BBVA | RESEARCH

Banking Watch

US

Houston, June 3, 2013
Economic Analysis

U.S.
Alejandro Vargas
Alejandro.vargas@bbvacompass.com

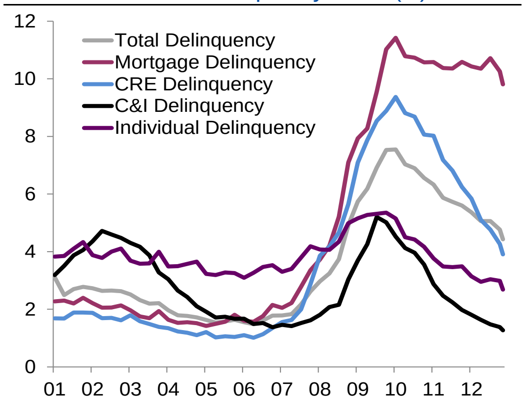
FDIC Banking Profile 2013Q1

Stronger Start to 2013 as Banks Post Income Growth

- Asset quality on the rise as banks report fewer noncurrent loans
- Higher noninterest income and lower provisions boost banks' net income
- Industry-wide gains point toward growth potential in coming quarters

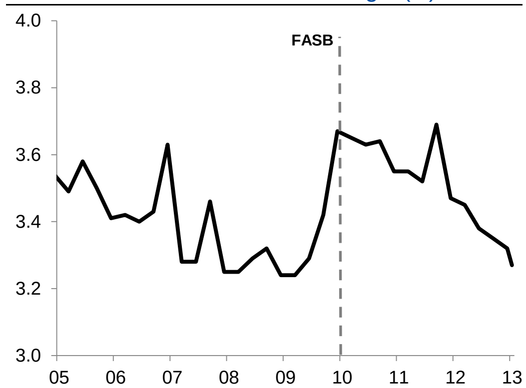
The Federal Deposit Insurance Corporation (FDIC) Quarterly Banking Profile (QBP) for 1Q13 points toward continuing improvement in the banking sector as net income rises and cost-cutting initiatives payoff. As we have seen in the past few quarters, asset quality continues to improve gradually (see our latest Quarterly Update), Noncurrent loans and leases for 1Q13 declined 6% to $261.1bn, their lowest levels since year end 2008, as the total delinquency rate fell to 4.4%. Declining quarter by quarter to a more sustainable level, the full percentage point decline in delinquencies since 1Q12 signals an improving situation for banks. Noncurrent loans and leases declined $15.7bn during 1Q13 lead by residential mortgage loans where balances declined by 5% ($8.7bn). Noncurrent real estate construction and development loans declined by $2.2bn and nonfarm non-residential loans for properties fell $2bn. Accordingly, loan losses declined for the 11th consecutive quarter to $16bn which is the smallest quantity since 3Q11. The improvement in charge-offs was across all loan categories with residential mortgages 39% lower on a YoY basis. Charge-offs for home equity lines of mortgages declined 33.4% while that for credit cards fell 11.5%. As banks appear to be getting rid of the tarnished loans, income is on the rise. Quarterly net income at commercial banks rose $40.3bn as one-time income and expense items helped lift earnings for 1Q13. Net operating income grew 19.6% YoY, a moderate level of growth given the headwinds banks faced at the end of 2012. Total noninterest income rose $5.1bn YoY and trading revenue rose 17.8% over the same period. Aiding net income growth was a $4.2bn decline in noninterest expense of which 50% of the decline came from one large bank. However, almost 60% of banks reported increases in noninterest expenses. Provisions for loan and lease losses fell to $11bn declining $3.3bn from 12 months ago with over half of banks reporting lower loss provisions from 1Q12. Net interest income declined to its lowest level since 4Q09 as both total interest income and total interest expense continued to decline.

