

Houston Business

A Perspective on the Houston Economy

Despite longstanding state restrictions on their activities, since 1985 a relatively small number of foreign agencies have staked out a significant presence in Texas, particularly in Houston.

Foreign Banks Bring Global Links to Houston

Houston's contingent of foreign banks is not well known to the public. These banks own no downtown buildings or supermarket branches, have no teller lines and don't bombard us with offers for certificates of deposit or home loans. To most of us, foreign banks are little more than names discreetly posted in the hallways of downtown skyscrapers: the Industrial Bank of Japan, Banque Paribas or the Arab Banking Corp. Their presence is somewhat mysterious, if only because they rarely touch our daily lives.

It is a mystery easily explained, however, as Texas forbids foreign banks from collecting retail deposits in the state and they have little interest in consumer or small business lending. Foreign banks throughout the United States operate almost exclusively in large wholesale banking markets. For example, they collectively made 29.9 percent of U.S. commercial and industrial loans in 1996, most of these earmarked for Fortune 500 and other very large companies. The General Accounting Office recently estimated that foreign banks fill half the U.S. market for contingent liabilities, such as loan commitments and standby letters of credit. These banks also hold 23 percent of the bank market for derivative products to hedge against fluctuations in foreign exchange rates, interest rates or commodity prices.

This article examines the role of foreign banks in the United States and, more specifically, in Houston. Why do they come to Houston? Just as elsewhere, they are here to fill a niche in wholesale banking: to lend to the capital-intensive oil, chemical, pipeline and other industries that operate from Houston; to serve many Houston companies in overseas markets, where foreign bank exper-

tise and experience are valued; to serve home-country customers; and to finance trade through the Port of Houston.

ORGANIZATION AND REGULATION

The first foreign banks in the United States were Canadian, entering New York and San Francisco during the 1850s and '60s. Banks from Hong Kong, France and the United Kingdom arrived before the turn of the century, and two dozen more banks—mostly European and primarily drawn to New York—operated here by the 1930s. With 77 percent of foreign bank assets in the United States in 1996, New York continues to be the center of foreign banking activity in this country.

Before 1978, only the states regulated foreign banks. The states often gave them distinct advantages over U.S. banks, which were subject to federal restrictions on deposit rate ceilings, interstate branching and reserve requirements. In 1978, the International Banking Act (IBA) was passed to provide “national treatment,” thus placing foreign bank operations on the same terms and conditions as U.S. banks. For the first time, federal licenses were made available to foreign banks. The IBA, which required foreign institutions to declare a “home state” in the United States, limited branching outside the home state. Nonbank activities, such as securities underwriting, were pulled under an umbrella similar to the Bank Holding Company Act and the Glass-Steagall Act. The IBA is widely credited for successfully leveling the playing field between U.S. banks and foreign competitors.

Additionally, in 1991, the Congress passed the Foreign Bank Supervision Enhancement Act, which authorized Federal Reserve oversight of foreign bank operations in the United States. This legislation set uniform financial and operating standards equivalent to those imposed on U.S. banks, and it prohibited foreign banks from accepting federally insured retail deposits of under \$100,000. Some retail activity continues under grandfathering provisions, as does the existence of some interstate branching by foreign banks following the passage of the IBA.

The IBA specifically authorized federally chartered banking institutions. A *federal branch* is an office or place of business where deposits are accepted, and it is broadly equivalent to a national bank. A *federal agency* cannot accept deposits, but it can engage in a full range of

lending and related activities. Although neither the IBA nor any other legislation specifically creates a *representative office*, it solicits loans and acts as a contact point between the foreign bank and the local business community. The IBA requires the registration of representative offices with the Comptroller of the Currency.

In Texas, state restrictions heavily influence foreign banking activity. The Texas Constitution specifically forbids deposit-taking activity by foreign banks, making federal or state charters of foreign branches impossible. Before 1985, Texas foreign bank activity was confined to nonbank subsidiaries, representative offices and Edge Act and agreement corporations that carry out business incidental to foreign business or international trade. In 1985, the Texas Legislature passed the Foreign Bank Agency Act, which specifically authorizes foreign banks to establish one agency in the state—that is, a place where loans can be booked and related activities performed. These agencies must be located in counties of 1.5 million or more (Dallas or Harris County), although there is no restriction on the number or location of representative offices.

