Commercial banks have been adversely affected by the current recession. Between 2000:IIIQ and 2001:IIIQ, their net income declined $1.9 billion to $17.4 billion. In 2001:IIIQ, as in 2000:IIQ, a decline in credit quality contributed significantly to lower net income. To cover their expected third-quarter loan losses, banks set aside $11.6 billion, the largest quarterly addition to reserves since 1990:IVQ. Net operating income, excluding discretionary transactions such as gains (or losses) on the sale of investment securities and extraordinary items, was 16.6% lower than a year earlier. Most of the industry’s decline in profits occurred at large banks that had sizable expenses for asset-quality problems. The industry’s return on assets fell to 1.08% in the 2001:IIIQ, compared to 1.28% a year earlier.

Banks’ net interest margin rose slightly between the second and third quarters of 2001. Because of lower interest rates, the cost of funding declined faster than income, thus increasing the net interest margin, but it is too early to tell whether this represents a significant reversal of trends.

In 2001:IIIQ, for the first time since 1997:IQ, the industry posted a decline in net loans. This reflects the smaller number of loan applications since the onset of the recession and, possibly, higher charge-offs and banks’ reluctance to issue loans. The ratio of net loans and leases to assets is at a six-year low of 57.9%.

Net charge-offs have continued to increase since 2001:IQ. Noncurrent loans and leases—the sum of loans and leases 90 days or more past due in nonaccrual status—have been growing steadily since 1998:IQ. This shows the underlying decrease in credit quality that commercial banks have been facing since 1998.