SECTION 4
Credit Risks

This chapter assesses the various areas of bank credit risk, ranging from commercial real estate lending to nonbank lending. It is organized by credit area, ordered by the level of exposure and risk to the banking industry, community banks in particular. Each section begins with an analysis of economic and operating conditions, followed by an assessment of bank exposure and credit quality.

Commercial Real Estate

- **Markets for most major commercial real estate (CRE) property types were resilient in 2023, but the markets for office and retail malls were weak.**
- **The banking industry remained active in CRE lending in 2023, and CRE loan exposure remained elevated, particularly among midsize banks.**
- **CRE loan quality overall remained favorable at year-end 2023, but weakness emerged, particularly among large bank CRE loan portfolios.**
- **The amount of CRE loans scheduled to mature through 2026 remains elevated. Amid high interest rates, softening property values, and emerging credit weakness, the ability to refinance CRE loans remains a challenge to the banking industry.**

Markets for most major CRE property types were resilient in 2023, but the office sector struggled and faces notable headwinds in 2024. Net absorption of office space was negative for the fourth straight year in 2023, which means that more office space was vacated than was newly leased. Demand for space was particularly weak in the largest U.S. office markets, reflecting in part the continuation of remote work and slow return to office in many cities.[17] Net absorption fell more than three times more sharply in the largest markets than in smaller markets in 2023.[18] Negative net absorption contributed to an increase in the U.S. office vacancy rate from 12.4 percent in fourth quarter 2022 to 13.5 percent in fourth quarter 2023.[19] In the largest U.S. markets, the vacancy rate increased from 13.2 percent to 14.6 percent during that time, while the vacancy rate in smaller markets increased from 5.4 percent to 5.6 percent. Industry forecasts expect weak demand for office space and a continued rise in vacancy in 2024 (Chart 21).

Challenges for other property types were more modest in 2023, but headwinds may emerge in 2024. Demand for multifamily units benefited from relatively low single-family home affordability, which may have kept many would-be homebuyers in the rental pool. Also, slowing rent growth contributed to improved apartment leasing. Nonetheless, demand for multifamily housing has not kept up with strong supply growth in recent years, which was triggered in part by pandemic-era demand and migration trends. Construction has been particularly strong in Sunbelt

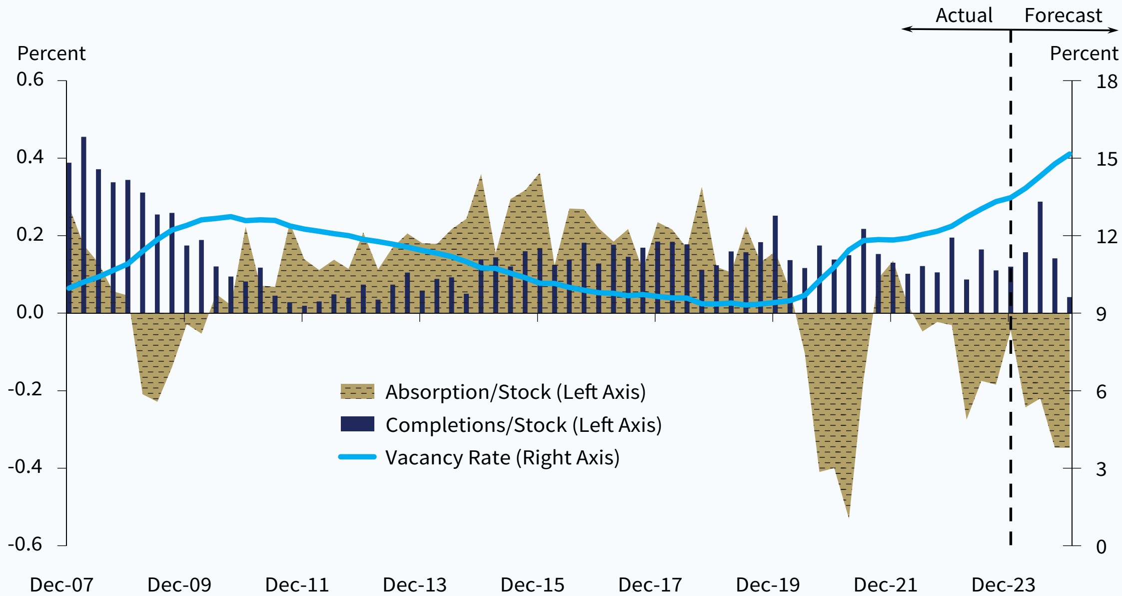
[17] According to Kastle Systems' "Back to Work Barometer" and University of Toronto cell phone tracking data, office attendance remains below pre-pandemic levels in many large cities.

[18] The largest markets are the 20 largest office markets in the country by inventory.

[19] Unless otherwise noted, CRE data are from CoStar as of fourth quarter 2023.

CHART 21

Office Demand Was Weak in 2023 and Is Not Forecast to Improve in 2024



Source: CoStar.
Note: Actual data are quarterly through fourth quarter 2023; the forecast is quarterly through fourth quarter 2024.

and Pacific Northwest markets, many of which have had strong population growth. Likely reflecting increased supply in many markets, multifamily property prices declined approximately 10 percent in 2023 and are expected to decline slightly less in 2024.

Industrial properties benefited from ongoing demand for warehousing and distribution services. Of the major property types, industrial had the highest rent growth at more than 6 percent in 2023. Due to these conditions, the pace of industrial construction remained at a multi-cycle high, with 32 percent more space added in 2023 than in 2022. Substantial construction contributed to an increase in the industrial vacancy rate in 2023, albeit from low levels.

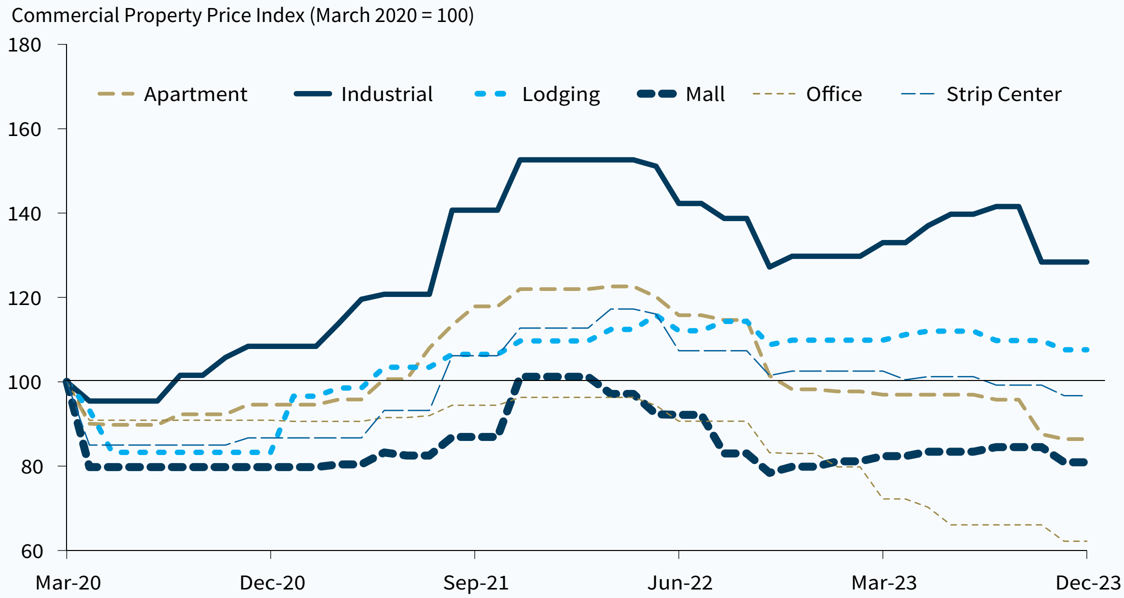
The retail property sector performed well in 2023. The U.S. vacancy rate on retail properties dropped to a 16-year low of 4.0 percent, and retailers were on track to open more stores than they closed in 2023. Very little new space was added in recent years, and demand easily kept pace with completions. The weak link in the retail sector is mall space, which has struggled with elevated supply of obsolete malls since before the pandemic. At nearly 8.5 percent, mall vacancy was more than twice that of the rest of the retail sector.

Reflecting varying conditions across property sectors in 2023, price performance also varied. Most notably, office building prices were soft amid weak demand for space. Retail mall prices also were weak (Chart 22). Following several years of rising interest rates, a more stable rate environment may bolster CRE conditions by year-end 2024. Some sectors, like office, will likely take time to recover. Lower property valuations could have implications on CRE asset quality by hindering a borrower's ability to refinance or repay a CRE loan.

CRE loan exposure remained elevated among the nation's banks. CRE loans held by banks grew for the 43rd consecutive quarter, reaching a record of more than $3.1 trillion in fourth quarter 2023. However, loan growth generally slowed in 2023 amid CRE market headwinds, tighter underwriting standards, higher interest rates, and lower loan demand.

CHART 22

Office and Mall Prices Remained Weak in 2023



Source: Green Street.
Note: Green Street defines Strip Centers as retail properties that are neither malls nor outlet centers. Data are monthly through December 2023.

As of fourth quarter 2023, loans for nonfarm nonresidential real estate properties comprised the majority ($1.8 trillion or 58 percent of total CRE loans) of the banking industry's CRE loan portfolio. The remaining CRE loans were multifamily loans ($612 billion or 19 percent), C&D loans ($502 billion or 16 percent), and other CRE loans ($211 billion or 7 percent). Other than multifamily loans, banks do not report CRE loans by collateral type (for example, office properties) on Consolidated Reports of Condition and Income (Call Reports).

Bank balance sheets continued to reflect substantial holdings of CRE loans in 2023. The banking industry's median CRE concentration increased to 198 percent as of fourth quarter 2023, up nearly 6 percentage points from the year before but down from the peak of 214 percent reached in 2008. As of fourth quarter 2023, 28 percent of banks reported an elevated concentration of CRE loans, down from 35 percent in 2008.[20]

Nearly all banks, regardless of size, participate in CRE lending to some degree. However, CRE concentrations among banks with $10 billion to $100 billion in total assets have expanded significantly from the 2009 cycle. This size group has a higher median CRE loan concentration than larger and smaller size groups (Chart 23). Concentrations among smaller banks, 93 percent of which are community banks, remained relatively constant over the past decade.

CRE credit quality remained generally favorable, but rising delinquencies create uncertainty. The median CRE loan delinquency rate among all FDIC-insured banks remained near historically low levels at 0.22 percent as of year-end 2023 but has increased for two consecutive quarters. For banks with an elevated CRE concentration, the median past-due rate of 0.25 percent also increased in recent quarters. While CRE credit quality remained favorable, some banks increased provisions for potential deterioration in CRE loans.

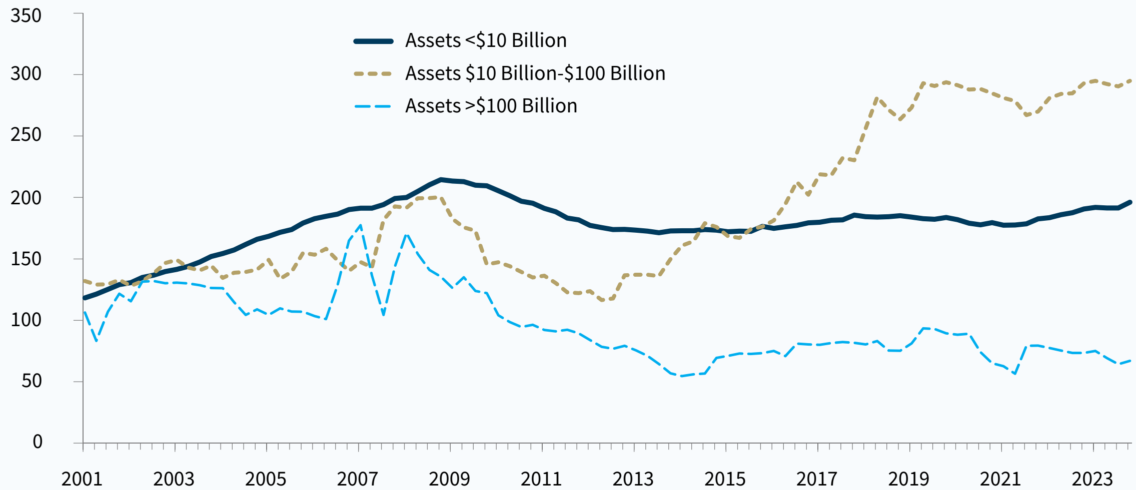
The increasing trend in CRE loan delinquencies was distinctly more pronounced among the largest banks, banks with assets greater than $100 billion, which experienced a sharp rise in nonfarm nonresidential

[20] In this report, all loan concentration ratios use tier 1 capital and credit loss reserves for loans and leases in the denominator. Banks with elevated concentrations of CRE loans are those banks with concentrations of 300 percent or more.

CHART 23

CRE Concentrations Rose Sharply Among Midsize Banks Over the Past Decade

CRE Concentrations by Asset Size
Median percent



Source: FDIC.
Note: Data are quarterly through fourth quarter 2023.

loan delinquencies, the category that includes office loans (Chart 24). The sharp rise in delinquencies among these institutions was mitigated by the fact that CRE loans represent a much smaller share of loans among the largest institutions. Community banks, which typically have less than $10 billion in assets, continued to report low CRE loan delinquency rates in the aggregate.

Loan delinquency rates for commercial mortgage-backed securities (CMBS) rose more noticeably than delinquency rates at banks last year. The overall CMBS loan delinquency rate reached 4.7 percent in February 2024, up from 3.1 percent the year before. The office sector accounted for much of the increase, as the office loan delinquency rate more than tripled from the year before to 6.7 percent (Chart 25). Office loans are the largest category of non-agency CMBS, making up more than one-quarter of the total. Banks hold $393 billion in CMBS exposure; however, bank exposure to the office sector through CMBS is minimal. Securities issued by U.S. agencies or government-sponsored enterprises account for 85 percent of the banking industry's CMBS exposure—substantially all of which is backed by multifamily properties.

