



## Conditions

# Fourth Quarter 2022 Banking Conditions

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Liquidity metrics pressured, margins continue to improve.

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Balance sheet trends continued to drive bank financials in the fourth quarter. Loan growth remained among historic highs across District banks, totaling more than 13 percent year-over-year (see Chart C9). Lending was funded in part by large decreases in cash, which declined another 10 percent during the quarter, or 57 percent since the prior year-end (see Chart C3). After reaching an all-time high in 2021, cash and reserve holdings as a percentage of assets fell to a 15-year low at year-end 2022 (see Chart C16). Loan growth was also funded by wholesale funding sources, such as borrowings. Banks primarily utilized Federal Home Loan Bank (FHLB) borrowings, which are now among record highs after reaching near historic lows in 2021, while also significantly increasing usage of brokered and uninsured time deposits (see Charts D10 and D12). Wholesale funding also helped fund recent runoff in core deposits, which have declined almost 3 percent year-over-year. The majority of District banks experienced declines in core deposits over the last quarter, with decreases mostly seen in money market deposit accounts.

Liquidity positions have been meaningfully impacted as a result of balance sheet changes. The loan-to-deposit ratio continues to increase due to loan growth and deposit runoff, though remains below pre-pandemic levels (see Chart D6). The liquid asset ratio declined to 17.5 percent, down from 25.3 percent at year-end 2021 (See Charts D7 and D9). Liquid asset levels are further restricted by large levels of unrealized losses in securities portfolios. While unrealized positions improved in the fourth quarter, unrealized losses in available-for-sale (AFS) securities remain considerable at 25 percent of Tier 1 capital (see Supplemental Chart 1).

Bank margins have benefitted from changes in the balance sheet mix and increasing market rates. Yields on earning assets totaled 4.5 percent in the fourth quarter, a significant increase from 3.2 percent just three quarters prior. Funding costs also increased, rising 65 basis points (bps) over the same time period. Deposit betas have increased as pricing pressures intensify in response to increasing market rates and deposit competition. Overall, gains in asset yields outweighed the rising cost of funds, resulting in continued increases in the net interest margin, which now totals 3.7 percent across District banks (see Chart A11).

Improving margins benefitted earnings performance while increasing overhead costs (see Chart A17) and declining noninterest income (see Chart A15) continue to hinder net income. The District return on average assets (ROAA) totaled 1.23 percent at year-end 2022, approximating its 10-year average (see Charts A4 and A6).

Provision expenses normalized from prior-year lows, with notable increases among larger District banks in the fourth quarter (see Chart B2). The Allowance for Loan and Lease Losses (ALLL) remained stable as a percent of loans, totaling 1.28 percent at year-end, due to elevated levels of loan growth despite increased provisioning. Asset quality metrics remain benign, with low levels of noncurrent loans across all major loan types (see Charts B6-8). Charge-offs and loans past due 30-89 days saw slight upticks in the fourth quarter though remain below historic averages.

Capital levels grew throughout 2022, benefitting from retained earnings and decreased dividend payments year-over-year. The District Leverage ratio improved to 9.7 percent at year-end (see Chart A2) as total assets remained relatively stable, increasing only 2 percent over the quarter, or 0.3 percent since the prior year-end. However, significant changes in balance sheet mix impacted risk-based capital metrics. District Tier 1 and Total Risk-Based Capital ratios decreased to 12.4 percent and 13.3 percent, respectively, at year-end as risk-weighted assets grew more than 18 percent during the year (see Supplemental Chart 2).<sup>\*</sup> Additionally, Tangible Common Equity (TCE) ratios remain low at 7.5 percent, though increased slightly over the quarter due to improvement in unrealized loss positions (see Supplemental Chart 3).<sup>\*\*</sup>

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