March 2020

**Condition of the Texas State Banking System** Texas Department of Banking Department of Savings and Mortgage Lending Financial Data as of December 31, 2020



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<u>Symb</u>	ools Used Throughout this Report:	Abbreviations Used Throughout this Report:
①	Improving or strong conditions	FDIC – Federal Deposit Insurance Corporation
①	Deteriorating or weak conditions	OCC – Office of the Comptroller of the Currency
〔〕	Mixed conditions	FRB – Federal Reserve Board

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# ECONOMIC REVIEW AND OUTLOOK

The second half of 2019 brought new challenges for the Texas economy, yet the state continued to outperform the U.S. as a whole. The State's economy grew at a solid pace amid one of the longest expansionary cycles in its history.

Although the report's primary focus is on the second half of 2019, we are compelled to mention the worldwide pandemic of Coronavirus Disease 2019 (COVID – 19) that began in December 2019. This quickly spreading pandemic has paralyzed the financial markets worldwide and created a significant amount of economic uncertainty.

All sectors of the Texas economy are being impacted, resulting in rising unemployment and major disruptions to the oil and gas industry as well as the service and hospitality sectors. Statistical data reflecting the true impact will not be available for several months.

However, to assist the economy, the Federal Reserve slashed interest rates by 150 basis points (bp) in two separate emergency meetings in early March 2020, the first unscheduled, emergency cuts since 2008. In addition, federal lawmakers are have passed two stimulus packages and a third larger relief package aimed in part at providing direct payments to individual taxpayers and support for small businesses is planned. Further discussion on this action and the impact of the COVID – 19 is offered in greater detail under the <u>Supervisory Concerns</u> section of this report.

Data for the remainder of the report focuses on year-end financial data and the analysis of the economy through that period.

While the energy sector weakened by year's end, drilling activity still managed to tick upward slightly. Home sales continued to rise, even as labor shortages remained a major concern. Home prices were largely flat, while input prices continued to climb. The agriculture picture remained mixed.

Crude oil production, residential construction, housing sales, and commodity exports on the other hand all increased year over year (YoY). Texas' annual nonfarm employment increased by nearly 309,700 jobs last year, exceeding national growth by a full percentage point at 2.5%.

Texas state-chartered banks also fared well during quarters three and four of 2019. Growth in loan demand increased and loan volume growth was broad based across all lending categories, led by real estate lending (both commercial and residential). Overall business activity improved at year-end 2019 versus the previous reporting period, and expectations for future activity have improved slightly.

Some of this optimism can be attributed to long-held anticipation of the new United States-Mexico-Canada Agreement (USMCA), an agreement modernizing the 25-year-old North American Free Trade Agreement (NAFTA), signed in November of 2018 but not ratified by Congress until December 2019. The new pact is predicted to be a significant benefit to Texas; The Perryman Group, the Waco-based economic forecasting firm, projects Texas' annual gross product will be \$17.6 billion greater and employment 164,700 higher under USMCA.

Other topics remain worrisome for many Texas bankers. Cybersecurity continues to be an item of urgency, a fact driven home in August when 23 local governments in Texas were impacted by a coordinated ransomware attack. This and the Capital One data breach the previous month, involving the data of an estimated 100 million people, continued to stoke bankers' concerns.

Although the Financial Accounting Standards Board in October unanimously approved delaying implementation of its controversial Current Expected Credit Losses (CECL) accounting standard until 2023 for most financial institutions, the vote did little to ease pressure from banking and credit union groups seeking a broader review or an outright delay.

Adopted in June 2016, CECL will result in an enormous change for loan-loss accounting, as it will require lenders to forecast and reserve for lifetime credit losses as soon as a loan is added to their portfolios.

The discontinued use of the London Inter-bank Offered Rate (LIBOR), as discussed under the Supervisory Concerns section, is a benchmark for estimating what individual banks may be charged to borrow from other banks, is yet another point of concern among bankers. A move away from this standard will bring with it an increased risk of systemic market disruption and potential contractual/legal issues.

# STATE-CHARTERED BANKING PROFILE (DEPARTMENT OF BANKING)

There were 224 Texas-chartered banks as of December 31, 2019, four fewer than at June 30, 2019. This net reduction during the second half of 2019 was the result of seven banks leaving the Texas state bank system:

- Three state banks merged with and into other Texas state banks; ٠
- Two state banks merged with and into out-of-state state banks;
- One state bank merged with and into a national bank; and
- One state bank merged with and into a Texas state savings bank.

This activity was offset by three banks entering the Texas state banking system:

- One conversion of a national bank to a Texas state bank;
- One conversion of a Texas state savings bank to a Texas state bank; and
- One de novo Texas state bank charter.

During the same period, the Department processed 145 filings related to banks, with approximately 46% involving office facilities and loan production activity, 34% involving changes in ownership/control or chartering authority, 16% involving bank identification and corporate governance issues, 3% involving subsidiary formations, and 2% involving foreign bank activity.

Despite the modest decline in the number of Texas state-chartered banks, the overall asset size increased from \$276.3 billion as of June 30, 2019, to \$284.5 billion at year-end 2019. The asset growth occurred from a combination of \$8.6 billion of internal asset growth and \$0.3 billion in conversion/chartering activity offsetting a \$0.7 billion decline from net merger activity. Overall, total assets for 2019 increased \$22.1 billion, rising to \$284.5 billion from \$262.4 billion in 2018.

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

State-chartered thrift assets under the Department's jurisdiction totaled \$27.5 billion as of December 31, 2019, an increase of 7% or \$1.8 billion over the prior six months. Through December 31, 2019, state thrifts had \$274.7 million in year-to-date net income. Increased profitability occurred in 60.9% of the thrift institutions through December 2019, due to an increase in the volume of loans at most institutions, offset by increased provisions for loan and lease losses and decreases in noninterest income. There were no unprofitable institutions as of December 31, 2019. Thrifts' net interest margins (NIM) have recovered slightly since the low of 3.6% in December 2018 to 3.7% in December 2019, due to increases in yields on earning assets. However, noninterest income decreased from a peak of 0.9% of assets in December 2018 to 0.3% of assets in December 2019.

The level of nonperforming loans and other real estate foreclosed remains low in state-chartered thrifts at 0.7% of total assets, which is down from 1.2% in December 2018. Despite these low levels, state and

federal regulators continue to closely monitor past due and nonaccrual loans, as well as foreclosed real estate.

The Department continued to receive and process applications, administering two branch office applications and various other applications during the past six months.

## **TEXAS ECONOMIC PROFILE**

The Texas economy weathered turbulence at both the state and national level in the second half of 2019 with only a limited number of setbacks. Ongoing trade tensions with China, fierce political divisions in Washington, a six-week strike affecting the auto industry, a slowing global economy, and the COVID – 19 outbreak proved to be strong headwinds to the current business-cycle expansion; however, the state's economy experienced more positive outcomes than negative.

The true impact of the COVID – 19 virus will not be known for months, but the effect on the oil and gas industry could be devastating. Brent crude oil fell to \$24.88 per barrel on March 23, the lowest since May 2003. Regulators with the Texas Railroad Commission are reportedly considering curtailing oil production to help staunch plunging prices. The state has not limited production since the 1970s.



Unemployment, which was already on the rise by December 2019, is expected to increase sharply, especially in but not limited to the oil producing Permian Basin region. According to the Federal Reserve Bank of Dallas (FRB Dallas), the unemployment rate increased by year-end 2019 for the first time since the previous January. Employment grew an annualized 2.6% in December, following a downward revision to 3.8% in November, after growing an annualized 0.7% in September and 1.8% in August.

Source: Federal Reserve Bank of Dallas

The FRB Dallas' Business-Cycle Index grew 4.3% annually, accelerating for the ninth straight month after nearly a year of slowing growth from mid-2018 to early 2019.

Meanwhile, the FRB Dallas' Texas Leading Index fell 0.3% in September after a large dip in August, pushing the index further into negative territory. Components driving this contraction included new unemployment claims, well permits, and the help-wanted index.

After an anemic 0.8% uptick in November, the index fell another 0.2% in December; the threemonth change, however, still held steady at 0.6%. December new unemployment claims, well





permits, and the U.S. leading index negatively impacted the Texas Leading Index, while average weekly hours made little to no significant impact.

Growth in Texas factory activity finally resumed in December, according to the FRB Dallas' Texas Manufacturing Outlook Survey. After falling four points to 13.9 in September, the production index, a key measure of state manufacturing conditions, rebounded to 3.6 after dipping into negative territory for the first time since mid-2016, falling seven points to -2.4.

The index for new orders rose from -3.0 to 1.6 by year-end 2019. The growth rate of orders index moved up but remained in negative territory for a third consecutive month, coming in at -5.0; however, the capacity utilization index shot up 13 points to 7.8, and the shipments index rose from -4.5 in October to 3.0 in December.

Activity in the Texas service sector accelerated in September, according to the FRB Dallas' Texas Service Sector Outlook Survey. The revenue index, a key measure of state service sector conditions, rose from 7.8 in August to 12.9 in September. The pace quickened once again by December, after a slight dip in November, moving to 17.9 from 12.2 in the previous month.

Growth in retail sales strengthened in September, according to FRB Dallas' Texas Retail Outlook Survey. The sales index picked up after holding flat for two months, rising from -0.2 to a five-month high of 7.7. Sales then accelerated markedly in December, rising seven points to 13.5, its highest level in more than a year.

#### EMPLOYMENT

As previously noted, the state continued to create jobs faster than the rest of the country and job growth remained broad based throughout 2019. Texas employment grew an annualized 2.6% in December, following a downwardly revised 3.8% in November. Growth remained above Texas' long-run average pace of 2.1%.

The state's job expansion was led by construction (up 5%), finance (up 3.5%), and education and health services (up 3.2%). Lower-performing sectors included government (up 0.3%), other services not in a specific sector (down 0.3%), and the oil and gas (down 2.7%).

Texas' labor force participation rate inched up to 64.1% by year-end 2019 as improved employment prospects pulled more than 236,700 workers back into the labor force. Accelerated hiring in Dallas and San Antonio pushed their indexes up 4.7% and 3.4%, respectively, while Fort Worth's economy continued its healthy expansion, increasing 4.2%.

Meanwhile, Austin's remarkably low unemployment rate held the FRB Dallas' Texas Business-Cycle Index at 7.4% growth despite a slowdown in hiring. Houston's figures slowed slightly to 3% growth amid energy sector struggles but hovered around its post-crisis average.



Source: Federal Reserve Bank of Dallas

Austin's unemployment ended 2019 at 2.7%, while Dallas-Fort Worth and San Antonio joblessness numbers fell to 3.2% and 3.1%, respectively. Houston was the outlier with an unemployment rate above the statewide average at 3.7% but still at a historic low.

Statewide, the seasonally adjusted Texas unemployment rate in December was 3.5%, up a tenth of a percentage point from 3.4% in November. Texas set a record in 2019 for the lowest unemployment rate since series tracking began in 1976.

Regarding wages, average real private hourly earnings balanced around their five-year average as inflation offset nominal gains.

