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Financial Insights

FIRM • FINANCIAL INSTITUTION RELATIONSHIP MANAGEMENT

CALENDAR OF EVENTS

March 11
Economic Roundtable
Abilene, Texas

March 25
Corporate Payments Council Meeting
Dallas, Texas

March 27
Community Depository Institutions Advisory Council Meeting
Dallas, Texas

April 15
Dialogue with the Dallas Fed
University of Mary Hardin-Baylor

April 24–25
Economic Roundtable
Midland, Texas

May 8
Economic Roundtable
Longview, Texas

May 22
Economic Roundtable
Las Cruces, New Mexico

For more information about these events, email FIRM at Dallas_Fed_Firm@dal.frb.org.

Bank Performance Strengthens

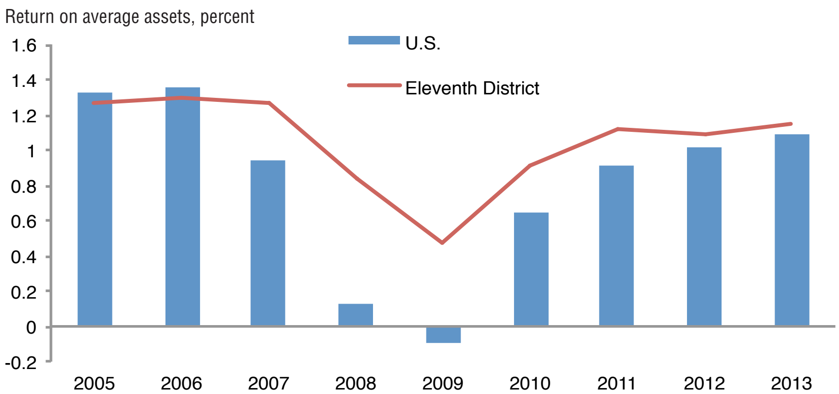
by Kelly Klemme

Bank performance, both nationwide and here in the Eleventh Federal Reserve District, has rebounded from the depths of the financial crisis.[1] Data for 2013 show ongoing improvement in profitability, asset quality and loan growth, with banks in the Eleventh District continuing to outperform their counterparts nationwide.

Upturn in Profitability Continues

Banks in the Eleventh District outperformed their national counterparts during the financial crisis, and this trend continued through 2013, although recent gains for U.S. banks have almost closed the gap (*Chart 1*). Eleventh District banks earned a return on average assets of 1.14 percent in 2013, compared with 1.09 percent for banks nationwide.[2] Both figures represent considerable improvement from 2009, when Eleventh District banks earned a return on average assets of only 0.47 percent and U.S. banks recorded a net loss.

Chart 1 Profitability Strengthens



SOURCE: Quarterly Reports of Condition and Income, Federal Financial Institutions Examination Council.

Chart 2 shows the contribution to improved profitability from the major income and expense components from 2009 to 2013. Within the Eleventh District, profitability, as measured by the return on average assets, increased 67 basis points from 2009 to 2013, despite a decline in both net interest income and noninterest income. For district banks, lower revenue was more than offset by a 106-basis-point decline in provision expense and a 53-basis-point decline in noninterest expense. For banks nationwide, the 118-basis-point improvement in profitability can be traced to a 174-basis-point decline in provision expense, as well as a smaller decline of 26 basis points in noninterest expense, both of which more than offset falling revenue.

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DALLAS FED RESOURCES

Economic Updates

Regional—"Regional Economy Builds Momentum in 2014"

National—"Moderate Growth Heading Into 2014"

International—"Global Economic Growth Acceleration Tempered by Deflation Risks"

Publications

Community Banking Connections

Dallas Beige Book
January 2014 Summary

Economic Letter
"Weakly Capitalized Banks Slowed Lending Recovery After Recession"

Southwest Economy
"Water Scarcity a Potential Drain on the Texas Economy"

Staff Papers
"Estimating the Output Gap in Real Time"

Surveys & Indicators

Agricultural Survey

Texas Business Outlook Surveys—Manufacturing, Service Sector, Retail

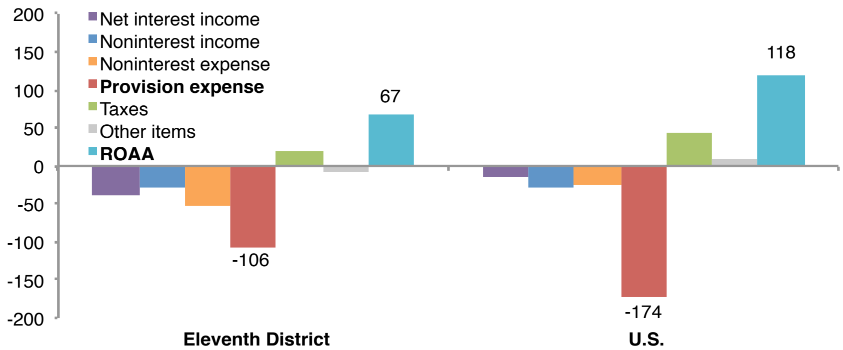
Texas Economic Indicators

Webcasts

Economic Insights: Conversations With the Dallas Fed
"2014 Economic Outlook"

Find other resources on the Dallas Fed website at www.dallasfed.org.

