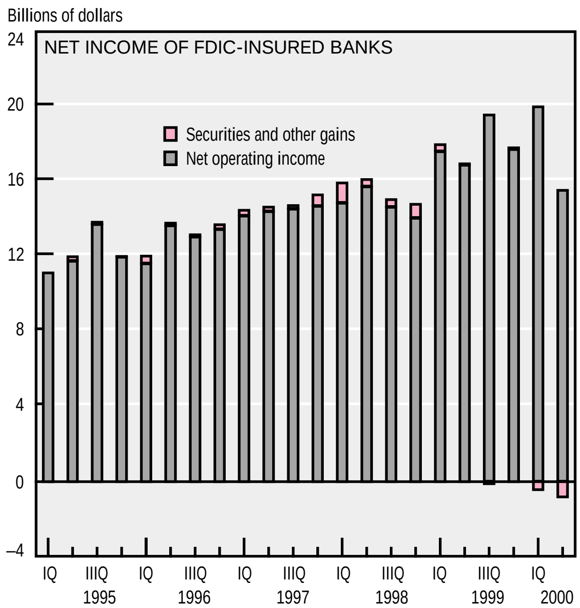
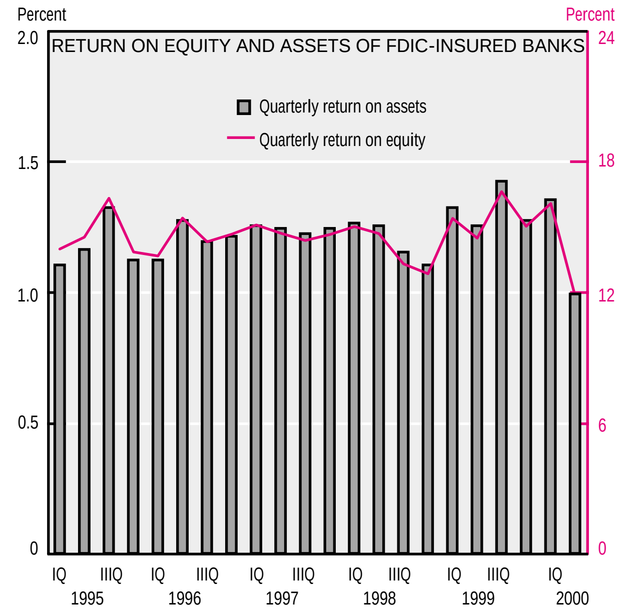
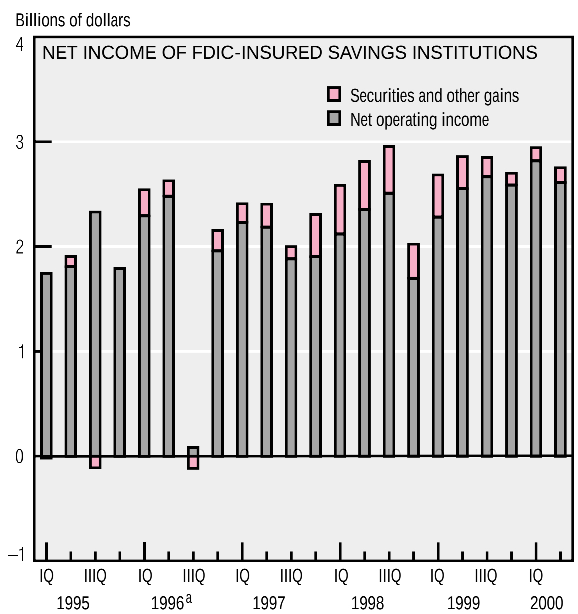
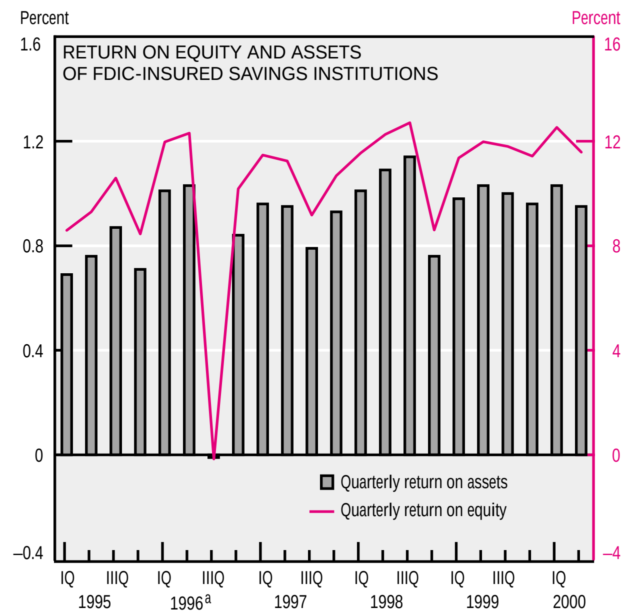
Banking Conditions









