Banking Watch

US

28 February 2012
Economic Analysis

US
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FDIC Banking Profile 2011Q4

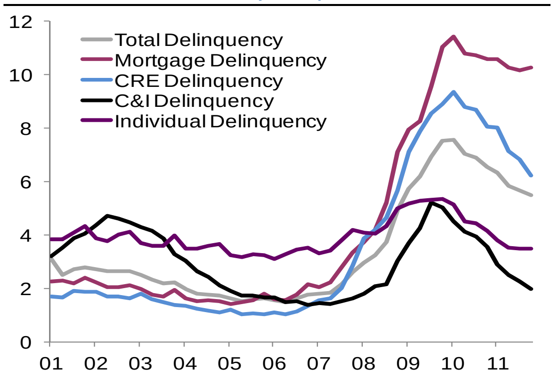
Widespread Performance Improvement Over 2010

- **Mortgage and CRE delinquencies lower than 2010 average**
- **C&I loans to small businesses rose for the first time in seven quarters**
- **Problem institutions declined 8% in 2011, banking outlook stable**

Steady improvements in asset quality, lower loan loss provisions boost net income

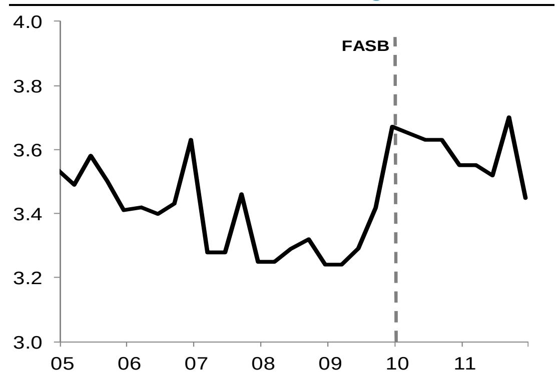
The Federal Deposit Insurance Corporation's (FDIC) Quarterly Banking Profile for 4Q11 highlights a similar trend in the banking sector compared to the previous report. Asset quality appears to be improving, reflecting declines in both charge-off and delinquency rates. Net charge-offs fell to the lowest level in more than three years at 1.4% of total loans, bringing the annual rate to 1.55% compared to 2.55% in 2010. Delinquencies declined only slightly for most loan categories, although mortgage delinquencies did increase from 10.2% to 10.3% for the quarter. While this emphasizes the lasting weakness of the housing crisis, we continue to see gradual improvement in real estate asset quality compared to year-ago rates. On average, mortgage and commercial real estate (CRE) delinquency rates hit 10.3% and 7.1%, respectively, in 2011, much lower than the 2010 averages of 10.9% and 8.7%. Outside of real estate, asset quality is stabilizing, with commercial and industrial (C&I) and consumer delinquencies recovering close to pre-recession levels. Total loan balances increased for the third consecutive quarter and at the fastest pace since 4Q07. C&I lending continues to drive total growth, though we expect the growth trajectory will flatten throughout 2012. In particular, C&I loans to small businesses increased for the first time in seven quarters and suggests underlying improvement in the economic outlook. Annual net income reached $119.5bn in 2011, showing significant growth over 2010 and marking the highest level since 2006. Much of this was due to lower provisions for loan losses, which declined more than 50% in 2011. We expect provision-related income performance to decline in the coming quarters given the steady improvement in asset quality. Despite the gain in total revenues, net interest margin declined to the lowest rate since 3Q09, influencing a loss in net operating income for only the second time in more than 70 years. Noninterest income also declined as expected in 2011 given limitations from the Dodd-Frank Act and other regulations.

