FEDERAL RESERVE BANK *of* ST. LOUIS

ABA Mega Conference
Little Rock, Arkansas

Following the events of this spring, uncertainty continues to be the theme

Allen North
Vice President
Supervision Division

CENTRAL TO AMERICA'S ECONOMY®

What are we going to talk about today?

- Prospects for the overall economy are positive. We'll discuss recent FOMC moves and prospects for what's ahead.
- Liquidity has tightened and is a primary focus of examination and interim monitoring work. The cost of funds have increased significantly, putting pressure on net interest margins.
- The events of the spring demonstrated the need for strong contingent funding. The Discount Window and the Bank Term Lending Program should be considered.
- The FDIC is considering changes to deposit insurance.
- Credit conditions seem to be shifting? We'll go through some recent CRE and consumer credit trends.

July 25-26 FOMC Meeting

- The Federal Open Market Committee maintained the target for the federal funds rate at a range of 5.25% to 5.5%.
- This followed 10 consecutive meetings of rate hikes for a cumulative tightening of 525 basis points.
- There were no changes to the Federal Reserve's balance sheet policy, where the reduction in holdings of Treasuries, agency debt and agency MBS continues as previously announced.
- The FOMC remains strongly committed to bringing inflation back to the 2% objective.

Prominent risks haven’t changed in the last year

Market/Liquidity Risk:

- Unrealized losses in the securities portfolio.
- Deposit competitive pricing pressures as we return to more pre-pandemic funding structure.

Credit Risk:

- Reduced cash flow from increasing rates and high inflation.
- Refinance risk as loans reprice at much higher rates.
- Commercial real estate is performing, but for how much longer and what segments may be impacted.

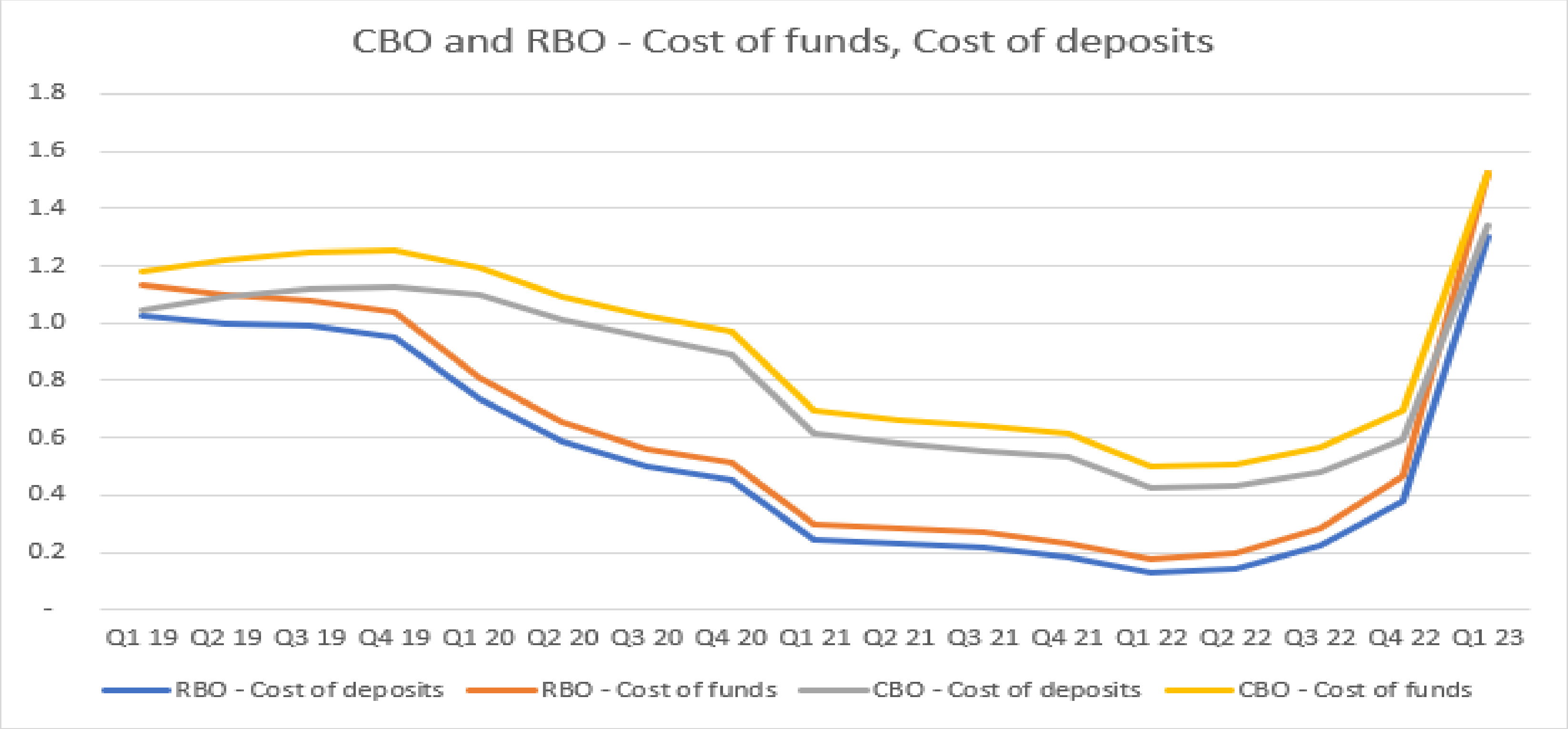
Liquidity has tightened and is likely to continue given the increase in funding costs.