a. The sharp decline in 1996 was partly caused by a special insurance assessment on the deposits of savings institutions.
SOURCE: Federal Deposit Insurance Corporation, *Quarterly Banking Profile*, 2000:IIQ.

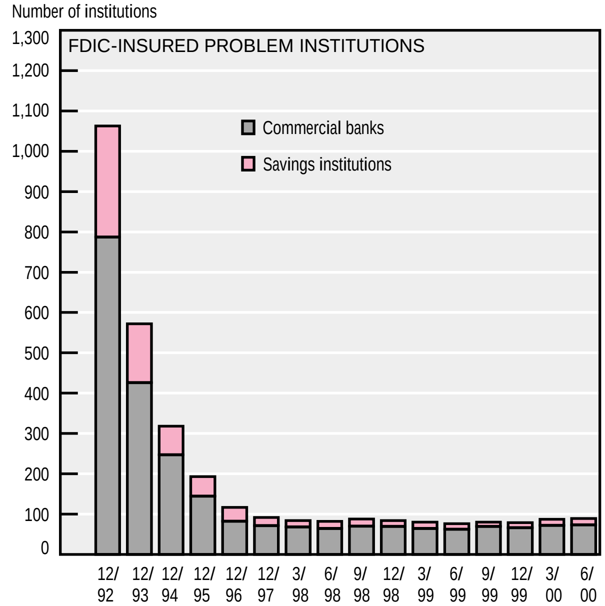
In the second quarter of this year, commercial banks posted their lowest earnings since 1997:IIQ as net income fell to $14.7 billion, $4.8 billion less than the record earnings reported in the first quarter. Most of this decline is due to a few large banks' unusually high expenses for restructuring and additions to loan-loss reserves. For the second consecutive quarter, securities and other gains were a drag on net income, as losses grew from $460 million to $860 million. Similarly, return on assets dropped from 16% to 12%, and return on equity slumped from 1.35% to 1% between the first and second quarters.

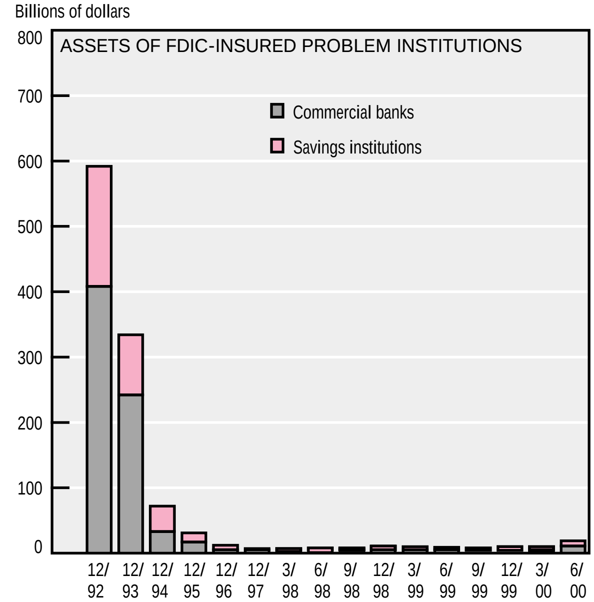
These aggregate figures mask the improved profitability reported by a majority of banks. Although large banks increased their average net charge-off rate to 0.68% from 0.54% a year ago, small banks' corresponding rate fell from 0.62% to 0.58%. Overall, banks' financial position remained strong as the ratio of equity to assets held at 8.41%. There was a net increase of just one in the number of banks considered problem institutions, but the assets of such institutions more than doubled, from $5 billion in the first quarter to $11 billion in the second quarter, the highest level since December 1995.

