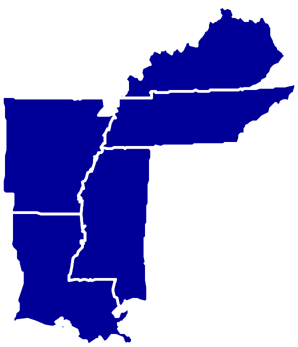
Regional Outlook

FEDERAL DEPOSIT INSURANCE CORPORATION SECOND QUARTER 1997

FDIC MEMPHIS REGION



In Focus This Quarter

■ ***Will Credit Scoring Transform the Market for Small-Business Lending? -*** **In an effort to reduce the cost of small-business lending, some institutions are using credit scoring technology to reduce underwriting costs and to grow their small-business lending portfolios, in some cases venturing into markets well beyond their local economies. The ramifications could be significant. An overreliance on credit scoring models could expose lenders to increased credit risks. Over time, the traditional niche enjoyed by small banks in small-business lending could come under considerable pressure.** *See page 3.*

■ ***Banking on the Internet: New Technologies, New Opportunities, New Risks -*** **Internet banking promises a wide range of new benefits. It also offers a host of new problems and some new twists on old ones. The tradeoff is one that depository institutions and regulators alike must grapple with as they stake out their positions in cyberspace.** *See page 7.*

DIVISION OF INSURANCE

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Regular Features

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Will Credit Scoring Transform the Market for Small-Business Lending?

- **Small-business lending, traditionally a segment in which small banks have enjoyed comparative advantages, is receiving greater focus from larger banks and nonbank financial companies.**

- **Some insured institutions are beginning to rethink traditional approaches to small-business loan underwriting to include the use of credit scoring models.**

- **The use of small-business lending credit scoring models, while providing banks opportunities for underwriting and servicing efficiencies, carries with it a number of potential risks.**

Background

As of 1994, there were more than 22 million small businesses in the U.S., making this a very attractive potential market for lenders. Small-business lending has been a line of business in which small banks have been very successful given their traditional strong niche in relationship banking. Small-business lending traditionally has been a relatively cost-intensive lending segment, since origination costs are spread over smaller loan balances. Some institutions are now beginning to use credit scoring technology to reduce underwriting costs and to grow their small-business lending portfolios. A number of larger banks, especially, appear to be looking to the efficiencies of credit scoring to help provide quick loan approvals and more competitive loan rates. With the aid of this technology, some institutions are rapidly expanding their loan portfolios, in some cases venturing into markets well beyond their local economies.

Commercial bank small-business lending exposures in the Memphis Region are considerable. (For purposes of this article, small-business lending refers to loans categorized as commercial and industrial loans with original amounts of $1 million or less reported on the June Call Reports.) At midyear 1996, commercial banks in this Region reported $15 billion of small-business loans, amounting to 56 percent of all commercial and industrial loans. This level is an increase of $1.1 billion or 8 percent from one year ago. There are 254 banks in the Region with small-business loan exposures exceeding 100 percent of equity, and 34 banks with exposure exceeding 200 percent of equity.

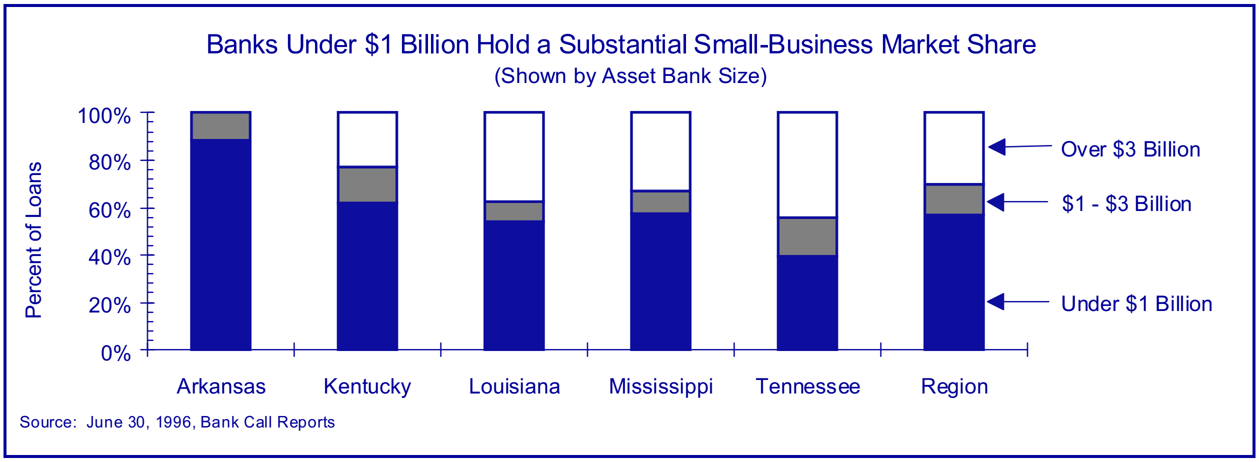
Small banks with assets under $1 billion have a substantial 57 percent share of the Region's small-business loans. Chart 1 (next page) provides a state-by-state summary of small-business market share. However, the market share held by the Region's small banks may come under fire as several large banking companies have announced nationwide programs to increase their share of small-business lending. These nationwide programs may have been prompted by new credit scoring technologies that have reportedly allowed some companies to offer pre-approved and pre-qualified lines of credit.

The Growing Importance of Credit Scoring

While credit scoring technology is not new, until recently it typically has been associated with consumer lending, particularly with credit card lending. Primarily using credit bureau information, credit scoring provides lenders with a tool to rank risks or probabilities of default, assigning statistically derived numerical ratings or scores based upon a borrower's past experience with paying debt. Based upon the enormous volume of historical information on consumers contained in credit bureaus, model developers link incidences of good and bad credit performance with borrower characteristics. Applicants then are compared to these credit performance indicators in order to make credit extension decisions. While credit scoring has helped consumer lenders reduce origination costs and to grow receivables at rapid rates, the recent rise in credit card charge-offs has raised concerns about the effectiveness of such models, or at least about how the models are being used.

Small-business credit scoring is a relatively new concept in scoring technology, but is gaining more attention from lenders. *Small-business credit scoring models are similar to consumer credit scoring models in one significant aspect -- the most important indicator of*

CHART 1



credit performance is the credit profile of the principals of the business derived from consumer credit bureau information. Other business information from companies such as Dun and Bradstreet Corporation and Experian (formerly TRW) also is used in the scoring process.

A primary vendor of these scoring models has cited analysis purporting to show that business financial statement information did not prove a useful indicator of credit performance for small-business loans. The reasons for this result may be due to inconsistency in financial statement quality and the difficulty in separating business entity cashflow information from the business owners' activities. Also, the relative importance of principals' credit history and financial statement information in predicting credit performance was found to change somewhat with the size of the business -- the larger the business the more important financial statements become in assessing performance.

Many institutions cite the potential cost savings involved in the underwriting process as one of the most significant characteristics of credit scoring. In many cases, with scoring technology, loan application processes have been streamlined to one page forms for loans up to $50,000, not dissimilar to that of consumer loan applications. In some cases, financial statements are not required at all. Reducing paperwork helps to reduce both processing time and costs. Table 1 illustrates how scoring has changed underwriting practices, as reported by one large bank at a recent conference on credit scoring. While it is impossible to know whether the information presented in Table 1 is representative of the way most institutions are using credit scoring models, it is clear that credit scoring may represent a significant departure from traditional underwriting methods.

Part of the reduction in underwriting costs may come from improvements in the allocation of underwriting resources. It has been argued that credit scoring allows banks to more easily identify those applicants which are clearly either approvals or denials. This process would enable banks to reallocate their underwriting resources more efficiently to those loans which pose intermediate risks and require closer attention. Other advantages of credit scoring systems that often are cited are greater consistency in underwriting, better measures for pricing strategies, and the potential to enhance the ability to securitize small-business loans.

What Are the Risks?

TABLE 1

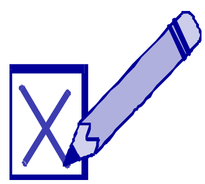
SMALL-BUSINESS LENDING: CREDIT SCORING VERSUS TRADITIONAL LOAN UNDERWRITING

	1993	1996	1997
PERCENT OF LOANS REQUIRING ANNUAL FINANCIAL STATEMENTS	100%	20%	--
PERCENT OF LINES REVIEWED ANNUALLY	100%	0 - 5%	--
PROCESSING TIME FOR LOANS OF $50,000 - $250,000	3 DAYS	1 DAY	1 HOUR

SOURCE: REPORTED BY A LARGE BANK AT A RECENT CONFERENCE ON CREDIT SCORING.

