
Solid Performance at Tenth District Banks

By William R. Keeton and Anne D. McKibbin

Commercial banks in Tenth District states turned in another solid performance in the first half of 1996, showing only a few signs of weakness. Profitability improved from a level that was already high. Loan quality was strong and loans grew at a healthy pace. The only negatives were sluggish growth in deposits and declines in loan quality and loan growth from a year ago. Banks in district states once again outperformed banks in the rest of the nation in profitability and loan quality, while enjoying slightly faster loan growth.

Performance of district banks

Profits at district banks edged higher in the first half of 1996 after holding steady for two years (Chart 1). Profits are measured by return on assets (ROA), the ratio of after-tax profits to average assets. ROA at district banks rose nine basis points from the first half of 1995 to 1.33 percent. District banks continued to outperform banks in the rest of the nation by a small margin, as ROA in the United States edged up to 1.18 percent.

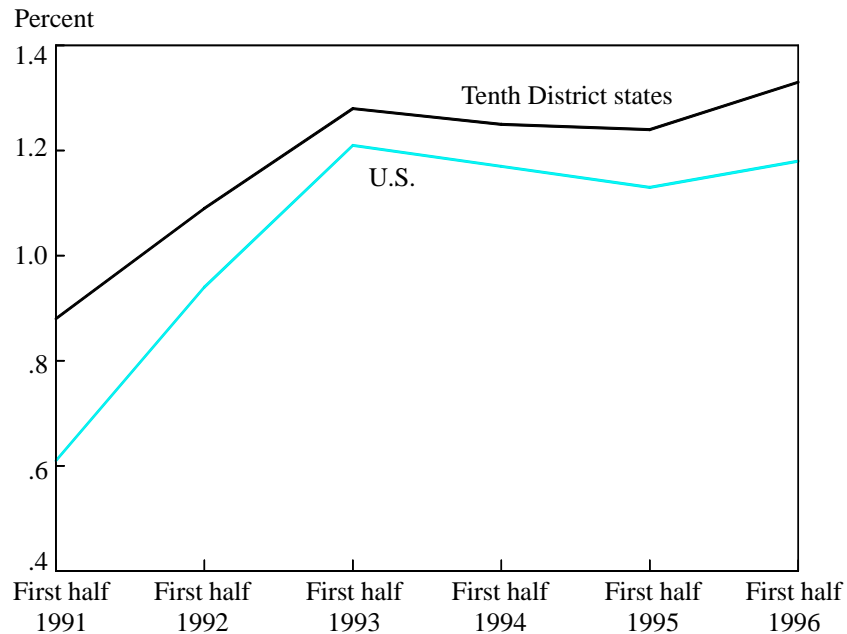
Profits increased because of improvements in net noninterest expense, net security gains, and extraordinary gains (Table 1). Net noninterest expense fell from 2.06 percent of assets to 1.83 percent, a 23-basis-point improvement, due partly to the reduction in FDIC insurance premiums in the second half of 1995. Net security gains rose four basis points, as higher bond prices enabled banks to sell their securities on more favorable terms than a year ago. Extraordinary gains also increased four basis points, but only because of a large one-time gain at one bank.

Profitability increased only modestly because these favorable changes were offset by a decline in net interest income and an increase in loan loss provisions. Interest income edged down and interest expense edged up, causing the ratio of net interest income to assets to fall seven basis points. Banks' loan loss provisions rose 11 basis points to 0.27 percent of assets, the highest level in four years. About half of the increase in loan loss provisions went to cover a six-basis point increase in loan chargeoffs, while the other half went into reserves against future chargeoffs.

Loan quality at district banks was slightly weaker than a year ago yet remained strong. Loan quality can be measured by noncurrent loans, which include loans at least 90 days overdue and not accruing interest. At the end of June, these noncurrent loans were 0.99 percent of total loans, 11 basis points higher than a year earlier. Delinquency rates jumped on credit card loans and farm operating loans, reflecting high debt burdens among some consumers, the aftereffects of the Southern Plains drought, and the depressed cattle industry. Delinquency rates edged down on real estate loans, however, and rose only modestly on business loans and consumer loans other than credit card loans. Even with the increase in overall delinquencies, the district delinquency rate remained slightly below the national delinquency rate of 1.12 percent.

