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Symbols Used Throughout this Report:	Abbreviations Used Throughout this Report:
<ul style="list-style-type: none"> ↑ Improving or strong conditions ↓ Deteriorating or weak conditions ↕ Mixed conditions ❖ Interest item 	<ul style="list-style-type: none"> FDIC – Federal Deposit Insurance Corporation OCC – Office of the Comptroller of the Currency FRB – Federal Reserve Board

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ECONOMIC REVIEW AND OUTLOOK

TEXAS BANKING SYSTEM

BANKING SYSTEM OVERVIEW

Texas institutions performance continues to improve and is among the healthiest in the country despite the continuing challenges in today's economy. Elevated levels of troubled assets, compressed net interest margins, reduced noninterest income, increased regulatory burden, and increased expenditures related to regulatory compliance along with seeking solutions to assist customers and communities in dealing with lingering drought conditions are some of the issues keeping bankers busy and a testament to their versatility. In essence, community bankers continue to wear many hats.

A study released in March by the Federal Reserve Bank of St. Louis found that a number of community banks throughout the nation performed well and prospered during the years 2006-2011. The study distinguishes between a surviving bank and a thriving bank using balance sheet and income statement ratios, along with other analysis. The study listed 15 states with the highest percentage of thriving banks, with Texas ranking third. Based on the analysis, states that did not experience large declines in property values and had a strong agricultural and/or energy sector fared well. Overall, the study illustrates the factors that enable community banks to operate in a safe and sound manner, while continuing to serve their communities.

Signs of an improving U.S. economy continue. Consumer spending and confidence are gradually improving and financial institutions should benefit from an increase in business and consumer spending. December 31, 2012 financial data reflects that consumer loan demand is gradually returning. For commercial customers, commercial loans provide an important source of funding to the business sector. Over the last several years, commercial and industrial lending has risen. As the economy continues to strengthen, state-chartered banks and thrifts financial statements are expected to reflect the improvement.

The trends and changes in the banking industry over the last several years have caused some bank directors to look into or consider a merger, acquisition (M&A) or consolidation. There were five Texas state-chartered banks that failed between 2007 and 2012; however, the majority of the decline in the number of charters in the last five years was due to mergers. In December 2007, there were 330 state-chartered banks. At the end of 2012, there were 293¹ state-chartered banks.

On the other hand, M&A and consolidation activity have not decreased the total assets held by state-chartered banks. At year-end 2007, total assets for state-chartered banks were at \$154.2 billion, and by

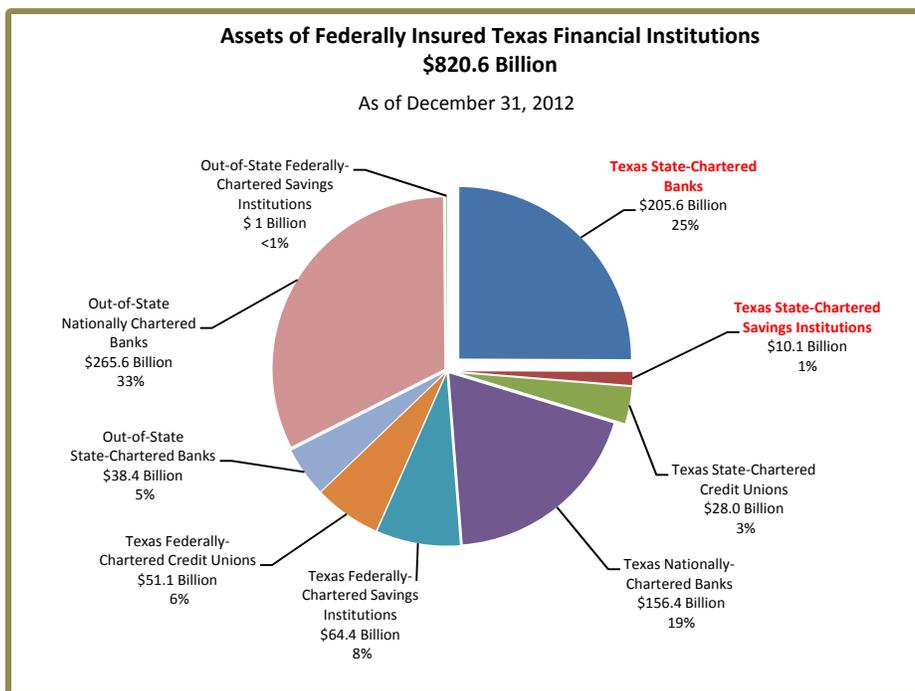


Chart 1 Source: FDIC December 2012 Summary of Deposits June 2012

¹ FDIC financial data does not include one state-chartered bank that has fiduciary activities only and does not have the power to accept or pay deposits. Therefore, the institution is not required to report financial information to the FDIC.

year-end 2012, total assets had grown to \$205.6 billion.

STATE-CHARTERED BANKING PROFILE (DEPARTMENT OF BANKING)

The net number of Texas state-chartered banks continued to trend downward in the second half of the year primarily due to mergers. However, the Texas banking system recognized substantial growth of total assets and total deposits reflecting improved economic conditions in Texas. Over the second half of 2012, total assets of Texas state-chartered banks grew markedly by \$9.3 billion or 9.5% annualized to \$205.6 billion, while total deposits increased by \$9.4 billion or 11.8% annualized to \$169.2 billion.

The Department continues to see an elevated interest in conversions to a Texas state-charter bank. In December 2012, two financial institutions converted to state-chartered banks. The resulting influx of banks by conversion has partially offset the trend in bank mergers as banks continue to take advantage of opportunities to grow and achieve economies of scale to better position themselves for the future.

STATE-CHARTERED THRIFT PROFILE (DEPARTMENT OF SAVINGS AND MORTGAGE LENDING)

Increased profitability occurred in 73% of the thrift institutions during 2012, due to an increase in the volume of loans, and reduced provisions for loan losses. Only 10% of the thrift charters were unprofitable in 2012, compared to 23% in 2011. Nonperforming loans and other real estate foreclosed decreased in state-chartered thrifts during 2012 by 1.54% of total assets from 7.49% to 5.95%.

State-chartered thrift assets under the Department's jurisdiction totaled \$10.14 billion as of December 31, 2012, and increased by 6.43% or \$612.6 million from last year. The total number of state-chartered savings banks at year-end 2012 remains thirty, with the addition of one conversion, the conversion of three banks under one holding company into the system which then merged into one, and two sets of mergers between state-chartered savings banks.

The Department continues to receive and process a fair volume of applications as the industry continues to expand. During the year, there have been four charter conversion applications, three from national banks and one from a federal savings bank; six branch office applications; three merger/reorganization applications; and various other types of applications. Due to the merger of the Office of Thrift Supervision into the Office of Comptroller of the Currency as of July 21, 2011, further conversions to state thrift charters are anticipated.

TEXAS ECONOMIC PROFILE

Texas continues to expand and progress in the post-recession, with only a few sectors exhibiting signs of slowing. The Texas Business-Cycle Index reflected strength in 2012, with only a slight decrease in the summer months. The index combines movements in employment and state real gross domestic product to provide a broader view of the state's economic health.

WORKFORCE

The Texas unemployment rate fell to 6.3% in January 2013, well below the national rate of 7.7%. The Lone Star State's unemployment figures have been below the national rate for the last six years.

HOUSING

Homes sales and construction permits all exhibited double digit percentage increases over the 12 month period ending in January 2013. It is anticipated that home sales, prices, and

Economic Progress Report

(Change from previous year)

Texas Unemployment	↓	Decreasing
Texas Nonfarm Employment	↑	Increasing
Texas Consumer Price Index	↑	Increasing
Sales Tax Collections, Retail Establishments	↑	Increasing
U.S. Consumer Confidence	↑	Increasing
Gasoline and Diesel Retail Prices	↑	Increasing

Source: Texas Comptroller of Public Accounts

new construction statewide for 2013 will continue to improve as the economy continues to improve and individuals are motivated to be home owners. Foreclosure rates remain higher in other states. In February 2013, the Texas foreclosure rate was one in every 1,824 mortgages according to RealtyTrac. In Texas, Harris County exhibited the highest count of foreclosure filings, followed by Dallas and Tarrant counties.

ENERGY SECTOR

A thriving oil and gas industry is keeping the Texas economy and revenues strong. However, labor-intensive jobs needed to get wells started may begin to drop off in the coming year as wells shift into production, which is much less labor intensive. Per the Texas Railroad Commission, there were 22,479 drilling permits issued in 2012 and 22,480 in 2011. Crude oil futures reached \$93.03 on March 14, 2013. Tax collections continue to be strong.

TAX REVENUE

Tax revenues are still on the rise for Texas. Sales tax collections for 2012 were 12.6% higher than 2011 partially due to strong business spending in the oil and gas and manufacturing sectors. The continued increase in tax collections signifies 32 consecutive months of gains. Higher tax collections between October 2011 and 2012 for sales of vehicles as well as rental tax collections were also exhibited.

FEDERAL GOVERNMENT SEQUESTER AND TEXAS IMPACT

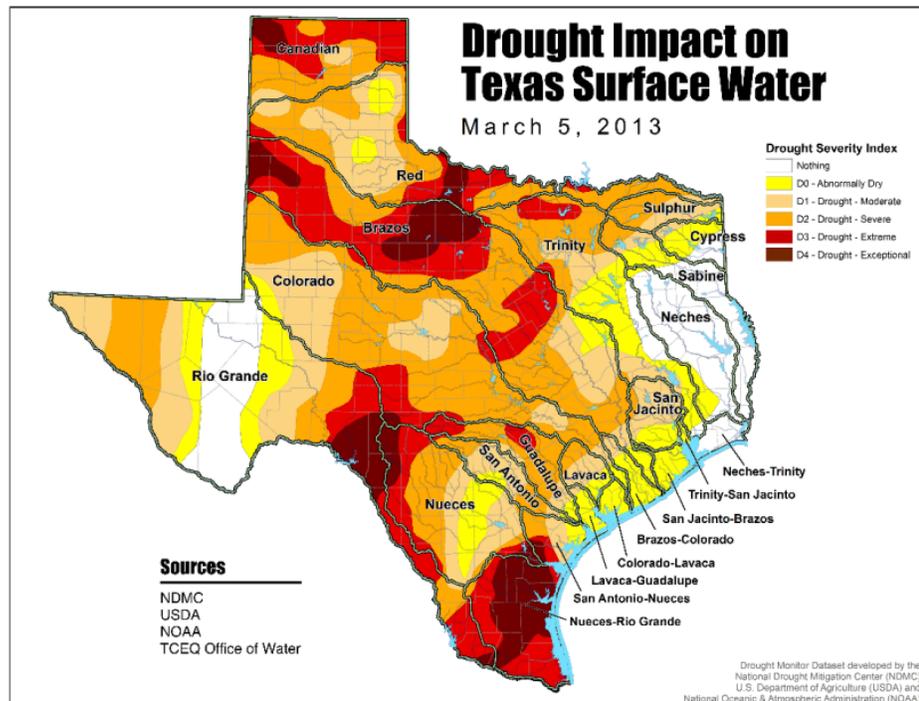
The March 1, 2013 deadline has passed, resulting in mandatory budget cuts across a variety of federal agencies. Congress is expected to announce a new spending plan sometime in April. In the meantime, the effects of the initial cuts are not yet reflected in the economic data. Economists are expressing concerns over the cumulative effect of new spending cuts on both individuals and businesses. The general concern is that spending cuts could dampen the state economies.

Reports indicate that Texas may not suffer as much as other states, whose economies are not as strong or diverse. Pending a new spending plan, a fact sheet posted on the White House website indicates that Texas' defense sector will suffer the largest cuts.

PERSISTENT DROUGHT

On July 5, 2011, Texas Governor Rick Perry issued an Emergency Disaster Proclamation certifying that exceptional drought conditions posed a threat of imminent disaster in specified counties in Texas. Since July 2011, the proclamation has been renewed every month, with the most recent renewal being on February 21, 2013.

According to the state climatologist, John Neilsen-Gammon, Texas is experiencing its third-worst drought. Although Texas had some precipitation early in 2013, the future weather outlook is not promising relief as the long range reports are for warmer than normal climates and minimal precipitation. The National Oceanic and Atmospheric



Administration (NOAA) released its weather prediction for the spring season in early March 2013. Their seasonal assessment is that Texas can expect the drought to persist or intensify, with drought-free areas of the state likely to see drought development.

With the lack of rainfall, the Lone Star State faces a water shortfall not only for domestic usage, but also for businesses. The 83rd Texas Legislature is presently reviewing possible options to help improve the state's water infrastructure as the population booms and the drought continues.

As expected, a variety of agricultural products have been affected by the drought. In February 2013, the National Cotton Council held its annual Economic Outlook meeting, in which it was discussed that the states of Texas, Oklahoma, and Kansas had decreased their total upland acres by 24% from the previous last year. In a survey conducted by the Council, 65% of respondents indicated they were planting less cotton and intended to move their acres into grain sorghum, wheat and corn. Between 10% and 15% of the responses indicated they plan to plant more cotton, with some of those acres coming from grains. The underlying reason for these planting changes appears to be weather. A large percentage of the acres are coming from growers that were unable to plant cotton in 2012 due to drought conditions. The relatively higher grain prices are an added benefit to growing grains over cotton.

On March 1, 2013, the Lower Colorado River Authority announced that irrigation water would not be made available for a second year to Texas rice farmers. The decision was made when the combined storage of Lake Travis and Buchanan was less than 850,000 acre-feet. It is estimated approximately 55,000 acres of rice production will be lost in 2013.

Challenges to the beef industry also continue. Beef supplies began to decline in 2007, and continue to decline due to the drought. Parched grazing land and high corn prices elevated cattle feed prices causing ranchers to reduce their cost and the number of cattle. A number of feedlots and yards have been reported to be empty or closed. News media outlets report that cattle ranchers may not be able to rebuild their herds, which is a multi-year process, until the drought abates. In January 2013, Cargill Beef, one of the nation's biggest meatpackers, temporarily closed a slaughterhouse in Plainview, and laid off 2,000 workers. The annual economic loss to the region is estimated at \$1.1 billion.

Worries about the lack of water are not limited to those in the agricultural industry. The Electric Reliability Council of Texas (ERCOT) is equally concerned. Large amounts of water are necessary to keep energy production equipment cool. In 2012, high temperatures resulting in high energy consumption caused the overnight closure of a plant. If the weather pattern continues, it is plausible that the state could experience another closure in the spring or summer months.

The longer this pattern persists, the longer it will take for the affected industries to return to pre-drought conditions.

SUPERVISORY CONCERNS BASED ON NATIONAL EVENTS AND MANDATES

The end result of the financial crisis was the reform of the financial regulatory system, leading to multiple changes to laws, regulations, and rules. The financial industry still has a long road ahead as numerous regulation and rule changes remain to be implemented pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank or the Act).

The Departments continue to monitor the impact of Dodd-Frank and the various provisions and rules which will become effective in the coming years. Changes in regulations and laws will impact management and expenses. The Act contains 398 rulemaking requirements. As of March 1, 2013, there have been 148 rules finalized, 121 proposed rules released, and 129 rules that have not yet been proposed. Of particular interest to the Departments are the following implemented rules:

Section 939A of the Dodd-Frank Act directed federal banking regulatory agencies to remove all references to the use of investment ratings provided by the Nationally Recognized Statistical Rating Organizations from their regulations regarding the assessment of credit-worthiness and to "substitute in such regulations such standard of credit-worthiness as each respective agency shall

determine as appropriate”. The new regulatory guidances became effective January 1, 2013. There is a concern that smaller financial institutions may not be able to meet these standards as they do not have the expertise or staffing resources to adequately evaluate bank portfolios independent of a credit rating. It may also force institutions into limiting the portfolio diversification due to the lack of familiarity or expertise. The existing Federal Financial Institutions Examination Council (FFIEC) guidance on the classification of securities, as set forth in FDIC FIL 70-2004 and FRB SR 04-09, has not yet been updated to reflect the new post-Dodd-Frank Act guidance. Updates to these guidelines are expected in the near future. Examination procedures that encompass these new expectations are also in the process of being developed at each of the federal regulators. The Departments are waiting to review both the updated FFIEC guidelines for the classification of securities and any new federal examination procedures for investments, before revising existing standards and examination procedures for state-chartered banks and thrifts. In the meantime, the Departments will examine for compliance with the existing federal guidance.