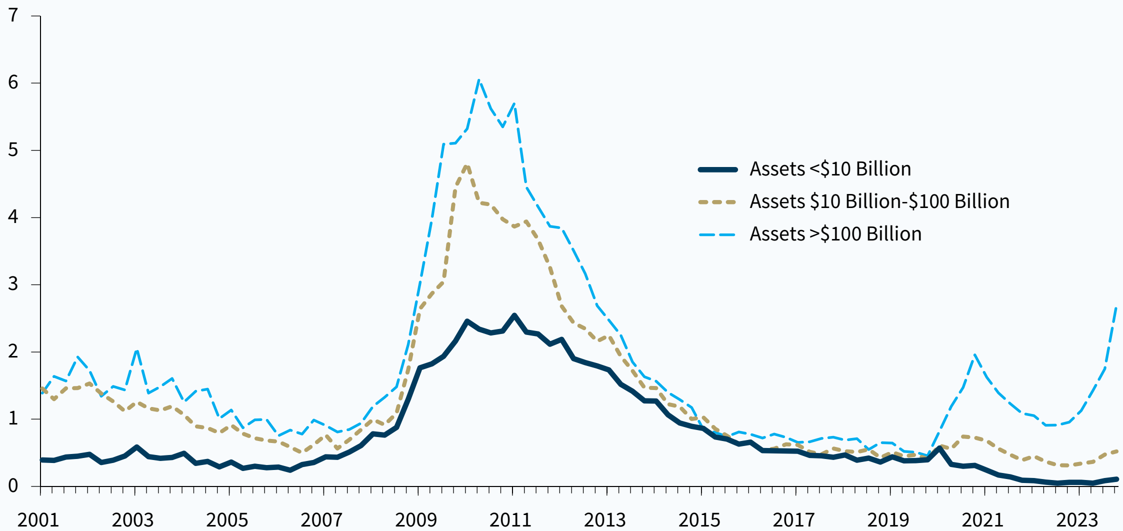
Refinancing of CRE loans could be challenging for some borrowers. The rising trend in delinquencies, coupled with softening collateral values, could weaken CRE loan portfolios, particularly from loans coming due during this period of higher interest rates. Borrowers could face difficulties refinancing

CRE properties due to higher borrowing costs, which affect repayment capacity, and lower collateral values, two essential components considered by lenders. An estimated $1.6 trillion in CRE loans mature between 2024 and 2026. More than half of these maturing CRE loans are held by banks and are predominantly loans to finance nonfarm nonresidential properties, which include office loans.[21] Large office loans (loans over $100 million) had the lowest refinance success rate among CRE loans in 2023, likely reflecting weak office conditions in larger markets—a trend likely to continue in 2024.[22]

CHART 24

Nonfarm Nonresidential Loan Delinquency Rates Rose More Among the Largest Institutions

Bank Nonfarm Nonresidential Loan Delinquency Rate by Asset Size
Median percent



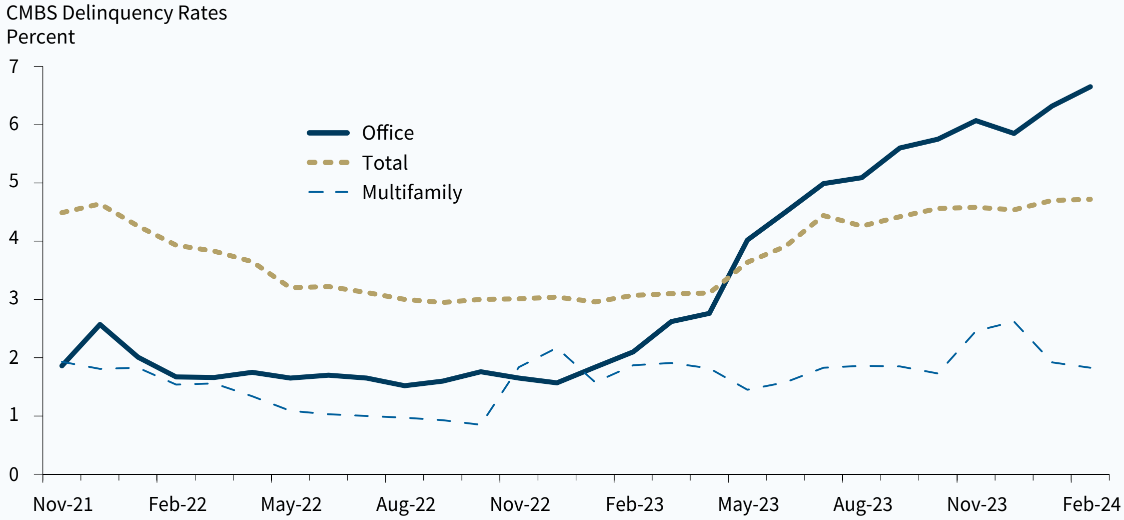
Source: FDIC.
Note: Data are quarterly through fourth quarter 2023.

[21] Trepp, Commercial Mortgage Maturities, Third Quarter 2023.

[22] Moody's Analytics, CRE Office Loan Maturity Monitor, "Office Borrowers Still Struggling for Takeouts; Also Time to Worry About Multifamily?" October 25, 2023.

CHART 25

Weakness in the Office Sector Contributed to an Increase in the CMBS Delinquency Rate



Source: Trepp.
Note: Data are monthly through February 2024, compiled from Trepp Loan Compendium Deal List.
CMBS is commercial mortgage-backed securities.

Overall, though CRE credit quality was resilient in 2023, weak office space demand and rising borrowing costs in the higher rate environment are likely to weigh on CRE performance in 2024. In anticipation of potential stress in the sector, the FDIC, together with other regulatory agencies, issued the "Policy Statement on Prudent Commercial Real Estate Loan Accommodations and Workouts" in 2023.[23] The FDIC also issued a Financial Institution Letter in December 2023 that conveys key risk management practices for institutions to consider in managing CRE loan concentrations in a challenging economic environment and the importance of effectively managing liquidity and funding risks.[24] Both publications promote working prudently and constructively with creditworthy borrowers during times of financial stress, retaining sufficient capital, and ensuring appropriate credit loss allowance levels.

[23] FDIC, Interagency Policy Statement on Prudent Commercial Real Estate Loan Accommodations and Workouts, FIL-34-2023, June 29, 2023.

[24] FDIC, Advisory: Managing Commercial Real Estate Concentrations in a Challenging Economic Environment, FIL-64-2023, December 18, 2023.

Residential Real Estate

- **High mortgage rates contributed to a slowdown in housing activity in 2023, as the supply of homes for sale remained tight.**
- **Home prices increased and contributed to a decline in affordability in 2023, especially for first-time homebuyers.**
- **While mortgage originations declined industrywide, community banks remained an important source of residential mortgages.**
- **Credit quality in bank 1–4 family residential loan portfolios remained sound, but early signs of stress emerged, especially at community banks.**

Higher mortgage rates contributed to a decline in home sales in 2023. After increasing sharply in 2022 from historic lows, mortgage rates remained higher through fourth quarter 2023. The average rate on a 30-year fixed-rate mortgage exceeded 7 percent during much of fourth quarter 2023, more than twice the rate at the beginning of 2022.[25] The sharp increase in mortgage rates in 2022 and 2023 curtailed buyer purchasing power and contributed to a slowdown in total home sales (Chart 26). Total single-family home sales (existing and new combined) were down 15.5 percent in 2023 from a year earlier.[26] Existing single-family home sales, which represent nearly 85 percent of total home sales, declined more than 18 percent in 2023 from a year earlier and remained well below levels in the years leading up to the pandemic.[27]

Reduced sales of existing homes largely reflected the desire of homeowners with fixed-rate mortgages below current market rates to stay in their homes and retain favorable mortgage terms. According to Freddie Mac, an estimated 60 percent of homeowners had a mortgage with a rate below 4 percent as of December 2023.[28] New single-family home sales increased 3.9 percent in 2023 from a year earlier, partially offsetting declines in existing home sales.[29]

Home prices increased and contributed to a decline in affordability in 2023, especially for first-time homebuyers. Home price growth resumed in 2023 after several months of declines in 2022. Fueled in part by a limited inventory of homes for sale, the S&P Case-Shiller House Price Index began to increase quarter over quarter in second quarter 2023, growing 1.6 percent, following three sequential quarterly declines of about 1 percent or less.[30] By fourth quarter 2023, the index had recouped recent losses and was 5.1 percent above the level of a year earlier.

Home affordability declined even further in 2023 following cumulative increases in home prices in previous years. The National Association of Realtor's Housing Affordability Index (Index) declined to 95.8 in fourth quarter 2023 from the year-earlier level of 103.4, after the third quarter index level reached the lowest point since the 1980s when mortgage rates were double digits. First-time homebuyers remained particularly constrained by low affordability, with the index for first-time buyers at 63.5 in fourth quarter 2023; this measure was also close to its lowest point since the 1980s and below the year-earlier level of 68.4.[31]

[25] According to the Freddie Mac Mortgage Market Survey, the 30 year-fixed weekly mortgage rate was 3.22 percent as of January 6, 2022.

[26] National Association of Realtors, U.S. Census Bureau.

[27] National Association of Realtors.

[28] Freddie Mac, Economic, Housing, and Mortgage Market Outlook, December 2023.

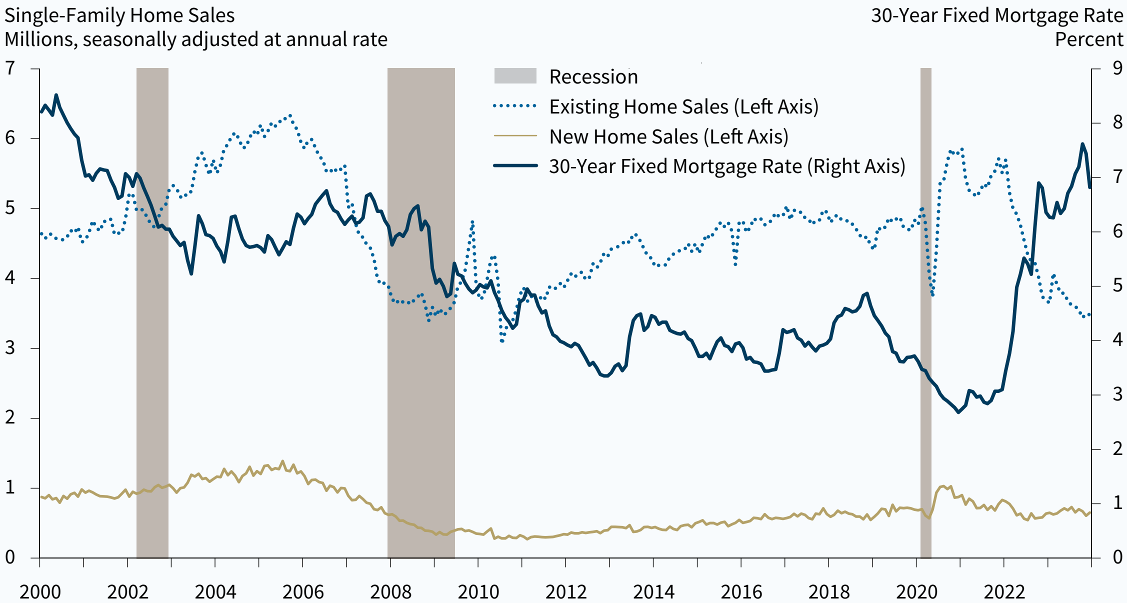
[29] U.S. Census Bureau.

[30] Price growth was not uniform across the country. Among 20 major metro areas tracked by Case-Shiller, most posted annual price growth as of fourth quarter, except Portland, which had a small annual price decline. Similarly, among states measured by the Federal Housing Finance Agency Purchase-Only index, prices increased annually as of fourth quarter except in Hawaii and the District of Columbia.

[31] The National Association of Realtors Affordability Index is calibrated so that a reading above 100 indicates that the median income is more than enough to qualify for a mortgage loan on a median-priced home with a down payment of 20 percent: an index above 100 conveys affordability, while an index below 100 conveys unaffordability. Haver Analytics-adjusted values from monthly to quarterly.

CHART 26

Existing Home Sales Sharply Declined Amid Higher Mortgage Rates



Sources: Census Bureau, National Association of Realtors, National Bureau of Economic Research, and Freddie Mac (Haver Analytics).
Note: Data are monthly through December 2023, and homes sales are seasonally adjusted at an annual rate.

High interest rates, low affordability, and lower home sales contributed to lower mortgage originations across all mortgage lenders. Originations of residential mortgages nationwide declined 27 percent in 2023 from 2022, for mortgages originated by banks and nonbanks alike, and remained well below pre-pandemic levels. In addition, many banks tightened underwriting standards for residential mortgage loans. According to the January 2024 Federal Reserve Senior Loan Officer Opinion Survey, a growing share of bank survey respondents tightened underwriting standards on residential real estate loans in fourth quarter 2023 relative to one year earlier.[32]

As mortgage originations contracted overall, the share of residential mortgage lending by the banking industry declined and nonbank mortgage loan providers gained market share. See the Nonbank Lending section of this chapter for more information on exposure by banks to nonbank mortgage lenders.

The banking industry reported higher residential mortgage loan balances with community banks, continuing their role as a key lending source.[33] The banking industry reported $2.8 trillion in residential mortgage loans in fourth quarter 2023, up 3.1 percent from one year earlier and the largest balance since 2008. Community banks continued to play an important role in residential lending; as of fourth quarter 2023, community banks accounted for 18 percent of the banking industry's total residential mortgage loans compared with 15 percent of the banking industry's total loans. Year-over-year residential mortgage loan growth among community banks was particularly strong in the West (15 percent) and South (8.4 percent).

Banks retained more residential loans on their balance sheets rather than selling in the secondary market due to rising mortgage rates and high inflation that increased the dollar amount of loans needed to finance home purchases. During 2023, the quarterly average of residential mortgage loans sold was $94.1

[32] Board of Governors of the Federal Reserve System, Senior Loan Officer Opinion Survey on Bank Lending Practices, January 2024.

