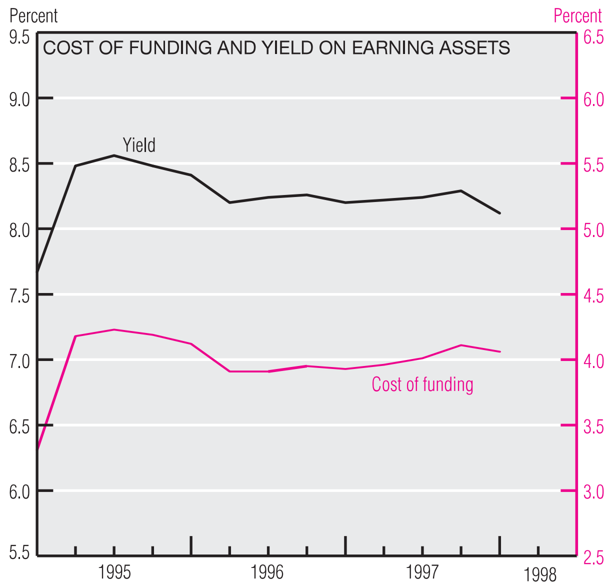
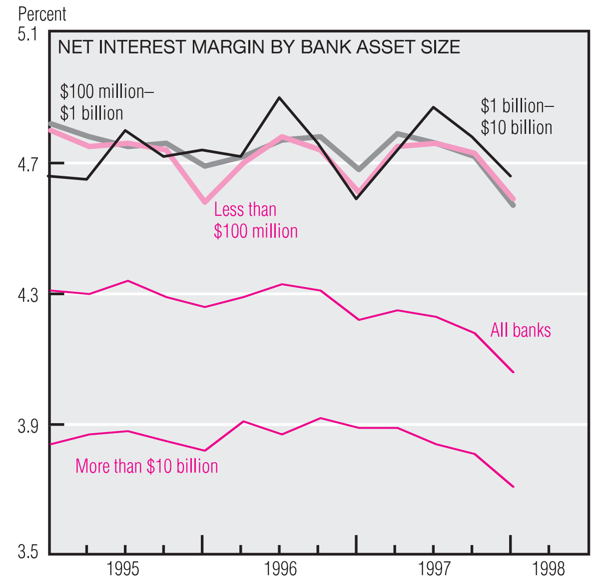
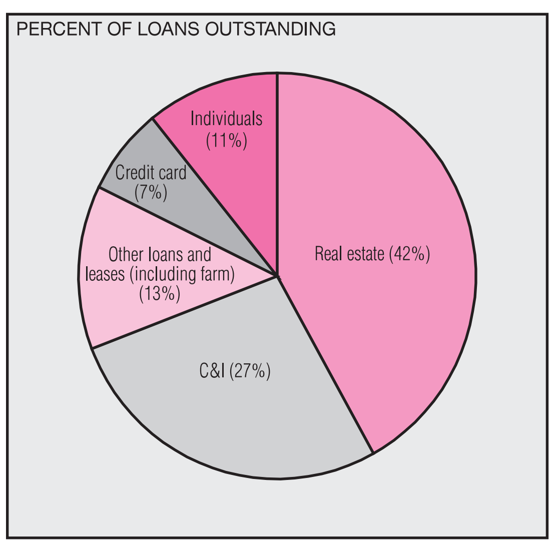
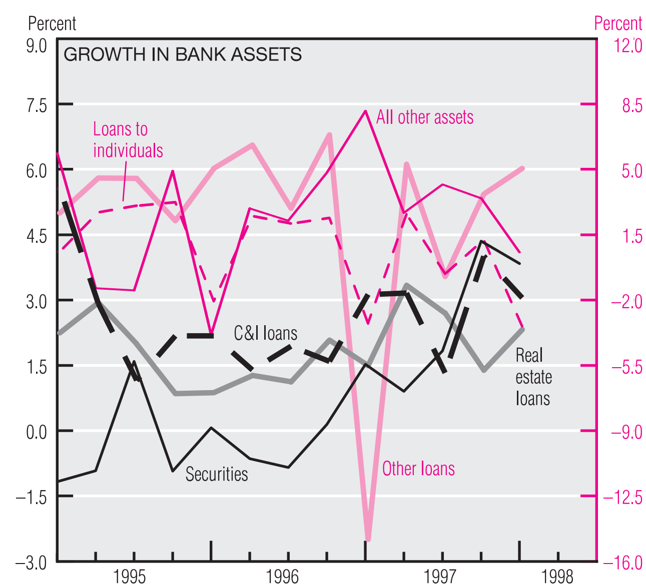
Banking Conditions









NOTE: All data are for FDIC-insured commercial banks.
SOURCE: Federal Deposit Insurance Corporation, *Quarterly Banking Profile,* various issues.

