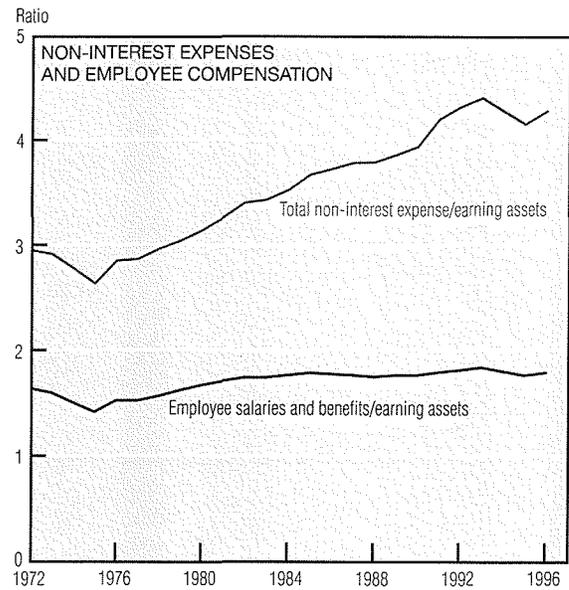
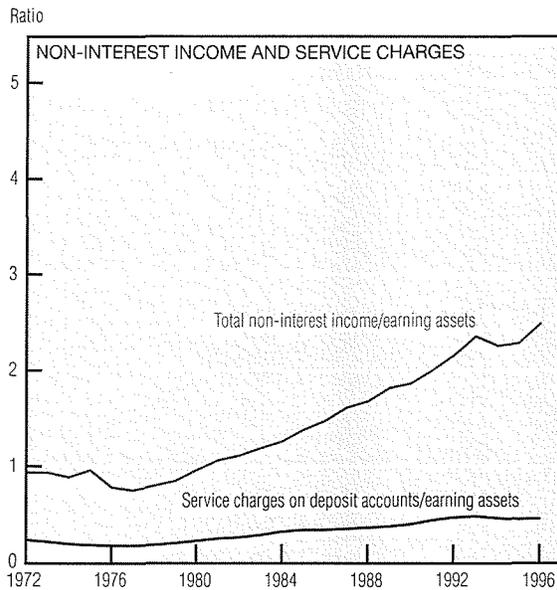
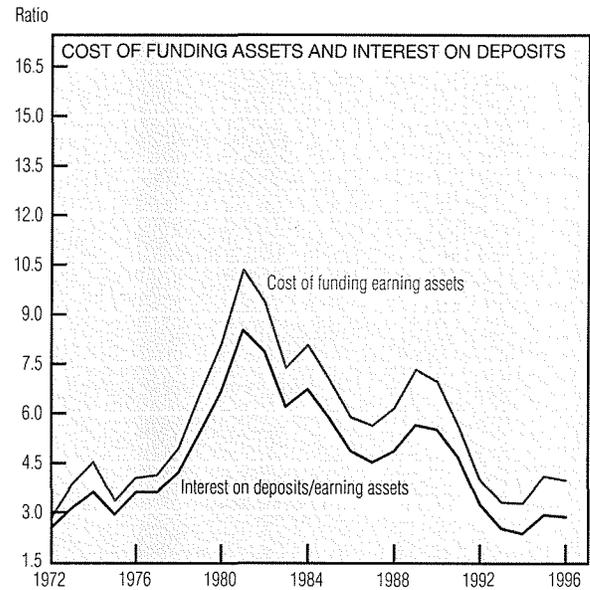
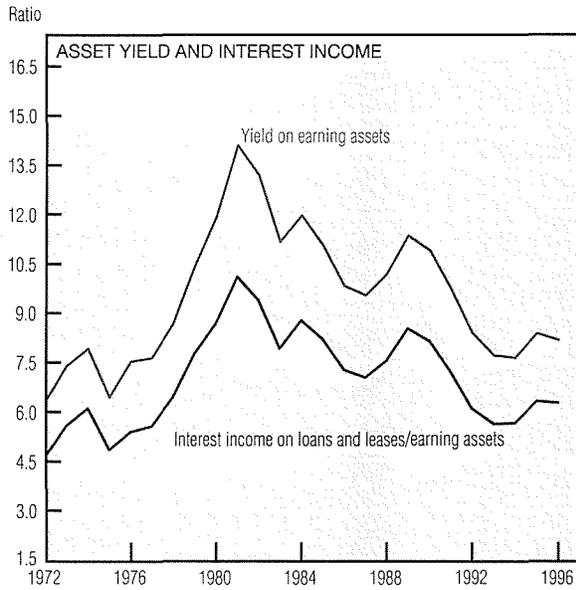


Banking Conditions



NOTE: All data are for FDIC-insured commercial banks.
 SOURCE: Federal Deposit Insurance Corporation.

Deregulation, new financial products, and new competitors are some of the explanations for the significant changes that have occurred in the U.S. banking industry. These changes have altered the relative importance of industry profitability components.

The main components usually considered in evaluating banks' profits are asset yields, the cost of funding earning assets, non-interest income, and non-interest expense.

These variables have shown two clear trends in the recent past: Since the early 1970s, the non-interest components of banks' profits have become more significant. Starting in 1981, the importance of the interest components—the yield on assets and the cost of funding earning assets—has been declining.

