Condition of the Texas State Banking System

March 2016

Texas Department of Banking Texas Department of Savings and Mortgage Lending

Financial Data as of December 31, 2015



TABLE OF CONTENTS

.1
.9
2
8
20
25
<u>29</u>
32
- 2

<u>Symb</u>	ols Used Throughout this Report:	Abbreviations Used Throughout this Report:
仓	Improving or strong conditions	FDIC – Federal Deposit Insurance Corporation
Û	Deteriorating or weak conditions	OCC – Office of the Comptroller of the Currency
Û	Mixed conditions	FRB – Federal Reserve Board
*	Interest item	

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This publication is also located on the Texas Finance Commission website: www.fc.texas.gov

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ECONOMIC REVIEW AND OUTLOOK TEXAS BANKING SYSTEM

BANKING SYSTEM OVERVIEW

The Texas banking industry remains healthy as the state continues to experience modest, positive economic growth. Although the Texas Business-Cycle index, which is designed to measure overall state economic activity, shows a downward trend in economic growth, the index still displays an optimistic outlook. Texas continues to add jobs, particularly in the services sector, though at a slower growth rate with some job losses in manufacturing, government, information, and mining and logging. While the January 2016 unemployment rate edged up slightly, Texas is still below the national rate.

Overall, state-chartered financial institutions operated profitably in 2015 with an average 1.1% return on assets. Even with the current challenges facing the banking industry, a majority of Texas banks and thrifts reported year-over-year increases to net income at December 31, 2015. Recent results from the Banker and Economic Business Survey support the current economic status of the state and the emerging challenges tackled by the industry. This survey is conducted quarterly by the Department of Banking, and invites executives from state-chartered banks to provide their opinions and observations on economic conditions, asset quality indicators, and overall bank performance.

Responses from the fourth quarter in 2015 agree with the latest financial data released by the Federal Deposit Insurance Corporation (FDIC). The FDIC reported a slight increase of noncurrent loans to loans for state banks from 0.7% in 2014 to 0.8%. Similarly, the survey suggests that past due loans remain stable; although, some bankers reported an increase in the volume of loans on their internal watch list. Executives also noted an increase in the loan loss provisions, mostly attributable to pressures in the energy sector. Community bankers are conscious of existing economic uncertainties as they must integrate them into their strategic plans to remain viable and prepare for the future. Among the risks noted by bankers are

interest rates, oil prices, competition, and regulations which lead the list.



In previous quarterly surveys, the drought was a prevalent concern for bankers as Texas experienced intense drought conditions. As of March 29, 2016, however, only 24.8% of the state was experiencing some level of drought, compared to 100% in 2011. In contrast, the Western United States continues to endure severe drought conditions with 66.4% experiencing some level of drought.



As of March 1, 2016, problem state-chartered financial institutions are at a low level, with only 3.2% or 8 state banks and no state thrifts classified as a regulatory concern. Problem banks are entities receiving an overall CAMELS rating of "3," "4," or "5." This is a significant improvement from 2010, a time in which problem entities peaked for state banks and thrifts at 18.5% and 37.9%, respectively. Nationally, the number of problem banks declined to 3.0% at year-end 2015, with only two insured financial institutions failing.

STATE-CHARTERED BANKING PROFILE (DEPARTMENT OF BANKING)

The number of Texas state-chartered banks continued its downward trend during the second half of 2015, with 252 banks as of December 31, 2015 as compared to 261 banks at June 30, 2015. The decline was due to a voluntary liquidation of a Texas state-chartered bank and eight mergers, four of which were mergers into national banks and four into Texas state-chartered banks.

Although mergers caused a decline in the number of Texas state-chartered banks, the overall asset size continues to increase due to internal asset growth. In this regard, the Texas state-chartered banking system grew from \$242.1 billion at June 30, 2015 to \$252.0 billion by December 31, 2015.



Source: Texas Department of Banking

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

Increased profitability occurred in 66.7% of the thrift institutions since the end of 2014, due to an increase in the volume of loans and additional noninterest income. No thrift charters were unprofitable at December 2015, which is improved from 7.4% as of year-end 2014. The median level of nonperforming loans and other real estate foreclosed remains low in state-chartered thrifts at 0.4% of total assets. Past due and nonaccrual loans, and foreclosed real estate continue to be monitored closely by state and federal regulators.

State-chartered thrift assets under the Department's jurisdiction totaled \$13.640 billion as of December 31, 2015, which represents an increase of 28.1% or \$2.99 billion from the end of last year. The total number of state chartered savings banks remains at twenty-seven.

The Department of Savings and Mortgage Lending continues to receive and process applications. During 2015, there have been 10 branch office applications, two merger/reorganization applications, and various other types of applications.



Source: Texas Department of Savings and Mortgage Lending

TEXAS ECONOMIC PROFILE

Texas experienced moderate growth in 2015 even with depressed oil prices and a strong U.S dollar. However, the Federal Reserve's Beige Book released in early March reports that economic activity in the Dallas District was flat over the last six weeks with mixed conditions. While real estate activity continued to expand, retail sales declined and the energy sector weakened further. Manufacturing dropped moderately and financial services continued to expand. Despite these challenges, the outlook remains somewhat optimistic for Texas.

Employment

Texas total nonfarm employment increased by 1.9% or 187,400 jobs between January 2015 and

January 2016, a slower growth rate than previous years. Most of this growth occurred in seven of the 11 major industries. Industries that reported losses include manufacturing, government, information, and mining and logging. Nationally, Texas contributed 17.1% of total nonfarm jobs added in January 2016. The U.S. and Texas added 151,000

and 25,814 nonfarm jobs, respectively.

In January 2016, the national unemployment rate was 4.9%, while the state's rate was 4.5%.

Although, the Texas unemployment rate weakened marginally in January 2016 by 0.1% compared to January 2015, it continues to be at or below the national rate for the last nine years.

Housing

An upward trend in home sales and the average price for Texas homes was recorded in 2015, with Texas leading the nation in housing construction. During the 12-month period ending in January 2016, a total of 310,560 existing single-family homes were sold, an increase of 4.5% from the previous year. According to the Real Estate Center at Texas A&M University, the average home sales price increased in 2015 by 5.2% to \$250,788 compared to 2014. The steadily increasing demand for homes along with the constrained supply is reflected in the rising Texas home prices. According to Jim Gaines,

> chief economist with the Real Estate Center at Texas A&M University, falling oil prices and drilling activity are just beginning to impact the Texas real estate market and some slowdown is expected during 2016.

While building permits issued for single-family homes declined by 1.0% to 99,330 over the 12 months ending in January 2016, multi-family building permits increased by 4.7% to

68,909. The Dallas-Fort Worth region contributed the most to the observed growth in permits. During December, Houston and Dallas-Fort Worth led the nation in the number of single family permits, followed by Phoenix and Atlanta.



Industries in Texas with Job Gains

Professional and Business

Trade, Transportation and

Education and Health Services

Leisure and Hospitality

Services

Utilities

Construction

Financial Activities

Other Services

Source: Real Estate Center at Texas A&M University



Tax Revenue

Total state revenue in fiscal year 2015 was \$109 billion, with total tax collections representing approximately 47.2%. Overall, the state's tax collections slowed starting in April 2015. For fiscal 2016 through February 2016, state revenue increased by 2.8% compared to the same period in 2015, while tax collections decreased by 7.0%.

Sales tax revenue makes up over half of total tax collections and for February 2016, sales tax collections were 6.8% lower than in February 2015. According to Texas Comptroller Glenn Hegar, much of the observed decline is attributed to the reduced spending in oil and gas related sectors. Receipts from other sectors such as construction, restaurants and retail trade, continued to grow, helping balance some of these reductions. Motor vehicle sales and rental tax collections, coming second to sales tax collections, increased by 5.2% in February 2016 compared to 2015. Oil and natural gas production tax collections for the first five months of fiscal 2016 were 99.0% lower than the same period in 2015, making up about 4.7% of total tax collections. During the same period in 2015, these collections represented 10.8% of total tax collections.

Crude Oil – Supply and Demand

The intermediate demand in the supply-chain has decreased overtime resulting in an oversupply. More crude oil is available in the market, placing pressure on oil prices over the last year. The Wall Street Journal reports that U.S. crude inventories are at the highest level in more than 80 years, and some storage hubs have little room left to store oil. In early March 2016, the U.S. Energy Department lowered the average price forecast based upon higher than anticipated production.



The U.S. Energy Information Administration reported that in December 2015, crude oil production averaged 9.3 million barrels per day. However, production hit a 44-year peak of 9.7 million barrels per day in April 2015. Going forward, a month-to-month decline is expected well into 2016.

