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Condition of the Texas State Banking System

Texas Department of Banking
Department of Savings and Mortgage Lending
Financial Data as of June 30, 2021





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<u>Symbols Used Throughout this Report:</u>	<u>Abbreviations Used Throughout this Report:</u>
↑ Improving or strong conditions	FDIC – Federal Deposit Insurance Corporation
↓ Deteriorating or weak conditions	OCC – Office of the Comptroller of the Currency
↕ Mixed conditions	FRB – Federal Reserve Board

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FDIC – Federal Deposit Insurance Corporation
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ECONOMIC REVIEW AND OUTLOOK

The Texas economy faced challenges on two fronts at the beginning of 2021. As the pandemic began its second year, a disastrous February winter storm—eventually branded Winter Storm Uri—briefly brought business activity to a crawl before the economy rebounded in quarter two.

The state's economic momentum slowed quarter-over-quarter entering 2021. Data revisions revealed steeper job losses than initially estimated during the second half of 2020, and employment growth plateaued in January 2021 as COVID-19 cases and initial jobless claims spiked after the holidays.

Economic activity was further stymied in February when the winter storm temporarily sent supply chains into disarray and the unemployment rate back to December 2020 levels. Manufacturing, construction, professional and business services, leisure and hospitality, and government sectors all posted losses.

The Texas economy began to improve in March as Texas added 99,000 jobs, a modest 13,000 in April, and another 34,400 in May, bringing the unemployment rate down to 6.5%.

Texas' economy extended its year-long recovery in June according to the Federal Reserve Bank of Dallas (FRB Dallas). Loan demand continued to expand at a robust pace, pushing up overall loan volumes and overall sentiment regarding general business activity improved. Eighty percent of respondents to an FRB Dallas survey reported an improvement based in part on stronger demand from borrowers for new government-backed lending programs discussed below.

Recently, some Texas bankers expressed concerns over commercial real estate lending. Commercial office space was showing signs of weakness prior to COVID-19 and the pandemic only worsened the situation, with some reporting a 37% decline in price per square-foot.

Demand remained sluggish and vacancies ticked up further, with vacancy rates as high as 30% in some central business district locations. Strip centers, conversely, have seen improvement in occupancy, where rates are lower and more negotiable.

Meanwhile, hotels were cited by others as experiencing the highest risk. Leisure travel has increased significantly, but business travel has yet to recover. Hotels dependent on this clientele, especially those attached to convention centers, are experiencing the greatest difficulties. With the shutdown of most conventions, these hotels may still be 12 to 24 months away from seeing normal cash flows.

All through this turbulent time, however, the state maintained its reputation for being an excellent place to do business. In April, the state was again named the "Best State for Business" in an annual survey conducted by *Chief Executive* magazine for a record-breaking 17th year in a row.

Nationally, the U.S. economy maintained steady growth. According to the U.S. Bureau of Labor Statistics, the Consumer Price Index (CPI) rose in quarter one 2021 at its fastest pace since the onset of the pandemic, yet its 1.4% year-over-year (YOY) increase remained lower than the Federal Reserve Board's 2% target. However, the CPI ended June 2021 5.3% higher YOY, not seasonally adjusted, as possible signs of inflation began to appear.

Real gross domestic product (GDP) increased at an annual rate of 6.3% in the first quarter of 2021, according to the U.S. Department of Commerce, up from a revised 4.3% in the fourth quarter of 2020. The economy continued growing in quarter two, with the GDP up another 6.6%, as government assistance payments in the form of loans to businesses and grants to state and local governments increased and direct economic impact payments to households decreased.

The Paycheck Protection Program (PPP), initially launched in April 2020 through the Coronavirus Aid, Relief and Economic Security Act and administered through the Small Business Administration, reopened January 11, 2021, initially to first-time borrowers, with second-time borrowers able to apply two days later.

Congress reauthorized the program with \$284 billion in funding as part of its \$900 billion coronavirus stimulus package passed in December 2020. In addition to the \$41.3 billion received in 2020, Texas businesses received an additional \$22.3 billion in PPP loans for a total of \$63.6 billion before officially closing on May 31, 2021. Further discussion on the impact of the coronavirus on the examination process for both agencies is offered under the [Supervisory Concerns](#) section of this report.

Unfortunately, COVID-19 cases began another steep increase in July, as the highly contagious Delta variant – first identified in India in December – swept rapidly through that country and Great Britain before reaching the U.S., where it became the dominant variant.

Other issues challenging the U.S. economy at the end of quarter two included a severe labor shortage, especially in the Construction, Hospitality and Leisure and Entertainment sectors; and disruptions in supply chains which led to rapid increases in commodity prices.

STATE-CHARTERED BANKING PROFILE (DEPARTMENT OF BANKING)

There were 216 Texas state-chartered banks as of June 30, 2021, as compared to the 217 reported as of December 31, 2020. The number of state banks was reduced by one during the reporting period due to the net effect of the following banking transactions:

- Two state banks merged with and into other Texas state-chartered banks; and
- One national bank converted into a Texas state-chartered bank.

During the same period, the Department processed 128 filings related to banks, with approximately 69% involving the opening and closing of offices and loan production facilities, 15% involving bank identification and corporate governance issues, 14% involving changes in ownership/control or chartering authority, 1% involving subsidiary formations, and 1% involving foreign bank activity.

While the number of Texas state-chartered banks decreased, the overall asset size increased from \$345.3 billion at year-end 2020 to \$365.1 billion as of June 30, 2021. The \$19.8 billion in asset growth was almost entirely internally related, \$19.4 billion, and the remainder, \$0.4 billion, due to merger and acquisition activity.

STATE-CHARTERED THRIFT PROFILE (DEPARTMENT OF SAVINGS AND MORTGAGE LENDING)

State-chartered thrift assets under the Department's jurisdiction totaled \$414.65 billion as of June 30, 2021, an increase of \$19 billion or 4.8% over the prior six months due to the continued growth. Through June 30, 2021, state thrifts had \$1.4 billion in year-to-date net income, which is comparable to the second six months of 2020. Increased profitability occurred in 70.8% of the thrift institutions through June 2021, due to the increased size of the industry, decreased cost of funds, and slight decrease in overhead expenses. Thrifts' net interest margin (NIM) as an industry total has decreased to 1.4%; however, this is due to outliers within the portfolio.

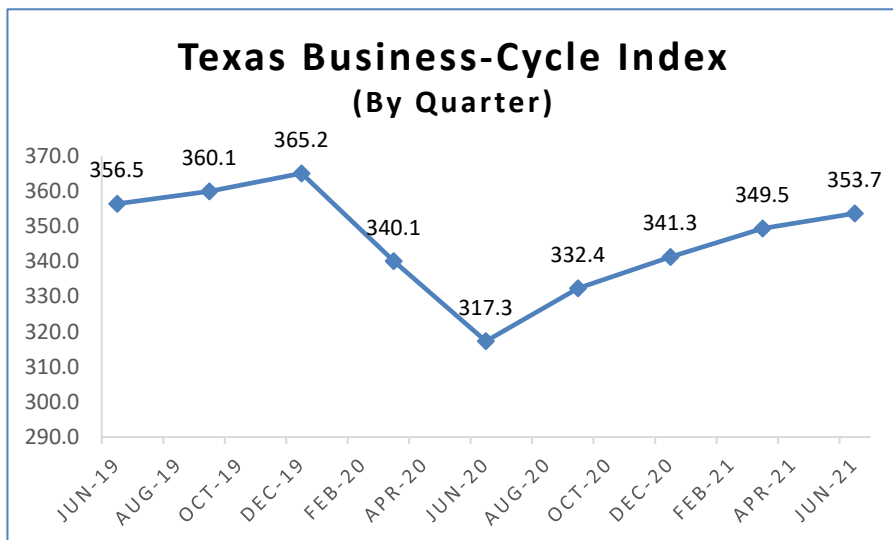
Total loans and leases increased \$5.1 billion or 12.8% compared to the prior six months, totaling \$44.7 billion as of June 30, 2021. The increase in total loans primarily consisted of first lien residential real estate loans, and consumer loans. The level of non-current assets plus other real estate owned to total assets remains low in state-chartered thrifts at 0.04% of total assets, a decrease from 0.07% as of six months ago. Despite these low levels, state and federal regulators continue to monitor past due and nonaccrual loans, as well as foreclosed real estate. Thrifts' other real estate owned decreased \$2.57 million or 24.5% since December 2020, totaling \$7.93 million as of June 30, 2021.

The Department continued to receive and process applications, including administering one state savings bank charter/merger, one conversion application, one reorganization application, two holding company registrations, and various other applications during the past six months.

TEXAS ECONOMIC PROFILE

In the first six months of 2021, the Texas economy began a comeback from the COVID-19 pandemic, but its status remained uncertain by the end of the second quarter.

The state's economy entered the first quarter of 2021 with less momentum than was experienced in the fourth quarter of 2020. The Lone Star State's unemployment rate eased slightly to 6.8% at the beginning of the first quarter, down from 6.9% in December 2020, yet still higher than the national rate of 6.3%.



Source: Real Estate Center at Texas A&M University

Economic activity within the state rose 10.5% in January on a seasonally adjusted annualized rate (SAAR) as indicated by the FRB Dallas Texas Business-Cycle Index; however, the rate of growth decelerated to its slowest pace since July 2020.

Meanwhile, factory activity softened in January, according to respondents to the FRB Dallas Texas Manufacturing Outlook Survey. The production index, a measure of state manufacturing conditions, fell from 26.8 to 4.6, indicating a sharp decline in output growth.

Service sector activity was also down month-over-month in January, according to the FRB Dallas Texas Service Sector Outlook Survey. The Survey's revenue index, a key measure of state service sector conditions, dropped from 5.5 in December to 0.8 in January. Meanwhile, the FRB Dallas Texas Retail Outlook Survey reported the sales index, fell from 2.9 to -1.0.

The energy sector began showing new life at the beginning of the first quarter, though the level of activity remained below YOY levels. The oil rig count rose, and drilling and well completion activity continued to improve. Respondents to an FRB Dallas survey in the exploration, production, and oilfield services reported stronger levels of business activity for the first time since the onset of the COVID-19 pandemic.

After February's winter storm, the economy began to gather momentum, as the distribution of COVID-19 vaccines began to ramp up statewide and businesses reopened. Texas added 99,000 jobs during March, a modest 13,000 in April, and another 34,400 in May.

The Texas Business-Cycle Index rose 7.2% as robust hiring resulted in solid first-quarter payroll growth, although unemployment figures remained persistent at 6.9%.

Factory activity expanded at a notably faster pace, surging 28 points to 48.0, its highest reading in the survey's 17-year history, while activity in the service sector increased at its fastest pace since mid-2019, jumping 19 points over the previous month to 21.6.

By April, the Texas Business-Cycle Index stabilized, growing 7.3%, an indication the state's economy was still on the path to recovery despite a slowdown in hiring. The state's nonfarm unemployment rate

managed to edge slightly down to 6.7%, despite adding just 13,000 jobs. Activity in the service sector increased at its fastest pace fastest since late 2014, while the manufacturing production index fell 14 points to 34.0.

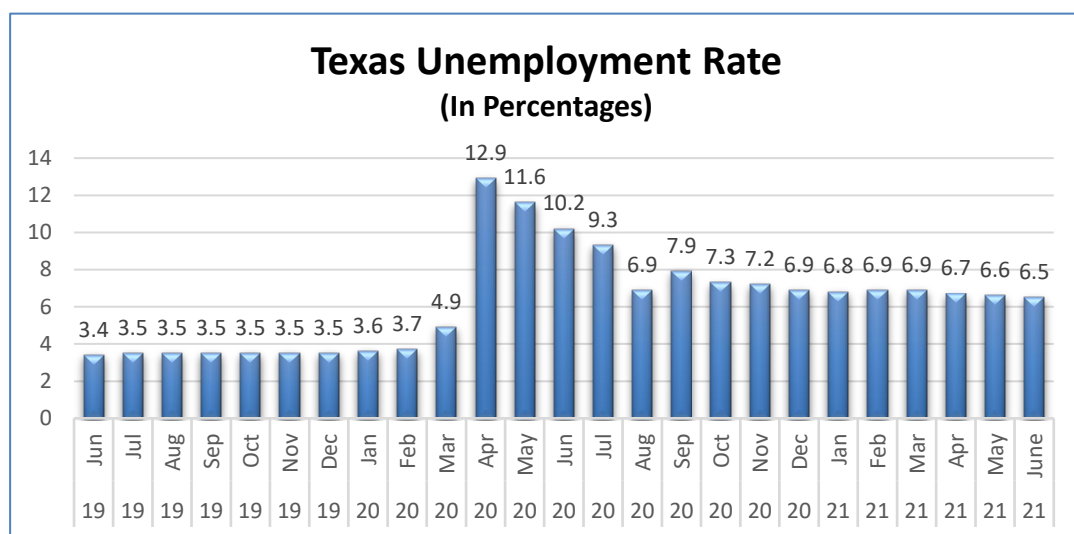
The state's economy continued to expand for the third consecutive quarter in May, according to the Texas Business-Cycle Index, which accelerated 8.2% amidst a surge in hiring. Manufacturing output faltered, however, as the production index, a key measure of state manufacturing conditions, fell 18 points to 15.7. Activity in the Texas service sector continued to increase, though at a slightly reduced pace, as the revenue index dipped from 26.1 in April to 23.9 in May.

The Texas Business-Cycle Index rose 7.8%, as factory activity expanded at a faster pace, according to the Texas Manufacturing Outlook Survey. The production index increased 14 points to 29.4, a reading indicative of strong output growth. The pace of growth in the service sector slowed in June, meanwhile, as the revenue index declined from 23.9 in May to 16.7 in June. The sales index managed to increase one point but remained in negative territory at -5.3.

With a rapid rise in COVID-19 cases in the summer due to the Delta variant of the virus, there is uncertainty on what impact the Delta variant will have on the state's economy.

EMPLOYMENT

Texas nonfarm employment rose for the ninth consecutive month in January, adding 30,800 jobs, which lowered the unemployment rate slightly to 6.8%, down from 6.9% in December 2020.



Source: U.S. Bureau of Labor Statistics

Employment gains were led by the professional and business services sector (adding 13,700 jobs), financial activities (adding 8,800 jobs), and trade, transportation, and utilities (adding 7,100 jobs).

Hiring hit a bump in February, however, as Winter Storm Uri disrupted supply chains and significantly reduced economic activity, resulting in nearly every sector of the economy posting a loss. The seasonally adjusted Texas unemployment rate rose once again to 6.9%.

By the end of the first quarter, the unemployment rate had stalled at 6.9%, still higher than the national figure of 6.0%, and significantly higher than the state's unemployment pre-pandemic levels of 3.7%. Nevertheless, the state managed to gain 99,000 total nonagricultural jobs in March, marking increases in 10 of the last 11 months.

Private sector employment increased 106,600 for the month, a solid rebound fueled in part by the relaxation of capacity restrictions for businesses on March 10 and the quickening pace of distribution of COVID-19 vaccines.

However, nonfarm employment added just 13,000 jobs in April, yet the state's unemployment rate managed to creep down to 6.7%, a figure still greater than the national rate of 6.1%. Industry sectors gaining the most jobs YOY at the beginning of quarter two included leisure and hospitality (up a

remarkable 46.5%), trade, transportation, and utilities (up 9.6%) and professional and business services (up 9.1%).

The only sector that remained in negative territory was mining and logging, which lagged at -11.6% YOY but still showed an improvement from January's -24.3% figure.

