
FRBSF WEEKLY LETTER

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Red Ink

The California banking industry registered a dismal third quarter, as aggregate bank performance deteriorated under the pressure of rising asset quality problems. The industry, with almost \$354 billion in assets, reported a net loss for the first time since 1987, when large banks had to build up loan loss reserves against problem loans to less developed countries. California bank performance weakened across all sizes of banks, as well as compared with industry performance nationally and elsewhere in the Twelfth District.

In 1991 the poor performance of banks in California was due in part to mounting real estate asset quality problems, especially construction and land development loans. However, noticeable increases in nonperforming business and consumer loans indicate that the recession has had a more general effect on bank earnings.

Earnings

Nationally, bank earnings for the third quarter were \$4.3 billion, up from \$3.6 billion in the same quarter in 1990, and return on assets (ROA) rose to 0.51 percent from 0.45 percent in the same period of 1990. All of the improvement, however, arose from the sales of securities and extraordinary gains, and not from net operating income.

In contrast to the improvement at the national level, California banks as a group recorded a net loss of \$75 million in the aggregate for the third quarter; in the same quarter a year ago, earnings were \$859 million. The ROA for the banks in the state was -0.08 percent, compared with 1 percent in the third quarter in 1990.

Earnings problems have not been limited to the larger banks in California. Performance has deteriorated across all size classes of banks, reflecting the breadth of the economic slump that has hit California. For example, 22 percent of the state's 480 banks reported a net loss for the first nine

months of 1991; in contrast, only 11.3 percent of banks nationally reported a net loss for the first three quarters of 1991.

Outside of California, western banks generally continued to record healthy earnings and to show a ROA well above the level for the rest of the nation. Still, the recession has had an impact, as earnings fell slightly in the third quarter 1991 to \$319 million from \$348 million in 1990, and the ROA slipped to 0.79 percent from 0.94 percent. But, more importantly, outside of California asset quality indicators generally remained favorable. Another positive sign was the turnaround in Arizona, where banks reported modest earnings of \$11 million for the third quarter, compared with a loss of \$16 million in the same quarter in 1990.

Asset quality

Nationally, third quarter problem loan ratios were somewhat improved over the second quarter, largely because of the FDIC's resolution of the Bank of New England failure. (Problem loan ratios are defined here as loans past due—30 days or more—plus nonaccrual loans divided by loans outstanding for all banks with more than \$100 million in assets.) Still, at 6.25 percent at the end of the third quarter, the problem loan ratio is well in excess of its peak in 1983, the year following the last recession. See Chart 1.

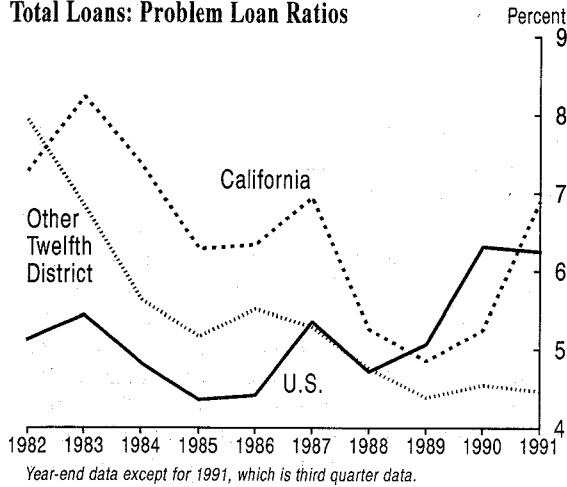
In California, the deterioration in loan quality is quite pronounced. As shown in the chart, recent increases in problem loans at California banks now place the state above the national ratio for total loans. In particular, the ratios for real estate loans for construction and land development and for business loans now exceed the national averages. The overall increase in problem real estate loans is significant, since 56 percent of California banks' total loans are secured by real estate, compared with 44 percent nationally.

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.