[33] Total residential mortgage loans include real estate loans secured by 1–4 family residential properties (home equity lines of credit plus all other 1–4 family residential real estate loans).

billion, representing 3.3 percent of total residential mortgage loans. By comparison, quarterly residential mortgage loans sold averaged $208 billion, or 8.5 percent of total residential mortgage loans, before the pandemic.

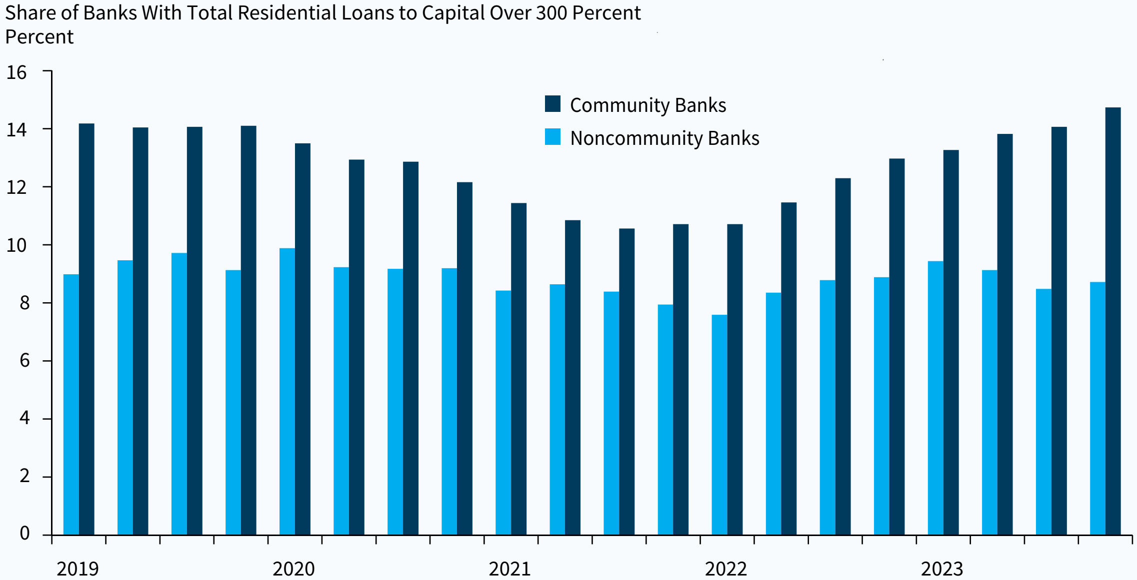
Higher residential loan balances held by banks overall in 2023 contributed to increased concentrations, especially among community banks. As of fourth quarter 2023, the median ratio of residential mortgage loans to capital rose to 138 percent, up from one year earlier and near the level reported in third quarter 2019. Community banks reported a median concentration of 142 percent in the fourth quarter, slightly higher than the pre-pandemic level. The share of community banks with a high concentration of residential mortgage loans to capital, above 300 percent, reached nearly 15 percent, a return to the pre-pandemic level (Chart 27). Almost two-thirds of these community banks are in the Midwest and Northeast.

As construction of new homes slowed, the volume of 1–4 family residential C&D loans declined. Banks reported $97 billion in 1–4 family residential C&D loans in fourth quarter 2023, down 7 percent from one year earlier and the largest annual decline since third quarter 2012. Both community banks and noncommunity banks reported a decline in 1–4 family residential C&D loan balances in 2023.

CHART 27

A Larger Share of Community Banks Continued to Report a Higher Concentration of Total Residential Loans

Share of Banks With Total Residential Loans to Capital Over 300 Percent



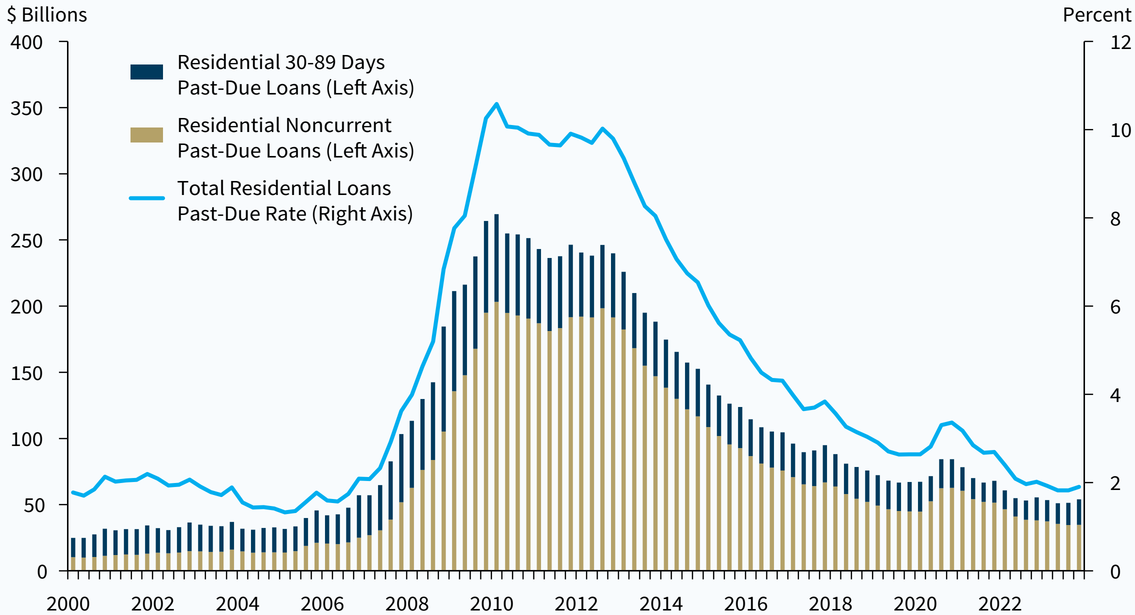
Source: FDIC.
Note: Data are quarterly through fourth quarter 2023. "Capital" is tier 1 capital and credit loss reserves for loans and leases.

Asset quality of residential mortgage loan portfolios among banks remained sound in 2023. The banking industry's aggregate total residential mortgage loan past-due rate declined to 1.91 percent, down from 2.02 percent a year earlier. The early-stage delinquency rate on residential mortgage loans also remained low, 0.68 percent in fourth quarter 2023, but was up slightly from one year earlier (Chart 28). Community banks reported an aggregate past-due rate to 1.07 percent, up from 1.02 percent one year earlier. Community banks in the South reported the highest residential past-due ratio at 1.3 percent in the fourth quarter.

The trend in 1–4 family residential C&D asset quality was negative in 2023, but the level of past-due loans was still moderate. The total past-due rate for all banks rose to 0.89 percent in fourth quarter 2023, up from 0.56 percent one year earlier. Among community banks, the past-due rate on 1–4 family residential C&D loans in 2023 rose to 1.04 percent from 0.56 percent in 2022. Deterioration was most pronounced among community banks in the Midwest and West. Noncommunity banks also reported a higher total past-due rate on residential C&D loans, 0.76 percent, up from 0.56 percent in 2022.

CHART 28

Overall Residential Mortgage Asset Quality Remained Sound in 2023



Source: FDIC.
Note: Data are quarterly through fourth quarter 2023.

Consumer

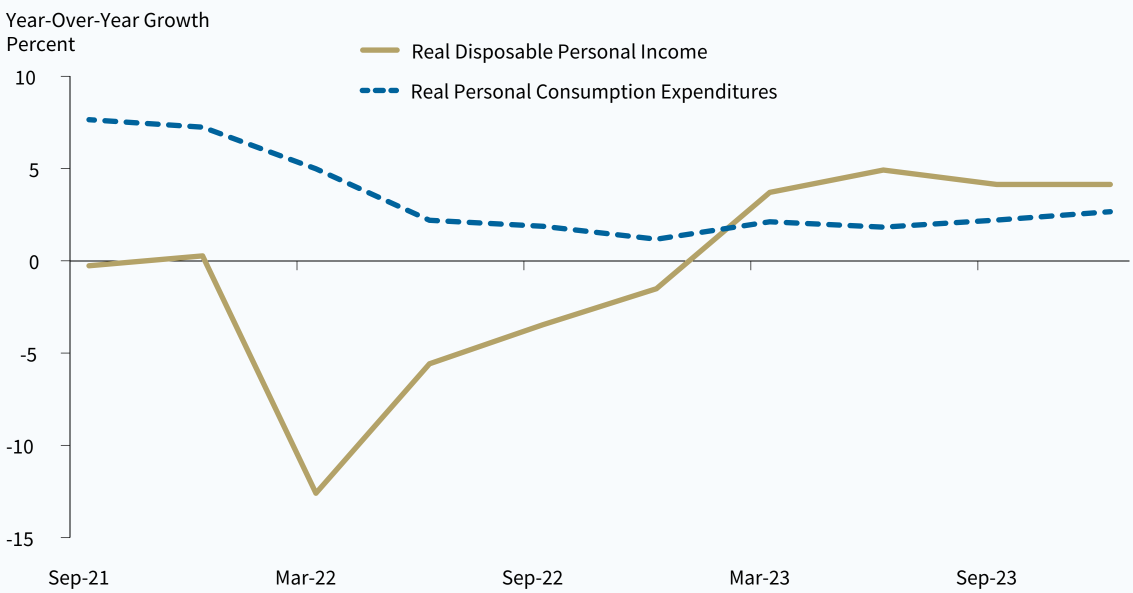
- **Household balance sheets were solid in 2023 along with higher net worth, but household savings declined despite higher incomes.**
- **Consumer loan growth at banks slowed in 2023 as banks tightened lending standards and households reduced their demand for loans.**
- **Consumer loan performance for the industry weakened in 2023.**
- **Consumer loan performance at community banks remained better than before the pandemic.**

Household balance sheets were generally solid in 2023 along with higher net worth, but household savings declined despite higher incomes. The labor market remained tight as job openings far exceeded the number of people looking for jobs, driving nominal wage growth to outpace inflation throughout the year. Real disposable personal income rose from year-earlier levels in each quarter, supporting strong consumer spending growth in 2023 (Chart 29). Even as consumer spending grew, the personal savings rate rose from a year earlier but remained below pre-pandemic (2019) levels.

Moderating inflation and an increase in household wealth helped support household spending in 2023. Household net worth rose quarter over quarter in the first half of 2023, fell in the third quarter as stock prices declined, and recovered in the fourth quarter. Household net worth was higher than a year earlier and up 34 percent from fourth quarter 2019. Debt burdens remained low, with the household debt service ratio below the year-end 2019 level throughout 2023 (Chart 30). Lower mortgage payments from households that locked in low mortgage rates in 2020 and 2021 continued to mitigate debt burdens.

CHART 29

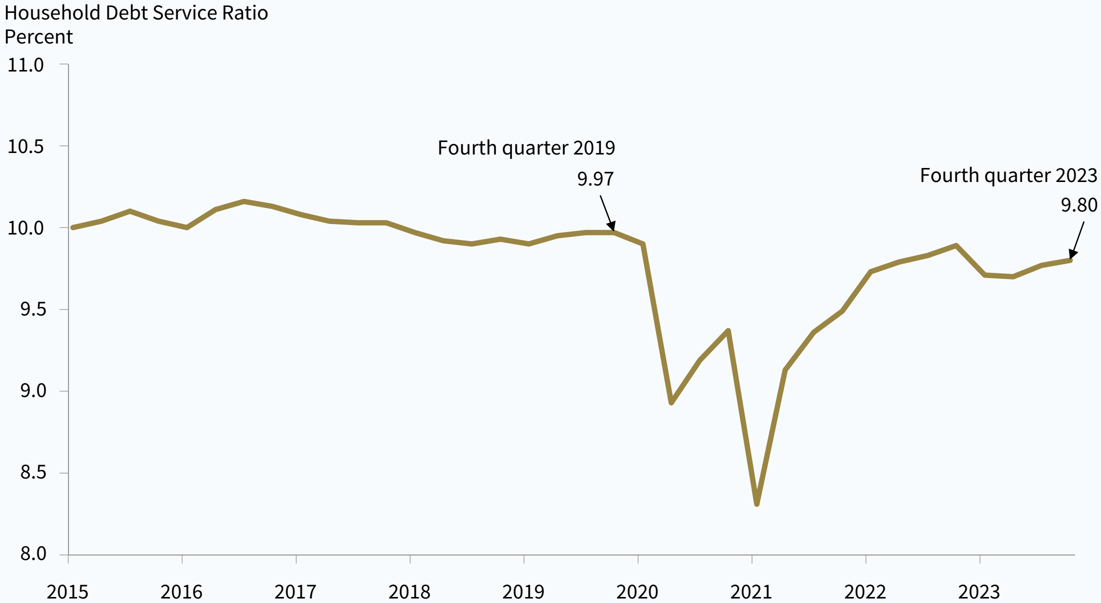
Real Income Accelerated in 2023, While Real Spending Growth Leveled Off



Source: Bureau of Economic Analysis (Haver Analytics).
Note: Data are quarterly through fourth quarter 2023.

CHART 30

Consumer Debt Burdens Remained Low in 2023



Source: Federal Reserve Board (Haver Analytics).
Note: The household debt service ratio is the ratio of estimated required payments on mortgages and consumer debt to disposable personal income. Data are quarterly through fourth quarter 2023.

The mortgage service ratio, the ratio of estimated mortgage payments to disposable personal income, declined 13 basis points from fourth quarter 2019 through fourth quarter 2023. The consumer debt payments ratio, the ratio of estimated payments on nonmortgage consumer debt to disposable personal income, fell only 5 basis points over the same period.

Tighter underwriting standards and reduced loan demand contributed to a decline in consumer loans in 2023. According to Federal Reserve Senior Loan Officer Opinion Surveys, on net, the banking industry tightened lending standards on credit card loans, auto loans, and other consumer loans throughout 2023. Banks also reported lower demand for consumer loans. As a result, the industry's loan growth slowed for all consumer credit categories in 2023 (Chart 31). Even as quarter-over-quarter credit card loan growth slowed in 2023, year-over-year growth was positive and remained above pre-pandemic levels. In contrast, auto and other consumer loan growth declined year over year in the second through fourth quarters.