The Lone Star State's economy added 42,000 jobs in May, accelerating 4.8%. Texas' unemployment rate declined for the second straight month as initial filings for unemployment insurance claims decreased for the second consecutive month in May to 110,400. On a weekly basis, claims ended the month at their lowest reading since March 2020.

By June, the unemployment rate had dropped significantly YOY, from 10.2% to 6.5%, solid proof the state's economy was recovering its footing. Texas added another 55,800 jobs that month, a 0.4% increase over the previous month. Preliminary figures from the U.S. Bureau of Labor Statistics indicated hiring in the mining and logging sector rebounded at the end of quarter two, growing 6.9% YOY. In fact, every sector of the economy ended the second quarter in positive territory YOY for the first time in 2021, except for the construction sector, which remained unchanged.

POPULATION

According to the 2020 U.S. Census, the Texas population is now an estimated 29.1 million, up from 25 million in April 2010. This represents an increase of 16.4%, or 4 million residents, more than the total population of the state of Oklahoma.

Texas' population rose 1.3% compared with nationwide growth of 0.4%. The rate of increase, however, has made little headway since decelerating to a three-decade low in 2018. Regardless, the state ranked fifth in the nation in terms of percentage change and first in number of residents added (374,000).

The only states to exceed Texas' population boom in percentage terms over the past ten years were Utah and Idaho, which grew 18.4% and 17.3%, respectively.

The Lone Star State experienced the largest population increase over the decade by a wide margin, followed by Florida (up 2.7 million), California (up nearly 2.3 million) and Georgia (up 1 million). Three states saw their population decline over this timeframe: West Virginia, Illinois, and Mississippi.

Much of this recent movement has been from the densest cities to more affordable areas. Data from the moving equipment and storage rental company U-Haul shows that Tennessee had the largest net gain last year based on one-way truck movements, followed by Texas and Florida. Texas has ranked first or second for the past five years, due largely to its healthy economy and business-friendly environment.

The U.S. grew by only 7.4% over the last decade, meanwhile, the slowest growth rate of any decade in the nation's history with the sole exception of the Great Depression decade of the 1930s, when the population expanded by just 7.3%.

The Census also revealed the number of Texas residents under age 18 rose by nearly 413,000 between 2010 and 2020, an increase of 6%. The Perryman Group notes this robust growth in the number of young people puts the state in an excellent position for future economic expansion opportunities.

However, the single most important aspect of Texas' increased population is the two additional representatives in Congress it will gain as a result. Other states will add one (Colorado, Florida, Montana, North Carolina, and Oregon), while others will lose one (California, Illinois, Michigan, New York, Ohio, Pennsylvania, and West Virginia).

In all, seven seats in the U.S. House of Representatives were reallocated, with only Texas adding more than one seat. The state will now have a 38-member delegation in Congress, greater than those of the 17 least-populous states combined. Combined with its two Senate seats, Texas will have a 40-vote presence in the Electoral College by the 2024 presidential election.

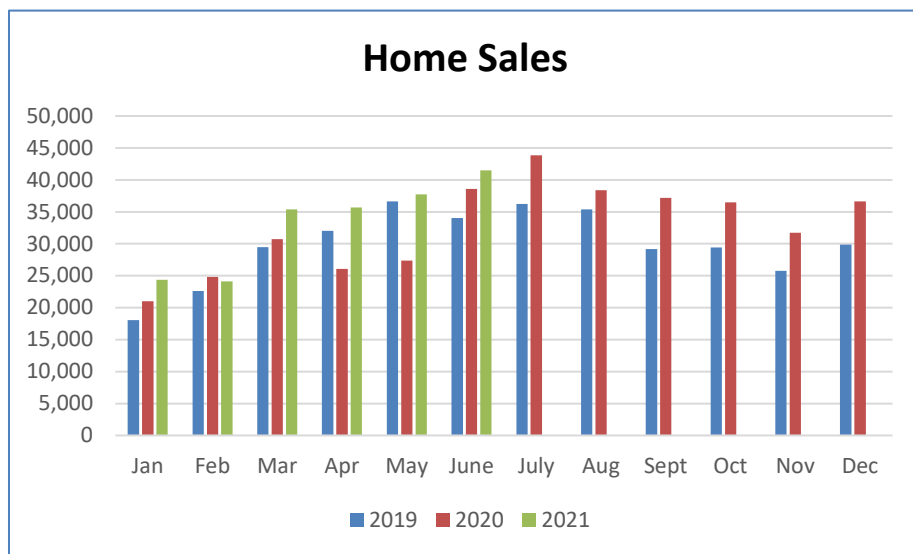
HOUSING

Total housing sales fell 6.4% in the first quarter of 2021 compared to the previous quarter amid rising mortgage rates, higher input prices, and weather-related disruptions that stalled business activity in February. Sales dropped 16.1% that month alone as Winter Storm Uri swept across the state, causing widespread power outages and interrupting supply chains.

However, new-home sales still rose 4.6% quarter-over-quarter, illustrating a strong demand for new construction. Total single-family housing starts inched down from its post-Great Recession high of 34,600 groundbreakings in quarter four 2020 but remained 25.1% higher YOY.

Overall housing demand remained healthy during the first quarter but constrained inventories at the lower end of the price spectrum – combined with soaring lumber, copper, concrete, and other commodity prices – contributed to median home prices accelerating 14.1% YOY in March to a record-breaking \$283,200.

The FRB Dallas Texas Residential Construction Cycle (Coincident) Index, which measures current construction levels, increased to a 12-month high during the first quarter on improved industry employment, wages, and construction values.



Source: Real Estate Center at Texas A&M University

Interest rates inched up, while home-purchase applications were down 12.4% year-to-date despite a slight increase in March from lowered activity the previous month resulting from the winter storm. The Residential Construction Leading Index rose to an all-time high to close the first quarter.

Total housing sales entered April falling an additional 2.5% on top of the first-quarter decline, a deceleration resulting from limited inventories for lower priced homes. Rising mortgage rates also impacted affordability, especially for first-time homebuyers. Conversely, sales for homes priced greater than \$400,000 increased for the second straight month.

Total housing sales fell 2.0% in quarter two as inventories remained relatively low due to the continued scarcity in affordable existing homes. The state's median home price increased for the sixth consecutive month, accelerating 19.3% YOY to a record-breaking \$298,013 in June. Overall, housing demand remained healthy but was hindered by depleted inventories, which pushed median home-price growth into double-digit territory for the first half of the year.

OIL AND GAS

The oil and gas (O&G) industry entered the first quarter of 2021 having made a remarkable rebound from the previous year, when the coronavirus pandemic caused crude oil prices to plummet, sending the sector into a tailspin.

Activity expanded strongly, according to O&G executives responding to the FRB Dallas Energy Survey. The business activity index, the survey's broadest measure of conditions facing energy firms, soared from 18.5 in fourth quarter 2020 to 53.6 in the first quarter of 2021, its highest reading in the survey's five-year

history. Exploration and production (E&P) and oilfield services firms both experienced a strong expansion in activity.

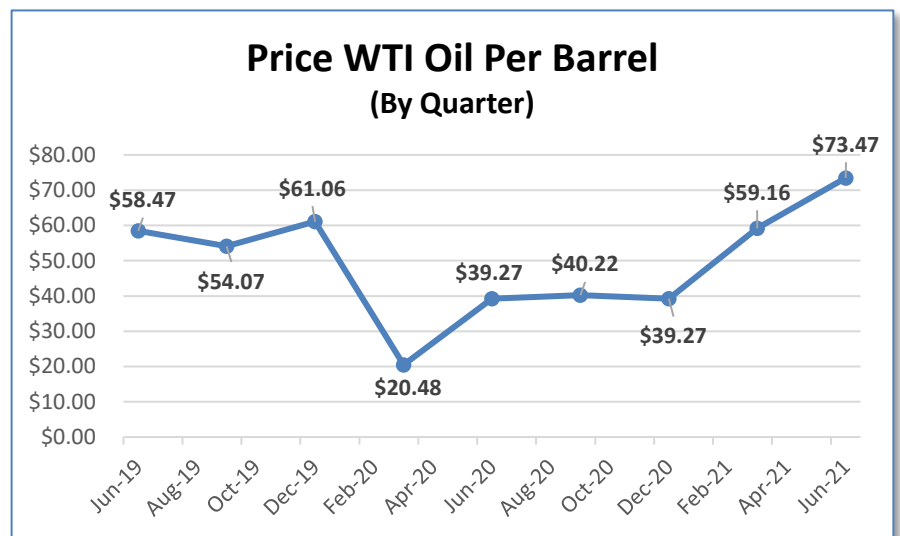
E&P executives surveyed reported increased production, as the oil production index rose to 16.3 in the first quarter from 1.0 in the previous quarter. Similarly, the natural gas production index moved into positive territory, increasing 18 points to 15.9.

Oilfield services firms reported all indicators trending positive: the equipment utilization index jumped 57 points to 63.2 in the first quarter as did operating margins, with its index increasing from -31.9 to 14.0.

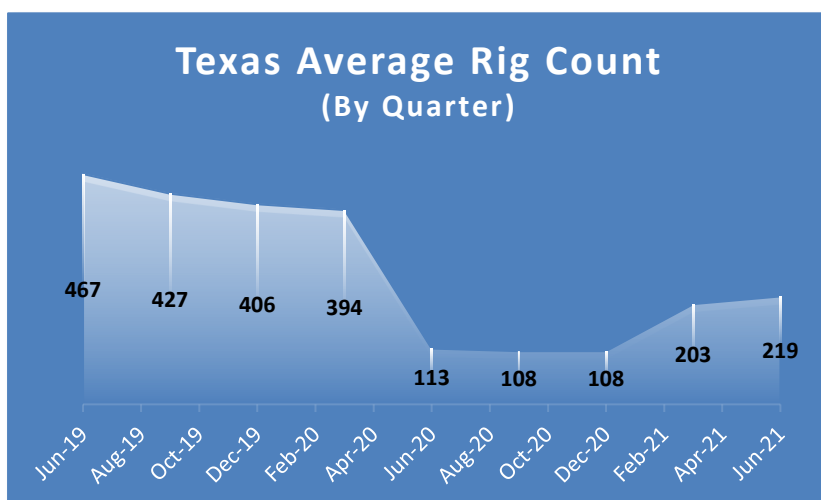
A week of freezing temperatures beginning on February 12 caused the state's power demand to skyrocket, straining natural-gas supplies to power plants. Many gas wells and pipelines were affected as well, and electric generation companies – which often purchase gas through “interruptible” contracts – found themselves competing for dwindling supplies used to warm about 35% of Texas homes.

The supply crisis pushed oil and natural-gas prices to their highest point in months, with West Texas Intermediate (WTI) crude moving above \$60 a barrel for the first time since January 2020. By March 5, WTI prices hit \$66.09 per barrel, its highest price since April 2019 and higher than last year's peak of \$63.27 reached on January 6, 2020.

O&G activity continued growing in the second quarter of 2021, according to the FRB Dallas Energy Survey, as COVID-19 vaccines became more widely available, and the economy began to reopen. The business activity index remained elevated at 53.0. The oil production index went from 16.3 in the first quarter to 35.0 in the second quarter, its second-highest reading ever. The natural gas production index increased another 19 points to 35.0.



Source: MacroTrends



Source: Baker Hughes

The index for capital expenditures also moved upward to 42.4 from 31.0, indicating an acceleration in spending among E&P companies. Furthermore, the index for the expected level of expenditures next year came in at 53.0, up from 49.5 in the first quarter.

The WTI price per barrel reached \$66.09 in March but ended the first quarter down slightly at \$59.16. However, as the economy began to pick up momentum, the price was above \$66 again by May, eased above \$70 in early June, and closed out the second quarter of 2021 at a high point of \$73.47 per barrel.

The Texas average rig count reflected the increased activity the FRB Dallas energy surveys reported, increasing each month during the entire first half of 2021. The average count began in January at 170 and jumped to 203 in March before ending the second quarter at 219.

AGRIBUSINESS

As with almost all other sectors of the Texas economy, the state's agriculture industry was severely impacted by February's punishing winter storm, as layers of ice and frigid temperatures resulted in massive losses for ag producers.

According to agricultural economists with the Texas A&M AgriLife Extension Service, Winter Storm Uri caused at least \$600 million in losses to crops, livestock, and associated infrastructure. Further discussion on the impact of this storm on the Texas economy is offered in a [special section](#) of this report.

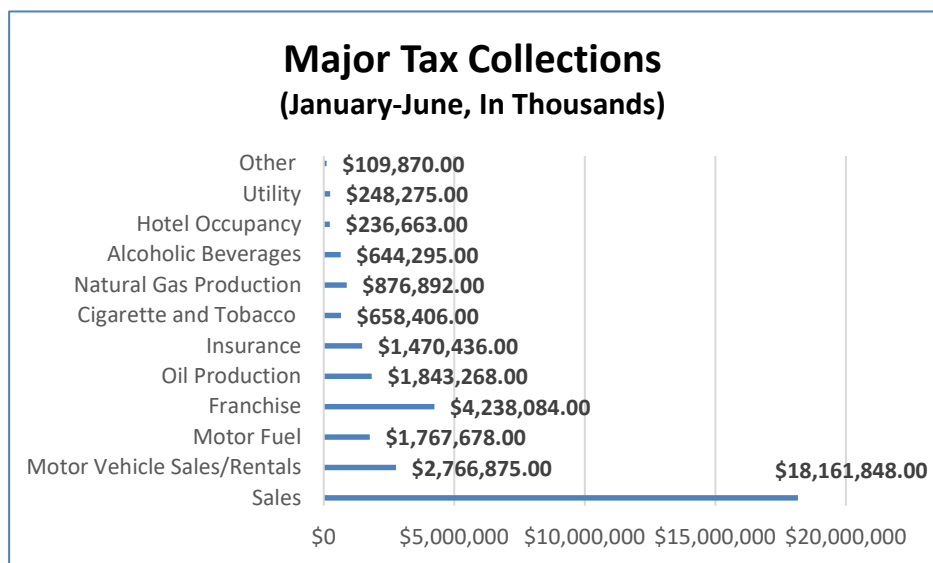
Demand for agricultural products remained solid entering 2021, as crop and cattle prices rose over the previous six weeks. Prices for crops less affected by the winter storm remained largely profitable entering quarter two, spurring optimism among producers, though there was some apprehension over higher input costs.

Significantly higher grain prices had a negative impact on the livestock sector, however, as feed costs nearly doubled from one year earlier. Beef exports were robust, having stabilized from the winter storm, driving up prices to well-above-average levels by the end of the second quarter.

On the financing front, first quarter demand for agricultural loans continued to decline, the FRB Dallas reported, with the loan demand index registering its 22nd quarter in negative territory. Loan renewals or extensions fell; however, the rate of loan repayment increased for the first time since 2014.

The loan demand index ended its 23rd quarter in negative territory at the end of June. Loan renewals or extensions fell for the second quarter in a row while the rate of loan repayment continued to increase. Loan volume decreased across all major categories in the second quarter of 2021 compared with a year ago except for farm real estate, non-real-estate farm, and operating loans.

TAX REVENUE



Source: Texas Comptroller of Public Accounts

Major tax collections for the first half of 2021 equaled \$33.02 billion, 33.7% higher than at the same point in time in 2020. Collections in the first half of 2021 can be broken down into two parts: the period prior to the widespread availability of COVID-19 vaccines and after.

Collections for January equaled \$4.42 billion, up \$340.97 million over December figures, yet still 7.6% lower than the previous January. State sales tax revenue, the largest source of collections, totaled \$3.07 billion that month, down 0.3% from one year ago.

