# FDIC: FYI - Loan Weakness Spreads; Banks' Defenses Hold

## Loan Weakness Spreads; Banks' Defenses Hold
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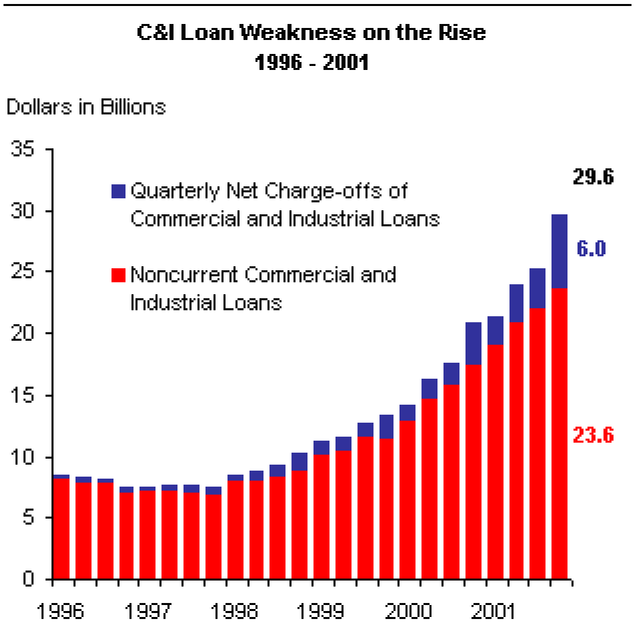
Large banks' business loans have been hit hardest by the recession, but some weakening is now appearing for smaller banks and for other kinds of loans. At a February 28 webcast, FDIC analysts discussed how bank earnings are holding up in the face of these loan-loss trends, based on preliminary fourth quarter 2001 data for commercial banks.

Credit quality problems at the nation's banks have resided principally in the commercial and industrial (C&I) portfolio (see chart below). C&I loans represent about 25 percent of the $3.9 trillion loan portfolio of all 8,080 FDIC-insured commercial banks, and as such provide an indication of the overall health of the business economy. Based on preliminary, year-end 2001 Call Report data, noncurrent C&I loans (that is, loans 90 days or more past due and those in nonaccrual status) grew to $23.6 billion -- 2.40 percent of all C&I loans.[1] Despite this rising trend, the noncurrent C&I rate remains considerably lower than the record, 5.19 percent, reached in 1987. Net chargeoffs of C&I loans increased to 2.41 percent in the fourth quarter of 2001.[2] The largest C&I chargeoff rate ever reported was 2.53 percent, at the end of 1991. Recent data show that C&I credit problems are trending upward, as illustrated by the chart. New announcements of corporate bankruptcies, debt defaults and ratings downgrades suggest that commercial lending problems will continue in the first quarter of 2002.

Chart 1




Source: FDIC *Preliminary Bank Earnings Report* , Fourth Quarter 2001

Larger banks in particular have felt the weakness in the U.S. economy through some of their major corporate borrowers. The impact can be observed in the table that follows, which compares performance measures for C&I and other loan types for the 400 institutions with assets in excess of $1 billion vs. the 7,680 smaller banks.

Table 1

| Loan Quality Varies Substantially by Loan Type and Bank Size<br>Fourth Quarter 2001 | | |
|---|---|---|
| | **Banks > $1 Billion** | **Banks < $1 Billion** |
| **C&I Loans** | | |
| **Noncurrent (%)** | 2.54 | 1.40 |
| **Chargeoffs (%)** | 2.57 | 1.25 |
| **Non C&I Loans** | | |
| **Noncurrent (%)** | 1.12 | 0.89 |
| **Chargeoffs (%)** | 1.05 | 0.42 |
| **All Loans** | | |
| **Noncurrent (%)** | 1.50 | 0.98 |
| **Chargeoffs (%)** | 1.46 | 0.57 |

Noncurrent loans are expressed as a percentage of total loans of the same type at quarter end.
Net Chargeoffs are expressed as a percentage of average loans over the quarter.

The table illustrates the uneven effects of the current economic downturn, which has been characterized as a "business recession." Impacts of the recession on consumers, however, are becoming more evident in the data. Consumer loan delinquencies and chargeoffs have turned upward at banks of all sizes with credit card debt contributing significantly to the volume of these problems. Consumer lending, at $1.57 trillion, represents 40.3 percent of all bank loans held in portfolio. [3,4] Chargeoffs of consumer loans increased from 1.06 percent and 1.28 percent for the final quarters of 1999 and 2000 respectively - to 1.43 percent for the fourth quarter of 2001.

The data show that the impact of the recession is now clearly discernable beyond C&I lending and at smaller institutions. However, the increase in credit weakness has been relatively modest so far - even though banks with assets of less than $1 billion experienced increases in their year-to-year noncurrent loan rates in 11 of 14 different loan types at year-end 2001, up from only five of the categories one year ago.[5] At the same time, noncurrent loan rates at smaller banks grew from 0.79 percent at the end of 1999 to 0.82 percent at year-end 2000 to 0.98 percent at the end of 2001. Loan chargeoffs at smaller banks showed a similar pattern with mostly moderate increases in all categories over the two-year period. In the fourth quarter of 2001, net chargeoffs by smaller institutions were 0.57 percent of average loans, up from 0.45 percent in the corresponding quarter of 2000 and from 0.47 percent in the fourth quarter of 1999.

A pattern of weakening in lending segments other than C&I was evident at larger banks as well. The aggregate noncurrent loan rate at larger banks, in all categories except C&I, was 0.91 percent at the end of 1999 and 0.98 percent in December 2000, increasing to 1.12 percent by the close of 2001. Chargeoffs by larger banks followed a similar pattern. The net chargoff rate for all loan categories except C&I loans was 0.76 percent in the fourth quarter of 1999, increasing to 0.90 percent and 1.05 percent in the fourth quarters of 2000 and 2001 respectively.

Despite these adverse trends, banks continue to maintain high levels of capital and reserves. Equity capital of the industry stands at 9.10 percent of assets, up from 8.49 percent a year ago. Loan loss reserves at year-end are $72.1 billion (1.85 percent of loans and leases) up from $64.1 billion (1.68 percent of loans and leases) one year ago.

Preliminary analysis of commercial banks' fourth quarter earnings will be released on February 28, 2002 at an FDIC news conference to be webcast on the Internet at www.fdic.gov. The *Preliminary Bank Earnings Report* is the earliest comprehensive analysis of the commercial banking industry each quarter, based on the quarterly Call Reports filed by all FDIC-insured commercial banks.

For the complete Preliminary Bank Earnings Report (published February 28, 2002), go to:
[http://www.fdic.gov/news/news/press/2002/pr2302a.html](http://www.fdic.gov/news/news/press/2002/pr2302a.html).

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1. Nonaccrual loans are credits of sufficiently doubtful quality that interest is not booked until payments are actually received.
2. Net chargeoffs consist of loans charged off during the quarter, less recoveries on previously charged off loans. The rate is annualized.
3. "Consumer lending" comprises the following categories: 1-4 family home mortgages, home equity loans, credit card debt and non-card consumer credit.
4. This discussion does not address loans that have been securitized and sold.
5. The categories are: business real estate, 1-4 family homes, multifamily, construction loans, home equity, loans secured by farmland, C&I, lease financing, agricultural production, credit card, non-card consumer, depository institutions, foreign governments, and all remaining loan categories combined.