Depository Institutions

SOURCE: Federal Deposit Insurance Corporation, *Quarterly Banking Profile*, various issues.

FDIC-insured depository institutions' net operating income declined to $20.1 billion in 2002:IVQ, a 7.3% drop from the previous quarter. However, compared to the same quarter a year earlier, it rose 14.5%. Net income, the sum of net operating income and securities gains and losses, also rose compared to the year before, by 17.4%. Weak demand for consumer and commercial loans led to a slight decline in net income.

Depository institutions' total interest income held pretty steady in 2002, averaging about $90 billion. This was significantly below the recent high of $113 billion in 2000:IVQ. Total noninterest income continued to grow in 2002 and was 8.4% higher than in 2001:IVQ, another sign that the earnings pressures that affected banks in the second and third quarters of 2001 are abating.

Commercial banks' strong earnings performance is also apparent in the net interest margin, which is interest plus dividends earned on interest-bearing assets minus interest paid to depositors and creditors. It is expressed as a percentage of average earning assets. The net interest margin rose from 3.91% in 2001 to 4.09% in 2002, its highest level since 1997. This rise offset asset growth of 7.99%, pushing depository institutions' return on assets to 1.33%, the highest rate since 1989. The 14.53% return on equity in 2002 was the highest since 1999.

Net loans and leases as a share of total assets decreased from 58.3% in 2001 to 57.7% in 2002. Although net

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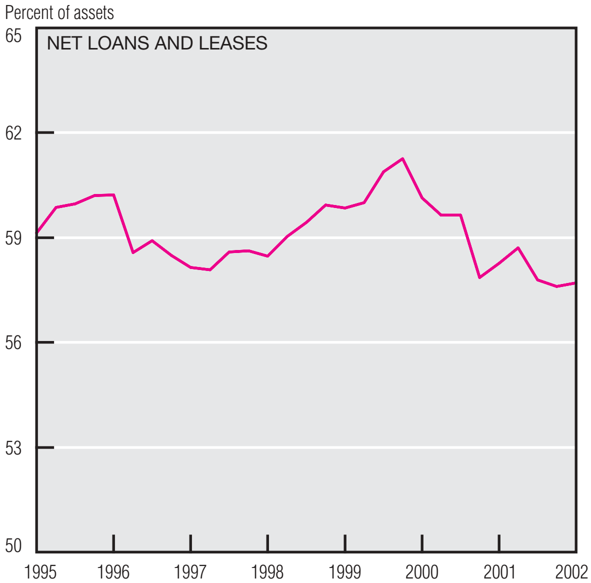
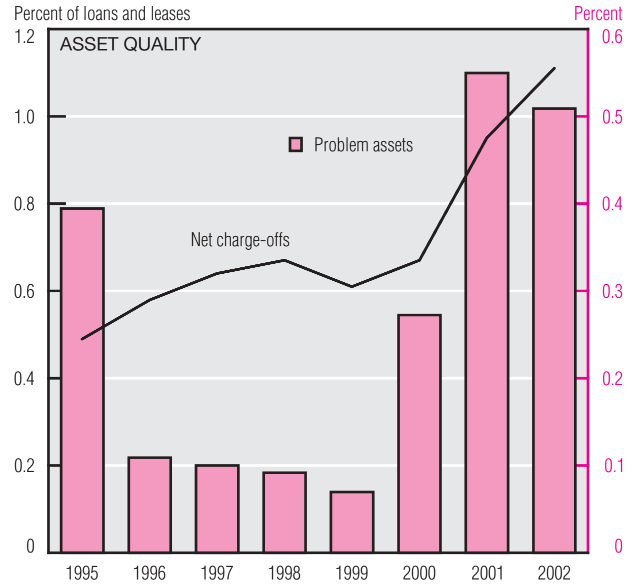
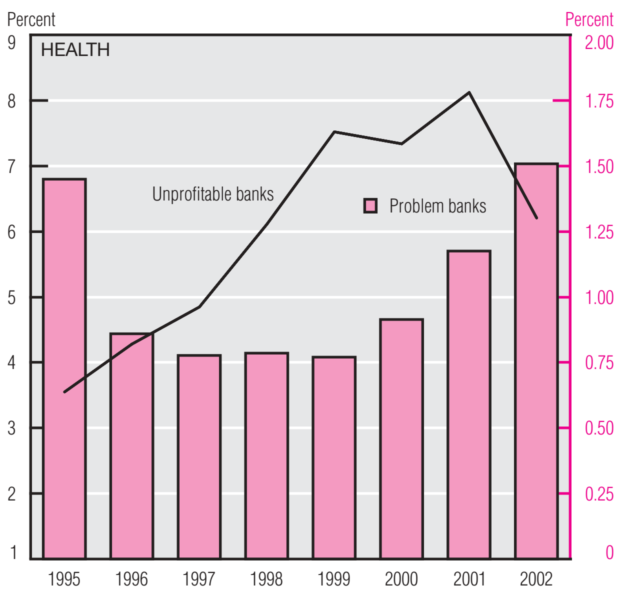
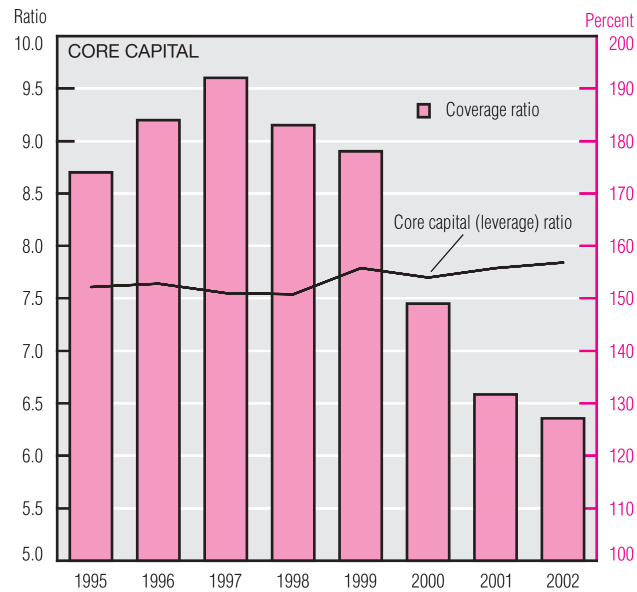
Depository Institutions *(cont.)*