Bankers Bank balances provide one measure of liquidity in the market

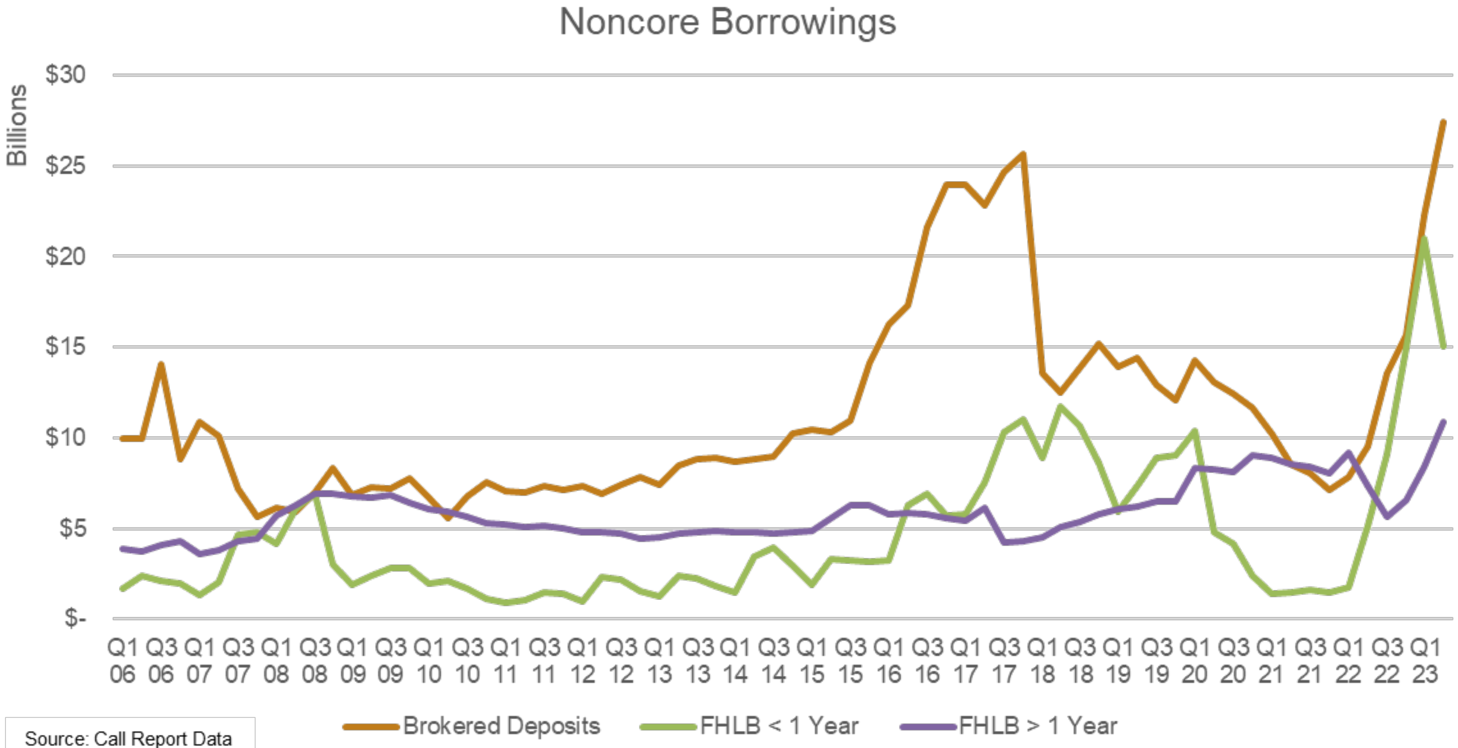
	Agent Pool (000)	EBA (000)	Total (000)
Dec-19	$6,916,723	$6,254,883	$13,171,606
Jan-20	$7,251,829	$6,097,651	$13,349,480
Feb-20	$7,491,357	$7,728,111	$15,219,468
Mar-20	$8,210,838	$6,533,296	$14,744,134
Apr-20	$8,606,087	$9,351,524	$17,957,611
May-20	$7,893,650	$11,971,746	$19,865,396
Jun-20	$7,793,911	$12,805,020	$20,598,931
Jul-20	$7,209,550	$12,873,276	$20,082,826
Aug-20	$7,030,588	$10,665,341	$17,695,929
Sep-20	$6,998,811	$12,560,548	$19,559,359
Oct-20	$8,689,111	$14,990,366	$23,679,477
Nov-20	$8,215,266	$17,066,649	$25,281,915
Dec-20	$8,036,114	$17,081,644	$25,117,758
Jan-21	$9,057,749	$19,098,088	$28,155,837
Feb-21	$7,870,365	$20,010,679	$27,881,044
Mar-21	$8,066,554	$21,003,531	$29,070,085
Apr-21	$7,854,127	$21,854,642	$29,708,769
May-21	$6,867,156	$20,840,108	$27,707,264
Jun-21	$6,294,311	$21,221,565	$27,515,876
Jul-21	$6,990,898	$23,010,283	$30,001,181
Aug-21	$7,238,150	$24,099,014	$31,337,164
Sep-21	$6,220,613	$23,021,138	$29,241,751
Oct-21	$6,729,633	$23,811,847	$30,541,480
Nov-21	$6,463,786	$23,562,027	$30,025,813
Dec-21	$5,814,283	$22,508,689	$28,322,972

	Agent Pool (000)	EBA (000)	Total (000)
Jan-22	$6,082,243	$22,457,686	$28,539,929
Feb-22	$6,217,558	$22,373,397	$28,590,955
Mar-22	$5,740,157	$23,129,658	$28,869,815
Apr-22	$5,777,106	$18,999,267	$24,776,373
May-22	$5,107,630	$15,660,749	$20,768,379
Jun-22	$4,746,576	$14,394,228	$19,140,804
Jul-22	$5,333,070	$13,684,147	$19,017,217
Aug-22	$5,214,574	$12,417,931	$17,632,505
Sep-22	$4,297,872	$11,008,503	$15,306,375
Oct-22	$4,444,894	$10,634,814	$15,079,708
Nov-22	$3,822,994	$9,778,960	$13,601,954
Dec-22	$3,181,769	$8,737,342	$11,919,111
Jan-23	$3,572,314	$8,400,402	$11,972,716
Feb-23	$4,009,603	$8,556,793	$12,566,396
Mar-23	$3,004,583	$9,976,084	$12,980,667

8th District Community Banking Organizations and Regional Banking Organizations Funding Cost