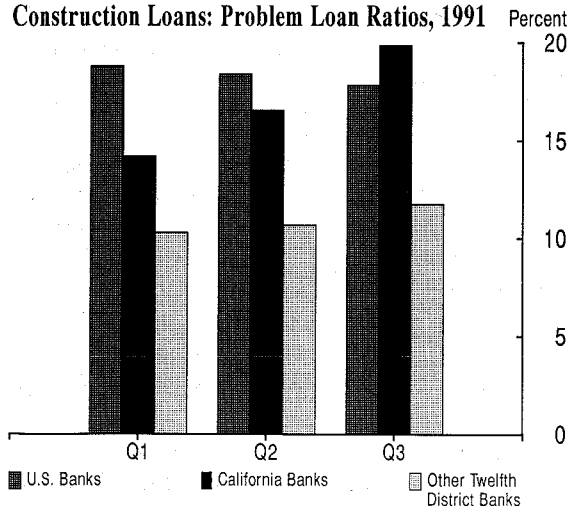
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Chart 1
Total Loans: Problem Loan Ratios



Problem construction loans in the state have soared since the first quarter of 1991 when these data became available. As shown in Chart 2, nearly 20 percent of California banks' \$23.1 billion in construction loans are either past due or on nonaccrual status, an increase of 5.6 percentage points in six months. Although problem construction loan ratios in the state are now 2 percentage points above the average for the U.S., they are still below the 26.4 percent level reported in New England. Furthermore, the surge in problem loans may have a more severe impact on California banks since they have a much higher proportion of construction loans to total loans than do banks nationally, about 10 percent versus 6 percent.

Chart 2
Construction Loans: Problem Loan Ratios, 1991



Deterioration in commercial real estate markets is another development affecting California lenders. From the first quarter to the third quarter, problem commercial real estate loans in California have risen over 1 percentage point, to 8.3 percent. Despite that increase, the California ratio was still below the national average of 8.7 percent.

Prospects of persistent problems in commercial real estate will only prolong pressure on banks' asset quality. Moreover, both nationally and in California, banks reported increased exposure to commercial real estate lending in the third quarter. This is consistent with reports from large banks that many borrowers are not able to find permanent lenders for maturing construction loans and "mini-perm" construction loans. Mini-perms, with maturities of up to eight years, became prevalent in the mid-1980s as a way of financing income properties. Thus, the increase in commercial real estate loans may reflect the reluctance of other lenders to supply long-term credit, rather than a signal that there has been a pickup in loan demand at banks.

The overall weakness in the economy and employment in California also are having an adverse impact on the quality of business and consumer lending. In the state the problem business loan ratio for the third quarter has climbed to nearly 8 percent, up almost 2½ percentage points from September 1990, and nearly 2 percentage points above the national average. California banks' problem consumer loan ratio also has increased, although it remains below the U.S. level.

Capital positions

While California banks as a group have a slightly higher loan loss reserve ratio than do banks nationally, that cushion has been offset by losses in 1991 that have actually lowered California banks' overall ratio of equity to assets to 6.17 percent, below the national level of 6.70 percent.

Moreover, chargeoffs by California banks have lagged behind chargeoff rates nationally. Thus, softness in California real estate markets, where California banks do most of their real estate lending, combined with a sharp upturn in problem loan ratios, suggests that California banks may find themselves facing additional pressure to charge off problem loans and to add to loan loss reserves.

