A REVIEW OF BANK PERFORMANCE IN THE FIFTH DISTRICT, 1984

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Fifth District banks generated strong profits during 1984. Though return on assets (ROA) and return on equity (ROE) were somewhat lower than in 1983, they were well above the average for the previous five years.

The rise of market interest rates in the first half of 1984 and their fall in the second half led to a net interest margin performance different in the Fifth District from that reported for all banks in the United States. For example, Fifth District banks were more successful than banks in the rest of the nation at controlling interest expense as a percentage of assets. At the same time, although District banks posted gains in interest income, banks reported even stronger results nationwide. The result in the Fifth District was a net interest margin lower than any reported in the last six years. In comparison, all U. S. banks reported a slight increase in net margin. Still, Fifth District margins remained well above those in the rest of the nation.

One of the most important factors affecting bank profitability in 1984 was the increase in provisions for loan losses, both in the Fifth District and for the whole United States. In addition, noninterest revenue and expense continued to play significant roles in offsetting changes in net interest margins. Although Fifth District banks could not match the performance of banks nationwide in increasing noninterest income, they have continued to be successful at reducing noninterest expense, a goal that has so far eluded banks at the national level.

Because of Fifth District banks' higher net interest margin, lower provision for loan losses, and declining noninterest expense, they were able to continue to outperform banks nationwide in both return on assets and return on equity. In an era of steadily declining profitability on the national level, banks in the Fifth District have been able to maintain high returns.

Interest Revenue

Gross interest ratio, defined as gross interest revenue divided by average assets, rose by 44 basis points during 1984 to 10.02 for banks in the Fifth Federal Reserve District (see Table I). This increase, in contrast with the decreases of the two previous years, reflects the generally higher market rates experienced over much of 1984 shown in Chart 1. With average market rates 1% to 1.5% above 1983 rates, 97% of Fifth District banks expanded their level of interest income compared with 1983 and 70% increased gross interest income as a percent of average assets. At the national level, the increase in the gross interest ratio was even greater (see Appendix).

This increase in gross interest revenue obscures some differences between the performance of various size categories of banks, as shown in Chart 2. For example, medium-sized banks, that is, those with total assets between $100 million and $750 million,

Chart 1

SELECTED INTEREST RATES
1982 – 1984

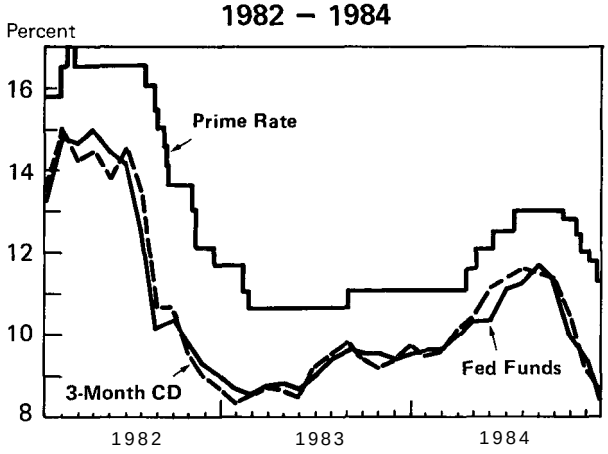


Table I

INCOME AND EXPENSE AS A PERCENT OF AVERAGE ASSETS FIFTH DISTRICT COMMERCIAL BANKS, 1979-1984

Item	1979	1980	1981	1982	1983	1984
Gross interest revenue	8.49	9.46	11.15	10.86	9.58	10.02
Gross interest expense	4.53	5.60	7.29	6.93	5.82	6.33
Net interest margin	3.96	3.86	3.86	3.93	3.76	3.69
Noninterest income	0.80	0.90	1.01	1.03	1.16	1.15
Loan loss provision	0.26	0.26	0.25	0.28	0.25	0.33
Securities gains or losses[2]						- 0.02
Noninterest expense	3.24	3.37	3.48	3.53	3.45	3.37
Income before tax	1.26	1.13	1.14	1.15	1.22	1.12
Taxes	0.28	0.20	0.19	0.18	0.22	0.19
Other[3]	- 0.04	- 0.04	- 0.09	-0.10	- 0.02	0.00
ROA[4]	0.94	0.89	0.86	0.87	0.98	0.93
Cash dividends declared	0.30	0.32	0.33	0.37	0.34	0.31
Net retained earnings	0.64	0.57	0.53	0.50	0.64	0.62
ROE[5]	13.51	12.79	12.56	13.12	15.21	14.62
Average assets ($ millions)	80,671	88,280	97,217	108,439	121,173	137,131

(Discrepancies due to rounding errors)

Source: Consolidated Reports of Condition and Income as submitted by insured banks to their primary regulators.