Oversupply is not only a domestic issue; the foreign energy markets are also dealing with the excess. Russia and the Organization of the Petroleum Exporting Countries (OPEC) disclosed that they are considering a production freeze to support prices in an oversupplied market. Ecuador's government made arrangements to host a meeting with Venezuela, Colombia, Ecuador and Mexico to collaborate on the oil situation. Not all oil producing nations are considering halting production to allow for supply-and-demand to recover. In February 2016, Kuwait appeared unwilling to freeze production unless Iran agreed. Iran reportedly did not see a benefit in the freeze as it will only ensure that the supply surplus is not adversely affected by them. Iraq's oil production is also an issue as they have greatly increased production since 2014.

At a more regional level, the rig count in Texas is 227 as of March 4, 2016, a noticeable decrease from 538 in March 2015. Analysts predict that if prices begin to rise above \$40, idle rigs will become active again, directly harming any price recovery by creating further oversupply.

Oil prices have steadily declined since 2015. On February 11, 2016, the price fell to \$26.17, the lowest since November 2002. A short rebound took place in early March, after news of the potential production freeze. With mixed forecasts, some analysts believe prices have bottomed out, while others anticipate the price to remain below \$40 until supply and demand recover balance.



SUPERVISORY MATTERS

Weaknesses in the economy, stresses in a particular industry, or movements in interest rates can place pressure on the state's banking system. Deterioration in a bank's performance typically lags behind unfavorable conditions as the effects of economic pressures on bank borrowers can be concealed for months. In these cases, there is a reasonable probability that increases in past due loans and problem assets could lead to a moderate rise in nonperforming assets. If this occurs, the state banking system could experience flat to slightly declining earnings due to additional loan loss provisions and a reduction in interest income. Given the current economic situation, the energy sector could push the banking system into this scenario.

Energy Customers

Continued pressure on the price of oil will cause some cash flow issues for weaker borrowers. which could stress loan portfolios. In the last year, the Department of Banking has been closely monitoring the energy sector and the effects on regulated entities. As the energy sector falters, bank management needs to be able to identify any risk or exposure that could be detrimental to a bank's loan portfolio. If oil prices remain low for a prolonged period of time, there could be performance deterioration in a bank's loan portfolio resulting in higher classified assets, nonperforming loans, allowance levels and ultimately credit losses. The Department continues to monitor state banks with charge offs and loan loss provisions on the rise due to moderate exposure to the energy sector. The data for the industry as a whole reflects that provisions rose considerably from 2014 to 2015. Future anticipated losses due to depressed oil prices and reduced oil production during the coming year will continue to drive increased provisions.

A select number of state-chartered banks have begun to see negative implications from lax risk management programs and poor management of problem credits affected by the energy sector. Lack of collateral inspections, in isolated instances, has been noted. In these cases, insufficient collateral coverage or charge-offs have impacted bank balance sheets. Proactive monitoring of credits should be a part of a solid risk management program. Programs with stress testing of energy portfolios may also help identify borrowers who could have problems repaying loans with oil selling at a lower price per barrel. A bank's Board of Directors is key in ensuring bank policies and procedures are being followed to help identify, measure, monitor, and control the bank's exposure to oil and gas activity. The Department will continue to monitor the situation thorough off-site monitoring and examinations.

Interest Rates

In December 2015, the Federal Open Market Committee lifted short-term interest rates above their near-zero threshold to 0.25%, ending the seven year monetary policy of a 0% rate. The Fed's benchmark rate remains low, amid last year's projection by central bank officials to raise rates in 2016 by 1%, most likely in four quarter increments. However, Fed officials voted not to raise its benchmark on March 16, 2016, now expecting only to increase rates by approximately 0.5% in 2016. Analysts anticipate the next rate hike to occur in June.

Although, U.S. economic activity has been expanding moderately, weak global economic conditions continue to pose a threat. Other major central banks are still actively engaged in monetary policies to help boost their economies, making it unlikely for them to also raise interest rates. The uncertainties with the energy sector and financial markets also contributed to the Fed's decision in March.

An increasing interest rate environment will likely affect all segments of the economy. Institutions that made efforts to sustain earnings, including acquiring higher-yielding, long-term assets in their portfolios, will be vulnerable to the rise in interest rates. As rates increase, financial institutions will be required to adjust their operations and review their portfolios for affected customers. Should rates increase several times this year, additional supervisory attention will be placed on this aspect of bank balance sheets.

Other issues that remain a supervisory concern include: increased bankruptcies of companies associated with the energy sector; commercial real estate; bank secrecy; internal watch lists and identification of problem loans, and fraud.

Cybersecurity

Cybersecurity remains a top examination priority for both agencies as the increasing number and sophistication of threats continue to evolve. It is vital for financial institutions, to embed cybersecurity into their governance, control and risk management systems as well as provide adequate training to their personnel on such policies.

Due to the advanced and increasing trend of cyber threats to the banking system, the Department of Banking issued a notice in September 2015 to the industry announcing that all banks would be required to measure their inherent cyber risk and cybersecurity preparedness by December 31, 2015. On January 1, 2016, the Department began reviewing cybersecurity assessments at examinations. Thus far, the prime weakness noted with the assessments, which have been reviewed, are bank personnel completing the tool without input from other areas of the bank. This appears to be less of an issue in banks with approximately \$750 million or less in assets, since most of the employees are familiar with all bank operations. In institutions over \$750 million and less than \$3 billion, a few more erroneous or inaccurate statements have been discovered as a result of the person completing the assessment not being familiar with all areas of the institution. In most of these cases, the Board and/or upper management had identified that a

management committee with knowledge of all areas of the bank needed to review the results and adjust where necessary. The Department recommends all key personnel review the tool to ensure it is completed accurately. There are several maturity levels for cyber risk and cybersecurity preparedness. The basic maturity level, known as baseline, is characterized by meeting the minimum expectations required by law, regulations, or recommended in the supervisory guidance, as well as compliancedriven objectives. Since the fourth quarter of 2015, only a few institutions were below the baseline. Banks with deficiencies had remediation plans in place to reach baseline.

Cybersecurity is becoming more important as time goes on. The sophistication of attacks is also concerning. On November 3, 2015, the Federal Financial Institutions Examination Council (FFIEC) issued a joint statement with other federal regulators warning banks of the increasing frequency and severity of cyberattacks involving extortion. In such attacks, cyber criminals target the institution's funds directly rather than its customers through malware penetration. Using a variety of tactics such as ransomware and denial-of-service (DoS) attacks, cyber criminals take control of computer systems by preventing or limiting access. In order to get service restored, the bank must pay the hackers a fee. Supervisory attention to this type of criminal activity is ongoing.

DEPARTMENTAL SUPERVISORY MEASURES BEING TAKEN

The supervisory practices of each Department are designed to identify trends in the industry as a whole, or practices of individual banks that could threaten the industry or an institution's safety and soundness. Changes in economic conditions, fluctuations in interest rates, weaknesses in key industries, cybercrimes, and fraud all influence these supervisory responses. Problems and other weaknesses can sometimes be prevented or improved by timely regulatory identification and positive management response. Below, each Department has detailed the areas in which supervisory staff is currently monitoring.

Texas Department of Banking -

- Assessing banks' inherent risks to cyber-security attacks and determining their preparedness for such attacks;
- Assessing the potential effects that reduced oil and gas prices may have on Texas banks;
- Assessing interest rate risk to determine if banks are extending the duration of their investment portfolio to improve net interest margins;
- Monitoring reductions in internal and external audit functions, and loan review and training programs to reduce overhead costs;
- Conducting targeted reviews of new product lines as banks seek additional sources of revenue;
- Initiating enforcement actions early in the detection of deteriorating trends;

- Continuing frequent on-site examinations of problem institutions;
- Communicating and coordinating joint enforcement actions and other supervisory activities with other federal regulators;
- Placing monthly calls to state banks to obtain industry input on prevailing economic conditions;
- Expanding off-site monitoring to more closely follow-up on examination concerns;
- 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; and,
- Increasing internal communication and training to improve examiner awareness of pertinent issues.

Texas Department of Savings and Mortgage Lending -

- Participate in FDIC Compliance examinations of each institution. Participate in regular conference calls and close coordination with other state and federal regulators;
- Engage in regular correspondence with state savings banks regarding institution-specific issues and industry issues;
- Perform targeted examinations of high risk areas of state savings banks;
- Issue enforcement actions and place supervisory agents when deemed necessary;
- Conduct 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);
- Develop 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;
- Monitor local, state, national and world political and economic events impacting the industry; and,
- Participate in FDIC Compliance examinations of each institution.

PERFORMANCE SUMMARY AND PROFILE TEXAS BANKING SYSTEM

FDIC INSURED STATE-CHARTERED BANKS

As of December 31, 2015, the Department of Banking supervised 252 state-chartered banks, down 15 from 2014. However, during this period, bank assets increased by 4.9% to \$247 billion. The total number of banks continues on a downward trend due to an increase in merger and acquisition activity. National banks chartered in Texas are experiencing a similar decline.

