Has the Quality of Bank Loans Deteriorated?

In recent years, bank supervisors have expressed concern about a deterioration in the standards of banks for underwriting loans. Examining recent trends in nonperforming loans at commercial banks through the first quarter of 1999 can help determine whether this concern is justified.

Nonperforming loans are identified as those past due 90 days or more or in nonaccrual status. Banks classify loans as nonaccrual when they cease to count interest due on the loans as current income. Banks report the amount of their loans that were nonperforming as of the end of each quarter.

Supervisors’ comments about bank underwriting practices have tended to focus more on commercial and industrial (C&I) loans than some of the other categories of bank loans. The first table indicates that there was a rise in the nonperforming rate on C&I loans in the first quarter among banks in each size group. Among the banks with total assets above $1 billion, the nonperforming rate in the first quarter was higher than in any quarter in the prior two years.

There are reasons to doubt whether the first-quarter data are the beginning of a new trend. For one thing, there appears to be a seasonal pattern in the nonperforming rates for banks with total assets below $20 billion. For these banks, the nonperforming rates rose during the first quarters of 1997 and 1998. This seasonal pattern reflects a tendency of smaller banks to charge off more of their nonperforming loans as losses in the fourth quarter of the year.

In addition, the first-quarter nonperforming rate for all bank loans, shown in the second table, has not deteriorated relative to the last two years. For the banks in each size group, the percentage of total loans that were nonperforming in the first quarter of this year was within the range of quarterly observations in the last two years.

In any event, nonperforming rates on C&I loans and total loans remain far below the levels of the late 1980s and early 1990s, when the rates were several percentage points higher. By the standard of this earlier period, when banks had serious loan quality problems, loan quality appears to be very good.

—Alton Gilbert