BBVA RESEARCH

Banking Watch

US

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Economic Analysis

U.S.

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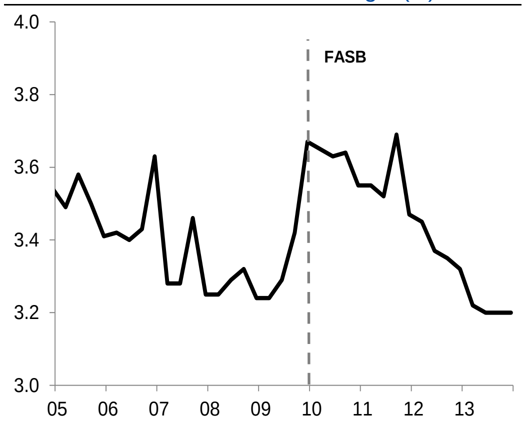
FDIC Banking Profile 2013Q4

Banks Post Solid Income Growth to Close Out 2013

- Noncurrent loans continue to fall as a percentage of total balances
- Overall net interest income increased, despite decline in interest income
- Fiscal certainty expected to boost net income growth moving forward

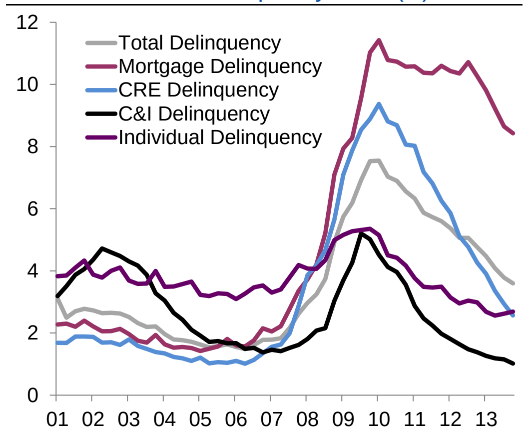
The Federal Deposit Insurance Corporation (FDIC) Quarterly Banking Profile (QBP) for 4Q13 shows continuing improvement in the banking sector as net income rose significantly for the quarter and from a year ago. For 2013, industry net income increased by 9.6% from 2012 to $154.7bn, marking the fourth consecutive year of an increase. Overall net operating revenue actually declined by 1.7% from a year ago, but the declines were largely offset by a 5.4% decline in noninterest expenses and a significant 53.7% drop in the cost of loan-loss provisions. Noninterest income fell by $4.2bn or 6.6% YoY, mostly attributed to a mix of the fall in 1-to-4 family residential mortgage loans, which were down 34.4%, likely due in part to the declining affordability of homes. Meanwhile, net interest income jumped by $1.4bn or 1.3% on a YoY basis, the first increase since 3Q12, despite a decrease in interest revenue. The average net interest margin appears to have bottomed out in the short run, but the low levels can be explained by lower asset yields in recent years replacing higher yield assets (Chart 1). Total assets increased by 0.9% from the previous quarter, driven by growth in loan portfolios as banks continue to receive business from the commercial and industrial sector as well as real estate. Total noncurrent loans and leases declined by 6.3% QoQ and a significant 25.2% YoY, falling to $207.1bn by the end of the year, as delinquency rates continue the trend of declining from their 2009 peaks (Chart 2). Furthermore, only 2.6% of all loan and lease balances were noncurrent, the lowest percentage witnessed since 2008. The reduction of noncurrent assets bodes well for the overall balance sheet of the banking industry in terms of flexibility, as the high majority of assets can be easily liquidated if necessary.

Chart 1
Commercial Bank Net Interest Margin (%)



Source: SNL Financial & BBVA Research

Chart 2
Commercial Bank Delinquency Rates (%)

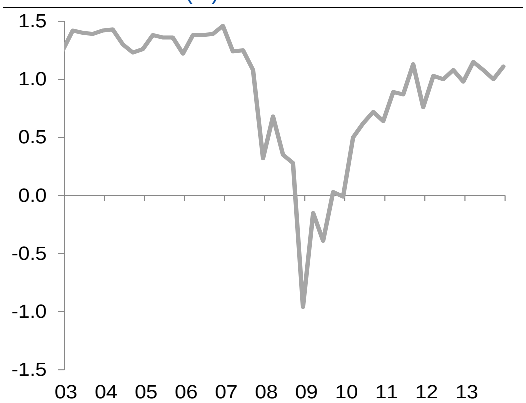


Source: SNL Financial & BBVA Research

Domestic Deposits Hit Record Highs and Banking Financials Continue to Improve

In 4Q13, total domestic deposits increased 3.7% from a year ago, breaking a record high for the second consecutive quarter. The growth in domestic deposits was a result of jumps in both interest and non-interest bearing deposits, which increased 3.9% and 2.8%, respectively. Overall, domestic deposits supported 66.5% of industry assets in 4Q13, which is the largest percentage in 20 years.

