
FRBSF WEEKLY LETTER

Number 93-16, April 23, 1993

California Banking Problems

1992 was a record earnings year for the U.S. banking industry, but one that many California bankers would rather forget. Over 93 percent of the nation's 11,382 commercial banks reported a profit for the year. Industry performance was bolstered by improvement in the economy, record net interest margins, and steadily improving asset quality. In contrast, only 69 percent of California's 450 banks were able to record a profit for 1992, as earnings were depressed by ongoing asset quality problems.

This *Weekly Letter* examines the divergence in 1992 bank performance between California and the nation. California banks have been hurt by the weak California economy and by their relatively heavy exposure to real estate lending. In 1992 small banks operating in Southern California's metropolitan areas experienced the most serious deterioration in performance, a finding that is consistent with economic conditions in Southern California relative to the rest of the state.

Record year for the industry

Nationally, wider net interest margins, improved asset quality, and asset growth came together to generate a record \$32 billion in earnings in 1992, up from only \$18.3 billion in 1991. As a result of these strong earnings fundamentals, return on assets (ROA), which measures the net income per dollar of assets, climbed to an industry record of 0.94 percent for the year, a dramatic increase from the 0.54 percent ROA recorded in 1991.

Bank earnings were boosted over \$8 billion by the large increase—24 basis points on average—in the differential between interest rates that banks earned on their loans and investments and the costs of funding those assets. Lower interest rates in 1992, and a shift to a funding mix with more equity funding and a larger share of lower cost retail deposits, resulted in a much larger

decline in interest expense than in interest income.

The problem loan ratio for total loans (defined as loans 30 days or more past due plus loans no longer accruing interest divided by total loans) at U.S. banks has now fallen for seven consecutive quarters. From year-end 1991 to year-end 1992, this ratio fell from 6.12 percent to 5.07 percent; and despite the sluggish economic recovery, problem ratios declined for real estate, business, and consumer loans. The improved outlook for credit quality allowed banks to reduce their 1992 expenses for provisions for building loan loss reserves by nearly \$8 billion from 1991 expense levels.

California's problems

California has accounted for a large share of the nation's job losses since the onset of the recession and it has been slow to show signs of recovery. With the slump in the California economy, earnings of banks in the state continue to lag those reporting nationally. Overall ROA for banks in the state was 0.58 percent last year (this excludes first quarter losses by Security Pacific, before its acquisition by Bank of America). Although this ROA is about triple the earning ratio posted in 1991, it is well short of the national figure. Also, nearly 31 percent of the state's banks, including two of the state's ten largest banks, reported losses in 1992, compared to only 25 percent in 1991.

There were three primary reasons that California bank earnings did not keep pace with the recovery in bank earnings nationally. First, while net interest margins improved at California banks, they did not increase nearly as much as they did nationally. Second, California banks have yet to experience the same degree of asset quality improvement as have U.S. banks. In California, the problem loan ratio appeared to peak in the

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.

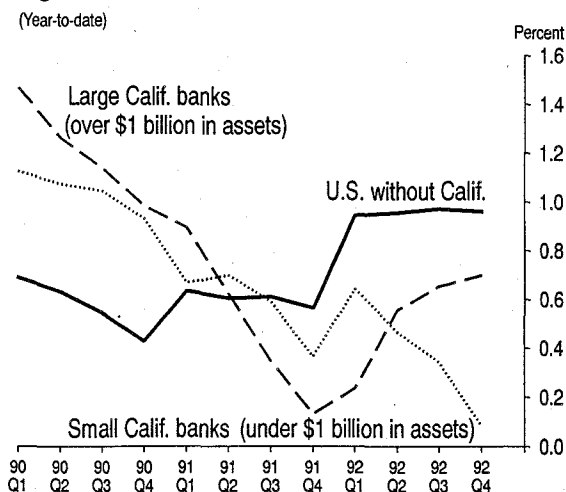
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first quarter of 1992, a year later than nationally, and from year-end 1991 to year-end 1992 fell from 6.96 to only 6.71 percent. Moreover, despite the improvement in total loans, the ratios for problem construction loans and single family mortgages continued to climb through year-end 1992. Finally, California banks' assets contracted by 6.6 percent in 1992 as the result of a 10.5 percent decline in total loans, while banks nationally generated earnings by expanding their assets by 2.1 percent.