Effective January 21, 2013, Section 611 of the Dodd-Frank prohibits state-chartered banks from engaging in derivative transactions unless “the law with respect to lending limits of the State in which the insured State bank is chartered takes into consideration credit exposure to derivative transactions.” To meet this new requirement, the Banking Department’s rules governing lending limits for state banks have now been amended to include credit exposures arising from derivative transactions and securities financing transactions (securities repurchase agreements, reverse repurchase agreements, securities lending transactions and securities borrowing transactions).

The banking industry continues to be faced with the implementation of Basel III and its impact on capital requirements. Although the proposal has been delayed by U.S. regulators, the underlining fact is that U.S. financial institutions will have to comply. The debate remains on whether or not the minimum leverage ratios should be based on tangible common equity against bank assets or be weighted for risk.

With the low rate environment, banks and thrifts are trying to find more ways to run leaner operations in an effort to improve their bottom lines. A number of banks have implemented plans to reduce headcount, trim branch networks, streamline workflow, and upgrade technology to reduce long-term expenses. Reports indicate that some banks are generating revenue by bundling services for a fee or making accounts conditionally free if a customer opts for e-statements, a debit card, or agree to maintain a specific account balance. If the conditions are not met, a fee is assessed.

In the same vein, banks are reevaluating their balance sheets to find other ways to generate revenue in this environment. A review of state-chartered bank assets between 2009 and 2012 shows that loan demand decreased approximately 7%. In an effort to supplement revenues, some institutions will hold assets for a longer term in order to obtain higher yields. Although holding longer-term assets can improve yields in the short-term, these assets have the risk of declining market value and liquidity if rates rise. However, a review of the state-chartered banks securities portfolio as of December 2012 reflects an increase in lower yielding assets, such as U.S. Treasuries and municipals. Between 2009 and 2012, U.S. Treasuries and municipals investments increased a substantial 222.5% from \$4.4 billion to \$14.3 billion.

SUPERVISORY CONCERNS BASED ON TEXAS EVENTS

Problem institutions peaked in 2010 for the Texas Department of Banking. These problem institutions exhibited weak asset quality, earnings, and capital. Since then, there has been a steady decline of problem institutions. The Texas Department of Banking and the Texas Department of Savings and Mortgage Lending continue to closely monitor the condition and progression of these problem entities. Monitoring and guiding institutions includes the utilization of many tools. These tools include the issuance of informal and formal enforcement actions detailing corrective actions necessary for improvement, performing examinations on a more frequent basis, reviewing periodic progress reports, and installing on-site supervisors as part of the bank monitoring activities.

Currently, supervisory attention continues to be directed towards asset quality, past due loans and

foreclosed real estate. The Departments have also focused on management's monitoring of credit concentrations and nonperforming assets and their ability to maintain earnings and capital levels. As the economy continues to strengthen, state-chartered banks and thrifts are expected to continue to reflect improvement in their balance sheets.

As mentioned in the Banking System Overview, trends show that Texas banks are shifting their lending to commercial and industrial loans. While this is a positive shift, there are additional servicing and monitoring challenges for bank management due to the differences in collateral. Commercial loans are generally collateralized by account receivables or inventory, which can be more difficult to value as opposed to commercial real estate loans collateralized by real estate, which has a more quantifiable value. Banks are also expanding their loan portfolios into new markets or business lines. This can create additional risks if the bank does not have the knowledge or expertise required in these areas.

In recent months there have been waves of cyber-attacks against financial institutions, large and small. Cybercrime, such as corporate account takeover, is one of the fastest growing crimes impacting banks and their customers. The Texas Department of Banking, in partnership with the U.S. Secret Service and the Texas Bankers Electronic Crimes Task Force, has been working to assist financial institutions in adopting practices designed to reduce the risks of corporate account takeovers. The Texas Department of Banking has also worked closely with the Conference of State Bank Supervisors to educate bankers nationwide on these risks. The Texas Department of Savings and Mortgage Lending similarly advised its state savings banks to be diligent in reducing the risks of corporate account takeover. Examination procedures and tools have been developed to address these issues.

Other areas receiving additional attention during examinations include: Bank Secrecy Act/Anti-Money Laundering compliance, risk management practices, capital levels, the composition of classified assets, fraud, internal watch lists, overdraft programs, private-label collateralized mortgage obligations, tax liens and issues affecting reputational risk. Bank practices on issues such as fair lending, deceptive trade practices, and foreclosures are also evaluated as they can impact a bank's reputation. Regulators assess both management and the board of directors' abilities at every examination.

SUPERVISORY MEASURES BEING TAKEN

The Departments remains focused on changes in economic conditions, the interest rate environment, asset quality and compliance related issues. Regulatory oversight will focus on practices that could cause banks to operate as less than safe and sound institutions. In many situations, problem status can be prevented, or a quick turnaround can be implemented, by timely regulatory identification and open communication with management. Enhanced staff training is also important along with continued diligence in monitoring the asset quality of our institutions.

The Texas Department of Banking is concentrating in the following areas:

- ❖ Focusing on practices and other conditions that can lead to problem institutions;
- ❖ Monitoring reductions in internal and external audit, loan review and training expenditures made by banks in an effort to modify operations to reduce overhead costs;
- ❖ Conducting targeted reviews of new product lines as banks seek additional sources of revenue;
- ❖ Assessing interest rate risks, as banks adjust to improve net interest margins;
- ❖ Initiating enforcement actions early in the detection of deteriorating trends;
- ❖ Conducting frequent on-site examinations of problem institutions;
- ❖ Communicating and coordinating joint enforcement actions and other supervisory activities with other state and federal regulators;
- ❖ Placing monthly calls to state banks to obtain industry input on prevailing economic conditions;
- ❖ Expanding off-site monitoring to include follow-up of examination concerns;
- ❖ Utilizing a risk-focused examination process to free up resources for problem institutions;
- ❖ Monitoring state, national, and world political and economic events impacting the industry such as federal programs designed to stabilize the financial markets and new regulations;
- ❖ Performing targeted reviews of specific troubled areas; and,

- ❖ Increasing internal communication and training to improve examiner awareness of pertinent issues.

The Texas Department of Savings and Mortgage Lending's supervisory monitoring and enforcement staff are taking the following actions:

- ❖ Conducting regular conference calls and close coordination with other state and federal regulators;
- ❖ Communicating regularly with state savings banks regarding institution-specific issues and industry issues;
- ❖ Conducting targeted examinations of high risk areas of state savings banks;
- ❖ Utilizing enforcement actions and placement of supervisory agents when deemed necessary;
- ❖ Off-site monitoring of each institution's activity (i.e., regulatory correspondence and approvals, independent audit reports, reports of examination, and institution responses to examination comments, criticisms and recommendations);
- ❖ Performing joint review by the FDIC and the Department of a savings bank's contingency / disaster recovery plans;
- ❖ Conducting regular assessments of each institution's activities, strengths and weaknesses, and revising the Department's plan of examination and monitoring for the institution, including the downgrading of institutions, if deemed necessary, by the Department and the FDIC;
- ❖ Reviewing concentrations in commercial real estate and monitoring compliance with Commercial Real Estate Lending Joint Guidance, issued December 12, 2006; and
- ❖ Monitoring local, state, national and world political and economic events impacting the industry.

PERFORMANCE SUMMARY AND PROFILE

TEXAS BANKING SYSTEM

FDIC INSURED STATE-CHARTERED BANKS

The industry's performance in 2012 was favorable, and is expected to continue improving in 2013. Texas banks continue to show resistance to adverse economic trends that have affected other parts of the United States primarily because the Texas economy has outperformed the nation in those areas. The low interest rate environment and increasing compliance cost will continue to challenge institutions.

Asset quality continues to improve as banks appear to be managing their troubled assets appropriately. Net charge-offs decreased 34 basis points (BP) between December 2011 and December 2012. Bank's noncurrent loans to total loans were 1.55% in December 2012 as opposed to 2.34% a year earlier. Bank's noncurrent assets plus other real estate owned to total assets decreased 68 BP to 1.20% for the same period.

Interest income increased from 2011 levels while interest expenses reduced over year-end 2011. The end result was net interest income increasing \$492 million over year-end 2011. The yield on earning assets continues to decrease faster than the cost of funding earning assets, impacting the net interest margin (NIM) and reducing it by 32 BP. Banks realized the beneficial effects of reduced loan loss provisions from \$499 million in 2011 to \$257 million in 2012. Securities gains of \$139 million in 2012 were also recognized. These factors resulted in a net effect of a slightly improved return on assets (ROA) of 5 BP from 0.95% at December 31, 2011 to 1.00% at year-end 2012. Although improving, it has not reached the pre-recessionary level.

Capital protection, though slightly reduced, remains strong in view of the improving asset quality and improving earnings performance. The leverage capital ratio at 9.54% is 44 BP lower than the 9.98% level at year-end 2011.

Overall, Texas state-chartered bank managements are managing their respective balance sheets, cutting costs, and improving performance. The percentage of unprofitable institutions in Texas fell to 6.83% from 8.94% a year ago and from 17.92% in December 2009. The number of problem institutions continues to

decline, and those operating under a corrective action are within manageable levels.

FDIC INSURED STATE-CHARTERED THRIFTS

For 2012, state thrifts had \$208.15 million in net income. ROA for thrifts increased to 2.11% at year-end 2012, up from 0.61% at the previous year. The level of unprofitable savings banks has decreased from 23% to 10%. Most recently chartered, reorganized or converted institutions have reached profitability. Provisions for loan and lease losses to average assets have decreased 124 BP. Non-interest income to earning assets has increased by 52 BP, while non-interest expense to earning assets has increased by 12 BP.

State thrifts experienced a 73 BP increase in their core capital levels during 2012 from 15.73% to 16.46%. The increase in the thrift capital ratio is due to the industry raising over \$31 million in capital and more net income as noted above. Texas state thrifts also continue to exceed the national capital ratios for all savings institutions, which was 10.87% for year-end 2012, and 10.65% for year-end 2011.

NIMs for state thrifts posted a 13 BP decrease from 5.20% to 5.07% at year-end. Year to date provisions to the allowance for loan losses decreased for thrifts \$111 million during the year. The Texas thrift allowances for loan and lease losses to non-current loans and leases, presently at 24.85%, is below the ratio of 46.02% for all FDIC-regulated savings institutions nationwide; however, the Texas thrifts ratio includes a large volume of covered assets (assets acquired from a failed bank, with downside loss protection from the FDIC), which if removed from this calculation would reflect a ratio for Texas thrifts stronger than the national average.

Thrifts' noncurrent assets plus other real estate owned to total assets decreased to a total of 5.95% at December 31, 2012. Thrifts also experienced a decrease in noncurrent loans as a percentage of total loans from 8.87% to 6.69%. Loss reserves have decreased and now represent 1.66% of loans. This is a 58 BP decrease for savings institutions since December 31, 2011.

Number of Institutions and Total Assets

FDIC financial data is reflective of FDIC insured institutions only

	<u>12-31-2012</u>		<u>12-31-2011</u>		<u>Difference</u>	
	<u>No. of Institutions</u>	<u>Assets</u>	<u>No. of Institutions</u>	<u>Assets</u>	<u>No. of Institutions</u>	<u>Assets</u>
Texas State-Chartered Banks	293	\$205.6	302	\$170.4	-9	+\$35.2
Texas State-Chartered Thrifts	30	\$10.1	31	\$9.5	-1	+\$0.6
	323	\$215.7	333	\$179.9	-10	+\$35.8
Other states' state-chartered:						
Banks operating in Texas*	27	\$38.4	25	\$36.0	+2	+\$2.4
Thrifts operating in Texas*	0	0	0	0	0	0
	27	\$38.4	25	\$36.0	+2	+\$2.4
Total State-Chartered Activity	350	\$254.1	358	\$215.9	-8	+\$38.2
National Banks Chartered in Texas	227	\$156.4	250	\$159.6	-23	-\$3.2
Federal Thrifts Chartered in Texas	12	\$64.4	13	\$57.9	-1	+\$6.5
	239	\$220.8	263	\$217.5	-24	+\$3.3
Other states' federally-chartered:						
Banks operating in Texas*	23	\$265.6	22	\$245.9	+1	+\$19.7
Thrifts operating in Texas*	9	\$0.9	10	\$0.9	-1	\$0
	32	\$266.5	32	\$246.8	0	+\$19.7
Total Federally-Chartered Activity	271	\$487.3	295	\$464.3	-24	+\$23.0
Total Banking/Thrift Activity	621	\$741.4	653	\$680.2	-32	+\$61.2

Assets in Billions

**Indicates estimates based on available FDIC information.*

Ratio Analysis

As of December 31, 2012

FDIC financial data is reflective of FDIC insured institutions only.

	<u>State-Chartered Banks</u>	<u>Texas National Banks</u>	<u>All Texas Banks</u>	<u>State-Chartered Thrifts</u>	<u>Texas Federal Thrifts</u>	<u>All Texas Thrifts</u>
<i>Number of Banks</i>	293	227	520	30	12	42
% of Unprofitable Institutions	6.83%	5.29%	6.15%	10.00%	16.67%	11.90%
% of Institutions with Earnings Gains	64.85%	69.60%	66.92%	73.33%	83.33%	76.19%
Yield on Earning Assets	3.65%	3.99%	3.80%	5.83%	4.47%	4.65%
Net Interest Margin	3.26%	3.64%	3.42%	5.07%	3.85%	4.01%
Return on Assets	1.00%	1.23%	1.10%	2.11%	1.30%	1.41%
Return on Equity	8.86%	11.48%	9.94%	12.95%	14.73%	14.32%
Net Charge-offs to Loans	0.32%	0.47%	0.39%	0.62%	1.42%	1.31%
Earnings Coverage of Net Loan C/Os	7.42	5.98	6.62	5.66	3.02	3.19
Loss Allowance to Loans	1.42%	1.78%	1.58%	1.66%	2.05%	1.99%
Loss Allowance to Noncurrent Loans	91.64%	82.94%	86.99%	24.85%	173.76%	102.45%
Noncurrent Assets+OREO to Assets	1.20%	1.68%	1.40%	5.95%	0.86%	1.55%
Net Loans and Leases to Core Deps	72.91%	75.43%	74.03%	107.79%	84.37%	87.01%
Equity Capital to Assets	10.92%	10.02%	10.53%	16.44%	8.76%	9.80%
Core Capital (Leverage) Ratio	9.54%	9.04%	9.32%	16.46%	8.71%	9.74%

Data for other state-chartered institutions doing business in Texas is not available and therefore excluded.