District bank loans grew slower in the first half of 1996 than in the first half of 1995, but the pace of growth was still solid. Loans at district banks increased at an annual rate of 5.7 percent in the first half, half as fast as a year ago and a percentage point faster than in the nation. More moderate

Chart 1
Return on Assets
 Commercial Banks



economic growth contributed to the slowdown in loan growth. The recent increase in delinquencies also played a role, as banks tightened their credit standards somewhat and borrowers sought to limit their debt burdens.

District bank deposits rose a mere 0.3 percent in the first half of the year, a couple of percentage points slower than in the nation. The sluggish deposit growth helped boost the district loan-deposit ratio to 72.7 percent, half a percentage point higher than a year ago.

Performance by state

While Tenth District banks performed well on average during the first half of the year, performance varied across the seven district states. Compared with a year ago, profitability increased in Wyoming, Kansas, Missouri, Oklahoma, and Colorado. Profitability was flat in New Mexico and fell in Nebraska (Chart 2). Loan quality deteriorated in Kansas, Nebraska, Oklahoma, and Wyoming but was little changed in Colorado, Missouri, and New

Mexico (Table 1). Loan growth was moderate to strong in all states except Kansas and Nebraska, while deposit growth was sluggish in all states except Oklahoma and Wyoming.

Wyoming. Average profitability rose sharply in Wyoming due to an unusually large increase in earnings at a large interstate bank. From the first half of 1995 to the first half of 1996, ROA rose 54 basis points to 2.29 percent, the highest profit rate in the district. Excluding the bank with the large increase, however, ROA was up a more modest seven basis points, as a sizable drop in net non-interest expense more than compensated for a decline in net interest income and an increase in loan loss provisions.

Loan quality deteriorated somewhat, while loans and deposits grew at a healthy pace. Noncurrent loans rose from 0.48 percent of total loans in June 1995 to 0.74 percent in June 1996, as the slump in the cattle market sharply boosted delinquencies on farm operating loans and a slower economy raised delinquencies on business loans.

