



Banking Observatory

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Clawing back to solvency and profitability

- Mortgage and commercial real estate delinquency rise to 10.85% and 8.89%, respectively, while consumer and commercial and industrial delinquency show signs of stability
- The number of total "problem list" institutions rises to 702
- Net interest margin at commercial banks increases to 3.50%
- Charge-offs increase \$52.1bn QoQ to 2.57% of total loans

Fourth quarter maneuvering, charge-offs and delinquencies

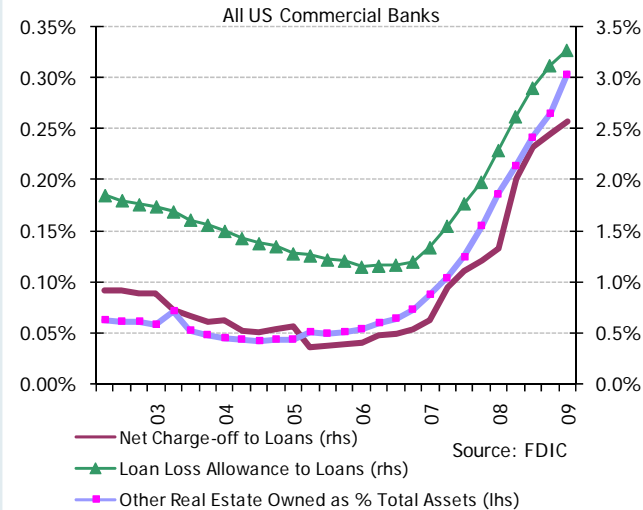
Given the pressures of the year since one of the largest financial crises in US history, commercial banks positioned themselves in 2009Q4 to charge-off as many loans as feasible in order to provide a cleaner slate for 2010, in line with our expectations. The most recent release of data by the Federal Deposit Insurance Corporation (FDIC) suggests that charge-offs increased by \$52.1bn QoQ from \$131bn in 2009Q3 to \$183.8bn in 2009Q4. Naturally, this increased the net charge-off rate to total loans to 2.57% from 2.46%. This arrives alongside a remarkable increase in mortgage delinquency, which advanced to 10.85% in 2009Q4 from 9.52% in 2009Q3. This is a clearly unwelcome sign for the banking system to witness such a large increase nearly one year after the financial crisis, but such high levels of delinquency are not unreasonable given the state of foreclosures and employment in the wider economy. Despite this bleak indicator, certain elements such as the levels of past due loans show some stability, an issue we expand on in the following BBVA Viewpoint section.

Loan levels declining amidst lower demand and deleveraging

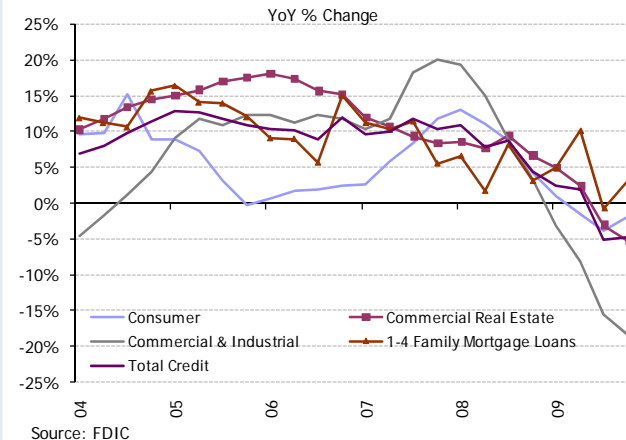
Domestic loan levels at commercial banks declined across the board as banks progress in their deleveraging. Commercial banks continue to shift their funding sources away from debt and towards insured deposits. The uses of these funds are constrained by the asset quality environment, reflected by the level of securities holdings at commercial banks increasing by \$453bn from 2008Q4 to 2009Q4, mostly in the form of US government obligations. Certain types of loans, such as commercial and industrial (C&I) and commercial real estate (CRE), grew at rapid rates in the pre-crisis years and now must readjust to a new economic environment. The correction is most striking in C&I loans, which showed YoY growth of 20% at the end of 2007 but are now declining at a -18.3% YoY in 2009Q4. CRE similarly grew at double digit rates in the years prior to 2008 and now are only beginning a lengthy loan balance decline. In particular, the level of outstanding residential construction loans declined by roughly half between 2008Q2 and 2009Q4.

