Condition of the Texas Banking System

September 2017





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

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ECONOMIC REVIEW AND OUTLOOK

BANKING SYSTEM OVERVIEW

In the first half of 2017, the Texas economy grew at a moderate pace. Growth occurred in different sectors including manufacturing, retail, and real estate. Despite the decline in the energy sector, Texas continued to create jobs supported largely by its diverse economy. Due to disruptions resulting from Hurricane Harvey, some challenges are expected for banks and the economy in the latter part of the year. While banks have exposure to borrowers affected by the hurricane, recovery efforts are expected to increase loan demand for real estate and auto loans. Growth is also expected in construction and retail as people begin to rebuild and replace damaged items.

The diminishing number of banks remains a concern within the banking industry. Banks continue to consolidate, increasing their size and complexity and in some cases, moving away from the community bank characteristics that offer the relationship approach. The relationship approach is when banks have specialized knowledge of their local community and their customers to make credit decisions, which is particularly important to small businesses. Based upon available FDIC information, as of June 30, 2017, community banks in Texas represented 93.2% of the 456 banks and thrifts chartered in Texas, both state and federal charters; however, they constituted only 38.9% of the total assets. Although community banks represent less than half of the total assets for Texas banks and thrifts, they provide essential financial services to customers in remote locations. Most of the agricultural and small business loans in Texas are provided by community banks. For the second quarter of 2017, community banks controlled 80.3% of the total agricultural loans and 68.7% of the total small business loans in Texas banks.

Over the last ten years, bank charters in Texas have declined from 653 to 456, largely due to industry consolidation and the lack of de novo entries. However, total assets for Texas banks continue to expand. As of June 2017, total assets for Texas state-chartered banks and thrifts were \$274.5 billion, up \$9.7 billion over the previous year. This growth occurred despite a reduction of ten institutions. Return on assets increased from 1.0% to 1.3%, the coverage ratio (loan loss reserves relative to noncurrent loans) increased from 122.7% to 132.1%, and the noncurrent loan rate improved from 1.0% to 0.9%. For the same period, total assets for national banks and federal thrifts chartered in Texas increased by \$12.8 billion to \$211.0 billion with a reduction of eight institutions. For these entities, return on assets increased from 1.1% to 1.3%, the coverage ratio increased from 115.2% to 152.0%, and the noncurrent loan rate improved from 1.3% to 0.9%.

As of September 15, 2017, problem state-chartered financial institutions remain stable at 5.0% or 12 state banks, and no state thrifts were classified as a regulatory concern. There have been no problem institutions in the Texas thrift industry since March 2015. The Texas Department of Banking and the Department of Savings and Mortgage Lending consider any bank with a Uniform Financial Institutions Composite Rating of 3, 4, or 5 a problem institution. This is a significant improvement from 2010, a time in which problem entities peaked for state banks and thrifts at 18.5% and 37.9%, respectively. The peak was primarily due to the economy at that time and its intensified adverse effect on asset quality issues at several state-chartered institutions. The departments continue to monitor state banks and thrifts affected by lower oil prices, changes in market interest rates, catastrophic events, and other factors that could impact an institution's financial condition.

STATE-CHARTERED BANKING PROFILE (DEPARTMENT OF BANKING)

The number of Texas state-chartered banks declined to 240 during the first half of 2017, compared to 244 at December 31, 2016. The reduction was due to three banks merging into other Texas state-chartered banks and one bank merging into a national bank. One national bank converted to a Texas state-chartered bank while one Texas state-chartered bank converted to a national bank. During the same period, the department processed 106 applications related to banks, with approximately 50% of the filings involving branch and loan production office activity and 17.9% involving changes in ownership and control.

The slight decline in the number of banks was accompanied by a modest decline in the overall asset size of Texas state-chartered banks, which reduced from \$254.6 billion at December 31, 2016, to \$253.9 billion by June 30, 2017. Actual organic asset growth of \$3.1 billion was offset by \$3.8 billion in assets leaving the Texas state banking system by conversion, merger, and purchase and assumption transactions.

Favorably noted during the period was the approval of The Bank of Austin charter. This is the first de novo state bank chartered in Texas since June 2009 and opened in Austin, Texas, during July 2017.

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

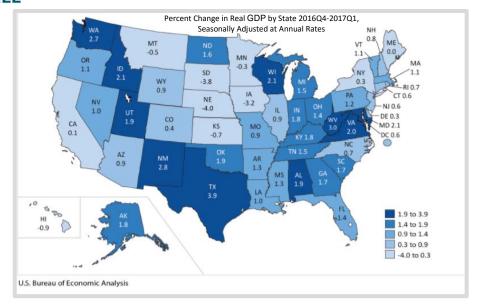
Increased profitability occurred in 65.4% of the thrift institutions since the middle of 2016, primarily due to an increase in the volume of loans at most institutions. All thrift charters were profitable as of June 2017, which mirrors the previous June. The level of nonperforming loans and other real estate foreclosed remains low at 1.3% of total assets. Past due and nonaccrual loans and foreclosed real estate continue to be monitored closely by state and federal regulators.

State-chartered thrift assets under the department's jurisdiction totaled \$20.6 billion as of June 30, 2017, which represents an increase of 29.5% or \$4.7 billion from this time last year. The total number of state-chartered savings banks has decreased by two from June 2016.

The department continues to receive and process applications. During the past twelve months, there have been three branch office applications, two merger/reorganization applications, and various other types of applications processed.

TEXAS ECONOMIC PROFILE

The Texas economy expanded at a steady pace in the first half of the year. Texas led the nation in real gross domestic product (GDP) growth from the fourth quarter 2016 to the first quarter 2017 at a 3.9%, seasonally adjusted annual rate. Texas sustained this moderate economic growth as indicated by the Texas Business Cycle Index (a measure of current economic activity in the state), which increased at an annualized rate of 5.1% in the second quarter. The Texas Leading Economic Index (a measure of future directional changes in the business cycle) also grew, jumping to a two-year high. Much of this growth is attributed to an increase in well permits and the depreciation of the Texas trade-weighted value of the dollar. The Texas trade-weighted value of the dollar



is the value of the U.S. dollar against the currencies of the countries to which the state exports. Mexico remained Texas' main trading partner, accounting for over a third of exports this year. Other top trading partners include Canada, China, and Brazil. Looking ahead, some factors that will impact the Texas economy include the damages caused by Hurricane Harvey and the political uncertainty related to the U.S. immigration policy.

Employment

Texas total nonfarm employment increased by 2.7% in June 2017, compared to June 2016, adding more than 319,000 jobs. The mining and logging sector experienced the strongest growth followed by education and health services, adding 21,900 and 63,100 jobs, respectively. Losses of 8,200 jobs were observed in the information sector. Although the Texas unemployment rate increased during the first quarter of 2017 to 5.0%, it improved in July to 4.3%.

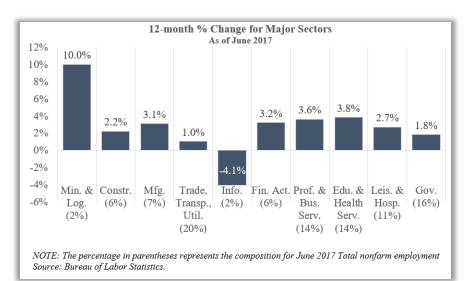
Over the same period, the nation added about 2.2 million jobs with a 1.2% lower growth rate than Texas. Nationally, the unemployment rate was also 4.3% in July.

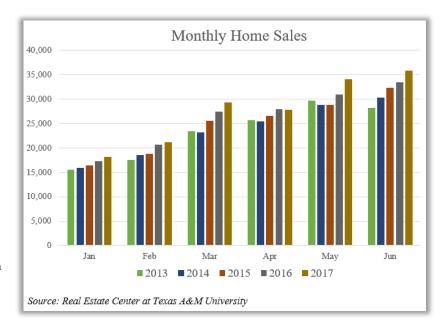
Housing

Housing activity continues to expand in Texas with home sales and building permits increasing. The foreclosure rate in Texas is well below the national average. RealtyTrac.com data shows that in July 2017, one in every 2,744 homes was foreclosed in Texas, while the national trend was one in every 1,997 homes.

According to the Real Estate Center at Texas A&M University, home sales for the second quarter increased by 5.9% compared to the same period last year. Second-quarter housing sales were particularly strong in San Antonio, rising 11.9%, while Austin and Dallas observed 4.9% and 2.7% increases, respectively. Despite improving economic conditions, sales in Houston dropped 4.2% in the second quarter and were flat year-over-year.

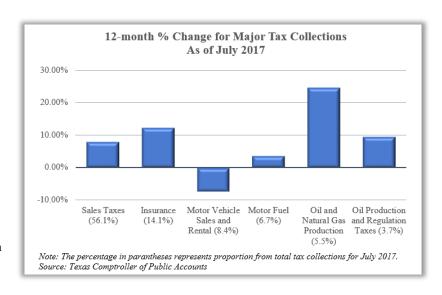
Texas led the country in total single-family building permits issued with about 60,000 for the first half of the year, a 13.8% increase from 2016. The median home price for Texas homes continues to increase with a median home price at \$232,000 in June 2017, a 5.6% increase from June 2016.





Tax Revenue

Sales tax receipts for the six months ending in July 2017 are 5.3% higher compared to the same period a year ago. Sales tax revenue is the largest source of funding for the state budget, accounting for more than half of total tax collections. Motor vehicle sales and rental taxes. motor fuel taxes, and oil and natural gas production taxes are other sources of tax revenue making up about 20% of total tax collections. In July 2017, tax collections for motor vehicle sales and rental taxes were down 7.3% from July 2016. Conversely, oil and natural gas production taxes and motor fuel taxes were up 24.6% and 3.7%, respectively.



Economic Impact of Hurricane Harvey

Unfortunately, the economic loss from Hurricane Harvey is likely to rank as one of the costliest natural disasters in the history of the U.S., considering the size and population of the areas affected. Texas Governor Greg Abbott estimates the total damages resulting from Hurricane Harvey to be upwards of \$180 billion with the City of Houston (in Harris county) suffering most of the losses. The Houston metropolitan area is the nation's fourth largest city by population and plays a major role in the energy, chemical, and shipping industries.

