Banking Observatory

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Commercial banks striving to manage vast sea of delinquencies with shift in past due hierarchy

- Stock of loans 30-89 days past due declines, while other categories' growth progresses as banks move to clear inventory
- Total delinquency for domestic loans increases to 6.41%
- Consumer domestic delinquency rate shows small 1.2% increase qoq, from 4.64% 20091Q to 4.70% 20092Q

Asset quality: draining the swamp, but faster

The issue facing US commercial banks today reflects the historical experience of many countries' financial crises. The banking sector cannot increase lending if the banks' balance sheets are stuffed with delinquent loans quarter-to-quarter. On the other hand, regulators push banks to clean out their past due assets in order to prepare the ground for a recovery. The FDIC's most recent 2009Q2 release of data on the commercial banking system suggests that while the scale of the problem remains large, for the first time in months the level of past due loans 30-89 days overdue has declined. This likely represents banks speeding loans through the past due status hierarchy as nonaccrual status assets rise rapidly. This is not necessarily a signal of health; it is merely a signal of a new stage of the banking system's delinquency management, especially considering impending trouble in the commercial real estate market.

Consumer lending: a pullback viewed in some metrics

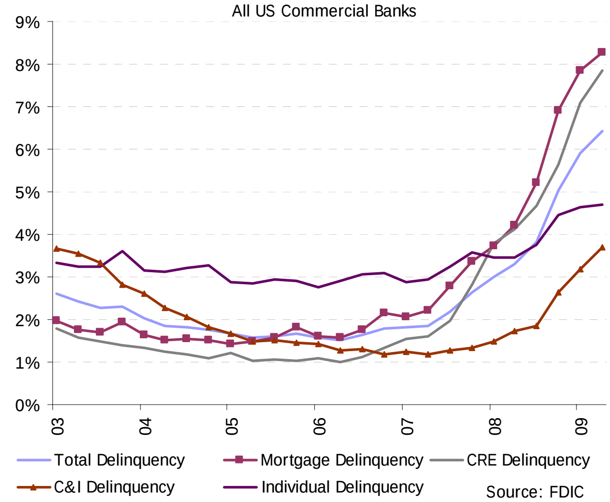
Consumer lending at commercial banks declined on a yoy basis by -1.4%, commensurate with a small increase in the consumer loans delinquency rate from 4.64% in 2009Q1 to 4.70% in 2009Q2. It appears that while consumers remain having trouble making payments, a much more conservative supply of consumer loans has acted to pull in the delinquency rate. Loans to consumers are defined here as domestic loans to individuals, including credit card balances and secured or unsecured consumer loans.

Leverage: procyclical as ever

Total assets in the commercial banking system are down by $415bn since the 2008Q4 crisis. Additionally, total equity capital at commercial banks has increased by $120bn. This represents a total deleveraging over the first half of 2009 of -13.8% and -4% for 2Q2009. This is completely within our baseline adverse scenario for the banking system's deleveraging cycle, as we expected a mild scenario to top at a balance sheet effect of $800bn for the year and we appear at pace to surpass this level. See our previous Banking Observatory, which estimated the baseline adverse scenario to top out at a $1.2tr balance sheet effect.

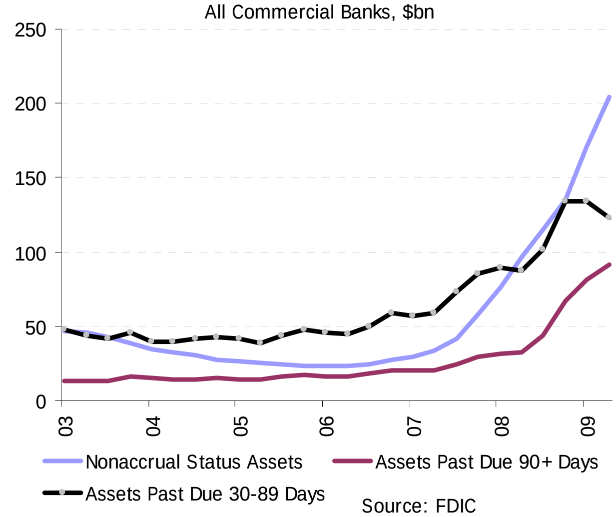
Bottom line: The banking system's swath of equity-raising provided relief, but inventories of past due loans are still imparting a dampening effect on the system overall, with delinquency management to continue into next year.

