Financial UPDATE

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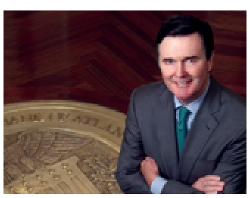
Bernanke: Fed Nurtures Links with Community Banks
Federal Reserve Chairman Ben Bernanke recently discussed the importance of the Fed's relationship with community banks, the Fed's desire to maintain an open dialogue with smaller banks, and the challenges community banks face in today's environment.

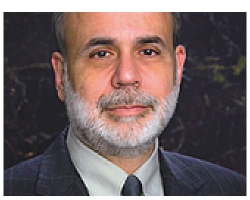
One in Five in U.S. Using Mobile Banking
Given the ubiquity of mobile phones, it's not surprising that using mobile phones for bank transactions is becoming common. A recent Federal Reserve survey showed that one fifth of U.S. consumers accessed their bank accounts via mobile phone last year, and that number is growing fast.

Fed Gov. Raskin: Low Interest Rates Not a Major Drag on Households
Federal Reserve Governor Sarah Bloom Raskin recently discussed the intended effects on households of the Fed's policy of keeping interest rates low, noting that the policy's long-run goal is a stronger economy that leads to higher returns for savers and investors.

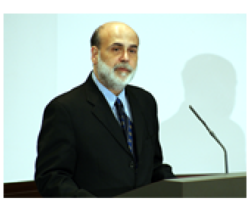
Fed Releases Banks' Plans to Remedy Foreclosure Servicing Problems
The Federal Reserve Board recently released plans that nine large financial institutions submitted to fix problems in their residential mortgage loan servicing and foreclosure processing. Among other steps, the banks discuss how they will strengthen communications and compliance.



Atlanta Fed CEO: Economy "Noticeably Better" in 2012
Recent positive economic data suggest that the recovery may be gaining traction, Atlanta Fed President Dennis Lockhart said during a recent speech. Improvements in employment, household income, and credit expansion support the view that growth in 2012 will improve upon 2011.



Fed Chair Bernanke: No "Silver Bullet" for Housing Woes
The slow recovery of the U.S. housing market has been well documented. In a recent speech, Federal Reserve Chairman Ben Bernanke said that while no quick fix exists for the market, some new approaches can help steer the market in a healthier direction.



Fed Chair Bernanke: Fed Attuned to Community Banks' Concerns
Because of community banks' importance to the local communities they serve, the Federal Reserve stays informed about issues that matter to them, Fed Chairman Ben Bernanke recently said. He added that community banks also provide crucial grassroots economic information that informs policy.

Consumer Credit Up Sharply in Late 2011
Among reports of easing consumer credit standards, consumer credit outstanding grew late last year, according to recent data from the Federal Reserve. The increase was buoyed primarily by an increase in student and credit card loans.

Reserve Banks Return $77 Billion to U.S. Treasury
In 2011, the Federal Reserve System transferred $76.9 billion to the U.S. Treasury. This revenue represents most of the Reserve Banks' net income and came from a number of sources.

Fed Gov. Raskin Discusses Small-Bank Supervision
Bank regulators must have a real understanding of the local economy to effectively supervise community banks, Fed Governor Sarah Bloom Raskin said in a recent speech. This supervisory approach differs from the one used to supervise larger, more complex financial institutions, she said.

Atlanta Fed President Explores Fundamentals Shaping the Recovery
The recovery of the U.S. economy is likely to remain tepid in 2012, Atlanta Fed President Dennis Lockhart said in a recent speech. He discussed five basic forces that are shaping the recovery and what role they could play in 2012.

Housing Recovery Key to Stronger Economy, Says Fed Governor Duke
Federal Reserve Governor Elizabeth Duke recently said she expects the U.S. economy to grow modestly in 2012, despite persistent headwinds. However, she noted that a more robust housing market is key to a strong recovery.

Bernanke: Fed Nurtures Links with Community Banks

The Federal Reserve places great importance on its relationship with community banks and seeks to maintain open and consistent communication with smaller institutions, Federal Reserve Chairman Ben Bernanke told attendees at the Independent Community Bankers of America National Convention in Nashville, Tenn., on March 14.

In a prerecorded video, Bernanke enumerated the various channels through which the Fed pursues dialogue with community bankers. He also discussed the challenges smaller banks face and summarized the improving state of community banks nationwide.

"I think we would all agree that two-way communication between regulators and community banks is critical," Bernanke said. "Banks need to understand supervisors' policies and expectations, but supervisors must also listen to and understand banks' concerns."

