Aggregate net income and overall profitability of insured commercial banks declined in the second quarter of 1986. Net income was down 11 percent from the level of a year ago, and down 18 percent from the first quarter of this year. Net income for the first half of 1986 was $9.25 billion, down 2.4 percent from the first half of 1985. The magnitude of these declines was limited by sizable gains from sales of securities and from nonrecurring items. Absent these gains, which have remained significant over the past several quarters, income would have been 18.4 percent lower than the second quarter a year earlier, despite asset growth of nearly 8 percent.

Falling interest rates contributed to year-to-year reductions in both total interest income and expense. Net interest margins contracted slightly, as earning assets growth of 8.5 percent outstripped net interest income expansion.

Banks’ loan-loss provisions increased by 36.4 percent over year-earlier levels, as asset-quality problems accounted for most of the downward pressure on bank earnings. The number of banks with earnings losses (net income less than zero) in the second quarter was 2,384, up from 1,876 in the same period of 1985. The FDIC’s “problem” list increased by 128 commercial banks during the quarter, to 1,321 as of June 30. Through the first six months of 1986, 64 insured commercial banks failed. The smallest commercial banks continue to exhibit the most severe earnings erosion of any segment of the industry, reflecting pressures from credit problems in agriculture and real estate portfolios.
Small banks' level of problem loans remained highest and showed the most pronounced deterioration of any size group in the second quarter. Banks in the Midwest still show the highest regional level of loan charge-offs, but Southwestern banks experienced the sharpest growth in charge-offs during the quarter.

Banks in the Southwest region have the highest proportion of nonperforming assets, and this level rose further in the second quarter.

Net loan-loss levels increased more rapidly than loan-loss reserves at commercial banks in the second quarter, as small banks' aggregate loss provisioning fell short of actual losses. Most larger banks continued to bolster their reserve levels. Banks in the largest asset-size group maintained the highest ratio of loss reserves to loans outstanding of any size group—1.67 percent. Equity capital and assets have grown at roughly comparable rates at commercial banks, while reserve growth has been much more rapid.

The Southwest region had the highest proportion of unprofitable banks in the second quarter—27 percent—while the Western region had the largest share of banks on the “problem” list. These results reflected a continuation of the deteriorating trends in both regions. The Southeast, Northeast and Central regions had the fewest troubled institutions, and showed improving trends in this area. Nonperforming asset levels stabilized, and growth in overall reserve coverage of loan portfolios improved at Western banks in the second quarter.

Through the first half of 1986, the Mississippi River has continued to represent a dividing line for commercial bank performance. Banks in the East have had fewer credit-quality problems and stronger asset growth than their Western counterparts. Problems in the agricultural and energy sectors have been the principal difference. Continuing growth in the number of “problem” banks portends no respite during the rest of 1986 from the high level of bank failures.

For the banking industry as a whole, recent trends of slowing GNP growth, lower industrial production and capacity utilization levels, and fewer housing starts all point to slack loan demand in the months ahead. The remainder of the year is likely to be marked by continued credit-quality problems among commercial and real estate loans stemming from the plunge in oil prices and lingering weakness in the agricultural sector. Continued growth in subquality asset levels may mean further increases in the number of problem banks. Slow economic growth and lower interest rates make lackluster year-to-year earnings comparisons likely for the second half of 1986. Net interest margins may remain under pressure with loan growth lagging behind last year's pace and lending spreads remaining narrow. The growth of nonperforming assets—up 10.8 percent in the first six months of 1986—will almost certainly lead to higher charge-off rates in the second half.
U.S. COMMERCIAL BANKING INDUSTRY QUARTERLY PROFILE
Aggregate Condition and Income Data, FDIC-Insured Commercial Banks
(dollar figures in millions)

Preliminary
<table>
<thead>
<tr>
<th>2nd Qtr</th>
<th>1st Qtr</th>
<th>2nd Qtr</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>1986</td>
<td>1986</td>
<td>1985</td>
<td>85.2-86.2</td>
</tr>
</tbody>
</table>

Number of banks reporting ........................................... 14,311
Total employees (full-time equivalent) ....................... 1,582,203

