

September 2016



CONDITION OF THE TEXAS BANKING SYSTEM

Financial Data as of June 30, 2016



**Texas Department of Banking
Texas Department of Savings and Mortgage Lending**



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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
❖	Interest item		

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This publication is also located on the Texas Finance Commission website: www.fc.texas.gov

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ECONOMIC REVIEW AND OUTLOOK

TEXAS BANKING SYSTEM

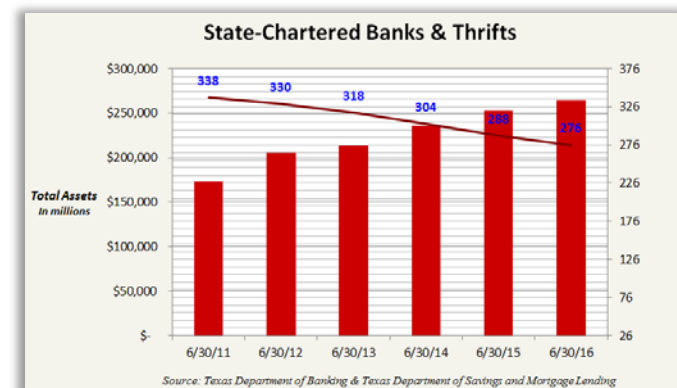
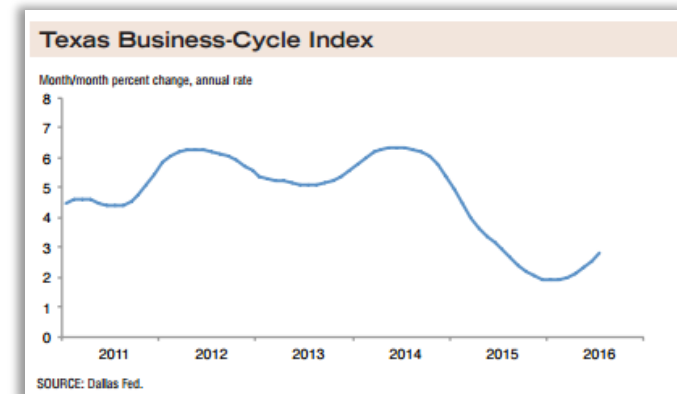
BANKING SYSTEM OVERVIEW

The first half of 2016 resulted in lower than anticipated economic growth for Texas and the U.S. Weaker global markets and intensified uncertainties, primarily related to lower oil and gas (O&G) prices and appreciation in the U.S. dollar, were major contributors in this economic pause. Education and health services, leisure and hospitality, and government led the list for adding jobs in July 2016, with losses observed in manufacturing and mining and logging. Texas real gross domestic product (GDP) declined to a 0.3% annualized rate in the first quarter, compared to 1.4% in the fourth quarter 2015. However, the Texas Business-Cycle index, which is designed to measure the current state of the economy, grew at a 2.8% annualized rate in July 2016. The Federal Reserve Bank of Dallas forecasts the second half of the year to emerge with improved employment and production.

Overall, state-chartered financial institutions operated profitably with an average 1.0% return of assets and a net interest margin of 3.4%, as of June 30, 2016. The Federal Deposit Insurance Corporation (FDIC) reported an average 1.0% return of assets and 3.1% net interest margin for all financial institutions in the U.S. Despite the current economic conditions facing the banking industry, only 2.2% of state-chartered institutions reported losses, compared to 4.3% on the national level. Texas banks and thrifts also have a lower average ratio of nonperforming loans to total loans relative to all institutions regulated by the FDIC at 1.0% versus 1.5%.

The Texas banking system remains vigilant to emerging economic factors and technological threats. Elevated exposures in lending, primarily in O&G and commercial real estate (CRE), requires prudent risk management practices. The Departments continue to monitor concentration risks with various types of reviews including quarterly off-site monitoring. Financial institutions are also continuously reminded and evaluated on sound cybersecurity practices.

The condition of the state banking industry has improved as evidenced by the decline in problem banks; those receiving an overall CAMELS rating of “3,” “4,” or “5.” As of June 30, 2016, of the 275 institutions regulated by the Departments, 4.4% are classified as problem institutions. This is down from 29.3% at the peak in 2010. The total number of banks regulated by the Departments continues on a downward trend due to an increase in merger and acquisition activity, however, total assets continue to expand.



STATE-CHARTERED BANKING PROFILE (DEPARTMENT OF BANKING)

The number of Texas state-chartered banks declined during the first half of 2016, with 249 banks as of June 30, 2016, compared to 252 banks at December 31, 2015. The reduction was due to four mergers, two of which were mergers into national banks and two into other Texas state-chartered banks. These four mergers offset the addition of one bank into the state banking system from the conversion of a national bank. During the same period, the Department received and processed 103 applications related to banks, with approximately 56.3% of the filings involving branch and production office activity, and 16.5% with issues involving ownership and control.

Despite the slight decline in the number of banks, the overall asset size of Texas state-chartered banks grew from \$247.0 billion at December 31, 2015, to \$248.5 billion by June 30, 2016. The asset growth occurred from a combination of \$0.9 billion internal asset growth and \$0.6 billion from a national bank that converted to a state charter. Of the 249 banks under supervision, 12 were defined as problem institutions as of June 2016.

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

Increased profitability occurred in 55.5% of the thrift institutions since the middle of 2015, primarily due to an increase in the volume of loans at most institutions. No thrift charters were unprofitable at June 2016. The median level of nonperforming loans and other real estate foreclosed remains low in state-chartered thrifts at 0.3% of total assets. Past due and nonaccrual loans, and foreclosed real estate continue to be monitored closely by state and federal regulators.

State-chartered thrift assets under the Department's jurisdiction totaled \$16.3 billion as of June 30, 2016, which represents an increase of 37.9% or \$4.5 billion from this time last year. The total number of state-chartered savings banks remains unchanged from June 2015 and none are classified as problem institutions.

The Department continues to receive and process applications. During the past twelve months, there have been four branch office applications, five merger/reorganization applications, and various other types of applications.

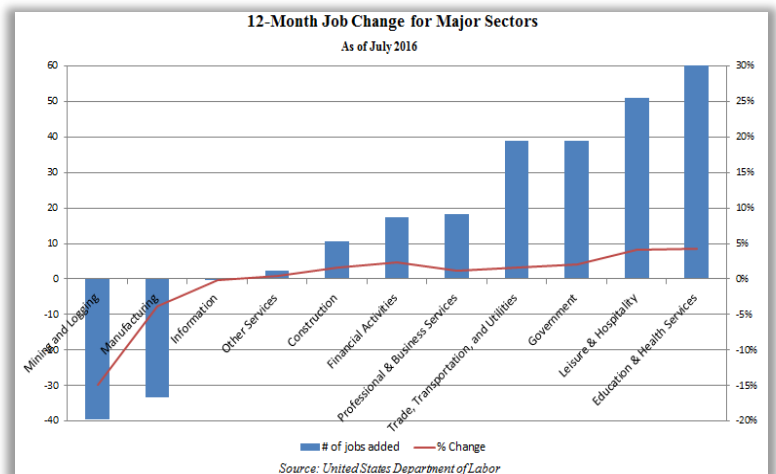
TEXAS ECONOMIC PROFILE

The Texas economy observed pressures during the first half of 2016, a combination of slow growth in the U.S. economy during the first quarter and low oil prices. However, according to the Federal Reserve Bank of Dallas, growth picked up in the second quarter. Apart from oil, Texas is one of the top manufacturing states in the country, and it continues to observe pressures with the appreciation of the U.S. dollar. A higher value of the dollar makes exports more expensive overseas resulting in a lower demand for these products, decreasing output for manufacturing companies, thus reducing employment.

