FRBSF Weekly Letter

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# Western Banks Outpace the Nation

Throughout most of the western region, banks reported strong earnings in 1989. Return on assets (ROA) exceeded one percent in the aggregate, a remarkable performance, compared to the 0.48 percent average ROA for the ten-year period ending in 1989. Improved asset quality and interest margins, stringent cost control, and asset growth all contributed to this record-breaking performance. In large measure, the improvement in fundamentals was due to continued economic growth in the region.

In contrast with the West, bank earnings nationally plummeted during the second half, leading to an aggregate ROA in 1989 that was about half the level in the West. Massive additions to northeastern banks' loan loss reserves in the second half account for the weak performance of banks nationwide since such additions are counted as expenses that reduce banks' current earnings.

**Strong regional performance**

Western bank earnings hit a record $4.6 billion for the year, compared to $3.7 billion in 1988. Aggregate ROA for the region rose to 1.01 percent, up from 0.88 percent in 1988. Likewise, return on equity (ROE) rose from 15 percent in 1988 to 16.2 percent in 1989. Earnings generally were strong across all size categories in the West, and the region's largest banking concerns posted exceptionally strong performances, with many reporting ROAs exceeding 1.2 percent.

Moreover, the strong performance was evident throughout most of the region. In fact, seven of the nine states in the region reported ROAs above one percent. Even in Alaska, where the industry has reported losses in the three previous years, banks posted very strong earnings as a result of higher oil prices, a turnaround in the economy, and consolidation of troubled banks. Utah banks posted a still-respectable ROA of 0.66 percent.

Only in Arizona did the industry report an aggregate loss for the year. This loss, which totaled nearly $500 million and led to an ROA of −1.9 percent, was the result of a $1 billion expense to replenish loss reserves following massive chargeoffs on real estate and business loans in that state.

**Asset quality**

Outside Arizona, which has been hit hard by a downturn in the real estate market, the economies of western states have enjoyed at least moderate growth, and are expected to continue in that direction in the near future. The health of the western economy contributed to improved asset quality at most banks. Banks in the region reduced their net losses associated with charging off bad debts by almost nine percent in 1989. And past due and nonperforming loans, an indicator of likely future chargeoffs, also recorded a decline, falling from 5.1 percent of total loans to 4.7 percent.

In contrast, banks' asset quality nationwide apparently deteriorated in 1989. As a proportion of total loans, past due and nonperforming loans rose above five percent nationally, largely as a result of real estate lending problems. Moreover, in the third quarter a number of money center banks set aside large reserves against future international loan losses. And in the fourth quarter, northeastern banks made sizeable additions to domestic loan loss reserves to cover deterioration in real estate loan quality.

**Wider margins, stable costs**

In the West, wider net interest margins (the difference between banks' yield on assets and the cost of funding those assets) contributed to the record earnings. Western banks' conservative pricing of retail deposits, especially NOW accounts, savings accounts, and money market deposit accounts (together, they account for over

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.

40 percent of deposits) appears to have helped boost interest margins, especially earlier in the year when rates on these retail accounts lagged behind the increase in market interest rates.

Western banks' efforts to keep operating costs under control also helped contain overhead expenses in the face of increases in both the number of employees and the number of branches operated by western banks. Increased competition in bank services, especially in California, led to longer operating hours and Saturday banking, and put upward pressure on costs. Nonetheless, banks were able to keep overall costs, including salaries and benefits, from rising as quickly as assets. Consequently, the ratio of net noninterest expenses to total assets, a measure of banks' overhead burden, declined slightly.

**Lending and funding patterns**

In 1989 western banks' assets grew at nearly a nine percent rate, compared to a 5.4 percent rate for the nation. Western banks recorded an 11.5 percent expansion in total loans, the fastest pace since early in the decade. As in previous years, the increase in loans was concentrated in consumer-oriented loans such as mortgage loans and credit cards.

Because of the rise in real estate values in much of the West, as well as the tax-deductibility of home mortgage interest, mortgage loans grew at a rapid 22 percent pace. Similarly, real estate lines of credit grew at a 42 percent rate, reaching $9.6 billion. At year-end 1989 real estate loans secured by single family properties accounted for $65.8 billion of total real estate lending in the region, and commercial real estate loans and construction and land development loans accounted for $34 billion and $30 billion, respectively.

Credit card lending and other revolving credit consumer loans also grew rapidly in 1989, at an 18 percent rate, but other types of consumer loans grew slowly. The growth in auto loans, in particular, was sluggish as a result both of intense competition from finance companies and thrifts and of the phase out of interest deductibility for these kinds of loans.