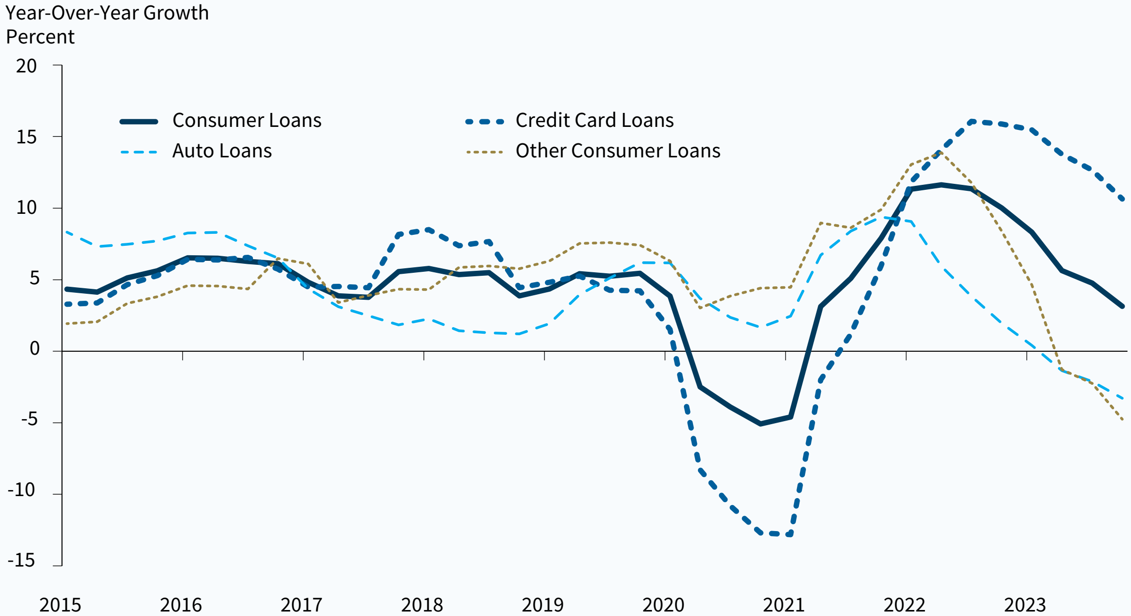
After strong growth early in the year, consumer loans at community banks contracted in 2023. "Other consumer loans," which comprise half of consumer loans at community banks, rose 35 percent from a year earlier in the first quarter, but growth slowed later in the year and turned negative in the second half of the year. Credit card loans at community banks also rose quickly in first quarter before slowing later in the year. But these loans comprise only 4 percent of consumer loans at community banks.[34] The banking industry's credit card lending is concentrated in a few banks; the top ten credit card lending banks held 90 percent of outstanding credit card loans at banks in fourth quarter 2023. Auto lending is also concentrated, but to a lesser extent; the top ten auto lending banks held three-quarters of outstanding auto loans at banks.

The banking industry's consumer loan quality weakened in 2023, and some measures ended the year worse than their pre-pandemic levels. Past-due and nonaccrual (PDNA) rates—the share of loans that are more than 30 days delinquent or

[34] Noncommunity banks hold a higher share of consumer loans than they do of industry assets. Noncommunity banks hold more than 99 percent of outstanding credit card loans, 94 percent of auto loans, and 93 percent of other consumer loans, compared with 89 percent of industry assets.

CHART 31

Loan Growth Slowed in 2023 for All Consumer Credit Categories



Source: FDIC.
Note: Data are quarterly through fourth quarter 2023.

in nonaccrual status—for auto and credit card loans increased throughout the year and ended above their pre-pandemic average levels (Chart 32). The industry's credit card PDNA rate in fourth quarter 2023 was 3.4 percent, the highest rate since third quarter 2011. Similarly, the PDNA rate for auto loans in fourth quarter 2023 was 332 percent, the highest rate since auto loan data became available in Call Reports in first quarter 2011. However, delinquency measures for other consumer loans, which comprise about a quarter of all consumer loans, remained below their pre-pandemic levels. Net charge-off rates for consumer loan categories were higher than pre-pandemic levels at year-end.

Consumer loan quality at community banks worsened in 2023 but remained better than before the pandemic. Consumer loan quality worsened at community banks as a whole in 2023, but the changes in performance were small for the median community bank. Past-due and nonaccrual rates were higher at the median community bank at year-end 2023 than a year earlier for all loan categories except credit cards, but the rates were all still well below pre-pandemic levels (Chart 33).[35]

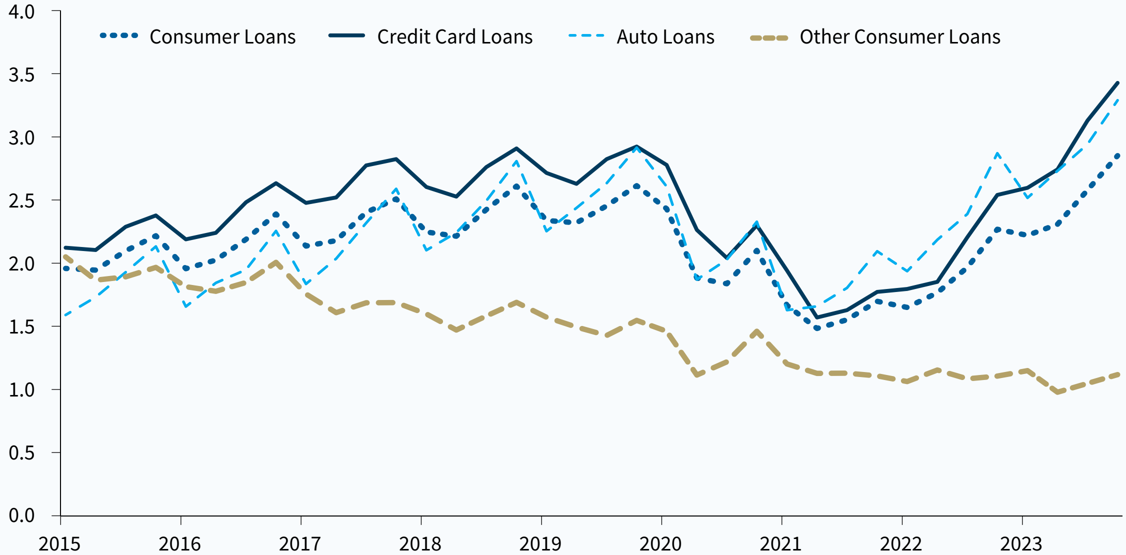
In 2024, the health of the consumer will be a key driver of U.S. economic growth. A continued strong job market would help to drive consumer spending. Consumer credit, especially within credit cards and auto loans, will warrant continued close monitoring.

[35] The calculations of medians exclude banks that do not make that type of loan. Only 604 community banks reported credit card loans on their balance sheets in fourth quarter 2023, while 3,697 had auto loans and 4,021 had other consumer loans.

CHART 32

Consumer Loan Quality Worsened in 2023, Led by Credit Card Loans

Share of Loans Past Due or in Nonaccrual Status
Percent

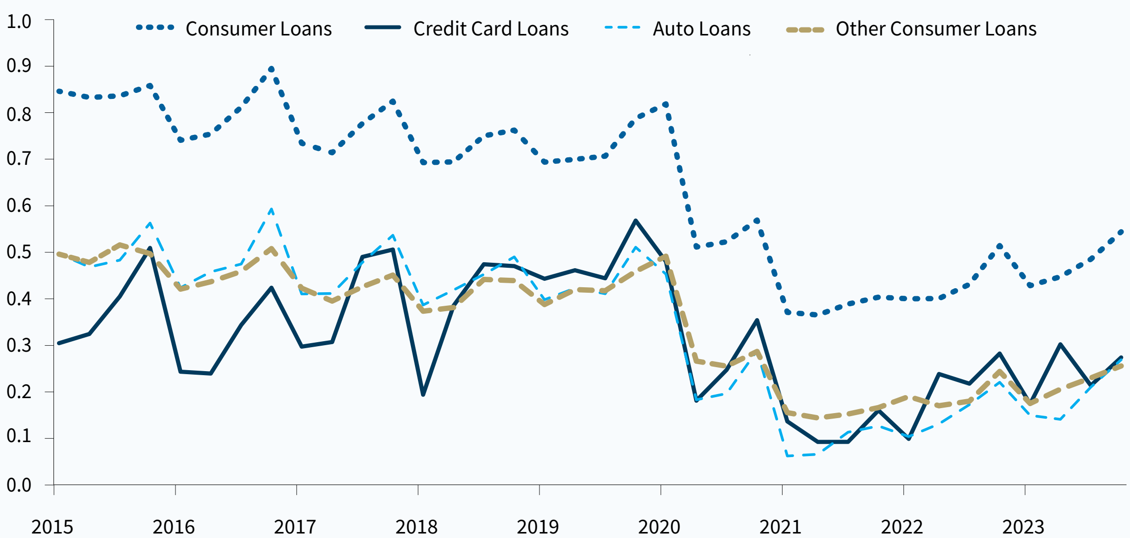


Source: FDIC.
Note: Data are quarterly through fourth quarter 2023.

CHART 33

Loan Quality at the Median Community Bank Remained Better Before the Pandemic

Median Past-Due and Nonaccrual Rate
Percent



Source: FDIC.
Note: Data are quarterly through fourth quarter 2023 for community banks.

Agriculture

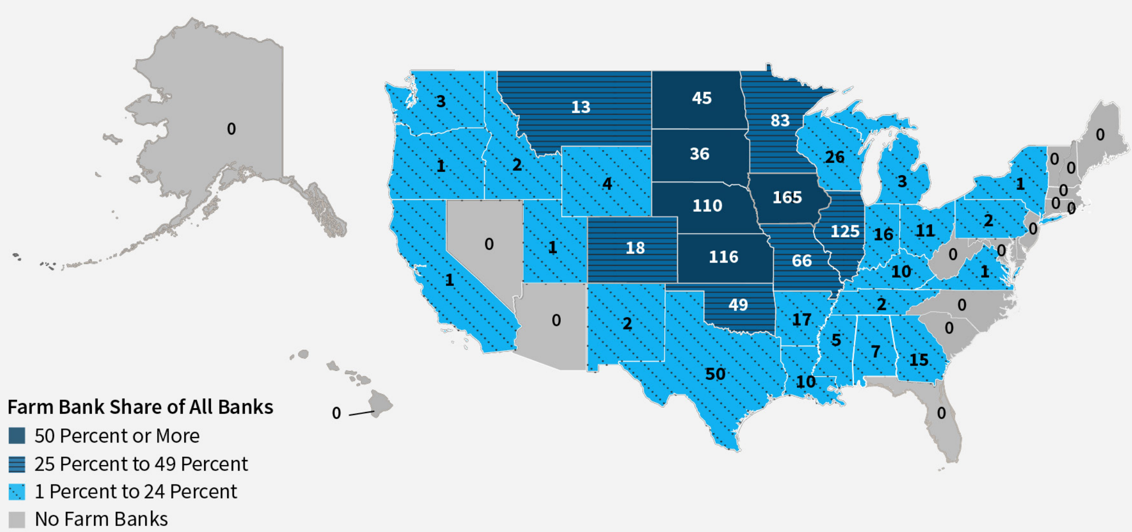
- **Despite some softening in 2023, conditions in the U.S. agricultural sector remained strong.**
- **Agricultural loan quality remained favorable in 2023 and agricultural loan growth was strong, contributing to higher loan concentrations at banks.**
- **Solid growth in agricultural operating loans is likely to continue in 2024.**
- **Farm real estate values remained strong, but appreciation may slow.**

Eighty-three percent of banks held agricultural loans of some type in fourth quarter 2023, representing a total of $199.2 billion. Farm banks held $84.2 billion, or 42.3 percent, of total farm loans.[36] The nation's 1,016 farm banks make up more than one-fifth of all FDIC-insured institutions in the United States. Most farm banks are smaller community banks with limited geographic footprints; as of year-end 2023, all but 12 of the nation's farm banks were community banks, and only 151 (14.9 percent) had total assets above $500 million.

Farm banks represent sizeable shares of banks throughout much of the Midwest. Two-thirds of states have at least one farm bank, but farm banks are highly concentrated in the middle of the country (Map 1). In five states, farm banks represent more than half of all banks in the state, and in another six states, farm banks represent more than a quarter of all banks in the state. In total, these 11 states headquarter more than 80 percent of all farm banks in the nation. Corn, soybeans, and wheat are the primary crops in these states, and cattle and hogs are the predominant livestock raised.[37] In aggregate, these commodities accounted for 84.4 percent of total farm cash receipts in these 11 states in 2023.

MAP 1

Farm Banks Are Concentrated in the Corn Belt and Plains States Where Row Crops and Livestock Are Dominant



Source: FDIC.
Note: Data are all FDIC-insured institutions as of fourth quarter 2023. Numbers are the count of farm banks in the state. Shading represents the percentage of all banks in the state that are farm banks.

[36] Farm banks have agricultural production loans plus real estate loans secured by farmland equal to or exceeding 25 percent of total loans and leases.

[37] According to U.S. Department of Agriculture (USDA) cash receipt data for 2022, corn ranked as a top-three commodity in nine of the eleven states, followed by cattle and soybeans in seven states, hogs in four states, and wheat in three states.