Chart 1
Commercial Bank Delinquency Rates (%)



Source: SNL Financial

Chart 2
Commercial Bank Net Interest Margin (%)

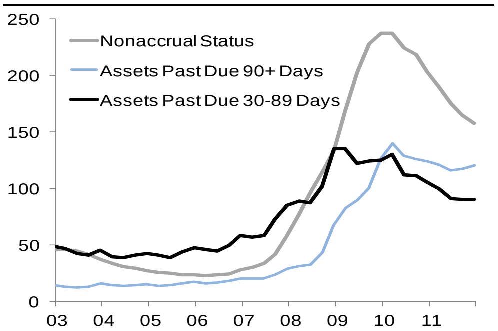


Source: SNL Financial

Problematic banks decline and strong deposit growth persists

The FDIC's problem list declined in 4Q11 to reach an annual total of 813 institutions, an 8% improvement over 2010's figure. Eliminating risk for the FDIC is a positive signal for the banking industry, however, levels remain extremely elevated compared to 2008 and earlier. Still, performance at FDIC-insured institutions is improving gradually on a YoY basis, with a rise in the Tier 1 risk-based and core capital ratios. As expected, deposits continue to grow at a robust pace, up 13.7% in 4Q11 despite steady declines in foreign office liabilities.

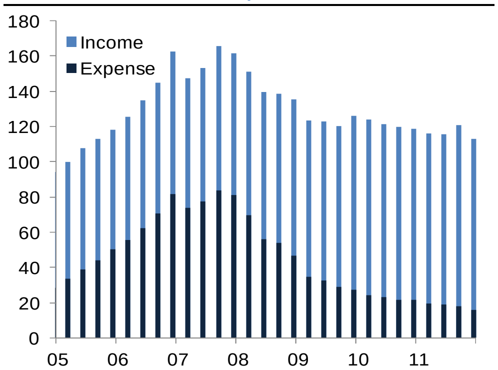
Chart 3
Past Due Loans at Commercial Banks, in $mn



Source: SNL Financial

Total nonaccrual assets have trended downward since the end of 2009, yet levels have recovered less than 50% from the crisis peak. Assets past due 90+ days increased slightly in 4Q11 and remain relatively unchanged from 4Q10. Most of the gain was due to mortgage loans, though consumer loans past due 90 days or more did increase slightly from the second and third quarters. As the real estate sector weighs heavily on asset quality, we expect trends to continue at a similar pace throughout 2012.

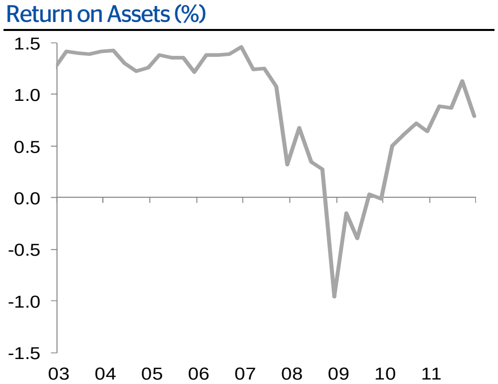
Chart 4
Interest Income and Expense, in $mn



Source: SNL Financial

Total interest income and expense declined throughout 2011 in large part due to interventions by the Federal Reserve. Commitments to keeping interest rates low through at least mid-2014 and outcomes related to Operation Twist (announced in September 2011) have successfully flattened the yield curve, limiting banks' interest income. Furthermore, increased competitiveness among banks has restricted significant income gains throughout the sector. We expect similar trends to continue in the near term as the Fed maintains its downward pressure on yields.

Chart 5
Return on Assets (%)



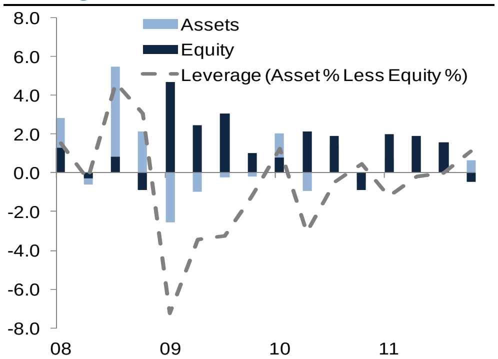
Source: SNL Financial

Return on assets declined slightly in 4Q11 to the lowest rate in 2011. However, the annual rate of 0.88% shows improvement over 0.65% in 2010 and -0.07% in 2009. Asset growth rate more than doubled from 2010 to 2011 and likely contributed to the latest annual gain. Although current returns are lower than the pre-recession trend, we maintain our view that performance is moving at a healthy pace. Banks have undergone significant adjustment and regulatory supervision since the financial crisis, and these structural changes may ultimately limit a jump in returns in the near term.

