
FRBSF WEEKLY LETTER

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California Banks' Problems Continue

In 1991 banks in the Twelfth District produced mixed results. In most states, the banking industry finished 1991 with a strong fourth quarter, reporting robust earnings for the year and little deterioration in asset quality. However, in California, where problem loans have been rising for over a year, the story was different. California banks finished the year with a huge loss in the fourth quarter, their second consecutive quarterly loss. As a result, California banks, with assets of \$352.4 billion, earned only \$651 million for the entire year.

While industry performance in California was dismal, there were important signs of improvement in the national earnings picture. For example, banking industry earnings for 1991 were \$18.6 billion, up 15.1 percent from 1990. And return on assets (ROA) for 1991, at 0.56 percent, is an improvement over the 0.49 percent recorded for both 1989 and 1990. There also was continued improvement in problem loan ratios in the fourth quarter, a hopeful indication that at least nationally, asset quality appears to be stabilizing.

The encouraging news on U.S. bank earnings is tempered somewhat by the composition of earnings. Almost \$3 billion of the 1991 earnings arose from gains from the sale of securities, as banks took advantage of the declines in interest rates over the year to generate gains by selling holdings of investment securities. Despite a boost to earnings from slightly wider net interest margins, the difference between the average cost of funds and the average return on loans and securities, net operating earnings from banking operations actually declined by over 1 percent from the year earlier.

Strong showing outside of California and Arizona

Bank performance generally remained robust among the nine states in the Twelfth District except California and Arizona. ROA for the fourth

quarter for the other seven states was at or near 1 percent, a strong figure; combined with healthy earnings in the first three quarters of 1991, it resulted in ROAs of greater than 1 percent for 1991 for banks in Alaska, Nevada, Washington, Hawaii, and Idaho, while banks in Oregon and Utah were not far behind, reporting ROAs of better than 0.80 percent for the year.

Outside of California, some Twelfth District states report increases in problem loan ratios, but they generally remain well below those in either California or the nation. Although banks in Arizona still face relatively high ratios of problem real estate and business loans, they recorded moderate earnings for 1991.

California: problems worsen

California banking industry earnings plummeted in the fourth quarter of 1991 as problem real estate assets grew worse and loan loss provisions soared. For the fourth quarter, California banks posted a \$384 million loss, compared to earnings of \$461 million in the same quarter of 1990, a relatively weak number to begin with. The sharp deterioration in bank earnings over the past year reflects the dramatic increase in problem loans and the building of loan loss reserves. California banks incurred \$2.2 billion in expenses for loan loss provisions in the fourth quarter alone, about \$1 billion more than average provisions in the first three quarters.

Despite losses of \$75 and \$384 million in the third and fourth quarters, respectively, California banks still managed to generate earnings of \$651 million for 1991 (ROA of 0.19 percent). However, 1991 earnings in California paled when compared either to industry performance nationwide or to California bank earnings of \$3.3 billion in 1990 (ROA of 0.98 percent).

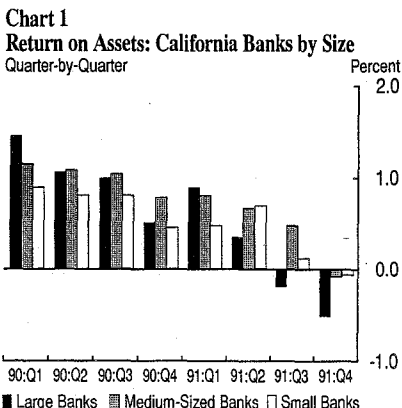
The depth of the problems facing California's banking industry is apparent from Chart 1, which

WESTERN BANKING

Western Banking is a quarterly review of banking developments in the Twelfth Federal Reserve District. It is published in the *Weekly Letter* on the fourth Friday of January, April, July, and October.

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shows that the losses hit the entire spectrum of banks, from the largest multinationals and regionals to the smallest community banks. Fully 25 percent of California banks reported losses for the year, up from only 12 percent in 1990. Nationally only 10.8 percent of U.S. banks recorded losses for the year.



Moreover, when analyzed by peer groups, each reported a loss in the fourth quarter. In the District states outside of California this pattern across peer groups does not occur. The current pattern also contrasts with the last period of significant losses, which was 1987, when losses were mostly confined to large banks with loans to less developed countries.

