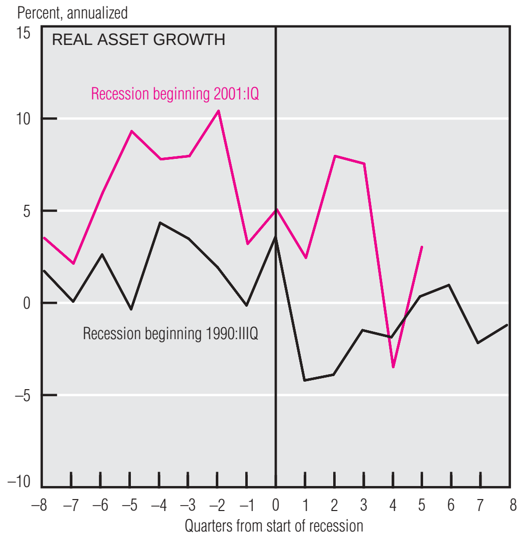
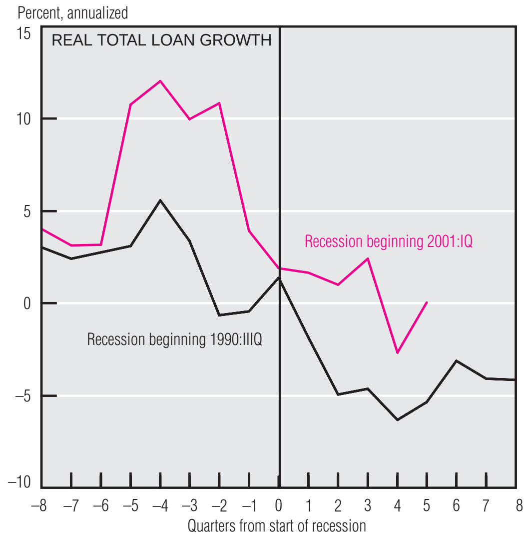
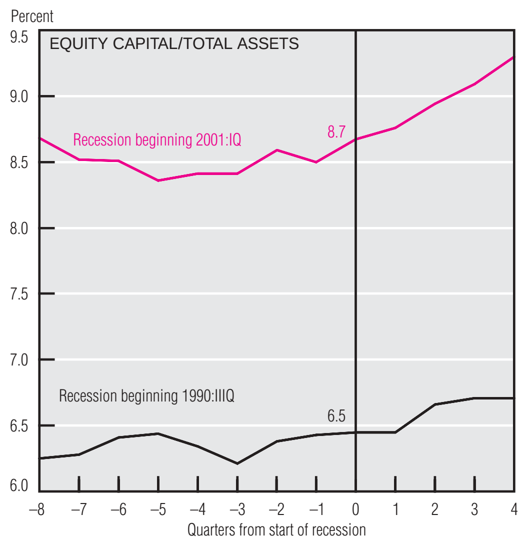
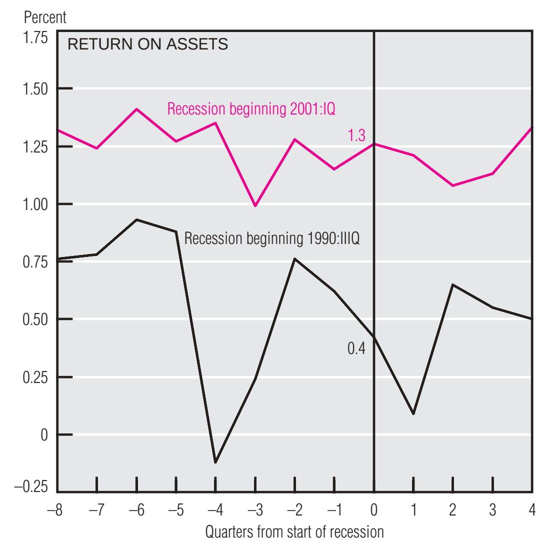
Banking Conditions in the Recessions of 1990 and 2001









SOURCES: Board of Governors of the Federal Reserve System; and Federal Deposit Insurance Corporation, *Quarterly Banking Report*, various issues.

Going into the 2001 recession, FDIC-insured commercial banks' real asset and loan growth was much stronger than in the late 1980s and early 1990. Both statistics dipped into negative territory when the 1990 recession began. Asset growth stayed there for five quarters, and loan growth was still negative after two years. In the 2001 recession, however, these statistics fell below zero only in 2002:IQ, largely because of a seasonal drop in balances due from depository institutions and a decline in commercial loans, residential mortgage loans, and consumer loans other than credit cards. Both growth numbers recovered in 2002:IIQ.

Equity capital cushions banks against unexpected losses. When the 1990 recession began, the ratio of equity capital to total assets stood at 6.5%, much lower than its 2001 level of 8.7%. Most significantly, after the current recession started, the equity ratio increased 50 basis points (bp) while total assets continued to grow. In contrast, the increase of 30 bp in 1990 resulted mainly from a decline in total assets.

The statistics for return on assets explain this healthy equity growth. Going into the 2001 recession, commercial banks' income was much higher and considerably less volatile than in the late 1980s. In fact, commercial banks' net income rose to a record high of $21.7 billion in 2002:IQ; for 64% of banks, net income was higher than in 2001:IQ, when the recession began (data not shown). The key factors were wider interest margins at large banks and slow growth in noninterest expense.