On September 4, 2017, 43 Texas counties were under federal disaster declaration by the Federal Emergency Management Agency (FEMA). Some areas in Southeast Texas received record high rain of more than 51 inches. FEMA expects more than 450,000 people to seek disaster assistance due to flooding. Reportedly, many of the homes affected by the hurricane do not have flood insurance. According to the Insurance Information Institute, only 15% of residents in Harris County have flood coverage. Similarly, vehicles in the affected counties suffered water damage with about 85% of motorists having vehicle insurance. Analysts estimate that as many as 500,000 storm-related claims will be filed in Texas. Higher auto sales are expected in the affected counties for the remainder of the year.

The Texas Gulf Coast is home to nearly a third of the nation's refining capacity. According to S&P Global Platts, as much as 22% of the nation's refining capacity was shut down or reduced because of the flooding. Oil and gas production was also affected, disrupting the supply of oil and gas in the region. Texas is the nation's top crude oil producing state, accounting for nearly a quarter of the total U.S. production. Due to the disruption, gasoline prices increased upwards of 25 cents per gallon in the weeks that followed Hurricane Harvey. However, the price is not expected to remain elevated for a long period. The Perryman Group, an economic and financial analysis firm based in Waco, Texas, estimates that "while the effect on the Texas economy is significant, it is not likely to derail its long-term pattern of growth for an extended period of time."

Immigration Policy

Senate Bill 4 passed by the 85th Texas Legislature, targeting undocumented workers, and the Trump Administration's decision to give Congress six months to address Deferred Action for Childhood Arrivals (DACA), an immigration program allowing individuals who entered the U.S. as children to remain in the U.S. for school or work, have the potential to impact the Texas labor force. A recent study published by the Perryman Group estimates that the number of undocumented workers in Texas is much larger than the total number of unemployed persons in the workforce. It is estimated that there are more than 250,000 undocumented construction workers in Texas, which is about 30% of the state's construction labor force with roughly one-third of them in the Houston area. From the 800,000 individuals enrolled in the DACA program 15.5% live in Texas with a high concentration in the Houston and Gulf Coast regions.

SUPERVISORY CONCERNS

Monitoring and identifying concerns surrounding the stability of our financial institutions and detecting individual banks that demonstrate an increased risk profile are critical. Examiners routinely review institutional exposures to changing economic conditions, and when appropriate, the agencies act to limit these risks. Each department strives to react quickly to changing economic conditions, or as with recent circumstances, respond to catastrophic events.

Hurricane Harvey

Loss estimates for the counties flooded by Hurricane Harvey are in the billions. News outlets and FEMA suggest a substantial economic impact. Given these facts, the departments are closely monitoring post-hurricane effects.

State and federal regulatory agencies are encouraging financial institutions to work with borrowers in communities affected by the hurricane. Commercial customers are expected to face challenges as their normal business operations are interrupted resulting in revenue losses that may hinder their ability to service debt obligations. As such, some banks are allowing borrowers to skip payments and/or extend loan terms to provide storm victims time to rebuild and reassess their financial situations.

Financial institutions with customers located in the disaster areas should consider performing risk assessments on a more frequent basis to identify loans and investments that are significantly affected and may show a higher potential for loss. The assessment should include a mechanism for monitoring collateral and the collectability and timing of insurance. This may necessitate an increase in the frequency of loan reviews and additional provisions for potential loan losses.

Bank management should also monitor municipal securities which might be negatively affected by the economic conditions in the Coastal Bend and greater Houston areas. Prudent efforts to monitor these investments should be taken as part of a bank's ongoing risk assessment process.

Real estate values in the area will experience significant fluctuations in value, affecting existing and new real estate loans. As recovery efforts begin, it is anticipated that loan demand will increase as consumers and businesses will need funds to rebuild. Policies and practices regarding estimating values on collateral in the real estate market should be prudent and reasonable for the current situation. Sufficient documentation should be retained in each loan file to support valuations and credit decisions.

Disaster recovery and business continuity plans were activated as the result of Hurricane Harvey. In general, institutional plans provided sound direction and institutions began restoring services to some extent in quick order. As institutions resume back to normal operations, it is important to review these plans and make any modifications necessary for future use. Factors to consider, include, but are not limited to: operating with limited staff; re-establishment of communications; restoration of systems; handling of destroyed documents, files, and collateral; and handing contaminated or destroyed safe deposit boxes and contents.

The Texas Department of Banking and the Department of Savings and Mortgage Lending have been in contact with affected institutions and will monitor conditions as recovery efforts continue. Each department is prepared to provide guidance as necessary to help address the needs of its regulated entities and their customers during this process.

Examinations Hot Topics

Bankers have increased lending in commercial real estate, construction and development, oil and gas, and agriculture lending. The result is portfolio concentrations in these areas. Rapid growth and increased competitive pressures with this type of lending raises concerns for regulators. Banks operating with high concentrations have begun tightening their underwriting standards to better manage their risk and meet regulatory



expectations. Each department is monitoring associated credits to ensure prudent lending practices are being followed.

Another area of concern is interest rate risk. The Federal Reserve is interested in restoring interest rates to more normal levels, and unwinding the Fed's balance sheet by ending quantitative easing (QE). QE is a monetary policy in which a central bank purchases government securities or other securities from the market to lower interest rates and increase the money supply. There is a level of uncertainty as to how the markets will react to the end of this policy and the degree bank balance sheets will be affected. It is important that bank management continues to assess the risks posed by increasing market interest rates.

As monetary policy changes are implemented, non-core funding sources may also be affected. Borrowings from the Fed and the Federal Home Loan Bank, as well as brokered deposits spiked during the credit crisis. These deposits are more sensitive to interest rate movements than traditional consumer bank deposits and their rates have moved up more quickly with the recent Federal Open Market Committee rate increases. Examiners are reviewing and analyzing liquidity and sensitivity indicators to gauge discernable market risk.

Washington D.C.

On June 12, 2017, U.S. Treasury Secretary Mnuchin released the first in a series of reports on regulating the financial system. The initial report focused on the depository system, while subsequent reports will cover capital markets, the asset management and insurance industries, and non-bank financial institutions and financial innovation. The Depository Report did not represent a full rollback of Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010. The U.S. Treasury's roadmap is less aggressive than the U.S. House of Representatives proposal (i.e., Choice Act) so it may be more appealing to the U.S. Senate.

Continuing tension over the North American Free Trade Agreement (NAFTA) is also causing concerns for many U.S. farmers and agricultural lenders. Texas bankers expressed concerns over the possibility of a NAFTA rollback at the Texas Department of Banking town hall meetings held in July and August 2017.

The Mexican government cut back on imports of soybean meal, corn, and chicken in the first four months of 2017, based on data from the Department of Agriculture. The pullback comes as U.S. farmers deal with other issues such as low commodity prices and overproduction in some segments. The Texas Department of Banking recommends that bankers encourage farmers to evaluate risk management, marketing strategies, crop insurance and revenue insurance plans.

Industry Consolidations

A concern exists that the continued decline in the number of community banks will have a negative impact on the Texas and U.S. economy. In some counties, community banks are the only financial institutions available to the public. There are several reasons for this consolidation: economies of scale; lack of management succession; and regulatory burden.

The departments continue to encourage de novo bank applications and supports right-sized federal regulation. Furthermore, the departments will continue to do their job in an appropriate manner, including attempts to moderate federal regulatory overreach as it is encountered.

DEPARTMENTAL SUPERVISORY MEASURES BEING TAKEN

Supervisory measures are designed to identify potential risks that could impact an institution's financial condition. Regulators must remain diligent in identifying and working with individual institutions that may be vulnerable to weaknesses in certain segments of the economy. Supervisors are aware that financial problems in institutions can often lag behind economic instability. Below is a listing of supervisory measures being utilized by each department.

Texas Department of Banking

- Monitoring the status of institutions that have been adversely affected by Hurricane Harvey and to the extent feasible, extending examinations;
- ❖ Monitoring institutions affected by lower oil prices and efforts to resolve problem credit relationships;
- Assessing the risks posed by increasing market interest rates on net interest margins, extended durations of investment securities, and economic value of equity;
- Determining preparedness for potential cybersecurity attacks and performing follow-up procedures for institutions that are below a baseline level of preparedness;
- * Reviewing institutions' efforts to prudently manage concentrations in commercial real estate, oil and gas, and agriculture lending;
- Monitoring reductions in internal and external audit functions, and loan review and training programs to reduce overhead costs:
- Conducting targeted reviews of new product lines as banks seek additional sources of revenue;
- ❖ Initiating enforcement actions early in the detection of deteriorating trends;
- Continuing frequent onsite examinations or visitations of problem institutions;
- Communicating and coordinating joint enforcement actions and other supervisory activities with federal regulators;
- Placing monthly calls to state banks to obtain industry input about prevailing economic conditions;
- Monitoring state, national, and world political and economic events impacting the industry such as federal programs designed to stabilize the financial markets and new regulations; and
- Increasing internal communication and training to improve examiner awareness of pertinent issues.

Department of Savings and Mortgage Lending

- Participating in regular conference calls and coordinating closely with other state and federal regulators;
- Engaging in regular correspondence with state savings banks regarding institution-specific and industry issues;
- Performing targeted examinations of high risk areas of state savings banks;
- ❖ Issuing enforcement actions and placing supervisory agents when deemed necessary;
- Conducting 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);
- Developing regular assessments of each institution's activities, strengths and weaknesses, and revising the plan of examination and monitoring for the institution, including the downgrading of institutions, if deemed necessary, by the department and the FDIC or Federal Reserve;
- Monitoring local, state, national and world political and economic events impacting the industry; and
- ❖ Participating in FDIC Compliance examinations of each institution.

