The FDIC Quarterly Banking Profile

L. William Seidman, Chairman

Second Quarter 1989

COMMERCIAL BANKING PERFORMANCE —SECOND QUARTER 1989

- ***Bank Earnings Remain Strong — First-Half Earnings Highest Ever***
- ***Banks Boost Net Worth Ratio to Pre-1987 Level***
- ***Asset Quality Problems Move East***
- ***Southwest Banks Register Loss, But Turnaround May Be Imminent***
- ***Number of Problem Banks Reaches Lowest Level in Three Years***

Commercial banks earned $7 billion in the second quarter, down from the $7.3 billion earned in the first quarter, but 30.7 percent above the $5.4 billion earned in the second quarter of 1988. For the first six months of 1989, industry net income totalled $14.3 billion, the most ever earned in a six-month period. Equity capital increased by $9.8 billion during that period, with $4.6 billion added during the second quarter. Asset quality showed some overall improvement, as nonperforming assets ended the first half below the level of a year ago, but regional trends were mixed. In a reversal of recent experience, nonperforming asset levels fell in the three regions west of the Mississippi River, and rose in the three eastern regions.

Continuing improvement in net interest income, strong gains in noninterest income, and reduced loan-loss expenses were key factors in the record earnings results. Earning assets were only 4.8 percent higher than a year earlier. Growth was led by real-estate loans, up 12.8 percent from a year ago, and consumer loans, up 6.0 percent. Funding shifted slightly from deposits, up 4.1 percent year-to-year, to nondeposit liabilities, up 7.1 percent. With interest rates mostly stable during the second quarter, smaller banks were able to increase their net interest margins over first-quarter levels. Larger banks' margins remained essentially unchanged.

Banks' aggregate loan-loss reserves have declined in each quarter after peaking in the first quarter of 1988. Large banks in particular have steadily increased their equity capital as a percentage of total assets, aided by strong earnings and prompted by new risk-based capital requirements. Because of this, the growth in the industry's equity capital has more than offset a decline in loss reserves, so that the cushion of equity and reserves has increased relative to nonperforming assets.

Chart A — Quarterly Net Income of FDIC-Insured Banks, 1985—1989

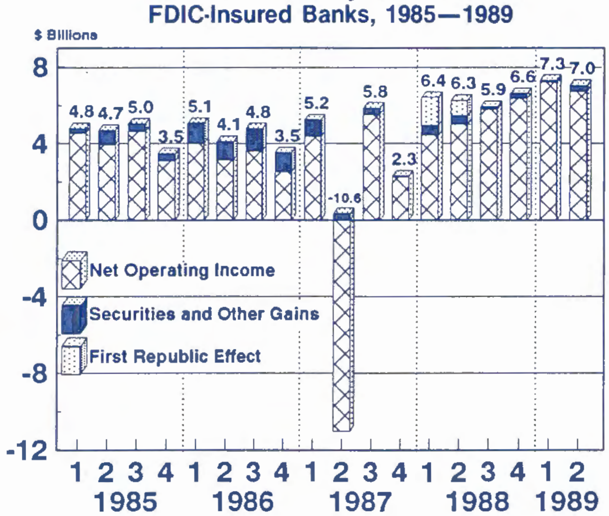
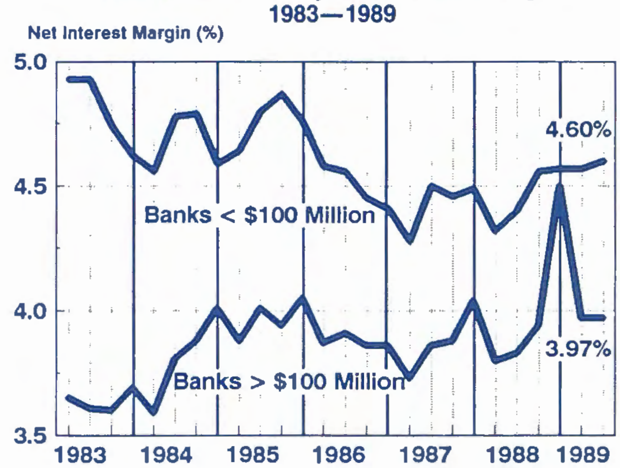