Comparison Report

Select Balance Sheet and Income/Expense Information
 FDIC financial data is reflective of FDIC insured institutions only.
 December 31, 2012

	State Banks*		State Thrifts	
	<u>End of Period</u>	<u>% of Total Assets</u>	<u>End of Period</u>	<u>% of Total Assets</u>
Number of Institutions	293		30	
Number of Employees (full-time equivalent) (In millions)	39,815		1,928	
Total Assets	\$205,610		\$10,143	
Net Loans and Leases	\$111,478	55.19%	\$6,816	67.20%
Loan Loss Allowance	\$1,637	0.80%	\$115	1.14%
Other Real Estate Owned	\$670	0.33%	\$140	1.38%
Goodwill and Other Intangibles	\$3,400	1.65%	\$37	0.37%
Total Deposits	\$169,154	82.27%	\$7,610	75.03%
Federal Funds Purchased and Repurchase Agreements	\$3,486	1.70%	\$0	0.0%
Other Borrowed Funds	\$5,748	2.80%	\$700	6.90%
Equity Capital	\$22,456	10.92%	\$1,667	16.44%
<u>Memoranda:</u>				
Noncurrent Loans and Leases	\$1,786	0.87%	\$464	4.57%
Earning Assets	\$185,954	90.44%	\$9,307	91.76%
Long-term Assets (5+ years)	\$57,568	28.00%	\$3,412	33.64%
	<u>Year-to Date</u>	<u>% of Avg. Assets</u>	<u>Year-to Date</u>	<u>% of Avg. Assets</u>
Total Interest Income	\$6,437	3.30%	\$524	5.32%
Total Interest Expense	\$687	0.35%	\$68	0.69%
Net Interest Income	\$5,751	2.95%	\$456	4.63%
Provision for Loan and Lease Losses	\$257	0.13%	\$15	0.15%
Total Noninterest Income	\$2,159	1.11%	\$129	1.32%
Total Noninterest Expense	\$5,264	2.70%	\$356	3.62%
Securities Gains	\$139	0.07%	\$3	0.03%
Net Income	\$1,944	1.00%	\$208	2.11%
<u>Memoranda:</u>				
Net Loan Charge-offs	\$357	0.18%	\$40	0.41%
Cash Dividends	\$1,457	0.75%	\$145	1.48%

*Excludes branches of state-chartered banks of other states doing business in Texas. As of December 31, 2012, there are an estimated twenty seven out-of-state state-chartered institutions with \$38.2 billion in assets.

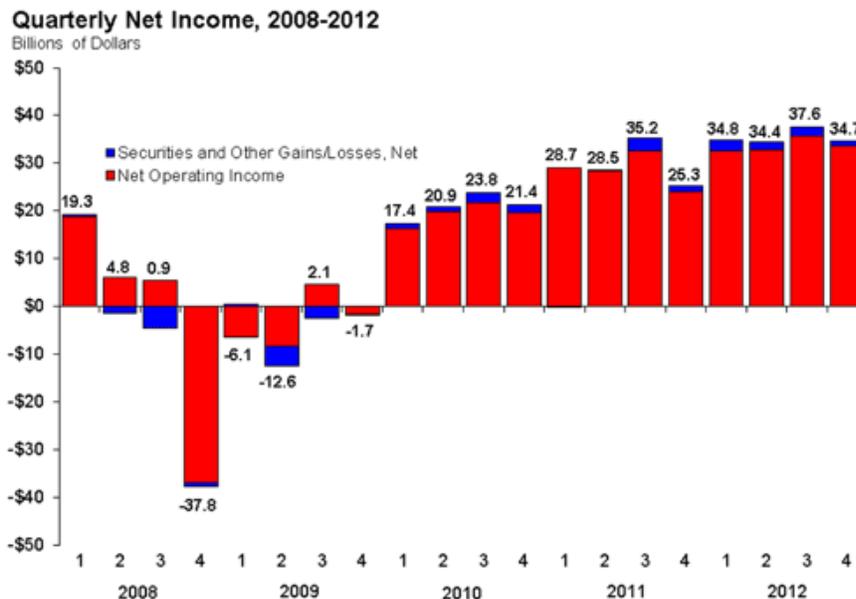
No branches of state-chartered thrifts of other states conducted business in Texas as of December 31, 2012.

PERFORMANCE SUMMARY

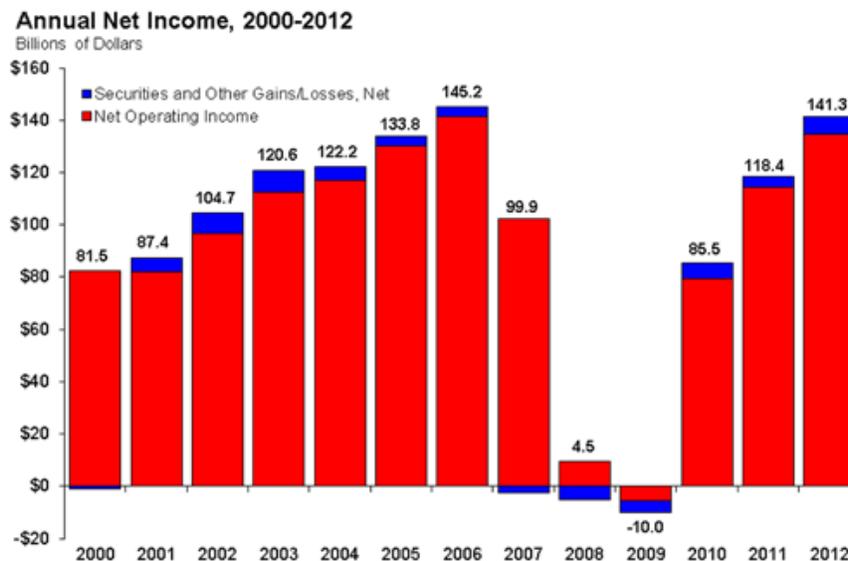
UNITED STATES BANKING SYSTEM

Quarterly Banking Profile – National Level Fourth Quarter 2012 Federal Deposit Insurance Corporation

↑ **Net Income is More Than a Third Higher Than in Fourth Quarter 2011** - Bolstered by higher noninterest income and lower provisions for loan losses, earnings at FDIC-insured institutions in fourth quarter 2012 posted a \$9.3 billion (36.9%) increase over the total for fourth quarter 2011. The \$34.7 billion in fourth-quarter net income was the highest total for a fourth quarter since 2006. Well over half of all institutions—60%—reported year-over-year improvement in quarterly earnings, while the share of institutions reporting net losses for the quarter fell to 14%, from 20% a year earlier. The average return on assets (ROA) rose to 0.97% from 0.73% in fourth quarter 2011.



↑ **Noninterest Income Rebounds From Year-Earlier Weakness** - The \$10 billion (18.2%) year-over-year improvement in noninterest income was driven primarily by higher gains on loan sales (up \$2.4 billion, or 132.4%, over fourth quarter 2011), increased trading revenue (up \$1.9 billion, or 75.3%), and reduced losses on sales of foreclosed property (down \$1.2 billion, or 72%). Additionally, noninterest income at some large banks was adversely affected a year ago by appreciation in the fair values of their liabilities; the absence of similar accounting losses in this quarter's results also helped to improve noninterest income. Overall, almost two out of every three banks (62.3%) reported year-over-year increases in noninterest income.



↑ **Insured Institutions Continue to Reduce Their Loss Provisions** -

Banks set aside \$15.1 billion in loan-loss provisions in the fourth quarter, a \$4.9 billion (24.6%) reduction compared with fourth quarter 2011. This is the smallest fourth-quarter loss provision since 2006, and marks the 13th consecutive quarter with a year-over-year decline in loss provisions. More than half of all institutions—53.6%—reported lower loss provisions.

Quarterly Revenue and Loan-Loss Provision, 2008-2012



↓ **Banks See Margins Erode** - The increase in noninterest income and reduction in loss provisions helped offset a \$2.7 billion (2.5%) year-over-year decline in net interest income. Fourth-quarter net interest income totaled \$104.4 billion, compared with \$107.1 billion a year ago. This is the lowest quarterly total since fourth quarter 2009, when the industry had \$1.4 trillion less in interest-bearing assets. The average NIM fell to 3.32%, from 3.57% in fourth quarter 2011, as average asset yields declined more rapidly than average funding costs. This is the lowest quarterly NIM for the industry since fourth quarter 2007. More than two-thirds of all banks—67.9%—reported year-over-year NIM declines.

↑ **Full-Year Earnings Are Second Highest Ever** - Full-year net income totaled \$141.3 billion, a \$22.9 billion (19.3%) improvement over 2011. This is the second-highest annual earnings ever reported by the industry, after the \$145.2 billion total in 2006, when the industry had \$2.7 trillion less in assets. The average ROA rose to 1.00% from 0.88% in 2011. The largest contribution to the increase in earnings came from reduced provisions for loan losses. Noninterest income was \$18.4 billion (8%) higher than in 2011, thanks to an \$11.2 billion (174.4%) increase in gains on loan sales, a \$6.8 billion (93.9%) increase in servicing income, and a \$2.4 billion (51.8%) reduction in losses on foreclosed property sales. The improvement in noninterest income was limited by a \$12.4 billion negative swing in results from trading credit exposures. Net interest income was \$1.3 billion (0.3%) lower than in 2011, as the full-year NIM fell from 3.60% to 3.42%. Realized gains on securities and other assets added \$4.2 billion (75.7%) more to pretax earnings than a year earlier.

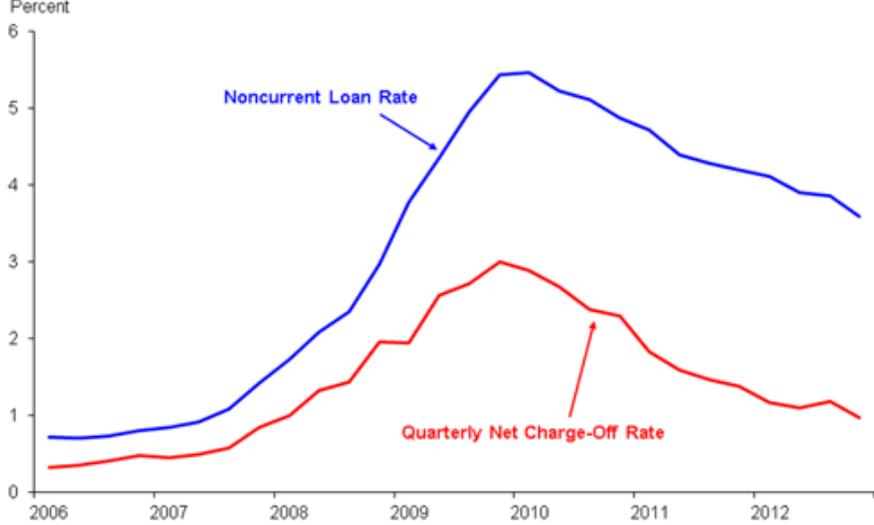
↑ **Loan Losses Improve Across All Loan Categories** - Asset quality indicators continued to improve in the fourth quarter. Net charge-offs (NCOs) totaled \$18.6 billion, down \$7 billion (27.4%) from fourth quarter 2011. This is the 10th consecutive quarter that NCOs have declined. It is the lowest quarterly NCO total since fourth quarter 2007. All major loan categories showed year-over-year improvement in quarterly NCO amounts. The largest declines occurred in:

- 1-to-4 family residential mortgages, where quarterly NCOs fell by \$1.5 billion (29.3%),
- Real estate construction and development loans, where NCOs declined by \$1.3 billion (62.6%),
- Credit cards, where NCOs were \$1 billion (14.1%) lower, and
- Loans to commercial and industrial (C&I) borrowers, where NCOs were also \$1 billion (39.7%) lower.

↑ **Noncurrent Rate Declines to Four-Year Low** - The amount of loans that were noncurrent (90 days or more past due or in nonaccrual status) declined by \$16.1 billion (5.5%) during the quarter. At year-

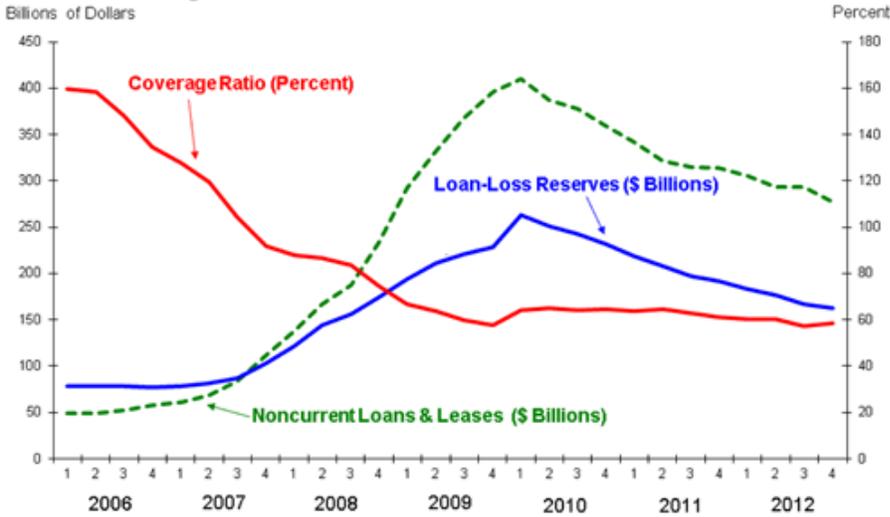
end, noncurrent loan balances totaled \$276.8 billion, compared with \$292.8 billion at the end of the third quarter. The percentage of total loans and leases that were noncurrent fell from 3.86% to 3.60%, the lowest level since the end of 2008. Noncurrent balances fell in all major loan categories in the fourth quarter. Noncurrent 1-to-4 family residential mortgage balances declined by \$6.4 billion (3.5%), while noncurrent real estate construction and development loans fell by \$3.6 billion (17.3%), and noncurrent nonfarm nonresidential real estate loans declined by \$3.1 billion (9.2%).

Noncurrent Loans and Loan Losses Continue to Fall but Remain Well Above Pre-Crisis Levels



↑ **Coverage of Noncurrent Loans Improves Despite Reduction in Reserves** - Insured institutions

Reserve Coverage Ratio*



* Loan-loss reserves to noncurrent loans & leases.

reduced their reserves for loan losses by \$5 billion (3%) in the fourth quarter, as fourth-quarter loss provisions replenished only \$15.1 billion of the \$18.6 billion taken out of reserves by NCOs. This is the 11th consecutive quarter that the industry's reserve balances have declined. The trend toward lower reserves continues to be led by larger institutions. More institutions added to their reserves than reduced them (48.8% versus 43.5%, respectively). Despite the overall reduction in reserves, the larger decline

in noncurrent loan balances at insured institutions meant that the industry's coverage ratio of reserves to noncurrent loans increased from 57.0% to 58.5% during the quarter.

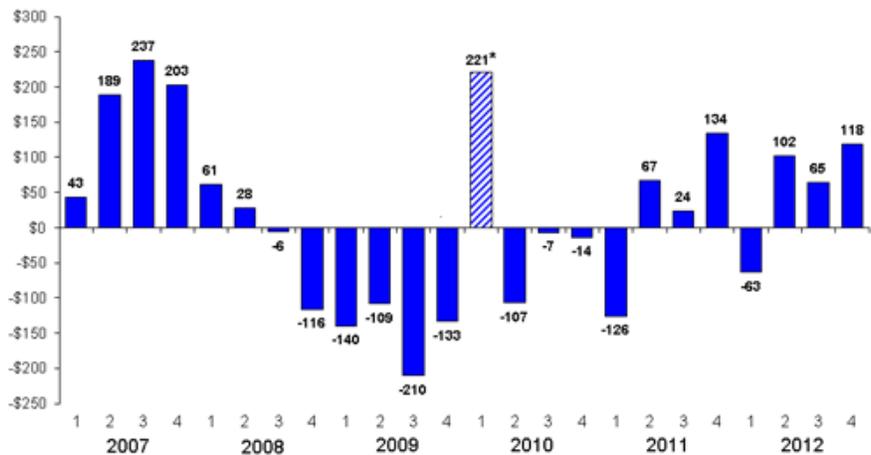
↓ **Decline in Securities Values Contributes to Reduction in Equity Capital** - Total equity capital fell

by \$5.6 billion (0.3%) in the fourth quarter. The decline reflected a \$7.2 billion decrease in accumulated other comprehensive income, as unrealized gains on securities held for sale fell by \$7.6 billion (10.4%). For the industry as a whole, retained earnings made no contribution to equity formation in the fourth quarter, as declared dividends of \$35.5 billion exceeded the \$34.7 billion in quarterly net income. The high level of dividends was the result of a large quarterly dividend declared at one institution. A majority of institutions, 55.2%, added to their equity capital during the quarter.