PERFORMANCE SUMMARY AND PROFILE TEXAS BANKING SYSTEM

STATE-CHARTERED BANKS

Texas state-chartered banks remain profitable, reporting \$1.6 billion in net income in the second quarter of 2017, an increase of \$343.1 million (28.4%) compared with the second quarter of 2016. Higher net operating revenue, lower noninterest expense and lower provisions for loan and lease losses contributed to the improved average return on assets of 1.2%, up from 1.0% a year ago. Texas statechartered banks with assets less than \$1 billion have a higher return on assets of 1.3%, while nationally, banks have an average return on assets of 1.1%. State banks reported an average net interest margin of 3.4% during the second quarter of 2017, up 6 basis points (BP) from the year before. More than half of the banks (58.3%) reported year-over-year growth in quarterly net income, with 2.9% reporting losses, a slight increase from 2.4% in the second quarter of 2016.

Asset quality indicators improved during the first half of the year with the noncurrent loan rate at 0.8%, an improvement from 0.9% during the same period in 2016. The noncurrent loan rate remains below the national rate of 1.2%. The coverage ratio (loan loss reserves relative to noncurrent loans) increased from 137.0% in the second quarter of 2016 to 145.6% in the second quarter of 2017. Net charge-offs to loans and leases also declined favorably by 13 BP to 0.2%. Likewise, noncurrent assets plus other real estate owned as a percent of total assets improved by 8 BP to 0.6%. Compared to Texas, the nation had a weaker performance, with a coverage ratio of 105.3% and a charge-off rate of 0.5%.

Loan growth remains strong with total loans increasing by 4.6 billion (3.0%) compared to the second quarter of 2016, supporting the growth in total assets of \$5.3 billion (2.1%). The largest increase occurred in commercial real estate (up \$2.5 billion or 6.2%), 1-4 family residential (up \$1.4 billion or 5.9%), and construction and land development (up 1.3 billion or 8.1%).

Banks set aside \$155 million in provisions for loan losses during the first half of 2017, a year-over year decrease of \$233.4 million. As a result, banks reduced their allowance for loan and lease losses (ALLL) slightly by \$8.6 million (0.5%) compared to June 2016. The largest decline occurred at banks with assets greater than \$10 billion. While banks with total assets greater than \$1 billion but less than \$10 billion increased reserves by \$11.5 million (2.4%).

Texas banks remain well capitalized with an average total risk based capital ratio of 14.4% and a 10.2% leverage ratio, compared to the nation at 14.5% and 9.6%, respectively. An increase in retained earnings helped lift the total equity capital of state-chartered banks by \$789.3 million (2.7%).

STATE-CHARTERED THRIFTS

Through June 30, 2017, state thrifts had \$174.9 million in year-to-date net income, compared to \$138.0 million in the first half of 2016. The pretax, quarterly return on average assets remains strong at 1.8%. Provision expenses for loan and lease losses remain low at 0.2% of average assets. Non-interest income to assets increased 2 BP, while non-interest expense decreased 47 BP.

State thrifts experienced a slight decrease in the core capital levels since one year earlier, from 15.2% to 11.5%. This decrease is a result of growth and the reallocation of capital between sister banks.

Quarterly net interest margins have narrowed 39 BP during the last twelve months, but remain healthy, from 4.3% to 3.9%. Year-to-date provisions to the ALLL have doubled from the prior year. The prior year was exceptionally low, primarily due to large reverse provisions at one institution with federal loss share agreements. The Texas thrift ratio of nonperforming loans plus other real estate owned to total assets remains low at 1.3%.

NUMBER OF **I**NSTITUTIONS AND **T**OTAL **A**SSETS

FDIC financial data is reflective of FDIC insured institutions only.

Assets in Billions

	06-30-	2017	06-30-	-2016	Difference		
	No. of <u>Institutions</u>	<u>Assets</u>	No. of <u>Institutions</u>	<u>Assets</u>	No. of <u>Institutions</u>	<u>Assets</u>	
Texas State-Chartered Banks Texas State-Chartered Thrifts	240 <u>26</u> 266	\$253.9 <u>\$20.6</u> \$274.5	249 <u>27</u> 276	\$248.5 <u>\$16.3</u> \$264.8	-9 <u>-1</u> -10	+\$5.4 <u>+4.3</u> +\$9.7	
Other states' state-chartered: Banks operating in Texas* Thrifts operating in Texas*	31 <u>0</u> 31	\$62.5 <u>0</u> \$62.5	28 <u>0</u> 28	\$57.3 <u>0</u> \$57.3	+3 <u>0</u> +3	+\$5.2 <u>0</u> +\$5.2	
Total State-Chartered Activity	297	\$337.0	304	\$322.1	-7	+\$14.9	
National Banks Chartered in Texas Federal Thrifts Chartered in Texas Other states' federally-chartered:	184 <u>6</u> 190	\$127.6 \$83.4 \$211.0	192 <u>6</u> 198	\$119.6 <u>\$78.6</u> \$198.2	-8 <u>0</u> -8	+\$8.0 <u>+4.8</u> +12.8	
Banks operating in Texas* Thrifts operating in Texas*	24 <u>6</u> 30	\$375.8 <u>\$0.3</u> \$376.1	24 <u>7</u> 31	\$347.5 <u>\$0.9</u> \$348.4	0 <u>-1</u> -1	+\$28.3 - <u>0.6</u> +\$27.7	
Total Federally-Chartered Activity	220	\$587.1	229	\$546.6	-9	+40.5	
Total Banking/Thrift Activity	517	\$924.1	533	\$868.7	-16	+\$55.4	

^{*}Indicates estimates based on available FDIC information.

RATIO ANALYSIS

As of June 30, 2017 FDIC financial data is reflective of FDIC insured institutions only.

	State- Chartered <u>Banks</u> 240	Texas National <u>Banks</u> 184	All Texas <u>Banks</u> 424	State- Chartered <u>Thrifts</u> 26	Texas Federal <u>Thrifts</u> 6	All Texas <u>Thrifts</u> 32
% of Unprofitable Institutions	2.92%	3.80%	3.30%	N/A	N/A	N/A
% of Institutions with Earnings Gains	58.33%	61.41%	59.67%	65.38%	50.00%	62.50%
Yield on Earning Assets	3.68%	3.85%	3.73%	4.55%	4.56%	4.55%
Net Interest Margin	3.39%	3.52%	3.44%	3.92%	4.34%	4.26%
Return on Assets	1.23%	1.54%	1.34%	1.81%	1.04%	1.19%
Return on Equity	10.63%	14.49%	11.84%	14.59%	11.77%	12.47%
Net Charge-offs to Loans	0.18%	0.15%	0.17%	0.12%	1.43%	1.14%
Earnings Coverage of Net Loan C/Os	16.33	21.88	18.09	24.98	3.00	3.51
Loss Allowance to Loans	1.19%	1.20%	1.19%	0.90%	1.82%	1.61%
Loss Allowance to Noncurrent Loans	145.63%	134.18%	141.52%	56.81%	177.23%	139.67%
Noncurrent Assets+OREO to Assets	0.61%	0.64%	0.62%	1.34%	0.61%	0.76%
Net Loans and Leases to Core Deps	80.72%	81.31%	80.92%	96.28%	73.19%	77.45%
Equity Capital to Assets	11.86%	10.91%	11.54%	11.24%	8.95%	9.40%
Core Capital (Leverage) Ratio	10.19%	10.57%	10.31%	11.45%	8.88%	9.38%
Common Equity Tier 1 Capital	13.14%	13.61%	13.30%	15.08%	13.53%	13.88%

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 June 30, 2017 FDIC financial data is reflective of FDIC insured institutions only. Assets in Billions

	< <u>\$1</u> 213	<u>\$1 - \$10</u> 24	> <u>\$10</u> 3
% of Unprofitable Institutions	3.29%	NA	NA
% of Institutions with Earnings Gains	56.34%	75.00%	66.67%
Yield on Earning Assets	4.20%	4.18%	3.15%
Net Interest Margin	3.81%	3.75%	3.01%
Return on Assets	1.31%	1.23%	1.21%
Return on Equity	11.82%	9.84%	10.60%
Net Charge-offs to Loans	0.15%	0.13%	0.22%
Earnings Coverage of Net Loan C/Os	18.25	20.73	13.94
Loss Allowance to Loans	1.28%	0.97%	1.31%
Loss Allowance to Noncurrent Loans	158.54%	141.31%	142.51%
Noncurrent Assets+OREO to Assets	0.63%	0.66%	0.56%
Net Loans and Leases to Core Deps	76.39%	102.63%	71.88%
Equity Capital to Assets	11.29%	12.73%	11.61%
Core Capital (Leverage) Ratio	10.96%	10.93%	9.39%
Common Equity Tier 1 Capital	16.35%	13.56%	11.65%

RATIO ANALYSIS BY ASSET GROUPS FOR STATE-CHARTERED THRIFTS

As of June 30, 2017 FDIC financial data is reflective of FDIC insured institutions only. Assets in Billions

	< <u>\$1</u> 21	<u>\$1 - \$10</u> 5	<u>>\$10</u> 0
% of Unprofitable Institutions	NA	NA	NA
% of Institutions with Earnings Gains	61.90%	80.00%	NA
Yield on Earning Assets	4.53%	4.56%	NA
Net Interest Margin	3.94%	3.91%	NA
Return on Assets	1.04%	2.23%	NA
Return on Equity	10.32%	16.29%	NA
Net Charge-offs to Loans	0.06%	0.16%	NA
Earnings Coverage of Net Loan C/Os	35.82	22.90	NA
Loss Allowance to Loans	0.97%	0.86%	NA
Loss Allowance to Noncurrent Loans	215.99%	39.66%	NA
Noncurrent Assets+OREO to Assets	0.37%	1.86%	NA
Net Loans and Leases to Core Deps	95.86%	96.50%	NA
Equity Capital to Assets	9.89%	11.96%	NA
Core Capital (Leverage) Ratio	10.56%	11.91%	NA
Common Equity Tier 1 Capital	14.17%	15.54%	NA

