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Economy Boosts Western Banking in '94

Banks in the West turned in a strong performance in 1994. In the Twelfth Federal Reserve District, banks registered record profits, improved their asset quality, and maintained the strong capital positions built up over the past few years.

The performance of banking mirrored the robust economic expansion in most of the region. The long-awaited turnaround in the California economy also contributed to improved banking conditions and a pickup in loan growth; though it was not enough to keep many community banks in the state from weak performances. The sharp rise in interest rate spawned by the strong national economy in 1994 had only a small negative effect on reported bank earnings in the District.

This *Letter* examines the performance of the banking industry in the Twelfth District in 1994, focusing on the effects of the growth in the economy and the rise in interest rates.

Record earnings

Profits among Twelfth District banks through the third quarter of 1994 were $4.6 billion, up from $3.9 billion over the comparable period in 1993. Annualized, the earnings in 1994 represent an aggregate return on assets (ROA) of 1.19 percent. That was a record rate for the District and marked last year as the first since 1990 that District bank performance at least matched the national average.

Within the District, the strength of bank performance was correlated with economic conditions. In some of the faster growing states, like Idaho, Nevada, and Oregon, for example, aggregate banks ROAs were well above the national average in 1994. Likewise in California, the recovery in the state's economy helped boost bank performance during the first three quarters of 1994, though the prolonged recession and slower recovery in the state kept aggregate bank ROA just below a 1 percent annual rate.

The drag on bank performance in California was apparent mainly at smaller banks. For example, as a group the three largest banks in the state posted earnings rates well above the national average. In contrast, community banks (institutions with assets under $300 million) in California reported an annualized ROA of only 0.36 percent through the third quarter of 1994. Community banks operating in Southern California, the area hit hardest during the recession, fared worse: As a group, they barely broke even in the first three quarters of 1994. Overall, nearly 20 percent of the banks in California lost money in the first three quarters of 1994. That is well above the national figure of 4 percent in 1994 and is indicative of the lingering effects of the nearly three years of recession in the state.

Asset quality plays a key role

The biggest boost to banking in the District from the economy was through the improvement in asset quality. The economy has strengthened the financial position of borrowers and has helped stabilize the value of collateral backing bank loans. As a result problem loans as a percent of total loans have been coming down in the District.

Outside of California, overall loan quality generally is quite good, with total problem loan ratios below the comparable U.S. ratios. In California, asset quality also has improved across the board. However, problem loan ratios for lending related to real estate remain above the national averages and continue to be a drag on bank performance, particularly for community banks in Southern California that have a high dependency on real estate loans.

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.

The impact from the overall improvement in asset quality on the bottom line for banks was a sizable reduction in expenses for contributions to loan losses reserves. In the first three quarters of 1994, expenses for loan losses for District banks were about $1 billion less than in the comparable period in 1993. Western banks also reduced their holdings of real estate obtained through defaults on loans, as they "cleaned up" their balance sheets by selling off those nonearning assets.

Boost from growth in credit services

Bank performance in the District got another boost from improved credit conditions through the growth in bank credit services. Total loans in the District rose by close to 6¾ percent from September 1993 to September 1994, following a contraction of over 3½ percent during the previous 12 months. The increase in lending was met in part by banks' drawing down their sizable reservoir of liquid assets. The pickup in lending helped bank earnings in the District, in part because loans tend to have higher yields than securities of comparable maturity.

The impact of the economy on credit services also was evident in the off-balance sheet activity at District banks in 1994. Over the 12 months ending September 1994, for example, loan commitments in the District were up 18 percent, a much faster rate than for total loans. Letters of credit, which banks sell to customers looking to enhance the credit quality of commercial paper and other types of borrowing, rose by about 13 percent. These off-balance sheet activities add to earnings through the points and other fees banks charge their customers.

Little impact from the rise in interest rates

The strong economy nationally pushed up short- and long-term interest rates in 1994. While the jumps in rates were sizable—250 basis points on 3-month Treasury bills and 200 basis points on 10-year Treasuries—they had little net effect on the aggregate performance of banking in the District during 1994.

One reason is that the rise in the average yield on bank assets kept pace with the increase in the cost of bank funding. In the District, net interest margins, which have been relatively high in recent years, narrowed only slightly, and then mainly at the region's larger banks. Smaller banks as a group actually reported wider margins in the other western states, other than Hawaii.

Another reason is that realized and unrealized losses on securities were limited. Changes in interest rates can affect the market value of securities held by banks. The market value of a fixed-rate bond, for example, tends to decline with a rise in interest rates, though a rise in rates could have the opposite effect on certain derivative securities. When securities are sold, banks report *realized* losses as current expenses, and they report gains as income.

