RESEARCH

Banking Watch

US

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Economic Analysis

U.S.
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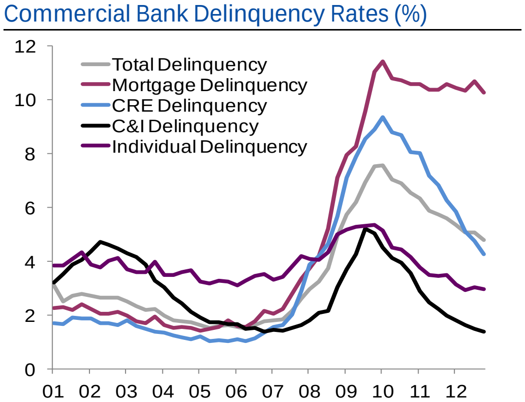
FDIC Banking Profile 2012Q4

Weaker End to 2012 but Annual Improvements Encouraging

- Asset quality on the rise as banks report fewer noncurrent loans
- Higher noninterest income and lower provisions boost bank net income
- Banking financials held steady through 2012, but room for progress in 2013

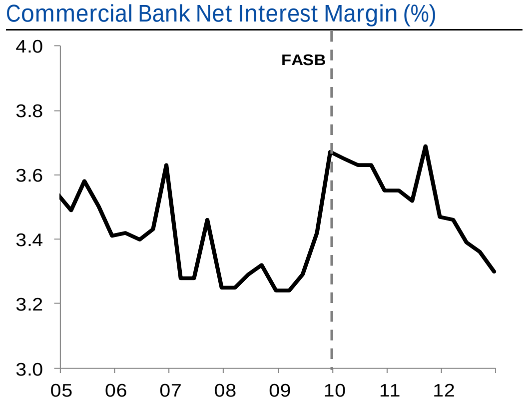
The Federal Deposit Insurance Corporation (FDIC) Quarterly Banking Profile (QBP) for 4Q12 builds on the continued improvements seen in the banking sector, with only a few hiccups related to heightened fiscal uncertainty and slower growth throughout the quarter. As we have seen in the past few quarters, asset quality continues to improve gradually (see our latest Quarterly Update), though mortgage delinquencies remain high. According to the FDIC QBP, noncurrent loans declined 5.5% in the final quarter of 2012 to a total of $276.8bn, with the delinquency rate falling below 4% to its lowest in four years. Still, the rate is close to 3% higher than the healthier levels seen in early 2007, prior to the recession (Chart 1). Noncurrent real estate construction and development loans led the overall decline, down 17.3% for the quarter, while nonfarm nonresidential real estate and 1-4 family mortgages fell 9.2% and 3.5%, respectively. Accordingly, net charge-offs in 4Q12 were 27.4% lower than in 4Q11, with the net charge-off to loan ratio at its lowest level since before the recession. Net income at commercial banks fell slightly to $34.7bn in 4Q12 from $37.6bn in 3Q12, though the final figure for the year reflects a significant 36.9% gain from 4Q11's $25.3bn. Net operating income declined somewhat from the third quarter while securities and other gains fell to the lowest level in almost two years. The 12-month improvement from the end of 2011 was mostly due to lower provisions and higher noninterest income. Loan-loss provisions, which banks set aside to account for future losses on bad loans, fell 24.6% from 4Q11 to only $15.1bn, a marginal increase from the prior three quarters in 2012 but still significantly lower than the $71.1bn seen during the peak of the recession in 4Q08. Noninterest income increased 18.2% from 4Q11 on account of increased gains on loan sales, higher trading revenue, and fewer losses on foreclosed property sales. The annual comparison is also a bit less skewed in 2012 given that 2011 data reflected the FASB adjustment in 2010. Overall, 2012 appears to have been a very stable and healthy year for the banking industry, with net income totaling $141.3bn compared to $118.4bn and $85.5bn in 2011 and 2010, respectively. Net interest income actually declined throughout 2012, down to $104.4bn in 4Q12 from $107.1bn in 4Q11. Likewise, the average net interest margin declined to 3.32% compared to 3.57% at the end of 2011, mostly on account of lower asset yields (Chart 2).

