THE FDIC PRELIMINARY BANK EARNINGS REPORT

- **GAINS ON SECURITIES SALES LIFT INDUSTRY PROFITS TO NEW RECORD, DESPITE DECLINE IN OPERATING EARNINGS**
- **TROUBLED COMMERCIAL & INDUSTRIAL LOANS CONTINUE TO GROW**
- **NARROWER NET INTEREST MARGINS HURT SMALL-BANK PROFITS**
- **LOANS REGISTER SMALLEST QUARTERLY INCREASE IN FOUR YEARS**

Insured commercial banks earned a record $19.9 billion in the first quarter, surpassing the previous record of $19.5 billion, set a year earlier. The higher profits were made possible by a $1.9-billion improvement in banks' proceeds from securities sales. Sales of securities in the quarter yielded gains of $1.2 billion, whereas a year ago, when interest rates were higher, securities sales produced net losses totaling $730 million. The average return on assets for the quarter was 1.27 percent, down from 1.34 percent in the first quarter of 2000. A majority of commercial banks -- 53.6 percent -- reported lower ROAs in the first quarter, compared to a year ago. More than half (55.8 percent) of all commercial banks reported an ROA of 1 percent or higher for the first quarter.

Excluding nonrecurring items such as the gains on securities sales, banks' net operating income was $565 million (2.8 percent) lower than a year ago. Narrower net interest margins have meant slower growth in net interest income, while a less-robust economy and lackluster stock market have contributed to a slowdown in growth in noninterest revenues. Provisions for loan losses continue to rise, particularly at large banks, in response to increasing levels of troubled loans to commercial borrowers. Net interest income was up by only 3.5 percent ($1.7 billion), even though interest-earning assets were 7.9 percent higher. Noninterest income was 4.6 percent ($1.8 billion) above the level of a year ago, down from the 6.2-percent growth rate registered in 2000. Banks set aside $7.9 billion in loan-loss provisions during the quarter, a $2.1-billion (36.1-percent) increase over the first quarter of 2000. Loss provisions absorbed 8.6 percent of commercial banks' net operating revenue (net interest income plus total noninterest income) in the first quarter, up from 6.6 percent a year earlier.

In an environment of falling short-term interest rates, the industry's net interest margin declined for the sixth consecutive quarter, to 3.83 percent. This is its lowest level since the first quarter of 1987. The average cost of funding interest-earning assets declined by 28 basis points, but the average yield on interest-earning assets fell by 35 basis points. Margin erosion was greatest at small banks. While the industry's margin declined by 7 basis points, the average margin for banks with less than $100 million fell by 19 basis points, and the margin for banks with assets between $100 million and $1 billion declined by 13 basis points.

Loan losses continued to rise in the first quarter. Banks charged-off $7.0 billion in bad loans during the quarter, an increase of $1.9 billion (38.1 percent) from the same quarter in 2000. Commercial and industrial loans accounted for more than half (54.8 percent) of the increase in net charge-offs. The annualized net charge-off rate on banks' commercial and industrial loans rose to 0.90 percent, from 0.52 percent a year earlier. The deterioration was concentrated among larger banks. Only one out of every three banks (33.6 percent) reported a higher net charge-off rate on their C&I loans in the first quarter, but these banks held 67.4 percent of the industry's C&I loans.

Even with the increase in charge-off activity, noncurrent loans -- loans 90 days or more past due or in nonaccrual status -- continued to increase as well. Total noncurrent loans increased by $3.2 billion (7.4 percent) during the quarter. Noncurrent commercial and industrial loans increased by $1.5 billion (8.7 percent), while noncurrent 1-4 family mortgage loans rose by $388 million (5.4 percent), and noncurrent real estate construction and development loans were up by $263 million (21.3 percent). Among the other loan categories, noncurrent loans were up by $997 million. Noncurrent levels were higher in home equity loans, leases, and "all other" loans, which include loans to finance securities purchases. At the end of the quarter, 1.2 percent of all loans held by commercial banks were noncurrent. This is the highest level since the third quarter of 1995. The noncurrent rate for commercial and industrial loans rose to 1.82 percent at the end of the quarter, a seven-year high.

Banks' reserves for losses increased by only $580 million (0.9 percent) during the quarter. This was enough growth to keep pace with sluggish loan growth, but it fell short of the increase in noncurrent loans. The industry's reserves represented 1.69 percent of total loans at the end of the quarter, up slightly from 1.68 percent at the beginning of the quarter. However, the industry's "coverage ratio" fell from $1.49 in reserves for every $1.00 of noncurrent loans to $1.40 during the quarter. It is now at its lowest level since the first quarter of 1994. A year ago, banks held $1.73 in reserves for every $1.00 in noncurrent loans.

Equity capital registered strong growth during the quarter, increasing by $16.8 billion (3.2 percent). An important part of the increase -- $4.5 billion -- came from the newly-reported item "Accumulated other comprehensive income," which includes both unrealized gains on available-for-sale securities and net gains and losses on cash flow hedges. The industry's ratio of equity capital to assets rose from 8.49 percent to 8.66 percent during the quarter, but the core capital (leverage) ratio used by regulators dipped slightly, to 7.69 percent from 7.70 percent, because changes in other comprehensive income are not reflected in regulatory capital.

Asset growth slowed for the second consecutive quarter, but remained strong by historical standards. For the twelve months ending March 31, total assets of commercial banks grew by 8.0 percent. Loan growth experienced a somewhat greater slowdown, as total loans registered their smallest quarterly increase (up $12.0 billion) in four years, and commercial and industrial loans declined for the first time since the third quarter of 1993. Home mortgage loans increased by $16.9 billion (2.1 percent) during the quarter. Overnight loans (federal funds) rose strongly for the second consecutive quarter, increasing by $47.3 billion (16.9 percent).

Deposits at commercial banks increased by only $7.1 billion during the quarter, the smallest quarterly rise in two years. The composition of banks' deposits underwent greater change, however. Deposits in foreign offices declined by $35.6 billion, while domestic office deposits grew by $42.7 billion. Domestic demand deposits registered a seasonal decline of $42.0 billion, while domestic savings deposits increased by $86.6 billion. This was the second consecutive quarter that savings deposits grew strongly. In the fourth quarter of last year, they were up by $69.5 billion. Brokered deposits continued to grow, with a significant boost from the sweeping of brokerage accounts into insured deposits at banks affiliated with brokerage firms. These sweep accounts increased by roughly $24 billion during the quarter, with $20 billion of the increase fully insured.

The number of insured commercial banks reporting financial results fell by 77 banks during the first quarter, from 8,315 to 8,238. There were 33 new charters, while 103 banks were absorbed by mergers, and one insured commercial bank failed. The number of commercial banks on the FDIC's "Problem List" increased from 76 to 78 during the quarter. Total assets of "problem" banks remained unchanged at $17 billion.

June 7, 2001
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Table I-A. Selected Indicators, FDIC-Insured Commercial Banks

Table II-A. Aggregate Condition and Income Data, FDIC-Insured Commercial Banks

Table III-A. First Quarter 2001, FDIC-Insured Commercial Banks

Table IV-A. Full Year 2000, FDIC-Insured Commercial Banks

Table V-A. Loan Performance, FDIC-Insured Commercial Banks

Quarterly Net Income & Quarterly Net Interest Margins, Annualized

Troubled Commercial and Industrial Loans & Maturity Distribution of Commercial Bank FHLB Advances

Composition of Commercial Banks' Noninterest Income & Quarterly Change in Domestic Loans vs Domestic Deposits