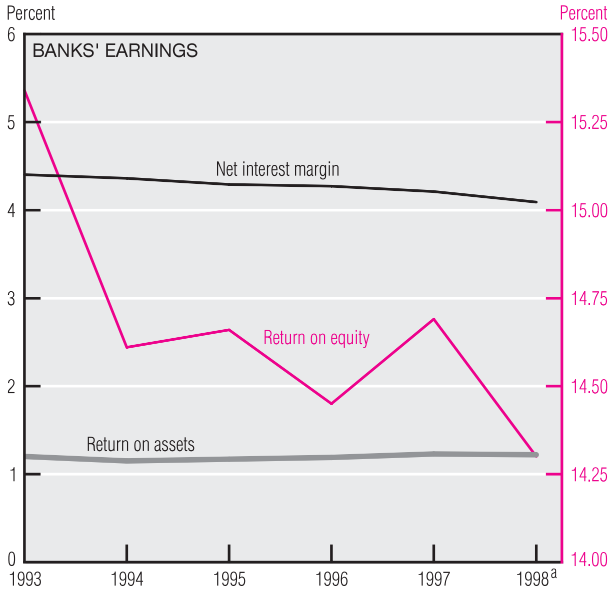
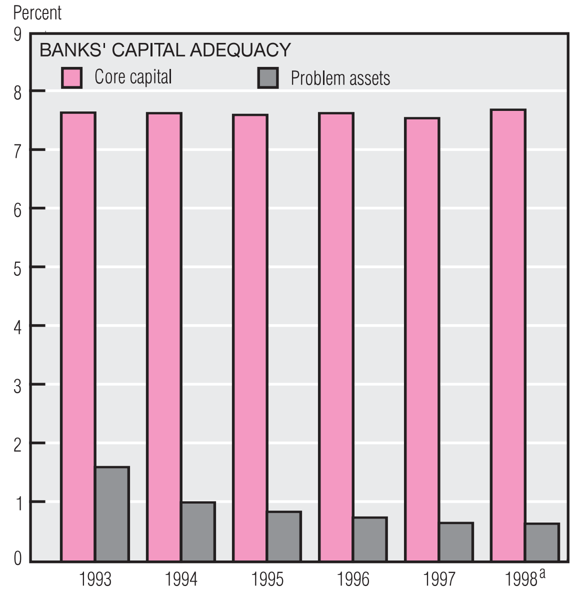
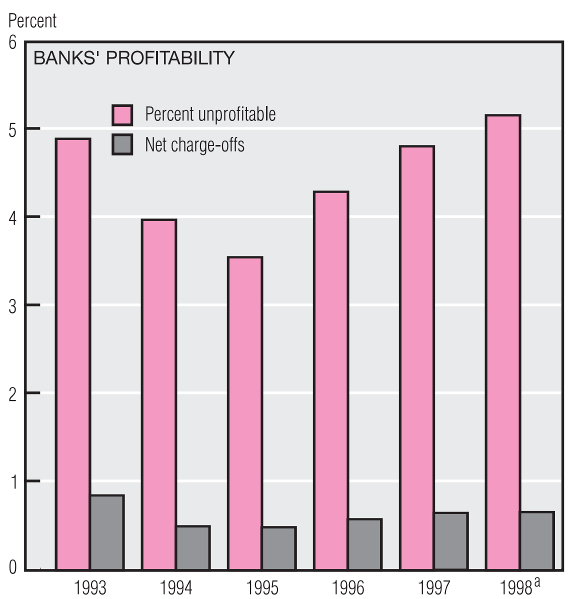
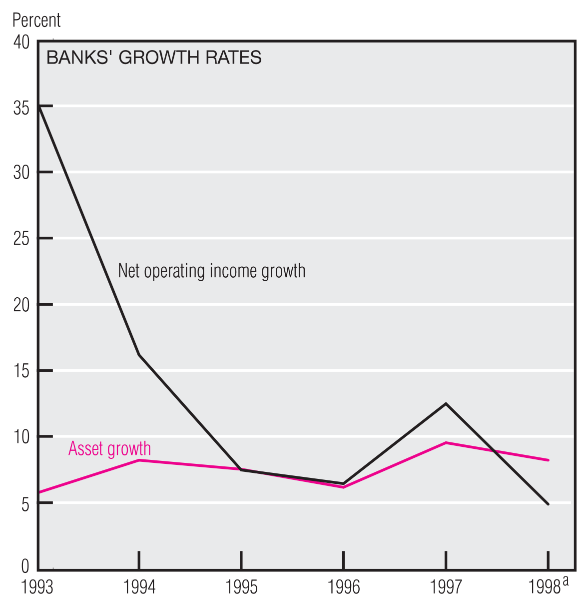
Banking Conditions