Fed stays in touch with small banks through special channels
The Fed stays in touch with smaller lenders through numerous vehicles. One is the recently established Community Depository Institutions Advisory Council (CDIAC). The council's members come from smaller banks, credit unions, and savings associations. Each of the 12 regional Reserve Banks, including the Atlanta Fed, maintains a local advisory council, and a representative from each local council serves with the national group that meets with the Federal Reserve Board twice a year.

These councils bring valuable intelligence to the Fed. For example, based on input from the CDIAC, the Board of Governors is working to clarify which banks will be affected by new regulatory proposals and final rules. In addition to the advisory council, the Board of Governors in 2010 set up a subcommittee to review policy proposals for their potential effect on the condition of, and the regulatory costs to, community and regional institutions.

Community banks meeting challenges
Regarding the challenges smaller banks face, the chairman noted that their range of profitable lending activities is narrowing. As larger banks have used their greater scale and pricing power to take over volume-driven businesses such as consumer lending, community banks have tended to specialize in other areas, including loans secured by commercial real estate, Bernanke noted. "That said, I know that community banks are continuing to look for ways to prudently diversify their revenue sources," he said.

Community banks appear to be meeting these challenges, the chairman remarked. Profits rose in 2011 from the year before, while asset quality and capital ratios also improved.

March 27, 2012

One in Five in U.S. Using Mobile Banking

A small but growing number of Americans don't go to the bank. The bank goes with them.
According to a new survey by the Federal Reserve Board of Governors, 20 percent of American consumers used their mobile phones to access their bank accounts, credit cards, or other financial accounts in the 12 months through January. An additional one out of five people said they would probably use mobile banking in the future. The majority of consumers who have a mobile phone but do not use mobile banking said they either had no need for these services or were concerned about security.

One third could go mobile soon
By 2013, mobile banking usage could grow to about 33 percent of mobile phone users, according to the survey.

Young people appear to be most comfortable banking with their phones. People between 18 and 29 account for about 44 percent of mobile banking users, while that age group makes up just 22 percent of mobile phone users. Meanwhile, people age 60 and over account for only 6 percent of all mobile banking users but 24 percent of mobile phone users. The survey also showed a higher level of mobile banking use among African-Americans (16 percent) and Hispanics (17 percent), even though those groups represent 11 percent and 13 percent of mobile phone users, respectively.

People who have bank accounts but who use check cashers, payday lenders, or payroll cards make relatively heavy use of mobile banking, according to the survey. Of this group, 29 percent used mobile banking in the year ending January 2012.

Some features prove more popular
The most common mobile banking activities are consumers checking their account balances or monitoring recent transactions. Less frequently used mobile banking functions include making online bill payments from a bank account, locating an in-network automated teller machine, and depositing a check by phone.

Knowledge Networks, an online consumer research firm, conducted the survey for the Fed Board of Governors. Nearly 2,300 respondents completed the survey.

March 26, 2012

Fed Gov. Raskin: Low Interest Rates Not a Major Drag on Households

While the Federal Reserve's accommodative monetary policy may temporarily limit returns for savers, ultimately the Fed's goal is a stronger economy that leads to higher returns for savers and investors.

Federal Reserve Governor Sarah Bloom Raskin delivered that message in a speech she delivered March 1 in Westport, Connecticut. In her remarks, Raskin explored notions that low interest rates could be hurting savers and hindering, rather than helping, the economic recovery.

As background, she recapped the nation's economic performance that led to the Fed's current policy approach. Undoubtedly, the recovery from the Great Recession of 2007–09 has been uneven, Raskin said. Though the recovery is about two and a half years old, only in mid-2011 did the level of real gross domestic product return to where it was just before the recession.

More recently, though, signs have indicated a modest upswing. Real gross domestic product increased at an annual rate of 2.5 percent in the second half of 2011, better than double the 1 percent growth in the first half. Job gains picked up starting in the fall, and in the past couple of months the unemployment rate has declined noticeably, Raskin pointed out.

Critics right in one sense, wrong on larger point

Nevertheless, the long economic slump and low interest rates will continue to have a major influence on household incomes. In one sense, Raskin said, critics have a point when they contend the Federal Reserve's accommodative monetary policy is a burden on households that rely on income from interest-bearing assets. The flow of interest income on household savings has declined about one-fourth since the recession began.

On the other hand, Raskin pointed out that many households are benefiting from low interest rates. Consumers can finance purchases of cars and other expensive items more cheaply. And many homeowners have been able to refinance their mortgages into lower-rate loans, freeing up income for other uses.

Only 7 percent of household assets earn interest

In addition, she noted, less than 7 percent of total household assets are directly held in interest-bearing investments such as transaction accounts, certificates of deposit, savings bonds, and bonds, according to the Federal Reserve's Survey of Consumer Finances. The bulk of household wealth is in stocks, retirement accounts, business equity, and real estate.

