Conditions

First Quarter 2024 Banking Conditions

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Margins at the forefront; credit quality metrics show increasing signs of stress

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District banks experienced further compression of the net interest margin (NIM) in the first quarter, marking five consecutive quarters of declining margins (see Chart A11). The District NIM decreased to 3.35 percent, which remains well below pre-pandemic levels and continues to be attributable to increasing costs of funds (See Supplemental Chart 1). During the quarter, yields on earning assets increased only marginally on aggregate. Yields on earning assets were primarily impacted by a shifting asset mix, as growth in loans (a higher-yielding asset) slowed and growth in liquid assets (a lower-yielding asset) increased. The notable exception to these trends was seen at the smallest District banks, or those under $250MM. These banks saw an aggregate increase in NIM, benefitting from large gains in yields on earning assets, which outweighed rising funding costs.

As a result of continued NIM compression, District bank earnings performance experienced some deterioration. The District return on average assets (ROAA) totaled 1.08 percent, which remains below its 20-year average (see Chart A4). The trend in NIM is the primary driver of earnings performance, while noninterest income and expense items remained relatively steady in the first quarter. Noninterest income remains below pre-pandemic levels, and overhead expenses normalized after a spike at year-end resulting from FDIC special assessment fees (see Charts A15 and A17). Further, provision expenses decreased modestly (see Chart B2).

Balance sheet growth was modest during the quarter. District banks took on more interest-bearing bank balances while securities declined and loan growth slowed (see Chart C3). As a result, the liquid asset ratio increased for the first time in over two years, now totaling 14.4 percent (see Chart D9). First quarter loan growth totaled less than 1 percent and was primarily seen in CRE (see Chart C4). Funding structures also shifted across District banks. During the quarter, core deposits[1] increased (1.7 percent), replacing brokered deposits (-2.7 percent) and Federal Home Loan Bank (FHLB) borrowings (-13.2 percent). The level of wholesale funds is declining, but noncore funding dependency remains elevated given significant utilization since the onset of the current rate cycle (see Charts D10 and D12). Recent balance sheet movements have also benefitted capital ratios. The

District Leverage ratio increased to 9.8 percent, its highest level since March 2020 (see Chart A2). Across District banks that report risk-based ratios, the total risk-based capital ratio increased to 13.8 percent, benefitting from growth in lower risk-weighted assets. Further, the tangible common equity (TCE) ratio improved slightly, despite a small uptick in unrealized losses on securities, which total 22 percent of Tier 1 capital across District banks (see Supplemental Chart 2).

Asset quality metrics remain sound though continue to show signs of deterioration. Following pandemic-era lows, charge-offs have normalized and noncurrent loans continue to increase (see Charts B3 and B5). While still below 10-year averages, past due and nonaccrual loans as a percent of total loans have increased for four consecutive quarters. Noncurrent CRE loans saw the largest increase in the first quarter compared to other major loan types (see Chart B6). Consumer noncurrent loans also increased and are approaching 10-year highs (see Chart B8). District banks continue to provision for potential losses, but allowance levels remained steady at 1.7 percent in the first quarter.

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Endnotes

[1] Core deposits as defined in the Uniform Bank Performance Report (UBPR).

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