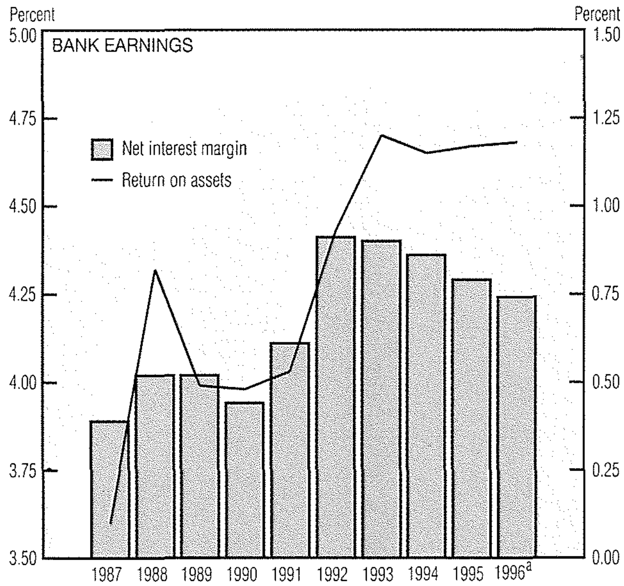
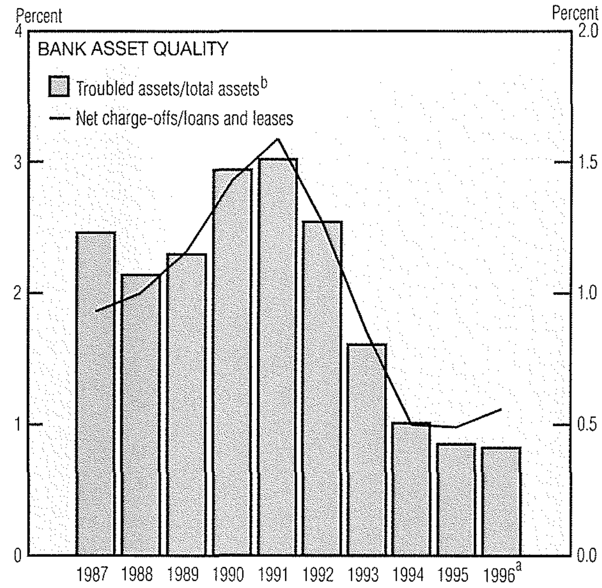
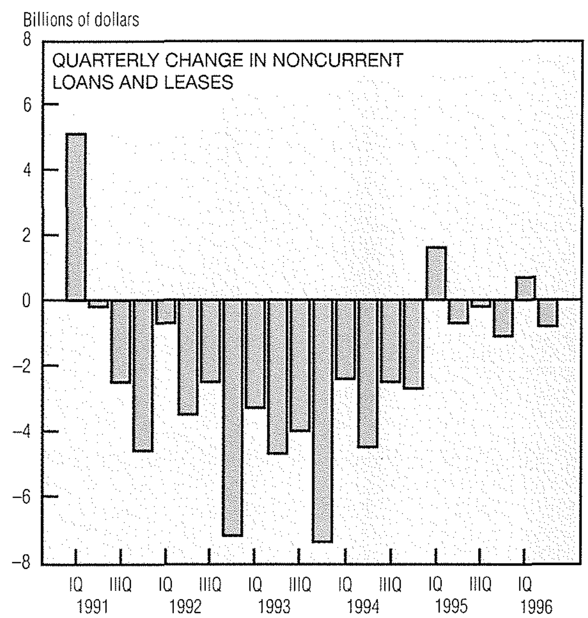
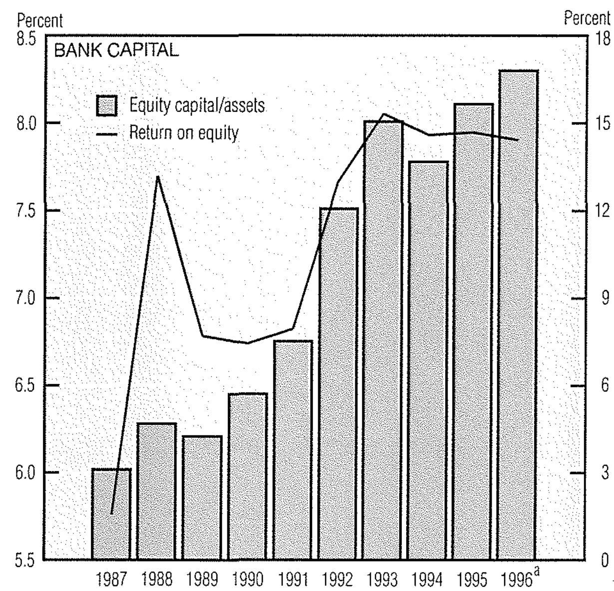
Banking Conditions