Delinquency Rates
All US Commercial Banks



Source: FDIC

Past Due Loan Inventory
All Commercial Banks, $bn



Source: FDIC

Leverage Indicators

QoQ %	2009Q2	2009Q1	2008Q4	2008Q3
Assets	-0.9%	-2.5%	2.2%	5.5%
Equity	3.1%	7.2%	-0.9%	0.8%
Leverage	-4.0%	-9.6%	3.0%	4.6%

Source: BBVA ERD and FDIC

Leverage is Asset% less Equity%

BBVA Viewpoint: Construction Loans and the Commercial Real Estate Market

Overview of the issue

Many commentators in the US are discussing the implications of asset quality declines in commercial real estate for the US banking system. In particular, the high exposure of small and medium-sized commercial banks to commercial real estate investments suggests certain banks will struggle under such circumstances. Commercial real estate here is defined as multifamily developments, construction loans, and nonfarm and nonresidential real estate. Perhaps as part of this dialogue, the FDIC has recently provided new series on one element of commercial real estate: lending for construction and development.

New data released by the government allows us to differentiate construction loans into loans for 1-4 family home construction and all other land and construction development. As home prices dropped, mortgage companies reduced lending, and sales declined, it is no surprise that the asset quality of domestic residential loans reached serious levels. For all commercial banks in the US with assets greater than $100mn, the delinquency rate for 1-4 family home construction is higher than that for all other construction and land development loans. This same tendency is reflected in state-level data.

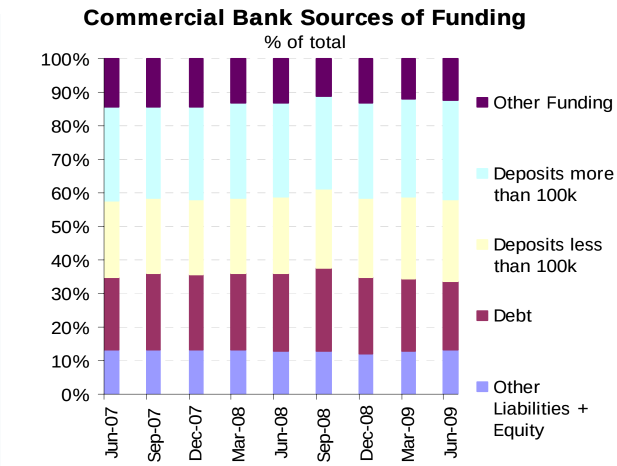
Trends within the BBVA Compass footprint

In terms of particular states, Arizona, California, Florida, and Alabama have 1-4 family home construction delinquency rates higher than the US average. Texas and Colorado maintain delinquency rates on all three types of commercial real estate loans lower than the US average. Arizona and Florida exhibit both high levels of exposure to construction and high construction delinquency rates.

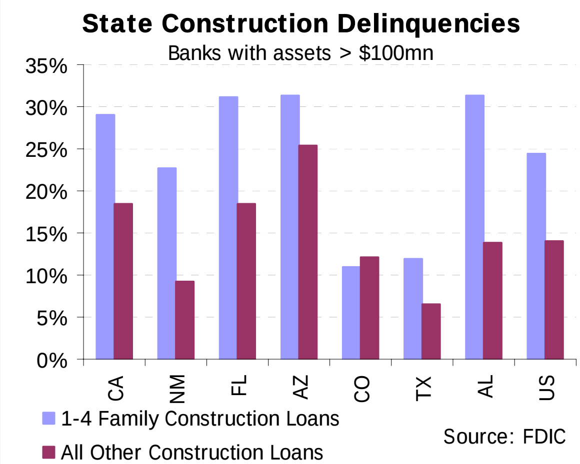
An additional issue to consider regarding construction loans is the cost of construction. Many factors contribute to a lower cost of construction. First, since a housing boom no longer exists, the prices for building supplies have likely declined as a result of decreased demand. Second, high construction employment pushes down the wage rate for labor, giving an additional cost saving to construction. As a result of these and other similar trends, the size of a construction loan is likely smaller today than in previous years. This trend is probably stronger given the fact that land development prices have likely declined as well due to lower real estate prices.

Bottom line

Although our disaggregated measures of construction are new, the trend for all construction loan delinquencies consistently demonstrates an upward trend over the past few quarters. For all commercial banks with assets $100mn or greater, the exposure to construction loans has decreased from 7.95% in 2008 Q4 to 7.5% in 2009Q2. The trend towards reducing exposure to construction loans will continue into the next year as banks manage high delinquency levels for construction loans. Some states are performing better than the US average. For example, Texas' nonfarm and nonresidential real estate and construction delinquencies are lower than the US average. All three of Colorado's commercial real estate delinquencies are lower that the US average.



