The FDIC Quarterly Banking Profile

L. William Seidman, Chairman

Third Quarter 1989

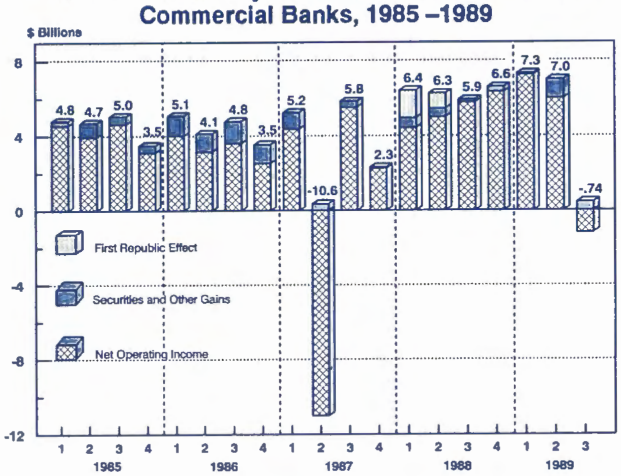
COMMERCIAL BANKING PERFORMANCE – THIRD QUARTER 1989

- ***Commercial Banks Register Aggregate Quarterly Loss***
- ***Additions to LDC Reserves Clobber Industry Earnings***
- ***Asset Growth Is Increasingly Dependent On Real Estate Lending***
- ***More Banks Showing Profits***
- ***Number of Problem Banks Continues to Fall***

Commercial banks reported an aggregate loss of $744 million for the third quarter of 1989. The quarterly loss was the industry's first since the second quarter of 1987. Just as in 1987, the loss resulted from large additions to reserves for loans to developing countries (LDCs) by several of the nation's largest banks. As a result of these provisions, the industry's net income of $13.7 billion through the first nine months of 1989 is almost $5 billion less than the amount earned in the first three quarters of 1988. *Real estate loan growth in the past twelve months has been equivalent to two-thirds of all bank asset growth during that time.*

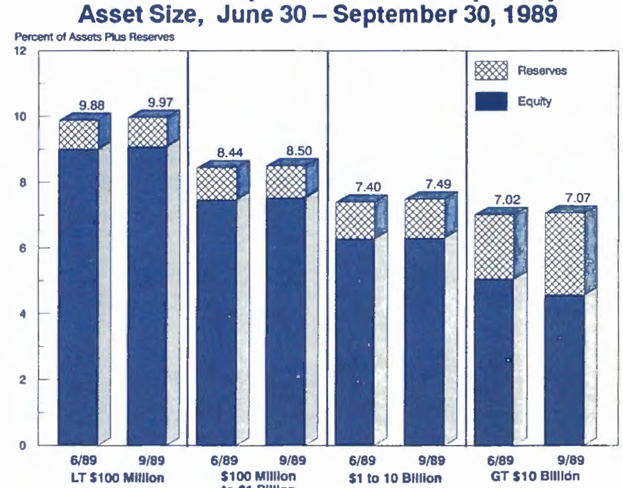
The large additions to reserves overshadowed other third-quarter developments. Gains from securities sales of just over $300 million exceeded the total for all of 1988. Nonperforming assets increased by $3.2 billion, but ended the quarter below the level of a year ago. As has been the case recently, asset quality showed improvement in the three regions west of the Mississippi River, and slippage in the three eastern regions, compared with the same quarter a year ago. Sixty-one banks failed or received assistance during the quarter, bringing the total for 1989 to 162. The number of banks on the FDIC's "Problem List" declined by 115 during the quarter, to 1,151.

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



Commercial banks' total third-quarter loss provision was $12.7 billion, almost three times as much as the $4.5 billion the industry set aside a year ago. Five of the ten largest banks in the U.S. set aside $6.3 billion in third-quarter loan-loss provisions, mostly to strengthen their reserves against future LDC loan losses. These five money-center banks incurred quarterly earnings losses of $5.6 billion. In all, commercial banks set aside $8.5 billion in loss provisions for foreign operations in the quarter, about half as much as they set aside in the second quarter of 1987. A year ago, they set aside $100 million. Many banks also increased their domestic reserves against future losses on troubled real estate loans.