↑ **Loan Balances Increase for Sixth Time in Seven Quarters** - Total assets

increased by \$227.8 billion (1.6%). Loans accounted for more than half of the increase, as net loan and lease balances rose by \$123.2 billion (1.7%). Loan growth was led by C&I loans (up \$53.4 billion, or 3.7%), credit cards (up \$28.2 billion, or 4.2%), and nonfarm nonresidential real estate loans (up \$14.6 billion, or 1.4%). Home equity loan balances fell by \$12.6 billion (2.2%) during the quarter, while balances of real estate construction and development loans declined by \$6.6 billion (3.1%). Loans to small businesses and farms increased by \$1.7 billion (0.3%), as small C&I loans (original amounts of \$1 million or less) rose by \$5.3 billion (1.9%) and small farmland loans (original amounts of \$500,000 or less) increased by \$234 million (0.6%). Cash and balances due from depository institutions increased by \$87.2 billion (6.4%), as banks increased their balances with Federal Reserve banks by \$60.2 billion (9.1%). Banks' investment securities portfolios grew by \$23.5 billion (0.8%) during the quarter.

Quarterly Change in Loan Balances, 2007-2012
Billions of Dollars

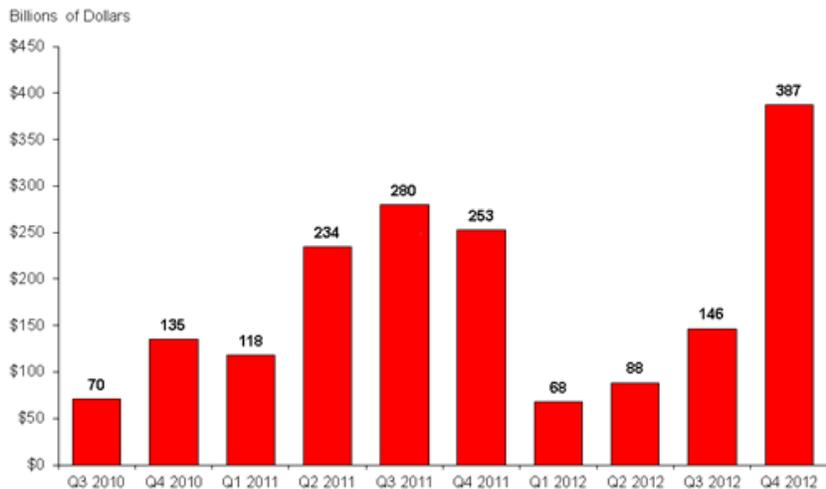


* FASB Statements 166 and 167 resulted in the consolidation of large amounts of securitized loan balances back onto banks' balance sheets in the first quarter of 2010. Although the total amount consolidated cannot be precisely quantified, the industry would have reported a decline in loan balances for the quarter absent this change in accounting standards.

↑ **Large Denomination Deposit Balances Surge** - Total deposits increased by \$313.1 billion (3%), as deposits in domestic offices posted a record \$386.8 billion (4.3%) increase. Most of the growth consisted of large denomination deposits. Balances in accounts of more than \$250,000 increased by \$348.5 billion (8.2%).

Uninsured deposit balances increased by \$252.7 billion (12.7%), while balances in noninterest-bearing transaction accounts above the basic FDIC coverage level of \$250,000 that had temporary full FDIC coverage through the end of 2012 increased by \$49.5 billion (3.3%). Banks reduced their nondeposit liabilities by \$76.9 billion (3.7%), and their foreign office deposits by \$73.7 billion (5.1%).

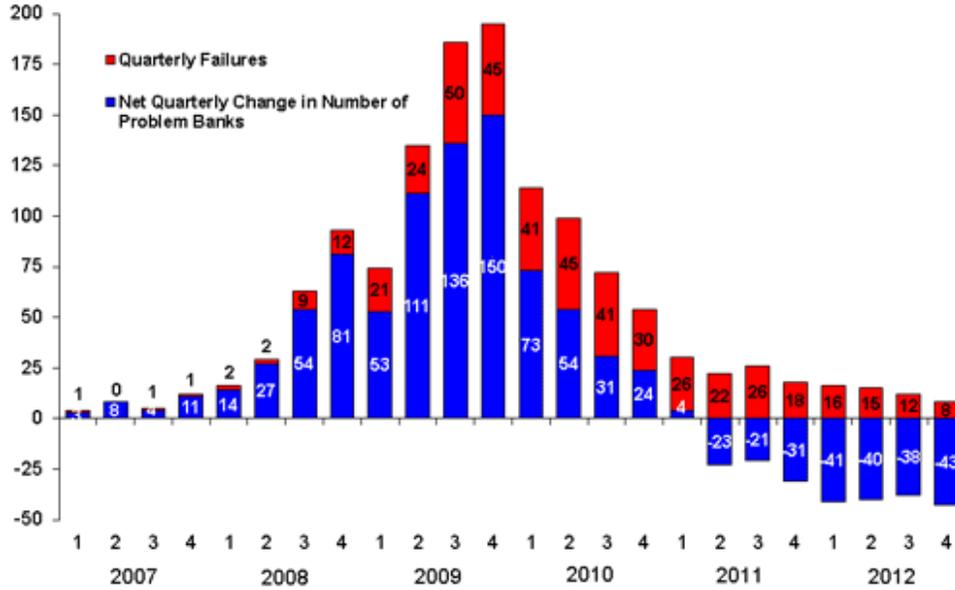
Quarterly Change in Domestic Deposits



↑ **Quarterly Failures Decline to 4 ½ Year Low** - In the fourth quarter, the number of insured commercial banks and savings institutions reporting financial losses fell from 7,181 to 7,083. During the quarter, 88 institutions were merged into other banks, and eight insured institutions failed. This is the smallest number of failures in a quarter since second quarter 2008. For the sixth quarter in a row, no new reporting institutions were added. Calendar 2012 is the first year in FDIC history that no new reporting institutions were added, and the second year in a row with no start-up de novo charters (the

three new reporters in 2011 were all charters created to absorb failed banks). The number of institutions on the FDIC's "Problem List" declined for a seventh consecutive quarter, from 694 to 651. Total assets of "problem" institutions fell from \$262 billion to \$233 billion.

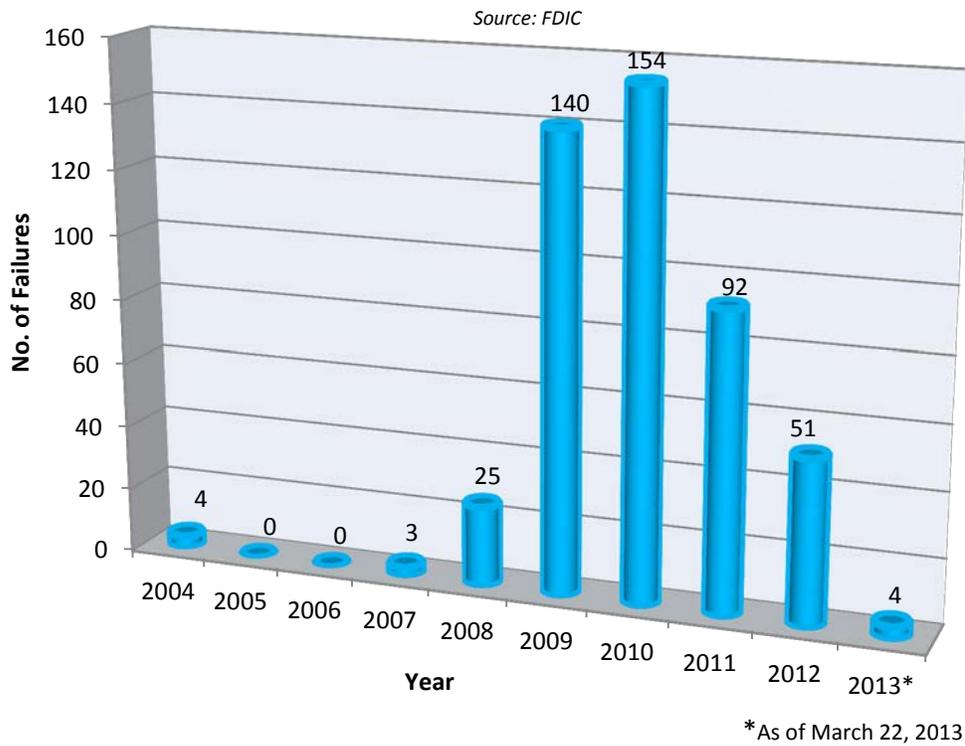
Quarterly Changes in the Number of Troubled Institutions, 2007-2012



**Bank and Thrift Closures Nationwide
Federal Deposit Insurance Corporation**



Nationwide Bank Failures 2004-2013



**Snapshot Stock Performance
Southwest Regional Banks**

Name	Last Trade	52 Wk Range	PE	EPS	Mkt Cap	Div/Shr	Div Yld
ACNB Corporation	03/04 16.50	14.06 17.02	11.65	1.42	98.34M	0.76	4.60%
BancFirst Corporation	03/04 40.55	36.49 44.90	12.07	3.36	618.06M	1.16	2.90%
Banco Bilbao Vizcaya Argentaria	03/04 9.69	5.30 10.57	23.07	0.42	52.65B	0.42	4.40%
BOK Financial Corporation	03/04 59.66	50.89 60.00	11.63	5.13	4.08B	1.52	2.60%
Cass Information Sys, Inc.	03/04 42.35	32.33 43.97	20.97	2.02	484.36M	0.72	1.70%
CoBiz Incorporated	03/04 8.34	5.22 8.50	15.22	0.55	326.21M	0.12	1.50%
Commerce Bancshares, Inc.	03/04 37.74	34.45 40.70	13.00	2.90	3.42B	0.90	2.40%
Comerica, Inc.	03/04 35.16	27.72 35.56	13.17	2.67	6.60B	0.68	2.00%
Community Shores Bank Corp	02/04 0.30	0.07 0.85	N/A	-0.18	440.40K	N/A	N/A
Cullen Frost Bankers, Inc.	03/04 60.66	53.37 61.68	15.72	3.86	3.73B	1.92	3.20%
Enterprise Fin Serv Corp	03/07 20.41	20.21 40.41	185.55	0.11	237.90M	N/A	N/A
First Community Corp S C	03/04 14.01	9.94 14.50	10.23	1.37	252.33M	0.21	1.50%
First Financial Bankshares, Inc.	03/04 8.966	7.20 9.25	11.35	0.79	46.87M	0.20	2.20%
Firstcity Financial Corp	03/04 45.26	30.50 45.48	19.19	2.36	1.41B	1.00	2.20%
Great Southern Bancorp, Inc.	03/04 9.85	7.00 10.83	3.47	2.84	103.98M	N/A	N/A
Guaranty Fed Bancshares, Inc.	03/04 24.57	20.75 31.81	7.68	3.20	334.05M	0.72	2.90%
Heartland Financial USA, Inc.	02/28 9.95	6.29 10.61	33.17	0.30	27.15M	0.00	0.00%
International Bancshares Corp	03/04 23.70	14.53 29.01	8.68	2.73	398.80M	0.40	1.70%
Landmark Bancorp, Inc.	03/04 20.06	16.92 21.89	14.43	1.39	1.35B	0.40	2.00%
Liberty Bancorp, Inc.	03/04 20.20	17.62 21.47	9.35	2.16	59.02M	0.76	3.80%
Mackinac Financial Corp	03/04 11.30	10.00 12.00	14.07	0.80	35.97M	0.10	0.90%
Metrocorp Bancshares, Inc.	03/04 8.55	5.61 8.70	5.86	1.46	47.53M	0.16	1.90%
MidWest One Finl Group, Inc.	03/04 10.47	7.75 11.82	16.89	0.62	191.73M	0.00	0.00%
OmniAmerican Bancorp, Inc.	03/04 22.41	16.80 24.25	11.43	1.96	190.04M	0.50	2.20%
Osage Bancshares, Inc.	03/04 26.00	17.63 26.61	47.27	0.55	297.54M	N/A	N/A
Prosperity Bancshares, Inc.	11/30 11.32	7.10 11.50	N/A	0.24	N/A	0.34	4.50%
QCR Holdings, Inc.	03/04 46.13	38.56 47.66	14.28	3.23	2.60B	0.86	1.90%
Southwest Bancorp, Inc.	03/04 16.20	9.51 16.29	8.76	1.85	79.67M	0.08	0.50%
Texas Capital Bancshares, Inc.	03/04 12.63	8.02 13.48	19.73	0.64	246.65M	0.00	0.00%
UMB Financial Corporation	03/04 41.76	32.55 52.17	13.88	3.01	1.70B	N/A	N/A
West Bancorp Incorporated	03/04 45.68	40.27 52.61	15.03	3.04	1.85B	0.86	1.90%
Zions Bancorp	03/04 11.03	9.02 12.35	11.99	0.92	191.96M	0.40	3.60%

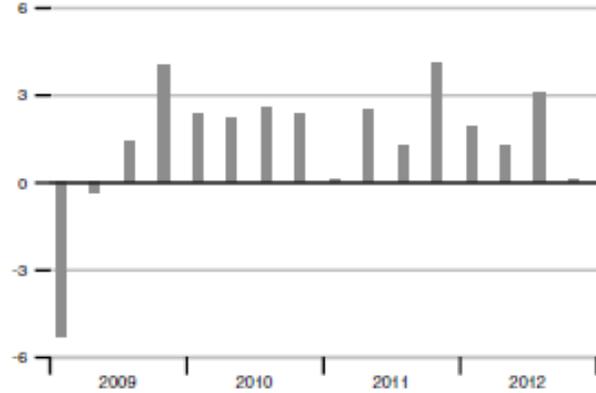
Source: Yahoo Finance (March 2013)

NA – Indicates information was not available.