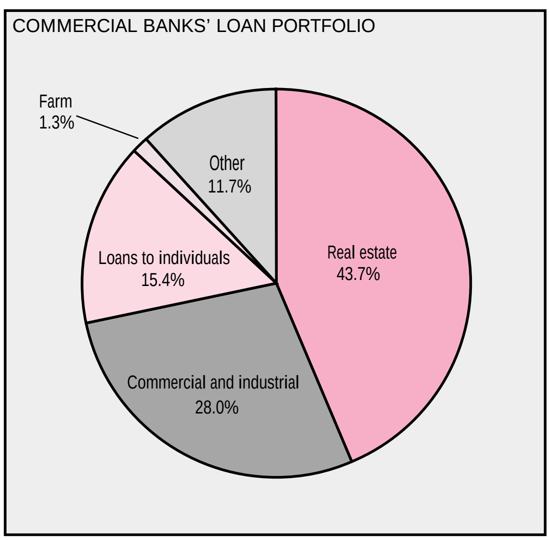
Savings institutions, free of the one-time charges that some large banks paid, turned in stronger numbers. Their net income declined a

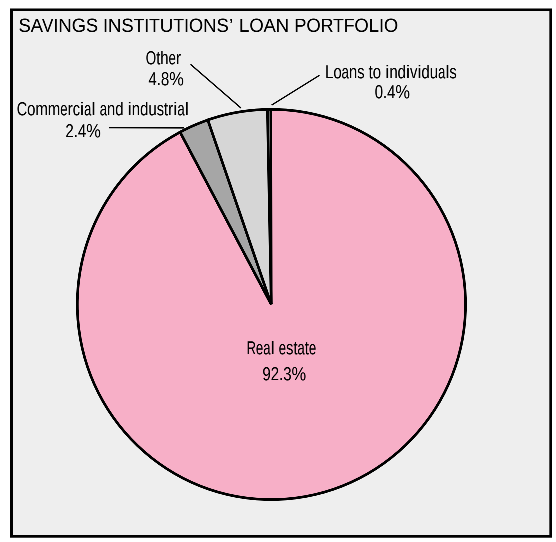
(*continued on next page*)

Banking Conditions (cont.)









SOURCE: Federal Deposit Insurance Corporation, *Quarterly Banking Profile*, 2000:IIQ.

modest $200 million to $2.6 billion for the quarter. In contrast to banks, savings institutions' earnings were boosted $140 million by securities and other gains, but even this was about $50 million less than average since the beginning of 1995. Savings institutions' return on assets remained virtually unchanged at about 1%, but return on equity fell slightly from 12.5% to 11.6% between the first quarter and the second. Net interest margins were reduced 21 basis points in the second quarter as a result of higher interest rates.

Nonetheless, the financial health of savings institutions remains sound. Loan-loss reserves rose to a record high of $1.34 for each dollar of noncurrent loans. As with commercial banks, thrifts showed a net increase of one problem institution in the second quarter, but thrifts' increase in the amount of assets in problem institutions was a more modest $3 billion, bringing the new total to $8 billion.

Asset portfolios of commercial banks continue to be quite different from those of savings institutions, although legislation has tended to blur the distinctions between the two types of charters over the years. While real estate loans comprise 43.7% of bank assets, they make up 92.3% of savings institutions' assets. At 28.0%, commercial and industrial loans form the second-largest asset class for banks; for savings institutions, they represent only 2.4% of assets. Loans to individuals constitute 15.4% of commercial banks' assets, but only 0.4% for savings banks.