Chart B – Composition of Bank Capital By Asset Size, June 30 – September 30, 1989

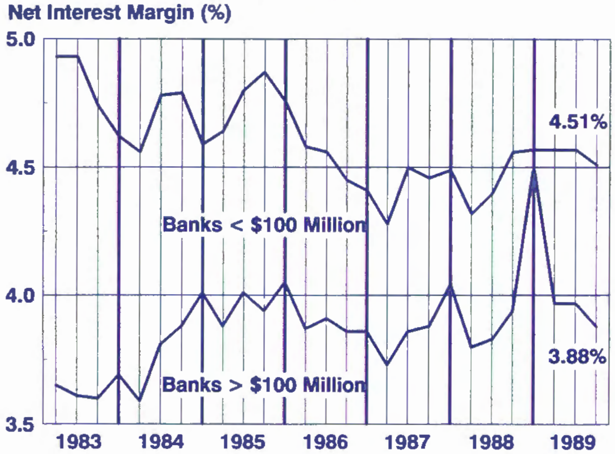


The banking industry's equity capital fell $2.2 billion during the third quarter. Equity of the five money-center banks that experienced quarterly losses declined by $5.1 billion, as their loss reserves increased by $5.7

FDIC
Division of Research
& Statistics
...aldrop
(...)98-3951

billion. The rest of the industry had equity growth of almost $3 billion and reserve growth of $2.1 billion.

Chart C – Quarterly Net Interest Margins, 1983 – 1989

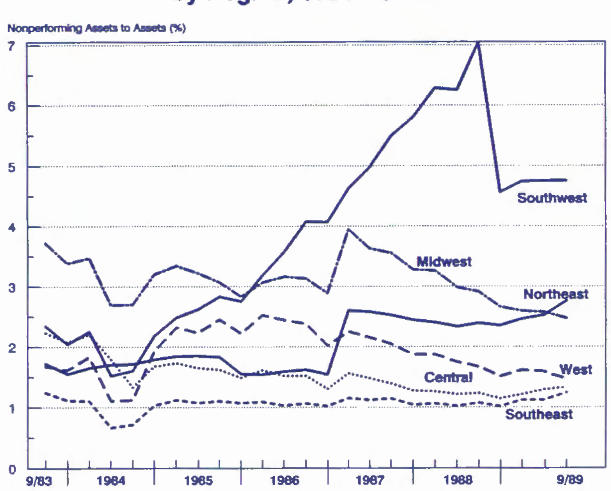


Net interest margins shrank between June and September as increases in banks' cost of funds outdistanced interest income growth. Margins were still slightly wider than in the same period of 1988, thanks in part to the small decline in nonperforming assets. *Noninterest income continued to show double-digit growth;* noninterest expense, while increasing less rapidly, grew at a more rapid rate than did assets.

Aggregate results in the Northeast Region, home to the five money-center banks, were most affected by third-quarter LDC reserving. Northeast Region banks were the only group other than banks in the Southwest to register an aggregate quarterly loss. Their third-quarter loss provision was $8.9 billion higher than a year ago. Over half the Region's banks had lower earnings than a year ago, and one in seven Northeast banks had a net loss for the quarter. *The percentage of real estate loans in nonaccrual status was double the level of a year ago.*

Southwest Region banks had a net loss for the third quarter, but they still showed a small profit for the first nine months of 1989. Noninterest income was more than fifty percent higher than in the third quarter of 1988, while noninterest expense growth was kept low. Net loan charge-offs fell as a percent of total loans, but remained at a higher level than any other region's. The percentage of Southwest Region banks with quarterly earnings losses declined from year-earlier levels for the sixth consecutive period.

