FDIC State Profile

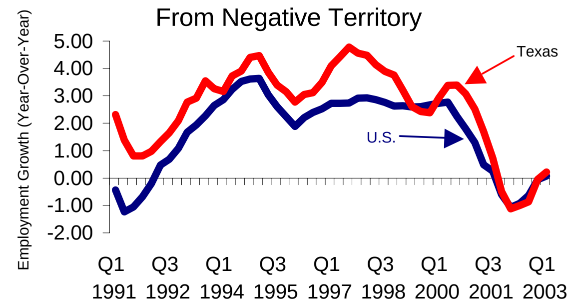
SUMMER 2003

Texas

Despite positive employment growth in Texas in first quarter 2003, a state budget deficit and continued woes in key industries, such as telecom, airlines, high-tech, and commercial real estate, could stall the state's recovery.

- Texas employment growth turned positive on a year-over-year basis in first quarter 2003, closely tracking the tepid U.S. recovery (see **Chart 1**). The Texas unemployment rate continues to climb, however, and stood at 6.6 percent in the first quarter, its highest level in nine years. Diversification away from energy and toward high-tech benefited the Texas economy greatly during the 1990s expansion. However, the downturn in the high-tech sector represents a major contributing factor in the state's sluggish economic performance since 2001.

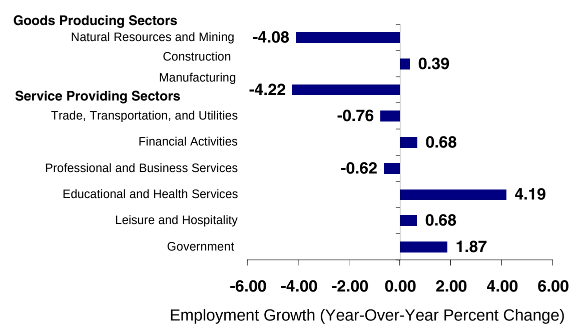
Chart 1: Employment Trends In Texas Closely Track U.S. Economy, With Texas Emerging From Negative Territory



Source: Bureau of Labor Statistics (Haver Analytics)

- Newly revised employment data for Texas indicates that the goods-producing sectors are causing most of the sluggishness in the state's employment performance. The Texas natural resource and mining and manufacturing sectors reported employment growth rates on a year-over-year basis of -4.08 percent and -4.22 percent, respectively, in first quarter 2003. The construction sector showed positive employment growth of 0.39 percent, primarily a reflection of the state's healthy residential construction market. The service-providing sectors have improved in four of the six categories reporting modest-to-moderate year-over-year employment gains (see **Chart 2**). Employment declines in trade, transportation, and utilities may intensify as American Airlines, the largest employer in the Dallas MSA, continues to struggle.

Chart 2: The Texas Goods Producing Sectors Continue To Lead Negative Employment Growth



Source: Bureau of Labor Statistics (Haver Analytics)

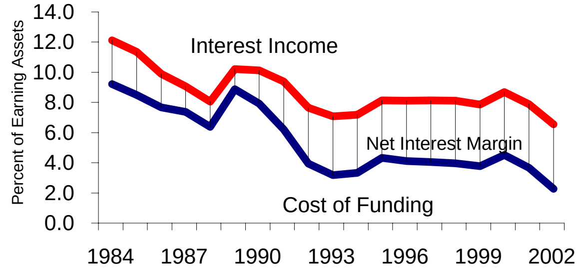
- Crude oil prices (West Texas Intermediate) surged in the early part of this year surpassing $37 a barrel (daily close) on the fears of a prolonged U.S.-Iraqi conflict and possible disruption to crude oil supplies. However, within weeks of the onset of Operation Iraqi Freedom, oil prices plunged $10 a barrel, dissipating what was left of the "war premium." Still, lean inventory levels of petroleum and refined products are expected to keep crude prices relatively high.
- Sluggish employment growth, a three-year decline in stock market values, contractions in the manufacturing and high-tech sectors, and soaring health care costs have undermined the Texas state budget. The 2003 budget deficit is estimated to be $1.8 billion, or 5.8 percent of the general state budget, and the deficit is projected to double in 2004. In response, the governor has called for a 7 percent reduction in most government programs. Areas with a large share of employment in local and state government will most likely be affected by these cuts.
- U.S. cotton acreage is expected to increase 2 percent according to USDA's March prospective planting reports. This should cause cotton prices to decline as global supply continues to outstrip demand. Cattle prices will be most affected by the prospects of inadequate rainfall. Lack of sufficient rainfall may cause many ranchers to prematurely liquidate herds, causing prices to decline. In January 2003, $3.1 billion in federal drought relief was approved. The amount of

federal drought relief earmarked for cattle producers, however, was only $250 million (8 percent of total funds available). This amount of aid does not sufficiently cover livestock producers' drought-related losses.

