FRBSF Weekly Letter

April 26, 1991

Record Earnings, But. . . .

Despite a fourth quarter marked by a sharp decline in net income and a noticeable softening of asset quality, overall bank performance in the region for 1990 was good. Earnings reached a record $4.8 billion, and return on assets (ROA) remained at nearly 1 percent.

In the aggregate, banks in the West outperformed the industry for the third year in a row. This strong performance is underscored by their contribution to aggregate industry earnings in 1990. While western banks' $493 billion in assets accounts for only 14.6 percent of bank assets nationwide, their earnings accounted for 29.1 percent of industry earnings for the year and more than 57 percent of industry earnings in the fourth quarter. The superior performance was due to stronger asset quality and faster growth. Because of their strong performance, western banks also were able to make sizable additions to their capital bases.

Industry performance

Industry earnings nationwide trended downward from over $6 billion in the first quarter to a dismal $1.4 billion in the fourth quarter. And while net income of $16.6 billion was a slight improvement over 1989 earnings, it was far below the record $24.8 billion earned in 1988. Because of increases in troubled assets, the nation's largest banks (over $1 billion in assets) recorded ROAs of .40 or less, about half the ROAs of smaller banks.

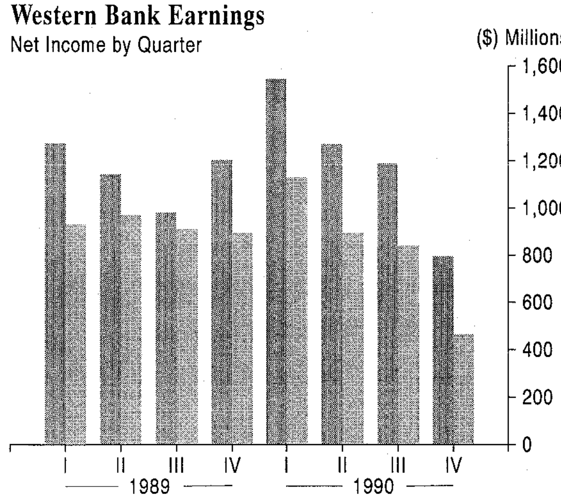
Banks in Alaska, Hawaii, Idaho, Oregon, Utah, and Washington reported increased earnings for the year, and all except Utah recorded ROAs of greater than 1 percent, a level considered excellent for the industry. As a result of asset quality pressures, California and Nevada bank earnings declined slightly from record levels in 1989, although ROAs remained high. Finally, although banks in Arizona continued to lose money in 1990, the aggregate loss was only a small fraction of the 1989 losses.

Dismal fourth quarter

For the first three quarters of the year, asset quality and earnings at western banks remained strong; in the fourth quarter, earnings plunged (see accompanying chart).

Western Bank Earnings

Net Income by Quarter



As the recession took hold, western banks, especially California banks, reported an upturn in problem loans. The aggregate ratio of loans past due (30 days or more) plus nonaccrual loans to total loans rose to 5.05 percent from the 4.40 percent ratio for the first three quarters. Moreover, the increases were pervasive, driving up the ratios for real estate, commercial, and consumer loans. Despite these increases, in all western states except Arizona, nonperforming loan ratios generally still remain well below industry ratios.

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.

Weakness in the economy and in asset quality led western banks to increase their expense for building loan loss reserves by $1.5 billion in the fourth quarter alone, and $3.9 billion for the year. Since banks' provisions for loan loss reserves are counted as a current expense, increased loan loss provisions directly reduce banks' net income.

Thus, while banks in the West generally benefited from relatively favorable levels of problem loans, by the fourth quarter the overall deterioration in the economy and asset quality had dampened even their performance.

Real estate loans led growth
While bank assets nationwide grew at an anemic 2.7 percent in 1990, in both the West and California banks' assets grew at a rate of more than 6 percent. The patterns of growth between the nation and the region also differed. Nationally, total assets and loans grew at about the same rate; but in the West total loans grew faster than assets—over 11 percent for the region and 13 percent for California.

Real estate loans accounted for almost all of the asset growth in the region. Western banks reported a 20.8 percent increase in total real estate loans outstanding for the year, and California banks reported even faster growth, 24.2 percent, both well above the 8.4 percent increase for the industry as a whole. These numbers tend to overstate the situation, however; consolidation in the thrift industry has allowed banks to capture thrift market share and, through thrift acquisition, to add real estate loans worth several billion dollars to their books. Yet, even excluding loans acquired from thrifts, western banks still increased their real estate loans by about twice the industry rate.

