PRESS RELEASE

Federal Deposit Insurance Corporation

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Media Contact:
Phil Battey (202) 898-6993

BANK EARNINGS IN THE FIRST QUARTER SET A NEW RECORD, BUT FDIC SEES INCREASED VULNERABILITY TO HIGHER INTEREST RATES, WEAKENING ECONOMY

Gains on equity investments helped lift commercial banks' net income to a new record in the first quarter of 2000, according to preliminary data released today by the FDIC. Industry earnings of $19.5 billion were $125 million greater than the previous quarterly record set in the third quarter of 1999, and were $1.6 billion (8.8 percent) higher than in the first quarter of 1999. But, the FDIC noted that banks' earnings are becoming increasingly dependent on favorable economic and financial conditions.

"Looking down the road we see several yellow lights flashing 'caution,'" said FDIC Chairman Donna Tanoue. "Because a growing share of bank earnings is dependent on conditions -- more exposed to higher interest rates and a less robust economy -- we see bank revenues becoming more volatile.

"The latest record for bank earnings reflects the industry's ability to prosper in good times -- but its growing exposure to shifts in the wind should give bankers -- as well as bank supervisors -- more reason to keep an eye open for clouds on the horizon," she said.

These were among the signs for caution cited by the FDIC:

- The percentage of commercial and industrial loans that were noncurrent (90 days or more past due or in nonaccrual status) rose to the highest level since the third quarter of 1994;

- The share of assets that mature or reprice at intervals of five years or longer continues to increase, while the share of lower-cost core deposits declines and short-term liabilities rise;

- The proportion of banks' loans that represent concentrations of credit risk -- their commercial loans with relatively large balances -- is the highest since 1991. With these loans, a small number of defaults can impair a bank's capital or income.

- The share of commercial banks' assets that is funded by deposits fell for the eighth time in the last nine quarters, to 72.4 percent. This declining trend in deposit funding is occurring at all FDIC-insured institutions; and

- Banks' reserves for credit losses increased by $1.1 billion in the first quarter, but the ratio of reserves to total loans remained at 1.68 percent, a 13-year low. The "coverage ratio" fell to $1.73 in reserves for every $1.00 in noncurrent assets, its lowest level since the first quarter of 1996.

Commercial banks' average return on assets (ROA), a time-honored yardstick of profitability, was the second best ever --1.35 percent, up from 1.32 percent a year ago. The primary source of the improvement in earnings was higher noninterest income, particularly market-related gains on equity investments. The industry also benefited from moderate growth in overhead expenses, and the absence of large merger-related restructuring charges that have characterized many recent quarters.

As for FDIC-insured savings institutions, they earned $2.9 billion in the first quarter, just $12 million below the all-time record, set in the third quarter of 1998. First-quarter profits were $259 million (10 percent) higher than a year ago. Higher noninterest income and lower expenses for income taxes were major factors in the earnings increase. The average ROA was 1.03 percent, compared to 0.98 percent a year earlier. Most of the improvement in profitability occurred at the largest savings institutions, as many smaller thrifts continue to experience declining ROAs.

Preliminary results for the first quarter of 2000 for the 8,518 FDIC-insured commercial banks and 1,633 FDIC-insured savings institutions are presented in the FDIC's latest *Quarterly Banking Profile*. The *Profile* offers the earliest comprehensive look back at the industry's most recent past performance, based upon quarterly reports of condition and income submitted by all FDIC-insured banks and thrifts. Highlights follow.

Commercial Banks

Continued strength in the economy was evidenced by strong loan growth and increased market-related revenues. Commercial banks' first quarter ROA of 1.35 percent was their second-best ever, trailing only the 1.42 percent registered in the third quarter of 1999. Earnings strength was fairly widespread; almost two out of every three banks (61.8 percent) recorded an ROA of one percent or higher in the quarter, and 59 percent had a higher ROA than in the first quarter of 1999.

Noninterest income was $3.7 billion (10.6 percent) higher than a year ago, while net interest income was $2.7 billion (5.7 percent) higher. A significant contribution to noninterest revenues came from venture capital gains (appreciation in banks' equity investments), which exceeded $1.3 billion. Noninterest expenses were only $2.3 billion (4.6 percent) above the level of a year ago. The year-to-year improvement in profits was limited by a $1.3 billion decline in proceeds from sales of securities, as higher interest rates caused a decline in the value of banks' securities portfolios. A year ago, banks posted a net gain of $565 million from securities sales; in the first quarter, securities sales yielded a net loss of $730 million.

While improving in most other loan categories, asset quality indicators deteriorated for bank loans to commercial and industrial (C&I) borrowers. The percentage of C&I loans that were noncurrent rose from 1.18 percent to 1.28 percent during the quarter. This is the highest level since the third quarter of 1994. The annualized net charge-off rate on C&I loans rose as well, to 0.52 percent from 0.44 percent in the first quarter of 1999. For all loans and leases, total net charge-offs were $5.0 billion, up by 0.9 percent compared to a year ago.

Commercial bank assets increased by $112.4 billion during the quarter, propelled by strong loan growth. Total loans and leases increased by $77.1 billion, as C&I loans rose by $30.6 billion, residential mortgage loans increased by $18.2 billion, and commercial real estate loans grew by $15.9 billion. The composition of banks' assets and liabilities continues to shift toward greater vulnerability to rising interest rates. The proportion of bank assets that have long maturities or repricing intervals (five years or longer) is increasing, so that banks' assets reprice upward more slowly when interest rates rise. At the same time, commercial banks' liabilities are becoming more interest-rate sensitive, as the proportion of funding provided by short-term liabilities increases, and the proportion of core deposits, which typically carry lower interest rates, declines. Therefore, banks' funds reprice upward more rapidly when interest rates rise.

The number of insured commercial banks declined by 62 institutions during the first quarter. There were 56 new commercial bank charters, while 118 banks were absorbed by mergers and one insured commercial bank failed. At the end of March, there were 72 commercial banks on the FDIC's "Problem List," up from 66 at the beginning of the quarter.

Savings Institutions

The performance gap between large and small savings institutions widened further in the first quarter. The largest asset size group -- thrifts with $5 billion or more in assets -- was the only group to register a higher ROA than a year ago. The average ROA at these institutions was 1.12 percent, up from 0.97 percent a year ago. In contrast, the average ROA at thrifts with less than $1 billion in assets fell to 0.79 percent, from 0.92 percent a year ago. Just 26 percent of insured savings institutions, representing approximately half of total industry assets, reported an ROA of over one percent in the first quarter.

Assets of insured savings institutions increased during the quarter by $7.3 billion, with much of the growth occurring in home mortgage loans. Thrifts' portfolios of one-to-four family residential mortgages increased by $6.8 billion, while securities holdings fell by $9.2 billion, and multifamily (five or more) residential mortgages declined by $1.7 billion. On the liabilities side, deposits increased by $4.2 billion, while Federal Home Loan Bank advances rose by $3.2 billion.

The number of insured savings institutions declined by eight during the first quarter. Mergers absorbed 13 institutions, and one insured savings institution failed, while five new charters were added to the industry. The number of "problem" thrifts rose from 13 to 15 during the quarter, but assets of these thrifts declined from $5.5 billion to $5.3 billion.