Approximately three out of every five statechartered banks, or 61.5%, reported year-overyear growth to their net income in 2015, a 9.8% decrease from 2014. Although, the percentage of banks reporting net operating losses rose to 4.4%, up from 3.4% last year, net operating revenue totaled \$10.35 billion in the fourth quarter, up 6.9% from a year earlier.

Despite current economic conditions and existing industry challenges, banks remain wellcapitalized with an average leverage ratio of 9.8%; a slight increase compared to 2014. The uncertainties driven by the oil and gas industry have led some banks to boost their reserves for loan losses which are impacting their earnings directly. The provision for loan and lease losses for 2015 is at its highest level since 2011 at \$364 million. Provisions continue to exceed charge-offs as banks prepare for potential losses.

The allowance for loan and lease losses (ALLL) to noncurrent loans or the "coverage ratio" decreased from 170.6% in 2014 to 156.5% but remain adequate. ALLL represents 1.2% of loans at year end, an increase from 1.1% the previous year. Asset quality remains strong as noncurrent loans to total loans is manageable at 0.8%.

While net income increased by 1.4% to \$2.54 billion for the year ended December 31, 2015, return on assets decreased slightly by 6 basis points (BP) to 1.1% from the same period last year. Texas state-chartered bank's net interest income as a percentage of earning assets

decreased slightly in 2015 resulting in a nominal decline in the net interest margin (NIM) of 4 BP from 2014. The Federal Reserve increased rates in December 2015, the first time since the financial crisis, and is expected to gradually increase them again, potentially helping to boost the NIM.

FDIC INSURED STATE-CHARTERED THRIFTS

Through December 2015, state thrifts had \$230 million in net income, compared to \$189 million for 2014. The pretax return on average assets for the median thrift remains strong at 1.2%. The level of unprofitable savings banks decreased from 7.4% to zero. The most recently chartered or reorganized institutions have reached profitability. Provision expenses for loan and lease losses also remain low at 0.1% percent of average assets. Non-interest income to average assets remained stable, though there was a decrease in non-interest expense of 9 BP.

State thrifts experienced a slight increase in the median core capital levels since year-end 2014, from 10.3% to 10.5%. This increase is a result of improved earnings.

Quarterly NIMs began to increase slightly after a period of narrowing, from 4.0% for the fourth quarter of 2015. Year to date provisions to the ALLL increased \$17 million from the prior year. The prior year was exceptionally low, primarily due to large reverse provisions at one institution with federal loss share agreements. ALLL coverage of nonperforming loans and leases, with a median level of 192%, is much stronger than the median ratio of 107% for all savings institutions nationwide.

The median Texas thrift ratio of nonperforming loans plus other real estate owned to total assets remains low at 0.4%. Texas thrifts also have a lower ratio of nonperforming loans to total loans relative to the thrift industry across the nation at 0.3% versus 1.1%, indicating less of a supervisory concern.

NUMBER OF INSTITUTIONS AND TOTAL ASSETS

FDIC financial data is reflective of FDIC insured institutions only. Assets in Billions

	12-31-2015		12-31	2014	Difference		
	No. of <u>Institutions</u>	<u>Assets</u>	No. of <u>Institutions</u>	<u>Assets</u>	No. of <u>Institutions</u>	<u>Assets</u>	
Texas State-Chartered Banks Texas State-Chartered Thrifts	252 <u>27</u> 279	\$247.0 <u>\$13.6</u> \$260.6	267 <u>29</u> 296	\$235.4 <u>\$11.0</u> \$246.4	-15 <u>-2</u> -17	+\$11.6 <u>+2.6</u> +\$14.2	
Other states' state-chartered: Banks operating in Texas* Thrifts operating in Texas*	28 <u>0</u> 28	\$57.3 <u>0</u> \$57.3	27 <u>0</u> 27	\$49.9 <u>0</u> \$49.9	+1 <u>0</u> +1	+\$7.4 <u>0</u> +\$7.4	
Total State-Chartered Activity	307	\$317.9	323	\$296.3	-16	+\$21.6	
National Banks Chartered in Texas Federal Thrifts Chartered in Texas Other states' federally-chartered:	195 <u>6</u> 201	\$117.4 <u>\$73.7</u> \$191.1	203 <u>8</u> 211	\$128.1 <u>\$71.3</u> \$199.4	-8 <u>-2</u> -10	-\$10.7 <u>+2.4</u> -8.3	
Banks operating in Texas*	24	\$347.5	22	\$342.3	+2	+\$5.2	
Thrifts operating in Texas*	<u>7</u> 31	<u>\$0.9</u> \$348.4	<u>8</u> 30	<u>\$0.9</u> \$343.2	<u>-1</u> +1	<u>0</u> +\$5.2	
Total Federally-Chartered Activity	232	\$539.5	241	\$542.6	-9	-3.1	
Total Banking/Thrift Activity	539	\$857.4	564	\$838.9	-25	+\$18.5	

*Indicates estimates based on available FDIC information.

RATIO ANALYSIS

As of December 31, 2015 FDIC financial data is reflective of FDIC insured institutions only.

	State- Chartered <u>Banks</u> 252	Texas National <u>Banks</u> 195	All Texas <u>Banks</u> 447	State- Chartered <u>Thrifts</u> 27	Texas Federal <u>Thrifts</u> 6	All Texas <u>Thrifts</u> 33
% of Unprofitable Institutions	4.37%	1.03%	2.91%	0.00%	0.00%	0.00%
% of Institutions with Earnings Gains	61.51%	57.44%	59.73%	66.67%	33.33%	60.61%
Yield on Earning Assets	3.53%	3.81%	3.62%	5.09%	4.68%	4.74%
Net Interest Margin	3.29%	3.55%	3.38%	4.57%	4.38%	4.41%
Return on Assets	1.06%	1.26%	1.12%	1.80%	0.98%	1.10%
Return on Equity	9.27%	11.72%	10.02%	10.62%	10.85%	10.80%
Net Charge-offs to Loans	0.14%	0.15%	0.14%	0.10%	1.15%	0.97%
Earnings Coverage of Net Loan C/Os	19.52	17.03	18.6	28.64	3.16	3.62
Loss Allowance to Loans	1.17%	1.45%	1.26%	1.02%	1.60%	1.50%
Loss Allowance to Noncurrent Loans	156.46%	104.08%	130.61%	39.39%	143.44%	108.91%
Noncurrent Assets+OREO to Assets	0.58%	0.99%	0.71%	2.51%	0.74%	1.02%
Net Loans and Leases to Core Deps	76.36%	82.54%	78.37%	111.64%	81.33%	85.43%
Equity Capital to Assets	11.40%	10.86%	11.22%	16.03%	9.09%	10.18%
Core Capital (Leverage) Ratio	9.77%	10.11%	9.88%	16.10%	9.24%	10.31%

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

Information derived from the FDIC website.

COMPARISON REPORT

Select Balance Sheet and Income/Expense Information FDIC financial data is reflective of FDIC insured institutions only. December 31, 2015

	State	Banks*	State	Thrifts
	<u>End of</u> Period	<u>% of Total</u> <u>Assets</u>	<u>End of</u> <u>Period</u>	<u>% of Total</u> <u>Assets</u>
Number of Institutions	252		27	
Number of Employees (full-time equivalent) (In millions)	42,310		2,449	
Total Assets	\$246,960		\$13,640	
Net Loans and Leases	\$144,931	58.69%	\$10,191	74.72%
Loan Loss Allowance	\$1,713	0.69%	\$105	0.77%
Other Real Estate Owned	\$336	0.14%	\$62	0.45%
Goodwill and Other Intangibles	\$5,046	2.04%	\$71	0.52%
Total Deposits	\$204,350	82.75%	\$10,086	73.95%
Federal Funds Purchased and Repurchase Agreements	\$3,026	1.23%	\$11	0.08%
Other Borrowed Funds	\$7,348	2.98%	\$1,198	8.78%
Equity Capital	\$28,155	11.40%	\$2,186	16.03%
Memoranda:				
Noncurrent Loans and Leases	\$1,095	0.44%	\$267	1.96%
Earning Assets	\$225,511	91.31%	\$12,699	93.10%
Long-term Assets (5+ years)	\$71,275	28.86%	\$4,229	31.01%
	<u>Year-to</u> Date	<u>% of Avg.</u> <u>Assets</u>	<u>Year-to</u> Date	<u>% of Avg.</u> <u>Assets</u>
Total Interest Income	\$7,707	3.21%	\$604	4.72%
Total Interest Expense	\$507	0.21%	\$61	0.48%
Net Interest Income	\$7,200	3.00%	\$543	4.24%
Provision for Loan and Lease Losses	\$364	0.15%	\$15	0.12%
Total Noninterest Income	\$3,151	1.31%	\$144	1.12%
Total Noninterest Expense	\$6,599	2.75%	\$406	3.17%
Securities Gains	\$19	0.01%	\$1	0.00%
Net Income	\$2,542	1.06%	\$230	1.80%
Memoranda:				
Net Loan Charge-offs	\$192	0.08%	\$10	0.08%
Cash Dividends	\$1,380	0.58%	\$173	1.35%

*Excludes branches of state-chartered banks of other states doing business in Texas. As of December 31, 2015, there are an estimated twenty-eight out-of-state state-chartered institutions with \$57.3 billion in assets.