NATIONAL ECONOMIC TRENDS FEDERAL RESERVE BANK OF ST. LOUIS

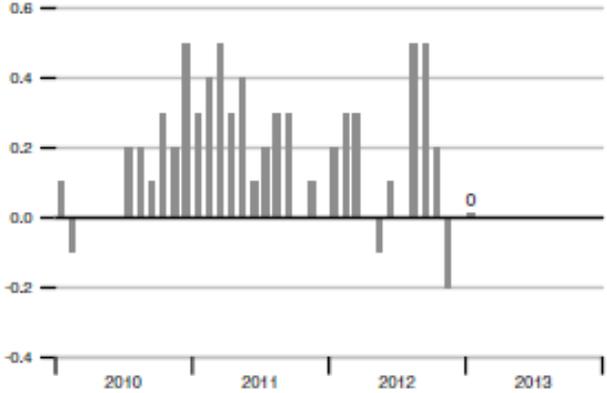
Real GDP Growth

Compounded annual rates of change



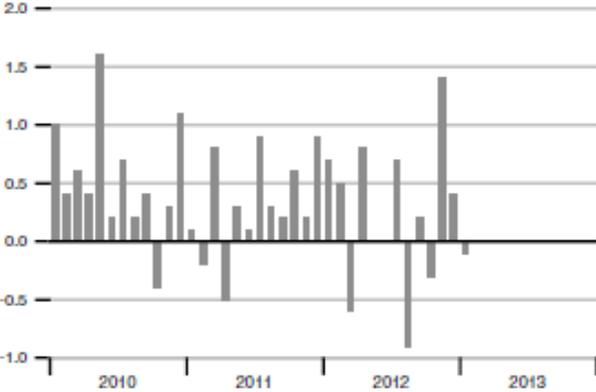
Consumer Price Index

Percent change



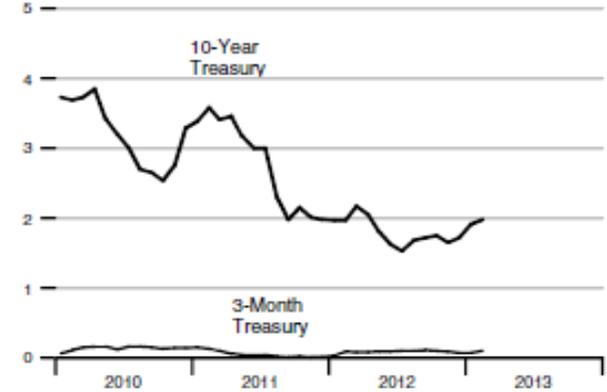
Industrial Production

Percent change



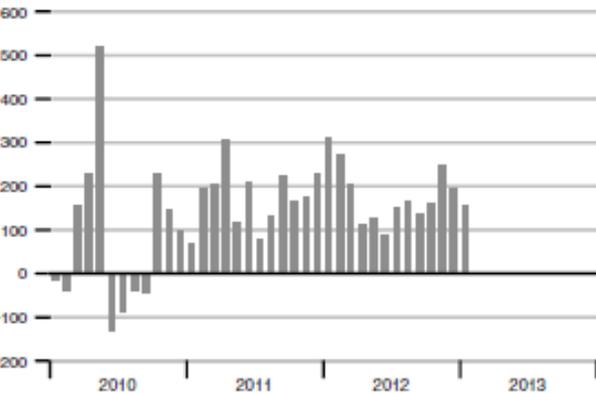
Interest Rates

Percent



Change in Nonfarm Payrolls

Thousands



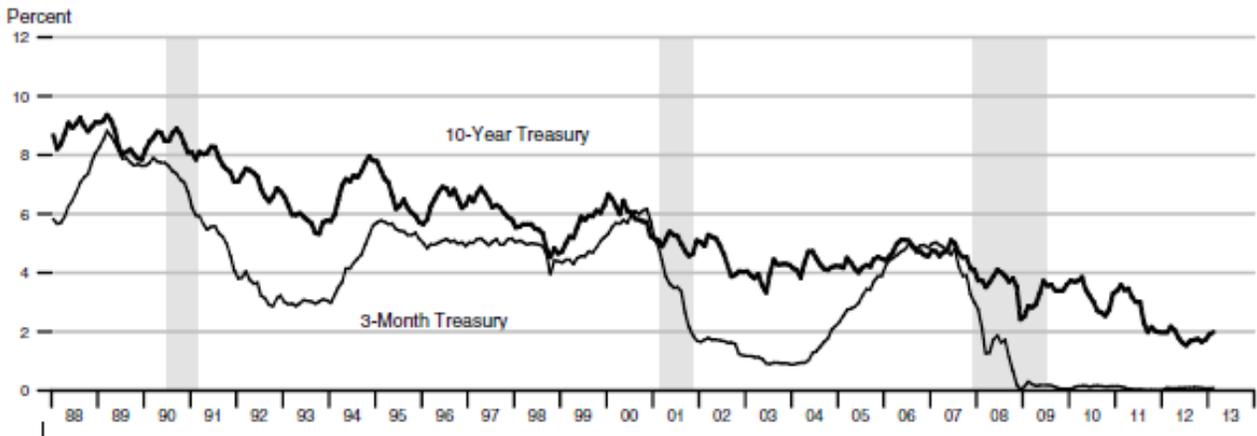
Unemployment Rate

Percent of labor force

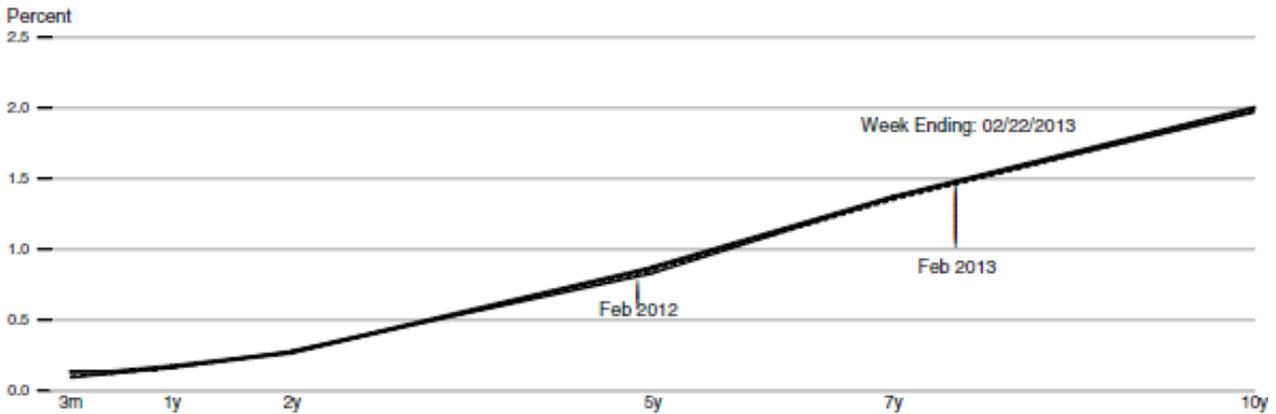


Provided by the Federal Reserve Bank of St. Louis, *National Economic Trends*.
Updated March 1, 2013.

Interest Rates



Treasury Yield Curve

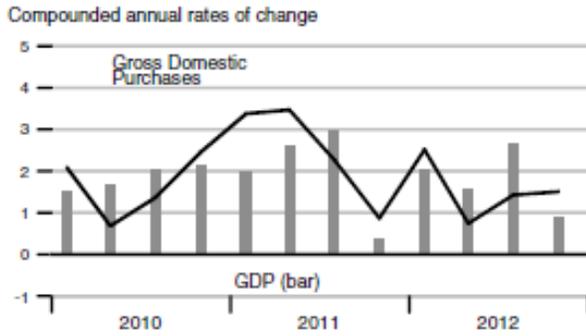


Standard and Poor's 500 Index with Reinvested Dividends

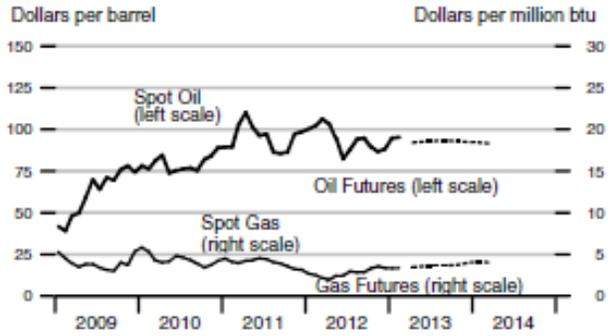


Provided by the Federal Reserve Bank of St. Louis, *National Economic Trends*.
Updated March 1, 2013.

NIPA Chain Price Indexes

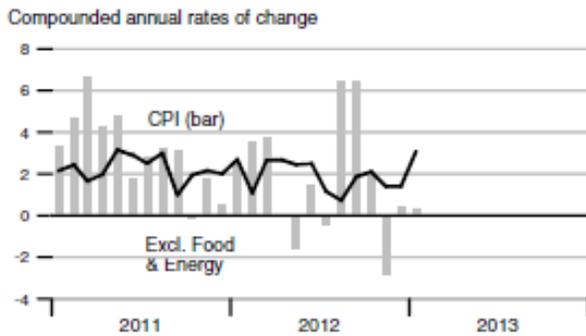


Oil & Natural Gas Prices: Spot & Futures

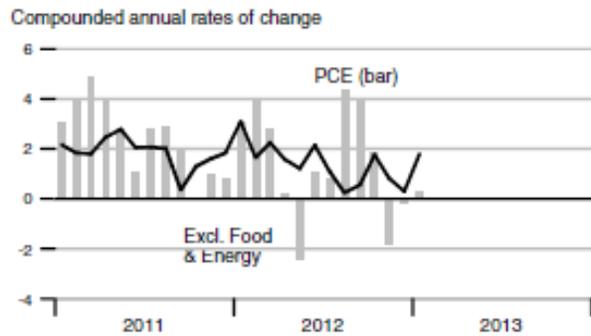


Note: Futures prices as of 2/28/2013.

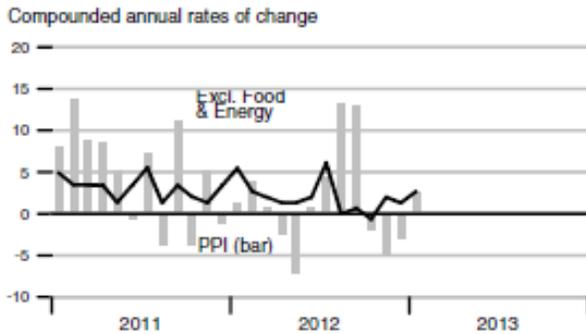
Consumer Price Index



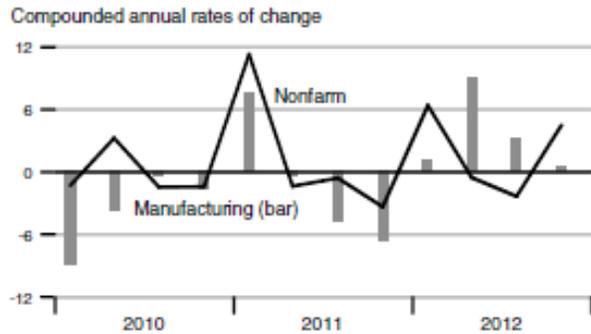
Consumption Chain Price Index



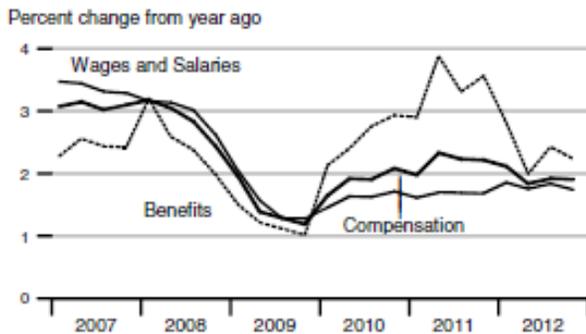
Producer Price Index, Finished Goods



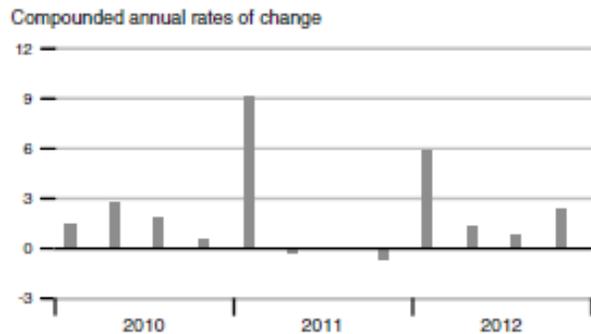
Unit Labor Cost



Employment Cost Index



Compensation per Hour

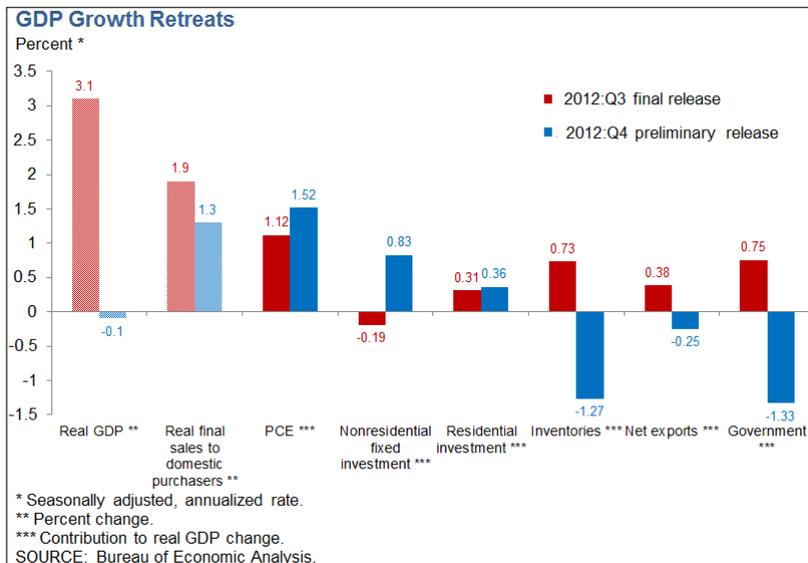


Provided by the Federal Reserve Bank of St. Louis, *National Economic Trends*.
Updated March 1, 2013.

ECONOMIC REPORTS AND FORECASTS UNITED STATES

National Update – February 2013 Federal Reserve Bank of Dallas

⇄ **Economy** - Recently released indicators suggest that overall U.S. economic activity decelerated in fourth quarter 2012, as moderate growth in consumption and housing continued amid notable declines in inventory and government spending. Real output contracted at a nearly flat 0.1% annual rate in the fourth quarter. Growth was hindered by expected pullbacks in government spending and inventories investment. The current upward trend in durable goods orders growth reflected a turning point for previously declining investment levels. The most strength can be found in the fact that retail sales growth has consistently posted a solid growth rate, and residential construction rose strongly amid other indications of a housing recovery. Job growth has decelerated to a moderate pace.

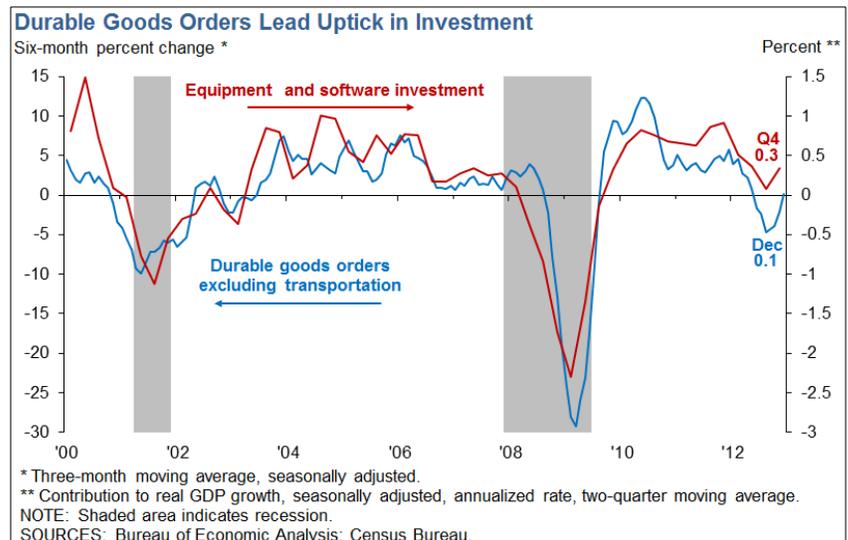


Looking ahead, output in first quarter 2013 should bounce back as a number of restraining factors are removed or dissipate.

⇄ **Contraction Closes Out 2012** - The U.S. economy slightly contracted at a pace of 0.1% in fourth quarter 2012. A temporary boost from government spending in the third quarter turned negative in the fourth quarter. The U.S. economy entered 2013 with less upward momentum than was generally recognized. Third-quarter real gross domestic product (GDP) growth was hardly revised, with overall output growth reported at 3.1% in the final release. Despite improvement in personal consumption expenditures (PCE), the fourth-quarter

growth rate revealed a decline in output for two reasons. The contribution of inventory investment to real GDP growth was 2.0% less than its contribution in the third quarter (0.7% versus -1.3%), and the contribution of government spending dropped by a similar amount. Surprisingly, while the contribution of equipment and software investment was -0.2% in the third quarter, the contribution of this component of business fixed investment grew to 0.9% in the fourth quarter. The negative impulses of inventories and government spending should lessen in the first half of 2013, leading to higher growth in the first quarter.

