CHAIRMAN DONALD E. POWELL
FEDERAL DEPOSIT INSURANCE CORPORATION
REMARKS TO
THE FDIC CORPORATE SECTOR ROUNDTABLE
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Media Contact:
David Barr (202) 898-6992

Good morning. It is wonderful to be here and we're honored all of you have taken time to attend today's roundtable event.

This is the second economic roundtable we've held this year, and the fourth in the last six months. In February, we hosted a Consumer Balance Sheet Roundtable in Washington, where we gathered experts on household finances and consumer credit quality.

They told us that the higher credit losses consumer lenders have seen in recent years are part of a long-term trend that is not likely to turn around anytime soon. They also said there was nothing wrong with consumer finances overall that some decent job growth couldn't cure.

We're here today, in part, to ask when that job growth is finally going to materialize and help to get the U.S. economy moving forward again on a more solid footing.

Consumers have been instrumental in keeping the economy growing for five consecutive quarters through December of last year. But consumers can't do it on their own forever.

The total number of payroll jobs remains over two million below what it was two years ago. Large companies have been very reluctant to hire and invest in recent months because they've been trying to get their financial house in order and because they've seen weak demand and weak pricing for their products.

What we're going to need to keep consumers in the game and to add some muscle to the recovery is a decided turnaround in the nonfinancial corporate sector that puts them more in the mood to hire and invest.

Let's look back for a moment at how we arrived here. The recession that began in March 2001 can truly be called a corporate-sector recession, because most of the bad economic news has been corporate news.

As you know well, the problems began in the manufacturing sector, but bigger problems soon materialized in high-tech industries, such as telecom, computers and dot-coms. The overhang of New Economy excesses remains with us three years after the tech bubble burst here on Wall Street. It's only been compounded by problems in airlines and insurance that were related to 9-11 and its aftermath.

The result has been a long, slow, painful restructuring process for corporate America. In the last five years, over 800 publicly traded U.S. companies with over $800 billion in assets have gone into bankruptcy. Many others cut back sharply on payrolls and investment plans.

Needless to say, very little happy news comes out of such a process. There are real human costs to these upheavals, involving dashed expectations and shattered dreams.

Stories of bankruptcy and scandal attract a great deal of media attention, as well they should, for they are cautionary tales of what can go wrong if we are not careful in how we run our businesses.

But these stories also tend to obscure another, more positive side of the story, and that is the ultimate benefits of promptly fixing investment mistakes.

It is widely recognized that the genius of the American economy is the ability of the private sector to identify and fund worthy new investment projects.

I would submit that it is equally valuable to be able to quickly identify and correct our investment mistakes.

To do so, it is sometimes necessary that companies fail and that workers be displaced. But it is an article of faith in our system that the ultimate health of our economy requires that we pursue these remedies so that we may then move on to more productive uses of capital and labor.

Our faith in this premise has allowed us to enjoy one of the highest standards of living anywhere in the world.

We at the FDIC have a great deal of first-hand experience with this process, having acted as trustee for the receiverships of over 1,500 failed institutions since 1989.

The interest that the FDIC takes in the prospects of the nonfinancial corporate sector goes beyond a concern about credit quality at large banks that lend to large corporate borrowers.

Yes, our mission is to promote financial stability, and that involves effective management of credit risks on the part of insured banks and thrifts.

But we mustn't lose sight of the fact that financial stability is not an end in itself but is a means to an end-and that is to promote the economic vitality of our great nation.

Bankers are directly involved in financing our dreams and our prosperity. The mission of the FDIC is to promote stability so that insured institutions can provide the credit the economy needs.

So now you know why we're here, and why we're asking these experts to inform us about the state of the corporate business sector and the outlook for its immediate future.

You know why we think the stakes are so high not just for our industry but for the U.S. economy as a whole.

And now you would probably like to know, "What does the FDIC think about the outlook for corporate credit quality and the economy?" We feel that just as our mission is vital to the economy, it also requires us to constantly be forward-looking instead of just reacting to events as they unfold.

Our economists and examiners work together to combine information from their respective disciplines to arrive at this outlook. I would like to share their perspectives with you today before we turn the program over to our invited panelists.