No branches of state-chartered thrifts of other states conducted business in Texas as of December 31, 2015.

PERFORMANCE SUMMARY UNITED STATES BANKING SYSTEM

FDIC QUARTERLY BANKING PROFILE Fourth Quarter 2015 - <u>www.fdic.gov</u>

Quarterly Net Operating Revenue



Quarterly Net Income

All FDIC-Insured Institutions



- 1 Earnings and Profitability Register Year-Over-Year Improvement – Declines in expenses for litigation at a few large banks combined with moderate revenue growth to lift fourth-guarter net income at FDIC-insured institutions to \$40.8 billion, an increase of \$4.4 billion (11.9%) compared with fourth quarter 2014. The improving trend in earnings was widespread. More than half of all banks, or 56.6%, reported year-over-year increases in quarterly net income. Meanwhile, the percentage of banks reporting negative guarterly net income fell to 9.1%, from 9.9% in the year-ago year. The average return on assets (ROA) rose to 1.03% from 0.95% in fourth quarter 2014.
- 企 Margins Improve at Banks – Net operating revenue-the sum of net interest income and total noninterest income-totaled \$174.3 billion in the fourth quarter, up \$6.8 billion (4.1%) from a year earlier. More than two-thirds of all banks, or 68%, reported year-over-year growth in revenues. Noninterest income was \$3 billion (5%) higher, as servicing income rose by \$2.1 billion (178%), and gains on asset sales were \$984 million (32%) higher. Net interest income increased by \$3.9 billion (3.6%) compared with fourth quarter 2014. The average net interest margin (NIM) was 3.13%, slightly higher than the 3.12% average the year before. This is the first time in five years that the average quarterly NIM hasn't been lower than the year earlier. Most of the margin improvement occurred at larger banks, whose asset portfolios were betterpositioned to benefit from the increase in short-term interest rates late in the quarter. Only 45% of all banks reported year-over-year NIM improvement.

① <u>Litigation Expenses Fall 80</u>

Percent – Total noninterest expenses were \$2.7 billion (2.5%) lower than in the year-ago quarter. Itemized litigation expenses at a few of the largest banks totaled \$616 million, a decline of \$2.4 billion (80%) from fourth quarter 2014. Salary and employee benefit expenses were \$1.2 billion (2.5%) higher, while expenses for premises and other fixed assets rose \$313 million (2.7%).

- Loss Provisions Rise to Three-Year <u>High</u> – Provisions for loan and lease losses increased year over year for a sixth consecutive quarter, rising by \$3.8 billion (45.5%). The \$12 billion in provisions that banks set aside in the fourth quarter is the largest quarterly total in three years. About 37% of banks reported higher quarterly provisions, while a similar proportion reported reductions in their loss provisions.
- Growth - Full-year earnings totaled \$163.7 billion, an increase of \$11.4 billion (7.5%) over the total for 2014. The average ROA in 2015 was 1.04%, up from 1.01% in 2014. Almost two out of every three banks. or 63.6%, reported higher net income in 2015. Only 4.6% of banks reported negative net income for the year. down from 6.3% in 2014. Net operating revenue increased \$14.9 billion (2.2%) in 2015, as net interest income rose by \$9.4 billion (2.2%) and noninterest income increased by \$5.5 billion (2.2%). Total noninterest expenses were \$5.5 billion (1.3%) lower than in 2014, as a few large banks reported \$6.6 billion (67.6%) less in itemized litigation expenses in 2015. Full-year loan-loss provisions registered an increase for the first time in six years, rising by \$7.2 billion (24.1%). Full-year net charge-offs were \$2.4 billion (6.1%) lower than in 2014.

Year-Over-Year Change in Quarterly Loan-Loss Provisions

All FDIC-Insured Institutions



Annual Net Income

All FDIC-Insured Institutions



2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015

Noncurrent Loan Rate and Quarterly Net Charge-Off Rate

All FDIC-Insured Institutions





Quarterly Change in Loan Balances

- Charge-Offs Rise in Commercial & Industrial, Consumer Portfolios - Net charge-offs totaled \$10.6 billion in the fourth quarter, an increase of \$690 million (7%) from a year earlier. This is the first year-over-year increase in guarterly charge-offs in 22 quarters. Net charge-offs of loans to commercial and industrial (C&I) borrowers rose by \$512 million (43.4%), as lower oil prices adversely affected some energy sector borrowers. Credit card charge-offs were \$292 million (5.6%) higher, an increase largely in line with the growth in total credit card balances. Net charge-offs of auto loans increased by \$105 million (15.9%). All other major loan categories had lower charge-offs than a year ago. The average net charge-off rate in the fourth quarter was 0.49%, almost unchanged from the 0.48% average in fourth quarter 2014.
- Provisions Exceed Charge-Offs for First Time in Six Years – Banks barely reduced their reserves for loan losses during the fourth guarter, as guarterly loan-loss provisions exceeded quarterly net chargeoffs for the first time in six years. Loan-loss reserves declined by \$586,000 (0.0005%) during the three months ended December 31. The average "coverage ratio" of reserves to noncurrent loans improved for a 13th consecutive quarter as a result of the decline in noncurrent loan balances. The coverage ratio improved from 85.2% to 86% during the quarter. This is the highest level for the ratio since mid-year 2008. Banks with assets greater than \$1 billion break out their loan-loss reserves for major loan categories. These institutions, which account for almost 90% of total industry reserves, increased their reserves for non-real estate commercial loan losses by \$2.3 billion (7.9%) during the quarter, and increased their reserves for credit card losses by \$460 million (1.7%). They reduced their reserves for all other loan and lease losses by \$2.3 billion (4.7%).

- **1** Lower Securities Values Limit Growth in Equity – Equity capital registered a modest \$4.4 million (0.2%) increase in the fourth quarter. Retained earnings contributed \$13.5 billion to equity growth, matching the contribution of a year earlier, as banks increased their fourth-quarter dividends by \$4.4 billion (19%). Accumulated other comprehensive income, which is included in equity capital, declined by \$13.5 billion during the quarter, as higher interest rates caused a decline in unrealized securities gains. At the end of 2015, 98.9% of all insured institutions, representing 99.8% of total industry assets, met or exceeded the requirements for the highest regulatory capital category as defined for Prompt Corrective Action purposes.
- 1 Pace of Loan Growth Accelerates Total assets increased by \$167.8 billion (1.1%) during the quarter. Total loans and leases rose by \$197.3 billion (2.3%), as credit card balances had a largely seasonal \$41.7 billion (5.8%) increase, C&I loans increased by \$39.6 billion (2.2%), and nonfarm nonresidential real estate loans rose by \$31.6 billion (2.6%). In addition, loans to nondepository financial institutions increased \$17.1 billion (6.5%), and multifamily residential real estate loans rose by \$15 billion (4.6%). Loans to small businesses and farms increased \$7.1 billion (1.1%). Investment securities holdings grew by \$49.6 billion (1.5%). Banks reduced their balances with Federal Reserve banks by \$42 billion (3.4%), with most of the decline occurring at a few of the largest banks. Assets in trading accounts fell by \$22.1 billion (3.8%).

- Deposits Continue to Fund Asset Growth – Total deposits increased by \$199.4 billion (1.7%) during the fourth quarter, as deposits in domestic offices rose by \$255.9 billion (2.4%), and foreign office deposits declined by \$56.5 billion (4.2%). Interest-bearing domestic deposits were up \$215.1 billion (2.8%), while noninterest-bearing deposits rose by \$40.7 billion (1.4%). Banks reduced their nondeposit liabilities by \$35.9 billion (1.8%) during the quarter.
- € "Problem List" Falls Below 200 Institutions – The number of FDIC-insured commercial banks and savings institutions reporting quarterly financial results declined from 6,270 to 6,182 in the fourth guarter. Mergers absorbed 81 institutions in the three months ended December 31, while two insured institutions failed. No new charters were added in the fourth quarter. Banks reported 2,033,758 full-time equivalent employees in the quarter, down from 2,038,490 in the third guarter and 2,047,945 a year ago. The number of insured institutions on the FDIC's "Problem List" declined from 203 to 183 during the quarter, and total assets of problem institutions fell from \$51.1 billion to \$46.8 billion. For all of 2015, there were 305 mergers of insured institutions, one new charter was added, and eight banks failed.