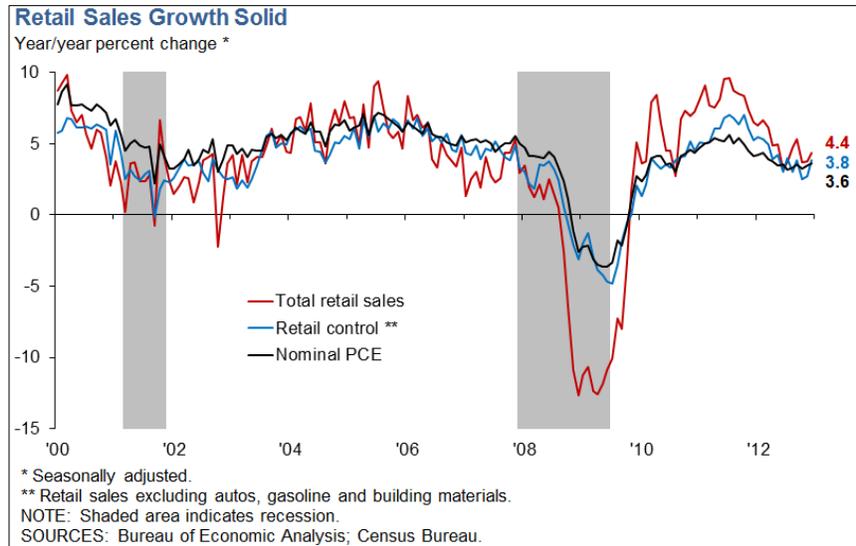
⇄ **Business Investment Reverses Decline** - The smoothed growth rate of durable goods orders excluding transportation tends to capture most swings in business equipment and software investment. The weakness of orders since June 2012 led the contribution to GDP growth of this key gauge of investment to decline throughout much of 2012; however, the recent trend toward positive growth in orders led the uptick in investment growth in fourth quarter 2012.



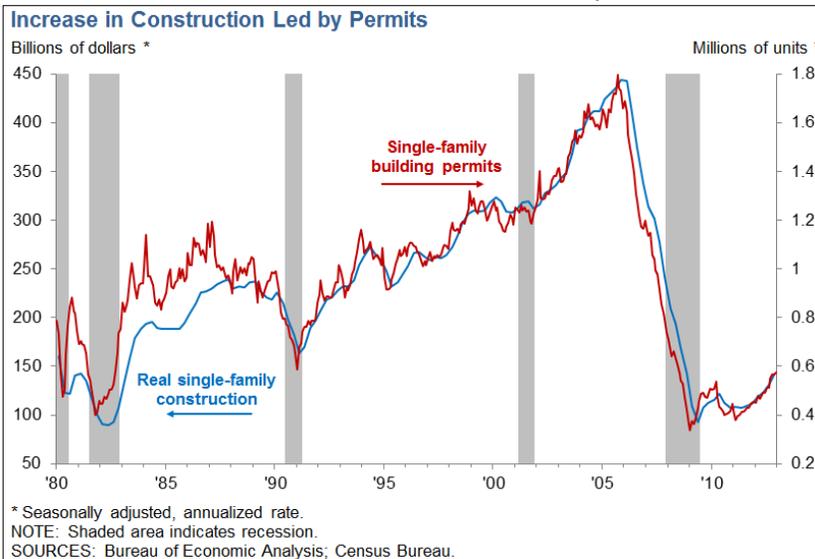
The uptick of equipment and software investment in the preliminary GDP release was greater than expected given such a slight increase in orders. In addition to the surprising positive impact of business fixed investment on GDP growth in the fourth quarter, PCE, which accounts for 71% of GDP, exhibited moderate growth.

↑ **Spending Maintains Solid Growth Through the Fourth Quarter** - Year-over-year readings of retail sales indicate that nominal total retail sales and personal consumption expenditures have been growing at a consistent pace, with a slight pickup in December to 4.4% and 3.6%, respectively. The retail control category (retail sales excluding autos, gasoline and building materials) has also posted solid growth, though

slightly lower than that of total retail sales. Personal spending has remained stable since spring 2012 after posting stronger growth in 2011. With inflation remaining between 1 and 2%, the implied real rates of personal spending expansion appear good enough to absorb the shock from the expiration of tax cuts in early 2013. Another good sign for personal spending is that strength in the housing market may create positive wealth effects for consumption.



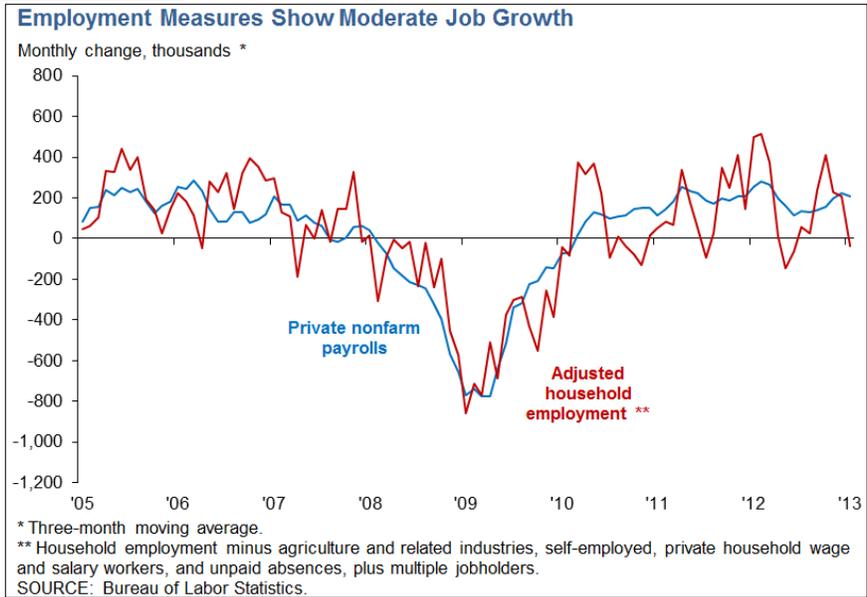
↑ **Residential Construction Rebound Continues** - While the upturn in housing activity is coming off historically low levels, it is still notable and likely reflects the beginning of a true recovery from the housing contraction. Gains in housing are likely to continue over the next few years because construction is still well below levels needed to replace demolished homes and meet the needs of a



growing population. Taking single-family permits as a leading indicator of real single-family construction, the housing market appears likely to continue its upward momentum. In addition, some regulatory and legal impediments to mortgage lending will probably be lessened and boost housing in coming months. Along with low mortgage rates and moderate job growth, the medium-term prospects are positive for housing construction and the housing market as a whole.

⇄ **Employment Growth Moderates in 2013** - Employment growth appears to have slowed from the stronger pace of third quarter 2012 to a pace consistent with moderate improvement in the labor market.

The payroll employment survey posted a gain of 166,000 private jobs in January while the household employment survey saw an increase of only 17,000 jobs. One reason to view the monthly readings from the household survey with extra care is that, in contrast to the payroll survey, the overall increase in household employment is affected



by shifts in self-employment, private employment not at business establishments, and multiple job holdings. Accounting for these differences with available data yields an adjusted household job growth reading on a near payroll-equivalent basis (though certainly still noisier). Both the payroll series and the adjusted household series have exhibited solid, but not strong, growth, with the three-month moving average of private payroll growth at 208,000 jobs. With the resolution of some tax uncertainty, employment growth could increase in 2013 as employers have a better idea of what fiscal policy will be.

The fourth-quarter pace of GDP growth fell well short of the third-quarter pace owing to a slowing of inventory investment and government spending. Against this weakness is the strength of an emerging housing recovery and solid personal spending growth, as well as strengthening business fixed investment. Recent moderate employment growth could improve following diminishing fiscal policy uncertainty. First-quarter GDP growth will likely rise as inventories and government spending exert less drag, but the growth should remain modest because personal spending growth will likely slow a bit early this year. The upshot is that if the euro crisis continues to ebb and remaining fiscal policy issues are reasonably handled, the U.S. economy appears poised to pick up from the modest pace of 2012 and gain momentum moving into the second half of 2013.

U.S. Economy at a Glance
U.S. Bureau of Labor Statistics

Data Series	Aug 2012	September 2013	Oct 2012	Nov 2012	Dec 2012	Jan 2013
Unemployment Rate ⁽¹⁾	8.1	7.8	7.9	7.8	7.8	7.9
Change in Payroll Employment ⁽²⁾	165	138	160	247	196(P)	157 (P)
Average Hourly Earnings ⁽³⁾	56386	23.6	23.58	23.67	23.74 (P)	23.78 (P)
Consumer Price Index ⁽⁴⁾	0.5	0.5	0.2	-0.2	0.0	0.0
Producer Price Index ⁽⁵⁾	1.0	1.0	-0.2 (P)	-0.4 (P)	-0.3 (P)	0.2 (P)
U.S. Import Price Index ⁽⁶⁾	1.2	1.0	0.3 (R)	-0.7 (R)	-0.5 (R)	0.6 (R)

Footnotes:

- (1) In percent, seasonally adjusted. Annual averages are available for not seasonally adjusted data.
(2) Number of jobs, in thousands, seasonally adjusted.
(3) Average hourly earnings for all employees on private nonfarm payrolls.
(4) All items, U.S. city average, all urban consumers, 1982-84=100, 1-month percent change, seasonally adjusted.
(5) Finished goods, 1982=100, 1-month percent change, seasonally adjusted.
(6) All imports, 1-month percent change, not seasonally adjusted.
(R) Revised.
(P) Preliminary.

Data Series	4 th Qtr 2011	1 st Qtr 2012	2 nd Qtr 2012	3 rd Qtr 2012	4 th Qtr 2012
Employment Cost Index ⁽¹⁾	0.5	0.4	0.5	0.4	0.5
Productivity ⁽²⁾	2.8	-0.5	1.9	3.2 (R)	-2.0

Footnotes:

- (1) Compensation, all civilian workers, quarterly data, 3-month percent change, seasonally adjusted.
(2) Output per hour, nonfarm business, quarterly data, percent change from previous quarter at annual rate, seasonally adjusted.
(R) Revised.

Data extracted on: March 1, 2013

**The Federal Reserve Board
The Beige Book – March 6, 2013
Excerpt**

↑ Reports from the twelve Federal Reserve Districts indicated that economic activity generally expanded at a modest to moderate pace since the previous Beige Book. Five Districts reported that economic growth was moderate in January and early February, and five Districts reported that activity expanded at a modest pace. The Boston District said the economy continued to expand slowly, and the Chicago District reported that economic activity grew at a slow pace.

Most Districts reported expansion in consumer spending, although retail sales slowed in several Districts. Automobile sales were strong or solid in most Districts, and tourism strengthened in a number of Districts. The demand for services was generally positive across Districts, most notably for technology and logistics firms. Transportation services activity was mixed among Districts, although the majority of contacts were optimistic about future activity. Manufacturing modestly improved in most regions, with several Districts reporting strong demand from the auto, food, and residential construction industries. Residential real estate markets strengthened in nearly all Districts and home prices rose amid falling inventories across much of the country. Commercial real estate activity was mixed or improved slightly in most Districts, and financing for commercial development remained widely available. Overall loan demand was stable or slightly higher across nearly all Districts, and several bankers noted stiff competition for qualified borrowers. Agricultural conditions varied across the country, with some areas continuing to suffer from drought while others reported considerable precipitation and improved soil moisture levels. Districts reporting on energy activity indicated modest expansions in crude oil and natural gas exploration, while mining activity slowed.

Price pressures remained modest, with the exception of increases in prices for certain raw materials and slightly higher retail prices in several Districts. Even with some input costs rising, most District contacts did not plan to increase selling prices. The majority of Districts reported modest improvements in labor market conditions, although hiring plans were limited in several Districts. Wage pressures were mostly limited, but some contacts reported upward pressure for skilled positions in certain industries due to worker shortages.

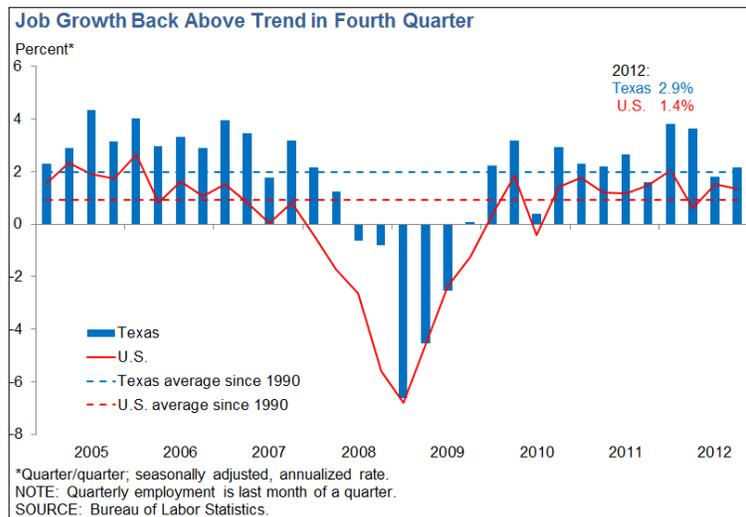
**Federal Reserve Bank of Dallas
The Dallas Beige Book – March 6, 2013
Excerpt**

↑ The Eleventh District economy expanded at a moderate pace over the past six weeks. Reports on manufacturing activity were mixed. Retail sales were flat to up slightly, while automobile dealers noted a seasonal slowdown in sales. In the nonfinancial services sector, legal and accounting demand increased, and reports from staffing firms were mixed. Rail and cargo firms said activity weakened, but demand was above year-earlier levels. Airlines said passenger demand was flat to up since the last report. Housing demand remained strong and commercial real estate activity improved. Lenders noted flat to moderate growth in loan demand, and activity in the energy sector remained at high levels. Prices remained stable overall, and there were limited reports of wage pressure. Employment levels were steady to up.

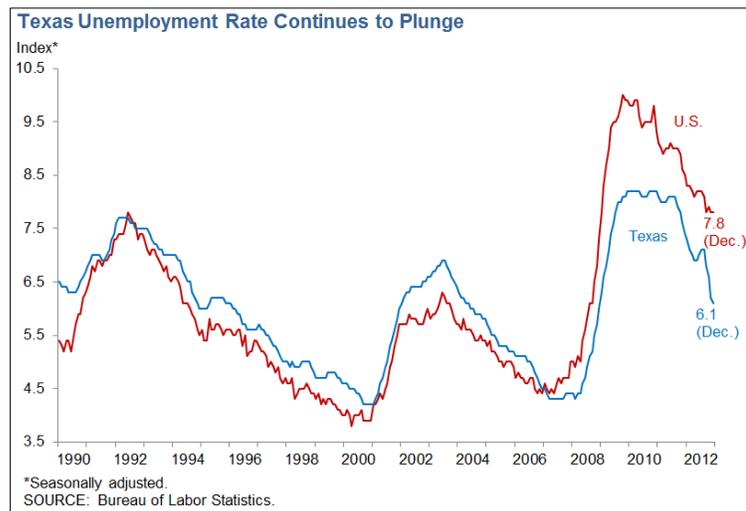
Economic Reports and Forecasts State of Texas

Regional Economic Update – February 2013 Federal Reserve Bank, Dallas

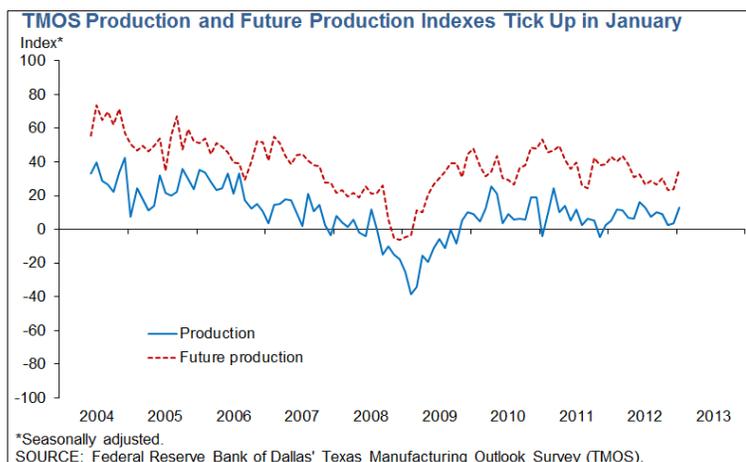
⇄ **Overall Economy** - Fourth-quarter payroll employment growth clocked in at a modest 2.2% annual rate in Texas, much slower than the 3.8% annual pace seen in the first quarter. Real estate construction continued to strengthen markedly, although energy sector growth decelerated somewhat from its 2012 peak. Employment growth of 2 to 3% for 2013 still seems likely, but there is little evidence that more robust growth is around the corner.



