An unprecedented quarterly loan-loss provision of $21.2 billion resulted in a $10.6 billion aggregate second-quarter loss for the commercial banking industry. Most of the loss provision was set aside by the largest banks, and was earmarked for their developing-country (LDC) loans, particularly loans to Brazil. Their actions followed the placement, in the first quarter, of much of their $23.6 billion in Brazilian loans on nonaccrual status, where interest income is not recorded until payment is actually received. The magnitude of the second-quarter loss provision overwhelmed the first quarter's record earnings, giving the industry an aggregate loss of $5.3 billion for the first half of the year. Even though bank earnings are expected to recover in the second half of this year, full-year industry profitability will be at its lowest level since 1934.

Earnings results were mixed at banks with no significant foreign lending exposure. Smaller banks continued to account for a disproportionate share of unprofitable operations and failures, but they showed some encouraging signs in the second quarter. Net charge-offs were well below the level of a year ago, and growth in nonperforming assets slowed considerably. Overall, small banks’ net operating income improved, due in large part to lower loan-loss provisioning. Bottom-line net income was lower, however, because of reduced profits from securities sales. Medium-sized banks outside the Southwest continued to perform well, with strong growth in consumer and real estate loans, good asset quality, and wider net interest margins.
The ten largest banks in the second quarter set aside $12 billion for reserves against anticipated future losses, producing an aggregate $9.7 billion loss for these banks in the quarter. Their combined equity capital fell by $9.6 billion, but this did not reduce their primary capital, since all of the $9.6 billion went into loss reserves, and transfers from equity to reserves have no effect on primary capital levels. Total capital of banks with foreign lending exposure continued to increase relative to their loans to troubled foreign borrowers.

Domestic loan problems continue to plague banks west of the Mississippi. In the West and Southwest regions, the sharp decline in oil prices in late 1985 and early 1986 is still being felt in higher levels of charge-offs and nonperforming loans, particularly in real estate and commercial and industrial loans. At banks in the Midwest region, charge-offs remained high, but they were lower than a year earlier, and the level of nonperforming assets was down. A year earlier in the Midwest, both nonperforming loans and net charge-offs were still increasing.

Forty-five commercial banks failed or required assistance to avert failure in the second quarter, bringing the total for the first half of this year to 99. At the present pace, total failures for the year will approach 200, surpassing last year's record total (since the inception of the FDIC) of 144. All of the failures in the first half involved banks with less than $300 million in assets. The number of banks on the FDIC's "problem" list increased by 100 in the second quarter, to 1,609 at midyear. All of the gain came from the western half of the country; the number of "problem" banks in the east declined in the second quarter.

Commercial bank earnings should recover in the second half, as loan-loss provisioning returns to more normal levels. Small banks will remain vulnerable in some regions, but there are signs that the worst may be over for farm banks in the Midwest. A number of large banks that boosted their reserves in the second quarter should demonstrate outstanding earnings results over the rest of the year. However, several of the largest banks are likely to report a net loss for the full year, and the industry's return on assets is unlikely to surpass 0.25 percent, compared to 0.64 percent for 1986.
Table I. Aggregate Condition and Income Data, FDIC-Insured Commercial Banks
(dollar figures in millions)

