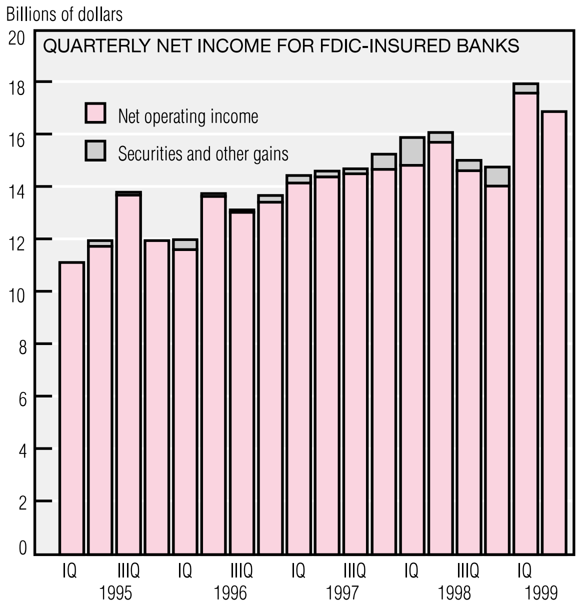
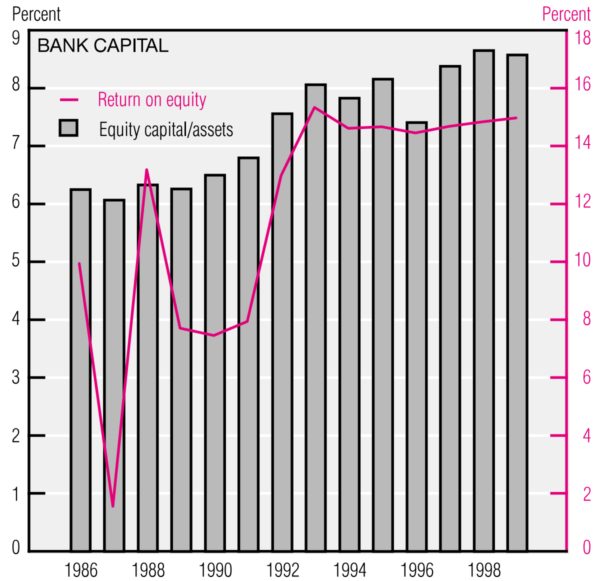
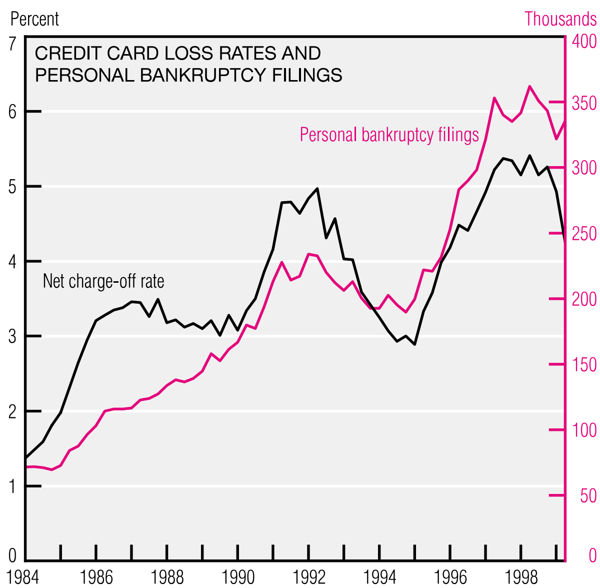
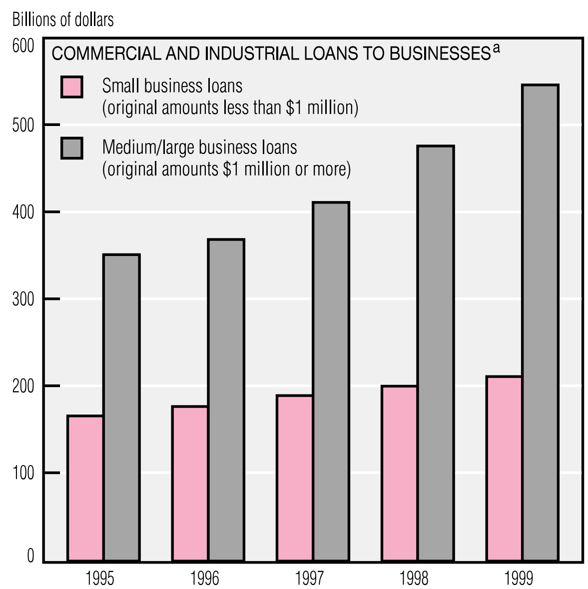
Banking Conditions









a. As of June 30, 1999.
SOURCE: Federal Deposit Insurance Corporation, *Quarterly Banking Profile,* 1999:IIQ.

