Risk Review

2025

FDIC FEDERAL DEPOSIT INSURANCE CORPORATION

Risk Review

2025

FEDERAL DEPOSIT INSURANCE CORPORATION

PAGE INTENTIONALLY LEFT BLANK

TABLE OF CONTENTS

PAGE INTENTIONALLY LEFT BLANK

INTRODUCTION

The FDIC was created in 1933 to maintain stability and public confidence in the nation's financial system. A key part of accomplishing this mission is the FDIC's work to identify and analyze risks that could affect the safety and soundness of banks. The Risk Review summarizes the FDIC's assessment of risks in economic and market conditions affecting the banking industry. The analysis pays particular attention to risks that may affect community banks, as the FDIC is the primary federal regulator for most community banks and has a unique perspective on these institutions.

The 2025 Risk Review provides an overview of market and credit risks to banks in 2024. The discussion of market risks covers net interest margins, liquidity, and funding. The credit risks discussed are commercial real estate, non-depository financial institution lending and private credit, consumer lending, residential real estate, corporate debt and leveraged lending, small business lending, agriculture lending, and energy.

PAGE INTENTIONALLY LEFT BLANK

SECTION 1
Executive Summary

Economic conditions remained solid in 2024, and financial market conditions remained generally stable. Economic growth exceeded expectations for much of 2024. Labor market growth slowed as the market came closer into balance. Inflation continued to ease but remained elevated. While short-term interest rates began to decline at the end of 2024, longer-term Interest rates remained elevated for much of the year. The yield curve remained inverted for most of 2024 but began to flatten in medium and longer maturities toward the end of the year. Interest rates remained elevated for much of the year, but shorter-term rates declined toward the end of the year.

Overall, the banking industry was resilient in 2024 despite the challenges of an inverted yield curve and higher interest rates. The industry's full-year net income was well above pre-pandemic levels; asset quality metrics remained favorable; liquidity was stable; and capital levels increased.[1] Deposits increased modestly in 2024. However, banks reported deterioration in certain loan portfolios and continued elevated levels of unrealized losses on securities. Community banks generally fared better than the rest of the industry during the year in deposit growth and loan growth rates, but reported higher growth in expenses, which reduced their income.

Key Risks to Banks

Market risks continued to challenge the banking industry in 2024 with higher interest rates and an inverted yield curve during much of the year. The banking industry's annual net interest margin (NIM) declined as growth in funding costs outpaced growth in asset yields. Lower interest rates may help ease funding cost pressure for the banks most negatively affected by higher interest rates in previous years, but interest rate uncertainty may be an ongoing challenge for banks overall. Even as short-term interest rates declined, banks continued to report unrealized losses in securities portfolios as longer-term rates remained elevated, representing a drag on future earnings. On-balance-sheet liquidity levels were stable in 2024. Deposits increased for the first time since 2021 as uninsured deposit growth resumed. Wholesale funding growth slowed, and the ratio of wholesale funds to total assets was within pre-pandemic norms.

Credit risks varied by loan type in 2024, with greater asset quality deterioration in certain commercial real estate (CRE) and consumer loan portfolios.

- **Commercial Real Estate:** CRE conditions varied by property type and market in 2024, with office underperforming other CRE types. CRE loan growth slowed in 2024. High interest rates continued to inhibit refinancing of CRE loans as borrowing costs rose, while higher operating costs, elevated vacancy rates, and slower rent growth weakened property-level cash flows. While CRE asset quality weakened, past-due and nonaccrual (PDNA) and net charge-off ratios remained far below levels reached during the Great Recession.

- **Non-Depository Financial Institution Lending and Private Credit:** Bank lending to non-depository financial institutions (NDFIs) is heavily concentrated in larger banks and has grown in recent years. Growth in alternative assets, particularly private equity and private credit, has played a key role in the evolution and growth of NDFI lending. Despite some vulnerabilities in the NDFI market, bank lending to NDFIs has historically presented relatively low credit risk.

- **Consumer Lending:** Household finances were solid in 2024 but were weaker than in 2023. Real income growth slowed but remained positive, and

[1] The pre-pandemic level is calculated as the average level from first quarter 2015 through fourth quarter 2019 and is used consistently throughout this report.

household wealth rose. Debt burdens remained near historic lows but rose from 2023 levels, and the savings rate fell. Consumer loan growth slowed as banks tightened lending standards and demand for loans eased. Asset quality worsened in 2024, but the pace of deterioration slowed.

- **Residential Real Estate:** A limited supply of homes for sale and high mortgage rates continued to weigh on the housing market in 2024. Home prices increased further last year, which contributed to lower housing affordability. The banking industry's residential mortgage balances continued to grow, but at a slower pace. Asset quality of residential mortgages held by banks remained generally sound.

- **Corporate Debt and Leveraged Lending:** Corporate debt increased in 2024 as market conditions improved, but high interest rates and inflation concerns continued to cause distress for some corporations. Bank lending to businesses remained weak and underwriting standards remained tight in 2024. Limited near-term corporate debt maturities could mitigate risks in the short term.

- **Small Business Lending:** Small businesses reported tighter financing conditions and higher inflation in 2024 but were supported by steady consumer spending. Community banks remained an important source of small business lending. Small business lending slowed during the year based on various measures, but asset quality for community bank commercial and industrial (C&I) loans, a proxy for small business loans, remained relatively sound in 2024.

- **Agriculture Lending:** Agricultural conditions softened in 2024 for the second consecutive year on weakness in the crop sector, and farm banks reported tighter liquidity positions as crop farmers increased borrowing. Despite operating losses for many crop farmers, agricultural loan quality reported by farm banks deteriorated only modestly in 2024. While farmers are generally well positioned to withstand weaker agricultural conditions, projected losses for 2025, primarily on corn and soybeans, could impair their ability to repay loans, posing credit risks to banks.

- **Energy:** Oil prices were relatively stable in 2024, and fundamentals of oil and gas companies generally remained sound. Large bank loan exposure to oil and gas firms declined further in 2024, while asset quality improved. The asset quality of loans held by community banks headquartered in energy-concentrated states weakened slightly but remained better than in previous years.

SECTION 2
Overview of Conditions and Banking Performance

Economic and Financial Market Conditions

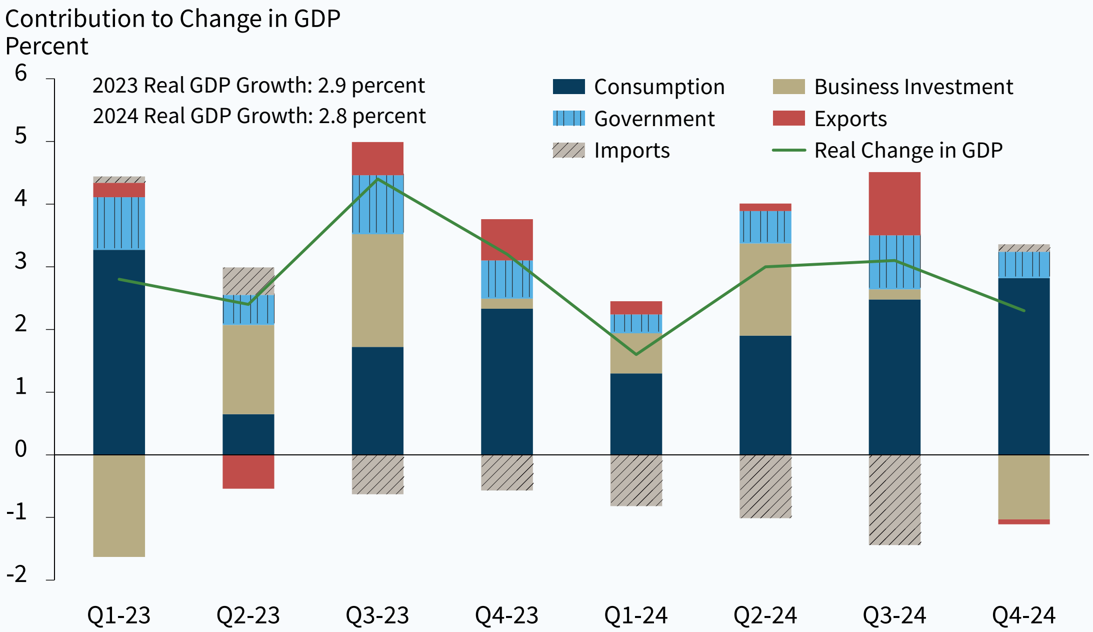
- **Economic growth was solid in 2024 and exceeded expectations for much of the year.**
- **Labor market growth slowed in 2024 as the market became more balanced from tight levels.**
- **Interest rates remained elevated for much of 2024, but shorter-term rates began to ease toward the end of the year.**
- **The yield curve remained inverted for most of 2024 but began to flatten in the medium and longer maturities toward the end of the year, ending the year with an upward slope.**

Real GDP growth was generally solid in 2024. The economy maintained relatively strong growth in 2024, despite a slower start to the year. Stronger consumer spending boosted growth in later quarters and helped offset weakness in business investment in the second half of the year (Chart 1).

Inflation continued to decline in 2024 but at a slower pace and remained above the Federal Reserve's 2 percent target. Annual Consumer Price Index inflation continued to decline in 2024 following rapid declines in 2023. Energy prices declined, but prices of other components remained steady or

CHART 1

The Economy Exceeded Consensus Expectations in 2024



Source: Bureau of Economic Analysis (Haver Analytics).
Note: Data are quarterly through fourth quarter 2024.

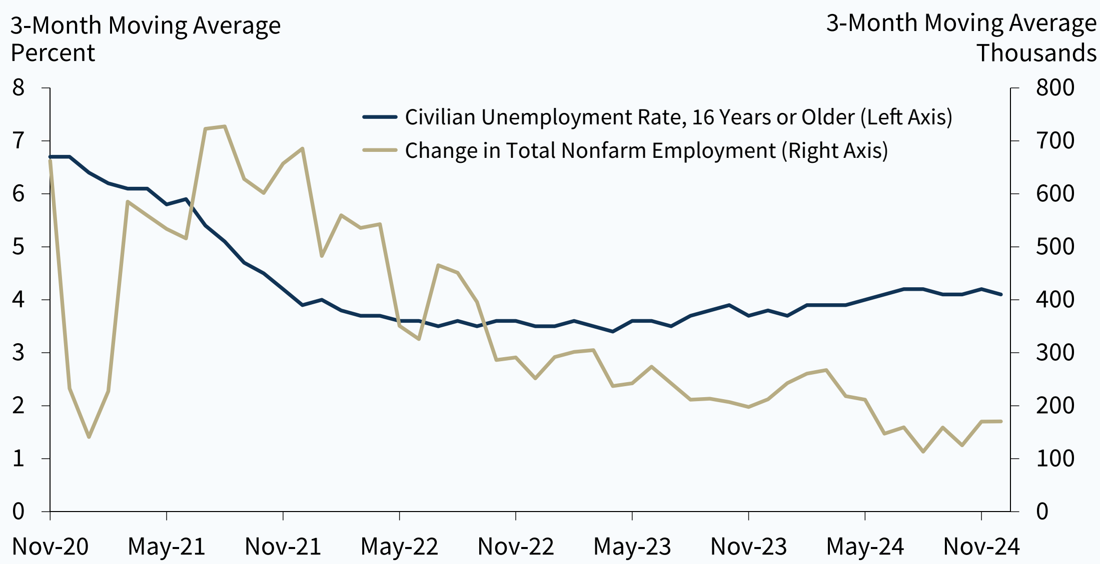
increased, resulting in more muted declines in core inflation, which excludes more volatile components of food and energy. Shelter inflation, which has been sticky, remained elevated as supply and affordability continued to pressure prices.

Labor markets cooled in 2024 as job openings and labor supply became more balanced. The number of job openings, which had been historically high, dropped to pre-pandemic levels in 2024, and the labor force participation rate of the working age population continued to trend higher. Average monthly payroll employment gains slowed in 2024, and the unemployment rate increased from multi-decade lows reached in previous years (Chart 2). As the labor market cooled, average wage gains also slowed, but wage gains remained above inflation.

Interest rates were elevated for much of 2024. The Federal Reserve Federal Open Market Committee (FOMC) held the federal funds target rate steady until its September 2024 meeting, and the Federal Reserve continued reducing its security holdings. The Federal Reserve's balance sheet contracted by more than 10 percent, ending 2024 around $6.8 trillion. With inflation progressing toward the 2 percent goal, the FOMC lowered the target federal funds rate 50 basis points in September, 25 basis points in November, and 25 basis points in December.

CHART 2

Average Monthly Job Gains Slowed and the Unemployment Rate Increased Mildly in 2024



Source: Bureau of Labor Statistics (Haver Analytics).
Note: Data are monthly through December 2024.

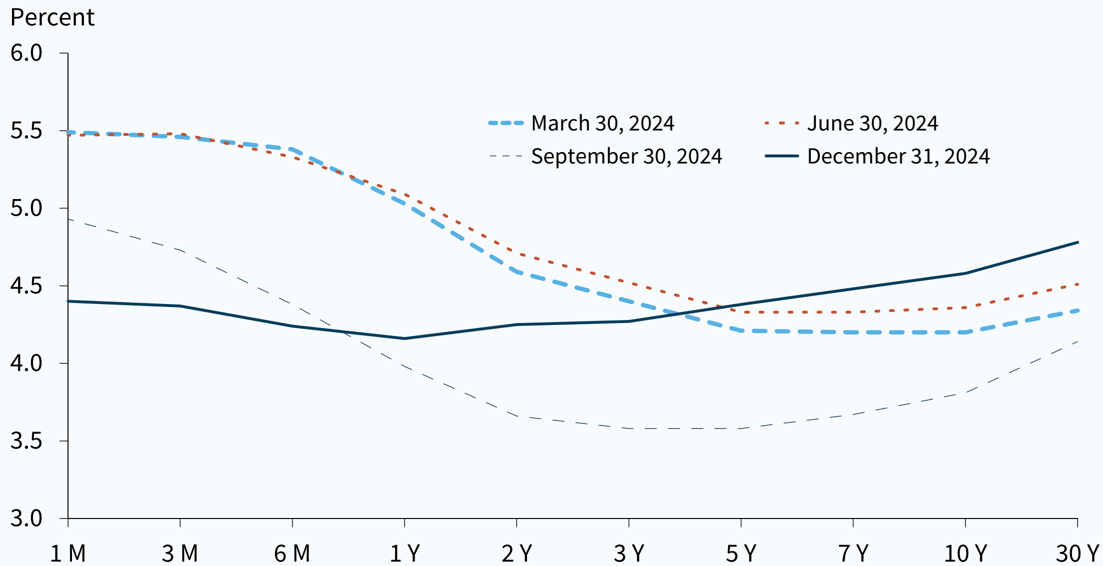
The yield curve ended 2024 with a positive slope, the first time in more than two years. Shorter-term interest rates declined during the year, while longer-term interest rates fluctuated but ended the year higher. The ten-year Treasury yield ended 2024 at 4.58 percent, 63 basis points above its yield at the start of 2024, while the two-year Treasury yield ended 8 basis points lower at 4.25 percent. Through the first half of the year, the compression of yields across medium- and long-maturity Treasuries and the decline in short-term interest rates flattened the yield curve, which had been inverted since mid-2022 (Chart 3). Higher longer-term yields toward the end of 2024 contributed to a positive sloping yield curve.

Conditions in the corporate bond market remained favorable. Bond issuances were higher in 2024 than in previous years, with high-yield issuances more than 60 percent higher than in 2023 and investment-grade issuances more than 20 percent higher. Spreads on both high-yield and investment-grade bonds tightened despite a temporary widening amid volatility in August. The options-adjusted spread on investment-grade bonds ended the year at 0.82 percent, and the spread on high-yield bonds ended at 2.92 percent. While prices of U.S. high-yield corporate bonds broadly rose in 2024, prices on U.S. investment-grade bonds increased through the third quarter before declining to levels slightly below those at the start of the year. Leveraged loan prices fluctuated through the first three quarters but rose at the end of the year. Short-term funding markets remained stable, with no meaningful disruptions during the year.

Equities performed well across most sectors. The S&P 500 Index reported a total return of 24 percent in 2024. Equity market growth in the final months of the year was broad-based, reflecting in part lower interest rates and economic data suggesting continued growth. Despite elevated interest rates for much of the year, bank stock indices were up in 2024.

CHART 3

The Yield Curve Uninverted in Fourth Quarter 2024



Source: CapitalIQ.
Note: 1M, 3M, 6M, and 1Y denote the Treasury bond yields. 2Y, 3Y, 5Y, 7Y, and 10Y represent Treasury note yields. 30Y denotes the Treasury bond yield.

Banking Performance Overview

- **The banking industry was resilient in 2024.**
- **The industry's net income in 2024 was well above pre-pandemic levels; asset quality metrics remained favorable; liquidity was stable; and capital levels increased.**
- **The industry continued to report elevated unrealized losses and asset quality weaknesses in certain loan portfolios.**
- **Community banks generally fared better than the rest of the industry in deposit growth and loan growth rates but reported higher expenses, which reduced their income.**

The banking industry's net income increased in 2024 and remained historically high. The banking industry's net income increased 5.6 percent to $268.2 billion in 2024 and remained above levels reported before the pandemic (Chart 4). Industry aggregate return on assets (ROA) increased 3 basis points to 1.12 percent, up from 1.09 percent in 2023 but below the pre-pandemic level of 1.14 percent, due to strong asset growth in the pandemic years of 2020 to 2022. The increase in net income primarily occurred due to one-time events in 2023 and 2024 that led to lower noninterest expense (down $8.5 billion or 1.4 percent), higher noninterest income (up $6.0 billion, or 2.0 percent), and lower realized securities losses (down $5.3 billion, or 46.3 percent) in 2024. Although increases in the federal funds rate ended in 2023, deposit costs continued to increase modestly in 2024. As a result, annual NIM fell 8 basis points in 2024 to 3.22 percent, as growth in full-year funding costs exceeded growth in full-year asset yields. Provision expenses increased 3.6 percent in 2024 as net charge-offs increased as well.

Unrealized losses on securities portfolios increased in 2024. Unrealized losses on securities totaled $482.4 billion in the fourth quarter, up 1.0 percent from fourth quarter 2023 (Chart 5).[2] While some banks repositioned securities portfolios during the year, taking realized losses, longer-term interest rates, in particular the 30-year mortgage and the 10-year Treasury rates, were higher than they were at the end of 2023, decreasing the value of securities on banks' books. See Section 3: Market Risks for more information.