For the District as a whole, banks reported a net realized loss from securities sales of only $79 million through the third quarter of 1994, compared to a net gain of $128 million for the same period in 1993. Only a few banks in the District had losses from securities sales that materially affected earnings, and only in Arizona were the isolated losses large enough to have a noticeable effect on aggregate earnings.

The bigger impact on banks was from unrealized losses on securities. Banks currently report unrealized losses on securities classified as available-for-sale. District banks held about $53 billion in available-for-sale securities as of September 1994, which was about 62 percent of their total investment securities. The unrealized losses reported through the third quarter were about $500 million.

While the unrealized losses were large compared to the realized losses, they still were relatively small. Unrealized losses in 1994, for example, represented only about 1 percent of total equity capital for banks in the District. Moreover, even if District banks had booked these losses in 1994, earnings would still have been on a par with their strong 1993 performance.

Fred Furlong
Vice President

Gary Zimmerman
Economist

REGIONAL BANK DATA

SEPTEMBER 30, 1994
(NOT SEASONALLY ADJUSTED, PRELIMINARY DATA)

		DISTRICT	ALASKA	ARIZ.	CALIF.	HAWAII	IDAHO	NEVADA	OREGON	UTAH	WASH.
ASSETS AND LIABILITIES -- $ MILLION (ALL COMMERCIAL BANKS)											
ASSETS	TOTAL	524,889	5,381	37,757	338,395	21,951	11,596	20,437	28,122	16,927	44,324
	FOREIGN	40,854	1	0	38,528	2,266	0	0	28	0	32
	DOMESTIC	484,036	5,381	37,757	299,868	19,685	11,596	20,437	28,094	16,927	44,292
LOANS	TOTAL	350,737	2,763	23,116	224,215	14,436	8,668	13,160	20,157	10,562	33,660
	FOREIGN	31,774	N/A	0	30,240	1,472	0	0	27	0	28
	DOMESTIC	318,963	2,756	23,116	193,975	12,964	8,668	13,160	20,130	10,562	33,632
	REAL ESTATE	167,275	1,276	9,355	114,667	7,983	2,814	2,958	8,308	4,781	15,132
	COMMERCIAL	63,383	836	2,778	38,680	3,085	1,736	858	5,395	1,690	8,324
	CONSUMER	60,230	489	7,464	24,001	1,086	2,692	9,047	4,264	3,350	7,838
	AGRICULTURAL	6,407	3	405	3,134	35	979	15	490	172	1,175
	OTHER LOANS	21,669	152	3,114	13,493	774	447	282	1,674	568	1,163
INVESTMENT SEC.	TOTAL	84,797	2,065	9,420	51,036	4,892	1,734	3,845	3,672	3,618	4,514
	U.S. TREASURIES	24,631	1,102	2,193	14,606	2,128	448	1,218	1,002	653	1,281
	U.S. AGENCIES, TOTAL	23,387	444	2,972	13,856	1,495	510	895	999	1,413	803
	U.S. AGENCIES, MBS	16,011	367	2,359	9,664	976	239	544	728	728	405
	OTHER MBS	4,206	135	269	3,373	19	46	67	14	113	170
	OTHER SECURITIES	32,574	384	3,986	19,201	1,249	731	1,666	1,657	1,439	2,260
LIABILITIES	TOTAL	479,362	4,687	34,572	310,011	20,088	10,696	18,000	25,613	15,379	40,317
	DOMESTIC	438,508	4,687	34,572	271,484	17,822	10,696	18,000	25,585	15,379	40,285
DEPOSITS	TOTAL	404,095	4,059	30,610	268,686	13,712	8,627	10,009	21,731	11,841	34,820
	FOREIGN	36,958	0	0	34,583	2,138	0	0	23	96	118
	DOMESTIC	367,137	4,059	30,610	234,102	11,574	8,627	10,009	21,708	11,745	34,702
	DEMAND	97,622	1,237	6,659	65,979	2,308	1,757	3,094	5,118	2,568	8,903