Employment

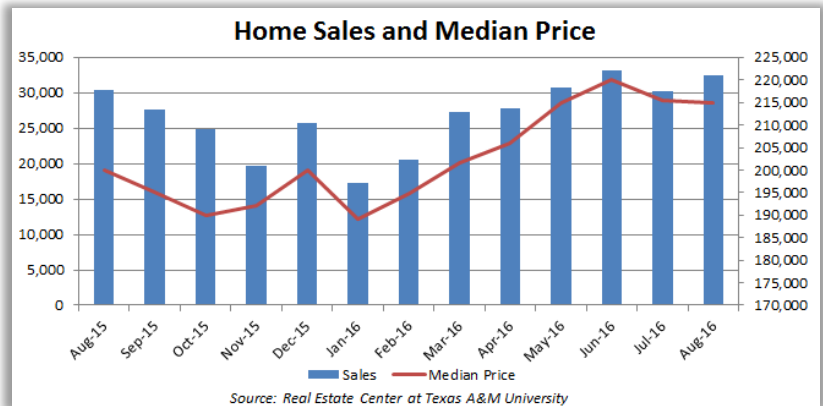
Texas total nonfarm employment increased by 1.5% in July 2016, compared to July 2015, adding more than 173,000 jobs. The majority of this growth is derived from education and health services and leisure and hospitality, which combined, make up about 24.5% of Texas nonfarm employment. Losses were experienced in manufacturing, mining and logging, and information, 10.6% of the Texas total nonfarm employment. The appreciation of the U.S. dollar along with depressed O&G prices led most of these losses. Nationally, Texas contributed to 8.6% of job growth in July, adding 23,600 nonfarm jobs, while the U.S. added 275,000.

Although, the Texas unemployment rate rose slightly to 4.6% in July, increasing by 0.2% from last year, it continues to be at or below the national rate. The U.S. unemployment rate remained steady at 4.9% with a 0.4% improvement compared to July 2015.



Housing

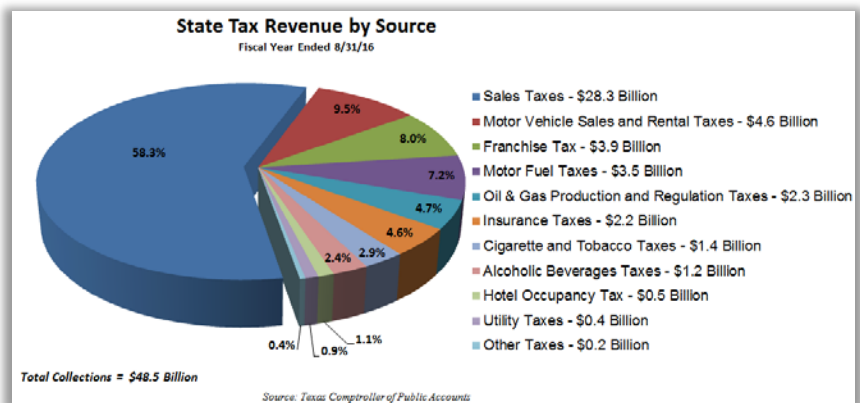
According to the Real Estate Center at Texas A&M University, existing-home sales declined in July 2016 from the previous year by 8.7% to 30,212 units, while the median sales prices increased by 6.7% to \$215,500. The average and median home sales price have risen dramatically in Texas since 2011 with Austin leading the house-price appreciation. The non-energy employment growth and strong services sector also caused Dallas-Fort Worth to record strong price appreciation. Houston has begun to experience some deterioration in price growth as a result of the weakening oil industry.



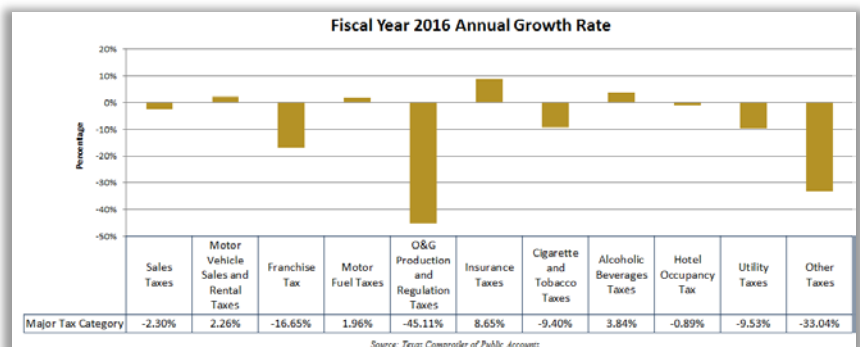
Building permits for single-family and multi-family homes also dropped from a year ago by 4.7% and 15.6%, respectively. Houston and Dallas-Fort Worth led the nation in the number of single-family home permits issued followed by Atlanta and Phoenix. Foreclosure rates for August 2016 are 45% lower than the national rate. One in every 2,522 homes is foreclosed in the state, while one in every 1,388 homes is foreclosed nationally.

Tax Revenue

Total state tax revenue for fiscal year 2016, ending August 31, 2016, was \$48.5 billion, a decline of 6.2% from the previous year. According to Texas Comptroller Glenn Hegar, due to the prolonged weaknesses in the O&G sector and the continued downward trend of sales taxes, a decline in total tax collections is expected. Overall, tax collections were more than \$1 billion lower than originally forecasted.



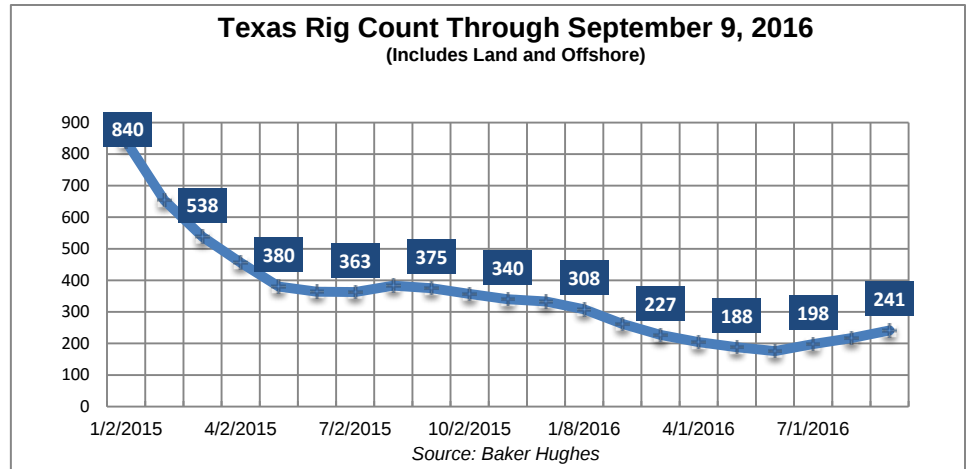
The largest contributors to tax collections are sales taxes, motor vehicle sales and rental taxes, and the franchise tax. Together they make up about 75% of the state's total tax revenue. Sales taxes and franchise tax collections declined from fiscal year 2015 by 2.3% and 16.7% respectively, while motor vehicle sales and rental taxes increased by 2.3%. Franchise taxes are lower due to permanent tax rate cuts enacted during the 2015 legislative session. The decline in state sales tax revenue was led primarily by reduced collections from the O&G related sectors, but collections from the retail trade and information sectors are also down compared to a year ago. Construction and restaurants continue to experience growth, helping offset some of the decreases to sales tax receipts. Oil and natural gas production taxes observed the most significant percent change by dropping 45.1% from last year, representing about 4.7% of total tax collections.



