BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date October 26, 1987

To Board of Governors

Subject

From Michael Prell

Although it was very early, and they were left little time to investigate, I asked the Reserve Bank research departments last week to check with their contacts regarding the apparent effects of the stock market drop on spending.

In general, the tenor of the Bank's findings was negative, but not such as to suggest a dramatic retrenchment by households and businesses.

Attachment

District I

Special survey: effect of recent drop in stock market on spending

The recent volatility in the stock market has had virtually no effect on the manufacturers contacted. Selected retailers have noticed a softening in sales that might be attributable to the market's decline. A couple of realtors also reported a slowing in buying activity, although a majority have seen no change.

Manufacturers uniformly said it was too soon to tell if the stock market decline would hurt their business. There has been no change in incoming orders (even for a manufacturer with a heavy volume of "consumable" products) and contacts have not altered their own orders or plans yet.

Of eleven merchants contacted, three said their data were not current enough to report on the last few days of sales or customer traffic, four had current sales data and reported no effect, and four have seen some fall-off in sales this week. Phone orders at a large mail-order concern have been noticeably (10 to 20 percent) below budgeted levels since Friday 10/16, although the shortfall was already easing by Tuesday 10/20. A lumber chain experienced a "dramatic" drop in sales on Tuesday and Wednesday. Sales at one department store chain were normal (running 5 to 6 percent ahead of a year ago) through Tuesday, then deteriorated to "flat" on Wednesday 10/21; this same chain stopped all outgoing orders for two days, but has now lifted the restriction. A "nonurban" discount chain reported sales off substantially on Monday, but starting to come back by Tuesday; they are uncertain whether this reflects the weather or the market. An upscale furniture chain had sales 15 to 20 percent below plan Tuesday, but 15 to 20 percent above plan Wednesday, for a net "no effect."

The mail-order firm believes the drop-off "reflects more distraction than economic problems" - they see a similar order decline when there is a hurricane or a presidential election - and hence the firm expects higher orders in coming weeks to make up these losses. Several contacts expressed the feeling that stock market difficulties, short of precipitating a recession, cannot undermine the positive economic fundamentals of the New England economy. Others, however, said continued volatility, even if the stock market returned to previous record levels, would cause businesses, lenders, and consumers to retreat, slowing the economy.

Of eight realtors contacted, five reported no change in buying activity and three reported that buying was unusually slow this week. The three experiencing a slowdown had already seen a fall-off in buying beginning about a month ago, but the slowdown has been more pronounced since the market's drop.

FEDERAL RESERVE BANK
OF NEW YORK

PRIVATE WIRE-OUTGOING

- An imported luxury car dealership reported the cancellation of 10 percent of its orders this week.
- A large real estate agency in suburban New York, dealing to a large extent in the high end of the market, reported that only one of the 100 or so houses under contract had the scheduled transaction cancelled. On the other hand, a few potential buyers, who cited lower expected income from their jobs in the financial sector dropped out of the housing market. Also, several sellers reduced their asking price.

END OF MESSAGE

Fousek - New York

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FEDERAL RESERVE BANK
OF NEW YORK

PRIVATE WIRE-OUTGOING

To: Michael Prell
BOARD OF GOVERNORS
TERMINAL

SUBJECT: Reply to Mr. Prell's Wire of October 20, 1987.

Most of our contacts indicated that it was too early to make a firm judgement about their sales prospects or their spending plans. But it does seem that there will be a scaling back of the spending plans of some wealthy individuals.

- Contacts at department stores indicated no impact on sales.
- A very large manufacturer of household and industrial goods saw no decline in sales, but felt it was too early to detect a change.
- Seven out of eight members of the small businessmen council (who met in this bank on Wednesday) said that they felt that their sales prospects were not harmed by the stock market's drop.
- A commercial real estate broker had experienced no loss of interest in properties in the wake of Monday's developments.

Effect of Stock Market Drop on Spending

The stock market drop on October 19 has had a minimal impact on current consumer and business spending and has not prompted changes in spending plans. These results are based on information obtained October 21-22, 1987.

Retailers, including automobile dealers, say they have observed no drop-off in sales attributable to consumer spending restraint prompted by the stock market drop. They say some effect might be felt next year if a significant bear market develops or if credit conditions become more constrained. They have not lowered their forecasts of sales for the balance of the year.