a. Ratios are annualized.
b. Troubled assets include noncurrent loans and leases plus other real estate owned.
NOTE: All data are for FDIC-insured commercial banks.
SOURCE: Federal Deposit Insurance Corporation.

Insured commercial banks reported their second-highest level of total quarterly earnings for 1996:IIQ—$13.78 billion, just below the $13.83 record set in 1995:IIIQ. These earnings were accompanied by the third-highest return on assets (ROA) in the industry's 14 years of quarterly earnings reports. More than 70% of all banks reported ROAs above 1%, and over 95% reported positive earnings. Only two federally insured commercial banks failed in the second quarter, bringing to three the total for 1996.

The vigorous performance derived from a record level of non-interest income, coupled with lower non-interest expenses and an increased net interest margin—only the second such increase in the last seven quarters. The net interest margin widened as funding costs fell faster than asset yields.

Banks' healthy income showings offset an increase in their loan-loss expenses in the second quarter; the $3.8 billion in charge-offs (loans removed from the balance sheet because they could not be collected) was the second in over two years. Losses on credit card debt accounted for most (61%) of the charge-offs. This gives 1996 a higher net charge-off ratio to date than 1995 or 1994. It also puts a negative interpretation on the decrease (both absolute and as a fraction of total assets) in non-current loans, because it means that instead of recovering, many of these ill-paying loans became uncollectable.