[1] Average assets are based on fully consolidated volumes outstanding at the beginning and at the end of the year.

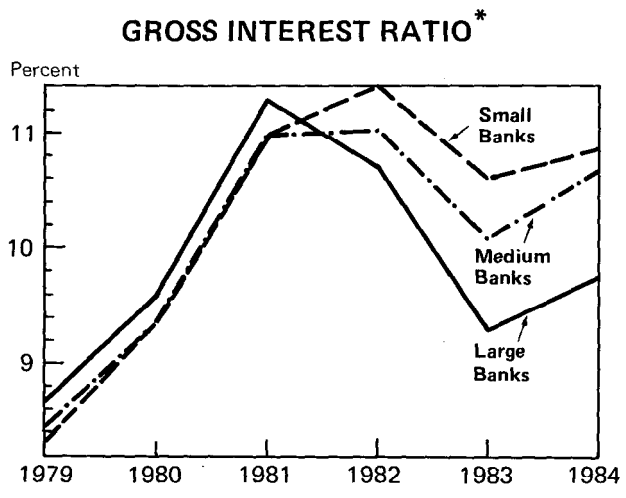
[2] Banks were required to report securities gains or losses above the tax line, on their income statements, for the first time in 1984.

[3] Includes securities and extraordinary gains or losses after taxes, for 1979-1983 data, and extraordinary items and other adjustments after taxes for 1984 data.

[4] ROA is net income divided by average assets.

[5] ROE is net income divided by average equity. Average equity is based on fully consolidated volumes outstanding at the beginning and at the end of the year.

Chart 2



*Interest revenue divided by average assets.

had a gross interest ratio increase of 59 basis points over 1983, while large banks (assets over $750 million) saw an increase of 46 basis points. In contrast, the smallest Fifth District banks (less than $100 million) experienced only a 26 basis point increase in gross interest revenue. As in previous years, this reflects the lower variability of the yields on loans in smaller banks' portfolios.

Table II shows that return on total loans for all Fifth District banks rose by 21 basis points. The insensitivity of small banks' loan portfolios to interest rate changes led to considerably slower growth in loan income than that achieved by the larger banks. Specifically, 31% of small Fifth District banks' loan portfolios consists of mortgage loans, which typically have fixed rates and long terms and are therefore comparatively insensitive to fluctuations

Table II

AVERAGE RATES OF RETURN ON SELECTED INTEREST-EARNING ASSETS
FIFTH DISTRICT COMMERCIAL BANKS, 1979-1984

item	1979	1980	1981	1982	1983	1984*
Total loans	11.25	12.50	14.48	14.14	12.38	12.59
Net loans	11.37	12.63	14.64	14.30	12.53	12.74
Total securities	6.43	7.15	8.57	9.27	9.20	9.68
U. S. Government	8.14	9.16	11.22	11.79	11.17	
State and local	5.17	5.56	6.11	6.68	6.74	
Other	2.88	3.25	4.20	5.82	5.96	
Total interest-earning assets	10.09	11.28	13.18	12.68	11.11	11.77

* Total and net loans here include leases while in other columns they do not.

in market rates. In comparison, mortgages averaged 21% of medium banks' and 13% of large banks' loan portfolios. At the same time, large banks held 30% of their gross loan portfolios in commercial and industrial (C&I) loans, while medium banks held 26% and small banks held 20%. C&I loans tend to be interest-sensitive because they often have short terms or carry variable interest rates.

It is important to look closely at loan growth patterns since, as is made clear by Table III, the prominence of loans relative to other assets in District banks' portfolios increased during 1984. Total loan growth (Table IV) picked up during the last quarter of 1984, and was spread evenly among most categories of loans. An exception to the pattern was agricultural loans, which grew as a percent of total loans during the first half of the year but declined in the second half. The result was that, as total loans grew by slightly more than 20% between the end of 1983 and the end of 1984, farm loans fell from

Table III

ASSET CATEGORIES AS A PERCENT OF TOTAL ASSETS
FIFTH DISTRICT COMMERCIAL BANKS, 1982-1984

Asset Category	1982	1983	1984
Securities	23.43	25.86	24.45
Loans and leases - Total	50.10	51.07	54.41
Home mortgages	10.22	9.55	9.56
Commercial real estate and development loans	6.78	7.20	8.49
Commercial and industrial loans	15.03	15.50	16.54
Consumer loans	14.34	14.60	15.88
Other loans	3.94	4.10	3.61
Leases	0.58	0.58	0.74
Agricultural loans	0.89	0.93	0.81
Less: Unearned income on loans	- 1.68	- 1.38	- 1.22
Less: Allowance for loan loss	- 0.59	- 0.61	- 0.71
Cash and due from balances	14.80	13.79	11.92
Fed funds	6.21	4.05	4.40
Other assets	6.04	5.84	5.52
Total	100.00	100.00	100.00