Losses at small banks

Figures for the U.S. show that earnings were strong for banks of all sizes in 1992. For example, banks with assets below \$1 billion had an excellent year, as ROA climbed above 1.00 percent. In California, however, quite a different pattern emerged, as 90 percent of 1992 bank earnings were concentrated in a few of the state's largest banks. Indeed, as a group, California's larger banks (over \$1 billion in assets) posted a sharp increase in earnings, with ROA up to a favorable 0.71 percent for 1992, about twice its 1991 ratio (see Figure).

Figure 1: Return on Assets



But banks in California with under \$1 billion in assets reported an ROA of only 0.09 percent for 1992. The state's smallest banks, with assets under \$100 million, suffered a net loss for the year. Unlike their larger statewide branch bank competitors, many of these banks are dependent on smaller local banking markets that are more likely to be susceptible to adverse local economic conditions.

Earnings problems arising from relatively high ratios of problem loans and net chargeoffs of problem assets took a significant toll on California banks in 1992. Small banks in particular have been hard-hit because they find it harder to diversify their lending activity outside of their local market area and because of their heavy concentration in real estate lending (63 percent of loans at these banks) at a time when some local real estate markets have been hurt by the state's weakened economy.

One way to examine the effects of local business conditions on banks is to look at the performance of community banks (assets of under \$300 million) across the state. This analysis clearly highlights the problems of community banks in the six metropolitan counties in the hard-hit Southern California region. The 215 banks in that area, with combined assets of \$19 billion, 6 percent of the state's total, suffered a huge loss in the fourth quarter of 1992. For the year they posted a net loss of \$82 million, for an ROA of -0.42 percent. Also, problem real estate loan ratios for community banks in Southern California remained well above the ratios for their peers located elsewhere in the state.

Other parts of the state, including the San Francisco Bay Area, have experienced job losses, but less so than Southern California. The 71 community banks in the Bay Area of Northern California reported virtually no earnings for the entire second half of 1992, but were able to post a 0.32 percent ROA for the entire year. Outside of the two major metropolitan centers, the state's other 89 community banks continued to report relatively low ratios of problem loans and strong earnings, a pattern that is generally consistent with economic conditions in these areas.

Light at the end of the tunnel?

Earnings problems arising from high ratios of problem loans and net chargeoffs of problem assets took a significant toll on California banks in 1992, especially small banks in Southern California. California banks' problem loan ratios still remain relatively high compared to the national figures; however, these banks bolstered their financial position by adding \$4 billion in equity capital in 1992, and their loan loss reserve ratio also remains well above the U.S. average. But, perhaps the best news for California banks was the overall improvement in asset quality in the fourth quarter and the tentative signs of improvement in the 1993 employment data. Taken together, these signs may mean that some relief is in store for the California banking industry.

Gary C. Zimmerman
Economist

REGIONAL BANK DATA

DECEMBER 31, 1992
(NOT SEASONALLY ADJUSTED, PRELIMINARY DATA)

