BBVA Research

U.S.

# Banking Watch

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**Economic Analysis**

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# FDIC Banking Profile 2010Q4

## Residential blocking more rapid balance sheet improvement

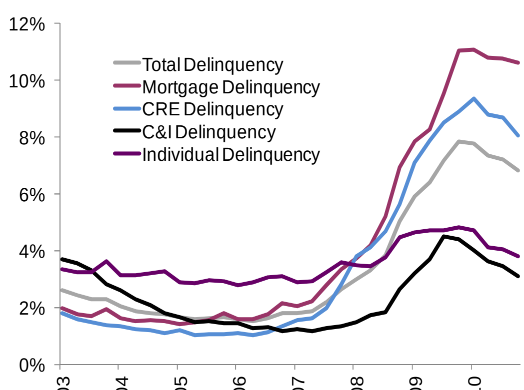
- **Total delinquency declines marginally, strongest improvements in commercial real estate**
- **The net charge-off on total loans declines for the third quarter in a row**
- **Residential real estate asset quality continues to wrestle with high delinquencies, past due loans**

**Loan loss allowances, net charge-off to loans, and other real estate owned decline**

Data from the Federal Deposit Insurance Corporation's (FDIC) Quarterly Banking Profile for 2010Q4 suggests that the total delinquency rate for commercial banks declined moderately, but that residential real estate credit persists in holding back a more rapid recovery in balance sheet conditions. Mortgage delinquency declined marginally and its past due loan inventory did not shift appreciably. All of the other major categories, however, posted stronger declines in delinquency and thus were the major drivers of the improvement in the headline delinquency rate. Commercial real estate (CRE) decreased more sharply than expected from 8.7% in 2010Q3 to 8.0% in 2010Q4. Within CRE, nonfarm-nonresidential loan delinquencies decreased marginally, multifamily real estate decreased sharply, and construction and development loans declined from 19% to 18%.

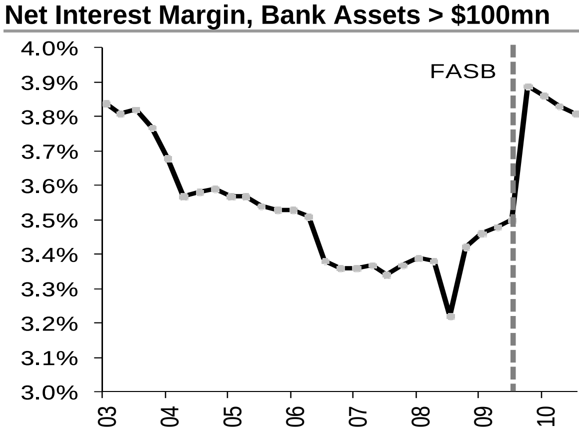
An important development is that other real estate owned on banks' balance sheets declined for the first time since 2005. It is unknown if legal troubles surrounding documentation and processing of foreclosures is a factor in this decline, but if it is a true measure of banks' processing of foreclosures, it represents a positive signal of improvement. Credit loss provisions as a percentage of net charge-offs are now half of their level in the quarter following the collapse of Lehman Brothers. The net interest margin has edged lower since the imposition of new FASB accounting changes. Compared to recent memory, however, net interest margin stands at a high level. Cost of funding earning assets is at an extremely low 0.87%, but interest rate increases anticipated in 2012 will likely crimp the yield-cost spread. The FDIC's list of problem institutions lengthened to 884, but the amount of problem institution assets increased only slightly.

Chart 1
**Commercial Bank Delinquency Rates**




Source: FDIC

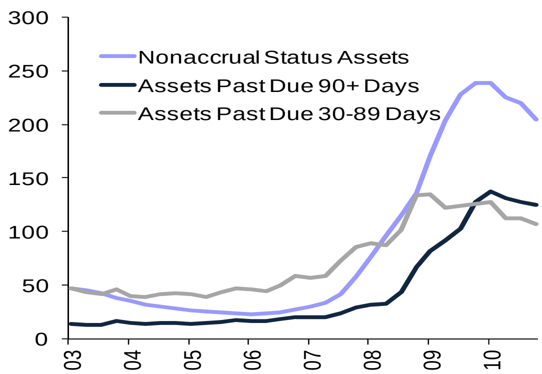
Chart 2
**Net Interest Margin, Bank Assets > $100mn**




Source: FDIC

**Improved profitability, but still dependent on a solid recovery in residential lending**
The industry as a whole posted a net income of $21.7bn and commercial banks reported a return on assets of 0.66%. This return on assets figure is around half of the average return on assets in the years prior to the crisis. Return on equity is at 6.0%, a figure that also stands around half or one-third the level of return on equity in the years leading up to the crisis, depending on the time period chosen. Positive earnings and improved returns on assets are heartening, but the figures still point to a banking industry in recovery mode. Residential mortgage asset quality is still a major linchpin in a fully-fledged breakout.