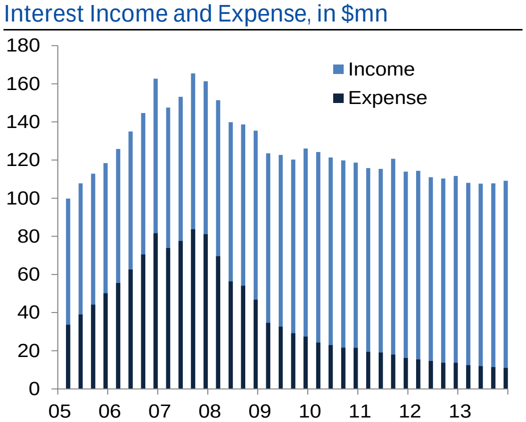
Chart 3
Return on Assets (%)



Source: SNL Financial & BBVA Research

Banks' average return on assets (ROA) rose during 4Q13 to 1.07%, the highest ROA rate since the recession. Hovering above 1.0%, ROA was in line with the quarter's growth in net income. Although the return rate is strong, we still do not expect to reach pre-recession levels of 1.5% in 2014. Still, all signs show that the growth is robust and banks appear to be distanced from the negative levels seen during 2009. Furthermore, the growth in ROA was seen despite the fact that overall total assets in the 4Q13 increased by $126 billion from the previous quarter and 1.9% from one year ago. Despite a drop in reserve balances, ratio of reserves to noncurrent loans increased to 65.6%,, marking the fifth straight QoQ increase and signaling an optimistic 1H14.

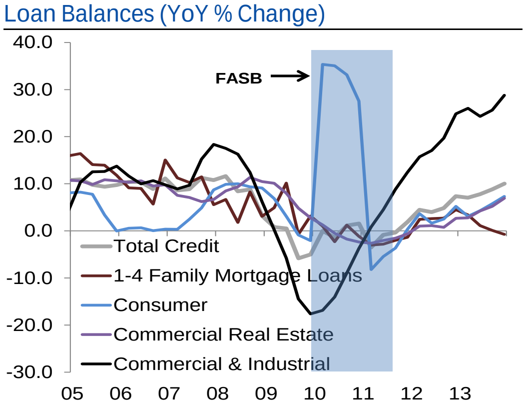
Chart 4
Interest Income and Expense, in $mn



Source: SNL Financial & BBVA Research

Total interest income for 4Q13 was slightly lower than in 4Q12 and was down 0.9% for 2013, but net interest income was up 1.3% YoY for 4Q13 for the first time in over a year. Bank's net interest margin declined to 3.26% in 2013, down from 3.42% in 2012, marking the third straight year of declines. This is the lowest net interest margin since 2008, and is likely due to the fact that older and higher yielding assets have reached maturity and have been replaced with lower yield assets. Until economic growth remains robust and the Fed adjusts monetary policy, we do not expect interest income to increase significantly for banks.

Chart 5
Loan Balances (YoY % Change)



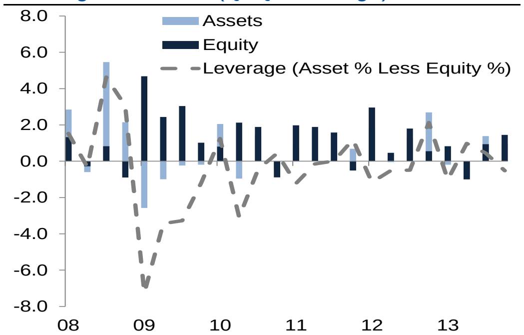
Source: SNL Financial & BBVA Research

Total loan and lease balances increased by $90.9bn or 1.2% for the quarter, as credit card balances were up 2.1%, posting a $14.3bn increase. C&I loans rose 1.7% while loans to nonfarm nonresidential properties were up 1.6%. Home equity loan balances, however, continued the downward trend and fell by 1.3%. As the low borrowing cost environment persists, loan growth can be witnessed across several categories. Shifting attention towards housing, 1-4 family mortgage loans declined by 0.7%, which is likely attributed to the recent jump in mortgage rates seen during 2H13.

