In May 2001, the net share of domestic and foreign commercial banks’ senior loan officers who reported tightening standards for commercial and industrial loans in 2001:IIQ fell to 50.9% for large and mid-size firms and 36.4% for small ones, the first slowdown in the tightening trend since 1999:IIIQ. This year’s first-quarter tightening was mostly reflected in higher spreads on riskier loans. Collateralization requirements and credit-line limits were affected least. The three most important reasons respondents gave for tightening their lending standards were a less favorable and more uncertain economic outlook, worsening of industry-specific problems, and lower risk tolerance.

Along with tightening in the commercial and industrial loan markets, loan demand has weakened since 1999:IIIQ. Senior loan officers, on balance, again reported moderately weaker demand for commercial and industrial loans this May, but this is good news compared to the substantial decline cited in January. The amount of outstanding seasonally adjusted commercial and industrial loans (around $1,116 billion) has been flat for the last five months.

The tightening trend is less significant on the consumer side: Only 20% of respondents tightened, compared to more than double that share for commercial loans, and 80% did not change their standards for consumer lending. The reasons most often given for tightening were a recent or expected increase in delinquency rates and consumers’ worrisome debt service burden. Even so, consumer loan demand has strengthened moderately since May, when 46% of the senior
loan officers surveyed reported stronger demand for residential mortgages and 10% reported stronger demand for consumer loans.

In 2001:IQ, the share of unprofitable FDIC-insured commercial banks rose to 7.1%, continuing an upward trend that began in 1996. Compared with 2000:IQ, the share of unprofitable banks increased in 24 states, remained unchanged in five, and decreased in 21 states and the District of Columbia. The most significant deterioration occurred in Arizona, where unprofitable institutions’ share jumped from 16% to 31%. No significant change occurred in Fourth District states.

Parallel to deterioration in the share of profitable institutions over the last five years, commercial banks’ annualized 2001:IQ return on assets and return on equity show that their profitability declined relative to 2000. Return on equity dropped from 16.0% in 2000 to 14.7% in 2001:IQ. Return on assets was 1.27%, down from 1.35% in 2000. The return on risk-weighted assets also indicates a decline in bank profitability. Focusing solely on first-quarter results, the return on risk-weighted assets showed its first decline since 1994 and currently stands at 1.61%.

The ratio of risk-weighted assets to total assets shows that commercial banks’ risk exposure lessened. As of 2001:IQ, this ratio stood at 78.1%, down from its all-time high of 80% in September 2000. One factor in this decline may be the tighter lending standards that senior loan officers have reported.