Other major sources of revenue accounted for \$408.08 million in motor vehicle sales and rental taxes (down 13.4% YOY), \$254.56 million in oil production taxes (down 35.7%) and \$102.70 million in natural gas production taxes (down 21.6%), and \$294.31 million in motor fuel taxes (down 4.7%).

When the winter storm disrupted the economy in February, collections still managed an increase to \$4.57 billion despite a monthly decline in nearly every tax category, although some of this may be attributed by an extension to the February 22 filing deadline.

The only categories seeing an increase included oil production taxes, which rose to \$290.68 million (up 14.2% over January), natural gas production taxes, which increased to \$113.03 million (up 10.0%), and insurance taxes, which soared to \$832.25 million (up 51.2%). However, February revenue totals still fell 17.4% from those of February 2020.

After businesses began to reopen and the state's economy stabilized to an extent in March, total tax collections rose to \$4.73 billion, up a modest 3.4% from the previous March, before starting the second quarter in April with a substantial 44.5% increase YOY (up to \$5.56 billion). May revenue totals were even higher, jumping to \$6.31 billion, a YOY increase of 55.0%.

To eliminate any doubt the state's economy was back on track, major tax collections ended the second quarter in June \$1.09 billion higher than May figures, totaling \$7.41 billion (up 91.7% YOY). Major categories seeing increases that month included insurance taxes (\$53.17 million, up 80.0%), utility taxes (\$18.17 million, up 192.2%), franchise taxes (\$2.38 billion, up 1,089.4%), and sales taxes (\$3.15 billion, up slightly 18.1%).

IMPACT OF WINTER STORM URI

A brutal winter storm hammered Texas February 12-19, as layers of ice and frigid temperatures crippled the state's electric grid and resulted in more than 200 deaths, a figure easily surpassing the 68 lives lost to Hurricane Harvey.

Designated Uri, it was the worst winter storm in recent history and while nothing can compare to this tragic loss of life, the storm also had enormous consequences for the Texas economy.

The storm's damage, unlike that of Harvey, touched every corner of the state; all 254 counties were included in Governor Greg Abbott's February 12 disaster declaration. Nearly every segment of the economy was impacted to some extent, disrupting supply chains, and affecting everything from manufacturing, oil production, and agriculture to name just a few.

Utilizing an assessment model and property damage estimates, the Waco-based economic forecasting firm The Perryman Group projected long-term losses in gross product over time due to the storm to be between \$85.8 billion and \$128.7 billion, with lost income of \$56.8 billion to \$85.1 billion.

When the final tally is known, these losses are likely to be higher than those associated with the most expensive weather events in Texas to date: Hurricanes Harvey and Ike.

Perhaps the most visible impact to the economy involved losses in the energy sector. While some power companies reaped large profits, others reported billions of dollars in losses after natural gas prices skyrocketed as freezing temperatures and power outages caused gas production to fall by nearly half.

For example, Vistra—the largest power company in Texas—reported a \$1.6 billion negative financial impact from the storm. Company officials reported the firm was forced to spend \$1.1 billion on natural gas in the spot market at a price of \$700 per million British thermal units (BTUs) during the storm. Its typical contract price is about \$3 per million BTUs.

Other companies in the oil and gas industry with a sizable presence in Texas reporting losses included such large corporations as:

- NRG (retail electric power), which lost \$967 million;
- Exxon Mobil (oil), losing \$600 million;
- Chevron (oil), which lost \$300 million; and
- Oncor (electric transmission/distribution), with losses totaling \$102 million.

In a state where agriculture plays a significant role in the economy, the impact on Texas agribusiness was also substantial. The storm caused at least \$600 million in losses across Texas, according to Texas A&M AgriLife Extension Service agricultural economists.

Estimates for citrus losses were projected to be around \$230 million, based primarily on losses in the Rio Grande Valley. AgriLife Extension horticulturists reported approximately 200 acres of lemons and limes produced in South Texas were destroyed completely, while producers lost virtually all their Valencia orange crop and more than 60% of their grapefruit crop.

Cool-season vegetable crops, such as leafy greens, beets, cabbage and celery, and warm-season crops, including potatoes and watermelons planted for early harvest, suffered losses as well. In total, the damage to vegetable crops could reach \$150 million.

Broken down by crop, the Texas A&M AgriLife Extension Service reported the following losses:

- \$42 million in sales of onions
- \$27 million in sales of leafy greens
- \$20 million in sales of watermelons
- \$15 million in sales of cabbage,
- \$42 million in additional vegetable and herb sales lost

Extended freezing temperatures killed or badly damaged landscape plants, shrubs, and trees in nurseries, garden centers and greenhouses throughout the state. They also temporarily shut down the sale of landscaping and gardening tools and supplies.

Texas, of course, is synonymous with beef, and livestock losses from Uri were particularly painful. Overall livestock losses are estimated by AgriLife Extension economists to be approximately \$228 million. This figure includes not only cattle, but also sheep and goats and their offspring that died or were badly injured during the freeze, and damage to the livestock industry infrastructure.

Statewide losses of livestock grazing materials such as oats, rye grass, and triticale also lost in the freeze added to ranchers' woes. Texas dairy operations lost as much as \$8 million a day because trucks were unable to pick up and deliver milk for processing. This was a huge financial blow to an industry which ranks fifth in U.S. production and number of dairy cows, generating \$12.7 billion in total wages for 253,000 direct and indirect jobs, according to the Texas Comptroller of Public Accounts.

The financial loss was not confined to land. The Texas Parks and Wildlife Department (TPWD) report an estimated minimum of 3.8 million fish were killed along the Texas coast during the freeze. At least 61 species were affected, with non-recreational species contributing to 91% of the total number lost. While non-game fish are not typically sought by most anglers, they remain ecologically important for providing food for larger game fish, as well as adding to the overall diversity of Texas bays, according to the TPWD.

Recreationally important game species accounted for the other 9% of the total, including spotted seatrout, black drum, sheepshead, sand seatrout, red drum, gray snapper, and red snapper, losses that will take time to recoup. A 2018 survey by the American Sportfishing Association, noted that recreational fishing in Texas generated \$7.2 billion in income and supported nearly 48,500 jobs.

SUPERVISORY CONCERNS

Both Departments monitor a variety of risk areas to proactively provide guidance to regulated entities or implement other supervisory action when warranted. COVID-19 has caused an unprecedented disruption to the state's banking system. The following section discusses the agencies' response to the pandemic and its impact on the banking industry in general, as well as new legislation at the state level.

The Department of Savings and Mortgage Lending has continued conducting examinations on an offsite basis during COVID and currently offers an onsite presence during examinations. Some challenges may

remain with access to large volume of documentation electronically. Communication with bank management well in advance of scheduled examinations remains the key practice.

The Banking Department continues to actively monitor and respond to the changing circumstances brought about by the pandemic. Most banks have reverted to normal operating schedules as vaccines became readily available; however, several instances of COVID-19 outbreaks have occurred resulting in temporary branch closures.

The Department maintains regular communication with regulated entities and performs offsite monitoring of key financial metrics. In July 2021, the Department began onsite examinations as well as in person management and board meetings on a limited basis. Banks and trust companies due for an examination are given the option for either an onsite or offsite examination based on management's comfort level and COVID-19 cases in the community.

The impact of the COVID-19 pandemic to bank loan portfolios has thus far been minimal. Adversely classified asset levels have increased modestly, and overall credit risk remains sound. Most of Texas state-chartered banks provided loan deferrals at the onset of the pandemic to help their customers cope with decreased cash flow. Subsequently, feedback from bankers indicates that only a small portion of the deferrals have not returned to original payment terms.

Regulators understand that since the beginning of the pandemic, banks have experienced an influx of deposits from various sources, including two rounds of PPP loans and three separate stimulus payments (April 2020, January 2021, and March 2021). The governmental assistance for consumer and businesses has led to an ample amount of liquidity. At the same time, options to deploy excess funds are limited and provide less than desired returns. Commercial and consumer loan demand has decreased and investment yields on securities remain low.

Loan renewals made during this period have been set at lower interest rates, leading to compressed earnings and decreased leverage ratios. While most businesses receiving PPP loans spent the funds on needed expenses, others chose to hold the funds in the event they were needed. These funds remain on the financial institutions' balance sheet. Banks that participated in PPP received fees related to PPP loans, however, leverage capital has struggled due to the growth in deposits compressing earnings.

At the recent Federal Open Market Committee meeting, officials suggested that they may favor raising interest rates by late 2022 or 2023, and further postponing any potential for deposit flight. The continuation of near zero low interest rates perpetuates the already negative consequences for growth and employment. Abundant liquidity and low interest rates have not led to higher productive investment but in liquidity hoarding.

The Departments consider any bank with a Uniform Financial Institutions Composite Rating of 3, 4, or 5, to be a problem bank. The number of problem banks are in the normal ranges. For the Banking Department, this is between 3% and 5% of the total number of institutions.

The support of the government stimulus programs has limited the economic fallout from the pandemic, and economic conditions continue to improve as businesses reopen. As a result, the risk of problem banks materially increasing due to the COVID-19 is lessening. As of the writing of this report, the Department of Savings and Mortgage Lending did not have any problem institutions.

Virtual Currency Custody Services

Many businesses are beginning to accept Bitcoin and other virtual "currencies" as a form of payment, though these currencies remain unregulated by most governments. House Bill (H.B.) 4474, passed during the 87th Texas Legislature, sought to adopt virtual currency standards into statute.

The bill allows individuals to know their rights regarding the control of virtual assets and help resolve disputes involving the ownership and transfer of virtual currency. The bill, effective September 1, 2021, amended a previous law relating to the control of virtual currency and the rights of purchasers who obtain control of virtual currency for purposes of the Uniform Commercial Code.

To address the change in statute, the Banking Department issued [Industry Notice 2021-03](#), to address the authority of Texas state-chartered banks to provide virtual currency custody services to customers on June 10, 2021. The notice affirms that state-chartered banks may provide customers with virtual currency custody services, so long as the bank has adequate protocols in place to effectively manage the risks and comply with applicable law.

The virtual currency services banks and savings banks may offer will vary based on their risk tolerance. Banks and savings banks also have the option to offer services in the fiduciary or non-fiduciary capacities. For example, some financial institutions may allow customers to directly control their own virtual currency, facilitating merely as storage for the customer's private keys associated with the currency. Each bank will determine which storage options best fits their needs.

Prior to entering a new line of business, such as offering virtual currency services, bank management should evaluate the risk and conduct due diligence regarding the new product or service. Should management and the bank's board of directors decide to move forward, effective risk management systems and controls must be executed to measure monitor, and control relevant risks associated with the product and/ or service.

DEPARTMENTAL SUPERVISORY MEASURES BEING TAKEN

TEXAS DEPARTMENT OF BANKING

- ❖ Assess and monitor the impact of COVID-19 on the Texas banking system and the financial service providers under the Department's supervision;
- ❖ Maintain regular contact with bank management regarding the bank's condition and the economic fallout from the COVID-19 pandemic;
- ❖ Assess bank management's efforts to properly identify and manage risks associated with the pandemic, including the potential volatility of increased deposits caused by U. S. Government stimulus efforts;
- ❖ Encourage banks to prudently work with their borrowers throughout the pandemic;
- ❖ Assess institutions' preparedness to identify, detect, respond to, protect against, and recover from cyber-attacks and perform follow-up evaluations for those below a base-line level of readiness;
- ❖ Investigate, assess, and oversee remediation and compliance efforts in response to institutions' material cybersecurity incidents;
- ❖ Encourage banks to take steps to reduce the risk of ransomware;
- ❖ Monitor banks' transition from LIBOR to a substitute reference rate;
- ❖ Monitor efforts to prudently assess and mitigate concentration risks in commercial real estate, oil and gas, and agriculture lending;
- ❖ Assess risks posed by compressed interest margins in this historical low-rate environment;
- ❖ Monitor bank preparations for the industry's transition to CECL;
- ❖ Conduct off-site monitoring of institution's key financial performance metrics and analyze exceptions;
- ❖ Initiate measured and tailored regulatory responses and enforcement action as warranted;
- ❖ Conduct scheduled examinations of all institutions, and more frequent examinations or visitations of problem institutions;
- ❖ Communicate and coordinate joint enforcement actions and other supervisory activities with federal regulators;
- ❖ Monitor state, national, and world political and economic events impacting the industry; and
- ❖ Engage and increase internal communication and training to improve examiner awareness of pertinent issues.

DEPARTMENT OF SAVINGS AND MORTGAGE LENDING

- ❖ Close coordination with other state and federal regulators;
- ❖ Engage in regular correspondence with state savings banks regarding institution-specific issues;
- ❖ Engage in regular correspondence with state savings banks as an industry by means such as Emerging Issues monthly calls, and Thrift Industry Day on industry wide issues;
- ❖ Perform targeted examinations of high-risk areas of state savings banks;
- ❖ Issue enforcement actions and place supervisory agents when deemed necessary;
- ❖ Conduct off-site monitoring of each institution's activity (i.e., regulatory correspondence and approvals, independent audit reports, reports of examination, and institution responses to examination comments, criticisms, and recommendations);
- ❖ Develop regular assessments of each institution's activities, strengths, weaknesses, revise the Department's plan of examination and monitoring for the institution, including the downgrading of institutions, if deemed necessary, by the Department and the primary federal regulator;
- ❖ Monitor any impact from volatility within the energy or agricultural industries;
- ❖ Assess interest rate risk;
- ❖ Monitor lending, investment, and funding concentrations;
- ❖ Monitor local, state, national, and world political and economic events impacting the industry;
- ❖ Participate in federal compliance examinations of each institution; and
- ❖ Respond promptly to state or national events that can impact the state savings bank industry.

PERFORMANCE SUMMARY AND PROFILE: TEXAS BANKING SYSTEM

STATE-CHARTERED BANKS

While the number of Texas state-chartered banks remains steady, balance sheets continue to expand. As of June 30, 2021, there were 216 Texas state-chartered banks. Total assets increased by \$45.4 billion (14.2%) over the past 12 months, with net loan and lease balances rising by \$5.0 billion (2.5%). On the contrary, the number of national banks chartered in Texas has reduced by ten since during the same period and total assets have increased only 1.0%.

Year-to-date net income improved by 87.2% to \$2.7 billion from a year earlier, assisted in-part by a reverse provision of \$354 million during the first six months of 2021. Average return on assets (ROA) increased by 57 basis points (BP) to 1.5% over the same period. About two out of every three state-chartered banks, or 65.4%, reported YOY growth to their net income, with only 3.7% reporting operating losses, compared to 4.6% during the same period in 2020. Conversely, during the same time frame, the NIM decreased by 41 BP to 3.0%, primarily due to decreasing yields on earning assets.

Asset quality remains sound with the average noncurrent rate at 0.7%, a slight increase of 6 BP from June 2020. However, the average net charge-off rate dropped sharply to 0.03% from 0.3% in the second quarter 2020. These rates are below the national averages with the noncurrent rate at 0.9% and charge-off rate at 0.3%. The allowance for loan and lease losses (ALLL) to noncurrent loans decreased from 222.5% to 183.9%. ALLL represents 1.3% of total loans compared to 1.4% a year earlier. Prior ALLL increases demonstrate bankers trying to prepare for deterioration in credit quality due to the shutdowns brought on by COVID-19. However, the impact of the pandemic to bank loan portfolios has thus far been minimal. As stated above, adversely classified asset levels have increased slightly, and overall credit risk remains sound.