Commercial lending was notably sluggish; total domestic business loans grew only around three percent. Among large corporate borrowers, loan demand was weak because of continued reliance on direct financing through the commercial paper and debt markets. And intense competition from foreign banks and finance companies for middle market and smaller commercial borrowers tended to limit loan growth here as well.

To fund the growth in assets, western banks relied heavily on deposit growth in 1989. Small-denomination time certificates and large certificates of deposit ($100,000 and over) accounted for most of the eight percent growth in total deposits. As the year progressed, western banks began to rely somewhat more heavily on nondeposit sources of funds, such as federal funds and other wholesale borrowings. Western banks' growing reliance on relatively expensive nondeposit funds and large CDs likely will place upward pressure on the cost of funds in 1990.

**Capitalization and the outlook**

Preparing for possible challenges ahead, Western banks added nearly $4 billion (book value) in equity in 1989, mostly from $3 billion in retained earnings and $800 million in new equity. As a result, the aggregate ratio of western banks' equity capital-to-assets rose to 6.14 percent, compared to 5.78 percent in 1988.

Increased capitalization provides western banks a larger cushion to face the challenges that lie ahead. Western banks face increased competition for deposits and intensified pressure in lending markets. Moreover, asset quality remains a concern, particularly if the real estate slump in Arizona were to spread to other states. These factors could slow growth, narrow net interest margins, increase overhead expenses, and squeeze earnings. However, increased capitalization and a generally favorable outlook for the western economy should lead to continued strength in 1990.

**Gary C. Zimmerman**
**Economist**

# REGIONAL BANK DATA

DECEMBER 31, 1989

(Not Seasonally Adjusted, Preliminary Data)