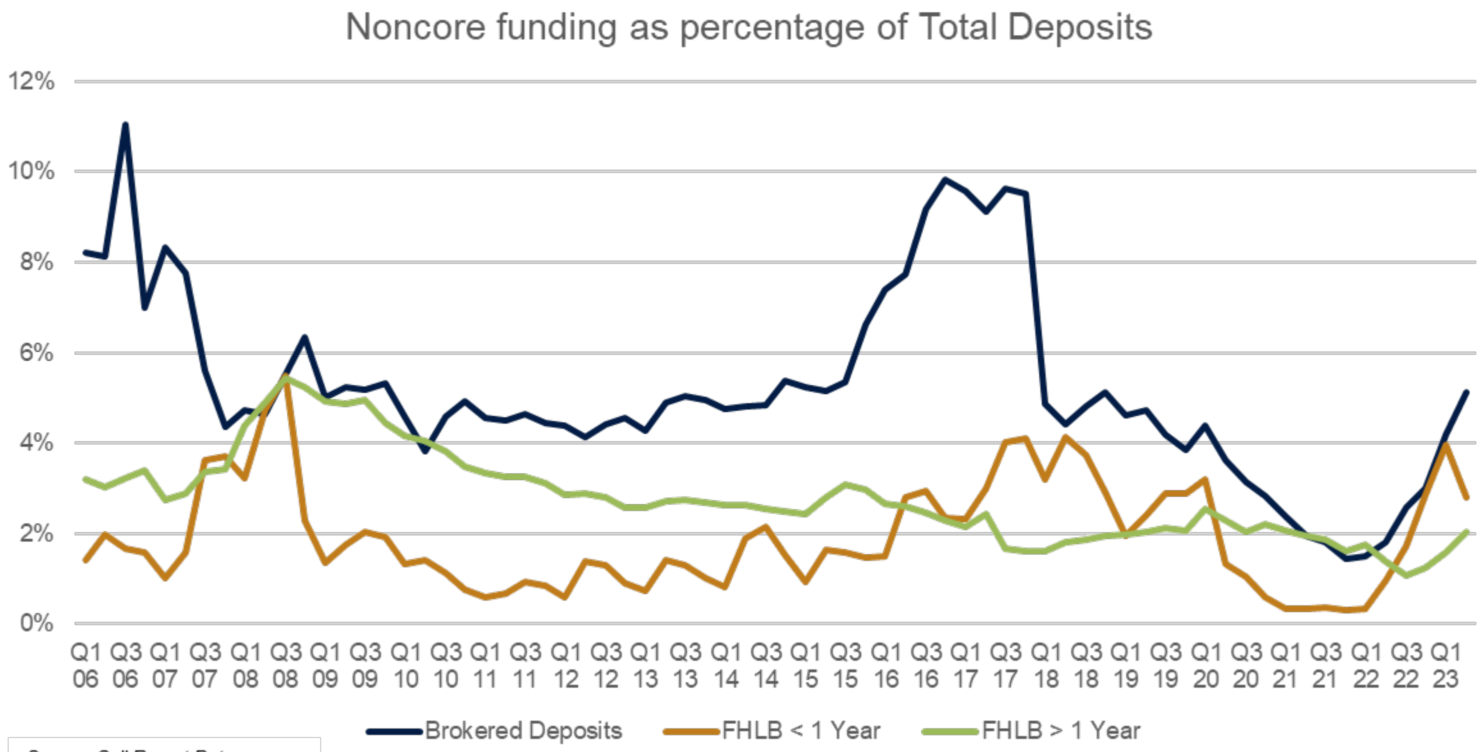


8th District noncore funding is elevated, led by brokered deposits



Source: Call Report Data

8th District noncore funding as percent of total deposits



Source: Call Report Data

Diversity in funding sources and balance sheet liquidity with a strong contingent funding plan is the order of the day.

Recent events have shown us the importance of liquidity

There are three main components to liquidity:

- Balance sheet liquidity, cash and cash equivalents, assets that can be sold to generate cash, often measured with a liquidity ratio.
- Funding on the liability side of the balance sheet:
  - Core deposits
  - Diversity in funding sources
  - Uninsured deposits
- Contingent sources of funding.

Contingent Sources – How quickly can you obtain cash?

- Should have enough availability to handle a fairly-severe adverse scenario.
- Establish multiple options including the Discount Window, Bank Term Funding Program, FHLB, Fed fund lines and other lines of credit with other lenders.
- Thoughtfully allocate collateral to maximize borrowing capacity.
- Test regularly.

Discount Window – What happened to “lender of last resort?”

- The Discount Window has played a key role in providing funding during significant events and more recently reduced contagion in the market, nevertheless, “stigma” keeps some banks from taking advantage of the benefits of the Discount Window.
- Market pressures for publicly traded companies and disclosure.
- Three forms of credit: primary, secondary, and seasonal.
- Examiners will not criticize the use of the Discount Window.

Bank Term Funding Program

Established on March 12, 2023 to provide loans for up to one year for eligible depository institutions pledging U.S. Treasuries, agency debt and mortgage-backed securities.

Borrower Eligibility	Banks eligible for primary credit
Rate	One-year overnight index swap plus 10 basis points
Collateral Valuation	Par value, margin is 100% of par
Prepayment	May prepay at any time without penalty
Fees	No fees
Recourse	There is recourse beyond the pledged collateral
Program Duration	Advances can be requested until March 11, 2024

The FDIC is investigating possible paths for changes to deposit insurance.

The Evolution of FDIC Insurance Limits

Date	$	Date	$
Jan 1934	$2,500	Dec 1969	$20,000
Jul 1934	$5,000	Nov 1974	$40,000
Sep 1950	$10,000	Mar 1980	$100,000
Oct 1966	$15,000	Oct 2008*	$250,000

*During the Great Recession, the Emergency Economic Stabilization Act (EESA) was passed. It temporarily raised the FDIC coverage limit to $250,000. On July 21, 2010, this increase was made permanent by the Dodd-Frank Wall Street Reform and Consumer Protection Act.

What's the history of uninsured depositors being left holding the bag?

- 37 of the 541 banks that have failed since the beginning of 2007 had uninsured depositors who have not yet fully recovered their cash.
- Total amount of uninsured deposits not recovered is only $145 million (IndyMac makes up $94 million of that balance).
- With roughly $780 billion in total deposits at banks that have failed in this 2007-to-date period, it provides a loss rate of less than 0.02% ($145 million / $780 billion).
- Most failures result in a bank assuming all the deposits in a whole bank FDIC-assisted acquisition.

Three Approaches to Reform

Limited
Maintain current structure while considering an increase to the $250,000 limit.

Unlimited
Unlimited coverage would provide limitless insurance coverage.

Targeted
Different levels of deposit coverage across different types of accounts.

Other options include private insurance or a combination of limited or targeted coverage where large concentrations of uninsured depositors would require that short-term liabilities be funded by short-term assets.

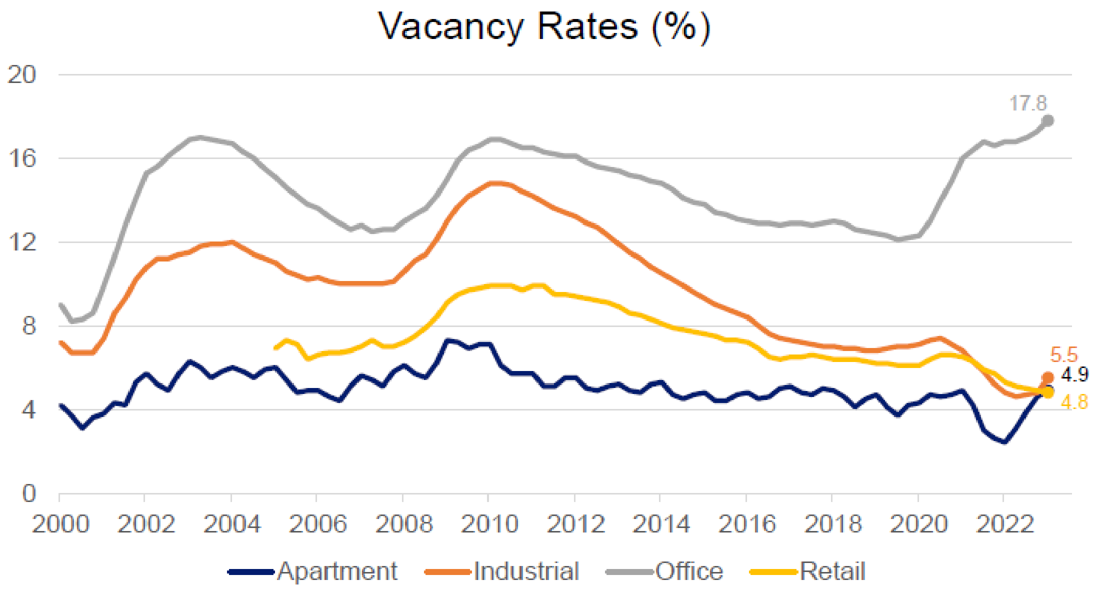
While overall credit conditions remain solid, Commercial Real Estate exposures cannot be ignored.

These forward-looking indicators are starting to reflect possible credit issues in the near future.

- Consumer credit has increased significantly, and the average number of outstanding credit cards per household is now at seven.
- It appears that many households are using credit to pay for living expenses.
- Credit card and other consumer credit past-dues are increasing.
- Anecdotally, bankers are starting to encounter some commercial credits that no longer cash flow at higher interest rates and expenses are pushing down margins.