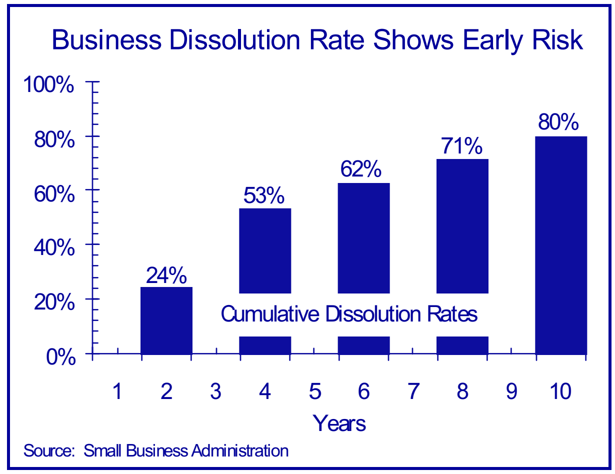
Small-business lending has historically been a profitable area of bank lending. This situation is most likely attributable to lenders thoroughly analyzing potential customers, persistently monitoring their performance, and building solid lending relationships. Credit scoring for small-business lending raises the possibility that some banks will forgo the traditional underwriting concepts of relationship lending in favor of a more mass-marketing approach, in a manner similar to credit card lending. To the extent that credit scoring is used to rapidly gain new customers by either targeting out-of-territory customers, or customers with less business experience, the risk profile of an institution's small-business lending portfolio may change. Any such change in profile may be significant due to the risks associated with newer borrowers. For example, new firms tend to fail at an extremely high rate, with 53 percent of new businesses failing within the first four years of inception (see Chart 2). Larger, more established commercial businesses tend not to exhibit such volatile characteristics.

There are potential dangers associated with placing undue reliance on credit scoring models. *The predictive value of any credit scoring system may be substantially diminished if the model is used for unintended purposes or customer types*. Therefore, misuse of a scoring system could expose an institution to considerable losses. Since only the largest banks have small-business loan portfolios large enough to create statistically valid scoring models customized for their own customer base, smaller companies should be especially aware of potential misuse. This risk takes on added meaning when one considers that a $1 million small-business loan represents substantially more capital to a $100 million bank than to a $10 billion bank. Adding further uncertainty, small-business credit scoring has been implemented during a period of relatively strong performance by businesses, with commercial and industrial loan delinquency ratios near historical lows. How well these models perform during an economic downturn remains to be seen.



Depending on the manner in which it is implemented, credit scoring for small-business lending may represent a fundamental shift in underwriting philosophy -- *viewing a small-business loan as more of a high-end consumer loan and, thus, granting credit more on the strength of the principals' personal credit history and less on the financial strength of the business itself.* While this may be appropriate in some cases, it is

CHART 2



important to remember that the income from small businesses remains the primary source of repayment of most loans. Banks that do not analyze business financial statements or periodically review their lines of credit may lose an opportunity for early detection of credit problems.

Competitive pressures in small-business lending are increasing not only because of large banks' efforts to expand their lending but also because of greater participation in the market by nonbank financial companies. Several large firms, such as American Express, AT&T, the Money Store, and GE Capital Services, are expanding their business lines to service the needs of small businesses. These companies are offering small-business credit cards, innovative new types of credit, and other services such as consulting, accounting and investment services. Some observers have suggested that the cost advantages of credit scoring may cause small-business lending in the future to be dominated by 12 to 15 large banks or financial firms. Faced with stiff competition, there may be strong motivation for some banks to increase the dollar threshold on low documentation loans, streamline the process for larger loans, or lower credit scoring thresholds for loan approvals.

The most recent ***FDIC Survey of Underwriting Practices*** and the ***Federal Reserve's Senior Loan Officer Opinion Survey on Bank Lending Practices*** both indicate that only a small percentage of banks reported an easing of standards on small-business loans. Aggressive competitive pressures and loan growth goals were seen as the main reasons for easing in these cases. With regard to small-business credit scoring techniques, the Federal Reserve survey pointed out that banks were most commonly using credit scores for automatic acceptance or rejection of loans up to $50,000.

Summary

Credit scoring has the potential to transform the market for small-business lending. The traditional niche enjoyed by small banks in this area may come under tremendous pressure from larger banks and nonbank companies employing this new technology. Credit scoring at a number of institutions is driving dramatic changes in underwriting methods for small-business lending. These changes may facilitate short-term revenue generation as business can be expanded rapidly and underwriting costs can be slashed. It is extremely important, however, that banks understand and control the potential risks inherent in such a strategy. The application of credit scoring to small-business lending merits the close attention of both bankers and their supervisors.

Andrea W. Bazemore, Banking Analyst

Banking on the Internet

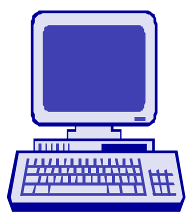
New Technologies, New Opportunities, New Risks

- **Despite the potential for lower transaction costs, increased efficiency, and greater asset diversification, few banks do business through the Internet.**

- **Although *competitive risks* are pushing banks to create an Internet presence, *operational risks* remain an obstacle to actually using those sites for moving information or money.**

- **The FDIC's Division of Supervision recently released examiner guidance on Internet banking and is developing training programs for its examiners.**

The Allure of Cyberbanking

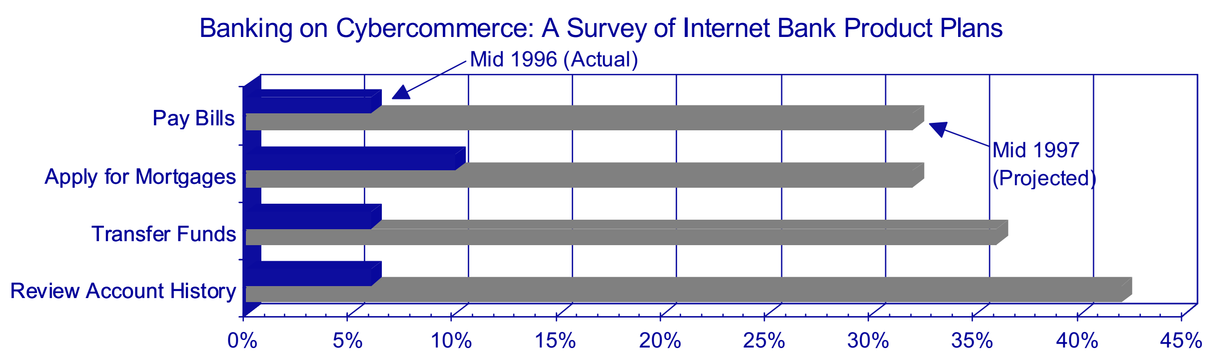


On-line Banking is a comprehensive term for transactions conducted over wires or from remote locations. It includes banking by telephone, banking by personal computer through a dial-up connection and, more recently, banking over the Internet. Internet banking, frequently referred to as *cyberbanking,* is of particular interest to banks because it exploits an existing and geographically extensive public network infrastructure and promises a range of new operating and marketing benefits. One such benefit is the ability for an institution to expand its trade area to include other cities, states, regions -- or even countries -- without a commensurate expansion of its branch structure. This greater geographic reach can do more than simply increase volume. It also can offer institutions -- particularly smaller ones -- the potential to diversify their asset portfolios across multiple regions, leaving them less exposed to the economic volatility of any single one. Another benefit is the lower cost of Internet delivery. A March 1996, study by ***Booz, Allen & Hamilton Inc.*** estimated an average Internet transaction cost of $0.01 compared to $0.27 for an ATM, $0.54 for a telephone, and $1.07 for a full-service branch.

Slow Migration to the Future

Another 1996 study, this one by ***Grant Thornton*** in July (see Chart 1), found that despite these potential benefits, most banks established an Internet presence for appearance's sake -- being perceived as a leader, advertising bank services or staying abreast of competitors -- rather than with an intent to grow deposits or capture the transaction economies that cyberbanking could provide. Of the 44 Internet institutions surveyed, only one in three expressed intentions to begin offering bill payment or funds transfer over the Internet by the end of the second quarter of this year. Even this subdued enthusiasm now appears optimistic. Despite the perceived benefits and the scarcity of competition, few banks have to date ventured into this area in a meaningful way. According to the ***Bankweb*** world-wide web site, only 800 or so banks -- less than 1 percent of the industry -- have an Internet site and only 18 of those permit transactions. In the Memphis Region, 75 institutions have an Internet presence but only one allows customers to pay bills or

CHART 1



Source: Grant Thornton "Banking on Cybercommerce: A Survey of Internet Bank Product Plans" transfer funds. A major question, then, is why so few institutions have chosen to exploit this medium?

