



## Conditions

# Second Quarter 2023 Banking Conditions

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Liquidity metrics pressured, credit quality remains sound

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Balance sheets across Tenth District banks continued to grow in the second quarter, driven by loan growth, which totaled almost 12 percent year-over-year (see Chart C9). Loan growth was realized across all major loan types, while liquid assets continued to decline (see Charts C3 and C4). After adding a significant amount of cash and due from balances in the first quarter, banks are again letting cash and due from items run off the balance sheet, with an 8 percent decline year-over-year (see Chart C16). Investment securities are also declining, down 6 percent year-over-year (see Chart C14), and banks have increased pledging of securities to secure funding options. As a result, the liquid asset ratio decreased to a 15-year low of 13.7 percent (see Charts D7 and D9). Further, asset-based liquidity continues to be hindered by large levels of unrealized losses on securities, which increased to 27 percent of Tier 1 capital.

Banks continue to fund growth in large part through noncore borrowing sources (see Charts D10 and D12). Federal Home Loan Bank (FHLB) funding remains widely utilized, and while institutions have largely shed Discount Window borrowings taken on in the first quarter, banks continue to utilize Bank Term Funding Program (BTFP) borrowings. Borrowings have also been used to fund declining deposit levels (see Chart C3). Deposit runoff has increased across District banks, with 74 percent of banks experiencing a decrease in core deposits quarter-over-quarter. Smaller District banks (under \$250MM in assets) saw the greatest level of runoff with a median decline in core deposits of 2.4 percent during the quarter. Deposit growth has been seen almost exclusively in time deposits and brokered deposits, which are generally more costly funding options (see Supplemental Chart 1).

Earnings declined during the quarter, with an ROAA of 1.2 percent across District banks, driven by continued compression in the net interest margin (NIM) (see Charts A4 and A6). Cost of funds continues to increase rapidly and is now at a 15-year high, totaling 1.7 percent compared to 0.2 percent in the same quarter last year, as a result of both the rising rate environment and shifts to higher cost funding sources. Though rising rates and loan growth have benefitted yields on assets, gains in interest income have been outpaced by the increase in interest expense (see Supplemental Chart 2). Other earnings components,

namely noninterest income and expense items, remain relatively stable (see Chart A9). Provision expenses continue to increase (see Chart B2), though current credit quality remains sound (see Chart B5).

[View the full article, including key charts](#)

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