

U.S.

Banking Watch

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Economic Analysis

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FDIC Banking Profile 2010Q3

Recovery progresses, but slowly

- **Total delinquency declines marginally; mortgage delinquency largely stands still**
- **The net charge-off on total loans drops for the second quarter in a row**
- **FDIC-insured institutions report lower provisions and reserves for 2010Q3**

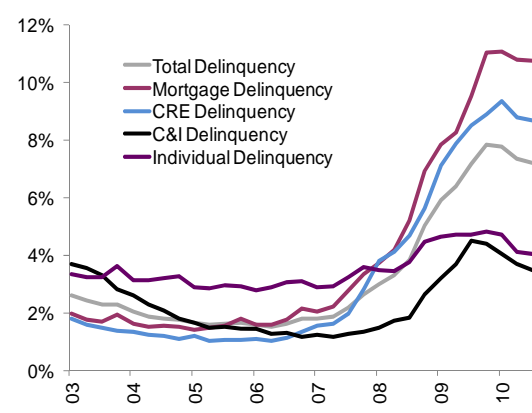
Delinquency rates improve marginally, scale of problem institutions slowly waning

Data from the Federal Deposit Insurance Corporation's (FDIC) Quarterly Banking Profile for 2010Q3 suggests that the total delinquency rate for commercial banks declined, but at a moderate pace. Mortgage delinquency declined only marginally and remained generally stable QoQ. All of the other major categories, however, posted declines in delinquency and thus were the major drivers of the improvement in the headline delinquency rate. Commercial real estate (CRE) decreased for the second quarter in a row from 8.8% in 2010Q2 to 8.7% in 2010Q3. Within CRE, nonfarm-nonresidential loan delinquencies increased marginally, multifamily real estate increased unexpectedly, and construction and development loans declined.

Although other real estate owned grows on balance sheets as foreclosures progress, commercial banks' loan loss allowance to total loans and net charge-off to loans declined for the second quarter in a row (see Chart 6). Steady progress in asset quality combined with improvements in balance sheet conditions will eventually allow the commercial banking system to gradually loosen lending standards and generate credit growth. However, improvement this quarter is decidedly marginal and this limits banks' ability to loosen terms of credit. This tendency is somewhat reflected in the most recent Federal Reserve survey of senior loan officers. An additional factor is the continued increase in problem institutions from 829 to 860, but it is notable that the scale of these problem institutions' assets is decreasing. In 2010Q3, problem institutions' assets declined from \$403bn to \$379bn, or from 3% to 2.8% of all FDIC-insured institutions' assets. Net interest margin has declined after the upward shock of changes to accounting rules (Chart 2).