Risk

The reason is risk. Banks are familiar with the control of exposures found in proprietary or private payment channels, but they are less comfortable with the new risks attendant to a public network. On one hand, there are *operational* exposures that convincingly argue against rushing headlong into cyberspace. On the other hand, there are *competitive* risks. Nonbank competitors with strong foundations in cybertechnology pose a budding threat to the banks' historical payment-services monopoly and argue with equal authority for an immediate Internet presence to gain or preserve market share. These opposing forces help explain the large numbers of banks establishing web sites that stop short of actually moving information or money.

Of these two types, operational risks are the most immediate and command the most attention. They derive from the formative state of both the technology supporting on-line commerce, and the legal and regulatory structure governing its use. These risks include theft or misappropriation of internal data or external transmissions, transaction fraud, errors in underwriting virtual transactions, liquidity shortfalls, changing technical standards, inadequate or geographically inconsistent regulatory and legal infrastructure, noncompliance with existing laws or regulations that were not designed for an on-line world, and damage to an institution's reputation from the realization of any or all of these risks (see ***Some Concerns or the CyberBanker,*** right).

Systemic Threats and a New Payments Model

In addition to bank-specific risks there are the systemic threats that a public domain payments model could bring. One of the key features of the Internet is redundancy. Any one of a large number of possible paths can be used for a given transaction and therefore the failure of any one path or node will not affect the functionality of the network as a whole. This feature presents a multitude of new and -- from a banker's perspective -- previously unconsidered points of vulnerability to technologically-sophisticated miscreants. In a cyberworld of small value transactions, the effects of an attack may not be much more severe than those which accompany credit card crime. However, there is good reason to expect that Internet transaction sizes will continue to grow. According to one software vendor,

Some Concerns or the CyberBanker

Internal Data Security. The Internet cannot distinguish between customers and criminals. Invasive attacks can range from simple vandalism to theft or destruction of proprietary operating or customer data. Firewall software, data encryption, specialized hardware configurations and commercial insurance can limit such exposures.

External Transmission Security. Because the Internet is an open network, transaction messages are completely exposed, rendering them vulnerable to theft or tampering. Message encryption is a common response, but hardware or implementation flaws can circumvent it. This threat will increase greatly if large value or interbank transactions migrate to the Internet.

Transaction Fraud. Fraud takes two forms: misrepresentation during a transaction or repudiation following it. This problem takes new dimensions in cyberspace because no physical relationship with a customer exists. Encryption protocols which include digital signatures are one response. Biometric authentication schemes, the most commonly proposed being fingerprint or retinal verification, are another.

Difficulties with Virtual Underwriting. Even if your cyber-borrowers are who they claim to be, there remain difficulties in establishing their creditworthiness. The lack of a personal relationship is one factor. The limited knowledge of local employers and credit grantors that appear on applications is another. Such difficulties could hasten and heighten dependency upon credit scoring models.

Liquidity Risks. Internet transaction volume and velocity are expected to increase rapidly, potentially creating transactions which occur so rapidly as to exceed immediate bank liquidity. Denial of service attacks, where a site is intentionally deluged with transactions in order to shut it down, also can affect liquidity if affected customers decide to close their accounts.

Lack of Technical Standards. An institution building an early presence on the Internet is making a financial bet as to which standards will endure.

Lack of Regulatory and Legal Infrastructure. Regulators are waiting and observing. Future promulgated "best practices" may not be those which an institution has already adopted. Similarly, a lack of legal precedent hinders criminal and civil prosecution of cybercriminals. Even where precedent exists, it is frequently inconsistent across jurisdictions.

Reputation Risk. An image of solidity is a cornerstone of banking. Internet banking confronts banks with more exposure and potentially greater publicity about losses.

Competitive Risks. Unlike the operational risks discussed above, competitive risks accrue to institutions not securing an Internet foothold. They involve the threat of lost market share or payment system position to more aggressive peers and nonbank competitors.

inter*branch* payments on the Internet are likely to begin in 1997 with inter*bank* activity to follow a year or so later. This development would be a significant evolution because wholesale transactions are generally large relative to bank liquidity. An attack or disruption of the Internet payments mechanism for a single large transaction could conceivably pass liquidity shocks to other banks in the same way that bad weather at a major airport can disrupt air traffic throughout the country.

New Technologies, Old Reporting

The advent of fully transactional web sites also could heat up bank competition for low cost deposits and frustrate regulatory oversight in the process. One possibility is a "deposit arbitrageur," a hybrid of brokered deposits and program trading in which a computer program could search the Internet for the highest deposit rates and immediately reallocate deposits accordingly. In the long run, such activities could harmonize local interest rates. In the short run, however, this rapid turnover could mean substantial liquidity drains on institutions accustomed to local deposit monopolies. From the regulatory perspective, this transaction velocity -- and its potential to rapidly alter bank balance sheets -- could present new challenges in a world of quarterly Call Reports and examination intervals that can exceed one year.

FDIC -- the CyberRegulator

New risks demand new supervision techniques and the FDIC's Division of Supervision (DOS) has responded with their recently-released electronic banking safety and soundness examination guidance. Under that guidance, institutions having Internet sites are placed into one of three tiers based upon the "maturity" of their site. Safety and soundness examination procedures focus on bank policies, procedures and planning. The examination procedures are cumulative -- meaning that each successive tier adds an additional level of scrutiny to the tiers below -- and do not require a technical knowledge of Internet systems. "Information Specialist" involvement also varies by tier (see Table 1). A DOS training program for all safety and soundness examiners already has begun, and technical training for information systems specialists is being developed. A new specialty, the electronic banking Subject Matter Expert, also is being established.

Measured Steps in a New Environment

Banks increasingly are becoming distributors of commodity-like products. As such, profitability may become dependent upon both cost efficiencies and high volume -- a combination sometimes argued as inconsistent with high-cost branch structures. Internet banking offers institutions a means to compete in this new environment. It also offers new risks. Recognizing this tradeoff, many banks have entered this realm with measured steps. Those who have not face risk of a different sort. They face instead the risk that their competitive position will pass to more innovative competitors -- competitors with new technologies and the drive to accomplish old business in thoroughly new ways.

Gary Ternullo, Senior Financial Analyst
gternullo@fdic.gov

Table 1

The Division of Supervision Classifications for Internet Banks

	Level 1	*Level 2*	*Level 3*
Description	An information-only site	A site permitting electronic submission of loan or deposit applications	Transactional site offering electronic bill payment or funds transfer services
Specialist Examination Requirement (in addition to Safety and Soundness Exam)	Information Specialist review required only if site is tied into internal bank systems.	Consultation with Information Specialist required to determine if further review is warranted.	Concurrent Information Specialist Examination required.

For More In ormation:

Division o Supervision

DOS currently is implementing examination guidance for safety and soundness examiners and developing training for technical specialists.

Cynthia Bonnette, Examiner
Chairman, New Banking Technologies Task Force
(202) 898-6583

Stephen White, Information Systems Review Examiner
Chairman, Information Systems Subcommittee
Federal Financial Institutions Examination Council Task Force on Supervision
(202) 898-6923

Division o Compliance and Consumer A airs

DCA is reviewing new banking technologies from a consumer protection, fair lending and CRA perspective to provide guidance on compliance matters. DCA also is coordinating outreach efforts with consumer community groups.

John Jackwood, Special Assistant to the Director
(202) 942-3854

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O ice of Policy Development

OPD provides leadership in developing FDIC policies, including those addressing new banking technologies. The office coordinates several interdivisional electronic banking efforts and represents the FDIC on the interagency U. S. Treasury Consumer Electronic Payments Task Force.