Realtors report that some cash sales that had been agreed upon have been cancelled and some cash purchases of homes that were being planned have been postponed. This is not a significant portion of total sales.

Several banks in the district have queried their commercial lending officers on business borrowing and spending plans. They report that there has been no change in business loan demand or utilization of credit lines in the days following the stock market drop. However, some banks are revising downward their forecasts of business lending volume for the next several months.

Some banks experienced higher than usual deposit outflows on October 19, when the stock market fell. In the days since, however, higher than expected increases in deposits have been noted which some believe is the result of redemption of mutual fund shares by individual investors.

FAX TO:

Michael Prell

Board of Governors

FOURTH DISTRICT

Wealth effects of the drop in the stock market are apparent both in the markdowns of latest forecasts submitted by this Bank's panel of 25 business economists and in the level of uncertainty attached to those forecasts. Those forecasts were generally prepared prior to the record decline in stock prices early last week but were received at this Bank for the October 23 meeting of the Fourth District Economists' Roundtable. Those forecasts showed a 2.7% annual rate of increase in real GNP in 1987:IVQ, and 2.7% from 1987:IVQ to 1988:IVQ.

Most of the economists were still inclined to expect an only moderate impact on all business activity, assuming of course that the decline in stock prices did not carry much further. Typically, expected real GNP growth in 1988 was marked down by one-half to one percentage point with the bulk of the impact in consumer outlays. The group uniformly expects that the growth rate of the economy will be sustained throughout 1988, with a real GNP growth range apparently at 2% to 2-1/2%. A few of the group did not rule out the possibility of a one quarter output decline in real GNP perhaps this quarter or next. A prevailing view is that even a one quarter decline may be avoided if the equities market holds in the 2,000-2,200 Dow Jones range over the next several weeks. Moreover, most of the group apparently expect that growth in real GNP in 1987:IVQ will be sustained because of inventory buildup, especially of new cars, even though final sales will probably weaken.

Several economists caution that the prerequisites for sustained expansion in output are lower interest rates, and ample supplies of credit by the Federal Reserve to compensate for the wealth loss, and a need to promptly restore confidence in financial markets. A financial economist urged prompt action to reduce federal deficits in a meaningful way by as much as a $50 billion increase in taxes as a means for restoring investment confidence. In his view, a tax increase is what the foreign investors are demanding to redress the imbalance between saving and consumption in the U.S.

Much of the markdown of real GNP growth for 1988 stems from anticipated effects of wealth loss on consumers. The group acknowledged the difficulty in assessing likely impacts of the wealth loss because of limited experience with abrupt declines of this order and there was considerable disagreement over the magnitude of those effects.

Economists associated with major auto producers expect a large inventory buildup in auto stocks this quarter to sustain growth of real GNP despite a slide in consumer spending, partly because of the incentive payback. An economist with a major retailer was very skeptical about the relationship between wealth and income, pointing out that despite the rapid run-up in equity prices in recent years, consumer spending did not increase any faster than income. Another economist, who reduced his 1988 real GNP forecast by one-half percentage point mostly because of an expected wealth effect on consumer spending, also doubted whether those effects will be large. He acknowledged, however, that effects on consumer sentiment may be greater than wealth effects. Another economist was skeptical about how large the effect on spending will be. He is hesitant about marking down his real GNP forecast for 1988 for the time being because he asserts that the public was aware that stocks were increasingly over-valued relative to bonds and therefore did not use recent wealth gains to support spending. In his view, the response by the Federal Reserve to the wealth change is more important than the reduction in stock prices.

Generally, economists associated with capital goods producers do not expect major impacts on capital spending. At most they would expect only a marginal reduction in capital spending for 1988. One expects his firm will continue their capital spending as planned, but will change the means of financing. Another expects a psychological rather than a wealth shock to the economy, with some cutback in capital spending for short-term delivery items, such as cars and trucks, but no cutbacks in spending for other durable goods.

John M. Davis
Federal Reserve Cleveland

ADMINISTRATIVE MESSAGE SYSTEM

SUBJECT: STOCK MARKET - DISTRICT 5

TO: MICHAEL PRELL
DIRECTOR OF RESEARCH
BOARD OF GOVERNORS

FROM: AL BROADDUS
DIRECTOR OF RESEARCH
FRB-RICHMOND

We asked about 70 of our business contacts if the recent drop and subsequent volatility in the stock market have had any effect on spending. The responses to our questions were mixed, but generally indicated it was "too early to tell." The negative effects that were reported tended to focus on household rather than on producer spending.

