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Q2 2021 Earnings from Large Banks: Trends & Implications for Small Banks

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The largest US banks reported very positive second quarter earnings last week despite generally lower net interest margin and negative loan growth. The positive earnings were mainly due to a significant loan loss provision benefit (negative loan loss provision).

- What are some of the noteworthy trends in the earnings results and what do they imply for smaller banks?

Let us first look at the reserves being reported. Figure 1 shows the *Loss Allowance to Loans* ratio in the last six quarters and "Day 1 CECL" for seven banks: Bank of America, Citigroup, JPMorgan Chase, PNC, Truist, U.S. Bank, and Wells Fargo.

The ratio peaked in 2Q2020 for all but two of the seven banks. Furthermore, JPMorgan and Citigroup had the fastest drop in the ratio since they also had the biggest increase from "Day 1 CECL" to 2Q2020.

These seven banks continue maintaining an excess level of loan loss reserves relative to pre-pandemic, i.e. "Day 1 CECL". In fact, Wells Fargo, PNC and Citigroup are the top 3 banks with such excess reserves in this group.

- As the ongoing recovery of the economy is further reflected in the CECL scenarios in the coming quarters, this may lead to additional improvement in credit quality and releases of loan loss reserves.

- We expect that the above pattern of reserve releases and drop in allowance ratio will also materialize for the mid-size banks in Q2 2021, namely for banks with assets greater than $10B. The vast majority of these banks has adopted CECL.

  Figures 2 and 3 depict two allowance ratios for the ">$250B" and "$10B-250B" bank groups from the Call Reports as of Q1 2021: *Loss Allowance to Loans* and *Loss Allowance to Noncurrent Loans* (*Coverage* ratio). The two bank groups have had highly correlated allowance ratios since Q1 2020, the start of the CECL adoption. On the other hand, the two ratios in the smaller bank groups do not seem to have peaked yet. The banks in these groups are currently reserving under the Incurred Loss model (ILM) and are expected to adopt CECL by January 1 2023.

  These observations are consistent with our recent RMA journal article, where we provided evidence that: (i) the adoption of CECL has decreased the allowance variation amongst banks and (ii) CECL allowance is less procyclical than ILM.

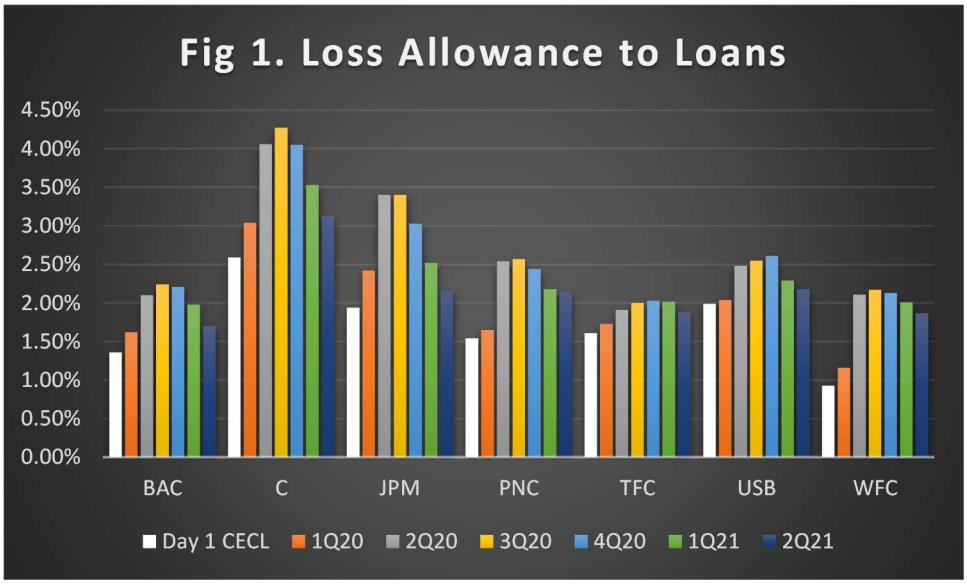
Fig 1. Loss Allowance to Loans
4.50%
4.00%
3.50%
3.00%
2.50%
2.00%
1.50%
1.00%
0.50%
0.00%
BAC
C
JPM
PNC
TFC
USB
WFC
Day 1 CECL
1Q20
2Q20
3Q20
4Q20
1Q21
2Q21