Loans secured by single-family residential properties, paced by very rapid increases in home equity lines of credit, climbed at a sharp 26 percent rate in the West, about twice the national rate. In contrast, commercial real estate lending weakened significantly as the year progressed due to both overbuilding in many commercial and retail real estate markets and deterioration in the quality of housing and construction loans, factors that also led banks to tighten lending standards. Still, construction lending in the region rose nearly 4 percent for the year.

One result of the continued growth in total real estate loans was that by year-end, aggregate real estate loans soared to 49 percent of bank loans in the region; California (with 55 percent) and Hawaii (54 percent) significantly exceeded the national average of 42 percent. High levels of exposure in these states have raised concerns about the ability of banks to maintain asset quality should real estate markets continue to soften.

Other forces
Along with relatively strong asset quality and strong growth, western banks also benefited from small reductions in net overhead expenditures per dollar of assets. For the most part, however, these savings were offset by lower net interest margins throughout the industry: the interest income banks earned (per dollar of assets) fell more than their cost of funding those assets.

Because of lower levels of problem loans and more rapid growth, banks in the West outperformed the industry by a wide margin in 1990 and added $4 billion in book value equity capital in 1990. Most of the increase came from $2.5 billion in retained earnings. In view of the problems facing the industry, such increases in capital are an important step towards maintaining an adequate capital cushion against future asset quality problems and in providing capital for potential expansion and acquisitions.

Despite these actions, the recession and fourth quarter deterioration in asset quality and earnings will continue to pressure western banks. If 1991 is to be as strong as 1990, western banks will need a favorable rebound in the western economy to improve their borrowers' financial health.

Gary C. Zimmerman
Economist

REGIONAL BANK DATA

DECEMBER 31, 1990

(Not Seasonally Adjusted, Preliminary Data)

