Conditions

Second Quarter 2022 Banking Conditions

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Balance sheet shifts and rising rates benefitted bank margins in the second quarter.

Significant swings in balance sheet composition largely explain changes seen in second quarter banking conditions. Overall, balance sheet sizes at District banks decreased during the first half of the year (see Chart C3), with assets declining almost 2 percent during the second quarter, the largest quarterly drop since the 1980s. Cash balances saw the steepest decline of all asset categories (see Charts C15-C16), decreasing $17 billion or 35 percent quarter-over-quarter, as a result of loan growth and deposit runoff in the second quarter. Investment security portfolios experienced only a slight overall decrease (see Charts C13-C14), though banks continued to buy US Treasury securities.

Despite the decline in balance sheet size, loans grew significantly during the quarter (see Charts C8-C9). When excluding Paycheck Protection Program (PPP) loans, loan growth totaled almost 12 percent year-over-year, or 4 percent quarter-over-quarter, the highest rate in decades. Lending across all major loan types increased, with the greatest gains in CRE and 1-4 family (see Charts C10-C11). Problem loans and charge-offs remain low (see Charts B4-B5).

Liquidity metrics continued to moderate as a result of recent balance sheet shifts. The liquid asset ratio (-415 bp) and the loan-to-deposit ratio (+385 bp) experienced the largest quarterly swings in decades, though the liquid asset ratio (21 percent) remains elevated, and the loan-to-deposit ratio (68 percent) remains low, historically (see Charts D5-D9). Additionally, deposit levels declined, with over half of District banks experiencing deposit run-off, while borrowings increased (see Chart C3).

The net interest margin increased in the second quarter, reversing a previously declining trend (see Charts A10-A11). Margins benefited from increasing interest income (see Charts A12-A13), driven by greater yields across earning assets and significant loan growth, while interest expense increased only marginally. As a result, the District ROAA increased to 1.2 percent despite slight upticks in overhead and provision expenses (see Charts A4-A6).

The Tier 1 Leverage ratio benefitted from the decline in balance sheet size, increasing to 9.3 percent (see Charts A1-A2). However, risk-weighted assets continued to increase as a result of lending activity, causing risk-based capital ratios to decline slightly (see the recent Community Banking Bulletin, "Capital Adequacy Measures Diverge During Pandemic," which illustrates this trend). Tangible capital* also decreased, totaling 7.6 percent of average assets (net of deductions, for the Leverage ratio) due to mounting unrealized losses on available-for-sale (AFS) securities (see Supplemental Chart 1, below). Unrealized loss positions continued to grow during the quarter and now represent 17 percent of Tier 1 capital (see Supplemental Chart 2, below).

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