BANKING BRIEF

Federal Reserve Bank of Philadelphia

For Pennsylvania, New Jersey, and Delaware

Fourth Quarter 2000

The deceleration in economic growth evident in the second half of 2000 did not have a dramatic effect on the financial performance of most banking organizations in the fourth quarter. The average return on assets (ROA) at large banks was 1.1 percent, down from 1.2 percent a year ago. The ROA at small banks remained unchanged at 1.2 percent. Chargeoffs and provisions for loan losses did increase in the fourth quarter, but this increase was largely concentrated at a few of the largest banks. The ratio of nonperforming loans to total loans at large banks increased by 0.3 percentage point since last year, to 1.2 percent. For community banks, this ratio did not increase.

Growth in assets, loans, and deposits among community banks in the region has been somewhat weaker than for community banks across the nation. But overall loan growth was stronger at community banks than at large banks in all loan categories except for consumer loans. Loan growth slowed at large national banks, as business and real estate loans declined during the quarter. These trends are consistent with the January Senior Loan Officer Opinion Survey, which reports that a substantial fraction of reporting banks tightened standards for both C&I loans and commercial real estate loans to large and middle-market firms. A smaller fraction of domestic banks tightened terms on C&I loans to small firms.

Large national banks experienced an impressive growth in consumer loans compared with large tri-state area and community banks. This might be a reflection of the ongoing consolidation of credit card portfolios among the largest banks and monoline companies, such as MBNA and Capital One Corporation. On the demand side, more than one-third of the banks surveyed in the Senior Loan Officer Opinion Survey noted weakened demand for all types of consumer loans.

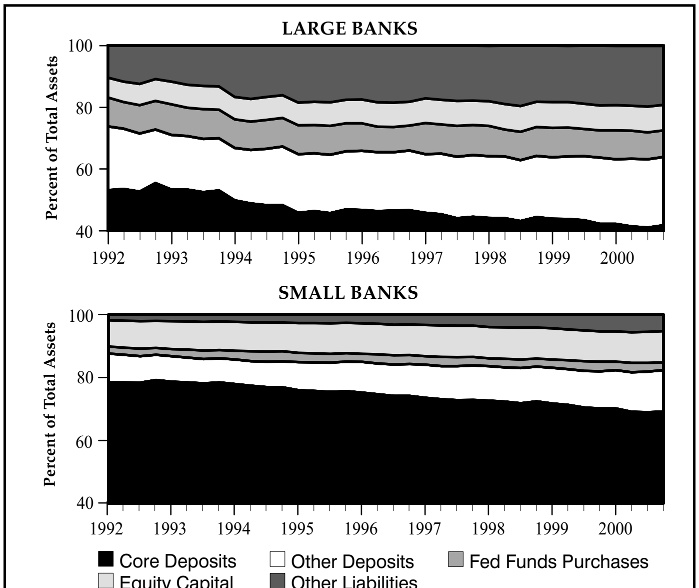
As Deposit Growth Slows, Banks Turn to Alternative Funding Sources

In recent years, rapid growth in contributions to money market and equity mutual funds came, in part, at the expense of deposit growth at banks. At the end of 2000, deposits funded almost two-thirds of bank assets, compared with 77 percent at the end of 1992. Core deposits (defined as total deposits minus time deposits greater than $100,000) declined from 62 percent of total bank assets to 46 percent.

Smaller banks traditionally rely more on deposits to fund their assets than do larger banks (see Figure).[1] But in recent years, the share of small bank assets funded by deposits has declined. Since 1995, among small community banks (banks with total assets less than $1 billion) total deposits have declined almost 3 percent while loans have risen 10 percent, resulting in an increase in the average loan-to-deposit ratio from 69 to 78 percent.[2] As a result, banks are turning to alternative funding mechanisms, such as advances from a Federal Home Loan Bank (FHLB), fed funds purchases, brokered deposits, repurchase agreements, and loan participations. A recent American Bankers Association (ABA) survey of community bankers found that FHLB advances are the most popular alternative funding source for banks of all sizes, cited by more than half of the survey's respondents.[3] Deposit specials, brokered CDs and deposits, Internet deposit brokers, and state CD programs were popular alternative sources of funds among banks with less than $500 million in assets.

FHLB advances are among the most cost-effective alternatives to core deposits. They have increased rapidly in recent years, rising from $60 billion in 1997 to $175 billion last year. One reason for this rapid increase is that in 1999 Congress relaxed an FHLB membership eligibility requirement that excluded financial institutions with less than 10 percent of their total assets in residential mortgage assets. Now, community financial institutions (defined in the bill as banks with less than $500 million in average total assets during the last three years) do not have to satisfy this requirement.

Figure



Note: Small banks are defined as those with total assets of less than or equal to $1 billion. Large banks have total assets greater than $1 billion.

