

U.S.

# Banking Watch

May 20, 2010

Economic Analysis

Jeffrey Owen Herzog  
jeff.herzog@bbvacompass.com

## Banks fight nonaccrual delinquencies to a standstill while gulping down FASB changes

- Mortgage delinquency rate hits 11.4%, but consumer posts first decline since crisis began
- Changes to FASB 166 and 167 cloud overall credit growth picture, past due loan inventory
- Number of problem list institutions grows from 702 in 2009Q4 to 775 in 2010Q1

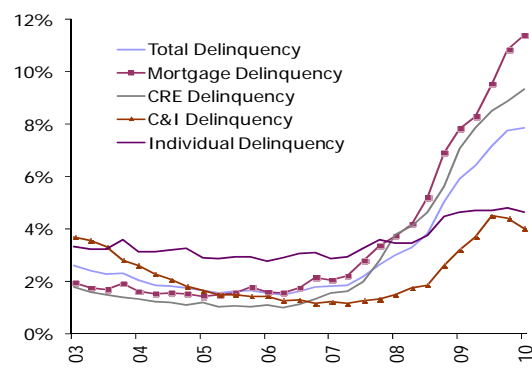
### Delinquency rates offer some improvement, but residential remains a threat

Data from the Federal Deposit Insurance Corporation's (FDIC) Quarterly Banking Profile for 2010Q1 suggest that commercial and industrial loan delinquencies at commercial banks declined dramatically from 4.4% to 4.0%. Alongside this development, the delinquency rate on consumer loans posted its first decline since the beginning of the financial crisis by dropping incrementally from 4.8% to 4.7%. Unfortunately, real estate-related delinquencies remain the major influence on the asset quality of the commercial banking sector. The FDIC's data suggests that the residential delinquency rate increased from 10.9% in 2009Q4 to 11.4% in 2010Q4. Similarly, the delinquency rate on commercial real estate increased from 8.9% to 9.3% in 2009Q4 and 2010Q1, respectively. All three components of commercial real estate – construction and development loans, nonfarm-nonfinancial, multifamily – posted delinquency increases between 2009Q4 and 2010Q4. Residential construction loan delinquencies remain extremely high, but declined from 29.4% to 26.3% between the two quarters. Total delinquency increased from 7.8% to 7.9%, representing a much slower rate of increase than the previous four quarters and is an encouraging sign of consolidation.

### FASB 166 and 167 changes moved roughly \$322.3bn in assets back onto balance sheets

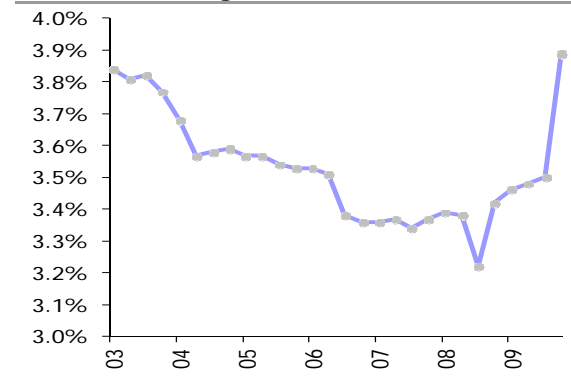
The FDIC estimates that around \$294.3bn in credit card loans returned to balance sheets this quarter, while the Federal Reserve estimates around \$322.3bn. This affected a number of variables such as the total credit growth, net interest margin, and coverage ratios. This change introduces some noise into the estimates of consumer credit growth, which we attempt to correct for in the data. As a result of the changes, net interest margin increased to a seven-year high. We expect continued gains in net interest margin, ex-FASB effects.