Dallas paid the highest nominal wages at approximately \$29 per hour, but real earnings remained flat for the second straight year. Houston real wages weighed down statewide figures, falling 1.2% for the fourth consecutive annual decline. Inflation-adjusted earnings in Austin also brought down the state average, dropping 2.7% after six straight years of growth. Conversely, San Antonio and Fort Worth wages increased 1.8% and 0.9%, respectively, in real terms.

#### POPULATION

According to the U.S Census Bureau, there are an estimated 28.9 million residents in Texas, a figure that did not change significantly over the past two quarters. Approximately 72.7% of Texans live in the state's biggest metropolitan areas, a proportion which has been rising over time.

Domestic and international migration accounted for nearly half of the state's population growth over the past few years and an even larger percentage of the growth of the working-age population. However, the number of people moving to Texas from other states is slowing, according to The Perryman Group, due in large part to the fact the national economy has strengthened over the past few years and many regions are at or near full employment.

Net international migration, meanwhile, fell to levels unseen since 1991, likely due to stricter immigration policies. The natural increase – births minus deaths – remained mostly unchanged from the previous year. Population growth in the major metros is expected to meet, if not exceed, the statewide average when 2019 data is released later this year.



An estimated 17.2% of all Texas residents are foreign-born and 35.9% of households speak a language besides English at home. This compares with 13.7% and 21.9%, respectively, for the rest of the U.S.

Nearly 30% of non-English speaking households in Texas speak Spanish, while 2.3% speak other Indo-European languages. Interestingly, this is less than Asian and Pacific Islander languages, which is spoken in 3.1% of Texas homes.

The state, like the rest of the U.S., is aging as the massive baby-boom generation enters its retirement years. Since 2010, the number of Texans age 65 and older rose by 1 million, a 38.5% increase, compared to the rest of the country, the rate for which was 30.2%.

At the same time, Texas also saw the highest rate of under-18 population growth among the six most populous states during this time period and second only to North Dakota.

#### HOUSING

Home sales rose broadly in the second half of 2019, with demand surpassing expectations in some areas thanks to healthy job growth and low mortgage rates.

Source: U.S. Census Bureau

Seasonally adjusted Texas housing sales decreased 2% in September from August but picked up momentum in the fourth quarter to end the year up 3.8%. A record 356,576 homes sold through Multiple Listing Services in 2019.

Much of the housing development in Houston and San Antonio targeted homes intended to sell for less than \$300,000.

Higher construction costs in Austin forced most of the development into the \$200,000-\$400,000 range, while activity in Dallas-Fort Worth slid backwards after eight consecutive annual increases but remained elevated compared with the Metroplex fiveyear average.

Total new housing starts faltered to start 2019 but finished strong, increasing 11.5% as the singlefamily sector gained momentum in quarters three and four.



Source: Real Estate Center at Texas A&M University

#### Starts for single-family homes

priced under \$200,000 rose for the first time since 2012, signaling renewed efforts to provide housing at the lower end of the price spectrum.

Nevertheless, housing starts in this price range still constituted just 6% of the 98,400 single-family homes that broke ground in the state's major metros.

In response to supply shortages resulting from a lack of labor and affordable land availability, developers accelerated activity at the earliest stage of the construction cycle; the number of new vacant developed lots in the Dallas-Houston-San Antonio triangle reached its highest level in the post-recessionary period at more than 107,000, resulting in 11.2% annual growth.

The downside: These shortages have led to a severely constricted supply, causing the state's housing affordability to steadily decline, a trend that can be traced as far back as 2013. Of equal concern has been the uneven housing recovery, particularly in rural areas of Texas.

For example, in the Killeen region, 20% of mortgages in the ZIP code covering Copperas Cove are seriously underwater, defined as owners owing more than 125% of their home's present value. The same may be said for more than 13% of mortgages in ZIP codes in the Brownsville, Laredo, Wichita Falls, and San Angelo areas.

Apartment demand remained healthy, with occupancy rates either holding steady or up YoY and rent growth holding above long-term averages. Overall occupancy rates entering the fourth quarter of 2019 – the most recent figures available – increased in all four major cities (Dallas at 92.4%, Austin at 92.3%, and San Antonio at 91.3%) except Houston, which remained steady at 90.7%.

#### OIL AND GAS

After setting production records in 2018 and early 2019, segments of the oil and gas (O&G) sector began to soften in the second half of the year, according to the FRB Dallas' Energy Survey.

Overall O&G production increased for the 12th and 13th consecutive quarters, respectively; the oil production index jumped from 15.7 in the third quarter to 24.7 in the fourth, and the natural gas production index increased from 6.5 to 15.6. Both indexes suggest that O&G production rose at a slightly faster pace relative to last quarter.

At the same time, the business activity index – the survey's broadest measure of conditions – fell to -7.4 in the third quarter from -0.6 in the second quarter but ended 2019 at -4.2. This falloff was led by oilfield services firms, with their business activity index slumping to -21.8 from 6.6. Pipeline limits, reduced flow from wells drilled too close together, low natural gas prices, and high land costs all conspired to degrade conditions.

This slowdown led Wall Street investors to begin pumping the brakes on lending, forcing many firms to cut back both on drilling activities and employment. Reduced funding could slow future growth in domestic O&G production and potentially bring more bankruptcies in the sector. Bankruptcy filings in 2019 among U.S. producers were at levels not seen since 2016, when U.S. crude slumped to \$26 per barrel.

The energy sector has been the worst performing in the Standard & Poor's 500 since 2018, falling 18% against a 12.8% increase for the broader index, and many publicly traded shale companies have performed even worse.

This crimp in financing is an especially serious threat to smaller companies already struggling to find other funding sources – e.g., issuing stock or bonds – as investors grow restless with years of lackluster returns in the shale sector after spending money on new wells just to maintain output.



Oil prices were up and down over the third and fourth quarters of 2019. West Texas Intermediate crude began August by slipping \$2.84 to settle in at \$56.25 a barrel on the New York Mercantile Exchange. By the end of October, the price had further slipped to \$54.18 but rallied to close the year at \$61.06 a barrel.

The oil rig count reflected this industry softening with a steady decline through the end of the year. The count began the second half of 2019 by adding eight rigs in August, rising to 475 from 467 in June, but slipped to 419 in October

and ended the year at 406. Overall, the Texas rig count fell 23.5% for the year.

#### AGRIBUSINESS

Higher temperatures and a lack of rainfall greeted Texas farmers in August which adversely affected crop yields, particularly corn, cotton, and wheat. Crop prices and demand for agricultural loans both continued to decline, with the FRB Dallas' Loan Demand Index registering its 16th consecutive quarter in negative territory.

Drought conditions only worsened as the year went on to the point Texas Governor Greg Abbott extended in September a disaster declaration due to drought conditions in seven south Texas counties to include another 31 counties. The governor in December issued a third disaster declaration due to significantly low rainfall and prolonged dry conditions.

By year-end 2019, the FRB Dallas was reporting overall weaker conditions across most regions, noting poor rainfall throughout the year contributing to dry conditions and poor crop yields. The Loan Demand Index declined for the 17th consecutive quarter. Loan renewals and extensions increased, and the rate of loan repayment continued to decline. Loan volume fell across all major categories compared with a year ago.

Source: Baker Hughes

Financial assistance through the U.S. Department of Agriculture's Market Facilitation Program and Price Loss Coverage payments helped, but by year-end 2019 it was not clear to what extent.

With respect to land values, irrigated cropland values stabilized the last fourth quarter, while dryland values held steady and ranchland values increased moderately. According to bankers who responded to an FRB Dallas survey in both fourth quarter 2019 and fourth quarter 2018, nominal cropland and ranchland values increased YoY.

The anticipated trend in farmland values index increased slightly at year's end after being flat for a year, suggesting survey respondents expect farmland values to pick up moderately.

The one sure bright spot for Texas agriculture was the ratification of the USMCA, which should secure greater market access for the state's farmers and ranchers. Texas is a major cattle, dairy, poultry, and egg producer, and USMCA opens new markets. Agricultural exports from Texas to its North American partners amounted to \$7.2 billion annually under NAFTA and stand to increase by another \$2.2 billion under USMCA.

#### STATE TAX REVENUE

Tax revenue in 2019, in many ways, mirrored the performance of the Texas economy. Revenue for the entire year was up 4.9% over that of 2018, increasing to \$60 billion from \$57.2 billion; however, this increase was significantly smaller than the 11.6% increase YoY 2017 to 2018. Revenue for the second half of 2019 totaled \$28.5 billion.

Revenue from sales tax equaled \$34.5 billion for the year, enjoying a slim 5.3% increase from July to December 2019, peaking at \$3.1 billion in October, and ending 2019 at \$17.6 billion. Figures for this tax category were up 4.8% at year-end 2019 over the same period in the previous year.



Taxes from oil production climbed 16%, moving from \$312.4 million in July to \$362.5 million in December, ending the fourth quarter at \$2 billion. However, revenue from the production of natural gas slipped over the same time period.

Taxes in this category began the second half of the year at \$128.9 million but ended the fourth quarter of 2019 at \$113.9 million, down 11.6%. Total revenue for quarters three and four equaled \$647.9 million.

Source: Texas Comptroller of Public Accounts

Motor fuel tax revenue remained relatively flat over quarters three and four, dipping slightly from \$311 million in July to \$310.6 million in December, down 0.1%. Meanwhile, revenue from motor vehicle sales and rentals also sank by 11.6%, moving from \$483.5 million in July to \$427.2 million in December, ending 2019 at \$2.7 billion.

Other tax revenue figures of note included franchise taxes, which went on an extended roller coaster ride over the last two quarters of 2019. Revenue went from \$34.7 million in June to \$237.1 million in August before spiraling down by \$43.4 million in October and another \$135 million by year's end. Franchise taxes totaled \$4.2 billion for the entire year but only \$132.4 million during the second half of 2019.

## **SUPERVISORY CONCERNS**

The departments continually monitor and identify concerns surrounding the stability of the financial industry and the impact on our regulated entities. The rapidly unfolding events regarding COVID – 19) are unprecedented. The data and facts for this report are through March 15, 2020. While COVID – 19 is front and center, this section highlights two other important topics: The Department of Banking cybersecurity rule and London Inter-bank Offered Rate (LIBOR).

#### COVID - 19 AND INTEREST RATES

In December 2019, COVID – 19 began to spread throughout China. On March 11, 2020, the World Health Organization declared COVID – 19 a pandemic, which has had serious impacts on the financial markets.

On March 3, 2020, the Federal Reserve revealed that the Federal Open Market Committee (FOMC) decided to lower the target range for the federal funds rate by 50 bp, ranging from 1% to 1.25%, down from 1.5% to 1.75%. While noting the economy remains strong, this decision was made during an emergency meeting to address the increasing risks to economic activity due to COVID – 19. On March 15, 2020, the FOMC cut rates further to a range of 0% to 0.25%.