In California, problem or delinquent loan ratios (reported here as loans 30 days or more past due plus nonaccrual loans divided by all loans of that category) generally rose in the fourth quarter, although not as rapidly as they did in the previous four quarters. Problem loan ratios in California now are near or above the ratios for the nation. For example, for California banks with more than \$100 million in assets, the total problem loan ratio for the fourth quarter of 1991 (6.96 percent) is now above the ratio for the U.S. (6.13 percent), and the ratio has increased by more than 2 percentage points since year-end 1989. In contrast to the growing problems in California, problem loan ratios for all other states in the District (except Nevada at 5.53 percent) are at or below 5 percent.

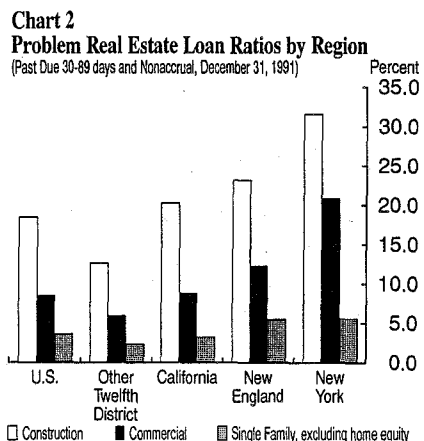
Real estate woes continue

Reflecting the continued weakness in real estate markets, especially in commercial real estate, the fourth quarter 1991 problem real estate loan ratio for California increased from 7.56 in the third quarter to 7.82 percent in the fourth quarter, and

rose relative to the problem loan ratios for the rest of the Twelfth District (5.21 percent) and the nation (8.12 percent). The ratio for California banks still was below the national average due to the better performance of residential mortgage loans in California.

Difficulties in commercial real estate markets, characterized by high vacancy rates and falling rents, are exerting a strong negative impact on the state's banking industry. In 1991 problem construction loan ratios and problem commercial real estate loan ratios stabilized nationally, while in California these ratios *increased* by 6.09 and 1.59 percentage points, respectively. At the end of the fourth quarter of 1991, problem construction loan ratios (18.60 percent for the U.S. and 20.29 percent for California) and commercial real estate loans (8.60 percent for the nation versus 8.84 percent for California) exceeded the U.S. ratios. As a group the largest banks in the state have even higher ratios.

Despite the increases, the ratios of problem construction and commercial real estate loans for California banks are not as bad as some other areas (see Chart 2). In particular, California's ratios still remain below those for New England (23.20 and 12.34 percent, respectively); the New England figures improved noticeably following the FDIC's resolution of Bank of New England.



On the horizon

It has often taken the banking industry several quarters to adjust to increased levels of problem loans. For example, following the recession that ended in 1982, problem loan ratios nationally stayed at abnormally high levels for almost two years. Thus, even if California banks' quality problems were to stabilize at present levels, banks will likely face a challenge over the next year or more as they work to resolve their problem loans.

Gary C. Zimmerman
Economist

REGIONAL BANK DATA

DECEMBER 31, 1991

(NOT SEASONALLY ADJUSTED, PRELIMINARY DATA)