While still positive, the industry's loan growth remained subdued in 2024, and underwriting standards remained tight for most loan categories. Total loan and lease balances increased 2.2 percent in 2024 after increasing 1.8 percent in 2023 (Chart 6). The largest portfolio increases were reported in "all other" loans and loans to non-depository financial institutions, largely due to reclassifications in reporting loans. Reclassifications also likely caused declines in other loan categories from which the loans were reclassified, particularly C&I and "other" consumer loans. In addition to these reclassifications, CRE loans, credit card loans, residential mortgages, and organic growth in loans to non-depository financial institutions contributed to annual loan growth. Bank underwriting standards remained tight for most loan categories and loan demand remained weak, according to the January 2025 Federal Reserve Senior Loan Officer Opinion Survey on Bank Lending Practices.

Although asset quality metrics remained favorable overall, some portfolios had elevated levels of delinquent loans. The PDNA loan ratio increased 14 basis points from the year-earlier quarter to 1.60 percent but remained below the pre-pandemic average of 1.94 percent. Annually, the industry reported the largest PDNA increases in CRE and C&I loan portfolios. Moreover, certain loan categories had higher PDNA rates compared to their pre-pandemic averages, primarily auto, CRE, credit card, and C&I loan portfolios.

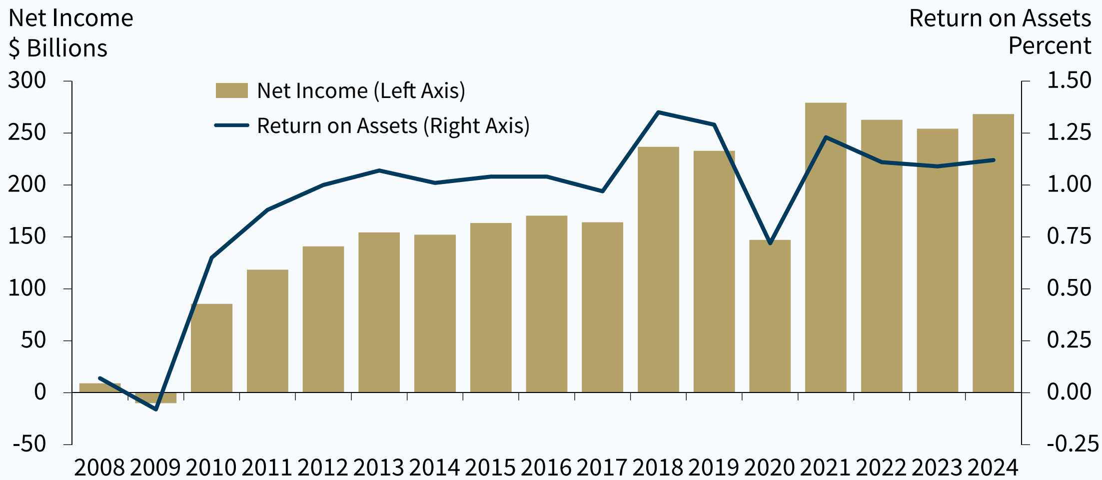
The net charge-off ratio remained above its pre-pandemic average with a slight increase in 2024 to 0.70 percent, the highest level since second quarter 2013. Credit card, C&I, and multifamily CRE loan net charge-offs drove the annual increase.

[2] Unrealized losses on securities reflect the difference between the market value as of quarter-end and the book value of non-equity securities. This calculation does not account for any unrealized gains or losses in accumulated other comprehensive income because these cannot be derived from Consolidated Reports of Condition and Income (Call Reports).

Deposits increased modestly in 2024. Total domestic deposits increased 2.3 percent from fourth quarter 2023 to $17.7 trillion. Estimated insured deposits increased only 0.5 percent in 2024, while estimated uninsured domestic deposits reversed a decline in 2023 with an increase of 5.4 percent in 2024. See Section 3: Market Risks for more information.

CHART 4

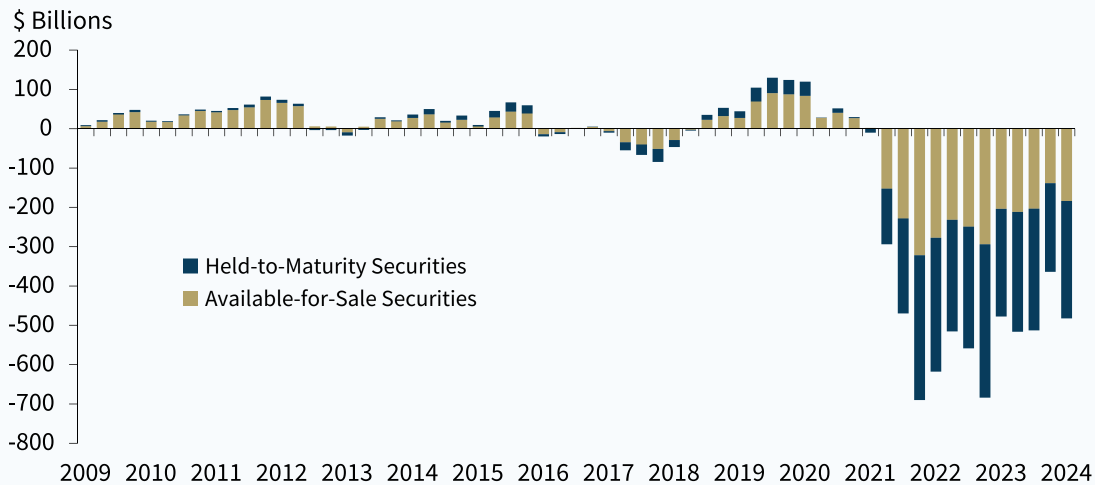
Full-Year 2024 Net Income Remained Well Above the Pre-Pandemic Level



Source: FDIC.
Note: Data are annual through 2024.

CHART 5

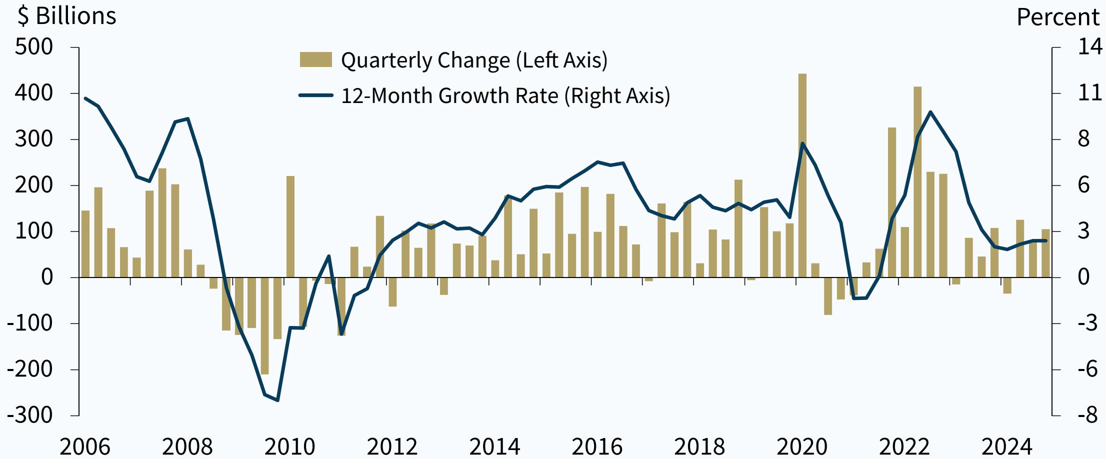
Unrealized Losses on Investment Securities Remained Elevated at Year-End 2024



Source: FDIC.
Note: Quarterly data as of fourth quarter 2024. Insured Call Report filers only. Unrealized losses on securities solely reflect the difference between the market value and book value of non-equity securities as of quarter end. This chart does not reflect unrealized gains or losses in other parts of the balance sheet.

CHART 6

Loan Growth Increased from 2023, but Remained Subdued



Source: FDIC.

Note: Quarterly data as of fourth quarter 2024. ASC Topics 810 and 860 resulted in the consolidation of large amounts of securitized loan balances back onto banks' balance sheets in the first quarter of 2010. Although the amount consolidated cannot be precisely quantified, the industry would have reported a decline in loan balances for the quarter absent this change in accounting standards.

Capital levels benefited from positive retained earnings. The industry's equity capital increased $118.9 billion (5.2 percent) from 2023. Retained earnings were positive, supporting equity capital levels. The leverage capital ratio increased 15 basis points from 2023 to 9.28 percent, and the tier 1 risk-based capital ratio increased 35 basis points to 14.27 percent.

The number of problem banks in the industry increased in 2024 but remained moderate. The number of banks on the FDIC's "Problem Bank List" increased from 52 at year-end 2023 to 66 at year-end 2024.[3] The number of problem banks represented about 1.5 percent of banks in the industry, in the normal range for non-crisis periods. Two banks failed in 2024.

Community banks generally fared better than the rest of the industry during the year in deposit growth and loan growth rates but reported higher expenses, which reduced their income. Community bank net income in 2024 fell 2.4 percent from 2023. While community banks reported larger growth in both interest and noninterest income, they also reported larger growth in noninterest expenses and provisions compared to the rest of the industry. Community bank pre-tax ROA declined 8 basis points to 1.14 percent from 2023 to 2024. Higher funding costs compressed margins for community banks in 2024; the community bank NIM was 3.33 percent, down from 3.39 percent in 2023.

Community banks reported loan growth of 5.1 percent in 2024, higher than the rest of the industry. Loan growth was broad-based across portfolios and was strongest in the CRE and 1–4 family residential portfolios. No major loan portfolio declined. Similar to the rest of the industry, community banks reported higher PDNA rates compared to 2023, but PDNA rates remained lower than their pre-pandemic averages. Community bank net charge-off rates were also higher in 2024 than in 2023 and above their pre-pandemic averages.

Community banks reported a larger increase in domestic deposits than the rest of industry, with a 4.7 percent increase in 2024.

Capital levels at community banks increased in 2024, with community bank equity rising $17.4 billion (6.7 percent) from 2023. The community bank leverage ratio (CBLR) for the 1,629 community banks that elected to use the CBLR framework increased from 12.18 percent at the end of 2023 to 12.22 percent at year-end 2024.

[3] Banks on the FDIC's Problem Bank List have a CAMELS composite rating of "4" or "5."

SECTION 3
Market Risks

Net Interest Margins, Liquidity, and Funding

- **The banking industry's annual net interest margin (NIM) declined as growth in funding costs outpaced growth in asset yields. Quarterly data indicate that the decline in NIM stabilized in the second half of the year.**
- **Unrealized losses on securities were little changed as longer-term interest rates remained elevated.**
- **On-balance-sheet liquidity levels were stable in 2024.**
- **Deposits increased for the first time since 2021 as uninsured deposit growth resumed.**
- **Wholesale funds declined from 2023. Wholesale funds as a share of assets were within pre-pandemic norms.**

The banking industry's annual NIM declined in 2024. Although increases in the federal funds rate ended in 2023, deposit costs continued to increase modestly in 2024. As a result, annual NIM fell 8 basis points in 2024 to 3.22 percent, as growth in full-year funding costs exceeded growth in full-year asset yields. About 53 percent of banks reported a year-over-year decline in annual NIM.

Quarterly data show that the decline in industry NIM subsided by mid-year, and banks reported modest NIM expansion during the second half of 2024, primarily due to a decline in funding costs in the fourth quarter (Chart 7). A reduction in deposit costs, down 16 basis points, drove the decline in total funding costs during the fourth quarter. Other borrowing costs, including the cost of Federal Home Loan Bank (FHLB) advances and other borrowings, fell 8 basis points during the quarter. Asset yields also fell during the fourth quarter, driven by a decline in income on balances due from other depository institutions and lower C&I loan yields. The NIM in fourth quarter 2024 was 3.28 percent, unchanged from 2023 but up 12 basis points from its second quarter trough.

Lower short-term interest rates have helped ease funding costs, but the overall impact of interest rate changes on industry NIM is uncertain. Despite lower shorter-term rates, longer-term rates remained elevated toward the end of 2024. Because assets and liabilities take time to reprice, the decline in rates in the final four months of 2024 is not fully reflected in the bank results discussed above. It is unclear how industry NIM will perform given the recent shifts in short-term and other interest rates: NIM tends to fall when short-term rates fall but rise when the yield curve steepens.[4] Although the yield curve remained relatively flat, the spread between the ten-year Treasury note and the three-month Treasury bill increased 173 basis points in 2024, the largest annual change since 2008.

A decline in short-term rates typically eases pressure on bank funding costs. Lower funding costs supported margin recovery at banks that reported the greatest NIM compression during and soon after the rising rate environment of 2022 and 2023.[5] This group of banks tended to be relatively liability-sensitive, meaning that their liabilities repriced more quickly than their assets. The median NIM for this group of banks declined 72

[4] For analysis on the response of NIM to changes in the federal funds rate, see Angela Hinton and Chester Polson, "The Historic Relationship Between Bank Net Interest Margins and Short-Term Interest Rates," FDIC Quarterly 15, no. 2. For analysis on the response of NIM to changes in yield curve shape, or term premia, see Pascal Paul, "Banks, Maturity Transformation, and Monetary Policy," Journal of Financial Intermediation 53, January 2023.

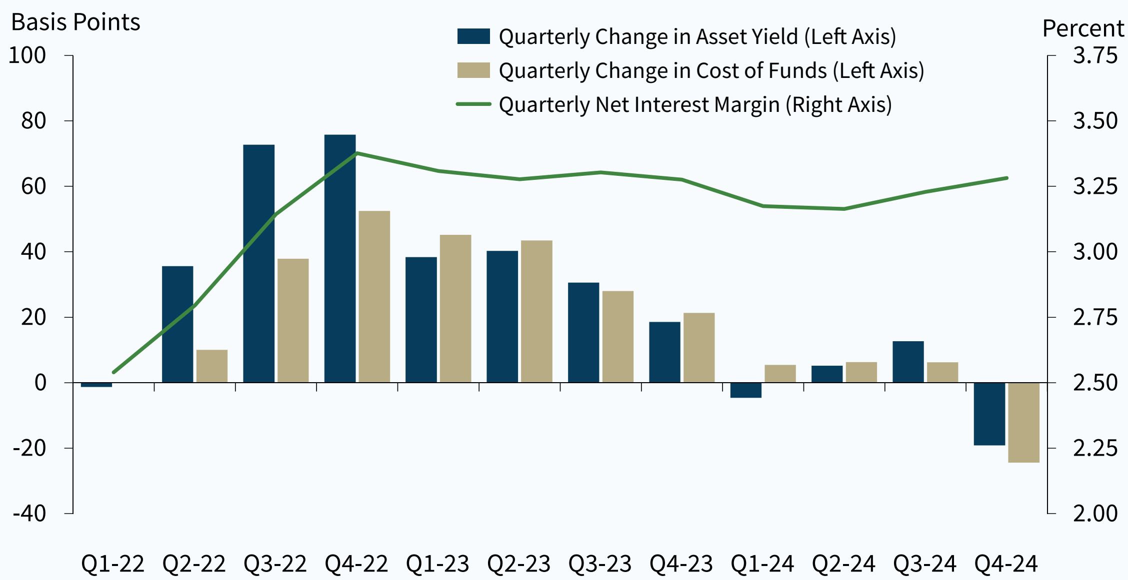
[5] Banks that reported the greatest NIM compression were those in the bottom quartile for change in NIM from fourth quarter 2021 to second quarter 2024.

basis points, from 3.47 percent to 2.75 percent, during and soon after the period of rising rates. As short-term rates declined in late 2024, the median NIM for these banks rebounded to 2.99 percent by year-end 2024, a larger rebound than the rest of the banking industry.

Even as short-term rates declined, unrealized losses on bank securities portfolios remained elevated, weighing on profitability. Bank securities portfolio values are more closely linked to long-term interest rates, which remained elevated even as short-term interest rates declined. Unrealized losses were $482 billion in fourth quarter 2024, or 8.4 percent of the securities' amortized cost. These losses represent a drag on future earnings and present immediate earnings risk should securities need to be sold or should a bank choose to restructure its balance sheet. Some banks repositioned their portfolios and sold securities, which contributed to higher realized losses. The amount of realized losses on securities in 2024 increased to $16.1 billion, up 33.9 percent from a year earlier, though the number of institutions realizing losses on securities sales was 1,040, down from 1,481 a year earlier. While securities sales contributed to higher realized losses in 2024, they helped lower unrealized securities losses.

CHART 7

Asset Yields and Cost of Funds Began Declining at the End of 2024

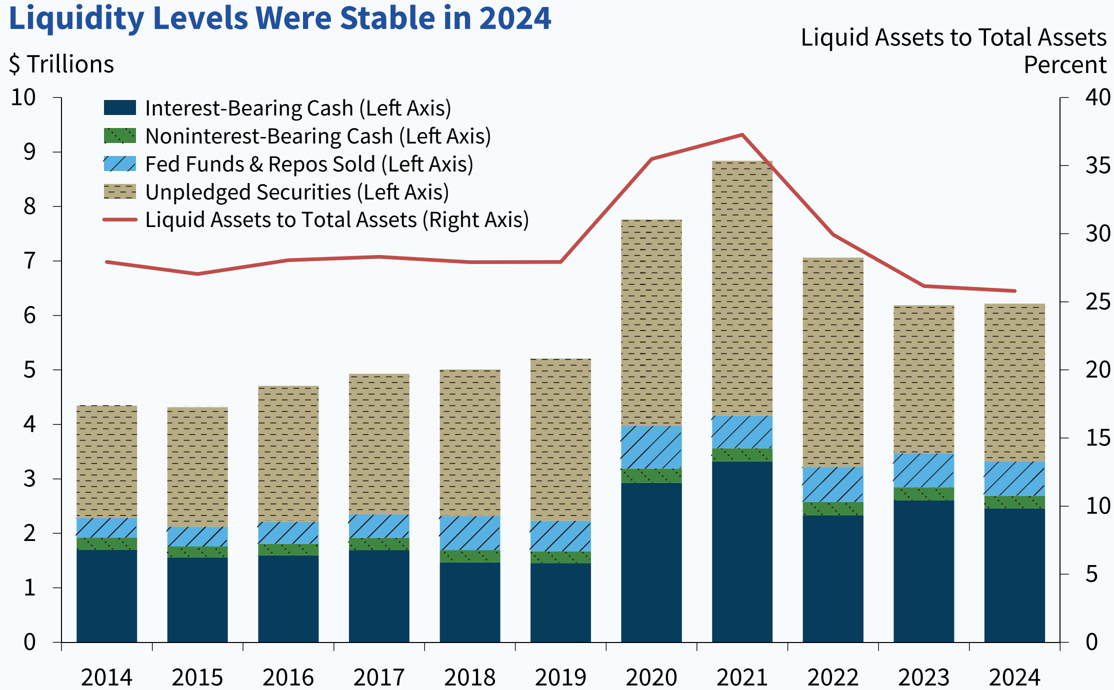


Source: FDIC.
Note: Data are quarterly through fourth quarter 2024. In a previous version of this chart, the data shown were for FDIC-defined community banks only. The chart has been replaced and now reflects data for all FDIC-insured institutions.

