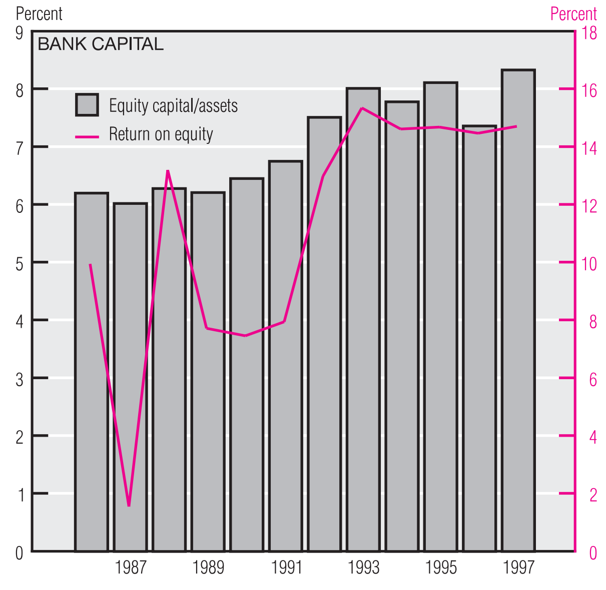
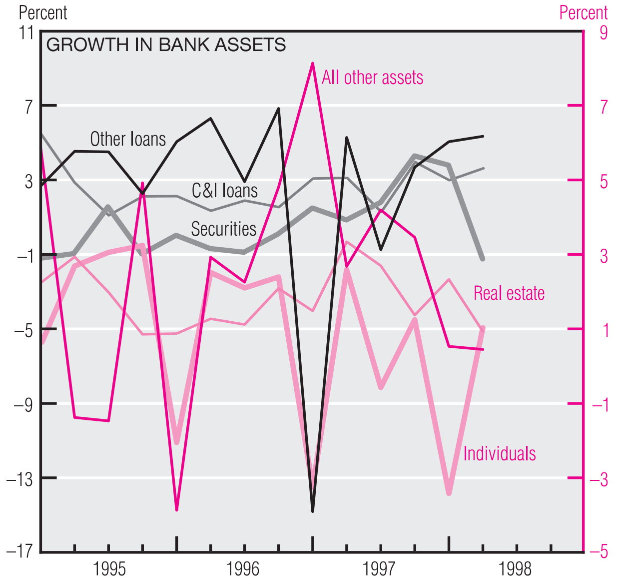
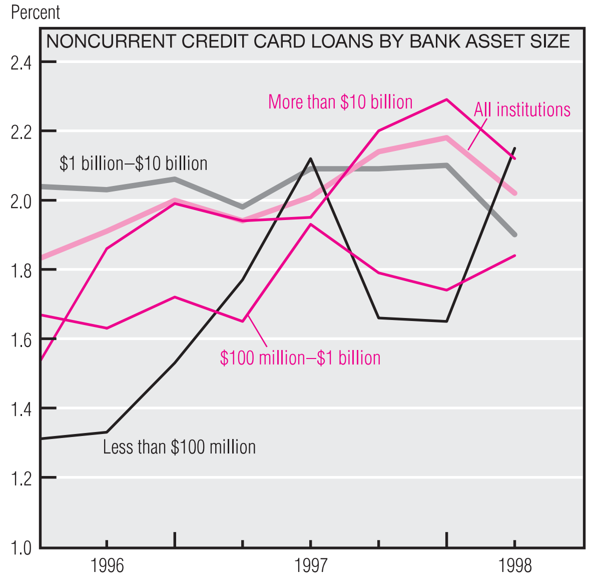
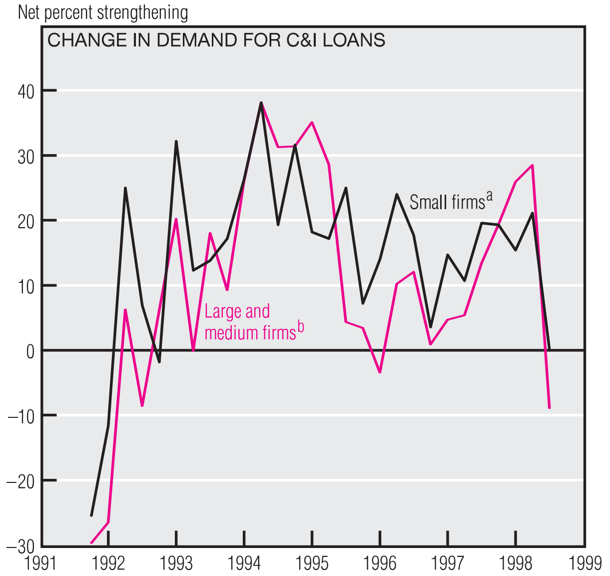
Banking Conditions