| | | DISTRICT | ALASKA | ARIZ. | CALIF. | HAWAII | IDAHO | NEVADA | OREGON | UTAH | WASH. |
|--|---------------------|----------|--------|---------|---------|--------|--------|--------|--------|--------|--------|
| ASSETS AND LIABILITIES -- \$ MILLION (ALL COMMERCIAL BANKS) | | | | | | | | | | | |
| ASSETS | TOTAL | 498,219 | 4,739 | 36,285 | 329,325 | 22,434 | 10,061 | 14,397 | 25,825 | 14,343 | 40,831 |
| | FOREIGN (RESIDUAL) | 24,591 | 0 | 0 | 22,300 | 2,184 | 0 | 0 | 0 | 89 | 37 |
| | DOMESTIC | 473,629 | 4,739 | 36,285 | 307,025 | 20,250 | 10,061 | 14,397 | 25,825 | 14,274 | 40,793 |
| LOANS | TOTAL | 334,926 | 2,152 | 20,098 | 228,907 | 13,891 | 6,739 | 7,868 | 17,394 | 8,402 | 29,476 |
| | FOREIGN (RESIDUAL) | 27,719 | 5 | 0 | 26,241 | 1,437 | 0 | 0 | 0 | 0 | 37 |
| | DOMESTIC | 307,207 | 2,147 | 20,098 | 202,666 | 12,453 | 6,739 | 7,868 | 17,394 | 8,402 | 29,439 |
| | REAL ESTATE | 162,649 | 946 | 7,105 | 119,183 | 7,217 | 2,110 | 2,573 | 7,218 | 3,361 | 12,945 |
| | COMMERCIAL | 62,755 | 723 | 2,654 | 40,194 | 3,266 | 1,480 | 820 | 4,461 | 1,567 | 7,588 |
| | CONSUMER | 55,706 | 345 | 6,117 | 28,922 | 1,128 | 1,962 | 4,316 | 3,603 | 2,782 | 6,682 |
| | AGRICULTURE | 5,766 | 4 | 348 | 3,029 | 50 | 763 | 14 | 413 | 156 | 990 |
| | INTERNATIONAL | 121 | 0 | 8 | 113 | 0 | 0 | 0 | 0 | 0 | 0 |
| SECURITIES | TOTAL | 69,629 | 1,990 | 8,220 | 37,401 | 4,433 | 1,801 | 3,559 | 4,611 | 3,269 | 4,326 |
| | U.S.T.S. | 22,871 | 881 | 2,695 | 11,292 | 2,183 | 410 | 1,588 | 1,398 | 714 | 1,512 |
| | SECONDARY MARKET | 35,527 | 577 | 4,699 | 20,897 | 1,713 | 807 | 1,553 | 2,318 | 1,702 | 1,459 |
| | OTHER SEC. | 11,432 | 532 | 826 | 5,412 | 537 | 584 | 418 | 897 | 872 | 1,354 |
| LIABILITIES | TOTAL | 457,282 | 4,135 | 32,947 | 303,321 | 20,831 | 9,327 | 12,883 | 23,521 | 13,092 | 37,244 |
| | DOMESTIC | 432,691 | 4,135 | 32,947 | 281,022 | 18,647 | 9,327 | 12,883 | 23,521 | 13,023 | 37,207 |
| DEPOSITS | TOTAL | 403,051 | 3,804 | 29,768 | 270,838 | 15,342 | 7,965 | 10,103 | 20,572 | 10,896 | 34,161 |
| | FOREIGN (RESIDUAL) | 24,206 | 0 | 0 | 22,183 | 1,915 | 0 | 0 | 0 | 69 | 37 |
| | DOMESTIC | 378,846 | 3,803 | 29,768 | 248,655 | 13,427 | 7,965 | 10,103 | 20,572 | 10,627 | 34,124 |
| | DEMAND | 95,431 | 1,075 | 6,148 | 68,359 | 2,548 | 1,580 | 2,615 | 4,224 | 2,336 | 8,547 |
| | TIME AND SAVINGS | 283,414 | 2,529 | 23,620 | 182,296 | 10,879 | 6,385 | 7,489 | 16,348 | 8,291 | 25,577 |
| | NOW | 42,935 | 335 | 3,537 | 25,703 | 1,637 | 1,046 | 1,325 | 3,278 | 1,516 | 4,559 |
| | MMDA | 94,148 | 555 | 7,345 | 86,191 | 1,959 | 1,511 | 2,473 | 4,298 | 1,797 | 8,020 |
| | SAVINGS | 44,024 | 688 | 3,381 | 26,721 | 3,058 | 924 | 1,737 | 2,195 | 1,564 | 3,756 |
| | SMALL TIME | 69,686 | 460 | 7,868 | 40,230 | 2,073 | 2,310 | 1,069 | 5,634 | 2,796 | 7,285 |
| | LARGE TIME | 32,232 | 453 | 1,489 | 23,232 | 2,149 | 593 | 842 | 941 | 654 | 1,879 |
| | OTHER BORROWINGS | 32,249 | 496 | 2,590 | 14,712 | 4,946 | 1,229 | 1,750 | 2,380 | 2,135 | 2,011 |
| EQUITY CAPITAL | 40,937 | 604 | 3,317 | 26,004 | 1,603 | 735 | 1,534 | 2,304 | 1,251 | 3,586 | |
| LOAN LOSS RESERVE | 10,138 | 40 | 543 | 7,555 | 230 | 107 | 362 | 452 | 195 | 655 | |
| LOAN COMMITMENTS | 197,491 | 632 | 29,605 | 121,916 | 6,490 | 2,367 | 1,789 | 10,186 | 6,538 | 17,969 | |