"For these other types of assets, rates of return depend primarily on the strength of the economy and how fast the economy is growing," Raskin said. "Thus, these returns should be supported, over time, by the accommodative monetary policy that we have in place."

Consumers actually saving more

As for the notion that an extended period of low interest rates will discourage savings, that does not appear to be happening. "In fact," Raskin said, "the portion of disposable income that households are saving has risen considerably since the recession began."

March 12, 2012

Fed Releases Banks' Plans to Remedy Foreclosure Servicing Problems

On February 27, the Federal Reserve Board released plans that nine large financial institutions submitted to fix problems in their residential mortgage loan servicing and foreclosure processing.

Along with the action plans, the Board posted on its website engagement letters between the financial institutions and independent consultants retained by the firms to review foreclosures that were in process in 2009 and 2010.

Specific steps delineated

The Federal Reserve last year issued enforcement actions that required the institutions to compile and submit the action plans. The enforcement actions direct mortgage loan servicers regulated by the Fed to file documents that

- describe, among other things, how the institutions will strengthen communications with borrowers by providing each borrower the name of a primary point of contact at the servicer
- set limits on foreclosures where loan modifications have been approved
- establish third-party vendor controls and
- strengthen compliance programs.

The Federal Reserve enforcement actions also require the parent holding companies of mortgage servicers to submit acceptable plans outlining how the companies will improve oversight of their subsidiaries' servicing and foreclosure processing operations. In addition, the Fed enforcement actions order the mortgage servicing subsidiaries to provide appropriate remediation to borrowers who lost money as a result of errors by the servicers, which is where the engagement letters come in. Those letters describe how the consultants will review servicers' foreclosure files to determine whether borrowers suffered financial injury as a result of servicer error.

Further corrective actions forthcoming

During Fed reviews in late 2010 and early 2011, examiners found unsafe and unsound processes and practices in home mortgage loan servicing and foreclosure processing at a number of institutions. The Fed pledged to monitor the implementation of the action plans to ensure that the financial institutions correct deficiencies and evaluate any harm that was done to homeowners in the foreclosure process in 2009 and 2010. The Fed expects to post more engagement letters and action plans soon.

February 29, 2012

Atlanta Fed CEO: Economy "Noticeably Better" in 2012

The recent spate of positive economic news suggests that the recovery may be gaining traction, said Atlanta Fed President Dennis Lockhart during a Valentine's Day speech in Sarasota, Florida.

Improvements in employment, household income, and credit expansion, among other factors, have bolstered Lockhart's view that "economic growth in 2012 will be noticeably better than 2011." Indeed, his outlook calls for 2.5 percent to 3 percent growth this year, barring shocks. This caveat is an important one given the role that shocks played in 2011, when higher commodity prices, supply chain disruptions, and other unexpected developments contributed to a markedly slower pace of growth than many economists had forecasted.

Policy statement reflects reality
Recent improvements in the economy may seem out of step with the Federal Open Market Committee's (FOMC) January 24 announcement that economic conditions would "likely warrant exceptionally low levels of the fed funds rate at least through 2014." However, Lockhart voiced continued support for that assessment, noting the path to full capacity will likely be "slow and arduous" as the economy works through several adjustments. These adjustments include steep declines in home values over the past several years, which have also constrained funding for start-up businesses, and tighter lending standards and a shrinking government sector.

These adjustments will not happen overnight, he noted. Accordingly, the 2014 policy statement reflects "the reality of where the economy is and what lies ahead."

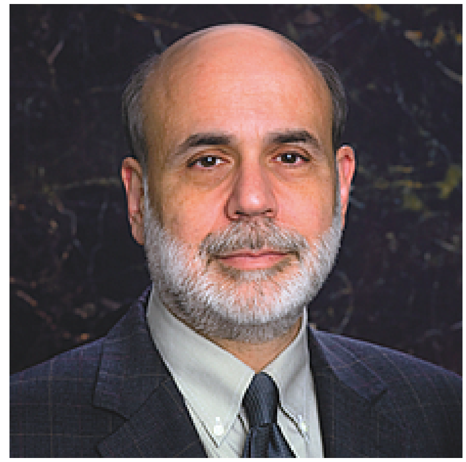
However, Lockhart emphasized that this should not be viewed as a commitment to keep rates low, but rather as a conditional statement that is "based on a best estimate of the path the economy is on." Thus, the time horizon could change if the economy performs contrary to the FOMC projections.

Communication a policy tool
In addition to publishing guidance on interest rates following its January meeting, the FOMC formally announced a longer-term inflation target of 2 percent. Both are key pieces of a broader communication strategy, which also serves as an important policy tool, Lockhart explained. The FOMC's adoption of a formal inflation target helps the public understand how the committee will react to developments in the economy. And by helping participants such as businesses and consumers predict future rates, the committee's enhanced communications "should help lenders and investors decide how to best allocate their resources."

