Continued Strength at Tenth District Banks

By William R. Keeton and Corey M. Koenig

Commercial banks in Tenth District states continued to perform well in the first half of 1994. Profitability leveled off at a high level, asset quality improved, and loan growth accelerated. Based on these performance measures, banks in district states once again outperformed banks in the rest of the nation.

Performance of district banks

Profits at district banks were virtually unchanged in the first half of 1994 following three consecutive years of increases (Chart 1). Profits are measured by return on assets (ROA), the ratio of after-tax profits to average assets. ROA at district banks fell 3 basis points from the first half of 1993 to 1.25 percent. District banks continued to outperform banks in the rest of the nation by a small margin, as ROA in the United States edged down to 1.17 percent.

Profits remained high because decreases in net interest income and extraordinary gains were offset by declines in net noninterest expense and loan loss provisions (Table 1). The ratio of net interest income to assets declined 7 basis points. Banks' cost of funds fell in lagged response to earlier decreases in market rates. But returns on loans and securities fell even more, reducing net interest income. Extraordinary gains fell 6 basis points due to a change in regulatory accounting rules that boosted earnings in 1993 but not in 1994. Helping to offset these changes was an 8 basis-point decline in net noninterest expense. And, loan loss provisions fell 8 basis points to only 0.14 percent of assets, as banks' substantial loan loss reserves and strong asset quality reduced the need to set aside funds for loan losses.

Asset quality continued to improve at district banks. Asset quality can be measured by the sum of other real estate owned and noncurrent loans. Other real estate owned consists mainly of foreclosed property, while noncurrent loans are loans at least 90 days overdue and not accruing interest. At the end of June, these problem assets were 0.92 percent of total assets, down from 1.34 percent a year earlier and well below the national average of 1.27 percent.

Loan growth also accelerated in the first half of 1994. Loans grew at an annual rate of 11.6 percent in the first half of 1994, almost twice the national average and up from 7.3 percent in the first half of 1993. The increase in loan growth appears even greater when adjusted for the absorption of savings institutions. Such absorption accounted for much of the growth in district bank loans in the first half of 1993 but very little of the growth in the first half of 1994.

Performance by state

Changes in banking performance varied across district states. Profits increased in Missouri, were stable in Colorado, Wyoming, and Nebraska, and declined in Kansas, New Mexico and Oklahoma (Chart 2). Asset quality improved in all states, but especially in New Mexico (Table 1). Loan growth was moderate to strong in all states and faster than a year ago in every state except Colorado and Nebraska.

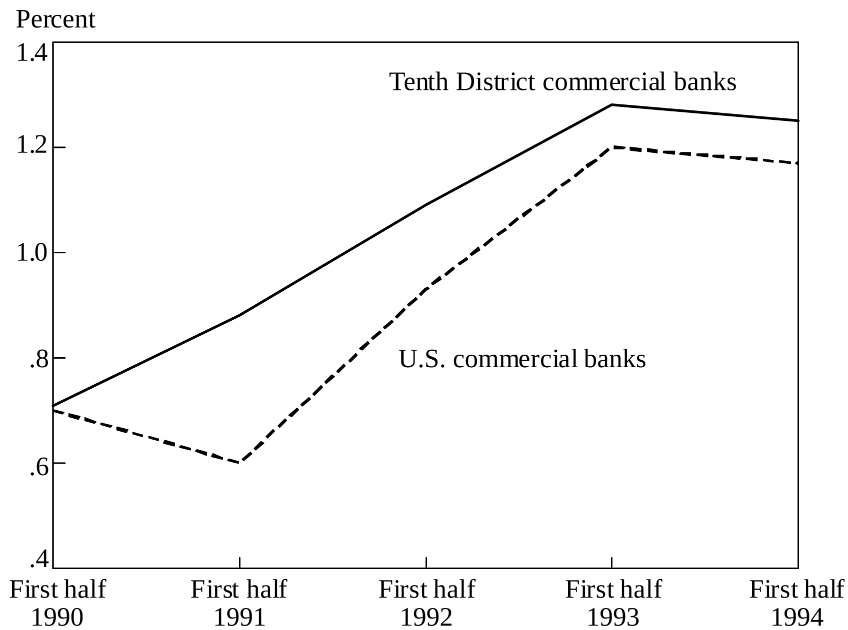
Missouri. Profits increased moderately at Missouri banks. ROA rose 14 basis points to 1.24 percent. An 18 basis-point decline in loan loss provisions accounted for most of the gain.