⇄ **Employment Growth Moderates** - Payroll employment increased at a tepid 1.3% annual rate in December and at a 2% annual rate in the second half of 2012. While the second-half rate reflects slowing employment growth, it is in line with Texas' long-term trend. The unemployment rate plummeted in December to 6.1%, its lowest level in four years, down from 7.3% in January 2012. Additionally, initial claims for unemployment insurance ticked down to the lowest level since the recession ended.



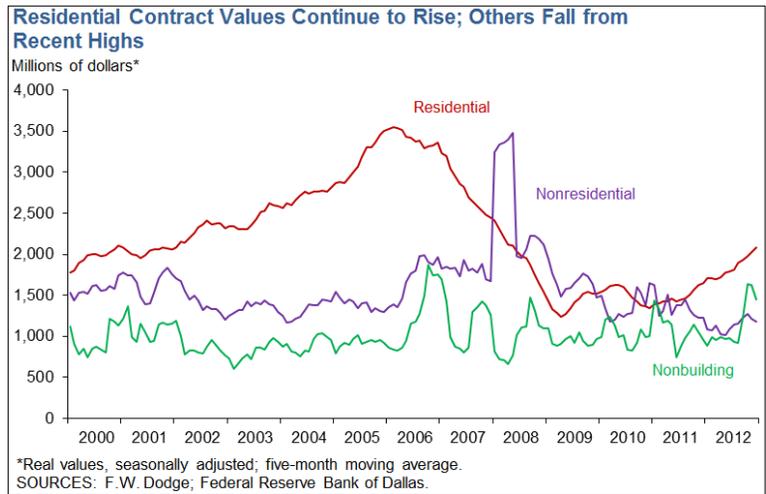
⇄ **Manufacturing Maintains Modest Growth** - The production and future production indexes from the Texas Manufacturing Outlook Survey (TMOS) ended the year near 2012 lows but rebounded somewhat in January. Manufacturing payroll employment expanded in 2012 at a 2.1% annualized rate. The most recent Dallas Fed Beige Book paints a mixed picture of within-sector growth, with relatively strong performances from automotive manufacturers but with slightly weaker production and orders from high-tech manufacturers.



Policy uncertainty was cited as a significant impediment to future growth. Bright spots were construction-related manufacturing for single-family housing and petrochemicals, for which export demand has remained strong despite an otherwise difficult global economic environment.

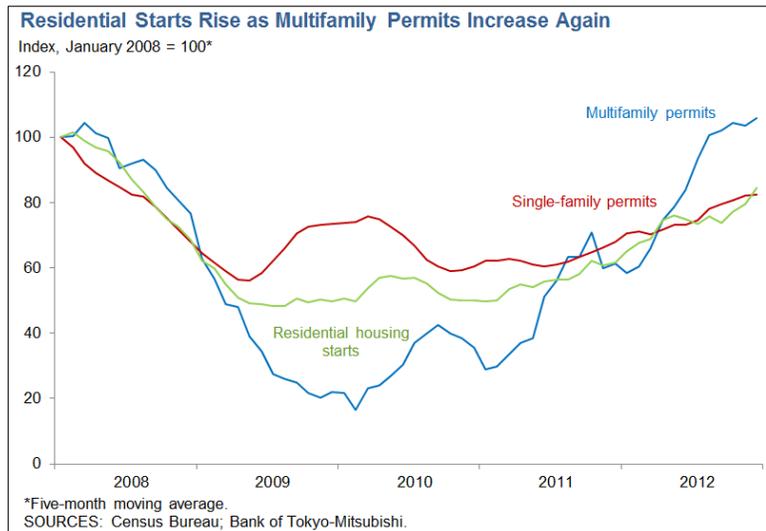
⇄ **Construction Contract Values and Real Estate Solid -**

Residential contract values rose 2.6% in December, while nonresidential and nonbuilding contract values fell back from recent highs. Within residential, residential starts improved and single-family permits were flat in December. Existing-home inventory fell to 4.7 months in December, its lowest level in more than six years. However, multifamily permits increased again, even amid anecdotal reports that an improving economy is beginning to motivate would-be renters to buy.



⇄ **Energy Remains Strong but Decelerates Slightly -**

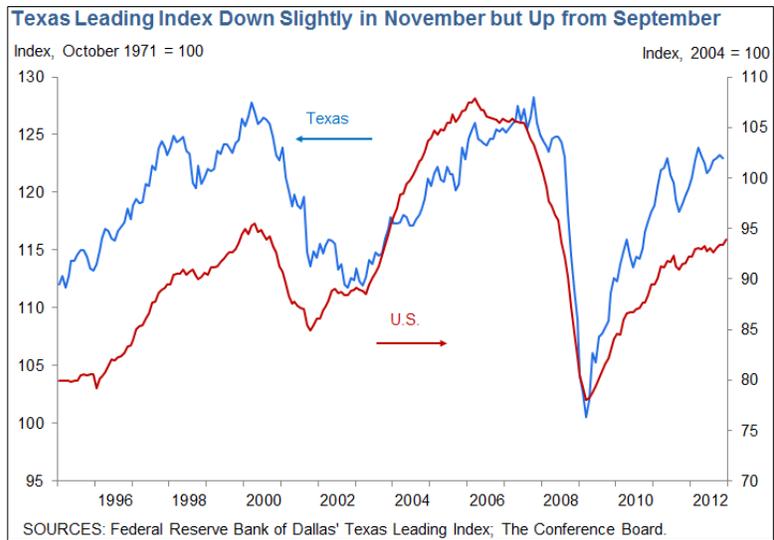
The rig count has fallen 3% since early December to 824 as oil prices have hovered somewhat below recent highs. While the sector remains strong, Beige Book contacts report that firms are increasingly concerned about new activity in higher-cost fields, given recent energy-price volatility. The expectation is that the first half of 2013 will continue on the path seen in the second half of 2012.



⇄ **Exports Rise as Mexico's Outlook Improves** - From September to November of last year, Texas exports rose 1.5% as exports from the remainder of the U.S. declined 3.4%. This may indicate continued strength in U.S.–Mexico and U.S.–Latin America trade. Mexico's gross domestic product grew 3.9 to 4% in 2012 and is expected to expand 3.5% in 2013.

⇄ **Wage and Price Pressures: Steady as She Goes** - Price pressures have been contained the past six weeks, with TMOS and Texas Service Sector Outlook Survey price measures remaining in the range they've occupied for the last year. Modest price increases were noted in the Beige Book for construction-related manufacturers and transportation services, with larger increases for accounting and legal firms. Two notable developments were a rise in freight charges and, for reasons relating to the ongoing drought, record-high prices for livestock feed.

⇄ **Outlook Reflects National Uncertainties** - The Texas Leading Index rose by a modest 0.21 points from September to November. The relative weakening of energy components pulled down the index slightly in November. The employment forecast based on this index suggests slightly lower growth of 2.4% next year, compared with a 2.5% forecast earlier in 2012. Headwinds remain from energy price volatility, as well as global economic and national fiscal policy uncertainty. But the Texas economy is still growing at a rate slightly above trend, with the exception of December's relatively low payroll figure, and the state continues to rapidly reduce the ranks of its unemployed.

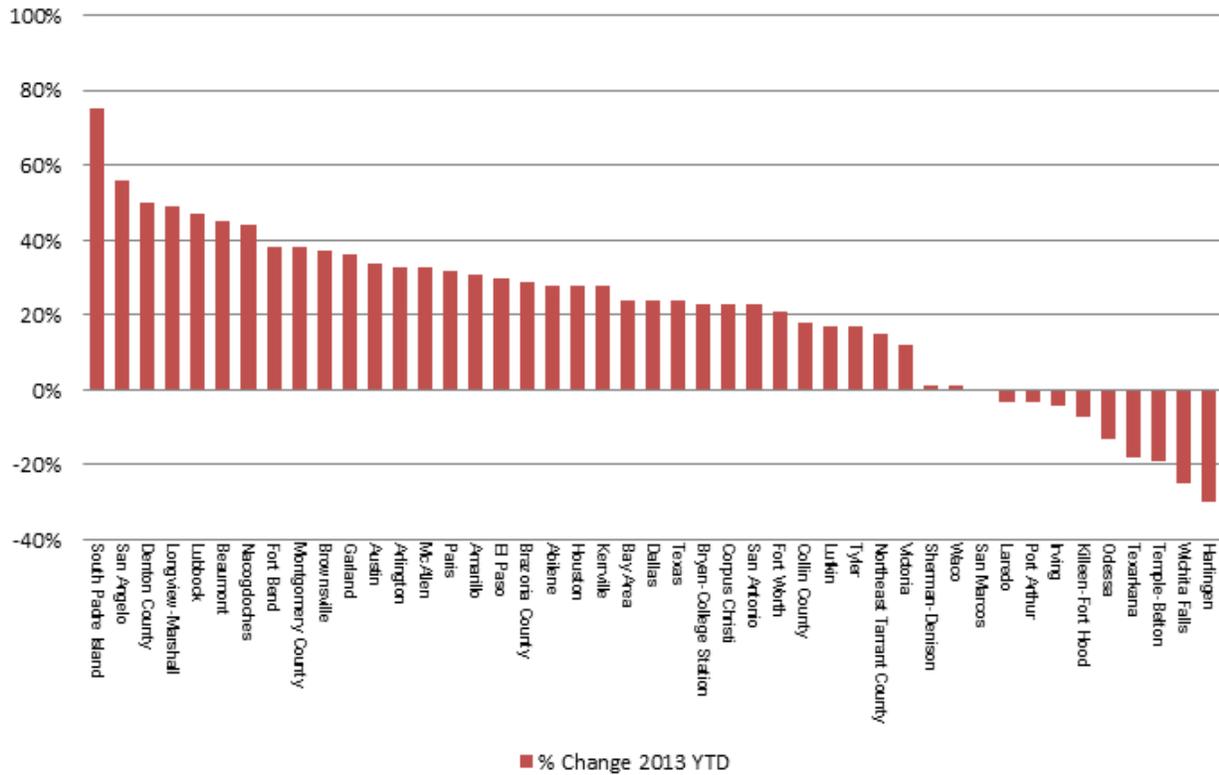


Texas Economic Statistics

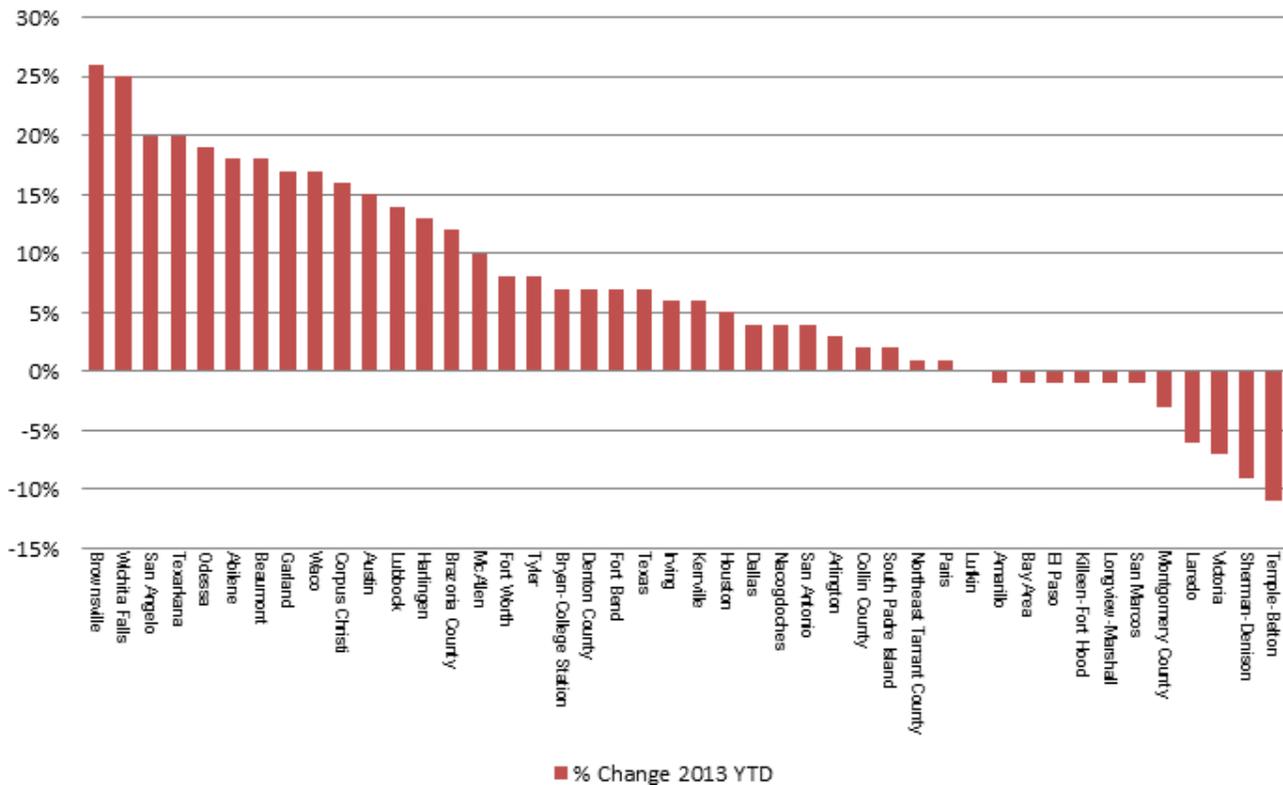
Data Series	Aug 2012	Sept 2012	Oct 2012	Nov 2012	Dec 2012	Jan 2013
Labor Force Data						
Civilian Labor Force (1)	(5) 12,596.1	(5) 12,599.8	(5) 12,619.6	(5) 12,630.2	(5) 12,650.2	
Employment (1)	(5) 11,743.7	(5) 11,774.0	(5) 11,809.0	(5) 11,840.3	(5) 11,867.9	
Unemployment (1)	(5) 852.4	(5) 825.8	(5) 810.6	(5) 789.9	(5) 782.2	
Unemployment Rate (2)	(5) 6.8	(5) 6.6	(5) 6.4	(5) 6.3	(5) 6.2	
Nonfarm Wage and Salary Employment						
Total Nonfarm (3)	10,836.6	10,846.6	10,875.4	10,899.9	(P) 10,904.0	
12-month % change	2.4	2.4	2.5	2.6	(P) 2.5	
Mining and Logging (3)	261.2	257.1	257.3	258.2	(P) 259.8	
12-month % change	9.2	6.3	4.7	3.9	(P) 2.5	
Construction (3)	596.4	589.8	602.7	595.6	(P) 591.5	
12-month % change	6.6	5.4	8.3	6.9	(P) 6.6	
Manufacturing (3)	853.6	855.6	853.9	847.3	(P) 850.3	
12-month % change	1.4	1.8	1.5	0.3	(P) 0.7	
Trade, Transportation, and Utilities (3)	2,158.2	2,167.5	2,162.6	2,181.5	(P) 2,182.0	
12-month % change	2.5	2.6	2.1	3.2	(P) 2.6	
Information (3)	192.0	189.9	192.1	190.9	(P) 190.2	
12-month % change	-2.1	-3.2	-1.6	-1.8	(P) -1.7	
Financial Activities (3)	651.3	653.6	651.8	652.7	(P) 651.4	
12-month % change	2.0	1.9	2.0	1.4	(P) 0.8	
Professional & Business Services (3)	1,390.3	1,401.8	1,391.5	1,393.6	(P) 1,406.9	
12-month % change	3.6	3.3	2.7	2.8	(P) 3.5	
Education & Health Services (3)	1,467.9	1,473.2	1,485.3	1,490.8	(P) 1,492.1	
12-month % change	2.7	2.6	2.9	3.2	(P) 3.2	
Leisure & Hospitality (3)	1,094.2	1,099.9	1,105.8	1,115.2	(P) 1,111.5	
12-month % change	4.7	5.0	4.6	5.0	(P) 4.5	
Other Services (3)	381.9	383.3	384.6	386.7	(P) 388.6	
12-month % change	3.0	2.8	2.3	2.3	(P) 2.6	
Government (3)	1,789.6	1,774.9	1,787.8	1,787.4	(P) 1,779.7	
12-month % change	-1.6	-0.9	0.5	0.6	(P) 0.2	
Mass layoffs						
Layoff events, all industries (4)	52	37	46	97	47	35
Initial claimants, all industries (4)	7,586	3,485	4,099	11,680	5,136	3,611
Footnotes						
(1) Number of persons, in thousands, seasonally adjusted.						
(2) In percent, seasonally adjusted.						
(3) Number of jobs, in thousands, seasonally adjusted.						
(4) See about the data.						
(5) Reflects revised population controls, model reestimation, and new seasonal adjustment.						
(P) Preliminary						