Despite recent good news about the economy, Lockhart remains cautious. "We haven't seen enough sustained improvement to be sure it will last," he said. "I am prepared to be somewhat patient and watch how the situation develops."

February 29, 2012

Fed Chair Bernanke: No "Silver Bullet" for Housing Woes



Strong housing markets have historically helped propel economic recoveries, but housing has not played that role in the current recovery, said Federal Reserve Chairman Ben Bernanke during a February 10 speech.

In remarks before the National Association of Homebuilders, Bernanke discussed some of the factors restraining the U.S. housing market and suggested some approaches to help manage the supply of vacant homes for sale. Recent estimates put the supply of vacant properties on the market at 1.75 million houses, significantly higher than the 1.25 million vacant homes that were the norm a decade ago, he noted.

Housing demand in decline

At the same time, demand for homes has dropped markedly. One reason for weaker housing demand is the lower rate of household formation, especially among young adults. Further, the weak job market and concerns about future house prices are also causing some people to forgo homeownership, while tight credit conditions have kept many potential homeowners on the sidelines. First-time homebuyers are having an especially hard time obtaining mortgage credit, Bernanke noted. Moreover, this group is a significant source of incremental housing demand, so their absence from the market is affecting home prices, construction, and the ability of current homeowners to move into larger homes, he explained.

Bernanke also highlighted the way in which tight mortgage credit conditions are affecting monetary policy, in part by dampening the effect of the Fed's actions to push down longer-term rates. As a result, these steps "have had less effect on the housing sector and overall economic activity than they otherwise would have had."

Policy plays a role

Policymakers have largely focused on policies to reduce the number of foreclosures. While that task is an important one, some foreclosures are unavoidable. Bernanke suggested several strategies to manage the large overhang of homes that make it into the foreclosure process. Many of these real estate–owned (REO) properties could be turned into rentals, which would help meet rising demand among families that are unable or reluctant to purchase homes.

However, REO-to-rental programs are not a silver bullet, the chairman warned, pointing to several challenges they present. For instance, rental investors have had trouble obtaining financing in some cases. Also, not all vacant properties are suitable for rentals—some are in poor condition, while others are not located close enough to other rentals to be managed easily, Bernanke explained.

Land banks may be a better option in some cases, especially for properties that have low value or are in poor condition. That approach comes with challenges. For one, many existing land banks are ill equipped to deal with the current supply of low-value properties.

"No single solution will be sufficient," Bernanke concluded, but these and other neighborhood stabilization efforts could help bring housing supply and demand into better alignment.

February 27, 2012

Fed Chair Bernanke: Fed Attuned to Community Banks' Concerns

The Federal Reserve System is continually enhancing its efforts to understand community banks because of their importance to the economy and to local communities, Fed Chairman Ben Bernanke said in a February 16 speech at the Future of Community Banking Conference in Arlington, Virginia.

In his remarks, Bernanke outlined various ways the Fed communicates with smaller financial institutions. "For the Federal Reserve in particular," Bernanke said, "community banks not only provide insights into their industry, but they are also an unmatched source of crucial grassroots information about developments in the economy as a whole, which is necessary for effective monetary policy."

Multiple channels of communication open

The Fed pursues a dialogue with community bankers through many channels. For example, each of the 12 regional Reserve Banks has a new Community Depository Institutions Advisory Council. Members come from banks, credit unions, and savings associations. The groups' meetings allow the Fed to hear directly from community bankers about regulatory issues and economic trends.

In addition to the advisory councils, the Federal Reserve Board in 2011 established a special supervision subcommittee to address community banking issues. Its mission is to deepen the Fed's understanding of community and regional banking conditions and to review policy proposals for their potential impact on community and regional institutions.

Regulatory changes bring concerns

Through various channels, the Fed often hears that community bankers are concerned about the changing regulatory landscape. One specific worry is the implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Bernanke noted Congress enacted the Dodd-Frank Act largely in response to the "too big to fail" issue and that most of its provisions apply only, or mainly, to large and internationally active banks. Bernanke said the Fed recognizes that new regulations and requirements may impose disproportionate costs on smaller banks, which have fewer staff members and less sophisticated information systems than larger institutions.

As for the current operating climate for community banks, the chairman said that despite economic uncertainties, conditions are generally improving.

February 23, 2012

Consumer Credit Up Sharply in Late 2011

Consumer credit outstanding grew late last year, according to data released by the Federal Reserve in January. In November 2011, consumer credit increased at a 10 percent annual rate, or $20.4 billion, buoyed primarily by an increase in student and credit card loans.