CRE Vacancies

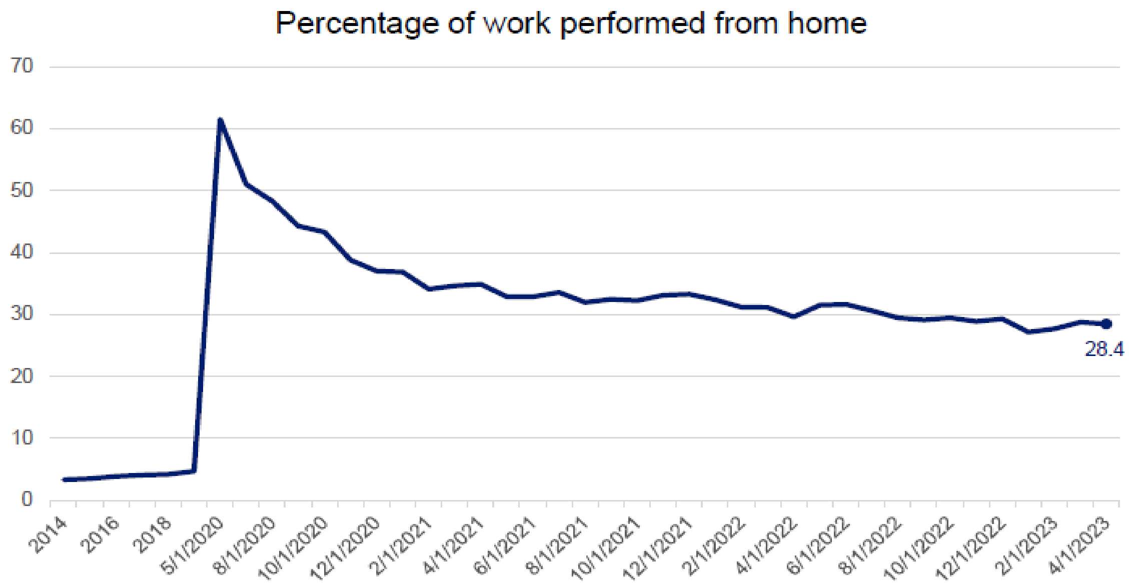
Vacancies on the rise in office and apartment sectors



Source: CBRE; Data through 2023 Q1.

Work from Home

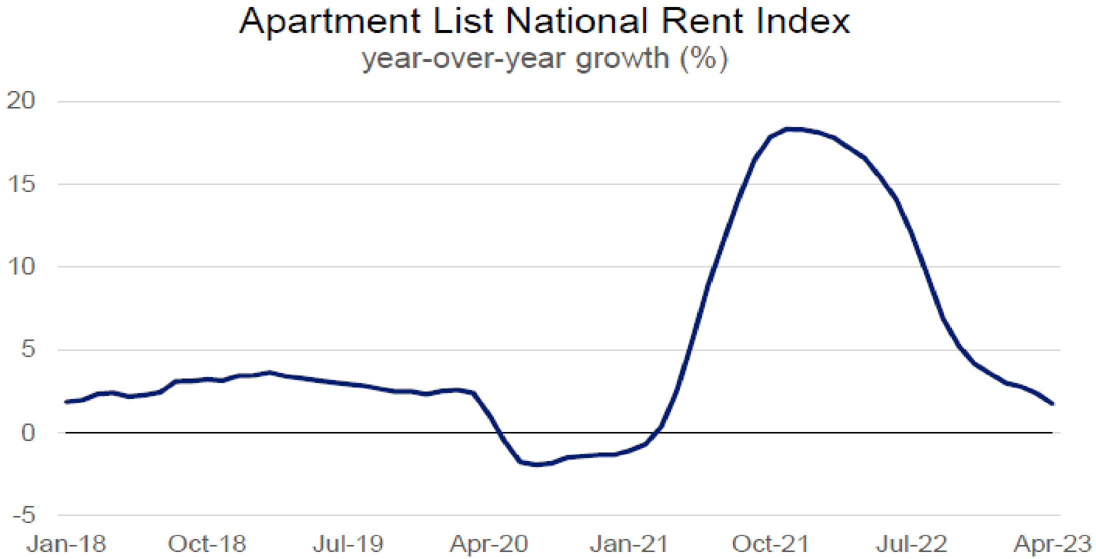
Increased hybrid, remote work reduces office demand



Source: Barrero, Jose Maria, Nicholas Bloom, and Steven J. Davis, 2021. "Why working from home will stick," National Bureau of Economic Research Working Paper 28731.

Apartment Rents

Apartment rental price growth eases after 2021 surge



Source: Apartment List; Data through April 2023.

CRE Update

- While many CRE metrics are not overly concerning, office space is now starting to show signs of weakness.
- Larger banks have tightened underwriting standards and in some cases are looking to offload risk.
- Some hospitality properties in larger metro areas, often considered convention destinations, are now in default and foreclosure.
- Banks should closely monitor all CRE and look beyond traditionally calculated vacancy rates.

Sound risk management practices are needed to mitigate the risk

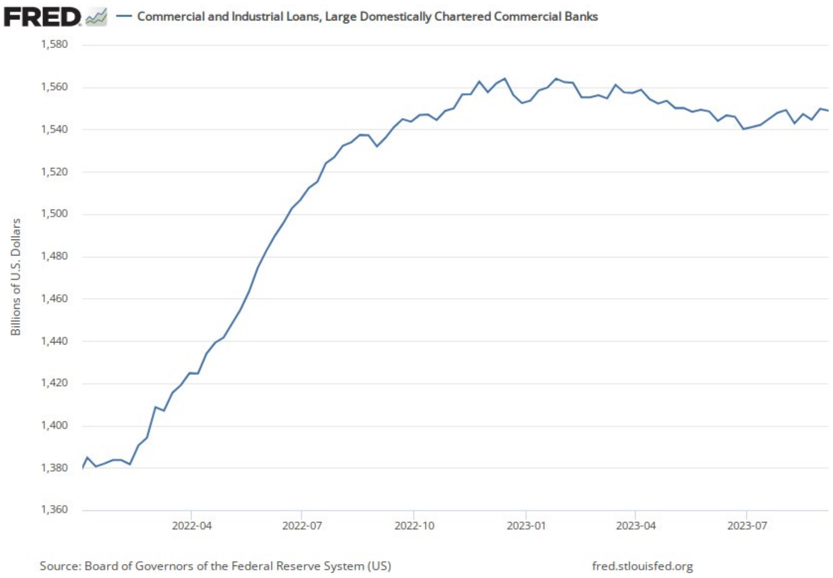
- Just like any concentration, CRE concentrations must be appropriately managed – SR Letter 07-1 Interagency Guidance on Concentrations in Commercial Real Estate.