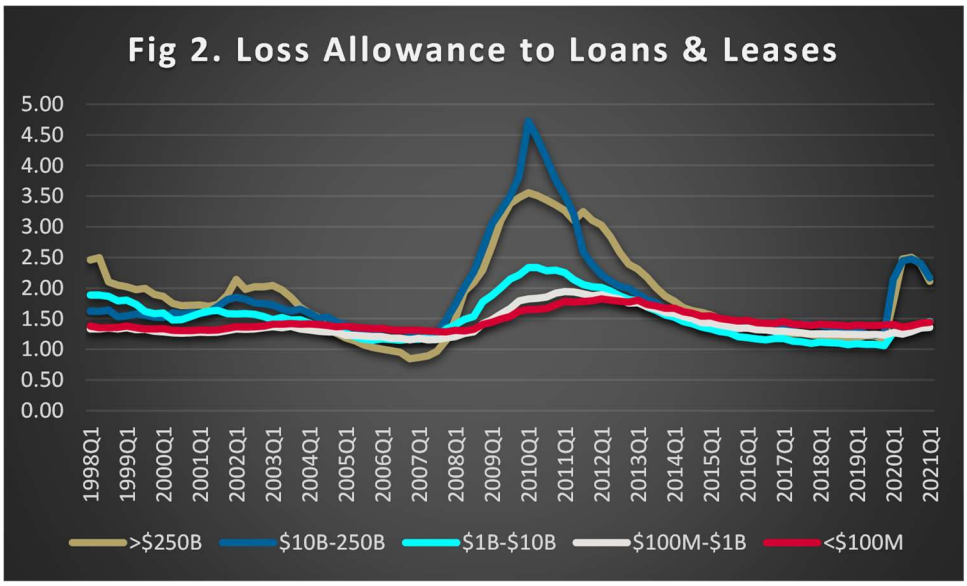
Fig 2. Loss Allowance to Loans & Leases
5.00
4.50
4.00
3.50
3.00
2.50
2.00
1.50
1.00
0.50
0.00
1998Q1
1999Q1
2000Q1
2001Q1
2002Q1
2003Q1
2004Q1
2005Q1
2006Q1
2007Q1
2008Q1
2009Q1
2010Q1
2011Q1
2012Q1
2013Q1
2014Q1
2015Q1
2016Q1
2017Q1
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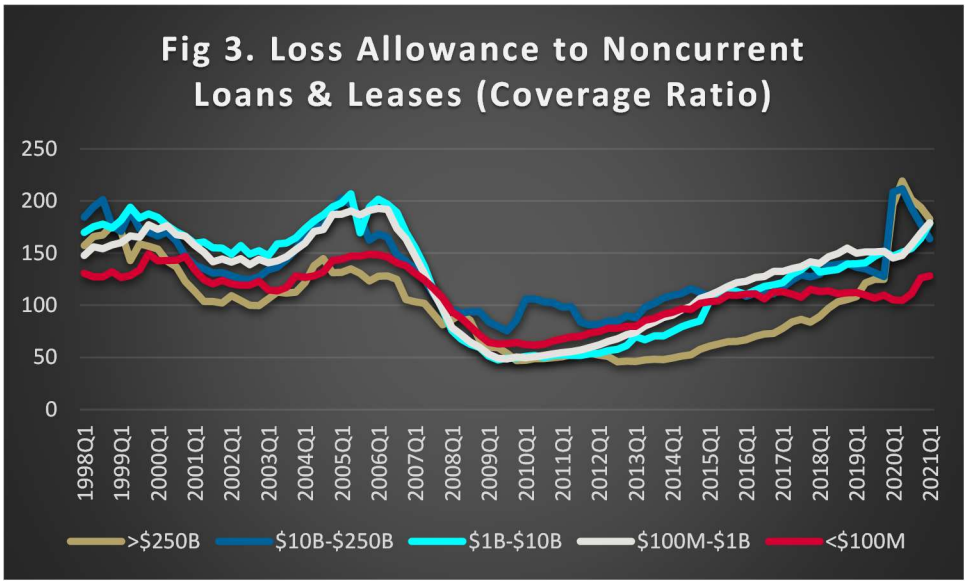
2019Q1
2020Q1
2021Q1
>$250B
$10B-250B
$1B-$10B
$100M-$1B
<$100M



The other story in the earnings reports of the largest banks has been the negative growth of loans. To further analyze this we examined the data in the Federal Reserve System's H.8 release as of July 16.