Today, foreign agencies have established a permanent presence in the state. Texas is home to 16 foreign agencies and 27 representative offices, and Houston is the hub of much of the state's activity, with 14 agencies and 18 representative offices. With only two exceptions, all foreign banking offices operating in Dallas are paired with an agency or representative office in Houston. The scale of activity in Texas remains much smaller than in New York, with its 300 branches and agencies, and smaller than in Los Angeles, Chicago, Miami and Atlanta.

WHY ARE THEY HERE?

Although foreign banking growth has slowed in recent years, it soared in the United States throughout the 1980s. From 1977 to 1990, the number of branches and agencies in the United States grew from 77 to 600, and the asset growth rate of foreign banks was more than 20 percent per year. Initially, many of these banks followed their home clients to the United States, as the share of imports in U.S. gross domestic product increased from 7.3 percent in 1977 to 13.6 percent in 1996. However, for a variety of reasons, their role has grown far beyond service to home-country clients. The United States is a large, open market, offering political sta-

bility and a key global currency. Rising federal deficits have increased U.S. demand for foreign capital. And the U.S. trade deficit has left large dollar-denominated deposits abroad that can provide foreign banks with a funding base to enter the United States.

In 1996, foreign banks held about 13 percent of total U.S. bank assets. However, as indicated above, foreign banks have staked out a specialized role in wholesale banking markets, and their market penetration is much greater for commercial lending, contingent liabilities and various derivative products. Houston's foreign agencies are essentially loan production offices, as the activity on their books reflects. Figure 1 tracks the rapid growth of lending by foreign agencies in Houston—from \$44 million in 1985 to \$8.1 billion through the first three quarters of 1996.

Ninety-eight percent of the loans booked by Houston agencies during 1996 were commercial and industrial, with the remainder divided between real estate and other loans. Among the commercial loans, 95 percent were to U.S. addresses, most of which were large U.S. corporations that represent high-quality credits. These loans are most often obtained through purchase or syndications. In recent years, foreign banks have purchased as much as half of all U.S. syndications, although their role in these syndications is typically limited. Foreign banks may act as agent or coagent in syndications, but top U.S. banks are usually the originators.

The off-balance-sheet activity of Houston foreign agencies complements their role as loan

Figure 1
Loans on the Books of Houston Foreign Agencies

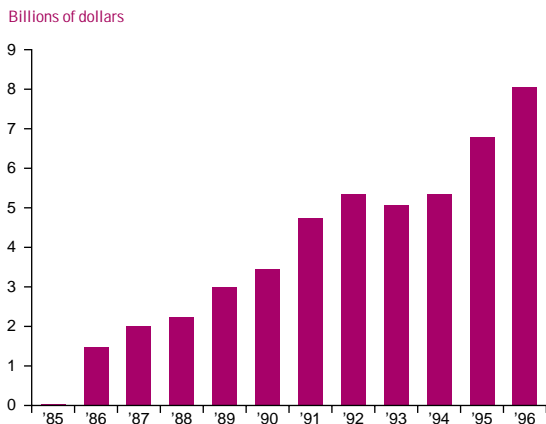
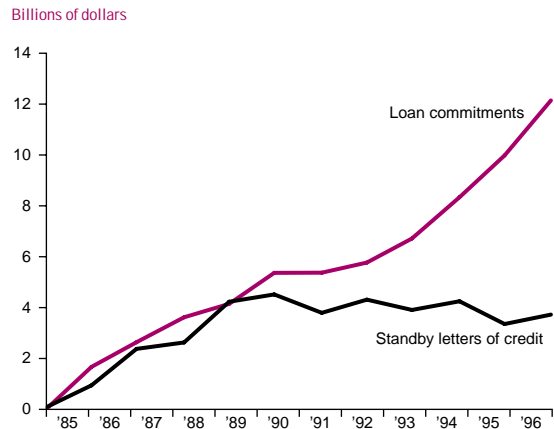


Figure 2
Large Non-Balance-Sheet Activities of Houston Foreign Agencies



NOTE: December 31 data, except 1996, which is September 30.

production offices. Figure 2 shows the growth of loan commitments and standby letters of credit to \$15.9 billion by third quarter 1996. The largest item was \$12.1 billion in commitments to make or purchase loans, which will be used for progress payments on construction loans, rotating or revolving credit arrangements, loan draws or similar transactions. The books also reflect \$3.5 billion in standby letters of credit, much of it to finance international trade, which represents a foreign agency's guarantee to a third party in case of a customer's default or nonperformance. Although nearly a billion dollars in interest rate swaps is carried on local agency balance sheets, most foreign exchange, interest rate and commodity derivatives are carried on the books of foreign branches in New York.