Liquidity levels were generally stable throughout the year. On-balance-sheet liquid assets increased modestly in 2024, slightly below the rate of total asset growth. As a result, the ratio of liquid assets to total assets declined marginally to 25.8 percent (Chart 8). The industry's liquidity ratio was below its pre-pandemic average in 2024, but higher levels of pledged securities that may not have been drawn upon were a drag on liquidity during the year.[6] The ratio of pledged loans and securities to total assets was 36.1 percent in 2024, compared to a pre-pandemic average of about 30 percent. Borrowings as a share of total assets have declined since the pandemic, suggesting bank borrowing capacity is more robust. The industry's ratio of highly liquid assets—liquid assets excluding securities—to total assets declined modestly from 2023 but remained above its pre-pandemic average.

CHART 8

Liquidity Levels Were Stable in 2024



Source: FDIC.
Note: Data are annual through 2024.

[6] Pledged securities are removed from the calculation of liquid assets, but some of these securities may be unencumbered and available to secure additional liquidity.

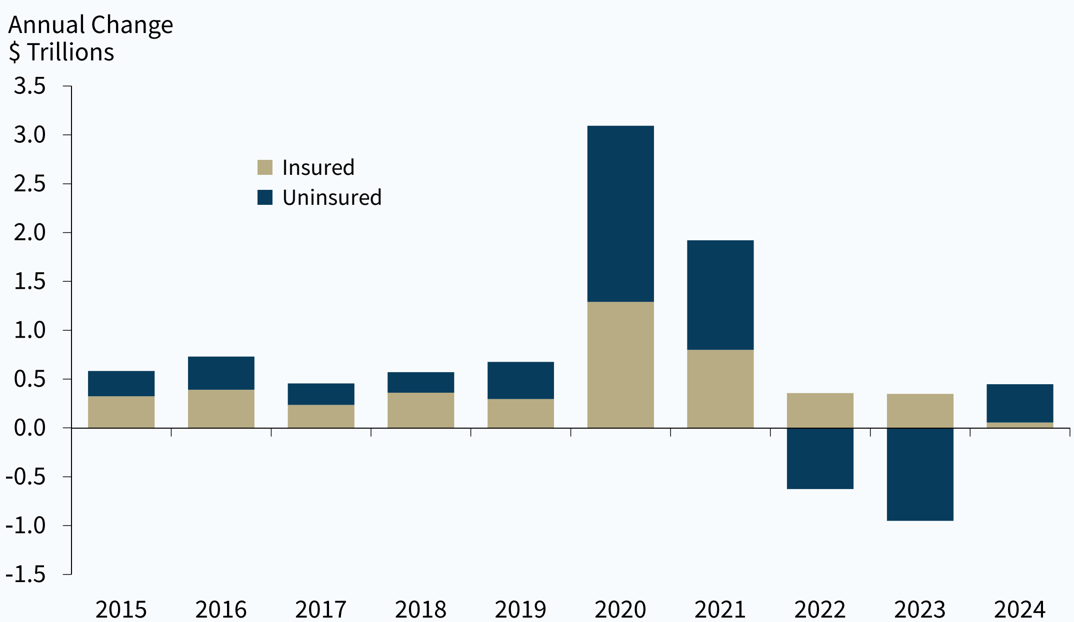
Deposit growth resumed in 2024 after declining for two consecutive years. Total domestic deposits increased 2.3 percent, supported by growth in insured deposits and a resumption of growth in uninsured deposits (Chart 9). Insured deposit growth slowed after increasing substantially the previous four years. Noninterest-bearing deposits declined for the third consecutive year and made up just 21.8 percent of total domestic deposits at the end of the year, the lowest share reported since 2010. Interest-bearing time deposits grew just 0.6 percent from 2023, a significant slowdown from the pace of growth last year.

Banks reduced reliance on wholesale funds. Wholesale funds declined 3.1 percent during the year, a significant reversal from the 18 percent annual growth rate in 2022 and 2023. The ratio of wholesale funds to total assets fell to 21.3 percent (Chart 10). Declines in brokered deposits and FHLB borrowings more than offset growth in repurchase agreements, federal funds purchased, and listing service deposits. The ratio of wholesale funds to total assets remained well below its pre-pandemic average.

Community bank market risks followed roughly the same pattern as the rest of the industry in 2024. Like the rest of the industry, community banks reported a decline in annual NIM, but quarterly data show that the decline reversed to an upward trend during the year. Community bank quarterly NIM in fourth quarter 2024 was 3.44 percent, up 21 basis points from its trough in the first quarter. The liquidity ratio at community banks increased slightly from a year earlier, but, similar to the rest of the industry, the ratio remained below pre-pandemic norms partly due to increases in pledged securities that were pre-positioned to secure contingent financing (Chart 11). The community bank ratio of highly liquid assets to total assets increased modestly from 2023 and exceeded its pre-pandemic average. Deposit growth was stronger at community banks than it was in the industry overall and increased 4.7 percent from 2023. Community banks' reliance on wholesale funding declined, reflecting in part deposit growth.

CHART 9

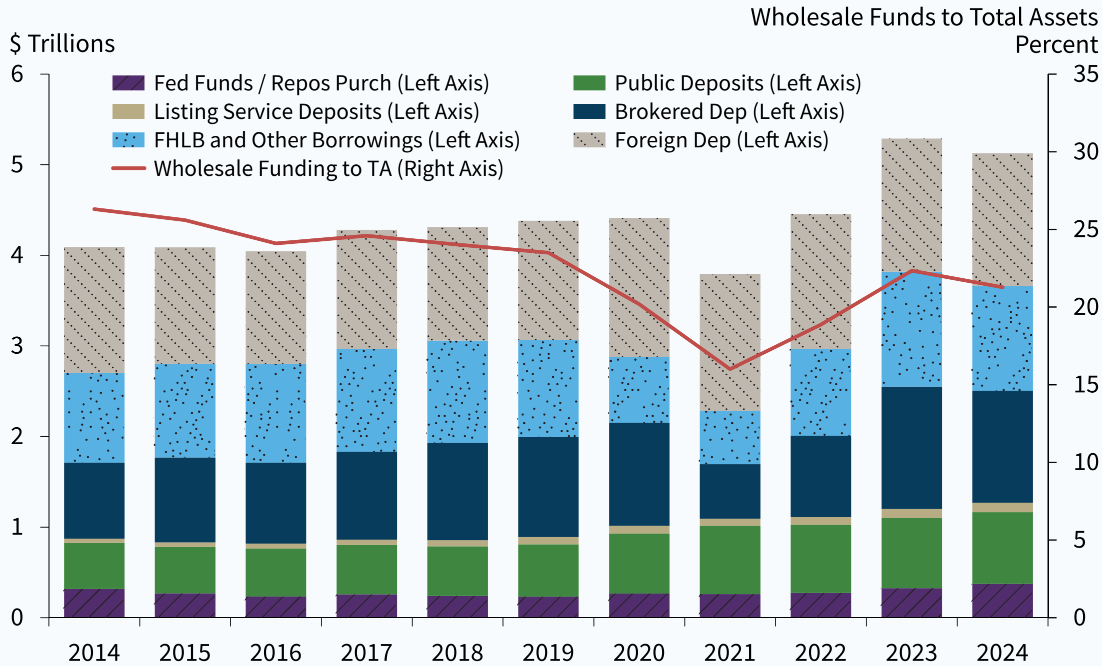
Domestic Deposit Growth Resumed After Two Consecutive Years of Uninsured Deposit Declines



Source: FDIC.
Note: Data are annual through 2024.

CHART 10

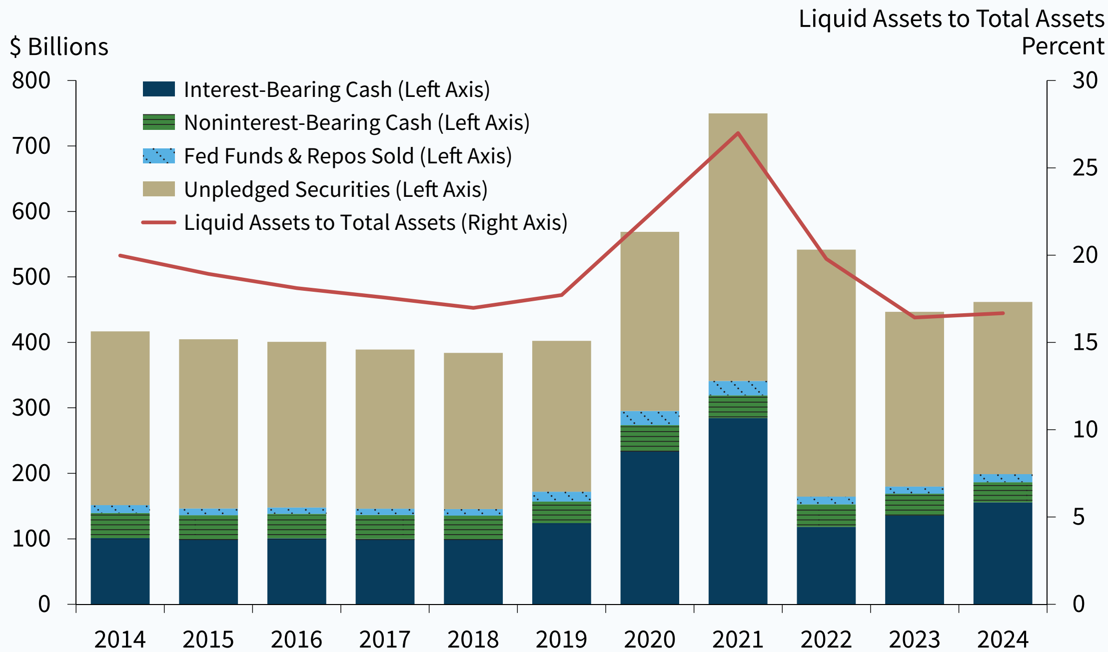
Wholesale Funds Declined in 2024 After Rising in the Prior Two Years



Source: FDIC.
Note: Data are annual through 2024. FHLB stands for Federal Home Loan Bank.

CHART 11

Community Bank Liquidity Increased Modestly in 2024



Source: FDIC.
Note: Data are annual through 2024.

PAGE INTENTIONALLY LEFT BLANK

SECTION 4
Credit Risks

Commercial Real Estate

- **Commercial real estate (CRE) conditions were uneven in 2024. Office underperformed other property types and is expected to continue to underperform in 2025.**
- **High interest rates continued to inhibit refinance capabilities of CRE loans as borrowing costs rose, while property-level cash flows weakened on rising operating costs, elevated vacancy rates, and slower rent growth.**
- **CRE loan growth slowed in 2024, and the volume of CRE loans scheduled to mature in 2025 remained high.**
- **CRE loan performance deteriorated, but charge-off ratios remained far below levels reached during and soon after the Great Recession. Deterioration was more pronounced among larger banks, but other banks had higher exposures to CRE loans.**

CRE conditions varied by property type and market in 2024. Vacancy rates rose and rent growth slowed across most property types. CRE performance varied widely by property type, with office continuing to underperform other sectors. Although headwinds remain, particularly in office, vacancy rates are expected to moderate (Chart 12).

The office sector continued to underperform in 2024, reflecting the structural shift in demand associated with remote work. Net absorption was negative for the third consecutive year, meaning that more space was vacated than newly leased.[7] Newly delivered space also contributed to the rise in the office vacancy rate, which increased from 13.3 percent to 13.8 percent in 2024.

Historically high vacancy rates in office were driven by weakness in the largest cities. Vacancy rates reached 15.2 percent in the top 20 office markets by total square footage in fourth quarter 2024, compared to 8.4 percent in other markets. As a result of the limited demand for office space and rising vacancy rates, rent growth for the sector remained relatively stagnant, reflecting a 1 percent year-over-year increase. Office conditions are expected to remain weak in 2025, with continued negative net absorption, rising vacancy rates, and weaker rent growth.

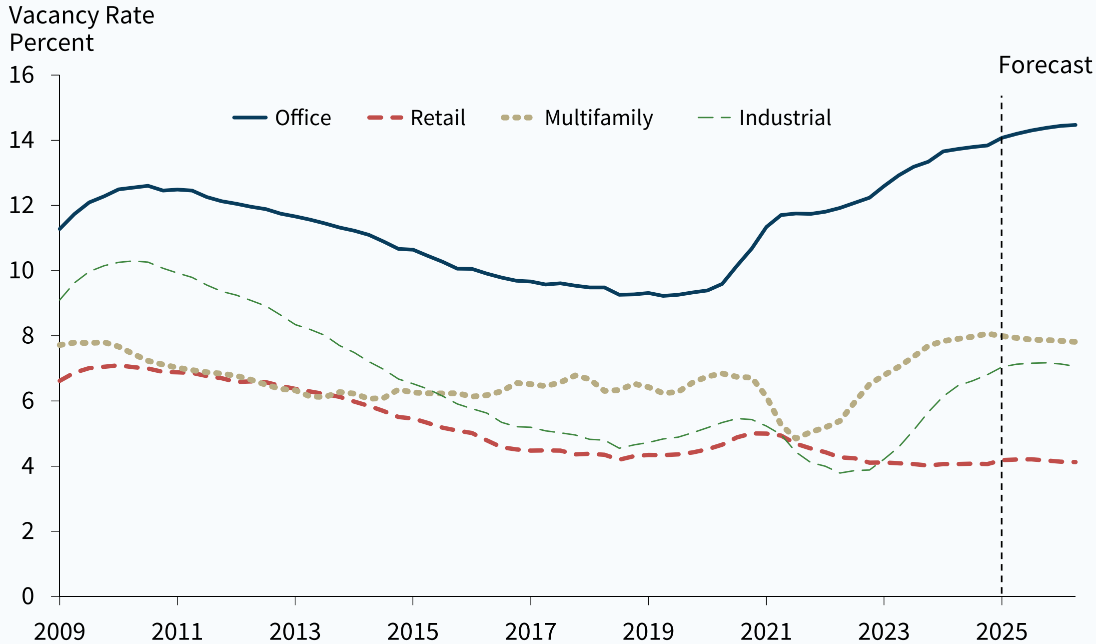
Supply factors weighed on other CRE property types in 2024. Vacancy rates increased for both multifamily and industrial properties in 2024, driven largely by elevated levels of newly delivered space. Vacancy rates for multifamily properties increased to 8.1 percent in fourth quarter 2024 from 7.7 percent the year before, while vacancy rates for industrial properties increased to 6.8 percent from 5.7 percent the year before. Construction of multifamily and industrial properties has been historically high for several years. The number of new apartments delivered in the past five years was roughly equal to the number delivered in the preceding decade, while the amount of industrial space delivered in the past five years exceeded the total space delivered in the preceding decade. Despite relatively stable demand, the boom in construction and resulting increase in vacancy rates were a drag on rent growth in both property segments.

Retail property vacancy rates remained largely unchanged as the amount of newly delivered space was relatively low and in line with sector demand.

[7] Absorption, completions, vacancy, and rent growth data are from CoStar as of fourth quarter 2024.

CHART 12

Vacancy Rates Increased Across Most Property Types in 2024



Source: CoStar.
Note: Data are quarterly through fourth quarter 2024, with forecast data through second quarter 2026.

Rent growth for retail properties declined in 2024 but remained solid at 2.0 percent. Mall properties continued to underperform with an overall vacancy rate more than twice that of other retail property types. Mall properties may continue to face headwinds in 2025, but retail vacancies in general are expected to remain relatively unchanged with stable rent growth.

In addition to rising vacancies and slowing rent growth, higher operating costs also weighed on property-level income in 2024. Recent inflationary pressures have affected CRE operating costs, with property-level expenses including insurance, taxes, maintenance costs, and debt service rising notably in recent years. Although the cost of insurance as a share of CRE income remained relatively low, it has doubled in the past five years.[8] Debt service costs, a larger expense item, also increased substantially in recent years as interest rates rose. Weighted average loan rates increased more than 200 basis points in office and multifamily loans between 2022 and 2024.[9] Rising expenses, slower rent growth, and rising vacancies negatively affected net operating income for CRE property, which could affect repayment capacity for borrowers. This is particularly troublesome for office properties, which experienced outright declines in net operating income in 2024. Other property types faced more modest declines (Chart 13).

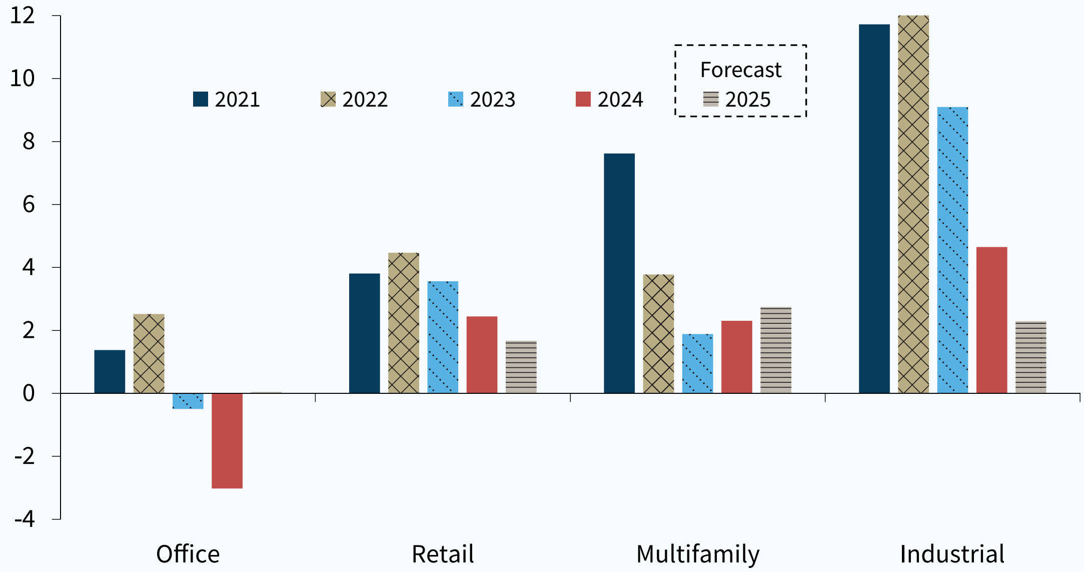
CRE property prices stabilized in 2024 with incremental improvement across most sectors (Chart 14). As of December 2024, office property values remained significantly below the pre-pandemic level (down 39 percent), while most other property types were roughly near pre-pandemic levels. Only industrial properties experienced a meaningful increase since the pandemic (30 percent above pre-pandemic). Uncertainty about the path of interest rates and credit performance in 2025 could negatively affect CRE property values. Higher interest rates put downward pressure on CRE values because capitalization rates increase on investor expectations

[8] MSCI Real Capital Analytics, "Insurance Has Bigger Bite of Commercial Property Income," December 9, 2024.
[9] Trepp, "Refinancing Maturing Commercial Real Estate Loans: An Interest Rate Analysis," December 2024.