	NOW	42,228	393	3,643	24,377	1,340	1,085	1,499	3,466	1,684	4,741
	MMDA & SAVINGS	137,776	1,395	11,471	90,056	4,495	2,623	3,905	7,296	4,110	12,425
	SMALL TIME	62,414	475	7,435	35,343	1,915	2,312	921	5,011	2,424	6,578
	LARGE TIME	26,715	496	1,402	18,112	1,512	850	590	800	955	1,997
	OTHER DEPOSITS	383	63	0	235	4	0	0	17	4	59
OTHER BORROWINGS		26,915	558	925	12,405	3,555	1,619	591	1,648	2,156	3,458
EQUITY CAPITAL		45,526	694	3,185	28,383	1,863	900	2,437	2,509	1,548	4,007
LOAN LOSS RESERVE		9,589	41	491	6,957	243	120	462	440	223	613
LOAN COMMITMENTS		241,224	720	36,387	128,160	7,575	3,807	20,912	15,185	10,070	18,408
TIER1 CAPITAL RATIO		0.097	0.194	0.107	0.092	0.108	0.094	0.134	0.096	0.122	0.090
TOTAL CAPITAL RATIO		0.125	0.204	0.129	0.124	0.127	0.112	0.147	0.113	0.137	0.113
LEVERAGE RATIO		0.080	0.130	0.071	0.077	0.081	0.075	0.117	0.084	0.086	0.082
QUARTERLY EARNINGS AND RETURNS (ANNUALIZED) -- $ MILLION (ALL COMMERCIAL BANKS)											
INCOME	TOTAL	11,815	113	840	7,202	426	246	857	713	412	1,006
	INTEREST	8,959	94	675	5,568	363	208	420	498	319	814
	FEES & CHARGES	785	6	62	513	12	16	18	54	24	78
EXPENSES	TOTAL	8,830	83	649	5,511	325	188	509	485	342	738
	INTEREST	2,991	31	221	1,850	154	84	113	156	122	260
	SALARIES	2,374	26	161	1,597	82	35	67	140	70	196
	LOAN LOSS PROVISION	409	1	43	230	10	6	61	16	16	26
	OTHER	3,056	25	224	1,835	79	63	267	172	135	257
TAXES		1,158	10	54	714	38	20	125	82	27	88
NET INCOME		1,645	20	21	930	62	38	223	136	42	172
ROA (% ANNUALIZED)		1.27	1.53	0.22	1.11	1.14	1.32	4.79	1.98	0.97	1.59
ROE (% ANNUALIZED)		14.45	11.76	2.61	13.11	13.34	16.98	36.53	21.68	10.91	17.21
NET INTEREST MARGIN (% ANNUALIZED)		4.61	4.77	4.78	4.45	3.84	4.28	6.60	4.98	4.56	5.10
ASSET QUALITY -- PERCENT OF LOANS (LARGE COMMERCIAL BANKS)											
LOAN LOSS RESERVE		2.79	1.40	2.10	3.18	1.69	1.35	3.62	2.26	1.99	1.89
NET CHARGEOFFS, TOTAL		0.52	0.08	0.45	0.56	0.22	0.19	1.87	0.19	0.19	0.23
	REAL ESTATE	0.45	0.01	0.08	0.63	0.30	0.01	-0.03	-0.02	-0.04	-0.05
	COMMERCIAL	-0.09	0.06	-1.77	-0.04	-0.22	0.05	0.38	-0.13	0.10	0.06
	CONSUMER	1.86	0.32	1.81	2.35	1.00	0.55	2.65	1.02	0.71	0.95
	AGRICULTURAL	-0.01	0.00	0.07	0.12	-4.40	0.18	-0.03	-0.21	-2.03	-0.05
PAST DUE & NON-ACCRUAL, TOTAL		2.87	2.19	1.94	3.39	2.38	1.27	3.89	1.03	1.48	1.81
	REAL ESTATE	4.06	2.10	2.27	5.00	2.53	1.09	2.94	1.22	1.34	2.11
	CONSTRUCTION	14.29	9.60	4.68	21.83	3.31	0.84	0.05	3.33	1.75	6.55
	COMMERCIAL	5.89	1.66	5.74	7.62	2.33	1.06	5.17	1.50	1.61	2.32
	FARM	3.96	0.00	8.15	4.02	3.81	3.65	0.00	3.90	9.93	2.13
	HOME EQUITY LINES	1.08	1.15	0.49	1.15	1.73	0.32	0.73	0.37	0.63	1.18
	MORTGAGES	2.37	1.93	1.14	2.76	3.20	1.32	1.34	0.98	1.25	0.97
	MULTI-FAMILY	5.10	0.72	0.72	7.31	0.64	0.00	0.25	0.01	0.82	0.09
	COMMERCIAL	1.82	2.17	1.39	1.92	2.64	1.67	2.67	0.60	1.79	1.63
	CONSUMER	2.41	2.17	2.37	2.46	2.33	1.34	4.39	1.06	1.55	1.31
	AGRICULTURAL	2.49	4.42	2.32	2.25	24.52	1.41	1.32	1.82	1.71	3.72
NUMBER OF BANKS		680	8	34	406	16	19	21	46	44	86
NUMBER OF EMPLOYEES		N/A	2,773	18,625	N/A	8,375	4,916	7,902	15,500	7,811	20,885

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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 NOVEMBER 1994, BY REGION