Figures 4-6 depict the balances of Residential Mortgages, C&I and CRE Loans for Large and Small domestically chartered commercial banks. Large banks are defined as the top 25 domestically chartered commercial banks ranked by size. The figures show that in the large banks the holdings of the above three asset classes have been in decline since the start of the pandemic. This is in contrast to the small banks that have experienced positive growth in all three segments.

Thus, Figure 7 depicts the growth in the above three segments for the two bank groups. It also includes a decomposition of CRE into Construction, Farmland, Multi-Family and Non-Residential. It is worth noting that the Large banks had negative growth across the three loan segments. The Large banks did not take advantage of the robust residential mortgage market of the last 12 months. In CRE, the Large banks only had positive growth in Construction and Multi-Family. On the other hand, Small banks had positive growth across the board and double digit growth in C&I loans mainly due to PPP.

- It will be interesting to see how loan growth evolves across the two bank groups as the economic recovery continues and loan demand returns to pre-pandemic levels.

- At the same time, the loan-to-deposit ratio in Figure 8 seems to be stabilizing for the two bank groups which is good news for future NIM expansion.

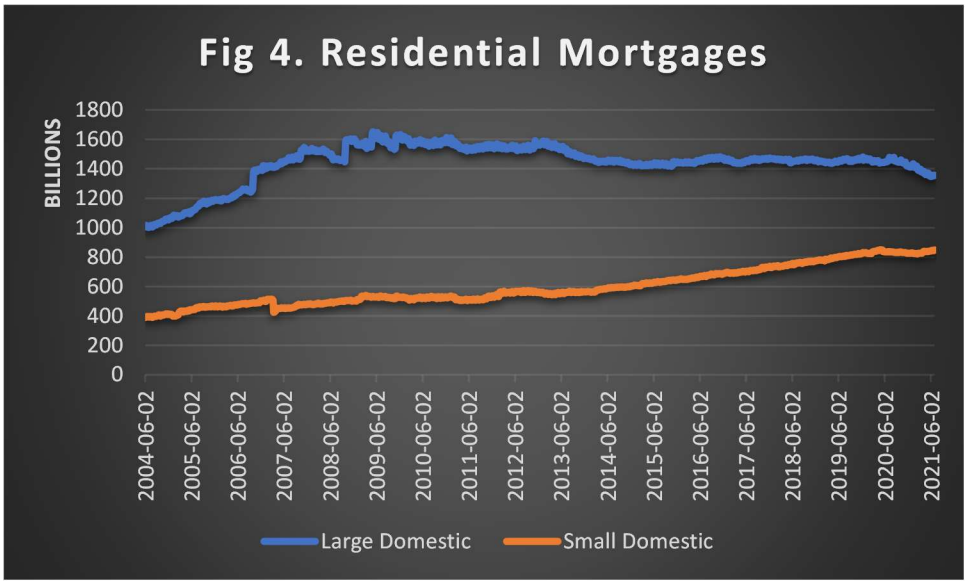


Fig 4. Residential Mortgages
BILLIONS
1800
1600
1400
1200
1000
800
600
400
200
0
2004-06-02
2005-06-02
2006-06-02
2007-06-02
2008-06-02
2009-06-02
2010-06-02
2011-06-02
2012-06-02
2013-06-02
2014-06-02
2015-06-02
2016-06-02
2017-06-02
2018-06-02
2019-06-02
2020-06-02
2021-06-02
Large Domestic
Small Domestic