COMPARISON REPORT

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

June 30, 2017

	State B	anks*	State T	hrifts
	End of Period	% of Total Assets	End of Period	% of Total Assets
Number of Institutions	240		26	
Number of Employees (full-time equivalent)	41,220		2,832	
(In millions)				
Total Assets	\$253,873		\$20,631	
Net Loans and Leases	\$154,342	60.79%	\$14,407	69.83%
Loan Loss Allowance	\$1,863	0.73%	\$130	0.63%
Other Real Estate Owned	\$259	0.10%	\$48	0.23%
Goodwill and Other Intangibles	\$5,329	2.10%	\$120	0.58%
Total Deposits	\$206,106	81.18%	\$16,900	81.92%
Federal Funds Purchased and Repurchase Agreements	\$2,562	1.01%	\$15	0.07%
Other Borrowed Funds	\$11,916	4.69%	\$1,136	5.51%
Equity Capital	\$30,118	11.86%	\$2,319	11.24%
Memoranda:				
Noncurrent Loans and Leases	\$1,279	0.50%	\$229	1.11%
Earning Assets	\$232,161	91.45%	\$19,413	94.10%
Long-term Assets (5+ years)	\$69,433	27.35%	\$7,074	34.29%
	Year-to-Date	% of Avg. Assets†	<u>Year-to-Date</u>	% of Avg. Assets [†]
Total Interest Income	\$4,229	3.36%	\$411	4.26%
Total Interest Expense	\$323	0.26%	\$57	0.59%
Net Interest Income	\$3,905	3.11%	\$354	3.67%
Provision for Loan and Lease Losses	\$155	0.12%	\$19	0.19%
Total Noninterest Income	\$1,610	1.28%	\$94	0.97%
Total Noninterest Expense	\$3,311	2.63%	\$242	2.51%
Securities Gains	\$3	0.00%	\$9	0.10%
Net Income	\$1,552	1.23%	\$175	1.81%
Memoranda:				
Net Loan Charge-offs	\$135	0.11%	\$8	0.09%
Cash Dividends	\$831	0.66%	\$574	5.95%

^{*}Excludes branches of state-chartered banks of other states doing business in Texas. As of June 30, 2017, there are an estimated thirty-one out-of-state state-chartered institutions with \$62.5 billion in assets. Assets are based upon the June 30, 2016 FDIC Summary of Deposits.

No branches of state-chartered thrifts of other states conducted business in Texas as of June 30, 2017.

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

PERFORMANCE SUMMARY UNITED STATES BANKING SYSTEM

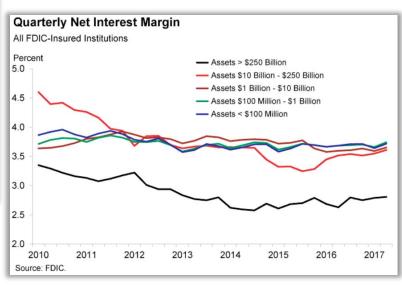
FDIC QUARTERLY BANKING PROFILE

Second Quarter 2017 - www.fdic.gov

Higher net interest income and restrained growth in operating expenses helped lift banking industry profits in second quarter 2017. The 5,787 commercial banks and savings institutions insured by the FDIC reported net income of \$48.3 billion for the quarter, an increase of \$4.7 billion (10.7%) compared with the second quarter of 2016. Almost two out of every three banks—63.4%—reported year-over-year earnings improvement, while only 4.1% were unprofitable, down from 4.6% a year earlier. The average return on assets (ROA) rose to 1.14% from 1.06% the year before. This is the highest quarterly ROA for the industry since second quarter 2007.

↑ Net Interest Margins Improve

Net operating revenue—the sum of net interest income and total noninterest income—rose to \$190.5 billion in the second quarter, an \$11 billion (6.1%) increase from second quarter 2016. Most of the improvement consisted of higher net interest income, which was \$10.3 billion (9.1%) higher than a year earlier. The increase in net interest income helped lift the industry's net interest margin (NIM) to 3.22%, from 3.08% in second quarter 2016. This is the highest quarterly NIM since fourth quarter 2013. While 57.7% of all banks reported higher NIMs, the improvement was greatest at larger institutions. More of their assets reprice or mature in the short term, and they are better-positioned to benefit from rising shortterm interest rates. Noninterest income totaled \$66.8 billion, up \$654 million (1%) from a year earlier. Income from asset servicing was \$1 billion (93.9%) higher, while gains on asset sales were \$1.6 billion (31.7%) lower. Trading income fell \$313 million (4.5%).



Noninterest Expense Growth Is Moderate

Banks set aside \$12 billion in loan-loss provisions during the second quarter, up \$273 million (2.3%) from the previous year. Slightly more than one-third of all banks—36.5%—increased their loss provisions versus second quarter 2016, while 32.2% reported lower provisions. Noninterest expenses totaled \$108.6 billion, an increase of \$3.5 billion (3.3%). Expenses for salaries and employee benefits were \$2.1 billion (4.3%) higher than a year earlier, as the total number of employees rose by 48,019 (2.3%).

Credit Card Charge-Offs Continue to Increase

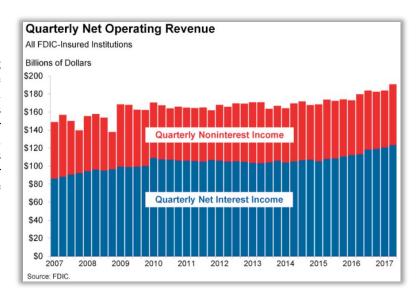
Loan losses rose from the year-ago level for a seventh consecutive quarter. Net charge-offs of loans and leases totaled \$11.3 billion in the second quarter, an increase of \$1.1 billion (11.2%) from a year earlier. Credit card charge-offs increased year over year for a seventh consecutive quarter, rising by \$1.4 billion (24.5%), while charge-offs in other major loan categories declined. Net charge-offs of loans to commercial and industrial (C&I) borrowers were \$210 million (9.7%) below the year-earlier level. The average net charge-off rate rose to 0.48%, from 0.45% in second quarter 2016.

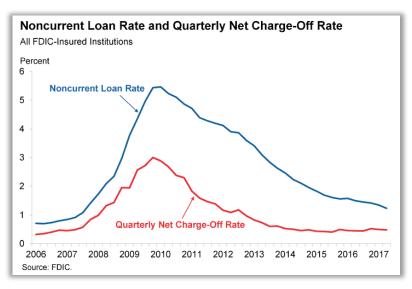
↑ Noncurrent Loan Balances Decline Further

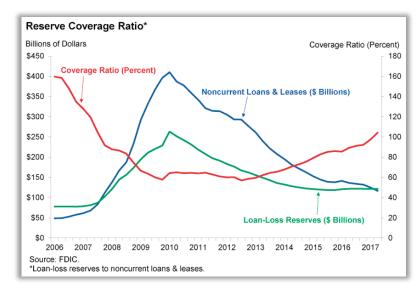
The amount of loans and leases that were noncurrent—90 days or more past due or in nonaccrual status—fell for the 28th time in the last 29 quarters, declining by \$8.4 billion (6.7%) in the three months ended June 30. Noncurrent balances declined in all major loan categories during the quarter. Noncurrent residential mortgage loans fell by \$4.8 billion (7.9%), while noncurrent C&I loans declined by \$2.2 billion (9.5%). The average noncurrent loan rate fell from 1.34% to 1.23% during the quarter, the lowest since third quarter 2007.

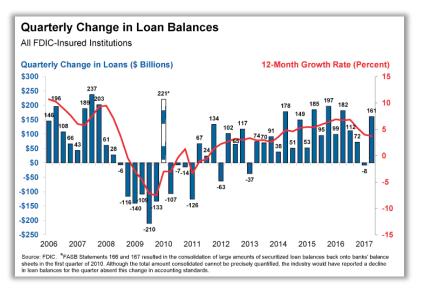
Banks Shift Their Reserve Allocations

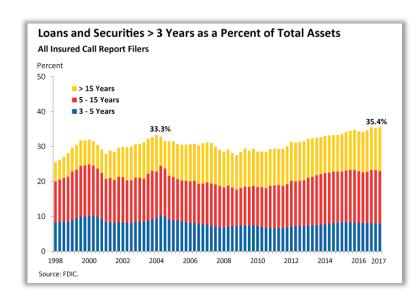
Total loan-loss reserves posted a modest (\$197 million, 0.2%) decline during the second quarter. The industry's coverage ratio of reserves to noncurrent loans and leases rose from 97.5% to 104.3%, the highest level since third quarter 2007. Banks with assets greater than \$1 billion, which account for 90% of the industry's loss reserves, increased their reserves for credit card losses by \$1.4 billion (4.3%), while reducing their reserves for commercial loan losses by \$1.1 billion (3.3%) and their reserves for residential real estate loan losses by \$922 million (5.5%).











↑ Retained Earnings Drive Capital Growth

Equity capital increased by \$38.7 billion (2%) during the quarter. Retained earnings contributed \$20 billion to the growth in capital, \$322 million (1.6%) less than in second quarter 2016. Banks declared \$28.3 billion in dividends in the quarter, up \$5 billion (21.4%) from the year-earlier quarter. Lower long-term interest rates contributed to an \$8 billion improvement in accumulated other comprehensive income, which was reflected in the equity capital increase. At the end of the quarter, 99.4% of all FDIC-insured institutions, representing 99.96% of total industry assets, met or exceeded the requirements for well-capitalized banks, as defined for Prompt Corrective Action purposes.

Banks Reduce Their Federal Reserve Bank Balances

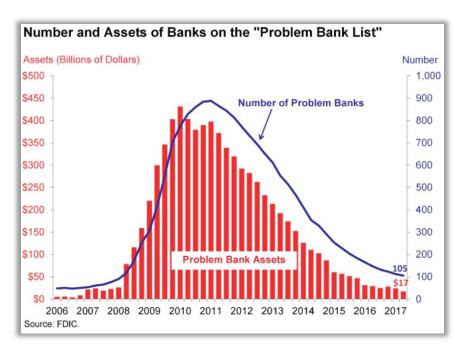
Industry assets surpassed \$17 trillion for the first time at the end of the second quarter, rising by \$100.8 billion (0.6%) during the three months ended June 30. Banks reduced their balances at Federal Reserve banks by \$102.4 billion (8%). They also reduced their investment securities by \$15 billion (0.4%), as U.S. Treasury securities fell by \$49.9 billion (9.7%), and mortgagebacked securities rose by \$38 billion (1.9%). Securities held in available-for-sale accounts declined by \$59 billion (9.7%), while securities in held-to-maturity accounts increased by \$44 billion (4.7%). Assets in trading accounts increased by \$18.7 billion (3.2%) during the quarter. The percentage of industry assets maturing or repricing in more than three years remained unchanged from the first quarter, at 35.4%. The all-time high level for this percentage—35.5%—occurred at the end of fourth quarter 2016.

