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# BANKING INDUSTRY PERFORMANCE REMAINS STRONG DESPITE LINGERING ECONOMIC WEAKNESSES

A report released today in the FDIC's ***Regional Outlook*** describes recent signs of a consumer-led recovery in the U.S. economy, but cautions that banks remain exposed to lingering economic risks, notably in the area of subprime consumer lending.

Bank performance has remained generally strong during the recession, despite higher losses on commercial and credit card loans. "Loan losses tend to lag the business cycle and may remain at high levels in the near term," cautions FDIC Chairman Don Powell. "However, at this time, the industry overall appears to be well positioned to weather the storm," adds Chairman Powell.

FDIC analysts note that obstacles to an economic recovery remain. Corporate profits remain weak, business fixed investment continues to decline, over-capacity exists in key industry sectors, commercial real estate vacancy rates are rising, and consumers and businesses are carrying high debt loads.

Going forward, the greatest near-term risk to FDIC-insured institutions appears to be subprime and high loan-to-value consumer lending. According to the FDIC report, not only are loan losses much higher than those experienced with prime consumer loans, but credit models used by subprime lenders have tended to under-predict actual losses. A longer-term vulnerability relates to the effects of the recent economic slowdown in formerly rapidly growing metropolitan areas. Many banks and thrifts in these areas have continued to add to exposure levels in traditionally higher-risk loan types, particularly commercial real estate.

Today's ***Regional Outlook*** addresses a variety of other regional developments including:

- **Atlanta Region.** Economic growth in certain metropolitan markets in the Region has slowed significantly as insured institutions in several of these markets continue to increase exposures in traditionally higher-risk loan categories.

- **Boston Region**. New England's economic recovery may lag the nation's because of continued weakness among information technology firms. Insured institution credit quality remains sound despite increases in commercial property vacancy rates and the slowing economy.

- **Chicago Region.** Credit quality deterioration is widespread across loan types, but is not severe overall and varies across the Region. However, allowance coverage of nonperforming loans dropped significantly.

- **Dallas Region**. Economic activity slowed during 2001, curbing demand for commercial real estate (CRE). At the same time, the percentage of the Region's insured institutions reporting relatively high CRE concentrations has never been higher.

- **Kansas City Region**. Provisions of the next farm bill could affect the creditworthiness of borrowers and asset quality among the Region's farm banks. Margin compression continues to pressure profitability among the Region's community banks.

- **Memphis Region.** Lingering economic weakness in the Region and deteriorating credit quality suggest that continued attention to the allowance for loan and lease losses is needed.

- **New York Region**. Increased concentrations of long-term assets, particularly among the Region's community banks, has heightened the importance of effective interest rate risk management.

- **San Francisco Region.** Commercial real estate deterioration, increases in personal bankruptcy rates, and weakness in the tourism sector pressured insured institution credit quality. Declining interest rates challenged community bank net interest margins.

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Attachment: Regional Outlook: 2nd Quarter 2002