Revolving credit, mostly made up of credit card debt, grew an annualized 8.5 percent in November—the third consecutive monthly increase in that category. Meanwhile, nonrevolving credit, which includes auto and student loans, jumped $14.8 billion, or 10.7 percent. A hefty share of the increase in revolving credit was in the government loan category, mostly composed of student debt. Credit outstanding in that category grew $6.4 billion from the previous month. In the 12 months to November, government loans increased more than any other type of nonrevolving loan tracked by the Fed.

The surge in consumer credit comes as banks report easing lending standards on some loans to consumers. According to the Federal Reserve's third quarter Senior Loan Officer Opinion Survey, banks reported easing standards on consumer credit card and auto loans. Federal Reserve Governor Elizabeth Duke referenced the survey in a January 6, 2012, speech, noting that recent easing in the consumer credit market is encouraging as it suggests that "when households do regain confidence in the recovery and are ready to begin spending on consumer goods again, the credit markets will not be as much of a constraint as they were during the recession."

January 31, 2012

Reserve Banks Return $77 Billion to U.S. Treasury

In 2011 the Federal Reserve System transferred most of its net income to the U.S. Treasury. The 2011 transfer totaled $76.9 billion.

Securities interest, commercial services generate income
The following list shows the primary components of the Federal Reserve Banks' 2011 net earnings:

- $83.6 billion in earnings on securities acquired through open market operations (U.S. Treasury securities, government-sponsored enterprise [GSE] debt securities, and federal agency and GSE mortgage-backed securities)
- $2.3 billion from realized gains on the sale of U.S. Treasury securities
- $152 million in foreign currency gains

The Reserve Banks had interest expenses of $3.8 billion on depository institutions' reserve balances and term deposits.

The income that the Reserve Banks generated through fees for providing services such as payments processing for depository institutions contributed an additional $479 million.

Tallying up
The operating expenses of the 12 Reserve Banks totaled $3.4 billion in 2011. In addition, the Reserve Banks were assessed $1.1 billion for the cost of new currency and Federal Reserve Board expenditures and $282 million to fund the operations of the Bureau of Consumer Financial Protection and Office of Financial Research.

Federal Reserve Board policy directs each Reserve Bank to transfer its yearly net income to the U.S. Treasury after paying statutory dividends ($1.6 billion in 2011) to Federal Reserve member banks and making adjustments necessary so that surplus equals paid-in capital ($375 million in 2011).

January 31, 2012

Fed Gov. Raskin Discusses Small-Bank Supervision

Blue crabs and banking regulation might appear completely unrelated. But in a recent speech about small-bank supervision, Federal Reserve Governor Sarah Bloom Raskin cited the prevalence of the crustaceans as an example of why regulators must have a deep understanding of the local concerns of community bankers and their customers.

The importance of thinking locally
"It is important that examiners also understand local market conditions to be able to put the bank's management and credit decisions in the proper context," said Raskin in a January 6 talk before the Maryland Bankers Association. "For example, when I was commissioner here, there was an old joke among state examiners that you never dared set foot in a bank on the Eastern Shore if you didn't know the latest monthly count of blue crabs."

Chesapeake Bay crabs are a culinary and economic staple in communities surrounding the bay. Raskin, former commissioner of financial regulation for the state of Maryland, explained the Fed's differing approaches to supervising community banks and larger, more complex banking companies.

Flow of credit receives supervisory attention
She noted that the Federal Reserve Board maintains a group dedicated to overseeing the supervision of smaller banks. That group, Raskin said, considers not only whether policies are appropriate for community banks but also whether the policies could restrict the flow of credit to sound borrowers. The latter point was a focus of her remarks.

"One of the things that I try to do whenever I review policies is to draw on my experience of working with community banks in Maryland and think about the effects these policies are likely to have on community banks and the areas they serve," said Raskin, a member of the Federal Reserve Board subcommittee that oversees the supervision of community banks. "Ideally, our supervisory policies result in stronger community banks that are able to lend and promote sustainable economic growth in their communities."

January 19, 2012

Atlanta Fed President Explores Fundamentals Shaping the Recovery

The nation's tepid economic recovery is likely to continue in 2012, Federal Reserve Bank of Atlanta President Dennis Lockhart said in a speech January 9.

In remarks before Atlanta's Downtown Rotary Club, Lockhart said he expects gross domestic product (GDP) growth for this year of 2.5 to 3 percent without major negative shocks and slow but steady progress in bringing down unemployment. "The Atlanta Fed's outlook anticipates a moderate pace of improvement but real progress on most fronts," Lockhart said.

While he is encouraged by the improved performance of the economy, Lockhart cautioned that uncertainty continues to weigh heavily on consumers and businesses. The sovereign debt situation in Europe, he believes, will be the biggest wild card in 2012.

