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DISTRICT HIGHLIGHTS

Federal Reserve Bank of Dallas March 1987

Branching Affects Texas Banking Structure

The advent of branch banking will significantly alter the Texas banking industry. Banking employment, already declining as a result of the state's recession, will decline further in response to the new law. While branch banking is likely to increase the number of banking locations, the number of banks will fall. Over the next year, branching will have an important effect on the Texas banking industry, as will bank mergers and general economic conditions.

Banking Employment Growth Slows

Banking employment in Texas has gone through three stages since the late 1970s. From 1975 through 1982, employment growth in the industry was strong at a 6.6-percent annual rate. After oil prices weakened in late 1982, employment growth at banks slowed but remained positive, averaging 2.2 percent annually from 1983 through 1985. During 1986, however, banking employment in Texas declined 4.6 percent. Problems in the energy and real estate industries lowered bank earnings, and banks responded partly by reducing employment in order to cut costs (Chart 1).

Branching Legislation Takes Effect

The 1986 passage of a state constitutional amendment paved the way for limited branch banking in Texas. Beginning in 1987, a Texas bank may have up to three branches in each county in which it operates. Within a county, affiliated banks of a multibank holding company can reorganize as one bank with a branch network.

One way of evaluating the potential effect of this legislation is to compare some characteristics of Texas banking and banking in states that already permit limited branching. The data presented in Chart 2 show that in relation to its population, Texas has more bank employees and more banks but fewer banking locations than other states that permit limited branching. If banking in Texas becomes more like banking in these states, estimates of the long-term impact of the legislation suggest that banking employment in Texas will fall more than 7 percent, the number of banks will decline almost 60 percent, and the number of banking locations may rise over 90 percent. These effects will take place over the next several years and may be offset or exacerbated by other factors, such as interstate banking and the state's economic activity.

The number of banks will fall because some existing banks will become branches, especially banks within multibank holding companies. When banks consolidate and streamline operations as a result of branch-

(Continued on back page)

Rural Banks Fare Better Than Urban Banks

Largely because of increasing loan losses, profitability has fallen for banks in both rural and urban areas of Texas. Rural banks, however, have sustained considerably smaller declines in profitability than have their urban counterparts. Most rural banks are small, and loan losses have been more severe at large banks. Nevertheless, rural banks have still fared better, even when only small banks are considered. The smaller declines in rural bank profitability can be traced to a lower loan-to-asset ratio and less severe loan difficulties. Urban banks have experienced greater loan difficulties because their lending has been linked more closely with industries hurt by lower oil prices.

Profitability Falls at Urban Banks

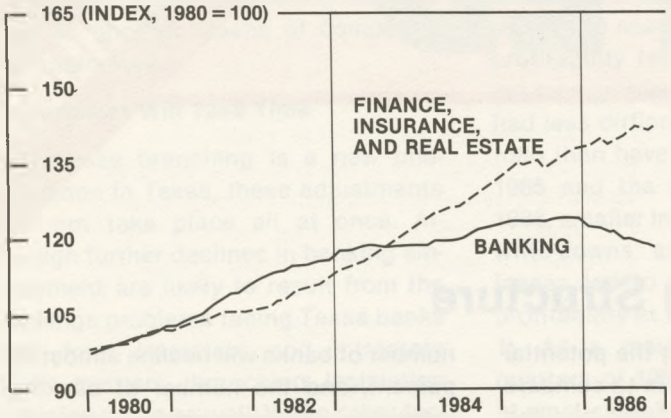
Loan losses have been a major contributor to recent declines in urban bank profitability in Texas. Adverse economic conditions have resulted in rising loan delinquency rates, forcing banks to write off increasing proportions of their loans. Provision for loan losses relative to assets at the state's small urban banks rose from 0.79 percent in 1984 to 1.12 percent in 1985 (Chart 3). Net income relative to assets at these banks correspondingly fell from 0.77 percent to 0.26 percent. Further increases in loan losses at the small urban banks in Texas led to an annualized return on assets of -0.24 percent over the first three quarters of 1986. In contrast, during the same period the annualized return on assets at small rural banks in the state was 0.75 percent.