Chart 1  
**Commercial Bank Delinquency Rates**



Source: FDIC

Chart 2  
**Net Interest Margin, Bank Assets > \$100mn**



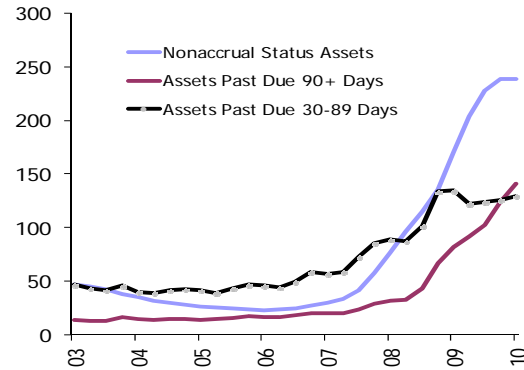
Source: FDIC

**Inventories of nonaccrual loans stay still for the first time since the crisis**

Nonaccrual loans at commercial banks remained stable at \$238.5bn between 2009Q4 and 2010Q1, an encouraging sign for the financial system. Assets past due 30-89 days increased marginally as a result of FASB treatments and assets past due 90 or more days increased by \$17.2bn. This is suggestive of a banking industry that is progressively working its way through delinquent loans and maintaining an upper bound on the stock of seriously delinquent loans. Part of this process is a faster rate of charge-offs on total loans, which increased from 2.6% to 3.0% and \$53.7bn in total for 2010Q1. The loan loss allowance also increased sharply from 3.27% to 3.69%, but the rate of provisioning is starting to decline at banks.

Chart 3

**Past Due Loan Inventory at Commercial Banks, in \$bn**

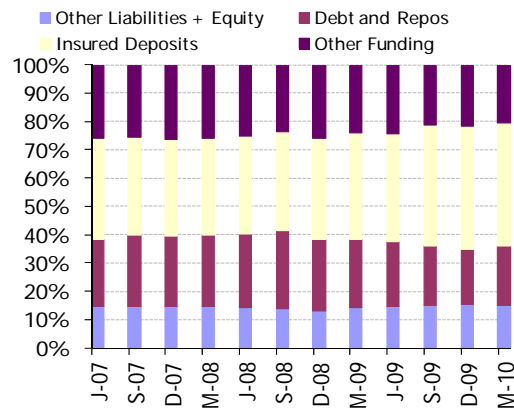


Previous to FASB changes we anticipated further declines in assets past due 30-89 days as a result of greater tightening stance by banks indicated from the Federal Reserve's Senior Loan Officer Survey. According to the FDIC, these new accounting conventions also affected cash flows, but not on the banking industry's reported increase in net income to a two-year high of \$18bn.

Source: FDIC

Chart 4

**Funding Structure, % of Total Liabilities**

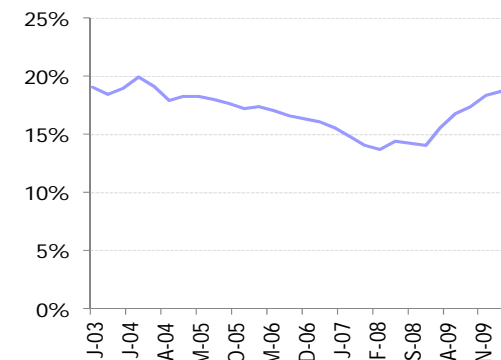


Another change as a result of FASB is a sudden influx of short-term secured borrowings that previously funded off-balance sheet loans. This created a rise in debt as a percentage of total liabilities, but the main message continues to revolve around an increasing reliance on deposit funding at commercial banks, a trend established since the beginning of the crisis and should not abate for some time despite what appears to be an increase in debt.

Source: FDIC

Chart 5

**Total Securities as % of Total Assets**



Commercial banks also continue to bulk up on securities holdings by increasing their stock of US Treasury securities by \$54bn. Commercial banks remained wary of private-label as they reduced their exposure by \$21.4bn. The recent crisis in Europe and regulatory changes pending in Congress create uncertainty for the banking system, which is partly the motivation for high holdings of government securities. The zero risk weight on government securities also helps commercial banks meet the future possibility of higher capital and liquidity requirements.

Source: FDIC

**What happened to deleveraging? An adjustment to the numbers shows that deleveraging continues, but we are closer to the end than the beginning as deleveraging slowed relative to past quarters.**

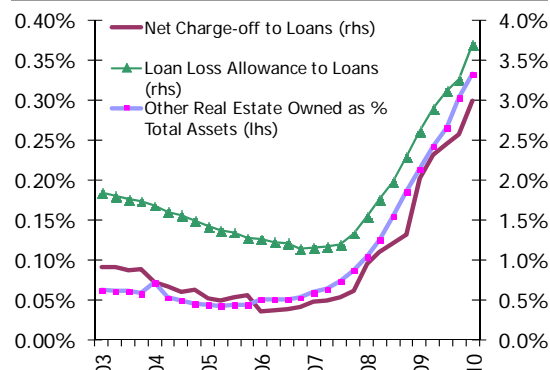
The FDIC data shows that total bank assets grew YoY by 2.0% and the FDIC notes that internal equity generation is slowly returning. However, subtracting \$322.3bn in FASB consolidation from total assets number implies a YoY decline of -0.7%. Given an increase in equity of 0.5% YoY, leverage increased by 1.5% YoY, but using the adjusted number the system continued its fifth straight quarter of deleveraging.