<table>
<thead>
<tr>
<th></th>
<th>Preliminary</th>
<th></th>
<th></th>
<th></th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2nd Qtr 1987</td>
<td>1st Qtr 1987</td>
<td>2nd Qtr 1986</td>
<td>2nd Qtr 86-87</td>
<td></td>
</tr>
<tr>
<td>Number of banks reporting</td>
<td>13,337</td>
<td>14,073</td>
<td>14,309</td>
<td>-2.6</td>
<td></td>
</tr>
<tr>
<td>Total employees (full-time equivalent)</td>
<td>1,626,421</td>
<td>1,554,906</td>
<td>1,581,882</td>
<td>2.8</td>
<td></td>
</tr>
<tr>
<td><strong>CONDITION DATA</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Assets</td>
<td>$2,912,420</td>
<td>$2,900,594</td>
<td>$2,774,202</td>
<td>5.0</td>
<td></td>
</tr>
<tr>
<td>Real estate loans</td>
<td>556,375</td>
<td>556,375</td>
<td>532,084</td>
<td>19.1</td>
<td></td>
</tr>
<tr>
<td>Commercial &amp; industrial loans</td>
<td>582,762</td>
<td>585,168</td>
<td>581,153</td>
<td>0.3</td>
<td></td>
</tr>
<tr>
<td>Loans to individuals</td>
<td>332,840</td>
<td>326,571</td>
<td>317,888</td>
<td>4.7</td>
<td></td>
</tr>
<tr>
<td>Farm loans</td>
<td>30,839</td>
<td>29,225</td>
<td>34,678</td>
<td>-11.1</td>
<td></td>
</tr>
<tr>
<td>Other loans and leases</td>
<td>265,166</td>
<td>263,787</td>
<td>269,934</td>
<td>-1.8</td>
<td></td>
</tr>
<tr>
<td>Total loans and leases</td>
<td>1,767,982</td>
<td>1,738,634</td>
<td>1,670,875</td>
<td>5.8</td>
<td></td>
</tr>
<tr>
<td>LESS: Reserve for losses</td>
<td>47,191</td>
<td>29,674</td>
<td>26,282</td>
<td>79.8</td>
<td></td>
</tr>
<tr>
<td>Net loans and leases</td>
<td>1,749,128</td>
<td>1,708,161</td>
<td>1,644,593</td>
<td>4.88</td>
<td></td>
</tr>
<tr>
<td>Temporary investments</td>
<td>449,529</td>
<td>449,975</td>
<td>448,814</td>
<td>2.0</td>
<td></td>
</tr>
<tr>
<td>Securities over 1 year</td>
<td>357,399</td>
<td>367,036</td>
<td>318,597</td>
<td>18.0</td>
<td></td>
</tr>
<tr>
<td>All other assets</td>
<td>366,301</td>
<td>374,422</td>
<td>362,199</td>
<td>1.1</td>
<td></td>
</tr>
<tr>
<td>Total liabilities and capital</td>
<td>$2,912,420</td>
<td>$2,900,594</td>
<td>$2,774,202</td>
<td>5.0</td>
<td></td>
</tr>
<tr>
<td>Noninterest-bearing deposits</td>
<td>471,081</td>
<td>462,807</td>
<td>469,337</td>
<td>0.5</td>
<td></td>
</tr>
<tr>
<td>Interest-bearing deposits</td>
<td>1,728,525</td>
<td>1,778,507</td>
<td>1,676,096</td>
<td>6.8</td>
<td></td>
</tr>
<tr>
<td>Other borrowed funds</td>
<td>350,555</td>
<td>348,413</td>
<td>327,816</td>
<td>7.0</td>
<td></td>
</tr>
<tr>
<td>Subordinated debt</td>
<td>17,283</td>
<td>17,282</td>
<td>16,137</td>
<td>7.1</td>
<td></td>
</tr>
<tr>
<td>All other liabilities</td>
<td>104,901</td>
<td>106,967</td>
<td>107,338</td>
<td>-2.3</td>
<td></td>
</tr>
<tr>
<td>Equity capital</td>
<td>218,843</td>
<td>212,883</td>
<td>199,243</td>
<td>9.8</td>
<td></td>
</tr>
<tr>
<td>Primary Capital</td>
<td>1,928,353</td>
<td>1,906,994</td>
<td>1,825,743</td>
<td>5.6</td>
<td></td>
</tr>
<tr>
<td>Nonperforming assets</td>
<td>335,900</td>
<td>332,320</td>
<td>321,691</td>
<td>18.0</td>
<td></td>
</tr>
<tr>
<td>Loan commitments and letters of credit</td>
<td>2,494,264</td>
<td>2,472,617</td>
<td>2,257,473</td>
<td>5.8</td>
<td></td>
</tr>
<tr>
<td>Domestic office assets</td>
<td>418,935</td>
<td>427,796</td>
<td>416,729</td>
<td>0.3</td>
<td></td>
</tr>
<tr>
<td>Foreign office assets</td>
<td>1,050,936</td>
<td>1,064,994</td>
<td>1,025,741</td>
<td>5.6</td>
<td></td>
</tr>
<tr>
<td>Foreign office deposits</td>
<td>335,900</td>
<td>332,320</td>
<td>321,691</td>
<td>18.0</td>
<td></td>
</tr>
<tr>
<td>Earning Assets</td>
<td>2,546,121</td>
<td>2,586,174</td>
<td>2,412,003</td>
<td>5.6</td>
<td></td>
</tr>
</tbody>
</table>