The latest statistics show that the U.S. banking industry continues to enjoy good health. In 1999:IIQ, banks posted $17 billion in earnings, despite a $1.5 billion net loss at one bank that had large, merger-related charges. Net gains in securities contributed little to this second-best quarterly profit ever. Other positive news was that return on equity inched up to 14.97%, improving further on the high level banks have achieved since 1993. Also, bank capital dipped slightly but remained near the record high achieved in 1998.

The number of problem institutions fell from 64 to 62, although the assets of these institutions remained at $5 billion. One blemish on this strong record was an increase in the share of unprofitable institutions from 4.5% for the first half of last year to 6.3% for the first half of 1999.

Asset quality picked up in 1999:IIQ, led by improvements in the quality of consumer loans, as both loan losses and noncurrent loans declined. The net charge-off rate dropped to 0.56%, the lowest level since 1996:IIIQ. The lion's share of the gain stemmed from a 20.4% decline in net charge-offs from credit card loans, 26.5% less than a year ago. The annualized net charge-off rate on credit card loans fell to 4.3% and is now the lowest quarterly charge-off rate since 1996:IQ. The lower level of personal bankruptcy filings relative to the record high of 1998 seems consistent with this recovery.

Bank lending to small businesses trails lending to larger commercial borrowers. The disparity is sometimes attributed to mergers, but recent research contradicts this view. A more likely reason is that the classification of borrowers is based on loan

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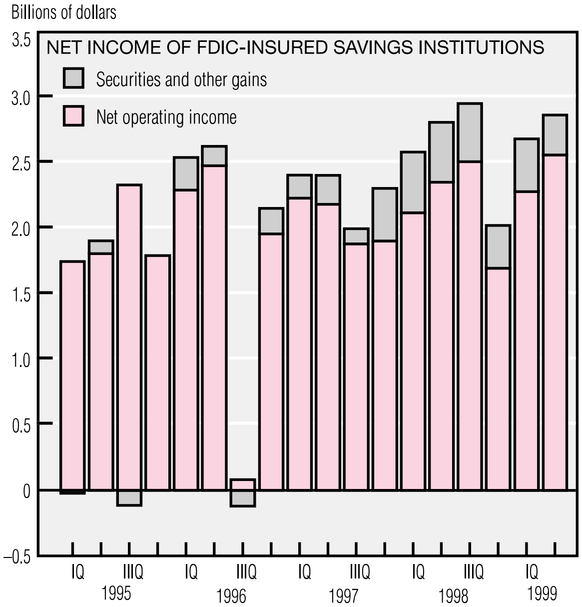
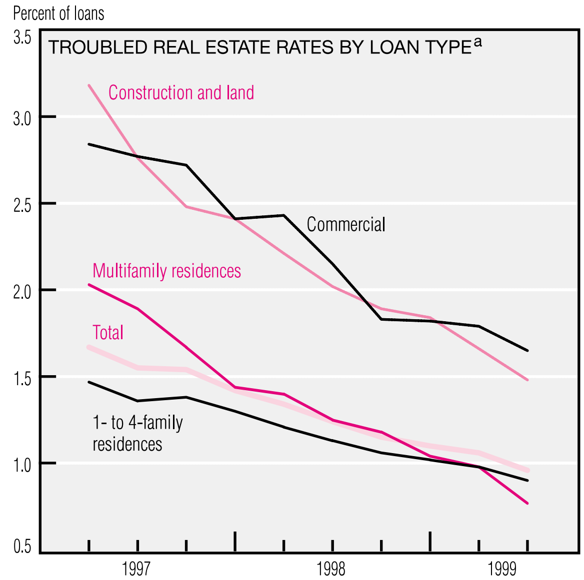
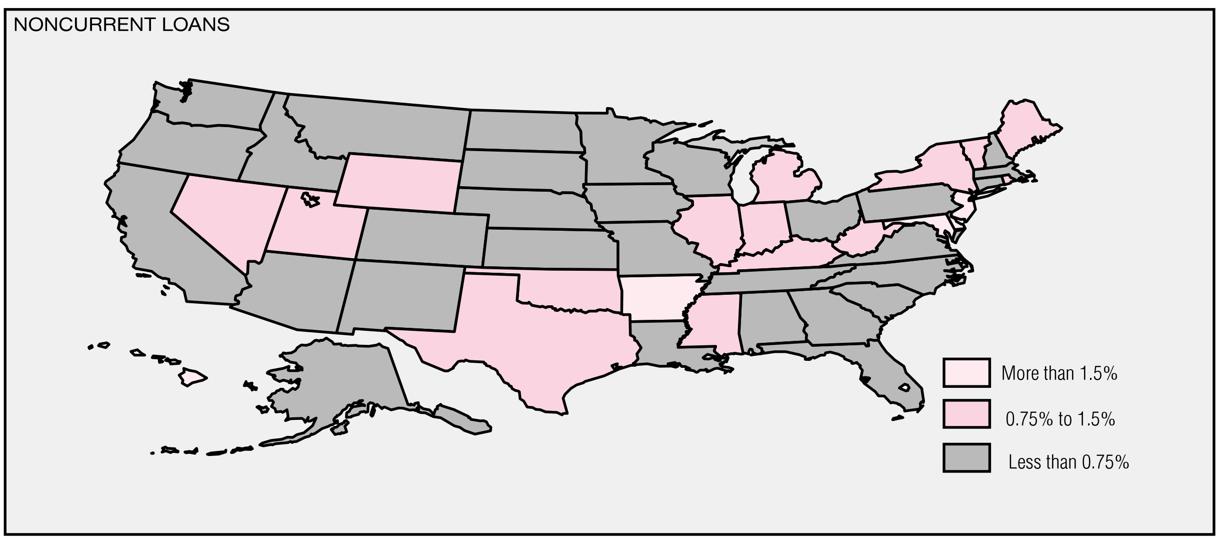
Banking Conditions (cont.)