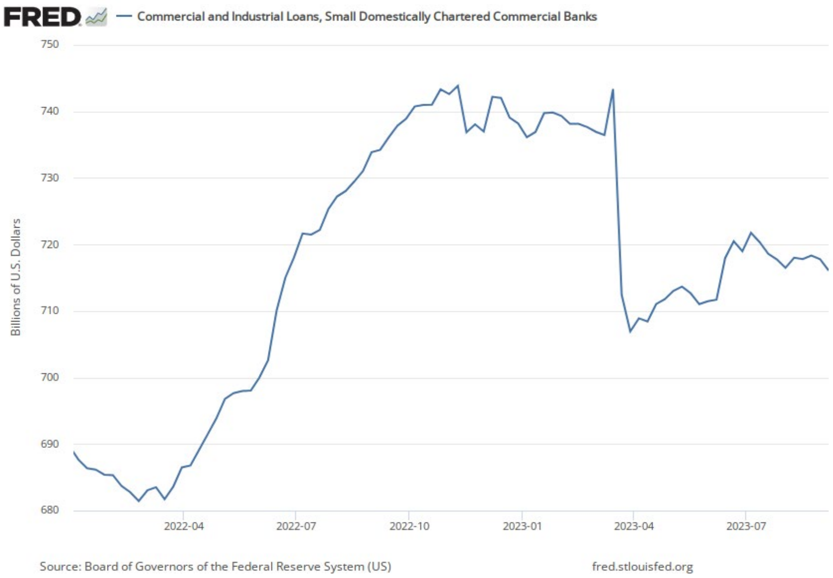
- An Eighth District CRE horizontal review identified the following common deficiencies:
  - Lack of adequate identification and monitoring, stratification, and a contingency plan to reduce exposures.

- Working with borrowers is always appropriate. SR Letter 23-5 Prudent Commercial Real Estate Loan Accommodations and Workouts provides some useful guidance and examples.

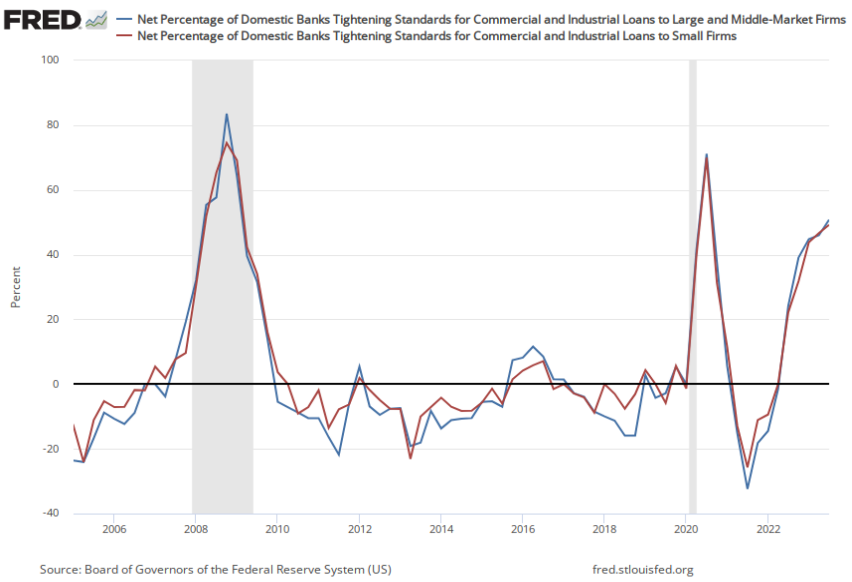
The level of Commercial and Industrial loans has not fully recovered from the events of the spring.

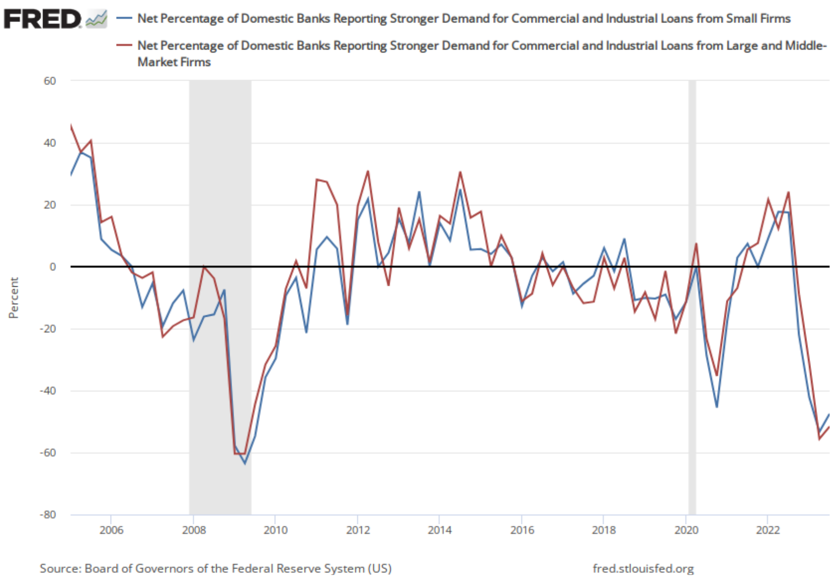
March pullback in C&I lending by “small” banks only partially recovered





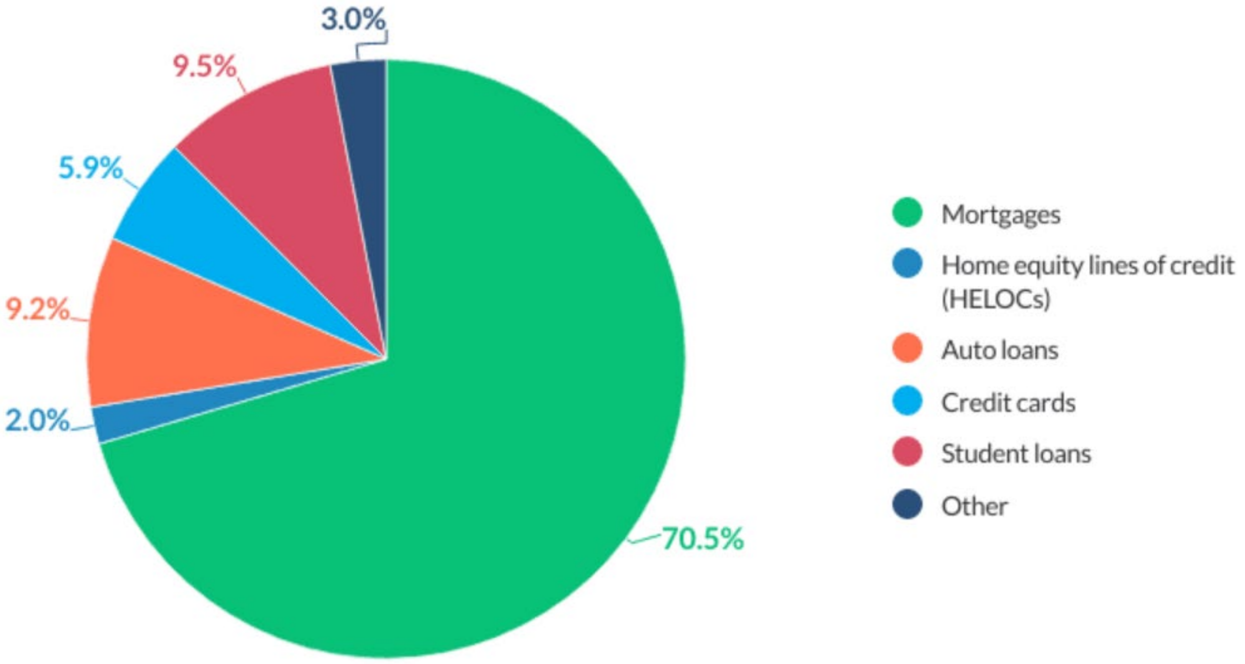
Banks signal tightening standards, weaker demand for C&I loans through mid-2023