Crude Oil & Global Economy

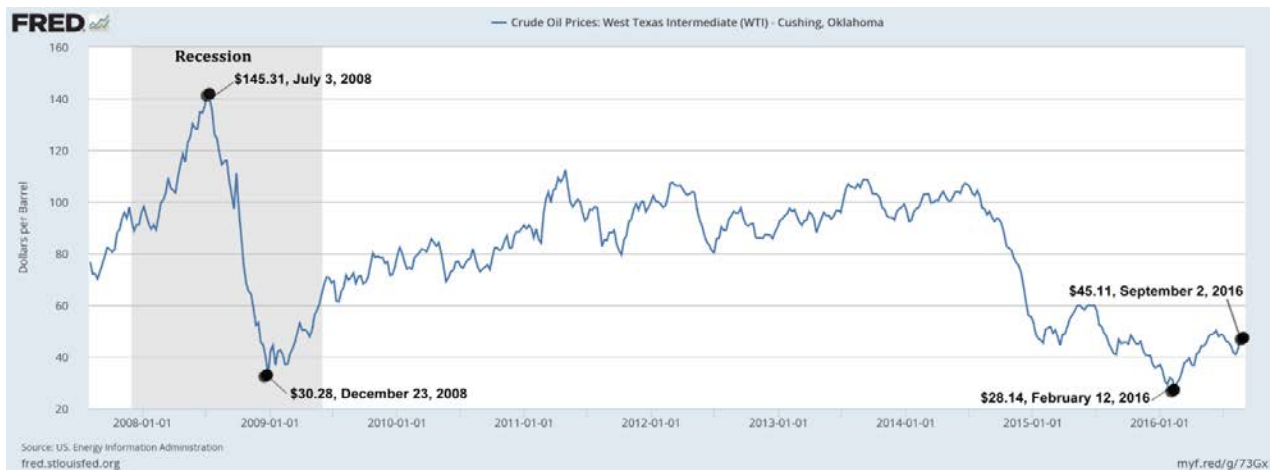
The storms that impacted the eastern seaboard and Gulf of Mexico in late August and early September slowed oil imports for a short time. Oil tankers were temporarily unable to reach their U.S. destinations and drilling in the Gulf of Mexico was interrupted. According to government data cited in reports from the Energy Information Administration (EIA) and American Petroleum Institute, the weather events resulted in the largest weekly crude-supply drop since 1999. Although a positive note for crude oil prices, analysts point out that oil prices will gradually reverse after ships reach their final destinations and drilling resumes.

Oil prices also traded higher in September following the issuance of a cooperation statement between Saudi Arabia and Russia. The cooperation was aimed at stabilizing the oil market; however, there are doubts over whether the two countries will follow through on formal production caps at a meeting in late September. Further helping raise crude oil prices is China's reduction in oil production. China is the second largest oil user after the U.S. and as they produce less, China is expected to increase the amount of imported oil. As China reduces its oil production, a few OPEC members have not followed through on the oil production freeze.



Over production in the U.S. has tapered off over the last 12 - 15 months. Since January 2015, oil rigs declined by 599, with the Texas Rig count at 241 as of September 2016. Prices have fallen and remain relatively low, hindering fracking companies that rely on \$70 a barrel to be profitable. Unable to weather the lower oil prices for an extended period of time, some companies maintained production at a loss or reduced maintenance costs. Other producers are no longer in business, leading to a reduction of oversupply. In late July 2016, Goldman Sachs forecasted oil prices to remain in the \$45-\$50-a-barrel range through mid-2017. Continued high global crude oil and petroleum product inventories and increased drilling activity in the U.S. are generally the cause for the pricing forecast.

Crude oil was at a 13-year record low in early 2016 but has risen since. On September 2, 2016, the price of a barrel of crude oil was \$45.11. As evidenced by the chart below, the price remains on the lower end of the pricing spectrum, in stark contrast to peak pricing in July 2008.



Dollars per Barrel, Weekly, Ending Friday, Average

SUPERVISORY MATTERS

The Departments continuously monitor the complex regulatory landscape and economic conditions that affect the financial services industry. Deterioration in bank and thrift performance typically lags weaknesses in the economy and monetary policy. Supervisory efforts remain focused on the timely identification of cyclical troughs and potentially damaging factors that may weaken institutions and, if left unchecked, could lead to an increased number of problem banks and thrifts.

Oil and Gas Portfolios

The Texas Department of Banking is closely monitoring the impact that recent increases in crude oil prices are having on O&G service and exploration entities. Only a few institutions have been downgraded to problem bank status as a result of deterioration in their O&G portfolios. Generally, financial institutions with elevated O&G exposure actively monitor their positions by stress testing these credits, and working closely with severely affected customers. The cash flow and debt service coverage of many service industry businesses remains stressed. However, it is anticipated that future improvements in commodity prices will lead to increased demand for their services and subsequent ability to repay their debt.

To effectively monitor state-chartered banks with potentially higher risk profiles, the Department of Banking is working closely with its federal counterparts to perform on-site follow-up reviews. By the end of September 2016, the Department expects to complete either an on-site visitation or full scope examination for most banks with significant O&G exposure. State banks known to be actively involved in O&G lending or those in areas of the state that depend on oil production continue to provide quarterly information. Department staff analyzes the information for trends, providing continual updates to senior management about developments in the energy sector. Other tools utilized by the Department to stay in contact with bankers include off-site monitoring and banker calls. Off-site monitoring is performed quarterly, and banker calls are conducted between each off-site examination.

Interest Rate Risk

With regard to interest rates, it appears that state banks and thrifts remain watchful and generally manage their interest rate risk reasonably. Though the industry as a whole has proven capable of controlling interest rate risks, supervisory efforts are focused on the outlying performers, or those that have assumed

an above average level of risk. It remains unclear if the Federal Reserve Board will increase interest rates later this year, which will likely impact all segments of the economy. Institutions making efforts to sustain earnings by acquiring high-yield, long-term assets in their portfolios, are vulnerable to the rise in interest rates. Supervisory monitoring continues on this aspect of bank balance sheets.

CRE Lending

Another balance sheet concern relates to CRE loans, which can comprise a major portion of a bank's loan portfolio. Over the last several years, it appears that financial institutions returned to CRE lending, resulting in a rising number of financial institutions with CRE concentrations. Recent financial data released by the FDIC shows that CRE for state banks in Texas has increased by 46% between June 2008 and June 2016.

The Federal Reserve, along with other federal bank regulators, released a joint statement in December 2015 with regard to prudent risk management practices for CRE lending. Federal regulators raised concerns over the rapid growth and increased competitive pressures with this particular type of lending. Weakened credit risk management practices were noted, including loosening underwriting standards, approving excessive underwriting policy exceptions and inadequately monitoring market conditions. For financial institutions operating with high CRE concentrations, the statement was a reminder of regulatory expectations and guidance for prudent CRE risk management practices.

Other Concerns

On the global front, the United Kingdom's vote to leave the European Union in July 2016 was feared to have a large negative impact on U.S. banks. As time has passed, it appears that the nation's financial institutions have been able to handle the impact of this global financial event. It is believed that the results from the Dodd-Frank Wall Street Reform and Consumer Protection Act stress tests prepared many U.S. institutions for such an occurrence. Brexit, as it is known, may reportedly keep the Federal Reserve Board from raising interest rates as it waits to further assess financial stability of the markets.

The Department of Banking held three town hall meetings in June 2016 to give Texas community bankers an open forum to discuss issues affecting community banks. A few financial institutions reported difficulties serving their customers due to increasing regulatory burden. In certain circumstances, financial institutions reported they made the decision to exit entire lines of business.

Town Hall Meetings

Other Areas of Concern:

- Complexity of Basel III capital rules and the uncertainty of future phase in periods;
- Fair lending;
- TILA-RESPA integrated disclosure requirements;
- Qualified mortgage rules; and,
- Small business lending.

Cybersecurity and Awareness

The number of threats and cyberattacks on financial institutions remains a concern for both Departments. Each agency continues to promote cybersecurity awareness, urging financial institutions to incorporate sound cybersecurity principles into their governance, control and risk management systems, and training. Cyberattacks continue to evolve, requiring financial

institutions and their staff to remain vigilant and knowledgeable.