Asset quality improved and loan growth accelerated. Problem assets fell from 1.63 percent of total assets in June 1993 to 1.15 percent in June 1994, as banks continued to work off their noncurrent loans and foreclosed property. Loans grew at an annual rate of 9.9 percent in the first half of 1994, up from 3.6 percent a year earlier.

Chart 1

Return on Assets

Tenth District States and U.S.



Colorado. Banks in Colorado earned almost the same profits as in 1993. ROA fell one basis point to 1.30 percent. Net interest income fell almost 20 basis points. Net noninterest expense fell even more, however, helping sustain profits.

Asset quality improved significantly, while loan growth moderated but remained very strong. The ratio of problem assets fell by half to 0.45 percent, the lowest rate in the district. Loans grew a strong 18.0 percent. This pace was down from the first half of 1993, but only because the absorption of a large savings institution inflated loan growth in the earlier period.

Wyoming. Profitability was virtually unchanged at Wyoming banks. ROA slipped a couple of basis points to 1.35 percent, leaving Wyoming with the second-highest profit rate in the district. Net interest income fell almost 30 basis points. The impact on profits, however, was offset by a moderate drop in loan loss provisions and a sharp decline in net noninterest expense.

Asset quality improved and loans continued to grow rapidly. Problem assets fell from 0.79 percent of assets to 0.46 percent, one of the lowest ratios in the district. Loans grew a strong 21.5 percent, up from 17.9 percent in the first half of 1993.

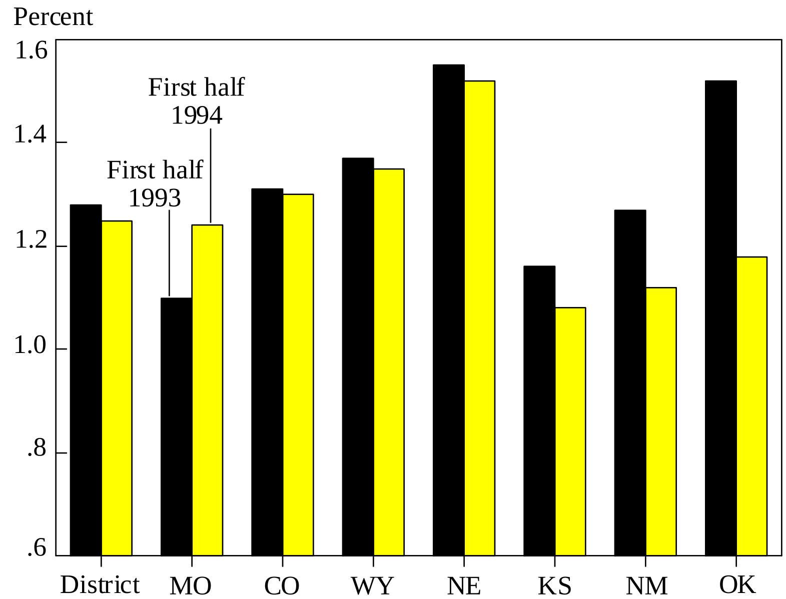
Nebraska. Bank profits fell slightly in Nebraska, as ROA slipped 3 basis points. Even with the decline, however, Nebraska banks earned an ROA of 1.52 percent, the highest profit rate in the district. The major components of profits changed by only small amounts and in largely offsetting directions.

Asset quality improved slightly and loans continued to grow at healthy pace. Problem assets edged down to 0.53 percent of total assets, well below the district average. Loans increased at a 6.2 percent rate, about the same as in the first half of 1993.

Kansas. Profits declined modestly at Kansas banks. ROA fell 8 basis points to 1.08 percent, the lowest rate in the district but still healthy. The decline in profits resulted from a 10 basis-point decline in net interest income and a 9 basis-point decline in extraordinary gains. Loan loss provisions also fell 11 basis points, limiting the drop in earnings.

Asset quality improved and loan growth picked up. Problem assets fell about 30 basis points to 1.25 percent of total assets, due mainly to a decrease in foreclosed property. Loans grew 5.2 percent in the first

Chart 2
Return on Assets by State
Commercial Banks



half of 1994 after declining modestly a year earlier.

