Overview of the Industry

The 8,856 FDIC-insured commercial banks and savings institutions filing financial reports for September 30 reported total net income of $102 billion for the first three quarters of 2005, an increase of $10.2 billion (11.1 percent) over the same period of 2004. The three highest quarterly earnings totals for the industry have all come in 2005, as strong loan demand, favorable asset quality, and improvements in market-related revenue have all supported growth in earnings. The improving trend has been broadly based; almost two out of every three insured institutions (64 percent) reported higher earnings for the first three quarters of 2005 than in the same period of 2004.

The average return on assets (ROA), a basic yardstick of earnings performance, was 1.31 percent, up from 1.29 percent in the same period of 2004. Merger accounting caused more than $3 billion to be excluded from 2004 earnings, so the year-over-year increase in earnings is somewhat overstated, but there was still substantial growth in profits. One important source of improvement was higher noninterest income, especially market-sensitive revenues such as trading income. Total noninterest revenue was $19.1 billion (12.8 percent) higher than in the first three quarters of 2004, as income from trading rose by $3.5 billion (46.3 percent). Transaction-based noninterest income registered strong growth, as service charges on deposit accounts increased by $1.4 billion (5.7 percent). Net interest income also helped boost earnings, rising by $20.3 billion (9.3 percent). Banks and thrifts were able to limit declines in their net interest margins despite a flattening yield curve, so that growth in interest-bearing assets was reflected in higher revenue.

There were few negatives contained in the first three quarters of the 2005 results. Unlike the previous two years, industry earnings received no benefit from lower credit expenses. Provisions for loan losses were $3 million higher than a year earlier (0.01 percent). Higher interest rates reduced the values of institutions' fixed-rate securities, and gains from sales of securities and other assets were $2.2 billion (33.5 percent) lower than in the first three quarters of 2004. Noninterest expenses were up by $20.5 billion (9.5 percent), but some of this increase reflected merger accounting in 2004, and the actual growth in overhead expenses was lower.

Residential real estate lending continued to support overall asset growth during the first three quarters of 2005. During the 12 months ended September 30, 2005, residential mortgage assets (1-4 family mortgage loans, home equity loans, mortgage-backed securities, and multifamily residential mortgage loans) increased by $426 billion (12.3 percent), accounting for 52 percent of total asset growth at insured institutions. Loans to commercial and industrial (C&I) borrowers was another area of strength; C&I loans increased by $99 billion (10.4 percent). Real estate construction and development loans grew by $98.5 billion (30.9 percent), and commercial real estate loans rose by $72 billion (9.9 percent).

Deposit growth remained strong, as rising short-term interest rates attracted more investment-oriented deposits into insured institutions. Total deposits increased by $585 billion (9.2 percent) in the 12 months ended September 30. Deposits in accounts of less than $100,000 grew by $185 billion (6.6 percent), while deposits in accounts of $100,000 or more increased by $318.5 billion (11.4 percent). Deposits in foreign offices rose by $82.9 billion (10.1 percent).

Capital growth kept pace with the growth in total assets during the first three quarters of 2005. The industry's equity capital ratio reached a 67-year high at mid-year, fueled in part by large increases in merger-related goodwill. At the same time, the industry's core capital (leverage) ratio, which excludes goodwill, reached its highest level in the 25 years that risk-based capital standards have been in effect. At the end of September 2005, more than 99 percent of all FDIC-insured institutions met or exceeded the highest standards for regulatory capital.