Texas insured institutions continue to report high commercial real estate exposures at a time when Texas commercial markets are showing signs of stress.

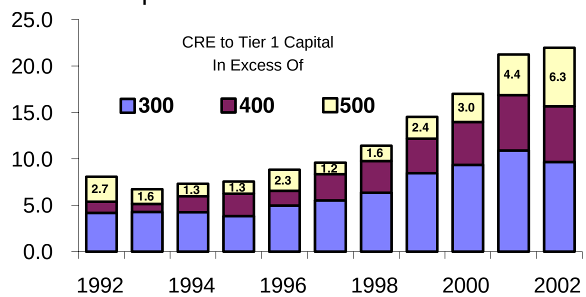
- Despite sluggishness in the state's economy, insured institutions based in Texas have performed well in general. The average return-on-assets (ROA), for the twelve months ending December 31, 2002 was 1.41 percent, up 17 basis points from a year ago, and the highest level on record. Lower funding costs are contributing to this trend. The cost of funding earning assets was 1.89 percent, the lowest level on record. However, not all insured institutions are reporting record profits. Community banks (assets less than $1 billion) reported a median ROA of 1.10 percent, below the 10-year average. The main reason for the lower ROA is that community banks have not developed other sources of noninterest income that have bolstered larger banks income statements. Past-due rates averaged 2.32 percent at year-end 2002, slightly lower than the prior year, and the core capital (leverage) ratio reached a ten-year high.
- Interest-rate risk is an area to watch. Historically, low short-term interest rates combined with an upward-sloping yield curve make the current interest rate environment ideal for bank profitability. Indeed, the average net interest margin for Texas institutions is at a 10-year high (see **Chart 3**). However, if short-term rates fall further, any drop in asset yield may not be matched by a drop in costs since deposit costs appear to be near effective floors.
- Texas insured institutions continue to report the highest level of commercial real estate (CRE) loans,[1] as a percent of Tier 1 capital, on record (see **Chart 4**). Despite this heightened exposure, CRE past-due and charge-off rates remain near five-year averages. The Dallas metro area has the highest office vacancy rate in the nation at 26.3 percent as of December 31, 2002. Austin ranks third at 24.3 percent. Both Fort Worth and Houston office vacancy rates are slightly above the national average. Industrial, retail, multifamily, and hotel property types are showing similar signs of weakness. Consequently, rental rates are falling in major markets, putting pressure on cash flow as leases renew. On the other hand, low interest rates have allowed many projects to refinance, thereby improving cash flow. While most banks and thrifts headquartered in Texas are not lenders to the largest CRE projects, rising vacancies and increasing unemployment may have negative implications for community bank loan portfolios

Chart 3: Texas Institutions Report The Highest NIM In Almost 20 Years As Short-Term Interest Rates Fall



Source: Bank and Thrift Call Report, Data Year End

Chart 4: Texas Institutions Still Face High Levels Of Commercial Real Estate Exposure Despite Weak CRE Fundamentals



Source: Bank and Thrift Call Reports, Data as of Year End

- Texas per capita bankruptcy rates continue to hover near record levels, albeit below national averages. Moreover, continued slow employment growth does not suggest a quick recovery. While total past-due and charge-off rates have remained stable, median consumer charge-off rates for Texas insured institutions are beginning to rise.
- Agricultural banks are beginning to show some signs of stress. While profitability held steady at the ten-year average, past-due rates have increased to the highest level in five years. Historically, high government subsidy levels have helped to mitigate the effects of low commodity prices and drought-related losses. Subsidies have also helped bolster farm land values. However, dependence on subsidies could pose problems for producers and agricultural lenders if future payment levels decline at the same time commodity prices are low.

[1] Commercial real estate is defined as nonresidential real estate, multifamily, plus construction and development.