Sharon Powers Sivertsen, Director
(202) 898-8710

Related Web Sites

FDIC	http://www.fdic.gov
FFIEC	http://www.ffiec.gov
NETBanker	http://www.netbanker.com
Bankweb	http://www.bankweb.com
National Computer Security Assoc.	http://www.ncsa.com
RSA Data Security Inc.	http://www.rsa.com
Smart Card Resource Center	http://www.smart-card.com
American Bankers Association	http://www.aba.com

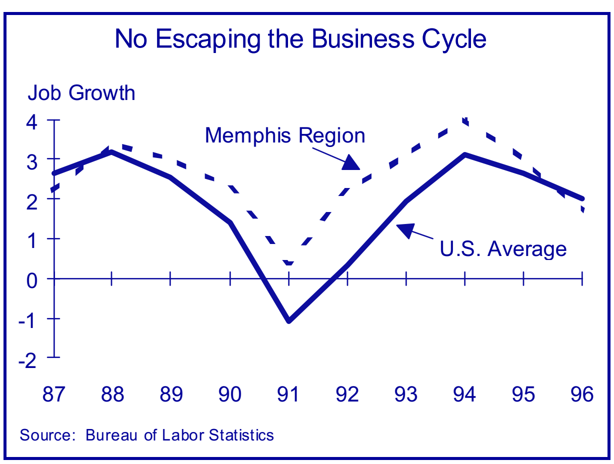
The Shifting Economic Structure of the Memphis Region

- **Growth in the Memphis Region appears to be slowing as the nation's economy continues to move away from its cyclical peak in 1994.**
- **Future volatility may increase as industrial production shifts toward durable goods.**
- **Slowing growth may be cause for concern given the substantial market space remaining in the retail real estate pipeline.**

Current Conditions

The current business cycle appears to be showing its age as illustrated by the continued weakening of the Memphis Region's economic performance (see Chart 1). At 1.7 percent, annual job growth in the Region in 1996 was below the national average (2 percent) for the first time in nearly a decade. The deceleration in growth has been most dramatic in Tennessee where employment rose by 1.4 percent in 1996, less than one-half its rate of expansion in 1995. This was Tennessee's weakest performance since the 1991 recession. Most of the Region's slowdown in growth can be traced to its manufacturing industries. Louisiana was the Region's fastest growing state with 2.2 percent employment growth in 1996. Analysts expect this Region's growth to remain subdued throughout 1997 as the nation's economy continues its move away from the cyclical peak in 1994. Reductions in automobile purchases nationwide should exert a dampening influence in Tennessee and Kentucky, further reducing growth. In February 1997, total sales of passenger cars in the U.S. were down 2.2 percent from one year earlier.

CHART 1

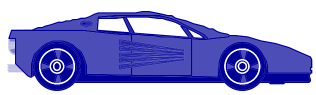


Pockets of healthy growth in the Region still remain, however. Even in some rural areas, labor markets remain exceptionally tight. Tennessee's Shelbyville (Bedford county) is an interesting case in point where growth is causing some local conflict in the economy. At issue is the proposed construction of a major new industrial park. Promoters argue the site would attract new manufacturers and high paying jobs to the Region. Major employers in the area oppose construction, contending that they already are unable to attract new workers given the county's tight labor market.

Implications: The deceleration in economic growth in recent quarters poses a number of challenges for the Region's banking industry. Slower job growth or concerns about job security could have an impact on consumers' spending activity, particularly for big ticket items such as automobiles, home furnishings, and appliances. Consequently, loan volumes may experience some weakening. Moreover, newly started and expanded small businesses spawned during the current expansion may suffer, if economic growth fails to generate sufficient revenues to compensate for debts incurred, adversely affecting banks' profit margins and credit quality.

Shifting Gears in Industry

The textile and apparel industry traditionally has been a source of wealth for the Memphis Region, providing thousands of manufacturing jobs. This industry has suffered a steady slide in payroll numbers with the strengthening in the last decade of competitors located overseas (see Chart 2 next page). The recent strength in the dollar versus other currencies could provide foreign competitors with an even greater cost advantage over



domestic producers. Fortunately, during the last decade another industry has emerged as an important force in the Region's manufacturing sector. Low levels of unionization, state and local government incentives, and low costs of doing business became a magnet to automobile assembly and parts manufacturers. Trade barriers also benefited the Region as foreign manufacturers, including Toyota and Nissan, spent hundreds of millions of dollars to enter the Region, particularly in Tennessee and Kentucky. Saturn Motor Company also set up new facilities in the Region, creating jobs for thousands of factory workers. Emerging growth industries have had a multiplier effect on the economy. New jobs have attracted in-migration and have fostered increases in local demand for goods and services. This, in turn, has spurred the Region's construction industry as commercial and residential developments have been rapidly spawned. In a decade, transportation equipment's share of total manufacturing employment in the Region doubled to over 10 percent, rivaling the textile industry's claim as the largest industrial employer. Tennessee now accounts for 10 percent of national automobile production.

The new jobs brought by the automotive manufacturers pay a higher wage than those in textiles and apparel. In the Memphis Region, the average hourly wage for transportation equipment workers ranges from $10.42 (Arkansas) to $17.12 (Kentucky), compared to a range of $6.76 (Louisiana) to $9.69 (Tennessee) in the textile and apparel industries.

The current contraction in manufacturing is the product of this shift to greater cyclicality in the economy. Since 1992, the erosion in textiles and apparel has been successfully offset by gains in durable goods production. This counterbalance was further accentuated by the influx of new automotive manufacturers. This occurred at a time when the nation was emerging from a recession in 1991 and car sales were booming, further fueling production. However, as the demand for new automobiles is tempered by cooling economic growth, jobs generated by the durable goods sector have become insufficient to offset losses in the textile industry.

Implications: As the economy's industrial make-up in the Memphis Region shifts increasingly toward durable goods production (e.g., transportation equipment) and away from nondurable goods manufacturing, economic growth is likely to become more volatile. In Chart 3, national job growth for the nation in durable and nondurable goods production is tracked since the early 1960s. The business cycle for durable goods production is far more volatile than that for nondurable goods production. As a result, the Region's banking industry may see greater variation in credit quality over time and across lending sectors.

Residential Real Estate Markets: Strong Growth in 1996

Residential real estate markets in the Memphis Region were vigorous in 1996, as permit issuance jumped by nearly 9 percent after slipping the previous year. The strongest growth was in multifamily construction. Two factors, however, may dampen future growth in residential construction in the Region. First, slower growth could cool homebuyer enthusiasm. Arkansas and Mississippi already have started to see construction activity abate. Over the longer term, the Region's real estate

CHART 2

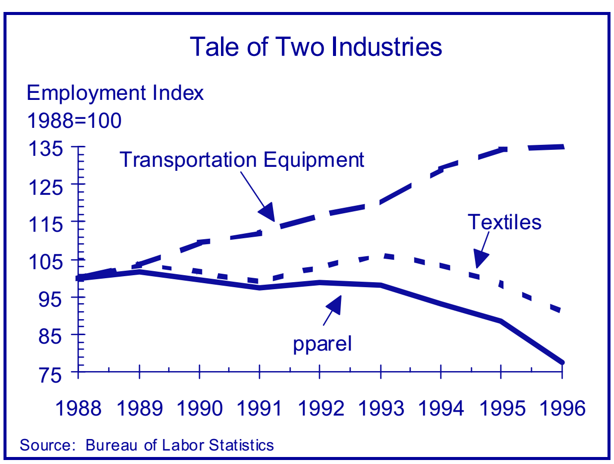
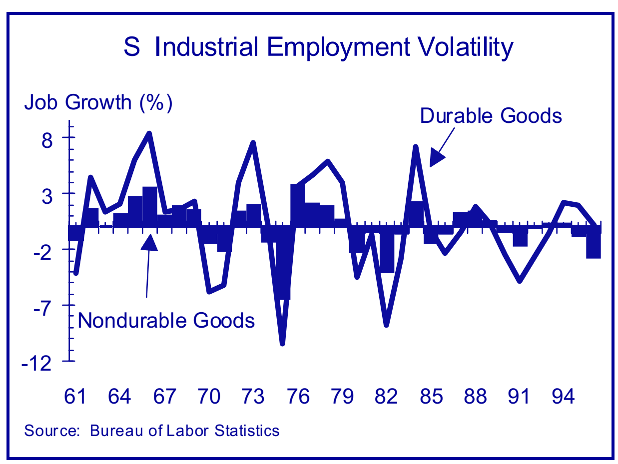


CHART 3



market potential may be limited by slow population growth. With an annual growth rate of 0.8 percent in 1996, the Region's population is rising more slowly than the nation's. Louisiana, moreover, may face even tighter constraints on housing demand as annual population growth was just 0.3 percent in 1996. If growth in residential construction were to outpace the limits on demand imposed by these market fundamentals, the potential for a downward correction exists.