Table II. Selected Indicators, FDIC-Insured Commercial Banks

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Return on assets</td>
<td>0.79%</td>
<td>0.71%</td>
<td>0.86%</td>
<td>0.65%</td>
<td>0.70%</td>
<td>0.64%</td>
<td>-0.37%</td>
</tr>
<tr>
<td>Return on equity</td>
<td>1.08%</td>
<td>1.21%</td>
<td>1.07%</td>
<td>1.03%</td>
<td>1.13%</td>
<td>1.06%</td>
<td>-0.57%</td>
</tr>
<tr>
<td>Equity capital to assets</td>
<td>5.83</td>
<td>5.87</td>
<td>6.00</td>
<td>6.15</td>
<td>6.20</td>
<td>6.21</td>
<td>6.01</td>
</tr>
<tr>
<td>Primary capital to assets</td>
<td>6.39</td>
<td>6.47</td>
<td>6.59</td>
<td>6.68</td>
<td>6.94</td>
<td>7.03</td>
<td>7.48</td>
</tr>
<tr>
<td>Nonperforming assets to assets</td>
<td>N/A</td>
<td>1.85</td>
<td>1.97</td>
<td>1.97</td>
<td>1.97</td>
<td>1.96</td>
<td>2.57</td>
</tr>
<tr>
<td>Net charge-offs to loans</td>
<td>0.37</td>
<td>0.56</td>
<td>0.67</td>
<td>0.76</td>
<td>0.84</td>
<td>0.99</td>
<td>0.76</td>
</tr>
<tr>
<td>Asset growth rate</td>
<td>9.36</td>
<td>8.12</td>
<td>6.75</td>
<td>7.11</td>
<td>8.86</td>
<td>7.62</td>
<td>4.98</td>
</tr>
<tr>
<td>Net operating income growth</td>
<td>7.60</td>
<td>-0.62</td>
<td>-3.69</td>
<td>3.40</td>
<td>6.30</td>
<td>-16.20</td>
<td>N/M</td>
</tr>
<tr>
<td>Number of unprofitable banks</td>
<td>741</td>
<td>1,196</td>
<td>1,530</td>
<td>1,851</td>
<td>2,453</td>
<td>2,784</td>
<td>2,243</td>
</tr>
<tr>
<td>Number of problem banks</td>
<td>196</td>
<td>326</td>
<td>603</td>
<td>800</td>
<td>1,088</td>
<td>1,457</td>
<td>1,609</td>
</tr>
<tr>
<td>Number of failed banks</td>
<td>7</td>
<td>34</td>
<td>45</td>
<td>78</td>
<td>118</td>
<td>144</td>
<td>99</td>
</tr>
</tbody>
</table>

*For 1987, return on assets, return on equity and net charge-off ratios are annualized.
N/A — Not available
N/M — Not meaningful, due to negative earnings in 1987.
### Table III. Second Quarter 1987 Bank Data (Dollar figures in billions, ratios in %)

<table>
<thead>
<tr>
<th>Asset Size Distribution</th>
<th>Geographic Distribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than $100 Million</td>
<td>EAST</td>
</tr>
<tr>
<td>between $100-300 Million</td>
<td>Northeast Region</td>
</tr>
<tr>
<td>$300-1,000 Million</td>
<td>1.0%</td>
</tr>
<tr>
<td>$1-5 Billion</td>
<td>23.5%</td>
</tr>
<tr>
<td>Greater than $5 Billion</td>
<td>76.3%</td>
</tr>
<tr>
<td>Largest Banks</td>
<td>10.0%</td>
</tr>
</tbody>
</table>

#### Number of banks reporting
- All Banks: 13,937
- Region: 1,081
- Northeast: 1,929
- Southeast: 3,078
- Central: 3,288
- Midwest: 3,010
- Southwest: 1,551
- West: 1,071

#### Total assets
- All Banks: $2,912.0 billion
- Region: $1,138.1 billion
- Northeast: $381.4 billion
- Southeast: $462.8 billion
- Central: $202.1 billion
- Midwest: $286.2 billion
- Southwest: $441.7 billion
- West: $441.7 billion

#### Total deposits
- All Banks: $2,264.3 billion
- Region: $1,138.1 billion
- Northeast: $381.4 billion
- Southeast: $462.8 billion
- Central: $202.1 billion
- Midwest: $286.2 billion
- Southwest: $441.7 billion
- West: $441.7 billion

#### Number of banks
- All Banks: 45
- Region: 10
- Northeast: 9
- Southeast: 2
- Central: 2
- Midwest: 1
- Southwest: 3
- West: 9

#### Performance Ratios (annualized)
- **Yield on earning assets**
  - 9.59% (100.0%) 9.60% (13.7%)
  - 9.60% (13.7%)

- **Cost of funding earning assets**
  - 5.67% (6.97%)
  - 5.16% (6.97%)

- **Net interest margin**
  - 3.92% (3.12%)
  - 4.44% (3.12%)

- **Net noninterest expense to earning assets**
  - 2.25% (1.95%)
  - 2.80% (1.95%)

- **Net operating income to assets**
  - -1.50% (-1.95%)
  - 0.57% (1.95%)

- **Return on assets**
  - -4.6% (8.6%)
  - 0.61% (8.6%)

- **Return on equity**
  - -23.43% (7.04%)
  - 2.00% (7.04%)

#### Condition Ratios
- **Loss allowance to loans and leases**
  - 2.66% (2.66%)
  - 1.63% (2.66%)

- **Nonperforming assets to assets**
  - 2.57% (2.57%)
  - 2.29% (2.57%)