Chart D – Nonperforming Assets to Assets Ratios by Region, 1984 – 1989

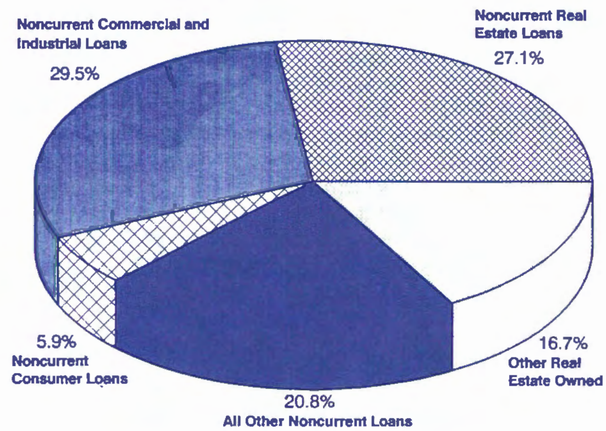


Banks in the Southeast Region had the strongest asset growth of any region, but net interest income growth did not keep pace, and net interest margins were narrower. *Real estate loans accounted for almost half of the region's asset growth in the third quarter.* Higher loss provisioning hurt Southeast banks' profitability.

Central Region banks recorded a small drop in profitability as their third-quarter loss provision was almost double last year's. Most of the increase in the loss provision went to bolster reserves for LDC loans.

Midwest banks improved their profitability slightly, despite marginal asset growth. Net charge-offs were higher, but nonperforming assets were lower, than a year ago. Strong noninterest income growth and containment of overhead costs helped earnings.

Chart E – Composition of Nonperforming Assets September 30, 1989



Banks in the West Region benefited from strong loan growth, especially real estate and consumer loans. Nonperforming assets and net charge-offs were lower than a year ago. *Depressed real estate markets continue to adversely affect the performance of some banks in the West.*

The outlook for fourth-quarter earnings depends on developments in depressed or overbuilt real estate markets, and on bank decisions regarding their reserves for loans to LDC borrowers. Further losses on troubled real estate loans can be expected to depress profits, and additional discretionary additions to LDC loss reserves are possible. Some of the money-center banks that depleted their equity capital in order to build loss reserves in the third quarter will begin restoring their equity through new stock issues in the fourth quarter. Net interest margins may show improvement in the fourth quarter, as consumer deposits roll over at lower interest rates. Total bank failures and assistance transactions will exceed 200 for the year, and are likely to end up only slightly below the 221 failures that occurred in 1988.

Table I. Selected Indicators, FDIC-Insured Commercial Banks

	1989*	1988*	1988	1987	1986	1985	1984
Return on assets	0.58%	0.82%	0.83%	0.12%	0.63%	0.70%	0.65%
Return on equity	9.06	13.38	13.37	2.00	9.94	11.31	10.73
Equity capital to assets	6.33	6.24	6.28	6.04	6.20	6.20	6.15
Primary capital ratio	7.92	7.93	7.85	7.70	7.22	6.91	6.91
Nonperforming assets to assets	2.34	2.45	2.14	2.46	1.94	1.87	1.97
Net charge-offs to loans	0.88	0.93	0.99	0.92	0.98	0.84	0.76
Asset growth rate	4.19	5.17	5.68	2.03	7.71	8.86	7.11
Net operating income growth	-26.51	N/M	1666.92	-85.27	-20.65	6.30	3.40
Percentage of unprofitable banks	10.66	13.59	14.44	17.66	19.79	17.09	13.06
Number of problem banks	1,151	1,429	1,394	1,559	1,457	1,098	800
Number of failed/assisted banks	162	186	221	201	144	118	78