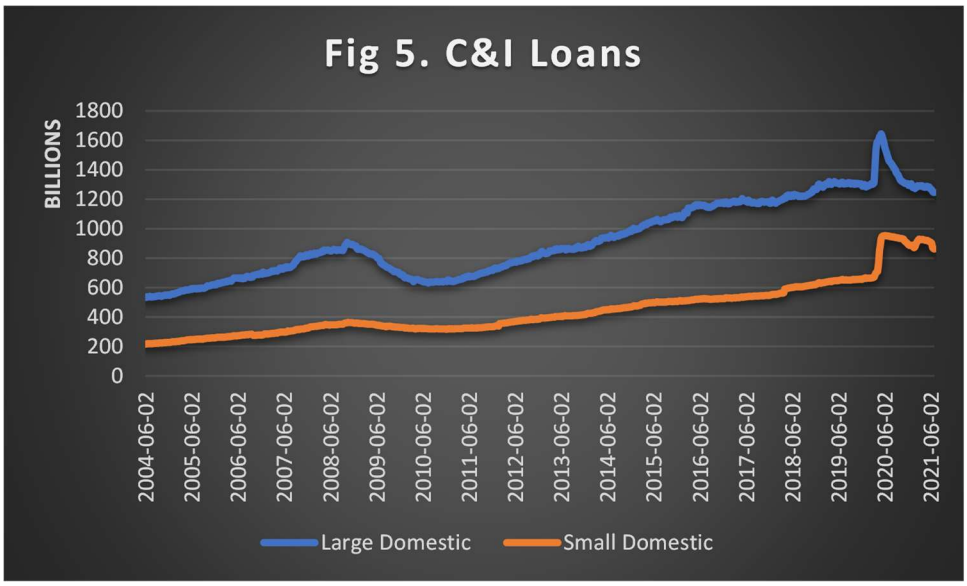


Fig 5. C&I Loans
BILLIONS
1800
1600
1400
1200
1000
800
600
400
200
0
2004-06-02
2005-06-02
2006-06-02
2007-06-02
2008-06-02
2009-06-02
2010-06-02
2011-06-02
2012-06-02
2013-06-02
2014-06-02
2015-06-02
2016-06-02
2017-06-02
2018-06-02
2019-06-02
2020-06-02
2021-06-02
Large Domestic
Small Domestic

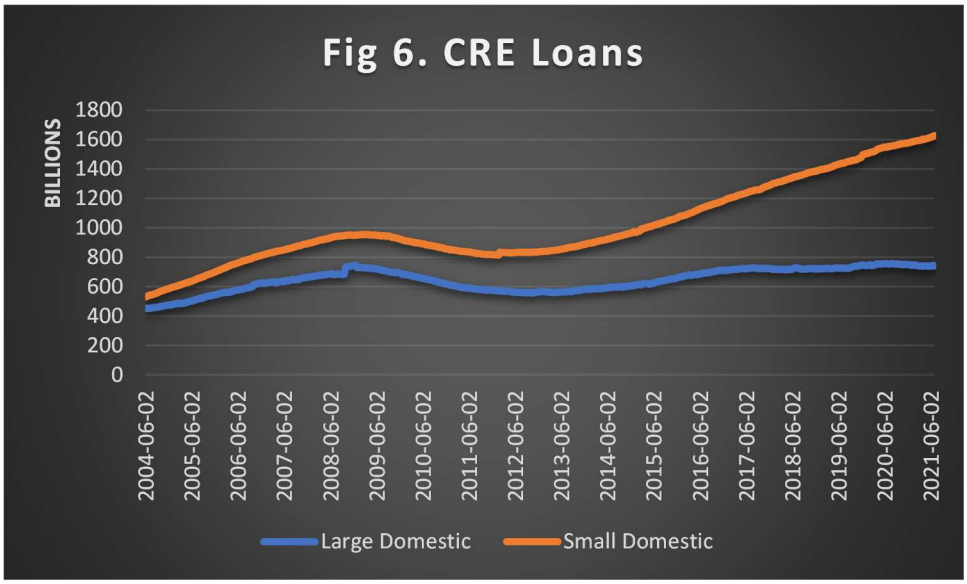


Fig 6. CRE Loans
BILLIONS
1800
1600
1400
1200
1000
800
600
400
200
0
2004-06-02
2005-06-02
2006-06-02
2007-06-02
2008-06-02
2009-06-02
2010-06-02
2011-06-02
2012-06-02
2013-06-02
2014-06-02
2015-06-02
2016-06-02
2017-06-02
2018-06-02
2019-06-02
2020-06-02
2021-06-02
Large Domestic
Small Domestic