The Annual Loan Growth Rate Slows for a Third Consecutive Quarter

Total loans and leases increased by \$161.2 billion (1.7%) during the second quarter. All major loan categories posted increases, led by residential mortgage loans (up \$35.1 billion, 1.8%), credit card balances (up \$23.6 billion, 3.1%), and C&I loans (up \$22.1 billion, 1.1%). Unused loan commitments increased by \$25.9 billion (0.4%). For the 12 months ended June 30, total loans and leases increased by \$337.6 billion (3.7%), while unused loan commitments rose by \$274.8 billion (3.9%). The 12-month growth rate for total loans and leases has slowed in each of the last three quarters. A year ago, the 12-month loan growth rate was 6.7%. The 12-month growth rate in unused loan commitments has slowed for six consecutive quarters. In 2015, unused commitments increased 6.6%.

The Number of Banking Employees Rises 2.3% Over the Past Year

The number of FDIC-insured commercial banks and savings institutions reporting financial results fell to 5,787 in the second quarter, from 5,856 in the first quarter. During the second quarter, three insured institutions failed, while 62 institutions were absorbed by mergers. No new reporters were added during the quarter. The number of institutions on the FDIC's Problem Bank List declined for a 25th consecutive quarter, from 112 to 105. This is the smallest number of problem banks since March 31, 2008, and is almost 90% below the peak of 888 at the end of March 2011. The number of full-time equivalent employees rose by 11,663 (0.6%) to 2,093,278 during the quarter, which was 48,019 higher than second quarter 2016 (2.3%). This is still 5.9% below the peak of 2,223,383 employees in first quarter 2007.



SNAPSHOT STOCK PERFORMANCE SOUTHWEST REGIONAL BANKS SEPTEMBER 2017

Name	Last	Trade		52 Wk Range						EPS	Mkt Cap	Div/Shr	Div Yld
ACNB Corporation	09/13	26.85	24.45	32.85	15.21	-	188.36M	0.80	2.99%				
BancFirst Corporation	09/13	51.60	34.06	51.80	20.34	2.79	1.64B	0.76	1.48%				
Banco Bilbao VizcayaArgentaria	09/13	8.84	5.78	9.35	13.35	0.61	57.73B	0.29	6.39%				
BOK Financial Corporation	09/13	82.98	65.74	88.80	18.11	5.57	5.43B	1.75	2.14%				
Cass Information Sys, Inc.	09/13	61.51	52.69	74.83	27.34	-	689.15M	0.91	1.50%				
CoBiz Incorporated	09/13	17.10	12.40	18.85	19.21	1.09	707.28M	0.20	1.29%				
Commerce Bancshares, Inc.	09/13	55.00	47.64	60.61	19.93	3.11	5.59B	0.88	1.64%				
Comerica, Inc.	09/13	68.48	45.14	75.72	17.1	5.25	12.05B	0.95	1.73%				
Community Shores Bank Corp	09/13	2.70	2.17	2.95	40.91	-	11.07M	-	-				
Cullen Frost Bankers, Inc.	09/13	89.15	67.86	99.20	17.56	5.69	5.73B	2.19	2.56%				
Enterprise Fin Serv Corp	09/13	39.15	30.59	46.25	17.04	3.05	918.58M	0.44	1.13%				
East West Bancorp, Inc.	09/13	56.49	35.52	60.42	16.14	3.83	8.16B	0.80	1.41%				
First Community Corp S C	09/13	20.25	14.80	23.55	20.3	1.28	135.62M	0.34	1.78%				
First Financial Bankshares, Inc.	09/13	40.50	35.05	46.70	24.97	1.85	2.68B	0.73	1.90%				
Great Southern Bancorp, Inc.	09/13	51.50	38.35	56.70	14.43	3.41	722.88M	0.90	1.88%				
Guaranty Fed Bancshares, Inc.	09/13	22.38	16.00	23.71	16.22	1.51	98.96M	0.38	1.77%				
Heartland Financial USA, Inc.	09/13	44.45	35.02	52.65	14.58	3.44	1.33B	0.42	0.99%				
International Bancshares Corp	09/13	36.70	28.47	42.25	16.99	-	2.42B	0.64	1.75%				
Landmark Bancorp, Inc.	09/13	28.30	25.88	32.40	12.64	-	109.63M	0.78	2.82%				
Liberty Bancorp, Inc.	09/13	21.50	18.10	23.94	10.8	-	77.40M	0.10	1.02%				
Mackinac Financial Corp	09/13	14.94	11.00	15.16	13.61	-	94.05M	0.44	3.20%				
MidWest One Finl Group, Inc.	09/13	33.88	27.93	39.20	16.49	2.66	413.96M	0.65	2.00%				
Prosperity Bancshares, Inc.	09/13	61.37	52.19	77.87	15.54	4.26	4.26B	1.32	2.20%				
QCR Holdings, Inc.	09/13	43.00	28.70	50.00	17.69	3.11	566.79M	0.18	0.47%				
Southside Bancshares, Inc.	09/13	33.18	30.47	38.08	17.47	2.32	976.27M	1.00	3.38%				
Southwest Bancorp, Inc.	09/13	26.25	17.07	29.70	23.23	1.46	490.48M	0.32	1.22%				
Texas Capital Bancshares, Inc.	09/13	78.30	50.67	93.35	21.73	4.97	3.88B	-	-				
UMB Financial Corporation	09/13	68.40	57.31	81.55	19.76	4.02	3.42B	1.01	1.51%				
West Bancorp Incorporated	09/13	21.95	18.75	25.05	14.73	1.66	355.84M	0.69	3.27%				
Zions Bancorp	09/13	43.05	29.63	48.33	17.14	3.16	8.70B	0.32	1.13%				

Source: Yahoo Finance (September 2017) NA – Indicates information was not available.

SNAPSHOT STOCK PERFORMANCE SOUTHWEST REGIONAL BANKS SEPTEMBER 2016

Name	Last	Trade		52 Wk Range		EPS	Mkt Cap	Div/Shr	Div Yld
ACNB Corporation	09/12	27.07	19.99	27.83	14.6	1.85	163.96M	0.80	2.94
BancFirst Corporation	09/12	69.87	51.14	71.14	16.96	4.12	1.09B	1.52	2.15
Banco Bilbao VizcayaArgentaria	09/12	6.32	5.14	9.24	23.85	0.26	40.78B	0.41	6.30
BOK Financial Corporation	09/12	68.58	44.13	75.18	18.92	3.62	4.52B	1.72	2.48
Cass Information Sys, Inc.	09/12	56.56	45.05	58.64	27.32	2.07	631.91M	0.88	1.55
CoBiz Incorporated	09/12	13.12	10.31	13.94	20.22	0.65	537.34M	0.20	1.52
Commerce Bancshares, Inc.	09/12	49.97	37.44	51.3	19.15	2.61	4.83B	0.90	1.80
Comerica, Inc.	09/12	46.37	30.48	47.7	20.13	2.30	8.06B	0.92	1.96
Community Shores Bank Corp	09/12	2.24	1.85	2.87	N/A	-0.09	9.19 M	N/A	N/A
Cullen Frost Bankers, Inc.	09/12	70.47	42.41	73.99	16.65	4.23	4.38B	2.16	3.01
Enterprise Fin Serv Corp	09/12	31.47	23.77	31.47	14.65	2.15	629.97M	0.44	1.39
East West Bancorp, Inc.	09/12	36.5	27.25	43.94	13.37	2.73	5.26B	0.80	2.19
First Community Corp S C	09/12	14.90	11.98	15.59	15.68	0.95	99.82M	0.32	2.13
First Financial Bankshares, Inc.	09/12	36.87	24.12	36.90	23.63	1.56	2.44B	0.72	1.96
Great Southern Bancorp, Inc.	09/12	43.33	34.48	52.94	13.54	3.20	602.78M	0.88	2.03
Guaranty Fed Bancshares, Inc.	09/12	16.60	14.15	18.7	13.68	1.22	73.97 M	0.32	1.92
Heartland Financial USA, Inc.	09/12	36.72	25.95	39.45	12.07	3.04	901.31M	0.40	1.07
International Bancshares Corp	09/12	29.72	21.05	31	15.24	1.95	1.96B	0.58	1.93
Landmark Bancorp, Inc.	09/12	26.24	23.80	27.54	9.86	2.65	94.99 M	0.80	3.03
Liberty Bancorp, Inc.	09/12	18.101	N/A	N/A	11.83	1.53	65.164M	0.18	0.99
Mackinac Financial Corp	09/12	11.71	9.90	12.03	20.53	0.57	72.85M	0.40	3.38
MidWest One Finl Group, Inc.	09/12	29.8	24.71	32.52	13.02	2.29	340.79M	0.64	2.12
Prosperity Bancshares, Inc.	09/12	54.28	33.57	57.04	13.67	3.97	3.77B	1.20	2.18
QCR Holdings, Inc.	09/12	31.34	18.05	31.52	14.35	2.18	409.38M	0.16	0.51
Southside Bancshares, Inc.	09/12	32.62	19.54	33.62	17.95	1.82	856.32M	0.96	2.92
Southwest Bancorp, Inc.	09/12	19	14	19.97	23.14	0.82	355.10M	0.32	1.62
Texas Capital Bancshares, Inc.	09/12	52.50	29.78	61.83	19.37	2.71	2.41B	N/A	N/A
UMB Financial Corporation	09/12	59.21	39.55	61.24	23.12	2.56	2.93B	0.98	1.65
West Bancorp Incorporated	09/12	19.60	16.04	21.09	14.10	1.39	316.20M	0.68	3.46
Zions Bancorp	09/12	30.94	19.65	31.28	20.52	1.20	5.03B	0.24	0.96

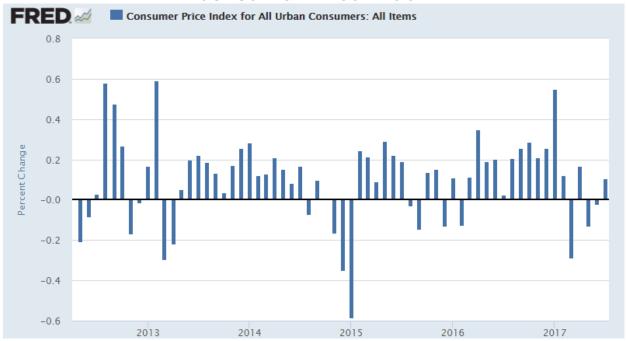
Source: Yahoo Finance (September 2016) NA – Indicates information was not available.