Table 1

Bank Performance Measures

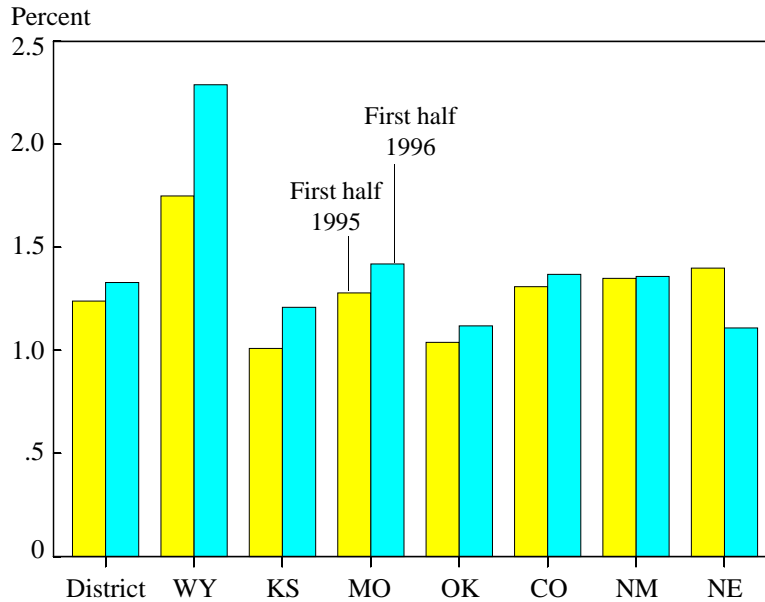
Tenth District states

	Tenth District states		Colorado		Kansas		Missouri	
	1995	1996	1995	1996	1995	1996	1995	1996
	Profits (ROA)	1.24	1.33	1.31	1.37	1.01	1.21	1.28
- Net interest income	4.21	4.14	4.70	4.70	4.03	4.06	3.89	3.82
- Loan loss provisions	.16	.27	.16	.29	.17	.31	.11	.20
- Net noninterest expense	2.06	1.83	2.44	2.26	2.12	1.82	1.74	1.50
+ Net securities gains	-.03	.01	-.04	.01	-.12	.00	.01	.01
+ Extraordinary gains	.00	.04	.00	.00	.00	.00	.00	.11
- Total taxes	.71	.76	.74	.79	.60	.73	.76	.82
Net chargeoffs	.14	.20	.17	.24	.12	.21	.09	.15
Noncurrent Loans	.88	.99	.55	.59	.95	1.18	.94	.92
Loan growth	11.7	5.7	13.0	9.7	8.7	2.3	13.7	7.1
Deposit growth	2.0	.3	-2.0	-.1	4.4	-1.3	-.1	-1.8
	Nebraska		New Mexico		Oklahoma		Wyoming	
	1995	1996	1995	1996	1995	1996	1995	1996
	Profits (ROA)	1.40	1.11	1.35	1.36	1.04	1.12	1.75
Net interest income	4.56	4.03	4.79	4.75	3.94	3.98	4.76	4.97
- Loan loss provisions	.33	.52	.17	.21	.13	.23	.08	.17
- Net noninterest expense	2.07	1.76	2.47	2.44	2.18	2.06	1.83	1.44
+ Net securities gains	.0	.00	-.02	.05	-.04	.00	-.15	.15
+ Extraordinary gains	.0	.00	.00	.00	.00	.00	.00	.00
- Total taxes	.77	.65	.78	.78	.54	.58	.94	1.23
Net chargeoffs	.27	.39	.21	.20	.12	.16	.04	.09
Noncurrent Loans	.77	1.09	1.09	1.01	1.15	1.44	.48	.74
Loan growth	6.4	1.6	3.9	5.9	10.5	4.1	29.9	5.0
Deposit growth	2.1	-4.4	2.2	2.1	3.4	5.5	26.4	13.3

Note: Data are for the first six months of the year. ROA may not equal the sum of the components due to roundoff error. ROA, components of ROA, and net chargeoffs are a percent of average assets. Noncurrent loans are a percent of total loans. Loan and deposit growth rates are annualized percent changes from December 31 of the prior year to June 30 and are adjusted for interstate migrations. Loans are net of unearned income and deposits are for domestic offices only.

Source: "The Consolidated Reports of Condition and Income" for all FDIC insured commercial banks in the seven states of the Tenth Federal Reserve District.

Chart 2
Return on Assets by State
 Commercial Banks



The overall delinquency rate remained one of the lowest in the district, but only because low delinquencies at a large interstate bank held down the average for the state. Loans grew a solid 5.0 percent during the first half of 1996, while deposits increased a strong 13.3 percent.

Kansas. Average profitability increased significantly in Kansas. ROA rose 20 basis points to 1.21 percent, bringing Kansas closer to the district average. Almost two-thirds of the increase was due to a jump in earnings at a large bank. At other banks, profits increased, but by a smaller amount, as a drop in noninterest expense outweighed an increase in loan loss provisions.

Loan quality worsened somewhat, and loans and deposits grew only sluggishly. Noncurrent loans rose 23 basis points to 1.18 percent of total loans, with delinquencies on farm operating loans showing an especially big increase. As in 1995, loan growth and deposit growth were distorted by the decision of several banks in the Kansas City area to move their headquarters across the state

line. After adjusting for interstate migrations, loans grew only 2.3 percent and deposits fell 1.3 percent, a considerably weaker performance than in the first half of 1995.