Number and Assets of Banks on the "Problem List"



SNAPSHOT STOCK PERFORMANCE SOUTHWEST REGIONAL BANKS MARCH 2016

	Last	Trade	52 Wk Ra		PE	EPS	Mkt Cap	Div/Shr	Div Yld
ACNB Corporation	03/14	21.87	N/A	N/A	12.39	1.76	131.98M	0.80	3.62
BancFirst Corporation	03/14	58.74	51.14	69.24	14.09	4.17	916.19M	1.44	2.50
Banco Bilbao VizcayaArgentaria	03/14	7.28	5.86	10.75	16.95	0.43	46B	0.35	4.74
BOK Financial Corporation	03/14	56.93	44.13	75.18	13.48	4.21	3.74B	1.72	3.00
Cass Information Sys, Inc.	03/14	49.87	43.78	59.09	24.92	2.00	565.26M	0.88	1.76
CoBiz Incorporated	03/14	11.28	10.31	13.94	18.04	0.62	452.94M	0.18	1.61
Commerce Bancshares, Inc.	03/14	44.52	37.44	47.11	17.42	2.56	4.33B	0.90	2.00
Comerica, Inc.	03/14	37.83	30.48	53.45	13.33	2.84	6.662B	0.84	2.23
Community Shores Bank Corp	03/14	2.20	1.85	3.00	0.88	2.50	3.23M	N/A	N/A
Cullen Frost Bankers, Inc.	03/14	56.50	42.41	80.23	13.27	4.27	3.52B	2.12	3.66
Enterprise Fin Serv Corp	03/14	28.05	19.68	30.73	14.84	1.89	561.48M	0.36	1.27
East West Bancorp, Inc.	03/14	32.33	27.25	46.50	12.17	2.66	4.66B	0.80	2.45
First Community Corp S C	03/14	13.26	N/A	N/A	14.57	0.91	88.72M	0.32	2.37
First Financial Bankshares, Inc.	03/14	28.61	24.12	36.51	18.58	1.54	1.89B	0.64	2.19
Great Southern Bancorp, Inc.	03/14	38.42	35.90	52.94	11.85	3.28	539.96M	0.88	2.25
Guaranty Fed Bancshares, Inc.	03/14	15.00	N/A	N/A	11.54	1.30	65.24M	0.32	2.13
Heartland Financial USA, Inc.	03/14	32.06	25.95	39.45	11.32	2.83	718.84M	0.40	1.24
International Bancshares Corp	03/14	24.62	21.05	31.00	11.96	2.05	1.63B	0.58	2.33
Landmark Bancorp, Inc.	03/14	24.63	23.19	28.68	8.46	2.91	86.97M	0.80	3.25
Liberty Bancorp, Inc.	03/14	16.25	N/A	N/A	12.60	1.29	58.5M	0.18	1.11
Mackinac Financial Corp	03/14	10.45	N/A	N/A	11.74	0.89	64.9897M	0.40	3.83
MidWest One Finl Group, Inc.	03/14	26.75	24.71	34.04	11.07	2.42	305.53M	0.64	2.38
Prosperity Bancshares, Inc.	03/14	44.63	33.57	59.97	10.93	4.09	3.16B	1.20	2.65
QCR Holdings, Inc.	03/14	23.48	17.51	24.90	14.58	1.61	276.15M	0.16	0.68
Southside Bancshares, Inc.	03/14	26.28	19.54	29.87	15.19	1.73	667.41M	0.92	3.45
Southwest Bancorp, Inc.	03/14	15.80	14.00	19.00	17.50	0.90	317.09M	0.32	1.98
Texas Capital Bancshares, Inc.	03/14	38.18	29.78	63.70	13.07	2.91	1.75B	1.62	4.17
UMB Financial Corporation	03/14	52.05	39.55	58.84	21.26	2.44	2.56B	0.98	1.87
West Bancorp Incorporated	03/14	18.45	16.04	21.09	13.67	1.35	296.39M	0.64	3.46
Zions Bancorp	03/14	24.63	19.65	33.03	20.52	1.20	5.03B	0.24	0.96

Source: Yahoo Finance (March 2016)

NA – Indicates information was not available.

SNAPSHOT STOCK PERFORMANCE SOUTHWEST REGIONAL BANKS MARCH 2015

Name	Last	Trade	52 Wk Ra		PE	EPS	Mkt Cap	Div/Shr	Div Yld
ACNB Corporation	03/12	20.35	17.99	22.90	11.87	1.71	122.41M	0.80	4.00%
BancFirst Corporation	03/12	60.95	52.51	69.49	15.09	4.04	944.97M	1.36	2.30%
Banco Bilbao VizcayaArgentaria	03/12	9.66	8.44	13.6	20.25	0.48	60.51B	0.38	3.90%
BOK Financial Corporation	03/12	60.64	53.01	71.10	14.37	4.22	4.19B	1.68	2.80%
Cass Information Sys, Inc.	03/12	52.72	39.00	56.70	25.59	2.06	607.12M	0.84	1.70%
CoBiz Incorporated	03/12	12.07	9.84	13.60	17.24	0.70	484.42M	0.16	1.40%
Commerce Bancshares, Inc.	03/12	42.74	38.10	45.38	16.36	2.61	4.12B	0.90	2.10%
Comerica, Inc.	03/12	46.88	40.09	53.50	14.84	3.16	8.36B	0.80	1.70%
Community Shores Bank Corp	03/12	2.75	0	3.60	N/A	2.95	N/A	N/A	N/A
Cullen Frost Bankers, Inc.	03/12	70.68	60.87	82.00	16.49	4.29	4.46B	2.04	2.90%
Enterprise Fin Serv Corp	03/12	20.59	16.38	20.93	15.20	1.36	408.46M	0.21	1.00%
First Community Corp S C	03/12	11.76	10.24	12.03	15.08	0.78	78.369M	0.28	2.40%
First Financial Bankshares, Inc.	03/12	27.89	24.46	32.54	20.06	1.39	1.77B	0.56	2.10%
Great Southern Bancorp, Inc.	03/12	38.63	28.00	40.44	12.46	3.10	532.01M	0.80	2.10%
Guaranty Fed Bancshares, Inc.	03/12	14.76	12.01	15.50	11.13	1.33	63.66M	0.20	1.30%
Heartland Financial USA, Inc.	03/12	32.37	22.38	32.41	14.78	2.19	599.201M	0.40	1.30%
International Bancshares Corp	03/12	26.27	22.24	28.49	11.52	2.28	1.74B	0.54	2.10%
Landmark Bancorp, Inc.	03/12	26.85	18.83	28.14	11.28	2.38	89.49M	0.76	2.80%
Liberty Bancorp, Inc.	03/12	15.90	0	17.00	17.28	0.92	57.24M	0.15	0.90%
Mackinac Financial Corp	03/12	11.40	9.95	15.06	38.00	0.30	71.43M	0.30	2.60%
Metrocorp Bancshares, Inc.	03/12	15.06	N/A	N/A	N/A	0.64	N/A	0.08	0.50%
MidWest One Finl Group, Inc.	03/12	28.98	22.50	29.82	13.23	2.19	242.56M	0.60	2.10%
OmniAmerican Bancorp, Inc.	03/12	26.17	N/A	N/A	N/A	0.52	N/A	0.20	0.80%
Osage Bancshares, Inc.	03/12	11.32	N/A	N/A	N/A	0.24	N/A	0.34	4.50%
Prosperity Bancshares, Inc.	03/12	53.29	45.01	67.68	12.34	4.32	3.73B	1.09	2.10%
QCR Holdings, Inc.	03/12	18.11	16.91	18.20	10.53	1.72	144.03M	0.08	0.50%
Southwest Bancorp, Inc.	03/12	17.63	14.97	18.49	16.48	1.07	338.37M	0.24	1.40%
Texas Capital Bancshares, Inc.	03/12	51.21	40.40	67.08	17.78	2.88	2.34B	N/A	N/A
UMB Financial Corporation	03/12	52.25	47.26	68.22	19.72	2.65	2.39B	0.94	1.80%
West Bancorp Incorporated	03/12	17.96	13.53	18.61	14.37	1.25	287.68M	0.56	3.20%
Zions Bancorp	03/12	28.04	23.72	33.33	16.69	1.68	5.7B	0.16	0.60%

Source: Yahoo Finance (March 2015) NA – Indicates information was not available.

NATIONAL ECONOMIC TRENDS



Source: Federal Reserve Bank of St. Louis, National Economic Trends, March 3, 2016.



Source: Federal Reserve Bank of St. Louis, National Economic Trends, March 3, 2016.

ECONOMIC REPORTS AND FORECASTS UNITED STATES

FEDERAL RESERVE BANK, DALLAS NATIONAL UPDATE February 2016 - www.dallasfed.org

- Economy Data released since the December 2015 Federal Open Market Committee meeting supports persistent, yet softer, growth. Service sector businesses continued to expand, while manufacturing activity weakened. The domestic economy has remained largely resilient, however, supported in large part by surprisingly strong labor market indicators and evidence that some core measures of inflation may be normalizing. Downside risks to U.S. growth have increased, particularly due to international factors that have negatively affected U.S. financial markets.
- Output Growth Weakens in Fourth Quarter 2015 – The first release of gross domestic product (GDP) growth for fourth quarter 2015 was lackluster across the board. Part of this weaker growth is attributable to softening manufacturing activity due to lower commodity prices and a rising trade-weighted value of the dollar. Evidence of this effect appears in the nonresidential investment and net exports categories, which cumulatively shaved 0.7 percentage points from overall GDP growth.

