weakening of the dollar. Almond exports to Europe and Asia, for example, increased substantially in the latter part of 1985. Even in this case, there has only been modest price increases as substantial surpluses are still being worked off. There also may be some relief from the wine grape producers as the strengthening of the dollar apparently has resulted in reduced wine imports. Grains and cotton exports are not expected to be affected immediately since, even with the decline in the exchange value of the dollar, world prices are still below domestic price supports.