surveys of consumers
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Monitoring trends for over 50 years

Subject: Loss of confidence in financial institutions.
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The latest survey provides evidence that consumers have lost confidence in financial institutions and believe that the financial crisis will have a significant negative impact on the overall economy. This loss in confidence will cause consumers to accelerate their spending cutbacks and those reductions are likely to persist through most of 2009. These data indicate that a longer and deeper recession is now likely. Spending is expected to decline through the first half of 2009, with total personal consumption expenditures falling by -0.5% in 2009 compared with 2008. In historical perspective, this is quite a negative outlook given that in the past half century there have been only two years that consumption has declined—in 1974 by -0.8% and in 1980 by -0.3%. The longest period of decline in consumption during the past half century was four quarters, which the current downturn is expected to equal. To be sure, the current forecast is not comparable in any way to the depth or the length of the downturn from 1930 to 1933, when consumption spending fell on average by -4.9% per year for four years.

Confidence in financial institutions has recently plunged. When asked about how their confidence in various financial institutions had changed, the majority of consumers cited less confidence in banks, brokerages, mutual fund companies, and insurance companies in the latest survey. The only financial institutions to avoid steep losses in confidence were credit unions. Perhaps the most significant result was that a majority of consumers reported that they had lost confidence in the Federal Reserve; indeed, a slightly higher percentage reported they were “a lot less confident” in the Federal Reserve than any other financial institution. This represents a significant loss of confidence in the federal agency responsible for the financial system in the midst of the worst crisis since the Great Depression. This not only reflects consumers’ judgements about the severity of the crisis but a decline in their confidence in the ability of the Fed to take the necessary corrective actions to end the crisis.

Importantly, the loss of confidence in the Fed was associated with less favorable levels of consumer sentiment. Among those that reported less confidence in the Fed, the Sentiment Index was 14.5 Index-points lower than those whose confidence had not changed or improved. While the loss of confidence in other financial institutions was also associated with less positive levels in the Sentiment Index, the difference was just 1.7 Index-points for banks, 6.2 points for brokerages and mutual fund companies, and 5.6 points for insurance companies. Although the loss of confidence in any one financial institution can have a significant economic impact, it pales in comparison to the potential repercussions of losses in confidence in the Fed.

While it is no surprise that consumers have recently lost confidence in financial institutions, the extent of the loss was large in comparison to when the same questions were asked in the aftermath of the 1987 stock market crash—a 20% price decline in one day. The largest loss in 1987 was in confidence in brokerages and mutual fund companies, with minor net losses in other institutions including the Federal Reserve. The 2008 losses of confidence in the Federal Reserve was more than five times as large when the net balance of replies is considered—from -10 to -51. Consumers reporting having “a lot less confidence” in the Fed increased to 29% in 2008 from just 7% in 1987. Moreover, there have been substantial losses of confidence in all other financial institutions when compared with the 1987 crash with the sole exception of credit unions.

Two-thirds of all consumers thought that the credit crisis would have a significant negative impact on the economy; just 12% thought that it would have little or no impact. The majority of households anticipated that the credit and financial crisis would have a negative impact on their personal finances, with one-in-five expecting a large negative impact. Spending plans were also reported to have been altered by the majority of consumers, with nearly one-in-three anticipating a substantial cutback. Overall, 10% of all households reported that they had problems obtaining credit during the past year. Moreover, in response to questions about buying conditions for a wide variety of purchases, consumers much more frequently mentioned that tighter credit conditions was a cause to postpone purchases (in addition to growing uncertainty about future jobs and incomes.)

Confidence in Financial Institutions Compared With Five Years Ago

	November - December 1987								October 2008							
	A Lot More	A Little More	Same	A Little Less	A Lot Less	DK; NA	Total	More-Less	A Lot More	A Little More	Same	A Little Less	A Lot Less	DK; NA	Total	More-Less
Federal Reserve System	4	5	67	12	7	5	100%	-10	3	3	35	28	29	2	100%	-51
Commercial Banks	3	4	70	12	9	2	100%	-14	1	1	37	34	26	1	100%	-58
Credit Unions	9	9	61	7	4	10	100%	7	5	11	51	18	7	8	100%	-9
Savings and Loans	4	7	58	15	12	4	100%	-16	0	3	44	33	17	3	100%	-47
Brokers/Mutual Fund Co.	3	5	46	19	18	9	100%	-29	1	2	29	36	28	4	100%	-61
Insurance Co.	7	6	56	12	16	3	100%	-15	1	5	42	28	23	1	100%	-45