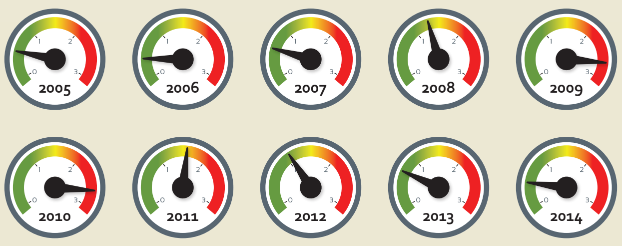
Margins and Mergers

US banks[1] may not be as burdened by delinquent loans as they have been in recent years, but the industry faces other challenges.

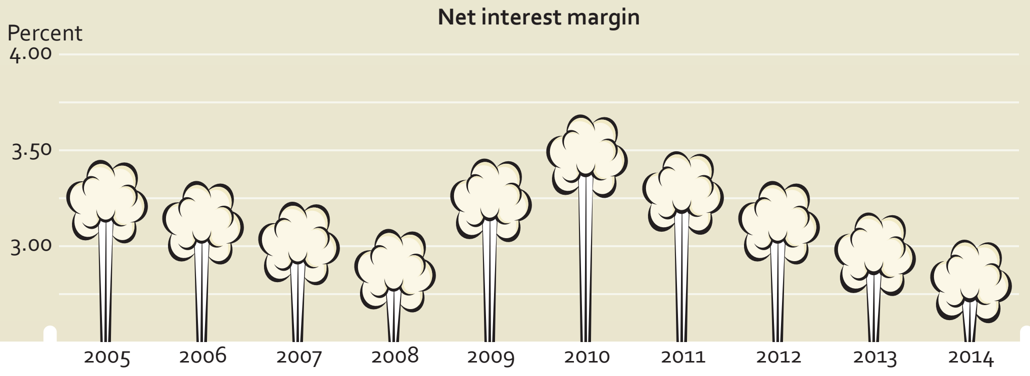
First, some good news. When a bank writes off a loan that a borrower is not paying, it's called a charge-off. Net charge-offs, as a percentage of US banks' total loans and leases, ballooned to 2.69 percent at year-end 2009, but since then have declined. As of year-end 2014, net charge-offs had returned to pre-recession levels.

Net charge-offs
(as a percent of total loans and leases)



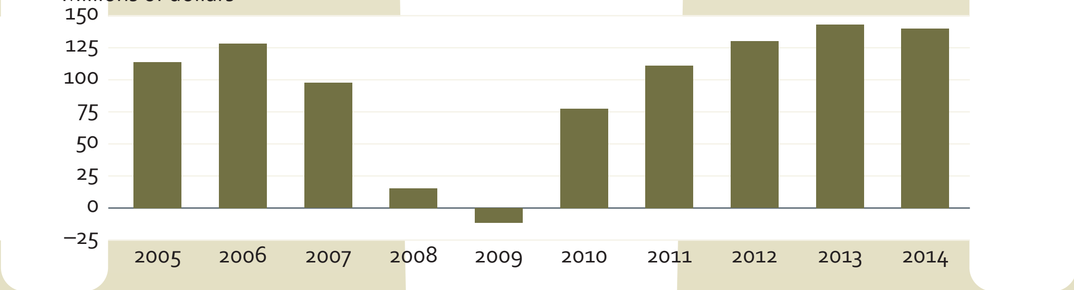
Banks remain under pressure, however. Competition for loans (from both banks and nonbanks such as hedge funds and insurance companies) is tight, and banks' net interest margin—the spread between how much interest banks pay for money they take in and how much interest they make lending it—is squeezed. In fact, banks' net interest margin hasn't been lower than it was at the end of 2014 since at least 1992.

Net interest margin

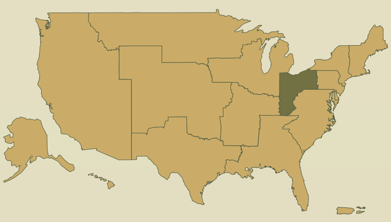


Although net interest margins are squeezed, the banking industry's profits have been on the upswing, growing every year since 2010—until 2014. Many institutions' profitability was due, in no small part, to money they were able to release from loan-loss reserves as the need to cushion against bad debts abated.
Between the end of 2013 and the end of 2014, though, US banks' net income dropped 2.3 percent.

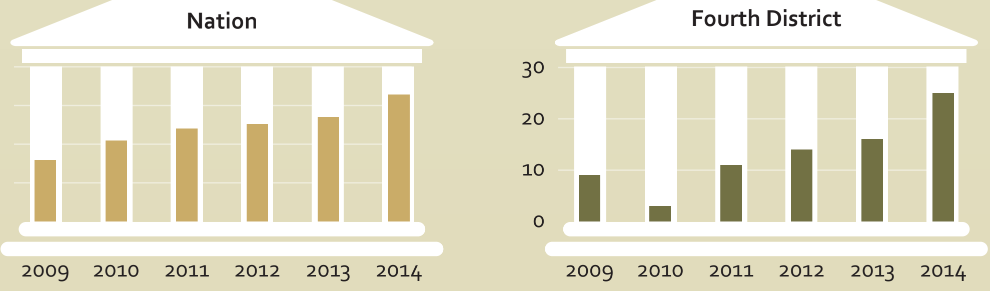
Bank profits



Bank mergers and acquisitions have picked up since 2010, increasing 57 percent nationally and a whopping 733 percent in the region the Cleveland Fed serves.[2] Often, bankers doing these deals cite squeezed margins and increased costs of compliance as reasons for the transactions.



Bank mergers and acquisitions



1. The term "US banks" refers to US institutions that have commercial bank charters.
2. The Federal Reserve Bank of Cleveland serves the Fourth Federal Reserve District, which comprises Ohio, western Pennsylvania, the northern panhandle of West Virginia, and eastern Kentucky.

Sources: Bank Call Reports; Bank FR Y-10 Reports

Read more on the present challenges and opportunities for banks: *Forefront* magazine at www.clevelandfed.org

FEDERAL RESERVE BANK *of* CLEVELAND