Bottom line: The continuing weakness of real estate-related delinquencies is overcoming stabilization trends in consumer and C&I delinquencies. However, improved net interest margin, higher reliance on core deposit funding and stabilizing income are a welcome positive trend.

Balance Sheet Conditions



Commercial Bank Loan Balances



Leverage Indicators

QoQ %	2009Q4	2009Q3	2009Q2	2009Q1	2008Q4	2008Q3
Assets	-0.2%	-0.2%	-0.9%	-2.5%	2.2%	5.5%
Equity	1.2%	3.1%	3.1%	7.2%	-0.9%	0.8%
Leverage	-1.4%	-3.4%	-4.0%	-9.6%	3.0%	4.6%

Source: BBVA ERD and FDIC

Leverage is Asset% less Equity%

BBVA Viewpoint: Asset Quality One Year after Crisis

Delinquency inventories in perspective

For a number of quarters, the message from the inventory of past due loans at commercial banks told a story of increasing weakness in the banking system. However, for two straight quarters, commercial banks have managed to maintain a lid on the growth of loans 30-89 days past due. Loans that are past due 90 days and loans in nonaccrual status continue to grow, but nonaccrual loans demonstrate in 2009Q4 a slight deceleration. This deceleration may relate to the large growth of charge-offs in the quarter. At the same time, it may reflect that the banking system is beginning to put a lid on the growth of nonaccrual status loans, a promising sign for the banking system. The situation at present remains ambiguous, but this is a better position than a signal that is unmistakably negative.

Part of the banking system's improvements in stemming the tide of growth in 30-89 days past due loans relates to C&I and consumer lending. Loan standards impart a more rapid response for these two lending categories as the term of a loan is usually shorter than that for real estate-related loans such as CRE and home mortgages. The delinquency rate for C&I loans declined from 4.51% in 2009Q3 to 4.45% in 2009Q4, the first loan category to register a delinquency decline since the crisis began. Consumer delinquency, for its part, managed to show stability in the last quarter and also in this quarter, although consumer delinquency increased marginally from 4.73% in 2009Q3 to 4.81% in 2009Q4. We regard this as stability compared to the nearly 14% QoQ increase in the delinquency rate for mortgages since 2009Q3.

Loan balances and deleveraging

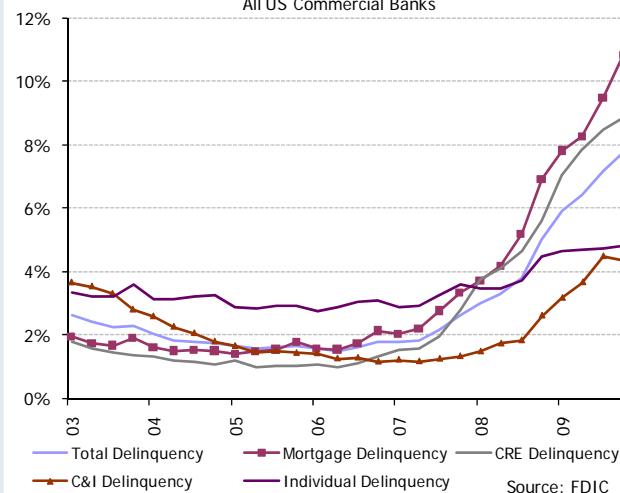
The inevitable result of a credit boom and asset quality decline is an imperative to deleverage, which the banking system has pursued with fervor since 2008Q4. As seen in the above table, deleveraging represents increases in bank equity capital and declines in assets. The latest 2009Q4 data from the FDIC suggests that QoQ deleveraging continues, but at a decelerating rate. The increases in equity this quarter are perhaps offset by higher charge-offs. Although the decelerating pace of deleveraging indicates improvement, we caution the interpretation at this point because of expected future loan balance declines in commercial real estate. One additional element in this deleveraging process is the unusually-abrupt decline in commercial and industrial loan balances at commercial banks. Based on data from the Federal Reserve H8 release, the downturn in commercial and industrial lending during this recession is remarkably different from other recessions. This is also the result of severely-reduced demand for goods and services diminishing the need for credit by commercial and industrial clients. It is also emblematic, however, of the pressures facing the business and the banking system to jointly return the economy to health as both depend on one another.

