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Banking Watch

US

Houston, June 7, 2012
Economic Analysis

U.S.
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FDIC Banking Profile 2012Q1

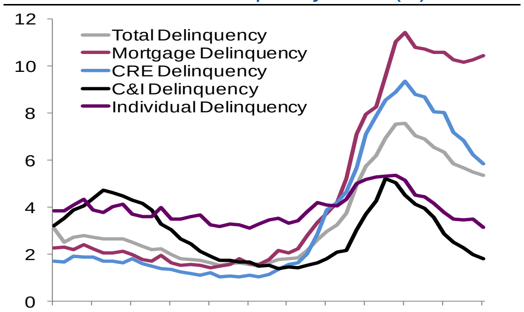
Bank Earnings Climb as Asset Quality Rallies

- Earnings and performance indicators reach record levels
- Net charge-offs hit 4-year low, mortgages still weighing on delinquencies
- Outlook for upcoming quarters mixed as global uncertainties linger

Improvements in asset quality boosting confidence in banking sector

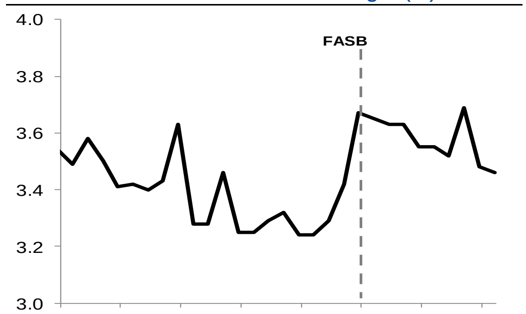
Data from the Federal Deposit Insurance Corporation's (FDIC) Quarterly Banking Profile for 2012Q1 suggests continued improvements in banking sector performance despite lingering uncertainties in the global economy. Commercial bank earnings increased 22.9% over the first quarter of 2011 to $35.3bn, hitting the highest level of the recovery period. Revenues increased 3.1% from last year's levels, mostly on account of higher loan portfolio sales. Net interest income was up slightly from the previous quarter but declined on a year-over-year basis, which is expected given the downward pressure on yields. Loan loss provisions declined 31.6% from the fourth quarter to the lowest quarterly total since mid-2007. Building on trends set in 2011Q4, credit quality is recovering in all loan categories, with losses down on a year-over-year basis (-32%) for the seventh consecutive quarter. Net charge-offs fell 34.8% from 2011Q1 to $21.8bn, the lowest figure in nearly four years, reflecting major declines in credit cards, real estate construction and land loans, and commercial and industrial (C&I) loans. Delinquencies declined for the eighth consecutive quarter to $305bn, finally approaching pre-recession levels. However, residential delinquencies have kept upward pressure on the total figure, with the national mortgage delinquency rate sill above 10% and only slightly lower than the peak of 11.4%. According to the FDIC data, the majority of residential delinquencies in 2012Q1 stemmed from the 14.3% increase in noncurrent Government National Mortgage Association (GNMA) loans, which are fully backed by the federal government. Excluding these loans, first-lien mortgage delinquencies actually declined 7.2% from 2011Q4, which hints at some progress for the sector. On a related note, only 16 institutions failed in the first quarter, the lowest number since 2008Q4, while the FDIC's "Problem List" declined for the fourth consecutive quarter from 813 to 772. Various responses from the Federal Reserve and individual institutions since the financial crisis have clearly contributed to reduced risk and a stronger overall performance for the banking industry.

Chart 1
Commercial Bank Delinquency Rates (%)



Source: SNL Financial & BBVA Research

Chart 2
Commercial Bank Net Interest Margin (%)