Date	Drop Amount	New Target Rate
15-Oct-98	25 basis points	5.00%
3-Jan-01	50 basis points	6.00%
18-Apr-01	50 basis points	4.50%
17-Sep-01	50 basis points	3.00%
22-Jan-08	75 basis points	3.50%
8-Oct-08	50 basis points	1.50%
3-Mar-20	50 basis points	1.0% - 1.25%
15-Mar-20	100 basis points	0% to 0.25%

The FOMC has cut interest rates only seven times between regularly scheduled meetings since 1998. The FOMC cut rates because they were concerned economic activity will slow due primarily to COVID – 19 and the energy sector. The FOMC states, "This action will help support economic activity, strong labor market conditions, and inflation returning to the Committee's symmetric 2% objective."

#### On March 6, 2020, an Interagency

Statement on Pandemic Planning was issued by the Federal Financial Institutions Examination Council (FFIEC) on behalf of its member agencies. Given the situation, institutions should review, test, and be prepared to implement their Business Continuity Plan. Sound preparations and planning will help mitigate interruptions in the normal course of business. The extent of the financial impact of COVID – 19 is currently unknown. Both departments support the provisions of the Joint Press Release issued on March 9, 2020, by the Board of Governors of the Federal Reserve System, Consumer Financial Protection Bureau, Federal Deposit Insurance Corporation, National Credit Union Administration, Office of the Comptroller of the Currency, and the Conference of State Bank Supervisors.

The departments trust our financial institutions will work with their customers in a safe and sound manner to help borrowers recover and ultimately repay their debt. As the evolution of this pandemic remains volatile, and until stabilization is reached, items such as determining asset classification and reserve adequacy are understandably fluid. The departments will work with state-chartered banks and thrifts through the lifespan of this pandemic.

#### **CYBERSECURITY INCIDENT REPORTS**

Financial institutions are facing continued increasing attacks in various forms by cybercriminals. These attacks have the potential to cause significant business disruption and potential loss of confidential business information, trade secrets, organizational strategies, and financial information.

<u>New rules</u>, which became effective January 2, 2020, require Department of Banking regulated state banks, trust companies, and money services business to report cybersecurity incidents to the Banking Commissioner promptly if they experience a material cybersecurity incident in its information systems, whether maintained by the entity, an affiliate, or third-party service provider. <u>The rules</u> define a "cybersecurity incident" and "information system".

The rules require a notice be submitted to the Department as soon as practicable, prior to customer notification, but not later than 15 days following the entity's determination that a qualifying cybersecurity incident has occurred. An incident must be reported if it will likely: (1) require a notice or report to another state or federal regulatory or law enforcement agency; (2) require sending a data breach notification to bank customers under applicable state or federal law; or (3) adversely impact the ability of the bank to process transaction for customers. The required notice is confidential pursuant to the Texas Finance Code.

#### Examples of Cybersecurity Incident Requiring Notice:

A bank's third-party vendor notices unusual activity on their system which alerts the vendor to perform a review. The review reveals that unauthorized access to the vendor's system has resulted in unauthorized access to bank customer account and personal information stored on the vendor's information systems. Notice to the Department is required since this is a data breach involving a bank's vendor and it is likely that customer notification is required by law.

Another example is the financial institution's network becomes encrypted with ransomware. Although no customer information was stolen, a decryption key was obtained and the network decrypted, meaning this is a material incident that jeopardizes the cybersecurity of the information system. A financial institution should notify the Department.

#### Example of Cybersecurity Incident Not Requiring Notice:

A customer's debit card information is compromised through a cybersecurity breach at an unaffiliated retailer. While the customer's bank debit card information may have been compromised, the bank's information systems were not compromised and therefore, notice is not required.

#### LIBOR

LIBOR is a benchmark interest rate at which major global banks lend to one another in the international interbank market for short-term loans. Major global banks submit the interest rate they would charge other banks for short-term loans daily. From the submissions, the highest and lowest figures are not included and then an average of the remaining numbers is calculated. LIBOR can be used to determine interest rates on corporate debt, home mortgages, financial contracts, etc. However, in recent years it has been noted that LIBOR can be manipulated and is instable.

LIBOR is set to sunset in the U.S. by the end of 2021. This will affect loans, securities, models, etc. tied to LIBOR. Banks and thrifts should determine all financial and non-financial risk exposures from the LIBOR transition and establish strategies and timelines for determining replacement reference rates. Transition planning for each institution will be understandably different. The risk identified within the institution coupled with the institution's size and complexity will help determine the level of governance the entity will need.

When choosing the alternative reference rate, institutions should be mindful of spread differentials and term structures. Further, tax and accounting differentials should be analyzed. As many alternative reference rates exist, institutions should perform proper due diligence on and understand the risks associated with the new reference rate before making a final decision. On March 12, 2020, Financial Accounting Standards Board issued a <u>guidance</u> to assist in the transition.

## **DEPARTMENTAL SUPERVISORY MEASURES BEING TAKEN**

#### TEXAS DEPARTMENT OF BANKING

- Monitor and assess the impact that COVID-19 will have on the Texas banking system and the financial service providers under the Department's supervision.
- Assess institutions' preparedness to identify, detect, respond to, protect against, and recover from cyber-attacks and perform follow-up evaluations for those below a base-line level of readiness;
- Investigate, assess, and oversee remediation and compliance efforts in response to institutions' material cybersecurity incidents;
- Monitor banks' transition from LIBOR to a substitute reference rate;
- Evaluate underwriting criteria during on-site examinations to assess the sensitivity of asset quality metrics to changes in economic conditions;
- Monitor efforts to prudently assess and mitigate concentration risks in commercial real estate, oil and gas, and agriculture lending;
- Assess bank liquidity levels, including dependence upon potentially volatile funding sources, funding concentrations, and deposit costs relative to local competition;
- Assess risks posed by increasing market interest rates on net interest margins, extended durations of investment securities, and economic value of equity;
- Monitor bank preparations for the industry's pending transition to CECL;
- Conduct off-site monitoring of institution's key financial performance metrics and analyze exceptions;
- Initiate enforcement actions early in the detection of deteriorating trends;
- Conduct frequent on-site examinations or visitations of problem institutions;
- Communicate and coordinate joint enforcement actions and other supervisory activities with federal regulators;
- Participate in monthly calls to state banks to obtain industry input regarding prevailing economic conditions;
- Monitor state, national, and world political and economic events impacting the industry; and
- Engage and increase internal communication and training to improve examiner awareness of pertinent issues.

#### DEPARTMENT OF SAVINGS AND MORTGAGE LENDING

- Close coordination with other state and federal regulators;
- Engage in regular correspondence with state savings banks regarding institution-specific issues;
- Engage in regular correspondence with state savings banks as an industry by means such as Emerging Issues monthly calls, and Thrift Industry Day on industry wide 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, weaknesses, revise the Department's plan of examination and monitoring for the institution, including the downgrading of institutions, if deemed necessary, by the Department and the primary federal regulator;
- Monitor any impact from volatility within the energy or agricultural industries;
- Assess interest rate risk;
- Monitor lending, investment, and funding concentrations;
- Monitor local, state, national, and world political and economic events impacting the industry;
- Participate in federal compliance examinations of each institution; and
- Respond promptly to state or national events that can impact the state savings bank industry.

# PERFORMANCE SUMMARY AND PROFILE: TEXAS BANKING SYSTEM

# **STATE-CHARTERED BANKS**

Financial institutions continue to decline by number while asset size continues to increase. As of December 31, 2019, the number of statechartered banks consists of 224 banks with \$284.5 billion in assets compared to 233 institutions and \$262.4 billion in assets at yearend 2018. This is an increase of 8.4% in assets and decrease of 4% in institutions. Year-end 2019 numbers primarily stayed in-line with yearend 2018, with a return on average assets (ROA) and core capital leverage ratios remaining at 1.5% and 10.8%, respectively. The NIM remained stable with a four-bp increase to 3.8%.

While the ROA remained stable, some asset quality changes are worth noting. Total loans and leases have increased by 8.3%. The average ALLL balance declined 11 bp to 1%. The ALLL to noncurrent loans dropped from 198% in 2018 to 164.5% at the end of 2019. However, net charge-offs to total loans decreased by one bp and noncurrent assets plus other real estate owned to total assets only increased by two bp to 0.44%. As of the issuance of this report, the U.S. economy is experiencing uncertainty as a result of the COVID – 19 pandemic.

As previously noted, total assets have increased by 8.4% with total loans mirroring the same level of growth. However, deposits only rose by 7% and borrowed funds increased by 18.6% to an average of 4% of total assets. Institutions were able to offset the increase in interest expense with a slight increase in interest income.

As of December 2019, Texas banks remain healthy with stabilized earnings and capital

levels. Net income totaled approximately \$4 billion, reflecting only a modest 3.3% gain over the same period in 2018. As of year-end 2019, 97.3% of state-chartered banks were rated a Composite 1 or a Composite 2. The Department considers any institution with a Uniform Financial Institution Composite Rating of a 3, 4, or 5 a problem institution.

## **STATE-CHARTERED THRIFTS**

From June 30, 2019, to December 31, 2019, state thrifts had \$150.9 million in net income, compared to \$123.8 million for the first half of 2019. The pretax return on average assets remains strong at 1.3%. From June 30, 2019, to date, non-interest income to assets increased 16 bp, while non-interest expense increased 6 bp.

The Texas thrift ratio of nonperforming loans plus other real estate owned to total assets has decreased from 1.2% to 0.7% in the last 12 months, and from 0.7 at June 2019.

State-chartered thrifts experienced a slight decrease in the leverage capital levels compared to June 30, 2019, from 11.5% to 10.7%, due to the growth in total assets and increased dividends paid. Total risk-based capital ratio decreased 88 bp from 16.21% at June 30, 2019 to 15.33%.

As of December 31, 2019, 96% of the thrifts were rated a Composite 1 or a Composite 2. The Department considers any institution with a Uniform Financial Institutions Composite Rating of a 3, 4, or 5 a problem institution.

## **NUMBER OF INSTITUTIONS AND TOTAL ASSETS**

	12-31	-2019	12-31	-2018	Differ	ence				
	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	224 <u>23</u> 247	\$284.5 <u>\$27.4</u> \$311.9	233 <u>24</u> 257	\$262.4 <u>\$24.4</u> \$286.8	-9 <u>-1</u> -10	+\$22.1 <u>+\$3.0</u> +\$25.1				
Other states' state-chartered: Banks operating in Texas* Thrifts operating in Texas*	42 <u>0</u> 42	\$70.8 <u>0</u> \$70.8	41 <u>0</u> 41	\$69.7 <u>0</u> \$69.7	+1 <u>0</u> +1	+\$1.1 <u>0</u> +\$1.1				
Total State-Chartered Activity	289	\$382.7	298	\$356.5	-9	+\$26.2				
National Banks Chartered in Texas Federal Thrifts Chartered in Texas	169 <u>4</u> 173	\$142.8 <u>\$90.8</u> \$233.6	176 <u>5</u> 181	\$137.5 <u>\$83.8</u> \$221.3	-7 <u>-1</u> -8	+\$5.3 <u>+\$7.0</u> +12.3				
Other states' federally-chartered: Banks operating in Texas* Thrifts operating in Texas*	30 <u>6</u> 36	\$431.8 <u>\$1.0</u> \$432.8	28 <u>6</u> 34	\$410.8 <u>\$1.0</u> \$411.8	+2 <u>0</u> +2	+\$21.0 <u>+\$0.0</u> +\$21.0				
Total Federally-Chartered Activity	209	\$666.4	215	\$633.1	-6	+33.3				
Total Banking/Thrift Activity	498	\$1,049.1	513	\$989.6	-15	+\$59.5				

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

\*Indicates estimates based on available FDIC information.