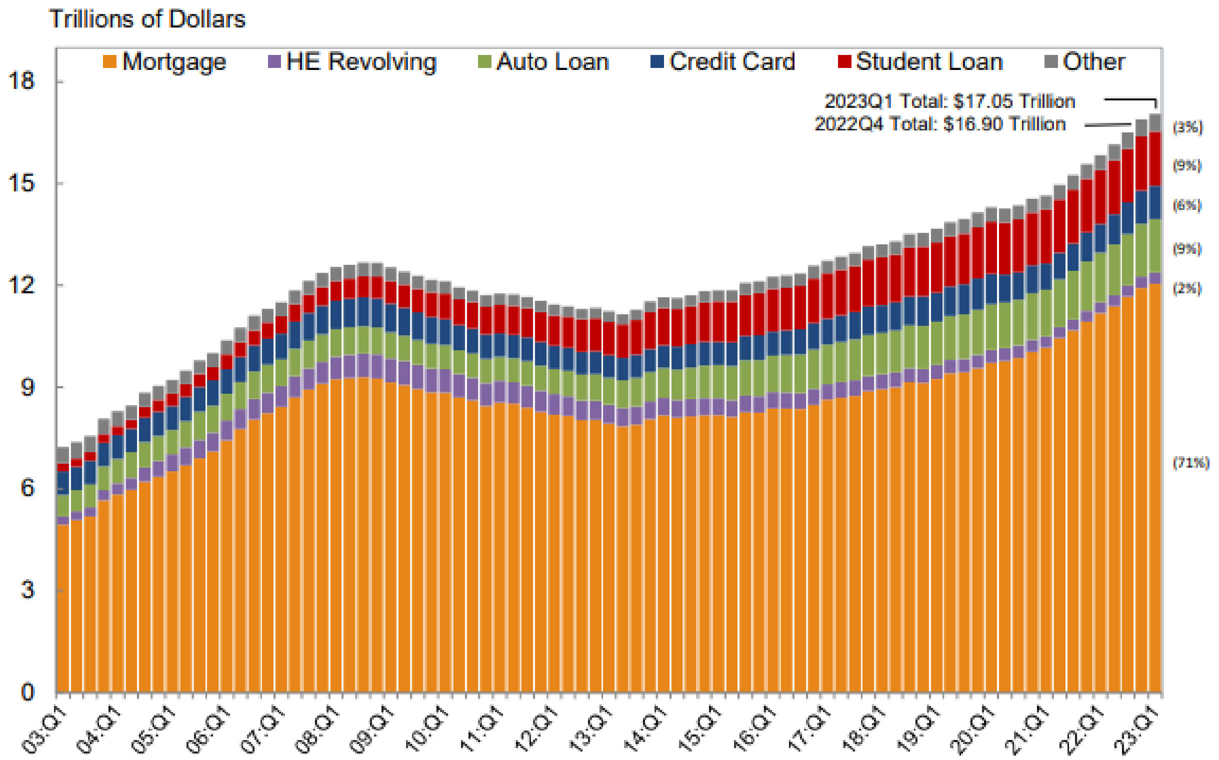
Consumer credit is starting to show signs of deterioration and future prospects don’t seem positive.

Distribution of outstanding consumer debt



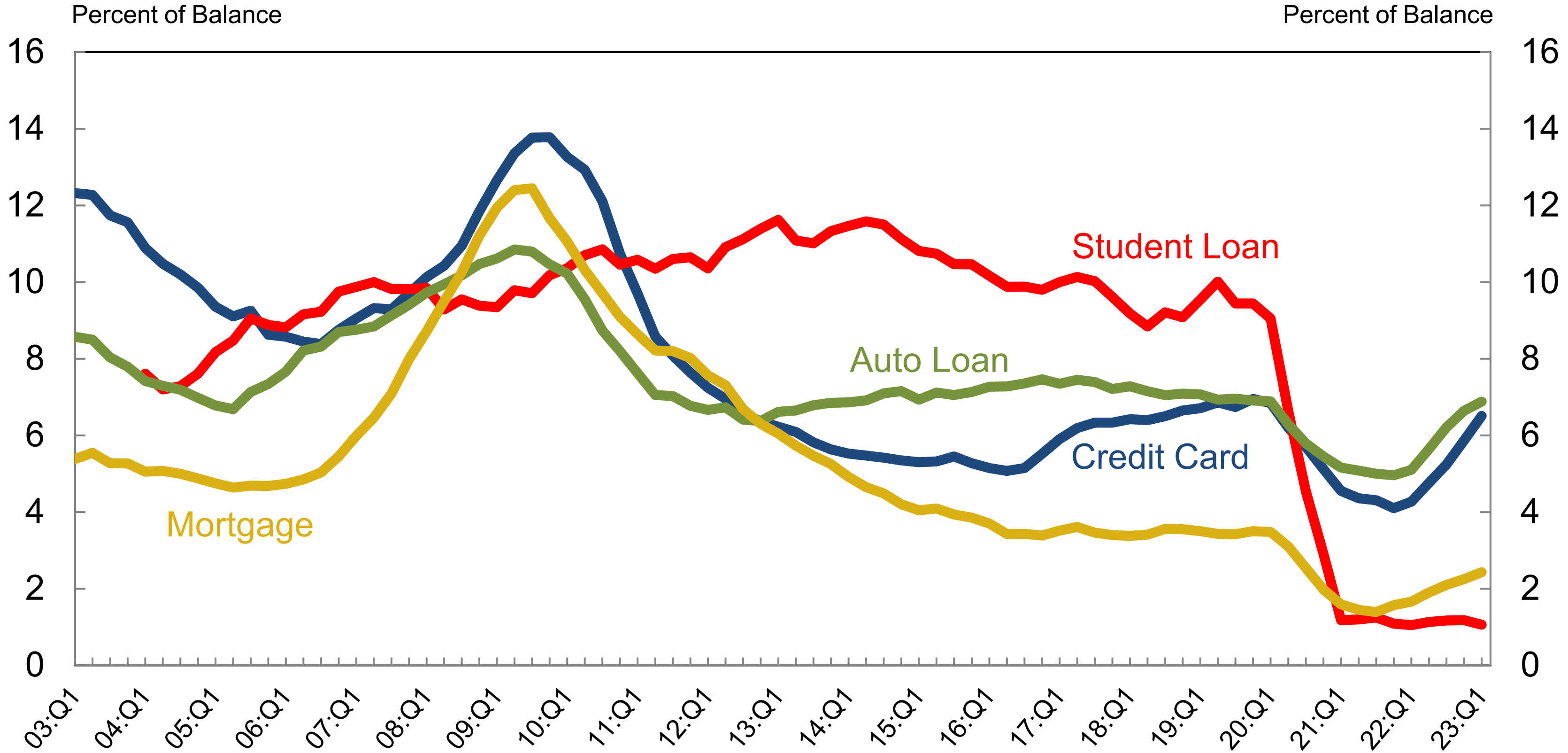
Source: New York Fed Consumer Credit Panel/Equifax data from Q4 2022. Totals don't add to 100% due to rounding.