Missouri. Profits rose moderately at Missouri banks. ROA increased 14 basis points to 1.42 percent, the second highest profit rate in the district. A 24-basis-point drop in net noninterest expense offset a moderate decrease in net interest income and a moderate increase in loan loss provisions. An 11-basis-point extraordinary gain also contributed to the increase in ROA. The gain was entirely at one bank, however, artificially boosting the state's average profitability.

Loan quality was little changed, loan growth was healthy, and deposit growth was weak. Noncurrent loans were virtually unchanged at 0.92 percent of total loans. As in 1995, loan growth and deposit growth were distorted by the movement of bank headquarters across state lines in the Kansas City and St. Louis areas. After adjusting for interstate migrations, loans grew 7.1 percent, slower than a

year ago but still a healthy pace. Deposits fell 1.8 percent after remaining unchanged a year earlier.

Oklahoma. Profits increased modestly in Oklahoma. ROA rose eight basis points to 1.12 percent but remained well below the district average. Net noninterest expense fell 12 basis points, offsetting a 10-basis-point increase in loan loss provisions. Net interest income and net security gains also improved slightly, contributing to the increase in ROA.

Loan quality deteriorated somewhat, while loans and deposits grew moderately. Noncurrent loans rose 29 basis points to 1.44 percent, the highest delinquency rate in the district. A sharp increase in delinquencies on farm operating loans accounted for most of the deterioration, as the drought and the slump in cattle prices took their toll. Loans grew 4.3 percent, less than half as fast as a year ago. Deposits rose a healthy 5.5 percent, slightly faster than a year earlier.

Colorado. Banks in Colorado earned slightly higher profits in the first half of 1996. ROA rose six basis points to 1.37 percent, close to the district average. Net noninterest expense fell 18 basis points and net security gains increased five basis points. Loan loss provisions rose 13 basis points, limiting the increase in profits.

Loan quality remained high, while loans grew rapidly and deposits stagnated. Noncurrent loans were 0.59 percent of total loans, up only a few basis points from a year ago and well below the district average. Delinquencies were low on business, real estate, and consumer loans and moderate on farm operating loans. Loan growth slowed somewhat but was still strong at 9.7 percent. Deposits were flat after falling a year earlier.

New Mexico. Bank profitability was virtually unchanged in New Mexico, with ROA rising one basis point to 1.36 percent. Net noninterest expense edged down and net security gains increased, offsetting a small deterioration in net interest income and loan loss provisions.

Loan quality and loan growth improved slightly, while deposit growth remained slow. Noncurrent loans fell from 1.09 percent to 1.01

percent, as lower delinquencies on real estate loans more than made up for sharply higher delinquencies on farm operating loans. Loans grew a solid 5.9 percent, up a couple of percentage points from a year ago. Deposits increased only 2.1 percent, about the same as a year earlier.

Nebraska. Bank profits fell sharply in Nebraska. ROA dropped 29 basis points to 1.11 percent, well below the district average. The decline in profits was concentrated at two of the state's largest banks. At Nebraska's other banks, profits held steady, as a decline in net noninterest expense offset an increase in loan loss provisions.

Loan quality deteriorated moderately, and loan and deposit growth were both slow. Noncurrent loans rose 32 basis points to 1.09 percent, slightly above the district average. The jump in delinquencies was mainly on farm operating loans and credit card loans, both of which are more important in Nebraska than in the rest of the district. Loan growth slowed to only 1.6 percent, while deposits fell a sharp 4.4 percent.

Conclusion

Banks in Tenth District states continued to do well in the first half of 1996, notwithstanding a few signs of weakness. Profitability was high and up slightly from a year ago. The overall quality of bank loan portfolios was strong, and loans grew at a healthy pace. The only unfavorable news was that loan quality and loan growth were both lower than a year ago, and deposit growth was sluggish. On balance, district banks continued to outperform banks nationwide by a small margin, earning higher profits, holding fewer delinquent loans, and enjoying slightly faster loan growth.

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