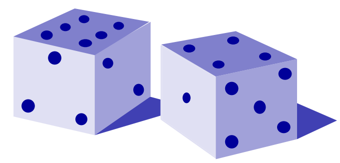
Retail Real Estate Markets Are Expanding

At the same time that the Region's growth appears to be cooling, substantial retail space is in the pipeline in a number of areas. For example, the Region will be home to two of the largest shopping malls opening in the nation this year. In **Baton Rouge**, where growth remained solid last year, planned construction remains at high levels. Over 1.4 million square feet of retail space is under construction, more than any other major metro area in the Memphis Region. The bulk of Baton Rouge's space is to be in the Mall of Louisiana, a 1.2 million square foot mall scheduled to open in late October. Large amounts of retail space also have come on-line in the Memphis metro area with the opening of the 1.1 million square foot Wolfchase Galleria in Shelby county. Completion is near for another one million square feet of retail space adjacent to the Wolfchase mall. **Nashville's** retail market also is seeing a large amount of space in the retail pipeline, with 1.2 million square feet in the planning stages. Conditions in Nashville's retail market have improved tremendously over the past five years. In 1991, the metro area's retail vacancy rate was in excess of 20 percent but now stands at 8.5 percent.

Implications: Construction is a notoriously volatile industry and thus presents a risk to banks that finance development activities. Growth in the Memphis Region will likely continue its deceleration this year and consequently absorption rates could retreat at a time when substantial market space remains in the pipeline. Metro areas, such as **Baton Rouge**, **Memphis,** and **Nashville**, that have seen large amounts of retail space injected into local markets could face varying degrees of retail dislocation due to new competition. As new malls open their doors, consumption patterns, geographically, have started to shift. Consequently, existing retail operations may see earnings slip as customers are wooed away by new malls. Overall retail sales in the metro areas, in contrast, may remain the same or increase only marginally.

Rolling the Dice in Gaming

Gaming has been a key source of growth in portions of the Memphis Region since legalized casinos opened in 1992. The industry now seems to be reaching a mature stage, with the last casino license available in Louisiana having been awarded in March (not including the unopened Harrah's casino in New Orleans) and a lack of new entrants in the Mississippi market. However, casinos should continue to boost local markets, as they expend large amounts in 1997 for amenities, such as hotels and golf courses. In Mississippi for example, 2,000 new hotel rooms are under construction and multimillion dollar infrastructure improvements are expected to expand northwestern Mississippi's ability to draw tourists.



The acceptance of gaming has stemmed from the seemingly successful experiences in some areas of the Region. In **Tunica**, Mississippi, alone a $1 billion per year gaming industry has emerged, providing thousands of jobs to an impoverished area. Income growth in Tunica county has been in the double-digits and per capita incomes have increased from 55 percent of the U.S. average to more than 70 percent in a few years. Elsewhere in the Region, gaming has helped offset job losses in key industries such as oil and gas and textiles and apparel. There are now 30 large-scale gaming operations in the state of Mississippi employing 30,000 workers, with another 20,000 jobs supported indirectly.

Despite the apparent success and subsequent enthusiasm for gaming as a source of jobs and income for local economies, gaming does not guarantee continued prosperity. For example, although Tunica has made seemingly enormous strides in the past few years, a large portion of the development that has occurred has been limited to the support of the gaming industry. Moreover, many jobs and contracts for support services have accrued to the Memphis metro area rather than to Tunica. As such, poverty is still widespread in some areas of Tunica county. Also, earlier growth rates may not persist in Tunica unless the gaming industry continues its rapid rate of expansion. After the casino market has been fully tapped, the gaming industry may be more a source of stability in some parts of Louisiana and Mississippi, rather than a major growth factor.

Implications: As gaming becomes increasingly widespread, casino earnings may soften, prompting a local shake-out in the industry. Lenders located in the casino markets should remain alert to the possibility that borrowers may fail to guard against a potential softening of the local casino industry and become overextended. The risk of excess capacity in areas such as lodging also should receive continued monitoring by those lending to this segment.

Gary L. Beasley, Senior Regional Analyst
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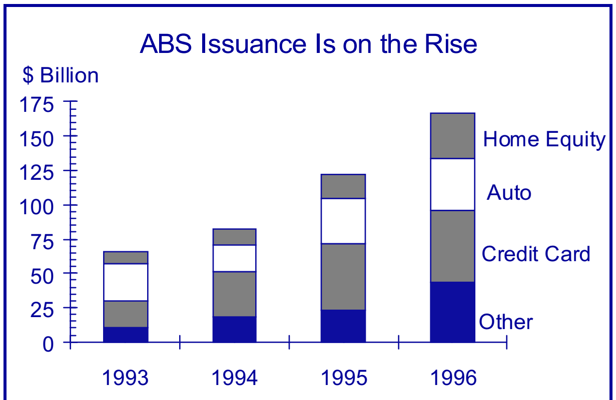
Financial Markets

- **While demand for asset-backed securities continues to be strong, further deterioration in consumer credit quality could have adverse effects on both investors and issuers.**
- **Although there has been little net change in the Treasury yield curve between September 30, 1996, and early March 1997, rates in the 5-year to 30-year segment of the yield curve did fluctuate modestly during this time period.**
- **During the fourth quarter 1996, the Memphis Region's Bank Index outperformed both the S&P Composite Bank Index and S&P 500, gaining 15 percent, compared to a 12 percent gain for the S&P Composite Bank Index and an almost 8 percent gain for the S&P 500.**
- **Banks' price/earnings ratios relative to the broader market have been trending upward since 1994, perhaps signaling an improved perception of the quality of bank earnings.**

The Asset-Backed Securities Market: The Effects of Weakened Consumer Loan Quality

Asset-backed securities (ABS) are debt securities that are backed by loans such as credit cards, car loans, and home equity loans. Over the past ten years, the ABS market has grown dramatically. In 1996, the issuance of ABS was $167 billion, up from $65 billion issued in 1993 as illustrated in Chart 1. Commercial banks and credit card companies accounted for approximately 35 percent of total ABS issuance last year. Major buyers of ABS were mutual funds, insurance companies, corporations, and foreign and domestic banks. Although it is difficult to quantify the amount of bank investment in the ABS market, market participants have observed that small and midsized banks have recently increased their holdings of ABS.

CHART 1



Source: Bloomberg, *Inside MBS and ABS*

Monoline credit card banks and large banks with significant credit card operations have been particularly active ABS issuers. Issuing banks generally structure ABS transactions as nonrecourse sales (loans that cannot be "put back" to issuers upon default), which results in the removal of the assets from the bank's balance sheet and lowers capital requirements. In order to receive investment grade ratings on their ABS, issuers must provide credit support either in the form of overcollateralization, reserve accounts, or third party credit enhancement from bond insurers.

Bank issuers benefit from the sales treatment of assets into the security without completely severing their economic interest in the income generated by the assets. The economic interest results when the revenue generated by the sold assets after charge-offs, servicing fees, and interest coupon payment is recognized as income by the issuer. This surplus is referred to as excess spread. Banks that issue ABS usually continue to service the underlying assets, which not only generates servicing income but also permits customer relationships to continue.

Delinquency and charge-off rates rose in 1996 on consumer loans, particularly in credit cards and auto loans. Despite this rise, the difference between ABS and Treasury yields of similar maturity did not increase. As Chart 2 (next page) shows, the average spread to the two-year Treasury note on selected ABS products continued to tighten during 1996. The lack of widening spreads despite the overall weakening in consumer credit quality reflects strong demand from an expanding investor base, which increasingly includes overseas buyers. Spreads on selected credit card and auto ABS products began to increase during the first quarter of 1997, however, as investors reacted to higher than expected charge-offs reported by some of the larger issuers.

The increasing frequency of rating agencies' reviews for possible downgrades of credit card transactions, as well as problems in the auto finance sector, have raised some concerns in the ABS market. How would a further deterioration in consumer credit affect the ABS market? For the issuer, higher charge-offs, absent a corresponding increase in fees or rates, reduces the excess spread from the ABS. If deterioration worsens, the ABS face potential rating downgrades. This situation may compel the issuer to improve the overall loan quality in the ABS or face what is termed an "early amortization" event. An early amortization event may result in the termination of the ABS issue prior to the maturity date. Once an early amortization occurs, new receivables associated with the accounts in the asset-backed security no longer move into the security but must be funded by the bank on their balance sheet and accounted for in determining capital requirements. In addition, an issuer's access to the ABS market may become more costly after an early amortization if investors demand higher yields on subsequent issues.