Chart 2 Lower Provision Expense Boosts Profitability

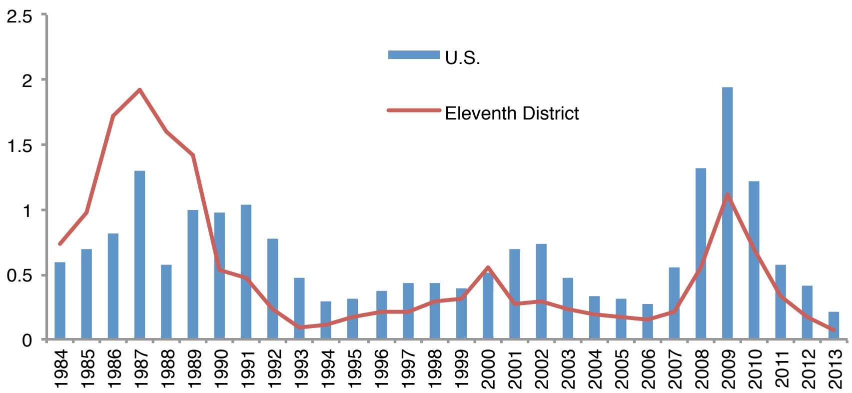


NOTE: Components of return on average assets (ROAA) are calculated as a percentage of average assets.

SOURCE: Quarterly Reports of Condition and Income, Federal Financial Institutions Examination Council.

Banks have made great strides in reducing their provision expense, which reached a historic low 0.07 percent of average assets for Eleventh District banks in 2013 and 0.20 percent of average assets for U.S. banks (*Chart 3*). As a result, future contribution to profitability from such reductions is unlikely, leading to concerns that profitability may stagnate if revenue does not start to increase.

Chart 3 Provision Expense Falls to Historic Lows



SOURCE: Quarterly Reports of Condition and Income, Federal Financial Institutions Examination Council.

Asset Quality Improving

Asset quality for banks nationwide and within the Eleventh District also has improved. Among Eleventh District banks, the percentage of loans noncurrent—past due 90 days or more or on nonaccrual status—fell to 1.3 percent at year-end 2013, compared with 2.6 percent for banks nationwide (*Chart 4*). These figures represent marked improvement from recent peaks of 3.2 percent among Eleventh District banks and a record 5.5 percent among U.S. banks. However, they are still high relative to precrisis lows of well below 1 percent.

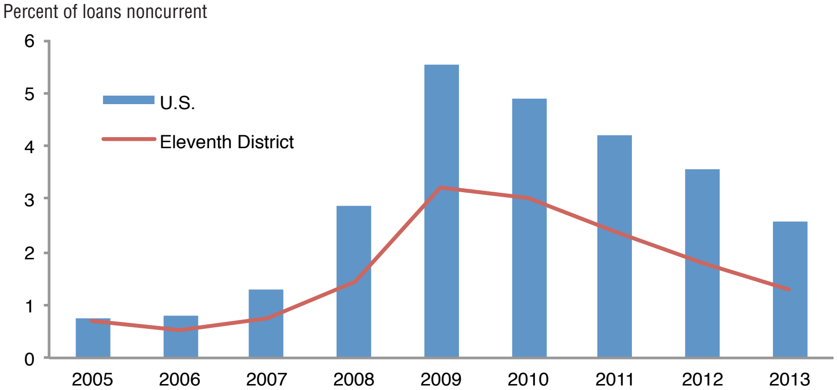
ABOUT *FINANCIAL INSIGHTS* AND FIRM

Financial Insights is published periodically by FIRM – Financial Institution Relationship Management – to share timely economic topics of interest to financial institutions.

FIRM was organized in 2007 by the Federal Reserve Bank of Dallas as an outreach function to maintain mutually beneficial relationships with all financial institutions throughout the Eleventh Federal Reserve District. FIRM's primary purpose is to improve information sharing with district financial institutions so that the Dallas Fed is better able to accomplish its mission. FIRM also maintains the Dallas Fed's institutional knowledge of payments, engaging with the industry to understand market dynamics and advances in payment processing.

FIRM outreach includes hosting economic roundtable briefings, moderating CEO forums hosted by Dallas Fed senior management, leading the Dallas Fed's Community Depository Institutions Advisory Council (CDIAC) and Corporate Payments Council (CPC), as well as creating relevant webcast presentations and this publication. In addition, the group supports its constituents by remaining active with financial trade associations and through individual meetings with financial institutions.