| LOANS SOLD | 20,853 | 29 | 248 | 19,685 | 131 | 33 | 90 | 221 | 138 | 279 | |
| EARNINGS AND RETURNS -- \$ MILLION, YEAR-TO-DATE (ALL COMMERCIAL BANKS) | | | | | | | | | | | |
| INCOME | TOTAL | 45,887 | 419 | 2,804 | 30,406 | 1,778 | 877 | 2,023 | 2,532 | 1,410 | 3,638 |
| | INTEREST | 36,025 | 344 | 2,204 | 23,837 | 1,577 | 755 | 1,373 | 1,923 | 1,137 | 2,883 |
| | FEES & CHARGES | 2,792 | 23 | 205 | 1,882 | 45 | 56 | 56 | 181 | 83 | 257 |
| EXPENSES | TOTAL | 39,298 | 310 | 2,623 | 26,829 | 1,405 | 691 | 1,429 | 2,008 | 1,093 | 2,909 |
| | INTEREST | 13,713 | 111 | 939 | 9,104 | 712 | 319 | 276 | 721 | 441 | 1,090 |
| | SALARIES | 8,888 | 93 | 634 | 6,053 | 324 | 126 | 183 | 530 | 211 | 714 |
| | LOAN LOSS PROVISION | 4,603 | 16 | 228 | 3,583 | 81 | 37 | 293 | 145 | 88 | 193 |
| | OTHER | 12,114 | 89 | 823 | 8,090 | 288 | 209 | 717 | 612 | 373 | 912 |
| INCOME BEFORE TAXES | 6,581 | 109 | 181 | 3,570 | 373 | 186 | 594 | 523 | 317 | 729 | |
| TAXES | 2,689 | 33 | 85 | 1,615 | 136 | 65 | 205 | 185 | 104 | 242 | |
| NET INCOME | 3,891 | 77 | 115 | 1,946 | 247 | 123 | 389 | 310 | 213 | 472 | |
| ROA (%) | 0.78 | 1.61 | 0.33 | 0.58 | 1.13 | 1.24 | 2.92 | 1.20 | 1.51 | 1.17 | |
| ROE (%) | 9.50 | 12.67 | 3.46 | 7.48 | 15.43 | 16.88 | 25.38 | 13.45 | 17.05 | 13.16 | |
| NET INTEREST MARGIN (%) | 4.47 | 4.91 | 3.61 | 4.41 | 3.96 | 4.42 | 8.25 | 4.65 | 4.94 | 4.45 | |
| ASSET QUALITY -- PERCENT OF LOANS (LARGE COMMERCIAL BANKS) | | | | | | | | | | | |
| LOAN LOSS RESERVE (ALL BANKS) | 3.03 | 1.84 | 2.70 | 3.30 | 1.65 | 1.59 | 4.60 | 2.60 | 2.32 | 2.22 | |
| NET CHARGE-OFFS, TOTAL | 1.33 | 0.79 | 1.35 | 1.52 | 0.40 | 0.33 | 3.38 | 0.85 | 0.55 | 0.54 | |
| REAL ESTATE | 1.05 | 0.90 | 1.12 | 1.29 | 0.11 | 0.08 | 0.51 | 0.49 | 0.37 | 0.13 | |
| COMMERCIAL | 1.21 | 0.89 | 2.75 | 1.30 | 0.85 | 0.49 | 0.83 | 1.15 | 0.52 | 0.57 | |
| CONSUMER | 3.08 | 0.55 | 1.90 | 3.96 | 0.99 | 0.53 | 5.47 | 1.45 | 1.67 | 1.18 | |
| AGRICULTURE | 0.26 | 0.00 | 1.57 | 0.07 | 1.13 | 0.36 | 0.26 | 0.18 | 0.63 | 0.22 | |
| PAST DUE & NON-ACCRUAL, TOTAL | 5.86 | 2.34 | 4.72 | 6.71 | 3.12 | 2.09 | 7.23 | 3.15 | 2.14 | 4.73 | |
| REAL ESTATE | 7.55 | 2.00 | 6.67 | 8.54 | 3.27 | 2.87 | 8.10 | 3.71 | 2.86 | 5.96 | |
| CONSTRUCTION | 21.27 | 2.09 | 18.43 | 23.74 | 8.78 | 9.85 | 16.30 | 10.22 | 3.49 | 19.05 | |
| COMMERCIAL | 8.10 | 1.78 | 11.82 | 9.47 | 0.88 | 2.97 | 8.15 | 4.58 | 3.55 | 3.79 | |
| FARM | 7.29 | 0.00 | 25.47 | 7.31 | 10.65 | 3.63 | 0.00 | 5.52 | 10.06 | 3.55 | |
| 1-4 FAMILY REV | 1.17 | 0.53 | 0.93 | 1.19 | 1.25 | 0.27 | 0.88 | N/A | 0.80 | 0.86 | |
| 1-4 FAMILY OTHER | 3.08 | 1.47 | 2.69 | 3.41 | 3.99 | 1.58 | 3.53 | N/A | 1.47 | 1.42 | |
| MULTI-FAMILY | 6.38 | 2.07 | 9.08 | 7.27 | 2.91 | 0.33 | 9.36 | 1.13 | 0.49 | 3.83 | |
| COMMERCIAL | 5.72 | 2.99 | 9.90 | 6.08 | 3.66 | 1.84 | 14.17 | 3.11 | 2.58 | 5.08 | |
| CONSUMER | 3.49 | 2.37 | 3.18 | 4.08 | 2.54 | 1.67 | 5.85 | 1.90 | 1.33 | 1.91 | |
| AGRICULTURE | 4.21 | 0.00 | 6.24 | 3.72 | 15.78 | 2.54 | 5.85 | 5.19 | 2.94 | 5.54 | |
| NUMBER OF BANKS | 749 | 8 | 38 | 452 | 17 | 20 | 18 | 48 | 54 | 94 | |
| NUMBER OF EMPLOYEES | 246,669 | 2,830 | 19,887 | 160,467 | 8,488 | 4,723 | 6,076 | 16,190 | 7,152 | 21,256 | |