(Discrepancies due to rounding errors)

Table IV

QUARTERLY GROWTH RATES IN SELECTED LOAN CATEGORIES
FIFTH DISTRICT COMMERCIAL BANKS, 1984

Loan Category	Q1	Q2	Q3	Q4
Home mortgages	1.99	3.64	3.60	3.78
Commercial real estate and development loans	7.63	7.40	5.96	9.43
Commercial and industrial loans	6.94	5.09	1.64	6.06
Consumer loans	2.62	6.65	5.36	7.15
Other loans	- 11.22	1.36	4.34	6.62
Leases	3.94	5.24	8.51	22.01
Agricultural loans	8.56	8.46	- 7.79	- 8.42
Total loans	3.51	5.41	3.72	6.44

1.84% to 1.49% of this total. Within the agricultural loan category, loans secured by farmland, which had remained fairly steady as a percent of total loans during 1983, fell throughout 1984. Other agricultural loans, which rose during the first half of 1984 and fell during the second half, were lower in each quarter than in the corresponding period in 1983.

Table II shows that gross returns on securities, the ratio of securities income to average securities outstanding, increased from 9.20% in 1983 to 9.68% in 1984. This increase, however, was due almost entirely to large banks' strong performance, since banks with less than $750 million in total assets showed little or no improvement in return on their securities.

Interest Expense

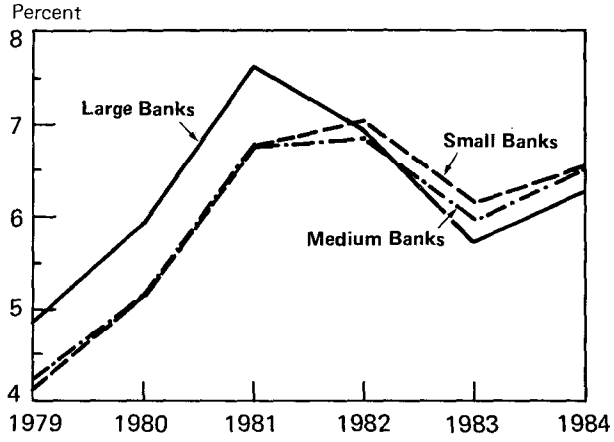
Just as the higher market rates prevalent during 1984 pushed up interest revenue, so did they push up interest expense. As a percent of average assets, interest expense in Fifth District banks increased 51 basis points from 5.82% in 1983 to 6.33% in 1984 (Table I).

Chart 3 reveals that the effect of higher market rates on interest expense varied with bank size. Fifth District banks with more than $100 million in assets had an average increase of 54 basis points in their interest expense ratio. For smaller banks, however, the increase was a more modest 37 basis points.

The average cost of interest-bearing liabilities in Fifth District banks rose 60 basis points during 1984, as reported in Table V. Contributions to this increase varied among the different categories of liabilities. The average cost of such liabilities as large time deposits, deposits in foreign offices, and Fed funds grew much more rapidly than this average figure. At the end of 1984, these relatively interest-sensitive liabilities accounted for 24% of total liabilities. Such liabilities as small time deposits (those in denominations less than $100,000), passbook savings accounts, individual retirement accounts, Super NOW accounts, NOW accounts, and money market deposit accounts (MMDA), all of which are included in the Other Deposits category in Table V, produced a much smaller increase in interest expenses because of the relatively less interest-sensitive nature of these accounts. Because the deposits included in the Other Deposits category together make up about 52% of all liabilities in Fifth District banks, they helped to offset the higher funds costs arising from the more interest-sensitive liabilities.

Chart 3

INTEREST EXPENSE RATIO*



*Interest expense divided by average assets.

Table V

AVERAGE COST OF FUNDS FOR SELECTED LIABILITIES FIFTH DISTRICT COMMERCIAL BANKS, 1979-1984

Item	1979	1980	1981	1982	1983	1984
Interest bearing deposit accounts	**7.15**	**8.68**	**10.63**	**9.91**	**8.19**	**8.72**
Large time deposits	**9.96**	**11.33**	**14.35**	**12.05**	**7.62**	**9.47**
Deposits in foreign offices	**10.28**	**13.17**	**15.18**	**12.79**	**7.73**	**9.19**
Other deposits	**6.16**	**7.54**	**9.23**	**9.12**	**8.34**	**8.55**
Subordinated notes and debentures	**8.19**	**8.20**	**8.11**	**8.34**	**8.32**	**8.03**
Fed funds	**11.94**	**13.34**	**15.54**	**11.21**	**8.52**	**9.58**
Other	**6.98**	**8.65**	**13.49**	**11.29**	**8.75**	**9.18**
Total	7.60	**9.13**	**11.23**	**10.10**	**8.24**	**8.84**

Fifth District institutions were considerably less reliant on funds with volatile yields than were banks nationwide. The relatively interest-sensitive categories of deposits provided 32% of total liabilities for all U.S. banks, while the Other Deposits category amounted to 41%. This helps explain the greater increase in interest expense for U.S. banks during 1984 compared with banks in the Fifth District.