a. Data are through 1998:IIIQ.
NOTE: All data are for FDIC-insured commercial banks.
SOURCE: Federal Deposit Insurance Corporation, *Quarterly Banking Profile*, September 1998.

Commercial banks' balance sheets showed continued signs of health through the third quarter of 1998. Despite a slowdown in profits relative to 1997, earnings remained strong, with the net interest margin remaining above 4%. Return on equity for the first nine months of 1998 was 14.3%. Moreover, nearly 95% of all commercial banks posted positive profits through the third quarter of 1998.

Strong bank balance sheets are reflected in core bank capital, which is at 7.7% of assets, its highest level in 47 years. Asset-quality problems are not yet evident, as nonperforming assets fell to 0.65% of assets. One sign of potential weakness is the increased level of net charge-offs to 0.66% of loans. However, while net charge-offs have reached their highest level in five years, they remain well below 1% of total loans and do not merit concern at this time.

Finally, the banking sector's growth showed signs of a moderate slowdown during the first nine months of 1998. Net operating income growth fell below 5%, its lowest level in five years. Bank asset growth, however, remained above 8% through the third quarter of 1998. Overall, the banking sector could continue to grow at current rates without compromising the recent trend in profitability or, more importantly, the quality of its assets.

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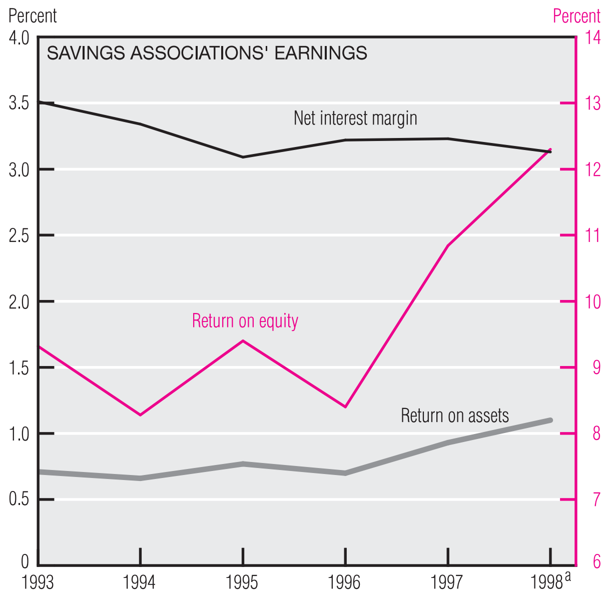
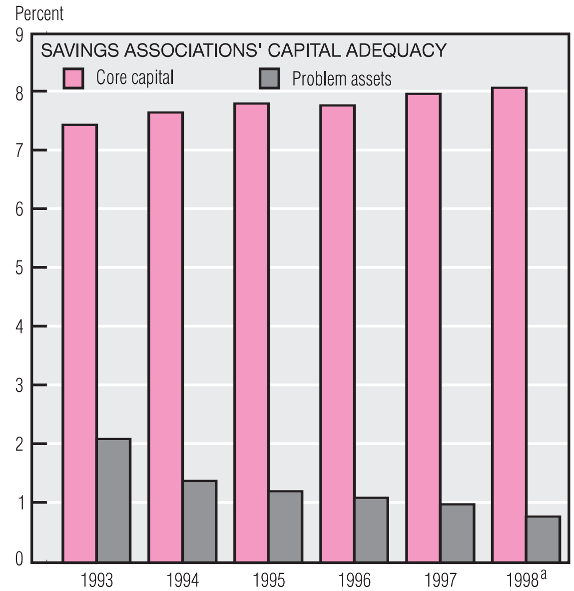
