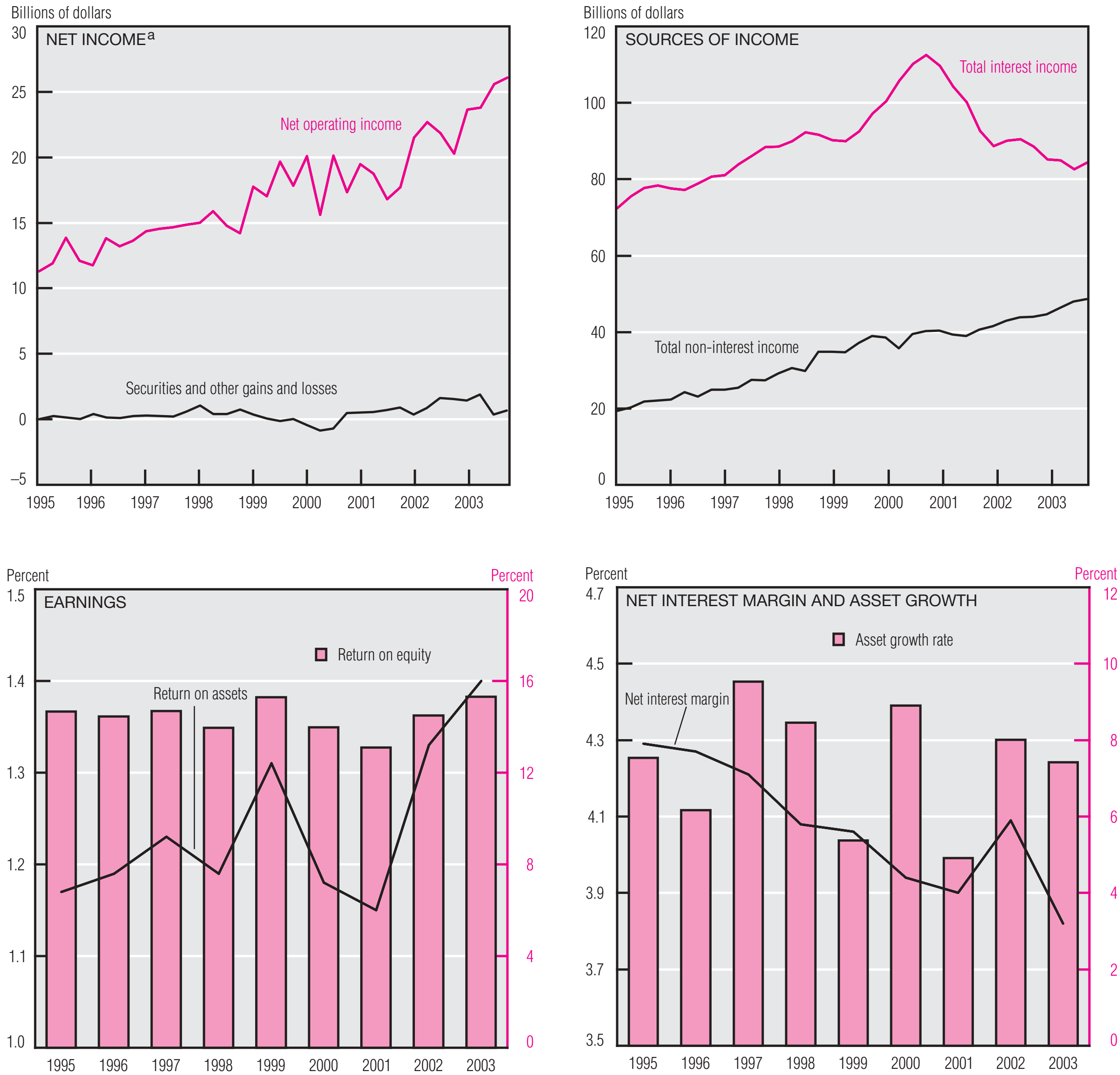
FDIC-Insured Commercial Banks



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

In 2003:IVQ, FDIC-insured commercial banks' net operating income improved from the previous quarter and recovered strongly (rising 28.9%) from its dip in the same quarter of the previous year. Net income (net operating income plus securities and other gains and losses) was also up, gaining 22.8% from a year earlier. The earnings increase was checked by reduced gains on the sales of securities and other assets.

Commercial banks' $84 billion in total interest income rose slightly between the third and fourth quarters of 2003. Falling interest rates kept it significantly lower than the $113 achieved in 2000:IVQ. Total non-interest income continued to grow, rising 10.5% from the previous year, another sign that the earnings pressures affecting banks in the recession of 2001 are finally abating.

