BANKING BRIEF

FOR PENNSYLVANIA, NEW JERSEY, AND DELAWARE

First Quarter 2005

Reduced noninterest expenses and provisions for bad loans compensated for the lack of significant revenue growth at commercial banks during the first quarter of 2005. Net interest margins, particularly at large banks, have been under pressure for the past several quarters. Interest rate hikes pushed up banks' funding costs. However, banks succeeded in keeping their costs in check and generating enough loan growth to have a profitable quarter. The average return on assets (ROA) remained at 1.2 percent at the nation's community and large banks.

The continued improvement in asset quality allowed banks to reduce loan-loss provisions. Commercial banks set aside $5.5 billion for loan losses during the first quarter of 2005, the lowest quarterly total since the late 1990s. During the first quarter, the ratio of nonperforming loans was 0.6 percent at both large and community commercial banks in the nation, down from last year's 0.9 percent.

Business-Loan Credit Standards

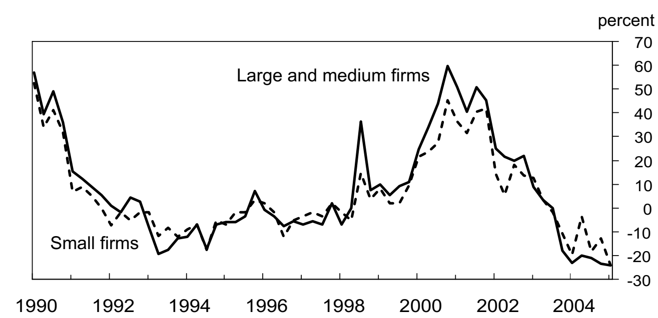
According to the April 2005 Senior Loan Officer Opinion Survey on Bank Lending Practices, bankers continued to ease lending standards and terms for commercial and industrial (C&I) loans over the first three months of 2005, in large part because of competition from other bank and nonbank lenders. Nearly a quarter of domestic respondents reported easing their standards for large and middle-market borrowers, about the same percentage that has prevailed in recent surveys (see Figure). On the demand side, the net percentage of U.S. banks reporting increased borrowing demand from large and medium-size businesses fell to 37 percent in the latest three months from 45 percent reported in January. The same net fraction of domestic respondents reported demand growth for small business loans. Banks that reported stronger business-loan demand most often cited financing needs for investment in plant and equipment, accounts receivable, and inventory financing.

The net fraction of U.S. and foreign banks that reported narrowing of the spread between their C&I loan rate and their cost of funds jumped to about 70 percent in the latest survey from 45 percent in the previous survey. The April figure is the highest since 1990, when the Fed began asking about loan spreads in the survey.

Collected from the loan officers at 54 domestic and 19 foreign banks, this quarter's survey also included responses to special questions from the Federal Reserve regarding longer term changes in C&I lending standards. The survey asked respondents to compare current lending standards and terms on C&I loans to those offered in 1996 and 1997, which were described as being "relatively accommodative" in terms of lending practices. According to the survey, lending standards and loan terms for C&I loans tightened considerably between 1998 and 2003 but generally eased throughout 2004 and early 2005.

Close to half of the respondents said the standards were very similar to those in the period before lending standards began tightening in 1998. Almost a third of large banks in the survey reported somewhat tighter lending standards on loans to large and middle-market firms compared to similar loans in the 1996-1997 period. Those banks whose lending standards were tighter cited improved measurement and risk-management techniques, followed in importance by concerns about corporate governance and the quality of financial reporting. Banks that reported easier current credit standards or loan terms relative to the 1996-1997 period cited increased competition from other banks and nonbank lenders.

Net Percentage of Domestic Banks That Tightened Credit Standards for C&I Loans, by Size of Firm Seeking Loan*



* Percentage of respondents reporting tightening credit standards on C&I loans minus percentage of respondents reporting easing credit standards on C&I loans.

Note: Large and medium firms are defined as having $50 million or more in sales

Source: Senior Loan Officer Opinion Survey on Bank Lending Practices

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First Quarter 2005

Community Banking Organizations

	Tri-State			*Nation*		
	$Bill	**% change from**		**$Bill**	**% change from**	
	05Q1	**04Q4**	**04Q1**	**05Q1**	**04Q4**	**04Q1**
Total Assets	85.6	3.5	6.7	1560.4	9.1	11.1
Total Loans	54.5	8.5	11.6	1026.6	10.4	14.6
Business	7.7	4.9	11.5	165.4	7.7	10.8
Real Estate	42.4	10.2	13.1	742.5	14.2	17.7
Consumer	2.7	-3.8	-2.8	68.6	-4.0	-0.9
Total Deposits	66.3	2.5	6.5	1235.5	10.1	10.3
Ratios (in %)	**05Q1**	**04Q4**	**04Q1**	**05Q1**	**04Q4**	**04Q1**
Net Income/ Avg Assets (ROA)	1.1	1.1	1.1	1.2	1.2	1.2
Net Interest Inc/ Avg Assets (NIM)	3.4	3.4	3.4	3.8	3.7	3.7
Noninterest Inc/ Avg Assets	1.1	1.1	1.2	1.0	1.0	1.1
Noninterest Exp/ Avg Assets	2.9	2.9	3.0	3.0	3.0	3.1
Loans/Deposits	82.1	81.0	78.3	83.1	83.0	80.0
Equity/Assets	9.8	9.8	9.6	9.7	9.7	9.9
Nonperforming Loans/ Total Loans	0.5	0.6	0.8	0.6	0.7	0.9

Large Banking Organizations

	Tri-State			*Nation*		
	$Bill	**% change from**		**$Bill**	**% change from**	
	05Q1*	**04Q4**	**04Q1**	**05Q1**	**04Q4**	**04Q1**
Total Assets	2121.5	18.6	13.4	6469.1	10.1	9.6
Total Loans	1103.3	11.5	8.1	3568.5	7.6	9.8
Business	223.1	10.3	5.9	741.3	18.9	9.0
Real Estate	654.0	24.4	14.8	1888.9	15.1	15.1
Consumer	92.2	-23.5	-5.9	499.5	0.4	9.0
Total Deposits	1408.8	4.6	9.9	4224.3	8.0	9.8
Ratios (in %)	**05Q1**	**04Q4**	**04Q1**	**05Q1**	**04Q4**	**04Q1**
Net Income/ Avg Assets (ROA)	1.4	1.4	1.4	1.2	1.2	1.3
Net Interest Inc/ Avg Assets (NIM)	2.7	2.8	3.0	2.7	2.7	2.9
Noninterest Inc/ Avg Assets	1.9	2.0	2.3	2.1	2.1	2.3
Noninterest Exp/ Avg Assets	2.7	2.8	3.1	2.9	3.0	3.1
Loans/Deposits	78.3	77.1	79.7	84.5	84.6	84.5
Equity/Assets	9.8	9.8	8.4	9.4	9.4	8.4
Nonperforming Loans/ Total Loans	0.4	0.6	0.4	0.6	0.8	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, 2004. 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—191 for the tri-state area and 5931 for the nation; (2) large banking organizations—19 for the tri-state area and 100 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.

*The reported levels are affected by the integration of FleetBoston's (Boston, MA) operations into Bank of America Corporation (Charlotte, NC).

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.philadelphiafed.org/econ/bb/index.html. To subscribe to this publication, please go to www.philadelphiafed.org/forms/orderform.htm and scroll down to Economic Research Publications.