NATIONAL ECONOMIC TRENDS

Real GDP



Consumer Price Index

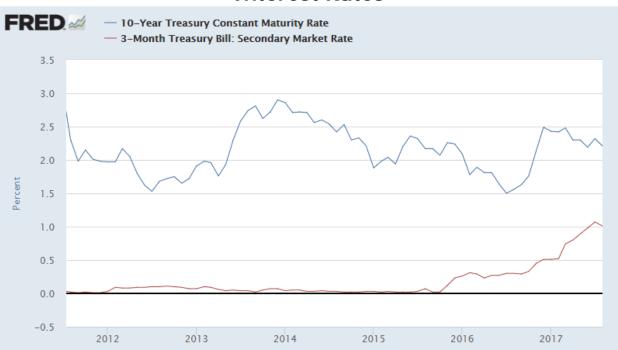


Source: Federal Reserve Bank of St. Louis, National Economic Trends, September 2017.

Unemployment Rate



Interest Rates

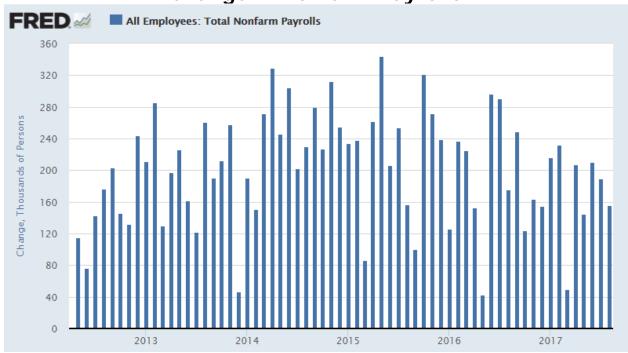


Source: Federal Reserve Bank of St. Louis, National Economic Trends, September 2017.

Treasury Yield Curve



Change in Nonfarm Payrolls



Source: Federal Reserve Bank of St. Louis, National Economic Trends, September 2017.

ECONOMIC REPORTS AND FORECASTS UNITED STATES

FEDERAL RESERVE BANK, DALLAS NATIONAL UPDATE

July 2017 - www.dallasfed.org

☆ Economy

Economic indicators released the past two months point to stronger growth in second quarter 2017 and the rest of the year. The economy is close to full employment, and business and consumer confidence remains strong. Real personal consumption expenditures (PCE) growth was positive in April and May, a reversal from the negative growth rates seen earlier in the year.

The first release for real GDP growth in second quarter 2017 came in at 2.6%, a rebound from the revised 1.2% growth in the first quarter. The increase came largely from PCE and nonresidential fixed investment. Forecasters expect robust growth of at least 2% for the third and fourth quarters this year.

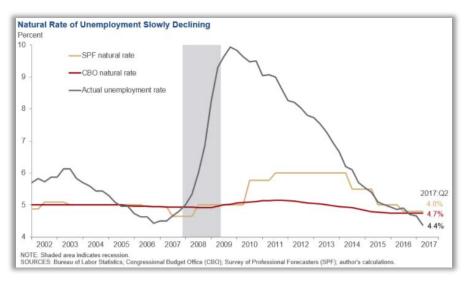
Headline and core inflation measures have dipped in recent months, but most forecasters still project both measures to reach the target rate of 2% by 2018.

Long-Term Unemployment Still High Nonfarm payrolls grew by 222,000 in June, well above the consensus forecast and up from 152,000 in May.

Job Growth Strengthens;

Nonfarm payrolls grew by 222,000 in June, well above the consensus forecast and up from 152,000 in May. The average monthly payroll increase in the first half of 2017 stood at 180,000. That is slightly below the 2016 average of 187,000 but above the average increase of 174,000 in 2006—when unemployment was similar to the current rate. Payrolls have now grown every month since October 2010.

The headline unemployment rate rose 0.1 percentage points to 4.4% in June but remained below the Congressional Budget Office's (CBO's) 4.7% estimate of the natural rate of unemployment—the rate that would persist in the absence of business-cycle fluctuations. Both the CBO's and Survey of Professional Forecasters' natural rate estimates have gradually declined over the past five years.



The headline U-3 rate—the total unemployed as a percent of the civilian labor force—and the broader U-6 unemployment rate—which includes discouraged workers, other marginally attached workers and those working part time for economic reasons—have returned to their average levels before the Great Recession, indicating tightness in the labor market.

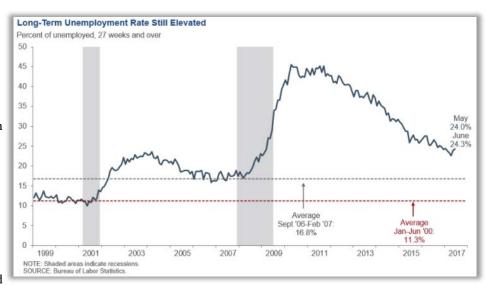
However, one segment of the labor force—the long-term unemployed, defined as those who have been looking for work for 27 weeks or more—has not returned to pre-Great-Recession levels. In June, the share of long-term unemployed was 24.3%, about 7.5 percentage points higher than the pre-Great-Recession average of 16.8%.

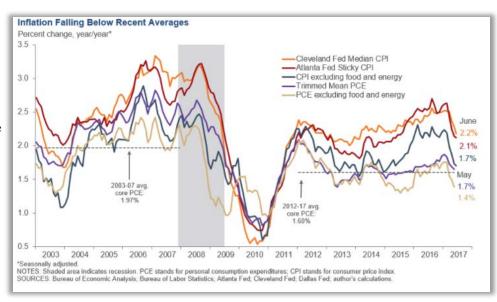
Labor ForceParticipationDeclines Sharply

From 2006 to 2016, the U.S. labor force participation rate fell from 66.2% to 62.8%, a decline of over 3 percentage points, the highest percentage-point decline among advanced economies. The participation rate either dipped less or increased in other countries, including those in the Organization for Economic Cooperation and Development (OECD) aggregate, which excludes the U.S. A major contributor to this decline is the prime-age (25–54) participation rate. Unlike other advanced countries, which reported increases in the prime-age participation rate from 2006 onward, the comparable U.S. rate declined from 82.9% in 2006 to 81.3% in 2016. As a result, the U.S. now has the lowest prime-age participation rate among these advanced economies. Potential explanations for this outsized decline include relatively poorer health outcomes in the U.S., demographic changes, and lower spending on job-search-assistance programs.

Inflation Declines, but Expectations Remain Anchored

Core PCE inflation, which excludes food and energy, dropped to 1.4% in May on a year-over-year basis. Meanwhile, the Dallas Fed's Trimmed Mean PCE year-over-year inflation measure came in at 1.7%. The chart to the right plots these two measures of inflation, along with the Atlanta Fed's Sticky Consumer Price Index (CPI) measure, the Cleveland Fed's Median CPI, and core CPI inflation. All five measures began trending down in March. Even after replacing March's monthly growth rate with the average growth rate over the past year (excluding March), inflation still declined, indicating that the current trend is not just the result of the sharp fall that occurred in March.

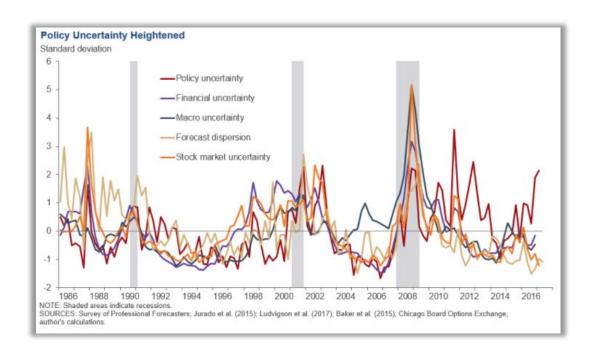




The Institute for Supply Management (ISM) manufacturing composite index stood at 57.8 in June—2.9 percentage points higher than in May and the highest reading since August 2014. The ISM non-manufacturing composite index also rose, from 56.9 in May to 57.4 in June. The Conference Board's Consumer Confidence Index climbed 1.3 points from May's reading to 118.9 in June, one of the highest values since June 2001. All of these releases indicate growing optimism about the U.S. economy.

Policy Uncertainty Continues

Recently, economists and business leaders have identified policy and other forms of uncertainty as possible sources of concern for the U.S. economy. The chart below plots five different types of uncertainty and their corresponding indexes (normalized for comparison purposes) from first quarter 1986 to second quarter 2017. As seen in the chart, all types of uncertainty are low right now, except for policy uncertainty.



