Guidance for uncertain times

By most conventional measures, financial institutions adjusted well in 2006 to an environment of rapid change. Profits were high, credit quality was strong, and for the second consecutive year no banks failed. (This streak—the longest since deposit insurance was created in 1934—ended with the failure of a small Pennsylvania bank in February 2007). Banks entered 2006 with cautious optimism. The Southeast had enjoyed years of robust housing demand and related real estate development activity fed by in-migration, and sales and price appreciation in the housing sector had just completed another record year. Corporate lending also had regained momentum following a slow recovery from the 2001 recession.

As always, financial institutions confronted their share of challenges. A persistently flat yield curve pressured net interest margins in 2006, and as the months passed it became clear that housing demand had peaked late in 2005 and was slowing. The slowdown was fairly sharp in some previously strong markets in the Atlanta Fed's district, dampening mortgage and construction loan growth for many banks.

During periods of change, bank regulators often find themselves in the unpopular position of reminding bankers about the potential dangers of growing too much, too fast and of the need to maintain solid risk management practices consistent with banks' growth and mix of activities. Prudent central bankers and regulators have a responsibility to ask sometimes unpleasant "what if" questions—even in the face of enthusiasm in the marketplace.

As evidence mounted throughout the year of a cooling in the housing sector, Atlanta Fed Supervision and Regulation staff kept abreast of evolving regional real estate market conditions and mortgage financing instruments. In addition, the bank conducted outreach across the Federal Reserve System in 2006 to help raise awareness among other Federal Reserve System examiners of the changes in real estate markets and how they might affect commercial banking institutions.

Beyond their focus on real estate, Atlanta Fed bank supervisors were involved in a wide spectrum of other activities in 2006. For instance, Supervision and Regulation staff continued to play a critical role in facilitating the ongoing financial integration between the United States and Latin America. The staff provided extensive technical assistance to supervisors throughout Latin America on credit, market, and operations risk, among other issues.

In addition, the Supervision and Regulation Division's Community Affairs Department worked with the Federal Reserve's Atlanta-based Retail Payments Office to strengthen the Directo a México International Automated Clearinghouse (ACH) service. The group developed comprehensive materials addressing legal and regulatory issues associated with banking the immigrant population and presented the information at more than a dozen forums throughout the United States and in Mexico City in 2006.

The Atlanta Fed's supervision staff will remain focused on monitoring changes in real estate markets in 2007. And they remain committed to working constructively with supervised institutions as they manage exposures to a broad range of risks, working toward the common goal of maintaining a safe and sound banking system.

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