Chart 1

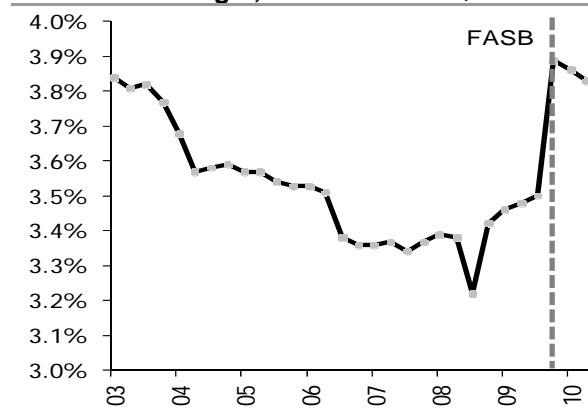
Commercial Bank Delinquency Rates



Source: FDIC

Chart 2

Net Interest Margin, Bank Assets > \$100mn



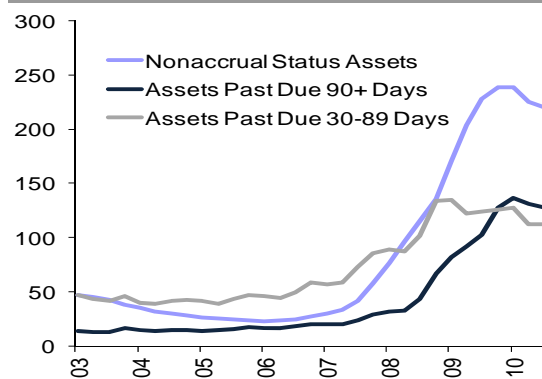
Source: FDIC

Earnings and loan loss provisions headed in the right direction

Loan loss allowances for commercial banks declined from \$237bn in 2010Q2 to \$228bn in 2010Q3, a trend that underscored the improved ability of commercial banks to generate profits with incrementally-abating asset quality indicators. Although loan loss provisions remain high, this second decline in a row suggests commercial banks are increasingly comfortable with the future. Absent a one-time goodwill impairment charge of \$10.4bn at one large financial institution, earnings for 2010Q3 would have been at a three-year high. The FDIC also reported that unprofitable institutions are at their lowest percentage since 2008Q2.

Chart 3

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

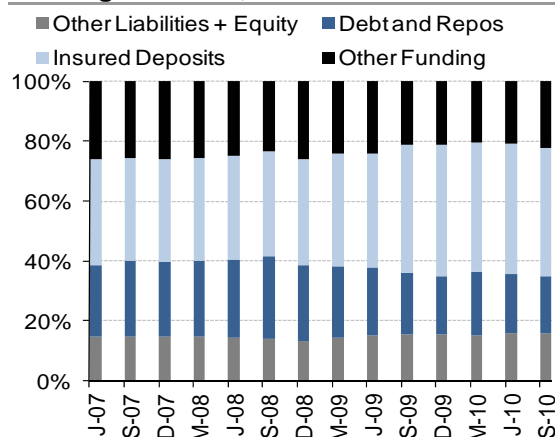


Alongside marginal improvements in delinquency rates, we also see marginal improvements in the past due loan inventory. Loans past due 30-89 days for the most part stood still and loans past due 90 days or greater staged only a marginal decrease. Nonaccrual loans, however, declined QoQ notably by roughly \$6bn. This is at a slower pace than in the previous quarter, but continued declines within this most severe of overdue loan categories is always welcome.

Source: FDIC

Chart 4

Funding Structure, % of Total Liabilities

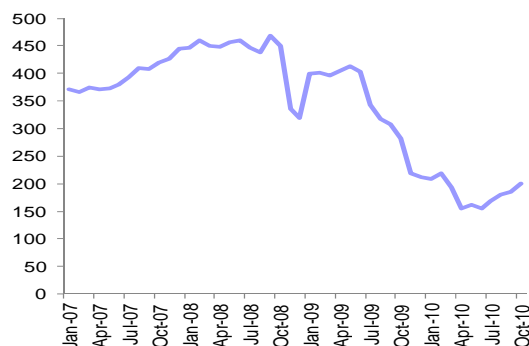


Commercial banks continue to rely more on deposit funding relative to the pre-Lehman Brothers bankruptcy era. In addition to less reliance on market-based funding sources subject to financial instability risks, banks also continue to rely on high-quality funding sources as regulatory conditions evolve towards greater scrutiny of funding risks. Recent changes to international capital standards such as Basel III introduce new requirements for short-term liquidity coverage that may also contribute to changes in commercial banks' funding structure.

Source: FDIC

Chart 5

Monthly Interbank Loans Outstanding, in \$bn



Over the past several months, interbank lending has shown signs of recovery. Of course, on a YoY basis interbank lending is exhibiting continued declines. The recent increases in interbank lending are remarkable as it may represent a sign of amplified trust between banks and better confidence in the overall financial system. It also enlarges the amount of credit available to the financial system overall.