Fundamentals of the economy
In addition to delivering an outlook for 2012 and summarizing the economy's 2011 performance, Lockhart explored five economic fundamentals that he said are undergoing "repair and restructuring." The fundamentals that Lockhart believes are shaping today's economic performance include:

- **Household finances** are improving, as evidenced by lower debt levels and higher consumption in the second half of 2011. Lockhart cautioned that the stronger consumption late in the year likely "was associated with falling savings rates, compensating for stagnating income growth. I question whether this consumer spending momentum will be sustained without a pickup in income growth."
- **Business finances are healthy**, particularly at larger companies. Because of lower costs and higher productivity, big businesses are profitable and positioned to sustain decent results, Lockhart noted. However, smaller companies are generally not on as sound of a financial footing.
- **The banking and financial system** has strengthened its capital position and reduced nonperforming assets, and capital markets have largely recovered from their impaired state. "Overall, much progress has been made, but the financial system is not yet back to full strength," Lockhart said. "We can't really have a healthy economy without a strong banking and financial sector."
- **Public sector finances** remain severely stressed. State and local governments have made painful cuts in services and jobs and face serious long-term challenges related to pension obligations. Meanwhile, federal spending and revenues remain out of balance. "Government finances are not on a sustainable path and continue to be a weak element in the overall economic picture," Lockhart explained.
- Finally, **new business formation** is a foundational economic element because start-ups account for about 10 percent of firms but generate nearly 20 percent of new jobs every year, on average. Beginning in the year the recession started, 2007, the rate of new establishment formation dropped and has rebounded slowly. Moreover, there appears to be a longer-term trend that started in the late 1990s of individual new businesses employing fewer people.

January 18, 2012

Housing Recovery Key to Stronger Economy, Says Fed Governor Duke

The U.S. economy will continue its gradual recovery in 2012 despite several persistent headwinds, said Federal Reserve Governor Elizabeth Duke during a January 6 speech.

Speaking at a banking conference in Richmond, Virginia, she shared her outlook for the U.S. economy in 2012 and discussed several options for speeding the recovery in the housing and mortgage markets, which is important to the overall economic recovery.

Despite some recent signs of improvement, stubbornly high levels of unemployment will continue to drag on the economy, Duke said. Recent gains include the 200,000 jobs the economy added in November, along with a decline in the unemployment rate to 8.5 percent, the lowest level in two and a half years. However, other data point to a more gradual decline in unemployment along a somewhat "choppy" path, she added.

"Glimmers of hope" in trade, consumer spending

Other headwinds include budget pressures at the federal, state, and local levels. However, there are some "glimmers of hope," Duke noted, including strong performance in the trade sector and a pickup in consumer spending. Easing credit conditions for households and businesses are another cause for optimism. While the recent thawing in credit markets has not included mortgage credit, it does suggest that "when households do regain confidence in the recovery and are ready to begin spending on consumer goods again, the credit markets will not be as much of a constraint as they were during the recession," she explained. Businesses—benefiting from strong cash positions and historically low levels of corporate debt—will also be well poised to increase spending once confidence returns, she noted.

Housing action could speed recovery

Weakness in the housing market has also been a barrier to a more robust recovery. That ongoing weakness stands in contrast to previous recoveries, which were led by housing, Duke noted. She discussed several actions aimed at the housing market that could also boost the economy, "moving us closer to full employment sooner and improving the lives of many Americans." Those actions include

- increasing the availability of credit to homeowners and investors
- modifying existing mortgages of struggling homeowners to prevent foreclosures
- shortening the time and lessening the cost of foreclosures by encouraging alternatives such as short sales and deed-in-lieu of foreclosure and
- broadening the options for disposing of real estate–owned properties, converting them to more efficient uses such as rentals and community development purposes.

No "miracle cure" exists for the ailing housing and mortgage markets, Duke noted, but policies such as these "have the potential to significantly influence the speed and strength of our economic recovery."

January 18, 2012

ViewPoint Introduction

By Michael Johnson, Senior Vice President
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Mike Johnson

Welcome to "ViewPoint" for the first quarter of 2012. In case you missed it, we thought it would be fitting to present a concise summary, amplified with video interview clips, of key takeaways from the 2012 Banking Outlook Conference the Atlanta Fed hosted on March 1.

But before we focus on what is ahead, I'll start with a look back on the performance and condition of Sixth District banks for 2011. On an aggregate basis, I am pleased to report that district banks posted their first positive earnings in over two years. While we anticipate and are still experiencing some bank failures in 2012, it is reassuring to see aggregate earnings turn positive, along with an improvement in asset quality metrics across the spectrum. To be sure, the number of problem banks remains high, but district banks' Texas ratios show that the amount of stressed assets at banks is declining, which should mean fewer failures and better performance going forward.