New Mexico. Banks in New Mexico experienced a moderate decline in profitability, as ROA fell 15 basis points to 1.12 percent. The decline in ROA was due to a decrease in net interest income and increase in loan loss provisions. Net noninterest expense also fell, but not enough to sustain profits. While New Mexico was the only state in which loan loss provisions increased, provisions remained low at 0.26 percent of assets.

Asset quality improved sharply and loans grew faster than in any other district state. The ratio of problem assets fell 80 basis points to 1.03 percent, reflecting steep declines in both noncurrent loans and foreclosed property. Loans increased at a 29.2 percent rate after declining slightly a year earlier. Much of the rapid loan growth this year was due to the transfer of a credit card bank from outside the state. Even without the new bank, however, loans would have grown a strong 12 percent.

Oklahoma. Banks in Oklahoma recorded the largest decline in profits among district states. ROA fell 34 basis points to 1.18 percent. Most of the decline was due to a sharp drop in extraordinary gains, reflecting a change in regulatory accounting rules that temporarily boosted profits in 1993. Net gains from security sales also fell, contributing to the decline in profits.

Asset quality continued to improve and loan growth accelerated. A substantial decline in foreclosed property helped reduce problem assets to 0.96 percent of total assets. Loan growth doubled to 11.9 percent, just above the average for the district.

Conclusion

Banks in Tenth District states continued to perform well in the first half of 1994. After three straight years of increases, profitability stabilized at a high level. Asset quality continued to improve and loan growth accelerated. District banks outperformed banks nationwide by all three measures, but especially asset quality and loan growth.

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Table 1
Bank Performance Measures
Tenth District States

	Tenth District States 1993	Tenth District States 1994	Colorado 1993	Colorado 1994	Kansas 1993	Kansas 1994	Missouri 1993	Missouri 1994
Profits (ROA)	1.28	1.25	1.31	1.30	1.16	1.08	1.10	1.24
Net interest income	4.21	4.14	4.65	4.47	4.08	3.98	3.84	3.83
– Loan loss provisions	.22	.14	.10	.08	.25	.14	.31	.13
– Net noninterest expense	2.15	2.07	2.71	2.42	2.18	2.15	1.81	1.76
+ Net securities gains	.04	.01	.05	.03	.04	.03	.03	.02
+ Extraordinary gains	.06	.00	.04	.00	.09	.00	.00	.00
– Total taxes	.66	.70	.63	.70	.62	.66	.64	.72
Net chargeoffs	.18	.10	.08	.08	.15	.12	.26	.06
Loan loss reserve ratio	137	169	275	354	139	147	98	134
Problem assets	1.34	.92	.90	.45	1.57	1.25	1.63	1.15
Loan growth	7.3	11.6	31.9	18.0	-1.6	5.2	3.6	9.9

	Nebraska 1993	Nebraska 1994	New Mexico 1993	New Mexico 1994	Oklahoma 1993	Oklahoma 1994	Wyoming 1993	Wyoming 1994
Profits (ROA)	1.55	1.52	1.27	1.12	1.52	1.18	1.37	1.35
Net interest income	4.70	4.72	4.49	4.36	4.14	4.06	4.54	4.27
– Loan loss provisions	.36	.30	.16	.26	.08	.07	.17	.08
– Net noninterest expense	2.02	2.08	2.42	2.33	2.22	2.19	2.32	2.13
+ Net securities gains	.04	.01	.01	.00	.08	-.03	.05	-.02
+ Extraordinary gains	.02	.00	.03	.00	.25	.00	-.01	.01
– Total taxes	.83	.84	.68	.65	.64	.60	.72	.69
Net chargeoffs	.28	.26	.14	.05	.10	.08	.09	.04
Loan loss reserve ratio	193	228	130	187	132	136	152	224
Problem assets	.66	.53	1.83	1.03	1.33	.96	.79	.46
Loan growth	6.5	6.2	-.5	29.2	5.9	11.9	17.9	21.5

Note: Data are for the first six months of the year. ROA may not equal the sum of the components due to roundoff error. ROA, components of ROA, and net chargeoffs are a percent of average assets. The loan loss reserve ratio is loan loss reserves as a percent of noncurrent loans at midyear. Problem assets are noncurrent assets plus other real estate owned, excluding direct and indirect investments, as a percent of total assets. Loan growth rates are annualized percent changes from December 31 of the prior year to June 30.

Source: "The Consolidated Reports of Condition and Income" for all FDIC insured commercial banks in the seven states of the Tenth Federal Reserve District.