Bottom line: Not quite stability, but improvement

It is difficult to suggest a banking system is showing signs of stability when the mortgage delinquency rate for commercial banks stands at 10.85%. Mortgages are a large and influential part of the commercial banks' portfolio, representing roughly 32% of total assets. Commercial real estate, similarly, shows no signs of stability and will likely experience lengthy loan balance declines and higher charge-off rates. Despite these issues we may point to areas of improvement. Notably, the stock of incoming loans 30-89 days past due remains stable and the latest data points to a slight deceleration in the rise of nonaccrual loans. Additionally, a decline in C&I delinquency may imply that banks will begin to assume more risk for this type of lending.

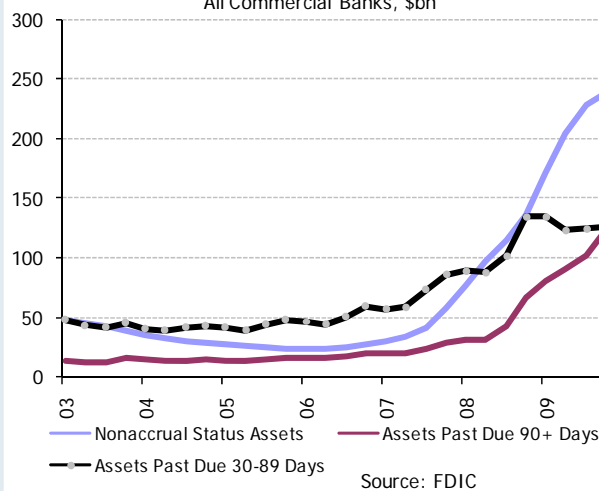
Delinquency Rates

All US Commercial Banks



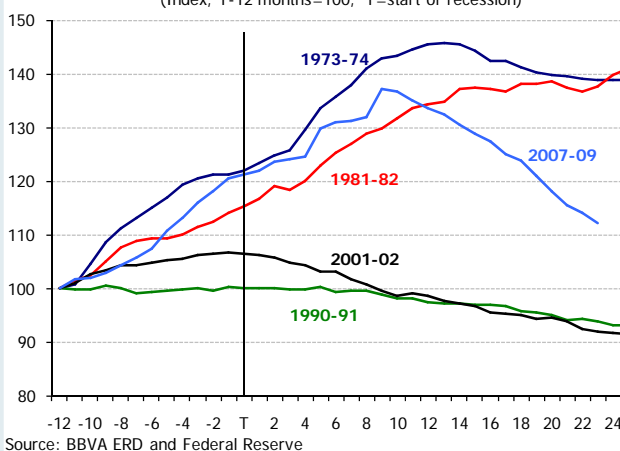
Past Due Loan Inventory

All Commercial Banks, \$bn



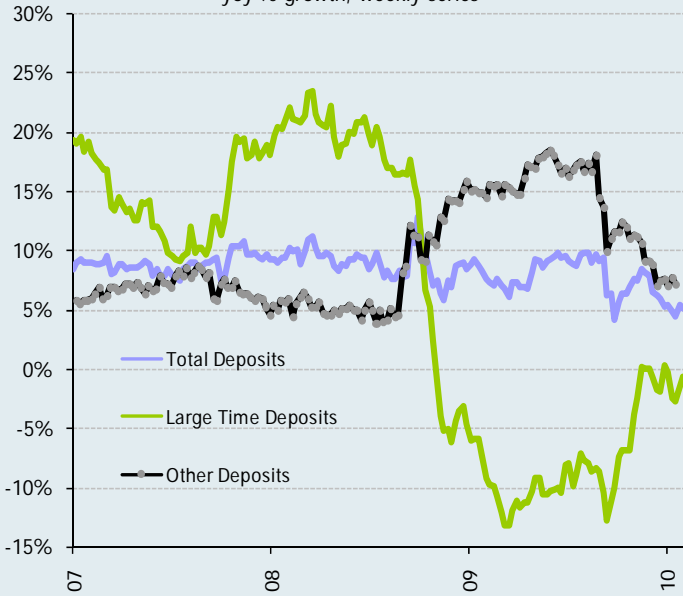
Commercial and Industrial Lending

(Index, T-12 months=100, T=start of recession)