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

Data Series	Feb 2017	Mar 2017	Apr 2017	May 2017	June 2017	July 2017
Unemployment Rate (1)	4.7	4.5	4.4	4.3	4.4	4.3
Change in Payroll Employment (2)	232	50	207	145	210	<u>(P)</u> 189
Average Hourly Earnings (3)	26.10	26.13	26.18	26.22	26.27	(P) 26.36
Consumer Price Index (4)	0.1	-0.3	0.2	-0.1	0	0.1
Producer Price Index (5)	0	0	<u>(P)</u> 0.6	<u>(P)</u> 0.0	<u>®</u> 0.1	(P) -0.1
U.S. Import Price Index (6)	0.3	-0.2	0.2	-0.1	-0.2	0.1

Footnotes:

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

Data Series	2 nd Qtr 2016	3 rd Qtr 2016	4 th Qtr 2016	1 st Qtr 2017	2 nd Qtr 2017
Employment Cost Index (1)	0.6	0.6	0.5	0.8	0.5
Productivity (2)	0.8	2.5	1.3	0.1	(R) 1.5

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: September 7, 2017

THE FEDERAL RESERVE BOARD THE BEIGE BOOK — SEPTEMBER 6, 2017 EXCERPT

Economic activity expanded at a modest to moderate pace across all twelve Federal Reserve Districts in July and August. Consumer spending increased in most Districts, with gains reported for nonauto retail sales and tourism, but mixed results for vehicle sales. Capital spending also increased in several Districts. Manufacturing activity expanded modestly on balance. That said, reports were mixed regarding auto production, and contacts in many Districts expressed concerns about a prolonged slowdown in the auto industry. Both residential and commercial construction increased slightly overall. Low inventories of homes for sale continued to weigh on residential real estate activity across the country, while commercial real estate activity increased slightly. Activity in the energy and natural resources sector was generally positive prior to shutdowns arising from Hurricane Harvey. Agricultural conditions were mixed overall, with drought conditions reported in multiple Districts. Business and consumer loan demand grew at a modest pace in most Districts, with a number of banks reporting rising competition from both other banks and non-bank lenders.

Employment growth slowed some on balance, ranging from a slight to a modest rate in most Districts. Labor markets were widely characterized as tight. There were reports of worker shortages in numerous industries, most notably in manufacturing and construction. Firms in the Atlanta, St. Louis, and Minneapolis Districts said that they had turned down business because they could not find the necessary workers. Many Districts indicated that businesses were having difficulty filling openings at all skill levels. In spite of the tight labor market, the majority of Districts reported limited wage pressures and modest to moderate wage growth. That said, there were reports from firms in the Dallas and San Francisco Districts that labor shortages were pushing up wages.

Prices rose modestly overall across the country. Input and materials costs generally increased, most notably for freight, lumber, and steel. In contrast, movements in energy and agricultural commodity prices were mixed. A number of Districts indicated that pass-through to downstream prices was limited, with increases in input prices exceeding gains in selling prices. Home prices moved up overall, as low inventories put upward pressure on prices in many regions.

A Special Note on the Impact of Hurricane Harvey

Hurricane Harvey created broad disruptions to economic activity along the Gulf Coast in the Dallas and Atlanta Districts, although it was too soon to gauge the full extent of the impact. Many firms and organizations in the affected areas closed due to flooding. A fifth of the oil and natural gas production in the Gulf of Mexico was offline, and many onshore producers in the Eagle Ford region temporarily stopped production. Harvey also affected fuel and petrochemical production, forcing fifteen refineries in the region to shut down temporarily and several others to operate at reduced capacity. Some areas experienced gasoline shortages, and supply was expected to remain tight in the Southeastern United States because of pipeline disruptions. Contacts in the Richmond District indicated that spot freight prices jumped after the storm, as freight was being redirected around the country. The Port of Charleston expected increased volumes in coming weeks as freight traffic is routed away from the Port of Houston.

ECONOMIC REPORTS AND FORECASTS: STATE OF TEXAS

FEDERAL RESERVE BANK, DALLAS REGIONAL ECONOMIC UPDATE

August 2017 - www.dallasfed.org

↑ Texas Economy Improves Further

The Texas economy is continuing to grow at a solid pace. Employment rose in June, and both manufacturing and service activity expanded, exceeding last year's index averages, according to the Dallas Fed's Texas Business Outlook Surveys (TBOS). However, growth in the energy sector slowed as oil prices fell. Nevertheless, increased activity in export-related manufacturing firms mitigated some of the deceleration in energy-related manufacturing.

The Dallas Fed's latest Texas Employment Forecast for 2017 ticked up from 2.6% to 2.8. The main risk factors going into the second half of the year continue to be a sharp decline in energy prices and uncertainty regarding trade and tax policy.

↑ Employment Growth Robust in June

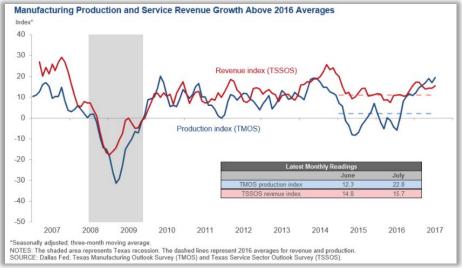
Texas payroll employment expanded at a 3.6% annual rate in June, stronger than May's 2.8% increase. On a quarterly basis, job growth ticked up from an annualized 2.7% in the first quarter to 2.8% in the second and was higher than the nation's 1.6% increase.

Employment growth has been strong among goods-producing industries. Oil and gas and support activities posted the fastest employment growth in the second quarter at an annualized 25.8%, followed by manufacturing at 5.9% and education and health services at 4.4%. Leisure and hospitality, financial activities and government grew 3.8%, 3.7% and 2%, respectively. Job growth in both the professional and business services and construction sectors decelerated considerably from the first quarter, growing 0.6%. Employment growth in trade, transportation and utilities has been practically flat in 2017, and information services employment contracted 5% in the second quarter.



↑ TBOS Indexes Suggest Continued Growth

Texas factory activity increased in July, and service sector activity continued to reflect expansion, according to business executives responding to the Texas Manufacturing Outlook Survey (TMOS) and the Texas Service Sector Outlook Survey (TSSOS). Both factory production and service revenue continued growing, exceeding last year's averages.



Energy Sector Activity Slows

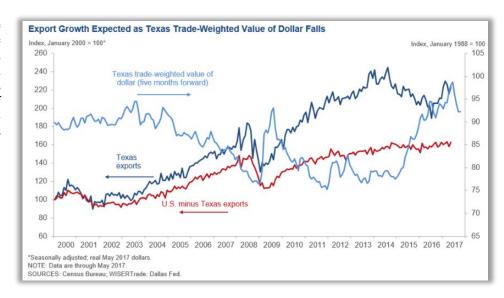
Growth in energy sector activity slowed as West Texas Intermediate (WTI) oil prices fell to around \$46 per barrel by mid-June. Rig counts in Texas climbed steadily from their May 2016 low of 173 to 458 at the end of May 2017; however, they have fluctuated around 460 since then. Beige Book contacts said that the pace of increase in the rig count may not be sustainable and that they expect it to taper off past mid-2017. This is consistent with the Dallas Fed's latest Energy Survey, which showed that business activity grew robustly in the second quarter, albeit at a slower pace than in the first quarter.

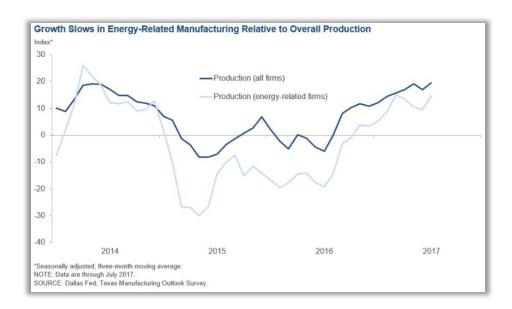
The Energy Survey company outlook index's second-quarter reading indicated prevailing business optimism, though to a lesser extent than in the first quarter. This tempering in optimism coincided with increased uncertainty regarding respondents' outlooks. Over 46% of firms reported increased uncertainty, up from 33.8% last quarter. On a positive note, the majority of respondents expected WTI oil prices to climb to between \$45 and \$59 by year-end, which is in line with the WTI price range needed to profitably drill a new well.



Texas exports grew 3.5% month over month in May and were up 7.5% during the first five months of the year. Texas exports should continue growing as the Texas trade-weighted value of the dollar falls and global growth improves. These factors should lift exports in the second half of the year, particularly in cross-border manufacturing sectors such as electronics and transportation.

Increased activity in export-related manufacturing has offset some of the deceleration in energy-related manufacturing. Three-month moving averages show continued growth in the TMOS production index even as output growth in energy-related manufacturing has been below overall production.





TEXAS ECONOMIC STATISTICS U.S. BUREAU OF LABOR STATISTICS

Data Series	Feb 2017	Mar 2017	Apr 2017	May 2017	June 2017	July 2017
Labor Force Data						
Civilian Labor Force (1)	13,461.60	13,520.10	13,548.80	13,526.80	13,468.70	(P) 13,401.4
Employment (1)	12,799.00	12,842.60	12,872.50	12,870.80	12,848.10	(P) 12,827.0
Unemployment (1)	662.6	677.5	676.3	656	620.5	(P) 574.4
Unemployment Rate (3)	4.9	5	5	4.8	4.6	(P) 4.3
Nonfarm Wage and Salary Employment						
Total Nonfarm (4)	12,205.60	12,217.70	12,246.70	12,266.10	12,306.70	(P) 12,326.3
12-month% change	1.9	2.1	2.1	2.3	2.7	(P) 2.4
Mining and Logging (4)	222.3	226.6	229.3	236.1	239.9	(P) 242.0
12-month% change	-6	-2.1	1.8	6.4	10	(P) 12.1
Construction (4)	710.3	716.2	707.9	712.2	713.9	(P) 713.0
12-month% change	1.9	3	0.7	1.6	2.2	(P) 1.5
Manufacturing (4)	856.3	858.6	864.7	867.8	871.1	(P) 874.0
12-month% change	0	0.6	1.7	2.4	3.1	(P) 3.5
Trade, Transportation, and Utilities (4)	2,447.20	2,444.00	2,444.20	2,437.80	2,439.00	(P) 2,442.0
12-month% change	1.4	1.2	1.2	1	1	(P) 0.7
Information (4)	196.6	196.5	193.6	193.1	194	(P) 192.8
12-month% change	-2.7	-2.5	-4.2	-4.5	-4.1	(<u>P)</u> -4.6
Financial Activities (4)	742.9	745.9	748.9	752.9	753.9	<u>(P)</u> 759.1
12-month% change	2.1	2.6	2.7	3	3.2	(P) 3.6
Professional & Business Services (4)	1,659.00	1,669.30	1,673.70	1,674.50	1,678.30	(P) 1,683.3
12-month% change	2.5	3.4	3.2	3.3	3.6	<u>(P)</u> 3.2
Education & Health Services (4)	1,668.90	1,668.10	1,678.60	1,678.40	1,688.30	(P) 1,687.2
12-month% change	3.3	3.1	3.6	3.3	3.8	(P) 3.1
Leisure & Hospitality (4)	1,325.50	1,313.00	1,320.70	1,322.20	1,320.60	(P) 1,327.6
12-month% change	3.5	2.6	2.9	2.9	2.7	(P) 2.9
Other Services (4)	432.1	432.5	435.6	437.9	448.5	(P) 447.0
12-month% change	2	2.3	3	2.6	6.4	(<u>P)</u> 6.1
Government (4)	1,944.50	1,947.00	1,949.50	1,953.20	1,959.20	(P) 1,958.3
12-month% change	2.1	2	1.8	1.7	1.8	(P) 1.4
Footnotes (1) Number of persons, in thousands, season (2) In percent, seasonally adjusted.	nally adjusted.		mber of jobs, in	n thousands, se	asonally adjust	ed.