Weak consumption growth was largely expected, given data from retail sales and personal income reports received over the course of the fourth quarter. However, softer consumption growth remains puzzling, especially considering strengthening indicators from the household sector. A more detailed breakdown shows that services consumption growth remained robust, yet consumption of goods fell. A decline in commodity prices, all else equal, should support stronger goods consumption, but this effect is not obvious from data collected in 2015. Relative to the current recovery, fourthquarter consumption growth is normal. suggesting that this is not a worrisome negative signal.

Growth Softer in 2015 Percentage points



*Contribution to total Gross Domestic Product (GDP) growth. SOURCE: Bureau of Economic Analysis.



Divergence Apparent Between Services and Manufacturing Activity Index*

'00 '01 '02 '03 '04 '05 '06 '07 '08 '09 '10 '11 '12 '13 '14 '15 ' Values greater than 50 indicate expansion and less than 50 indicate contraction. NOTE: Shaded areas indicate U.S. recessions. SOURCE: Insitute for Supply Management.

Business Sector Indicators Show Weakness in Manufacturing Sectors – Business sector indicators provide additional evidence of a

divergence in manufacturing and service industries. Surveys from the Institute for Supply Management reported a contraction in manufacturing industries, whereas nonmanufacturing purchasing managers indicated continued expansion in December.

Other manufacturing-specific indicators suggested continued softening in December. The Federal Reserve Board's headline industrial production index fell 1.76% on a yearover-year basis. Similarly, capacity utilization ticked downward again to 76.5%, now 2.5 percentage points below year-ago levels. The Census Bureau's report on capital goods, excluding defense and aircraft, showed a continuing decline in new orders.

1 Household Sector Continues to

<u>Reassure</u> – Despite weakness in the manufacturing sector, U.S. households remain on solid footing, supported in large part by a robust labor market. The economy added 292,000 nonfarm jobs in December, well above Bloomberg consensus estimates of 200,000. Measures of unemployment stayed put, with the headline U3 reading of 5.0% and the broader U6 unemployment value remaining at 9.9% for December. Moreover, job opening rates from the Job Opening and Labor Turnover Survey remained at all-time highs. These signals have remained resilient, even with declines in oil-and-gas-related employment.

A tightening labor market may be encouraging wage growth. Average hourly earnings of production and nonsupervisory employees ticked upward to 2.4%, year over year, in December. A more comprehensive measure of salary and wage growth from the Employment Cost Index remained flat at 2% year-over-year growth for fourth quarter 2015. Subtracting trimmed mean PCE inflation from these measures yields a positive real-wage growth that is trending upward.

Real Wages Continue to Climb



** Subtracting year-over-year trimmed mean PCE inflation growth

NOTE: Shaded areas indicate U.S. recessions.

SOURCE: Bureau of Labor Statistics.

CPI Core Inflation Showing Signs of Acceleration, PCE Core Still Soft Percent*



NOTE: Shaded areas indicate U.S. recessions.

SOURCES: Bureau of Economic Analysis; Federal Reserve Bank of Dallas.

- Consumer Price Index Inflation Finally <u>Picking Back Up</u> – Inflation showed further signs of acceleration in December. The Consumer Price Index (CPI) growth, excluding food and energy prices, grew 2.1% year over year in December. The core personal consumption expenditures price index (PCE) also ticked upward, but remains relatively low at 1.4%, year over year. Trimmed mean splits the difference between CPI and PCE at 1.7%. It is most likely that headline measures of PCE inflation will tend toward the trimmed mean measure over the coming year.
- International Financial Fritz Spills into U.S. Markets – Stock market volatility has increased since the beginning of the year. Following downward revisions to Chinese growth prospects, financial conditions have tightened further and equity prices have dropped.

Financial conditions may have some spillover effects into the real economy. Declines in equity prices tend to decrease household consumption through wealth effects. However, this effect is small and contingent on the persistence of price declines. Moreover, housing wealth continues to rise, offsetting much of the effects from equity markets. On balance, financial stress remains in line with overall averages.



NOTE: Shaded areas indicate U.S. recessions.

SOURCES: Federal Reserve Bank of Cleveland; Federal Reserve Bank of St. Louis.

U.S. ECONOMY AT A GLANCE

U.S. BUREAU OF LABOR STATISTICS

Data Series	Sept 2015	Oct 2015	Nov 2015	Dec 2015	Jan 2016	Feb 2016
Unemployment Rate (1)	5.1	5.0	5.0	5.0	4.9	4.9
Change in Payroll Employment ⁽²⁾	149	295	280	271	<u>(Р)</u> 172	<u>(P)</u> 242
Average Hourly Earnings ⁽³⁾	25.14	25.21	25.27	25.26	<u>(P)</u> 25.38	<u>(P)</u> 25.35
Consumer Price Index ⁽⁴⁾	-0.1	0.2	0.1	-0.1	0.0	-0.2
Producer Price Index ⁽⁵⁾	-0.5	-0.2	<u>(Р)</u> 0.3	<u>(Р)</u> -0.2	<u>(P)</u> 0.1	<u>(Р)</u> -0.2
U.S. Import Price Index ⁽⁶⁾	-1.1	-0.3	-0.6	<u>(R)</u> -1.2	<u>(R)</u> -1.0	<u>(R)</u> -0.3

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) Final Demand, 1-month percent change, seasonally adjusted.

(6) All imports, 1-month percent change, not seasonally adjusted.

(R) Revised.

(P) Preliminary.

Data Series	4th Qtr 2014	1st Qtr 2015	2nd Qtr 2015	3rd Qtr 2015	4th Qtr 2015
Employment Cost Index (1)	0.5	0.7	0.2	0.6	0.6
Productivity ⁽²⁾	<u>(R)</u> -1.7	<u>(R)</u> -0.8	<u>(R)</u> 3.1	<u>(R)</u> 2.0	<u>(R)</u> -2.2

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 17, 2016

THE FEDERAL RESERVE BOARD THE BEIGE BOOK – MARCH 2, 2016 EXCERPT

Reports from the twelve Federal Reserve Districts continued to indicate that economic activity expanded in most Districts since the previous Beige Book report. Economic growth increased moderately in Richmond and San Francisco and at a modest pace in Cleveland, Atlanta, Chicago, and Minneapolis. Philadelphia reported a slight increase in economic activity, and St. Louis described conditions as mixed. Most contacts in Boston cited higher sales or revenues than a year-ago but mixed results since the previous month. New York and Dallas described economic activity as flat, and Kansas City noted a modest decline in activity. Across the nation, business contacts were generally optimistic about future economic growth.

Consumer spending increased in the majority of Districts, although Kansas City and Dallas noted some weakness. Auto sales were mixed, but remained at elevated levels in most Districts. Tourism activity strengthened in most reporting Districts.

Nonfinancial services activity grew slightly since the previous report, and demand for staffing services moved higher. Transportation activity was mixed, with weakness in the energy and agriculture sectors and lower export volumes limiting gains.

Overall, manufacturing activity was flat, although conditions varied considerably across Districts. Most Districts noted that weak demand from the energy sector was creating a significant headwind for manufacturers, although contacts in San Francisco mentioned that low energy costs had reduced production costs for steel products. Many Districts reported that the strengthening dollar and weakening global outlook had negatively affected international exports.

Residential real estate sales rose in most Districts since the last report, and home inventories were low in the majority of Districts. Residential construction activity strengthened, as several Districts noted strong growth in multifamily construction. Nonresidential real estate sales also picked up, on net, although sales ranged from flat to strong across all Districts.

In the banking and finance sector, most Districts reported slight to modest increases in loan demand, stable credit quality and unchanged credit standards.

Agricultural economic conditions were flat to down moderately, as low commodity prices and weak global demand continued to put downward pressure on farm income. The energy sector contracted further since the last report due to lower coal production and additional declines in the oil and gas industry.

Labor market conditions continued to improve, with the majority of Districts reporting modest gains. Wage growth varied considerably, from flat to strong, across all Districts, and most Districts reported that consumer prices held steady.