a. Troubled real estate rate is defined as the ratio of noncurrent real estate loans plus other real estate owned (OREO) to total real estate loans plus OREO.
SOURCE: Federal Deposit Insurance Corporation, *Quarterly Banking Profile,* 1999:IIQ.

size, not on the status of the borrower, which is not reported.

Thrifts insured by the FDIC earned $2.9 billion in 1999:IIQ, a level exceeded only by the nearly $3.0 billion posted in 1998:IIIQ. Return on equity fell to 11.7% for the year to date, somewhat lower than the 11.9% achieved at the same point last year. Small institutions, however, continued to lag the rest of the industry. Those with less than $100 million eked out only a 5.5% return, compared to the 13.6% earned by institutions with more than $5 billion.

Thrifts' problems often show up in real estate loans first. They can be gauged by the overall troubled real estate rate—the ratio of noncurrent real estate loans plus other real estate owned (OREO) to total real estate loans plus OREO—which hit a record low of 0.96% in 1999:IIQ. All types of real estate loans have improved consistently over the last two years.

Noncurrent loan rates averaged 0.62% for the nation as a whole, but this figure masks a great deal of regional variation. While the Southwest and Northeast had the highest levels, there was considerable variation within each region. In the Southwest, for example, Arkansas' rate was 3.1%, but Louisiana's was only 0.4%.

With fewer than 100 days left until 2000, regulators feel increasingly confident that the financial industry's electronic infrastructure will be prepared. Other key electronic infrastructures appear to be nearing readiness as well. Preparations have cost private firms at least $50 billion. Despite uncertainties associated with our links to less-prepared countries, the probability of a systemic breakdown is now seen as negligible. (Of course, even this cannot guarantee

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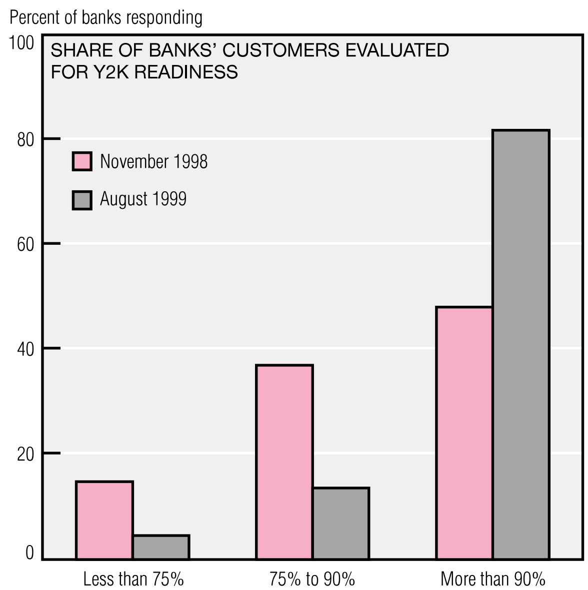