Chart B — Quarterly Net Interest Margins 1983—1989



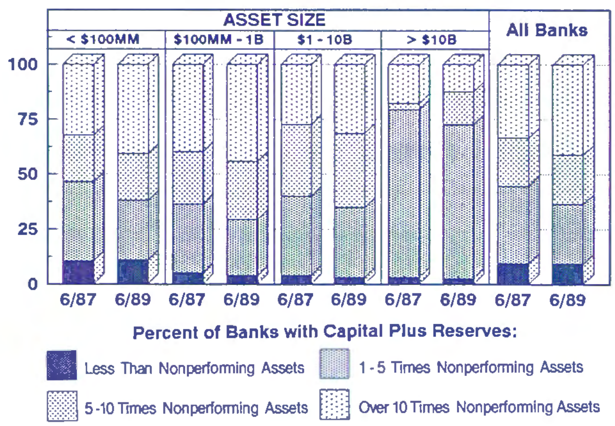
FDIC
Division of Research & Statistics

John Quinn
(...)98-3940

...aldrop
(202) 898-3951

The increase in nonperforming assets in the eastern regions has come from troubled loans to developing countries and real estate. The 20 percent write-down of loans to Argentina that was mandated in the second quarter was the main reason that banks in the Northeast and Central regions had a higher quarterly charge-off rate than in the second quarter of 1988. Banks in the other four regions had lower charge-off rates than a year earlier. The decline in asset quality has been greatest in the Northeast region, with banks in the Central and Southeast regions reporting only slight increases in the percentage of nonperforming assets. The Northeast was the only region to show a year-to-year increase in the proportion of banks losing money.

Chart C — Distribution of Banks by Problem Asset Coverage Levels and Asset Size June 1987 & June 1989

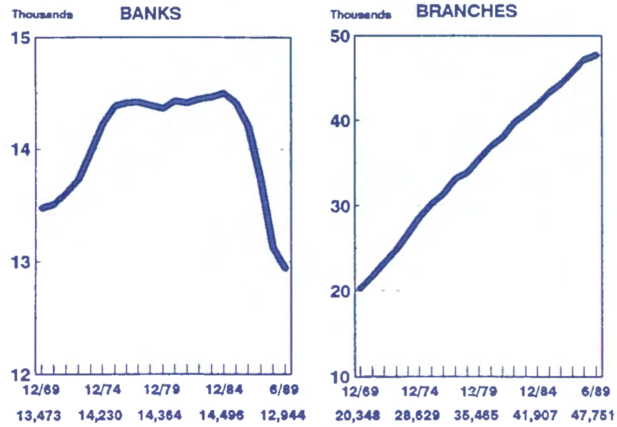


Recent trends in Southwest bank performance suggest that the prolonged deterioration of that region's banking sector may have finally ended. The improvement in asset-quality indicators in the Southwest region is especially encouraging, even though much of the improvement is attributable to FDIC intervention in failure and assistance transactions in recent years. Second-quarter net charge-offs were almost two-thirds lower than a year earlier, and nonperforming assets declined by 27.6 percent. The percentage of banks with earnings losses has been declining in recent quarters. Southwest banks still have the highest percentage of nonperforming assets, more than twice the national average, as well as the highest percentage of banks on the FDIC's "Problem List."

The number of commercial banks fell during the quarter, as the industry continues the consolidation process begun in 1985. The 12,944 banks operating at the end of June was a record low since the creation of the FDIC in 1934. A continued high rate of bank failures, a lower rate of new bank charters, and conversion of multibank holding company subsidiaries into branches have contributed to reducing the number of commercial banks. Despite this shrinkage, the total number of banking offices has continued to grow.

In the first six months of 1989, 101 banks failed or received assistance to avert failure, the same

Chart D — Numbers of FDIC-Insured Commercial Banks & Branches, 1969—1989



number as in the first half of 1988. For the second half of 1989, the failure rate is expected to moderate, with the average asset size of failed institutions well below the average for failed banks in 1988. This expectation is based on the continuing decline in the number of "problem" banks since midyear 1987. The 1,256 commercial banks on the "Problem List" is the fewest since June 1986.