ECONOMIC REPORTS AND FORECASTS STATE OF TEXAS

FEDERAL RESERVE BANK, DALLAS REGIONAL ECONOMIC UPDATE February 2016 - <u>www.dallasfed.org</u>

- <u></u> Texas Economy – The Eleventh District economy continued its modest growth through the end of 2015 even as the near-term outlook dimmed. The manufacturing sector saw persistent softness in 2015, and a January 2016 decline in the Texas Manufacturing Outlook Survey (TMOS) production index signifies this trend may continue into the new year. However, both the Texas Service Sector Outlook Survey (TSSOS) and service sector employment point to sustained moderate growth in services, which make up about three-quarters of the state economy. Exports fell for the fourth time in the last five months in November, and the state's unemployment rate ticked up for the fourth consecutive month in December. The employment growth forecast for 2016 currently stands at 1.1%, 0.4 percentage points below 2015's growth and 2.5 percentage points below 2014's.
- Employment Gains Remain Modest Texas payroll employment grew at a 1.6% annual rate in December—the first time in a decade that Texas has trailed the U.S. for three consecutive months. Overall job growth for the state was 1.5% in 2015 (December over December), less than half the 3.6% rate seen in 2014.

While the state's unemployment rate has increased 0.6 percentage points from its low of 4.1 in August 2015, the labor force has also been growing in recent months, suggesting that some of the change in the unemployment rate is due to new job seekers, not just those losing jobs.



SOURCES: Bureau of Labor Statistics; Texas Workforce Commission; seasonal adjustments by Federal Reserve Bank of Dallas. Oil Prices and Rig Count Decline Further, Oil Production Weakens Only in Some Regions – Oil prices have declined significantly since December, although they ticked up to \$32 per barrel for the week ending Jan. 29. From early December through the end of January, oil prices dropped 21% and the rig count fell by 52 rigs (15.6%).

The impact of these declines has not been uniform across energy-producing regions. While Eagle Ford production has fallen sharply in response to low energy prices, production in the relatively low-cost Permian Basin maintained steady growth in 2015.

Oil and Gas Not the Only Sector Adversely Affected by Low Oil Prices – Headline TMOS production index plummeted 23 points to -10.2 in January, while the growth rate of orders remained in negative territory, where it has been since November 2014. The TMOS employment index (not shown), which remained negative or near zero for most of 2015, fell 15.1 points in January to -4.2 and is consistent with the employment woes felt in the Texas manufacturing sector.

Manufacturing sector employment declined in 2015 at a 4.1% annual rate (December/December). Breaking manufacturing out by some of its subsectors shows that nondurable goods manufacturing—food and chemical for example—fared better than durable goods—such as primary metals, fabricated metals and machinery manufacturing. This is likely due to a higher concentration of energy-related manufacturing present in the durable goods subsectors in Texas.

The stronger dollar, which has dampened exports, has also negatively impacted the state's manufacturing sector. While the Texas manufacturing sector has sustained significant losses, U.S. manufacturing sector employment actually grew by 0.2% in 2015.

Oil Production Plummets in Eagle Ford but not the Permian

Million barrels per day



NOTES: Plotted are the top four oil-producing regions. Locations of regions noted in parentheses SOURCE: Energy Information Administration.

TMOS Production and Order Growth Indexes Fall in January





Manufacturing Employment in Industries Tied to Energy Suffer the Most Percent change, December/December

SOURCES: Bureau of Labor Statistics; Texas Workforce Commission; seasonal adjustments by Federal Reserve Bank of Dallas. Û **Construction Contracts Fall,** Some Weakness Seen in Houston Housing and Office Markets - The five-month moving average for Texas construction contract values fell 3.5% in December. Declines were seen across the five-monthmoving-averages for most categories except residential contract values, which increased 0.1%. Nonresidential contract values fell 1.7%, and nonbuilding contract values-encompassing projects such as roads and bridges-were down 14.6%.

The Houston office vacancy rate rose 2.6 percentage points from Q4 2014 to Q4 2015 compared with decreases of 1.0 percentage point in Austin and 0.7 percentage points in Dallas, according to CBRE. Net absorption of space in DFW was near record highs in 2015, while there is weakness in Houston, where rent concessions are being offered. Existing-home inventories continue their rise in Houston, indicating some softening in the Houston housing market. Inventories across Texas and the other metros remain at low levels.

Outlook Has Weakened <u>Somewhat</u> – The Texas Leading Index declined again in December, a pattern that has persisted through most of 2015, contributing to the employment forecast of 1.1% growth for 2015 (December/December). On the upside, the Texas service sector continues to show resilience during this most recent slump in oil prices.

The Texas Business-Cycle Index, which was designed to gauge overall state economic activity, shows the gradual downshifting in economic growth over the course of 2015. While it does not indicate recession at this point in time, it does show a noticeable dip in recent months, consistent with the negative state economic impact of low energy prices.

Existing-Home Inventories Rise in Houston



2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 *Seasonally adjusted.

SOURCES: Multiple Listing Service; National Association of Realtors; seasonal adjustments by Federal Reserve Bank of Dallas.





2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 *Annualized rate.

SOURCE: Federal Reserve Bank of Dallas.

TEXAS ECONOMIC STATISTICS U.S. BUREAU OF LABOR STATISTICS

Data Series	July 2015	Aug 2015	Sept 2015	Oct 2015	Nov 2015	Dec 2015
Labor Force Data						
Civilian Labor Force <u>(1)</u>	(<u>4)</u> 13,055.9	(4) 13,071.8	(<u>4)</u> 13,090.4	(<u>4)</u> 13,109.5	(<u>4)</u> 13,127.1	(4) 13,142.4
Employment (1)	(4) 12,481.0	(<u>4)</u> 12,491.4	(<u>4)</u> 12,502.5	(<u>4)</u> 12,513.4	<u>(4)</u> 12,523.4	(4) 12,531.9
Unemployment (1)	(<u>4)</u> 574.9	(<u>4)</u> 580.4	(<u>4)</u> 587.9	(<u>4)</u> 596.1	<u>(4)</u> 603.7	(<u>4)</u> 610.6
Unemployment Rate (2)	<u>(4)</u> 4.4	(<u>4)</u> 4.4	<u>(4)</u> 4.5	(<u>4)</u> 4.5	<u>(4)</u> 4.6	(<u>4)</u> 4.6
Nonfarm Wage and Salary Employment						
Total Nonfarm <u>(3)</u>	11,822.70	11,819.30	11,848.50	11,866.30	11,891.50	<u>(P)</u> 11,916.4
12-month% change	2.2	2	2	1.7	1.6	<u>(Р)</u> 1.4
Mining and Logging (3)	294.4	289.7	284.9	284.5	286.1	(<u>P)</u> 286.0
12-month% change	-4.7	-7	-9.3	-9.9	-9.6	<u>(P)</u> -10.5
Construction (3)	663.4	667.2	667.9	671.6	681	(<u>P)</u> 684.8
12-month% change	1.6	1.8	1.2	0.9	1.7	(<u>P)</u> 1.0
Manufacturing (3)	860.7	855.6	858.5	855.3	854.1	(<u>P)</u> 849.3
12-month% change	-2.9	-3.5	-3.2	-3.8	-4.2	(<u>P)</u> -4.7
Trade, Transportation, and Utilities (3)	2,379.00	2,372.80	2,384.00	2,384.70	2,379.30	(<u>P)</u> 2,378.4
12-month% change	2.8	2.3	2.4	1.9	1.7	<u>(P)</u> 1.3
Information (3)	207.3	207.4	208.9	207.2	207.4	(<u>P)</u> 207.8
12-month% change	1.9	2.1	2.8	2.6	1.8	(<u>P)</u> 1.8
Financial Activities (3)	707.2	703.5	705.5	709.2	712.2	(<u>P)</u> 715.5
12-month% change	1	0.1	0.2	0.3	0.3	(<u>P)</u> 0.3
Professional & Business Services (3)	1,585.60	1,590.90	1,598.10	1,598.80	1,608.40	(<u>P)</u> 1,620.9
12-month% change	2.3	2.4	2.6	3.1	2.8	(<u>P)</u> 2.8
Education & Health Services (3)	1,594.30	1,599.00	1,611.30	1,611.40	1,614.00	<u>(P)</u> 1,621.4
12-month% change	4.6	4.7	5.3	4.6	4.3	(<u>P)</u> 4.4
Leisure & Hospitality (3)	1,254.90	1,259.70	1,261.50	1,269.40	1,268.20	<u>(Р)</u> 1,267.8
12-month% change	5.5	5.7	5.3	5	4.6	(<u>P)</u> 4.6
Other Services (3)	418.5	419.1	416.3	415.7	417.6	(<u>P)</u> 417.6
12-month% change	2.2	2.1	1.5	0.6	1.3	<u>(P)</u> 1.3
Government (3)	1,857.40	1,854.40	1,851.60	1,858.50	1,863.20	(<u>P)</u> 1,866.9
12-month% change	1.5	1.3	1.1	1.4	1.5	(<u>P)</u> 1.4
Footnotes			evised populat	ands, seasona ion controls, m		tion, and

(1) Number of persons, in thousands, seasonally adjusted. (2) In percent, seasonally adjusted. (4) Reflects revised population controls, model reestimation, and new seasonal adjustment
(P) Preliminary.