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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 1993, 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 | 39 | 6 | 70 | 4 | 28 | 92 | 1 | 7 | 48 | 46 | 6 | 65 | 29 | 5 | 91 | 5 | 4 | 73 | 23 | 3 | 81 | 10 | 9 | 77 | 8 | 15 | 57 | 34 | 9 |
| DEMAND | 90 | 5 | 5 | 99 | 0 | 1 | 96 | 0 | 4 | 89 | 8 | 5 | 89 | 3 | 8 | 95 | 0 | 5 | 97 | 3 | 0 | 94 | 1 | 5 | 90 | 3 | 6 | 90 | 6 | 3 |
| NOW | 84 | 28 | 8 | 59 | 6 | 35 | 88 | 0 | 10 | 58 | 38 | 7 | 87 | 31 | 3 | 93 | 3 | 4 | 78 | 16 | 6 | 84 | 8 | 8 | 82 | 3 | 15 | 86 | 23 | 11 |
| SAVINGS & MMDAS | 80 | 31 | 9 | 55 | 4 | 41 | 90 | 0 | 9 | 56 | 37 | 7 | 80 | 34 | 7 | 82 | 4 | 4 | 80 | 15 | 5 | 77 | 10 | 13 | 70 | 6 | 24 | 57 | 26 | 17 |
| SMALL TIME | 32 | 65 | 3 | 75 | 9 | 18 | 95 | 1 | 4 | 23 | 74 | 3 | 52 | 46 | 2 | 88 | 10 | 1 | 43 | 54 | 3 | 77 | 17 | 6 | 77 | 15 | 7 | 40 | 58 | 4 |
| LARGE TIME | 44 | 46 | 10 | 95 | 2 | 3 | 93 | 0 | 6 | 39 | 51 | 10 | 73 | 22 | 6 | 89 | 6 | 5 | 62 | 38 | 0 | 75 | 12 | 13 | 70 | 10 | 19 | 44 | 54 | 2 |