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

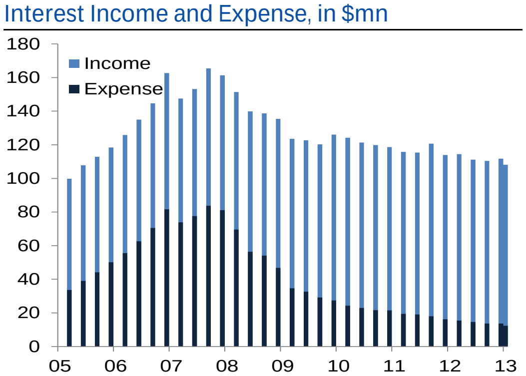
Domestic deposits declined in 1Q13 after a massive leap at the end of 4Q12, falling $20.5bn to just below its record high set the period prior. This decline was influenced heavily by the fall in non-interest bearing deposits which primarily indicates that the payroll tax increase at the beginning of 2013 influenced peoples spending habits, reducing the savings rate in 1Q13 as consumers used these funds instead to maintain consistent levels of consumption.

Chart 3
Return on Assets (%)

Source: SNL Financial & BBVA Research

Banks average return on assets rose during 1Q13 to 1.14% following a relatively stable 2012. Climbing above 1%, ROA was in line with the quarter's growth in net income. The strongest start to a year in terms of ROA since 2007, we still do not expect to reach pre-recession levels of 1.5% anytime soon but given the stronger economic outlook for 2H13, this quarter's ROA is unlikely to be highest reading for the year. Aiding in the ROA calculation is the fact that total assets of insured institutions in 1Q13 declined by $26.3bn or 0.2%, the first quarterly decline since 4Q10. Despite the drop, the ratio of reserves to noncurrent loans did improve, prompting continued optimism for 2H13.

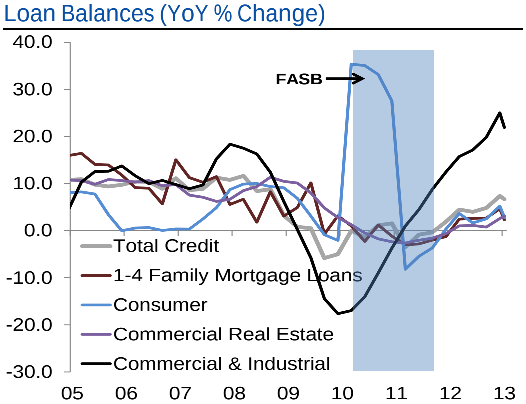
Chart 4
Interest Income and Expense, in $mn



Source: SNL Financial & BBVA Research

Interest income for 1Q13 was 4.8% lower than in the same period last year and net interest income was a similar story, down 2.2%. Low interest rates for the coming years are still expected given the Fed's recent outlook and will force interest income to remain muted. Bank's net interest margin declined to 3.27% from 3.35% in 4Q12. According to the data, this is the lowest figure since 4Q06 and given the slow recovery, may not rise much in the near future. Additionally, older and higher yielding assets are reaching maturity and being replaced with lower yield ones, rapidly reducing average yields.

Chart 5
Loan Balances (YoY % Change)



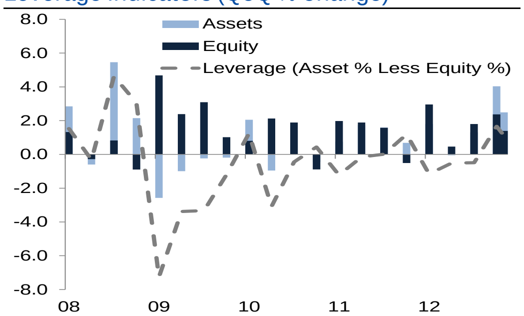
Source: SNL Financial & BBVA Research

After a significant increase in 4Q12, loan balances declined by $36.8bn or 0.5% as a seasonal decline in credit card balances put a strain on the figure. Home equity lines of credit also declined by $16bn as sales of mortgages outpaced originations. Not all loan categories declined, however. C&I loans rose 1.6% and loans to foreign depository institutions rose by 16.9%. Given low borrowing costs, there has been a tendency for loan growth to be more focused in real estate but this report points toward a broad set of categories that saw loan growth, including autos.