Source: FDIC



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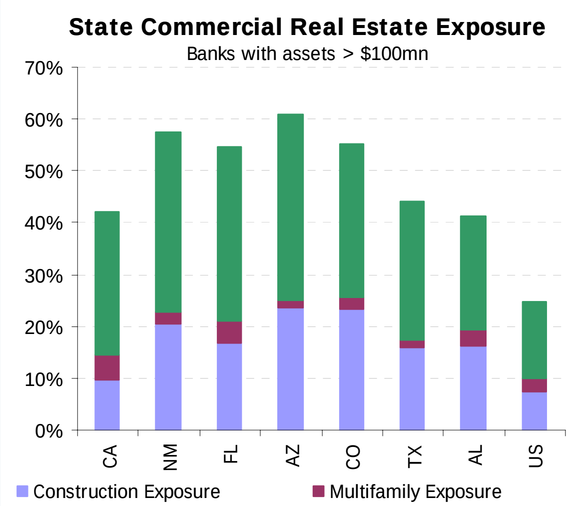

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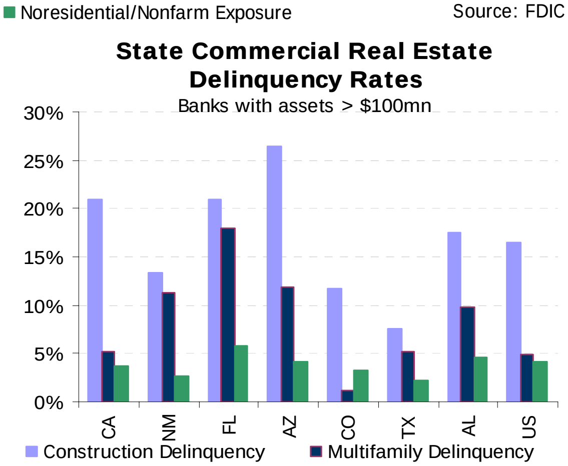

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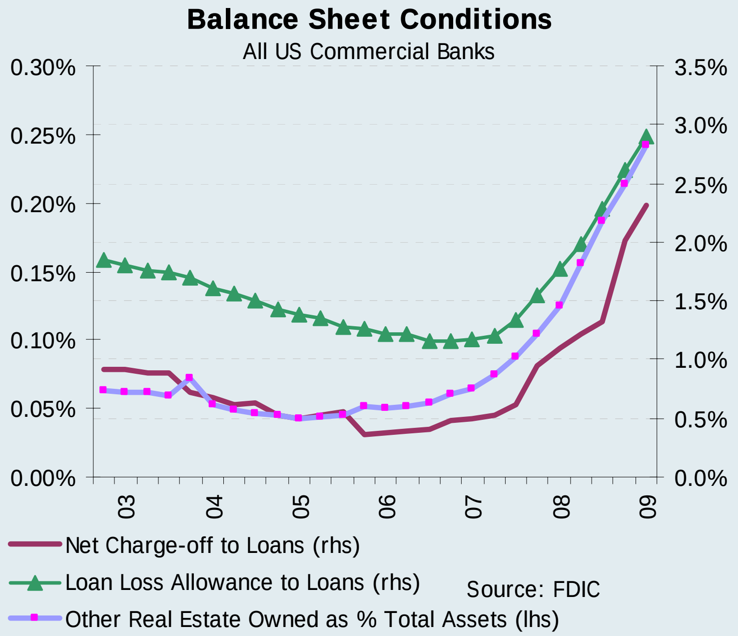