Overall, there are more positive trends than negative ones, and the outlook for 2012, as discussed at our March 1 conference, appears guardedly better for banks than it did in 2011. Despite an array of risks on the horizon, my hope is that prospects augur well for continued improvement in banking conditions and increased profitability for district banks, in particular.

In addition, I want to draw your attention to the following three supervisory letters that the Federal Reserve System recently issued. SR 12-2 addresses frequently asked questions about the interagency advisory on interest rate risk management issued in early 2010. SR 12-3 provides interagency guidance on allowance estimation practices for junior lien loans and lines of credit, a key risk on our radar screen. And SR 12-4 is intended to provide more transparency regarding the factors the Federal Reserve will consider in evaluating whether to upgrade supervisory ratings for community banking organizations. For more information on these and other supervision and regulation letters, please refer to the Board of Governors' website.

Lastly, you probably saw the results from the recently released stress test. Clearly, the banking industry has added significant capital buffers sufficient to withstand the draconian scenario depicted in this year's test. While specific capital stress tests are only required for the largest banks, it is always important to understand key vulnerabilities and risks and the potential impact on your bank.

As always, I look forward to hearing from our readership, so please share with me any feedback you may have at ViewPoint@atl.frb.org, and good luck in 2012.

ViewPoint Spotlight: Outlook Conference

This annual conference explored the 2012 outlook for the banking industry. As the economy gradually improves, are banks finally poised for a turnaround? If so, where will loan growth and earnings opportunities come from—consumers, small businesses, real estate? As banks struggle to adapt to changing economic realities, they must also navigate a regulatory environment being reshaped by the Dodd-Frank Act, the Basel Committee, and a new consumer financial protection agency. Where are the agencies in this process, and how are banks adjusting so far?

ViewPoint State of the District

Asset Quality :: Balance Sheet Growth :: Bank Failures :: Capital :: Earnings Performance :: Liquidity

Asset Quality

News of an improving economy has perhaps lessened the concern about nonperforming loans, but they remain an issue for many banks in the district. Noncurrent loans barely dropped in the fourth quarter of 2011 compared with the prior quarter, which saw a significant drop. In contrast to the Sixth District, noncurrent loans at out-of-district banks continued a sharper decline (see the chart), which may signal how weak economic conditions remain in the district.

In aggregate, there were $9.4 billion in noncurrent loans in Sixth District banks in the fourth quarter, the lowest level since the fourth quarter of 2008. The ratio of noncurrent loans to total loans was 5.5 percent in the fourth quarter (see the table).

On a national level, the ratio of noncurrent loans to total loans remains near its peak because of the lack of new loan growth. Charge-offs of nonperforming loans ticked up during the quarter, although the increase was not unexpected (see the chart).

Sometimes charge-offs are higher at year end as banks evaluate their portfolios and decide to charge off certain loans in order to enter the new year with a cleaner balance sheet. The increase in charge-offs may also have contributed to the low coverage ratio in the Sixth District. The coverage ratio is a measure of the level of reserves for nonperforming assets. In the fourth quarter, provision for loan expense declined while nonperforming loans remained stable. As a result, banks have reserves for less than 50 percent of their noncurrent loans. Given the level of charge-offs and noncurrent loans, banks may need to be prepared to maintain their current allowance for loan loss by increasing their provision for loan loss expense through the first half of 2012.

Balance Sheet Growth

Much like the situation for banks under $10 billion on a national level, loan growth remains elusive for same-sized banks in the Sixth District. However, there was some success at generating commercial and industrial (C&I) loans during the fourth quarter. On an aggregate basis, C&I loans grew by $200 million over the prior year. C&I loans are a portfolio that banks have actively sought to grow to help offset the still-heavy concentration of real estate loans. While demand for C&I loans has been uneven over the past few quarters, according to the Federal Reserve Board's Senior Loan Officer survey, demand has generally trended upward (see the chart).

Sixth District banks also continue to lead their out-of-district peers in small business lending (see the chart).

It appears there has been some success in changing the basis on loans away from real estate collateral to more business assets, as commercial real estate lending continued to decline. In fact, while there has been some growth in certain parts of the loan portfolio, total loan growth remains anemic for Sixth District institutions (see the chart).

Loans now represent 62 percent of total assets on the balance sheet, down from 70 percent at the start of the crisis (see the table).

Without loan growth, banks continue to increase their securities portfolios, which have grown nearly 5.5 percent as a share of assets since the start of the crisis. While banks would like to get a higher yield on their securities, they are reluctant to invest in longer-term products because of the possibility of a rising-rate market and having the liquidity to make loans when demand returns.