Rural Banks Suffer Less

As a group, rural banks in Texas have had considerably smaller declines

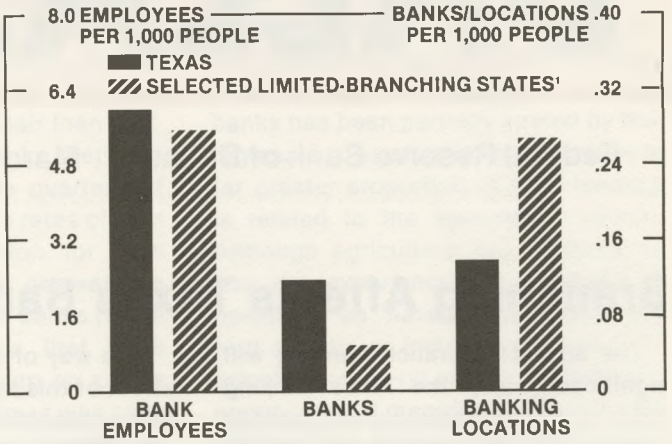
(Continued on back page)

Chart 1
EMPLOYMENT IN BANKING AND FINANCE, INSURANCE, AND REAL ESTATE



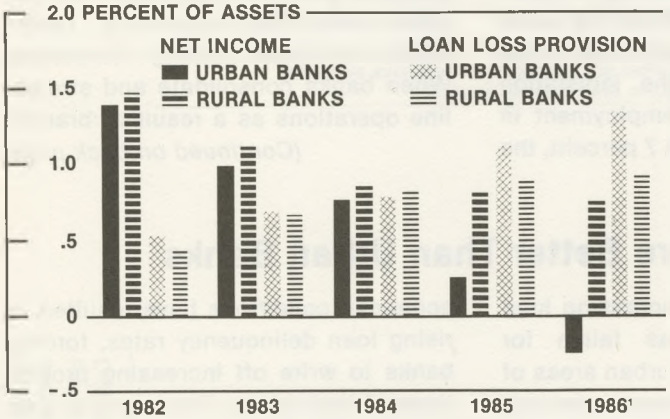
SOURCES OF PRIMARY DATA: U.S. Bureau of Labor Statistics.
Federal Reserve Bank of Dallas.

Chart 2
BANKING INDUSTRY CHARACTERISTICS IN RELATION TO POPULATION



1. Louisiana, Michigan, New Mexico, Ohio, Pennsylvania, and Tennessee.
SOURCES OF PRIMARY DATA: Federal Deposit Insurance Corporation.
Federal Reserve Bank of Dallas.

Chart 3
INCOME AND PROVISION FOR LOAN LOSSES RELATIVE TO ASSETS AT SMALL TEXAS BANKS



1. Figures for the year are annualized from the first three quarters.
NOTE: Calculated for insured commercial banks with total assets under $100 million.
SOURCE: Federal Reserve Bank of Dallas.

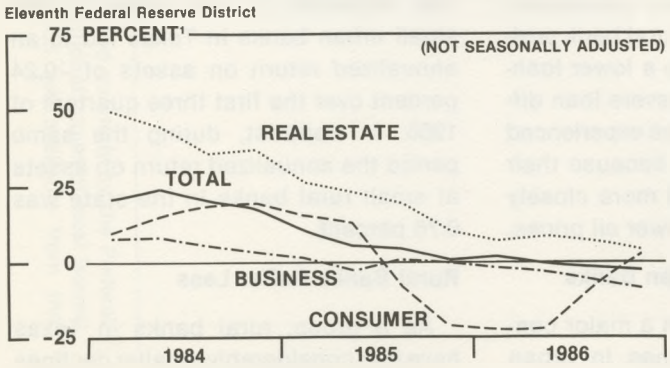
Table 1
SELECTED RATIOS FOR SMALL TEXAS AND U.S. BANKS

Ratio	Texas urban banks 1986[1]	Texas urban banks 1985	Change	Texas rural banks 1986[1]	Texas rural banks 1985	Change
	Percent			Percent		
Net income/ assets	-.24	.26	-.50	.75	.81	-.06
Net write-offs/ loans	1.80	1.41	.39	1.58	1.54	.04
Loan loss provision/ loans	2.27	1.77	.50	1.88	1.76	.12
	Other U.S. urban banks			Other U.S. rural banks		
Net income/ assets	.77	.70	.07	.78	.69	.09

1. Figures for the year are annualized from the first three quarters.
NOTE: Calculated for insured commercial banks with total assets under $100 million.
SOURCES: Board of Governors, Federal Reserve System.
Federal Reserve Bank of Dallas.

