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First Quarter Bank Results: Good News, Bad News

After several quarters of poor performance in the banking sector, the first quarter of 1992 contained some good news. The nation's banks reported record profits, rising returns on assets (ROA), and declining problem loan ratios. The Twelfth Federal Reserve District, however, had mixed results. Outside of California, the District's banks performed well, echoing the improvements in the rest of the country. California's banks, in contrast, reported declining revenues relative to the previous year, low ROA, and rising problem loan ratios. These poor results confirm that the region's banks are suffering from hard times.

The results for California banks, however, may overstate the extent of their problems. California banks aggressively set aside reserves against future loan losses, and despite weak earnings, continued to build equity capital ratios. While these factors provide some cause for optimism, it is difficult to say how long the California banks' problems will persist. In this *Letter*, we describe the first quarter bank results and try to place these results in perspective.

In the nation: higher earnings, lower losses

In the first quarter of 1992, commercial banks nationally earned a record $7.5 billion, nearly $2 billion more than in the same quarter of 1991. A favorable interest rate environment especially helped the nation's banks, as they enjoyed their highest net interest margins since 1988. Low interest rates also created opportunities to profit from the sale of investment securities, which contributed more than $680 million to the year-over-year improvement in pre-tax earnings. Return on assets for U.S. banks stood at 0.88 in the first quarter of 1992, up from 0.67 a year earlier.

Banks used the increased earnings to add to loan loss reserves and to build equity capital cushions. Loan loss provisions nationwide were $7.2 billion in the first quarter of 1992, roughly the same as a year ago. Equity capital as a percent of total assets rose from 6.7 percent in the first quarter of 1991 to 7.0 percent in the first quarter of this year.

Accompanying these improved financial results were declining problem loan ratios nationwide. Total problem loan ratios (defined as all loans 30 or more days past due or on nonaccrual status, divided by total loans) fell from 6.7 percent in the first quarter of 1991 to 6.0 percent in the first quarter of 1992. Fewer problem real estate loans, business loans, and consumer loans all contributed to the decline. Net chargeoffs also leveled off, suggesting that credit quality problems at banks nationally may have stabilized.

California lags behind

Excluding California, Twelfth District bank performance was strong in the first quarter. Earnings were $467 million, up 10 percent from the previous year's first quarter. Banks in every state except California and Arizona reported ROAs over 1.0. Problem loan ratios at banks in the Twelfth District, excluding California, were stable or declining in the quarter and were below national averages.

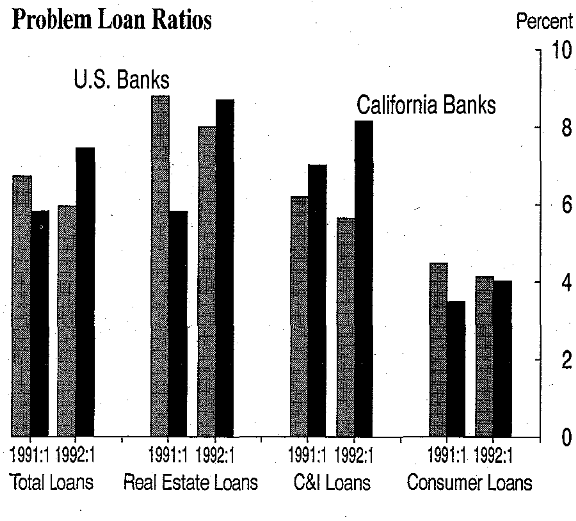
In California, first quarter earnings were $270 million, down 64 percent from a year earlier. Much of this earnings decline can be attributed to loan loss provisions of $1.2 billion—more than double the provision from the first quarter of 1991—and to the performance of a few of the

WESTERN BANKING *Western Banking* is a quarterly review of banking developments in the Twelfth Federal Reserve District. It is published in the *Weekly Letter* on the fourth Friday of January, April, July, and October.

largest banks in the state. Combined earnings at the ten largest California banks fell 80 percent from a year earlier, a drop of almost $490 million. In contrast, the next ten largest banks reported a combined earnings increase of almost 80 percent (a little over $20 million). But the problems in California are not confined to a few big banks. The remaining 450 banks in the state posted a 4 percent decline in combined earnings from the first quarter of 1991, a drop of about $4 million. First quarter ROAs reflect the same pattern as earnings: 0.19 for the ten largest banks, 1.45 for the next ten largest banks, and 0.58 for the rest of California's banks.