Amid concerns that loan standards may be easing too much, insured commercial banks reported their fifth consecutive quarter of record earnings. First-quarter bank profits totaled $15.9 billion, a 4.1% increase over the previous record, set in 1997:IVQ. The industry's return on average assets also improved to 1.26%, from 1.24% in the previous quarter. Analysts attributed earnings' strength to the continued strong asset expansion, growth in contributions from noninterest revenue sources, and favorable asset quality. However, the industry's net income did receive a boost of more than $1 billion from nonrecurring gains, the returns from a one-time sale of assets. There are other points of concern: Net interest margins have continued to narrow for banks of all asset sizes, credit-loss provisions have risen, and noninterest expenses related to mergers and holding company restructurings have increased.

Of the three largest categories of loans outstanding—real estate, commercial and industrial (C&I) loans, and other loans and leases (including farms)—two improved on their strong growth of the previous quarter. Loans to individuals, the most volatile loan category, shrank 3.42% in 1998:IVQ after a modest 1.24% growth rate in the previous quarter.

Commercial banks' securities acquisitions slowed from the 4.35% growth rate posted in 1997:IVQ, yet remained at a robust 3.84%, still strong relative to recent experience. Respondents to the Federal Reserve's May 1998 senior loan officer opinion survey indicated that banks were purchasing securities to leverage up their capital and boost returns on equity. The old standby strategy—repurchasing shares to pay out excess capital—is not