	DISTRICT	ALASKA	ARIZONA	CALIF.	HAWAII	IDAHO	NEVADA	OREGON	UTAH	WASH.
ASSETS AND LIABILITIES -- $ MILLION (ALL COMMERCIAL BANKS)										
ASSETS AND LIABILITIES ($ MILL.)										
ASSETS TOTAL	492,755	4,450	32,621	339,908	17,865	8,583	14,439	22,949	12,192	39,748
FOREIGN	38,491	0	N/A	36,095	2,050	N/A	N/A	N/A	80	266
DOMESTIC	454,264	4,450	32,621	303,813	15,815	8,583	14,439	22,949	12,112	39,481
LOANS TOTAL	364,592	1,964	21,095	260,999	10,536	5,775	10,278	16,314	7,719	29,913
FOREIGN	33,952	7	N/A	32,569	1,262	N/A	N/A	N/A	N/A	114
DOMESTIC	330,640	1,957	21,095	228,429	9,274	5,775	10,278	16,314	7,719	29,799
REAL ESTATE	161,463	769	6,610	124,265	4,473	1,555	2,686	5,537	2,901	12,667
COMMERCIAL	80,408	699	3,652	55,453	2,852	1,533	1,434	5,328	1,708	7,748
CONSUMER	57,497	290	4,698	32,128	1,309	1,635	5,699	3,392	2,138	6,208
AGRICULTURE	5,847	4	445	2,978	42	712	18	427	141	1,080
INTERNATIONAL	190	N/A	10	173	0	N/A	N/A	6	N/A	0
SECURITIES TOTAL	43,435	1,767	4,011	21,384	3,745	1,706	1,793	3,184	2,348	3,497
U.S.T.S.	12,343	975	1,179	6,021	1,162	395	515	583	459	1,053
SECONDARY MARKET	19,550	350	1,751	10,197	1,714	812	639	1,550	1,302	1,234
OTHER SEC.	11,542	441	1,080	5,166	870	498	640	1,050	586	1,211
LIABILITIES TOTAL	460,351	3,951	30,339	318,321	16,813	8,024	13,282	21,268	11,396	36,957
DOMESTIC	421,859	3,951	30,339	282,226	14,763	8,024	13,282	21,268	11,316	36,690
DEPOSITS TOTAL	398,426	3,494	28,368	274,912	15,406	6,916	8,910	18,015	9,647	32,758
FOREIGN	34,681	0	N/A	32,370	1,864	N/A	N/A	N/A	80	367
DOMESTIC	363,745	3,494	28,368	242,542	13,542	6,916	8,910	18,015	9,567	32,391
DEMAND	84,070	996	4,914	59,536	2,443	1,232	2,158	3,519	1,978	7,293
TIME AND SAVINGS	279,675	2,498	23,454	183,006	11,099	5,684	6,751	14,496	7,589	25,097
NOW	35,285	256	2,567	22,353	1,439	794	965	2,340	1,169	3,403
MMDA	70,585	444	5,568	48,241	2,045	1,042	1,919	3,461	1,583	6,281
SAVINGS	31,714	394	1,693	21,823	1,479	401	893	1,376	820	2,835
SMALL TIME	84,083	762	11,344	47,973	1,806	2,735	1,458	5,465	3,281	9,257
LARGE TIME	57,690	622	2,261	42,486	4,328	674	1,517	1,836	732	3,233
OTHER BORROWINGS	39,674	415	1,382	25,264	880	1,022	3,527	2,607	1,567	3,012
EQUITY CAPITAL	32,404	499	2,282	21,587	1,052	559	1,157	1,682	796	2,791
LOAN LOSS RESERVE	7,920	35	648	5,882	152	89	256	266	151	441
LOAN COMMITTMENTS	198,614	532	11,902	146,878	7,280	1,916	2,113	9,384	3,008	15,601
LOANS SOLD	50,155	13	369	48,854	101	73	88	378	25	253
ASSET QUALITY -- PERCENT OF LOANS (LARGE COMMERCIAL BANKS)										
LOAN LOSS RESERVE (ALL BANKS)	2.17	1.77	3.07	2.25	1.44	1.54	2.49	1.63	1.96	1.48
NET CHARGEOFFS, TOTAL	1.14	1.12	1.98	1.17	0.08	0.35	3.21	0.53	0.81	0.47
REAL ESTATE	0.35	1.93	2.40	0.25	-.01	0.14	0.29	0.21	0.50	0.36
COMMERCIAL	0.71	0.73	4.15	0.58	-.07	0.46	2.72	0.57	1.36	0.29
CONSUMER	2.09	0.42	2.31	2.06	0.56	0.63	4.85	1.19	1.20	0.95
AGRICULTURE	-.26	N/A	-.02	-.83	4.55	0.04	0.37	0.39	0.34	0.64
PAST DUE & NON-ACCRUAL, TOTAL	5.05	5.14	6.50	5.25	1.19	2.09	9.74	3.66	3.83	3.51
REAL ESTATE	5.18	6.09	11.80	5.08	1.12	2.47	5.21	4.73	5.81	4.53
COMMERCIAL	5.80	6.07	12.80	6.23	0.94	2.13	7.28	4.16	3.63	2.54
CONSUMER	3.92	2.09	2.04	3.22	2.04	2.00	12.80	1.71	2.88	2.86
AGRICULTURE	5.42	39.10	10.20	5.98	4.02	2.40	0.66	2.21	2.54	4.95
EARNINGS AND RETURNS -- $ MILLION, YEAR-TO-DATE (ALL COMMERCIAL BANKS)										
INCOME TOTAL	55,097	457	3,182	38,196	1,708	894	2,496	2,560	1,251	4,352
INTEREST	45,979	389	2,618	31,806	1,526	794	1,977	2,137	1,089	3,643
FEES & CHARGES	2,425	21	167	1,656	36	46	56	145	67	231
EXPENSES TOTAL	47,950	374	3,309	33,149	1,394	754	2,074	2,138	1,099	3,660
INTEREST	25,490	196	1,533	17,825	883	451	857	1,174	612	1,958
SALARIES	8,630	84	620	6,017	257	117	201	427	168	739
LOAN LOSS PROVISION	3,887	15	369	2,664	25	21	402	137	73	181
OTHER	9,944	79	788	6,643	228	164	614	400	246	782
INCOME BEFORE TAXES	7,095	83	-127	5,003	314	140	422	422	148	691
TAXES	2,449	20	-51	1,813	114	45	141	128	45	196
NET INCOME	4,799	63	-76	3,332	200	96	284	294	104	501
ROA (%)	0.98	1.42	-.23	0.98	1.16	1.14	2.06	1.26	0.88	1.27
ROE (%)	14.8	12.6	-3.3	15.4	19.0	17.1	24.6	17.5	13.1	17.9
NET INTEREST MARGIN (%)	4.17	4.34	3.31	4.11	3.71	4.08	8.13	4.14	4.05	4.28
NUMBER OF BANKS	708	8	38	429	10	22	18	50	39	94
NUMBER OF EMPLOYEES	243,406	2,568	18,954	158,981	7,703	4,818	6,378	14,509	6,506	22,989

Editorial comments may be addressed to the editor (Judith Goff) or to the author. . . . Free copies of Federal Reserve publications can be obtained from the Public Information Department, Federal Reserve Bank of San Francisco, P.O. Box 7702, San Francisco 94120. Phone (415) 974-2246.