| DISTRICT | | ALASKA | ARIZONA | CALIF. | HAWAII | IDAHO | NEVADA | OREGON | UTAH | WASH. | |
|---|---------------------|---------|---------|--------|---------|--------|--------|--------|--------|--------|--------|
| ASSETS AND LIABILITIES -- \$ MILLION (ALL COMMERCIAL BANKS) | | | | | | | | | | | |
| ASSETS | TOTAL | 517,590 | 4,611 | 35,596 | 352,414 | 20,766 | 9,760 | 15,214 | 25,741 | 13,849 | 39,639 |
| | FOREIGN | 34,301 | 0 | N/A | 32,400 | 1,745 | N/A | N/A | 3 | 84 | 70 |
| | DOMESTIC | 483,288 | 4,611 | 35,596 | 320,014 | 19,021 | 9,760 | 15,214 | 25,739 | 13,765 | 39,569 |
| LOANS | TOTAL | 366,929 | 2,041 | 23,230 | 255,645 | 13,209 | 6,589 | 10,752 | 17,193 | 8,655 | 29,614 |
| | FOREIGN | 30,719 | 5 | N/A | 29,234 | 1,416 | N/A | N/A | N/A | N/A | 63 |
| | DOMESTIC | 336,211 | 2,036 | 23,230 | 226,411 | 11,793 | 6,589 | 10,752 | 17,193 | 8,655 | 29,551 |
| | REAL ESTATE | 169,615 | 877 | 7,288 | 127,460 | 6,671 | 2,035 | 2,603 | 6,633 | 3,192 | 12,856 |
| | COMMERCIAL | 73,276 | 688 | 2,984 | 49,823 | 3,099 | 1,510 | 1,109 | 4,808 | 1,755 | 7,500 |
| | CONSUMER | 60,151 | 309 | 5,520 | 31,940 | 1,233 | 1,769 | 6,303 | 3,571 | 3,058 | 6,447 |
| | AGRICULTURE | 5,957 | 5 | 393 | 3,016 | 24 | 761 | 16 | 496 | 162 | 1,084 |
| | INTERNATIONAL | 127 | N/A | 8 | 120 | 0 | N/A | N/A | N/A | N/A | 0 |
| SECURITIES | TOTAL | 54,150 | 1,915 | 5,040 | 29,266 | 4,155 | 1,868 | 1,977 | 3,635 | 2,788 | 3,505 |
| | U.S.T.S. | 17,121 | 931 | 1,609 | 9,036 | 1,694 | 407 | 831 | 1,020 | 437 | 1,158 |
| | SECONDARY MARKET | 25,000 | 512 | 2,319 | 14,467 | 1,683 | 973 | 622 | 1,688 | 1,587 | 1,448 |
| | OTHER SEC. | 12,029 | 473 | 1,112 | 5,763 | 778 | 488 | 524 | 927 | 765 | 1,200 |
| LIABILITIES | TOTAL | 483,061 | 4,055 | 32,845 | 330,538 | 19,342 | 9,091 | 14,139 | 23,666 | 12,723 | 36,662 |
| | DOMESTIC | 448,760 | 4,055 | 32,845 | 298,139 | 17,597 | 9,091 | 14,139 | 23,663 | 12,639 | 36,592 |
| DEPOSITS | TOTAL | 417,729 | 3,534 | 30,353 | 286,743 | 16,190 | 7,618 | 9,086 | 20,272 | 10,497 | 33,435 |
| | FOREIGN | 32,974 | 0 | N/A | 31,121 | 1,554 | N/A | N/A | N/A | 84 | 214 |
| | DOMESTIC | 384,755 | 3,534 | 30,353 | 255,621 | 14,636 | 7,618 | 9,086 | 20,272 | 10,414 | 33,221 |
| | DEMAND | 86,694 | 985 | 5,167 | 61,392 | 2,439 | 1,277 | 2,171 | 3,789 | 1,994 | 7,480 |
| | TIME AND SAVINGS | 298,061 | 2,549 | 25,186 | 194,229 | 12,197 | 6,342 | 6,915 | 16,483 | 8,420 | 25,741 |
| | NOW | 39,633 | 300 | 3,099 | 24,848 | 1,470 | 951 | 1,106 | 2,752 | 1,330 | 3,777 |
| | MMDA | 86,202 | 523 | 6,718 | 60,597 | 2,127 | 1,315 | 2,236 | 3,968 | 1,812 | 6,907 |
| | SAVINGS | 38,654 | 547 | 2,449 | 25,268 | 2,339 | 635 | 1,403 | 1,689 | 1,069 | 3,255 |
| | SMALL TIME | 85,613 | 611 | 10,912 | 48,554 | 2,290 | 2,805 | 1,242 | 6,753 | 3,387 | 9,058 |
| | LARGE TIME | 47,570 | 537 | 1,996 | 34,760 | 3,970 | 635 | 925 | 1,318 | 812 | 2,619 |
| OTHER BORROWINGS | EQUITY CAPITAL | 44,320 | 480 | 2,047 | 26,732 | 2,551 | 1,366 | 4,241 | 2,794 | 2,017 | 2,093 |