a. Less than $50 million in annual sales.
b. $50 million or more in annual sales.
SOURCES: Board of Governors of the Federal Reserve System, *Senior Loan Officer Opinion Survey on Bank Lending Practices*, August 1998; and Federal Deposit Insurance Corporation, *Quarterly Banking Profile,* various issues.

Commercial banks continued to post strong performances in 1998:IIQ as earnings rose for the eighth consecutive quarter, topping $16 billion and setting their sixth consecutive quarterly record. What's more important for shareholders, commercial banks' profitability continued to be high, with return on equity running at 14.8%. As the economic environment becomes more volatile, banking regulators can take some comfort from the continued high ratio of equity capital to assets.

Income rose and profitability remained high, even though net interest margins declined slightly. The yield on earning assets held steady, but the cost of funding earning assets rose two basis points. One reason for banks' continued strong performance is that noninterest income rose sharply—up 21.3% over the last year—and now accounts for a record 40.2% of banks' net operating revenue.

Growth in bank assets slowed from 1.9% to 1.4% between the first and second quarters, although commercial and industrial (C&I) loans and other loans and leases continued their recent strong growth rates. Most other asset categories saw a decline in growth rates. Banks' securities holdings actually declined 1.2% after growing strongly over the previous three quarters.

For the most part, the industry benefited from slower growth in domestic credit-loss provisions, even though new accounting rules expanded the coverage of this expense item in 1998. Credit card charge-offs accounted for over 60% of the $5.3 billion in loss provisions during the second quarter. While noncurrent credit card loans declined for banks overall, they rose sharply for institutions with fewer than $100 million in assets.