The outlook for bank performance in the remainder of 1989 is clouded by uncertainties as to the earnings impact of the recently completed Mexican debt restructuring. The outlook for other developing-country loans remains problematic. The continuing rapid expansion of domestic real-estate loan portfolios, in the face of rising nonperforming rates in some areas, may portend more losses ahead. The recent economic climate, characterized by positive economic growth and low interest-rate levels, has been largely favorable for asset quality. Any adverse changes in these conditions could exacerbate current asset problems and trigger losses, especially in commercial credits extended in highly-leveraged transactions. At this point it is uncertain whether full-year earnings will exceed the all-time record of $25.1 billion earned last year.

Chart E — Percent of Banks on "Problem List" by Region, June 1987 & June 1989

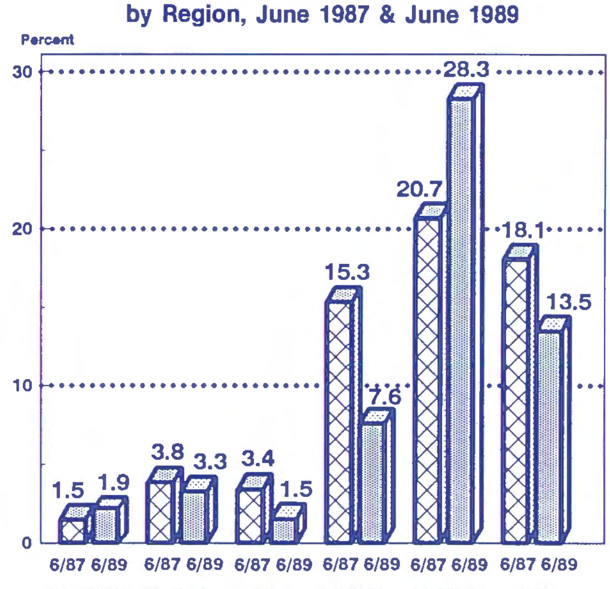


Table I. Selected Indicators, FDIC-Insured Commercial Banks

	1989*	1988*	1988	1987	1986	1985	1984
Return on assets	0.91%	0.69%	0.83%	0.12%	0.63%	0.70%	0.65%
Return on equity	14.22	11.35	13.37	2.00	9.94	11.31	10.73
Equity capital to assets	6.44	6.15	6.28	6.04	6.20	6.20	6.15
Primary capital ratio	7.99	7.86	7.85	7.70	7.22	6.91	6.91
Nonperforming assets to assets	2.25	2.39	2.14	2.46	1.94	1.87	1.97
Net charge-offs to loans	0.87	1.00	0.99	0.92	0.98	0.84	0.76
Asset growth rate	4.95	4.92	5.68	2.03	7.71	8.86	7.11
Net operating income growth	47.98	N/M	1666.92	-85.27	-20.65	6.30	3.40
Percentage of unprofitable banks	9.72	13.46	14.44	17.66	19.79	17.09	13.06
Number of problem banks	1,256	1,455	1,394	1,559	1,457	1,098	800
Number of failed/assisted banks	101	101	221	201	144	118	78

*Through June 30; ratios annualized where appropriate. N/M—Not meaningful

Table II. Aggregate Condition and Income Data, FDIC-Insured Commercial Banks
(dollar figures in millions)

	Preliminary 2nd Qtr 1989	1st Qtr 1989	2nd Qtr 1988	%Change 88:2-89:2
Number of banks reporting	12,944	13,003	13,411	-3.5
Total employees (full-time equivalent)	1,544,594	1,526,179	1,536,763	0.5
CONDITION DATA				
Total assets	$3,207,318	$3,150,604	$3,055,956	4.9
Real estate loans	719,640	695,032	638,107	12.8
Commercial & industrial loans	612,341	604,348	599,454	2.1
Loans to individuals	379,152	371,494	358,255	5.8
Farm loans	31,048	28,729	30,617	1.6
Other loans and leases	246,958	247,327	256,422	-3.7
Total loans and leases	1,989,139	1,946,929	1,883,077	5.6
LESS: Reserve for losses	45,065	45,891	49,305	-8.6
Net loans and leases	1,944,074	1,901,037	1,833,771	6.0
Temporary investments	478,735	484,320	467,712	2.4
Securities over 1 year	394,640	386,505	387,746	1.8
All other assets	389,869	378,741	366,728	6.3
Total liabilities and capital	3,207,318	3,150,604	3,055,956	4.9
Noninterest-bearing deposits	455,846	440,200	463,096	-1.6
Interest-bearing deposits	1,997,018	1,988,462	1,893,216	5.5
Other borrowed funds	420,674	399,338	391,125	7.6
Subordinated debt	17,684	17,350	17,206	2.8
All other liabilities	109,568	103,339	103,438	5.9
Equity capital	206,527	201,916	187,875	9.9
Primary capital	255,227	251,671	240,967	5.9
Nonperforming assets	72,052	69,503	72,901	-1.2
Loan commitments and letters of credit	849,830	837,726	813,634	4.4
Domestic office assets	2,788,717	2,736,044	2,638,775	5.7
Foreign office assets	418,601	414,560	417,181	0.3
Domestic office deposits	2,129,554	2,103,810	2,027,190	5.0
Foreign office deposits	323,311	324,852	329,122	-1.8
Earning assets	2,817,449	2,771,863	2,689,228	4.8
Volatile liabilities	1,138,678	1,116,099	1,070,636	6.4