Increased ransomware attacks on U.S. businesses and individuals, including the banking industry, have raised concerns throughout the regulatory community. Ransomware victims are not only at risk of losing files, but may also experience financial losses, loss of productivity, legal fees, and/or added cost for purchasing credit monitoring services for employees or customers who are impacted. Furthermore, victims may experience increased costs related to network countermeasures and enhanced information technology services. The Federal Bureau of Investigation (FBI), U.S. Secret Service, and the Financial Services – Information Sharing Analysis Center (FS-ISAC) regularly host events aimed at testing business preparedness. Participation in these types of events is strongly encouraged.

As a leading agency in identifying and addressing cybersecurity measures for the banking industry, the Department of Banking continues to support and participate in various programs, work groups, and initiatives to provide cybersecurity guidance and helpful strategies to financial institutions. For example, the Director of IT Security Examinations is one of six members of the Cybersecurity and Critical Infrastructure Work Group (CCIWG). The Federal Financial Institutions Examination Council created this work group to address cyber threats to the financial system. At the examination level, staff works with the banking industry to enhance policies, procedures, and practices that institutions can use to counter cyber threats. As a mechanism to help bankers assess their cyber risk, the Department's IT Specialists began reviewing completed cybersecurity assessments (CATs) at all IT examinations in January 2016.

DEPARTMENTAL SUPERVISORY MEASURES BEING TAKEN

The supervisory measures of each Department are designed to identify potential risks that could impact an institution's financial condition. Changes in economic conditions, technological threats, changes in interest rates, and competitive pressures all influence the supervisory measures listed below.

Texas Department of Banking

- ❖ Assessing the potential effects that reduced O&G prices may have on Texas banks;
- ❖ Assessing banks' inherent risks to cybersecurity attacks and determining their preparedness for such attacks;
- ❖ Assessing interest rate risk to determine if banks are extending the duration of their investment portfolio to improve net interest margins;
- ❖ Monitoring reductions in internal and external audit functions, and loan review and training programs to reduce overhead costs;
- ❖ Conducting targeted reviews of new product lines as banks seek additional sources of revenue;
- ❖ Initiating enforcement actions early in the detection of deteriorating trends;
- ❖ Continuing frequent on-site examinations of problem institutions;
- ❖ Communicating and coordinating joint enforcement actions and other supervisory activities with federal regulators;
- ❖ Placing monthly calls to state banks to obtain industry input about prevailing economic conditions;
- ❖ Expanding off-site monitoring to more closely follow-up on examination concerns;
- ❖ Monitoring state, national, and world political and economic events impacting the industry such as federal programs designed to stabilize the financial markets and new regulations; and,
- ❖ Increasing internal communication and training to improve examiner awareness of pertinent issues.

Department of Savings and Mortgage Lending

- ❖ Participate in regular conference calls and close coordination with other state and federal regulators;
- ❖ Engage in regular correspondence with state savings banks regarding institution-specific and industry 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 and weaknesses, and revising the Department's plan of examination and monitoring for the institution, including the downgrading of institutions, if deemed necessary, by the Department and the FDIC;
- ❖ On-going monitoring of any impact to the energy industry;
- ❖ On-going monitoring of interest rate risk;
- ❖ Monitor local, state, national and world political and economic events impacting the industry; and,
- ❖ Participate in FDIC Compliance examinations of each institution.

PERFORMANCE SUMMARY AND PROFILE

TEXAS BANKING SYSTEM

FDIC INSURED

STATE-CHARTERED BANKS

While the number of Texas state-chartered banks continues to diminish, balance sheets are continuously expanding for the Texas banking system. As of June 30, 2016, there were 249 Texas state-chartered banks, down by 12 from the prior year. Total assets increased by \$7.2 billion (3.0%) over the past 12 months, with net loan and lease balances rising by \$7.0 billion (4.9%). On the contrary, national banks chartered in Texas are experiencing declines to both their total assets, down by 5.4%, and number of banks, reduced by 6.

Although, year-to-date net operating revenue improved by 4.4% to \$5.4 billion from a year earlier, net income declined by 6.7% to \$1.2 billion due to increased provisions. Consequently, the average return on assets (ROA) declined slightly by 10 basis points (BP) to 1.0%. About two out of every three state-chartered banks, or 66.3%, reported year-over-year growth to their net income with only 2.4% reporting operating losses, compared to 4.2% during the same period in 2015. During the last 12 months, the leverage ratio increased from 9.8% to 9.9%, which was influenced primarily by loan growth. The net interest margin (NIM) increased nominally by 5 BP to 3.3%, aided by increasing yields on earning assets.

Asset quality remains sound with the average noncurrent rate at 0.9%, an increase of 20 BP from 2015. The average net charge-off rate also rose to 0.3%, from 0.1% in the second quarter 2015. These rates are below the national averages with the noncurrent rate at 1.5% and charge-off rate at 0.4%. The allowance for loan and lease losses (ALLL) to noncurrent loans decreased from 159.4% to 136.9%. ALLL represents 1.3% of total loans compared to 1.1% a year earlier.

Texas state-chartered banks continue to build their reserves amid current economic conditions. Year-to-date, banks added \$387.7 million in loss provisions, an increase of 190.1% from the prior year. Net loan and lease charge-offs are 215.7% higher than the year before at \$229.1 million. However, provisions continue to exceed net charge-offs.

STATE-CHARTERED THRIFTS

Through June 30, 2016, state thrifts had \$139.4 million in year-to-date net income, compared to \$112.3 million for the first half of 2015. The pretax, quarterly return on average assets for the median thrift remains strong at 1.1%. Provision expenses for loan and lease losses remain low at 0.1% of average assets. Non-interest income to assets decreased 26 BP, while non-interest expense decreased 25 BP.

State thrifts experienced a slight decrease in the median core capital levels since one year earlier, by 5 BP to 10.0%. This decrease is a result of growth in lending.

The quarterly NIM narrowed 30 BP during the last twelve months, but remains healthy, at 4.3%. Year-to-date provisions to the ALLL increased \$7 million from the prior year. The prior year was exceptionally low, primarily due to large reverse provisions at one institution with federal loss share agreements. ALLL coverage of nonperforming loans and leases with a median level of 190% is much stronger than the median ratio of 119% for all savings institutions nationwide.

The median Texas thrift ratio of nonperforming loans plus other real estate owned to total assets remains low at 0.3%. Texas thrifts also have a lower ratio of nonperforming loans to total loans relative to the thrift industry across the nation at 0.4% versus 0.7%, indicating less of a supervisory concern.

NUMBER OF INSTITUTIONS AND TOTAL ASSETS

FDIC financial data is reflective of FDIC insured institutions only.

Assets in Billions

	06-30-2016		06-30-2015		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	249	\$248.5	261 [^]	\$241.3	-12	+\$7.2
Texas State-Chartered Thrifts	27	\$16.3	27	\$11.8	0	+4.5
	276	\$264.8	288	\$253.1	-12	+\$11.7
Other states' state-chartered:						
Banks operating in Texas*	28	\$57.3	27	\$49.9	+1	+\$7.4
Thrifts operating in Texas*	0	0	0	0	0	0
	28	\$57.3	27	\$49.9	+1	+\$7.4
Total State-Chartered Activity	304	\$322.1	315	\$303.0	-11	+\$19.1
National Banks Chartered in Texas	192	\$119.6	198	\$126.4	-6	-\$6.8
Federal Thrifts Chartered in Texas	6	\$78.6	7	\$72.5	-1	+6.1
	198	\$198.2	205	\$198.9	-7	-0.7
Other states' federally-chartered:						
Banks operating in Texas*	24	\$347.5	22	\$342.3	+2	+\$5.2
Thrifts operating in Texas*	7	\$0.9	8	\$0.9	-1	0
	31	\$348.4	30	\$343.2	+1	+\$5.2
Total Federally-Chartered Activity	229	\$546.6	235	\$542.1	-6	+4.5
Total Banking/Thrift Activity	533	\$868.7	550	\$845.1	-17	+\$23.6

*Indicates estimates based on available FDIC information.