Chart 1
Commercial Bank Delinquency Rates (%)



Source: SNL Financial & BBVA Research

Chart 2
Commercial Bank Net Interest Margin (%)



Source: SNL Financial & BBVA Research

Domestic Deposits Hit Record Highs, Banking Financials Continue to Improve

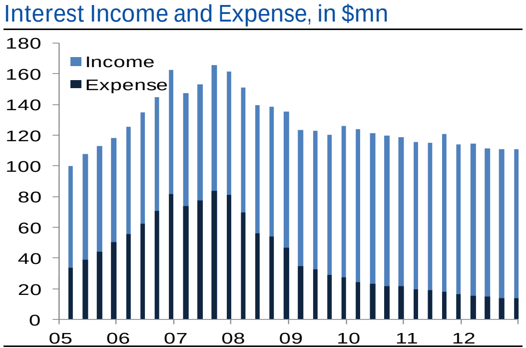
Domestic deposits increased at an unprecedented rate, up $387bn in the fourth quarter of 2012 compared to a mere $146bn increase in 3Q12. Although much of the increase was due to large denomination deposits, this significant jump most likely reflects the looming uncertainty that both businesses and consumers faced towards the end of the year while fiscal negotiations in Washington remained stressful.

Chart 3
Return on Assets (%)

Source: SNL Financial & BBVA Research

Banks' average return on assets held steady throughout 2012 following a sharp drop at the end of 2011, hovering around 1.0% for several quarters. In 4Q12, the ROA fell slightly to 0.97%, marking a minor decline from 3Q12 but still a significant jump from the 0.73% seen in 4Q11. For the year, the average ROA reached 1.00% in 2012 (the first time since 2006), compared to 0.88% in 2011 and 0.65% in 2010. Although overall banking conditions are improving, it seems unlikely that the average ROA will approach pre-recession levels (near 1.5%) anytime soon. Still, we can be satisfied with the recovery thus far considering the devastating damage that was caused by the financial crisis.

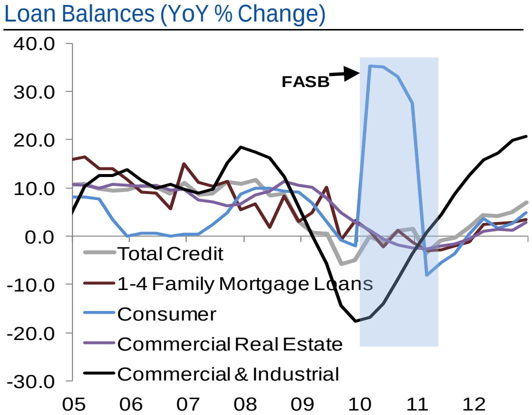
Chart 4
Interest Income and Expense, in $mn



Source: SNL Financial & BBVA Research

Interest income in 2012 declined 4% from 2011, holding steady near $111mn throughout all four quarters. This, of course, is not surprisingly given the extended low interest rate period set by the Fed, limiting banks' potential for gains. On the other hand, total interest expenses continue to decline at a rapid pace, down 22.3% from 2011, as borrowing costs remain extremely low. Looking ahead to the next few years, we are likely to see both interest income and expenses hold relatively steady near current levels, at least through 2014 while the Fed waits for policy guidance thresholds to be reached.

Chart 5
Loan Balances (YoY % Change)



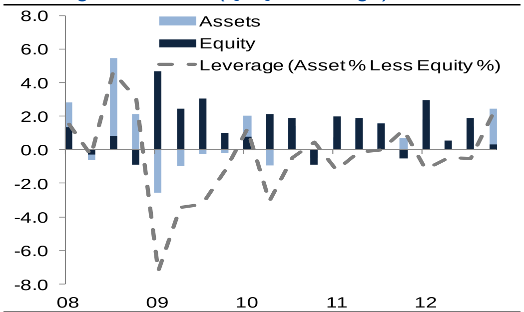
Source: SNL Financial & BBVA Research

Loan balances jumped $118bn in 4Q12, up significantly from the mere $65bn gain in 3Q12 but still a bit lower than 4Q11's $134bn increase. Within the different loan categories, credit card balances increased the most throughout the quarter (up 4.2%), while C&I and nonfarm nonresidential real estate loans rose 3.7% and 1.4%, respectively. Overall, loan balances in all categories are showing strength compared to year-ago levels, even in real estate. Since the recession, C&I loan balances have shown the greatest improvements as businesses and other investors take advantage of lower borrowing costs and healthy margins.