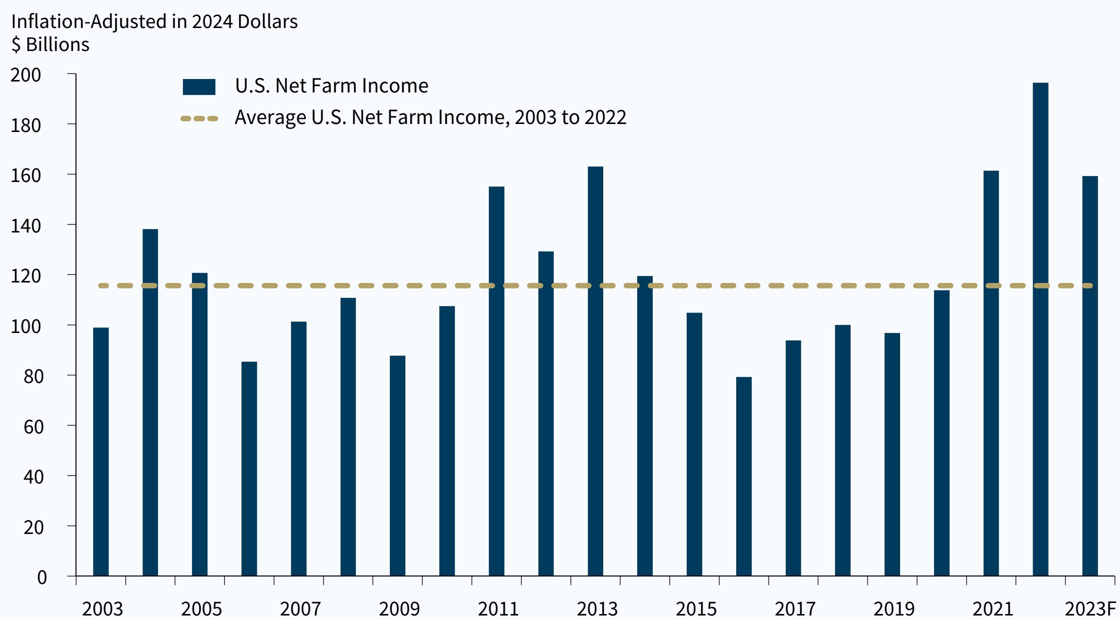
The U.S. agricultural sector softened in 2023 but remained strong. The U.S. Department of Agriculture (USDA) forecasts that 2023 nominal net farm income declined 16.0 percent year over year to $155.9 billion on both higher production expenses and lower cash receipts.[38] This projection represents a moderation from record farm income in 2022 but is still more than 30 percent above its long-term average on an inflation-adjusted basis (Chart 34). Both crop and livestock receipts are expected to have declined in 2023 on lower prices; livestock was also affected by lower sales. The USDA forecast shows that higher interest expense, property taxes, labor costs, and purchase costs for livestock and poultry drove higher production expense in the sector.

Corn, soybean, and wheat prices declined in 2023 after a strong year in 2022. Lower prices for corn and soybeans were the result of a combination of solid U.S. production, a strong U.S. dollar, record production in South America, and China's greater reliance on Brazil for its imports. These factors resulted in weaker U.S. exports and a strong increase in U.S. corn inventory levels. Wheat prices were also lower after a good harvest year in the United States and weaker export activity that caused wheat inventories to rise.

Cattle and hog producers had markedly different years in 2023. Cattle prices remained elevated in 2023 due to drought-induced herd liquidations that caused historically low inventory levels. Cow-calf ranchers that were largely unaffected by drought and feedlot operators (finishing cattle for slaughter) were largely profitable in 2023. In contrast, hog prices declined and high input costs caused many hog producers to be unprofitable during the year. But farm bank credit exposure to hog production is most often concentrated in facilities financing loans to contract growers, so borrowers and banks are largely insulated in the short term from much of the price and cost exposure from hog markets.

CHART 34

Farm Profits Declined in 2023 but Remained Above the Long-Term Average



Source: USDA/ERS Farm Income and Wealth Statistics.

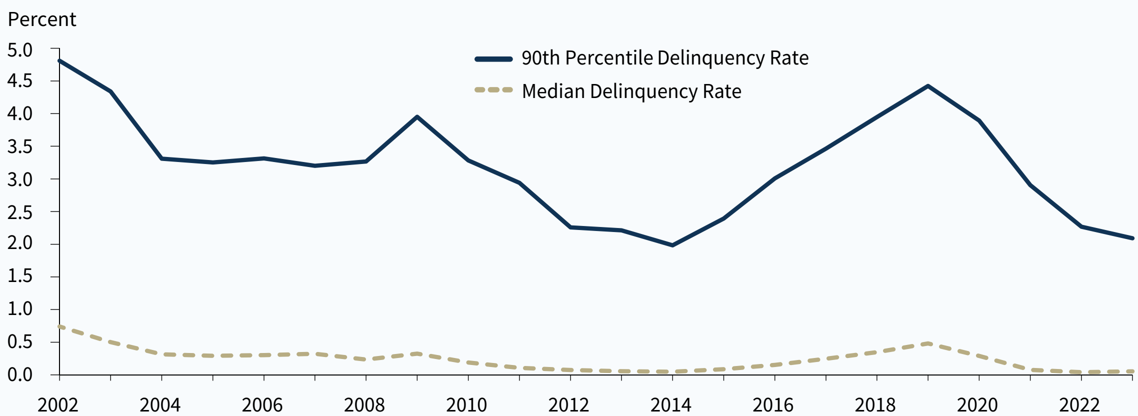
[38] See USDA, 2024 Farm Sector Income Forecast, February 7, 2024. The 2023 forecast will become an estimate with the USDA's next forecast release scheduled for September 2024.

Agricultural loan quality remained favorable in 2023. Reflecting the recent strength in farm income, past-due and nonaccrual agricultural loan ratios at farm banks remained near historic lows at year-end 2023. With just 56 percent of farm banks reporting any PDNA agricultural loans, the median PDNA agricultural loan ratio for all farm banks was 0.05 percent in fourth quarter 2023, up from 0.04 percent one year earlier (Chart 35). At the same time, the 90th percentile PDNA ratio for farm banks was near a 20-year low. PDNA agricultural loan ratios could rise modestly in 2024 as producers face tighter operating margins and lower liquidity positions.

Solid growth in agricultural production loans in 2023 contributed to higher agricultural loan concentrations at banks. Strong incomes in 2021 and 2022 greatly reduced agricultural production loan demand from farmers as they self-financed greater shares of their operating expenses. However, borrowing increased in 2023 as expenses remained high and operating margins narrowed. In fourth quarter 2023, total agricultural loans held by all banks were 4.6 percent higher than prior-year levels. Agricultural production loans accounted for approximately 67 percent of this growth and increased 7.5 percent year over year—the fastest pace of growth since first quarter 2016. The combination of ongoing high

CHART 35

Farm Bank Delinquency Rates on Agricultural Loans Remained Low in 2023



Source: FDIC.
Note: Data are as of the fourth quarter in each year through 2023. Delinquent loans are those 30 or more days past due plus those in nonaccrual status.

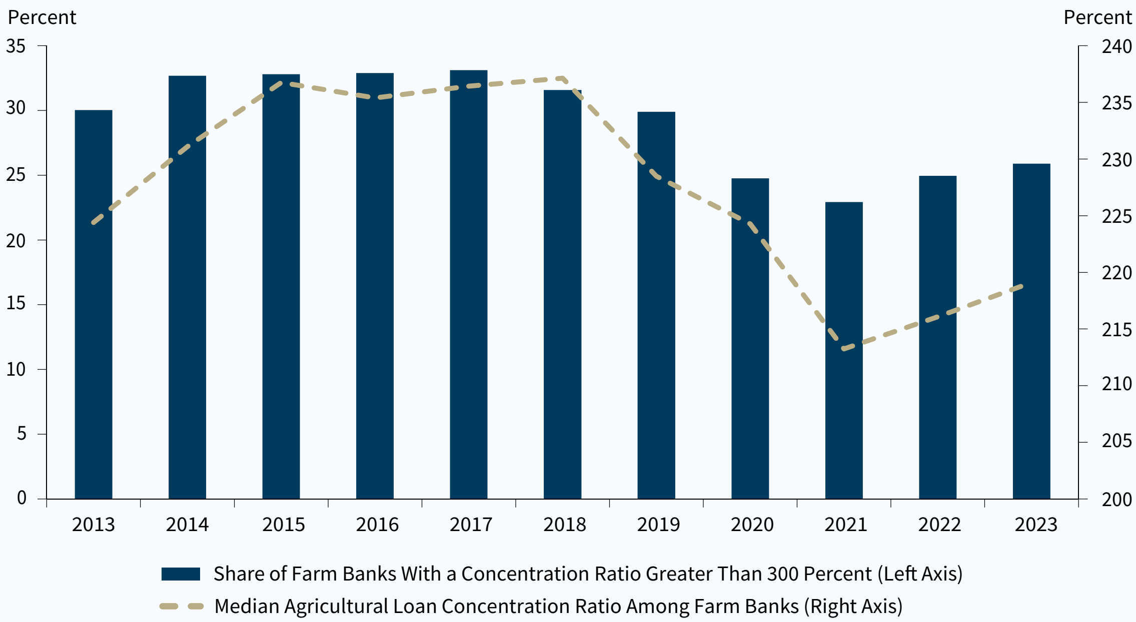
expenses, weaker operating returns in 2023, and lower cash balances is likely to drive continued demand for agricultural loans in 2024.

Because of strong loan growth, concentrations in agricultural loans increased slightly in 2023. The median ratio of agricultural loans to capital at farm banks increased to 219.1 percent from 216.1 percent in 2022, though it remained well below pre-pandemic levels (Chart 36). Just over one-quarter of farm banks (263 banks, or 5.7 percent of all banks in the nation) held a concentration of agricultural loans above 300 percent of capital.

Farm real estate values remained strong, but appreciation may slow. Despite much higher interest rates, demand for farmland remained strong in 2023 and farm real estate values rose 7.4 percent on average according to the USDA. On an inflation-adjusted basis, farm real estate values have appreciated 11.6 percent since 2020 and are at an all-time high. The five states in which agricultural banks make up the majority of commercial banks reported much higher inflation-adjusted farm real estate appreciation than the national average, ranging between 16.6 percent (North Dakota) and 39.2 percent (Kansas) (Map 2). Bankers remain cautious about farmland loan-to-value ratios, mitigating supervisory concerns about excessive lending against inflated land values that was one of the key causes of the agricultural crisis in the 1980s. However, valuation-to-rent ratios are high, and the combination of higher borrowing costs and prospects of lower incomes will likely dampen demand for farmland in 2024.[39]

CHART 36

Concentrations in Farm Loan Portfolios Increased in 2023

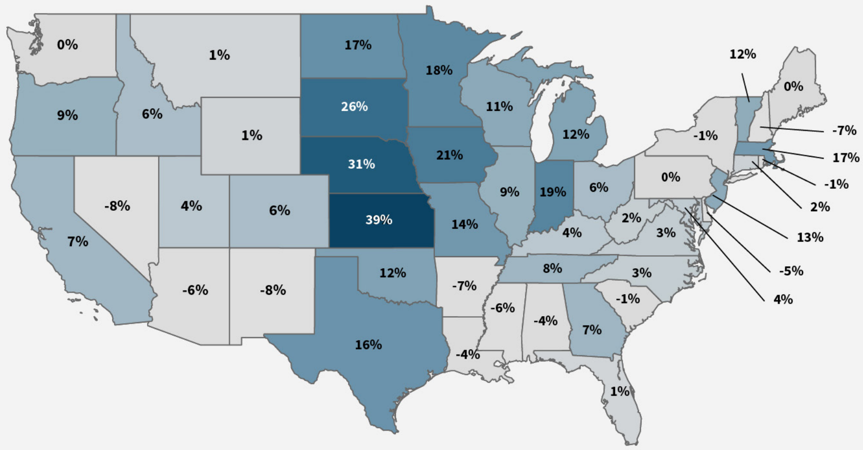


Source: FDIC.
Note: Data are as of the fourth quarter in each year through 2023.

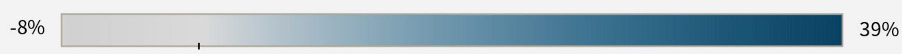
[39] The strong appreciation in farmland values since 2020 has outpaced growth in cash rental rates, causing farmland price to cash rent multiples to increase. Using USDA average cropland value and average cash rent data, the national cropland price to cash rent multiple increased from 29.5 in 2020 to 35.2 percent in 2023, which exceeds the most recent peak of 32.6 set in 2007. The rent multiple had been fairly flat from 2013 through 2020.

MAP 2

Farmland Values Continued to Rise Throughout 2023, Particularly in States With a High Concentration of Farm Banks



Farm Real Estate Value Percentage Change $ per Acre, 2020–2023



Source: USDA NASS.

Small Business

- **Steady consumer spending helped support business conditions in 2023.**
- **Community banks remained an important source of small business lending.**
- **Commercial and industrial (C&I) loan asset quality, a proxy for small business loan performance, remained relatively sound in 2023, but uncertain small business conditions may be a source of credit risk.**

Steady consumer spending helped support business conditions in 2023. In January 2024, the National Federation of Independent Business (NFIB) reported that 20 percent of small business owners said inflation was the single-most important problem in operating their business. This share is down from July 2022 when 37 percent of businesses reported this concern, but it is still well above normal levels. Respondents similarly reported that the quality of available labor was concerning; 21 percent of small business owners reported they had job openings that were hard to fill. To address the labor shortage, a net 39 percent of respondents reported raising worker compensation in fourth quarter 2023.

Despite these adverse business conditions, consumer spending helped to buoy small business in 2023. Consumer spending grew throughout most of the year, though at a pace closer to pre-pandemic levels than to the strong pace in 2021. Surveys suggest that consumers have increased their share of purchases from small businesses. In the first half of 2023, consumer credit card spending at small and medium-sized retailers was up 63 percent from the first half of 2019, higher than the 44 percent gain for large retailers.[40] A 2023 survey from BankRate found that 72 percent of shoppers planned to shop at small businesses over the holiday season, up from 65 percent in 2022.[41]

Business applications for service industries increased from 2022, led by retail trade. Business applications for service-based industries, which include 86 percent of small businesses, increased throughout 2023.[42] This is consistent with the continued recovery of the services sector that reached low points during the pandemic. Retail trade and accommodation and food services business applications outpaced other sectors, as consumers continued to purchase items and to travel.