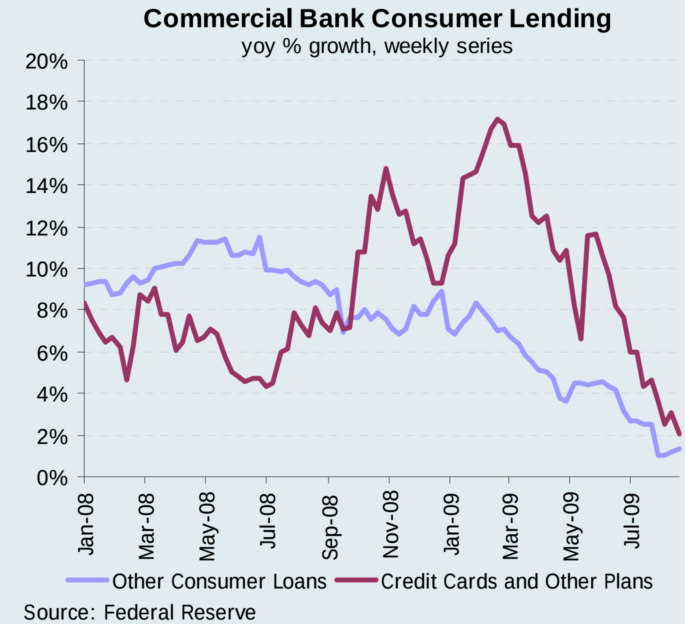

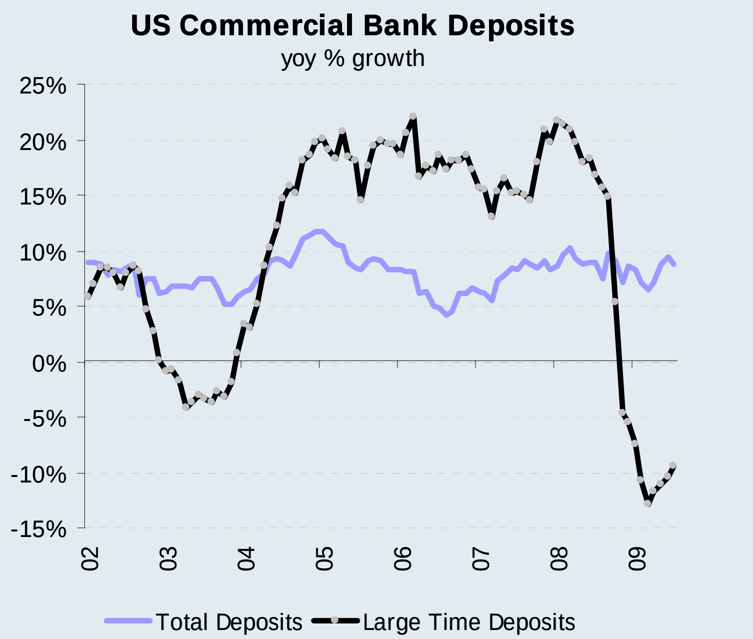

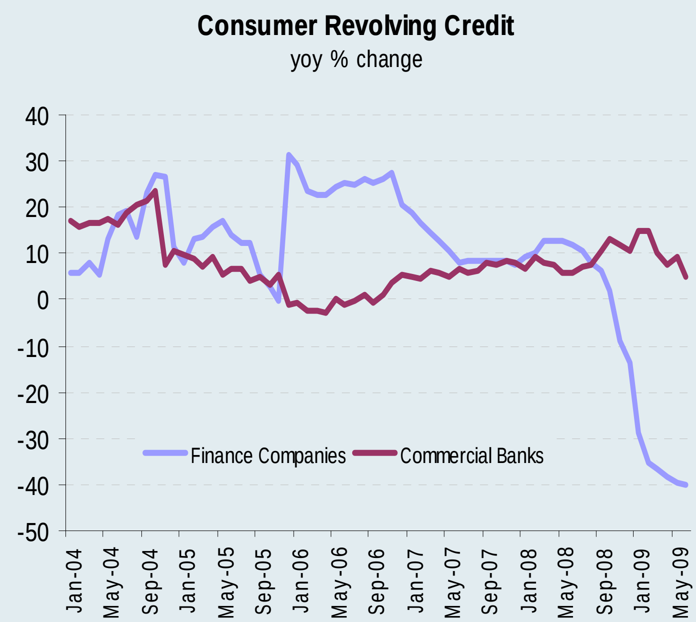

FDIC Statistics on Depository Institutions	6/30/2009	3/31/2009	12/31/2008	9/30/2008	6/30/2008	3/31/2008	12/31/2007
Total Delinquency	6.4%	5.9%	5.0%	3.8%	3.3%	3.0%	2.6%
Mortgage Delinquency	8.3%	7.8%	6.9%	5.2%	4.2%	3.7%	3.4%
CRE Delinquency	7.9%	7.1%	5.6%	4.7%	4.1%	3.8%	2.8%
C&I Delinquency	3.7%	3.2%	2.6%	1.8%	1.7%	1.5%	1.3%
Individual Delinquency	4.7%	4.6%	4.5%	3.7%	3.5%	3.5%	3.6%
Net interest margin	3.47%	3.42%	3.23%	3.39%	3.40%	3.38%	3.35%
Net operating income to assets	0.11%	0.21%	0.17%	0.49%	0.53%	0.68%	0.95%
Return on assets (ROA)	0.07%	0.24%	0.13%	0.44%	0.52%	0.68%	0.93%
Return on Equity (ROE)	0.74%	2.43%	1.35%	4.36%	5.08%	6.69%	9.12%
Net charge-offs to loans	2.32%	2.02%	1.32%	1.21%	1.10%	0.95%	0.62%
Earnings coverage of net charge-offs (x)	1.62	1.90	2.06	2.74	3.03	3.62	5.25
Loss allowance to loans	2.90%	2.62%	2.29%	1.98%	1.77%	1.55%	1.34%
Tier 1 risk-based capital ratio	10.74%	10.39%	9.73%	9.46%	9.46%	9.39%	9.43%
Assets % change qoq	-0.9%	-2.5%	2.2%	5.5%	-0.6%	2.9%	3.6%
Total Equity % change qoq	3.1%	7.2%	-0.9%	0.8%	-0.3%	1.3%	3.9%
Leverage %change qoq	-4.0%	-9.6%	3.0%	4.6%	-0.3%	1.5%	-0.3%
Noncurrent loans % of Total Loans	4.36%	3.71%	2.91%	2.27%	1.91%	1.61%	1.31%

Source: FDIC