For the investor, the threat of a ratings downgrade usually impairs the market value of the security. Investors also may forfeit some interest income in an early amortization because principal may be paid prior to the scheduled maturity date. ABS investors would lose principal, however, only if the deterioration in the quality of the underlying loans is severe enough to deplete the entire credit support. The high level of credit support demanded by rating agencies on existing ABS deals minimizes the risk of principal loss by investors.

During 1996, some bankcard issuers took steps to prevent a ratings downgrade or a possible early amortization. Methods used by bank issuers to support deteriorating ABS have included the sale of new receivables at a discount, the repurchase of low quality receivables from the issue, and the infusion of additional cash into a reserve account of the ABS. However these strategies were specifically cited by the Office of the Comptroller of the Currency (OCC) as actions that could be considered recourse and require full risk-based capital treatment for the assets in the particular ABS issue. The FDIC is working with other regulatory agencies through the Federal Financial Institutions Examination Council (FFIEC) on new Risk-Based Capital Guidelines that are expected to address limitations on post-sale actions and capital requirements for direct credit substitutes or credit enhancements for ABS.

Given the continuing trend of higher charge-offs and delinquencies for credit card loans, investors consider the ABS market less homogeneous in terms of issuer quality and therefore are scrutinizing the securitizations of issuers more closely. Although the risks vary by ABS issuer, banks that issue or invest in the ABS market should be cognizant of the changing market conditions and potential risks associated with ABS.

Changes in Interest Rates and Bond Values

Chart 3 (next page) shows little change in the Treasury yield curve between September 30, 1996, and early March 1997. What this chart does not show, however, is how rates in the 5-year to 30-year segment of the yield

CHART 2

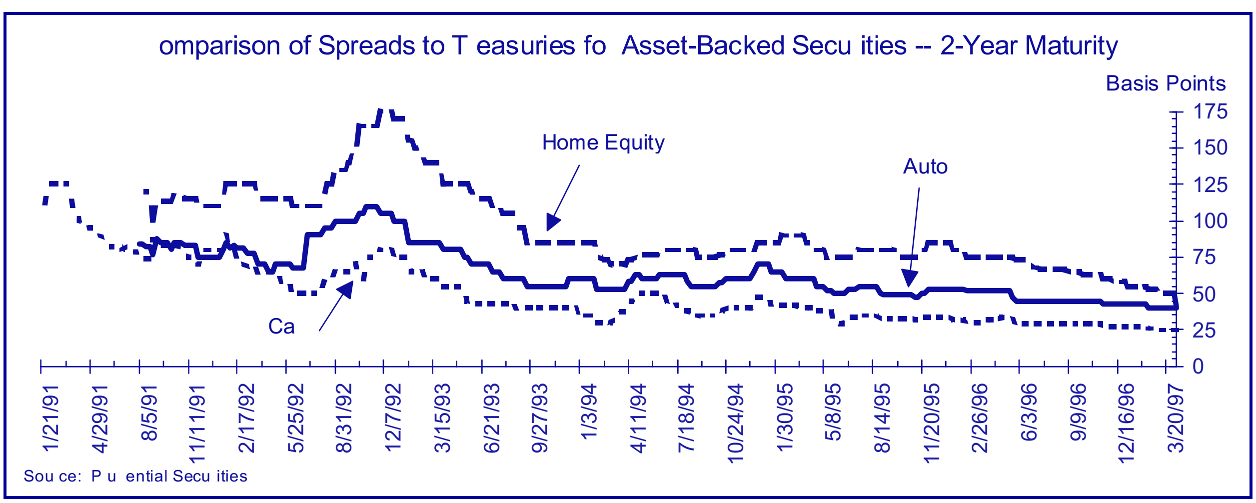


Chart 3

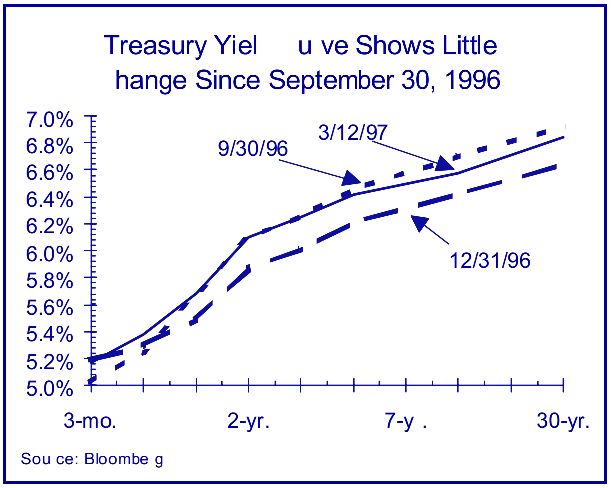
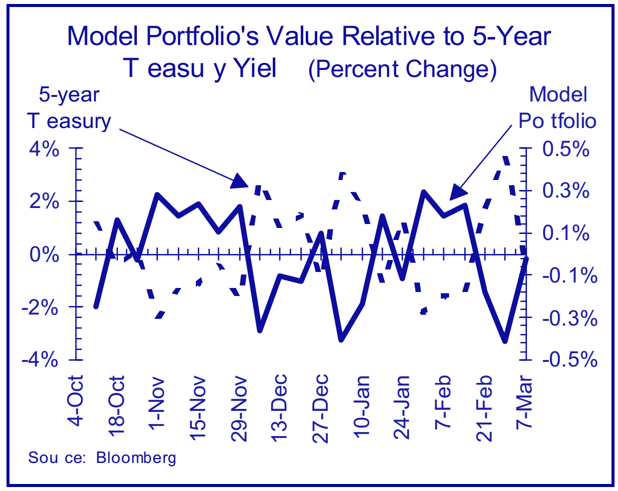


Chart 4



curve fluctuated during this time period. The path of yields on Treasury bonds with 5-year through 30-year maturities changed directions four times, rising or falling by more than 30 basis points. Movements in the shorter segment of the yield curve have been less pronounced.

In order to consider the effect that these rate swings may have had on banks' fixed income portfolios, Chart 4 shows the percent change in the yield on the 5-year Treasury and the percent change in the market value of a model bank portfolio created by the Division of Insurance. The presentation of this model portfolio extends an analysis that was introduced in the first quarter 1997 edition of the ***Regional Outlook***, which looked at the market values of several common fixed income instruments relative to interest rate movements.

In order to enhance the model portfolio's applicability to bank portfolios, the type and amount of the securities chosen for the portfolio are based on an aggregation of securities-related Call Report data. The limitations of Call Report data concerning the maturity distribution of securities required that assumptions be made when choosing the maturity of the securities for the model portfolio. An effort was made, however, to construct a model portfolio that approximates, in the aggregate, the maturity distribution of the aggregate commercial bank portfolio. The model portfolio is shown in Table 1.

As shown in Table 1, the total market value of the portfolio changed less than one-half of 1 percent since September 30, 1996. The portfolio's period-high value, representing a 1.51 percent increase from September 30, 1996, occurred on November 29, 1996, when the 5-year

Table 1

Type of Security	Par Value	Percent of Portfolio	Maturity or WAL	Percent Change from 9/30/96 to 12/31/96	Percent Change from 12/31/96 to 3/12/97	Percent Change from 9/30/96 to 3/12/97
U.S. Treasury 5.6%	2,000	20%	1yr	0.35%	-0.05%	0.30%
FNMA Agency 5.8% Callable	1,200	12%	2yr	0.59%	-0.25%	0.34%
State County Municipal GO 4.8%	800	8%	11yr	1.95%	-0.64%	1.95%
FNMA Mortgage Passthrough 7.5%	3,000	30%	8yr	1.08%	-0.30%	0.78%
FNMA (REMIC) 8.0% PAC	2,000	20%	2.5yr	0.58%	-0.68%	-0.10%
Credit Card Asset-Backed Security	1,000	10%	5yr	0.10%	0.00%	0.10%
Total	10,000	100%	4.85yr	0.77%	-0.29%	0.48%

Treasury rate fell to its period-low of 5.83 percent. Observe that, while longer term rates fluctuated modestly over the reporting period, the reasonably short weighted average life (WAL) of the portfolio further moderated the value changes sustained by the portfolio. Changes in the value of the model portfolio demonstrate a higher correlation to changes in the 5-year Treasury yield than to other maturities along the yield curve because the 5-year bond's maturity better matches the WAL of the model portfolio. Even though the 30-year Treasury rate is often cited as a benchmark for daily rate changes, it may not be the most significant rate in assessing exposures of bank securities portfolios to changes in interest rates.