	DISTRICT			ALASKA			ARIZONA			CALIF			HAWAII		
DEPOSIT TYPE	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU
TOTAL DEPOSITS	57	35	8	72	3	24	92	1	8	51	42	7	62	30	8
DEMAND	91	6	3	98	0	2	98	0	2	90	8	3	89	8	3
NOW	66	25	9	61	5	34	88	0	12	60	32	8	63	33	5
SAVINGS & MMDAS	63	26	11	58	4	38	89	0	11	60	31	9	55	33	12
SMALL TIME	33	63	5	76	6	18	94	2	5	24	72	4	49	47	4
LARGE TIME	46	44	11	95	1	4	90	1	9	37	50	12	69	21	10

	IDAHO			NEVADA			OREGON			UTAH			WASH		
DEPOSIT TYPE	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU
TOTAL DEPOSITS	92	5	4	78	17	5	83	7	10	80	5	16	56	34	10
DEMAND	97	0	2	98	2	0	96	2	2	91	4	4	90	9	1
NOW	90	4	6	78	14	8	85	5	10	82	1	16	65	22	13
SAVINGS & MMDAS	91	4	6	76	15	9	79	6	15	74	2	23	54	28	18
SMALL TIME	89	9	2	43	51	6	78	13	8	79	11	10	38	56	6
LARGE TIME	94	4	3	88	11	0	78	11	12	71	9	20	45	53	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

TYPE OF RETAIL DEPOSIT ACCOUNT OR LOAN		AUG 1992	NOV 1992	FEB 1993	MAY 1993	AUG 1993	NOV 1993	FEB 1994	MAY 1994	AUG 1994	NOV 1994
SAVINGS ACCOUNTS AND MMDAS	U.S	3.14	2.90	2.80	2.65	2.55	2.48	2.43	2.50	2.63	2.80
	DISTRICT	3.29	3.05	2.96	2.78	2.67	2.58	2.56	2.65	2.81	2.88
92 TO 182 DAYS CERTIFICATES	U.S	3.36	3.14	3.08	2.98	2.96	2.92	2.93	3.28	3.61	4.22
	DISTRICT	3.34	3.14	3.01	2.88	2.85	2.81	2.83	3.03	3.34	3.84
2-1/2 YEARS AND OVER CERTIFICATES	U.S	4.87	4.70	4.59	4.45	4.40	4.28	4.35	4.89	5.33	6.08
	DISTRICT	4.75	4.49	4.41	4.27	4.19	4.09	4.13	4.58	4.96	5.52
COMMERCIAL SHORT TERM FIXED	U.S	4.42	4.17	4.16	3.91	4.02	3.95	4.03	4.68	5.28	5.67
	DISTRICT	5.38	4.79	4.28	4.19	4.75	4.43	4.95	6.78	5.39	6.32
COMMERCIAL SHORT TERM FLOATING	U.S	5.95	5.91	5.85	5.58	5.53	5.56	5.49	6.32	6.83	7.36
	DISTRICT	6.29	6.59	6.36	5.40	6.48	6.46	6.36	6.38	7.34	7.78
COMMERCIAL LONG TERM FIXED	U.S	6.28	5.97	6.43	6.02	6.21	5.38	5.41	6.17	6.66	7.30
	DISTRICT	8.20	6.44	9.19	10.86	8.05	6.62	6.58	N/A	9.82	N/A
COMMERCIAL LONG TERM FLOATING	U.S	6.60	6.53	6.38	6.47	6.05	5.70	5.98	6.61	6.99	7.59
	DISTRICT	7.63	8.09	8.43	8.55	8.77	7.68	8.16	N/A	N/A	N/A
CONSUMER, AUTOMOBILE	U.S	9.15	8.60	8.57	8.17	7.98	7.63	7.54	7.76	8.41	8.75
	DISTRICT	9.39	8.76	8.98	8.23	8.09	7.70	7.68	7.86	8.15	8.41
CONSUMER, PERSONAL	U.S	13.94	13.55	13.57	13.63	13.45	13.22	12.89	12.96	13.33	13.59
	DISTRICT	13.68	12.83	12.67	13.87	12.69	13.00	12.02	12.26	13.37	12.87
CONSUMER, CREDIT CARD	U.S	17.66	17.38	17.26	17.15	16.59	16.30	16.06	16.15	16.25	N/A
	DISTRICT	18.46	18.29	17.76	17.60	17.58	17.00	17.17	17.61	17.34	16.33

SOURCES: MONTHLY SURVEY OF SELECTED DEPOSITS, SURVEY OF TERMS OF BANK LENDING, AND TERMS OF CONSUMER CREDIT
MOST COMMON INTEREST RATES ON RETAIL DEPOSITS, WEIGHTED AVERAGE INTEREST RATE ON LOANS