State-chartered banks remain well-capitalized with average leverage capital of 9.6% in June 2021. While capital ratios have seen a decline from 9.9% as of June 30, 2020, they remain well-capitalized

and prepared for the future compared to a national average of 8.8%. Dividends have declined from approximately \$854 million in June 2020 to \$791 million for the first half of 2021.

As of June 30, 2021, problem state-chartered financial institutions represent approximately 4.6% of the total number of banks. This illustrates that industry conditions were relatively strong headed into the financial crisis brought about by COVID-19.

STATE-CHARTERED THRIFTS

As of June 30, 2021, state thrifts had \$1.427 billion in net income for the first half of 2021, with the largest institution's net income being \$1.158 billion. The pretax return on average assets remains strong at 0.9%. As of June 30, 2021, non-interest income to assets remained the same at 0.05%, however, non-interest expense to assets decreased 4 BP, totaling 0.5%.

The Texas thrift ratio of nonperforming loans plus other real estate owned to total assets decreased three BP to 0.04% as of June 30, 2021, and remains minimal. Provision for credit losses for the first half of 2021 totaled \$(18.63) million compared to \$19 million for the second half 2020.

The total risk-based capital ratio for the industry increased 575 BP from 19.0% in December 2020 to 24.8% in June 2021 due to the low-risk asset growth of the largest institution. Additionally, total capital levels improved primarily due to cash dividends decreasing to \$14.21 million as of June 30, 2021, compared to the \$36.85 million as of December 31, 2020, and funds contributed to banks increasing by \$6.53 billion, totaling \$7.20 billion as of June 30, 2021. Three state savings banks elected the Community Bank Leverage Ratio in the second quarter 2021, and therefore, do not report any capital ratios besides the leverage ratio.

As of June 30, 2021, 100% of the thrifts continued to be either a Composite 1 or Composite 2. The Department considers any institution with a Uniform Financial Institutions Composite Rating of a 3, 4, or 5 as a problem institution.

NUMBER OF INSTITUTIONS AND TOTAL ASSETS

FDIC financial data is reflective of FDIC insured institutions only.
Assets in Billions

	6-30-2021		6-30-2020		Difference	
	<u>No. of Institutions</u>	<u>Assets</u>	<u>No. of Institutions</u>	<u>Assets</u>	<u>No. of Institutions</u>	<u>Assets</u>
Texas State-Chartered Banks	216	\$365.1	217	\$319.8	-1	+\$45.3
Texas State-Chartered Thrifts	24	\$412.6	25	\$349.1	-1	+\$63.5
	240	\$777.7	242	\$668.9	-2	+\$108.8
Other states' state-chartered:						
Banks operating in Texas*	48	\$85.3	42	\$70.8	+6	+\$14.5
Thrifts operating in Texas*	0	0	0	0	0	0
	48	\$85.3	42	\$70.8	+6	+\$14.5
Total State-Chartered Activity	288	\$863.0	284	\$739.7	+4	+\$123.3
National Banks Chartered in Texas	159	\$173.6	169	\$165.7	-10	\$7.9
Federal Thrifts Chartered in Texas	4	\$117.9	4	\$103.1	0	+\$14.8
	163	\$291.5	173	\$268.8	-10	+22.7
Other states' federally-chartered:						
Banks operating in Texas*	31	\$632.2	31	\$432.0	0	+\$200.2
Thrifts operating in Texas*	5	\$1.0	6	\$1.0	-1	+\$0.0
	36	\$633.2	37	\$433.0	-1	+\$200.2
Total Federally-Chartered Activity	199	\$924.7	210	\$701.8	-11	+222.9
Total Banking/Thrift Activity	487	\$1,787.7	494	\$1,441.5	-7	+\$346.2

*Indicates estimates based on available FDIC information.

RATIO ANALYSIS

As of June 30, 2021
FDIC financial data is reflective of FDIC insured institutions only.

	<u>State- Chartered Banks</u> 216	<u>Texas National Banks</u> 159	<u>All Texas Banks</u> 375	<u>State- Chartered Thrifts</u> 24	<u>Texas Federal Thrifts</u> 4	<u>All Texas Thrifts</u> 28
% of Unprofitable Institutions	3.69%	1.26%	2.66%	NA	25.00%	3.70%
% of Institutions with Earnings Gains	65.44%	63.52%	64.63%	69.57%	50.00%	66.67%
Yield on Earning Assets	3.16%	3.16%	3.16%	1.44%	3.21%	1.82%
Net Interest Margin	2.96%	2.91%	2.94%	1.41%	3.13%	1.78%
Return on Assets	1.50%	1.28%	1.43%	0.71%	-0.14%	0.52%
Return on Equity	7.58%	8.27%	7.79%	10.08%	-1.72%	7.08%
Net Charge-offs to Loans	0.03%	0.06%	0.04%	0.22%	0.77%	0.50%
Earnings Coverage of Net Loan C/Os	97.53	40.19	67.82	41.49	-1.36	8.08
Loss Allowance to Loans	1.31%	1.27%	1.29%	0.36%	2.24%	1.27%
Loss Allowance to Noncurrent Loans	183.92%	194.15%	187.15%	101.81%	47.16%	51.15%
Noncurrent Assets+OREO to Assets	0.44%	0.42%	0.43%	0.04%	1.63%	0.39%
Net Loans and Leases to Core Deps	69.37%	71.93%	70.20%	11.96%	41.90%	18.17%
Equity Capital to Assets	11.66%	10.16%	11.18%	7.83%	8.66%	8.01%
Core Capital (Leverage) Ratio	9.64%	9.38%	9.55%	7.22%	8.40%	7.48%
Total Risk-Based Capital Ratio	15.18%	15.69%	15.33%	24.91%	19.17%	23.11%

Data for other state-chartered institutions doing business in Texas is not available and therefore excluded.
Information derived from the FDIC website.

RATIO ANALYSIS BY ASSET GROUPS FOR STATE-CHARTERED BANKS

As of June 30, 2021
FDIC financial data is reflective of FDIC insured institutions only.
Assets in Billions

	<u>< \$1</u> <u>173</u>	<u>\$1 - \$10</u> <u>37</u>	<u>> \$10</u> <u>6</u>
% of Unprofitable Institutions	4.62%	NA	NA
% of Institutions with Earnings Gains	61.27%	78.95%	100.00%
Yield on Earning Assets	3.77%	3.70%	2.76%
Net Interest Margin	3.45%	3.37%	2.64%
Return on Assets	1.27%	1.55%	1.53%
Return on Equity	11.60%	13.05%	12.97%
Net Charge-offs to Loans	0.02%	0.04%	0.03%
Earnings Coverage of Net Loan C/Os	114.39	73.62	112.34
Loss Allowance to Loans	1.22%	1.23%	1.37%
Loss Allowance to Noncurrent Loans	262.39%	155.92%	186.76%
Noncurrent Assets+OREO to Assets	0.33%	0.53%	0.43%
Net Loans and Leases to Core Deps	69.59%	80.35%	64.71%
Equity Capital to Assets	10.85%	11.85%	11.77%
Core Capital (Leverage) Ratio	10.50%	10.32%	9.11%
Total Risk-Based Capital Ratio	18.26%	15.87%	14.47%

RATIO ANALYSIS BY ASSET GROUPS FOR STATE-CHARTERED THRIFTS

As of June 30, 2021
FDIC financial data is reflective of FDIC insured institutions only.
Assets in Billions

	<u>< \$1</u> <u>15</u>	<u>\$1 - \$10</u> <u>7</u>	<u>> \$10</u> <u>2</u>
% of Unprofitable Institutions	NA	NA	NA
% of Institutions with Earnings Gains	66.67%	100.00%	NA
Yield on Earning Assets	4.14%	4.77%	1.28%
Net Interest Margin	3.67%	4.40%	1.26%
Return on Assets	0.91%	1.84%	0.66%
Return on Equity	9.24%	16.18%	9.67%
Net Charge-offs to Loans	0.07%	0.78%	0.00%
Earnings Coverage of Net Loan C/Os	23.27	3.89	NA
Loss Allowance to Loans	0.85%	1.04%	0.04%
Loss Allowance to Noncurrent Loans	140.30%	148.30%	23.64%
Noncurrent Assets+OREO to Assets	0.44%	0.49%	0.01%
Net Loans and Leases to Core Deps	88.03%	106.28%	8.39%
Equity Capital to Assets	9.84%	11.95%	7.63%
Core Capital (Leverage) Ratio	10.06%	10.25%	7.07%
Total Risk-Based Capital Ratio	18.03%	13.97%	26.29%

COMPARISON REPORT

Select Balance Sheet and Income/Expense Information
FDIC financial data is reflective of FDIC insured institutions only.
June 30, 2021

	State Banks*		State Thrifts	
	<u>End of Period</u>	<u>% of Total Assets</u>	<u>End of Period</u>	<u>% of Total Assets</u>
Number of Institutions	216*		24*	
Number of Employees (full-time equivalent) (In millions)	41,380		3,915	
Total Assets	\$365,132		\$412,638	
Net Loans and Leases	\$200,467	54.90%	\$42,984	10.42%
Loan Loss Allowance	\$2,654	0.73%	\$153	0.04%
Other Real Estate Owned	\$165	0.05%	\$6	0.00%
Goodwill and Other Intangibles	\$8,271	2.27%	\$411	0.10%
Total Deposits	\$308,524	84.33%	\$375,121	90.91%
Federal Funds Purchased and Repurchase Agreements	\$3,446	0.94%	\$26	0.01%
Other Borrowed Funds	\$5,479	3.77%	\$1,541	0.37%
Equity Capital	\$38,552	1.50%	\$32,295	7.83%
Memoranda:				
Noncurrent Loans and Leases	\$1,443	0.40%	\$150	0.04%
Earning Assets	\$335,664	91.93%	\$408,878	99.09%
Long-term Assets (5+ years)	\$103,020	28.21%	\$311,270	75.43%
	<u>Year-to-Date</u>	<u>% of Avg. Assets[†]</u>	<u>Year-to-Date</u>	<u>% of Avg. Assets[†]</u>
Total Interest Income	\$5,175	2.91%	\$2,878	1.43%
Total Interest Expense	\$340	0.19%	\$62	0.03%
Net Interest Income	\$4,835	2.71%	\$2,816	1.39%
Provision for Loan and Lease Losses	-\$354	-0.20%	-\$20	-0.01%
Total Noninterest Income	\$2,030	1.14%	\$97	0.05%
Total Noninterest Expense	\$3,990	2.24%	\$1,060	0.52%
Securities Gains	\$22	0.01%	\$20	0.01%
Net Income	\$2,670	1.50%	\$1,435	0.71%
Memoranda:				
Net Loan Charge-offs	\$29	0.02%	\$45	0.02%
Cash Dividends	\$791	0.44%	\$14	0.01%

*Excludes branches of state-chartered banks of other states doing business in Texas. As of June 30, 2021, there are an estimated 48 out-of-state state-chartered institutions with \$85.3 billion in assets. Assets are based upon the June 30, 2021, FDIC Summary of Deposits.

†Income and Expense items as a percentage of average assets are annualized.

No branches of state-chartered thrifts of other states conducted business in Texas as of June 30, 2021.

PERFORMANCE SUMMARY: UNITED STATES BANKING SYSTEM

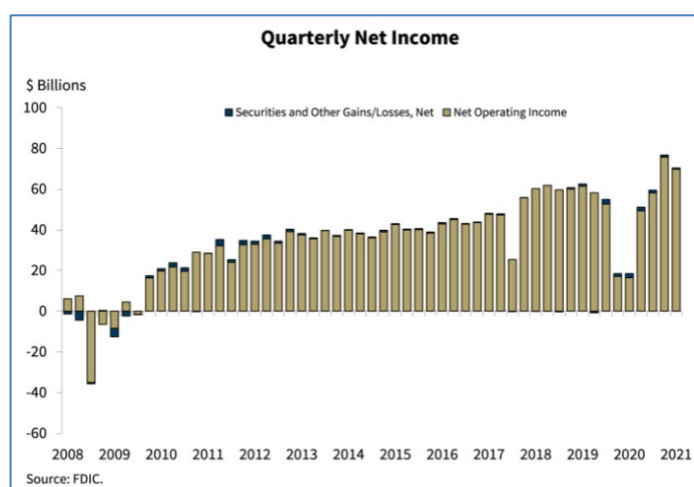
FDIC QUARTERLY BANKING PROFILE

Second Quarter 2021 - www.fdic.gov

All Institutions Performance

Reports from the 4,951 commercial banks and savings institutions insured by the FDIC reflect aggregate net income of \$70.4 billion in second quarter 2021, an increase of \$51.9 billion (281%) from a year ago. This increase was driven by further economic growth and improved credit conditions, which led to a second consecutive quarter of aggregate negative provision expense.

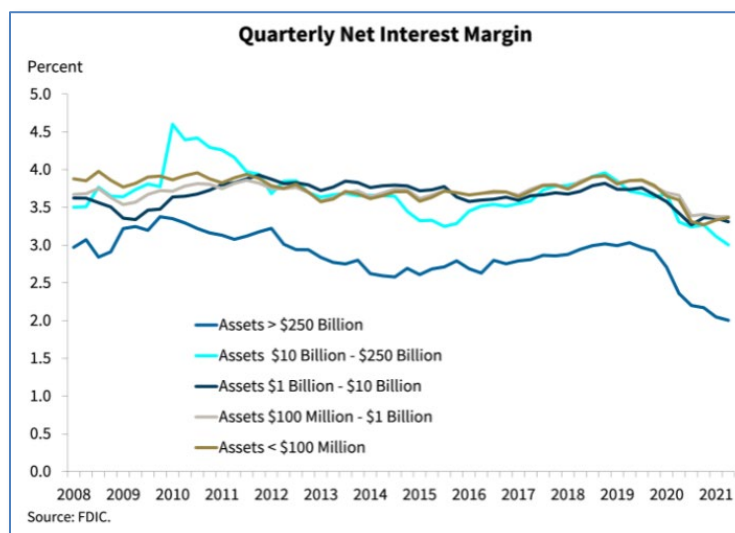
↑ Quarterly Net Income Continued to Increase Year Over Year, Driven by a Second Consecutive Quarter of Negative Provision Expense



Net income totaled \$70.4 billion in second quarter 2021, an increase of \$51.9 billion (281%) from the same quarter a year ago, driven by a \$73 billion (117.3%) decline in provision expense. Two-thirds of all banks (66.4%) reported year-over-year improvement in quarterly net income. The share of profitable institutions increased slightly, up 1.4% year over year to 95.8%. However, net income declined \$6.4 billion (8.3%) from first quarter 2021, driven by an increase in provision expense from first quarter 2021 (up \$3.7 billion to negative \$10.8 billion). The aggregate return on average assets ratio of 1.24% rose 89 basis points from a year ago but fell 14 basis points from first quarter 2021.

↓ Net Interest Margin Contracted Further to a New Record Low

The average net interest margin contracted 31 basis points from a year ago to 2.50%—the lowest level on record. The contraction is due to the year-over-year reduction in earning asset yields (down 53 basis points to 2.68%) outpacing the decline in average funding costs (down 22 basis points to 0.18%). Both ratios declined from first quarter 2021 to record lows. Aggregate net interest income declined \$2.2 billion (1.7%) from second quarter 2020. Reductions in net interest income at the largest institutions drove the aggregate decline in net interest income, as more than three-fifths of all banks (64.1%) reported higher net interest income compared with a year ago.



