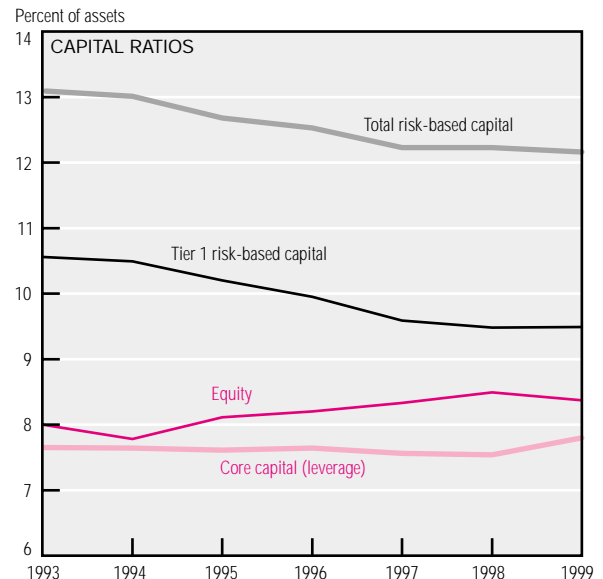
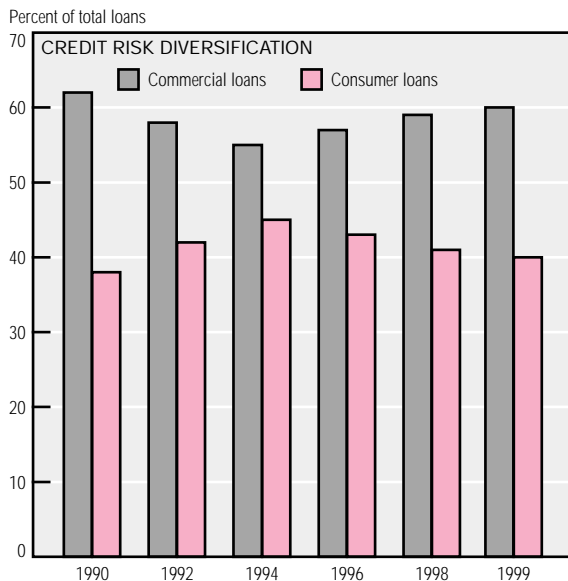
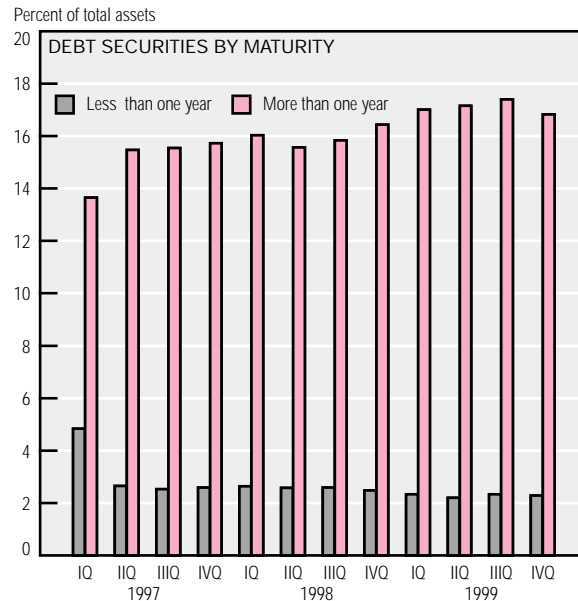
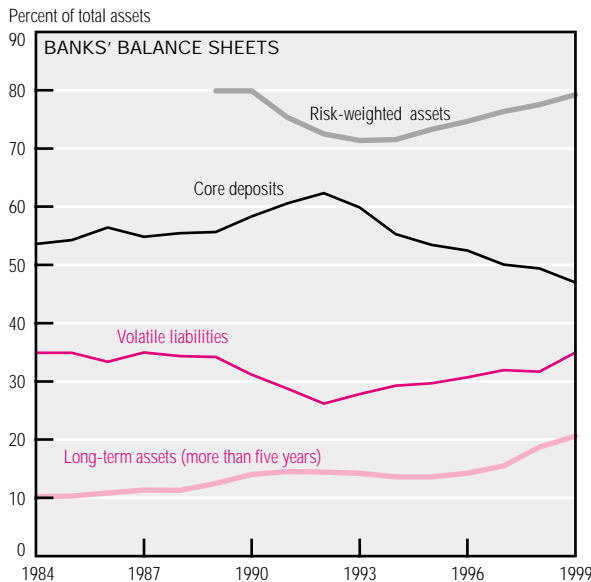


Banking Conditions



SOURCE: Federal Deposit Insurance Corporation, *Quarterly Banking Profile*, 1999:IVQ.

Despite record commercial bank profits in 1999:IVQ, some indicators suggest increased risk exposure. Banks continue to move toward volatile liabilities, which reprice or mature in less than a year, and away from core deposits, which tend to have greater interest rate stability. These factors indicate increased exposure to interest rate risk. Banks' holdings of long-term assets continue to rise, implying that earnings from asset holdings are less sensitive to interest rate changes. Overall, such changes in the composition of banks' balance sheets

increase their vulnerability to rising interest rates. Of course, banks can hedge these risks by using off-balance-sheet derivatives, but large spreads on interest rate swaps during 1999 may have discouraged them from using these instruments.

Although rates of noncurrent loans to individuals do not indicate a significant decline in the quality of those holdings, some concern may arise regarding changes in asset composition. The latter part of the 1990s witnessed rapid growth in commercial and industrial loans made by commercial banks. Concur-

rently, consumer loans decreased as a share of total bank loans. This shift may be cause for concern due to increasing charge-off rates and noncurrent loan rates for commercial and industrial loans during 1999. Some studies demonstrate a positive correlation between rapid loan growth and future loss and failure rates.

Adequate levels of bank capital provide a cushion against potential losses. In 1999, the core bank capital-asset ratio increased to 7.8%. However, the ratio for risk-based capital declined slightly in 1999.