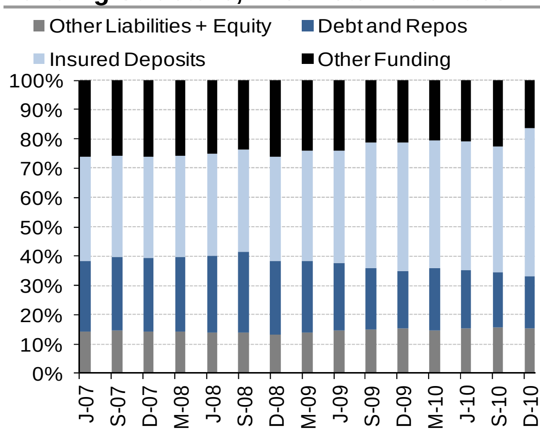
Chart 3
**Past Due Loan Inventory at Commercial Banks, in $bn**




Source: FDIC

An encouraging sign is that nonaccrual assets have improved notably over the past two quarters. More than half of the QoQ decline in nonaccrual loans is attributable to construction loans (a $6.2bn decline) and commercial and industrial loans (a $2.8bn decline). The delinquency rate on construction loans is the most dire of all credit categories, so the improvement in nonaccrual status loans may be a reflection of a more rapid recovery in the future for these loans.

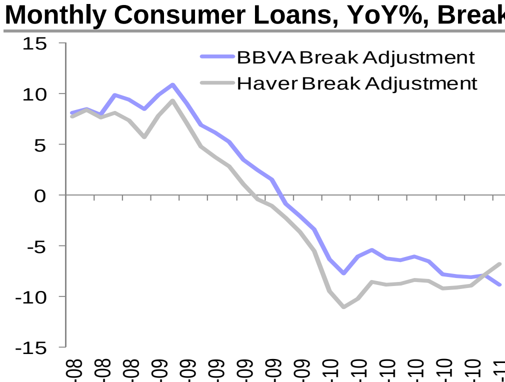
Chart 4
**Funding Structure, % of Total Liabilities**




Source: FDIC

The FDIC noted in its Quarterly Banking Profile that, for the industry as a whole, deposits as a percentage of funding reached its highest level since 1996Q1. Our measures of the funding structure of commercial banks confirm this sentiment. However, deposit growth is generally slow. The latest YoY growth rate for deposits in 2010Q4 is 2.2%, while the average YoY rate since 2004 is 7.9%. This is likely the result of extremely low interest rates, as even during 2008 deposits grew at an average quarterly YoY rate of 10.1%.

Chart 5
**Monthly Consumer Loans, YoY%, Break-Adjusted**




Source: Haver Analytics and BBVA Research

In March 2010, new accounting rules forced over $300bn in consumer loans back onto banks' balance sheets. Additionally, in January commercial banks divested $25bn in consumer loans to nonbanks. These issues cause breaks in the data series and create uncertainty over the growth rate of consumer loans. We compare our chosen break-adjustment scheme with that of Haver Analytics. Our series suggests more of a downward trend over the past several months. Additionally, we have eliminated the January divestment from the data. The treatment of the data affects the outlook for consumer credit.

**Deleveraging at a standstill, but most deleveraging is probably behind us**

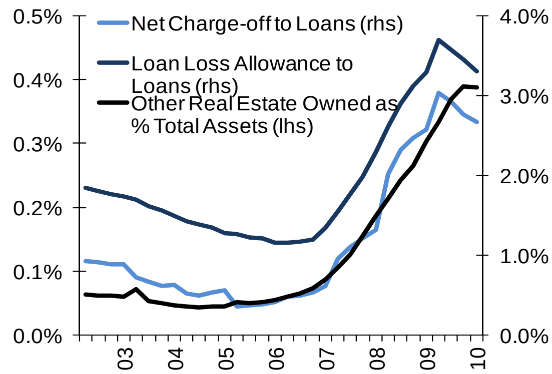
According to our measures of deleveraging, the commercial banking system this quarter continued its pause in deleveraging for the second quarter in a row. Equity raisings have been robust and additional need for equity is lower now as a result. Asset growth is caught between areas that are improving (commercial and industrial) and areas that are still hurting (commercial real estate). We regard this as a signal that deleveraging is mostly over, but we may need a couple more quarters of similar rates as 2010Q4.