Manufacturers

Ten of 21 manufacturers said their senior staff members had met to discuss changes in business plans. All but two of these 10 said they had not changed their plans for capital spending. One of the two exceptions, a large textile producer, postponed a public stock offering, but hoped to raise funds elsewhere for capital outlays. The other, a paper products manufacturer, said their capital spending probably will be affected.

Nearly all manufacturing respondents said they had not changed plans for production or for inventories. Most said it was too soon to see an impact on demand for their products. One large tobacco manufacturer said that his firm considered the stock market decline to be a "crazy aberration," and that they would wait a week or two for things to settle down before changing any plans. However, some furniture manufacturers noticed declines in retailer demand this week at the semiannual furniture market in High Point, North Carolina.

Retailers

Seven of ten automobile dealers reported no change in the pattern or volume of purchases from their showrooms. However, three dealers blamed the stock market for a few cancelled orders for new cars, and some dealers plan to reduce inventories. For example, a West Virginia dealer has postponed his usual yearend increases in inventories until January.

Seven of eight department store managers saw no change in consumer behavior this week. They anticipated no change in planned inventory levels as they were already stocked for the Christmas season.

Four of eight retail furniture stores reported lower sales this week. In one store that caters to a high income clientele, two customers cancelled orders for complete rooms of furniture. The manager attributed the cancellations to the stock market decline. Another store manager described this week as his slowest of the year, with sales off more than 50 percent. He attributed the slowness in sales to the stock market. This same manager cancelled orders to manufacturers this week for the first time this year. On the positive side, one Washington store had more business than usual on Wednesday, and customers paid cash.

Housing

Reports from real estate agents were mixed. Two agents said they observed increased interest in home purchases, but several others said that customer traffic declined this week. One agent who experienced improved business attributed the increased activity to expectations of a decline in mortgage rates. Where business slowed, the agents felt the stock market was a factor.

Other

A representative from a large brokerage firm said the recent volatility in the stock market is evidence of its limited capacity to handle large volumes of transactions. She said the market was overwhelmed by the heavy volume. As a result, information was not processed fast enough to allow market participants to monitor prices or transactions.

Some respondents expressed concern about the economic outlook. The president of a large manufacturing firm said the recent decline in the stock market indicated that a recession might be closer than had been expected. Two manufacturers of consumer goods worried about the psychological effects of the stock market decline on consumer confidence. A few of the business contacts felt that the media had distorted coverage of the stock market, and contributed to consumer nervousness.

The agriculture members of our advisory council said they had not yet observed any effects on farm markets. They indicated, however, that the prices of agricultural commodities might be adversely affected.

A. C. 140

FEDERAL RESERVE BANK OF ATLANTA

PRIVATE WIRE SYSTEM

Original

OUTGOING

TO MIKE PRELL
BOARD

ATLANTA, GA.

OCTOBER 23, 1987

DISTRICT 6

OUR SURVEY INCLUDED A SMALL SAMPLE OF BUSINESSES IN THE CONSUMER GOODS AND BASIC INDUSTRIES.

WITH THE EXCEPTION OF ONE AUTOMOBILE DEALER, ALL NOTED THAT THEY WERE NOT CHANGING PLANS IN LIGHT OF RECENT FINANCIAL MARKET DEVELOPMENTS. ALL BUT ONE OF THE MANUFACTURERS WERE GOING AHEAD WITH PLANNED INVESTMENT EXPENDITURES. ONE, A SMALL FURNITURE COMPANY, HOWEVER, WAS SCALING BACK A PROPOSED EXPANSION.

CONSUMER GOODS RETAILERS, WITH THE EXCEPTION OF THE AUTO DEALER, SAID THAT BUSINESS HAD NOT DIFFERED FROM EXPECTATIONS IN RECENT DAYS. ONE WAS PLANNING TO CONTINUE WITH CURRENT EXPANSION PLANS AND HAD ACCELERATED A PROGRAM TO REPURCHASE ITS OWN STOCK. A GM DEALER NOTED THAT TRAFFIC AND SALES HAD DROPPED OFF SUBSTANTIALLY, EVEN THOUGH THEY HAD BEEN STRONG IN THE FIRST HALF OF THE MONTH, CONTRARY TO NATIONAL EXPERIENCE. IT WAS NOTED THAT GM DEALERS HAD BEEN EXPECTING A STRIKE, AND SO INVENTORIES AT THIS POINT ARE LIKELY EXCESSIVE.