↑ **Noninterest Income Continued to Increase Despite Lower Trading Revenue**

Noninterest income increased (up \$5 billion, or 7.1%) from second quarter 2020 due to improvement in several categories. During the year ending second quarter 2021, “all other noninterest income” rose \$7.9 billion (27.5%), offsetting both a \$5.9 billion (42.1%) decline in trading revenue and a reduction in net gains on loan sales of \$1.5 billion (19.7%). Increased income from service charges on deposit accounts (up \$1.5 billion, or 21.5%) and fiduciary activities (up \$1.2 billion, or 13.1%) from second quarter 2020 also supported the year-over-year improvement in noninterest income. More than two-thirds of all institutions (69.6%) reported higher noninterest income compared with the year-ago quarter.

↕ **Noninterest Expense Relative to Average Assets Declined to a Record Low**

Noninterest expense rose \$3.7 billion (3%) year over year, led by an increase in salary and benefit expense and “all other noninterest expense.” Nearly three-fourths of all banks (74.5%) reported higher noninterest expense year over year. Higher average assets per employee (up \$0.9 million) also increased from a year ago to \$11.1 million. However, noninterest expense as a percentage of average assets continued to decline, reaching a record low of 2.23%, down 14 basis points from the year-ago quarter.

↕ **Net Operating Revenue to Average Assets Continued to Decline**

Net operating revenue (net interest income plus noninterest income) increased \$2.8 billion (1.4%) from the year-ago quarter as improvement in noninterest income offset the decline in net interest income. However, growth in average assets and declining net interest income contributed to a 29 basis point decline in the ratio of quarterly net operating revenue to average assets. The ratio stood at 3.62 %for the quarter—the lowest level since third quarter 1984.

↑ **Provision Expense Was Negative for the Second Consecutive Quarter**

Provisions for credit losses (provisions) increased \$3.7 billion from first quarter 2021 but declined \$73 billion (117.3%) from the year-ago quarter to negative \$10.8 billion. More than three-fifths of all institutions (63.3%) reported lower provisions compared with the year-ago quarter. Nearly 14% of institutions reported an increase in provisions during the same period, while the remaining institutions reported no material change. The net number of banks that have adopted current expected credit loss (CECL) accounting fell by 1 to 319 from first quarter 2021. CECL adopters reported aggregate negative provisions of \$10.7 billion in second quarter, an increase of \$4.3 billion from the previous quarter and a reduction of \$67.6 billion from one year ago. Provisions for banks that have not adopted CECL accounting totaled negative \$128.1 million (a reduction of \$530.6 million from a quarter ago and \$5.2 billion from one year ago).

↓ **Allowance for Loan and Lease Losses to Total Loans Remained Higher Than Pre-Pandemic Level**

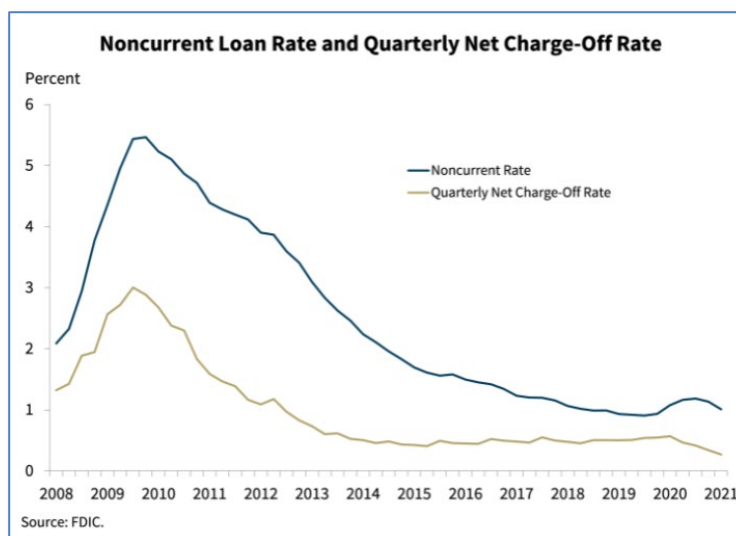
The allowance for loan and lease losses (ALLL) as a percentage of total loans and leases declined 41 basis points to 1.80% from the year-ago quarter due to negative provisions, but ALLL remains higher than the level of 1.18% reported in fourth quarter 2019. Similarly, the ALLL as a percentage of loans that are 90 days or more past due or in nonaccrual status (coverage ratio) declined 27% points from the year-ago quarter to 178% but continued to exceed the financial crisis average of 79.1%. All insured institutions except the largest Quarterly Banking Profile asset size group (greater than \$250 billion) reported higher aggregate coverage ratios compared with first quarter 2021.

↑ Noncurrent Loans Continued to Decline Quarter Over Quarter

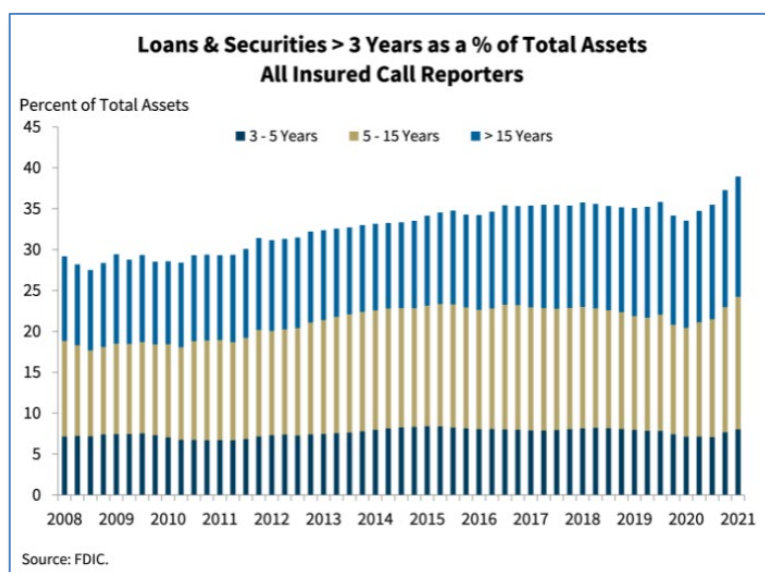
Loans that were 90 days or more past due or in nonaccrual status (noncurrent loans) continued to decline (down \$13.2 billion, or 10.8%) from first quarter 2021, supporting a 12 basis point reduction in the noncurrent rate to 1.01%. Noncurrent 1–4 family residential loans declined most among loan categories from the previous quarter (down \$5.9 billion, or 10.9%), followed by noncurrent commercial and industrial (C&I) loans (down \$3.1 billion, or 13.9%). Three-fifths of all banks reported a reduction in noncurrent loans compared with first quarter 2021.

↑ The Net Charge-Off Rate Declined Further to a Record Low

Net charge-offs continued to decline for the fourth consecutive quarter (down \$8.3 billion, or 53.2%). In second quarter, the net charge-off rate fell 30 basis points to 0.27 percent, a record low. A decline in net charge-offs of credit card loans (down \$3.3 billion, or 39.8%) and C&I loans (down \$2.9 billion, or 69.7%) drove three-fourths (75.5%) of the reduction in net charge-offs from the year-ago quarter. More than half of all banks (51.6%) reported a decline in net charge-offs from a year ago.



↑ Total Assets Increased, Especially Those With Maturities of More Than Five Years



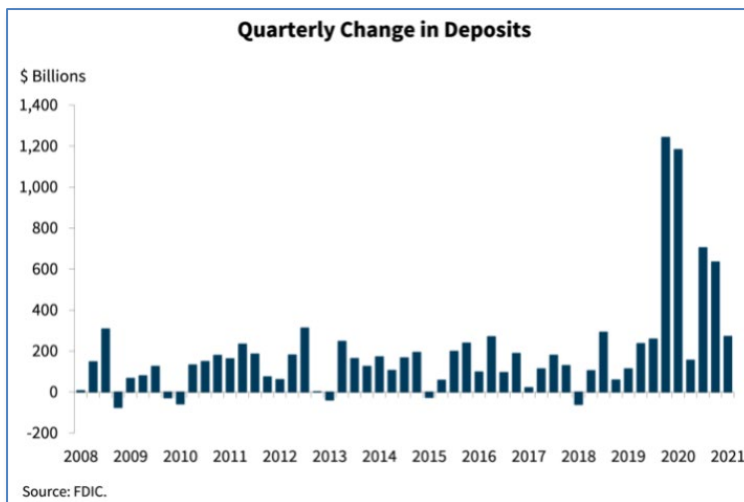
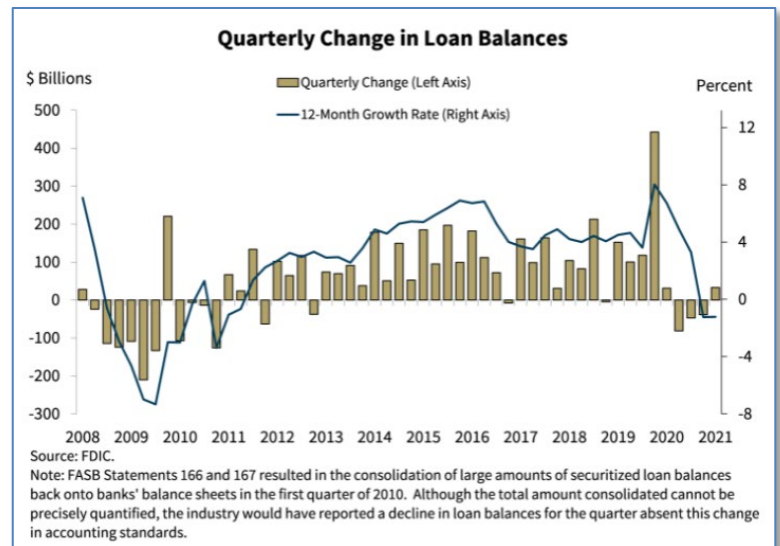
Total assets increased \$224.8 billion (1%) from first quarter 2021 to \$22.8 trillion. More than four-fifths (86.1 percent) of all banks reported an increase in assets with contractual maturities greater than five years compared with a quarter ago. Cash and balances due from depository institutions declined \$108 billion (3 percent), while securities rose \$248.9 billion (4.5 percent). Growth in mortgage-backed securities (up \$122.7 billion, or 3.8 percent) and U.S. Treasury securities (up \$91.2 billion, or 8.5 percent) continued to spur quarterly increases in total securities. Growth in held-to-maturity securities from first quarter 2021 (up \$273.6 billion, or 16.8 percent) outpaced that of available-for-sale (AFS) securities (down \$27.3 billion, or 0.7 percent).

↑ Quarterly Loan Balances Grew for the First Time Since Second Quarter 2020

Loan and lease balances increased \$33.2 billion (0.3%) from the previous quarter, the first quarterly increase in loan balances since second quarter 2020. An increase in credit card loan balances (up \$30.9 billion, or 4.1%) and an increase in auto loan balances (up \$18.9 billion, or 3.8%) drove this growth. Half (50.3%) of all institutions reported a quarterly increase in total loans.

Compared with second quarter 2020, loan and lease balances contracted slightly (down \$133.9 billion, or 1.2%), driven by a reduction in C&I loans (down \$360.4 billion, or 13.4%). An increase in “all other loans” (up \$182.8 billion, or 18.2%) mitigated the annual contraction in total loan balances. Compared with the year-ago quarter, more than half (52.8%) of all institutions reported a decline in total loans, but more than three-quarters (76.4%) of all institutions reported an increase in unused commitments to lend.

↑ Deposits Continued to Grow but at a Moderated Pace in Second Quarter 2021



Deposits grew \$271.9 billion (1.5%) in second quarter, down from the growth rate of 3.6% reported in first quarter 2021. The deposit growth rate in second quarter is near the long-run average growth rate of 1.2%. Deposits above \$250,000 continued to drive the quarterly increase (up \$297.8 billion, or 3.1%) and offset a decline in deposits below \$250,000 (down \$53.6 billion, or 0.7%). Noninterest-bearing deposit growth (up \$175 billion, or 3.5%) continued to outpace that of interest-bearing deposits (up \$53.3 billion, or 0.4%), with more than half of banks (57.3%) reporting higher noninterest-bearing deposit balances compared with the previous quarter.

↑ Equity Capital Growth Remained Strong

Equity capital rose \$55.3 billion (2.5%) from first quarter 2021. Retained earnings contributed \$33.9 billion to equity formation despite a decline in retained earnings from first quarter (down \$19.1 billion, or 36%). Banks distributed 51.9% of second quarter earnings as dividends, which were up \$12.7 billion (53%) from a quarter ago. Nearly one-third (32%) of banks reported higher dividends compared with the year-ago quarter. The number of institutions with capital ratios that did not meet Prompt Corrective Action requirements for the well-capitalized category increased by three to nine from first quarter 2021.

↑ Three New Banks Opened in Second Quarter 2021

The number of FDIC-insured institutions declined from 4,978 in first quarter 2021 to 4,951.8 During second quarter 2021, three new banks opened, 28 institutions merged with other FDIC-insured institutions, two banks ceased operations, and no banks failed. The number of banks on the FDIC's "Problem Bank List" declined by four from first quarter to 51. Total assets of problem banks declined \$8.4 billion (15.4%) from first quarter to \$45.8 billion.

SNAPSHOT STOCK PERFORMANCE

SOUTHWEST REGIONAL BANKS (MSECTOR415)