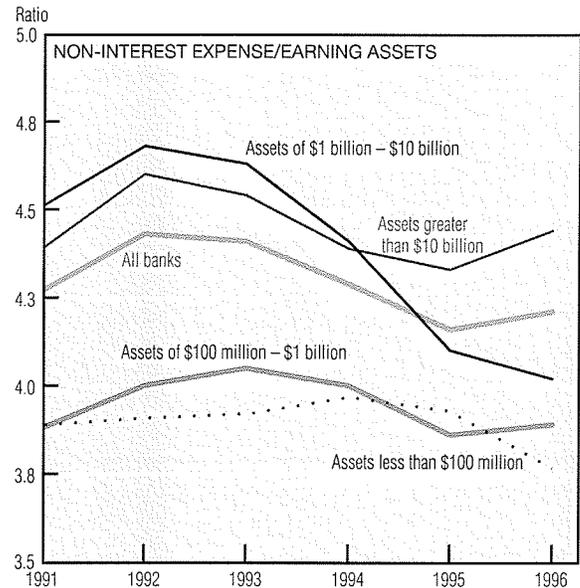
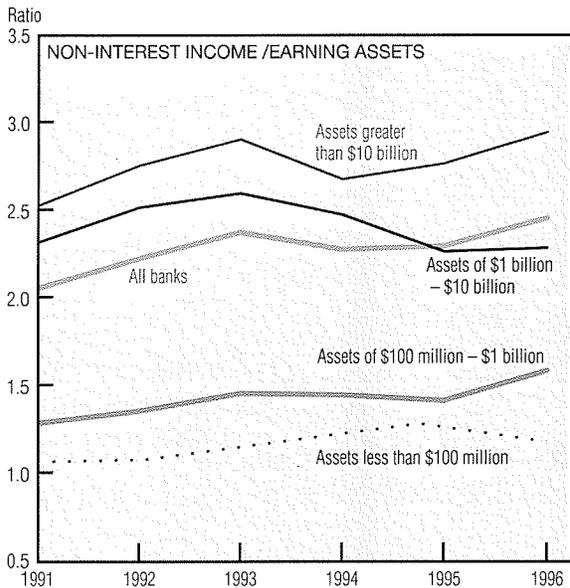
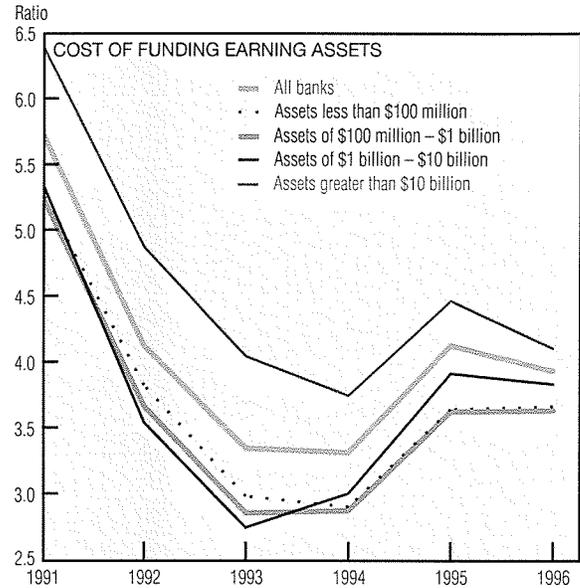
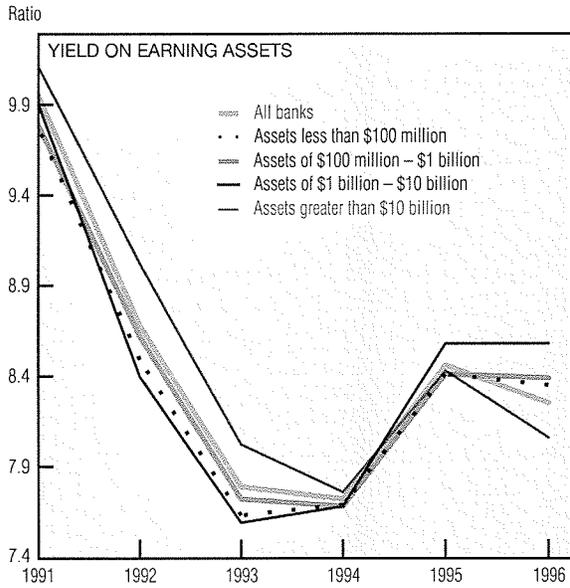
The yield on earning assets and the cost of funding earning assets have followed a common pattern, determined largely by market inter-

est rates. The same is true of the variables' main components—the interest income on loans and leases and the interest on deposits. These variables reached their highest values in 1981, when the yield on earning assets was 14.1% and the cost of funding assets was 10.4%. By 1996, these variables had fallen to 8.2% and 4.0%, respectively.

In contrast to downward trends in the yield on assets and the cost of

(continued on next page)

Banking Conditions (cont.)



NOTE: All data are for FDIC-insured commercial banks.
 SOURCE: Federal Deposit Insurance Corporation.

funding is the growing importance of the non-interest components. The ratio of non-interest income to earning assets jumped from 0.9% in 1972 to 2.5% in 1996. During the same period, the ratio of non-interest expense to earning assets rose from 3.0% to 4.3%. Note that these increases occurred despite the steadiness of the variables' main components—service charges on deposit

accounts and the cost of employee salaries and benefits, respectively.

The change in the components of profits varied with the size of the bank. Between 1991 and 1996, the variation in interest components had a similar pattern for all banks. Furthermore, the value of these components did not differ significantly with institution size except in the case of the largest banks, which had a

higher cost of funding earning assets throughout the entire period. The evolution of non-interest components, however, depended more heavily on bank size, as did their values at each point in time. One clear difference among banks of different sizes is that non-interest income and non-interest expense are far less important for smaller banks than for larger ones.