CHART 13

Net Operating Income Growth Declined in 2024

Year-Over-Year Change in Net Operating Income
Percent

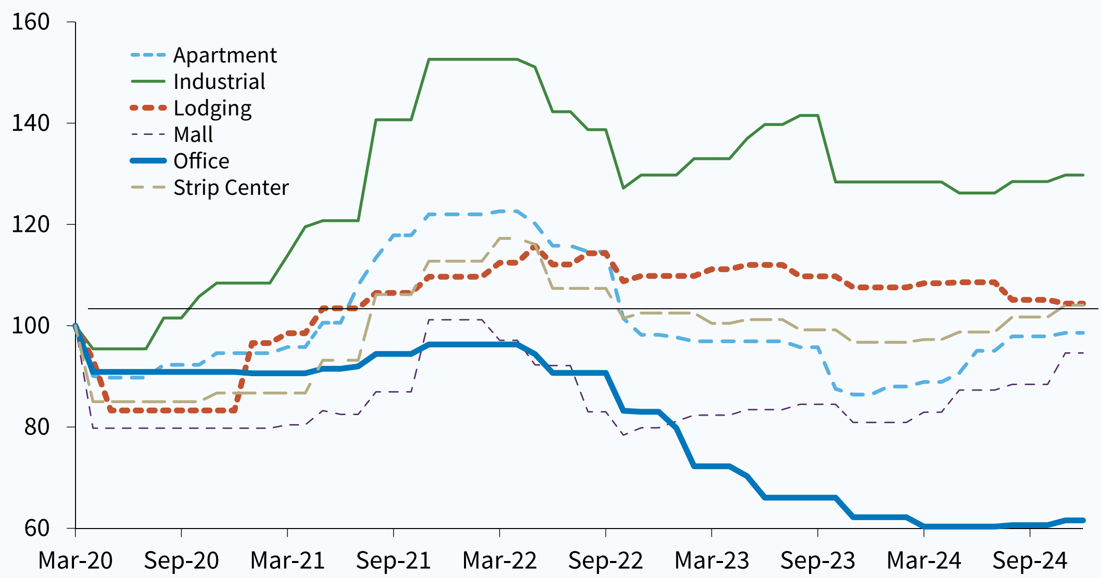


Source: CoStar.
Note: Data are annual through fourth quarter 2024. Forecast data are quarterly through 2025.

CHART 14

CRE Values Stabilized Across Most Sectors in 2024

Commercial Property Price Index
March 2020 = 100



Source: Greenstreet.
Note: Data are monthly through December 2024. CRE stands for commercial real estate.

of higher returns and borrowing costs rise for term borrowings such as CRE loans.

The volume of all CRE loans scheduled to mature in 2025 remains high. CRE loans maturing or reaching interest rate reset periods could face difficulties with interest rates still well above the levels for loans issued before 2023. Higher vacancy rates, slower rent growth, and recent pressures on collateral protection may also weigh on CRE loan performance. These concerns are particularly acute for office property loans, which account for nearly one-quarter of CRE maturities in 2025 (Chart 15).

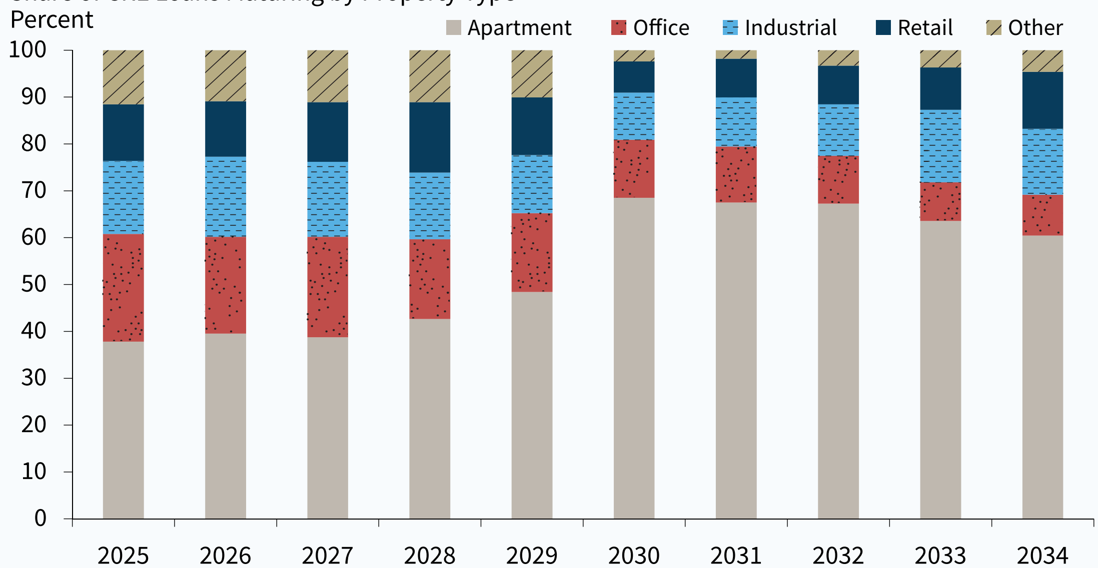
Amid the uncertain operating environment and elevated interest rates, CRE loan growth slowed in 2024. CRE loans held by banks reached $3.2 trillion in fourth quarter 2024, a record level in dollar volume but, relative to bank assets and total loans, unchanged from a year earlier. Nonfarm nonresidential (NFNR) loans ($1.8 trillion) remained the largest component of the CRE loan portfolio, followed by multifamily loans ($628.8 billion). Bank NFNR and multifamily loan portfolios expanded from a year earlier. Elevated interest rates and apprehensions around economic and geopolitical uncertainties tempered the pace. Quarterly growth for the NFNR loan portfolio was limited, averaging less than half of a percent in 2024. Multifamily loan growth was also subdued, averaging 1 percent in the first three quarters of 2024 before the portfolio slightly decreased in fourth quarter 2024. The acquisition, development, and construction (ADC) loan portfolio contracted in 2024. ADC loans totaled $484.1 billion, representing only 15 percent of the CRE portfolio at year-end 2024, compared to more than 33 percent leading into the Great Recession.

Credit risk continued to rise in the commercial mortgage-backed securities (CMBS) market. Nearly half of banks hold exposure to CMBS investments. However, credit risk is mitigated by the fact that more than 86 percent of total CMBS exposure held by banks consists of CMBS issued by U.S. government agencies and government-sponsored entities. The remaining 14 percent of CMBS exposure held by banks, or non-agency CMBS, had a total market value of $53 billion as of fourth quarter 2024, representing less than 3 percent of total industry capital.[10]

CHART 15

Office Loans Account for Nearly One-Quarter of CRE Maturities in 2025

Share of CRE Loans Maturing by Property Type



Source: MSCI Real Capital Analytics.
Note: Forecast annual data are 2025 through 2034. CRE stands for commercial real estate.

[10] Tier 1 capital.

CMBS delinquency rates increased for most major property types in 2024. The overall delinquency rate for CMBS loans increased to 6.57 percent in December 2024, up from 4.51 percent in 2023.[11] The increase in delinquency rates was driven largely by weakness in office and multifamily loans. CMBS office loan delinquency rates increased to 11.01 percent, surpassing the previous peak reached in 2012.

Despite deterioration from historically low levels during the past few years, primarily among larger banks, CRE PDNA and charge-off rates remained far below peaks reached during, and soon after, the Great Recession. CRE loan performance weakened in 2024, mainly reflecting weakness among office portfolios. At year-end 2024, after nine consecutive quarters of deterioration, the banking industry's total CRE PDNA ratio reached 1.42 percent, up from 1.08 percent one year earlier. In comparison, the CRE PDNA ratio grew to 7.52 percent by the end of the Great Recession (second quarter 2009) and eventually peaked at 8.90 percent in first quarter 2010. Higher PDNA ratios for the NFNR, ADC, and multifamily portfolios contributed to the overall rise in the CRE loan PDNA ratio in 2024.

Deterioration in CRE loan performance was most pronounced at larger banks, those with assets greater than $100 billion (Chart 16). At year-end 2024, the median CRE loan PDNA ratio at banks over $100 billion was 1.93 percent, up 55 basis points from year-end 2023 and considerably higher than the 0.36 percent reported at year-end 2019. In 2024, loans on office buildings, which are included in the NFNR category, were the greatest concern, driving some large banks to build their allowances for credit losses substantially. While the larger banks displayed worse CRE loan performance than their smaller counterparts, the larger banks' overall exposure to CRE loans remained modest and considerably below levels held by the other bank asset-size cohorts (Chart 17). The median CRE loan concentration ratio among banks over $100 billion was 69 percent at year-end 2024.

CRE loan PDNA ratios remained low relative to historical levels for community banks, but exposure to CRE loans remained high. Ninety percent of banks are community banks, which generally have low exposure to large urban office properties. This has helped temper PDNA ratios in community bank CRE loan portfolios. At the median, community banks' CRE loan PDNA ratio was 0.31 percent, up slightly from year-end 2023. The median CRE loan PDNA ratio at noncommunity banks with assets less than $100 billion was also low at 0.48 percent, 15 basis points higher than at year-end 2023.

CRE loan exposure levels remained highest among community banks and noncommunity banks with assets less than $100 billion (Chart 17). Almost all community banks held CRE loans, and 30 percent of community banks were CRE-concentrated as of fourth quarter 2024.[12] While community banks held just 15 percent of the banking industry's total loan portfolio, they held 29 percent of the CRE loans. Community banks' median CRE concentration ratio was 195 percent, up almost a percentage point from year-end 2023. Noncommunity banks with assets less than $100 billion have been an increasingly important source of CRE financing since the Great Recession. The median CRE concentration ratio for this subgroup was 258 percent at year-end 2024. Certain segments of banks were even more entrenched in CRE lending. For example, regional banks (banks with assets $10 billion to $100 billion) had median CRE loan concentrations of 289 percent and banks with assets $1 billion to $10 billion had median CRE loan concentrations of 314 percent. Banks smaller than $1 billion had a much lower median at 163 percent.

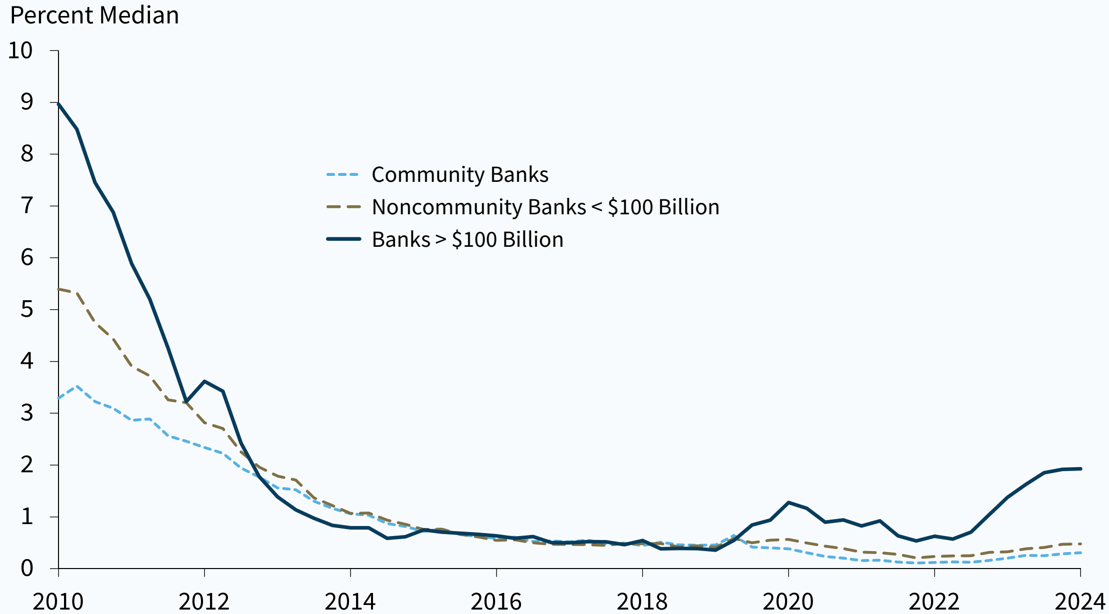
CRE loan quality and collateral values may continue to be a source of risk for banks. Concerns about weakness in the office sector remained high. Higher interest rates weighed on the CRE sector and increased refinancing risk for CRE borrowers. While larger banks experienced more deterioration in CRE loan performance than their smaller counterparts in 2024, balance sheets of regional banks and other smaller bank cohorts remained more exposed to CRE lending. Interest rates may continue to affect the CRE sector, including bank CRE loan performance.

[11] Trepp, CMBS Delinquency Report, December 2024.

[12] CRE-concentrated is total CRE loans >300 percent, or ADC loans >100 percent, of tier 1 capital and the allowance for credit losses. Unfunded commitments are not included. Roughly 31 percent of all banks (1,374 banks) were CRE-concentrated at year-end 2024, resembling year-end 2023.

CHART 16

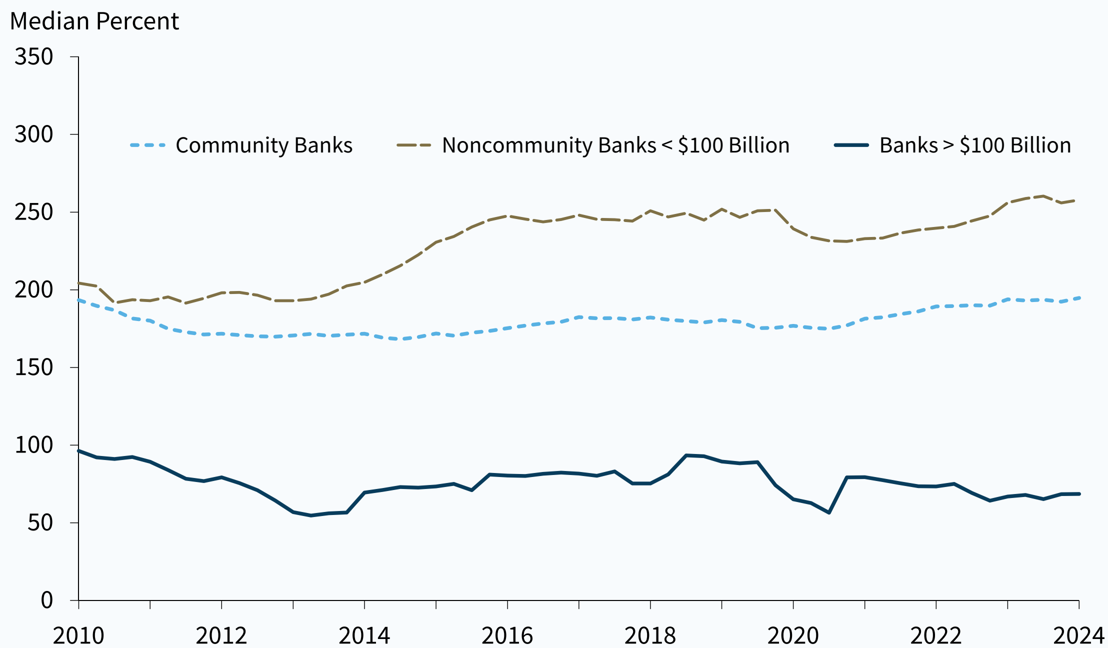
Largest Banks Had a Steeper Rise in CRE PDNA Ratio



Source: FDIC.
Note: Data are quarterly through fourth quarter 2024. CRE stands for commercial real estate. PDNA stands for past-due and nonaccrual.

CHART 17

CRE Concentration Level Varies by Bank Type



Source: FDIC.
Note: Data are quarterly through fourth quarter 2024. CRE stands for commercial real estate.

Non-Depository Financial Institution Lending and Private Credit

- **Bank lending to non-depository financial institutions (NDFIs) has grown rapidly since the Global Financial Crisis (GFC) and is heavily concentrated in banks with assets greater than $100 billion.**
- **Growth in alternative assets, particularly private equity and private credit, has played a key role in the evolution and growth of NDFI lending.**
- **While bank lending to NDFIs on the surface presents relatively low credit risk, several trends suggest vulnerabilities in the market.**

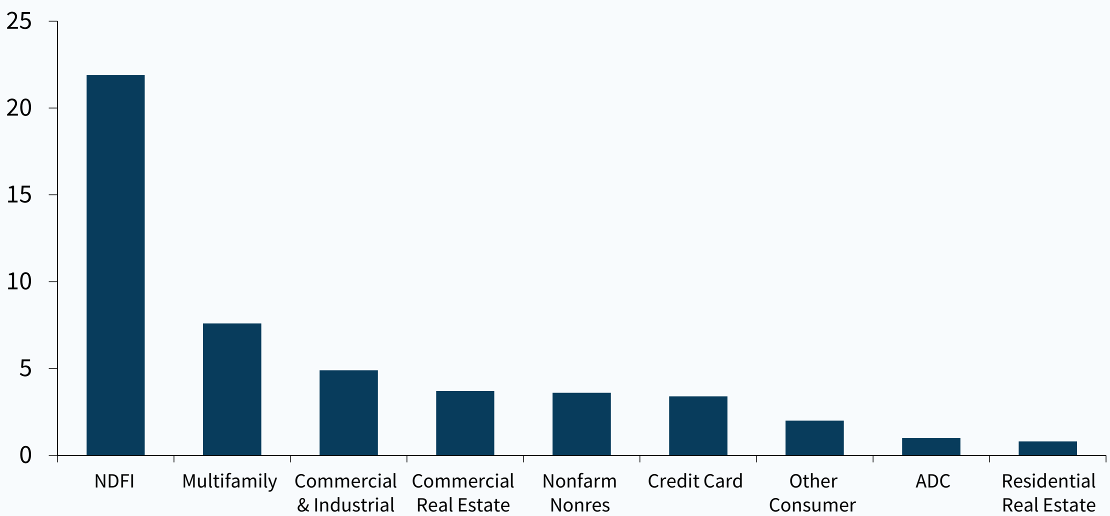
Bank loans to NDFIs have been the fastest growing loan segment since the 2008–2009 GFC, and the banking industry continues to increase its exposure to nonbanks through a variety of products and services, including direct loans. Banks provide vital liquidity and leverage to nonbanks in support of their daily operations or investment strategies, which may include intermediating credit for consumers and corporations or deploying investor capital across various asset classes. NDFIs include a wide range of entities and structures including private equity funds, mortgage lenders, private credit funds, insurers, Real Estate Investment Trusts, Business Development Companies, securitization vehicles, and other special purpose entities.

