Loan Portfolios in Eighth District Are Healthy Despite Increase in Problem Loans

Contact: Charles B. Henderson (314) 444-8311

For release: August 6, 1996

ST. LOUIS Banks in the Federal Reserve's Eighth District posted record earnings of $2.2 billion in 1995, but problem loans, particularly in the consumer area, are up by some 30 percent. The increase in these "nonperforming" loans (ones that are 90 days or more past due, or not accruing interest) appears dramatic, however, because the level of such loans in the District has been so low in the last several years.

That evaluation comes from Mark D. Vaughan, an economist, and Dusan Stojanovic, a senior research associate, at the Federal Reserve Bank of St. Louis. Their findings appear in "Loan Quality in the Eighth District: Worth a Closer Look," in the July 1996 issue of The Regional Economist, the St. Louis Fed's quarterly publication of business and economic issues.

"Except for agricultural loans," said Vaughan, " all categories of nonperforming loans rose at District banks in 1995, with consumer loans showing the largest increase, up 35 percent. Even more noteworthy than consumer nonperforming loans, though, was the 25.2 percent increase in nonperforming real estate loans. In fact, real estate loans dominate District loan portfolios, accounting for 54 percent of total loans. We saw a $34.4 million hike in nonperforming construction loans and a $38.7 million uptick in nonperforming one- to four-family residential loans."

Vaughan said this trend is not surprising it's in line with history. He pointed out that boosts in District nonperforming loans typically follow spurts in loan growth. "Banks increase their loan portfolios as demand rises during expansions," he noted. "As these expansions continue, fewer high-quality loans are available, so some banks may ease credit standards to keep up their loan growth. Also, as the economy weakens, loans to cyclical industries like real estate tend to slide into the nonperforming' column."

From another angle, the rise in nonperforming loans reflects what statisticians call "the low-base effect." In other words, because nonperforming loans were at a record 10-year low in 1994, any increase would seem large on a percentage basis. "Moreover," said Vaughan, "the overall level of nonperforming loans in the District when viewed in relation to total loans compares favorably with U.S. peer banks, those banks with less than $15 billion in average assets. Although Eighth District nonperforming loans as a percentage of total loans rose 12 basis points in 1995 to finish at 0.78, that ratio is still well below the U.S. peer bank average of 1.07 percent. Also, the District ratio is well below its normal range of 1.5 percent to 2.0 percent."

Vaughan and Stojanovic note that the level of nonperforming loans rose in six of the seven District states, although by different amounts:

- Arkansas posted the largest increase in nonperforming loans (25 percent), followed by Kentucky (16.6 percent), Tennessee (11.1 percent), and Missouri (10.8 percent).

- Illinois and Mississippi experienced more modest growth in nonperforming loans (3.3 percent and 0.3 percent, respectively).

- Only Indiana enjoyed lower levels of nonperforming loans down 6.2 percent, a result of a 17.9 percent decline in nonperforming real estate loans, which, in turn, was fueled by a 69.1 percent drop in nonperforming loans for

construction and land development.

Vaughan said banks in the District appear well-positioned to deal with the recent rise in nonperforming loans. "Higher loan loss provisions may reduce their earnings somewhat in the coming quarters," he said, "but there is no evidence to suggest that a serious loan quality problem will emerge to torpedo earnings."

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