CONDITION DATA
Total Assets ........................................................... $2,774,592
Real estate loans ......................................................... 467,382
Commercial & industrial loans ....................................... 561,208
Loans to individuals ....................................................... 317,899
Farms loans ................................................................ 34,737
Other loans and leases .................................................... 269,967
Total loans and leases ..................................................... 1,670,964
LESS: Reserve for losses .................................................. 26,244
Net loans and leases ....................................................... 1,644,720
Temporary investments ...................................................... 448,879
Securities over 1 year ....................................................... 318,714
All other assets .......................................................... 362,279
Total liabilities and capital ........................................... $2,774,592
Noninterest-bearing deposits ......................................... 469,663
Interest-bearing deposits ................................................. 1,678,103
Other borrowed funds ...................................................... 327,528
Subordinated debt .......................................................... 16,194
All other liabilities ....................................................... 107,328
Equity capital ............................................................. 175,776

Nonperforming assets ...................................................... 56,615
Loan commitments and letters of credit ......................... 733,101
Domestic office assets ..................................................... 2,257,871
Foreign office assets ....................................................... 416,721
Domestic office deposits ................................................ 1,826,075
Foreign office deposits .................................................... 321,691

INCOME DATA
Total interest income ......................................................... $121,626
Total interest expense ....................................................... 74,673
Net interest income ......................................................... 46,953
Provisions for loan losses ................................................ 9,963
Total noninterest income .................................................. 43,581
Applicable income taxes ..................................................... 3,133
Net operating income ....................................................... 7,231
Securities gains, net ........................................................ 1,881
Extraordinary gains, net .................................................... 140
Net Income ............................................................... 9,252
Net charge-offs ............................................................. 6,900
Net additions to capital stock ........................................ 390
Cash dividends on capital stock ....................................... 7,346

Selected Performance and Condition Indicators, FDIC-Insured Commercial Banks

Return on assets .......................................................... 0.71%
Return on equity .......................................................... 7.11%
Equity capital to assets ................................................... 5.87%
Net charge-offs to loans ................................................... 0.56%
### Preliminary Bank Data and Performance and Condition Ratios, Distributed by Asset Size and by Region, Second Quarter 1986

*Dollar figures in billions, ratios in %*

<table>
<thead>
<tr>
<th>Asset Size Distribution</th>
<th>All Banks</th>
<th>Geographic Distribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than $25 Million</td>
<td></td>
<td>Northeast Region</td>
</tr>
<tr>
<td>$25-100 Million</td>
<td></td>
<td>Southeast Region</td>
</tr>
<tr>
<td>$100-300 Million</td>
<td></td>
<td>Central Region</td>
</tr>
<tr>
<td>$300-1 Billion</td>
<td></td>
<td>Midwest Region</td>
</tr>
<tr>
<td>Greater than $3 Billion</td>
<td></td>
<td>Southwest Region</td>
</tr>
<tr>
<td></td>
<td></td>
<td>West Region</td>
</tr>
</tbody>
</table>

#### Number of banks reporting
- Northeast: 14,311
- Southeast: 5,065
- Central: 6,597
- Midwest: 1,813
- Southwest: 518
- West: 198
- All Banks: 120

#### Total assets
- Northeast: $2,774.6 billion
- Southeast: $74.1 billion
- Central: $332.5 billion
- Midwest: $289.6 billion
- Southwest: $261.7 billion
- West: $338.0 billion
- All Banks: $1,478.7 billion

#### Total deposits
- Northeast: $2,147.8 billion
- Southeast: $65.4 billion
- Central: $296.5 billion
- Midwest: $254.4 billion
- Southwest: $218.1 billion
- West: $267.5 billion
- All Banks: $1,055.7 billion

#### Number of profitable banks
- Northeast: 1,081
- Southeast: 1,970
- Central: 3,162
- Midwest: 3,366
- Southwest: 3,140
- West: 1,592
- All Banks: 7,081

#### Number of failed banks
- Northeast: 1,174
- Southeast: 1,420
- Central: 2,241
- Midwest: 2,485
- Southwest: 2,498
- West: 3,002
- All Banks: 8,610