From 2010 through fourth quarter 2024, outstanding balances of bank loans to NDFIs had a compound annual growth rate (CAGR) of 22 percent, more than double the next highest sector, multifamily lending, which grew at an 8 percent CAGR (Chart 18). In 2024, NDFI loans grew 30 percent year over year; however,

CHART 18

Growth in Bank Loans to NDFIs Outpaced Other Major Loan Categories Since the 2008–2009 Great Financial Crisis

Compound Annual Growth Rate from 2010–2024
Percent



Source: FDIC.
Note: Data are annual through 2024. ADC stands for acquisition, development, and construction loans. NDFI stands for non-depository financial institution.

some of this growth is attributed to banks changing how some loans were categorized due to revised Call Report instructions on NDFI loans. As of December 31, 2024, bank loans outstanding to NDFIs totaled $1,039.5 billion, which represented 4 percent of total bank assets.

Bank loans to NDFIs are heavily concentrated in the largest banks. As of December 31, 2024, 87 percent of the NDFI balance was held by banks with assets over $100 billion (98 percent was held by banks with more than $10 billion in assets).[13] NDFI loans now make up a material portion of total loans outstanding at the largest institutions. Since 2010, for banks with assets over $250 billion, loans to NDFIs grew from 1 percent of total loans to 12 percent, and NDFI loans as a percentage of capital increased from 8 percent to 60 percent (Table 1). In contrast, for banks with assets under $10 billion, loans to NDFIs increased from 0.1 percent of total loans to 1 percent, and the NDFI capital concentration grew from 1 percent to 5 percent.

Several factors have contributed to the growth in NDFI loans at the largest banks over the past 14 years (Chart 19). Most of the growth in bank loans to NDFIs has been led by loans to private equity and private credit entities. Community banks typically lack relationships with such entities, while large banks have established relationships with NDFIs through a variety of services in their treasury management and investment banking arms. In addition, the size of NDFI loans is typically larger and outside of the risk appetite and capital capacity of community banks. Other factors underlying the growth in NDFI loans include banks seeking to reduce risk in direct lending in certain types of loans post-GFC, and stronger demand from investors seeking higher-yielding investments during a prolonged period of low interest rates. These factors drove significant growth in assets under management by NDFIs, which total more than $100 trillion and are three times larger than total assets held by U.S. banks (see box on “Private Credit” for more information).[14]

Key risks to banks include credit risk from their NDFI exposures, potential for looser underwriting standards in response to market competition, and shock to capital from NDFI stress. The composition and structure of bank loans to NDFIs generally exhibit a lower degree of credit risk. Most of the credit facilities to NDFIs are short-term revolving credit lines that are typically collateralized with conservative advance rates against the collateral pledged, providing a layer of loss protection. Supervisory observations reflect strong historical performance and more favorable credit ratings for banks’ loans to NDFIs compared to traditional commercial loans.

However, credit risk may emerge and result in losses exceeding past industry experience. As more entrants into the private credit sector emerge, increased competition could weaken underwriting and credit quality standards. Further, it can be particularly difficult for banks to assess the credit decisions and management of loans originated by private credit firms, resulting in potentially growing credit risk in

TABLE 1

Bank Loans to NDFIs Were Heavily Concentrated in Larger Banks

	Bank Size by Total Assets ($ Billions)			
Year	Over 250	100 to 250	10 to 100	Under 10
	NDFI Loans as a Percent of Total Loans			
2010	1	1	1	0.1
2024	12	10	5	1
	NDFI Loans as a Percent of Tier 1 Capital			
2010	8	7	5	1
2024	60	63	33	5

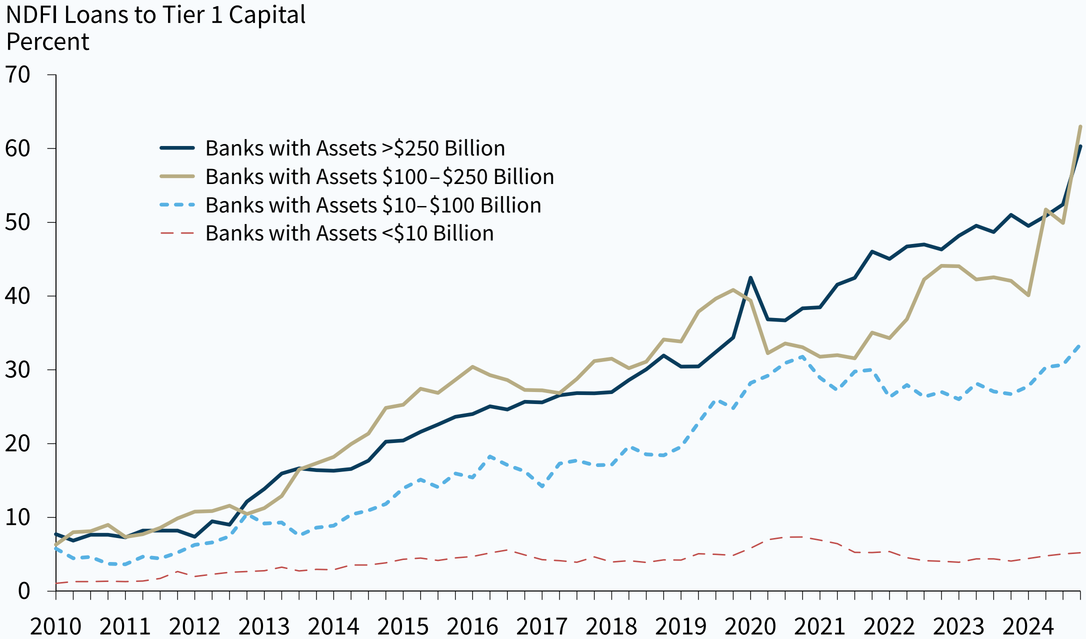
Source: FDIC calculations based on Call Report data.
Note: NDFI stands for non-depository financial institution.

[13] Financial Stability Oversight Council, FSOC 2024 Annual Report, December 2024.

[14] Federal Reserve Bank of New York, “The Basics of Nonbank Financial Institutions,” *The Teller Window*, November 21, 2024.

CHART 19

Larger Banks Have the Highest Concentration of Loans to NDFIs



Source: FDIC.

Note: Data are quarterly through fourth quarter 2024. NDFI stands for non-depository financial institution.

loans pledged as collateral under a bank facility. Finally, loans originated outside the banking system are not subject to the same safety and soundness standards as bank loans, which could lead to higher-risk lending across the financial system.

NDFI vulnerabilities also could pose direct credit risks to banks. Some NDFIs rely upon less-stable funding sources, such that in the event of an economic downturn they could face significant liquidity stress due to margin calls on collateral pledged under their bank facilities or pressures from high investor redemption rates. This could also increase liquidity demands at banks, as NDFIs collectively draw on bank-funded borrowing lines to safeguard operations. Private credit funds also provide committed revolving facilities to borrowers, a product type traditionally supported by banks. In the event of a downturn in private credit, many borrowers may find themselves without access to funding, causing more strain in the operating environment and headwinds for economic growth.

Another potential vulnerability is the growing number of banks providing capital call facilities or subscription loans, which are now one of the largest NDFI loan categories. These loans have traditionally provided short-term bridge financing to private equity and credit funds, facilitating operations while capital commitments are collected from limited partners. However, NDFIs have increasingly been using this product to further leverage their positions and improve returns. This practice deviates from the original intention and structure of the credit and increases the bank's risk to the investment decisions made by the private entity. In addition, not requiring the periodic paydown of a capital call line creates increased uncertainty about whether the limited partners will honor their capital commitments should the need for repayment of the bank financing materialize.

Finally, bank capital may be at risk from some NDFI loans being structured at origination to achieve lower asset risk weighting. If the credit quality of these loans suddenly declines, resulting in a default, the loans would be reclassified from a low risk weight to a higher risk weight, which could cause stress to a bank's regulatory capital ratios if a significant volume of these loans deteriorate.

Data on bank lending to NDFIs has provided limited visibility on NDFI subsegments. Until recently, banks have been required to report only their aggregate exposure to NDFIs. To improve transparency, the Federal Financial Institutions Examination Council (FFIEC) issued regulatory reporting changes in 2024 that require banks with more than $10 billion in assets to segment loans to NDFIs by type (such as mortgage credit intermediaries or private equity funds) and begin reporting NDFI data on past-due loans, nonaccrual loans, and unfunded commitment balances. In addition, the reporting instructions were revised to improve clarity and consistency among banks. Banks have started to report this information on a best-effort basis, and comprehensive data are expected in 2025.[15]

BOX 1: Private Credit

Introduction to Private Credit

The Financial Stability Oversight Council (FSOC) defines private credit as "direct lending by nonbank financial institutions to businesses."[16] The private credit market is among the fastest-growing segments of NDFIs, with global assets under management growing at a compound annual rate of 18 percent since 2000 and totaling around $1.7 trillion at year-end 2023.[17] While the private credit market remains a modest part of the overall U.S. corporate credit market, some of its characteristics may contribute to elevated systemic risk under certain conditions.[18]

For example, private credit typically lends to more highly leveraged borrower businesses than banks lend to; valuations of private credit assets are often stale given the lack of robust secondary markets and infrequent appraisals, raising the potential for sudden repricing events; and rising competition among private credit funds and with other financial institutions, including banks, creates incentives to lower loan underwriting standards.

However, other attributes of private credit may help mitigate risk. For example, most private credit funds face little liquidity transformation risk since both investors and borrowers commit to long time horizons; private credit funds' direct loans typically have greater covenant protection than syndicated bank loans; and private credit funds generally have substantially lower direct leverage than banks.[19]

Interconnections with Banks

Large banks are shifting to indirect engagement with the non-IG corporate credit market, in large part through linkages with private credit funds. This indirect engagement takes various forms, such as bank provision of capital call facilities to private credit funds, joint deals with private credit funds to provide credit to nonfinancial firms, and credit risk transfer with private credit entities. Bank credit flows to private credit funds are difficult to measure but appear substantial.[20] The opacity of the private credit market impairs measuring its interactions with banks and the associated risk exposures to the banking system. For example, data on private credit fund deposits or deposits under the control of a single asset manager in banks are generally not publicly available and such large uninsured deposits may be a source of vulnerability during times of stress.

[15] For more information, see FIL-84-2024 December 23, 2024.

[16] Financial Stability Oversight Council, FSOC 2024 Annual Report, December 2024.

[17] Fang Cai and Sharjil Haque, Private Credit: Risks and Characteristics, FEDS Notes, February 23, 2024. The growth rate is calculated by the FDIC, using data from Table 1b associated with this source.

[18] According to Apollo Academy, private credit held a 6 percent share in 2023. See Torsten Sløk, "Private Credit Is a Small Share of Total Lending to Corporates," Apollo Academy, October 22, 2024.

[19] Fitch Ratings, "What Investors Want to Know: U.S. Private Credit Growth and Challenges," March 28, 2024; International Monetary Fund, Global Financial Stability Report, April 2024.

[20] The IMF estimated that U.S. banks extended $200 billion in credit to private credit funds in 2021, and it is likely this figure has grown since then with the sharp expansion of private credit assets under management. The FSOC estimates that U.S. banks committed $117 billion to business development companies in 2024.

BOX 1: Private Credit *(continued)*

Asset Quality Conditions

The private credit market has felt the effects of interest rate increases and economic slowdown since 2022, but through fourth quarter 2024 these effects seemed relatively muted. Estimated default rates of private credit loans range from approximately 2 percent to 5 percent, which are comparable to default rates in the broadly syndicated loan market.[21]

Vulnerabilities in the Private Credit Market

Further signs of stress in the private credit market were present but contained in 2024:

- **PIK**. The share of payment-in-kind (PIK) net investment income for Business Development Companies has risen by nearly 200 basis points since 2023, a sign that borrower firms may be experiencing liquidity constraints.[22]
- **ICR**. In 2024, 27 percent of surveilled private credit borrowers had interest coverage ratios (ICRs) under 1.0, a modest reduction from 2023.[23] The median ICR for a sample of borrowers was 1.7x, a slight increase from 2023, suggesting that as interest rates decline, borrowers' capacity to meet interest expenses improves.[24]
- **Leverage**. The leverage rates of private credit borrowers tend to be higher than those of borrowers receiving bank loans. In 2024, median earnings before interest, taxes, depreciation, and amortization leverage rates declined to 5.9x from 6.3x in 2023, a sign of improving asset quality.[25]
- **Spreads**. Private credit loan spreads have decreased appreciably since 2022, as growing competition with the broadly syndicated loan market and other lenders placed pressure on all competitors.[26] Three-month average pricing on loans to borrowers with $100 million or more in earnings before interest, taxes, depreciation, and amortization as of November 2024 was in the range of the Secured Overnight Financing Rate +500 basis points, down from nearly 650 basis points in 2022.[27] Tightening spreads may reduce margins for private credit funds.

[21] KBRA estimated private credit default rates were 1.9 percent in 2024. See KBRA, "Private Credit: 2025 Outlook," January 14, 2025. Fitch's Private Credit Default Rate at the end of 2024 Q4 was 4.6 percent. See Fitch Ratings, "U.S. Private Credit and Middle Market Chartbook: 4Q24," January 31, 2025.

[22] Oaktree Capital, "Performing Credit Quarterly," Insights, third quarter 2024.

[23] KBRA, "Private Credit: Q4 2024 Middle Market Borrower Surveillance Compendium—5% at Risk," February 4, 2025.

[24] Fitch Ratings, "U.S. Private Credit and Middle Market Chartbook: 4Q24," January 31, 2025.

[25] Ibid.

[26] Pitchbook, Global Private Debt Report, H1 2024, September 24, 2024.

[27] KBRA, Private Credit: 2025 Outlook, January 14, 2025.

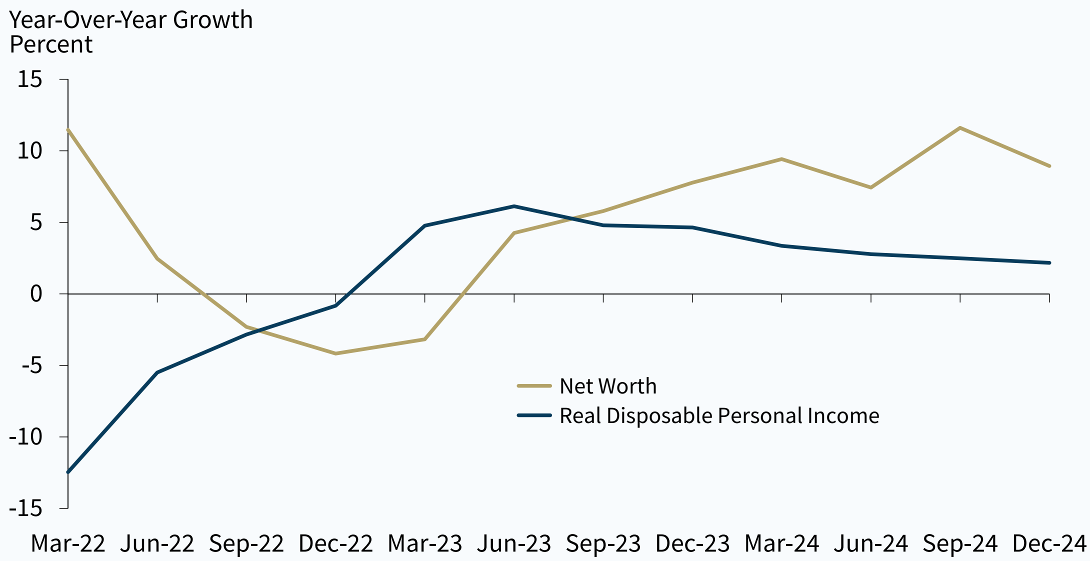
Consumer Lending

- **Household finances were solid in 2024 but showed signs of weakening from 2023. Real income growth slowed from 2023 but remained positive. Household wealth rose, but the savings rate fell after rising in January. Debt burdens remained near historic lows.**
- **Consumer loan growth at banks slowed in 2024 as banks tightened lending standards and households reduced their demand for loans. Consumer loan asset quality worsened in 2024, but the pace of the decline slowed.**
- **Consumer loan asset quality deteriorated more at community banks than the rest of the industry in 2024. But median PDNA rates remained lower at community banks than the rest of the industry.**

Household finances were solid in 2024 but started to show signs of weakening. Although the labor market cooled in 2024, the unemployment rate remained below its decades-long average and wage growth remained above its decades-long average.[28] Real income growth was positive in 2024 but slowed from 2023 levels, and household wealth growth accelerated (Chart 20). Debt burdens generally remained low owing in part to lower mortgage payments from households that locked in low mortgage rates in 2020 and 2021 (Chart 21). Household debt as a share of GDP, one measure of debt burdens, fell in 2024 as strong GDP growth outpaced debt growth. But the household debt service ratio, another measure of debt burdens relative to household income, continued to rise in 2024. The savings rate fell for most of 2024 and ended the year 2.3 percentage points below the average savings rate from 2015 to 2019.