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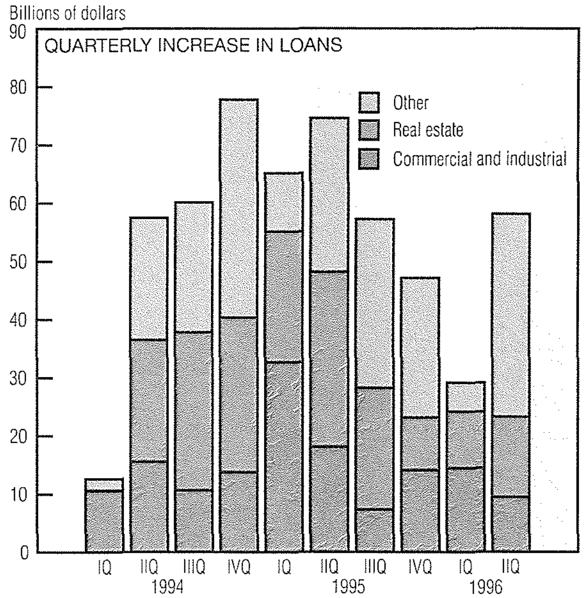
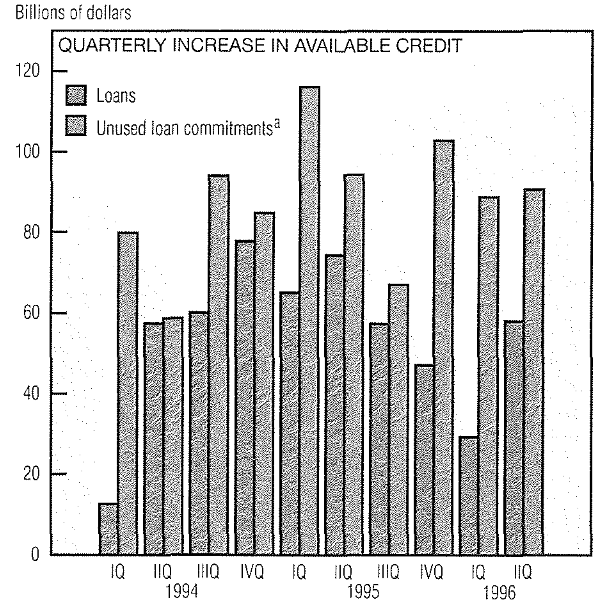
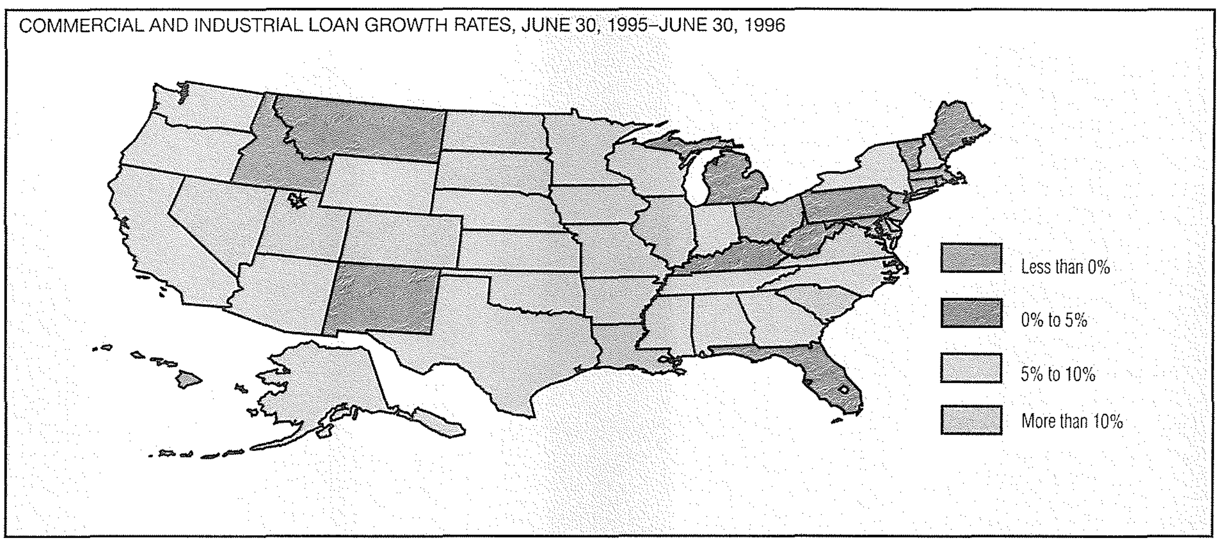
Banking Conditions (cont.)







a. Includes credit card lines, home equity lines, commitments for construction loans, loans secured by commercial real estate, and unused commitments to originate or purchase loans.
NOTE: All data are for FDIC-insured commercial banks.
SOURCE: Federal Deposit Insurance Corporation.

Strong earnings also mean that, despite the higher charge-offs, bank capital has remained strong, rising to 8.3% through June. Return on equity (ROE) stays high at 14.43%, and follows the pattern of ROA. The influx of equity is evidently not seriously diluting earnings. The increase in the capital/asset ratio lies behind the slight divergence between ROA and ROE.

Healthy loan growth in the second quarter also accompanied the favorable earnings performance. While real estate and commercial and industrial loans showed real but modest gains, loans classified as "other" (including consumer loans and farm loans) grew much faster, to almost seven times the first quarter's increase. Despite the acceleration in loan growth, unused loan commitments still increased faster than loans, which seems to indicate that credit remains readily available to businesses and consumers.

This improvement is widely distributed across the country, as states with high loan growth (above 10%) appear in the Northeast, South, Midwest, and West. The primary exception is the northeast corridor from Maryland to Massachusetts, which shows a disproportionate concentration of states with a decrease in loan volume. This should serve as another reminder that even with near-record overall earnings, some banks can fail, and strong nationwide loan growth may mask regional imbalances.