Data extracted on: September 7, 2017

FEDERAL RESERVE BANK SENIOR LOAN OFFICER OPINION SURVEY

The July 2017 Senior Loan Officer Opinion Survey on Bank Lending Practices (SLOOS) addressed changes in the standards and terms on, and demand for, bank loans to businesses and households over the past three months. This summary discusses the responses from 76 domestic banks and 22 U.S. branches and agencies of foreign banks.

Regarding loans to businesses, the July survey results indicated that, on balance, demand for commercial and industrial (C&I) loans weakened over the second quarter of 2017 while banks left their standards on C&I loans basically unchanged. Survey respondents also reported that standards on commercial real estate (CRE) loans tightened while demand weakened on net.

For loans to households, banks reported that lending standards on all categories of residential real estate (RRE) loans eased or remained unchanged, although the net share of banks reporting easing was, at most, moderate in each category. Banks also reported, on net, that demand for most categories of RRE loans strengthened over the second quarter, although, again, the net share was never more than moderate. In addition, modest net fractions of banks reported tightening standards and weaker demand for auto and credit card loans.

Responses to a set of special annual questions on the approximate levels of lending standards suggested that domestic banks' lending standards for all categories of C&I loans are currently easier than the midpoints of the ranges that have prevailed since 2005 (explained more fully later). In contrast, banks also indicated that standards on all types of CRE loans are currently tighter than the midpoints of their respective ranges.

In addition, on balance, banks reported that the levels of standards for all types of RRE loans are currently at least as tight as the midpoints of the ranges observed since 2005. Moreover, banks indicated that the levels of standards for consumer loans to subprime borrowers are currently still tighter than the midpoints of their respective ranges, while the analogous readings for consumer loans to prime borrowers are currently easier than their midpoints.

BUSINESS LENDING

C&I Loans

On balance, banks reported that standards for C&I loans were basically unchanged over the past three months for loans to both small firms and large and middle-market firms. However, terms on C&I loans became less restrictive, on balance, with specific loan terms all either easing or remaining basically unchanged. Specifically, a significant net percentage of banks reportedly narrowed spreads of loan rates over the cost of funds, while a moderate net share of banks reportedly increased the maximum size of credit lines and decreased the use of interest rate floors for large and middle-market firms. A modest net percentage of banks reported easing these terms to small firms as well. Besides a few other terms for large and middle-market firms that were modestly eased, other terms remained basically unchanged on

Among the domestic respondents that reportedly eased standards or terms on C&I loans over the past

three months, more aggressive competition from other bank or nonbank lenders was by far the most emphasized reason for easing. In particular, a majority of banks reported that more aggressive competition was an important reason for easing, with almost five times as many banks identifying the reason as "very important" as any other reason.

Regarding the demand for C&I loans, a moderate net share of domestic banks reported that demand from large and middle-market firms weakened, while a modest net share of banks reported that demand from small firms did so. The reported reasons for weakening loan demand were less concentrated than the reasons for having eased standards. Each of the following reasons for weaker demand was cited by at least half of the banks that reported weaker demand: shifts in customer borrowing to other bank or nonbank sources and decreases in customers' needs to finance inventory, accounts receivable, investment in plant or equipment, and mergers or acquisitions.

Meanwhile, foreign banks reported that C&I lending standards and demand remained basically unchanged, on balance, in the second quarter of 2017. Changes in C&I loan terms were mixed; a moderate net share of banks reported having narrowed loan spreads and reduced the use of interest rate floors, but a modest net share reported decreasing the maximum size of credit lines.

CRE Lending

On net, domestic survey respondents indicated that their lending standards for all major categories of CRE loans tightened during the second quarter. In particular, a moderate net fraction of banks reported tightening standards for construction and land development loans and loans secured by multifamily residential properties, while a modest net share of

banks reported tighter standards for loans secured by nonfarm nonresidential properties.

Banks also reported that demand for CRE loans weakened during the second quarter. A modest net fraction of banks reported weaker demand for construction and land development loans and loans secured by multifamily residential properties, while demand for nonfarm nonresidential loans remained basically unchanged on net.

Meanwhile, a modest net share of foreign banks reported tightening standards for CRE loans. Also, in contrast to the domestic respondents, a significant net share of foreign banks indicated that demand for CRE loans strengthened in the second quarter of 2017.

LENDING TO HOUSEHOLDS

RRE Lending

On balance, banks reported that standards for all surveyed categories of RRE lending either eased or were unchanged over the past three months. A moderate net share of banks reported easing underwriting standards for jumbo residential mortgages that do not conform to qualified mortgage (QM) rules, while a modest net share of banks reported easing standards for QM jumbo mortgages and mortgages that are eligible to be securitized by government sponsored enterprises (GSE eligible). Standards for other categories of home-purchase mortgages as well as for revolving home equity lines of credit were basically unchanged on net.

Banks also reported stronger demand for most categories of RRE loans on net. A moderate net share of banks reported stronger demand for QM jumbo mortgages, while a modest net share reported stronger demand for GSE-eligible, government, and non-QM jumbo mortgages. However, a modest net fraction of banks reported weaker demand for non-QM non-jumbo residential mortgages. Demand for other mortgage categories and for home equity lines of credit was basically unchanged on net.

Consumer Lending

A modest net share of banks reported tightening lending standards on credit card and auto loans, whereas standards on other consumer loans remained basically unchanged. Regarding terms on consumer loans, modest net fractions of banks reportedly widened spreads of loan rates over their cost of funds in all three consumer loan categories. Additionally, a modest net share of banks reported increasing their minimum required credit score for credit card loans, although a similar net share of banks also reported increasing the limits on their credit cards. Other terms on consumer loans remained basically unchanged.

Banks reported that demand for consumer loans weakened in the second quarter. A modest net share reported that demand for auto and credit card loans weakened, while demand for other consumer loans reportedly remained basically unchanged on net.

LENDING STANDARDS

The July survey included a set of special questions that asked respondents to describe the current levels of lending standards at their bank. Specifically, for each loan category surveyed, respondents were asked to consider the range over which their bank's standards have varied between 2005 and the present and then to report where the current level of standards for such loans currently resides relative to the midpoint of that range.

Domestic banks reported that their current lending standards on all categories of C&I loans remained at levels that are easier than the midpoints of their respective ranges since 2005. A significant net share of domestic banks reported that standards are currently easier than the respective midpoints for non-syndicated loans to both small and large and middle-market firms as well as for syndicated loans to investment-grade firms. Additionally, a moderate net share of domestic banks reported a relatively easy level of standards for loans to very small firms, while a modest share reported a relatively easy level of standards for syndicated loans to below-investment-grade firms. Moreover, relative to the responses in the July 2016 survey, the level of lending standards appears to have eased, on net, for all categories over the past year.

In contrast, foreign banks reported that the current levels of their C&I lending standards are, if anything, generally tighter than the midpoints of their respective ranges. A significant net share of foreign banks reported that the level of standards is tighter than the midpoint of its range for non-syndicated loans to large and middle-market firms, while a moderate net share of banks reported a tighter level for non-syndicated loans to small firms. The level of standards for syndicated loans is reportedly around the midpoint of its range on net.

Regarding the levels of standards on CRE loans, domestic banks reported that the current levels of their standards on all major categories of these loans are tighter than the midpoints of the ranges that have prevailed since 2005. A significant percentage of domestic banks reported, on balance, that current levels of standards are tighter than the respective midpoints on loans secured by multifamily residential properties and on loans for construction and land development purposes, while a moderate net percentage reported that levels of standards are tighter than the midpoint on loans secured by nonfarm nonresidential properties. A major net share of foreign banks reported a relatively tight level of standards for construction loans, while a significant net share did so for multifamily and nonfarm nonresidential loans. However, only about half of the foreign banks responded to each question, as foreign banks are a relatively small part of the CRE loan market.

With respect to RRE loans, on balance, domestic banks reported that lending standards for most of the five categories included in this survey remained somewhat tighter than the midpoints of the ranges of those standards since 2005. Subprime residential mortgages remained the category that was most consistently reported as tight, on net, with a significant net share of banks reporting that standards are currently tighter than their respective midpoint. Additionally, a moderate net share of banks reported relatively tight standards on jumbo loans and on home equity lines of credit, while the current level of standards was reported to be around the midpoint, on net, for GSE-eligible and government residential mortgages.

On balance, banks' current levels of standards on consumer loans were reported to be on the tight end of the range since 2005 for subprime borrowers while being somewhat easier for prime borrowers. In particular, significant net fractions of banks reported that the levels of their standards are currently tighter than the midpoints of their respective ranges for both auto and credit card loans to subprime borrowers. However, a moderate net percentage of banks reported that the current level of standards is easier than the midpoint, on net, for auto loans to prime borrowers, while standards are around the midpoint for credit card loans to prime borrowers. A modest net share of banks also reported that the current level of standards is tighter than the midpoint for consumer loans other than credit card and auto loans. However, even for loans to prime customers, banks indicated tightening relative to last year—in all five consumer loan categories, banks reported that the current levels of standards are tighter, on net, than in the July 2016 survey.

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MarketWatch, Inc., New York, New York

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Thomas Reuters, New York, New York

U.S. Bureau of Labor Statistics, Washington, D.C.

U.S. Treasury, Washington, D.C.

Wall Street Journal, New York, New York

Yahoo Finance, online