CHART 20

Income and Net Worth Rose in 2024, Supporting Household Spending

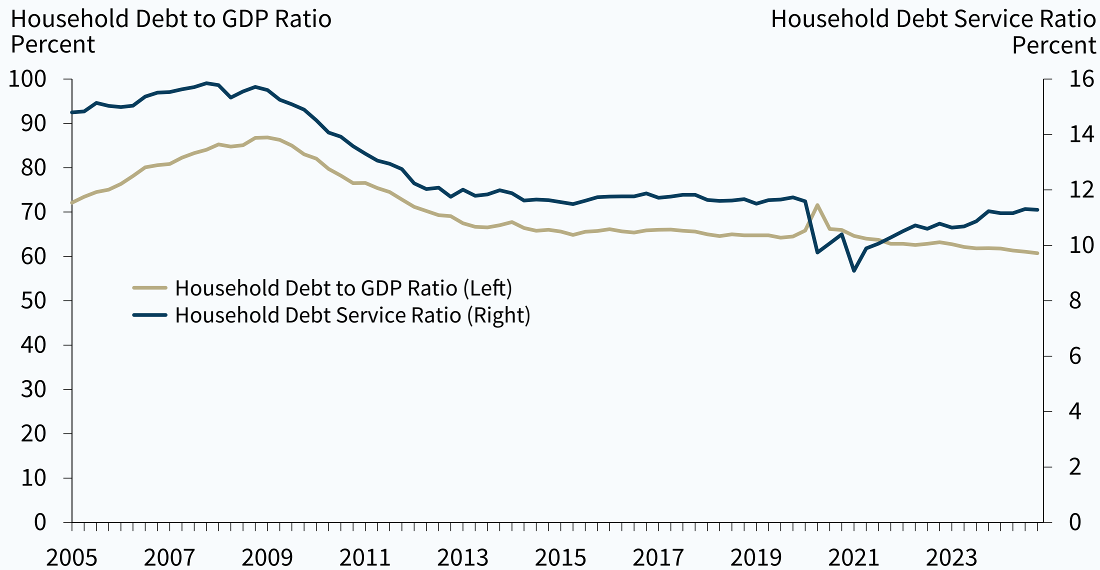


Sources: Bureau of Economic Analysis, Federal Reserve Board (Haver Analytics).
Note: Data are quarterly from first quarter 2022 through fourth quarter 2024.

[28] These averages are calculated from 2000 through 2024.

CHART 21

Debt Burdens Remained Manageable in 2024



Sources: Federal Reserve Bank of New York, Federal Reserve Board, Bureau of Economic Analysis (Haver Analytics).
Note: The household debt service ratio is the ratio of household debt payments to disposable personal income. Data are quarterly through fourth quarter 2024.

Consumer loan growth at banks slowed in 2024 as households reduced their demand for loans and banks tightened lending standards. Annual loan growth for total consumer loans held by the banking industry slowed in 2024 from the prior year. Credit card loan growth was in line with the 2015 to 2019 average and offset declines in other consumer lending types. Total auto and "other" consumer loans held by the banking industry fell in 2024, but the pace of contraction for auto loans eased later in the year.[29]

According to the Federal Reserve Senior Loan Officer Opinion Survey on Bank Lending Practices, the banking industry, on net, reported lower demand for credit card loans, auto loans, and other consumer loans in each quarter of 2024. Banks also reported net tightening of lending standards on each of these consumer loan types for much of the year, but the share reporting tightening standards declined from a year earlier and standards loosened for auto loans in the fourth quarter.

Consumer loan growth at community banks also slowed in the first half of last year. Consumer loans held by the median community bank declined later in the year and were lower at year-end 2024 than at year-end 2023. Auto and other consumer loan balances fell at the median community bank, while credit card loan growth slowed but remained positive.[30] However, credit card loans were only 4 percent of consumer loans at community banks.

The banking industry's consumer loan asset quality weakened in 2024. Aggregate PDNA rates for total consumer loans, auto loans, and credit card loans increased throughout the year (Chart 22). The aggregate PDNA rates for credit card and auto loans were above their 2015 to 2019 average levels in fourth quarter 2024, but the pace of the increase in PDNA rates slowed. In contrast, delinquency measures for "other" consumer loans, which were about a quarter of all consumer loans, remained below their pre-pandemic levels.[31]

[29] The reduction in "other" consumer loans in fourth quarter was largely due to a reclassification of margin loans from this category following the finalization of changes to how certain loan products should be reported.

[30] The calculations of medians exclude banks that do not make that type of loan. Only 577 community banks reported credit card loans on their balance sheets in fourth quarter 2024, while 3,613 had auto loans and 3,922 had other consumer loans.

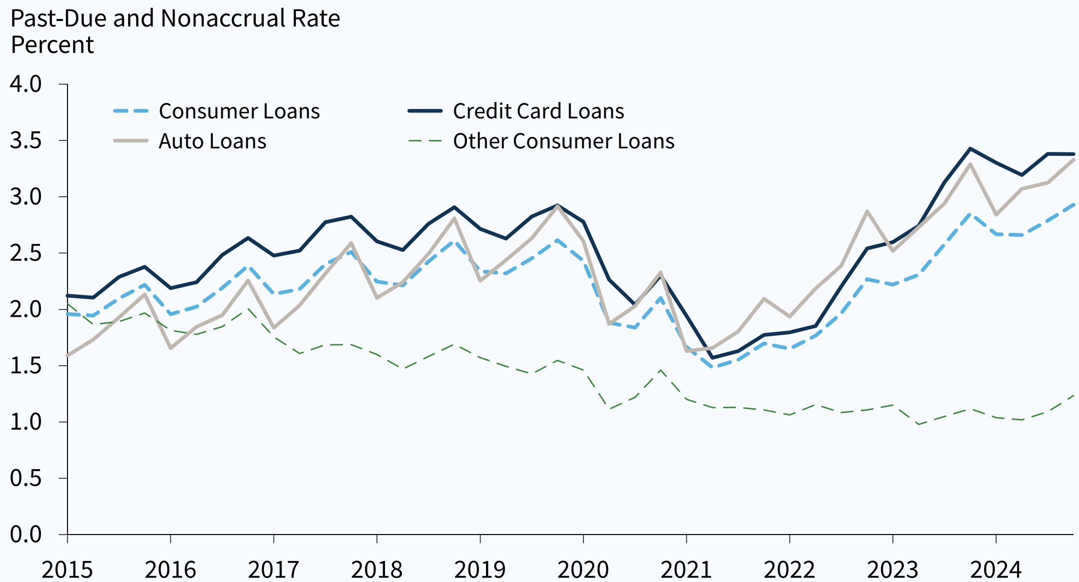
[31] The rise in the PDNA rate for "other" consumer loans in fourth quarter may be from lower asset quality or from the decline in "other" consumer loans resulting from reclassifications of margin loans.

Aggregate net charge-off rates for all consumer loan categories rose from a year earlier and were higher than average pre-pandemic levels.

Deterioration of consumer loan asset quality ratios was more pronounced among community banks than the rest of the industry. The median PDNA rates were higher at community banks in fourth quarter 2024 than a year earlier for all loan categories. Except for credit cards, the rates were still well below 2015 to 2019 pre-pandemic levels.

CHART 22

Delinquency Rates Were Generally Above Pre-Pandemic Levels



Source: FDIC.
Note: Data are quarterly through fourth quarter 2024.

Residential Real Estate

- **A limited supply of homes for sale and high mortgage rates continued to weigh on housing activity in 2024.**
- **Home prices increased last year, which contributed to low housing affordability.**
- **The banking industry's residential mortgage balance continued to grow in 2024 but at a slower pace than in previous years.**
- **Asset quality in residential mortgage loan portfolios held by the banking industry was generally sound.**

High mortgage rates and a limited supply of homes for sale continued to dampen home sales in 2024. Mortgage rates remained high and contributed to weak housing demand. After increasing sharply in 2022 from historic lows, mortgage rates remained elevated through 2024.[32] The average rate on a 30-year fixed-rate mortgage averaged 6.65 percent in fourth quarter 2024, around twice the rate at the beginning of 2022, despite some easing from 2023.[33] Higher mortgage rates weighed on home sales. Total single-family home sales stagnated in 2024 following sharp declines in previous years.[34] Sales of existing homes, which account for nearly 85 percent of home sales, continued to decline and reached the lowest level since 1995.[35] Existing sales continued to be hampered by limited supply as homeowners held onto fixed-rate mortgages that were locked-in at lower rates, incentivizing them to stay in their homes. An estimated 55 percent of homeowners had mortgages with rates below 4 percent as of late 2024, below prevailing mortgage rates during the year.[36] Despite weakness in home sales overall, new home sales rose during the year (Chart 23).[37] The number of newly constructed single-family homes for sale rose in 2024 to its highest level since 2007. Sales of new homes increased to the pre-pandemic level. Annual permit issuance for 1–4 family homes, an indicator of housing starts going forward, increased by about 8 percent in the year ending fourth quarter 2024, surpassing the long-term median level.[38] Despite increased construction trends, supply remained short of demand.[39] Freddie Mac estimated that the national demand for homes still exceeded supply by approximately 3.7 million units. While new homes have become an increasing share of total homes for sale, they are still well below the level of existing homes on the market.

Home prices increased in 2024 from recent years. The S&P Case-Shiller House Price Index increased 3.7 percent year over year as of fourth quarter 2024, extending growth from 2023 when prices rebounded from a dip that coincided with higher mortgage rates in 2022.[40] Among the 20 major metro areas tracked by Case-Shiller, most had price growth in the year ending fourth quarter 2024, led by New York. Most of these metros also had prices higher than 2022 peaks, except San Francisco, Seattle, Denver, Portland, Phoenix, and Dallas, which continued to recover.[41]

Home affordability remained under pressure in 2024. The National Association of Realtors Housing Affordability Index was just above the unaffordable threshold nationally in fourth quarter 2024 with an index at slightly over 100 and above the low of the 1980s when mortgage rates were in the double digits.[42] An index value below 100 indicates that the median income level cannot qualify for a mortgage on the median-priced home.[43] The index for first-time

[32] Freddie Mac Mortgage Market Survey.

[33] Ibid.

[34] National Association of Realtors and the U.S. Census Bureau.

[35] Ibid. Nearly 85 percent of single-family home sales in 2024 were existing home sales.

[36] Realtor.com, third quarter 2024, latest data published.

[37] The U.S. Census Bureau and the National Association of Realtors.

[38] Census Bureau, median 1–4 family annualized permit issuance from 1981 to 2024.

[39] Freddie Mac Economic, Housing, and Mortgage Market Outlook, November 2024.

[40] S&P, Case Shiller, CoreLogic.

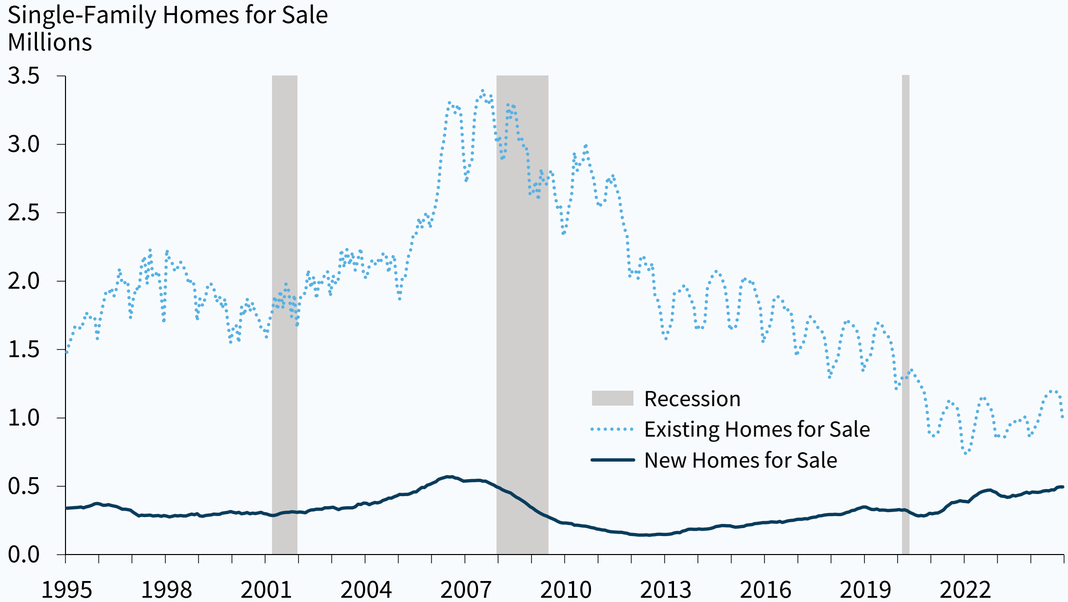
[41] Ibid.

[42] National Association of Realtors Housing Affordability Index data from 1981 to 2024, adjusted from monthly to quarterly values by Haver.

[43] National Association of Realtors Housing Affordability Index is calculated 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.

CHART 23

Inventory of Homes for Sale Improved Slightly in 2024 but Remained Near Historically Low Levels



Sources: Census Bureau, National Association of Realtors, National Bureau of Economic Research (Haver Analytics).
Note: Data are monthly figures from January 1995 through December 2024. Shaded areas indicate recessions.

homebuyers was noticeably lower and well below the unaffordable threshold, making the purchase of a home even more difficult for this cohort.[44] High mortgage rates and high home prices weighed on affordability. Moreover, higher costs for homeowners' insurance further challenged affordability, and reductions in coverage may pose credit risks.[45]

Residential mortgage loan growth slowed in 2024. As of fourth quarter 2024, banks reported $2.88 trillion in residential mortgage loans, representing 23 percent of total loans. Residential loans increased each quarter in 2024 and were up 1.7 percent in fourth quarter from one year earlier, the smallest year-over-year increase since 2021. Growth in residential mortgage loan balances was widespread as roughly three out of four banks reported higher residential loan balances in fourth quarter 2024 from one year earlier.

Asset quality of residential mortgage loan portfolios remained sound, but some regions reported post-pandemic deterioration. The banking industry's residential mortgage PDNA rate was 1.97 percent in fourth quarter 2024, up from previous quarters in 2024 and well below historical levels. Most banks reported relatively low residential mortgage PDNA rates (Chart 24). However, banks in 13 states, mostly in the West, reported a post-pandemic increase in total residential mortgage PDNA rates from fourth quarter 2019 compared with fourth quarter 2024.

The residential mortgage loan portfolio among community banks generally performed well. Community banks also continued to play an important role in residential lending, accounting for 18 percent of the banking industry's total residential mortgages as of fourth quarter 2024 compared with 15 percent of the industry's total loans. Community banks reported $520.3 billion in residential loans in fourth quarter 2024, up 3.2 percent from one year earlier and higher

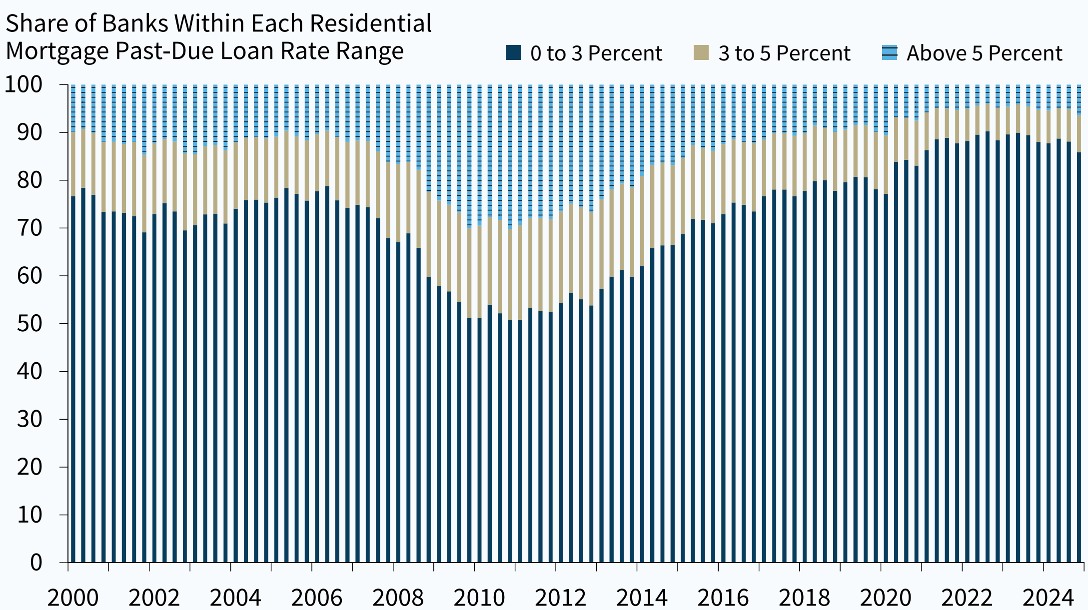
[44] National Association of Realtors First-Time Homebuyer Affordability Index data from 1981 to 2024, adjusted from monthly to quarterly values by Haver.
[45] Michael Bender, "Regulator Focus on Insurance Woes May Help Credit Risk," The Risk Management Association, July 17, 2024.

than the 1.4 percent growth reported for the rest of the industry over the same period. Asset quality of community bank mortgage portfolios remained sound. Although up 19 basis points from year-earlier levels, the total residential mortgage PDNA rate in fourth quarter 2024 for community banks remained significantly below pre-pandemic levels and was lower than the rate for the rest of the industry, continuing a trend dating to 2006.

Sound underwriting and relatively high levels of homeowner equity may be contributing to favorable residential mortgage asset quality conditions. According to the January 2025 Federal Reserve Senior Loan Officer Opinion Survey on Bank Lending Practices, lending standards remained tight on net in fourth quarter 2024 for nearly all residential real estate loan categories except those classified as subprime and non-qualified jumbo mortgages, for which a modest net share of banks reported tighter standards. Higher homeowner equity levels relative to those in the years leading up to the GFC may help to mitigate potential foreclosures in the event of severe asset quality deterioration in residential mortgages.

CHART 24

Residential Mortgage Asset Quality Remained Sound in 2024 as More Banks Reported Relatively Low Delinquency Rates



Source: FDIC.
Note: Data are quarterly through fourth quarter 2024.