a. Net income equals net operating income plus securities and other gains and losses.
SOURCES: Federal Deposit Insurance Corporation, *Quarterly Banking Profile*, various issues.

loans and leases grew 7.0%, total assets rose 8.0%, causing the ratio between them to decrease slightly between 2001:IVQ and 2002:IVQ. Although the ratio is well below the recent high of 61.3% in 2000:IIIQ, lending was brisk during the fourth quarter, partly because low interest rates in the lending market spurred refinancing activity.

Asset quality showed disparate signs in 2002. Net charge-offs (total loans and leases removed from an institution's balance sheet because of uncollectibility minus recoveries) have been rising since 1999 and reached 1.1% of depository institutions' commercial and industrial loans in 2002. Problem assets (nonperforming loans and repossessed real estate) as a percent of loans and leases fell slightly, from 0.55% in 2001 to 0.51% the following year.

Problem banks (those with substandard exam ratings) reached 1.51%, the highest level since 1994. However, declining asset quality is not a significant problem for FDIC-insured depository institutions, whose percent of unprofitable institutions has been falling and now stands at 6.21%. The coverage ratio (prudential reserves as a share of noncurrent loans and leases) fell from 132% in 2001 to 127% in 2002 but is still well below its recent high of 192% in 1997. Core capital, which protects depository institutions against unexpected losses, is at its highest level—7.84%—up from 7.79% in 2001. Combined, these indicators give a mixed account of the banking sector's recent performance.