SEPTEMBER 2021

Name	Last Trade		52 Wk Range		PE	EPS	Mkt Cap	Div/Shr	Div Yld
ACNB Corporation	09/28	27.96	20.05	33.74	8.17	3.42	243.849M	1.00	3.60%
Allegiance Bancshares, Inc.	09/28	38.05	22.25	43.34	10.63	3.58	769.173M	0.48	1.29%
BancFirst Corporation	09/28	60.20	39.88	77.38	13.64	4.41	1.974B	1.44	2.41%
Bank7 Corp.	09/28	20.88	9.07	24.23	9.33	2.24	188.977M	0.44	2.10%
Business First Bancshares, Inc.	09/28	23.53	13.86	24.95	9.21	2.56	482.753M	0.48	2.07%
BOK Financial Corporation	09/28	90.29	49.81	98.95	10.15	8.90	6.237B	2.08	2.34%
Cadence Bancorporation	09/28	22.14	8.37	23.88	6.10	3.63	2.763B	0.60	2.76%
Cass Information Sys, Inc.	09/28	41.99	36.26	48.55	23.20	1.81	600.726M	1.08	2.53%
CBTX, Inc.	09/28	26.82	16.06	33.29	17.30	1.55	655.76M	0.52	1.94%
Commerce Bancshares, Inc.	09/28	70.48	51.56	83.06	15.11	4.66	8.232B	1.05	1.49%
Cullen Frost Bankers, Inc.	09/28	120.54	61.84	125.00	18.59	6.49	7.672B	3.00	2.45%
Enterprise Fin Serv Corp	09/28	45.42	26.86	52.00	11.60	3.91	1.754B	0.76	1.65%
First Community Corp S C	09/28	19.30	12.95	22.00	11.29	1.71	145.514M	0.48	2.42%
First Financial Bankshares, Inc.	09/28	46.00	27.48	52.49	29.30	1.57	6.505B	0.60	1.30%
First Financial Northwest, Inc.	09/28	16.37	16.36	16.50	14.22	1.15	156.085M	0.44	2.69%
First Guaranty Bancshares, Inc.	09/28	19.98	11.86	21.29	8.63	2.31	194.63M	0.64	3.29%
Great Southern Bancorp, Inc.	09/28	55.05	35.43	60.55	10.91	5.05	747.717M	1.44	2.56%
Guaranty Fed Bancshares, Inc.	09/28	24.01	13.85	26.99	13.80	1.74	105.285M	0.60	2.50%
Heartland Financial USA, Inc.	09/28	48.23	29.51	54.04	9.98	4.83	2.038B	1.00	2.11%
Home Bancorp, Inc.	09/28	38.55	24.05	39.84	7.68	5.02	333.3M	0.92	2.35%
Investar Holding Corp.	09/28	21.87	12.51	23.69	11.66	1.88	227.971M	0.32	1.47%
International Bancshares Corp	09/28	41.27	25.44	53.06	11.21	3.68	2.615B	1.20	2.85%
Landmark Bancorp, Inc.	09/28	27.84	20.76	28.50	6.19	4.50	132.504M	0.80	2.89%
Mackinac Financial Corp	09/28	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
MidWest One Finl Group, Inc.	09/28	30.03	17.41	33.68	13.45	2.23	476.729M	0.90	2.96%
Origin Bancorp, Inc.	09/28	42.60	20.60	46.65	11.93	3.57	1.001B	0.52	1.22%
Prosperity Bancshares, Inc.	09/28	70.54	50.43	83.02	12.33	5.72	6.555B	1.96	2.77%
QCR Holdings, Inc.	09/28	52.20	26.64	53.35	10.96	4.76	823.152M	0.24	0.47%
Solera National Bancorp, Inc.	09/28	11.39	9.26	13.95	5.40	2.11	32.556M	N/A	N/A
Southside Bancshares, Inc.	09/28	38.17	23.90	43.69	11.21	3.40	1.246B	1.32	3.41%
Spirit of Texas Bancshares, Inc.	09/28	24.24	10.82	24.94	10.05	2.41	416.181M	0.48	1.96%
Texas Capital Bancshares, Inc.	09/28	60.44	29.87	93.26	12.40	4.87	3.058B	N/A	N/A
Two Rivers Fin Group	09/28	41.05	24.15	44.89	4.43	9.27	91.69M	0.66	1.60%
Triumph Bancorp, Inc.	09/28	91.97	30.05	97.49	20.31	4.53	2.31B	N/A	N/A
UMB Financial Corporation	09/28	97.25	47.85	99.98	11.50	8.46	4.702B	1.48	1.51%
Veritex Holdings, Inc.	09/28	38.83	16.67	39.94	18.11	2.14	1.923B	0.80	2.12%
West Bancorp Incorporated	09/28	30.11	15.53	31.98	12.03	2.50	498.465M	0.96	3.14%

Source: Yahoo Finance (September 2021)

Thirteen banks have been added to this list since the September 2020 report.

N/A – Indicates information was not available.

SNAPSHOT STOCK PERFORMANCE

SOUTHWEST REGIONAL BANKS (MSECTOR415)

SEPTEMBER 2020

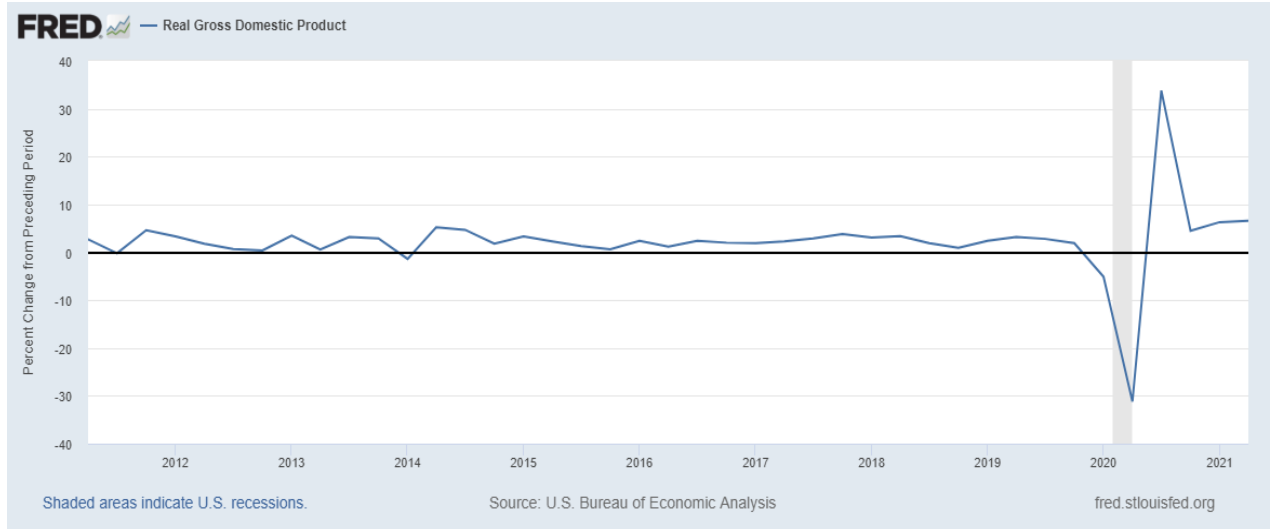
Name	Last Trade	52 Wk Range	PE	EPS	Mkt Cap	Div/Shr	Div Yld
ACNB Corporation	09/03 21.75	21.41 21.75	10.66	2.04	189.135M	1.00	4.69%
BancFirst Corporation	09/03 45.08	26.00 63.96	13.33	3.38	1.472B	1.36	3.09%
BOK Financial Corporation	09/03 57.94	34.57 88.28	10.78	5.37	4.069B	2.04	3.63%
Cass Information Sys, Inc.	09/03 39.27	28.85 60.97	20.89	1.88	566.317M	1.08	2.74%
Commerce Bancshares, Inc.	09/03 59.22	45.51 71.92	22.33	2.65	6.594B	1.08	1.83%
Cullen Frost Bankers, Inc.	09/03 70.42	47.69 99.42	12.67	5.56	4.415B	2.84	4.08%
Enterprise Fin Serv Corp	09/03 30.65	21.70 48.81	9.52	3.22	803.214M	0.72	2.34%
First Community Corp S C	09/03 13.00	12.23 22.00	10.07	1.29	97.32M	0.48	3.79%
First Financial Bankshares, Inc.	09/03 30.97	20.70 36.45	24.58	1.26	4.37B	0.52	1.70%
First Financial Northwest, Inc.	09/03 9.70	7.90 15.47	10.77	0.90	97.403M	0.40	4.18%
Great Southern Bancorp, Inc.	09/03 39.82	32.23 64.48	8.65	4.60	560.944M	1.36	3.53%
Guaranty Fed Bancshares, Inc.	09/03 13.80	12.70 26.93	6.82	2.02	60.272M	0.60	4.32%
Heartland Financial USA, Inc.	09/03 34.39	25.26 51.85	10.29	3.33	1.263B	0.80	2.37%
International Bancshares Corp	09/03 31.42	15.60 44.00	11.37	2.76	1.988B	1.10	3.55%
Landmark Bancorp, Inc.	09/03 22.20	14.95 27.78	7.10	3.13	102.517M	0.80	3.69%
Mackinac Financial Corp	09/03 10.05	6.52 17.75	7.98	1.26	105.863M	0.56	5.53%
MidWest One Finl Group, Inc.	09/03 19.70	15.25 39.03	9.03	2.18	317.156M	0.88	4.60%
Prosperity Bancshares, Inc.	09/03 54.80	42.02 75.22	10.89	5.03	5.078B	1.84	3.41%
QCR Holdings, Inc.	09/03 30.13	22.39 44.76	8.61	3.50	475.798M	0.24	0.80%
Solera National Bancorp, Inc.	09/03 9.47	8.00 11.60	10.44	0.91	16.402M	N/A	N/A
Texas Capital Bancshares, Inc.	09/03 32.58	19.10 64.88	16.05	2.03	1.643B	N/A	N/A
Two Rivers Fin Group	09/03 27.00	22.16 33.50	9.71	2.78	60.308M	0.64	2.44%
UMB Financial Corporation	09/03 55.10	39.47 70.26	14.47	3.81	2.646B	1.24	2.28%
West Bancorp Incorporated	09/03 17.70	13.74 25.93	9.41	1.88	291.507M	0.84	4.77%

Source: Yahoo Finance (September 2020)

N/A – Indicates information was not available.

NATIONAL ECONOMIC TRENDS

Real Gross Domestic Product

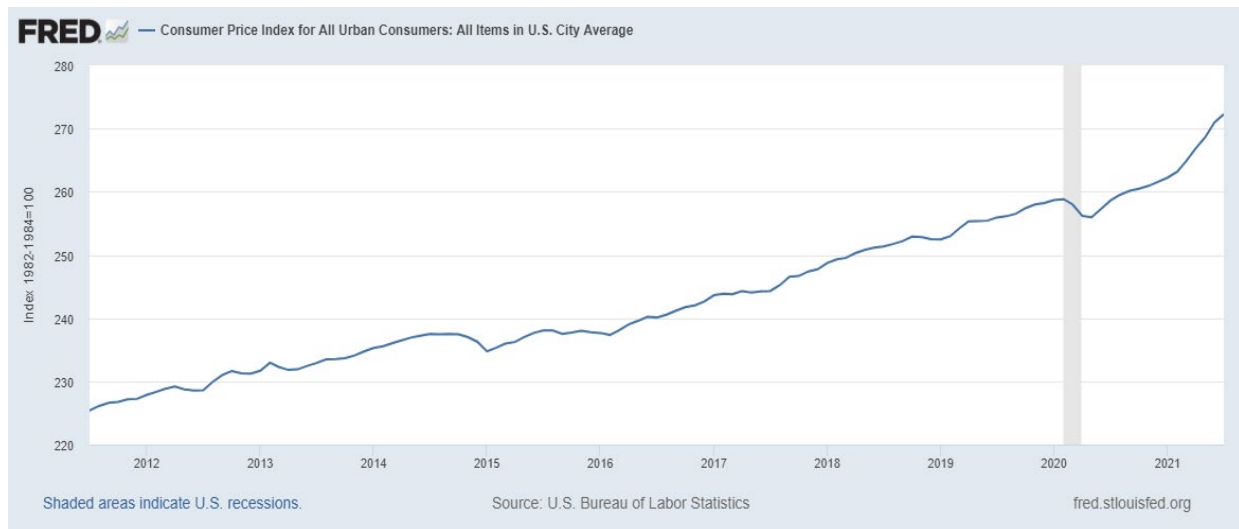


Consumer Price Index

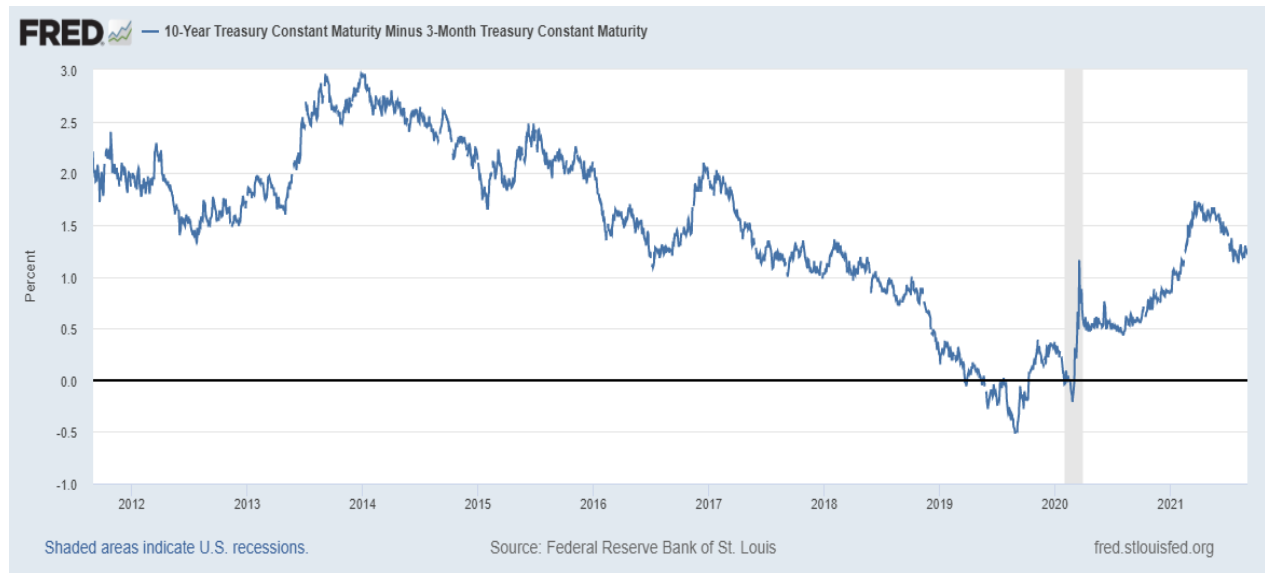


Source: Federal Reserve Bank of St. Louis, National Economic Trends, September 2021

Unemployment Rate



Interest Rates



Source: Federal Reserve Bank of St. Louis, National Economic Trends, September 2021

ECONOMIC REPORTS AND FORECASTS: UNITED STATES

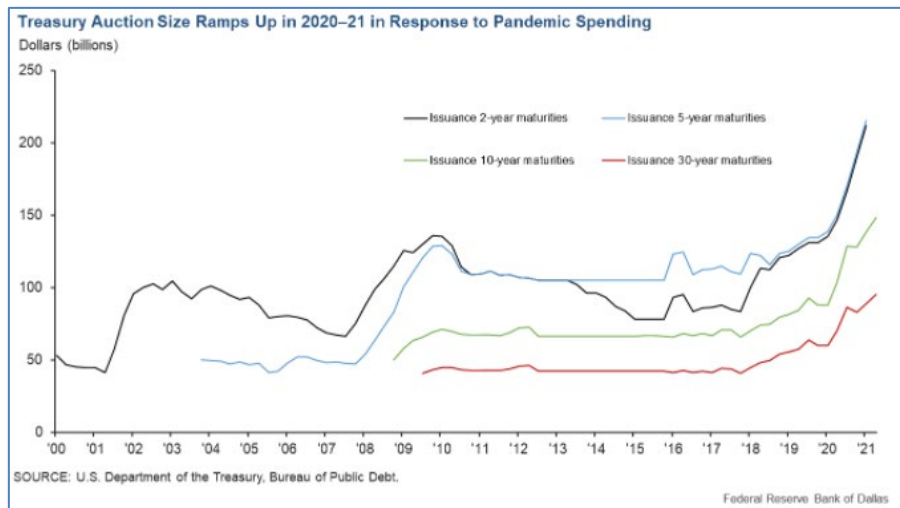
FEDERAL RESERVE BANK, DALLAS NATIONAL UPDATE

August 2021 - www.dallasfed.org¹

Treasury Auctions During the Pandemic: Stresses but Few Surprises

The federal government undertook a \$2.4 trillion spending and relief program in 2020 in response to the COVID-19 outbreak and accompanying economic dislocation. To help cover the costs, the government sold a variety of Treasuries at auction.

The amount of new-issue two-, five-, 10- and 30-year maturities sold at auction has increased 40 to 50 percent since the pandemic began in February 2020. Given the amount of new Treasury issuance, the degree of market participation in Treasury auctions is of particular interest.



Source: Federal Reserve Bank of Dallas

We present new work on an indicator designed to measure the success of 10-year Treasury note auctions to discern whether the outcomes of these sales are surprising in light of prevailing financial conditions.

This indicator suggests that Treasury auctions faced significant headwinds early in the pandemic. While there have been periodic concerns in the financial press about the health of Treasury auctions during the

COVID-19 outbreak, we find most 10-year Treasury auction results have been within what could be expected given overall financial considerations.