Corporate Debt and Leveraged Lending

- **Corporate debt increased in 2024 as market conditions improved, driven by better-than-expected economic growth and expectations for lower interest rates.**
- **High interest rates during the year continued to drive distress for some corporations.**
- **Bank lending to businesses remained weak and underwriting standards remained tight in 2024.**
- **Banks remained exposed to corporate debt both through their direct holdings and investment banking activities and indirectly through the potential of corporate debt to affect macroeconomic conditions.**
- **Limited near-term corporate debt maturities could mitigate risks in the short term.**

Corporate debt increased in 2024. Debt issuance rose in 2024 for corporate bond and leveraged loan markets, surpassing their 2023 levels, and issuance of collateralized loan obligations (CLOs) reached a new record (Chart 25).[46] Companies refinanced existing debt, reducing near-term maturities. Though nonfinancial corporate debt rose further in 2024, debt relative to corporate profits and to GDP declined.[47]

Favorable market conditions in 2024 supported corporate debt issuance, but bank loan growth to businesses remained weak. Depository institution loans outstanding to nonfinancial corporations as of fourth quarter were 7.0 percent lower than 2023 levels, according to Federal Reserve data.[48] Bank underwriting standards to businesses remained relatively tight. Banks on net reported tighter lending standards in fourth quarter, though fewer banks reported tightening than earlier in the year, according to the Federal Reserve Senior Loan Officer Opinion Survey on Bank Lending Practices.

Corporations reported higher profits in 2024, and bond defaults remained near historic lows. But other measures of distress continued to rise (Chart 26). Corporate profits were up 6 percent in 2024 but rose at a slower pace than in 2023, and more corporations showed signs of distress. While high-yield bond default rates remained near historic lows, they have trended up. Corporate loan default rates continued to rise, and bankruptcies edged up as some businesses struggled with high interest rates.[49] The Leveraged Loan Default Index remained near its historic ten-year average, but the default rate, including distressed exchanges, trended higher. In addition, corporations increased liability management exercises to restructure distressed debt, which is a sign of distress.[50] Moreover, loan recoveries declined in 2024, suggesting higher losses from defaults.

Banks face both credit and interest rate risks to corporate debt and leveraged lending markets. Banks are primarily exposed to credit risk from leveraged loans through their direct holdings. Bank holdings of syndicated loans, which include leveraged loans, increased slightly to $1.38 trillion in second quarter 2024 from year-end 2023, accounting for 5.8 percent of bank assets and down 0.1 percent from fourth quarter 2023.[51] Though issuance of CLOs increased, bank holdings of CLOs, which contain leveraged loans, fell to $144 billion as of fourth quarter 2024, a decrease of 12.1 percent from fourth quarter 2023. Bank holdings of CLOs accounted for 0.9 percent of bank assets as of fourth quarter 2024.[52] 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—generally the largest

[46] See Chart 1.

[47] Federal Reserve Board and Bureau of Economic Analysis. 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.

[48] Federal Reserve Board of Governors, Financial Accounts of the United States data on U.S.-Chartered Depository Institutions.

[49] Fitch, U.S. Leveraged Finance Restructuring Series First-Lien Ultimate Recoveries, December 9, 2024. Recoveries in 2024 were the lowest since 2016.

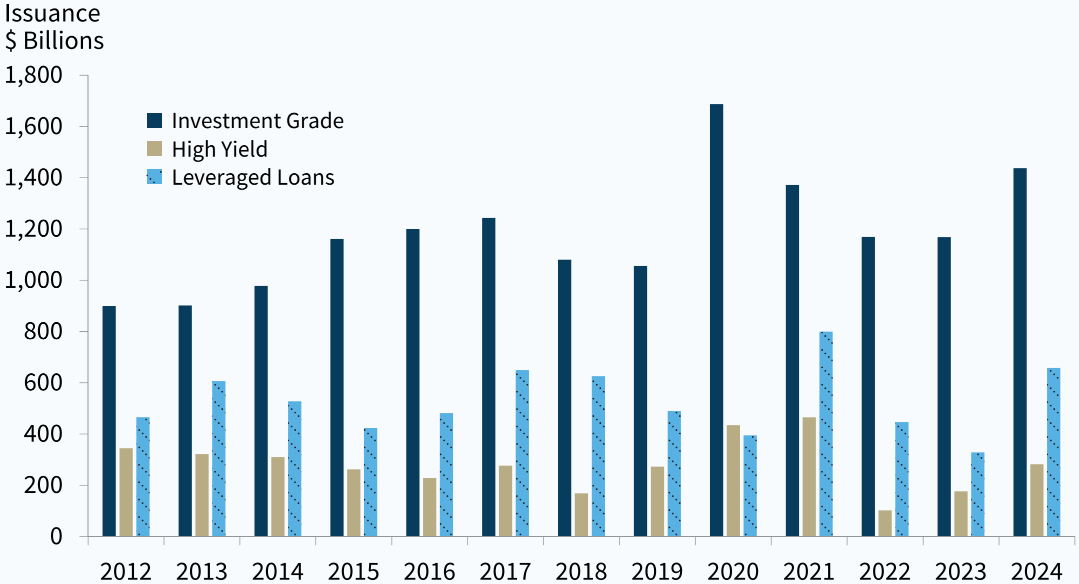
[50] A liability management exercise (LME) is a strategy that companies use to restructure their debt obligations and improve their financial health. LMEs can vary but are generally used in situations of distress.

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

[52] FDIC Consolidated Reports of Condition and Income (Call Reports).

CHART 25

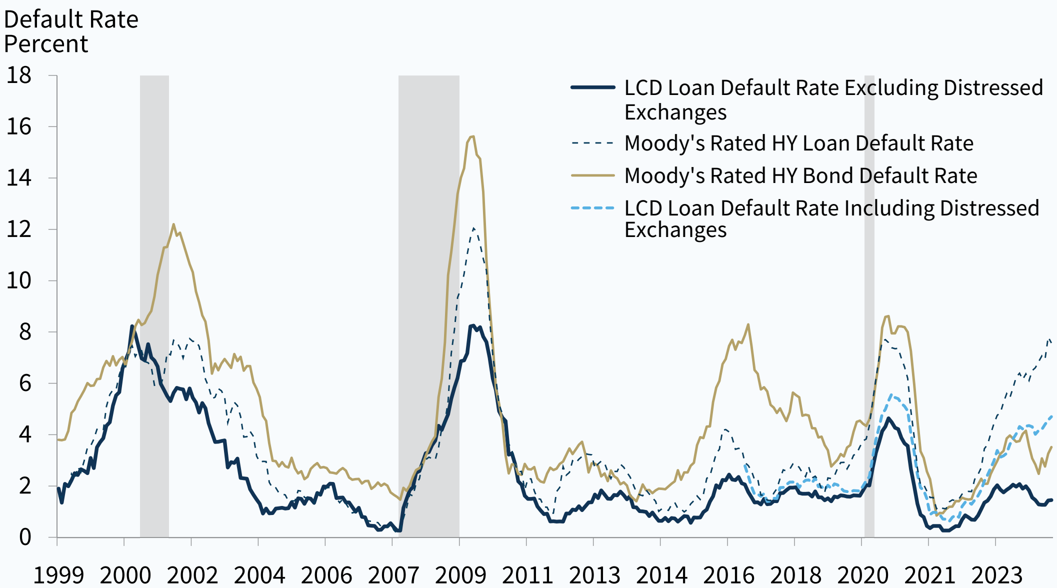
Corporate Debt Issuance Rose in 2024 Exceeding 2023



Source: PitchBook Leveraged Commentary & Data.
Note: Data are annual through 2024.

CHART 26

Corporate Debt Default Rates Have Trended Up



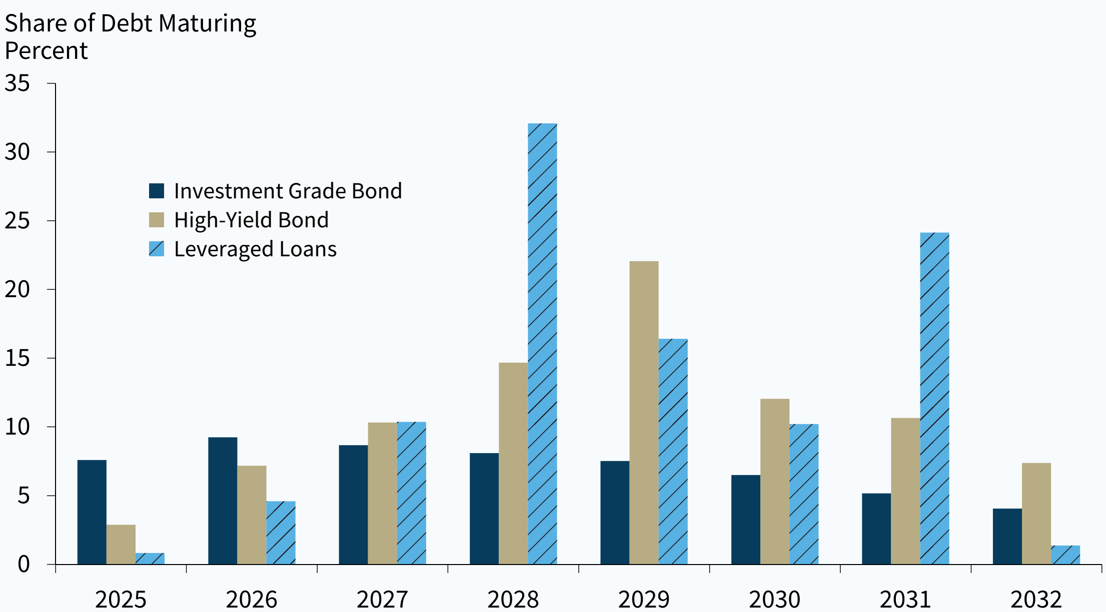
Sources: PitchBook Leveraged Commentary & Data (LCD) and Moody's.
Note: Shaded areas indicate recession. LCD default rate is lagging 12-month rate. Data including distressed exchanges available from December 2016. Moody's data are issuer-weighted U.S. speculative grade (high-yield) debt default rates. Data are monthly through December 2024.

ones—also earn noninterest income from underwriting and arranging corporate bond and leveraged loan issuances, which can fluctuate based on changes in corporate bond market conditions.

Bank holdings of fixed-rate corporate bonds also expose banks to both interest rate risk and credit risk.[53] Banks held roughly $676.4 billion of corporate and foreign bonds as of fourth quarter 2024, a decrease of 5.8 percent from fourth quarter 2023, according to Federal Reserve data on depository institutions.[54] The share of fixed-rate corporate bonds to total banking assets was 2.8 percent as of fourth quarter 2024, down 0.2 percent from the prior year.[55] Credit risks may be mitigated in coming quarters by limited near-term corporate debt maturities for leveraged lending and high-yield debt (Chart 27). 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 broader effects of corporate debt distress on macroeconomic conditions.

CHART 27

U.S. Corporate Debt Maturities for High-Yield and Leveraged Loans Are Limited in 2025 and 2026



Source: Bloomberg.
Note: Leveraged Loans come from Bloomberg's Leveraged Loan Index. Maturities taken as of January 1, 2025.

[53] 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.

[54] Federal Reserve Board of Governors, Financial Accounts of the United States data on U.S.-Chartered Depository Institutions.

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

Small Business Lending

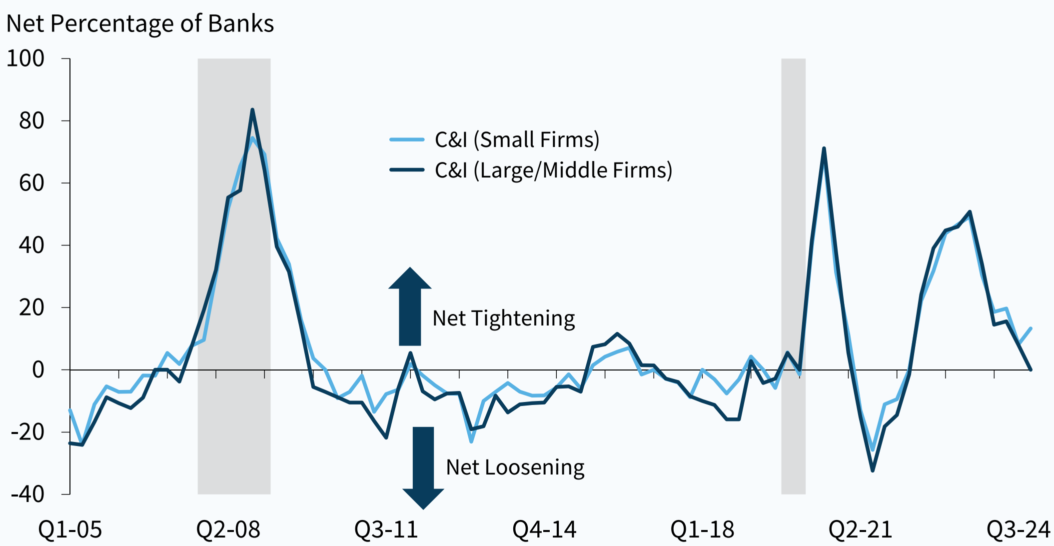
- **Small businesses reported tighter financing conditions and higher inflation. However, steady consumer spending helped support business conditions in 2024.**
- **Community banks remained an important source of small business lending.**
- **Small business lending slowed in 2024. Asset quality for C&I loans reported by community banks, a proxy for small business loans, remained relatively sound in 2024, but uncertain small business conditions may be a source of credit risk.**

Small business financing became more costly in 2024 as lending standards remained tight and interest rates remained high. As of fourth quarter 2024, median interest rates on new small business loans decreased on average 77 basis points from a year earlier but were up 6 basis points on average from the start of 2023, making it more costly to maintain a small business and reducing overall loan demand.[56] Interest rates remained a top concern among small businesses, ranking 13th out of the top 75 concerns, according to the 2024 edition of "Small Business Problems and Priorities," published by the National Federation of Independent Business.[57] Banks, on net, maintained tight lending standards for small businesses throughout 2024 and reported tightened collateralization requirements and loan covenants, according to the January 2025 release of the Senior Loan Officer Opinion Survey on Bank Lending Practices (Chart 28).

Costly financing and high inflation weighed on optimism according to the National Federation of Independent Business. Despite high inflation and high interest rates, strong consumer demand and

CHART 28

Lending Standards to Businesses Remained Tight in 2024



Source: Federal Reserve Board (Haver Analytics).
Note: Data are quarterly through fourth quarter 2024. Shaded areas indicate recession. Large and middle-market 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.

[56] Daniel Harbour and Nicholas Courtney, "Small Business Loan Demand Increases Despite Year-Over-Year Decreases in New Small Business Lending and Tightening Credit Standards," Small Business Lending Survey, Federal Reserve Bank of Kansas City, March 27, 2025.

[57] Holly Wade and Madeleine Oldstone, "Small Business Problems & Priorities 11th Edition," National Federation of Independent Business, July 2024.

spending in 2024 may have helped support small business conditions. Entrepreneurship continued to surge; the United States averaged 430,000 new business applications per month in 2024, 50 percent more than in 2019. According to the U.S. Census Bureau, retail trade continues to lead the growth in business applications.

Small business lending grew in 2024 but at a slower pace than in 2023. Small-dollar C&I loans outstanding at banks grew 1.7 percent in 2024, down from 4.6 percent in 2023. New small business loan balances at banks were down 5.6 percent over the year in fourth quarter 2024 but the quarterly pace of growth slowed from 2023, according to survey data from the Federal Reserve Bank of Kansas City.[58]

Community banks remained an important source of small business lending in 2024. As of December 31, 2024, the banking industry held $411 million in small business loans, as measured by small dollar loans.[59] Community banks maintained an outsize share—21.6 percent—of the industry's total small business loans despite holding only 15.2 percent of total industry loans. This share was significantly higher than the community bank share of total C&I loans, which was 10.2 percent as of December 31, 2024. Annual small-dollar C&I loan growth reported by community banks slowed to 0.4 percent in fourth quarter 2024, down from 4.1 percent in 2023 and a much slower rate than the rest of the industry. Small-dollar C&I lending by community banks also grew at a slower rate than total C&I lending by community banks, which grew 3.2 percent in 2024 (down from 5 percent in 2023).

C&I loan quality overall remained sound in 2024, 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 can be used as a proxy for small business loan performance to track business loan trends. The C&I PDNA rate reported by community banks declined at the onset of the pandemic and remained below the pre-pandemic average of 1.62 percent, but the rate slowly increased for eight consecutive quarters to 1.60 percent in fourth quarter 2024 (Chart 29). The PDNA rate for the rest of the industry also increased and was slightly above its pre-pandemic average.

CHART 29

Community Bank Commercial and Industrial Loan Past-Due and Nonaccrual Rate Continues to Rise

Source: FDIC.
Note: Data are quarterly through fourth quarter 2024.

[58] The Federal Reserve Bank of Kansas City defines small business lending as commercial and industrial lending to organizations generally defined as having less than $5 million in gross annual revenue unless otherwise noted.

[59] FDIC defines small business loans 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.

Agriculture Lending

- **Agricultural conditions softened in 2024 for the second consecutive year on weakness in the crop sector.**
- **Farm banks reported tighter liquidity positions as crop farmers increased borrowings.**
- **Despite operating losses for many crop farmers, agricultural loan quality reported by farm banks deteriorated only modestly in 2024.**
- **Farmers have generally been well positioned to weather weakening conditions in the agricultural sector. However, projected losses for 2025, primarily on corn and soybeans, could impair loan repayment capacity.**

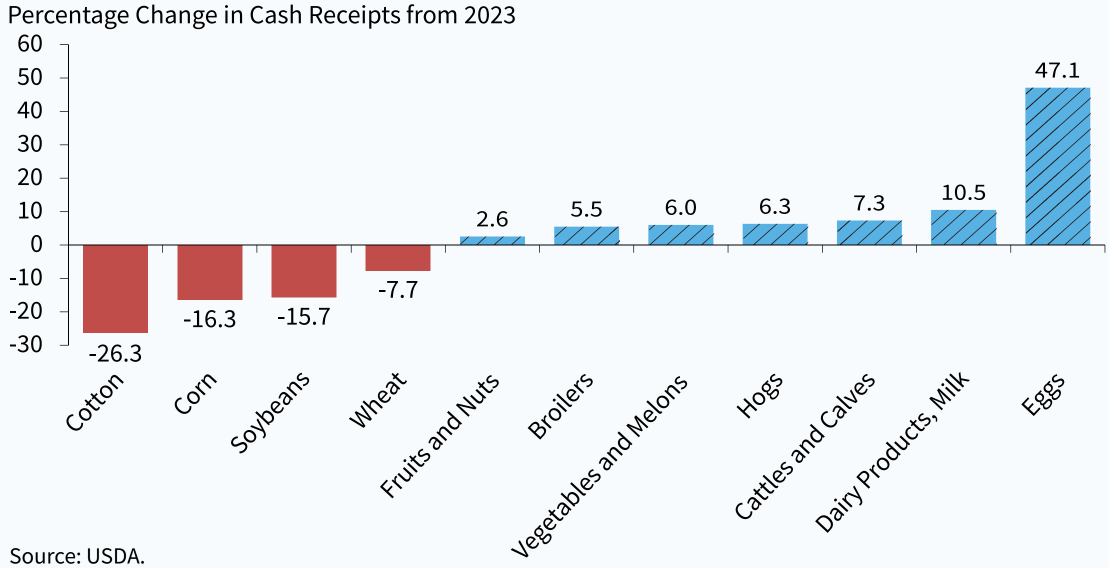
FDIC-insured institutions held $205.2 billion in agricultural loans in fourth quarter 2024, up 3.0 percent from one year earlier. The 993 farm banks that make up more than one-fifth of all U.S. banks tend to be small community banks located in the middle of the country where agriculture is dominated by row crop and cattle production.[60]

The U.S. Department of Agriculture (USDA) projects that net farm income declined for the second consecutive year in 2024, driven by a decline in crop receipts. Aggregate nominal net farm income declined 5.6 percent year over year to $139.1 billion, with a $22.2 billion decline in crop receipts slightly exceeding a $22.0 billion increase in animal and animal product receipts.[61] The mostly price-driven decline in crop receipts is concentrated in row crops and has resulted in slim or negative operating margins for many row crop producers (Chart 30).[62] In contrast, cattle and calf receipts may rise, reflecting ongoing low cattle inventories coupled with steady demand for beef, according to industry experts.