#### Performance ratios (annualized)

<table>
<thead>
<tr>
<th>Ratio</th>
<th>Northeast</th>
<th>Southeast</th>
<th>Central</th>
<th>Midwest</th>
<th>Southwest</th>
<th>West</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yield on earning assets (%)</td>
<td>9.80%</td>
<td>10.81%</td>
<td>10.49%</td>
<td>10.29%</td>
<td>9.99%</td>
<td>9.79%</td>
</tr>
<tr>
<td>Cost of funding earning assets (%)</td>
<td>5.92%</td>
<td>6.01%</td>
<td>5.97%</td>
<td>5.87%</td>
<td>5.86%</td>
<td>5.72%</td>
</tr>
<tr>
<td>Net interest margin (%)</td>
<td>3.88%</td>
<td>4.49%</td>
<td>4.42%</td>
<td>4.42%</td>
<td>4.44%</td>
<td>4.27%</td>
</tr>
<tr>
<td>Net operating income to assets (%)</td>
<td>2.21%</td>
<td>2.78%</td>
<td>2.72%</td>
<td>2.72%</td>
<td>2.77%</td>
<td>2.78%</td>
</tr>
<tr>
<td>Return on equity (%)</td>
<td>0.61%</td>
<td>0.91%</td>
<td>0.87%</td>
<td>0.87%</td>
<td>0.82%</td>
<td>0.83%</td>
</tr>
<tr>
<td>Net charge-offs to loans and leases</td>
<td>0.94%</td>
<td>1.29%</td>
<td>0.93%</td>
<td>0.93%</td>
<td>0.90%</td>
<td>0.90%</td>
</tr>
</tbody>
</table>

#### Condition Ratios

<table>
<thead>
<tr>
<th>Ratio</th>
<th>Northeast</th>
<th>Southeast</th>
<th>Central</th>
<th>Midwest</th>
<th>Southwest</th>
<th>West</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loss reserve to loans and leases (%)</td>
<td>1.57%</td>
<td>1.62%</td>
<td>1.44%</td>
<td>1.37%</td>
<td>1.49%</td>
<td>1.41%</td>
</tr>
<tr>
<td>Nonperforming assets to assets (%)</td>
<td>2.04%</td>
<td>2.72%</td>
<td>2.31%</td>
<td>1.95%</td>
<td>1.87%</td>
<td>1.75%</td>
</tr>
<tr>
<td>Equity capital ratio (%)</td>
<td>6.34%</td>
<td>9.98%</td>
<td>8.37%</td>
<td>7.47%</td>
<td>6.97%</td>
<td>6.69%</td>
</tr>
<tr>
<td>Primary capital ratio (%)</td>
<td>7.16%</td>
<td>10.77%</td>
<td>9.01%</td>
<td>8.14%</td>
<td>7.73%</td>
<td>7.46%</td>
</tr>
<tr>
<td>Net loans and leases to assets (%)</td>
<td>59.28%</td>
<td>49.67%</td>
<td>51.88%</td>
<td>55.96%</td>
<td>60.01%</td>
<td>61.56%</td>
</tr>
<tr>
<td>Net assets repricable in one year or less to assets (%)</td>
<td>-4.76%</td>
<td>-4.74%</td>
<td>-6.87%</td>
<td>-6.45%</td>
<td>-7.56%</td>
<td>-4.10%</td>
</tr>
</tbody>
</table>