INCOME DATA	Preliminary First Half 1989	First Half 1988	%Change	Preliminary 2nd Qtr 1989	2nd Qtr 1988	% Change
Total interest income	$155,511	$129,450	20.1	$80,177	$65,751	21.9
Total interest expense	99,326	78,095	27.2	51,945	39,722	30.8
Net interest income	56,185	51,355	9.4	28,232	26,029	8.5
Provision for loan losses	7,983	9,203	-13.3	4,383	4,589	-4.5
Total noninterest income	24,544	22,144	10.8	12,829	11,131	15.3
Total noninterest expense	52,850	50,090	5.5	26,977	25,218	7.0
Applicable income taxes	5,965	4,791	24.5	2,981	2,424	23.0
Net operating income	13,932	9,415	48.0	6,720	4,930	36.3
Securities gains, net	212	534	-60.3	161	142	13.0
Extraordinary gains, net	178	436	-59.1	148	306	-51.8
Net income	14,322	10,385	37.9	7,028	5,378	30.7
Net charge-offs	8,529	9,298	-8.3	5,053	5,305	-4.8
Net additions to capital stock	314	347	-9.4	114	144	-20.5
Cash dividends on capital stock	6,675	6,086	9.7	3,504	2,906	20.6

Table III. First Half Bank Data *(Dollar figures in billions, ratios in %)*

		Asset Size Distribution				Geographic Distribution					
						EAST			WEST		
	All Banks	Less than $100 Million	$100 Million to $1 Billion	$1-10 Billion	Greater than $10 Billion	Northeast Region	Southeast Region	Central Region	Midwest Region	Southwest Region	West Region
FIRST HALF *Preliminary* *(The way it is . . .)*											
Number of banks reporting	12,944	10,081	2,487	336	40	1,094	1,958	2,884	3,064	2,446	1,498
Total assets	$3,207.32	$371.76	$588.54	$1,042.66	$1,204.35	$1,275.86	$457.76	$519.79	$207.44	$258.05	$488.42
Total deposits	2,452.86	329.09	503.67	773.54	846.57	913.65	362.54	413.37	164.39	216.41	382.51
Net income *(in millions)*	14,322	1,668	2,808	4,401	5,445	5,515	2,224	2,768	1,150	84	2,580
Percentage of banks losing money	9.7%	11.0%	5.3%	5.9%	2.5%	8.8%	9.5%	3.4%	4.6%	21.8%	13.7%
Percentage of banks with earnings gains	64.9%	62.6%	73.1%	72.3%	65.0%	71.2%	67.1%	68.0%	59.5%	59.0%	72.0%
Performance Ratios *(annualized)*											
Yield on earning assets	11.25%	10.49%	10.79%	11.05%	11.91%	11.89%	10.80%	10.61%	10.92%	10.15%	11.39%
Cost of funding earning assets	7.18	5.90	6.15	6.74	8.55	8.28	6.53	6.61	6.43	6.59	6.15
Net interest margin	4.06	4.59	4.64	4.31	3.36	3.61	4.27	4.00	4.49	3.56	5.24
Net noninterest expense to earning assets	2.05	2.75	2.63	2.21	1.36	1.67	2.37	2.03	2.03	2.31	2.63
Net operating cash flow to assets	1.77	1.68	1.81	1.86	1.70	1.69	1.69	1.76	2.21	1.06	2.25
Net operating income to assets	0.88	0.88	0.96	0.84	0.89	0.87	0.97	1.08	1.10	0.03	1.00