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

INTEREST RATES ON DEPOSITS AND LOANS AS OF FEBRUARY 1993 (%)

| TYPE OF ACCOUNT OR LOAN | DATE | US | DISTRICT | ARIZ | CALIF | HAWAII | IDAHO | OREGON | UTAH | WASH |
|-----------------------------------|--------------------|-------|----------|------|-------|--------|-------|--------|------|-------|
| SAVINGS ACCOUNTS AND MMDAS | DEC92 | 2.88 | 3.05 | 2.72 | 2.77 | 3.36 | 3.51 | 2.88 | 3.23 | 3.25 |
| | JAN93 | 2.85 | 3.01 | 2.68 | 2.73 | 3.23 | 3.47 | 2.86 | 3.2 | 3.25 |
| | FEB93 | 2.8 | 2.96 | 2.67 | 2.7 | 3.09 | 3.38 | 2.79 | 3.21 | 3.16 |
| 92 TO 182 DAYS CERTIFICATES | DEC92 | 3.16 | 3.15 | 2.88 | 2.9 | 3.05 | 3.24 | 3.08 | 3.28 | 3.49 |
| | JAN93 | 3.13 | 3.08 | 2.87 | 2.86 | 2.67 | 3.22 | 3.08 | 3.27 | 3.47 |
| | FEB93 | 3.08 | 3.01 | 2.83 | 2.88 | 2.5 | 3.19 | 3.06 | 3.23 | 3.38 |
| 2-1/2 YEARS AND OVER CERTIFICATES | DEC92 | 4.77 | 4.55 | 4.11 | 3.98 | 4.61 | 5.13 | 5.05 | 4.68 | 4.62 |
| | JAN93 | 4.72 | 4.52 | 4.09 | 4.04 | 4.28 | 5.13 | 5.05 | 4.68 | 4.62 |
| | FEB93 | 4.59 | 4.41 | 4.06 | 4.01 | 4.03 | 5.2 | 5.05 | 4.56 | 4.61 |
| COMMERCIAL, SHORT TERM* | AVE. RATE | 4.92 | 5.96 | 6.79 | 5.71 | 6.85 | 8 | 6.25 | 4.87 | 5.93 |
| | AVE. MAT. (DAYS) | 58 | 70 | N/A | 84 | 101 | N/A | 305 | 57 | N/A |
| COMMERCIAL, LONG-TERM* | AVE. RATE | 6.39 | 8.69 | N/A | 8.99 | N/A | N/A | 9.25 | 8.81 | N/A |
| | AVE. MAT. (MONTHS) | 44 | 29 | N/A | 29 | N/A | N/A | 35 | 27 | N/A |
| LOANS TO FARMERS* | AVE. RATE | 7.62 | 6.33 | 6.76 | 6.07 | N/A | 7.51 | 6.81 | 8.72 | 7.03 |
| | AVE. MAT. (MONTHS) | 14 | 22 | N/A | 21 | N/A | N/A | N/A | 30 | N/A |
| CONSUMER, AUTOMOBILE | AVE. RATE | 8.57 | 8.98 | 8.9 | 9.02 | N/A | 10 | 8.78 | 8.9 | 8.51 |
| CONSUMER, PERSONAL | AVE. RATE | 13.57 | 12.67 | 15 | 13.87 | N/A | 10.5 | 11.34 | 11.5 | 11.68 |
| CONSUMER, CREDIT CARDS | AVE. RATE | 17.26 | 17.76 | 14.9 | 18.8 | N/A | N/A | 19.25 | 14.9 | 18.3 |

SOURCES: SURVEY OF TERMS OF BANK LENDING AND TERMS OF CONSUMER CREDIT; MOST COMMON INTEREST RATES ON SELECTED ACCOUNTS.

* DATA ARE COMPOUNDED ANNUAL RATES.