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FDIC REPORT ANALYZES VULNERABILITY OF BANKING INDUSTRY TO A SLOWING ECONOMY

FOR IMMEDIATE RELEASE

In a semi-annual report on risks in banking released today, analysts with the Federal Deposit Insurance Corporation (FDIC) identified several factors that have weakened the current economic expansion. Rising energy prices, high levels of corporate and household debt, tight labor markets and a weakening stock market all could portend slower economic growth and a more challenging environment for insured institutions.

In the fourth quarter edition of the FDIC's ***Regional Outlook***, analysts also report that while overall the banking industry remains strong, aggregate risk to insured institutions appears to be rising, as evidenced by a shifting over the past several years, in certain banking markets, of asset mixes toward commercial and industrial, commercial real estate, and construction and development loan categories, increasing concentrations in these traditionally higher-risk loan types. After nearly a decade of improving asset quality, the level of problem loans has begun to edge upward, but remains favorable compared with the late 1980s and early 1990s. In addition, this report discusses the growing reliance on non-core funding to support asset growth, heightened interest rate risk sensitivity at some institutions, and declining net interest margins.

"It appears that insured institutions' high levels of profitability in recent years have been achieved, in part, by an increased appetite for risk," said FDIC Chairman Donna Tanoue. "More recently, there have been reports that some banks have begun to tighten credit standards."

FDIC analysts note that insured institutions in selected banking environments may be exposed to increasing risk on several fronts, and that a combination of these exposures could create challenges for these institutions should economic growth slow significantly.

These economic and banking trends are reflected in the following regional developments.

- **Atlanta Region.** Some community banks in the Region are assuming more credit risk as their real estate and commercial and industrial loan portfolios continue to grow rapidly. In addition, interest rate risk has increased slightly as community banks' reliance on non-core funding has grown and the net duration of assets has lengthened.

- **Boston Region.** Slow core deposit growth in the Region has caused institutions to seek alternative funding sources. Increased non-core funding may constrain liquidity, heighten interest rate risk and encourage increased credit risk to preserve interest margins.

- **New York Region.** Housing markets in some of the Region's major cities have shown significant price appreciation, though at a more modest rate than during the Region's 1980s housing boom.

- **Memphis Region.** With increasing competition compressing net interest margins, many banks are expanding the volume of higher risk loan categories in order to improve asset yields, which could heighten the vulnerability of the Region's banks to any deterioration in economic conditions.

- **Kansas City Region.** The Region's community banks have experienced compression in net interest margins since 1992, largely because of competitive pressures on both sides of the balance sheet. This compression has occurred even though banks have greatly increased loan-to-asset ratios, which typically would help to boost margins.

- **Dallas Region.** Many of the Region's insured institutions are expanding loan exposure and shifting loan portfolios into traditionally higher-risk assets during a time when the economy could be slowing, potentially increasing the level of credit risk.

- **Chicago Region.** New banks are forming rapidly, particularly in the Region's larger metropolitan areas, and are contributing to an already competitive banking environment. The risk profile of new banks appears to be increasing, compared to other established community banks, because of heightened exposure to traditionally higher-risk loan categories and a greater reliance on non-core funding.

- **San Francisco Region.** Rapid growth in commercial real estate development has occurred in five metropolitan statistical areas, Las Vegas, Phoenix, Seattle, Salt Lake City, and Portland. Should demand weaken, the potential for overbuilding could exist. At the same time, community banks in these areas have experienced rapid loan growth and increased concentrations in commercial real estate and construction and development loans.