The Outlook for Next Quarter

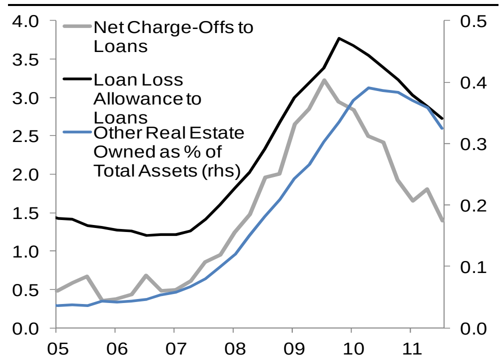
Financial institutions have shown significant improvement since the recession, though it is clear that the real estate sector weighs heaviest on bank balance sheets. While we do not expect housing conditions to deteriorate much further, the potential gains for 2012 are extremely limited due to increasing foreclosures and insufficient demand. Annual improvements in asset quality are widespread, yet regional weakness may become a more pressing issue in the coming quarters. The banking profile for 1Q12 should be similar to 4Q11, though we may seem some seasonal effects fade in regards to CRE loan balances and asset quality.

Chart 6
Leverage Indicators (QoQ %)



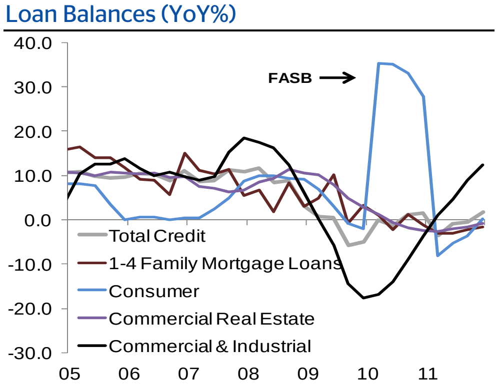
Source: SNL Financial and BBVA Research

Chart 7
Balance Sheet Conditions (%)



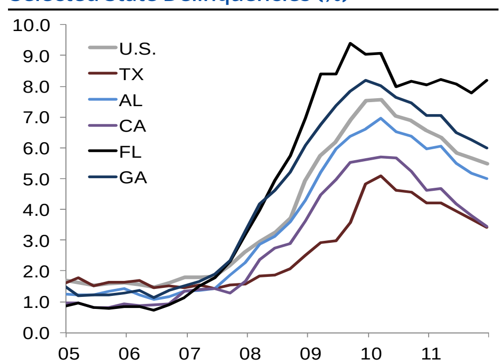
Source: SNL Financial

Chart 8
Loan Balances (YoY%)



Source: SNL Financial

Chart 9
Selected State Delinquencies (%)



Source: SNL Financial

Table 1
FDIC Data Summary

FDIC Statistics on Depository Institutions	2011Q4	2011Q3	2011Q2	2011Q1	2010Q4
Total Delinquency (%)	5.49	5.66	5.84	6.33	6.56
Mortgage Delinquency	10.27	10.16	10.26	10.58	10.58
CRE Delinquency	6.23	6.81	7.15	8.01	8.06
C&I Delinquency	1.97	2.25	2.51	2.88	3.56
Individual Delinquency	3.48	3.48	3.51	3.79	4.17
Net interest margin (%)	3.45	3.70	3.52	3.55	3.55
Net operating income to assets (%)	0.59	0.77	0.56	0.49	0.32
Return on assets (ROA) (%)	0.79	1.13	0.87	0.89	0.64
Return on Equity (ROE) (%)	7.04	10.11	7.67	7.99	5.81
Net charge-offs to loans (%)	1.40	1.81	1.65	1.92	2.41
Earnings coverage of net charge-offs (%)	2.13	2.18	2.07	1.86	1.42
Loss allowance to loans (%)	2.73	2.88	3.03	3.23	3.39

Source: SNL Financial