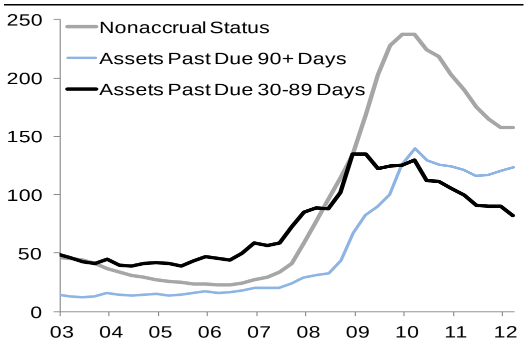


Source: SNL Financial & BBVA Research

Loan balances declined for the first time in a year, capital levels strengthen

A 5.6% drop in credit cards and a 4.9% fall in real estate construction and land loans influenced a modest 0.8% decline in total loan and lease balances among commercial banks. Most other loan volumes declined as well, except for C&I and auto loans which both increased near 2% from the previous quarter. On average, the leverage capital ratio matched a high of 9.2% while the tier 1 risk-based capital ratio reached 13.3%, surpassing the historical peak and highlighting the strengthening performance of the banking sector.

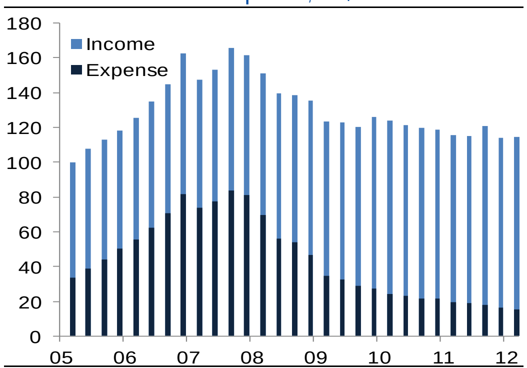
Chart 3
Past Due Loans at Commercial Banks, in $mn



Source: SNL Financial & BBVA Research

Past due loans at commercial banks were less encouraging in the first quarter, with those in nonaccrual status relatively unchanged from 2011Q4. Assets past due 90 days or more increased slightly, offsetting a small decline in the number of assets past due 30-89 days. While levels have trended downward throughout the past few years, there is still a long way to go to fully recover from the crisis. The average severity of past due loans in the commercial banking system has dropped significantly from the midst of the recession, but weakness in real estate lending remains a considerable risk.

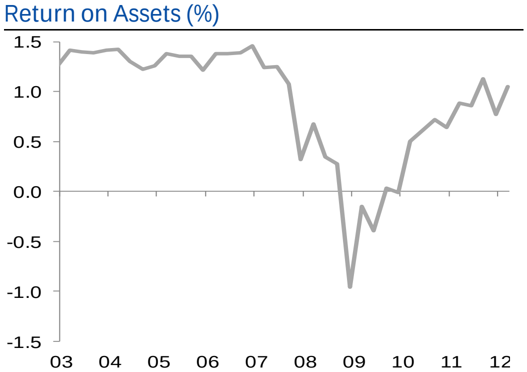
Chart 4
Interest Income and Expense, in $mn



Source: SNL Financial & BBVA Research

Total interest income and expense was relatively unchanged in 2012Q1 as monetary policy remained stable. Since the crisis, the Federal Reserve has intervened in the market in order to stimulate economic activity, announcing quantitative easing plans and committing to keeping interest rates low for an extended period of time. Economic data was mostly positive in the first quarter, so there was little incentive for the Fed to act. However, the recent slowing in activity, particularly in the labor market, may influence an extension of Operation Twist or additional quantitative easing that will limit growth in commercial bank interest income.

Chart 5
Return on Assets (%)



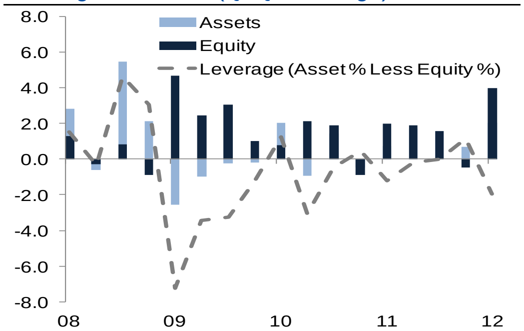
Source: SNL Financial & BBVA Research

Total assets have increased on a quarterly basis since the beginning of 2011 and in 2012Q1 increased 0.3%. Throughout the past 12 months, assets grew 3.8% compared to only 0.6% in the 2010Q1 to 2011Q1 period. Average return on assets recovered from a slight dip in the fourth quarter of 2011 to 1.05%, slightly below the recovery peak of 1.13% reached in 2011Q3. Still, returns remain reasonable when compared to historical trends and considering the significant regulatory adjustments imposed on commercial banks since the recession.