Demand deposits continued to decline as a percentage of total deposits in Fifth District banks. In 1983, these non-interest-bearing checking accounts represented 25.5% of total domestic deposits. By the end of 1984 this ratio had fallen to 24.8%, although it should be noted that this decline was smaller than that which had taken place from 1982 to 1983. As the significance of demand deposits in the liability structures of banks declines, interest expense as a percent of liabilities or assets increases due to the rise in the importance of interest-paying liabilities. Because holders of demand deposits are compensated implicitly through services provided by their banks, increases in interest expense should be offset somewhat by diminutions in noninterest expense. Since the reduction of the importance of demand deposits in the Fifth District was small relative to total liabilities, it is unlikely that much of this shift from noninterest expense to interest expense took place during 1984.

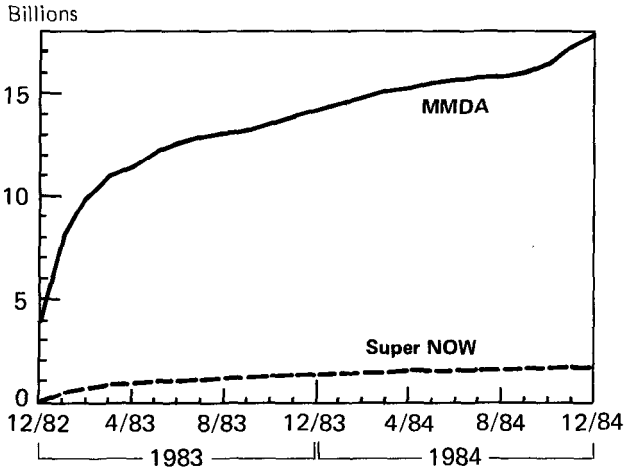
In 1984, Fifth District banks did not experience the same rapid growth in MMDAs and Super NOW accounts that occurred in 1983.[1] As seen in Chart 4, MMDA growth was steady throughout the year, expanding by $3.7 billion during the year, from an initial figure of $14.1 billion to an end-of-year $17.8 billion. During this same period, Super NOWs grew by about $400 million. By the end of 1984, MMDAs and Super NOWs together made up 14.5% of total liabilities, while at the end of 1983 they accounted for 13%. On the one hand, if consumers replaced maturing certificates of deposit with MMDAs or Super NOWS, this liability structure shift may have lowered Fifth District banks' total interest cost. On the other hand, if depositors simply replaced regular demand deposits and savings deposits with Super NOWs and MMDAs, banks may have experienced interest expense increases as the latter accounts grew in importance.[2]

[1] See F. Ward McCarthy, Jr. (1984), pp. 24-S.

[2] Michael C. Keeley and Gary C. Zimmerman (1985) provide evidence regarding sources of funds for MMDAs.

Chart 4

MMDA AND SUPER NOW GROWTH



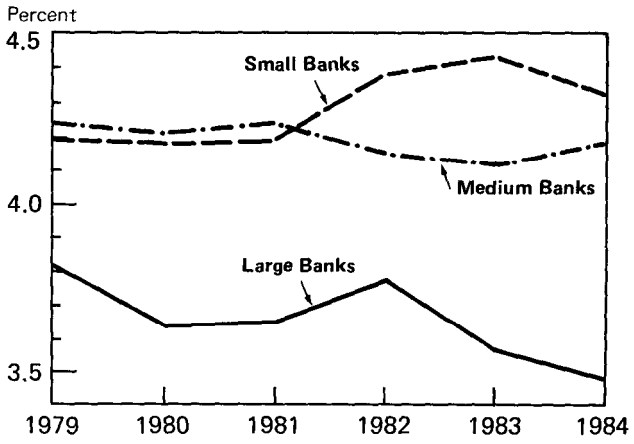
Net Interest Margin

Since interest expense in the Fifth District rose more quickly relative to average assets than did interest income in 1984, net interest margin declined from 3.76% to 3.69%. This seven basis point decline contrasts with the one basis point increase enjoyed by banks on the national level, and is also difficult to explain given that the spread between the prime rate and the 90-day certificate of deposit rate increased through most of the second half of 1984. However, the negative net interest margin growth in the Fifth District conceals the differences between banks in the three size categories (see Chart 5). Although net margin decreased eleven basis points for small banks and eight for large banks, it actually increased by six basis points for medium-sized banks.