Consumer debt distribution over past 20 years



Source: New York Fed Consumer Credit Panel/Equifax

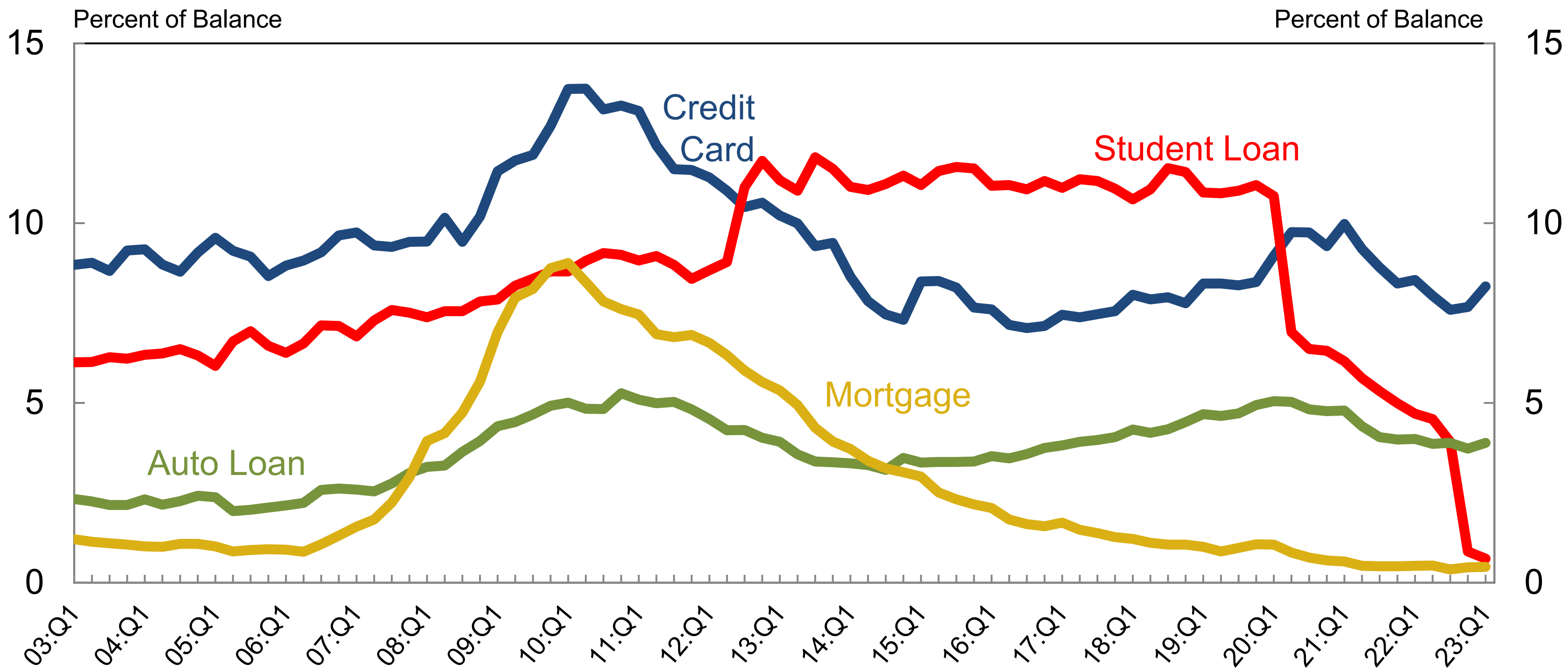
Transition into Delinquency (30+) by Loan Type



Source: New York Fed Consumer Credit Panel/Equifax

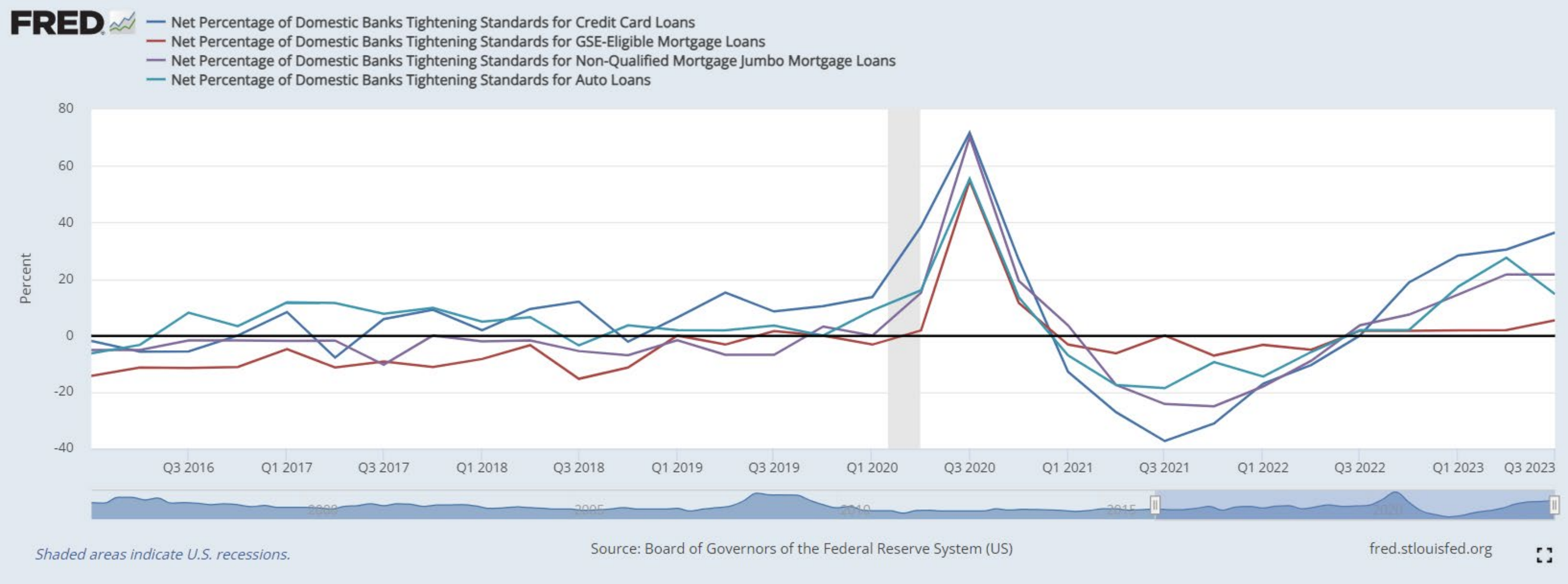
Note: 4 Quarter Moving Sum
Student loan data are not reported prior to 2004 due to uneven reporting

Percent of Balance 90+ Days Delinquent by Loan Type



Source: New York Fed Consumer Credit Panel/Equifax

Standards tightening across most loan types



Recent student loan statistics

- Outstanding balance of $1.8 trillion
  - 92% are Federal Student Loans
- Average balance is $37 thousand
- 43.6 million student loan recipients
- Payments resume October 1, interest to resume accruing September 1
- Estimated average monthly payment is $393

Delinquency rates were highest prior to pause – what will happen when payments resume?