[^] One state-chartered bank was inadvertently removed from the FDIC database.

RATIO ANALYSIS

As of June 30, 2016

FDIC financial data is reflective of FDIC insured institutions only.

	<u>State-Chartered Banks</u> 249	<u>Texas National Banks</u> 192	<u>All Texas Banks</u> 441	<u>State-Chartered Thrifts</u> 27	<u>Texas Federal Thrifts</u> 6	<u>All Texas Thrifts</u> 33
% of Unprofitable Institutions	2.41%	3.65%	2.95%	0.00%	0.00%	0.00%
% of Institutions with Earnings Gains	66.27%	61.98%	64.40%	55.56%	50.00%	54.55%
Yield on Earning Assets	3.58%	3.82%	3.66%	4.83%	4.69%	4.71%
Net Interest Margin	3.33%	3.54%	3.40%	4.29%	4.43%	4.41%
Return on Assets	0.98%	1.22%	1.06%	1.85%	1.02%	1.15%
Return on Equity	8.43%	11.22%	9.30%	12.10%	11.35%	11.54%
Net Charge-offs to Loans	0.31%	0.25%	0.29%	0.04%	1.28%	1.05%
Earnings Coverage of Net Loan C/Os	8.48	10.42	9.05	59.03	3.1	3.54
Loss Allowance to Loans	1.23%	1.37%	1.28%	0.95%	1.67%	1.53%
Loss Allowance to Noncurrent Loans	136.92%	96.35%	118.66%	45.42%	155.22%	119.45%
Noncurrent Assets+OREO to Assets	0.69%	1.03%	0.80%	1.95%	0.67%	0.89%
Net Loans and Leases to Core Deps	80.54%	84.23%	81.76%	112.58%	76.78%	81.99%
Equity Capital to Assets	11.80%	11.04%	11.55%	14.71%	8.92%	9.91%
Core Capital (Leverage) Ratio	9.94%	10.22%	10.03%	15.05%	8.98%	10.00%

Data for other state-chartered institutions doing business in Texas is not available and therefore excluded.

Information derived from the FDIC website.

COMPARISON REPORT

Select Balance Sheet and Income/Expense Information
FDIC financial data is reflective of FDIC insured institutions only.
June 30, 2016

	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	249		27	
Number of Employees (full-time equivalent)	42,485		2,674	
(In millions)				
Total Assets	\$248,535		\$16,285	
Net Loans and Leases	\$149,718	60.24%	\$11,957	73.42%
Loan Loss Allowance	\$1,871	0.75%	\$115	0.71%
Other Real Estate Owned	\$360	0.14%	\$50	0.30%
Goodwill and Other Intangibles	\$5,076	2.04%	\$86	0.53%
Total Deposits	\$201,159	80.94%	\$12,319	75.64%
Federal Funds Purchased and Repurchase Agreements	\$2,792	1.12%	\$91	0.56%
Other Borrowed Funds	\$10,637	4.28%	\$1,311	8.05%
Equity Capital	\$29,331	11.80%	\$2,395	14.71%
Memoranda:				
Noncurrent Loans and Leases	\$1,367	0.55%	\$254	1.56%
Earning Assets	\$226,761	91.24%	\$15,147	93.01%
Long-term Assets (5+ years)	\$68,862	27.71%	\$4,970	30.52%
	<u>Year-to Date</u>	<u>% of Avg. Assets[†]</u>	<u>Year-to Date</u>	<u>% of Avg. Assets[†]</u>
Total Interest Income	\$4,028	3.27%	\$336	4.49%
Total Interest Expense	\$283	0.23%	\$38	0.51%
Net Interest Income	\$3,745	3.04%	\$298	3.99%
Provision for Loan and Lease Losses	\$388	0.31%	\$9	0.12%
Total Noninterest Income	\$1,627	1.32%	\$69	0.92%
Total Noninterest Expense	\$3,429	2.78%	\$222	2.97%
Securities Gains	\$33	0.03%	\$8	0.11%
Net Income	\$1,210	0.98%	\$139	1.85%
Memoranda:				
Net Loan Charge-offs	\$229	0.19%	2	0.03%
Cash Dividends	\$784	0.64%	63	0.85%

*Excludes branches of state-chartered banks of other states doing business in Texas. As of June 30, 2016, there are an estimated twenty-eight out-of-state state-chartered institutions with \$57.3 billion in assets.

[†]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, 2016.

PERFORMANCE SUMMARY

UNITED STATES BANKING SYSTEM

FDIC QUARTERLY BANKING PROFILE

Second Quarter 2016 - www.fdic.gov

↑ Earnings Improvement Is Broad-Based

Expanding loan portfolios generated higher levels of net interest income, helping lift the total earnings of FDIC-insured commercial banks and savings institutions to \$43.6 billion in second quarter of 2016. Industry net income was \$584 million (1.4%) higher than in second quarter of 2015. The average return on assets (ROA) was 1.06%, down from 1.09% the year before, as asset growth outpaced the increase in quarterly net income. More than half of all banks—60.1%—reported higher quarterly earnings compared with the year-earlier quarter, while the percentage of banks reporting negative quarterly net income fell to 4.5%, from 5.8% in second quarter 2015.

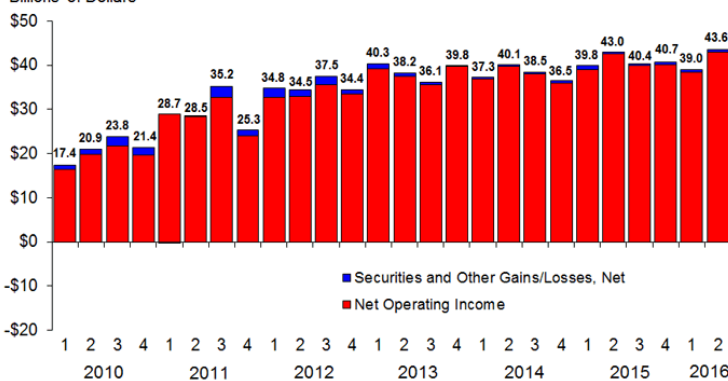
↑ Net Interest Income Accounts for Most of the Growth in Revenue

Net operating revenue—the sum of net interest income and total noninterest income—totaled \$179.3 billion in the second quarter, an increase of \$5.8 billion (3.3%) from the year-earlier quarter. Net interest income was up \$5.2 billion (4.8%), as average interest-bearing assets were 4.4% higher than second quarter 2015. The average net interest margin of 3.08% was almost unchanged from the 3.07% average in second quarter 2015. Noninterest income was \$600 million (0.9%) higher than the year before. Trading income rose \$1.4 billion (24.9%), while servicing income fell by \$3.4 billion (74.4%).