ABOUT HALF NOTED THAT THEY EXPECTED OTHERS TO BE A LITTLE MORE CAUTIOUS IN THE MONTHS AHEAD. IN THIS REGARD, THE RETAILERS ARE PARTICULARLY VULNERABLE, BECAUSE, WHILE THEY EXPECT GOOD CHRISTMAS SALES, THEY HAVE ALREADY STOCKED UP FOR THE BUSY SEASON. ANY SLOWDOWN WOULD LEAD TO A QUICK AND STEEP ACCUMULATION OF INVENTORY. THERE WAS SOME SPECULATION THAT THE LUXURY SEGMENT OF THE CONSUMER GOODS MARKET WAS THE MOST LIKELY TO BE IMPACTED ADVERSELY.

PLEASE NOTE THAT ALL RESPONDENTS STRESSED THAT IT WAS MUCH TOO EARLY TO DISCERN ANY REAL EFFECTS FROM THE WEEK'S EVENTS.

SLT

SHEILA L. TSCHINKEL
DIRECTOR OF RESEARCH
FRB ATLANTA

SLT:MSR:ALC

MEMORANDUM
Federal Reserve Bank of Chicago

1987 OCT 23 PM 4:06

TO: Mr. Michael Prell - Board of Governors 10/23/87

FROM: Anne Marie Gonczy Amg and Phil Cummins

SUBJECT: Seventh District response to your 10/20 wire requesting information on noticeable spending impact from recent stock market drop.

Comments from contacts ranged from "It's too soon to tell" to evidence of significant cutbacks in spending. Whether these cutbacks are sustained or widespread will depend, in part, on whether instability in financial markets continues.

One contact also noted a "Wall Street" versus "Main Street" mentality, with some viewing the stock market drop as predominantly a financial market problem.

A large retailer said that business was "awful" on Monday, especially, and Tuesday, but not as bad on Wednesday and Thursday--back to about even with a year earlier. First contacted on Wednesday, he reported every category of goods was down on Monday and Tuesday. Sales in the North as well as the South were weak--our contact did not have a finer regional breakdown. "Nothing looks good." He noted that volatility scares people more than the market being down. He views underlying economic factors are favorable for consumer spending, but believes consumer psychology was adversely affected early in the week. Recontacted on Friday, he said that the effects appear to have been very temporary, and the impact seems to have blown over.

The outlook for consumer psychology and spending will depend on what happens to the stock market, Fed policy, and how the media treat events of this week, one retail analyst commented. In 1974, the media said we were going to have a depression, and consumer psychology turned down sharply. This is the worst time of the year, from retailers' point of view, for consumer confidence to turn negative. However, if things settle down by mid-November, Christmas could still be okay.

Another retailer said that Monday's sales were down sharply and Tuesday's sales continued bad but sales bounced back strongly on Wednesday. The only persistent weakness through Wednesday was in furniture. Monday and Tuesday's slow sales may have been random, according to the contact with this store, rather than attributable to some other cause such as the stock market drop. The firm does not expect a very good Christmas.

Two other large retailers indicated that October started weak and has gotten weaker.

A retail outlet selling expensive stereos has seen "no traffic" this week. A seller of Oriental rugs saw $100,000 of sales last weekend cancelled this week.

An economist with a trade group for the home appliance industry has not yet heard any reports of effects on spending. His own personal view is that there will be some negative effects on spending from the stock market drop. The subsequent market rebound may partially alleviate the negative effects, but he expects some lingering adverse impact.

In contrast, a small supplier of office automation equipment said business is normal--if anything, it is up. Customers (including an insurance firm, and law firms) seem just as confident as before. This firm has seen no cancellations of appointments for next week expected to result in sizable sales.

However, another contact said that his personal response has been to stop spending for big items. He had been thinking of buying a $200 suit, for example, but now plans to defer that purchase. He has been a bear for some time, and sold 2 condos including one last spring, sold a sailboat last month, and is trying to sell another condo. He wants to be very liquid, with no debt.