Table VI breaks down various aspects of net interest margin performance for all Fifth District banks and for the three size classes. Looking at per-

Chart 5

NET INTEREST MARGIN*



*Net interest income divided by average assets.

Table VI

CHANGES IN NET INTEREST MARGINS IN RELATION TO INTEREST INCOME AND INTEREST EXPENSE GROWTH RATES AND BALANCE SHEET COMPOSITION FIFTH DISTRICT COMMERCIAL BANKS, 1984

Total Assets ($ millions)	Number of Banks	A Interest Income Growth	B Interest Expense Growth	C Percent of Rate-Sensitive Liabilities[1]	D Percent of Rate-Sensitive Assets[2]	E Percent Change in Net Margin
Less than 100						
Increased margin	155	17.07	15.80	54.29	41.55	7.97
Others	307	14.12	20.98	54.90	41.95	−7.55
Total	462	15.03	19.27	54.71	41.82	−3.20
100 to 750						
Increased margin	37	21.65	20.36	58.17	50.71	10.96
Others	63	17.36	24.14	54.58	44.19	−6.13
Total	100	19.11	22.50	56.07	46.88	0.25
750 and over						
Increased margin	15	23.65	23.47	57.32	54.36	9.51
Others	18	14.52	21.98	57.21	51.95	−8.92
Total	33	18.71	22.70	57.26	53.09	−1.29
All banks						
Increased margin	207	22.72	22.33	57.17	52.79	9.48
Others	388	14.89	22.13	56.47	49.26	−8.21
Total	595	18.26	22.22	56.79	50.83	−1.35

[1]Rote-sensitive liabilities include Super NOW accounts, and money market deposit accounts. In addition, the following ore included provided they have immediately adjustable interest rates or maturities of one year or less: time deposits. deposits in foreign offices, and nondeposit interest-bearing liabilities.

[2]Rate-sensitive assets include those loons and leases, debt securities, and other interest bearing assets with immediately adjustable interest rates or with maturities of one year or less.

formance for the aggregate of all banks, it appears that the major differentiating factor between banks experiencing higher and those experiencing lower net margins is ability to generate higher interest income growth. In 1983, the situation was just the opposite, there being little difference between interest income performance while ability to reduce interest expense was crucial to higher margins. Further, in 1983 this was true for all three size classes.[3] A closer look at the 1984 numbers shows, however, that there are more differences between banks than is apparent from the aggregate figures for all banks. Among small and medium banks, for example, interest income and interest expense growth were of roughly equal significance in determining changes in net margins. For large banks, however, interest income growth was a far more important determinant of margins than was interest expense growth.

It is more difficult to draw any strong conclusions from differences between banks with regard to the sensitivity of banks' assets and liabilities to changes in interest rates. During a period of rising market rates, holding relatively interest-sensitive assets and interest-insensitive liabilities should cause margins to rise. Alternatively stated, if the duration of assets is less than that of liabilities, assets will be repriced (at higher rates) more frequently than liabilities.[4] Looking at the aggregate of banks, it appears that interest-sensitive assets could have been helpful to those banks having higher net margins. Once the figures are broken into size classes, however, relative sensitivities become less informative. More definite statements could be made on this subject if durations of bank balance sheets were computed, but that is beyond the scope of this paper.

As noted above, Fifth District banks with between $100 million and $750 million in total assets at the end of 1984 produced a six basis point rise in their net interest margin overall. However, only 37% of these banks had an increased net margin ratio, the others experiencing a decline. Medium-sized banks with improved net margins were, in fact, larger in terms of total assets than the average for their category. As a group, small banks experienced the largest decline in net margins. Only 33% of these banks were able to improve their net margins compared to last year.

Noninterest Revenue and Expense

Noninterest income in Fifth District banks was 12% higher during 1984 than in 1983. Asset growth exceeded noninterest income growth, however, so noninterest income relative to assets fell by one basis point (Table I). Service charge income, which made up about 34% of noninterest income, increased relative to average assets over 1983, as did leasing income (Table VII). These increases were offset by declines in Other Noninterest Income, which includes such items as income from fiduciary activities, credit card fees, and safe deposit box rentals. In contrast, noninterest income at the national level rose significantly in 1984, the major contributing factor being an increase in Other Noninterest Income.

Fifth District banks' flat noninterest income performance was more than offset by an eight basis point decrease in noninterest expense as a percent of assets, compared to a ten basis point increase at the national level. Decreases in both salaries expense and bank premises costs contributed to this fall. The decline in the Fifth District was largely the result

Table VII

NONINTEREST INCOME AS A PERCENT OF AVERAGE ASSETS FIFTH DISTRICT COMMERCIAL BANKS 1983 AND 1984

Item	1983	1984
Total noninterest income	**1.16**	**1.15**
Service charge income	0.37	0.39
Leasing income	0.07	0.08
Other noninterest income	0.72	0.69
Total noninterest expense	3.45	3.37
Salaries	1.78	1.74
Bank premises	0.60	0.56
Other	**1.07**	**1.07**
Noninterest margin	2.29	- 2.22

(Discrepancies due to rounding errors)

[3] McCarthy (1984), pp. 26-7.

