

Monetary Trends



How Long Can Strong Loan Growth Continue?

U.S. banks have enjoyed a prolonged spurt of loan growth in this business cycle expansion. Since the end of the last recession in early 1991, loans on the books of U.S. banks have increased at a compound annual (nominal) growth rate of 5.4 percent. And, since the first quarter of 1993, loans have grown at an 8.4 percent rate. Although loan growth peaked in mid-1995, when loans outstanding rose 12.6 percent from their year-ago level, growth remains strong (see chart).

Loan growth has been broad-based, with every major category of loans showing similar rates of increase since early 1993. Real estate loans have increased at a rate of 7.9 percent, while commercial and industrial (C & I) loans have risen at an 8.8 percent rate and consumer loans have grown at an 8.1 percent rate. A strong economy and healthy bank balance sheets explain much of the continued strength in lending. Rates of return on lending remain high relative to alternatives, like investment securities.

One of the more remarkable aspects of this loan spurt is the continued improvement in measured aggregate loan quality. Since the third quarter of 1991, when it peaked at 3.91 percent, the ratio of nonperforming loans (loans that are 90 days or more past due or in nonaccrual status) to total loans has fallen continually and currently stands at 0.95 percent. Net charge-offs are also extremely low by historical standards. Although Comptroller of the Currency Eugene Ludwig, Federal Reserve Chairman Alan Greenspan, and other bank regulators have issued warnings in recent months of impending asset quality problems—based on bank exams and anecdotal reports of looser underwriting standards—such problems have yet to appear in the published data. The only category of loans showing any recent deterioration is the consumer portfolio. The ratio of nonperforming consumer loans to total consumer loans declined to 1.01 percent at year-end

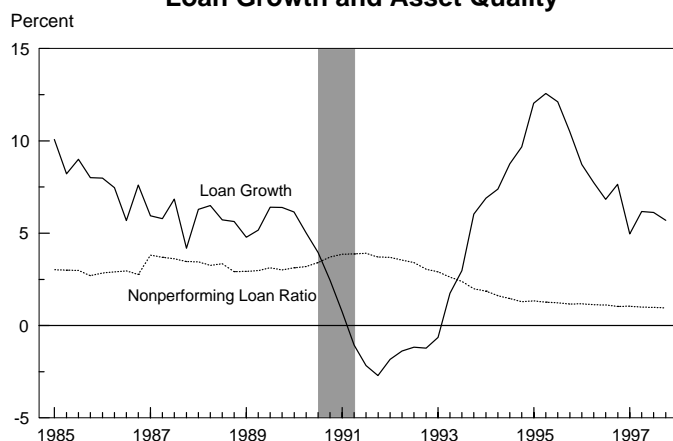
1994, but has since risen to 1.46 percent. The net charge-off rate for consumer loans has also risen over the past several years. Most of the increase in these ratios can be traced to defaults on credit card debt.

Loan portfolio composition explains much of the overall improvement in asset quality at U.S. banks. Single-family residential mortgages and home equity loans—traditionally the least risky of all bank loans as measured by default and loss rates—have accounted for 27 percent of the \$937 billion increase in total loans since the first quarter of 1993. Declining interest rates and rising household income explain much of the growth in bank residential mortgage lending; thrift acquisitions by banks are another factor. C & I loans accounted for 27.9 percent of the increase in bank loans over the period. Credit card loans, recently among the riskiest of bank loans, have accounted for just 9.7 percent of the increase in total bank loans since 1993.

How long will the good news on loan growth and asset quality last? With time—and possibly a downturn in the economy—we will know more about the risks banks have assumed in recent months.

—Michelle Clark Neely

Loan Growth and Asset Quality



Loan growth is measured as the simple change from its year-ago level. Shaded area represents a business recession.

