PRESS RELEASE
Federal Deposit Insurance Corporation

March 19, 2003

Media Contact:
David Barr (202) 898-6992

# RESOLVING ECONOMIC UNCERTAINTIES KEY TO 2003 OUTLOOK FOR U.S. BANKING INDUSTRY

**FOR IMMEDIATE RELEASE**

The economic environment for U.S. banks in 2003 will be shaped largely by progress made in resolving sources of uncertainty that appear to be holding back recovery from the 2001 recession, according to a report in the Spring 2003 *FDIC Outlook*.*

The report contends that despite the challenges associated with restructuring in hard-hit corporate industry sectors, economic recovery has proceeded on the strength of expansionary monetary and fiscal policies and gains in productivity. The recovery has been slow-paced, with only modest gains in business investment and an absence of net job growth. The key impediment to a more robust economic expansion appears to be growing uncertainty on the part of consumers, investors, and business executives. However, this uncertainty relates to factors such as terrorism, war, and corporate governance reform where current negative sentiment may be subject to sudden reversal.

One bright spot in the economic outlook is the apparent success banks have had in managing the fallout associated with rising loan losses.

"Strong earnings and capital positions have helped to insulate the banking industry from the more severe effects of corporate sector restructuring," said FDIC Chairman Don Powell. "The generally strong financial condition of the banking industry bodes well for the U.S. economic outlook."

According to the *FDIC Outlook*, banks are recognizing loan losses promptly, taking advantage of the development of an active secondary loan market, and increasing the use of derivative instruments to manage risk in the commercial loan portfolio. Rising levels of noninterest income have helped to offset the effects of loss provisions on earnings, and a steep yield curve has contributed significantly to an increase in net interest income. FDIC analysts conclude that unless there is a substantial rise in short-term interest rates that could impair net interest income, the factors that have helped to offset rising loan loss provisions should remain in place this year.

***FDIC Outlook*** addresses a variety of regional developments including:

**Atlanta Region.** The region struggled to emerge from the recession in 2002. However, exposure to certain stressed industries could weaken the recovery and contribute to further deterioration in insured institution asset quality.

**Chicago Region.** Amid improving economic and generally healthy banking conditions, the evolving nature of residential lending may challenge some lenders' risk management systems.

**Dallas Region**.

- **Midsouth** -- Job losses slowed overall as well as in the area's key manufacturing sector. Credit quality deterioration abated and earnings improved among the area's insured institutions. However, option risk appears to be increasing in the securities portfolio.

- **Southwest** -- Continued weak employment growth could contribute to deterioration in residential loan portfolios, particularly in markets in which home price appreciation outpaces household income.

**Kansas City Region.** The nation's largest banks have benefited from inflows of deposits during the recent recession. However, growth of noncore funds continues to outpace the increase in core deposits among the region's community banks.

**New York Region.**

- **Mid-Atlantic** -- Insured institutions headquartered in metropolitan areas that lagged national employment trends reported generally favorable conditions. However, should local economies remain sluggish, credit quality could weaken. Securities gains by large banks partially offset declines in market-sensitive revenues.

- **New England** -- Insured institutions continue to report favorable conditions. Rates of home price appreciation may be unsustainable in some of the region's markets, but the potential for home prices to decline is modest.

**San Francisco Region**. Home price appreciation may slow in some areas because of weak employment and low affordability. Shifts in mortgage portfolio composition and changes in underwriting standards may challenge lenders in certain markets.

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** Note: For the past eight years, the FDIC has been committed to providing useful, risk-focused information through the **Regional Outlook**. This quarter, the publication has a new look and a new name - **FDIC Outlook**. The new, single-issue format tells the national economic and banking story and relates this story to regional economic and banking trends. The new name reflects our goal of providing forward-looking information about the national and regional economies and banking sectors.*