Small business financing became more costly throughout 2023 as lending standards tightened. Median interest rates on small business loans increased more than 300 basis points from 2022, making it more costly to maintain a small business and reducing small business loan demand. As banks tightened lending standards, small businesses faced credit constraints that resulted in an 18.1 percent year-over-year decline in lending to those businesses in third quarter 2023 and a 16.4 percent decline from second quarter 2023.[43] An NFIB survey completed in December 2023 that focused on financing concerns reflected the continued tightening and showed that 80 percent of small business owners who accessed credit in the past three months reported high interest rates as their largest financing complaint, up from 58 percent in July 2023.[44] The Federal Reserve Senior Loan Officer Opinion Survey released in January 2024 showed that the net share of banks that reported tightening lending standards on C&I loans to firms of all sizes cited a less favorable or a more uncertain economic outlook, reduced tolerance for risk, and less aggressive competition from banks as important reasons for doing so (Chart 37).

[40] Mastercard, "U.S. Small Business Growth in a Shifting Economy," October 10, 2023.

[41] Sarah George, "Survey: More Holiday Shoppers Will Likely Shop on Small Business Saturday Than Black Friday This Year," Bankrate, November 13, 2023.

[42] U.S. Census Bureau, Annual Business Survey, Nonemployer Statistics, 2019. For information on business formation, see Census Bureau Business Formation Statistics.

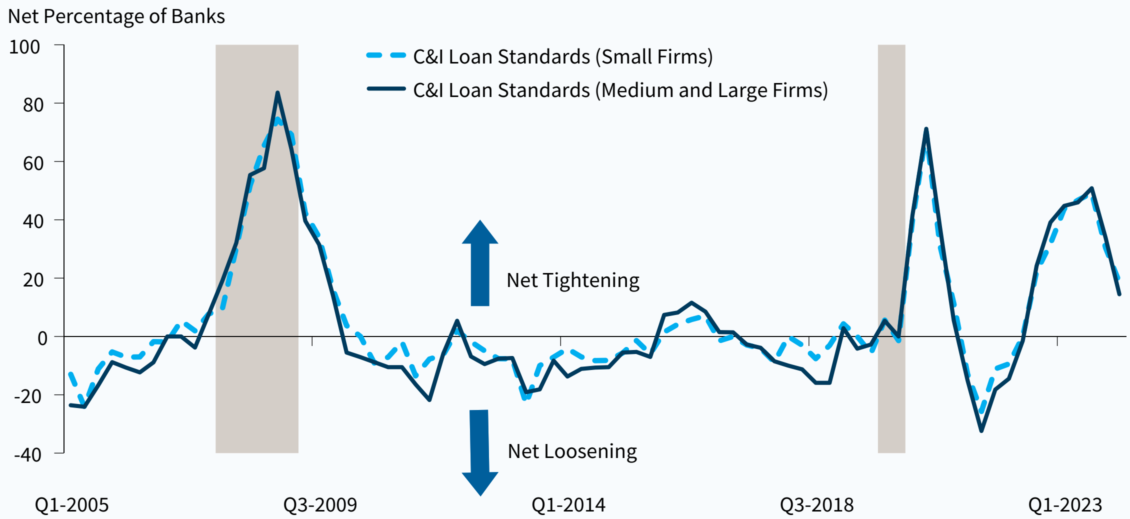
[43] Dustyn DeSpain and Lauren Bennett, "Small Business Lending Demand Continues to Decline," Federal Reserve Bank of Kansas City, Small Business Lending Survey, December 20, 2023.

[44] National Federation of Independent Business, "New NFIB Survey: Small Business Owners Concerned With High Interest Rates," December 27, 2023.

CHART 37

Lending Standards to Businesses Continued to Tighten in 2023

Net Percentage of Domestic Banks Reporting Tightening C&I Loan Standards to Firms



Source: Federal Reserve Board (Haver Analytics).
Note: Shaded areas indicate recession. Data are quarterly through first quarter 2024. Large firms are defined as firms with annual sales of $50 million or more, and small firms are those with annual sales of less than $50 million. C&I is commercial and industrial.

Despite tighter underwriting, community banks remained an important source of small business lending in 2023. At year-end 2023, the banking industry held $404 million in small business loans.[45] Community banks are an important source of funds for small businesses; as of year-end, these banks maintained an outsize share of the industry's total small-business loans at 22.2 percent, despite holding only 14.9 percent of total industry loans. This share is significantly higher than the community bank share of total C&I loans, which was 9.6 percent at year-end 2023. Annual small business loan growth reported by community banks was 4.1 percent in fourth quarter 2023.[46]

Commercial and industrial loan quality remained sound in 2023, especially for community banks. In the absence of asset quality data reported by banks for small business loans, loan performance measures for banking industry C&I loans have historically been a good proxy for small business loan performance. The C&I past-due and nonaccrual rate reported by community banks declined at the onset of the pandemic and remained favorable through first quarter 2023, but the rate slowly increased throughout the rest of the year. Still, the past-due and nonaccrual rate for community banks remained below its pre-pandemic average and below the rate for noncommunity banks (Chart 38).

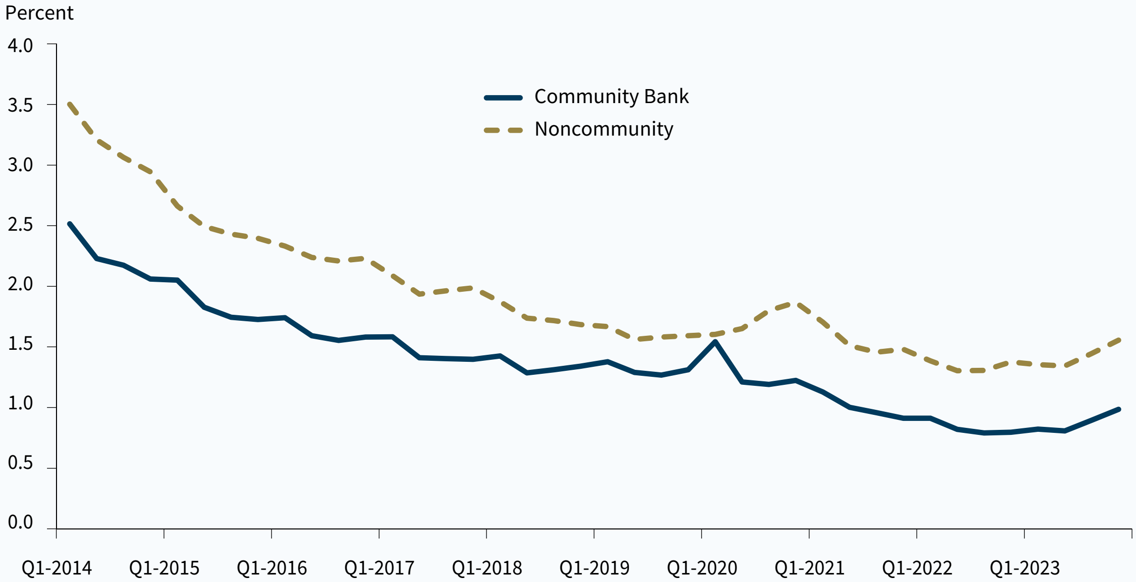
Small businesses reported weaker conditions in 2023, which may be a source of credit risk for banks. Small business owners reported concerns about operating conditions in the near term. The January 2024 NFIB survey reported that the seasonally adjusted Optimism Index remained low at 89.9, down from 2022 levels. Further, a net negative 38 percent of survey respondents said they believed that business conditions will improve over the next six months. Uncertainty about business conditions is an ongoing concern for small businesses, as the last net positive survey response for this measure was in November

[45] Small business loans are defined as commercial and industrial loans less than $1 million, regardless of the size of the business, and are reported in Call Reports semiannually on June 30 and December 31.

[46] This calculation is net of Paycheck Protection Program loans.

CHART 38

The Community Bank Commercial and Industrial Loan Past-Due and Nonaccrual Rate Is Lower Than the Noncommunity Bank Rate



Source: FDIC.
Note: Data are quarterly through fourth quarter 2023.

2020. Amid these challenges, business demand for loans weakened in 2023, according to the January 2024 Federal Reserve Senior Loan Officer Opinion Survey. Moreover, business bankruptcies increased in 2023 and approached pre-pandemic levels. While levels of business bankruptcies remain moderate, higher interest rates combined with weaker business conditions going into 2024 suggest a potentially challenging year for small businesses and their lenders.

Corporate Debt and Leveraged Lending

- **Corporate debt increased in 2023 as market conditions improved, while bank lending to businesses continued to tighten.**
- **Banks remained exposed to corporate debt through both direct credit risk exposure and investment banking activities and indirectly through its potential to affect macroeconomic conditions.**
- **Limited near-term corporate debt maturities should mitigate some risks in the short term.**

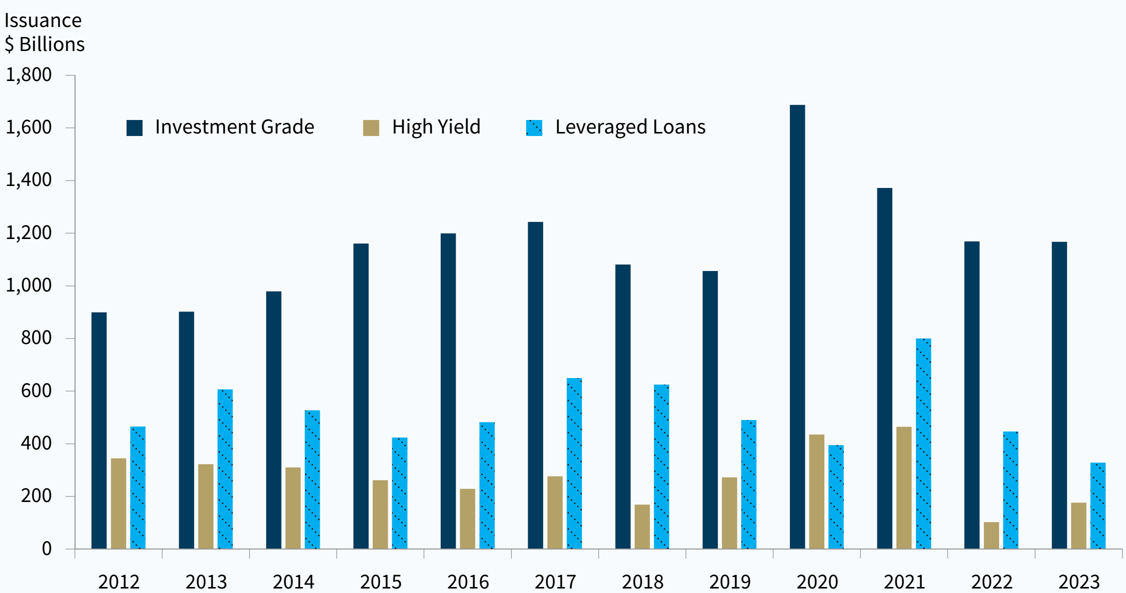
Corporate debt increased as borrowing improved through year-end, while bank lending to businesses tightened. Corporate bond and leveraged loan markets mostly rebounded from a low base in 2023; prices increased and spreads tightened. Corporate debt issuance across types was mixed amid relatively high interest rates, which rose among lower-rated bond issuers and moderated for higher-rated bonds and leveraged loan borrowers (Chart 39). Overall, nonfinancial corporate debt increased in 2023, but debt relative to corporate profits and to GDP declined (Chart 40).

While market conditions improved, bank lending to businesses in general tightened. According to the Federal Reserve Senior Loan Officer Opinion Survey results from January 2024, bank business lending conditions tightened overall in 2023. Bank net lending standards tightened for C&I loans, and demand for C&I loans weakened throughout the year.

Banks face direct and indirect exposure to corporate debt and leveraged lending markets. Leveraged loans are typically floating-rate instruments, so credit risk is the primary risk to banks from direct loan holdings, while holdings of fixed-rate

CHART 39

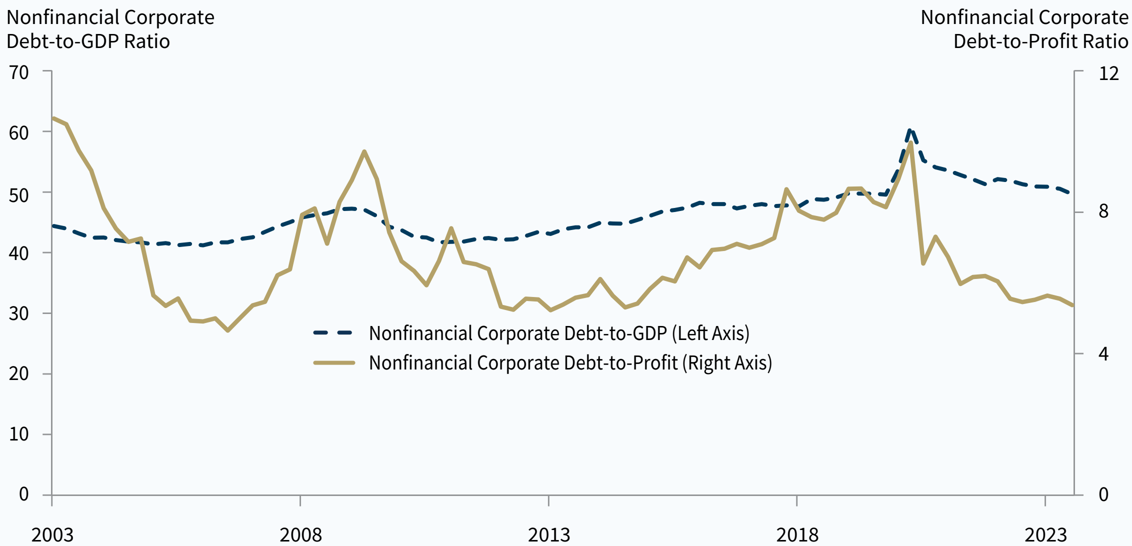
High-Yield Corporate Bond Issuance Rose in 2023 From the Decade Low in 2022, While Leveraged Loan Issuance Moderated



Source: PitchBook Leveraged Commentary & Data.