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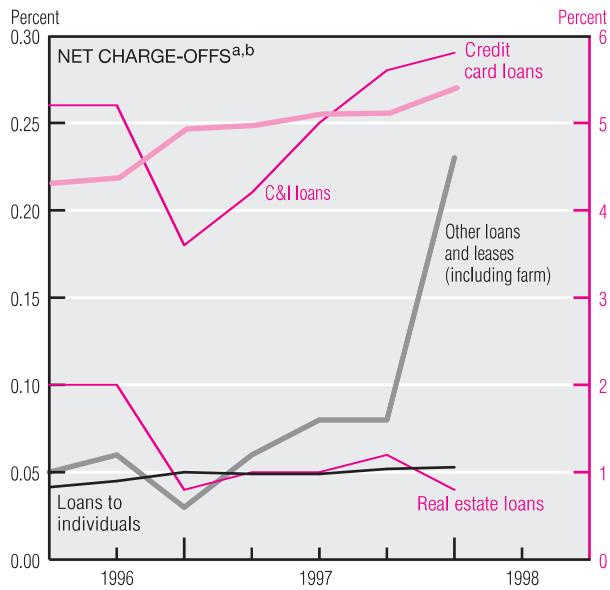
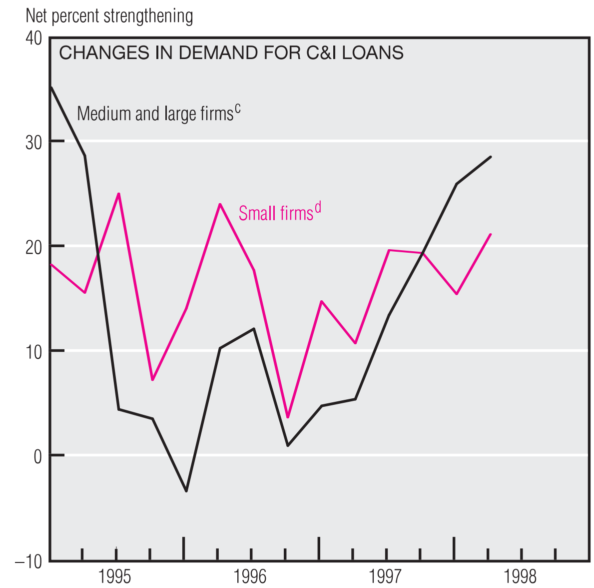
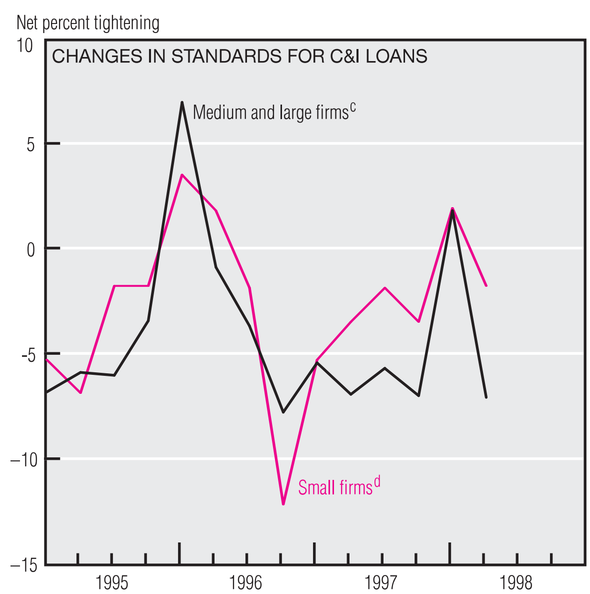
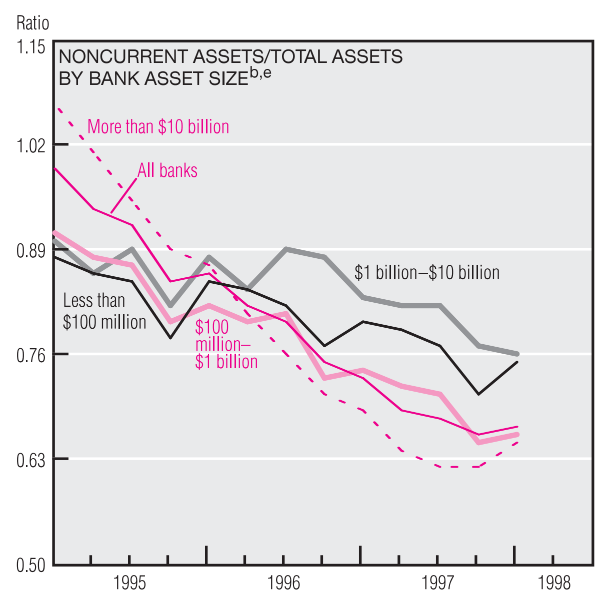
Banking Conditions (cont.)









a. The net charge-off rate is the percentage of total loans that banks remove from their balance sheets because of uncollectibility, less amounts recovered on loans previously charged off, expressed as an annual rate.
b. All data are for FDIC-insured commercial banks.
c. $50 million or more in annual sales.
d. Less than $50 million in annual sales.
e. Noncurrent assets are the sum of loans, leases, debt securities, and other assets that are 90 days or more past due or in nonaccrual status. Banks' noncurrent assets include "other real estate owned."
SOURCES: Board of Governors of the Federal Reserve System, *Senior Loan Officer Opinion Survey on Bank Lending Practices,* May 1998; and Federal Deposit Insurance Corporation, *Quarterly Banking Profile,* various issues.

attractive in an environment of high stock prices. In addition, legal restrictions bar holding companies that engage in pooling-of-interest mergers from repurchasing shares for a time. For banks in these holding companies, securities purchases serve to put excess capital to work.

In recent months, banking regulators have begun to express concern about the loosening of loan standards. Net loan charge-offs jumped 18.8% in the first quarter over the same period in 1997. The largest increases in net charge-offs resulted from C&I loans and credit cards. Although credit card charge-offs accounted for 62.3% of all loan charge-offs taken by commercial banks in the quarter, credit card lending remains one of banks' most profitable lending areas, generating high-interest-rate loans and significant noninterest income.

The Fed's May 1998 survey of senior loan officers revealed that standards for C&I loans eased, despite the continued strong demand for them. The cause most often cited by respondents was more aggressive competition from other commercial banks and from nonbank lenders. While standards eased slightly overall, most banks (more than 85%) held loan standards unchanged.

Noncurrent assets rose for banks of most asset sizes, but the increases were fairly modest and these ratios remain near their four-year lows.