Banking Watch

US

May 24, 2011
Economic Analysis

US

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FDIC Banking Profile 2011Q1

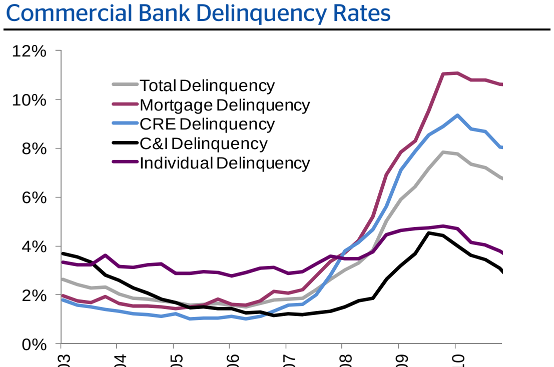
Light at the end of the tunnel, but it's a long tunnel

- **ROA improves considerably, profitability posts continued gains**
- **Net charge-off to total loans falls from 2.7% to 1.9% QoQ**
- **Real estate asset quality now primary blockage to improved asset quality**

FDIC data continues to point to struggles in real estate asset quality

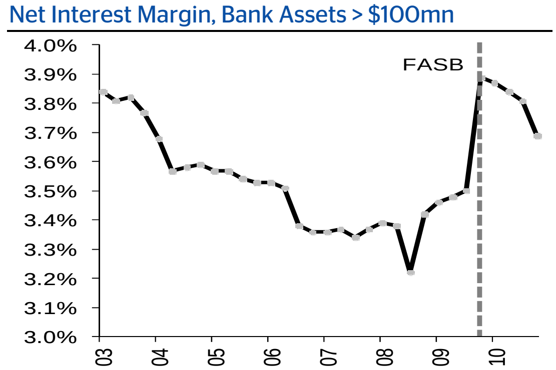
Data from the Federal Deposit Insurance Corporation's (FDIC) Quarterly Banking Profile for 2011Q1 suggests that the total delinquency rate for commercial banks declined moderately. Similar to the previous two quarters, residential real estate credit persists in holding back a more rapid recovery in balance sheet conditions. While other real estate owned (OREO) as a percentage of total assets is no longer increasing – suggesting commercial banks are stemming the tide of foreclosures more effectively – this ratio is not demonstrating significant improvement. The level of OREO remained largely the same from last quarter to the present quarter, but the total amount of assets on commercial banks' balance sheets declined. This is the main factor driving the OREO ratio. Mortgage delinquency barely declined, while all other major categories posted stronger declines in delinquency and thus were the major drivers of improvement in total delinquency. Improvements in total delinquency are in many ways becoming more dependent on real estate-sensitive asset quality as commercial and industrial (C&I) and consumer may be exhausting their scope for future gains. The current consumer and C&I delinquency rates are similar to their levels in 2004. Net interest margin declined strongly from 2010Q4 to the present quarter, but we believe this is largely the result of continued processing of formerly securitized credit card loans resulting from FASB accounting changes last year. One positive trend is that the net charge-off to total loans ratio declined dramatically QoQ from 2.7% to 1.9% in 2011Q1. Charge-offs and recoveries are typically expressed as year-to-date data. So far with one quarter of data, total recoveries are largely the same as this point last year, but total charge-offs are notably lower. For commercial banks as a whole, the efficiency ratio increased to its highest level since 2003 and total allowances for loan losses declined by $12.5bn. The FDIC's list of problem institutions lengthened from 884to 888, but the amount of problem institution assets increased only by $7bn. Problem institution assets are only around 3.2% of total commercial bank assets.