CONCLUSION

Despite longstanding state restrictions on their activities, since 1985 a relatively small number of foreign agencies have staked out a significant presence in Texas, particularly in Houston. In 1996, commercial lending by Houston foreign agencies represented 43.5 percent of such lending by Houston metropolitan area banks. Houston and Dallas agencies make up 22 percent of statewide commercial lending. Significant levels of off-balance-sheet activity supplement this lending and provide Houston and Texas with important links to the global economy.

— Robert W. Gilmer
Timothy K. Hopper

Healthy growth continues in 1997 led by the strong performance of Houston's oil and gas services and durable manufacturing. The Houston purchasing manager's index, a measure of strength in the industrial sector, soared by nearly 10 points in February to 62.6. A value greater than 50 indicates an expanding manufacturing sector, and these results reflect tremendous pressure on local inventories. Compared with the month previous, many more purchasing managers were reporting price increases and growing lead times.

RETAIL AND AUTO SALES

Local retailers successfully worked through their annual cycle of markdowns to clear out winter goods, which has left inventories in good shape and given retailers optimism about the spring season. They generally report running ahead of their annual plans. Auto dealers report sales are seasonally slow (typical of January and February), but they remain upbeat about the coming sales year.

ENERGY PRICES

Energy prices have lost steam in recent weeks, as warm weather in Europe and key domestic markets brought an early end to the heating season. After peaking at \$26 per barrel in early January, prices for light sweet crude were near \$20 at the end of February. Heating oil prices fell from over 70 cents per gallon to about 60 cents and pulled down crude prices just as they had pushed them up earlier in the winter. Natural gas prices also fell back to less than \$2 per thousand cubic feet; inventories are now 19 percent higher than at this time last year.

OIL SERVICES AND MACHINERY

The story was unchanged for oil services and machinery despite weaker energy prices. The usual new year dip in drilling was short-lived, suggesting that the industry is running at capacity. Oil service and machinery companies report that demand is growing and all available factory capacity and equipment are fully utilized. Shortages of workers with key skills, such as machinists and drilling crews, continue.

REFINING

The prices of heating oil and gasoline fell sharply in recent weeks, and both fell faster than the price of crude oil. The result was further pressure on margins, which have been weak for most of the winter. To prepare for the coming driving season, refineries began their annual switch to gasoline production, but warm weather drove up inventories of heating oil despite this temporary loss of capacity. Low gasoline inventories on the Gulf Coast have raised concerns about spring gasoline supplies.

PETROCHEMICALS

Petrochemical producers took significant losses over the winter as the price of natural gas and gas liquids soared. These high feedstock costs cut deeply into margins and led to a flurry of price increases for products such as polyethylene, polystyrene and polyvinyl chloride. Strong domestic and international demand allowed many of these price increases to stick. So as energy prices have fallen, petrochemical margins have improved substantially. There is now optimism that for the next few months, many petrochemicals may be highly profitable.

REAL ESTATE

January sales of existing homes were 6.2 percent higher than those of a year ago and set a record for the month. Brisk sales over the past 12 months have reduced the existing-home inventory by 4.5 percent, and nice homes in the right locations are selling at a premium. However, despite a strong market, new home sales were down 20 percent compared with those of a year earlier. Housing starts were 11 percent higher than those of last January.

The commercial real estate market's strength persists, following one of the best years for Houston real estate since the early 1980s. Speculative warehouse construction continues in several parts of the city, and suburban office building construction has become a reality in Fort Bend County and the Woodlands. Retail construction is one of the few weaknesses, as overconstruction during the past few years has curtailed new projects.

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