#### Growth Rates (from year-ago quarter)

<table>
<thead>
<tr>
<th>Category</th>
<th>Northeast</th>
<th>Southeast</th>
<th>Central</th>
<th>Midwest</th>
<th>Southwest</th>
<th>West</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets (%)</td>
<td>7.9%</td>
<td>7.3%</td>
<td>7.7%</td>
<td>9.2%</td>
<td>12.4%</td>
<td>15.0%</td>
</tr>
<tr>
<td>Earning assets (%)</td>
<td>8.5%</td>
<td>7.3%</td>
<td>7.7%</td>
<td>9.2%</td>
<td>13.1%</td>
<td>15.0%</td>
</tr>
<tr>
<td>Loans and leases (%)</td>
<td>7.3%</td>
<td>4.3%</td>
<td>5.2%</td>
<td>9.3%</td>
<td>14.3%</td>
<td>16.3%</td>
</tr>
<tr>
<td>Loss reserve (%)</td>
<td>25.4%</td>
<td>24.5%</td>
<td>23.6%</td>
<td>22.8%</td>
<td>32.6%</td>
<td>30.3%</td>
</tr>
<tr>
<td>Net charge-offs (%)</td>
<td>34.9%</td>
<td>23.6%</td>
<td>23.1%</td>
<td>26.7%</td>
<td>63.5%</td>
<td>62.0%</td>
</tr>
<tr>
<td>Nonperforming assets (%)</td>
<td>6.1%</td>
<td>23.9%</td>
<td>22.6%</td>
<td>23.2%</td>
<td>30.7%</td>
<td>16.5%</td>
</tr>
<tr>
<td>Deposits (%)</td>
<td>7.4%</td>
<td>8.3%</td>
<td>8.2%</td>
<td>9.6%</td>
<td>12.6%</td>
<td>14.9%</td>
</tr>
<tr>
<td>Equity capital (%)</td>
<td>8.9%</td>
<td>7.5%</td>
<td>9.2%</td>
<td>8.7%</td>
<td>10.2%</td>
<td>20.3%</td>
</tr>
<tr>
<td>Interest income (%)</td>
<td>-4.8%</td>
<td>-2.0%</td>
<td>-2.0%</td>
<td>-0.4%</td>
<td>2.5%</td>
<td>3.9%</td>
</tr>
<tr>
<td>Interest expense (%)</td>
<td>-9.5%</td>
<td>-4.5%</td>
<td>-5.2%</td>
<td>-4.3%</td>
<td>-1.5%</td>
<td>-0.9%</td>
</tr>
<tr>
<td>Net interest income (%)</td>
<td>3.6%</td>
<td>1.4%</td>
<td>2.8%</td>
<td>5.3%</td>
<td>8.2%</td>
<td>11.2%</td>
</tr>
<tr>
<td>Loan loss expense (%)</td>
<td>22.8%</td>
<td>10.0%</td>
<td>12.0%</td>
<td>22.3%</td>
<td>46.9%</td>
<td>85.3%</td>
</tr>
<tr>
<td>Noninterest income (%)</td>
<td>15.7%</td>
<td>13.1%</td>
<td>7.0%</td>
<td>8.8%</td>
<td>13.1%</td>
<td>16.8%</td>
</tr>
<tr>
<td>Noninterest expense (%)</td>
<td>7.9%</td>
<td>7.7%</td>
<td>8.8%</td>
<td>9.1%</td>
<td>16.3%</td>
<td>10.7%</td>
</tr>
<tr>
<td>Net income (%)</td>
<td>-18.4%</td>
<td>-66.4%</td>
<td>-23.4%</td>
<td>-14.0%</td>
<td>-25.5%</td>
<td>-15.8%</td>
</tr>
<tr>
<td>Net income (%)</td>
<td>-11.0%</td>
<td>-44.4%</td>
<td>-13.3%</td>
<td>-5.8%</td>
<td>-17.4%</td>
<td>-6.1%</td>
</tr>
</tbody>
</table>

**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
NOTES TO USERS

Computation Methodology for Performance and Condition Ratios

All income figures used in calculating performance ratios represent amounts for that quarter, annualized. All asset and liability figures used in calculating performance ratios represent average amounts (beginning-of-period amount plus end-of-period amount, divided by two). All asset and liability figures used in calculating the condition ratios represent amounts as of the end of the period.

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 but before gains (or losses) from securities transactions and nonrecurring items. The profit earned on banks’ regular banking business.

Return on Assets — net income (including securities transactions and nonrecurring items) as a percentage of average total assets. A 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 due to uncollectibility, less amounts recovered on previous charge-offs.

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

Primary Capital — total equity capital plus the allowance for loan and lease losses plus minority interests in consolidated subsidiaries plus qualifying mandatory convertible debt, 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.

Net Assets Repriceable in One Year or Less — short-term and variable rate interest-earning assets, minus interest-bearing liabilities maturing or repricable within the same one-year interval. A measure of banks’ sensitivity to interest rate changes, where a positive value indicates that banks’ income from assets is more sensitive to movements in interest rates than is the expense of their liabilities, and vice-versa for a negative value.

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. These are banks’ more liquid investments.

Loan Loss Expense — the addition to the allowance for loan and lease losses, the reserve maintained to absorb expected loan losses.

Additional information regarding bank performance, bank failures and economic issues affecting the banking industry is available in the Banking and Economic Review, published by the Division of Research and Strategic Planning, FDIC. Information on legislative issues and changes in state and federal laws and regulations governing banks is contained in the Regulatory Review, also published by the Division of Research and Strategic Planning. Single-copy subscriptions are available to the public free of charge. Requests should be mailed to:

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Division of Research and Strategic Planning
Federal Deposit Insurance Corporation
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