US Bank Deposits

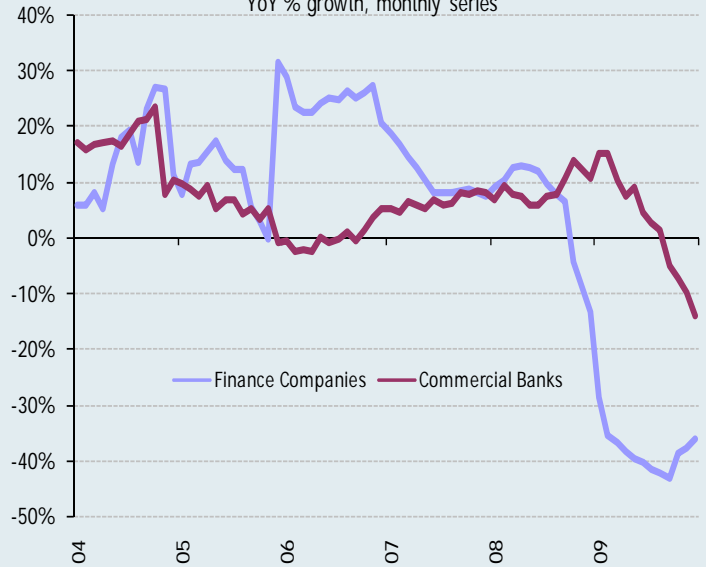
yoy % growth, weekly series



Source: Federal Reserve

Consumer Revolving Credit

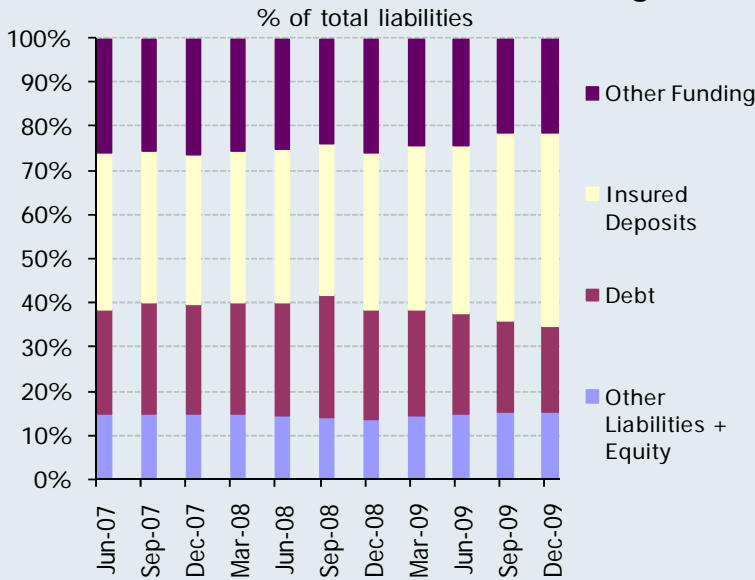
YoY % growth, monthly series



Source: Federal Reserve G19 Release

Commercial Bank Sources of Funding

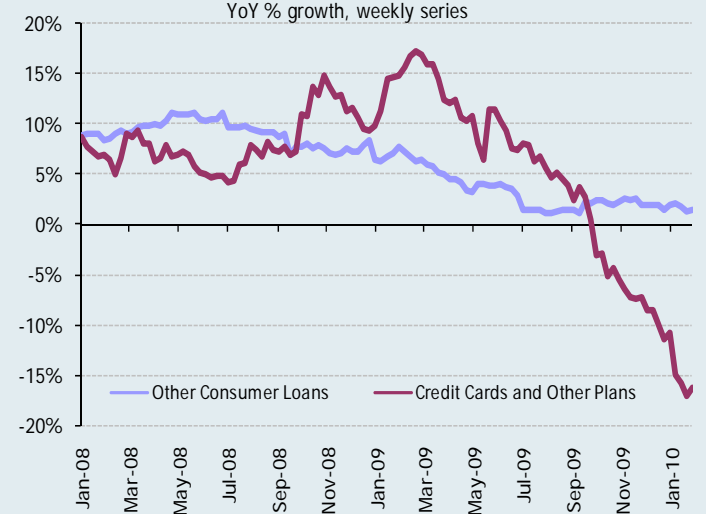
% of total liabilities



Source: FDIC

Commercial Bank Consumer Lending

YoY % growth, weekly series



Source: Federal Reserve H8 Release

FDIC Statistics on Depository Institutions	12/31/2009	9/31/2009	6/30/2009	3/31/2009	12/31/2008	9/30/2008	6/30/2008	3/31/2008
Total Delinquency	7.8%	7.2%	6.4%	5.9%	5.0%	3.8%	3.3%	3.0%
Mortgage Delinquency	10.8%	9.5%	8.3%	7.8%	6.9%	5.2%	4.2%	3.7%
CRE Delinquency	8.9%	8.5%	7.9%	7.1%	5.6%	4.7%	4.1%	3.8%
C&I Delinquency	4.4%	4.5%	3.7%	3.2%	2.6%	1.8%	1.7%	1.5%
Individual Delinquency	4.8%	4.7%	4.7%	4.6%	4.5%	3.7%	3.5%	3.5%