Quarterly Net Income

All FDIC-Insured Institutions

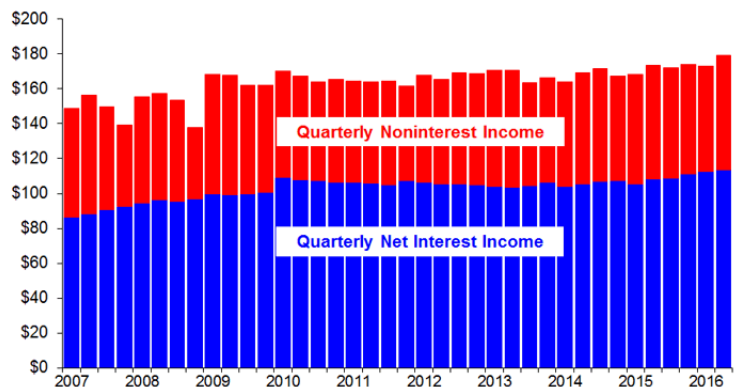
Billions of Dollars



Quarterly Net Operating Revenue

All FDIC-Insured Institutions

Billions of Dollars



↑ Noninterest Expenses Decline at Many Large Banks

Noninterest expenses totaled \$104.8 billion, an increase of only \$271 million (0.3%) from the year-earlier quarter, as nonrecurring charges at several large banks declined by more than \$1.2 billion. In second quarter 2015, three large banks reported itemized litigation expenses totaling \$508 million. In the most recent quarter, one bank reported a \$473 million release of litigation reserves (a negative litigation expense), so the year-over-year reduction in litigation charges was \$981 million. In addition, charges for goodwill impairment were \$278 million lower than the year before. The declines in these noninterest expense items almost canceled out a \$1.4 billion (2.8%) year-over-year increase in salary and employee benefit expenses. Eight of the ten largest banks reported year-over-year declines in their total noninterest expenses, but for the industry as a whole, only 30% reported lower noninterest expenses.

↓ Charge-Offs of C&I Loans Post Further Increase

Net loan and lease charge-offs were higher than the year before for the third consecutive quarter. Charge-offs totaled \$10.1 billion, a \$1.2 billion (13.1%) increase over second quarter 2015. Fewer than half of all banks—44.9%—reported year-over-year increases in their quarterly net charge-offs. Most of the increase occurred in loans to commercial and industrial (C&I) borrowers. C&I net charge-offs rose to \$2.2 billion from \$1.1 billion a year earlier, an increase of \$1.1 billion (100.3%). This is the fifth consecutive quarter that C&I charge-offs have been higher than the year-earlier quarter. Banks reported smaller year-over-year increases in credit cards, auto loans, and agricultural production loans. The average net charge-off rate rose to 0.45%, from 0.42% in second quarter 2015.

⇅ Total Noncurrent Loan Balances Decline, Although Noncurrent C&I Loans Rise

The amount of loans and leases that were noncurrent—90 days or more past due or in nonaccrual status—declined by \$4.8 billion (3.4%) during the second quarter. Noncurrent C&I loans increased for a sixth consecutive quarter, rising by \$2.1 billion (8.9%), but all other major loan categories registered quarterly declines in noncurrent balances. The average noncurrent rate declined from 1.58% to 1.49% during the quarter. This is the lowest noncurrent rate for the industry since year-end 2007.

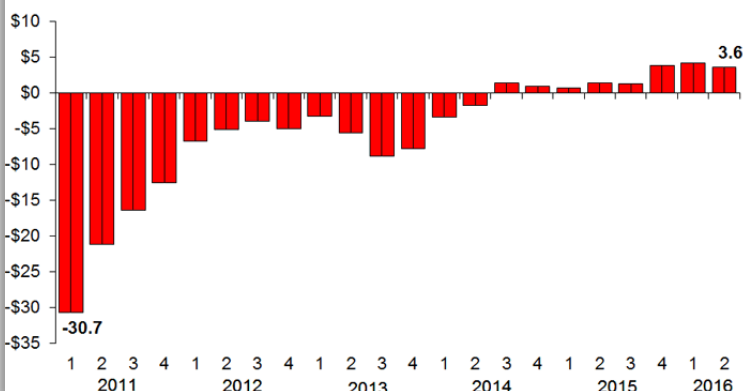
↓ Banks Continue to Build Their Reserves

Insured institutions increased their reserves for loan losses by \$1 billion (0.8%) during the quarter, as the \$11.8 billion in loss provisions added to reserves exceeded the \$10.1 billion in net charge-offs subtracted from reserves. Banks with assets greater than \$1 billion, which also report their reserves for specific loan categories, increased their total reserves by \$987 million (0.9%). The largest increase was in reserves for credit card losses, which increased by \$1.3 billion (4.7%). They also increased their reserves for commercial loan losses by \$787 million (2.2%), while reducing their reserves for residential real estate losses by \$1.1 billion (5.1%). The increase in total reserves, combined with the reduction in total noncurrent loan balances, lifted the average coverage ratio of reserves to noncurrent loans from 85.5% to 89.2% during the quarter. The increase in reserves did not keep pace with the growth in total loan balances, however, as the average reserve ratio of reserves to total loans and leases fell from 1.35% to 1.33%. This is the 23rd time in the last 24 quarters that the industry's reserve ratio has declined, and it is now at its lowest level since year-end 2007.

Year-Over-Year Change in Quarterly Loan-Loss Provisions

All FDIC-Insured Institutions

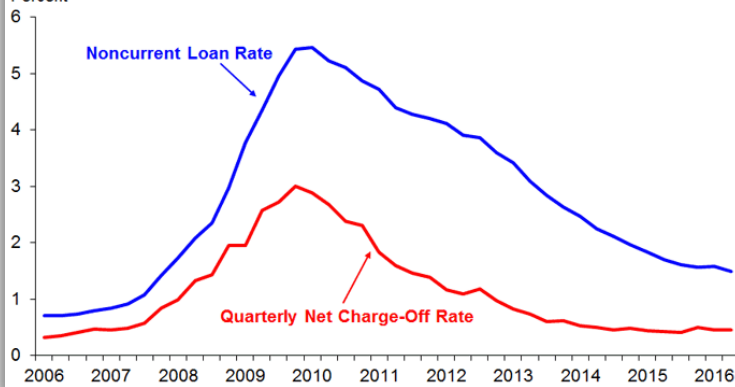
Billions of Dollars



Noncurrent Loan Rate and Quarterly Net Charge-Off Rate

All FDIC-Insured Institutions

Percent

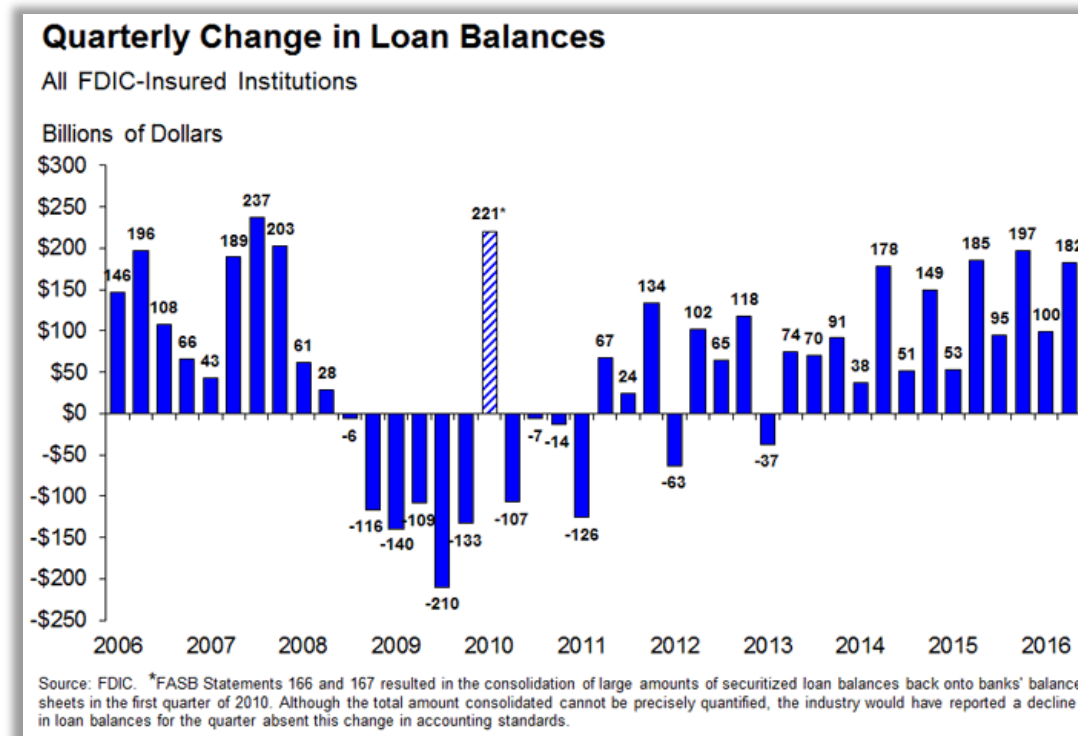


↑ Internal Capital Generation Grows

Equity capital increased by \$30.4 billion (1.7%) in the quarter, as retained earnings contributed \$20.4 billion to capital growth and an increase in the market values of securities portfolios added to total equity. Retained earnings were \$6.7 billion (49.2%) higher than the year before, as banks reduced their quarterly dividends by \$6.1 billion (20.9%), compared with second quarter 2015 levels. Accumulated other comprehensive income, which includes changes in the values of banks' available-for-sale securities, increased by \$9.7 billion during the quarter. At the end of the second quarter, more than 99% of all banks, representing 99.9% of total industry assets, met or exceeded the requirements for well-capitalized banks as defined for Prompt Corrective Action purposes.