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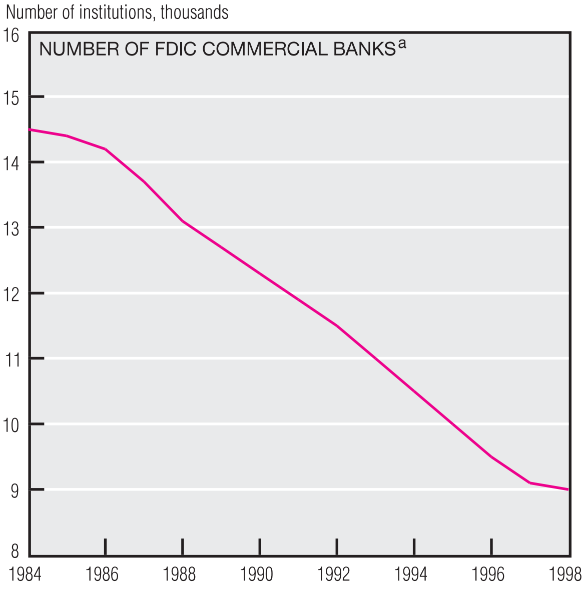
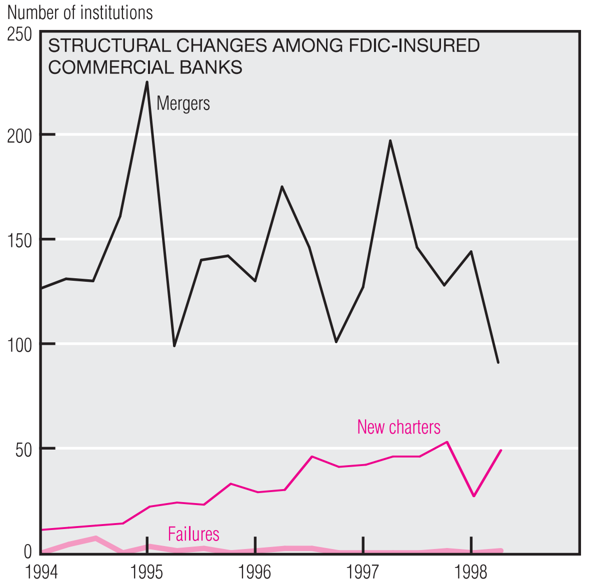
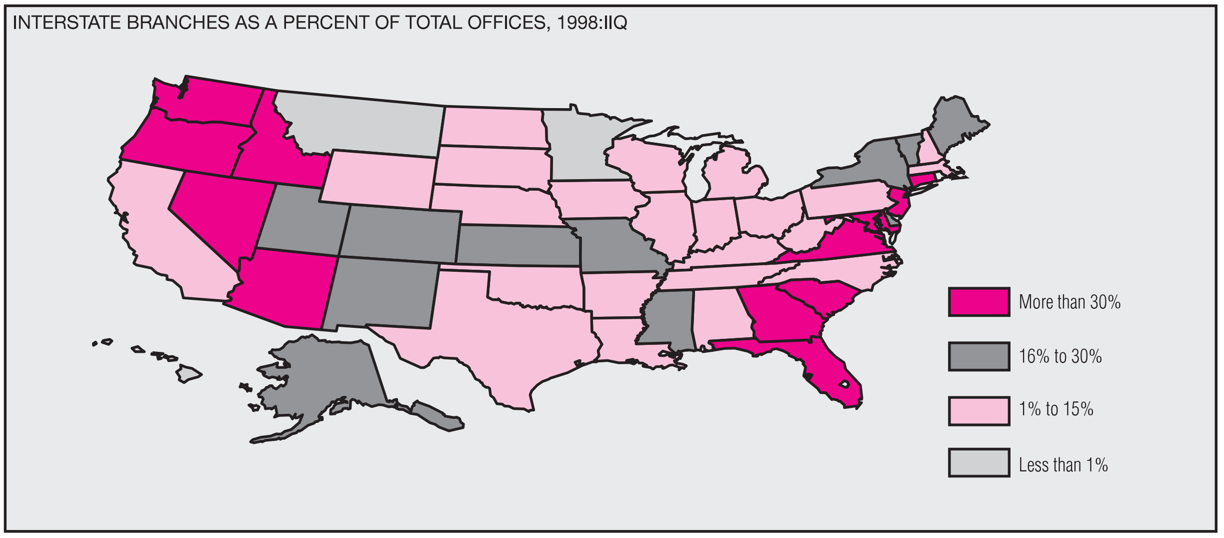
Banking Conditions (cont.)







a. Through 1998:IIQ.
SOURCE: Federal Deposit Insurance Corporation, *Quarterly Banking Profile,* 1998:IIQ.

Standards for C&I loans, an important category, remained relatively unchanged last quarter as the spreads of loan rates over banks' cost of funds continued to narrow. A possible sign of weakening in the economy is that the net percentage of domestic respondents reporting stronger demand for C&I loans declined for the first time since 1996.

Last quarter saw the earliest indication that the decline in the number of FDIC-insured commercial banks may be slowing. Their numbers have fallen by about 500 institutions every year since 1986, but fell by only 40 institutions in 1998:IIQ. Merger activity absorbed 91 banks, the lowest number since the most recent peak in 1997:IIQ. The recent general decline in stock prices may further dampen merger activities. New charters continued to be issued at a relatively brisk rate (49 in the last quarter). Only one institution failed.

Interstate branching has led to very different effects across states, as measured by interstate branches' share of total offices. The Southeast and the Pacific West (except for California) have the highest share of interstate offices. The District of Columbia (90.2%), Idaho (80.6%), and Oregon (70.5%) have the highest degree of interstate branch penetration, while Montana (0.6%), Hawaii (0.5%), and Minnesota (0.1%) have the lowest. Within the Fourth District, Kentucky (12.8%), Pennsylvania (12.4%), and West Virginia (10.9%) all have similar shares of interstate branches. Ohio's share, 3.1%, is significantly lower than that of other states in the District.