*Through September 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 3rd Qtr 1989	2nd Qtr 1989	3rd Qtr 1988	%Change 88:3-89:3
Number of banks reporting	12,824	12,944	13,241	-3.1
Total employees (full-time equivalent)	1,527,645	1,541,482	1,525,536	0.1
CONDITION DATA				
Total assets	$3,224,360	$3,207,431	$3,094,814	4.2
Real estate loans	743,459	719,522	657,485	13.1
Commercial & industrial loans	616,892	612,339	594,950	3.7
Loans to individuals	387,964	379,337	367,579	5.2
Farm loans	31,795	31,038	31,136	2.3
Other loans and leases	244,492	246,948	250,995	-2.6
Total loans and leases	2,024,602	1,989,185	1,902,145	6.4
LESS: Reserve for losses	52,895	45,092	49,186	7.5
Net loans and leases	1,971,707	1,944,093	1,852,959	6.4
Temporary investments	464,406	478,760	483,000	-3.8
Securities over 1 year	400,176	394,630	382,870	4.5
All other assets	388,072	389,948	375,984	3.2
Total liabilities and capital	3,224,360	3,207,431	3,094,814	4.2
Noninterest-bearing deposits	441,827	455,761	450,818	-2.0
Interest-bearing deposits	2,025,288	1,997,100	1,924,417	5.2
Other borrowed funds	424,078	420,861	403,908	5.0
Subordinated debt	19,068	17,684	17,197	10.9
All other liabilities	109,863	109,536	105,208	4.4
Equity capital	204,237	206,489	193,267	5.7
Primary capital	260,593	255,219	246,050	5.9
Nonperforming assets	75,294	72,057	75,798	-0.7
Loan commitments and letters of credit	858,842	851,349	819,260	4.8
Domestic office assets	2,793,347	2,791,172	2,678,541	4.3
Foreign office assets	431,013	416,259	416,272	3.5
Domestic office deposits	2,143,684	2,129,550	2,046,873	4.7
Foreign office deposits	323,430	323,311	328,362	-1.5
Earning assets	2,836,289	2,817,482	2,718,829	4.3
Volatile liabilities	1,144,780	1,138,841	1,101,879	3.9

INCOME DATA	Preliminary First Three Qtrs 1989	First Three Qtrs 1988	%Change	Preliminary 3rd Qtr 1989	3rd Qtr 1988	% Change
Total interest income	$235,656	$197,430	19.4	$80,914	$69,684	16.1
Total interest expense	151,755	119,684	26.8	52,905	42,783	23.7
Net interest income	83,901	77,746	7.9	28,009	26,901	4.1
Provision for loan losses	20,600	11,669	76.5	12,715	4,453	185.5
Total noninterest income	37,269	33,338	11.8	12,827	11,410	12.4
Total noninterest expense	79,627	74,538	6.8	27,142	25,406	6.8
Applicable income taxes	8,088	7,385	9.5	2,165	2,601	-16.8
Net operating income	12,854	17,491	-26.5	-1,186	5,851	N/M
Securities gains, net	520	516	0.9	307	1	N/M
Extraordinary gains, net	313	592	-47.0	134	157	-14.5
Net income	13,688	18,599	-26.4	-744	6,009	N/M
Net charge-offs	13,072	13,053	0.1	4,818	4,568	5.5
Net additions to capital stock	353	1,427	-75.3	42	248	-83.0
Cash dividends on capital stock	10,010	8,962	11.7	3,371	2,911	15.8