CHART 40

Corporate Debt Relative to GDP and Corporate Profits Moderated Further in 2023 Compared to the Spike Seen in 2020 and 2021



Sources: Federal Reserve Board and Bureau of Economic Analysis (Haver Analytics).
Note: Nonfinancial corporate debt includes loan and debt security liabilities. Nonfinancial corporate profit is quarterly before tax and includes inventory valuation adjustment at a seasonally adjusted annual rate. Data are quarterly through third quarter 2023.

corporate bonds expose banks to interest rate risk and credit risk.[47] Bank holdings of syndicated loans, which include leveraged loans, increased to more than $1.38 trillion in fourth quarter 2023, up a modest 2 percent year over year after rising more than 20 percent in 2022.[48] The slower growth in 2023 can be partly attributed to the lower overall supply of leveraged loans during the first half of the year.

In addition, bank holdings of collateralized loan obligations (CLOs), which contain leveraged loans, decreased to $164 billion in fourth quarter 2023.[49] Bank holdings of CLOs decreased 1.8 percent in 2023, compared to an increase of 9.4 percent in 2022. While banks typically hold the higher-rated parts of CLOs, they may also have a variety of exposures to nonbank financial institutions that hold or arrange CLO securities. These interconnected risks may expose banks to stress in the underlying leveraged loan market in ways that are difficult to measure.

Banks also earn noninterest income from underwriting and arranging corporate bond and leveraged loan issuances, making them susceptible to reduced revenue from these activities when issuance volumes fall. Reduced corporate debt and leverage lending activity would reduce fee income for banks that gain revenue from these activities. These types of underwriting activities are primarily confined to the largest banks.

While direct exposures to corporate debt markets through lending activities and securities holdings are concentrated in larger banks, other banks may face indirect exposures through the effects of corporate debt distress on macroeconomic conditions. For example, significant corporate debt distress could magnify an economic downturn by forcing firms to pull back on investment and lay off employees.

[47] Banks may hedge a portion of this credit risk through use of credit derivatives such as credit default swaps. For more information on the amount of credit derivatives held by FDIC-insured banks, see FDIC Quarterly Banking Profile Table VI-A.

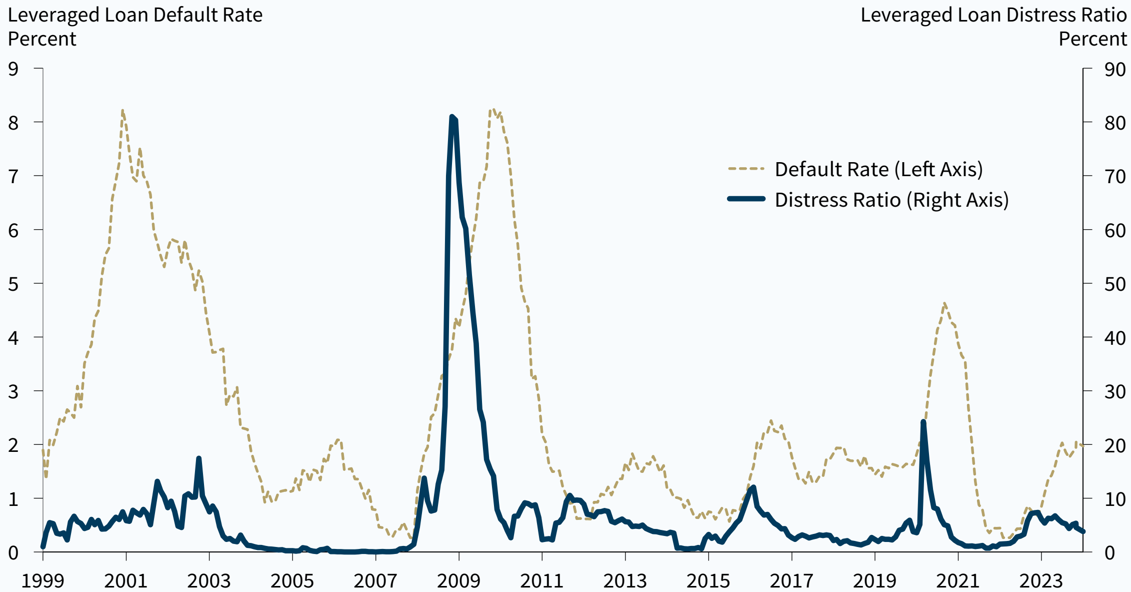
[48] Federal Reserve Board of Governors, Financial Accounts of the United States—Enhanced Financial Accounts.

[49] FDIC, Call Reports.

Limited near-term corporate debt maturities should mitigate some risks in the short term. In 2023, leveraged loan default rates increased, while corporate-debt distress rates declined modestly. Default rates for corporate bonds ended 2023 at 3.0 percent, up from 1.4 percent at the end of 2022 but below pre-pandemic levels. Leveraged loan default rates increased to 2.0 percent in January 2024 from 0.85 percent a year earlier, while leveraged loan distress ratios decreased from 6.1 percent to 3.8 percent. Both signals of weakness in the leveraged loan market are near normal levels and well below prior stress periods (Chart 41).

CHART 41

Two Signals of Weakness in Leveraged Loans Are Near Normal Levels

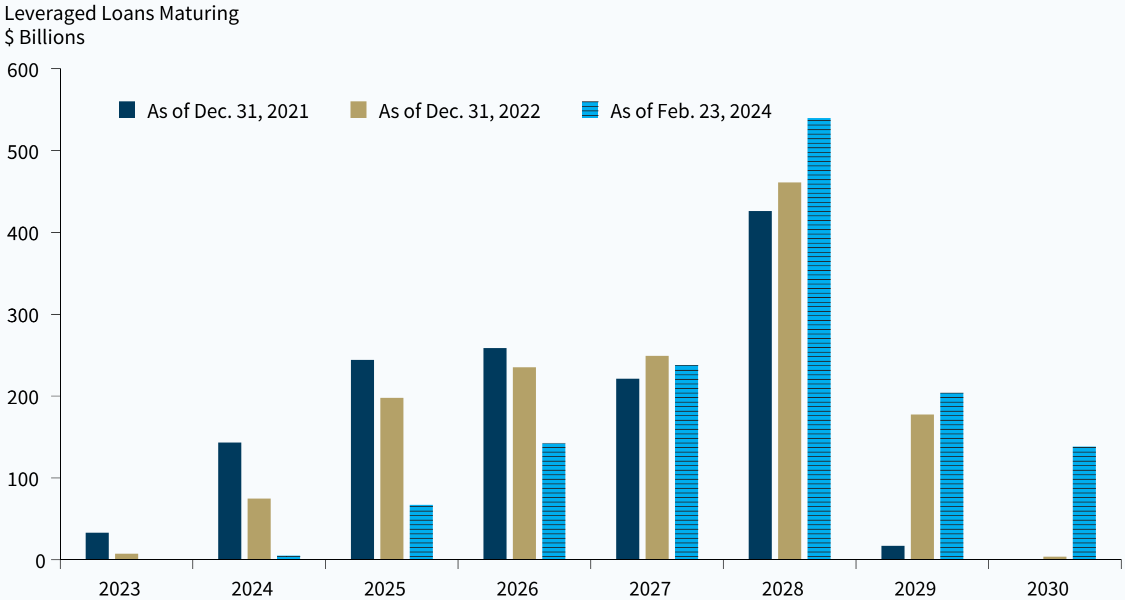


Source: PitchBook Leveraged Commentary & Data.
Note: Default rate is lagging 12-month rates. Distress ratio is the share of loans priced below 80 (par is 100). Data are monthly through January 2024.

A slowing economy in 2024 could cause some companies to face more challenging economic conditions. In addition, should interest rates remain higher for longer than market participants expect, corporate profitability and repayment or refinancing capabilities could be adversely affected, particularly among lower-rated companies.[50] Fortunately, many corporations extended their debt maturities during the early years of the pandemic, taking advantage of lower interest rates that will thereby limit their refinancing needs in the near term (Chart 42).[51]

CHART 42

Leveraged Loan Borrowers Extended Maturities Into the Late 2020s, Reducing Near-Term Refinancing Risks



Source: PitchBook Leveraged Commentary & Data.

[50] Continuum Economics, "U.S. Outlook: Slower Growth to Sustain Improved Inflation Picture," December 15, 2023; Moody's Analytics, "U.S. Outlook: Sizing Up the Surprises," December 18, 2023; and Continuum Economics, "2024 and 2025 DM Rate Cuts," January 2, 2024.

[51] S&P Global, "Credit Conditions North America Q1 2024," November 28, 2023.

Nonbanks

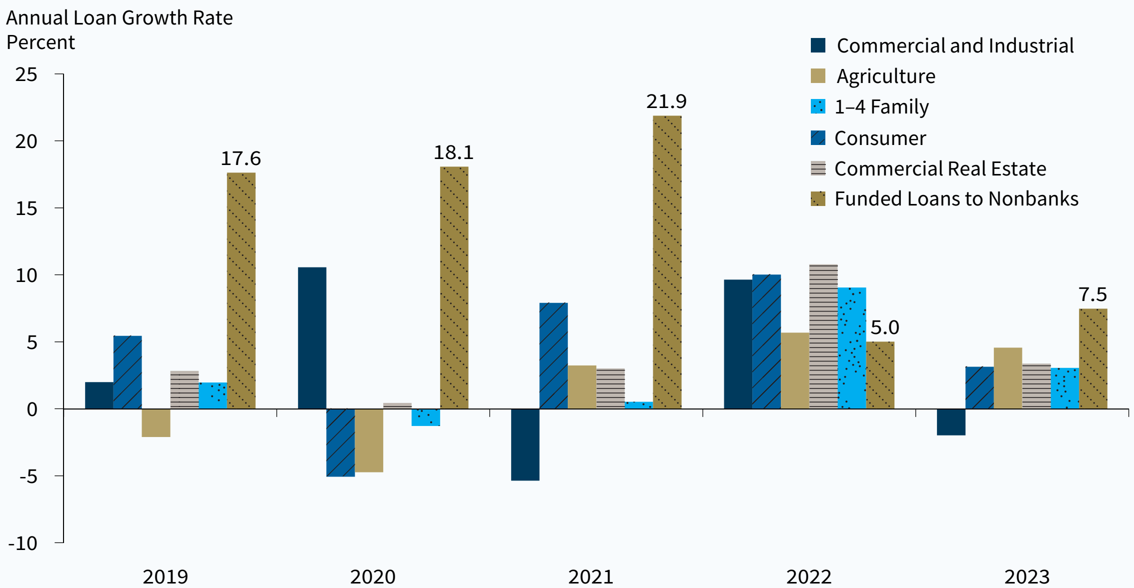
- **As the nonbank financial sector has continued to expand, so has lending by banks to nondepository financial institutions (NDFIs).**
- **Global systemically important banks continued to have the highest concentration of loans to NDFIs. Community bank exposure to nonbank entities is limited to a small group of banks and continued to decline in 2023.**
- **Despite current favorable asset quality measures, sudden changes in market conditions may pose potential indirect and direct risks to nonbanks and their lenders.**

The banking industry continued to lend to nonbanks in 2023, and the rate of NDFI loan growth increased. In 2023 the nonbank financial sector continued to expand, and direct bank lending to NDFIs remained robust. While overall loan growth in the banking industry moderated in fourth quarter 2023, the year-over-year growth rate in NDFI lending continued to outpace growth rates in all other major loan portfolios (Chart 43). Banks lend to many different types of NDFIs, including investment firms, nonbank mortgage companies, insurers, financial vehicles, transaction processors, private credit funds, and other entities. Banks provide credit-line commitments to these firms, and NDFIs rely on these lines as a key source of liquidity for day-to-day operations and for funds to lend or to invest.

Global systemically important banks (GSIBs) continued to have the highest concentration of loans to NDFIs. GSIBs hold more than 60 percent of all bank loans to NDFIs, and in fourth quarter 2023 GSIBs reported 10.9 percent year-over-year growth in funded NDFI balances.[52] Funded NDFI loan commitments as a share of capital reached 54.8 percent at GSIBs in fourth

CHART 43

Growth in Nonbank Financial Institution Lending Outpaced Other Major Loan Categories in 2023



Source: FDIC.

[52] The eight U.S. GSIBs are Bank of America, Bank of New York Mellon, Citigroup, Goldman Sachs, JPMorgan Chase, Morgan Stanley, State Street Corporation, and Wells Fargo.

quarter 2023, up from 39.6 percent at year-end 2019 (Chart 44). In addition to credit-line commitments, GSIBs issue term loans, asset-based loans, and other facilities to nonbanks. While GSIBs lend to a wide variety of nonbank entities, their largest commitments tend to be to investment firms and financial vehicles.

Community bank exposure to nonbank entities, which is limited to a small group of community banks, continued to decline in 2023, largely because of challenges in the nonbank mortgage industry. Only 9.2 percent of community banks held loans to NDFIs, and these loans accounted for only 0.60 percent of total community bank lending. Community bank loan commitments decreased 48.0 percent from the peak level at year-end 2021 and have declined year over year in each quarter since third quarter 2022. Supervisory observations suggest that most lending to NDFIs by community banks is through warehouse lines of credit to nonbank mortgage companies. As mortgage originations declined amid rising interest rates in 2022 and 2023, many nonbank mortgage companies reduced their credit-line usage at banks.