Source: Equifax US National Consumer Credit Trends Report, FRB NY, Bankrate

Recent auto debt statistics

- $1.5 trillion outstanding auto debt
- $725 average monthly payment amount for new auto
- $516 average monthly payment for used auto
- Outstanding accounts up 1.5%, outstanding balances up 7% YOY

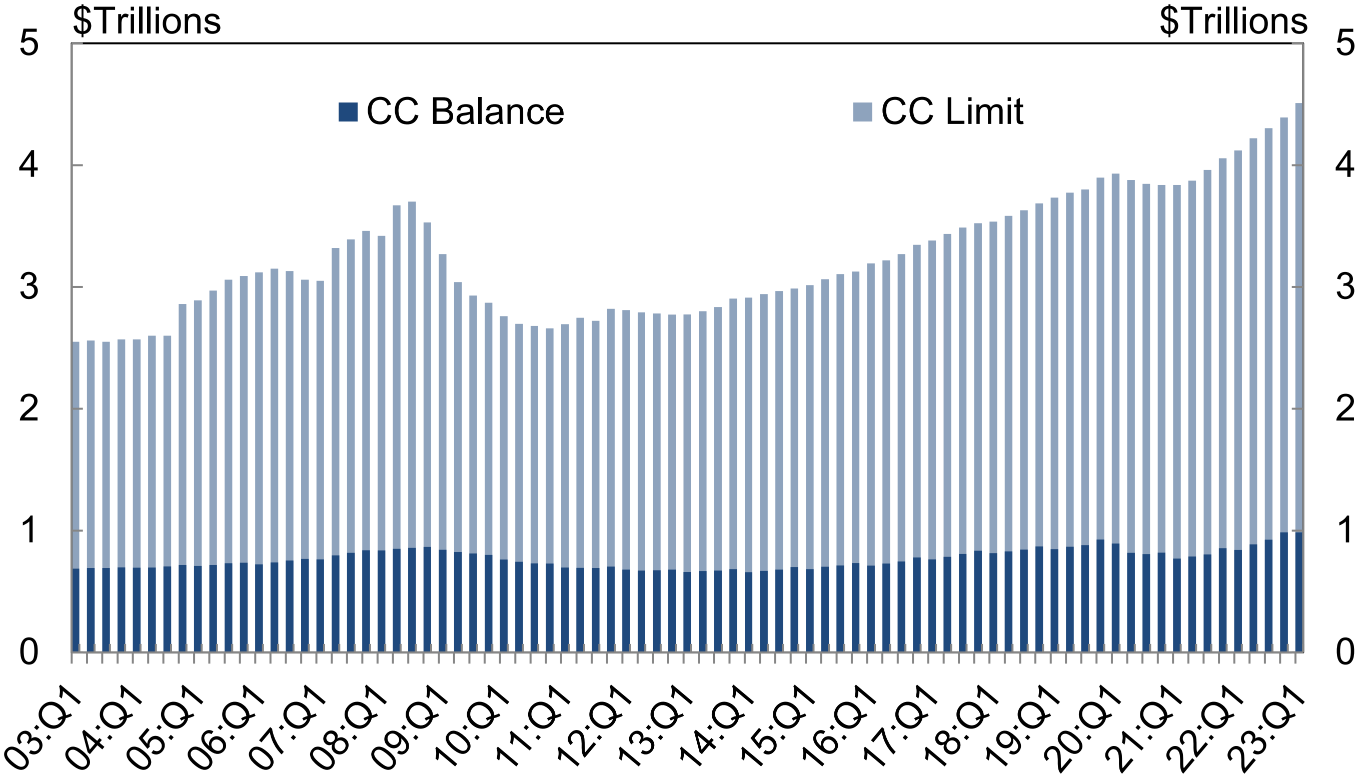
Accessibility to debt still does not seem to be a problem.

Source: Equifax US National Consumer Credit Trends Report, Experian State of the Automotive Finance Market Q1

Mortgage rates closer to historical levels, but aggregate debt much higher

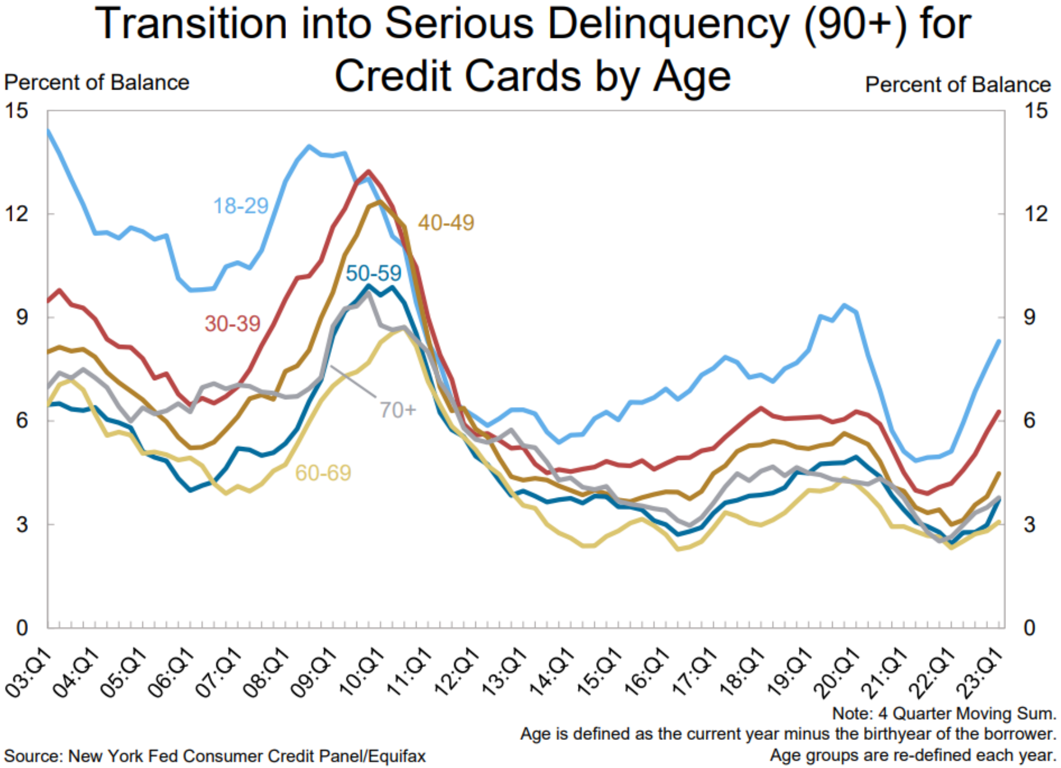
- Lack of housing supply is keeping prices high and affordability is low.
  - 92% of mortgages are at below market rates.
- Delinquency rates remain low and flat.
- Little incentive to move, and lower incentive for developers and builders to construct starter homes.
- While debt remains accessible, sizeable down payments and higher monthly payments serve as deterrents to borrowers.

Credit card limits increasing



Source: New York Fed Consumer Credit Panel/Equifax

Transition to 90-day delinquencies increasing, more so in younger demographics



Consumer Credit Takeaways

- Consumer debt has been increasing at a high rate.
- Delinquency levels will likely continue their upward trend as student loan payments resume and consumers face the decision of which monthly payments to prioritize.
- Credit availability will be drained from the consumer as it is either restricted based on credit score, or simply too expensive based on pricing for risk.

Questions?