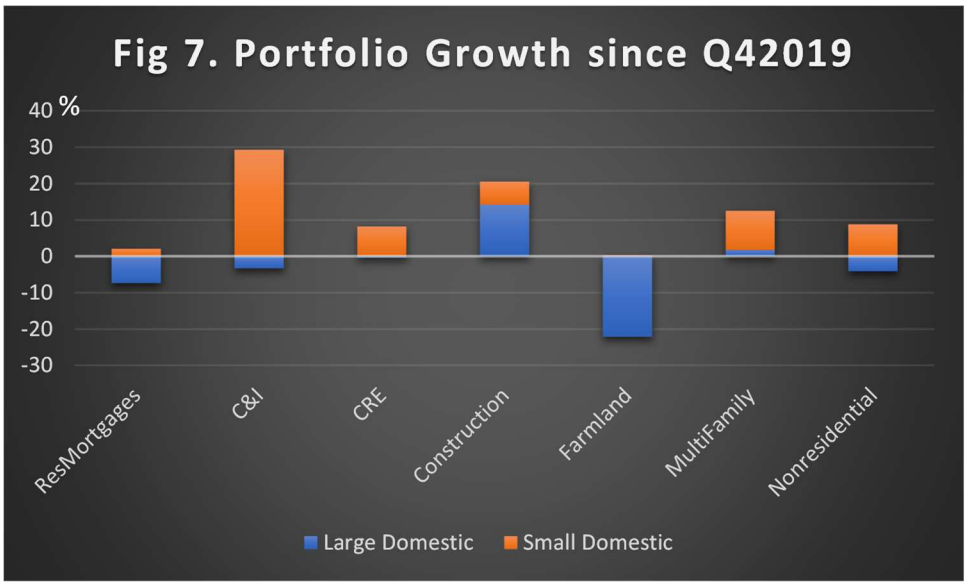
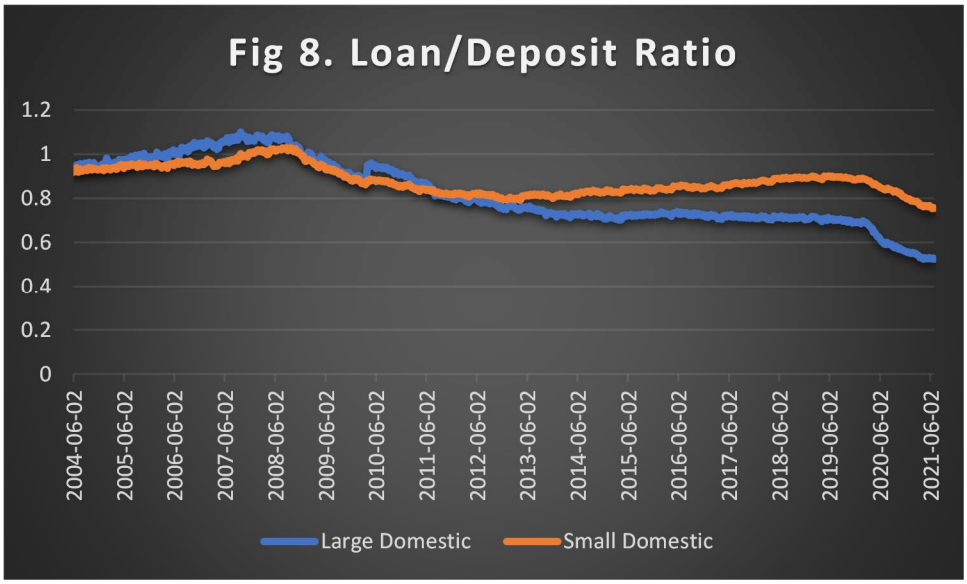


Fig 7. Portfolio Growth since Q42019
%
40
30
20
10
0
-10
-20
-30
ResMortgages
C&I
CRE
Construction
Farmland
MultiFamily
Nonresidential
Large Domestic
Small Domestic



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