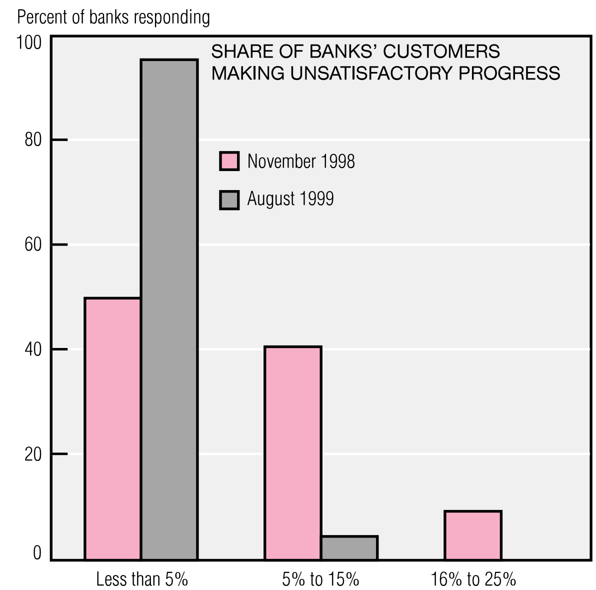

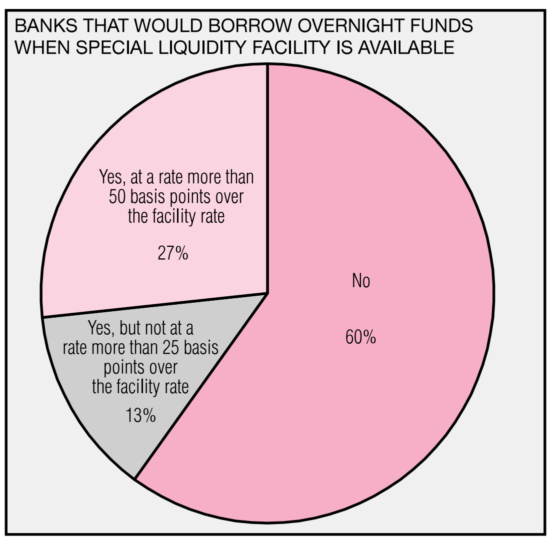

Effect of Special Liquidity Facility on Banks' Willingness to Extend Credit during the Century-Date-Change Period

	To nondepository institutions	To depository institutions
More willing	5.6%	11.1%
Not affected	94.4%	88.9%
Less willing	0%	0%

SOURCE: Board of Governors of the Federal Reserve System, *Senior Loan Officer Opinion Survey on Bank Lending Practices*, November 1998 and August 1999.

zero failures. On an average day in the U.S., 1% to 2% of ATMs are out of service; it would be unreasonable to expect the systems that support modern life to be any more reliable next January.)

A recent survey buttresses this optimism. Since last November, banks have made great progress in evaluating the Y2K readiness of their material business customers. Last November, fewer than half of banks had evaluated more than 90% of their customers; by August, over 80% had. More important, the share of customers making unsatisfactory progress has plummeted. Virtually all banks now report that less than 5% of their customers are lagging behind.

A key uncertainty is how the American people will respond in the months ahead. To be prepared for all contingencies, the Federal Reserve has made plans to provide currency to banks in the remote possibility of heavy withdrawals. Also, the Fed's Board of Governors has amended Regulation A to establish a special lending program. Under this program, Reserve Banks will extend credit at a rate that is 150 basis points above the Federal Open Market Committee's targeted federal funds rate to eligible institutions, in order to accommodate greater liquidity needs during the century-date-change period. Unlike adjustment credit, these loans will not require borrowers to seek credit elsewhere first. Uses of funds will not be limited, and loans may be outstanding for any period while the facility is open. A recent survey suggests that although banks are likely to use this program, it will have little effect on their willingness to extend Y2K credit.