# PRESS RELEASE

Federal Deposit Insurance Corporation

June 21, 2000

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## "NEW ECONOMY" MAY INCREASE BANKING RISKS, FDIC ANALYSTS REPORT

**FOR IMMEDIATE RELEASE**

Changes in the U.S. economy during the current, record-long expansion may be increasing financial and market risks for the banking industry, according to a report by analysts at the Federal Deposit Insurance Corporation (FDIC).

In the second quarter edition of the *Regional Outlook*, FDIC analysts describe how "New Economy" trends, which may produce longer expansions, also introduce the possibility of more severe recessions. The report notes that while the consensus economic outlook remains positive, financial imbalances are developing that could magnify the severity of any economic slowdown.

"The extraordinary duration of this economic expansion has been a tremendous boon to banks and thrifts," said FDIC Chairman Donna Tanoue. "There are indications, however, that banking risks associated with the U.S. business cycle may actually be increasing, making tomorrow's challenges much different from those of the recent past. Yellow-caution lights are flashing."

According to the report, long expansions allow banks and their customers to take on more leverage and possibly more risk. Growing indebtedness by consumers and businesses leaves both vulnerable to rising interest rates, and raises concerns about consumer and commercial credit quality. The report also notes that given the size of bank lending exposures to commercial borrowers, recent signs of deterioration in commercial credit quality deserve close monitoring.

The report also warns that the outlook for the economy and the banking industry is clouded by a growing vulnerability to financial market disruptions. It argues that favorable conditions in the financial markets have been a key factor behind the current economic expansion. At the same time, some banks' reliance on market-based sources of revenue, such as venture capital and trading income, has increased. The emergence of less favorable financial market conditions, such as those experienced during the fall of 1998, could derail the expansion and dim the prospects for bank earnings growth.

Analysts in the Boston Region - as well as in other Regions - report that many insured institutions, particularly savings banks, have become increasingly exposed to rising interest rates. There appears to be little change in the duration of liabilities to offset growth in long-term assets. At the same time, most insured institutions are not using off-balance sheet strategies to mitigate this rising level of risk. The analysis also shows that depositors have tended to seek higher-yielding investments when interest rates rise, particularly when the rates paid on core deposits lag increases in market interest rates.

Developments in other Regions include:

- **Atlanta Region.** Economic strength in the Atlanta Region, low interest rates, and adequate available sources of credit have promoted growth in residential real estate construction in recent years, particularly in urban areas. Commercial real estate development has increased substantially as high-tech ventures and supporting industries have moved to or expanded in the northern Virginia suburbs surrounding Washington, D.C.

- **San Francisco Region.** Commercial lenders in many of the Region's states reported rapid growth and increased concentrations in construction, commercial real estate, and commercial and industrial loans during 1999.

- **New York Region.** Higher interest rates and changes in mortgage preferences could challenge the Region's banks' interest rate risk management programs.

- **Dallas Region.** While the Region's banks and thrifts are experiencing a more favorable cost of funding than other institutions nationwide, a lengthening maturity of insured institutions' securities portfolios may adversely affect margins should interest rates continue to rise.

- **Chicago Region.** Although the median Tier 1 leverage capital ratio among the Region's community institutions remains near the decade high, it has recently begun to decline modestly. This is occurring even as some measurements suggest that risk levels are increasing.

- **Kansas City Region.** Higher vacancy rates in the St. Louis office market may suggest a risk of overbuilding, as population and employment growth appear insufficient to support the current level of construction activity.

- **Memphis Region.** Recent changes in the tobacco sector, primarily sharply lower demand, could affect farmers and communities dependent on tobacco production.

The *Regional Outlook* is published quarterly by the FDIC's Division of as a source of information on economic and banking risks affecting insured depository institutions. *The*

*Regional Outlook* for each FDIC Region, as well as the National Edition are available on the Internet at www.fdic.gov. Printed copies of the *Regional Outlook* are available from the FDIC's Public Information Center (800-276-6003 or (703) 562-2200).

Attachment: *Regional Outlook*