Texas at a Glance

General Information	Dec-02	Dec-01	Dec-00	Dec-99	Dec-98
Institutions (#)	715	735	759	806	851
Total Assets (in thousands)	216,919,847	199,335,895	233,380,019	240,138,031	232,557,270
New Institutions (# < 3 years)	16	20	27	38	31
New Institutions (# < 9 years)	53	53	50	48	42

Capital	Dec-02	Dec-01	Dec-00	Dec-99	Dec-98
Tier 1 Leverage (median)	8.97	8.81	9.06	8.94	8.84

Asset Quality	Dec-02	Dec-01	Dec-00	Dec-99	Dec-98
Past-Due and Nonaccrual (median %)	2.24%	2.19%	2.04%	1.90%	2.31%
Past-Due and Nonaccrual >= 5%	120	130	102	112	146
ALLL/Total Loans (median %)	1.25%	1.21%	1.18%	1.18%	1.23%
ALLL/Noncurrent Loans (median multiple)	1.71	1.84	2.04	2.10	1.95
Net Loan Losses/Loans (aggregate)	0.42%	0.42%	0.36%	0.45%	0.47%

Earnings	Dec-02	Dec-01	Dec-00	Dec-99	Dec-98
Unprofitable Institutions (#)	45	54	34	46	47
Percent Unprofitable	6.29%	7.35%	4.48%	5.71%	5.52%
Return on Assets (median %)	1.11	1.06	1.20	1.12	1.14
25th Percentile	0.71	0.66	0.86	0.73	0.80
Net Interest Margin (median %)	4.48%	4.44%	4.75%	4.55%	4.59%
Yield on Earning Assets (median)	6.37%	7.60%	8.29%	7.71%	7.93%
Cost of Funding Earning Assets (median)	1.90%	3.16%	3.51%	3.15%	3.30%
Provisions to Avg. Assets (median)	0.20%	0.16%	0.16%	0.14%	0.13%
Noninterest Income to Avg. Assets (median)	0.89%	0.89%	0.88%	0.87%	0.86%
Overhead to Avg. Assets (median)	3.42%	3.42%	3.48%	3.42%	3.40%

Liquidity/Sensitivity	Dec-02	Dec-01	Dec-00	Dec-99	Dec-98
Loans to Deposits (median %)	63.22%	62.37%	62.14%	59.04%	55.22%
Loans to Assets (median %)	54.66%	54.27%	54.65%	51.70%	48.85%
Brokered Deposits (# of Institutions)	57	49	46	39	37
Bro. Deps./Assets (median for above inst.)	3.31%	1.91%	2.01%	2.20%	2.10%
Noncore Funding to Assets (median)	16.55%	16.46%	15.92%	15.38%	13.94%
Core Funding to Assets (median)	72.62%	72.76%	73.04%	74.04%	75.12%

Bank Class	Dec-02	Dec-01	Dec-00	Dec-99	Dec-98
State Nonmember	294	301	311	334	356
National	332	342	358	380	403
State Member	43	43	40	39	39
S&L	11	12	10	11	15
Savings Bank	12	13	16	15	15
Mutually Insured	23	24	24	27	23

MSA Distribution	# of Inst.	Assets	% Inst.	% Assets
No MSA	374	33,866,679	52.31%	15.61%
Dallas TX PMSA	79	45,504,020	11.05%	20.98%
Houston TX PMSA	50	28,821,740	6.99%	13.29%
Ft Worth-Arlington TX PMSA	40	7,884,359	5.59%	3.63%
Austin-San Marcos TX	20	2,288,434	2.80%	1.05%
San Antonio TX	18	50,274,930	2.52%	23.18%
Longview-Marshall TX	12	1,551,320	1.68%	0.72%
Killeen-Temple TX	11	2,430,430	1.54%	1.12%
Waco TX	11	1,619,891	1.54%	0.75%
McAllen-Edinburg-Mission TX	10	7,164,598	1.40%	3.30%
Lubbock TX	10	5,558,996	1.40%	2.56%
Corpus Christi TX	8	1,085,057	1.12%	0.50%
Brazoria TX PMSA	7	745,198	0.98%	0.34%
Sherman-Denison TX	7	1,107,234	0.98%	0.51%
Galveston-Texas City TX PMSA	7	1,595,456	0.98%	0.74%