

With competition causing low deposits and forcing lower charges, "we're getting pressed from both sides."

Thomas M. Petro, below, president and CEO, Fox Chase Bancorp Inc., which expects to release second-quarter earnings next week.



MICHAEL PEREZ / Inquirer Staff Photographer

Big squeeze, small growth

By Harold Brubaker
INQUIRER STAFF WRITER

Pity the poor banker. With banks in the midst of a marathon of second-quarter earnings announcements this week, there has been little to get excited about, particularly at small regional and community banks.

Most earnings out so far for banks in the Philadelphia area are not showing strong growth.

For about two years, the interest-rate environment — with long-term rates about the same or lower than short-term ones — has squeezed banks' profit margins.

Other long-term structural changes are posing even greater challenges to banks that derive the bulk of their profits from the difference between the interest rate they charge borrowers and the rate they pay depositors — their net interest margin.

First, competition for deposits is intensifying, as baby boomers are less likely than previous generations to keep large amounts of money in banks, and higher interest offered by Internet-only banks forces other banks to pay more to attract deposits.

Meanwhile, competition is causing banks to charge less for the risks they assume when they make business loans.

"We're getting pressed from both sides," said Thomas M. Petro, president and chief executive officer of Fox Chase Bancorp Inc. in Hat-

boro, which expects to release second-quarter earnings next week.

Analysts say the interest-rate environment is beginning to improve. "The margin pressure is still there, but we sense it is bottoming," said Gerard Cassidy, a banking analyst at RBC Capital Markets.

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Banks' quarterly profit results, due this week, will likely show the challenges firms are facing.

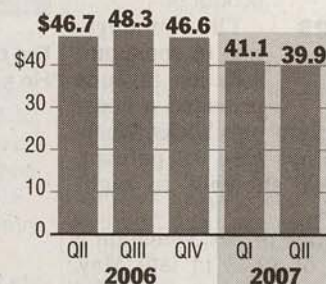
Uneven Times

Profits for banks in the Philadelphia area have not shown consistently strong gains, reflecting the difficult environment for the industry.

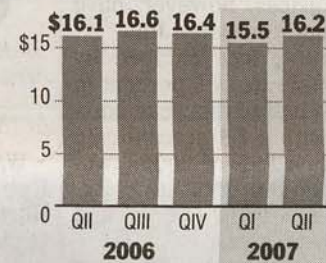
Quarterly net income for local banks that have reported second-quarter results.

In millions.

Fulton Financial Corp.



National Penn Bancshares



Sovereign Bancorp



Sun Bancorp



SOURCE: Companies listed

MIKE PLACENTRA / Inquirer Staff Artist

Banking

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For example, Sovereign Bancorp Inc. said yesterday that its second-quarter net interest margin was 2.71 percent, up from 2.70 percent in the first quarter, but off from 2.86 percent in the second quarter of 2006.

Sun Bancorp Inc., Vineland, decided last year as part of its retail strategy to attract deposits by paying better rates. As a result, the bank's deposits were 5 percent greater at the end of June than a year ago, but the total amount of quarterly interest it paid on those deposits rose 38 percent.

The biggest concern now for Cassidy and other banking analysts is the credit quality of banks' loan portfolios.

"Credit problems are now starting to arise," Cassidy said. "Part of the problem is, it was so good for so long that credit standards were thrown out the window."

Problems showed up first in the rise of defaults in subprime home mortgages.

James E. Rohr, chairman and chief executive of PNC Financial Services Group Inc., said the problems in subprime lending were caused by huge amounts of liquidity. "There are all kinds of people trying to put money someplace," he said.

Now, analysts are concerned that the weak underwriting has spread to the commercial-lending market.

Executives at National Penn Bancshares Inc., Boyertown, said Tuesday that they were seeing some loans with "questionable credit structures," which can mean that lenders have less protection if something goes wrong for the borrower.

JPMorgan Chase & Co. said yesterday that it had boosted its provision for credit losses in the latest quarter to \$587 million, from \$292 million in the first quarter of 2007 and \$100 million for the second quarter of 2006.

A key measure of credit quality — the share of nonperforming loans to the value all loans and foreclosed properties — at the nation's top 50 banks has climbed from a low of 0.47 percent in 2005 to an anticipated 0.55 percent in the second quarter, Cassidy said.

PNC's Rohr countered: "The trend is off a remarkably good base." PNC is scheduled to report earnings today.

To top it all off, the slowdown in the housing market has reduced banks' fee income from originating mortgages and has sharply cut the business of lending to homebuilders.

"It's not like doom and gloom. I don't want to give that impression," said Sidney R. Brown, acting president and CEO of Sun Bancorp. "You just have to roll up your sleeves and work a little harder at it."

Contact staff writer Harold Brubaker at 215-854-4651 or hbrubaker@phillynews.com.