Table III. First Three Quarters 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 THREE QUARTERS *Preliminary* *(The way it is . . .)*											
Number of banks reporting	12,824	9,927	2,526	330	41	1,086	1,959	2,861	3,042	2,381	1,495
Total assets	$3,224.36	$367.86	$604.82	$1,045.26	$1,206.41	$1,273.98	$466.09	$524.20	$209.03	$255.92	$495.13
Total deposits	2,467.11	325.38	515.67	772.77	853.30	915.34	366.69	414.86	166.01	215.10	389.12
Net income *(in millions)*	13,688	2,429	4,146	6,415	698	977	3,233	3,980	1,708	150	3,640
Percentage of banks losing money	10.7%	11.9%	5.9%	8.2%	24.4%	11.8%	11.1%	3.7%	4.6%	23.1%	15.2%
Percentage of banks with earnings gains	63.8%	62.0%	70.2%	67.9%	48.8%	64.9%	62.7%	67.4%	60.5%	59.9%	70.0%
Performance Ratios *(annualized)*											
Yield on earning assets	11.33%	10.54%	10.83%	11.08%	12.06%	12.06%	10.82%	10.65%	10.96%	10.13%	11.41%
Cost of funding earning assets	7.29	5.98	6.23	6.78	8.72	8.47	6.61	6.69	6.49	6.58	6.23
Net interest margin	4.03	4.56	4.59	4.30	3.34	3.59	4.21	3.96	4.46	3.55	5.18
Net noninterest expense to earning assets	2.04	2.73	2.60	2.14	1.43	1.70	2.36	1.96	2.02	2.26	2.58
Net operating cash flow to assets	1.75	1.67	1.81	1.90	1.62	1.65	1.64	1.79	2.20	1.10	2.25
Net operating income to assets	0.54	0.87	0.92	0.82	0.03	0.07	0.92	1.03	1.08	0.02	0.94
Return on assets	0.58	0.90	0.94	0.84	0.08	0.10	0.95	1.04	1.12	0.08	1.01
Return on equity	9.06	9.85	12.48	13.36	1.54	1.75	13.57	15.11	14.44	1.33	16.51
Net charge-offs to loans and leases	0.88	0.63	0.63	0.91	1.04	0.92	0.50	0.66	1.11	1.51	0.99
Loan loss provision to net charge-offs	157.58	126.09	128.63	130.02	192.44	212.32	135.06	112.61	98.16	126.37	115.92
Condition Ratios											
Loss allowance to:											
Loans and leases	2.61%	1.67%	1.59%	1.81%	4.10%	3.46%	1.34%	1.93%	1.86%	2.77%	2.54%
Noncurrent loans and leases	83.40	72.63	74.63	81.49	87.56	84.93	87.48	99.59	99.22	49.02	88.28
Nonperforming assets to assets	2.34	1.90	1.77	1.77	3.24	2.76	1.24	1.33	1.46	4.75	2.47
Equity capital ratio	6.33	9.16	7.61	6.38	4.79	5.70	7.07	6.94	7.76	5.89	6.24
Primary capital ratio	7.92	10.05	7.97	7.54	7.57	7.98	7.91	7.50	8.91	7.24	8.17
Net loans and leases to deposits	79.92	59.57	71.51	87.89	85.54	85.80	79.39	75.23	72.72	59.04	86.21
Growth Rates *(year-to-year)*											
Assets	4.2%	6.0%	9.1%	10.1%	2.5%	2.4%	9.9%	6.0%	1.0%	-2.4%	6[illegible]
Equity capital	5.7	5.0	9.4	12.1	2.5	1.7	9.5	7.8	2.8	0.9	13.[illegible]
Net interest income	7.9	9.7	13.8	13.0	6.9	6.7	7.8	8.1	3.2	1.9	14.6
Net income	-26.4	18.0	11.0	4.8	-91.1	-88.8	3.8	2.5	6.3	109.7	29.4
Nonperforming assets	-0.7	3.5	17.3	35.4	-12.1	18.6	26.7	13.6	-12.0	-34.2	-9.8
Net charge-offs	0.1	-0.4	10.8	5.0	6.8	35.2	-5.4	2.8	-9.5	-42.5	-7.0
Loan loss provision	76.5	4.0	22.7	47.9	250.1	236.4	18.9	42.2	-1.7	-28.0	33.7
PRIOR FIRST THREE QUARTERS *(The way it was . . .)*											
Return on assets 1988	0.82%	0.74%	0.78%	0.78%	0.91%	0.96%	1.01%	1.08%	1.06%	-0.80%	0.84%
1986	0.68	0.67	0.78	0.80	0.53	0.80	1.09	0.93	0.77	-0.13	0.33
1984	0.67	0.98	0.94	0.77	0.30	0.67	1.04	0.42	0.90	0.79	0.51
Equity capital ratio 1988	6.24	8.92	7.33	6.23	4.81	5.74	7.10	6.83	7.63	5.70	5.88
1986	6.40	8.70	7.25	6.21	5.15	5.95	6.86	7.09	7.67	6.84	5.61
1984	6.26	8.83	7.25	5.87	4.76	5.57	6.97	6.82	7.74	7.11	5.51
Nonperforming assets to assets 1988	2.45	2.06	1.84	1.59	3.64	2.38	1.08	1.24	1.68	7.05	2.92
1986	2.09	2.42	1.98	1.68	2.36	1.62	1.06	1.52	2.38	4.07	3.13
1984	1.65	0.69	0.87	1.49	2.68	1.71	0.71	1.33	1.12	1.60	2.70
Net charge-offs to loans and leases 1988	0.93	0.75	0.75	1.02	0.99	0.72	0.58	0.69	1.30	2.39	1.16
1986	0.90	1.25	0.88	0.85	0.81	0.58	0.52	0.60	2.03	1.72	1.20
1984	0.67	0.64	0.52	0.59	0.82	0.34	0.35	1.22	0.81	0.97	0.80