| | LOAN LOSS RESERVE | 34,529 | 556 | 2,751 | 21,875 | 1,424 | 669 | 1,074 | 2,075 | 1,126 | 2,977 |
| | LOAN LOSS RESERVE | 10,419 | 40 | 560 | 8,074 | 204 | 93 | 321 | 413 | 205 | 509 |
| LOAN COMMITMENTS | LOANS SOLD | 198,548 | 555 | 18,577 | 138,081 | 5,939 | 2,257 | 1,752 | 9,622 | 6,132 | 15,633 |
| | LOANS SOLD | 30,420 | 11 | 266 | 29,212 | 275 | 32 | 118 | 279 | 67 | 160 |
| ASSET QUALITY -- PERCENT OF LOANS (LARGE COMMERCIAL BANKS) | | | | | | | | | | | |
| LOAN LOSS RESERVE (ALL BANKS) | | 2.84 | 1.98 | 2.41 | 3.16 | 1.54 | 1.41 | 2.99 | 2.40 | 2.37 | 1.72 |
| NET CHARGEOFFS, TOTAL | | 1.38 | 0.17 | 1.48 | 1.52 | 0.13 | 0.43 | 2.94 | 1.03 | 1.49 | 0.54 |
| | REAL ESTATE | 0.70 | 0.13 | 2.15 | 0.74 | 0.03 | 0.05 | 0.38 | 0.59 | 0.56 | 0.22 |
| | COMMERCIAL | 1.73 | 0.09 | 2.30 | 1.90 | 0.10 | 0.96 | 4.72 | 1.68 | 2.53 | 0.54 |
| | CONSUMER | 2.70 | 0.55 | 1.84 | 3.29 | 0.74 | 0.69 | 3.86 | 1.38 | 2.37 | 1.18 |
| | AGRICULTURE | 0.29 | N/A | 2.74 | 0.05 | 1.37 | -0.06 | -0.08 | 0.05 | 0.18 | 0.34 |
| PAST DUE & NON-ACCRUAL, TOTAL | | 6.08 | 4.53 | 4.97 | 6.96 | 1.70 | 2.13 | 5.53 | 4.66 | 4.62 | 3.85 |
| | REAL ESTATE | 7.16 | 4.55 | 9.13 | 7.82 | 1.65 | 2.64 | 4.41 | 6.00 | 6.43 | 4.88 |
| | COMMERCIAL | 7.10 | 5.26 | 11.09 | 7.83 | 1.87 | 2.65 | 12.38 | 4.39 | 5.24 | 4.08 |
| | CONSUMER | 3.61 | 3.03 | 2.64 | 4.14 | 2.04 | 1.77 | 5.39 | 1.67 | 2.94 | 2.08 |
| | AGRICULTURE | 5.05 | N/A | 8.32 | 5.41 | 1.17 | 1.42 | 0.36 | 5.88 | 3.65 | 4.94 |
| EARNINGS AND RETURNS -- \$ MILLION, YEAR-TO-DATE (ALL COMMERCIAL BANKS) | | | | | | | | | | | |
| INCOME | TOTAL | 54,342 | 448 | 3,480 | 37,010 | 1,880 | 954 | 2,161 | 2,696 | 1,468 | 4,244 |
| | INTEREST | 44,724 | 381 | 2,772 | 30,579 | 1,684 | 836 | 1,614 | 2,187 | 1,238 | 3,435 |
| | FEES & CHARGES | 2,728 | 22 | 191 | 1,846 | 39 | 53 | 64 | 170 | 75 | 267 |
| EXPENSES | TOTAL | 50,645 | 349 | 3,382 | 35,550 | 1,523 | 798 | 1,857 | 2,398 | 1,289 | 3,499 |
| | INTEREST | 22,717 | 166 | 1,559 | 15,708 | 913 | 449 | 555 | 1,071 | 618 | 1,678 |
| | SALARIES | 9,064 | 90 | 652 | 6,246 | 295 | 127 | 215 | 497 | 194 | 747 |
| | LOAN LOSS PROVISION | 7,195 | 8 | 257 | 5,777 | 44 | 33 | 399 | 315 | 139 | 223 |
| | OTHER | 11,669 | 85 | 914 | 7,818 | 271 | 189 | 687 | 516 | 338 | 851 |
| INCOME BEFORE TAXES | | 3,629 | 99 | 98 | 1,394 | 357 | 156 | 304 | 297 | 180 | 745 |
| TAXES | | 1,479 | 28 | 36 | 736 | 131 | 55 | 99 | 91 | 54 | 248 |
| NET INCOME | | 2,146 | 71 | 62 | 651 | 226 | 101 | 206 | 206 | 126 | 497 |
| ROA (%) | | 0.42 | 1.55 | 0.18 | 0.19 | 1.12 | 1.05 | 1.50 | 0.81 | 0.93 | 1.27 |
| ROE (%) | | 6.21 | 12.70 | 2.24 | 2.98 | 15.88 | 15.13 | 19.14 | 9.93 | 11.16 | 16.71 |
| NET INTEREST MARGIN (%) | | 4.29 | 4.73 | 3.45 | 4.23 | 3.83 | 4.02 | 7.74 | 4.39 | 4.59 | 4.48 |
| NUMBER OF BANKS | | 782 | 8 | 39 | 475 | 20 | 22 | 19 | 51 | 55 | 93 |
| NUMBER OF EMPLOYEES | | 240,189 | 2,559 | 18,828 | 153,563 | 8,356 | 4,991 | 6,420 | 15,978 | 7,049 | 22,445 |