## **RATIO ANALYSIS**

As of December 31, 2019 FDIC financial data is reflective of FDIC insured institutions only.

	State- Chartered <u>Banks</u> 224	Texas National <u>Banks</u> 169	All Texas <u>Banks</u> 393	State- Chartered <u>Thrifts</u> 23	Texas Federal <u>Thrifts</u> 4	All Texas <u>Thrifts</u> 27
% of Unprofitable Institutions	2.68%	2.37%	2.54%	N/A	N/A	N/A
% of Institutions with Earnings Gains	70.54%	69.82%	70.23%	60.87%	50.00%	59.26%
Yield on Earning Assets	4.52%	4.55%	4.53%	4.96%	5.27%	5.20%
Net Interest Margin	3.78%	3.71%	3.75%	3.69%	4.92%	4.64%
Return on Assets	1.52%	1.55%	1.53%	1.06%	0.84%	0.89%
Return on Equity	11.84%	14.24%	12.57%	9.25%	8.56%	8.73%
Net Charge-offs to Loans	0.14%	0.20%	0.16%	0.12%	1.44%	1.08%
Earnings Coverage of Net Loan C/Os	22.32	14.22	18.67	16.40	2.28	2.69
Loss Allowance to Loans	0.98%	1.05%	1.00%	0.71%	1.59%	1.34%
Loss Allowance to Noncurrent Loans	164.49%	142.35%	155.56%	86.23%	109.25%	105.12%
Noncurrent Assets+OREO to Assets	0.44%	0.55%	0.48%	0.70%	0.81%	0.78%
Net Loans and Leases to Core Deps	84.06%	88.86%	85.70%	108.23%	69.69%	77.46%
Equity Capital to Assets	13.07%	10.96%	12.36%	11.39%	9.59%	10.01%
Core Capital (Leverage) Ratio	10.77%	10.22%	10.58%	10.70%	9.61%	9.86%
Common Equity Tier 1 Capital	13.26%	13.70%	13.40%	14.63%	14.78%	14.74%

Data for other state-chartered institutions doing business in Texas is not available and therefore excluded. Information derived from the FDIC website.

# RATIO ANALYSIS BY ASSET GROUPS FOR STATE-CHARTERED BANKS

As of December 31, 2019 FDIC financial data is reflective of FDIC insured institutions only. Assets in Billions

	<u>&lt; \$1</u> 192	<u>\$1 - \$10</u> 27	<u>&gt;\$10</u> 5
% of Unprofitable Institutions	3.12%	NA	NA
% of Institutions with Earnings Gains	70.31%	74.07%	60.00%
Yield on Earning Assets	4.78%	4.90%	4.27%
Net Interest Margin	3.97%	4.02%	3.61%
Return on Assets	1.38%	1.48%	1.58%
Return on Equity	11.78%	10.68%	12.38%
Net Charge-offs to Loans	0.08%	0.12%	0.16%
Earnings Coverage of Net Loan C/Os	31.71	24.62	20.15
Loss Allowance to Loans	1.15%	0.97%	0.93%
Loss Allowance to Noncurrent Loans	197.01%	135.26%	169.66%
Noncurrent Assets+OREO to Assets	0.45%	0.62%	0.37%
Net Loans and Leases to Core Deps	78.27%	92.23%	82.93%
Equity Capital to Assets	11.83%	13.95%	13.10%
Core Capital (Leverage) Ratio	11.51%	11.94%	10.06%
Common Equity Tier 1 Capital	16.91%	15.28%	11.57%

## RATIO ANALYSIS BY ASSET GROUPS FOR STATE-CHARTERED THRIFTS

As of December 31, 2019 FDIC financial data is reflective of FDIC insured institutions only. Assets in Billions

	<u>&lt; \$1</u> 17	<u>\$1 - \$10</u> 6	<u>&gt;\$10</u> 0
% of Unprofitable Institutions	NA	NA	NA
% of Institutions with Earnings Gains	58.82%	66.67%	NA
Yield on Earning Assets	4.91%	4.97%	NA
Net Interest Margin	3.68%	3.69%	NA
Return on Assets	1.15%	1.04%	NA
Return on Equity	10.57%	8.90%	NA
Net Charge-offs to Loans	0.12%	0.12%	NA
Earnings Coverage of Net Loan C/Os	17.45	16.12	NA
Loss Allowance to Loans	0.86%	0.67%	NA
Loss Allowance to Noncurrent Loans	175.77%	73.92%	NA
Noncurrent Assets+OREO to Assets	0.45%	0.76%	NA
Net Loans and Leases to Core Deps	101.78%	110.00%	NA
Equity Capital to Assets	11.43%	11.38%	NA
Core Capital (Leverage) Ratio	11.45%	10.50%	NA
Common Equity Tier 1 Capital	16.88%	14.08%	NA

## **COMPARISON REPORT**

Select Balance Sheet and Income/Expense Information FDIC financial data is reflective of FDIC insured institutions only. December 31, 2019

	State Banks*		State T	hrifts
	End of Period	<u>% of Total</u> <u>Assets</u>	<u>End of</u> Period	<u>% of Total</u> <u>Assets</u>
Number of Institutions	224		23	
Number of Employees (full-time equivalent) (In millions)	41,800		3,404	
Total Assets	\$284,537		\$27,459	
Net Loans and Leases	\$177,379	62.34%	\$19,353	70.48%
Loan Loss Allowance	\$1,751	0.62%	\$137	0.50%
Other Real Estate Owned	\$194	0.07%	\$31	0.11%
Goodwill and Other Intangibles	\$7,929	2.79%	\$341	1.24%
Total Deposits	\$229,720	80.73%	\$20,513	74.70%
Federal Funds Purchased and Repurchase Agreements	\$2,963	1.04%	\$2	0.01%
Other Borrowed Funds	\$11,409	4.01%	\$3,485	12.69%
Equity Capital	\$37,184	13.07%	\$3,127	11.39%
Memoranda:				
Noncurrent Loans and Leases	\$1,064	0.37%	\$159	0.58%
Earning Assets	\$257,949	90.66%	\$25,567	93.11%
Long-term Assets (5+ years)	\$73,904	25.97%	\$7,406	26.97%
	Year-to-Date	<u>% of Avg.</u> <u>Assets</u> †	Year-to-Date	<u>% of Avg.</u> <u>Assets</u> †
Total Interest Income	\$10,926	4.10%	\$1,191	4.60%
Total Interest Expense	\$1,793	0.67%	\$306	1.18%
Net Interest Income	\$9,133	3.43%	\$885	3.42%
Provision for Loan and Lease Losses	\$265	0.10%	\$32	0.12%
Total Noninterest Income	\$3,163	1.19%	\$68	0.26%
Total Noninterest Expense	\$7,148	2.68%	\$609	2.36%
Securities Gains	\$14	0.01%	\$15	0.06%
Net Income	\$4,041	1.52%	\$275	1.06%
Memoranda:				
Net Loan Charge-offs	\$231	0.09%	\$21	0.08%
Cash Dividends	\$2,991	1.12%	\$99	0.38%

\*Excludes branches of state-chartered banks of other states doing business in Texas. As of December 31, 2019, there are an estimated 42 out-of-state state-chartered institutions with \$70.8 billion in assets. Assets are based upon the June 30, 2019, FDIC Summary of Deposits.

†Income and Expense items as a percentage of average assets are annualized.

No branches of state-chartered thrifts of other states conducted business in Texas as of June 30, 2019.

# PERFORMANCE SUMMARY: UNITED STATES BANKING SYSTEM

# FDIC QUARTERLY BANKING PROFILE

Fourth Quarter 2019 - <u>www.fdic.gov</u> All Institutions Performance

#### Full-Year 2019 Net Income Declines to \$233.1 Billion

For the 5,177 FDIC-insured commercial banks and savings institutions, full-year 2019 net income totaled \$233.1 billion, down \$3.6 billion (1.5%) from 2018. The decline was primarily attributable to slower growth in net interest income (up \$5.5 billion, or 1%) and higher loan-loss provisions (up \$5 billion, or 9.9%). Average net interest margin (NIM) declined from 3.40% in 2018 to 3.36% in 2019, as average earning assets grew at a faster rate than net interest income. The average return on assets (ROA) fell from 1.35% in 2018 to 1.29% in 2019.



#### Quarterly Net Income Declines Almost 7 Percent From a Year Ago to \$55.2 Billion



Quarterly net income totaled \$55.2 billion during fourth quarter 2019, down \$4.1 billion (6.9%) from a year ago. The annual decline in quarterly net income was a result of lower net interest income and higher noninterest expenses. About half (45.6%) of all banks reported year-over-year declines in net income, and the percentage of unprofitable banks in the fourth quarter remained stable from a year ago at 7.2%. The average ROA was 1.20% in fourth quarter 2019, down 13 basis points from a year ago.

# Net Interest Income Declines 2.4 Percent From Fourth Quarter 2018

Net interest income declined by \$3.4 billion (2.4%) from 12 months ago, marking the first annual decline since third quarter 2013. NIM for the banking industry fell by 20 basis points from a year ago to 3.28%, as average asset yields declined more rapidly than average funding costs. The annual decline in NIM occurred for all five asset size groups featured in the Quarterly Banking Profile but was especially pronounced among banks with total assets between \$10 billion and \$250 billion. Banks responded to the low interest-rate environment by growing longer-term assets, but these assets generated lower yields and contributed to the NIM decline.

#### Noninterest Expense Increases 3.2 Percent From Fourth Quarter 2018

Noninterest expense was \$121.5 billion in fourth quarter 2019, up \$3.7 billion (3.2%) from fourth quarter 2018. About two out of every three banks (67.5%) reported annual increases in noninterest expense. Close to 80% of the aggregate increase was attributable to higher salary and employee benefits, which grew by \$2.9 billion (5.4%). The average assets per employee increased from \$8.7 million in fourth

quarter 2018 to \$9 million in fourth quarter 2019.

#### Noninterest Income Expands 2.5 Percent From 12 Months Ago

Noninterest income totaled \$66 billion during the fourth quarter, up \$1.6 billion (2.5%) from 12 months ago. The increase was broadbased, as more than half (61.8%) of all banks reported higher annual noninterest income. The annual increase was driven by higher trading revenues (up \$3.2 billion, or 76.4%) and net gains on loan sales (up \$1.1 billion, or 41.6%).