[4] Duration may be defined as the weighted average life of a security or as the sensitivity of the value of a security to interest rate changes. See George G. Kaufman (1984).

of a twelve basis point average decline at large banks, medium banks experiencing only a three basis point decline and small banks a two point rise. At the national level, noninterest expense was pushed up by both salaries and Other Noninterest Expense, which includes such costs as legal fees, federal agency assessments, travel expenses, and telephone bills.

Loan loss provisions in Fifth District banks grew more in 1984 than in any of the past four years. In fact, relative to average assets, this expense item was approximately one-third greater in 1984 than in the previous year. Although this is a significant increase by Fifth District standards, some perspective may be gained by comparing the Fifth District results in Table 1 with the national loan loss provisions shown in the Appendix. Through 1981, loan loss provisions for the Fifth District banks were similar to those for all U. S. banks. In 1952, however, loan loss provisions relative to assets grew 50% over the previous year for all U.S. banks, while they went up by only 12% in the Fifth District. Similarly, 1983 national loan loss provisions grew by over 20%, while in the Fifth District they actually declined. Thus, although the 32% Fifth District increase in 1954 loan loss provisions represents a greater change than does the national change of 17%, it should be borne in mind that Fifth District loan loss provisions as a percentage of assets remain significantly lower than those for the aggregate of all banks in the nation.

Within the Fifth District, most of the increase in provision for loan loss took place during the fourth quarter. Banks with more than $750 million in assets were principally responsible for the larger than normal increase, since these banks as a group increased provisions by ten basis points relative to assets. This increase was to a great extent made necessary by rapid loan growth. At the same time, small and medium-sized banks increased their provisions an average of only two basis points.

Loan and lease chargeoffs net of recoveries were .29% of total loans and leases in Fifth District banks in 1984, essentially unchanged from the previous year. In comparison, the 1984 figure for all U.S. banks was .71%. Past due, nonaccrual, and renegotiated loans and leases amounted to 3.32% of total loans in Fifth District banks in 1984, while they averaged 5.07% for all U.S. banks. The most significant illustration of Fifth District banks' continuing pattern of conservative writeclown policies may be seen in the ratio of current year recoveries to previous year chargeoffs, which gives an indication of how aggressively loans are being charged off. This ratio was 30.5% for Fifth District banks in 1984, while the same ratio for all U.S. banks was 20.3%.[5] Since this ratio generally increases as banks both enforce vigorous collection procedures and take less time to write off doubtful loans, there is no evidence that Fifth District banks have abandoned their tradition of conservative chargeoff policies.

Profits and Dividends

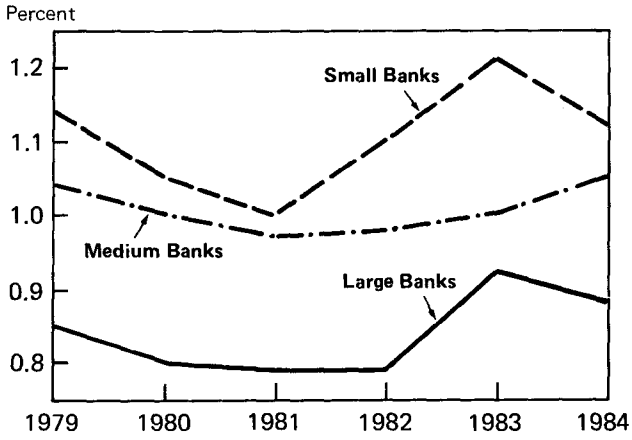
Profits before taxes relative to average assets fell by ten basis points from 1983 levels at banks in the Fifth District. Small and large banks had fifteen and eleven basis point declines, respectively, while medium-sized banks realized a nine basis point increase. Had Fifth District banks not increased provisions for loan losses, income before taxes relative to average assets would have been only two basis points below its 1983 level. Taxes as a percent of average assets fell by five basis points at both large and small banks but increased by four basis points at medium-sized banks.

Return on assets (ROA), defined as net income divided by average assets, declined for the aggregate of Fifth District banks from .98% in 1983 to .93% in 1954. As Chart 6 shows, however, these figures mask interesting variations among banks of different sizes. For example, large banks produced an average decline in ROA of four basis points to .88%. Although these institutions experienced declining net margins and noninterest income along with a significant increase in provisions for loan losses, they enjoyed lower noninterest expenses, losses on securities, and taxes. Medium-sized banks, where the 1.05% ROA represented a rise of five basis points over 1983, had higher net interest margin, greater noninterest income, and lower noninterest expense than in 1983. However, some of these gains were offset by a slight increase in provision for loan losses, an increase in securities losses, and higher taxes. Small banks' ROA fell on average by nine basis points to 1.12%. This decline was the result of a

[5] For a more detailed breakdown of this ratio on the national level, see Federal Deposit Insurance Corporation (1985), p. 13.