Data extracted on: March 11, 2016

FEDERAL RESERVE BANK SENIOR LOAN OFFICER OPINION SURVEY

The January 2016 Senior Loan Officer Opinion Survey on Bank Lending Practices addressed changes in the standards and terms on, and demand for, bank loans to businesses and households over the past three months. The survey included two sets of special questions: The first set asked banks about their outlook for lending practices and conditions over 2016, and the second set asked banks about their outlook for credit quality in 2016. This summary discusses the responses from 73 domestic banks and 24 U.S. branches and agencies of foreign banks.

Regarding loans to businesses, the January survey results indicated that, on balance, banks tightened their standards on commercial and industrial (C&I) and commercial real estate (CRE) loans in the fourth quarter of 2015. The survey results indicated that demand for C&I loans had weakened somewhat and demand for CRE loans strengthened somewhat during the fourth quarter on net. In response to the special questions, banks, on net, indicated that they expected standards on C&I and CRE loans to tighten over 2016 and loan performance of C&I loans and loans secured by multifamily residential properties (MF loans) to deteriorate over that same period.

Regarding loans to households, on balance, the survey found a moderate easing of standards on some categories of residential mortgage loans as well as on auto loans, while banks reported having left standards on credit card loans basically unchanged. Moderate net fractions of banks reported weaker demand across most categories of residential real estate loans, while demand for auto loans and credit card loans remained basically unchanged on net. In response to the special questions, banks, on net, indicated that they expected to ease standards on some categories of residential mortgage loans over 2016 and that delinquency and charge-off rates on subprime auto loans would increase.

BUSINESS LENDING

Commercial & Industry (C&I) Loans - On balance, a modest net fraction of banks reported a tightening of lending standards for C&I loans to large and middle-market firms over the past three months. Meanwhile, standards for C&I loans to small firms remained basically unchanged on net. A moderate fraction of banks reported that they had increased premiums charged on riskier loans to large and middlemarket firms on net. At the same time, for loans to large and middle-market firms, a moderate fraction of banks reported that spreads of loan rates over their cost of funds narrowed, a moderate fraction of large banks reported that the maximum size of credit lines increased, and banks reported that most other terms remained basically unchanged on net. Meanwhile, modest net fractions of foreign respondents reported a tightening of lending standards for C&I loans or credit lines. Moderate net fractions of foreign banks reported that the cost of credit lines increased and spreads over their cost of funds widened. Foreign banks reported similar trends to those of domestic banks for loans to large and middle-market firms for most of the remaining lending terms on net.

A majority of the domestic respondents that tightened either standards or terms on C&I loans over the past three months cited a less favorable or more uncertain economic outlook as well as a worsening of industry-specific problems affecting borrowers as important reasons, with some banks noting in their optional comments that energy-related industries, including oil and gas, were the concern. Significant net fractions of banks also attributed the tightening of loan terms to reduced tolerance for risk; decreased liquidity in the secondary market for these loans; and increased concerns about the effects of legislative changes, supervisory actions, or changes in accounting standards.

On balance, a moderate fraction of banks reported that demand for C&I loans was weaker during the fourth quarter for loans to large and middle-market firms as well as for loans to small firms. Among the banks that reported weaker loan demand, decreased investment in plant or equipment was the most commonly cited reason, though a reduced need to finance merger and acquisition activity, customer accounts receivable, and inventories were also cited by the majority of respondents. Additional reasons for weaker loan demand cited by significant net fractions of respondents included customers' internally generated funds increased and customers' borrowing shifted from the bank surveyed to another bank or nonbank source. During the fourth quarter of 2015, foreign bank respondents reported that demand for C&I loans remained basically unchanged on net.

Commercial Real Estate Lending – On net, survey respondents indicated that their lending standards for CRE loans of all types tightened during the fourth quarter. A significant net fraction of banks reported tightening standards for MF loans, a moderate net fraction reported tightening standards for construction and land development loans (CLD loans), and a small net fraction reported tightening standards for loans secured by nonfarm nonresidential properties (NFNR loans). Regarding changes in demand, modest net fractions of banks indicated that they had experienced stronger demand for all three types of CRE loans during the fourth quarter of 2015. Meanwhile, nearly all foreign banks reported leaving CRE lending standards unchanged, while a significant net fraction of foreign banks reported experiencing stronger demand for such loans.

LENDING TO HOUSEHOLDS

Residential Real Estate Lending – During the fourth quarter, a moderate net fraction of banks reported having eased standards on GSEeligible loans, while a modest net fraction of banks reported having eased standards on QM jumbo and non-QM jumbo residential mortgage loans. Meanwhile, banks left lending standards basically unchanged for all other categories of residential real estate loans on net. On the demand side, a moderate net fraction of banks reported weaker demand across most categories of home-purchase loans. Credit standards were reportedly little changed for approving applications of revolving home equity lines of credit, and a moderate fraction of banks reported that demand for such revolving home equity lines of credit had strengthened, all on net.

Consumer Lending – A moderate net fraction of banks indicated that they were more willing to make consumer installment loans compared with three months prior. Survey respondents stated that standards for credit card loans remained basically the same, on net, while a few large banks indicated that they had eased standards for approving applications for auto loans. Regarding terms on consumer loans, a modest net fraction of banks reported that they had increased credit card limits on new or existing credit card accounts, while all remaining terms surveyed remained basically unchanged on net.

Regarding demand for consumer loans, on balance, banks reported that demand for credit card and auto loans remained about unchanged during the fourth quarter.

BANK'S OUTLOOK FOR LENDING PRACTICES AND CONDITIONS OVER 2016

Survey respondents were asked about their expectations for lending practices and conditions over 2016, assuming that economic activity progresses in line with consensus forecasts. Modest net fractions of banks stated they expect to tighten their lending standards on C&I loans, moderate net fractions of banks stated they expect to tighten their lending standards on NFNR loans, and significant net fractions stated they expect to tighten their lending standards on CLD and MF loans over the course of this year. A majority expect interest rates charged on all categories of business loans to rise. Respondents expect spreads over their costs of funds to remain basically unchanged on C&I loans to large and middle-market firms, on net, while a small net fraction expects spreads over their cost of funds to widen for C&I loans to

small firms. Moderate net fractions of banks expect spreads over their cost of funds to widen for NFNR and MF loans, while a significant net fraction expects spreads over their costs of funds to widen for CLD loans over 2016. On balance, a moderate net fraction of banks expects the volume of originations to increase for C&I loans to large and middle-market firms, and a significant net fraction of banks expects the volume of originations to increase for C&I loans to small firms. A significant net fraction expects the volume of originations to decrease for MF loans over 2016, and a moderate net fraction expects the volume of originations to decrease for CLD loans; meanwhile, respondents expect the volume of originations of NFNR loans to remain basically unchanged on net.

Significant net fractions of foreign banks expect to tighten their standards and expect spreads over their costs of funds to rise on all categories of business loans over 2016. A significant net fraction expects interest rates to rise on C&I loans, and majorities expect interest rates to rise on all categories of CRE loans. Modest net fractions of foreign banks expect the volume of originations of C&I loans to large and middlemarket firms to decrease over 2016. On net, foreign banks expect the volume of originations of all categories of CRE loans except NFNR loans to remain unchanged over 2016. Moderate net fractions of foreign banks expect the volume of originations of NFNR loans to increase over 2016.

In contrast to their outlook for business loans, modest net fractions of domestic respondents expect to ease their standards for GSE-eligible and nonconforming jumbo residential mortgage loans. A majority expect interest rates to rise, and a moderate net fraction expects spreads over their cost of funds to increase. A small net fraction of respondents expects the volume of originations of GSE-eligible mortgage loans to decrease, while respondents expect the volume of originations of nonconforming jumbo residential mortgage loans to remain basically unchanged on net.

BANK'S OUTLOOK FOR LOAN PERFORMANCE OVER 2016

The January survey also contained a set of special questions on respondents' expectations for loan performance in 2016, assuming that economic activity progresses in line with consensus forecasts. These questions have been repeated annually, with some changes in loan categories, since 2006. On balance, a significant fraction of domestic banks reported that they expect an increase in delinquency and charge-off rates for all categories of C&I loans included in the survey over this year. A moderate net fraction of banks reported that they expect a deterioration of credit quality for MF loans, while credit quality for CLD and NFNR loans is expected to remain basically unchanged on net in 2016. In the consumer loan category, a significant net fraction of banks reported that they expect their delinquencies and charge-offs on subprime auto loans to increase in 2016.

A majority of foreign respondents expect an increase in delinquency and charge-off rates for syndicated leveraged C&I loans to large and middle-market firms this year, and a significant net fraction expects such an increase for C&I loans to small firms. A moderate net fraction of foreign respondents expects an increase in delinquency and charge-off rates for syndicated nonleveraged and nonsyndicated C&I loans to large and middle-market firms. Foreign respondents expect loan quality to remain basically unchanged for CRE loans.

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