Chart 4 Noncurrent Loans Continue to Fall



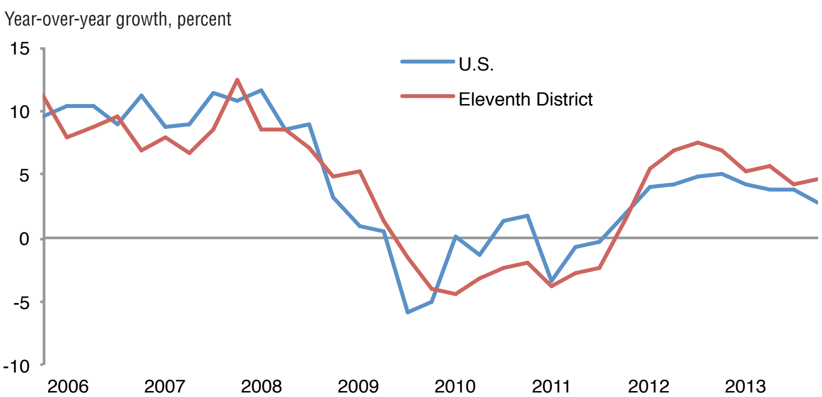
NOTE: Noncurrent loans are defined as loans past due 90 days or more plus loans on nonaccrual status.

SOURCE: Quarterly Reports of Condition and Income, Federal Financial Institutions Examination Council.

Loan Growth Resumes

As of year-end 2013, banks in this region and nationwide have recorded nine consecutive quarters of year-over-year loan growth, with growth among Eleventh District institutions continuing to outpace nationwide figures. Loans outstanding at Eleventh District banks expanded 4.7 percent in 2013, compared with 2.9 percent for all banks nationwide (*Chart 5*). Business loans—commercial and industrial loans and loans secured by nonfarm nonresidential real estate—grew at an even faster pace last year than overall lending. Year-over-year growth in business loans was 5.3 percent among Eleventh District banks and 5.6 percent for banks nationwide. Small business loans, which are defined on bank call reports as business loans with original amounts of $1 million or less, were also up at Eleventh District banks in 2013 but were generally flat for U.S. banks. At year-end 2013, Eleventh District banks' small business loans were 2.1 percent higher than at year-end 2012, compared with no growth for U.S. banks.

Chart 5 Lending Rebounds



SOURCE: Quarterly Reports of Condition and Income, Federal Financial Institutions Examination Council.

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Outlook for Profitability

Data for 2013 show continued improvement in profitability, asset quality and loan growth, with banks in the Eleventh District outperforming their counterparts nationwide. As the economic recovery gained steam and asset quality improved, banks boosted profitability by reducing provisions for future loan losses. Banks have also been successful at reducing their overhead, or noninterest, expense. However, the low interest rate environment, together with increased competition, has led to tighter margins and lower fee income, prompting some concern about the durability of bank profits going forward.

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NOTES
[1] The Eleventh Federal Reserve District consists of Texas, northern Louisiana and southern New Mexico.
[2] Data used in this article were obtained from the Federal Financial Institutions Examination Council Reports of Condition and Income from 1984 to current. Data for the Eleventh District banking industry have been adjusted for structural changes involving recent relocations of banks into the district.

Noteworthy Items

Federal Reserve Chair Janet Yellen provides the semiannual monetary policy report to Congress (Feb. 11, 2014)
Yellen addressed the longer-run goals and current monetary policy strategy of the Federal Open Market Committee (FOMC) in her recent report. According to Yellen, the FOMC members anticipate that economic activity and employment will expand at a moderate pace this year and next, the unemployment rate will continue to decline toward its longer-run sustainable level and inflation will move back toward 2 percent over coming years.

Community Outlook Survey results indicate that declines in the housing outlook discourage service providers in the Eleventh District (February 2014)
Explored in this report are issues of high population growth, including influx of college students who drive up costs, as well as the fact that many developers prefer projects with higher margins than affordable housing typically offers.

Richard Fisher provides remarks before the Dallas and Fort Worth chapters of Financial Executives International (Feb. 11, 2014)
Dallas Fed President Richard Fisher argues that fiscal policy is not only "not an ally of U.S. growth," it is its enemy. "It is my firm belief that the fault in our economy lies not in monetary policy but in a feckless federal government that simply cannot get its fiscal and regulatory policy geared so as to encourage businesses to take the copious amount of money we at the Fed have created and put it to work creating jobs and growing our economy."

Economic Insights: Conversations With the Dallas Fed '2014 Economic Outlook' (Feb. 12, 2014)
Evan F. Koenig, senior vice president and principal policy advisor, discusses the economic and policy prospects for the year ahead. He asserts that the unemployment rate will continue to decline, inflation will rise and GDP growth will remain strong. Mine Yücel, senior vice president and director of research, discusses the regional outlook, including a 3 percent increase in Texas jobs.