Rising problem loan ratios are particularly evident at California banks. For all banks in the state, the ratio of problem loans to total loans rose 1.7 percentage points from a year earlier, to 7.5 percent (see Chart 1). In fact, problem loan ratios in all major loan categories rose from the first quarter of 1991 to the first quarter of 1992. Problem real estate loans, in particular, plague California banks. For example, the problem loan ratio for construction loans, which are a component of real estate loans, is over 27 percent for California banks with over $1 billion in assets, while nationally the average is about 19 percent. Similarly, problem commercial real estate loans at these large banks were about 12 percent in the first quarter, compared to the national average of 8.7 percent. For the smaller California banks, problem real estate loan ratios were below national averages in the first quarter but rose significantly.

Chart 1
Problem Loan Ratios



A ray of hope for California?

The figures above suggest that the difficulties facing California's banks are significant. While the industry nationwide exhibits steady improvement, the condition of California banks, particularly in the area of problem loan ratios, continues to worsen. However, the data do provide some reasons for optimism.

First, despite a very weak economic climate and large loan loss provisions, banks in California still reported positive earnings for the first quarter after two consecutive quarters of negative earnings. Second, banks in California are actively reclassifying credits, recognizing current and potential problem loans, and are making large additions to loan loss reserves. Thus, banks in the state are actively recognizing that problems exist and have begun to build the financial reserves to absorb future losses. Finally, despite the weakness in earnings, California banks increased equity capital ratios. The ratio for the state's banks was 6.5 percent of assets in the first quarter of 1992, up from 6.4 percent in the first quarter of 1991.

Where have all the bank loans gone?

The first quarter results reflect another important development affecting the banking industry nationally, namely, slow growth in bank assets. Compared to year-earlier figures, total assets at the nation's banks grew only 2.3 percent. More important, total loans fell over 2.5 percent from the first quarter of 1991. This year-over-year decline in bank loans includes a 10.2 percent drop in business loans, a 3.7 percent decline in consumer loans, and a 2.9 percent increase in real estate loans. The only component of bank portfolios that showed any significant growth was securities holdings, which rose 15 percent. These asset growth patterns were even more pronounced in California: loans dropped 4 percent from the first quarter of 1991 to the first quarter of 1992, while securities holdings skyrocketed more than 43 percent.

Clearly, these bank asset growth figures reflect general economic conditions as well as a shift by some borrowers away from bank credit. Facing weak loan demand, banks have sought alternative assets and have accumulated large securities portfolios, especially of Treasury and government-backed mortgage securities. Regulatory pressures also may have influenced bank decisions in this regard, as these securities receive favorable treatment under the risk-based capital standards.

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REGIONAL BANK DATA

MARCH 31, 1992

(NOT SEASONALLY ADJUSTED, PRELIMINARY DATA)