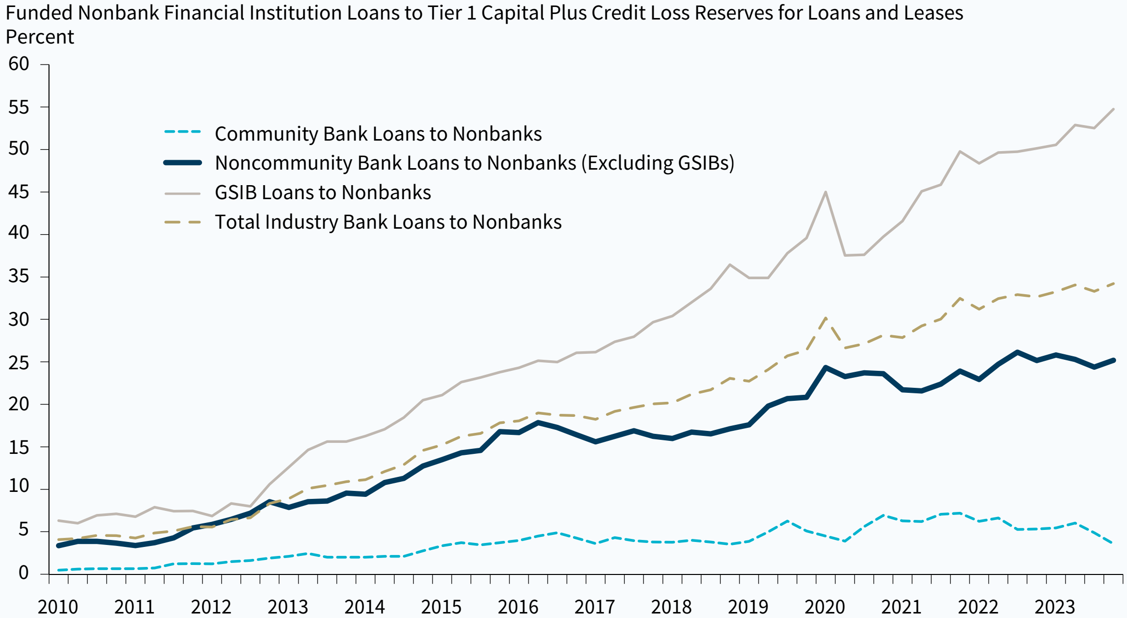
A decline in home sales has challenged the nonbank mortgage industry. Should households become strained from the impact of inflation or a slowing economy, the industry may face an increase in borrower delinquencies. Widespread delinquencies might strain nonbank mortgage servicers' liquidity, as some servicers have to repurchase distressed mortgages while maintaining investor payments. Stress for these nonbanks could lead to larger systemic issues given nonbanks' large and increasing share of the mortgage market.[53]

Despite current favorable asset quality measures, sudden changes in market conditions may pose potential indirect and direct risks to nonbanks and their lenders. The past-due and nonaccrual rate for

CHART 44

GSIBs Have the Highest Concentration of Loans to Nonbank Financial Institutions

Funded Nonbank Financial Institution Loans to Tier 1 Capital Plus Credit Loss Reserves for Loans and Leases



Source: FDIC.
Note: Data are quarterly through fourth quarter 2023. GSIBs are global systemically important banks.

[53] Financial Stability Oversight Council, 2023 Annual Report.

"all other loans," the Call Report category that includes loans to NDFIs, was 0.45 percent in fourth quarter 2023, 51 basis points below the average rate from 2010 through 2019.[54] Yet vulnerabilities exist within the NDFI ecosystem because of rising interest rates and inflationary pressures.

Structurally, nonbanks are typically highly leveraged and prone to liquidity mismatches more so than banks. These structural differences may lead to indirect and direct risks to the banking industry. For example, nonbanks typically obtain funding through more volatile sources than do banks. Some NDFIs allow investors to recall their capital regularly even though they may hold relatively illiquid assets. Forced or sudden deleveraging by NDFIs for liquidity purposes may contribute to changes in asset prices and, if sizable, may amplify price declines market-wide.[55] Research suggests that some NDFIs extend credit to riskier borrowers than banks lend to and reduce lending considerably more so than the banking industry during financial shocks.[56] Ultimately, some NDFIs' illiquid structure and exposure to riskier borrowers could result in direct risk to their bank lenders should they fail.

[54] "All other loans" (as defined in Schedule RC-N) comprises loans to nondepository financial institutions, loans for purchasing or carrying securities, obligations of states and political subdivisions in the United States, and on the FFIEC 041 only, all loans to finance agricultural production. Loans to NDFIs comprised approximately half of "all other loans" (as defined in Schedule RC-C) in third quarter 2023.

[55] International Monetary Fund, "Global Financial Stability Report: Safeguarding Financial Stability Amid High Inflation and Geopolitical Risks," April 2023.

[56] Iñaki Aldasoro, Sebastian Doerr, and Haonan Zhou, "Nonbank Lending During Crises," Bank for International Settlements and Princeton University, June 27, 2023.

Energy

- **Economic conditions in energy-producing states were generally favorable and relatively stronger than in other states.**
- **U.S. oil production increased, while oil prices declined during the latter half of 2023.**
- **Bank loan exposure to oil and gas firms continued to decline in 2023. Higher prices that prevailed in the first three quarters of the year enabled oil and gas firms to reduce their borrowing needs.**
- **Community bank asset quality in energy-concentrated states deteriorated slightly in 2023. Loan delinquency rates rose somewhat but remained low by historical standards.**

U.S. oil production increased in 2023, and economic conditions were generally favorable in energy-producing states. U.S. oil production rose sharply in 2023, aided by the post-pandemic easing in supply constraints (rigs, parts, and workers) and efficiency gains that boosted production growth. The Energy Information Administration estimates that U.S. crude oil production reached an all-time high of 13.3 million barrels per day in December 2023.[57] Eight states collectively referred to as "energy-producing states" in this chapter accounted for 79 percent of the nation's crude oil production in December 2023, a gain of almost 11 percent from the same month a year earlier.[58]

Economic conditions among energy-producing states were favorable in 2023. Total employment in energy-producing states increased 3.0 percent in 2023 compared to 2.2 percent for the rest of the nation.[59] Real GDP in energy-producing states grew 4.5 percent in 2023 compared to 2.1 percent in non-energy-producing states.[60]

Geopolitical events and economic conditions pushed oil prices higher through most of 2023, but increased non-OPEC production kept oil prices from surging. Oil prices began to rise in mid-2023 after a series of production cuts undertaken by OPEC+ in an effort to stabilize global oil markets (Chart 45). These cuts cumulatively reduced oil output from the market by about 5 million barrels per day, roughly equal to 5 percent of global demand. The production cuts initially boosted West Texas Intermediate oil prices, but prices declined later in the year due to expectations of lower demand from softening global economic conditions, stronger-than-expected supply from non-OPEC producers, and new reserve discoveries. Record-high U.S. crude oil production has been spurred by productivity increases at new wells brought about by advances in horizontal drilling and hydraulic fracturing technologies. Employment growth in many energy-producing states consequently benefited as a result of the jobs, labor income, and household spending by workers and owners.

Bank lending to the oil and gas industry continued to decline in 2023, while credit quality strengthened further, reflecting sound oil and gas industry fundamentals during the year. Results of the 2023 Shared National Credit review showed a slight decline in the volume of oil and gas commitments and continued asset quality improvement. Total oil and gas commitments declined 8 percent between 2020 (the height of credit stress during the pandemic) and 2023. The "Special Mention + Classified" rate also declined from 20 percent to 5 percent during this time, in part reflecting improved industry fundamentals.[61]

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[57] U.S. Energy Information Administration, "Short-Term Energy Outlook," February 2024, p. 3.

[58] The eight energy-producing states are Alaska, Colorado, Louisiana, New Mexico, North Dakota, Oklahoma, Texas, and Wyoming. Data are from the U.S. Energy Information Administration.

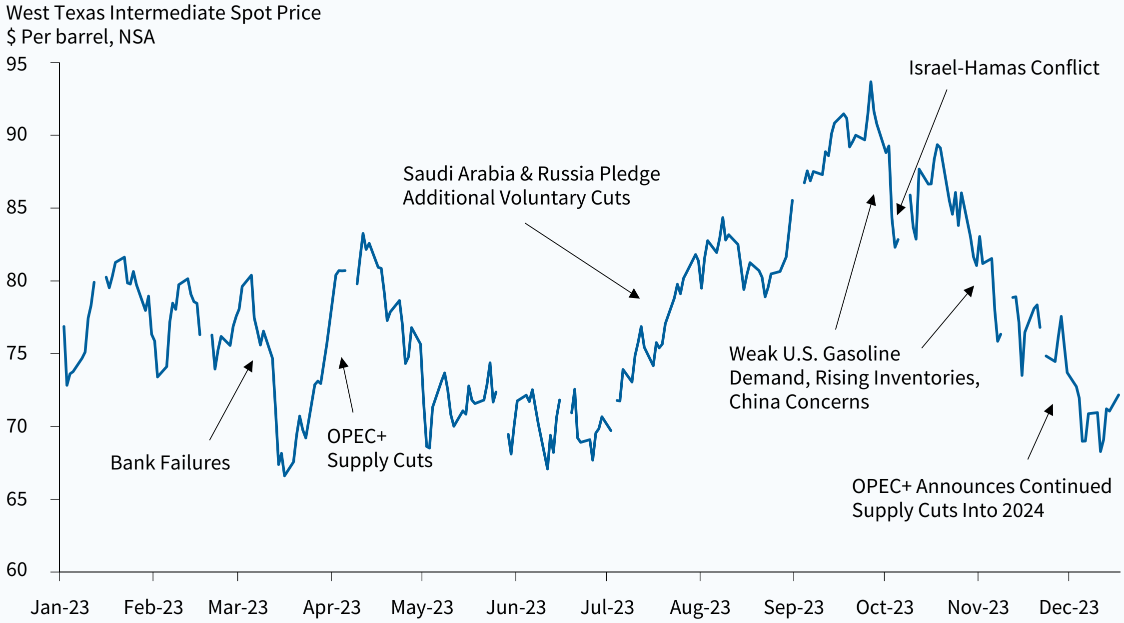
[59] Employment data estimates are from the Oxford Economics Databank based on U.S. Bureau of Labor Statistics data.

[60] GDP estimates are from Oxford Economics based on Bureau of Economic Analysis data.

[61] Oil and gas sector lending is not available at the bank level in Call Report data. However, the Shared National Credit (SNC) Program, which reviews large, syndicated loans by industry sectors that are held by banks, may serve as a proxy for bank loan exposure to the oil and gas industry. The SNC Program assesses risk in complex credit loan commitments to borrowers in excess of $100 million that are shared by multiple regulated financial institutions. SNC reports can be found here.

CHART 45

Oil Prices in 2023 Were Roiled by Economic Conditions and Geopolitical Events



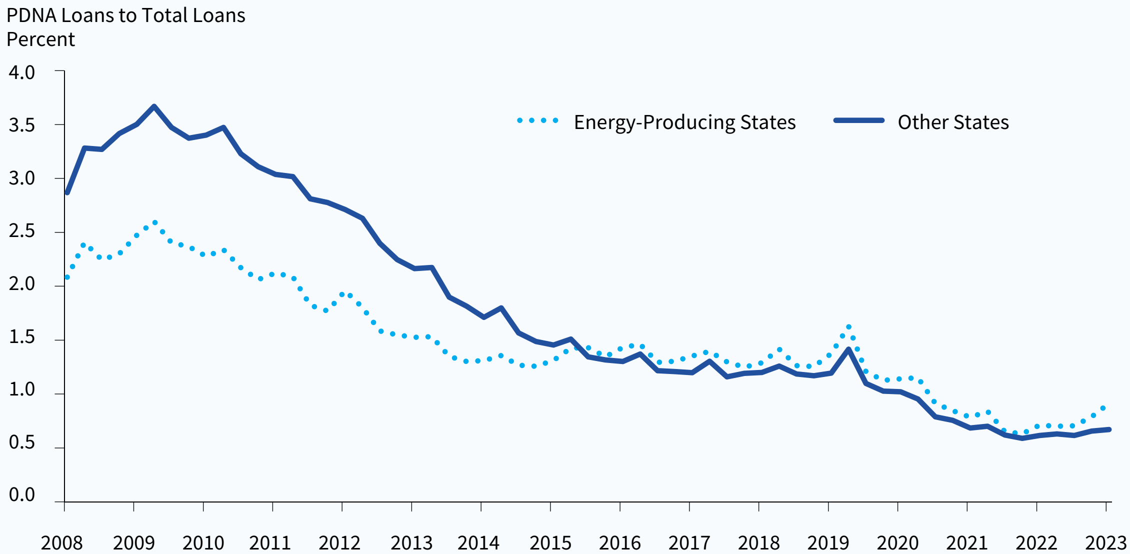
Sources: U.S. Energy Information Administration and Moody's Analytics.
Note: Data are daily through December 18, 2023. Line breaks are due to holidays when data are not released. NSA is not seasonally adjusted.

In addition to reduced direct loan obligations from large banks, oil and gas firms also issued relatively low amounts of public debt and equity in 2023. Although new issuance volumes by these firms recovered from a trough reached in 2022, combined debt and equity issuance volumes for 2023 were still the second lowest over the past ten years and just over half the amount issued in 2020.

Asset quality of community banks headquartered in energy-producing states deteriorated slightly in 2023. Although community banks generally do not lend directly to the energy sector, these banks are often active lenders and providers of banking services in energy-producing areas. In 2023, loan quality deterioration was somewhat more pronounced in energy-producing states than in other states despite relatively favorable economic conditions. The median total past-due loan rate for community banks headquartered in energy-producing states was 0.91 percent in fourth quarter 2023, up 20 basis points from one year earlier but still below the pre-pandemic five-year average of 1.34 percent. Still, the group's past-due loan rate remained noticeably higher than the 0.67 percent for community banks not headquartered in energy-producing states (Chart 46).

CHART 46

Despite Extreme Oil Price Volatility, Community Bank Past-Due Loans Have Remained Low and Stable in Energy-Producing States



Source: FDIC.
Note: Data are quarterly through fourth quarter 2023 for community banks. PDNA Loans are those that are 30+ days past due or on nonaccrual status. Paycheck Protection Program loans are excluded. Energy-producing states are Alaska, Colorado, Louisiana, New Mexico, North Dakota, Oklahoma, Texas, and Wyoming. Data are quarterly through fourth quarter 2023.