CHART 30

Crop Receipts Fell in 2024 on Lower Prices, Driving an Overall Decline in Net Farm Income

Percentage Change in Cash Receipts from 2023



Source: USDA.
Note: Data are annual as of 2024. 2024 data are forecast.

[60] Major row crops are corn, cotton, soybeans, and wheat. Cattle production includes cow/calf ranching and feedlot operations. FDIC supervisory data suggest that agricultural loan exposure for most farm banks is concentrated in these commodities.

[61] See USDA ERS, 2024 Farm Sector Income & Finances: Farm Sector Income Forecast, February 6, 2025. The 2024 figures are considered a forecast and will become an estimate with the USDA's next release scheduled for September 3, 2025.

[62] Cash receipts for major row crops declined in 2023 as well. Between 2022 and 2024, the declines in cash receipts were 27.4 percent for corn, 36.3 percent for cotton, 19.8 percent for soybeans, and 15.6 percent for wheat.

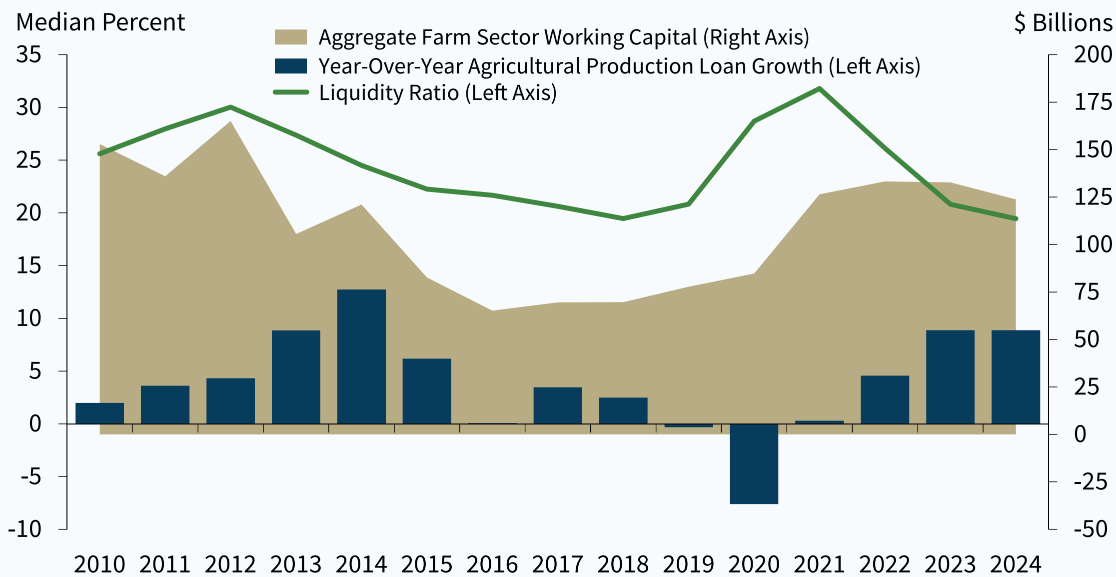
Weakness in the crop sector has contributed to a decline in agricultural working capital, which increased agricultural loan demand and reduced liquidity ratios among U.S. farm banks. The USDA forecast estimates that farm working capital declined 6.7 percent in 2024 and is now at its lowest point since 2020 (Chart 31). With compressed or negative margins continuing to erode working capital, farmers remained less able to self-finance their operations and, as in 2023, turned to bank loans. The median year-over-year agricultural production loan growth rate at farm banks was 8.9 percent in fourth quarter 2024. This trend is comparable to the beginning of the last downturn in the farm economy in the mid-2010s. This time, however, banks hold less liquidity, with the median farm bank liquidity ratio at 19.5 percent as of fourth quarter 2024, down 1.4 percentage points from one year earlier and 7.9 percentage points below its level before the last downturn. As a result, any prolonged weakness in the agricultural economy could affect farm banks more in the current period than it did in the mid-2010s.

Agricultural loan quality among farm banks declined only modestly in 2024. Fifty-eight percent of farm banks reported delinquent agricultural loans in 2024. Among those banks, the median PDNA agricultural loan ratio rose modestly to 0.67 percent in fourth quarter 2024, up slightly from recent lows but well below the 1.24 percent reported in fourth quarter 2019 (a recent high following the last agricultural downturn).

Further credit weakness may emerge in early 2025 as borrowers go through the annual loan renewal process with their lenders. Having generated strong profits in recent years, producers have generally been well positioned to weather this downturn, but several years of sustained losses could continue to drain working capital and strain cash flows. The weakness could also put downward pressure on farmland and machinery values, which may undermine the value of key sources of farm bank collateral. However, these effects may be mitigated by agricultural support programs implemented in 2025.

CHART 31

With Working Capital Declining, Farmers Have Turned to Bank Borrowings and Farm Bank Liquidity Positions Have Tightened



Sources: FDIC, USDA.
Note: Bank data are fourth quarter figures for farm banks only through fourth quarter 2024. USDA data are annual figures through 2024. 2024 data are forecast.

Energy Lending

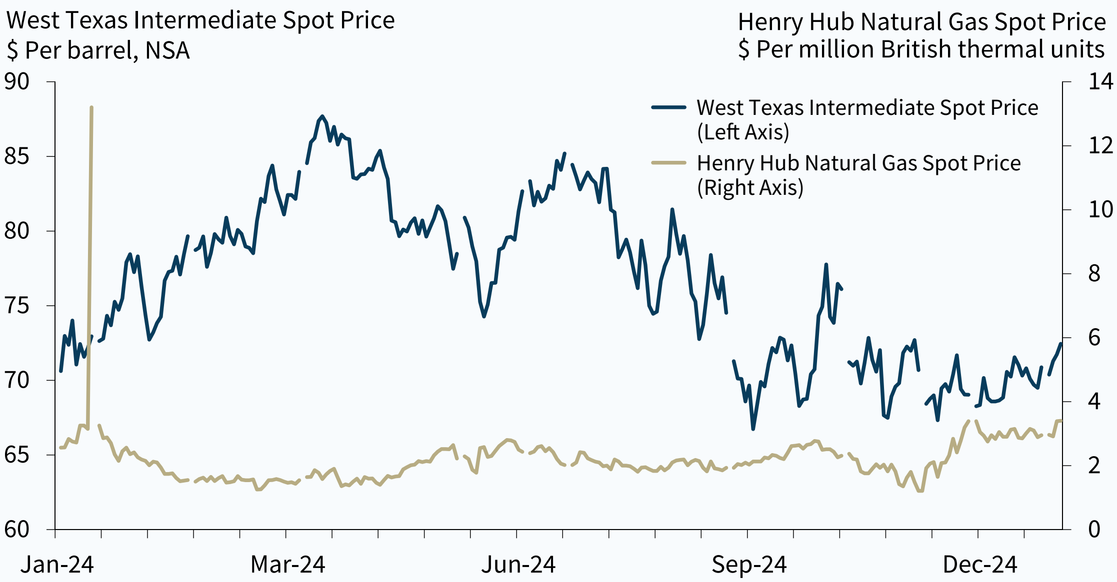
- **Oil and gas prices fluctuated throughout 2024, but ended the year relatively unchanged. Oil prices were volatile and natural gas prices fell to record lows during the year.**
- **Fundamentals of oil and gas companies generally remained sound in 2024. Large bank loan exposure to oil and gas firms declined further in 2024, while asset quality improved.**
- **Despite modest weakening, asset quality measures among community banks headquartered in energy-concentrated states remained better than in previous years.**

Energy prices fluctuated throughout 2024 but ended the year relatively unchanged for both oil and natural gas. West Texas Intermediate (WTI) crude oil prices averaged $76.55 per barrel in 2024, down 1.4 percent from year-end 2023. During 2024, WTI prices ranged from $88 per barrel in early April to about $67 per barrel in mid-September (Chart 32). Sustained OPEC+ production cuts, slowing non-OPEC+ supply growth, and weakening demand from China significantly affected oil prices during the year.

Henry Hub natural gas spot prices have remained generally low since 2023, aside from price spikes in early 2024 that were due to brief cold snaps. Otherwise, weekly average natural gas prices remained between $1.40 and $3.19 per million British Thermal Units in 2024, falling to all-time lows after adjusting for inflation, owing to a generally warm winter in Europe and the United States that reduced both domestic heating and liquefied natural gas export demand. An increase in natural gas supplies further depressed prices in 2024. While most firms lowered production, those companies that generate natural gas only as a by-product of oil production kept producing large amounts of natural gas in response to relatively strong oil prices.

CHART 32

Energy Prices Fluctuated Throughout 2024 but Ended the Year Relatively Unchanged



Source: U.S. Energy Information Administration (Federal Reserve Economic Data).
Note: Data are daily through December 31, 2024. Line breaks are due to holidays when data are not released. NSA is not seasonally adjusted.

Fundamentals of the oil and gas industry were generally sound in 2024. Oil and gas companies maintained balance sheets with relatively lower overall leverage, a result of concerted efforts in recent years to reduce debt and provide returns to shareholders. However, energy firms increased debt and equity issuances in 2024, partly reflecting an improved rate environment for debt and a slight uptick in the number of merger and acquisition transactions. The aggregate dollar volume of debt issuances in 2024 was the highest since 2020, while the transaction value of new equity issuances reached levels last observed in 2018.[63]

Large banks continued to reduce lending to the oil and gas industry in 2024, while credit quality of loans to the industry strengthened. Results of the 2024 Shared National Credit (SNC) review showed further decline in the dollar volume of oil and gas commitments held by large banks and continued asset quality improvement last year. While total debt issued by oil and gas companies in the capital markets has risen, total oil and gas commitments declined 10 percent between 2020 (the height of credit stress during the pandemic) and 2024. The "Special Mention + Classified" rate, a proxy for credit quality, also improved from 20 percent to 3 percent of total oil and gas loans reviewed during this time, in part reflecting strengthening industry fundamentals.[64]

Loan quality of community banks headquartered in energy-producing states slightly weakened in 2024 yet remained strong compared to historical indicators. Although community banks generally do not lend directly to the energy sector, including oil and gas firms, these banks are often active lenders and providers of banking services to their local communities. The median past-due loan rate for community banks headquartered in energy-producing states increased somewhat in fourth quarter 2024 from one year earlier, but it remained below its previous ten-year average. Given strong performance in the oil and gas sector, this slight increase was likely due to other factors affecting economies in these states.

[63] S&P Global Market Intelligence. Transactions Statistics-Equity. S&P Capital IQ Pro.

[64] Oil and gas sector lending is not available at the bank level in Call Report data. However, the 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 more than $100 million that are shared by multiple regulated financial institutions. See Office of the Comptroller of the Currency, "Shared National Credit Report."

ACRONYMS AND ABBREVIATIONS

ADC .... Acquisition, Development, and Construction

C&I .... Commercial and Industrial

Call Reports .... Consolidated Reports of Condition and Income

CBLR .... Community Bank Leverage Ratio

CLO .... Collateralized Loan Obligation

CMBS .... Commercial Mortgage-Backed Securities

CRE .... Commercial Real Estate

FDIC .... Federal Deposit Insurance Corporation

FHLB .... Federal Home Loan Bank

FOMC .... Federal Open Market Committee

GDP .... Gross Domestic Product

GFC .... Global Financial Crisis

NDFI .... Non-Depository Financial Institution

NFNR .... Nonfarm Nonresidential

NIM .... Net Interest Margin

OPEC .... Organization of the Petroleum Exporting Countries

PDNA .... Past Due and Nonaccrual Loans

S&P .... Standard and Poor’s

SNC .... Shared National Credit

USDA .... U.S. Department of Agriculture

PAGE INTENTIONALLY LEFT BLANK

GLOSSARY OF TERMS

Bond	A certificate of indebtedness issued by a government or corporation.
Call Report	A report of a bank's financial condition that is filed quarterly with the FDIC and known officially as the Report of Condition and Income.
Capital	The net worth or value that remains if an institution paid off all of its liabilities. At its core, bank capital is equity. Bank capital or equity can be expressed by the basic accounting formula: Assets – Liabilities = Equity.
Central Bank	An institution that oversees and regulates the banking system and quantity of money in the economy. The Federal Reserve System is the central bank of the United States.
Collateral	Property required by a lender and offered by a borrower as a guarantee of payment on a loan. Also, a borrower's savings, investments, or the value of the asset purchased that can be seized if the borrower fails to repay a debt.
Collateralized Loan Obligations (CLOs)	Securitization vehicles backed predominantly by commercial loans.
Community Bank	FDIC-insured institutions meeting the criteria for community banks as defined in the FDIC's 2012 Community Banking Study. Noncommunity banks are banks that do not meet these criteria.
Default	Failure to promptly pay interest or principal when due.
Farm Bank	A bank with agricultural production loans plus real estate loans secured by farmland equal to or exceeding 25 percent of total loans and leases.
Federal Funds Rate	The interest rate at which a depository institution lends funds that are immediately available to another depository institution overnight.
High Yield	A term that is generally synonymous with noninvestment grade, which refers to the lowest-rated bonds subjected to third-party credit risk assessments by nationally recognized statistical ratings organizations. In the United States, noninvestment grade bonds are typically rated Ba1 or below by Moody's or BB+ or below by Standard & Poor's or Fitch.
Inflation	The rate of increase in prices over a given period of time.

Investment Grade .... Generally, the highest-rated bonds subjected to third-party credit risk assessments by nationally recognized statistical rating organizations. In the United States, investment-grade bonds are typically rated Baa3 or above by Moody's or BBB- or above by Standard & Poor's or Fitch.

Leveraged Loans .... Numerous definitions of leveraged lending exist throughout the financial services industry and commonly contain some combination of the following:

- Proceeds used for buyouts, acquisitions, or capital distributions.

- Transactions in which the borrower's total debt divided by EBITDA (earnings before interest, taxes, depreciation, and amortization) exceeds 4 X EBITDA or senior debt divided by EBITDA exceeds 3 X EBITDA, or other defined levels appropriate to the industry or sector.

- A borrower recognized in the debt markets as a highly leveraged firm, which is characterized by a high debt-to-net-worth ratio.

- Transaction in which the borrower's post-financial leverage, as measured by its leverage ratios (for example, debt-to-assets, debt-to-net-worth, debt-to-cash flow, or other similar standards common to particular industries or sectors), significantly exceeds industry norms or historical levels.

Liquid Assets .... Interest-bearing and noninterest-bearing deposits, fed funds sold, reverse repurchase agreements, and the fair value of available-for-sale and held-to-maturity securities less the value of pledged securities.

Long-Term Assets.......................... Loans and debt securities with remaining maturities or repricing intervals of more than three years.

Negative Equity............................ A situation in which a borrower's mortgage principal is greater than the value of the underlying collateral, often real estate.

Net Interest Margin .... The difference between interest and dividends earned on interest-bearing assets and interest paid to depositors and other creditors, expressed as a percentage of average earning assets. No adjustments are made for interest income that is tax exempt.

Nonaccrual Loans and Leases ..... Loans and leases 90 or more days past due and for which payment in full of principal or interest is not expected.

Nonbank .... Firms that are not part of or affiliated with FDIC-insured depository institutions.

Noncurrent Loans and Leases..... The sum of loans and leases 90 days or more past due, and loans and leases in nonaccrual status.

OPEC+	An alliance formed in December 2016 of top oil-producing countries including members of the Organization of the Petroleum Exporting Countries (OPEC) and ten non-OPEC partner countries.
Past-Due and Non-Accrual Loans	Loans 30 or more days past due or in nonaccrual status.
Problem Banks	Federal regulators assign a composite rating to each financial institution based upon an evaluation of financial and operational criteria. The rating is based on a scale of 1 to 5 in ascending order of supervisory concern. Depending upon the degree of risk and supervisory concern, problem banks are rated either "4" or "5."
Real Gross Domestic Product	The total market value of all final goods and services produced in an economy in a given year calculated by using a base year's price for goods and services; nominal GDP adjusted for inflation.
Recession	A period of declining real income and rising unemployment; significant decline in general economic activity over a period.
Short-Term Liquid Assets	Cash and due from accounts, federal funds sold, securities purchased under resale agreements, and securities maturing in less than one year.
Treasury Yield	The effective interest rate paid by the U.S. government to borrow money for different lengths of time. It is the return on investment on the government's debt obligations.
Wholesale Funding	Federal funds purchased and securities sold under agreement to repurchase; borrowings from the Federal Home Loan Bank; brokered and listing service, municipal and state, and foreign deposits; and other borrowings (such as from the Federal Reserve's Payment Protection Program Liquidity Facility). Providers of wholesale funding closely track institutions' financial condition and may cease or curtail funding, increase interest rates, or increase collateral requirements if they determine an institution's financial condition is deteriorating.
Yield Curve	The relationship between maturities and interest rates on government bonds. The yield curve captures the cost of borrowing money to finance consumption, investment, or government spending and thus is of central importance to the entire economy. Yield curves generally exhibit three different shapes—normal, flat, and inverted—which are characterized by long-term interest rates being above, similar to, or below short-term interest rates. The shape of the yield curve often is viewed as an indicator of future economic activity.

FDIC-019-2025

FEDERAL DEPOSIT
INSURANCE CORPORATION