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

165 (INDEX, 1980 = 100)

FINANCE, INSURANCE, AND REAL ESTATE

BANKING


Chart 2
BANKING INDUSTRY CHARACTERISTICS IN RELATION TO POPULATION

8.0 EMPLOYEES PER 1,000 PEOPLE

TEXAS

SELECTED LIMITED-BRANCHING STATES


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

2.0 PERCENT OF ASSETS

NET INCOME

URBAN BANKS

RURAL BANKS

LOAN LOSS PROVISION

URBAN BANKS

RURAL 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.


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

<table>
<thead>
<tr>
<th>Ratio</th>
<th>Texas urban banks</th>
<th>Texas rural banks</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1986*</td>
<td>1985</td>
</tr>
<tr>
<td></td>
<td>1986*</td>
<td>1985</td>
</tr>
<tr>
<td>Net income/</td>
<td>-24</td>
<td>.26</td>
</tr>
<tr>
<td>assets</td>
<td>-.50</td>
<td>.75</td>
</tr>
<tr>
<td>Net write-offs/</td>
<td>1.60</td>
<td>1.41</td>
</tr>
<tr>
<td>loans</td>
<td>.39</td>
<td>1.58</td>
</tr>
<tr>
<td>Loan loss provision/</td>
<td>2.27</td>
<td>1.77</td>
</tr>
<tr>
<td>loans</td>
<td>.50</td>
<td>1.88</td>
</tr>
<tr>
<td>Other U.S. urban banks</td>
<td>.77</td>
<td>.70</td>
</tr>
<tr>
<td>Other U.S. rural banks</td>
<td>.07</td>
<td>.07</td>
</tr>
<tr>
<td>Net income/</td>
<td>.78</td>
<td>.69</td>
</tr>
<tr>
<td>assets</td>
<td>.09</td>
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</tr>
</tbody>
</table>

1. Figures for the year are annualized from the first three quarters.

NOTE: Calculated for insured commercial banks with total assets under $100 million.


LOANS—LARGE WEEKLY REPORTERS

Eleventh Federal Reserve District

75 PERCENT (NOT SEASONALLY ADJUSTED)

REAL ESTATE

TOTAL

BUSINESS

CONSUMER

1. Percent change from same quarter in previous year.

SOURCE: Federal Reserve Bank of Dallas.

DEPOSITS—LARGE WEEKLY REPORTERS

Eleventh Federal Reserve District

22 PERCENT (NOT SEASONALLY ADJUSTED)

TIME AND SAVINGS

TOTAL

DEMAND

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**

- 12 PERCENT
- (QUARTERLY AVERAGES, SEASONALLY ADJUSTED)
- UNITED STATES
- TEXAS

**HOUSING PERMITS IN TEXAS**

- 24 THOUSAND
- (QUARTERLY AVERAGES, SEASONALLY ADJUSTED)
- TOTAL
- SINGLE-FAMILY

**CONSUMER PRICE INDEX**

- 8 PERCENT
- (SEASONALLY ADJUSTED)
- DALLAS-FORT WORTH
- UNITED STATES
- HOUSTON

**TEXAS INDUSTRIAL PRODUCTION INDEX**

- 320 (1967 = 100)
- (QUARTERLY AVERAGES, SEASONALLY ADJUSTED)

1. Louisiana, New Mexico, and Texas.
SOURCES: Texas Employment Commission.
Federal Reserve Bank of Dallas.

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

1. Percent change from same quarter in previous year.
Federal Reserve Bank of Dallas.
Branching (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.

—Robert T. Clair and William T. Long III

Rural Banks (cont.)

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.

—Jeffery W. Gunther

The views expressed are those of the authors and do not necessarily reflect the positions of the Federal Reserve Bank of Dallas or the Federal Reserve System.