		DISTRICT	ALASKA	ARIZ.	CALIF.	HAWAII	IDAHO	NEVADA	OREGON	UTAH	WASH.
ASSETS AND LIABILITIES -- $ MILLION (ALL COMMERCIAL BANKS)											
ASSETS	TOTAL	510,770	4,580	35,650	345,781	21,334	9,619	15,077	25,524	13,937	39,268
	FOREIGN	34,668	1	N/A	32,453	2,036	N/A	N/A	0	110	68
	DOMESTIC	476,102	4,579	35,650	313,328	19,298	9,619	15,077	25,524	13,827	39,200
LOANS	TOTAL	359,064	2,013	22,249	248,646	13,287	6,535	10,300	18,066	8,645	29,325
	FOREIGN	29,520	5	N/A	28,070	1,385	N/A	N/A	N/A	N/A	59
	DOMESTIC	329,545	2,008	22,249	220,575	11,901	6,535	10,300	18,066	8,645	29,266
	REAL ESTATE	168,204	865	7,218	125,622	6,794	2,037	2,771	6,866	3,323	12,709
	COMMERCIAL	70,842	685	2,855	48,038	3,050	1,508	895	4,642	1,645	7,524
	CONSUMER	57,459	309	5,337	29,886	1,179	1,773	5,872	3,572	3,036	6,494
	AGRICULTURE	5,448	6	364	2,717	41	665	15	443	154	1,043
	INTERNATIONAL	123	N/A	7	115	0	N/A	N/A	N/A	N/A	0
SECURITIES	TOTAL	57,702	1,953	5,973	30,939	4,493	1,767	2,253	3,783	2,889	3,652
	U.S.T.S.	19,227	847	2,072	9,877	2,103	359	1,075	1,114	518	1,262
	SECONDARY MARKET	26,748	592	2,987	15,325	1,643	915	692	1,760	1,667	1,167
	OTHER SEC.	11,726	514	914	5,737	747	493	486	909	703	1,223
LIABILITIES	TOTAL	475,131	4,003	32,920	323,385	19,865	8,925	13,675	23,369	12,772	36,217
	DOMESTIC	440,463	4,003	32,920	290,932	17,830	8,925	13,675	23,369	12,662	36,149
DEPOSITS	TOTAL	413,291	3,501	30,309	283,670	15,648	7,496	9,046	20,107	10,534	32,980
	FOREIGN	32,717	1	N/A	30,709	1,788	N/A	N/A	N/A	110	108
	DOMESTIC	380,574	3,500	30,309	252,961	13,859	7,496	9,046	20,107	10,424	32,871
	DEMAND	85,945	1,009	5,178	61,086	2,248	1,224	2,140	3,727	1,945	7,387
	TIME AND SAVINGS	294,629	2,491	25,131	191,875	11,611	6,271	6,907	16,380	8,479	25,484
	NOW	40,084	288	3,281	24,793	1,470	950	1,147	2,877	1,378	3,899
	MMDA	90,434	547	7,367	63,581	2,046	1,369	2,337	4,256	1,899	7,031
	SAVINGS	41,437	565	2,829	26,420	2,657	763	1,439	1,853	1,187	3,724
	SMALL TIME	80,137	558	9,840	45,880	2,168	2,627	1,178	6,341	3,208	8,338
	LARGE TIME	42,122	504	1,796	30,992	3,268	561	803	1,049	803	2,344
OTHER BORROWINGS		41,061	459	2,078	22,728	3,604	1,312	3,861	2,694	2,027	2,299
EQUITY CAPITAL		35,639	577	2,730	22,396	1,469	694	1,402	2,155	1,165	3,051
LOAN LOSS RESERVE		10,783	41	556	8,332	212	96	362	429	213	542
LOAN COMMITTMENTS		195,994	587	18,749	135,225	5,842	2,379	1,752	9,471	6,494	15,495
LOANS SOLD		36,724	9	228	35,724	267	27	67	206	32	164
ASSET QUALITY -- PERCENT OF LOANS (LARGE COMMERCIAL BANKS)											
LOAN LOSS RESERVE (ALL BANKS)		3.00	2.02	2.50	3.35	1.60	1.47	3.52	2.37	2.47	1.85
NET CHARGEOFFS, TOTAL		1.40	0.12	1.94	1.54	0.20	0.36	2.72	0.68	1.07	0.66
	REAL ESTATE	0.79	-0.06	1.79	0.90	0.00	-0.03	0.37	0.15	0.47	0.25
	COMMERCIAL	1.75	0.27	6.31	1.87	0.50	0.81	1.01	1.20	0.74	0.70
	CONSUMER	3.20	0.33	2.66	4.03	0.66	0.63	4.32	1.65	2.17	1.24
	AGRICULTURE	0.30	N/A	-0.44	0.39	N/A	0.03	N/A	0.14	1.87	0.39
PAST DUE & NON-ACCRUAL, TOTAL		6.35	5.28	4.15	7.45	2.18	2.44	5.55	4.17	3.38	4.16
	REAL ESTATE	7.82	5.36	7.58	8.71	2.22	3.08	6.73	5.09	4.71	5.76
	COMMERCIAL	7.22	5.92	7.63	8.17	2.76	2.44	6.59	5.62	3.15	4.10
	CONSUMER	3.48	2.92	2.64	4.03	1.92	1.47	5.48	1.67	2.37	1.92
	AGRICULTURE	6.19	N/A	8.59	7.19	1.19	4.62	0.17	6.37	3.18	3.85
EARNINGS AND RETURNS -- $ MILLION, YEAR-TO-DATE (ALL COMMERCIAL BANKS)											
INCOME	TOTAL	12,475	109	821	8,360	445	223	544	645	357	971
	INTEREST	10,002	88	655	6,715	400	192	386	509	290	767
	FEES & CHARGES	724	6	52	495	11	14	12	44	20	70
EXPENSES	TOTAL	11,116	78	782	7,698	353	180	377	523	296	829
	INTEREST	4,269	32	311	2,905	193	90	91	211	122	314
	SALARIES	2,298	23	158	1,594	79	32	39	132	50	191
	LOAN LOSS PROVISION	1,576	2	90	1,225	15	8	81	46	32	79
	OTHER	2,974	22	223	1,975	67	51	166	134	92	244
INCOME BEFORE TAXES		1,323	31	39	627	92	42	167	121	61	143
TAXES		602	9	24	360	33	15	56	41	19	45
NET INCOME		737	21	27	270	59	28	111	80	42	98
ROA (%)		0.58	1.90	0.31	0.31	1.17	1.17	2.96	1.26	1.25	1.01
ROE (%)		8.27	14.85	3.98	4.83	16.17	16.05	31.56	14.92	14.51	12.84
NET INTEREST MARGIN (%)		4.50	5.05	3.90	4.39	4.08	4.27	7.90	4.67	4.96	4.68
NET OVERHEAD MARGIN (%)		-2.32	-2.53	-2.51	-2.37	-2.02	-2.18	-1.30	-2.10	-2.20	-2.45
NUMBER OF BANKS		771	8	39	468	19	22	19	51	54	91
NUMBER OF EMPLOYEES		239,500	2,579	18,277	154,699	8,350	4,893	6,125	15,623	7,137	21,817