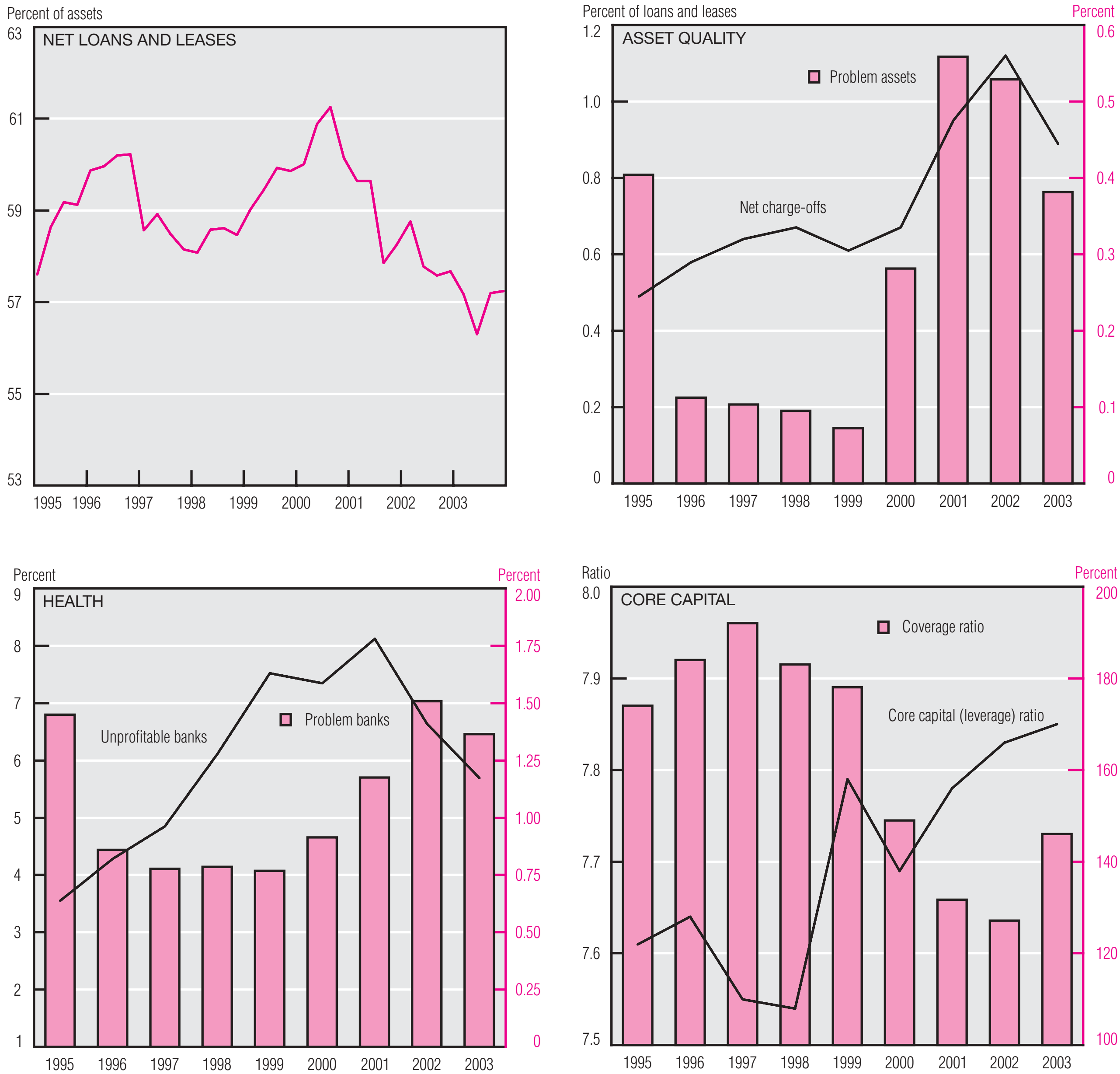
Overall earnings improved despite narrowing net interest margins (interest plus dividends earned on interest-bearing assets minus interest paid to depositors and creditors, expressed as a percentage of average earning assets), which declined from 4.09% in 2002 to 3.82% in 2003.

Low interest rates are one cause of shrinking margins, but strong asset growth is just as important. FDIC-insured commercial banks' assets grew 7.4% in 2003. But even with this near-record asset growth, their return on assets reached 1.4%, the highest since 1999. Their 15.3% return on equity was also at a post-1999 peak.

Although net loans and leases' 57.2% share of total assets remained

(continued on next page)

FDIC-Insured Commercial Banks (cont.)



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

unchanged between the third and fourth quarters of 2003, it was still lower than in 2002:IVQ. Net loans and leases grew 6.6%, but total assets grew 7.4%, causing a slight decrease in the year-over-year ratio. Although the ratio was well below its recent high of 61.3% in 2000:IIIQ, lending was brisk in 2003, partly because refinancing activity was stimulated by low interest rates in the lending market.

Asset quality showed signs of improvement in 2003. Net charge-offs (uncollectible loans and leases removed from the balance sheet, minus recoveries) declined to 0.9% of total loans, its first drop since 1999. Problem assets (nonperforming loans and repossessed real estate as a share of loans and leases) fell to 0.38% from 0.53% at the end of 2002. Asset quality was improved by aggressive tightening of lending standards and by the lower debt-servicing costs that resulted from refinancing at lower interest rates.

FDIC-insured commercial banks' improvement in asset quality is also reflected in a decline in unprofitable institutions' share to 5.7%. Problem banks (those with substandard exam ratings) as a share of total banks also fell to 1.36% in 2003. The coverage ratio (prudential reserves as a share of noncurrent loans and leases) rose from 127% in 2002 to 146% in 2003, the first increase since 1997. Core capital, which protects commercial banks against unexpected losses, increased slightly to 7.85%. All of these performance indicators point to strengthening in the banking sector.