LOANS—LARGE WEEKLY REPORTERS

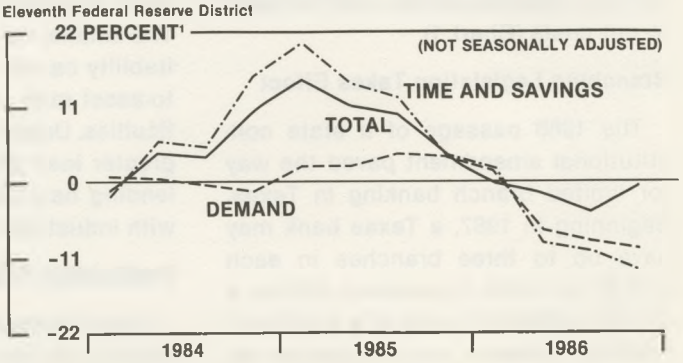
Eleventh Federal Reserve District



1. Percent change from same quarter in previous year.
SOURCE: Federal Reserve Bank of Dallas.

DEPOSITS—LARGE WEEKLY REPORTERS

Eleventh Federal Reserve District



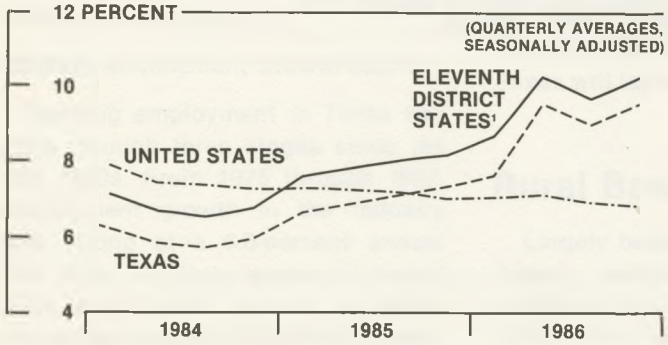
1. Percent change from same quarter in previous year.
SOURCE: Federal Reserve Bank of Dallas.

DISTRICT BRIEFS

The Eleventh District economy is showing some signs of a recovery. Weakness continues, however, in the important energy and construction sectors.

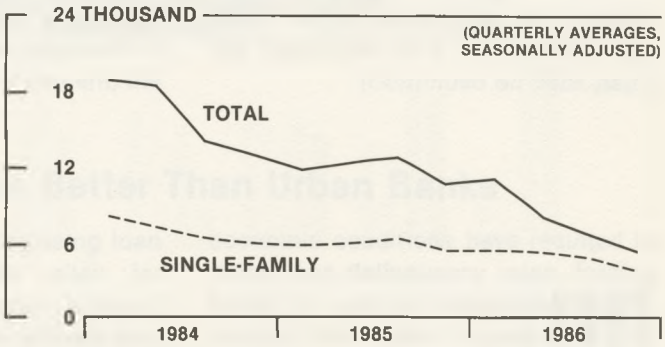
- In Texas, nonagricultural employment growth has been slow but steady since June. Gains in service-producing industries have more than offset the weaknesses in oil and gas extraction, manufacturing, and construction. The biggest employment gains have been accounted for by local government hiring. Personal and business services and finance, insurance, and real estate have also produced jobs at a steady rate.
- The employment picture is less bright in Louisiana, owing to the high concentration of energy industries. Although the rate of contraction has slowed, total nonagricultural employment in the state continues to decline. Among the three District states, New Mexico has proved to have the most resilient economy. The state's nonfarm employment grew at a robust rate in the fourth quarter of 1986.
- Construction activity has slipped markedly, mainly because residential building declined sharply in the latter months of 1986. Nonresidential construction remains steady after ending its steep decline earlier in 1986.
- Business conditions for the District's manufacturers have remained sluggish. The problems in the energy and construction sectors have adversely affected many durable goods industries.
- OPEC's actions to cut production and raise prices have led to marginally better conditions in the energy industry, but further improvement is questionable. Although the drilling rig count has edged up since September, the count slipped back slightly in January.
- The balance sheets of the District's large banks continue to reflect the weak economy. Both total loans and total deposits have contracted sharply.