Outlook for Next Quarter

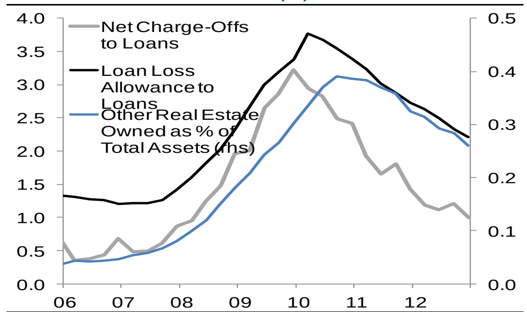
Quantitative and qualitative reports over the past few years have made it very clear that the 2008 financial crisis permanently changed the banking world. Strict regulations and monitoring systems put in place have alleviated much of the risk, and the number of problem institutions continues to fall (down 6% in 4Q12, with only eight failures for the quarter). Not surprisingly, looming fiscal uncertainties at the end of 2012 resulted in the slowest pace of quarterly growth in almost two years, yet the banking sector continues to emerge stronger as time passes. The latest data for 2013 suggest a pickup in growth from 4Q12, though we expect conditions to be a bit stronger later in the year. The financial system in Europe still has more holes to fill, but domestic banks should continue to shown annual improvements. While the worst of the fiscal negotiations in Congress may not be behind us just yet, we expect that banks will see little impact and thus will continue on this more sustainable (albeit gradual) path to a more successful future.

Chart 6
Leverage Indicators (QoQ % Change)



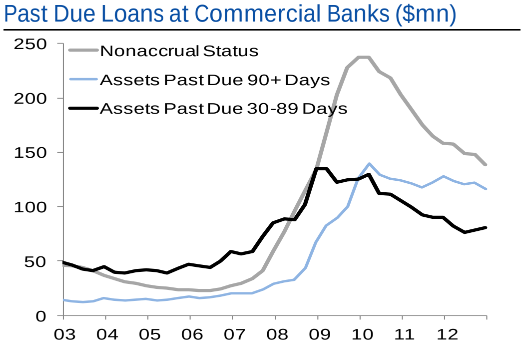
Source: SNL Financial & BBVA Research

Chart 7
Balance Sheet Conditions (%)



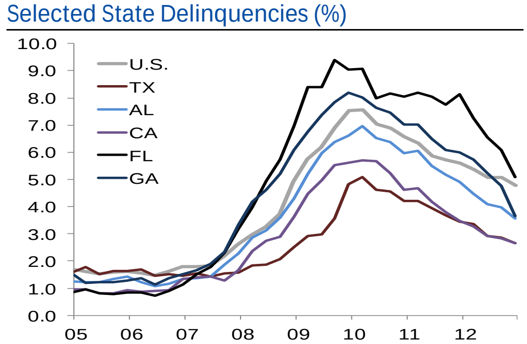
Source: SNL Financial & BBVA Research

Chart 8
Past Due Loans at Commercial Banks ($mn)



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	2012Q4	2012Q3	2012Q2	2012Q1	2011Q4
Total Delinquency (%)	4.77	5.06	5.06	5.37	5.60
Mortgage Delinquency	10.27	10.70	10.35	10.43	10.59
CRE Delinquency	4.27	4.76	5.11	5.84	6.25
C&I Delinquency	1.38	1.49	1.64	1.81	1.97
Individual Delinquency	2.97	3.04	2.94	3.13	3.48
Net interest margin (%)	3.30	3.36	3.39	3.46	3.47
Net operating income to assets (%)	0.88	0.85	0.81	0.82	0.57
Return on assets (ROA) (%)	0.99	1.08	0.99	1.03	0.76
Return on Equity (ROE) (%)	8.70	9.47	8.73	9.27	6.77
Net charge-offs to loans (%)	1.00	1.21	1.12	1.19	1.43
Earnings coverage of net charge-offs (%)	3.25	2.86	2.97	2.84	2.08
Loss allowance to loans (%)	2.21	2.33	2.49	2.63	2.73

Source: SNL Financial & BBVA Research