| | DISTRICT | ALASKA | ARIZONA | CALIF. | HAWAII | IDAHO | NEVADA | OREGON | UTAH | WASH. |
|---|---|---|---|---|---|---|---|---|---|---|
| **ASSETS AND LIABILITIES -- $ MILLION (ALL COMMERCIAL BANKS)** | | | | | | | | | | |
| ASSETS TOTAL | 464,229 | 4,338 | 26,436 | 319,394 | 16,775 | 8,280 | 17,004 | 22,132 | 11,317 | 38,551 |
| FOREIGN | 39,369 | 1 | N/A | 36,807 | 1,979 | N/A | N/A | N/A | 93 | 488 |
| DOMESTIC | 424,860 | 4,337 | 26,436 | 282,587 | 14,795 | 8,280 | 17,004 | 22,132 | 11,224 | 38,064 |
| LOANS TOTAL | 330,975 | 1,800 | 18,248 | 231,931 | 10,024 | 5,347 | 13,351 | 14,674 | 7,257 | 28,343 |
| FOREIGN | 31,113 | 0 | N/A | 29,983 | 940 | N/A | N/A | N/A | N/A | 190 |
| DOMESTIC | 299,862 | 1,799 | 18,248 | 201,948 | 9,084 | 5,347 | 13,351 | 14,674 | 7,257 | 28,153 |
| REAL ESTATE | 135,442 | 647 | 7,485 | 100,353 | 4,501 | 1,380 | 2,043 | 4,593 | 3,003 | 11,435 |
| COMMERCIAL | 76,635 | 682 | 4,031 | 51,872 | 2,452 | 1,444 | 1,695 | 5,298 | 1,782 | 7,379 |
| CONSUMER | 59,952 | 267 | 4,686 | 31,575 | 1,364 | 1,467 | 9,267 | 3,269 | 1,826 | 6,231 |
| AGRICULTURE | 5,202 | 7 | 493 | 2,636 | 30 | 595 | 17 | 343 | 124 | 956 |
| INTERNATIONAL | 419 | N/A | 9 | 410 | 0 | N/A | N/A | N/A | N/A | 0 |
| SECURITIES TOTAL | 42,431 | 1,665 | 3,226 | 21,393 | 3,027 | 1,699 | 1,948 | 3,844 | 2,058 | 3,571 |
| U.S.T.S. | 12,208 | 1,122 | 1,186 | 5,508 | 872 | 479 | 583 | 968 | 397 | 1,092 |
| SECONDARY MARKET | 17,329 | 181 | 674 | 10,263 | 1,113 | 704 | 570 | 1,517 | 1,109 | 1,198 |
| OTHER SEC. | 12,894 | 362 | 1,365 | 5,621 | 1,042 | 516 | 795 | 1,359 | 552 | 1,280 |
| LIABILITIES TOTAL | 435,745 | 3,906 | 25,028 | 300,195 | 15,725 | 7,738 | 15,958 | 20,635 | 10,567 | 35,993 |
| DOMESTIC | 396,376 | 3,905 | 25,028 | 263,388 | 13,745 | 7,738 | 15,958 | 20,635 | 10,473 | 35,505 |
| DEPOSITS TOTAL | 372,287 | 3,431 | 23,119 | 259,425 | 14,601 | 6,529 | 7,829 | 16,803 | 9,056 | 31,495 |
| FOREIGN | 34,241 | 1 | N/A | 31,810 | 1,797 | N/A | N/A | N/A | 93 | 540 |
| DOMESTIC | 338,046 | 3,431 | 23,119 | 227,616 | 12,803 | 6,529 | 7,829 | 16,803 | 8,963 | 30,955 |
| DEMAND | 85,879 | 1,012 | 4,856 | 62,417 | 2,291 | 1,138 | 2,032 | 3,375 | 1,804 | 6,954 |
| TIME AND SAVINGS | 252,167 | 2,418 | 18,262 | 165,198 | 10,512 | 5,390 | 5,797 | 13,428 | 7,159 | 24,001 |
| NOW | 32,355 | 212 | 2,126 | 20,792 | 1,209 | 771 | 845 | 2,256 | 1,037 | 3,107 |
| MMDA | 62,451 | 452 | 4,941 | 42,748 | 2,003 | 1,060 | 1,529 | 2,522 | 1,494 | 5,702 |
| SAVINGS | 31,167 | 336 | 1,192 | 22,231 | 1,440 | 350 | 889 | 1,403 | 767 | 2,559 |
| SMALL TIME | 69,490 | 656 | 7,638 | 38,016 | 2,067 | 2,534 | 1,164 | 5,467 | 2,864 | 9,084 |
| LARGE TIME | 56,179 | 746 | 2,347 | 41,054 | 3,792 | 650 | 1,370 | 1,767 | 992 | 3,461 |
| OTHER BORROWINGS | 41,369 | 425 | 1,417 | 22,773 | 612 | 1,119 | 7,453 | 3,049 | 1,311 | 3,210 |
| EQUITY CAPITAL | 28,484 | 432 | 1,408 | 19,199 | 1,050 | 542 | 1,046 | 1,497 | 750 | 2,559 |
| LOAN LOSS RESERVE | 7,970 | 41 | 680 | 6,049 | 152 | 90 | 206 | 204 | 143 | 406 |
| STANDBY LETTERS OF CREDIT | 33,531 | 22 | 651 | 29,466 | 564 | 116 | 166 | 665 | 281 | 1,599 |
| LOAN COMMITTMENTS | 141,570 | 304 | 4,458 | 112,809 | 4,315 | 1,049 | 1,496 | 4,722 | 1,624 | 10,792 |
| LOANS SOLD | 82,611 | 45 | 1,157 | 80,634 | 85 | 48 | 58 | 165 | 33 | 388 |
| **ASSET QUALITY -- PERCENT OF LOANS (LARGE COMMERCIAL BANKS)** | | | | | | | | | | |
| LOAN LOSS RESERVE (ALL BANKS) | 2.41 | 2.28 | 3.73 | 2.61 | 1.52 | 1.68 | 1.54 | 1.39 | 1.97 | 1.43 |
| NET CHARGEOFFS, TOTAL | 1.16 | 1.56 | 4.44 | 1.03 | 0.11 | 0.29 | 1.99 | 0.57 | 0.93 | 0.49 |
| REAL ESTATE | 0.52 | 2.08 | 6.80 | 0.05 | -.01 | 0.01 | 0.77 | 0.42 | 0.72 | 0.46 |
| COMMERCIAL | 0.58 | 1.25 | 4.89 | 0.42 | 0.01 | 0.20 | 0.61 | 0.47 | 1.19 | 0.05 |
| CONSUMER | 1.77 | 0.51 | 2.04 | 1.85 | 0.42 | 0.77 | 2.52 | 1.12 | 1.26 | 1.08 |
| AGRICULTURE | 0.24 | N/A | 1.15 | -.27 | -.61 | 0.19 | -.01 | 0.31 | 0.30 | 1.36 |
| PAST DUE & NON-ACCRUAL, TOTAL | 4.71 | 5.28 | 9.75 | 4.86 | 1.30 | 1.81 | 4.67 | 2.45 | 3.73 | 3.37 |
| REAL ESTATE | 4.46 | 6.84 | 16.20 | 3.71 | 1.20 | 2.24 | 3.54 | 3.42 | 5.39 | 4.88 |
| COMMERCIAL | 5.41 | 6.16 | 8.91 | 6.15 | 1.19 | 1.92 | 3.10 | 2.24 | 2.68 | 2.07 |
| CONSUMER | 2.98 | 1.84 | 2.47 | 2.71 | 2.34 | 1.83 | 5.29 | 1.99 | 3.18 | 2.01 |
| AGRICULTURE | 7.38 | 20.90 | 7.99 | 9.48 | 5.15 | 2.08 | 0.58 | 2.61 | 3.23 | 5.68 |
| **EARNINGS AND RETURNS -- $ MILLION, YEAR-TO-DATE (ALL COMMERCIAL BANKS)** | | | | | | | | | | |
| INCOME TOTAL | 52,071 | 424 | 2,941 | 36,462 | 1,607 | 849 | 2,284 | 2,251 | 1,194 | 4,059 |
| INTEREST | 43,717 | 359 | 2,515 | 30,218 | 1,423 | 762 | 1,999 | 1,948 | 1,049 | 3,443 |
| FEES & CHARGES | 2,183 | 18 | 149 | 1,500 | 34 | 41 | 51 | 120 | 61 | 209 |
| EXPENSES TOTAL | 45,416 | 368 | 3,765 | 30,967 | 1,316 | 726 | 1,817 | 1,891 | 1,097 | 3,470 |
| INTEREST | 23,906 | 200 | 1,463 | 16,651 | 808 | 437 | 887 | 1,056 | 605 | 1,799 |
| SALARIES | 8,170 | 72 | 562 | 5,753 | 253 | 114 | 184 | 364 | 162 | 705 |
| LOAN LOSS PROVISION | 3,577 | 25 | 1,052 | 1,837 | 31 | 24 | 237 | 112 | 84 | 175 |
| OTHER | 9,764 | 71 | 688 | 6,727 | 223 | 151 | 509 | 359 | 247 | 791 |
| INCOME BEFORE TAXES | 6,609 | 56 | -825 | 5,456 | 291 | 121 | 466 | 360 | 95 | 589 |
| TAXES | 2,412 | 9 | -334 | 2,099 | 104 | 33 | 184 | 110 | 27 | 179 |
| NET INCOME | 4,601 | 46 | -491 | 3,707 | 187 | 88 | 308 | 252 | 74 | 431 |
| ROA (%) | 1.01 | 1.08 | -1.9 | 1.17 | 1.18 | 1.12 | 1.95 | 1.17 | 0.66 | 1.17 |
| ROE (%) | 16.20 | 10.70 | -35.00 | 19.30 | 17.80 | 16.20 | 29.40 | 16.80 | 9.80 | 16.80 |
| NET INTEREST MARGIN (%) | 4.35 | 3.72 | 4.07 | 4.29 | 3.89 | 4.12 | 7.06 | 4.14 | 3.99 | 4.48 |
| NUMBER OF BANKS | 724 | 7 | 43 | 433 | 20 | 23 | 16 | 49 | 41 | 92 |
| NUMBER OF EMPLOYEES | 238,593 | 2,470 | 17,217 | 157,149 | 8,045 | 4,741 | 6,258 | 12,846 | 6,405 | 23,462 |