UNEMPLOYMENT RATE



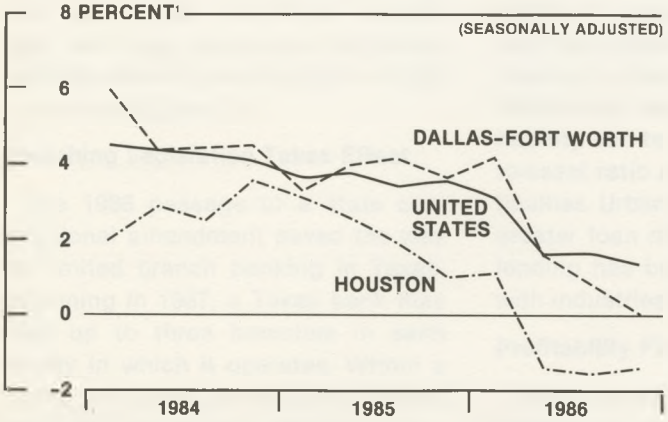
1. Louisiana, New Mexico, and Texas.
SOURCES: Texas Employment Commission.
U.S. Bureau of Labor Statistics.
Federal Reserve Bank of Dallas.

HOUSING PERMITS IN TEXAS



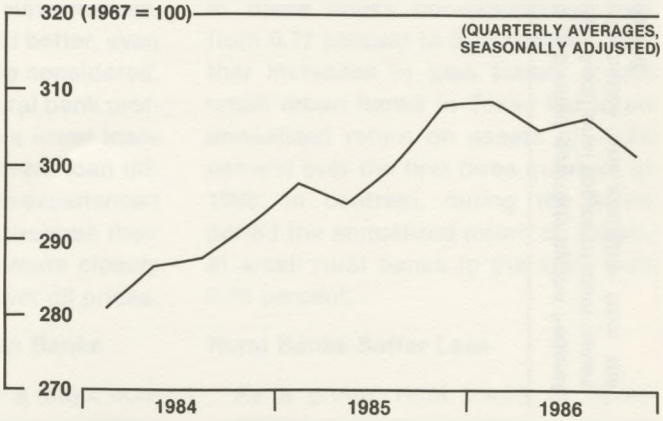
SOURCES: U.S. Bureau of the Census.
Federal Reserve Bank of Dallas.

CONSUMER PRICE INDEX



1. Percent change from same quarter in previous year.
SOURCES: U.S. Bureau of Labor Statistics.
Federal Reserve Bank of Dallas.

TEXAS INDUSTRIAL PRODUCTION INDEX



SOURCE: Federal Reserve Bank of Dallas.

Branching (cont.)

ing, fewer employees are needed. The number of locations will probably rise as branching allows banks to use location as another means of competing for customers.

Adjustment Will Take Time

Because branching is a new phenomenon in Texas, these adjustments will not take place all at once. Although further declines in banking employment are likely to result from the earnings problems facing Texas banks and from interstate and intrastate bank mergers, branching legislation will play a role as well. While other factors, such as the state's economic health and population growth, will affect the number of banks and banking locations, branching legislation will also have an important effect on these variables in Texas over the next year.

—Robert T. Clair and William T. Long III

Rural Banks (cont.)

in profitability over the past two years than have urban banks. Rural banks have held a smaller amount of loans relative to assets, making their overall profitability less sensitive to increasing loan problems. Moreover, they have had less difficulty with their loan portfolio than have urban banks. Between 1985 and the first three quarters of 1986, smaller increases in rates of loan write-downs and provision for loan losses led to a smaller decrease in profitability at small rural banks (Table 1). As a result, for the first three quarters of 1986, the return on assets at small rural banks in Texas was comparable to the return on assets reported by small banks, both rural and urban, in the rest of the nation. This contrasts sharply with the large difference between the negative return on assets at small urban banks in Texas and the return on assets at small banks elsewhere in the nation.

Differences Reflect Economic Trends

The large increase in loan losses at urban banks in Texas identifies a closer link between their loan portfolio and industries that have been hurt by lower oil prices. Profitability at rural banks has been partially spared by the regional economic downturn because a far greater proportion of their lending is related to the agricultural sector. Although agriculture has suffered, it has not experienced as dramatic a downturn as have Texas industries hurt directly or indirectly by lower oil prices, such as oil and gas extraction, energy-related manufacturing, and real estate. The Texas economy is expected to recover modestly this year, but bank profits tend to lag economic recoveries. Thus, profitability at urban banks in Texas will probably remain fairly low through most of 1987 and then show improvement.

—Jeffery W. Gunther

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