At one large real estate broker, a few regional managers had reported some impact--2 "lookers" were no longer looking and a few customers who picked out houses last weekend did not follow through with contracts. It is too soon to tell if there will be any further impact on sales. Unfortunately, the press is saying consumer spending is going to drop since this could adversely affect consumer confidence. Also, this contact believes that press reports of adverse implications for pension funds are inaccurate--if properly funded, which most are, there should not be a problem. Many pension funds were overfunded and may still be.

A real estate salesperson with another firm indicated that activity (inquiries, etc.) in the brokerage office has slowed this week. There is a lack of buyers. Some persons directly dependent on employment in stock or commodity markets for their incomes have inquired about listing homes because of fear of loss of income.

Another person, commenting on this week's financial market activity, "there goes the room addition."

A large insurance firm does not expect to see any spending impact--consumers will continue to pay their premiums. On the investment side, the insurer's surplus has shrunk, but not enough to cause a problem. Their investment policy is very conservative, and they have little in the stock market. They have been trying to determine what precipitated the stock market drop--program trading, overvalued market, etc. Some $60-70 billion involved in "dynamic asset allocation" and "portfolio insurance" programs is thought to have contributed.

A steel producer has not yet seen any effects on spending. Our contact expects an effect similar to what happened in early May. At that time, some of this firm's customers put projects on hold until there was a break in financing. A similar effect is expected as a result of recent stock/financial market developments, but our contact has not seen any signs of it yet.

A diversified capital goods producer commented that it's too early to tell the extent of the impact. Our contact did not know of any changes at his firm. In general, most people are still trying to assess what is really going on.

An economist at an oil company commented that it is much too soon to see any impact. The impact on spending, if any, will depend on what happens over the next few weeks. If wild fluctuations continue, spending would probably drop, which would affect some of their products.

Another contact, with a large Michigan utility, expressed concerns about the combined effects of the stock market drop on net worth and confidence, leading to lower auto sales, adverse effects on the Michigan economy, and reduced electric power sendout. He was aware of no spending cutbacks yet in response to the stock market drop, other than a newspaper report of an individual who decided to postpone an auto purchase.

An analyst whose firm maintains a "stock-bond valuation model" said that stocks (S&P 500) were 30% overvalued in September relative to government bonds, according to the model, were about on par with bonds following Monday's crash, and closed Wednesday about 10% overvalued. The model includes dividend and interest yields and assumptions about future profits and dividend payouts.

Another contact noted that wider quality spreads in the "junk" bond market, or a drying-up of that market, could adversely affect deals to be financed with below-investment grade issues. He sees a two-tier "junk" bond market evolving--"true" junk and "better" junk, with "true" junk bonds those having both business and credit risk.

ESSAGE: H1RSH02M0519
UBJECT: STOCK MARKET RECEIVED: 10/23/87 14:40:10

TO: M1DSB00

MICHAEL PRELL ROOM 3046-B MAIL STOP 62

M: A.E. BALBACH—EIGHTH DISTRICT

IMPACT OF THE STOCK MARKET DROP ON SPENDING IN THE EIGHTH DISTRICT

OBER 23, 1987

CONTACTS GENERALLY REPORTED THAT THE RECENT VOLATILITY IN THE STOCK MARKET S HAD LITTLE OR NO NOTICEABLE EFFECT ON SPENDING IN THE EIGHTH DISTRICT SO R. MOST RESPONDENTS SAID, HOWEVER, THAT IT WAS STILL TOO EARLY TO DETERMINE AT ANY FUTURE EFFECT WILL BE. SELLERS OF CONSUMER ELECTRONICS AND MAJOR PLIANCES IN PARTICULAR REPORTED NO IMPACT. A WOMEN'S CLOTHING STORE OBSERVED EFFECT EXCEPT FOR THE CANCELLATION OF AN ORDER FOR AN EXPENSIVE COAT BY E CUSTOMER WHO HAD SUFFERED LARGE STOCK MARKET LOSSES. SEVERAL REALTORS PORTED THAT THERE HAD NOT YET BEEN A DISCERNIBLE EFFECT ON THE SALES OR ICES OF NEW OR EXISTING SINGLE-FAMILY HOMES. REALTORS EXPECT STRONGER LES, HOWEVER, IF THE STOCK MARKET DOWNTURN IS ASSOCIATED WITH LOWER INTEREST TES.