Outlook for Next Quarter

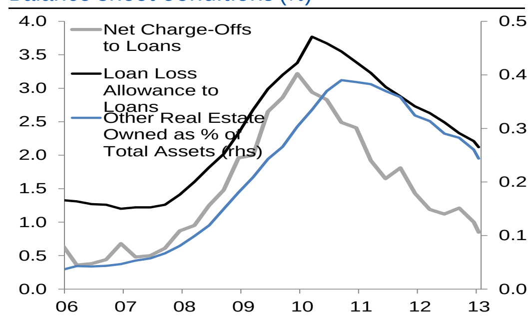
While consumers were fretting over the fiscal debates taking place in early 2013, banks were expecting less traffic in the early months as both industries and individuals dealt with the tax increase and continuing uncertainty. However, it seems as though the situation turned out quite positive with over 90% of institutions posting positive net income and fewer institutional failures (only four). Despite the decline in assets, incomes remain strong and earnings have been boosted by the expiration of some short-term costs. With the domestic situation improving and sectors like C&I and real estate taking the helm in terms of loan growth, banks are likely to see an improvement in the coming quarter as consumer lending is poised to grow along with autos. In terms of headwinds, reduced interest income may continue to put pressure on net income but will likely be overshadowed by growth in loan originations and better credit quality.

Chart 6
Leverage Indicators (QoQ % Change)



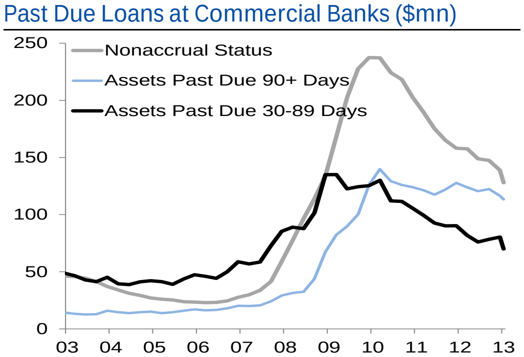
Source: SNL Financial & BBVA Research

Chart 7
Balance Sheet Conditions (%)



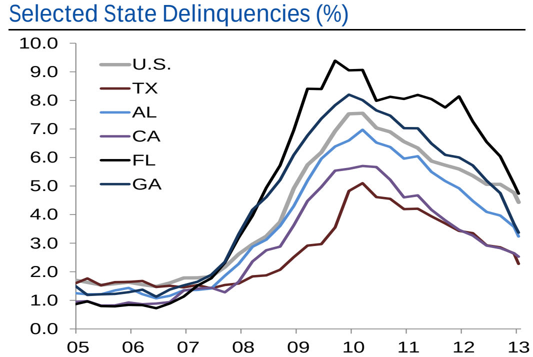
Source: SNL Financial & BBVA Research

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	2013Q1	2012Q4	2012Q3	2012Q2	2012Q1	2011Q4
Total Delinquency (%)	4.43	4.76	5.06	5.06	5.36	5.60
Mortgage Delinquency	9.81	10.26	10.72	10.35	10.43	10.59
CRE Delinquency	3.91	4.26	4.77	5.10	5.84	6.25
C&I Delinquency	1.27	1.38	1.48	1.64	1.81	1.97
Individual Delinquency	2.68	2.99	3.04	2.95	3.14	3.49
Net interest margin (%)	5.33	3.32	3.35	3.38	3.45	3.47
Net operating income to assets (%)	1.00	0.88	0.85	0.82	0.81	0.57
Return on assets (ROA) (%)	1.14	0.98	1.08	1.00	1.03	0.76
Return on Equity (ROE) (%)	10.07	8.68	9.45	8.76	9.27	6.77
Net charge-offs to loans (%)	0.85	1.00	1.21	1.12	1.19	1.43
Earnings coverage of net charge-offs (%)	4.23	3.23	2.86	2.99	2.84	2.08
Loss allowance to loans (%)	2.12	2.21	2.33	2.49	2.63	2.73

Source: SNL Financial & BBVA Research