Net interest margin	3.50%	3.49%	3.47%	3.42%	3.23%	3.39%	3.40%	3.38%
Net operating income to assets	0.12%	0.14%	0.11%	0.21%	0.17%	0.49%	0.53%	0.68%
Return on assets (ROA)	0.09%	0.09%	0.07%	0.24%	0.13%	0.44%	0.52%	0.68%
Return on Equity (ROE)	0.85%	0.87%	0.74%	2.43%	1.35%	4.36%	5.08%	6.69%
Net charge-offs to loans	2.57%	2.46%	2.32%	2.02%	1.32%	1.21%	1.10%	0.95%
Earnings coverage of net charge-offs (x)	1.45	1.54	1.62	1.90	2.06	2.74	3.03	3.62
Loss allowance to loans	3.27%	3.12%	2.90%	2.62%	2.29%	1.98%	1.77%	1.55%
Tier 1 risk-based capital ratio	11.38%	11.15%	10.74%	10.39%	9.73%	9.46%	9.46%	9.39%
Assets % change qoq	-0.2%	-0.2%	-0.9%	-2.5%	2.2%	5.5%	-0.6%	2.9%
Total Equity % change qoq	1.2%	3.1%	3.1%	7.2%	-0.9%	0.8%	-0.3%	1.3%
Leverage %change qoq	-1.4%	-3.4%	-4.0%	-9.6%	3.0%	4.6%	-0.3%	1.5%
Noncurrent loans % of Total Loans	5.53%	5.00%	4.36%	3.71%	2.91%	2.27%	1.91%	1.61%

Source: FDIC