On March 25, 1997, the Federal Reserve Open Market Committee met and raised the target federal funds rate 25 basis points to 5.50 percent. By the following day, the 5-year Treasury yield had risen to 6.66 percent, 23 basis points higher than the 5-year Treasury yield dated March 12, 1997, displayed in Chart 3 (previous page). The rise in rates from March 12 to March 26 caused the model portfolio's market value to fall 0.56 percent to $9,965.

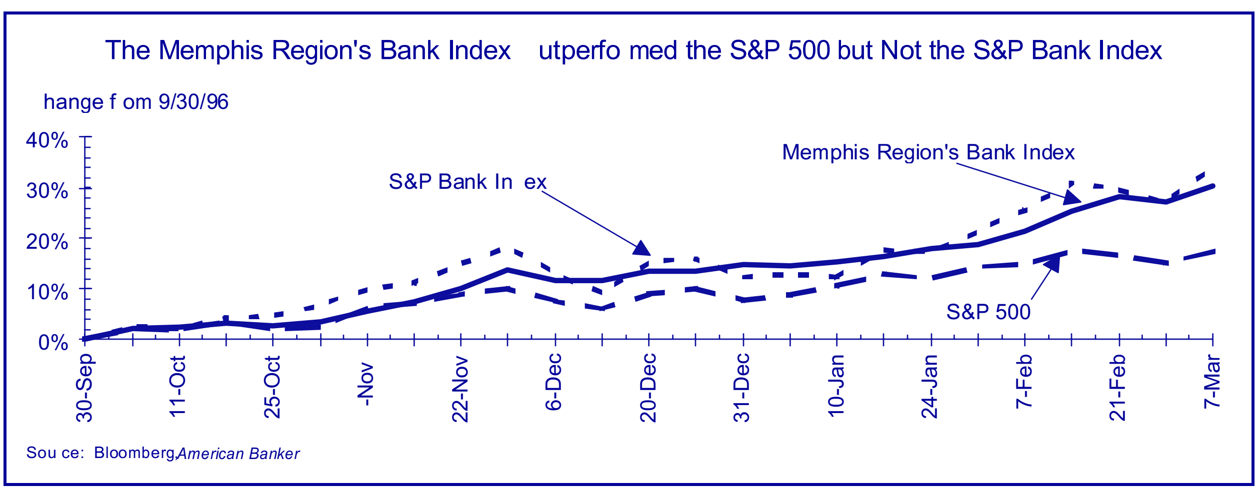
This model portfolio will be used regularly to show the effects on bond values of interest rates movements from quarter to quarter. It also will be used from time to time to illustrate how investment choices that portfolio managers make concerning duration, optionality, and other risk factors affect a portfolio's relative volatility.

Banks' Stock Prices and Price/Earnings Ratios Continued to Rise in 1996. Is the Market Improving its Perception of the Quality of Bank Earnings?

During the fourth quarter of 1996, the S&P Composite Bank Index outperformed the S&P 500, gaining over 12 percent compared to an almost 8 percent gain for the S&P 500. The fourth quarter results topped off a year during which the S&P Composite Bank Index gained 37 percent compared to a 20 percent gain for the S&P 500. As shown in Chart 5, the Memphis Region's Bank Index (MRBI) gained 15 percent in the fourth quarter 1996. The ARBI gained more than 24 percent for the full year 1996: enough to outperform the S&P 500, but not the S&P Composite Bank Index. The year's moderate economic growth, contained inflation, and favorable interest rates are credited for providing a friendly environment for bank stocks. As 1997 began with much the same economic conditions, bank equities have continued to do well. The MRBI is up a more than 13 percent compared to an almost 20 percent gain for the S&P Bank Index and a 9 percent gain for the S&P 500, through March 7, 1997.

While appreciating stock prices provide an obvious positive signal about the health of the industry, the market provides other information about the prospects for the industry through the price/earnings (P/E) ratio. The P/E ratio presents the price of a company's stock as a multiple of its earnings per share and is derived by dividing the stock's market value by the company's earnings per share. Typically investors are willing to pay a higher price for a company with earnings that are expected to be consistent and growing. However, firms with more volatile earnings are generally penalized by investors in terms of stock price and lower P/E ratios. Generally, a higher P/E ratio can be interpreted to mean that investors have more confidence in the outlook for

CHART 5

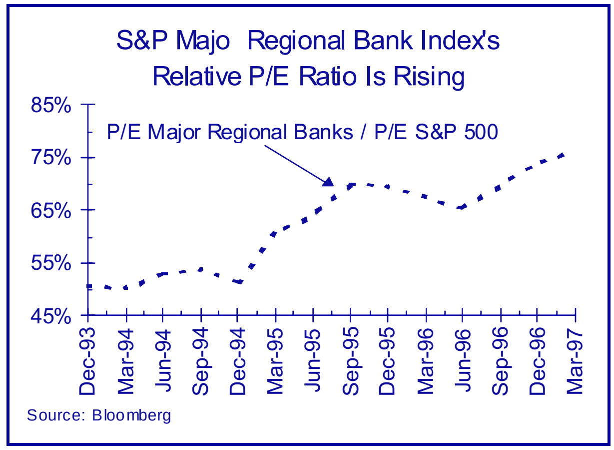


future earnings performance.

The relationship between bank P/E ratios and the P/E ratios for the broader market provides further insight into the market's perception of the quality of bank earnings compared to other firms. Historically, bank P/E ratios have been lower in the aggregate as compared to the rest of the market. The rationale posed for this discounted bank P/E ratio relative to the broader market has been that the primary sources of bank revenue, deposit taking and lending activities, traditionally have been viewed as being more volatile because they are prone to rising and falling with changes in the business cycle. For example, despite recording some of the highest quarterly return on equity averages ever at the end of 1993, the P/E ratio of the major regional bank index was at a level that was still only about 50 percent of the broader market P/E.

Over the past two years the magnitude of the banking sector's P/E discount has declined. As seen in Chart 6, the P/E discount has gone from 50 percent to only 24 percent (a relative P/E ratio of 76 percent). The higher P/E ratio may represent a view by market participants that bank earnings are becoming less sensitive to the business cycle, perhaps as a result of geographic or product-related diversification and more efficient management of overhead expenses. Another factor contributing to higher bank P/E ratios could include speculation on bank stocks as investors anticipate potential acquisitions.

Chart 6



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Current Regional Banking Conditions

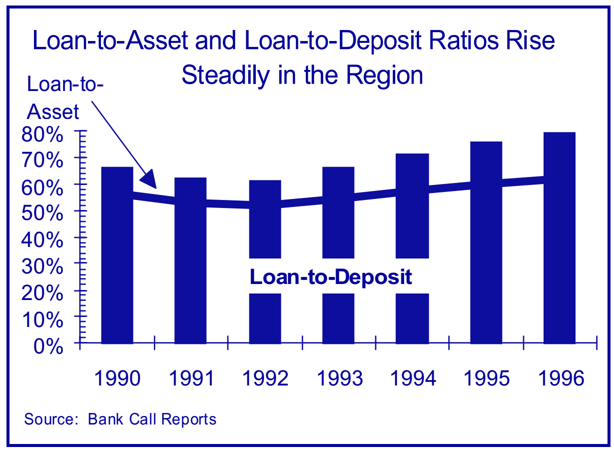
- **Fourth quarter results for commercial banks in the Memphis Region were marked by stable earnings and capital levels, a continued increase in loan-to-deposit ratios, and reliance on volatile funding sources.**
- **Thrifts ended 1996 with improved earnings and solid capital levels.**
- **Some commercial banks are joining a movement to grant higher loan-to-value residential mortgages.**
- **Agricultural issues that arose in 1996 likely will affect more than just the 119 banks in the Region that are significant direct lenders to this sector.**

Commercial Banks Achieve Good Results for Another Year but Continue to Increase Use of Volatile Funding

The Region's commercial banks ended 1996 with an aggregate return on assets (ROA) of 1.3 percent, identical to the 1995 level. Capital coverage, measured by the leverage ratio, also was essentially unchanged from the prior year, with Tennessee institutions (as a group) having the lowest coverage at 8.4 percent and Mississippi banks with the highest coverage at 9.4 percent.