THE MOST SEVERE IMPACT WAS REPORTED BY A DEALER OF GERMAN LUXURY CARS. HE PORTED THAT SALES, WHICH HAD SLOWED CONSIDERABLY IN EARLY OCTOBER, WORSENED IS WEEK. AT LEAST THREE ORDERS MADE LAST WEEK WERE REPORTEDLY CANCELLED IS WEEK DUE TO THE STOCK MARKET DOWNTURN.
/23/87 13:39:31
D OF MESSAGE

MESSAGE: I1VIP01M0454
SUBJECT: PRELL

RECEIVED: 10/26/87
10:18:11

TO: M1FRB00

O: MIKE PRELL - BOARD OF GOVERNORS
FR: ART ROLNICK - FRB MINNEAPOLIS

N RESPONSE TO YOUR QUESTION, 'HAS THE DROP IN THE STOCK MARKET HAD A NOTICEABL
. EFFECT ON SPENDING?', OUR BUSINESS CONTACTS UNANIMOUSLY SAY IT IS REALLY TOO
ARLY TO TELL. THEY HAVE SEEN NO NOTICEABLE CHANGE IN CONSUMER SPENDING.

OME BANKERS HAVE SEEN THEIR DEPOSITS INCREASE FROM PEOPLE SELLING STOCK AND PU
TTING THEIR FUNDS TEMPORARILY INTO DEPOSITS. ONE OF OUR SMALL TOWN BANKERS THO
GHT THAT HE HAD A MINOR RUN ON HIS BANK AS THERE WAS A SURGE OF WITHDRAWALS.
OWEVER, HE EXPECTED FUNDS TO COME BACK IN A SHORT PERIOD OF TIME.
0/26/87 09:48:06
END OF MESSAGE

TELEGRAM

FEDERAL RESERVE
PRIVATE COMMUNICATIONS SYS

FCH 10 (8-73)

130 BD
101 OCTOBER 23, 1987
MIKE PRELL, DIRECTOR, DIVISION OF RESEARCH AND STATISTICS

SUBJECT: SURVEY RESULTS OF SPENDING EFFECTS OF THE RECENT DROP IN THE STOCK MARKET. -- FEDERAL RESERVE BANK OF KANSAS CITY

A telephone survey was conducted on October 22 and 23, 1987. Four groups were contacted: Reserve Bank Directors from a range of nonfinancial businesses, Reserve Bank Branch Directors from the savings and loan industry, a sample of Tenth District retailers, and automobile dealers' associations in six district states.

Most respondents report little or no effect on their businesses from the recent stock market decline. While few respondents foresee any generalized effects on future business activity, most emphasize that it is too soon to judge well and that the uncertainties are great.

Retail industry respondents report no detectable change in consumer purchases this week, and most expect little effect in upcoming months from stock market changes to date. But some retail respondents express concern that sales could slow significantly during the important holiday season. That concern stems from a fear that consumers will hold back due to wealth effects and to uneasiness about the stability of financial markets. Nearly all respondents stress a "wait and see" attitude with regard to possible strategies for handling the situation, with no changes in plans under way at this time. With stocks of goods already in place or on the way, little change is possible in retail inventories for Christmas sales.

One director noted that many of their affiliated retail outlets are small businesses, and expressed some concern that the owners may be hurt because of reduced values in wealth holding such as IRA's and Keough plans. A construction firm respondent directly attributed the cancellation of a modest-sized construction contract to the stock market drop, but other clients have not indicated any changes in their construction plans.

Respondents from the savings and loan industry have experienced differing deposit flows this week. All respondents said it was a little early to judge the effects, but they expected eventually to observe deposit inflows. The 5-day settlement period for stock transactions suggests more effects will be observed next week. One thrift in Lincoln, Nebraska reported a substantial improvement in deposits, but this gain could partly reflect interest rate increases prior to the stock market decline. In contrast, deposits were only marginally higher at an Oklahoma City thrift, and a Denver thrift reported a small outflow. The effect on the Tenth District housing market is expected to be negative, but some respondents stressed that their area housing markets are already depressed. One thrift reported it had realized substantial gains on its bond portfolio, which should improve the bottom line this quarter.

