Banking Brief
For Pennsylvania, New Jersey, and Delaware

First Quarter 2006

While there was a slight drop in bank profitability during the first quarter, return on assets (ROA) remained quite high by historical standards. In fact, ROAs were generally higher than in the same quarter of 2005, though not at large banks in the tri-state area. Net interest margins dropped slightly, except at small banks nationally, while overhead expense ratios were unchanged.

The ratio of nonperforming loans to total loans increased from last year among large banks nationally and at community banks both locally and nationally. At the community banks, this was primarily because of increases in nonperforming consumer loans. At the larger banks, nonperforming business loans contributed to the increase.

Real estate loans continued to grow strongly at community banks. Business loans also showed good growth. Consumer loans decreased, particularly at banks in the tri-state area. For large banking organizations, all three categories of loans showed strong growth. In particular, business loans were up sharply.

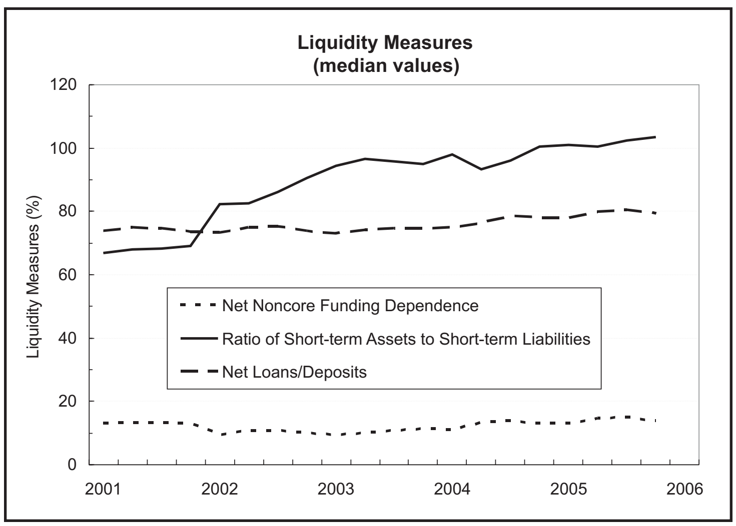
Measuring Bank Liquidity

One aspect of a bank's health that regulators always monitor is liquidity. Liquidity can be defined as the resources a bank has available to meet its current financial obligations, in essence, the funds it has on hand to pay its bills. Some obligations can be anticipated — for example, if a bond issue matures this quarter. Others may be unanticipated, such as a number of large depositors withdrawing their accounts. Banks always need to keep some of their assets in a liquid form (e.g., in cash or short-term securities) in case some contingency arises that requires ready money. In addition to meeting cash needs, maintaining adequate liquidity is also important to a bank's net interest income. Thus, how liquid a bank chooses to be can be affected by changes in the yield curve.[1] In managing their liquidity, banks must maintain a delicate balance between the ability to raise cash and the need for stable, longer-term sources of income.

Regulators use several ratios to measure a bank's liquidity.[2] The figure to the right shows two measures of a bank's ability to raise cash quickly with existing funds, and a third that measures how volatile this funding is. The ratio of net loans to total deposits measures how much of a bank's funding is available to invest in assets more liquid than loans. As the figure shows, this ratio has been fairly stable over time. The ratio of short-term assets to short-term liabilities measures how easily a bank can liquidate short-term assets to meet an unplanned contingency without impairing its ability to satisfy its short-term liabilities. As shown below, this ratio has increased substantially since 2001. While no reason can be cited with certainty, it is possible that the securitization of long-term assets and a yield curve that was flat until very recently were contributing factors.

Most types of deposits are not volatile — the account-holders aren't likely to move their funds in response to changes in economic conditions, such as changing interest rates. These are called *core* deposits, and they include nearly all deposits of less than $100,000. Other, *noncore* deposits, basically all deposits greater than $100,000 and brokered deposits, are considered much more volatile.

One measure of the volatility of a bank's funding in response to interest rates is called noncore funding dependence. This ratio is a measure of how sensitive a bank's earnings are to changes in interest rates. A negative number indicates that a bank's interest income will increase as interest rates increase. A positive number means the opposite. As shown below, this ratio has been fairly stable. It does vary greatly among individual banks, however.