Chart 6

RETURN ON ASSETS*



*Net income divided by average assets.

substantial decrease in net interest margin with other factors cancelling one another. In comparison, for all U.S. banks, the average ROA fell from .67% in 1983 to .64% in 1984.

Return on average equity (ROE) decreased by 59 basis points to 14.62% for all Fifth District banks. Despite this decline, ROE in 1984 was still high compared with the preceding five years. As shown in Table VIII, aggregate leverage (average assets divided by average equity) increased thirteen basis points over last year, but this was not sufficient to counteract the effect of lower return on assets. Again, the aggregate numbers conceal some variation, since medium-sized banks' ROE increased by 74 basis points (see Chart 7). For all U.S. banks, the average ROE fell from 11.24% in 1983 to 10.63% in 1984.

Dividends paid out by Fifth District banks to stockholders declined from .34 cents per dollar of average assets in 1983 to .31 cents in 1984. Small banks paid out 31% of net income as dividends, which was the lowest payout for the three size categories. Medium banks distributed 39% as dividends, while large banks paid out 33%. The average dividend to net income ratio for all banks in the United States was 49% in 1984, compared to only 34% for Fifth District banks.

Capital Adequacy

Capital[6] was augmented at Fifth District banks in 1984. According to the data in Table IX, banks in the Fifth District increased primary capital from 7.24% of adjusted assets in 1983 to 7.28% in 1984,

[6] The measure of capital used here is not precisely the same as that used by any of the regulatory agencies. In this article, primary capital includes common stock, perpetual preferred stock, surplus, undivided profits, capital reserves, mandatory convertible instruments up to a certain percentage of primary capital, reserves for loan and lease losses, and minority interest in consolidated subsidiaries. Secondary capital (total capital less primary capital) includes limited life preferred stock, subordinated notes and debentures, and those mandatory convertible instruments not eligible for primary capital. In addition, the measure used here subtracts intangible assets from average assets plus loan loss reserves (to yield adjusted assets), and from capital. For a detailed explanation of capital adequacy standards, see R. Alton Gilbert et al. (1985).

Table VIII

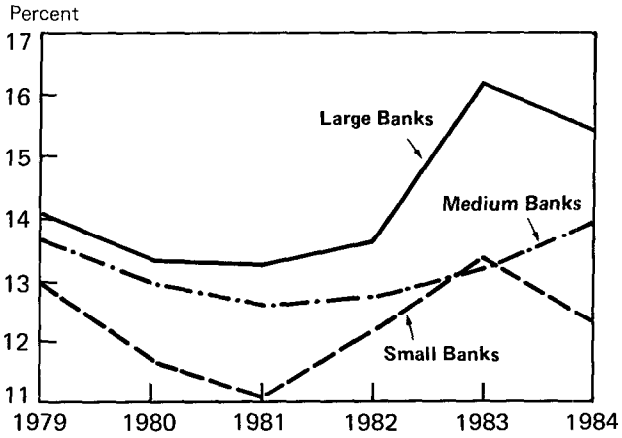
RATES OF RETURN AND LEVERAGE FOR FIFTH DISTRICT COMMERCIAL BANKS

Year	Return on Assets		Assets/ Equity		Return on Equity
1979	0.94	X	14.37	=	13.51
1980	0.89	X	14.35	=	12.79
1981	0.86	X	14.56	=	12.56
1982	0.87	X	15.06	=	13.12
1983	0.98	X	15.53	=	15.21
1984	0.93	X	15.66	=	14.62

(Discrepancies in calculations are due to rounding errors.)

Chart 7

RETURN ON EQUITY*



*Net income divided by average equity.

Table IX

CAPITAL ADEQUACY
FIFTH DISTRICT AND ALL U. S. COMMERCIAL BANKS

	Small Banks	Medium Banks	Large Banks	Total
1983				
Fifth District				
Primary ratio	11.65	8.00	6.35	7.24
Total ratio	11.70	8.15	6.61	7.46
All U. S. banks				
Primary ratio	9.48	7.80	5.69	6.73
Total ratio	9.78	8.10	6.04	7.02
1984				
Fifth District				
Primary ratio	9.60	8.35	6.64	7.28
Total ratio	9.63	8.41	6.92	7.49
All U. S. banks				
Primary ratio	9.24	7.94	6.35	7.11
Total ratio	9.31	8.15	6.66	7.36

and total capital from 7.46% to 7.49%. Primary and total capital ratios were higher for Fifth District banks than for all U.S. hanks both in 1983 and 1984, although the capitalization ratios increased by a somewhat greater percentage nationally than was the case in the Fifth District.

