Second Quarter 2024 Banking Conditions

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Net interest margins see some relief; liquidity remains challenged.

Balance sheet composition shifted across District banks in the second quarter, with an overall slight decrease in total assets. Loan growth was modest at 1.5 percent quarter-over-quarter (q/q) and was seen across all major loan types with the exception of consumer loans (see Chart C4). Loan growth was funded by declining liquid asset levels, which now total 13.7 percent across District banks (see Chart D9). After significant growth in the prior two quarters, cash and reserve holdings declined again, down 12 percent q/q (see Chart C16).

Bank funding profiles continue to be challenged. Following four quarters of increasing deposit levels, total deposits decreased in the second quarter (see Supplemental Chart 1). Declines in deposits were seen in most major deposit account types and were primarily driven by a decrease in core deposits (-0.8 percent) and brokered deposits (-4.6 percent), though money market deposit accounts and time deposits continued to grow. At the same time, District banks took on more borrowings, primarily Federal Home Loan Bank (FHLB) borrowings, which grew 7.2 percent during the quarter (see Chart D10).

Capital levels improved during the quarter. The District Tier 1 Leverage ratio increased to 9.9 percent, the highest level since the onset of the pandemic, benefitting from both retained earnings and a reduction in assets (see Chart A2).

District bank earnings increased, though remain below 10-year averages. After five consecutive quarters of compression in the net interest margin (NIM), the District NIM increased during the quarter, totaling 3.4 percent (see Chart A11). In contrast to the prior year, improvements in yields on earning assets outpaced increases in cost of funds (see Supplemental Chart 2). While cost of funds continues to increase, the pace has slowed (+0.07 q/q). Comparatively, the increase in earning asset yields accelerated this quarter (+0.13 q/q). In the current rate environment, earning assets are generally repricing at higher rates as banks continue to shorten portfolios (see Charts D2 and D4). In particular, District banks under $250 million have the shortest weighted average maturity on earning assets, while also experiencing greater loan growth, and therefore have seen the greatest improvement in the net interest margin.

Noninterest earnings items remained stable during the quarter. Earnings benefit from continued low overhead, which declined further as a percent of average assets in the second quarter and remains below 10-year averages (see Chart A17). Conversely, noninterest income remains a challenge for banks and, despite slight improvement during the quarter, remains below 10-year averages (see Chart A15). Provision expenses are also relatively stable, totaling 0.2 percent of average assets in the second quarter, though are higher in the larger District banks above $1 billion (see Chart B2).

Credit quality metrics are generally sound with noncurrent loan levels stable and below 10-year averages (see Charts B5, B6, and B8). District banks under $1 billion have seen slightly more deterioration in noncurrent loan levels, particularly in CRE noncurrents. However, past due and nonaccrual rates in the District remain below national levels. District allowance levels are stable as bank provisions have kept pace given limited loan growth, despite normalized charge-offs (see Chart B3).

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