Table 1  
**Leverage Indicators**

Leverage Indicators				
QoQ %	2010Q1	2009Q4	2009Q3	2009Q2
Assets	-0.7%	-0.2%	-0.2%	-0.9%
Equity	0.5%	1.2%	3.1%	3.1%
Leverage	-1.2%	-1.4%	-3.4%	-4.0%
<i>Leverage is Asset% less Equity%</i>				
<i>Adjusted by \$322.3bn</i>				

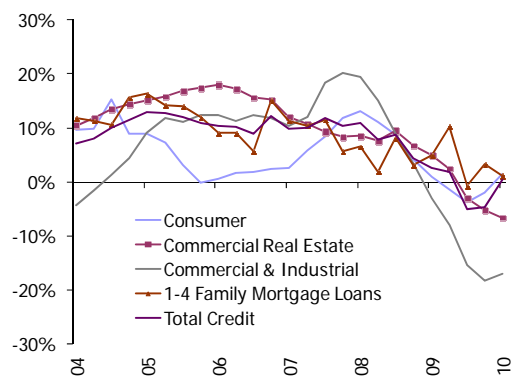
Source: BBVA Research and FDIC

Chart 6  
**Balance Sheet Conditions**



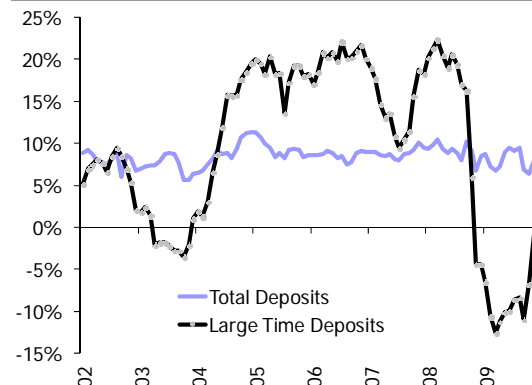
Source: FDIC

Chart 7  
**Loan Balances (Consumer Adjusted)**



Source: BBVA Research and FDIC

Chart 8  
**Deposits, YoY % Change**



Source: Federal Reserve

Table 2  
**FDIC Data Summary 2010Q1**

FDIC Statistics on Depository Institutions	3/31/2010	12/31/2009	9/31/2009	6/30/2009	3/31/2009
Total Delinquency	7.9%	7.8%	7.2%	6.4%	5.9%
Mortgage Delinquency	11.4%	10.8%	9.5%	8.3%	7.8%
CRE Delinquency	9.3%	8.9%	8.5%	7.9%	7.1%
C&I Delinquency	4.0%	4.4%	4.5%	3.7%	3.2%
Individual Delinquency	4.6%	4.8%	4.7%	4.7%	4.6%
Net interest margin	3.89%	3.50%	3.49%	3.47%	3.42%
Net operating income to assets	0.50%	0.12%	0.14%	0.11%	0.21%
Return on assets (ROA)	0.53%	0.09%	0.09%	0.07%	0.24%
Return on Equity (ROE)	4.82%	0.85%	0.87%	0.74%	2.43%
Net charge-offs to loans	3.00%	2.57%	2.46%	2.32%	2.02%
Earnings coverage of net charge-offs (x)	1.4	1.45	1.54	1.62	1.90
Loss allowance to loans	3.69%	3.27%	3.12%	2.90%	2.62%

Source: FDIC

**Disclaimer**

This document was prepared by Banco Bilbao Vizcaya Argentaria's (BBVA) BBVA Research U.S. on behalf of itself and its affiliated companies (each BBVA Group Company) for distribution in the United States and the rest of the world and is provided for information purposes only. Within the US, BBVA operates primarily through its subsidiary Compass Bank. The information, opinions, estimates and forecasts contained herein refer to the specific date and are subject to changes without notice due to market fluctuations. The information, opinions, estimates and forecasts contained in this document have been gathered or obtained from public sources, believed to be correct by the Company concerning their accuracy, completeness, and/or correctness. This document is not an offer to sell or a solicitation to acquire or dispose of an interest in securities.