Overview of the Industry

The 9,025 commercial banks and savings institutions insured by the FDIC reported total earnings of $91.8 billion for the first three quarters of 2004, an increase of $2.0 billion (2.3 percent) over the same period of 2003. The industry set new earnings records in two of the first three quarters of the year, as a strengthening economy and positive interest rate conditions boosted loan demand and helped reduce the level of troubled loans. Net interest income, (the difference between the interest that institutions earn on their loans and other investments and the interest they pay on deposits and other interest-bearing liabilities), registered strong growth, and lower provisions for loan losses also contributed to the improvement in earnings.

Insured commercial banks reported $78.1 billion in net income for the first three quarters of 2004, $2.0 billion (2.6 percent) more than they reported for the first three quarters of 2003. The improvement would have been greater, except that a few large mergers caused more than $3 billion in income to be excluded from year-to-date reported earnings for 2004. Almost two out of every three of the nation's 7,660 commercial banks (62.3 percent) reported higher earnings than a year earlier. Loan-loss provisions were $6.7 billion (25.2 percent) lower, while net interest income increased by $5.6 billion (3.2 percent). These were the two largest factors contributing to the improved earnings. In contrast, noninterest income was $2.6 billion (1.9 percent) lower than a year earlier, and gains on sales of securities and other assets were $1.8 billion (33.9 percent) smaller. The average return on assets (ROA) for the first three quarters of 2004 was 1.31 percent, compared to 1.39 percent for the same period of 2003.

An overall strengthening in loan demand was evident in 2004. Through the first three quarters of the year, total loans and leases grew by $386.2 billion (8.7 percent), while during the first three quarters of 2003, loans increased by $194.8 billion (4.7 percent). Accelerating growth in home equity and other consumer loans and a return to growth in loans to commercial and industrial (C&I) borrowers outweighed the effect of a slowdown in residential mortgage lending. Home equity loans increased by $90.6 billion (31.9 percent) in the first nine months of 2004, compared to an increase of $46.1 billion (21.4 percent) in the first nine months of 2003. Commercial and Industrial (C&I) loans increased by $19.5 billion in the first three quarters of 2004; in the first three quarters of 2003, C&I loans declined by $32.8 billion (3.6 percent). Reduced mortgage refinancing activity in 2004 was reflected in somewhat slower growth in mortgage assets. Banks' holdings of residential mortgage-related assets, including home mortgage loans and mortgage-backed securities, increased by $126.3 billion (7.1 percent) during the first three quarters of 2004, compared to an increase of $137.3 billion (8.3 percent) during the same period in 2003.

The strong growth in total loans was responsible for the increase in banks' net interest income, since the average net interest margin for the first three quarters of 2004 was 3.59 percent, well below the 3.83 percent average in the first three quarters of 2003. Asset-quality indicators, which began improving in 2003 following three years of deterioration, continued to improve in 2004. During the first nine months of the year, the amount of commercial banks' loans that were 90 days or more past due or in nonaccrual status declined by $9.0 billion (17.0 percent). The amount of loans that banks charged-off in the first three quarters of 2004 was $6.9 billion (24.6 percent) less than their charge-offs in the first three quarters of 2003.

Insured savings institutions reported slightly higher net income during the first three quarters compared to a year earlier, thanks to strong loan growth, but reduced gains on sales of securities and other assets limited the improvement. Net income increased by only $79 million (0.6 percent), as a $2.2 billion (7.0 percent) improvement in net interest income and a $3.2 billion (28.5 percent) increase in noninterest income were offset by a $3.5 billion (14.0 percent) rise in noninterest expenses and a $2.4 billion (43.8 percent) decline in gains on securities sales. The average ROA for the 1,365 insured savings institutions was 1.19 percent, down from 1.29 percent in the first three quarters of 2003. Fewer than half of all savings institutions (46.6 percent) had higher earnings than a year earlier. The average net interest margin for the first three quarters of 2004 was 3.20 percent, down from 3.29 percent for the first three quarters of 2003. Asset quality indicators registered modest improvement. Net charge-offs were $85 million (3.9 percent) lower than a year earlier, and loan-loss provisions were $179 million (8.4 percent) lower.