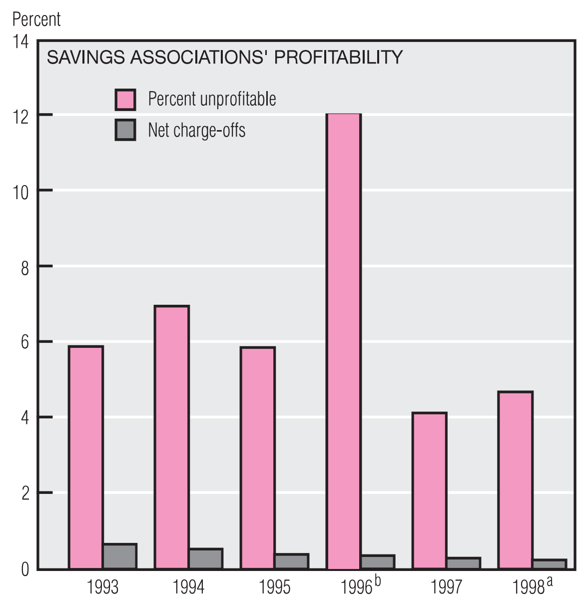
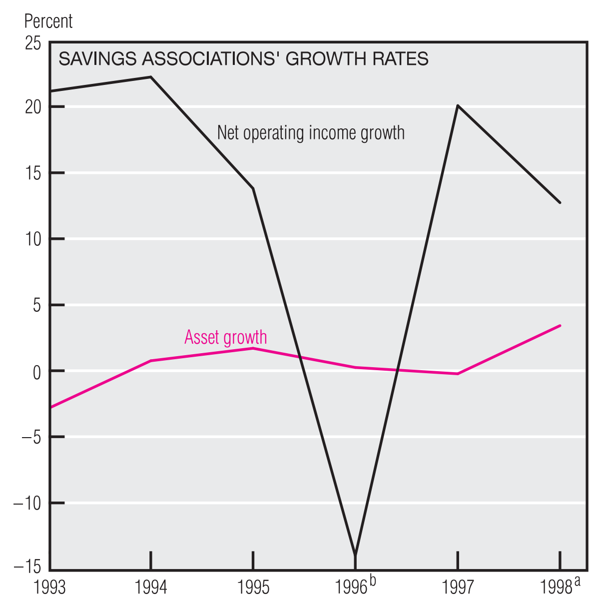
Banking Conditions (cont.)









a. Data are through 1998:IIIQ.
b. The sharp decline in operating income growth in 1996 was driven, in part, by a special insurance assessment on the deposits of savings associations.
NOTE: All data are for FDIC-insured savings associations.
SOURCE: Federal Deposit Insurance Corporation, *Quarterly Banking Profile*, September 1998.

Savings associations' performance continued to be strong during the first nine months of 1998. A return on equity of 12.3% was the highest level since 1985. However, unlike that of 1985, this return on equity was generated by a return on assets of 1.1%—the highest level since 1955—and a steady net interest margin of 3.13%. Moreover, less than 5% of savings associations reported losses through the third quarter of 1998.

Savings associations' balance-sheet strength improved, with core capital exceeding 8% of total assets at the end of the third quarter. Asset quality continues to improve, as nonperforming assets fell to 0.75% of total assets and net charge-offs fell to 0.21% of loans.

While the industry shrank slightly in 1997, it rebounded in 1998, its assets growing at a rate of 3.42% through the end of the third quarter. This asset growth was accompanied by growth in operating income of nearly 13%, suggesting that asset growth in 1998 did not come at the expense of profit margins. Overall, recent industry performance suggests that savings associations will continue to play an important role in the economy, albeit a smaller one than they have played in the past.