Data extracted on March 1, 2013
Source: U.S. Bureau of Labor Statistics

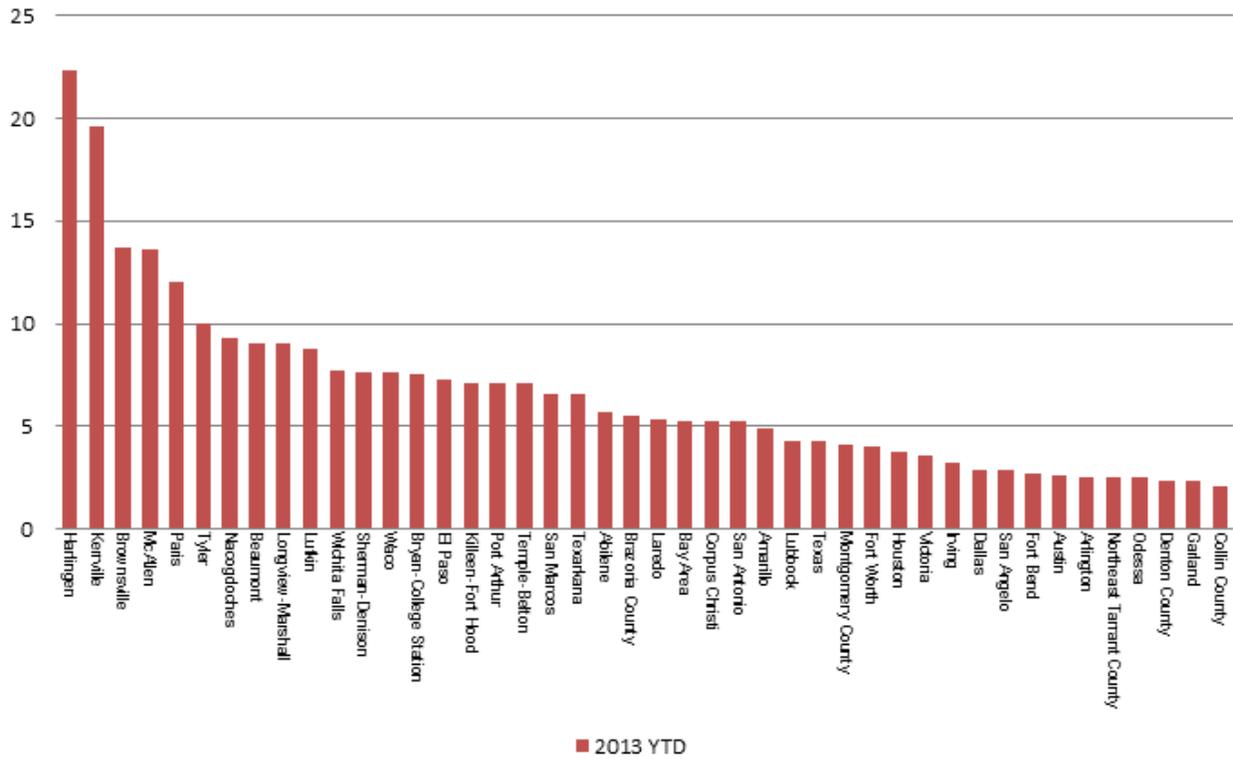
Home Sales



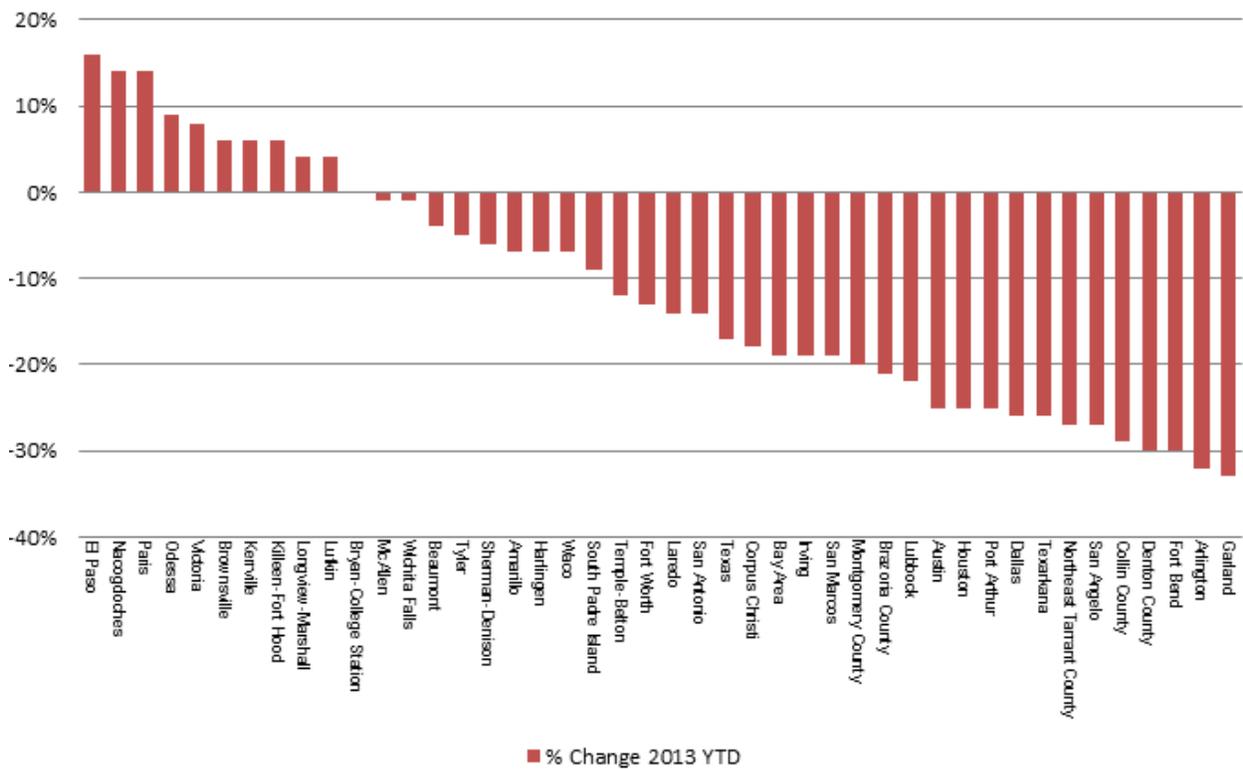
Average % Change in Home Prices



MLS Months Inventory



MLS Total Listings



Federal Reserve Bank Survey Senior Loan Officer Opinion Survey

The January 2013 Senior Loan Officer Opinion Survey on Bank Lending Practices addressed changes in the supply of, and demand for, bank loans to businesses and households over the past three months. This summary is based on responses from 68 domestic banks and 22 U.S. branches and agencies of foreign banks. In the January survey, generally modest fractions of domestic banks reported having eased their standards across major loan categories over the past three months on net. Domestic respondents indicated that demand for business loans, prime residential mortgages, and auto loans had strengthened, on balance, while demand for other types of loans was roughly unchanged. U.S. branches and agencies of foreign banks, which mainly lend to businesses, reported little change in their lending standards, while demand for their loans was reportedly stronger on net.

On balance, small percentages of domestic respondents reported that lending standards on commercial and industrial (C&I) loans had been eased over the past three months and that many terms on such loans had also been loosened. In addition, moderate net fractions of domestic banks reported that demand for C&I loans from firms of all sizes had increased over the survey period. Small net fractions of domestic and foreign respondents indicated that commercial real estate (CRE) lending standards had been eased over the past three months, while significant percentages of both types of respondents reportedly experienced increased demand for such loans on net. On the household side, domestic banks reported that standards for both prime and nontraditional mortgages were essentially unchanged over the past three months. Respondents indicated that demand for prime residential mortgages increased, on net, while demand for nontraditional residential mortgages was unchanged. Within consumer lending, a moderate fraction of domestic banks reported an easing of standards on auto loans, on net, while standards on other types of consumer loans were about unchanged. On balance, banks indicated having eased selected terms on consumer loans over the survey period. A moderate fraction of respondents continued to experience stronger demand for auto loans, on net, while demand for credit card loans was reportedly unchanged.

The January survey also included three sets of special questions: The first set asked banks about lending to and competition from banks headquartered in Europe; the second set asked banks about changes in their lending policies on CRE loans over the past year; and the third set asked banks about their outlook for asset quality in major loan categories during 2013. In response to the first set, only a small fraction of domestic banks indicated that lending standards to European banks and their affiliates had been tightened, on net, while foreign respondents' standards were reportedly little changed for such institutions. In response to the second set, respondents indicated that they had eased selected CRE loan terms over the past 12 months on net, with the rest of the surveyed terms having been about unchanged. Finally, respondents' answers for the outlook for asset quality revealed that moderate to large fractions of banks expect improvements in credit quality in most major loan categories on balance.

Business Lending

C&I Loans - Modest fractions of domestic survey respondents, on net, indicated that their C&I lending standards had been eased somewhat for all firm sizes over the survey period. On balance, most loan terms were eased regardless of firm size. Moderate to large fractions of banks again reported having reduced spreads of loan rates over their banks' cost of funds, the use of interest rate floors, and the cost of credit lines for all firm sizes. Almost all respondents that reported having eased either standards or terms over the past three months cited more-aggressive competition from other banks or nonbank lenders as an important reason for having done so. As in the previous survey, no other reasons were broadly cited as important.

Moderate fractions of domestic banks indicated stronger demand for C&I loans by firms of all sizes, on net, and cited their customers' increased investment in plant or equipment and increased need to finance mergers or acquisitions and accounts receivable as the main reasons for increased loan demand. In addition, several banks also noted that some firms had borrowed in part to fund payments to employees and investors ahead of anticipated changes to the tax code after year-end. On balance, U.S. branches and agencies of foreign banks reported that their C&I lending standards had remained about the same over the past three months. A moderate net fraction of foreign respondents reported having reduced

loan spreads over their cost of funds, while only small fractions reported having changed other lending terms on net. About 20% of foreign respondents reported stronger demand for C&I loans over the past three months, on net, and most cited their customers' increased merger or acquisition financing needs as a very important reason for stronger demand.

European Exposure - The January survey again included special questions about lending to European banking institutions and their affiliates. On balance, about 10% of domestic banks reported that their standards for loans to European banks had tightened over the past three months, a smaller fraction relative to the previous two surveys. Furthermore, foreign respondents indicated that their standards on such loans were essentially unchanged. Respondents reported that they had experienced little change in demand for loans from European banks. Most domestic banks who reported competing with European banks indicated that they had experienced a decrease in competition from such institutions over the past three months, but the decrease did not appreciably boost their business. About one-third of respondents that reportedly compete

with European banks noted an increase in business to some extent.

CRE lending - A modest net fraction of domestic banks reported that they had eased standards on CRE loans over the previous three months and a large share indicated that demand for such loans had increased. On balance, foreign respondents reported similar trends in CRE lending conditions in the fourth quarter; a small fraction indicated that they had eased lending standards and a large fraction reportedly experienced stronger demand for CRE loans. The January survey also included a special question regarding changes in specific lending policies for CRE loans over the past year (repeated annually since 2001). During the past 12 months, on net, many domestic banks reportedly had reduced the spreads on CRE loans and several banks eased policies regarding the maximum size and maturity of such loans. However, banks indicated no change in their policies for debt service coverage ratios or loan-to-value ratios. Foreign respondents also indicated that policies on spreads and maximum loan size for CRE loans were eased somewhat, on balance, and those on other terms were about unchanged.

Lending to Households

Residential real estate lending - Respondents reported little change in their standards for both prime and nontraditional residential real estate loans. Demand for prime residential mortgage loans had reportedly increased over the past three months, on net, while demand for nontraditional residential mortgage loans was about unchanged. Standards for home equity lines of credit (HELOCs) were about unchanged while a small fraction of banks reportedly experienced weaker demand for such loans on net.

Consumer Lending - Responses from domestic banks indicated that they had again eased standards on auto loans over the past three

months. However, standards on credit card loans and other consumer loans were little changed. On balance, several banks reported that they had reduced spreads on consumer loans other than credit card loans. A modest fraction of banks also reported having increased the maximum maturity of auto loans on net. Other terms for consumer loans were reportedly little changed over the past three months. Demand for auto loans reportedly increased on balance, while demand for credit card loans was essentially unchanged. A modest fraction of banks reported stronger demand for other consumer loans on net.

Bank's Outlook for Asset Quality in 2013

The January survey contained a set of special questions on respondents' expectations for loan quality in 2013 (repeated annually since 2006). Overall, large fractions of domestic banks, on net, expected improvements in delinquency and charge-off rates during 2013 for most loan categories included in the survey, assuming that economic activity progresses in line with consensus forecasts. Moreover, expectations for improvement in most loan categories were about the same as the corresponding net fractions from a year ago.

Regarding the outlook for the quality of business loans, about 40% of domestic banks, on net, reportedly expect delinquency and charge-off rates on their C&I loans to all sizes of firms to decline in 2013. These responses indicate a somewhat less widespread expected improvement in the quality of C&I loans relative to the 2012 survey, which is largely consistent with already low delinquency and charge-off rates on such loans by historical standards. Similar to last year, about 55% of domestic banks indicated that they expect improvement in the quality of CRE loans in 2013. Turning to foreign respondents, about 20%, on net, anticipate improvement in the quality of C&I loans to large and middle-market firms this year. Meanwhile, about 45% of foreign respondents forecast improvement in the quality of CRE loans on balance, a sizable increase from the 25% that reportedly expected improvement last year.

About 50% of domestic banks expect the delinquency and charge-off rates on prime and nontraditional residential real estate loans to improve in 2013, on net, about the same fractions reported in last year's survey. Expectations for improvements this year in the quality of HELOCs stayed roughly the same as last year, with about one-third of the respondents anticipating an improvement in the quality of such loans.

Among major loan categories, domestic banks were least likely to expect improvement in the quality of consumer loans in 2013. On balance, about 10% of banks expected improvement in credit card loans, and similar fractions projected improvement in auto and other consumer loans.

Acknowledgements

Associated Press, New York, NY
Federal Deposit Insurance Corporation, Washington, D.C.
Federal Reserve Bank of Dallas, Dallas, TX
Federal Reserve Bank of St. Louis, St. Louis, MO
Federal Reserve Board, Washington D.C.
Lower Colorado River Authority, Austin, TX
National Cotton Council of America, Cordova, TN
National Oceanic and Atmospheric Administration, Washington, D.C.
New York Times, New York, NY
Office of the Governor, Rick Perry, Austin, Texas
Pew Research Center, Washington, D.C.
San Angelo Standard Times, San Angelo, TX
Texas A&M University, Real Estate Center, College Station, TX
Texas A&M University, AgriLife Extension Service, College Station, TX
Texas Comptroller of Public Accounts, Austin, TX
Texas Department of Banking, Austin, TX
Texas Department of Savings and Mortgage Lending, Austin, TX
Texas Railroad Commission, Austin, TX
The Drought Monitor, Lincoln, NE
U.S. Bureau of Labor Statistics, Washington, D.C.
White House, Washington, D.C.
Yahoo Finance