BANKING BRIEF

FOR PENNSYLVANIA, NEW JERSEY, AND DELAWARE

Second Quarter 2003

Commercial banks in the nation and the tri-state region exhibited rapid growth in assets, deposits, and total loans during the second quarter of 2003. The total volume of loans generated by all banks increased over the quarter. Both large and community banks reported gains in real estate lending. The fastest growing contributor to the growth in assets was a rise in total securities. Compared with the first quarter of this year, the book value of total securities rose 9 percent at community banks and 27 percent at large banks in the nation.

Business loans rose at community banks. This stands in contrast to C&I lending at large banking organizations, which experienced a drop of 11.5 percent during the second quarter and almost 8 percent compared to last year. The Senior Loan Officer Opinion Survey for August reports that the demand for C&I loans remains low by historic standards and banks continue to tighten lending standards, but the trend in both of these measures may point to a future pickup in business borrowing patterns. The net fraction of banking institutions reporting tightening of lending standards fell from the high of about 60 percent at the beginning of 2001 to only 3 percent in August of this year. The percentage of large and medium-size banks reporting stronger demand for C&I loans increased from about -65 percent in late 2001 to about -20 percent in August.

Notwithstanding the modest economic growth, banks displayed impressive performances, reporting the average return on assets of 1.2 percent across all size categories. Two out of three major factors that drove earnings during the last quarter were directly influenced by the favorable interest rate environment: the continued rise in mortgage originations and gains from the sales of securities and loans. Another factor contributing to higher earnings is declining provisioning for loan losses as more banks resolve past credit-quality problems.

In its latest release, Mortgage Bankers of America estimated that as a result of the continued low interest rates, mortgage originations for 2003 will total $3.2 trillion, two-thirds of which are anticipated to be loans to refinance existing mortgages. The total dollar volume of mortgages for home purchases is also expected to rise, partly because of higher home prices and average mortgage amounts.

Despite the weak recovery, credit quality, as evidenced by the nonperforming loans ratio, improved over the last quarter among all banks in the nation and the tri-state area. The nonperforming loans ratio fell from 1.76 percent during the second quarter of 2002 to 1.43 percent this quarter at large banks in the nation, while the ratio at community banks fell from 1.12 percent to 1.06 over the same time period.

BETTER PROSPECTS ON ASSET QUALITY

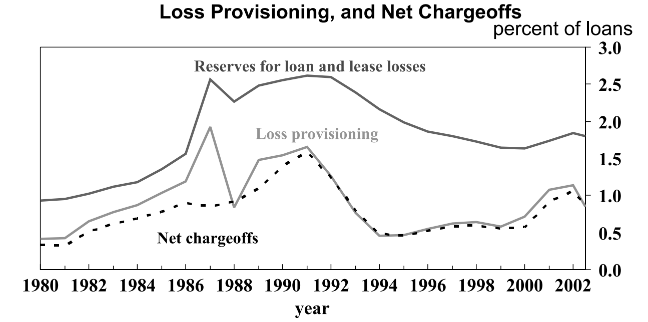
For the past few years, we have devoted the second-quarter *Banking Brief* to the issue of credit quality. In 2000 we reported that nonperforming loans were on the rise, particularly at large banks whose credit problems stemmed from their exposures to bad loans from the high-tech bubble of the late 1990s (later, exposures to the airline industry were added to the list of troubled loans). In 2001, the charge-off rates continued to rise as banks tried to unload their problem loans. But this quarter we observe an improvement in asset quality for commercial and industrial loans, which might be a sign that financial institutions are resolving past credit-quality problems.

The charge-off rate for commercial loans fell from its highest level of 2.11 percent during the fourth quarter of 2001 to 1.4 percent this quarter. The major influence on the overall charge-off rate is still derived from the top 100 banks whose rate, albeit higher than at smaller banks, fell from a peak of 2.36 percent during the third quarter of 2002 to 1.52 percent this quarter. The smaller banks' charge-off rate for commercial and industrial loans was 0.97 percent.

Second-quarter credit card charge-off rates rose from last quarter but remained lower than in the early part of 2002. Personal bankruptcy filings continued to rise, reaching an all-time high of 1.7 million for the 12-month period ending in June.