Gary C. Zimmerman
Economist

REGIONAL BANK DATA

SEPTEMBER 30, 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	515,673	4,622	35,344	353,709	20,060	9,442	13,027	25,713	13,552	40,203
	FOREIGN	36,425	0	N/A	34,392	1,835	N/A	N/A	9	92	98
	DOMESTIC	479,247	4,621	35,344	319,318	18,225	9,442	13,027	25,704	13,460	40,105
LOANS	TOTAL	365,795	2,057	23,178	257,091	12,775	6,442	8,757	17,106	8,486	29,903
	FOREIGN	31,596	5	N/A	30,116	1,374	N/A	N/A	8	N/A	93
	DOMESTIC	334,199	2,052	23,178	226,975	11,401	6,442	8,757	17,098	8,486	29,810
	REAL ESTATE	168,999	866	7,384	127,078	6,470	2,015	2,620	6,405	3,135	13,028
	COMMERCIAL	75,783	705	3,064	52,226	2,914	1,463	1,174	4,998	1,699	7,541
	CONSUMER	56,720	310	5,131	31,167	1,254	1,749	4,297	3,462	2,946	6,405
	AGRICULTURE	5,975	6	426	2,914	20	818	17	469	156	1,150
	INTERNATIONAL	142	N/A	8	133	1	N/A	N/A	N/A	N/A	0
SECURITIES	TOTAL	50,756	1,881	4,587	27,012	4,052	1,766	1,959	3,279	2,649	3,572
	U.S.T.S.	16,159	922	1,468	8,556	1,534	440	799	736	519	1,186
	SECONDARY MARKET	22,941	486	2,238	12,780	1,711	843	626	1,597	1,445	1,213
	OTHER SEC.	11,656	473	881	5,676	807	483	534	945	685	1,172
LIABILITIES	TOTAL	481,551	4,076	32,790	331,847	18,685	8,790	11,971	23,675	12,460	37,258
	DOMESTIC	445,126	4,075	32,790	297,455	16,850	8,790	11,971	23,666	12,368	37,160
DEPOSITS	TOTAL	415,271	3,530	30,284	284,122	16,406	7,463	8,965	20,521	10,554	33,427
	FOREIGN	34,914	0	N/A	32,965	1,680	N/A	N/A	38	92	139
	DOMESTIC	380,358	3,530	30,284	251,156	14,726	7,463	8,965	20,483	10,462	33,288
	DEMAND	81,309	1,052	4,734	56,826	2,196	1,192	2,138	3,774	1,851	7,545
	TIME AND SAVINGS	299,048	2,478	25,550	194,330	12,530	6,271	6,827	16,709	8,611	25,743
	NOW	37,496	297	2,860	23,574	1,363	878	1,013	2,643	1,285	3,583
	MMDA	81,962	471	6,490	57,025	2,203	1,189	2,145	3,965	1,819	6,654
	SAVINGS	36,814	482	2,301	24,518	1,937	540	1,259	1,702	969	3,106
	SMALL TIME	89,843	649	11,787	50,755	2,365	2,947	1,322	6,999	3,593	9,426
	LARGE TIME	52,506	557	2,099	38,235	4,662	910	1,085	1,362	935	2,862
OTHER BORROWINGS		44,114	495	1,871	29,442	1,740	1,237	2,272	2,556	1,697	2,804
EQUITY CAPITAL		34,122	546	2,555	21,863	1,375	652	1,056	2,038	1,092	2,945
LOAN LOSS RESERVE		9,482	40	584	7,203	198	94	286	400	206	471
LOAN COMMITMENTS		195,444	534	18,521	135,149	6,264	2,206	1,897	9,546	5,762	15,565
LOANS SOLD		29,984	34	184	28,915	169	35	71	244	30	302
ASSET QUALITY -- PERCENT OF LOANS (LARGE COMMERCIAL BANKS)											
LOAN LOSS RESERVE (ALL BANKS)		2.59	1.95	2.52	2.80	1.55	1.45	3.27	2.34	2.43	1.58
NET CHARGE-OFFS, TOTAL		1.24	0.06	1.50	1.30	0.11	0.39	3.95	1.15	1.42	0.50
	REAL ESTATE	0.55	0.03	2.12	0.53	0.01	0.05	0.21	0.73	0.59	0.25
	COMMERCIAL	1.31	-0.11	2.67	1.31	0.05	0.85	5.64	1.84	2.17	0.38
	CONSUMER	2.82	0.55	1.80	3.28	0.70	0.66	6.05	1.40	2.46	1.16
	AGRICULTURE	0.40	N/A	3.02	0.18	2.17	0.02	-0.08	0.10	0.06	0.29
PAST DUE & NON-ACCURAL, TOTAL		6.05	3.30	4.76	6.90	2.43	2.03	6.28	4.01	4.25	4.01
	REAL ESTATE	6.99	3.55	8.90	7.56	2.04	2.47	6.62	4.72	6.32	5.28
	COMMERCIAL	7.23	3.36	9.81	7.94	3.52	2.56	11.63	4.62	4.37	4.13
	CONSUMER	3.32	2.74	2.49	3.77	2.33	1.70	5.56	1.56	2.79	1.94
	AGRICULTURE	4.09	0.36	7.46	5.25	7.11	1.57	0.50	1.42	1.78	2.44
EARNINGS AND RETURNS -- \$ MILLION, YEAR-TO-DATE (ALL COMMERCIAL BANKS)											
INCOME	TOTAL	40,871	337	2,567	28,022	1,403	713	1,541	2,021	1,106	3,161
	INTEREST	34,021	286	2,071	23,353	1,262	628	1,231	1,651	938	2,603
	FEES & CHARGES	2,010	17	140	1,358	29	39	47	127	56	198
EXPENSES	TOTAL	37,501	264	2,530	26,127	1,142	598	1,413	1,831	976	2,620
	INTEREST	17,553	128	1,189	12,168	694	342	433	828	477	1,294
	SALARIES	6,831	68	492	4,720	221	93	163	366	145	563
	LOAN LOSS PROVISION	4,689	6	200	3,618	30	22	301	271	104	139
	OTHER	8,428	63	650	5,621	197	141	516	367	249	624
INCOME BEFORE TAXES		3,349	73	36	1,877	260	115	128	189	131	540
TAXES		1,296	21	6	836	94	39	39	49	40	172
NET INCOME		2,050	52	31	1,036	167	76	89	140	91	369
ROA (%)		0.54	1.55	0.12	0.39	1.13	1.07	0.91	0.74	0.91	1.26
ROE (%)		8.01	12.75	1.60	6.32	16.17	15.45	11.22	9.18	11.05	16.69
NET INTEREST MARGIN (%)		4.31	4.69	3.39	4.26	3.84	4.05	8.20	4.34	4.62	4.47
NUMBER OF BANKS		791	8	40	480	21	23	19	51	54	95
NUMBER OF EMPLOYEES		242,183	2,680	19,227	154,886	8,357	4,970	6,435	15,882	7,133	22,613