Banks in the Region continue to steadily increase loan to deposit ratios, while using more volatile fund sources for an increasing share of total funds. Growth in loan-to-deposit ratios is not uncommon during good economic times and is not necessarily a cause for concern. However, when coupled with greater reliance on volatile funding, this trend may warrant monitoring of liquidity for some institutions. For the fourth quarter, 625 banks held large time deposits (those exceeding $100,000) in excess of 10 percent of total assets, which represents 124 more institutions in that category than existed at the end of 1994. Total reliance on volatile funding increased from 18.6 percent of total funding to 20 percent between year-end 1995 and year-end 1996. Still, the Region's banks are much less reliant on volatile funding than banks in the nation as a whole, where an average of 30.7 percent of funding is from volatile sources.

CHART 1



Fourth Quarter 1996 Results for Thrifts Are Generally Positive

Earnings for the Region's thrifts recovered quickly from the effect of the one-time SAIF special assessment that was charged to third quarter 1996 earnings. The 138 thrifts in the Region posted an aggregate net income figure of just over $43 million for the final quarter of 1996, resulting in an ROA of 0.62 percent for the year. Thrifts in Mississippi were the most profitable and the only group on a state-by-state basis to achieve a 1 percent ROA for the year, while Kentucky thrifts turned in the weakest performance with an aggregated ROA of just under 0.50 percent.

For the quarter, assets held by thrifts declined in every state except for Louisiana. The resulting decline in assets of $3.7 billion, or 14.5 percent, was primarily due to charter changes and mergers of thrifts with banks. For example, the Region's largest thrift, Leader Federal Bank for Savings, with total assets of approximately $3.3 billion, merged with the lead bank of the Region's largest holding company, Union Planters Corporation. Lower thrift asset volumes had the expected effect of improving capital coverage from 9.6 percent to 10.1 percent. Past-due loan percentages increased slightly in every state except for Mississippi after adjusting for these mergers.

Residential Lending Standards Come Under

Pressure From Large Banks and NonBank Lenders

It appears some banks may be easing credit standards in an effort to compete for residential mortgages and other consumer loans. On a nationwide basis, finance companies and other subprime lenders are offering loan packages that allow the consumer to consolidate all mortgage, home equity, and credit card debts into one loan secured by the borrower's residence. Debt consolidation loans are not a new idea; however, some institutions have acknowledged increasing the maximum threshold amount financed in relation to the value of the collateral. Loan-to-value (LTV) ratios have increased from previous standards of 80 to 90 percent to as much as 125 percent of appraised value.

Some banks in this Region are joining this trend toward high LTV residential lending: 100 percent financing is now routinely offered by a number of institutions. Institutions extending this type of credit also are permitting extended periods of interest-only payments, in some cases, up to as long as ten years. It appears that most small community banks are not actively seeking these types of loans. However, interest in participating in high LTV residential loan programs could increase if both consumer demand and competition from larger institutions continue to grow.

Residential mortgage lending represents a significant business for banks in the Region. A total of 124 institutions hold portfolios of residential mortgage loans that exceed 25 percent of total loans and 100 percent of Tier 1 capital. By the end of 1996, banks in the Region had increased their holdings of 1-to-4 family mortgages to $43.3 billion or approximately 29 percent of total loans, making residential lending the largest single loan category for the Region's banks. Residential loan growth, adjusted for a major merger, has increased slightly to a rate of 13 percent (annualized).

Underwriters of high LTV mortgages should be cautious not to make credit and pricing decisions based on assumptions that the favorable economic conditions experienced over the past six years will continue indefinitely. Low interest rates, coupled with high employment and rising income levels, have contributed to the ability of consumers to service increasing debt loads. These circumstances also are major factors in the increasing value of residential properties in all of the Region's major markets, a trend which appears to be moderating (see ***The Shifting Economic Structure of the Memphis Region***). Adverse changes in these key factors could increase potential credit losses from this type of lending. There are a number of additional considerations that lenders should take into account.

For example:

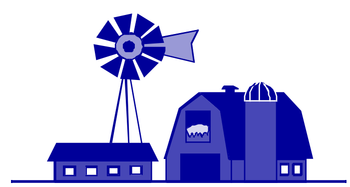
- Loans collateralized by 1-to-4 family dwellings with high LTVs generally will not meet secondary market standards set by government-sponsored enterprises, such as Fannie Mae and Freddie Mac, meaning the loans will likely be less liquid and will remain in the loan portfolio (at least initially).

- Banks that engage in this type of lending may be more exposed to changing economic conditions that adversely affect consumer income levels and the value of residential properties.

While consolidating unsecured debt into a secured loan structure may provide some comfort to the lender, the possibility remains that some consumers will simply increase credit card debt after the consolidation is completed, thereby increasing the likelihood of bankruptcy.

Agriculture Is Big Business in the Region

The performance of agricultural businesses is important to the health of the Region's banks. Agricultural-related lending totaled $5.7 billion at the end of 1996, or about 4 percent of total loans. While this level may not seem like a significant concentration, there are a number of institutions where agricultural lending is a principal business line. *Table 1 (next page) provides information by state on 119 agriculture banks, defined in this article as institutions with more than 25 percent of their total loans extended for agricultural purposes.* As indicated in Table 1, on average these institutions appear to enjoy significant financial strength.



The full effect of agriculture in the Region is understated, however, if one considers only direct bank lending in this area. For example, a recent study by ***the Agricultural Economics Department of Mississippi***

Table 1

Agriculture Banks* Display Strong Balance Sheets and Overall Performance					
	Number of Ag Banks *	Return on Assets	Leverage Capital	Nonperforming to Total Assets	Net Loan Charge-Offs
Arkansas	49	1.34%	11.10%	0.59%	0.16%
Kentucky	30	1.39%	11.03%	0.53%	0.19%
Louisiana	15	1.26%	11.22%	1.56%	0.33%
Mississippi	20	1.34%	11.18%	1.12%	0.49%
Tennessee	5	1.37%	11.21%	1.05%	0.30%
United States	2,467	1.14%	11.07%	0.74%	0.26%

Source: December 31, 1996, Bank Call Reports
* Banks with 25 percent of their total loans extended for agricultural purposes.

State University (MSU) provides a broad measure of the effect that agriculture has on Mississippi. The MSU study determined that approximately one in three Mississippians are employed directly or indirectly in agriculture, including forestry, accounting for 23 percent of wages and salaries in the state. The study also estimated that agriculture accounts for one-third of the state's total annual production. A second example is provided in a study by the ***Louisville Chamber of Commerce***, which estimates that agribusiness accounts for more than 35,000 local jobs, $1 billion in personal income, $6 billion in product value, and $100 million in Kentucky and Louisville tax revenue. Considering such information, it seems clear that the performance of most, if not all insured institutions operating in markets heavily influenced by agriculture, including certain institutions in large metropolitan areas, will be affected by this sector. Therefore, an awareness of significant events that affect this sector is important for both banks in the Region and their supervisors.

A number of issues arose in 1996 that warrant continued monitoring. A fourth quarter ***Federal Reserve*** survey of active agricultural lenders disclosed that 32 percent of the respondents have significant concerns over the portfolio risks caused by reductions in federal farm subsidies contained in the 1996 Farm Bill. The changes implemented in the bill are expected to introduce more volatility in prices paid to farmers for crops, because supply and demand factors will drive prices rather than artificial price subsidies. Absent the artificially established price targets, farmers are more likely now than in the past to determine what crops to plant by watching futures prices. *However, planting decisions based on futures prices could result in excessive supplies of some crops, causing downward pressure on prices and income for some farmers.* The impact on income could of course be mitigated by hedging activities or obtaining "revenue insurance."

Other agribusiness-related issues that came to the forefront in 1996 and that may be important to some lenders include:

- The emergence of increased underwriting and pricing pressures from competitors, such as chemical suppliers, as recently cited by some bankers in Louisiana;

- The increasing competitiveness of foreign producers is becoming a bigger factor in the prices for some domestic crops, such as soybeans, which have encountered recent price fluctuations attributed partially to weather conditions and labor unrest in Brazil;

- Higher exports to foreign countries such as China, which is the second largest purchaser of poultry and therefore particularly important to Arkansas businesses like Tyson's; and

- Negative demand and price ramifications from lawsuits and general attacks leveled against the tobacco industry (in 1995 tobacco was a $637 Million crop in Kentucky).

The ***U.S. Department of Agriculture*** provides information on the Internet for those interested in agricultural-related issues such as crop prices, stages of planting, special research papers, and production forecasts. The USDA homepage may be found on-line at http://www.usda.gov/, and the USDA Statistics

Service home page may be found at http://www.usda.gov/nass/.

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