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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 1990, 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 | 48 | 48 | 4 | 74 | 5 | 22 | 54 | 42 | 4 | 43 | 53 | 4 | 66 | 29 | 5 | 87 | 10 | 3 | 68 | 29 | 3 | 66 | 28 | 6 | 68 | 22 | 10 | 56 | 37 | 7 |
| DEMAND | 92 | 4 | 4 | 100 | 0 | 0 | 91 | 4 | 5 | 92 | 4 | 4 | 93 | 4 | 3 | 93 | 1 | 6 | 99 | 1 | 0 | 94 | 1 | 4 | 92 | 3 | 4 | 93 | 4 | 3 |
| NOW | 62 | 31 | 7 | 59 | 5 | 36 | 70 | 22 | 9 | 57 | 37 | 6 | 72 | 26 | 3 | 88 | 8 | 3 | 77 | 16 | 6 | 77 | 17 | 6 | 74 | 15 | 11 | 66 | 22 | 12 |
| SAVINGS & MMDA | 59 | 33 | 8 | 52 | 5 | 43 | 68 | 23 | 9 | 56 | 37 | 7 | 63 | 27 | 10 | 88 | 8 | 4 | 77 | 19 | 5 | 68 | 22 | 10 | 69 | 10 | 21 | 59 | 26 | 15 |
| SMALL TIME | 28 | 68 | 3 | 76 | 8 | 16 | 41 | 56 | 3 | 22 | 75 | 3 | 40 | 57 | 3 | 83 | 15 | 2 | 41 | 57 | 2 | 52 | 43 | 5 | 55 | 38 | 7 | 44 | 52 | 4 |
| LARGE TIME | 39 | 60 | 1 | 92 | 5 | 3 | 37 | 62 | 1 | 35 | 64 | 1 | 79 | 19 | 2 | 85 | 11 | 4 | 70 | 30 | 0 | 75 | 24 | 1 | 76 | 19 | 5 | 44 | 55 | 1 |