Return on assets	0.91	0.91	0.97	0.86	0.92	0.88	0.99	1.09	1.13	0.07	1.08
Return on equity	14.22	10.07	12.98	13.66	17.99	14.61	14.18	15.89	14.68	1.12	17.85
Net charge-offs to loans and leases	0.87	0.64	0.62	0.87	1.05	0.90	0.46	0.67	0.93	1.77	0.95
Loan loss provision to net charge-offs	93.59	123.10	123.09	119.07	61.03	74.51	138.57	92.65	117.96	98.29	106.61
Condition Ratios											
Loss allowance to:											
Loans and leases	2.27%	1.67%	1.57%	1.73%	3.26%	2.64%	1.32%	1.89%	1.96%	2.56%	2.54%
Noncurrent loans and leases	74.19	72.27	75.52	85.75	69.56	68.97	96.28	99.15	94.56	44.66	83.50
Nonperforming assets to assets	2.25	1.92	1.77	1.58	3.16	2.52	1.12	1.29	1.59	4.75	2.57
Equity capital ratio	6.44	9.08	7.55	6.35	5.16	6.06	7.02	6.89	7.82	5.84	6.15
Primary capital ratio	7.99	9.96	8.53	7.51	7.53	7.90	7.88	8.16	9.02	7.07	8.18
Net loans and leases to deposits	79.26	59.41	71.50	86.77	84.73	84.97	78.76	74.34	73.09	59.63	85.15
Growth Rates *(year-to-year)*											
Assets	4.9%	5.8%	9.5%	11.1%	4.1%	4.6%	9.5%	6.8%	0.8%	−4.7%	7.[illegible]
Equity capital	9.9	5.3	9.3	12.0	14.3	11.7	9.7	8.7	4.7	2.8	14.[illegible]
Net interest income	9.4	11.9	16.9	15.2	6.6	8.1	10.3	10.1	4.4	−1.2	17.2
Net income	37.9	22.3	18.8	10.4	1.5	−3.9	9.1	6.8	7.0	N/M	49.5
Nonperforming assets	−1.2	3.3	16.4	24.6	3.1	13.0	15.3	13.2	−8.6	−27.6	−7.4
Net charge-offs	−8.3	1.7	17.9	−7.2	16.2	45.8	−17.6	−3.3	−29.5	−53.6	−6.4
Loan loss provision	−13.3	2.6	17.8	30.5	5.9	12.6	13.3	16.8	−2.7	−63.9	23.4
PRIOR FIRST HALVES *(The way it was . . .)*											
Return on assets . . . 1988	0.69%	0.72%	0.78%	0.69%	0.64%	0.96%	0.99%	1.09%	1.06%	−2.08%	0.77%
. . . 1986	0.68	0.75	0.85	0.75	0.49	0.80	1.10	0.93	0.77	−0.08	0.26
. . . 1984	0.63	0.97	0.92	0.73	0.22	0.63	0.99	0.25	0.93	0.82	0.47
Equity capital ratio . . . 1988	6.15	8.78	7.35	6.20	4.58	5.67	7.01	6.76	7.53	5.41	5.80
. . . 1986	6.33	8.65	7.23	6.16	5.03	5.83	6.80	7.02	7.53	6.92	5.57
. . . 1984	6.07	8.66	7.16	5.82	4.41	5.39	6.79	6.45	7.65	7.01	5.38
Nonperforming assets to assets . . . 1988	2.39	2.07	1.81	1.72	3.36	2.33	1.07	1.21	1.75	6.26	2.99
. . . 1986	2.03	2.37	1.90	1.59	2.33	1.59	1.03	1.52	2.44	3.57	3.16
. . . 1984	1.70	0.66	0.84	1.46	2.86	1.70	0.66	1.79	1.10	1.52	2.69
Net charge-offs to loans and leases . 1988	1.00	0.75	0.74	1.16	1.06	0.65	0.62	0.75	1.40	3.40	1.09
. . . 1986	0.84	1.16	0.78	0.80	0.81	0.57	0.50	0.60	1.81	1.53	1.12
. . . 1984	0.61	0.59	0.48	0.56	0.72	0.33	0.32	1.00	0.69	0.93	0.77