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Research Department
Federal Reserve
Bank of
San Francisco

P.O. Box 7702
San Francisco, CA 94120

MARKET SHARE STATISTICS

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

(PERCENT OF COMBINED MARKET TOTAL FOR NOVEMBER 1991, BY REGION)

DEPOSIT TYPE	DISTRICT			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	CB	SL	CU
TOTAL DEPOSITS	54	41	5	72	4	24	93	1	7	48	48	4	68	28	5	91	5	4	71	26	3	81	11	8	78	8	13	56	36	8
DEMAND	91	4	5	99	0	1	96	0	4	90	5	5	90	3	7	91	0	9	99	1	0	95	1	4	90	4	6	91	6	3
NOW	65	28	7	58	6	36	90	0	10	60	34	6	69	28	3	94	3	3	79	15	6	84	8	8	84	4	13	65	24	11
SAVINGS & MMDA	60	32	7	54	4	42	90	0	10	56	38	5	63	29	7	93	3	3	81	15	4	78	10	12	72	6	22	59	25	17
SMALL TIME	34	62	3	75	8	16	95	1	4	25	72	3	43	53	4	89	9	2	43	55	3	76	18	6	77	15	8	42	54	4
LARGE TIME	50	45	5	93	4	3	93	1	6	45	50	5	83	16	2	91	5	4	66	34	0	84	10	6	76	10	14	49	50	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 NOVEMBER 1991 (%)

TYPE OF ACCOUNT OR LOAN	DATE	US	DISTRICT	ARIZ	CALIF	HAWAII	IDAHO	OREGON	UTAH	WASH
SAVINGS ACCOUNTS AND MMDAS**	SEP91	5.03	NA	NA	NA	NA	NA	NA	NA	NA
	OCT91	4.87	4.94	4.75	4.87	5.27	5.07	4.62	5.11	4.81
	NOV91	4.63	4.68	4.46	4.65	4.90	4.86	4.28	4.90	4.65
92 TO 182 DAYS CERTIFICATES	SEP91	5.44	5.35	5.19	5.43	5.27	5.35	5.35	5.39	5.52
	OCT91	5.22	5.14	4.84	5.17	5.15	5.08	5.10	5.23	5.38
	NOV91	4.89	4.76	4.45	4.81	4.84	4.80	4.69	4.91	4.90
2-1/2 YEARS AND OVER CERTIFICATES	SEP91	6.58	6.34	6.14	6.43	6.67	6.73	6.47	6.36	6.32
	OCT91	6.29	6.08	5.68	6.16	6.42	6.31	6.27	6.02	6.12
	NOV91	5.96	5.71	5.31	5.78	6.00	6.00	5.92	5.73	5.74
COMMERCIAL, SHORT-TERM*	AVG. RATE	6.81	7.93	8.41	7.63	8.88	9.18	8.09	7.11	8.71
	AVG. MAT. (DAYS)	54	140	224	188	110	254	76	50	332
COMMERCIAL, LONG-TERM*	AVG. RATE	7.81	8.93	N/A	8.91	8.40	N/A	N/A	9.55	N/A
	AVG. MAT. (MONTHS)	44	24	N/A	21	15	N/A	N/A	51	N/A
LOANS TO FARMERS*	AVG. RATE	9.08	7.97	8.11	7.77	N/A	9.28	8.80	6.34	8.74
	AVG. MAT. (MONTHS)	8	8	N/A	8	N/A	17	6	7	8
CONSUMER, AUTOMOBILE	AVG. RATE	10.61	10.77	13.00	10.90	N/A	11.00	10.50	10.45	9.46
CONSUMER, PERSONAL	AVG. RATE	14.88	14.29	15.00	17.70	N/A	11.00	12.88	15.01	12.25
CONSUMER, CREDIT CARDS	AVG. RATE	18.19	18.41	18.00	18.82	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.