↑ Loan Growth Remains Strong

Total assets increased by \$240.6 billion (1.5%) during the quarter. Total loan and lease balances rose by \$181.9 billion (2%). The largest increases occurred in residential mortgages (up \$42.4 billion, 2.2%), real estate loans secured by nonfarm nonresidential properties (up \$26.9 billion, 2.1%), credit card balances (up \$22.3 billion, 3.1%), and loans to nondepository financial institutions (up \$19.8 billion, 6.9%). All major loan categories saw increases in balances outstanding during the second quarter. For the 12 months ended June 30, total loans and leases increased 6.7%, down slightly from 6.9% for the 12 months ended March 31. In addition to the growth in loan balances, banks increased their unfunded loan commitments by \$36.4 billion (0.5%). This is the smallest quarterly increase in unfunded commitments since fourth quarter 2013. For a second consecutive quarter, unfunded commitments to make C&I loans declined, falling by \$24.1 billion (1.3%). Banks' investments in securities rose by \$36.1 billion (1.1%), with \$28.7 billion of the growth coming from increased holdings of mortgage-backed securities. Balances with Federal Reserve banks declined by \$90.6 billion (7.2%).



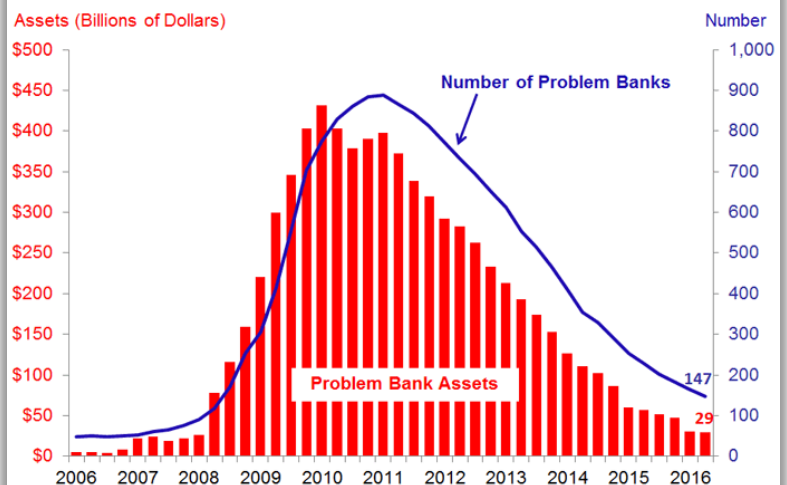
↕ Banks Increase Borrowings From Federal Home Loan Banks

Nondeposit liabilities funded a larger share of asset growth than deposits in the second quarter. These borrowings rose by \$111.7 billion (5.5%), as advances from Federal Home Loan Banks increased by \$64.4 billion (13.4%). Total deposits increased by \$98.6 billion (0.8%). Deposits in domestic offices rose by \$94.8 billion (0.9%), while foreign office deposits increased \$3.8 billion (0.3%). Interest-bearing domestic office deposits were up \$52.2 billion (0.6%), while balances in noninterest-bearing accounts rose by \$42.5 billion (1.4%). At banks that offer consumer deposit accounts (checking or savings accounts intended primarily for individuals for personal, household, or family use), balances in these accounts declined by \$13 billion (0.3%) during the quarter. At banks with assets greater than \$1 billion that offer consumer accounts, quarterly service charge income on these accounts increased by \$35 million (0.8%) from the year before.

↑ 'Problem List' Shrinks to 147 Institutions

Nationally, the number of FDIC-insured commercial banks and savings institutions reporting quarterly financial results declined to 6,058 from 6,122 in the second quarter. During the quarter, mergers absorbed 57 insured institutions, two banks failed, and no new charters were added. The number of banks on the FDIC's "Problem List" declined from 165 to 147, and total assets of problem banks fell from \$30.9 billion to \$29 billion. This is the smallest number of problem banks in eight years. Banks reported 2,045,221 full-time equivalent employees in the quarter, an increase of 5,302 compared with the first quarter, and 2,816 more than in second quarter 2015.

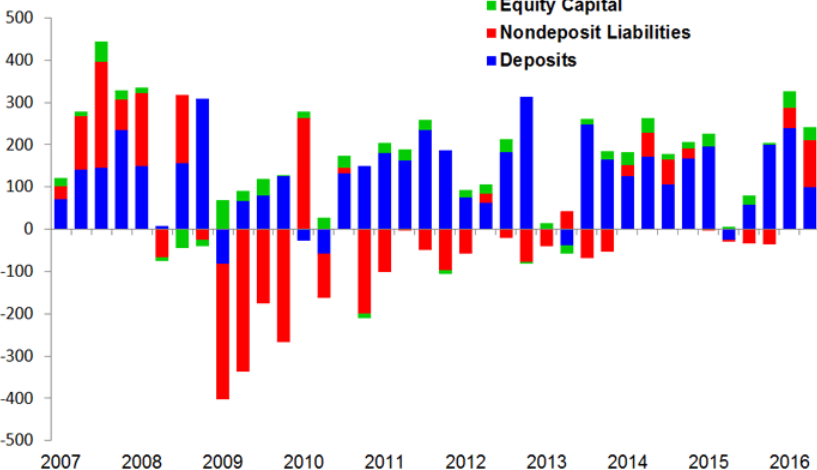
Number and Assets of Banks on the "Problem List"