As mentioned earlier, the reduction in banks' loan-loss provisions improved industry earnings this quarter. Banks maintain loan-loss reserves that represent management's best estimate of the credit losses embedded in their loan portfolios. Banks make provisions, an expense category, for expected loan losses, and provisions fund the reserves against which losses are eventually charged. Loan-loss provisions and net charge-offs exhibit a largely contemporaneous relationship, as seen in the figure. After trending up since 1995, both ratios have fallen during this quarter. While reserves for loan and lease losses fell slightly this quarter, they have been on the rise since 2000.

Reserves for Loan and Lease Losses, Loss Provisioning, and Net Chargeoffs



Note: Data are quarterly
Source: Quarterly Reports of Condition and Income, FRB

Second Quarter 2003

Community Banking Organizations

	Tri-State			*Nation*		
	$Bill	**% change from**		**$Bill**	**% change from**	
	03Q2	**03Q1**	**02Q2**	**03Q2***	**03Q1**	**02Q2**
Total Assets	97.4	13.1	10.8	1403.2	10.4	10.4
Total Loans	57.6	10.4	7.6	889.4	12.0	9.0
Business	9.0	22.3	6.4	152.9	7.3	4.9
Real Estate	41.3	9.7	8.9	611.5	14.1	12.4
Consumer	5.0	-4.1	-2.7	75.7	0.1	-3.3
Total Deposits	73.7	10.0	9.4	1123.6	8.6	9.5

Ratios (in %)	**03Q2**	**03Q1**	**02Q2**	**03Q2**	**03Q1**	**02Q2**
Net Income/ Avg Assets (ROA)	1.2	1.2	1.2	1.2	1.2	1.1
Net Interest Inc/ Avg Assets (NIM)	3.5	3.6	3.6	3.8	3.9	3.9
Noninterest Inc/ Avg Assets	1.3	1.3	1.3	1.2	1.1	1.1
Noninterest Exp/ Avg Assets	3.1	3.1	3.2	3.1	3.1	3.1
Loans/Deposits	78.2	78.1	79.5	79.2	78.5	79.6
Equity/Assets	9.5	9.5	9.3	9.8	9.8	9.7
Nonperforming Loans/ Total Loans	0.9	0.9	1.0	1.1	1.1	1.1

Large Banking Organizations

	Tri-State			*Nation*		
	$Bill	**% change from**		**$Bill**	**% change from**	
	03Q2	**03Q1**	**02Q2**	**03Q2**	**03Q1**	**02Q2**
Total Assets	1020.2	20.7	12.7	5573.4	19.9	11.7
Total Loans	571.1	3.8	5.9	3064.1	8.6	8.0
Business	142.8	-20.7	-13.1	706.2	-11.5	-7.8
Real Estate	298.7	22.7	22.9	1510.4	21.5	19.1
Consumer	53.7	-2.6	2.2	409.8	0.7	6.9
Total Deposits	673.7	17.4	12.8	3553.7	14.8	12.0

Ratios (in %)	**03Q2**	**03Q1**	**02Q2**	**03Q2**	**03Q1**	**02Q2**
Net Income/ Avg Assets (ROA)	1.3	1.2	1.1	1.2	1.2	1.1
Net Interest Inc/ Avg Assets (NIM)	3.1	3.2	3.2	3.1	3.1	3.2
Noninterest Inc/ Avg Assets	2.4	2.4	2.4	2.3	2.3	2.2
Noninterest Exp/ Avg Assets	3.2	3.3	3.2	3.2	3.2	3.2
Loans/Deposits	84.8	87.4	90.4	86.2	87.4	89.4
Equity/Assets	9.1	9.1	9.3	8.3	8.3	8.7
Nonperforming Loans/ Total Loans	1.3	1.5	1.7	1.4	1.6	1.8

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, 2002. 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—205 for the tri-state area and 6066 for the nation; (2) large banking organizations—17 for the tri-state area and 99 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. Quarterly percentage changes are compound annualized rates.

* This quarter's sample excluded one bank that changed its charter from a thrift to a bank.

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.