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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 1991, BY REGION

	DISTRICT			ALASKA			ARIZONA			CALIF			HAWAII			IDAHO			NEVADA			OREGON			UTAH			WASH		
DEPOSIT TYPE	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	CB	SL	CU
TOTAL DEPOSITS	51	44	5	73	4	23	84	10	6	45	51	4	69	28	3	87	10	4	70	26	4	76	17	7	79	8	13	56	37	8
DEMAND	92	3	4	99	0	1	94	0	5	92	4	4	92	3	5	91	1	8	99	1	0	95	1	5	92	2	6	92	5	3
NOW	64	29	7	60	6	35	87	4	9	59	35	6	73	25	1	89	8	3	78	14	8	82	11	7	85	3	12	65	23	12
SAVINGS	51	32	17	36	3	62	66	7	27	49	38	12	53	38	9	78	11	11	67	17	16	59	21	20	58	5	37	45	20	35
MMDA	66	31	2	90	8	2	93	5	1	61	37	2	82	18	0	94	6	0	82	15	2	88	9	4	83	6	11	68	30	2
SMALL TIME	33	64	3	76	8	16	79	18	4	24	73	3	42	55	3	84	14	2	49	48	3	65	29	5	77	13	10	42	54	4
LARGE TIME	46	51	3	92	5	3	88	7	5	41	56	3	83	16	1	85	10	5	66	34	0	84	11	5	79	11	10	49	49	1

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 1991 (%)

TYPE OF ACCOUNT OR LOAN		DATE	US	DISTRICT	ARIZ	CALIF	HAWAII	IDAHO	OREGON	UTAH	WASH
MONEY MARKET DEPOSIT ACCOUNTS		DEC90	6.04	5.89	5.81	6.21	5.47	5.96	5.97	5.95	5.88
		JAN91	5.87	5.66	5.62	5.89	5.40	5.86	5.66	5.66	5.58
		FEB91	5.68	5.54	5.38	5.69	5.29	5.70	5.50	5.66	5.48
92 TO 182 DAYS CERTIFICATES		DEC90	7.19	6.73	6.50	7.07	6.39	6.92	6.51	6.97	6.80
		JAN91	6.82	6.42	6.01	6.75	6.16	6.68	6.33	6.58	6.64
		FEB91	6.44	6.04	5.68	6.29	5.90	6.00	6.12	6.04	6.38
2-1/2 YEARS AND OVER CERTIFICATES		DEC90	7.52	7.27	7.01	7.43	7.44	7.48	6.93	7.43	7.35
		JAN91	7.31	6.97	6.51	7.14	7.19	7.43	6.95	7.13	7.15
		FEB91	7.04	6.73	6.27	6.86	6.99	6.82	6.87	6.81	6.98
COMMERCIAL, SHORT-TERM*	AVE. RATE		8.43	9.09	9.22	8.89	9.33	10.02	9.35	8.31	9.54
	AVE. MAT. (DAYS)		64	135	48	168	86	228	95	50	150
COMMERCIAL, LONG-TERM*	AVE. RATE		9.34	9.53	10.61	9.80	9.58	N/A	N/A	11.27	7.17
	AVE. MAT. (MONTHS)		45	40	23	43	13	N/A	N/A	43	60
LOANS TO FARMERS*	AVE. RATE		10.43	9.06	9.56	9.06	N/A	10.35	9.42	7.06	9.71
	AVE. MAT. (MONTHS)		10	5	7	4	N/A	5	10	5	7
CONSUMER, AUTOMOBILE	AVE. RATE		11.60	12.28	12.63	13.19	N/A	13.50	10.54	11.46	11.78
CONSUMER, PERSONAL	AVE. RATE		15.42	16.22	16.50	19.79	N/A	13.50	14.59	15.26	15.60
CONSUMER, CREDIT CARDS	AVE. RATE		18.28	18.76	18.00	19.44	N/A	N/A	19.24	21.00	17.97

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