Little direct information is yet available about the effect of the stock market drop on new car sales. Some auto dealers expect the recent stock market decline and associated uncertainties about the economy to lead consumers to postpone auto purchases, but others expect no major effect on auto sales.

Auto dealers generally are waiting anxiously to see this weekend's sales activity.

THOMAS E. DAVIS - FRB-KC

TED

TED:mj
Sta. 15

ELEVENTH DISTRICT

Dallas

Business contacts in the Eleventh District have discerned little or no effect on current consumer or business spending from the recent 500 point drop in the stock market. Although contacts report increased uncertainty about the future strength of the economy, these concerns have not yet resulted in altered spending plans. Some respondents note that the effects of the stock market plunge cannot be distinguished from those linked to the overall sluggishness of the District economy.

District retailers generally report no decline in sales in response to the stock market drop. Although some merchandise retailers attribute slower sales of big ticket items to the plunge, most say sales have not changed noticeably this week. Auto dealers, for whom sales have been slow recently, are not able to attribute any additional weakness to the stock market.

Real estate respondents are mixed in their evaluation of the effect of the market fall. Although contacts in residential real estate report no change in an already sluggish housing market, some respondents do characterize potential home buyers as being in a holding pattern. Commercial realtors say one major effect on their business has been to raise concern about the viability of some projects because of what the stock market may suggest about future economic activity.

Bankers report that the stock market collapse has had no immediate effect on spending plans as far as they can tell from customer reaction. Some bankers did report heightened customer concerns about a national recession, which they note could dampen spending plans in the future. Most bank contacts express the notion that it is too early to tell what effect the drop in equity prices will have because their customers have adopted a wait-and-see attitude without changing their spending behavior.

According to District manufacturers, it is too early for them to revise their investment spending plans as a result of the stock market drop, although they do note that the increased market volatility has raised concerns about the future course of the economy.

October 23, 1987

SURVEY ON IMPACTS OF STOCK MARKET DECLINE

Twelfth District - San Francisco

Most reports suggest that concern regarding future economic conditions has risen noticeably since Monday, but there appears to be little panic. At this early point, changes in portfolio allocations are the most prevalent responses to the market fluctuations. Demand for CDs and treasury bills has increased as funds shift into these markets. In addition, the recent decrease in interest rates makes bond financing more attractive.

Banks are in the process of examining loans secured by stock. Some problems seem to exist, but the extent of exposure is relatively small. Large Twelfth District banks currently have about $1.5 billion in securities loans outstanding.

Some equity issues and acquisitions have been put on "hold" until the market stabilizes and firms have a better sense of whether they should proceed with those plans, and if so, how deals should be priced. Several large banks expect an increase in "bridge" financing until the market settles down. Stock buybacks also have generated additional lending activity.

None of these moves, however, appears to have changed firms' fundamental business plans at this point. There was a marked absence of reports that firms have cancelled major projects, and few had postponed such plans. One airline noted that capital spending plans had not been changed, but would be reevaluated in the light of the sharp decline in the firm's stock price. Spending plans likely would go ahead as long as the airline perceives the decline as a marketwide phenomenon rather than one associated with the firm itself. However, financing plans likely will be altered by changes in the relative prices of different funding sources. A commercial real estate agent with several deals in the pipeline reports no changes in any of his clients' plans. Moreover, the California Department of Commerce, which deals with firms planning major relocations or expansions, currently has about 30 projects in progress, and plans have not changed for any of them.

Overall, the mood appears remarkably calm, aided by the responsiveness of the Federal Reserve and other regulatory agencies. Many respondents are adopting a "wait and see" attitude until the markets settle down and the implications for investment decisions and consumer spending are more clear. Several respondents noted that current spending plans were drawn up conservatively, so planned projects are the most necessary ones and those plans are unlikely to change. Other firms had no major investment plans at all. Lower interest rates reduced anxiety, as well as the consumer debt burden associated with floating-rate loans.

Most respondents expect that consumer spending will decline during the next few months as a result of the collapse in stock prices. Few have seen any changes in consumer spending at this early date, although there have been scattered reports of car sales that have fallen through. Mercedes and other luxury cars appear to be bearing the brunt of these lost sales. Car sales at low and middle price levels were slow already, but do not appear to have slowed further during the past week. A San Francisco auto dealer which handles many makes and price ranges reports that sales have been at their "usual, steady pace" throughout the week.

BEEBE -- San Francisco