[1] The yield curve represents the relationship between time to maturity and interest rate. Usually, shorter-term instruments have smaller yields than longer-term ones. When the spread between these shrinks, the yield curve is said to be flattening.

[2] For an exact description of the measures described here and plotted in the figure, contact the author.

First Quarter 2006

Community Banking Organizations

	Tri-State			*Nation*		
	$Bill	% change from		$Bill	% change from	
	06Q1	05Q4	05Q1	06Q1	05Q4	05Q1
Total Assets	95.5	4.47	6.30	1,662.3	7.48	9.55
Total Loans	63.3	10.95	10.53	1,120.8	9.80	12.40
Business	8.8	7.30	9.23	174.2	5.99	8.62
Real Estate	49.4	12.72	11.90	817.5	13.18	13.78
Consumer	3.2	-8.80	-3.47	69.5	-6.30	1.34
Total Deposits	74.2	4.36	6.96	1,327.3	8.77	10.26

Ratios (in %)	**06Q1**	**05Q4**	**05Q1**	**06Q1**	**05Q4**	**05Q1**
Net Income/ Avg Assets (ROA)	1.15	1.17	1.11	1.22	1.23	1.20
Net Interest Inc/ Avg Assets (NIM)	3.41	3.42	3.36	3.80	3.78	3.72
Noninterest Inc/ Avg Assets	1.18	1.17	1.15	0.96	0.97	1.02
Noninterest Exp/ Avg Assets	2.90	2.90	2.90	2.92	2.91	2.95
Loans/Deposits	85.31	84.01	82.56	84.44	84.24	82.84
Equity/Assets	10.25	10.25	9.89	9.79	9.79	9.71
Nonperforming Loans/ Total Loans	0.64	0.61	0.53	0.65	0.65	0.63

Large Banking Organizations

	Tri-State			*Nation*		
	$Bill	% change from		$Bill	% change from	
	06Q1	05Q4	05Q1	06Q1	05Q4	05Q1
Total Assets	2,251.3	10.59	5.82	7,048.3	14.74	8.14
Total Loans	1,240.8	17.22	12.29	3,971.9	11.37	10.40
Business	258.4	24.65	14.19	844.4	24.54	13.00
Real Estate	724.0	10.53	10.72	2,134.6	6.63	11.67
Consumer *	104.0	8.62	3.45	516.4	10.70	3.36
Total Deposits	1,485.3	6.74	5.56	4,609.3	9.45	8.29

Ratios (in %)	**06Q1**	**05Q4**	**05Q1**	**06Q1**	**05Q4**	**05Q1**
Net Income/ Avg Assets (ROA)	1.32	1.38	1.36	1.21	1.22	1.16
Net Interest Inc/ Avg Assets (NIM)	2.64	2.67	2.73	2.69	2.72	2.70
Noninterest Inc/ Avg Assets	1.93	1.93	1.91	2.21	2.20	2.07
Noninterest Exp/ Avg Assets	2.58	2.57	2.65	2.93	2.93	2.93
Loans/Deposits	83.54	81.61	78.53	86.17	85.80	84.52
Equity/Assets	9.90	9.90	9.90	9.34	9.34	9.48
Nonperforming Loans/ Total Loans	0.39	0.46	0.41	0.68	0.72	0.58

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, 2005. 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 — 189 for the tri-state area and 5865 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.
*Consumer loan figures among large tri-state area banks reflect Wachovia Corp.'s acquisition during the quarter of Westcorp, a major automobile lender. The growth rates for consumer loans reported in this table are *pro forma*, i.e., they include Westcorp's consumer loans in the previous quarter and year. The unadjusted growth rates were 77.4 percent for the quarter and 14.3 percent for the year.

Any questions or comments should be directed to Jim DiSalvo at (215) 574-3820 or jim.disalvo@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 website at www.philadelphiafed.org/econ/bb/index.html. To subscribe to this publication, please go to http://www.philadelphiafed.org/phil_mailing_list/dsp_user_login.cfm.