Outlook for Next Quarter

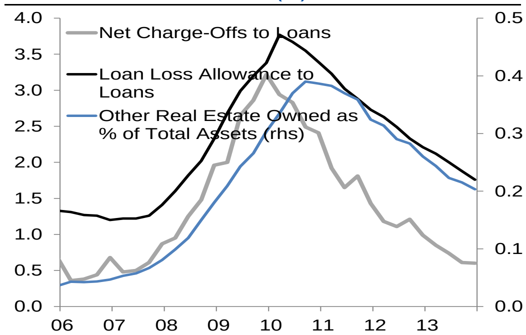
After suffering from massive uncertainty regarding fiscal policy throughout most of the past year, banks were unsure of what to expect in terms of activity and traffic from industries. Overall, 2013 finished strong, as only two insured institutions failed in 4Q13, the smallest number of failures since the recession. As interest rates remain suppressed, it is likely that interest income will continue to weaken or at least remain stagnant for the time being, but it is not likely that this will have a large impact on overall net income, as growth in other areas of the balance sheet, such as commercial and industry loans and commercial real estate, are poised to overshadow the decline. Now that fiscal policy has been mostly settled, we expect a resurgence of confidence and certainty to boost quarterly growth for banks moving forward, and we are likely to see increases in total loans drive overall net income.

Chart 6
Leverage Indicators (QoQ % Change)



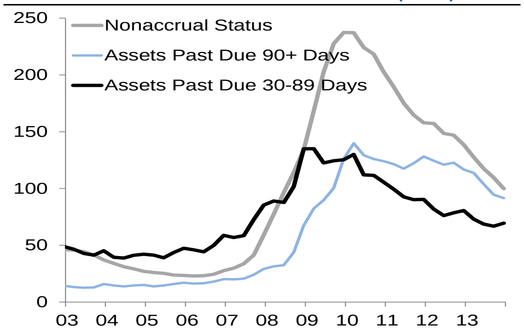
Source: SNL Financial & BBVA Research

Chart 7
Balance Sheet Conditions (%)



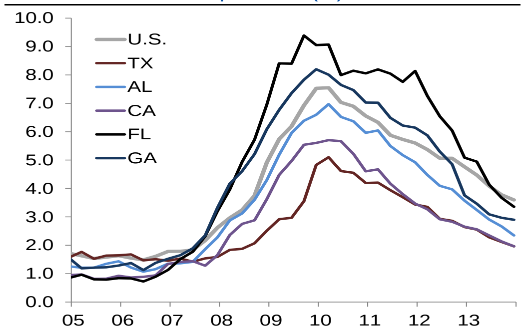
Source: SNL Financial & BBVA Research

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	2013Q4	2013Q3	2013Q2	2013Q1	2012Q4	2012Q3
Total Delinquency (%)	3.60	3.78	4.08	4.47	4.77	5.06
Mortgage Delinquency	8.43	8.65	9.22	9.81	10.27	10.72
CRE Delinquency	2.56	2.93	3.36	3.91	4.26	4.77
C&I Delinquency	1.02	1.15	1.18	1.27	1.38	1.48
Individual Delinquency	2.69	2.62	2.56	2.68	2.98	3.04
Net interest margin (%)	3.20	3.20	3.20	3.22	3.32	3.35
Net operating income to assets (%)	0.98	0.82	0.92	1.00	0.88	0.85
Return on assets (ROA) (%)	1.11	1.00	1.08	1.15	0.98	1.08
Return on Equity (ROE) (%)	9.94	8.90	9.54	10.08	8.65	9.45
Net charge-offs to loans (%)	0.60	0.61	0.74	0.85	0.99	1.21
Earnings coverage of net charge-offs (%)	5.48	4.80	4.55	4.25	3.24	2.87
Loss allowance to loans (%)	1.76	1.88	2.00	2.12	2.21	2.33

Source: SNL Financial & BBVA Research