#### Loan-Loss Provisions Increase Modestly From a Year Ago

In the fourth quarter, banks set aside \$14.8 billion in loan-loss provisions, an increase of \$779 million (5.5%) from a year ago. More than one-third (38.4%) of all banks reported year-over-year increases in loan-loss provisions. The increase was mostly concentrated at larger institutions. Loan-loss provisions as a share of net operating revenue increased to 7.3% during the fourth quarter, the highest level since year-end 2012.

#### Net Charge-Offs Rise by \$1.3 Billion From a Year Ago

Net charge-offs totaled \$13.9 billion during the fourth quarter, an increase of \$1.3 billion (10.4%) from fourth quarter 2018. The largest contributor to the year-over-year increase in net charge-offs was the commercial and industrial (C&I) loan portfolio, which registered a charge-off increase of \$591.2 million (34.3%), and the credit card portfolio, which registered a charge-off increase of \$409.9 million (5%). The average net charge-off rate increased by 4 basis points from fourth quarter 2018 to 0.54%. The C&I net



charge-off rate was 0.42% during fourth quarter 2019, up from 0.32% a year ago but below the recent high of 0.50% reported in fourth quarter 2016. The credit card net charge-off rate increased by 4 basis points from fourth quarter 2018 to 3.75%.

# Noncurrent Loan Rate Remains Stable at 0.91 Percent

Noncurrent loan balances (90 days or more past due or in nonaccrual status) remained

relatively stable (down \$46.4 million, or 0.05%) from the previous quarter. About half of all banks (51.2%) reported declines in noncurrent loan balances. All major loan categories experienced declining levels of noncurrent loans from the previous quarter, except for credit card balances, which increased by \$1.3 billion (10.3%). The credit card loan portfolio also registered the largest quarterly increase in the noncurrent rate, up 7 basis points to 1.47%.

#### Loan-Loss Reserves Decline Modestly From Third Quarter 2019

Loan-loss reserves totaled \$123.9 billion at the end of fourth quarter 2019, down \$1.3 billion (1%) from the previous quarter. As



banks that itemize their loan-loss reserves, those with total assets of \$1 billion or more, residential real





estate reserves declined by \$831.4 million (8%) and commercial real estate reserves fell by \$669.6 million (2%). Loan-loss reserves for credit card portfolios rose by \$775.6 million (1.9%) from third quarter 2019.

# Total Assets Increase From the Previous Quarter

Total assets increased by \$163.4 billion (0.9%) from the previous quarter, primarily because of growth in loan and leases balances (up \$117.9 billion). Banks increased their securities holdings by \$45.5 billion (1.2%), as mortgage-backed securities rose by \$24.4 billion (1%) and holdings of U.S. Treasury securities grew by \$8.5 billion (1.4%). Cash and balances due from depository institutions rose by \$40.6 billion (2.5%).

# Loan Balances Expand From the Previous Quarter and a Year Ago

Total loan and lease balances rose by \$117.9 billion (1.1%) from third quarter 2019. More than half (59.2%) of all banks grew their loan and lease balances from the third quarter. Almost all of the major loan categories registered quarterly increases, except for the C&I loan portfolio which registered the first quarterly decline since fourth quarter 2016 (down \$11 billion, or 0.5%). Quarterly growth among major loan categories was led by consumer loans (up \$58.2 billion, or 3.3%), nonfarm nonresidential loans (up \$21.6 billion, or 1.4%), and residential mortgage loans (up \$19.1 billion, or 0.9%). Over the past year, total loan and lease balances rose by \$366.3 billion (3.6%), slightly below the annual growth rate reported in third quarter 2019. The slowdown in annual growth of total loan and lease balances was led by the C&I loan portfolio, which expanded at its slowest rate since 2010 (1.9%).

#### Deposits Rise 1.8 Percent From the Previous Quarter

Total deposit balances increased by \$258.4 billion (1.8%) from the previous quarter, as interest-bearing accounts rose by \$216.3 billion (2.2%) and noninterest-bearing accounts grew by \$22.6 billion (0.7%). Deposits held in foreign offices increased by \$19.5 billion (1.5%). Nondeposit liabilities, which include fed funds purchased, repurchase agreements, Federal Home Loan Bank (FHLB) advances, and secured and unsecured borrowings, fell by \$69 billion (5%) from the previous quarter. The change in nondeposit liabilities was led by a decline in securities sold under agreements to repurchase (down \$30 billion, or 13.3%), the largest quarterly dollar decline since fourth quarter 2013. FHLB advances were lower by \$16.3 billion (3.3%).

#### 1 Equity Capital Increases From Third Quarter 2019

Equity capital rose by \$12.8 billion (0.6%) from third quarter 2019. Fourth quarter 2019 declared dividends of \$49.1 billion were below quarterly net income of \$55.2 billion. Common equity tier 1 ratio increased by 5 basis points from a year ago to 13.21%. Fourteen insured institutions with \$1.8 billion in total assets were below the requirements for the well-capitalized category as defined for Prompt Corrective Action purposes.

#### 1 Three New Banks Are Added in Fourth Quarter 2019

The number of FDIC-insured commercial banks and savings institutions declined from 5.258 to 5.177 during fourth quarter 2019. Three new banks were added, 77 institutions were absorbed by mergers, and three banks failed. For full-year 2019, 13 new banks were added, 226 institutions were absorbed by mergers, and four banks failed. The number of institutions on the FDIC's "Problem Bank List" fell from 55 at the end of third guarter to 51 at the end of fourth quarter, the lowest level since fourth guarter 2006. Aggregate total assets of problem banks declined from \$48.8 billion in third guarter 2019 to \$46.2 billion in fourth quarter 2019.



# SNAPSHOT STOCK PERFORMANCE SOUTHWEST REGIONAL BANKS (MSECTOR415) MARCH 2020

Name	Last	Trade	rade 52 Wk Range		PE	EPS	Mkt Cap	Div/Shr	Div Yld
ACNB Corporation	03/11	27.82	27.64	39.57	8.28	3.36	241.46M	1.00	3.55%
BancFirst Corporation	03/11	37.12	35.89	63.96	9.17	4.05	1.214B	1.28	3.38%
BOK Financial Corporation	03/11	47.39	45.31	88.70	6.74	7.03	3.35B	2.04	3.97%
Cass Information Sys, Inc.	03/11	37.66	37.14	60.97	18.19	2.07	728.812M	1.08	2.73%
Commerce Bancshares, Inc.	03/11	53.53	51.68	71.92	14.96	3.58	6B	1.08	1.91%
Cullen Frost Bankers, Inc.	03/11	56.45	50.17	104.53	8.22	6.86	3.538B	2.84	4.64%
Enterprise Fin Serv Corp	03/11	29.89	29.68	48.81	8.42	3.55	793.98M	0.72	2.24%
First Community Corp S C	03/11	17.10	16.81	22.00	11.79	1.45	127.225M	0.48	2.74%
First Financial Bankshares, Inc.	03/11	24.06	23.61	36.45	19.88	1.21	3.422B	0.48	1.84%
First Financial Northwest, Inc.	03/11	11.87	11.31	17.24	11.52	1.03	121.703M	0.40	3.30%
Great Southern Bancorp, Inc.	03/11	42.60	42.01	64.48	8.29	5.14	605.465M	1.36	3.05%
Guaranty Fed Bancshares, Inc.	03/11	23.02	21.89	26.93	10.91	2.11	99.287M	0.60	2.61%
Heartland Financial USA, Inc.	03/11	33.65	33.18	51.85	8.13	4.14	1.237B	0.80	2.22%
International Bancshares Corp	03/11	27.45	27.12	44.00	8.80	3.12	1.79B	1.10	3.73%
Landmark Bancorp, Inc.	03/11	20.40	19.01	26.00	8.83	2.31	93.787M	0.80	3.81%
Liberty Bancorp, Inc.	03/11	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Mackinac Financial Corp	03/11	12.20	11.26	17.75	9.46	1.29	131.134M	0.56	4.17%
MidWest One Finl Group, Inc.	03/11	24.31	23.94	39.03	8.30	2.93	392.822M	0.88	3.11%
North Dallas Bank & Trust Co. TX	03/11	73.99	70.05	84.51	15.54	4.76	95.793M	1.00	1.32%
Prosperity Bancshares, Inc.	03/11	50.98	48.88	75.22	11.29	4.52	4.836B	1.84	2.80%
QCR Holdings, Inc.	03/11	33.20	31.56	44.76	9.22	3.60	525.493M	0.24	0.60%
Solera National Bancorp, Inc.	03/11	9.11	9.11	11.80	10.44	0.87	13.483M	N/A	N/A
Texas Capital Bancshares, Inc.	03/11	32.29	31.11	66.61	5.20	6.21	1.626B	N/A	N/A
Two Rivers Fin Group	03/11	30.29	30.10	33.50	8.58	3.53	67.656M	0.64	1.99%
UMB Financial Corporation	03/11	48.10	47.45	71.97	9.70	4.96	2.361B	1.24	2.13%
West Bancorp Incorporated	03/11	17.84	17.51	25.93	10.26	1.74	289.51M	0.84	3.52%

Source: Yahoo Finance (March 2020)

N/A – Indicates information was not available.

# SNAPSHOT STOCK PERFORMANCE SOUTHWEST REGIONAL BANKS (MSECTOR415) MARCH 2019

Name	Last	Trade	52 Wk R	- 1	PE	EPS	Mkt Cap	Div/Shr	Div Yld
ACNB Corporation	03/11	36.53	28.05	41.45	11.83	3.09	257.398M	0.92	2.49%
BancFirst Corporation	03/11	54.79	48.07	65.70	14.57	3.76	1.787B	1.20	2.20%
BOK Financial Corporation	03/11	86.21	69.96	107.00	13.00	6.63	6.229B	2.00	2.32%
Cass Information Sys, Inc.	03/11	50.17	47.74	62.08	24.72	2.03	728.812M	1.04	2.11%
Commerce Bancshares, Inc.	03/11	60.65	53.40	69.10	16.05	3.78	6.739B	1.04	1.73%
Cullen Frost Bankers, Inc.	03/11	101.45	81.87	121.66	14.68	6.91	6.391B	2.68	2.66%
Enterprise Fin Serv Corp	03/11	43.28	36.09	58.15	11.29	3.83	1.093B	0.56	1.30%
First Community Corp S C	03/11	20.00	17.93	26.25	13.79	1.45	152.67M	0.44	2.17%
First Financial Bankshares, Inc.	03/11	60.54	45.05	66.83	27.27	2.22	4.077B	0.84	1.40%
First Financial Northwest, Inc.	03/11	15.93	13.75	21.81	11.14	1.43	170.207M	0.32	2.12%
Great Southern Bancorp, Inc.	03/11	55.30	43.30	61.65	11.74	4.71	783.584M	1.28	2.35%
Guaranty Fed Bancshares, Inc.	03/11	22.91	20.11	27.39	13.97	1.64	102.258M	0.52	2.27%
Heartland Financial USA, Inc.	03/11	46.32	41.36	46.88	13.16	3.52	1.601B	0.64	1.40%
International Bancshares Corp	03/11	39.86	32.56	47.98	12.30	3.24	2.616B	0.84	2.12%
Landmark Bancorp, Inc.	03/11	24.59	21.00	28.08	10.29	2.39	107.51M	0.80	3.17%
Liberty Bancorp, Inc.	03/11	25.25	22.35	27.00	15.59	1.62	62.077M	0.27	1.07%
Mackinac Financial Corp	03/11	15.61	12.60	17.58	16.61	0.94	167.225M	0.48	3.02%
MidWest One Finl Group, Inc.	03/11	30.22	23.80	35.20	12.19	2.48	367.808M	0.81	2.71%
North Dallas Bank & Trust Co. TX	03/11	84.51	79.55	92.00	34.21	2.47	217.106M	1.00	1.18%
Prosperity Bancshares, Inc.	03/11	73.27	57.01	79.20	15.90	4.61	5.118B	1.64	2.27%
QCR Holdings, Inc.	03/11	34.78	30.15	49.60	12.16	2.86	546.679M	0.24	0.71%
Solera National Bancorp, Inc.	03/11	10.70	8.37	11.40	16.98	0.63	43.481M	N/A	N/A
Texas Capital Bancshares, Inc.	03/11	59.20	47.86	103.05	10.22	5.79	2.975B	N/A	N/A
Two Rivers Fin Group	03/11	32.00	31.00	35.51	13.97	2.29	71.508M	0.64	2.00%
UMB Financial Corporation	03/11	66.57	57.00	82.14	16.96	3.92	3.265B	1.20	1.81%
West Bancorp Incorporated	03/11	21.75	18.06	26.96	12.50	1.74	345.427M	0.80	3.70%