Asset quality in FDIC-insured commercial banks has improved substantially since 1990. In 2001:IQ, banks'

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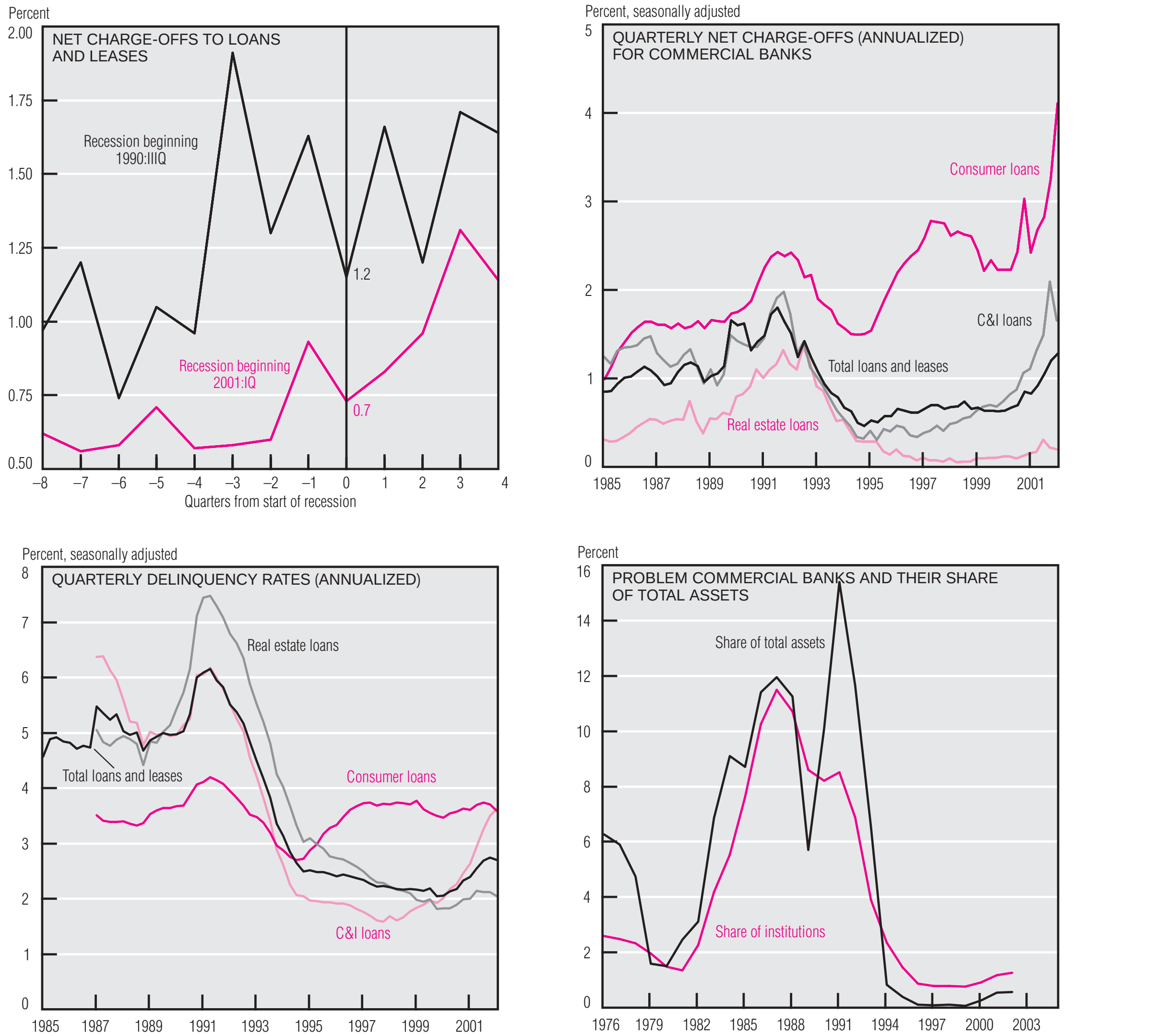

SOURCES: Board of Governors of the Federal Reserve System; and Federal Deposit Insurance Corporation, *Quarterly Banking Report*, various issues.

net charge-offs to total loans and leases stood at 0.7%, compared to 1.2% in 1990:IIIQ. However, the rate has recently increased to 1.1%, mainly because charge-offs rose sharply for credit cards and moderately for commercial loans. The decline in the quality of credit card loans results partly from the economic slowdown, but another important factor is the personal bankruptcy legislation pending in Congress. The legislation, which will make it more difficult to erase unsecured credit card debt, may have prompted some consumers to declare bankruptcy while they can.

Although the current total charge-off rate seems to have approached its early-1990s high, loan delinquencies are still very low. The commercial loan delinquency rate, 3.6% in 2002:IQ, is well below its high of 6.2% in 1991. Real estate loan portfolios are much healthier now than 10 years ago. The current delinquency rate of 2% is far lower than the 7.5% rate for 1991. Moreover, banks today are much better equipped to absorb potential losses that these problem loans could cause. For every dollar in problem loans, banks now hold $1.30 in loan loss reserves; in 1991, that number was only about 67 cents (data not shown).

The number of problem banks—those that receive a poor rating from bank examiners—has been declining since the early 1990s and now constitutes 1.3% of all banks and only 0.6% of total banking assets. In 1991, 10% of banking assets were held by problem institutions.

Overall, the data indicate that commercial banks are well prepared to weather the current recession.