FDIC-insured commercial banks reported record earnings of $74.3 billion in 2001, $3.2 billion over the record set in 1999. These record profits translated into a return on assets of 1.16%, down slightly from 1.19% in 2000. The downside of the bank earnings picture is that capital gains accounted for more than 6% of first-half profits. Downward pressures on core earnings continued as the net interest margin fell to 3.90% for 2001, a drop of 5 basis points (bp) from the end of 2000.

Return on equity for 2001 was 13.1%, down from 14.07% for 2000. This deterioration results from a drop of 3 bp in return on assets, magnified by a slight decrease in leverage as core capital rose from 7.71% at the end of 2000 to 7.79% at the end of 2001. The recession that began in March has had only minor effects on overall bank asset quality. Both problem assets and net charge-offs increased in 2001; however, despite an increase of 30 bp, problem assets remained less than 1% of total assets.

Although earnings improved during 2002:IQ compared to year-end 2001, the share of banks with standard examination ratings—problem banks—rose to 1.18% in 2001. In addition, the share of unprofitable banks increased from 7.06% at year-end 2000 to 7.54% at year-end 2001.

While most of these changes are consistent with a strong banking sector, the latest data are mixed. There appears to be continued deterioration, albeit minimal, in asset quality. Moreover, it remains to be seen whether noninterest sources of income can continue to offset declining net interest margins.