The only size category of banks that experienced declining ratios was that of small banks, and this was true nationally as well as for the District. This should not be a cause for concern, however, since capitalization of small banks as a group was well above the threshold of regulatory concern[7] in both years. Large Fifth District banks increased their primary ratio by 29 basis points while the average for all large banks in the country grew by 66 points. Even with the greater increase at all large U. S. banks, however, large Fifth District commercial banks remained, on average, more extensively capitalized at the end of 1984 than did their peers throughout the country. Finally, medium-sized banks in the Fifth District increased their capital ratios at about the same rate as did large District banks, while all U. S. banks in the middle category reported minor increases. The inference to be drawn from all this is that Fifth District banks are as a group well capitalized by national standards, although it should be borne in mind that such averages as are presented here conceal a great deal of variation among individual banks, especially in the smallest size category.

It is of interest to examine more closely how growth in capitalization was brought about. Increasing equity capital is one means of augmenting capital ratios, and in 1984 Fifth District banks increased equity capital by 13.4%. Retained earnings, the difference between net income and cash dividends, provided 77% of this increase. Table VIII shows, however, that leverage increased in the Fifth District in 1984, which in turn implies that asset growth continued to outpace equity growth. Thus, higher capital to assets ratios were not attributable to increases in equity capital. Rather, higher allowance for loan losses was apparently the most significant factor contributing to the rise for District banks. For all U. S. banks, the most important factors were increases in subordinated notes and mandatory convertible debt.

Concluding Comments

Fifth District banks' 1984 performance, relative to the average for all U. S. banks, was outstanding. Fifth District banks had a much higher ROA and ROE than the national average. Their loan charge-offs and nonperforming loans relative to total loans were a fraction of the national average. Finally, Fifth District banks had capital ratios which demonstrated stronger capital positions than their peers nationwide. These strong capital ratios not only show the results of the District's traditionally conservative approach to banking, but also place District banks in a good position for continued growth in 1985.

Still, District banks should note that their higher performance levels conceal some significant differences between them and other banks in the nation. First, interest revenue in the Fifth District was below the national level. Second, noninterest income performance was far better at the national level than in the District. Finally, although net interest margins in the Fifth District remained higher than those for the nation, they have been declining steadily in the District while staying fairly steady nationwide. In the coming years, it will be important for banks in the Fifth District to pay attention to these areas, while continuing to make the **most** of their considerable strengths.

[7] The FDIC and Comptroller have established 6 percent as the minimum total capital ratio, while the Fed generally considers under 6 percent to be undercapitalized, 6 percent to 7 percent acceptably capitalized, and over 7 percent to be adequately capitalized. For a description of the Federal Reserve standards, see 50 Fed. Reg. 16057.

APPENDIX

INCOME AND EXPENSE AS A PERCENT OF AVERAGE ASSETS[1] ALL U. S. COMMERCIAL BANKS, 1979-1984

Item	1979	1980	1981	1982	1983	1984
Gross interest revenue	8.62	9.87	11.81	11.19	9.50	10.11
Gross interest expense	5.50	6.78	8.75	8.02	6.36	6.95
Net interest margin	3.12	3.09	3.07	3.17	3.15	3.16
Noninterest income	0.78	0.89	0.99	1.05	1.12	1.27
Loan loss provision	0.24	0.25	0.26	0.39	0.47	0.55
Securities gains or losses[2]						- 0.01
Noninterest expense	2.54	2.63	2.76	2.91	2.95	3.05
Income before tax	1.12	1.10	1.04	0.91	0.84	0.82
Taxes	0.28	0.28	0.24	0.17	0.18	0.19
Other[3]	- 0.04	- 0.03	- 0.04	- 0.03	0.00	0.01
ROA[4]	0.80	0.79	0.76	0.71	0.67	0.64
Cash dividends declared	0.28	0.29	0.30	0.31	0.33	0.31
Net retained earnings	0.52	0.50	0.46	0.40	0.34	0.33
ROE[5]	13.90	13.70	13.20	12.20	11.24	10.63
Average assets ($ billions)	1,593	1,768	1,940	2,100	2,253	2,398

(Discrepancies due to rounding errors)

Source: Federal Reserve Bulletin, 1981, 1984 (1979-83 data), Consolidated Reports of Condition and Income as submitted by insured banks to their primary regulators (1984 data).

[1] See Table I, footnote 1.

[2] See Table I, footnote 2.

[3] See Table I, footnote 3.

[4] See Table I, footnote 4.

[5] See Table I, footnote 5.

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