Source: Yahoo Finance (March 2019)

N/A – Indicates information was not available.

# NATIONAL ECONOMIC TRENDS



#### **Real Gross Domestic Product**

# Consumer Price Index



Source: Federal Reserve Bank of St. Louis, National Economic Trends, March 2020.



### **Unemployment Rate**

**Interest Rates** 



Source: Federal Reserve Bank of St. Louis, National Economic Trends, March 2020.

# ECONOMIC REPORTS AND FORECASTS: UNITED STATES

### FEDERAL RESERVE BANK, DALLAS NATIONAL UPDATE

February 2020 - <u>www.dallasfed.org</u>1

# An Assessment of Economic Conditions and the Stance of Monetary Policy

In our most recent Federal Open Market Committee (FOMC) meeting, the Federal Reserve decided to leave the federal funds rate unchanged in a range of 1.5 to 1.75%. In addition, we made a 5-basis-point upward adjustment to the interest paid on excess reserves (IOER) held by banks on deposit at the Fed. This was a technical adjustment intended to support the setting of the federal funds rate well within the range set by the FOMC.

I supported these decisions as well as the post-meeting communication regarding the path of the Federal Reserve balance sheet. The Fed balance sheet expanded rapidly in the fourth quarter of 2019 as repurchase agreement (repo) operations and Treasury bills purchases were needed to maintain reserve levels.

It is my hope and expectation that, as reserves in the banking system meet or exceed ample levels of at least \$1.5 trillion, the Fed balance sheet will expand only gradually to reflect trend growth in the demand for currency and other Federal Reserve liabilities. I would expect that, over the first half of 2020, the pace of balance sheet expansion will moderate significantly as active repo operations gradually decline and reserve management purchases of Treasury bills slow in the second quarter.

I continue to support a review of our supervisory guidance and regulatory policies in an effort to assess whether we could put Treasury bills and reserves on a more equal footing in terms of bank liquidity management. I also remain open to consideration of other alternatives which could help the Fed run an ample reserves regime with a sensitivity to limiting growth in the size of the Federal Reserve balance sheet.

In this essay, I will briefly discuss my outlook for the U.S. and global economies. In addition, I will explore the impact of these and other developments on the outlook for the energy industry. Lastly, I will describe my views on the current stance of monetary policy in the U.S.

#### **Economic Outlook**

It is the base-case view of Dallas Fed economists that U.S. gross domestic product (GDP) will grow at a rate of approximately 2 to 2.25% in 2020. This forecast is based on our expectation that global growth is likely to remain sluggish but will show signs of stabilization due to some calming of trade uncertainties—particularly as a result of the ratification of the United States–Mexico–Canada Agreement, the Phase One agreement with China, and some greater clarity regarding Brexit. In this regard, we also expect U.S. manufacturing to remain sluggish but show some signs of stabilization. Lastly, we expect business fixed investment to firm somewhat from disappointing levels in 2019. These developments, combined with a strong U.S. consumer (which accounts for approximately 70% of U.S. GDP), should lead to solid growth in 2020.

<sup>&</sup>lt;sup>1</sup> Robert S. Kaplan, President and CEO, Federal Reserve Bank of Dallas

Of course, this outlook is clouded by the impact of the coronavirus originating in Wuhan, China. This development will likely mean slower growth in China and risks to the downside for global growth. Dallas Fed economists are considering various alternative scenarios for how this virus could impact U.S. and global GDP growth. However, at this stage, it is still too soon to predict with confidence the ultimate impact of this virus on the U.S. and global economies. Our Dallas Fed team will continue to actively monitor this situation and assess its ongoing implications.

In addition, I am cognizant that the delay in production of the Boeing 737 Max airplane is likely to reduce U.S. GDP growth by as much as 0.4% (annualized) in the first quarter of 2020. The extent of the full-year effect will ultimately be determined by the timing of a return to production, likely later in the year. Finally, the first half of 2020 will benefit from the return of post-strike production at General Motors.

Against this backdrop, the U.S. consumer continues to be the key underpinning of the U.S. economy. Household debt to GDP has gone from a peak of 98% in 2008 to approximately 74% as of third quarter 2019. In addition to this improvement in household balance sheets, the current rate of unemployment in the U.S. is approximately 3.6%. Furthermore, the U-6 measure of unemployment—which takes into account the unemployed, plus discouraged workers who have given up looking for work, plus workers who work part time but would prefer to work full time—is currently running at approximately 6.9%. This reading is near its historic low of 6.7% reached in December 2019. The labor force participation rate (the percentage of 16 year olds and above either employed or actively looking for work) now stands at 63.4%, its highest level since June 2013. All this suggests to Dallas Fed economists that the U.S. economy is likely at or past the level of full employment. This further bolsters our near-term confidence in the strength of the U.S. consumer.

Based on our forecast, we would expect headline unemployment to drift down from the current reading of 3.6% to approximately 3.5% during 2020. In addition, Dallas Fed economists believe that the personal consumption expenditures (PCE) inflation rate will gradually move toward the Fed's 2% target in the medium term. This confidence is bolstered by the fact that the Dallas Fed's Trimmed Mean PCE measure of inflation, which exes out inflation components with extreme moves to the upside or the downside, is currently running at approximately 2% on a 12-month basis. Our research indicates that the trimmed mean is a good indicator of future headline PCE inflation trends.

#### **Potential GDP Growth**

Expected 2020 growth of 2 to 2.25% is in line with the average growth rate of the U.S. economy since 2010. However, this level of growth is sluggish by historical standards. GDP growth is made up of growth in the workforce plus growth in productivity. As I've discussed in previous essays, aging demographics and sluggish workforce growth and more modest productivity growth are negatively impacting potential GDP growth in the U.S.



The rate of U.S. workforce growth has declined from a yearly average of approximately 2.71% in the 1970s to 1.27% in the 1990s to an expected 0.24% in the 2020s. This deceleration in workforce growth is not being offset by improvements in productivity per worker. The rate of U.S. productivity growth has declined from a yearly average of almost 2% in the 1990s to 0.85% since 2010.

It's the view of Dallas Fed economists that structural reforms are needed if we are to improve U.S. workforce growth. These reforms could include policies that facilitate child care and transportation

services, which make it easier for marginally attached workers to enter and stay in the workforce. In addition, immigration reform that focuses on skills and employer needs could also help increase the rate of U.S. workforce growth.

Productivity growth could be enhanced by policies that help workers impacted by technology and technologyenabled disruption to get reskilled. Dallas Fed economists believe that the



emphasis on skills training programs could be dramatically increased in the U.S. In addition, policies that focus on improving early-childhood literacy and the overall math, science and reading skills of our next generation of workers would help improve their adaptability and productivity. Lastly, investments in selected infrastructure improvements could help create greater efficiencies in the U.S. economy.

We would also note that, in this context, global trade is likely an opportunity for the U.S. to grow faster. In particular, integrated logistics and supply-chain arrangements, especially those with Mexico and, to a lesser extent, Canada have been critical to improving the global competiveness of U.S. firms, which has allowed these firms to add jobs and domicile their businesses in the U.S.

Finding ways to improve the potential growth rate of the U.S. economy is critical given that the amount of U.S. government debt held by the public is now approximately 79% of GDP and the present value of unfunded entitlements is now approximately \$59 trillion.

While monetary policy has a key role to play in enhancing the ability of the U.S. economy to grow at its potential, it is not a substitute for structural reforms and policies that can improve the level of potential growth in the U.S. As a central banker, I believe it is important to point out the limits of monetary policy and the need for broader policies to improve the economic future of the U.S. (See the essay "Economic Conditions and the Key Structural Drivers Impacting the Economic Outlook," Oct. 10, 2019, which discusses these structural challenges and opportunities).

#### **Oil Industry Outlook**

The Eleventh District of the Federal Reserve is home to the Permian Basin, which accounts for approximately 36% of U.S. crude oil production. Due to the emergence of the U.S. shale industry, the U.S. now produces approximately 12.9 million barrels per day (mb/d) of crude oil. This compares with crude oil production of approximately 11.3 mb/d by Russia and 9.7 mb/d by Saudi Arabia.

It is the view of Dallas Fed economists that global oil production (crude oil and liquids) will increase by 0.7 mb/d to approximately 102.3 mb/d from fourth quarter 2019 to fourth quarter 2020. This production forecast assumes growth of 0.7 mb/d in the U.S. and 0.7 mb/d in other non-OPEC countries, and a decline of 0.7 mb/d in OPEC oil production.

The International Energy Agency (IEA) forecasts that global consumption will likely grow by approximately 1.0 mb/d to 102.2 mb/d in 2020. The coronavirus presents a meaningful risk to demand growth globally as overall Chinese oil consumption represented approximately 14% of total global consumption and approximately 57% of global consumption growth in 2019. The IEA consumption forecast indicates that,

due to the impact of the virus, first quarter 2020 global oil demand will decline by approximately 0.4 mb/d versus the first quarter of 2019. It further assumes that a substantial portion of this consumption decline will reverse in subsequent quarters of 2020. It is worth noting that the expected first-quarter consumption decline would be the first year-over-year drop in quarterly oil demand since the Great Recession of 2007–09.

In this context, Dallas Fed economists expect U.S. crude oil production growth of approximately 0.4 mb/d in 2020. This compares with production growth of 2.0 mb/d in 2018 and 0.9 mb/d in 2019. These forecasts assume West Texas Intermediate oil prices stay in the range of approximately \$50 to \$60 per barrel.