Chart 1
Commercial Bank Delinquency Rates



Source: FDIC

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

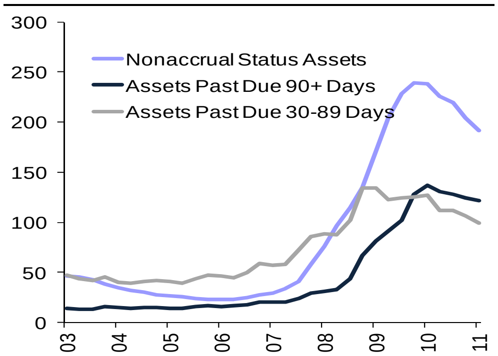


Source: FDIC

Return on assets improves considerably, profitability posts continued gains

The industry as a whole posted a net income of $29bn and commercial banks reported a return on assets of 0.90%. This return on assets figure is around two-thirds of the average return on assets in the years prior to the crisis. Both tier 1 and core capital ratios increased QoQ. All FDIC-insured institutions posted the highest quarterly net income since the financial crisis. Most asset growth, however, occurred in non-loan categories. Total loans and leases declined QoQ and total securities increased QoQ. The FDIC reported that net loans and leases comprised the lowest share of total assets of all institutions since the early 1970s.

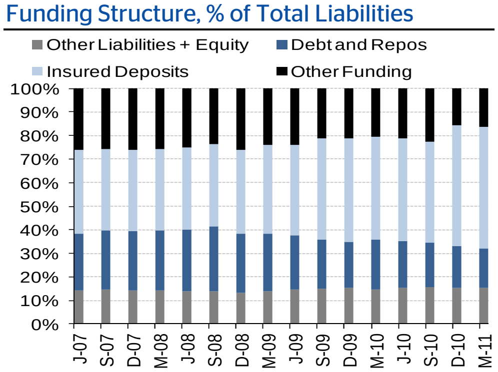
Chart 3
Past Due Loans at Commercial Banks, in $bn



Source: BLS and BBVA Research

Nonaccrual loans continue to improve strongly over the past few quarters, while loans 90+ days past due remain sticky. Construction and land development loans again contributed strongly to the decline in nonaccrual status assets. The FDIC also for the first time began to explicitly breakout automobile and "other" consumer loans. This needed disaggregation of commercial bank consumer lending will be extremely useful down the road with more data collection.

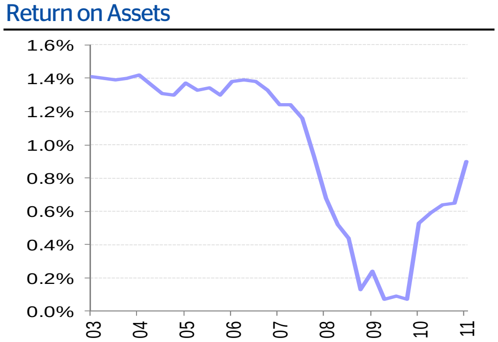
Chart 4
Funding Structure, % of Total Liabilities



Source: FDIC

Deposit growth rebounded from very low YoY growth rates of the past two quarters. Commercial banks, in turn, are accelerating the shift of their funding structure to more reliance on retail deposits. Interbank lending markets continue to face challenges from extremely-low short-term rates and decreased risk appetite. Impending regulatory changes may also impact banks' funding structure considerations.

Chart 5
Return on Assets



Source: FDIC

Return on assets (ROA) improved considerably over the past quarter. Using the benchmark of the pre-crisis ROA level of roughly 1.4%, the current ROA is getting farther away from crisis levels. Nonetheless, a return to 1.4% is unlikely given the disappearance of many sources of noninterest income that prevailed before the crisis. Overall, a ROA that has cleared 0.9% and appears headed for some marginal further gains is a welcome trend.

Deleveraging appears to be stabilizing

The most encouraging elements of the FDIC's release of the 2011Q1 Quarterly Banking Profile are the decline in net charge-offs and the recovery in ROA. Both of these elements will enable the commercial banking system to more effectively process the amount of past due loans currently on balance sheets, no matter if the lag in processing them is turning out to be extremely long as in the case of residential real estate. Improvements in consumer and C&I have led improvements in total delinquency, but now more of the burden must be carried by commercial and residential real estate. Indications so far appear that these two categories are progressing very slowly.

