Commercial banks’ quarterly earnings ($19.9 billion for 2001:IQ) surpassed the record of $19.4 billion reported for 2000:IQ. These profits translate into an annualized return on assets of 1.27% for 2001:IQ, up slightly from 1.19% for the year 2000. On the down side, capital gains realized through security sales accounted for more than 6% of first-quarter profits. Downward pressure on core earnings continued as the net interest margin for 2001:IQ fell to 3.83%, its lowest level in more than 10 years.

Return on equity for 2001:IQ was 14.78%, compared to 14.07% for the year 2000. This improvement results from the rebound in return on assets and a slight increase in leverage as core capital fell from 7.71% of total assets at year-end 2000 to 7.68% at the end of 2001:IQ. The slower economy of the past 12 months is not yet manifest as asset-quality problems in bank portfolios: Problem assets remained less than 1% of total assets. And, despite an increase of nearly 10 basis points, net charge-offs remain below the early 1990s’ levels.

While first-quarter earnings improved from year-end 2000, the share of problem banks—those with substandard examination ratings—rose slightly in 2001:IQ to 0.95%. On the other hand, the share of banks that are unprofitable fell from 7.06% in 2000 to 6.86% in 2001:IQ.

Thus, while most performance indicators seem consistent with a strong banking sector, others may not be. There does appear to be continued deterioration, albeit minimal, in asset quality. Moreover, it remains to be seen whether noninterest sources of income can continue to offset declines in net interest margins.