This expected decline in U.S. production growth is influenced by weaker global demand growth and is also heavily influenced by a dramatic increase in pressure from capital providers to see "discipline" in capital allocation from energy and production firms. In practice, this means that capital expenditures for drilling activity will have to be funded by internal cash flow versus debt issuance. This is a fairly significant change from historic practice. It should be noted that shale projects are more "short-cycle" investments than typical conventional projects—they can be drilled and brought onstream very quickly and, on average, for approximately \$6 million to \$8 million per well. However, as output of wells tends to decline rapidly in the first few years of production, producers must continuously invest in order to maintain overall production levels.

As a result of these developments, our Dallas Fed oil industry contacts have indicated to us that they expect capital spending in the U.S. oil and gas sector could be down by as much as 10 to 15% in 2020. This reduction in capital spending is likely to have a substantial impact on energy service companies. Several companies have already announced restructurings, charge-offs and layoffs. In light of this, we would expect that 2020 will be a year of restructurings, consolidation where possible, and general belt tightening.

#### Implications for Texas and the U.S. Economy

Despite a more challenging environment for oil and gas production, Dallas Fed economists still expect 2020 job growth in Texas to be approximately 2.1%. While the state's economy has grown substantially and become much more diversified over the past several decades, the energy sector still represents approximately 9% of Texas GDP and remains a key economic driver in a number of important regions of the state.

In the U.S. more broadly, lower oil prices should benefit U.S. consumers by freeing up more of their disposable income for the consumption of non-oil goods and services. However, because the U.S. is no longer a net importer of oil and petroleum products, the benefit to U.S. GDP of lower oil prices for consumers may be increasingly offset by the negative impact on domestic energy producers in terms of capital spending and employee compensation. Changes in oil prices will increasingly redistribute income between sectors and states within the U.S., as opposed to impacting the transfer of income between the U.S. and other oil-exporting nations.

As a result of these developments, over the past several years, the U.S. has become somewhat less sensitive than in the past to oil price fluctuations. Additionally, since the 1970s, the U.S. economy has become less oil-intensive due to substitution for oil by other forms of energy, improved fuel efficiency, and growth in the less-energy-intensive services sector as a share of the overall economy.

#### **Growth in Renewables**

Dallas Fed energy economists expect that global energy consumption will increasingly reflect reduced reliance on fossil fuels (oil, natural gas and coal) as a share of total consumption. This reduced reliance is primarily due to expected growth in renewable energy. Renewable energy sources include hydropower, solar power, wind power (offshore and onshore), geothermal and modern bioenergy production (including energy content in solid, liquid and gaseous products derived from biomass feedstocks and biogas). While

estimates of the increase in renewable energy production vary, there is clear evidence that a transition is underway in the energy industry.

The International Energy Agency (IEA) base-case forecast suggests that renewables are likely to substantially increase as a percentage of global energy consumption over the next 20 years. Their forecast indicates that, under stated policies, renewables will grow approximately 125% over the period, outpacing global oil and natural gas consumption growth of approximately 2%. However, the IEA notes that if global regulators take a much more aggressive stance to achieve the energy-related goals of the United Nations Sustainable Development agenda, it estimates that renewables could grow by over 200% and global oil and natural gas consumption could decline by as much as 20% by 2040. In that case, renewables would account for nearly 33% of global energy consumption.

Our Eleventh District industry contacts report to us that they believe investments in sustainability and innovative approaches to mitigate the impacts of climate change are likely to provide substantial growth opportunities for U.S. businesses. We are already seeing a number of these investments in Texas.

#### The Stance of Monetary Policy

It is my view that, based on my base-case outlook for the U.S. economy, the current setting of the federal funds rate at 1.5 to 1.75% is roughly appropriate. Consistent with this view, my Summary of Economic Projections (SEP) submission in December 2019 indicated that I expected no movement in the federal funds rate through 2020.

Of course, my views are subject to revision based on how the outlook for the U.S. economy evolves over the course of this year. In that regard, I will be closely monitoring a variety of economic developments and, in particular, continuing to assess how the coronavirus ultimately will impact the U.S. and global economies.

# **U.S. ECONOMY AT A GLANCE U.S. BUREAU OF LABOR STATISTICS**

Data Series	Sept 2019	Oct 2019	Nov 2019	Dec 2019	Jan 2020	Feb 2020
Unemployment Rate <sup>(1)</sup>	3.5	3.6	3.5	3.5	3.6	3.5
Change in Payroll Employment <sup>(2)</sup>	208	185	261	184	<sup>(P)</sup> 273	<sup>(P)</sup> 273
Average Hourly Earnings <sup>(3)</sup>	28.16	28.24	28.34	28.37	<sup>(P)</sup> 28.43	<sup>(P)</sup> 28.52
Consumer Price Index <sup>(4)</sup>	0.1	0.2	0.2	0.2	0.1	0.1
Producer Price Index <sup>(5)</sup>	-0.3	0.3	<sup>(P)</sup> -0.1	(P) 0.2	(P) 0.5	<sup>(P)</sup> -0.6
U.S. Import Price Index <sup>(6)</sup>	0.1	-0.4	0.2	<sup>(R)</sup> 0.2	<sup>(R)</sup> 0.1	-0.5

#### 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, one-month percent change, seasonally adjusted.

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

(P) Preliminary.

(R) Revised.

Data Series	4th Qtr 2018	1 <sup>st</sup> Qtr 2019	2nd Qtr 2019	3rd Qtr 2019	4th Qtr 2019
Employment Cost Index <sup>(1)</sup>	0.7	0.7	0.6	0.7	0.7
Productivity <sup>(2)</sup>	(R) 0.5	(R) 3.8	<sup>(R)</sup> 2.6	<sup>(R)</sup> -0.3	<sup>(R)</sup> 1.2

#### 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 13, 2020

# THE FEDERAL RESERVE BOARD THE BEIGE BOOK – JANUARY 15, 2020 EXCERPT

#### **Overall Economic Activity**

Economic activity generally continued to expand modestly in the final six weeks of 2019. The Dallas and Richmond Districts noted above-average growth, while Philadelphia, St. Louis, and Kansas City reported sub-par growth. Consumer spending grew at a modest to moderate pace, with a number of Districts noting some pickup from the prior reporting period. On balance, holiday sales were said to be solid, with several Districts noting the growing importance of online shopping. Vehicle sales generally expanded moderately, though a handful of Districts reported flat sales.

Tourism was mixed, with growth reported in the eastern seaboard Districts but activity little changed in the Midwest and West. Manufacturing activity was essentially flat in most Districts, as in the previous report. Business in nonfinancial services was mixed but, on balance, growing modestly. Transportation activity was also mixed across Districts, with a majority reporting flat to weaker activity. Banks mostly characterized loan volume as steady to expanding moderately.

Home sales trends varied widely across Districts but were flat overall, while residential rental markets strengthened. Some Districts pointed to low inventories as restraining home sales. New residential construction expanded modestly. Commercial real estate activity varied substantially across Districts. Agricultural conditions were little changed, as was activity in the energy sector. In many Districts, tariffs and trade uncertainty continued to weigh on some businesses. Expectations for the near-term outlook remained modestly favorable across the nation.

#### Highlight of Dallas Federal Reserve

Economic activity expanded solidly, with growth increasing in most sectors. Home sales continued to rise while energy activity remained weak. Hiring continued at a steady pace. Selling prices were largely flat, even as input prices rose. Outlooks generally improved, with reduced trade uncertainty boosting optimism.

# ECONOMIC REPORTS AND FORECASTS: STATE OF TEXAS

# FEDERAL RESERVE BANK, DALLAS

#### January 2020 - <u>www.dallasfed.org</u>

The Texas economy continued to grow in December, with payrolls expanding at an above-average pace. The unemployment rate increased for the first time since January 2019. The Texas Leading Index fell, and singlefamily home inventories tightened. Construction contract values ticked down. Migration to Texas between July 2018 and July 2019 increased.

#### 1 Labor Markets

Texas employment grew an annualized 2.6% in December, following a downwardly revised 3.8% in November. Growth remains above Texas' long-run average pace of 2.1%. U.S. payrolls also expanded during the month, though at less than half the pace of Texas. December job growth was strongest in Austin and Dallas, expanding at an annualized rate of 8.4% and 6.2%, respectively. All other major metros posted modest growth in the month except Fort Worth, which shed jobs. The Texas unemployment rate edged up to 3.5% after holding steady at 3.4% for six months, while the U.S. unemployment rate stayed flat at a 50-year low of 3.5%. Unemployment fell by roughly 0.1 percentage points in most major metros except McAllen, where it ticked up 0.1 percentage points.







## Texas Leading Index

The Texas Leading Index, which is used to estimate the Dallas Fed's Texas Employment Forecast, sheds light on the future of the state's economy. After increasing 0.8% in November, the index fell 0.2% in December. The three-month change, however, held steady at 0.6%. In December, new unemployment claims, well permits and the U.S. leading index were drags on the Texas Leading Index,

while average weekly hours made no significant contribution. All other components boosted the index.

#### 1 Real Estate

Single-family home inventories fell to 3.5 months of supply in the U.S. and Texas in December. Inventories in most Texas major metros also dipped last month, with the exception of Fort Worth and Houston, which held steady at 2.5 months and 3.8 months, respectively. Inventories are below their long-run averages in the U.S. and Texas and its major metros—partly due to solid demand. The five-month moving average of construction contract values slipped 3.7% in December, following strong gains in November. This dip is due to the 15.6% decline in nonbuilding construction





values in December, following 21.6% growth in November. In 2019, total construction values in Texas increased 4.2% relative to their 2018 values. The majority of this increase came from the 19.1% growth in nonresidential building construction. Nonbuilding construction remained mostly flat with 0.4% growth over the year, and residential building construction slipped 4.3%. Total construction amounts in December were 28.6% higher than the long-run average of \$6.2 billion.

#### Migration

From July 2018 to July 2019, Texas grew by 367,000 people, with more than half the increase stemming from migration from other states (domestic) or other countries (international). The other large contributor to net growth in the state during that period was natural increase— births minus deaths—which added 176,000 people. Net domestic migration to Texas climbed 50.0% from July 2018 to July 2019 to 126,000, while net international migration slipped 8.7% to 65,000—its lowest level since 1991. Overall, Texas has consistently benefited



from net in-migration. Domestic in-migration has outpaced international almost every year since 2006 with the exception of 2017. In 2006, Texas saw its largest spike in net domestic migration as many people affected by Hurricane Katrina relocated from Louisiana to Texas.