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MARKET SHARE STATISTICS

DEPOSITORY INSTITUTIONS REQUIRED TO HOLD RESERVES WITH THE FEDERAL RESERVE ON A WEEKLY BASIS

(PERCENT OF COMBINED MARKET TOTAL FOR MAY 1992, BY REGION)

	DISTRICT			ALASKA			ARIZONA			CALIF			HAWAII			IDAHO			NEVADA			OREGON			UTAH			WASH		
DEPOSIT TYPE	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU
TOTAL DEPOSITS	54	40	6	71	4	25	92	0	7	48	47	5	67	28	5	91	5	3	72	25	3	80	11	9	78	8	14	56	35	9
DEMAND	90	4	5	99	0	1	95	0	5	90	5	6	89	4	7	94	0	6	98	2	0	94	1	5	89	4	7	90	7	4
NOW	64	28	8	59	6	35	89	0	11	58	35	6	67	30	3	93	3	3	78	16	6	84	8	8	83	4	13	64	24	12
SAVINGS & MMDAS	60	32	8	54	4	41	90	0	10	56	38	6	61	31	8	93	4	3	82	15	4	76	11	13	71	6	23	57	26	18
SMALL TIME	33	63	3	75	8	16	95	1	4	25	73	3	46	50	4	89	10	1	41	56	3	76	18	6	78	15	7	40	56	4
LARGE TIME	48	45	7	94	2	4	94	0	5	43	49	8	81	16	3	88	6	5	59	41	0	79	11	10	73	11	16	50	48	2

CB = COMMERCIAL BANKS; SL = SAVINGS & LOANS AND SAVINGS BANKS; CU = CREDIT UNIONS; MAY NOT SUM TO 100% DUE TO ROUNDING

INTEREST RATES ON DEPOSITS AND LOANS AS OF MAY 1992 (%)

TYPE OF ACCOUNT OR LOAN		DATE	US	DISTRICT	ARIZ	CALIF	HAWAII	IDAHO	OREGON	UTAH	WASH
SAVINGS ACCOUNTS AND MMDAS**		MAR92	3.74	3.79	3.45	3.70	4.01	4.17	3.53	4.00	3.68
		APR92	3.63	3.70	3.25	3.60	4.02	4.01	3.42	3.91	3.65
		MAY92	NA	3.67	3.22	3.56	3.88	4.04	3.37	3.86	3.68
92 TO 182 DAYS CERTIFICATES		MAR92	4.01	3.86	3.67	3.82	4.08	3.72	3.73	4.13	3.85
		APR92	3.90	3.81	3.61	3.75	4.08	3.68	3.66	4.02	3.93
		MAY92	NA	3.76	3.47	3.63	4.05	3.72	3.60	3.93	4.00
2-1/2 YEARS AND OVER CERTIFICATES		MAR92	5.49	5.10	4.50	5.16	5.71	5.46	5.09	5.32	4.93
		APR92	5.48	5.15	4.47	5.18	5.71	5.46	5.12	5.32	5.14
		MAY92	NA	5.17	4.47	5.08	5.63	5.62	5.37	5.30	5.30
COMMERCIAL, SHORT-TERM*	AVE. RATE		5.38	6.59	7.66	6.75	7.13	NA	6.88	7.20	5.91
	AVE. MAT. (DAYS)		44	199	145	226	91	NA	57	251	32
COMMERCIAL, LONG-TERM*	AVE. RATE		6.78	7.76	NA	7.29	8.72	NA	NA	8.64	NA
	AVE. MAT. (MONTHS)		40	41	NA	33	30	NA	NA	57	NA
LOANS TO FARMERS*	AVE. RATE		8.06	7.09	7.09	7.02	NA	7.78	6.91	5.01	7.75
	AVE. MAT. (MONTHS)		14	7	NA	9	NA	NA	7	2	6
CONSUMER, AUTOMOBILE	AVE. RATE		9.52	9.67	10.25	9.74	NA	10.50	8.98	9.82	8.96
CONSUMER, PERSONAL	AVE. RATE		14.28	13.80	14.38	14.50	NA	11.00	12.38	14.98	12.43
CONSUMER, CREDIT CARDS	AVE. RATE		17.97	18.52	18.00	18.98	NA	NA	19.25	21.00	17.97

SOURCES: SURVEY OF TERMS OF BANK LENDING AND TERMS OF CONSUMER CREDIT; MOST COMMON INTEREST RATES ON SELECTED ACCOUNTS.
* DATA ARE COMPOUNDED ANNUAL RATES. ** SAVINGS AND MMDAS COMBINED AS OF APRIL 1992.