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MARKET SHARE STATISTICS

DEPOSITORY INSTITUTIONS REQUIRED TO HOLD RESERVES WITH THE FEDERAL RESERVE ON A WEEKLY BASIS

(PERCENT OF COMBINED MARKET TOTAL FOR FEBRUARY 1992, BY REGION)

| DEPOSIT TYPE | ALASKA | | | ARIZONA | | | CALIF | | | HAWAII | | | IDAHO | | | NEVADA | | | OREGON | | | UTAH | | | WASH | | | | | |
|-----------------|--------|----|----|---------|----|----|-------|----|----|--------|----|----|-------|----|----|--------|----|----|--------|----|----|------|----|----|------|----|----|----|----|----|
| | CB | SL | CU | CB | SL | CU | CB | SL | CU | CB | SL | CU | CB | SL | CU | CB | SL | CU | CB | SL | CU | CB | SL | CU | CB | SL | CU | | | |
| TOTAL DEPOSITS | 54 | 41 | 5 | 71 | 4 | 24 | 93 | 1 | 7 | 47 | 48 | 5 | 68 | 28 | 5 | 91 | 5 | 3 | 72 | 25 | 3 | 81 | 11 | 8 | 78 | 8 | 13 | 56 | 36 | 9 |
| DEMAND | 91 | 4 | 5 | 99 | 0 | 1 | 95 | 0 | 5 | 90 | 5 | 6 | 89 | 3 | 7 | 93 | 0 | 7 | 99 | 1 | 0 | 94 | 1 | 5 | 88 | 3 | 9 | 90 | 7 | 4 |
| NOW | 65 | 28 | 7 | 59 | 6 | 35 | 90 | 0 | 10 | 59 | 35 | 6 | 69 | 28 | 3 | 94 | 3 | 3 | 78 | 16 | 6 | 84 | 8 | 8 | 84 | 4 | 13 | 64 | 24 | 11 |
| SAVINGS & MMDAS | 60 | 32 | 8 | 55 | 4 | 41 | 90 | 0 | 10 | 56 | 38 | 6 | 63 | 29 | 7 | 94 | 3 | 3 | 82 | 14 | 4 | 78 | 10 | 12 | 72 | 6 | 22 | 58 | 25 | 17 |
| SMALL TIME | 33 | 63 | 3 | 75 | 8 | 17 | 95 | 1 | 4 | 25 | 73 | 3 | 44 | 52 | 4 | 89 | 10 | 2 | 41 | 56 | 3 | 76 | 18 | 6 | 77 | 15 | 8 | 41 | 55 | 4 |
| LARGE TIME | 48 | 46 | 5 | 94 | 2 | 3 | 94 | 1 | 6 | 43 | 51 | 6 | 82 | 16 | 2 | 89 | 6 | 4 | 62 | 38 | 0 | 83 | 10 | 7 | 83 | 10 | 7 | 50 | 49 | 2 |