[1] Data are compiled from Report of Condition and Income (Call Reports). For a discussion of recent trends in core deposits within large and small banks, see Hesna Genay's article in the Chicago Fed Letter for December 2000.

[2] The definition of community banks we use in *Banking Brief* does not limit community banks to assets of less than $1 billion. In our sample of community banks, deposits have grown over the last several years.

[3] See the ABA's *Bank Funding and Liquidity Issue* at http://www.aba.com. The ABA *Banking Journal* surveyed 1034 community banks from 49 states; the results were released in February 2001.

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	Community Banking Organizations						Large Banking Organizations						
	Tri-State			Nation				Tri-State			Nation		
	$Bill	% change from		$Bill	% change from			$Bill	% change from		$Bill	% change from	
	00Q4	00Q3	99Q4	00Q4	00Q3	99Q4		00Q4	00Q3	99Q4	00Q4	00Q3	99Q4
Total Assets	$78.0	8.6%	7.7%	$1176.3	13.4%	10.6%	Total Assets	$868.7	9.3%	-2.3%	$4663.3	9.4%	6.0%
Total Loans	48.5	5.5	8.8	757.0	11.0	13.4	Total Loans	536.0	-2.1	-2.9	2804.9	1.4	6.4
Business	6.5	19.4	7.4	139.1	14.0	13.7	Business	190.7	-4.6	-1.3	885.8	-0.7	6.2
Real Estate	35.0	5.4	9.8	485.7	13.4	15.4	Real Estate	215.9	0.8	-1.9	1135.2	-1.8	7.1
Consumer	5.4	-2.5	6.2	85.8	0.5	5.8	Consumer	46.0	1.3	-13.1	355.7	18.4	5.0
Total Deposits	61.4	11.4	9.0	956.8	14.5	10.2	Total Deposits	569.9	14.5	-0.9	3009.1	13.9	5.8
Ratios (in %)	**00Q4**	**00Q3**	**99Q4**	**00Q4**	**00Q3**	**99Q4**	**Ratios (in %)**	**00Q4**	**00Q3**	**99Q4**	**00Q4**	**00Q3**	**99Q4**
Net Income/ Avg Assets (ROA)	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	Net Income/ Avg Assets (ROA)	1.1%	1.0%	1.2%	1.1%	1.1%	1.2%
Net Interest Inc/ Avg Assets (NIM)	3.7	3.7	3.8	4.0	4.1	4.1	Net Interest Inc/ Avg Assets (NIM)	3.3	3.3	3.3	3.1	3.1	3.2
Noninterest Inc/ Avg Assets	1.1	1.1	1.0	1.0	1.0	1.0	Noninterest Inc/ Avg Assets	2.7	2.8	2.8	2.4	2.4	2.4
Noninterest Exp/ Avg Assets	3.0	3.0	3.0	3.1	3.1	3.2	Noninterest Exp/ Avg Assets	3.6	3.9	3.9	3.3	3.4	3.4
Loans/Deposits	78.9	80.0	79.1	79.1	79.8	76.9	Loans/Deposits	94.0	97.8	96.0	93.2	96.0	92.7
Equity/Assets	8.7	8.7	8.2	9.2	9.2	8.9	Equity/Assets	8.4	8.4	8.1	8.0	8.0	7.9
Nonperforming Loans/ Total Loans	0.6	0.7	0.7	0.8	0.8	0.8	Nonperforming Loans/ Total Loans	1.2	1.1	0.9	1.2	1.0	0.9

A banking organization is an independent bank or all the banks within a highest-level bank holding company; however, banks less than five years old and those whose credit card loans make up greater than 50 percent of their total loans are excluded. The large banking organization sample is based on banking organizations whose total assets were at least as large as those of the 100th largest banking organization in the United States as of December 31, 1999. The community banking organization sample is based on the remaining banking organizations. Tri-state large banking organizations are those large banking organizations that have either at least 5 percent of the deposits of the region or any state therein or at least 5 percent of their deposits in the region. Tri-state community banking organizations are those community banking organizations that are headquartered in the region. The numbers of banking organizations in the categories are as follows: (1) community banking organizations —190 for the tri-state area and 6034 for the nation; (2) large banking organizations —17 for the tri-state area and 94 for the nation. Ratios are aggregates, that is, the numerators and denominators are summed across all banks in the group, then divided. Data are adjusted for mergers.

Any questions or comments should be directed to Victoria Geyfman at (215) 574-6431 or victoria.geyfman@phil.frb.org. Detailed documentation on the methodology used in constructing this document, back issues, and the current issue of *Banking Brief* are available on our web site at www.phil.frb.org/econ/bb/index.html. To subscribe to this publication, please contact the Publications Desk at (215) 574-6428 or lois.newell@phil.frb.org.

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