REGIONS: Northeast — Connecticut, Delaware, District of Columbia, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Puerto Rico, Rhode Island, Vermont

Southeast — Alabama, Florida, Georgia, Mississippi, North Carolina, South Carolina, Tennessee, Virginia, West Virginia

Central — Illinois, Indiana, Kentucky, Michigan, Ohio, Wisconsin

Midwest — Iowa, Kansas, Minnesota, Missouri, Nebraska, North Dakota, South Dakota

Southwest — Arkansas, Louisiana, New Mexico, Oklahoma, Texas

West — Alaska, Arizona, California, Colorado, Hawaii, Idaho, Montana, Nevada, Oregon, Pacific Islands, Utah, Washington, Wyoming

Table IV. Second Quarter Bank Data *(Dollar figures in billions, ratios in %)*

		Asset Size Distribution			
	All Banks	Less than $100 Million	$100 Million to $1 Billion	$1-10 Billion	Greater than $10 Billion
OND QUARTER *Preliminary* *.he way it is . . .)*					
Number of banks reporting	12,944	10,081	2,487	336	40
Net income	7,028	801	1,401	2,036	2,790
Percentage of banks losing money	10.4%	11.8%	5.6%	6.3%	5.0%
Percentage of banks with earnings gains	61.9%	59.6%	69.9%	72.3%	62.5%
Performance Ratios *(annualized)*					
Yield on earning assets	11.49%	10.66%	10.99%	11.29%	12.20%
Cost of funding earning assets	7.45	6.05	6.34	6.98	8.89
Net interest margin	4.05	4.60	4.65	4.31	3.31
Net noninterest expense to earning assets	2.03	2.74	2.63	2.20	1.33
Net operating cash flow to assets	1.77	1.69	1.82	1.87	1.69
Net operating income to assets	0.85	0.84	0.95	0.77	0.87
Return on assets	0.89	0.87	0.96	0.79	0.93
Return on equity	13.78	9.58	12.78	12.45	18.20
Net charge-offs to loans and leases	1.03	0.74	0.68	0.94	1.36
Loan loss provision to net charge-offs	86.75	118.68	116.96	127.50	48.95
Growth Rates *(year-to-year)*					
Net interest income	8.5	10.5	15.0	14.3	5.8
Net income	30.7	20.2	20.5	2.8	2.8
Net charge-offs	–4.8	3.2	5.1	–14.7	46.8
Loan loss provision	–4.5	4.6	9.6	31.9	6.5
PRIOR SECOND QUARTERS *(The way it was . . .)*					
Return on assets . . . 1988	0.71%	0.67%	0.75%	0.67%	0.74%
. . . 1986	0.60	0.63	0.80	0.80	0.32
. . . 1984	0.56	1.00	0.94	0.74	–0.02
Net charge-offs to loans and leases . 1988	1.14	0.89	0.93	1.38	1.10
. . . 1986	0.97	1.45	0.94	0.86	0.92
. . . 1984	0.77	0.69	0.63	0.72	0.93

	Geographic Distribution					
	EAST			WEST		
	Northeast Region	Southeast Region	Central Region	Midwest Region	Southwest Region	West Region
OND QUARTER *Preliminary* *.he way it is . . .)*						
Number of banks reporting	1,094	1,958	2,884	3,064	2,446	1,498
Net income	2,786	1,132	1,381	541	–34	1,222
Percentage of banks losing money	9.3%	10.3%	3.8%	5.5%	22.4%	14.5%
Percentage of banks with earnings gains	64.7%	62.1%	65.4%	57.7%	57.6%	68.4%
Performance Ratios *(annualized)*						
Yield on earning assets	12.16%	10.95%	10.83%	11.28%	10.45%	11.60%
Cost of funding earning assets	8.59	6.71	6.83	6.72	6.93	6.37
Net interest margin	3.58	4.23	4.01	4.56	3.51	5.23
Net noninterest expense to earning assets	1.68	2.33	1.95	2.15	2.28	2.57
Net operating cash flow to assets	1.66	1.70	1.84	2.16	1.05	2.28
Net operating income to assets	0.83	0.97	1.08	1.05	–0.11	0.95
Return on assets	0.88	1.00	1.08	1.07	–0.05	1.02
Return on equity	14.58	14.26	15.64	13.60	–0.91	16.58
Net charge-offs to loans and leases	1.19	0.51	0.74	0.92	1.92	1.04
Loan loss provision to net charge-offs	59.54	132.08	93.65	118.08	106.28	113.69
Growth Rates *(year-to-year)*						
Net interest income	7.0	9.5	9.2	4.6	–2.1	16.0
Net income	–5.6	13.9	8.8	–1.8	N/M	49.7
Net charge-offs	102.1	–2.0	9.4	–32.0	–64.2	–20.4
Loan loss provision	18.3	3.0	32.3	–9.8	–52.9	30.3
PRIOR SECOND QUARTERS *(The way it was . . .)*						
Return on assets . . . 1988	0.97%	0.96%	1.06%	1.08%	–1.79%	0.73%
. . . 1986	0.77	1.09	0.90	0.77	–0.15	–0.04
. . . 1984	0.61	1.04	–0.25	0.94	0.84	0.54
Net charge-offs to loans and leases . 1988	0.63	0.57	0.73	1.41	4.75	1.40
. . . 1986	0.64	0.56	0.66	2.06	1.93	1.28
. . . 1984	0.41	0.37	1.48	0.89	0.97	0.94