Measuring Auction Success

Traders of Treasuries gauge an auction's success by looking at a few key metrics, such as the bid-to-cover ratio and the auction "tail."

The bid-to-cover ratio is the quantity of bids for a new issue divided by the quantity accepted by the Treasury. A high bid-to-cover ratio indicates strong demand and a successful auction from the Treasury's perspective.

The auction's tail is computed from the "when issued" yield. Between the announcement of an upcoming auction and the actual issuance of securities afterward, market participants can trade the security on a

¹ Michael L. Tindall and Michael A. Perez

forward basis—in anticipation of the bonds being available—with trades settling when the Treasury finally issues the note.

The yield (or expected interest payment relative to the bond's price) on a Treasury determined in this forward trading is referred to as a when-issued yield. The tail is the highest yield accepted at auction less the security's when-issued yield immediately before the auction's conclusion.

A large positive tail indicates that the auction did not go well because the yield realized in the auction exceeded market expectations, indicating weaker-than-expected demand. The tail is a measure of unanticipated shifts in demand for a Treasury issue prior to auction.

However, the tail is an imperfect measure. Events in the last hours preceding an auction that may affect its success are not present in the tail. Thus, the tail only measures the deviation between auction results and what traders expected immediately before the auction occurred.

We compute an alternative metric, a “synthetic tail.” It is composed of the high yield at auction minus the 10-year note yield at the close the day before. The synthetic tail provides a measure of auction performance relative to expectations the previous day.

Creating a Model to Measure Auction Success

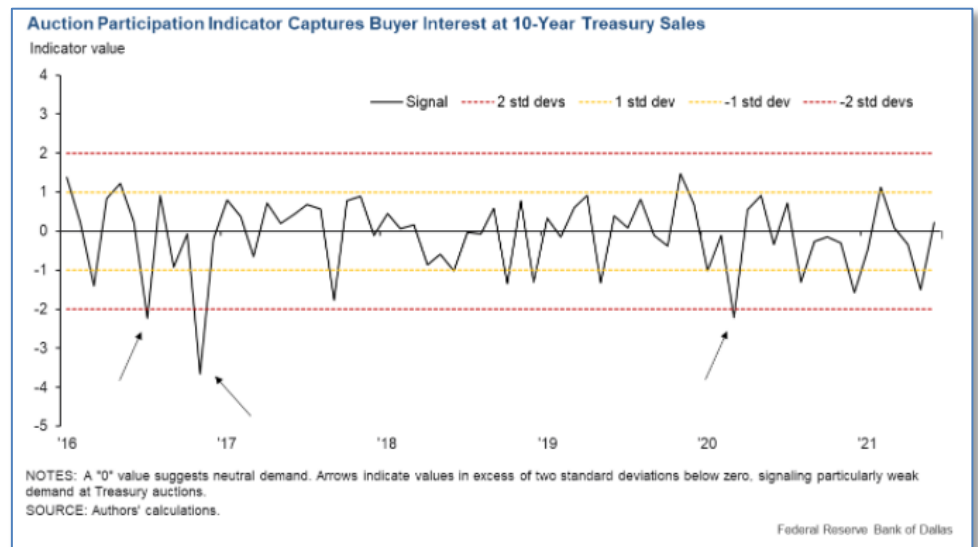
The U.S. Treasury publishes detailed results for each auction. They contain data that could influence the expectations of traders. We use this data to construct empirical models of the synthetic tail and bid-to-cover ratio for 10-year Treasury note auctions.

Besides the U.S. Treasury data, the model includes past values of the BBB spread (the difference in interest yield between low-investment-grade corporate debt and Treasuries), the VIX stock market volatility index, the yield-curve slope (defined as the 10-year Treasury yield minus the 3-month Treasury bill yield). A final element is the 30-year Treasury swaps spread (the difference between fixed-rate interest payments in lieu of interest rate payments that will vary with the market over a 30-year period) — higher spreads indicate greater perceived levels of risk.

The data cover three areas. The Treasury auction data provide broad background information on the 10-year auctions. The BBB spread, VIX and yield slope provide widely used bellwether information on general market conditions. The swaps spreads are a key indicator of conditions specific to the Treasury market.

The models are used to form estimates of the bid-to-cover ratio and the synthetic tail. Deviations of reported values from these model-generated estimates indicate the success of a Treasury 10-year note auction and form the basis of a “surprise indicator.”

A machine-learning technique is used to select plausible scenarios and construct the models of the bid-to-cover ratio and the synthetic tail for 10-year Treasury auctions. The deviations of the observed value of the bid-to-cover ratio from the model-estimated bid-to-cover ratio and the observed value of the synthetic tail from the model-estimated



Source: Federal Reserve Bank of Dallas

synthetic tail are scaled so that each has equal influence. The bid-to-cover tail deviations are then combined into a single indicator of auction surprise.

To test its performance, we computed the indicator beginning in January 2016 and compared its behavior to known events in the auctions. The indicator exhibited extremely weak values, or negative “surprises,” for three 10-year Treasury auctions. The surprise indicator for the 10-year Treasury auction ended 2020 more than one standard deviation below the neutral reading of zero, suggesting weak auction demand, but it has rebounded in 2021.

Newspaper reports describe what was happening when those three “surprising” auctions occurred. *The Wall Street Journal* said in its report on the July 12, 2016, auction:

“Reduced buying interest in [high-grade] bonds led to a tepid \$20 billion sale of 10-year Treasury notes. ...

“Another factor hurting demand for Treasury debt: Skinny yields encouraged firms to sell new debt. New corporate bond sales offer more attractive yields than comparable-maturity Treasury bonds.”

The second surprise occurred Nov. 9, 2016, the day after the 2016 presidential election. At the time, market participants were beginning to weigh the effects of the election on Treasury borrowing. *The Wall Street Journal* reported the next day:

“A selloff in government bonds picked up more momentum Thursday, spreading across the world as investors reacted to the prospect of increased U.S. fiscal stimulus under [the new administration]. Investors are now asking whether Mr. Trump’s victory marks a turning point for fixed-income markets that have been on a lengthy bull run.”

During the third instance—the March 11, 2020, auction—markets were coming to grips with the effects of the COVID-19 pandemic. It occurred in the midst of a 23-day period in which the S&P 500 Index declined by about 30 percent peak to trough. The day after the 10-year auction, March 12, the *New York Times* ran an article headlined “Something Weird Is Happening on Wall Street, and Not Just the Stock Sell-Off.” It said:

“It has been an unsettling week on global financial markets. ... On a day when major economic disruptions resulting from the coronavirus pandemic appeared to become likelier—which might be expected to make typical market safe havens more popular—many of them fell instead Wednesday.

“And there were reports from trading desks that many assets that are normally liquid ... were freezing up. ... This was true of the bonds issued by municipalities and major corporations but, more curiously, also of Treasury bonds, normally the bedrock of the global financial system.”

The Treasury auction surprise indicator suggests that, despite a sharply negative reading in March 2020, Treasury auction outcomes have normalized. Results have not been surprising given other financial conditions despite the increased government borrowing in response to the pandemic.

U.S. ECONOMY AT A GLANCE

U.S. BUREAU OF LABOR STATISTICS

Data Series	Jan 2021	Feb 2021	Mar 2021	Apr 2021	May 2021	June 2020
Unemployment Rate ⁽¹⁾	6.3	6.2	6.0	6.1	5.8	5.9
Change in Payroll Employment ⁽²⁾	233	536	785	269	614	(P) 938
Average Hourly Earnings ⁽³⁾	29.92	30.00	29.97	30.17	30.31	(P) 30.43
Consumer Price Index ⁽⁵⁾	0.3	0.4	0.6	0.8	0.6	0.9
Producer Price Index ⁽⁶⁾	1.2	0.7	0.8	(P) 0.7	(P) 0.8	(P) 1.0
U.S. Import Price Index ⁽⁷⁾	1.5	1.2	1.5	(R) 0.9	(R) 1.3	(R) 1.1

Footnotes:

- (1) In percent, seasonally adjusted. Annual averages are available for Not Seasonally Adjusted data.
 (2) Number of jobs, in thousands, seasonally adjusted.
 (3) Average Hourly Earnings for all employees on private nonfarm payrolls.
 (4) All items, U.S. city average, all urban consumers, 1982-84=100, 1-month percent change, seasonally adjusted.
 (5) Final Demand, 1-month percent change, seasonally adjusted.
 (6) All imports, 1-month percent change, not seasonally adjusted.
 (P) Preliminary
 (r) Revised

Data Series	2nd Qtr 2020	3rd Qtr 2020	4th Qtr 2020	1st Qtr 2021	2nd Qtr 2021
Employment Cost Index ⁽¹⁾	0.6	0.5	0.7	0.9	0.7
Productivity ⁽²⁾	11.2	4.2	-3.8	(R) 4.3	2.3

Footnotes:

- (1) Compensation, all civilian workers, quarterly data, three-month percent change, seasonally adjusted.
 (2) Output per hour, nonfarm business, quarterly data, percent change from previous quarter at annual rate, seasonally adjusted.
 (R) Revised.

Data extracted: August 24, 2021

THE FEDERAL RESERVE BOARD

THE BEIGE BOOK – SEPTEMBER 8, 2021, EXCERPT

Overall Economic Activity

Economic growth downshifted slightly to a moderate pace in early July through August. The stronger sectors of the economy of late included manufacturing, transportation, nonfinancial services, and residential real estate. The deceleration in economic activity was largely attributable to a pullback in dining out, travel, and tourism in most Districts, reflecting safety concerns due to the rise of the Delta variant, and, in a few cases, international travel restrictions. The other sectors of the economy where growth slowed or activity declined were those constrained by supply disruptions and labor shortages, as opposed to softening demand. In particular, weakness in auto sales was widely ascribed to low inventories amidst the ongoing microchip shortage, and restrained home sales activity was attributed to low supply. Growth in non-auto retail sales slowed a bit in some Districts, rising at a modest pace, on balance, across the nation. Residential construction was up slightly, on balance, and nonresidential construction picked up modestly. Trends in loan volumes varied widely across Districts, ranging from down modestly to up strongly. Reports on the agriculture and energy sectors were mixed across Districts but, on balance, positive. Looking ahead, businesses in most Districts remained optimistic about near-term prospects, though there continued to be widespread concern about ongoing supply disruptions and resource shortages.

Highlight of Dallas Federal Reserve

Solid expansion continued in the Eleventh District economy, though surging COVID-19 cases has added uncertainty to outlooks. Growth in the manufacturing and nonfinancial services sectors remained strong, and retail sales rose in August after holding steady in recent months. Home sales remained solid but eased. Overall loan volumes rose broadly, led by commercial real estate lending. Energy activity rose steadily, and agricultural conditions were very strong. Employment growth was robust, and wage growth remained elevated amid widespread labor shortages. Ongoing supply chain disruptions continued to drive up prices, though pressures eased slightly over the reporting period. Outlooks improved, though uncertainty increased.

ECONOMIC REPORTS AND FORECASTS: STATE OF TEXAS

FEDERAL RESERVE BANK, DALLAS

August 2021 - www.dallasfed.org¹

Texas Economy Strongly Expands Despite Supply-Chain Disruptions, Hiring Challenges

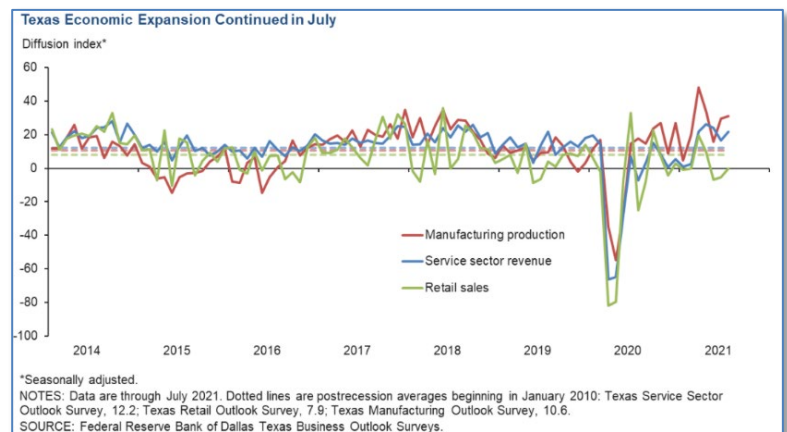
Economic activity continued to expand at a robust pace in July, though growth was constrained by continued supply-chain disruptions and hiring difficulties. Texas employment rose at a healthy pace in June, and the unemployment rate inched down.

The labor market remained tight despite the rollback of supplemental federal unemployment benefits in late June. There has been strong upward pressure on prices and wages, though there were some signs of easing in July. The hot housing market continued to push up apartment rents, housing prices and construction.

↑ Economic Activity Expands at Strong Pace

The Texas Business Outlook Surveys (TBOS) for July point to strong output expansion. The manufacturing sector exhibited solid growth, with the production index increasing from 29.4 in June to 31.0 in July. The TBOS diffusion indexes measure the difference between the percentage of firms reporting increases and those reporting decreases, so large positive numbers are indicative of rising activity levels.

Growth in the service sector picked up as well; the revenue index climbed from 16.7 to 21.7 in July. Retail activity also improved but remained weak, with the sales index coming in at near zero in July. Retail businesses, such as auto dealerships, face challenges making sales because they have low inventories and disrupted supply chains.



Source: Federal Reserve Bank of Dallas

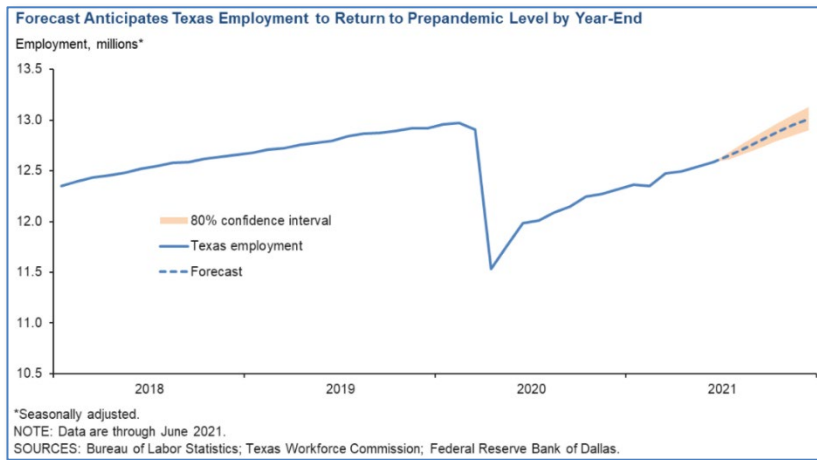
↓ Supply and Labor Constraints Abound

Economic growth is stymied by supply-chain disruptions and hiring difficulties. On the labor front, there are too few job applicants and a high quit rate. Even as businesses raise wages and the expanded federal unemployment benefits expired in Texas in June, TBOS respondents cited the lack of applicants and material shortages as obstacles to growing business operations in July. However, respondents expect the disruption to the supply chain to moderate significantly over the next six months.

¹ Carlee Crocker and Yichen Su

Price and wage pressures were near record levels in July, and expected price increases for the year were up markedly from the December 2020 survey. In July, businesses expected input price growth for 2021 of 6.7%, up from 3.7% in December 2020; they expected wage growth of 5.1%, up from 4.3 in December, and selling price growth of 5.3 percent, up from 3.4%. Survey respondents anticipate that price and wage growth will slow in 2022 from the breakneck pace of 2021, although the rate of increase will remain above average.