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. Third Quarter 1989 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
IRD QUARTER *Preliminary* *(The way it is . . .)*											
Number of banks reporting	12,824	9,927	2,526	330	41	1,086	1,959	2,861	3,042	2,381	1,495
Net income	−744	778	1,219	2,083	−4,824	−4,500	1,029	1,236	560	−129	1,059
Percentage of banks losing money	11.5%	12.8%	6.6%	8.5%	31.7%	13.6%	12.7%	4.6%	6.3%	21.8%	15.8%
Percentage of banks with earnings gains	54.8%	53.7%	58.8%	61.5%	36.6%	49.1%	52.3%	58.8%	53.3%	54.7%	58.1%
Performance Ratios *(annualized)*											
Yield on earning assets	11.47%	10.68%	10.94%	11.15%	12.29%	12.36%	10.87%	10.71%	11.00%	10.24%	11.41%
Cost of funding earning assets	7.50	6.18	6.41	6.90	9.04	8.80	6.76	6.82	6.60	6.72	6.35
Net interest margin	3.97	4.51	4.53	4.26	3.25	3.56	4.10	3.89	4.40	3.51	5.06
Net noninterest expense to earning assets	2.03	2.68	2.58	2.03	1.54	1.77	2.35	1.83	2.00	2.35	2.47
Net operating cash flow to assets	1.71	1.66	1.77	1.98	1.46	1.57	1.57	1.84	2.16	0.99	2.24
Net operating income to assets	−0.15	0.81	0.80	0.77	−1.69	−1.49	0.84	0.94	1.03	−0.30	0.82
Return on assets	−0.09	0.85	0.82	0.80	−1.59	−1.42	0.89	0.95	1.08	−0.20	0.86
Return on equity	−1.45	9.30	10.73	12.66	−32.01	−24.08	12.65	13.73	13.83	−3.44	13.91
Net charge-offs to loans and leases	0.96	0.71	0.74	1.04	1.06	0.98	0.57	0.64	1.47	1.72	1.07
Loan loss provision to net charge-offs	263.89	124.00	129.11	138.76	445.07	459.31	124.62	153.40	74.03	145.38	131.57
Growth Rates *(year-to-year)*											
Net interest income	4.1	4.4	7.1	8.5	4.3	4.9	2.5	5.1	0.4	−5.0	8.4
Net income	N/M	7.1	−6.0	−3.3	N/M	N/M	−5.4	−4.8	4.1	N/M	−3.0
Net charge-offs	5.5	4.8	10.4	36.3	−3.8	19.7	23.3	19.0	38.3	−33.0	−8.4
Loan loss provision	185.5	8.7	27.7	67.0	755.7	687.0	25.0	94.8	0.5	−39.7	49.6
PRIOR THIRD QUARTERS *(The way it was . . .)*											
Return on assets 1988	0.78%	0.73%	0.70%	0.68%	0.94%	0.97%	1.04%	1.06%	1.05%	−1.53%	0.96%
1986	0.69	0.50	0.64	0.89	0.61	0.79	1.08	0.94	0.74	−0.25	0.46
1984	0.75	0.97	0.96	0.85	0.43	0.73	1.09	0.75	0.81	0.70	0.57
Net charge-offs to loans and leases 1988	0.97	0.83	0.86	0.90	1.12	0.87	0.52	0.58	1.11	2.32	1.28
1986	1.01	1.43	1.11	0.97	0.84	0.59	0.58	0.61	2.48	2.17	1.32
1984	0.79	0.76	0.59	0.64	1.00	0.37	0.42	1.64	1.04	1.07	0.83

FDIC
Federal Deposit Insurance Corporation
Washington, DC 20429

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.

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

Volatile 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.