NOTES TO USERS

COMPUTATION METHODOLOGY FOR PERFORMANCE AND CONDITION RATIOS

All income figures used in calculating performance ratios represent amounts for that period, annualized (multiplied by the number of periods in a year).

All asset and liability figures used in calculating performance ratios represent **average** amounts for the period (beginning-of-period amount plus end-of-period amount plus any periods in between, divided by the total number of periods).

All asset and liability figures used in calculating the condition ratios represent amounts as of the end of the quarter.

DEFINITIONS

"Problem" Banks—Federal regulators assign to each financial institution a uniform composite rating, 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. "Problem" banks are those institutions with financial, operational or managerial weaknesses that threaten their continued financial viability. Depending upon the degree of risk and supervisory concern, they are rated either "4" or "5".

Earning Assets—all loans and other investments that earn interest, dividend or fee income.

Yield on Earning Assets—total interest, dividend and fee income earned on loans and investments as a percentage of average earning assets.

Cost of Funding Earning Assets—total interest expense paid on deposits and other borrowed money as a percentage of average earning assets.

Net Interest Margin—the difference between the yield on earning assets and the cost of funding them, i.e., the profit margin a bank earns on its loans and investments.

Net Noninterest Expense—total noninterest expense, excluding the expense of providing for loan losses, less total noninterest income. A measure of banks' overhead costs.

Net Operating Income—income after taxes and before gains (or losses) from securities transactions and from nonrecurring items. The profit earned on banks' regular banking business.

Net Operating Cash Flow—pre-tax net operating income before the provision for loan and lease losses; a measurement of banks' cash flow, net of interest and overhead expenses, from regular operations. Previously referred to as "adjusted net operating income".

Return on Assets—net income (including securities transactions and nonrecurring items) as a percentage of average total assets. The basic yardstick of bank profitability.

Return on Equity—net income as a percentage of average total equity capital.

Net Charge-offs—total loans and leases charged off (removed from balance sheet because of uncollectibility) during the quarter, less amounts recovered on loans and leases previously charged off.

Nonperforming Assets—the sum of loans past-due 90 days or more, loans in nonaccrual status, and noninvestment real estate owned other than bank premises.

Noncurrent Loans & Leases—the sum of loans past-due 90 days or more and loans in nonaccrual status.

Primary Capital—total equity capital plus the allowance for loan and lease losses plus minority interests in consolidated subsidiaries plus qualifying mandatory convertible debt (cannot exceed 20 percent of total primary capital), less intangible assets except purchased mortgage servicing rights.

Net Loans and Leases—total loans and leases less unearned income and the allowance for loan and lease losses.

¯ʌmporary Investments—the sum of interest-bearing balances due from depository institutions, federal funds sold and resold, trading-account assets and investment securities remaining maturities of one year or less.

.tile Liabilities—the sum of large denomination time deposits, foreign office deposits, federal funds purchased, and other borrowed money.

Requests for copies of and subscriptions to the FDIC Quarterly Banking Profile should be made through the FDIC's Office of Corporate Communications, 550 17th Street N.W., Washington, D.C. 20429; telephone (202) 898-6996.