Table 1
### Leverage Indicators

| QoQ Change in Leverage | | | | | |
|---|---|---|---|---|---|
| QoQ % | 2010Q4 | 2010Q3 | 2010Q2 | 2010Q1 | 2009Q4 |
| Assets | -0.4% | 1.4% | -1.0% | -0.7% | -0.2% |
| Equity | -0.2% | 1.9% | 1.9% | 0.5% | 1.0% |
| Leverage | -0.3% | -0.4% | -2.9% | -1.2% | -1.2% |
| *Leverage is Asset% less Equity%* | | | | | |
| *2010Q1 Adjusted by $322.3bn for FASB* | | | | | |

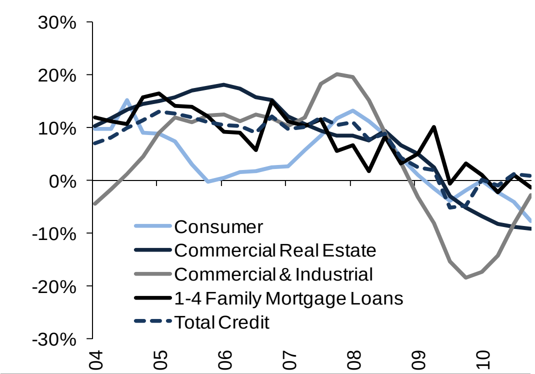
Source: BBVA Research and FDIC

Chart 6
### Balance Sheet Conditions



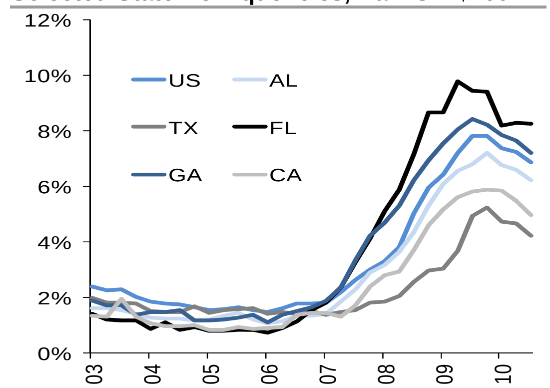

Source: FDIC

Chart 7
### Loan Balances YoY%, FASB Break-Adjusted




Source: BBVA Research and FDIC

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




Source: FDIC

Table 2
### FDIC Data Summary

| FDIC Statistics on Depository Institutions | 12/31/2010 | 9/30/2010 | 6/30/2010 | 3/31/2010 | 12/1/2009 |
|---|---|---|---|---|---|
| Total Delinquency | 6.8% | 7.2% | 7.3% | 7.8% | 7.8% |
| Mortgage Delinquency | 10.6% | 10.8% | 10.8% | 11.1% | 11.0% |
| CRE Delinquency | 8.0% | 8.7% | 8.8% | 9.4% | 8.9% |
| C&I Delinquency | 3.1% | 3.5% | 3.6% | 4.0% | 4.4% |
| Individual Delinquency | 3.8% | 4.0% | 4.1% | 4.7% | 4.8% |
| Net interest margin | 3.81% | 3.83% | 3.86% | 3.89% | 3.50% |
| Net operating income to assets | 0.62% | 0.62% | 0.57% | 0.50% | 0.10% |
| Return on assets (ROA) | 0.66% | 0.66% | 0.60% | 0.53% | 0.07% |
| Return on Equity (ROE) | 5.99% | 6.00% | 5.49% | 4.85% | 0.64% |
| Net charge-offs to loans | 2.67% | 2.77% | 2.93% | 3.04% | 2.58% |
| Earnings coverage of net charge-offs (x) | 1.43 | 1.44 | 1.39 | 1.38 | 1.44 |
| Loss allowance to loans | 3.30% | 3.45% | 3.58% | 3.69% | 3.29% |

Source: FDIC

## Disclaimer