↑ Texas Employment Continues to Grow



Texas employment grew an annualized 4.3 percent month over month in June, similar to the 4.4% growth posted in May. In the first half of the year, Texas payrolls expanded an annualized 4.4%—a pace that slightly trailed national job growth of 4.6%. The Dallas Fed's 2021 Texas employment forecast is 5.6% for the year (December/December). If statewide payrolls grow as predicted, Texas employment will reach prepandemic (February 2020) levels by year-end.

↑ Texas Unemployment Edges Down in June

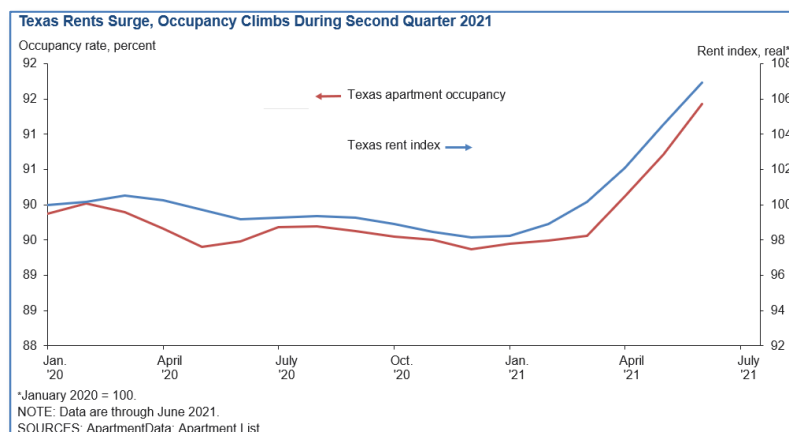
The Texas unemployment rate fell by 0.1 percentage points to 6.5% in June, its lowest level since March 2020. Despite this decline, the statewide measure remains higher than the national rate, which was 5.9% in June.

Even though the unemployment rate is higher in Texas than in the U.S., other indicators suggest there is not much labor market slack. For example, the June employment-to-population ratio of 59.7 in Texas was on par with the nation's 59.0%. The Texas unemployment rate in recent months has been higher than the nation in part because the Texas labor force participation rate is higher than the nation's.

The employment situation has improved for minority groups in Texas in recent months. While the unemployment rates for Hispanic and non-Hispanic Black Texans remain higher than those of non-Hispanic whites, they have declined far more rapidly. In addition, the employment-to-population ratio for non-Hispanic Blacks in Texas has surged since April and surpassed that of both Hispanics and non-Hispanic whites as of June. The employment-to-population ratio for Hispanics is similar to that of non-Hispanic whites in Texas. It bears noting that the estimates for Texas may be slightly less reliable than the national estimates due to a smaller household survey sample size.

↑ Texas Housing Market Heats Up Further

The housing market in Texas continues to be hot. With the continued in-migration of residents from other states and the surging demand for homes, home-price growth in Texas has largely been on par with national home-price growth since the beginning of last year.



Source: Federal Reserve Bank of Dallas

spread of the Delta variant, the timeline for businesses bringing their workforce back into the office is unclear.

↑ Economic Outlook Broadly Optimistic

The increase in new COVID-19 cases and the spread of the Delta variant pose downside risks to the Texas growth outlook. The Texas vaccination rate lags behind the nation with only 55% of Texans age 18 or older fully vaccinated as of July 27, compared with 60% nationwide. Notwithstanding the elevated COVID-19 risks and continued challenges in the supply chain and labor market, Texas business respondents remained positive in July. Company outlooks remained far above average, reflecting broad optimism and high growth expectations for the fall.

Multifamily markets are also heating up. Texas apartment rents surged in second quarter 2021 after declining throughout the pandemic until early this year. Consistent with rising rents, apartment occupancy rates also increased markedly across Texas metros in the second quarter.

Office occupancy in Texas major metros declined in second quarter 2021 for the sixth quarter in a row. The drop was sharpest in Austin, where a large portion of workers are able to work from home. With the high demand from many white-collar workers to work remotely and the recent increase in COVID cases due to the

TEXAS ECONOMIC STATISTICS

U.S. BUREAU OF LABOR STATISTICS

Data Series	Jan 2021	Feb 2021	Mar 2021	Apr 2021	May 2021	June 2021
Labor Force Data						
Civilian Labor Force ⁽¹⁾	14,063.5	14,005.2	14,032.3	14,035.0	14,056.0	14,068.7
Employment ⁽¹⁾	13,105.0	13,034.9	13,064.9	13,087.8	13,133.3	13,159.8
Unemployment ⁽¹⁾	958.6	970.3	967.4	947.2	922.7	909.0
Unemployment Rate ⁽²⁾	6.8	6.9	6.9	6.7	6.6	6.5
Nonfarm Wage and Salary Employment						
Total Nonfarm ⁽³⁾	12,404.2	12,401.8	12,511.5	12,526.5	12,568.5	12,627.4
12-month% change	-4.3	-4.4	-3.1	8.8	6.9	5.5
Mining and Logging ⁽³⁾	177.4	180.2	186.9	184.5	186.3	189.2
12-month% change	-24.3	-23.3	-19.9	-11.6	-1.1	6.9
Construction ⁽³⁾	726.6	725.4	749.5	734.7	729.9	726.0
12-month% change	-6.7	-7.1	-3.9	1.9	0.3	-0.1
Manufacturing ⁽³⁾	858.9	859.9	869.9	867.8	871.8	874.4
12-month% change	-5.8	-5.5	-4.2	1.5	1.8	1.7
Trade, Transportation, and Utilities ⁽³⁾	2,521.8	2,537.5	2,553.4	2,551.2	2,558.1	2,570.1
12-month% change	-0.6	0.1	0.8	9.6	7.5	5.5
Information ⁽³⁾	199.6	200.4	201.5	201.1	202.2	203.1
12-month% change	-6.0	-5.3	-4.2	5.0	5.8	6.3
Financial Activities ⁽³⁾	815.8	816.1	825.8	825.1	826.4	825.
12-month% change	-0.1	-0.3	0.9	4.0	3.9	3.7
Professional & Business Services ⁽³⁾	1,821.5	1,807.9	1,822.4	1,830.6	1,842.6	1,857.2
12-month% change	-0.3	-1.4	-0.1	9.1	8.7	9.0
Education & Health Services ⁽³⁾	1,706.2	1,706.6	1,712.7	1,711.1	1,710.3	1,720.9
12-month% change	-3.8	-3.9	-3.4	7.0	3.8	2.7
Leisure & Hospitality ⁽³⁾	1,216.6	1,211.9	1,233.5	1,251.6	1,272.5	1,293.1
12-month% change	-14.0	-14.4	-10.5	46.5	27.0	16.8
Other Services ⁽³⁾	400.4	398.8	402.4	403.6	406.1	406.8
12-month% change	-11.5	-12.1	-9.9	18.8	14.2	7.5
Government ⁽³⁾	1,959.4	1,957.1	1,953.5	1,965.2	1,962.3	1,960.9
12-month% change	-2.0	-2.1	-2.4	0.8	2.4	2.3
Footnotes			⁽³⁾ Number of jobs, in thousands, seasonally adjusted.			
⁽¹⁾ Number of persons, in thousands, seasonally adjusted.						
⁽²⁾ In percent, seasonally adjusted.						

Data extracted: August 24, 2021

FEDERAL RESERVE BANK

SENIOR LOAN OFFICER OPINION SURVEY

The July 2021 Senior Loan Officer Opinion Survey on Bank Lending Practices addressed changes in the standards and terms on, and demand for, bank loans to businesses and households over the past three months, which generally correspond to the second quarter of 2021.

Regarding loans to businesses, respondents to the July survey, on balance, reported easier standards and stronger demand for commercial and industrial (C&I) loans to firms of all sizes over the second quarter. For commercial real estate (CRE), standards on multifamily and construction and land development loans eased, while standards on loans secured by nonfarm nonresidential properties remained basically unchanged. Banks reported stronger demand for all CRE loan categories.

For loans to households, banks eased standards across most categories of residential real estate (RRE) loans, on net, and reported stronger demand for most types of RRE loans over the second quarter. Banks also eased standards and reported stronger demand across all three consumer loan categories—credit card loans, auto loans, and other consumer loans.

The survey included an additional set of special questions inquiring about the current level of lending standards relative to the midpoint of the range over which banks' standards have varied since 2005. Banks, on balance, reported that their lending standards on C&I loans are currently at the easier end of the range of standards between 2005 and the present. For subprime consumer loans and most categories of commercial or residential mortgages, banks reported currently having relatively tighter levels of lending standards on net. However, the reported levels of lending standards eased for all loan categories relative to the July 2020 survey.

Additionally, banks were asked to report when standards reached their easiest and tightest points since 2005. Most banks reported that standards were easiest between 2005 and 2007 and tightest between 2008 and 2010, indicating that the ranges of standards in consideration have not changed significantly since 2011—the first year that special questions on the levels of standards were asked.

BUSINESS LENDING

C&I Loans

Over the second quarter, banks reported having eased standards and terms on C&I loans to firms of all sizes. On net, significant shares of banks reported having eased standards on loans to large and middle-market firms and small firms. Banks eased all queried lending terms on loans to large and middle-market firms and eased most their lending terms on loans to small firms. Easing was most widely reported for spreads of loan rates over the cost of funds and costs of credit lines, with significant net shares of banks reporting easing these terms for C&I loans to small and large and middle-market firms.

Additionally, significant net shares of banks reported easing the following terms on C&I loans to large and middle-market firms: the maximum size of credit lines, loan covenants, the use of interest rate floors, and premiums charged on riskier loans. Other C&I loan terms were either eased by a modest share of banks or remained basically unchanged on net. Foreign banks reported having left standards and most of their lending terms on C&I loans unchanged. However, a moderate net share of foreign banks reported narrowing spreads of loan rates over the cost of funds, and modest net shares eased loan covenants and risk premiums.

Major net shares of banks that reported easing standards or terms cited a more-favorable or less uncertain economic outlook, more-aggressive competition from other banks on nonbank lenders, and improvements in industry-specific problems as important reasons for doing so. Significant net shares of banks also mentioned increased tolerance for risk and improvements in their current or expected liquidity or capital positions as important reasons for easing lending standards and terms.

Regarding demand for C&I loans over the second quarter, modest net shares of banks reported stronger demand from small and large and middle-market firms. Furthermore, a significant net share of banks reported a higher number of inquiries from potential borrowers regarding the availability and terms of new credit lines or increases in existing lines over the second quarter. Meanwhile, a modest net fraction of foreign banks reported stronger demand for C&I loans.

Major shares of banks that reported stronger demand cited increases in customers' needs

to finance inventory, accounts receivable, investment in plant or equipment, and mergers and acquisitions as important reasons for stronger demand. Most of the banks that reported weaker demand cited an increase in customers' internally generated funds as an important reason.

CRE Lending

Over the second quarter, moderate and modest net shares of banks reported easing standards on multifamily loans and construction and land development loans, respectively. Meanwhile, standards on nonfarm nonresidential loans remained basically unchanged on net.

Significant net shares of banks reported stronger demand for multifamily loans and construction and land development loans, while a moderate net share of banks reported stronger demand for loans secured by nonfarm nonresidential properties. A modest net share of foreign banks eased standards on CRE loans, while a moderate net share of foreign banks reported stronger demand for such loans.

LENDING TO HOUSEHOLDS

Residential Real Estate Lending

Over the second quarter, banks eased lending standards for most mortgage loan categories and for revolving home equity lines of credit (HELOCs). The two exceptions were for government-sponsored enterprise (GSE)-eligible mortgages—for which standards were basically unchanged on net—and for subprime mortgages, which few banks reported as originating. The easing in residential mortgage standards was most widely reported for jumbo loans, with significant net shares of banks reporting easing standards for qualified mortgage (QM) jumbo mortgages and non-QM jumbo mortgages.

Banks also reported stronger demand for most RRE loan categories over the second quarter. The three exceptions were for government residential mortgages and HELOCs—for which demand was basically unchanged on net—and for subprime

residential mortgage loans. The strengthening in demand was most pronounced for jumbo loans, with significant net shares of banks reporting stronger demand for QM and non-QM jumbo mortgages.

Banks also reported stronger demand for most RRE loan categories over the second quarter. The three exceptions were for government residential mortgages and HELOCs—for which demand was basically unchanged on net—and for subprime residential mortgage loans. The strengthening in demand was most pronounced for jumbo loans, with significant net shares of banks reporting stronger demand for QM and non-QM jumbo mortgages).

Consumer Lending

Over the second quarter, a significant net share of banks eased standards for credit card loans, and moderate net shares of banks eased standards for auto loans and for other consumer loans. Consistent with easier

lending standards, a significant net share of banks reduced the minimum required credit score on credit card loans, and moderate net shares of banks did so on auto and other consumer loans. Additionally, a significant net share of banks increased credit limits on credit card accounts. Other surveyed terms on consumer loans either remained basically

unchanged, on net, or had a modest net share of banks report easing.

Regarding demand for consumer loans, significant net shares of banks reported stronger demand for auto and credit card loans, and a modest net share of banks reported stronger demand for other consumer loans.

SPECIAL QUESTION ON BANKS' OUTLOOK FOR 2020

As with all July surveys since 2011, the July 2021 survey included a set of special questions that asked respondents to describe the current levels of lending standards at their bank. Specifically, respondents were asked to consider the range over which their lending standards have varied between 2005 and the present and to report where the level of standards currently is relative to the midpoint of that range.

In addition to the annual special questions on the current level of standards, in this edition of the July survey, banks were also asked to report when standards reached their easiest and tightest points since 2005. Most banks reported that standards were easiest between 2005 and 2007 and tightest between 2008 and 2010 across all loan categories. These results indicate that the ranges of standards in consideration have not changed in a significant way over the course of the pandemic, facilitating comparisons of the levels of standards over time.

Overall, responses to the July 2020 and 2021 surveys indicate that banks' lending standards have eased notably since 2020. For all loan categories, the net shares of banks reporting standards on the tighter end of their range fell enough to offset most of last year's increase.

For C&I loans, banks reported levels of standards that were easier, on net, than the midpoints of their historical ranges for all C&I loan categories. Banks' responses regarding the current level of lending standards were basically unchanged, on net, relative to the July 2019 survey.

Among foreign banks, respondents reported C&I loan standards that are tighter than the midpoints of their historical ranges, except for syndicated loans to investment-grade borrowers, for which standards were near the midpoint. For all such categories, the levels of standards have eased since the July 2020 survey but remain tighter than the levels reported in 2019.

For CRE loans, banks reported standards that are tighter than the midpoints of their historical ranges for nonfarm nonresidential loans and construction and land development loans, and standards that are near the midpoint of the range for multifamily loans. The net shares of banks reporting standards on the tight end of their ranges fell since 2019 for all CRE categories, driven entirely by smaller banks—the levels of CRE standards tightened, on net, since 2019 for large and foreign banks.

Regarding RRE loans, moderate net shares of banks reported that lending standards for residential mortgages—GSE-eligible, government, and jumbo mortgages—were on the tight ends of their ranges, while a significant net share of banks reported standards for HELOCs were on the tight end of their range. Though the net shares of banks reporting relatively tight standards have declined since the 2020 survey, they are still higher than in the 2019 survey for most RRE categories.

Regarding consumer loans, standards for prime auto and credit card loans are near the midpoints of their historical ranges, while standards for subprime auto and credit card loans and for other consumer loans are on the tight end of their historical ranges. Banks' responses regarding the levels of standards for consumer loans were generally in line with those from the 2019 survey.

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*Visit the Finance Commission of Texas [website](#) for previous
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