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

## INTEREST RATES ON DEPOSITS AND LOANS (%)

| TYPE OF ACCOUNT OR LOAN | DATE | US | DISTRICT | ARIZ | CALIF | HAWAII | IDAHO | OREGON | UTAH | WASH |
|---|---|---|---|---|---|---|---|---|---|---|
| MONEY MARKET DEPOSIT ACCOUNTS | DEC89 | 6.43 | 6.26 | 6.02 | 6.50 | 5.97 | 6.03 | 6.17 | 6.45 | 5.81 |
| | JAN90 | 6.37 | 6.22 | 5.92 | 6.47 | 5.87 | 6.05 | 6.08 | 6.46 | 6.02 |
| | FEB90 | 6.32 | 6.21 | 5.89 | 6.47 | 5.68 | 6.07 | 6.13 | 6.45 | 6.18 |
| 92 TO 182 DAYS CERTIFICATES | DEC89 | 7.83 | 7.54 | 7.47 | 7.94 | 6.96 | 7.66 | 7.87 | 7.62 | 7.17 |
| | JAN90 | 7.75 | 7.47 | 7.46 | 7.73 | 6.89 | 7.50 | 7.70 | 7.72 | 7.14 |
| | FEB90 | 7.76 | 7.47 | 7.43 | 7.76 | 6.89 | 7.45 | 7.77 | 7.78 | 7.06 |
| 2-1/2 YEARS AND OVER CERTIFICATES | DEC89 | 7.86 | 7.76 | 7.74 | 7.90 | 7.76 | 7.85 | 7.73 | 7.76 | 7.77 |
| | JAN90 | 7.86 | 7.74 | 7.71 | 7.89 | 7.57 | 7.93 | 7.82 | 7.77 | 7.74 |
| | FEB90 | 7.87 | 7.86 | 7.67 | 7.91 | 7.57 | 7.96 | 8.45 | 7.94 | 7.75 |
| COMMERCIAL, SHORT-TERM* | AVE. RATE | 9.93 | 9.80 | 9.57 | 9.55 | 9.63 | 11.90 | 10.53 | 11.22 | 10.34 |
| | AVE. MAT. (DAYS) | 43 | 66 | 105 | 39 | 90 | 177 | 85 | 92 | 136 |
| COMMERCIAL, LONG-TERM* | AVE. RATE | 10.92 | 10.80 | 11.30 | 10.99 | N/A | N/A | 10.29 | 11.92 | 10.64 |
| | AVE. MAT. (MONTHS) | 46 | 59 | 82 | 65 | N/A | N/A | 57 | 30 | 30 |
| LOANS TO FARMERS* | AVE. RATE | 11.78 | 10.52 | 10.40 | 10.25 | 9.75 | 11.41 | 10.82 | 12.99 | 10.95 |
| | AVE. MAT. (MONTHS) | 13 | 8 | 4 | 7 | N/A | 29 | 5 | 44 | 15 |
| CONSUMER, AUTOMOBILE | AVE. RATE | 11.80 | 12.19 | N/A | 12.49 | N/A | 13.50 | 10.83 | 11.97 | 11.29 |
| CONSUMER, PERSONAL | AVE. RATE | 15.27 | 16.17 | N/A | 19.73 | N/A | 13.50 | 13.89 | 17.32 | 14.84 |
| CONSUMER, CREDIT CARDS | AVE. RATE | 18.12 | 18.39 | N/A | 19.44 | N/A | N/A | 19.24 | 20.00 | 16.50 |

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