Outlook for Next Quarter

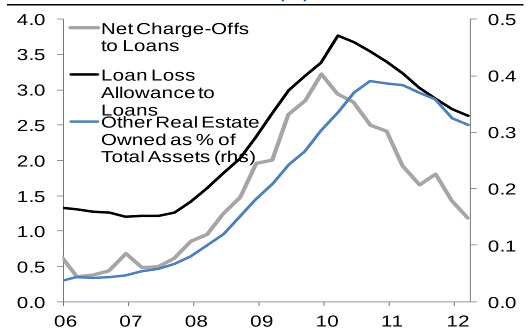
Data from the banking sector is mostly positive, with performance in 2012Q1 building on trends set in the prior quarters. Credit quality is improving gradually, with some loan categories less risky than others. As in the previous quarters, residential lending remains a leading risk to the industry and we expect that it could be a few more years before the situation becomes more comfortable. For 2012Q2, we expect that most of these positive trends will continue. However, the latest macroeconomic data have been mixed, with increasing concerns regarding the financial stability in Europe. This uncertainty, combined with the flattened yield curve, will limit significant improvements in the upcoming quarter.

Chart 6
Leverage Indicators (QoQ % Change)



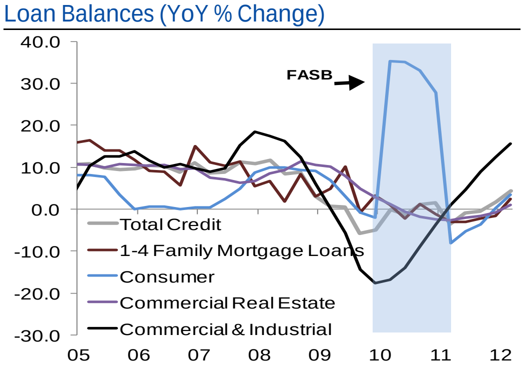
Source: SNL Financial & BBVA Research

Chart 7
Balance Sheet Conditions (%)



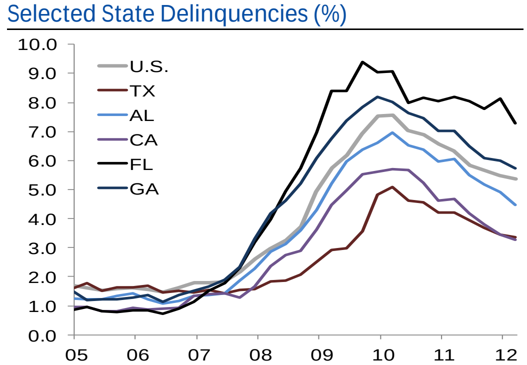
Source: SNL Financial & BBVA Research

Chart 8
Loan Balances (YoY % Change)



Source: SNL Financial & BBVA Research

Chart 9
Selected State Delinquencies (%)



Source: SNL Financial & BBVA Research

Table 1
FDIC Data Summary

FDIC Statistics on Depository Institutions	2012Q1	2011Q4	2011Q3	2011Q2	2011Q1
Total Delinquency (%)	5.37	5.50	5.66	5.83	6.33
Mortgage Delinquency	10.44	10.28	10.16	10.26	10.58
CRE Delinquency	5.85	6.24	6.82	7.17	8.03
C&I Delinquency	1.80	1.97	2.25	2.50	2.87
Individual Delinquency	3.13	3.48	3.46	3.48	3.76
Net interest margin (%)	3.46	3.48	3.69	3.52	3.55
Net operating income to assets (%)	0.84	0.57	0.77	0.56	0.49
Return on assets (ROA) (%)	1.05	0.77	1.13	0.86	0.89
Return on Equity (ROE) (%)	9.40	6.83	10.11	7.66	7.99
Net charge-offs to loans (%)	1.19	1.43	1.81	1.65	1.92
Earnings coverage of net charge-offs (%)	2.96	2.08	2.17	2.07	1.86
Loss allowance to loans (%)	2.63	2.73	2.88	3.03	3.23

Source: SNL Financial & BBVA Research