
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).

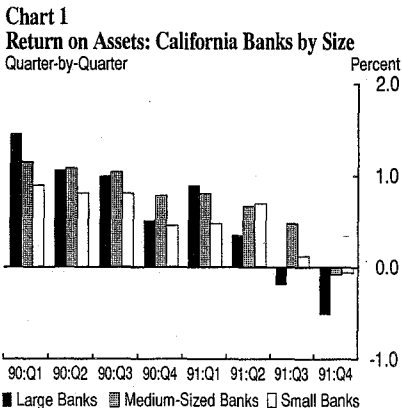
The depth of the problems facing California's banking industry is apparent from Chart 1, which

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.

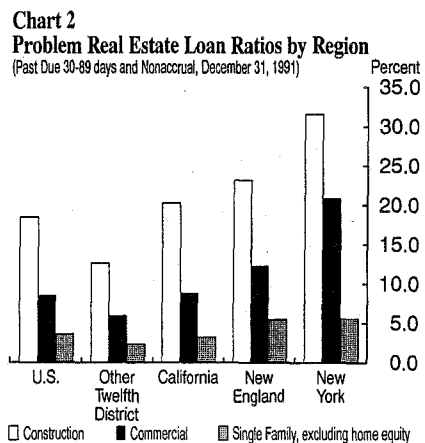
Real estate woes continue

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.

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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	1,148
	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		44,320	480	2,047	26,732	2,551	1,366	4,241	2,794	2,017	2,093
EQUITY CAPITAL		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		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	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	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	6.66	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.