First, as a general matter, we see tangible signs that the nonfinancial corporate sector is stabilizing.

What are these signs? Briefly, we're starting to see consistent gains in profitability and cash flow, driven mostly by controlling borrowing and costs. The first quarter earnings results we've seen so far have been fairly encouraging in this regard.

In short, we think the worst is over. And although this is not a heroic statement, you will find many who would still dispute it.

And that is exactly why we've come to New York to consult with you and this panel of experts to gain more insight into where we are in this vital corporate restructuring process.

Second, we are seeing real improvement in commercial credit quality in large bank loan portfolios.

After two years of fairly rapid increases in problem commercial credits at large banks, we saw noncurrent commercial and industrial (or C&I) loans fall by $1.2 billion in the fourth quarter.

Commercial loan chargeoffs in the quarter were down 30 percent from year-ago levels.

Granted, this is only a one-quarter decline in these measures of problem loans. But we are confident that it marks the beginning of a more substantial trend toward improved credit quality in bank C&I loan portfolios.

One reason is that risk selection has improved over time as lending standards have been tightened. Regulatory surveys show that this tightening began in earnest in 2000 as loan performance began to deteriorate.

Just as a period of relaxed standards eventually leads to higher losses, tighter standards eventually result in improved loan performance.

In addition, insured banks have generally been proactive in addressing problem credits as they have arisen and recognizing losses early.

One way they've been able to do this is through the rapidly growing secondary market for distressed loans. Some $48 billion in distressed loans changed hands last year, or double the volume of just two years ago.

This type of proactive approach to commercial loan problems is essential to preserving the ability of banks to make new loans to creditworthy borrowers when economic conditions improve, as they inevitably will.

Another factor pointing to continued improvement in bank commercial credit quality is the underlying trend in corporate bond defaults.

We saw 12-month average default rates on spec-grade bonds peak early last year at 11.5 percent. Since then, the default rate has fallen steadily, all the way to 5.7 percent as of last month.

If history is any guide, this bodes well for commercial loan performance at FDIC-insured banks.

The final element of our outlook relates to the recent weakness of overall economic conditions and the lack of confidence that has been reported by businesses of all sizes.

In this environment, right up to the present time, we observe that business borrowers and lenders remain very cautious. And this raises doubts as to whether commercial loan volumes will rise appreciably over the course of the year.

In the climate of uncertainty that led up to the war in Iraq, borrowers appeared reluctant to utilize lines of credit to build inventories or to finance expansion.

Lenders, too, showed little appetite to take on lending risks that did not appear to be justified by sufficiently high returns.

It is important to point out that there are no apparent financial or regulatory barriers to an expansion of commercial credit by banks.

Rather, it appears to be the weakness of final demand and pricing seen by corporate borrowers--both here and abroad--that has been discouraging the growth of bank commercial loans to finance economic activity.

Many economists have maintained that uncertainty associated with Iraq has been a prime reason for the weakness in demand and investor sentiment in recent months.

If this is indeed the case, then the reverse should also be true - the successful resolution of much uncertainty in Iraq should serve to stimulate demand and lending activity.

We will all see in the coming weeks and months whether this will be the case. Our expectation is that all the other necessary factors for economic recovery are in place, namely:

significant progress in restructuring the corporate sector,
continued financial strength in the banking industry, and
expansionary monetary and fiscal policies.
At the same time, policymakers here and abroad must avoid complacency. We're not out of the woods yet.

The weakness of global demand remains a problem, and we must remain on our guard to deal with it appropriately and forcefully.

With these thoughts as prologue, I am pleased to turn the program over to our panelists to consider the financial state of the U.S. corporate sector. Thank you for participating in this important discussion with us here today.

Congress created the Federal Deposit Insurance Corporation in 1933 to restore public confidence in the nation's banking system. The FDIC insures deposits at the nation's 9,354 banks and savings associations and it promotes the safety and soundness of these institutions by identifying, monitoring and addressing risks to which they are exposed. The FDIC receives no federal tax dollars - insured financial institutions fund its operations.

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