- **Equity capital ratio**
  - 6.01% (6.01%)
  - 5.16% (6.01%)

- **Primary capital ratio**
  - 7.48% (7.48%)
  - 5.16% (7.48%)

- **Net loans and leases to assets**
  - 59.08% (59.08%)
  - 51.26% (59.08%)

- **Net assets repriceable in one year or less**
  - -6.39% (-5.82%)
  - -9.82% (-5.82%)

#### Growth Rates (from year-ago quarter)
- **Assets**
  - 5.0% (5.0%)
  - 5.1% (5.0%)

- **Earning assets**
  - 5.6% (5.6%)
  - 5.7% (5.6%)

- **Loans and leases**
  - 5.6% (5.6%)
  - 5.7% (5.6%)

- **Loss reserve**
  - 79.6% (79.6%)
  - 16.7% (79.6%)

- **Net charge-offs to loans and leases**
  - 33.2% (33.2%)
  - 3.7% (33.2%)

- **Deposits**
  - 5.4% (5.4%)
  - 5.3% (5.4%)

- **Equity capital**
  - -0.2% (-0.2%)
  - 3.6% (-0.2%)

- **Interest income**
  - 1.6% (1.6%)
  - -2.8% (1.6%)

- **Interest expense**
  - -0.7% (-0.7%)
  - -6.6% (-0.7%)

- **Net interest income**
  - 5.1% (5.1%)
  - 6.0% (5.1%)

- **Loan loss expense**
  - 397.0% (397.0%)
  - 14.0% (397.0%)

- **Noninterest income**
  - 13.4% (13.4%)
  - 10.7% (13.4%)

- **Noninterest expense**
  - 8.5% (8.5%)
  - 6.9% (8.5%)

- **Net operating income**
  - N/A (N/A)
  - 24.9% (N/A)

- **Net income**
  - N/A (N/A)
  - -3.0% (N/A)

#### 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

N/A - Not meaningful, due to negative earnings in 1987.
### Table IV. First Half 1987 Bank Data *(Dollar figures in billions, ratios in %)*

<table>
<thead>
<tr>
<th>Asset Size Distribution</th>
<th>Geographic Distribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than $100 Million</td>
<td>EAST</td>
</tr>
<tr>
<td>$100-300 Million</td>
<td>Region</td>
</tr>
<tr>
<td>$300-1,000 Million</td>
<td>95</td>
</tr>
<tr>
<td>$15 Billion</td>
<td>94</td>
</tr>
<tr>
<td>Greater than $5 Billion</td>
<td>0</td>
</tr>
<tr>
<td>Ten Largest Banks</td>
<td>0</td>
</tr>
<tr>
<td>Largest Banks</td>
<td>0</td>
</tr>
</tbody>
</table>

- **Performance Ratios (annualized):**
  - Yields on earning assets: 9.34%
  - Cost of funding earning assets: 5.50%
  - Net interest margin: 3.84%

- **Net noninterest expense to earning assets:** 2.19
  - Net operating income to assets: -0.45
  - Return on assets: -0.37
  - Return on equity: -6.07
  - Net charge-offs to loans and leases: 0.78

- **Growth Rates (from first half of 1986):**
  - Net charge-offs: 0.1
  - Interest income: -2.5
  - Interest expense: -6.4
  - Net interest income: -3.9
  - Loan loss expense: 152.7
  - Noninterest income: 12.5
  - Noninterest expense: 7.7
  - Net operating income: N/M
  - Net income: N/M

- **NOTES TO USERS:**
  - **COMPUTATION METHODOLOGY FOR PERFORMANCE AND CONDITION RATIOS:**
    - All 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 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.

- **Yield on Earning Assets**—total interest income plus other investment income as a percentage of average earning assets.

- **Cost of Funding**—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 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.

- **Noninterest Income**—all the income other than interest income that a bank earns.

- **Noninterest Expense**—all the expenses other than interest expense that a bank incurs.

- **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.

- **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.

- **Growth Rates**—the rate of increase or decrease in a particular period, usually expressed as a percentage.

- **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.

- **Return on Equity**—total interest income 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.

- **Noninterest Income**—all the income other than interest income that a bank earns.

- **Noninterest Expense**—all the expenses other than interest expense that a bank incurs.

- **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.

- **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.

- **Growth Rates**—the rate of increase or decrease in a particular period, usually expressed as a percentage.

- **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.

- **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.

- **Net Assets Reproducible in One Year or Less**—all assets with interest rates that are repricable in one year or less plus assets with remaining maturity of one year or less, minus all liabilities that are repriced or due to mature within one year of the reporting date. 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.

- **Loan Loss Expense**—the quarterly addition to the loan loss reserve that will keep the balance of the reserve adequate to absorb the quarter’s anticipated loan losses.