For more detailed information on small business conditions in the Sixth District, see the Federal Reserve Bank of Atlanta's Small Business website.

Bank Failures

It was a tough year for banks located in the Sixth District in 2011. Georgia led the nation in bank failures, with 23 in 2011 and 75 since 2008 (see the table), but it only had one failure between mid-November and mid-February after having seven failures between mid-August and mid-November.

Florida was a distant second. After being failure-free through most of the crisis, Tennessee had two failures in one week in early 2012 (see the table).

The number of Sixth District banks with high Texas ratios is declining (see the chart), which should mean fewer failures in the district this year.

Capital

Sixth District banks have improved their equity positions over the past year. Aggregate total equity was at its lowest point in five years in the first quarter of 2011. Over the year, total equity grew 6 percent. Tier 1 leverage ratios increased 52 basis points over the past 11 quarters. But Sixth District banks have fallen from having a Tier 1 leverage ratio 32 basis points (bps) higher than out-of-district peers to as much as 26 bps below out-of-district peers (see the chart).

Overall, the banking industry has been slowly building its capital levels. Aggregate total risk-based capital has increased nearly 300 bps since the fall of 2008 (see the chart).

Earnings Performance

Sixth District community banks (those with assets under $10 billion) continued to post positive earnings in the fourth quarter, representing a continuing trend in the second half of 2011 (see chart

1).

On an aggregate basis, return on average assets (ROAA) for the fourth quarter was 0.13 percent versus ROAA from the prior year of –1.58 percent (see the table).

Although much improved, ROAA remains far below the out-of-district peer ratio of 0.73 percent (see the table).

The improvement during the quarter came from both an increase in net interest margin—which is part of the banks' core earnings—and lower provision expense (see the table).

The boost from the net interest margin was not as significant as in the third quarter of 2011, but it remained better than the prior year. Interest income increased sharply in the fourth quarter even as interest expense continued to decrease. Banks have been very effective at pushing down their funding costs while trying to stabilize their loan pricing. Contrary to the concerns of the industry, noninterest income also improved, even as the Durbin Amendment became fully implemented in the fourth quarter. Many smaller banks feared that although they were exempt from the limits on interchange fees, they would still lose income from the fees as merchants sought out the lowest-cost option.

Provision expense continued to decline in the fourth quarter and the aggregate coverage ratio for banks in the Sixth District is the lowest it's been in a decade. While a limited reduction in provision expense has been warranted, the level of coverage has reached a point where banks may not be able to reduce it any further.

Liquidity

Core deposits continue to be both a source of strength and concern for banks. Core deposits represented just over 64 percent of assets in the Sixth District, its highest level in nearly a decade. Out-of-district banks had the same level of core deposits. Core deposits have contributed to banks' improving net interest margins, as they represent a lower cost of funding, but without any loan demand, banks have been unable to fully deploy the excess funding. On an aggregate basis for banks across the country, the ratio of loans to deposits has dropped to roughly 83 percent from a peak of 128 percent for large banks (see the chart).

Banks have had trouble using the deposits in a meaningful way and, in some cases, have been turning away deposits. There is a concern among community banks that the expiration of the Transaction Account Guarantee (TAG) program may cause some runoff of core deposits. Nationally, TAG now insures $1.2 trillion in deposits in excess of $250,000.

Community banks are advocating extending the program for another five years, with the extension paid for by an FDIC premium. The level of reliance on noncore funding continues to decline but not as quickly as it has in out-of-district peers. The aggregate net noncore funding dependence ratio for district banks fell to 18.91 percent, the lowest ratio sine the first quarter of 2006. By comparison, the same ratio for out-of-district peers was 12.55 percent.

ViewPoint National Banking Trends

U.S. commercial banks across the nation continued their uneven progress toward better profitability in the fourth quarter. Aggregate return on average assets (ROAA) turned down slightly from the prior quarter of 2011 (see chart 1).

The decline was evident across all sizes of institutions. ROAAs are typically lower in the fourth quarter as banks determine what expenses need to be recognized prior to moving into a new year. Net interest margin improved slightly in the fourth quarter. One of the concerns going into the fourth quarter was centered on noninterest income as a result of caps on interchange fees. For banks under $10 billion, noninterest income actually increased over the prior quarter while it declined for larger banks. Banks under $10 billion were exempted from the interchange fee cap. The story with earnings continues to be more a function of cost control than an improvement in net interest margin.

Loan growth is improving, but only at banks with an asset size greater than $10 billion (see chart 2). Annualized loan growth for all commercial banks was 7.8 percent, but larger banks had annualized growth of 10.4 percent in the fourth quarter, and smaller banks had negative loan growth.

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