Table 1
Leverage Indicators

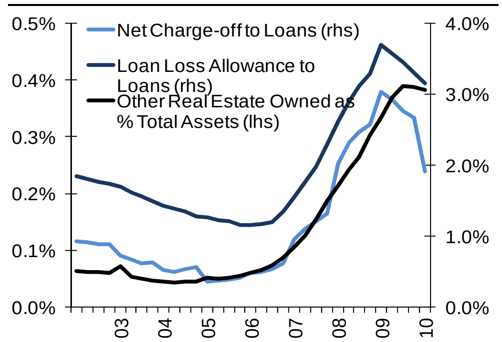
QoQ Change in Leverage

QoQ %	2011Q1	2010Q4	2010Q3	2010Q2	2010Q1
Assets	0.8%	-0.4%	1.4%	-1.0%	-0.7%
Equity	1.4%	-0.3%	1.9%	1.9%	0.5%
Leverage	-0.6%	-0.2%	-0.4%	-2.9%	-1.2%

Leverage is Asset% less Equity%
2010Q1 Adjusted by $322.3bn for FASB

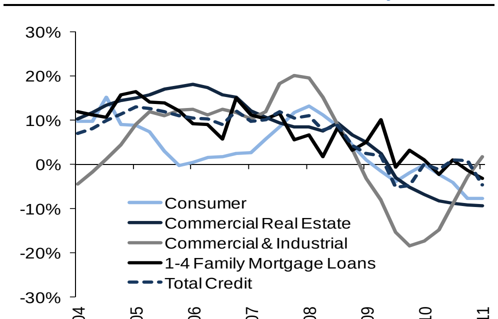
Source: FDIC and BBVA Research

Chart 6
Balance Sheet Conditions



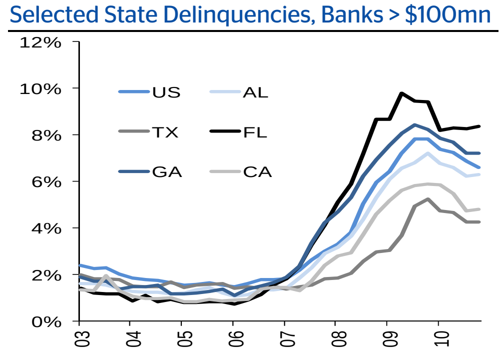
Source: FDIC

Chart 7
Loan Balances YoY%, FASB Break-Adjusted



Source: FDIC

Chart 8
Selected State Delinquencies, Banks > $100mn



Source: FDIC

Table 2
FDIC Data Summary

FDIC Statistics on Depository Institutions	3/31/2011	12/31/2010	9/30/2010	6/30/2010	3/31/2010
Total Delinquency	6.6%	6.8%	7.2%	7.3%	7.8%
Mortgage Delinquency	10.6%	10.6%	10.8%	10.8%	11.1%
CRE Delinquency	8.0%	8.0%	8.7%	8.8%	9.4%
C&I Delinquency	2.5%	3.1%	3.4%	3.6%	4.0%
Individual Delinquency	3.4%	3.8%	4.0%	4.1%	4.7%
Net interest margin	3.69%	3.81%	3.84%	3.87%	3.89%
Net operating income to assets	0.91%	0.61%	0.60%	0.56%	0.50%
Return on assets (ROA)	0.90%	0.65%	0.64%	0.59%	0.53%
Return on Equity (ROE)	8.03%	5.90%	5.83%	5.37%	4.85%
Net charge-offs to loans	1.91%	2.67%	2.77%	2.93%	3.04%
Earnings coverage of net charge-offs (x)	1.87	1.43	1.42	1.38	1.38
Loss allowance to loans	3.16%	3.30%	3.45%	3.58%	3.69%

Source: FDIC