CB = COMMERCIAL BANKS; SL = SAVINGS & LOANS AND SAVINGS BANKS; CU = CREDIT UNIONS; MAY NOT SUM TO 100% DUE TO ROUNDING

INTEREST RATES ON DEPOSITS AND LOANS AS OF FEBRUARY 1992 (%)

| TYPE OF ACCOUNT OR LOAN | DATE | US | DISTRICT | ARIZ | CALIF | HAWAII | IDAHO | OREGON | UTAH | WASH |
|-----------------------------------|--------------------|-------|----------|-------|-------|--------|-------|--------|-------|-------|
| SAVINGS ACCOUNTS AND MMDAS** | DEC91 | 4.30 | 4.32 | 3.87 | 4.31 | 4.63 | 4.20 | 3.98 | 4.67 | 4.48 |
| | JAN92 | 3.93 | 3.93 | 3.57 | 3.82 | 4.41 | 4.13 | 3.64 | 4.08 | 3.84 |
| | FEB92 | 3.78 | 3.81 | 3.55 | 3.76 | 3.99 | 4.16 | 3.55 | 4.02 | 3.72 |
| 92 TO 182 DAYS CERTIFICATES | DEC91 | 4.42 | 4.31 | 3.93 | 4.26 | 4.50 | 4.06 | 4.20 | 4.48 | 4.52 |
| | JAN92 | 4.07 | 3.91 | 3.62 | 3.89 | 4.03 | 3.70 | 3.73 | 4.16 | 4.21 |
| | FEB92 | 4.00 | 3.85 | 3.66 | 3.86 | 4.05 | 3.70 | 3.70 | 4.12 | 3.88 |
| 2-1/2 YEARS AND OVER CERTIFICATES | DEC91 | 5.55 | 5.37 | 4.76 | 5.17 | 5.66 | 5.67 | 5.39 | 5.47 | 5.36 |
| | JAN92 | 5.30 | 4.96 | 4.47 | 4.86 | 5.12 | 5.39 | 4.99 | 5.28 | 4.93 |
| | FEB92 | 5.37 | 5.03 | 4.74 | 4.87 | 5.29 | 5.44 | 5.09 | 5.33 | 4.80 |
| COMMERCIAL, SHORT-TERM* | AVE. RATE | 5.54 | 6.64 | 7.41 | 6.41 | 6.46 | N/A | 7.01 | 5.61 | 7.06 |
| | AVE. MAT. (DAYS) | 53 | 129 | 63 | 155 | 92 | N/A | 15 | 50 | 215 |
| COMMERCIAL, LONG-TERM* | AVE. RATE | 6.38 | 7.95 | N/A | 7.84 | 9.75 | N/A | N/A | 9.44 | 7.12 |
| | AVE. MAT. (MONTHS) | 41 | 40 | N/A | 34 | 50 | N/A | N/A | 44 | 35 |
| LOANS TO FARMERS* | AVE. RATE | 8.06 | 6.81 | 7.21 | 6.84 | N/A | 7.91 | 5.97 | 8.75 | 7.76 |
| | AVE. MAT. (MONTHS) | 14 | 6 | N/A | 7 | N/A | N/A | 3 | 11 | 10 |
| CONSUMER, AUTOMOBILE | AVE. RATE | 9.89 | 9.90 | 11.00 | 10.11 | N/A | 10.50 | 8.92 | 9.94 | 9.16 |
| CONSUMER, PERSONAL | AVE. RATE | 14.39 | 13.64 | 14.00 | 13.18 | N/A | 11.00 | 13.47 | 15.00 | 13.16 |
| CONSUMER, CREDIT CARDS | AVE. RATE | 18.09 | 18.51 | 18.00 | 18.98 | N/A | N/A | 19.25 | 21.00 | 17.93 |

SOURCES: SURVEY OF TERMS OF BANK LENDING AND TERMS OF CONSUMER CREDIT; MOST COMMON INTEREST RATES ON SELECTED ACCOUNTS.
* DATA ARE COMPOUNDED ANNUAL RATES. ** SAVINGS AND MMDAS COMBINED AS OF OCTOBER 1991.