# **TEXAS ECONOMIC STATISTICS U.S. BUREAU OF LABOR STATISTICS**

Data Series	July 2019	Aug 2019	Sept 2019	Oct 2019	Nov 2019	Dec 2019
Labor Force Data						
Civilian Labor Force (1)	<sup>(R)</sup> 14,042.6	<sup>(R)</sup> 14,091.0	<sup>(R)</sup> 14,133.2	<sup>(R)</sup> 14,160.9	<sup>(R)</sup> 14,161.2	<sup>(R)</sup> 14,155.9
Employment (1)	<sup>(R)</sup> 13,555.6	<sup>(R)</sup> 13,598.5	<sup>(R)</sup> 13,637.4	<sup>(R)</sup> 13,663.8	<sup>(R)</sup> 13,664.9	(R) 13,660.1
Unemployment <sup>(1)</sup>	<sup>(R)</sup> 487.0	<sup>(R)</sup> 492.5	<sup>(R)</sup> 495.8	<sup>(R)</sup> 497.1	<sup>(R)</sup> 496.3	<sup>(R)</sup> 495.8
Unemployment Rate (2)	<sup>(R)</sup> 3.5	( <u>R</u> ) 3.5				
Nonfarm Wage and Salary Employment						
Total Nonfarm <sup>(3)</sup>	12,837.9	12,852.4	12,867.3	12,913.9	12,946.9	<sup>(P)</sup> 12,976.7
12-month% change	2.5	2.4	2.4	2.5	2.6	<sup>(P)</sup> 2.7
Mining and Logging <sup>(3)</sup>	256.0	254.8	255.4	255.5	251.5	<sup>(P)</sup> 246.7
12-month% change	3.4	2.1	1.3	0.4	-1.3	( <del>P</del> ) -3.8
Construction (3)	785.2	788.4	794.8	798.2	805.7	( <del>P</del> ) 809.5
12-month% change	6.4	6.0	6.9	7.2	7.7	<sup>(P)</sup> 7.4
Manufacturing (3)	910.6	912.4	911.9	910.9	917.5	( <sup>P)</sup> 917.8
12-month% change	3.1	3.1	2.8	2.5	2.5	<sup>(P)</sup> 2.0
Trade, Transportation, and Utilities (3)	2,533.6	2,531.9	2,525.4	2,536.9	2,547.8	<sup>(P)</sup> 2,559.4
12-month% change	1.9	1.8	1.2	1.5	1.5	( <u>P)</u> 2.0
Information (3)	202.4	201.9	201.3	202.8	202.3	🕑 201.9
12-month% change	-0.8	-0.7	-1.5	0.0	-1.4	🕑 -1.2
Financial Activities (3)	805.1	807.9	809.0	809.4	811.6	🕑 818.3
12-month% change	3.4	3.6	3.6	3.5	3.8	<b>P</b> 4.7
Professional & Business Services (3)	1,778.5	1,775.4	1,787.3	1,795.4	1,792.9	<sup>(P)</sup> 1,803.4
12-month% change	2.1	1.7	2.3	2.5	2.6	<sup>(P)</sup> 3.3
Education & Health Services (3)	1,744.2	1,751.7	1,757.5	1,765.7	1,773.3	( <del>P)</del> 1,773.1
12-month% change	2.6	2.9	3.1	3.3	3.7	<sup>(P)</sup> 3.4
Leisure & Hospitality <sup>(3)</sup>	1,407.3	1,409.3	1,407.1	1,415.7	1,414.5	( <del>P)</del> 1,415.6
12-month% change	3.7	3.4	3.9	3.1	3.5	<sup>(P)</sup> 3.1
Other Services (3)	452.7	452.8	452.6	454.2	458.6	( <sup>P)</sup> 459.7
12-month% change	5.0	4.5	3.8	3.9	4.8	( <del>P</del> ) 4.9
Government (3)	1,962.3	1,965.9	1,965.0	1,969.2	1,971.2	( <del>P)</del> 1,971.3
12-month% change	0.3	0.4	0.5	0.7	0.8	( <del>P)</del> 0.7
Footnotes(P) Preliminary.(1) Number of persons, in thousands, seasonally adjusted.(R) Revised.(2) In percent, seasonally adjusted.(R) Revised.						

(3) Number of jobs, in thousands, seasonally adjusted.

Data extracted on: March 9, 2020

# FEDERAL RESERVE BANK SENIOR LOAN OFFICER OPINION SURVEY

The January 2020 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, which generally corresponds to the fourth quarter of 2019.

Regarding loans to businesses, banks in the January survey indicated that, on balance over the fourth quarter, they left standards on commercial and industrial (C&I) loans basically unchanged, while demand weakened from firms of all sizes. Also, banks reported that lending standards and demand were unchanged for all commercial real estate (CRE) loan categories except construction and land development loans, for which standards tightened and demand weakened over the fourth quarter of 2019.

For loans to households, banks reportedly left their lending standards unchanged for all types of residential real estate loans (RRE) over the fourth quarter, while demand strengthened for most categories of closed-end mortgage loans and weakened for home equity lines of credit (HELOCs). However, banks reportedly tightened their lending standards on credit card and auto loans, while demand remained unchanged for credit cards and weakened for auto loans.

In addition, the survey included a set of special questions inquiring about banks' expectations for lending standards, loan demand, and loan performance over 2020. Banks reported expecting to tighten standards for most categories of business loans, credit card loans, and auto loans, but to leave standards unchanged for closed-end mortgage loans. Banks expect demand to remain unchanged for all types of loans except multifamily CRE and auto loans, for which they expect demand to weaken, and credit cards, for which they expect demand to strengthen. Meanwhile, banks expect loan performance to deteriorate somewhat for most surveyed loan categories. As one notable exception, banks expect no deterioration in loan performance for closed-end residential mortgage loans over 2020. In contrast, credit card and auto loans to nonprime borrowers stand out as the loan categories for which the largest net shares of banks expect a deterioration in loan performance over 2020.

#### **BUSINESS LENDING**

#### **C&I Loans**

Over the fourth quarter of 2019, banks reported that standards for C&I loans to firms of all sizes remained basically unchanged. However, banks reportedly eased some key terms on C&I loans, especially to large and middle-market firms.4 In particular, a significant net share of banks reported lowering the interest rate spreads on loans to large and medium-market firms, and a moderate net share of banks reported doing so for loans to small firms. In addition, modest net shares of banks reported lowering the cost of credit lines and easing loan covenants to large and middle-market firms. However, banks also reported tightening some terms on loans to large and middle-market firms. Modest net shares of banks reported increasing the premiums charged on risky loans and the use of interest rate floors for such firms. Meanwhile, foreign banks reported tightening

standards but lowering interest rate spreads for C&I loans.

Nearly every bank that reported having eased standards or terms over the fourth quarter attributed this change, in part, to increased competition from other banks or nonbank lenders. In contrast, among the banks that reported having tightened standards or terms over the fourth quarter, major net shares cited a less favorable or more uncertain economic outlook as well as reduced tolerance for risk as important reasons.

Regarding demand for C&I loans over the fourth quarter, moderate net shares of domestic banks reported that demand for such loans weakened from firms of all sizes, while a modest net share of foreign banks also reported weaker demand for C&I loans. A majority of the banks that reported weaker demand over the fourth quarter cited decreases in customers' investment in plants and equipment as well as lower needs to finance accounts receivable, inventories, and mergers and acquisitions as important reasons for weaker demand.

#### **CRE Lending**

Over the fourth quarter, banks reportedly left their lending standards unchanged for all CRE

loan categories except construction and land development, for which a modest net share of banks reported tightening standards. Meanwhile, demand was basically unchanged for all CRE loan types except construction and land development loans, for which a modest net share of banks reported weaker demand.

# **LENDING TO HOUSEHOLDS**

#### **Residential Real Estate Lending**

Over the fourth guarter, banks reportedly left standards unchanged for all types of RRE loans, including all closed-end mortgage loan categories and HELOCs. Meanwhile, banks reported stronger demand for most mortgage loan categories but weaker demand for HELOCs. Specifically, significant net shares of banks reported stronger demand for government-sponsored enterprise (GSE)-eligible residential mortgages, moderate net shares of banks reported stronger demand for qualified mortgage (QM) and non-QM jumbo residential mortgages, and modest net shares of banks reported stronger demand for QM and non-QM non-jumbo residential mortgages. In contrast, a moderate net share of banks reported weaker demand for HELOCs. While, on balance, banks reported stronger demand for most closed-end mortgage categories, several banks with large holdings of closed-end mortgages reported weaker demand for such loans.

#### **Consumer Lending**

Over the fourth guarter, a moderate net share of banks reported tighter standards on credit card loans, and a modest net share of banks reported tighter standards on auto loans, while banks reportedly left standards unchanged for other consumer loans. Some banks also reported tightening terms on credit card loans. Specifically, a moderate net share of banks reportedly increased minimum credit scores, while modest net shares of banks tightened credit limits and reduced the extent to which loans are granted to customers that do not meet credit score thresholds for credit card loans. Meanwhile, banks reported that demand remained unchanged for credit card and other consumer loans. A modest net share of banks reported that demand for auto loans weakened during the fourth quarter, although several banks with large auto loan portfolios reported stronger demand for auto loans over the fourth guarter.

# SPECIAL QUESTION ON BANKS' OUTLOOK FOR 2020

A set of special questions asked banks about their expectations for lending standards, loan demand, and loan performance as measured by delinquencies and charge-offs over 2020, assuming that economic activity progresses in line with consensus forecasts. On balance, banks reported expecting tighter standards and a deterioration in loan performance for most loan categories over 2020. With a few exceptions, banks expect loan demand to remain unchanged.

Regarding the outlook for loans to businesses, modest net fractions of banks reportedly expect to tighten standards on C&I loans to large and medium-market firms and also on nonfarm nonresidential CRE loans. In addition, moderate net shares of banks expect to tighten standards on construction and land development as well as multifamily CRE loans. Meanwhile, banks expect demand to remain unchanged for all business loan categories other than multifamily CRE loans, for which modest net shares of banks expect weaker demand. Additionally, banks reportedly expect performance to deteriorate somewhat for all types of business loans surveyed except multifamily CRE loans, for which performance is expected to remain unchanged.

The outlook for loans to households over 2020 was mixed across RRE and consumer loans.7 Banks reportedly expect to keep standards unchanged for closed-end mortgage loans, while a moderate net share of banks expect tighter standards for credit card loans, and a modest net share expect tighter standards on auto loans. Meanwhile, banks reported expecting demand to remain unchanged for closed-end mortgage loans, whereas modest net shares of banks expect stronger demand for credit card loans and weaker demand for auto loans. In addition, banks reportedly expect loan performance to remain unchanged for closed-end mortgage loans, and also for credit card loans to prime borrowers. However, a modest net share of banks expect performance to deteriorate for HELOCs, a moderate net share expect performance to deteriorate for auto loans to prime borrowers, and significant net shares of banks expect performance to deteriorate for both credit card and auto loans to nonprime borrowers.

Banks that reported expecting to tighten standards for any loan category were additionally asked to assess the importance of several potential reasons for the expected tightening.8 A majority of banks pointed to an expected deterioration in the quality of their loan portfolios, an expected reduction in their risk tolerance, and an expected deterioration in collateral values as important reasons for the expected tightening in lending standards.

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Yahoo Finance, online

Visit the Finance Commission of Texas <u>website</u> for previous Condition of the Texas State Banking System Reports.