Source: Federal Reserve

Deleveraging pauses, equity raisings continue

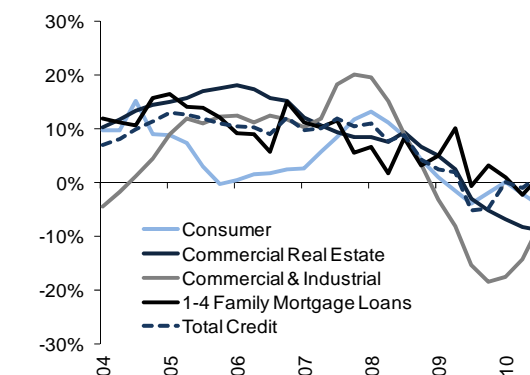
According to our measures of deleveraging, the commercial banking system this quarter demonstrated a pause in deleveraging. However, since the start of the crisis commercial banks have made significant strides in deleveraging. For example, total equity capital at commercial banks increased 19.4% since 2008Q4. In particular, the FDIC noted that tier 1 leverage capital for all institutions increased QoQ 2.1%, the highest quarterly increase since 2009Q1 when the Troubled Asset Relief Program (TARP) occurred.

Table 1
Leverage Indicators

QoQ Change in Leverage					
QoQ %	2010Q1	2010Q2	2010Q1	2009Q4	2009Q3
Assets	1.3%	-1.0%	-0.7%	-0.2%	-0.2%
Equity	1.1%	1.9%	0.5%	1.0%	3.1%
Leverage	0.3%	-2.9%	-1.2%	-1.2%	-3.4%
<i>Leverage is Asset% less Equity%</i>					
<i>2010Q1 Adjusted by \$322.3bn for FASB</i>					

Source: BBVA Research and FDIC

Chart 7
Loan Balances YoY%, FASB Break-Adjusted



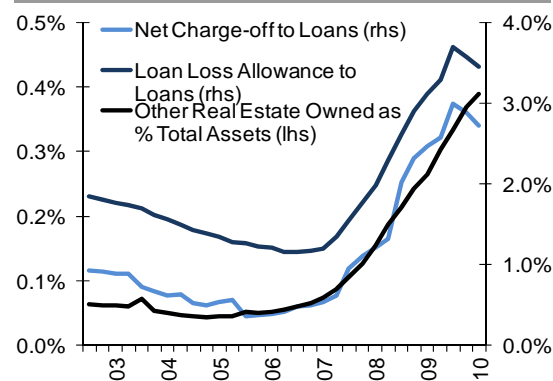
Source: BBVA Research and FDIC

Table 2
FDIC Data Summary

FDIC Statistics on Depository Institutions	9/30/2010	6/30/2010	3/31/2010	12/1/2009	9/1/2009
Total Delinquency	7.2%	7.3%	7.8%	7.8%	7.2%
Mortgage Delinquency	10.8%	10.8%	11.1%	11.0%	9.5%
CRE Delinquency	8.7%	8.8%	9.4%	8.9%	8.5%
C&I Delinquency	3.5%	3.7%	4.0%	4.4%	4.5%
Individual Delinquency	4.1%	4.1%	4.7%	4.8%	4.7%
Net interest margin	3.83%	3.87%	3.89%	3.50%	3.49%
Net operating income to assets	0.50%	0.57%	0.50%	0.10%	0.14%
Return on assets (ROA)	0.54%	0.60%	0.52%	0.07%	0.09%
Return on Equity (ROE)	4.90%	5.41%	4.77%	0.64%	0.87%
Net charge-offs to loans	2.72%	2.89%	3.00%	2.58%	2.46%
Earnings coverage of net charge-offs (x)	1.39	1.41	1.4	1.44	1.54
Loss allowance to loans	3.45%	3.58%	3.69%	3.29%	3.12%

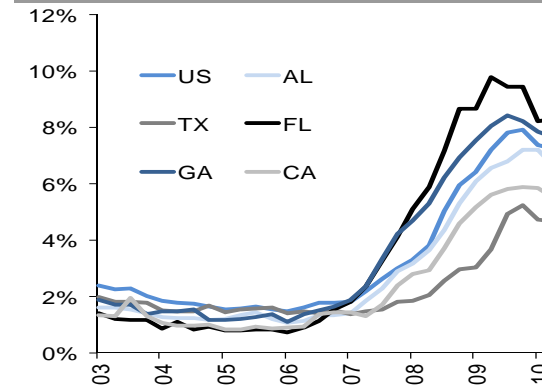
Source: FDIC

Chart 6
Balance Sheet Conditions



Source: FDIC

Chart 8
Selected State Delinquencies, Banks > \$100mn



Source: FDIC

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