Quarterly Change in Asset Funding

All FDIC-Insured Institutions

Billions of Dollars



SNAPSHOT STOCK PERFORMANCE

SOUTHWEST REGIONAL BANKS

SEPTEMBER 2016

Name	Last Trade		52 Wk Range		PE	EPS	Mkt Cap	Div/Shr	Div Yld
ACNB Corporation	09/12	27.07	19.99	27.83	14.6	1.85	163.96M	0.80	2.94
BancFirst Corporation	09/12	69.87	51.14	71.14	16.96	4.12	1.09B	1.52	2.15
Banco Bilbao VizcayaArgentaria	09/12	6.32	5.14	9.24	23.85	0.26	40.78B	0.41	6.30
BOK Financial Corporation	09/12	68.58	44.13	75.18	18.92	3.62	4.52B	1.72	2.48
Cass Information Sys, Inc.	09/12	56.56	45.05	58.64	27.32	2.07	631.91M	0.88	1.55
CoBiz Incorporated	09/12	13.12	10.31	13.94	20.22	0.65	537.34M	0.20	1.52
Commerce Bancshares, Inc.	09/12	49.97	37.44	51.3	19.15	2.61	4.83B	0.90	1.80
Comerica, Inc.	09/12	46.37	30.48	47.7	20.13	2.30	8.06B	0.92	1.96
Community Shores Bank Corp	09/12	2.24	1.85	2.87	N/A	-0.09	9.19M	N/A	N/A
Cullen Frost Bankers, Inc.	09/12	70.47	42.41	73.99	16.65	4.23	4.38B	2.16	3.01
Enterprise Fin Serv Corp	09/12	31.47	23.77	31.47	14.65	2.15	629.97M	0.44	1.39
East West Bancorp, Inc.	09/12	36.5	27.25	43.94	13.37	2.73	5.26B	0.80	2.19
First Community Corp S C	09/12	14.90	11.98	15.59	15.68	0.95	99.82M	0.32	2.13
First Financial Bankshares, Inc.	09/12	36.87	24.12	36.90	23.63	1.56	2.44B	0.72	1.96
Great Southern Bancorp, Inc.	09/12	43.33	34.48	52.94	13.54	3.20	602.78M	0.88	2.03
Guaranty Fed Bancshares, Inc.	09/12	16.60	14.15	18.7	13.68	1.22	73.97M	0.32	1.92
Heartland Financial USA, Inc.	09/12	36.72	25.95	39.45	12.07	3.04	901.31M	0.40	1.07
International Bancshares Corp	09/12	29.72	21.05	31	15.24	1.95	1.96B	0.58	1.93
Landmark Bancorp, Inc.	09/12	26.24	23.80	27.54	9.86	2.65	94.99M	0.80	3.03
Liberty Bancorp, Inc.	09/12	18.101	N/A	N/A	11.83	1.53	65.164M	0.18	0.99
Mackinac Financial Corp	09/12	11.71	9.90	12.03	20.53	0.57	72.85M	0.40	3.38
MidWest One Finl Group, Inc.	09/12	29.8	24.71	32.52	13.02	2.29	340.79M	0.64	2.12
Prosperity Bancshares, Inc.	09/12	54.28	33.57	57.04	13.67	3.97	3.77B	1.20	2.18
QCR Holdings, Inc.	09/12	31.34	18.05	31.52	14.35	2.18	409.38M	0.16	0.51
Southside Bancshares, Inc.	09/12	32.62	19.54	33.62	17.95	1.82	856.32M	0.96	2.92
Southwest Bancorp, Inc.	09/12	19	14	19.97	23.14	0.82	355.10M	0.32	1.62
Texas Capital Bancshares, Inc.	09/12	52.50	29.78	61.83	19.37	2.71	2.41B	N/A	N/A
UMB Financial Corporation	09/12	59.21	39.55	61.24	23.12	2.56	2.93B	0.98	1.65
West Bancorp Incorporated	09/12	19.60	16.04	21.09	14.10	1.39	316.20M	0.68	3.46
Zions Bancorp	09/12	30.94	19.65	31.28	20.52	1.20	5.03B	0.24	0.96

Source: Yahoo Finance (September 2016)

NA – Indicates information was not available.

SNAPSHOT STOCK PERFORMANCE

SOUTHWEST REGIONAL BANKS

SEPTEMBER 2015

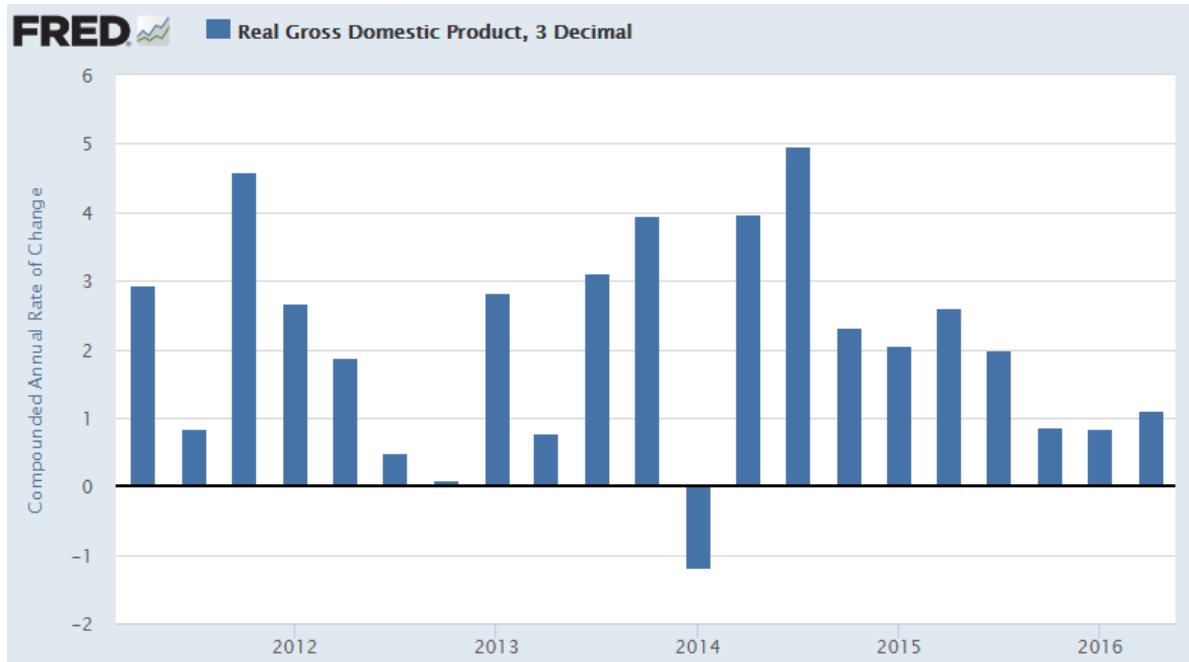
<i>Name</i>	<i>Last Trade</i>		<i>52 Wk Range</i>		<i>PE</i>	<i>EPS</i>	<i>Mkt Cap</i>	<i>Div/Shr</i>	<i>Div Yld</i>
ACNB Corporation	09/14	20.24	18.85	22.9	11.66	1.74	122.05M	0.80	4.01
BancFirst Corporation	09/14	61.59	55.51	69.49	14.06	4.38	959.62M	1.44	2.35
Banco Bilbao VizcayaArgentaria	09/14	8.78	8.44	12.62	11.71	0.75	55.29B	0.35	3.92
BOK Financial Corporation	09/14	63.42	53.01	71.66	14.94	4.25	4.37B	1.68	2.65
Cass Information Sys, Inc.	09/14	48.02	39	59.09	24.01	2.00	548.42M	0.84	1.70
CoBiz Incorporated	09/14	13.06	10.88	13.6	18.55	0.70	529.14M	0.18	1.38
Commerce Bancshares, Inc.	09/14	44.36	38.1	48.7	16.63	2.67	4.14B	0.90	2.02
Comerica, Inc.	09/14	41.99	40.09	53.45	13.63	3.08	7.47B	0.84	2.00
Community Shores Bank Corp	09/14	2.45	1.25	3.24	0.92	2.67	3.6M	N/A	N/A
Cullen Frost Bankers, Inc.	09/14	62.33	59.35	82	13.82	4.51	3.94B	2.12	3.41
Enterprise Fin Serv Corp	09/14	24.21	16.38	25.07	15.14	1.60	483.19M	0.28	1.16
First Community Corp S C	09/14	12.74	10.51	12.97	14.28	0.89	85.1M	0.28	2.24
First Financial Bankshares, Inc.	09/14	30.46	24.46	36.2	20.58	1.48	1.95B	0.64	2.08
Great Southern Bancorp, Inc.	09/14	41.99	29.8	42.99	12.54	3.35	581.72M	0.88	2.13
Guaranty Fed Bancshares, Inc.	09/14	14.59	12.11	15.5	10.64	1.37	63.9M	0.20	1.39
Heartland Financial USA, Inc.	09/14	36.63	23.33	38.96	13.32	2.75	755.6M	0.40	1.10
International Bancshares Corp	09/14	25.77	22.47	28.49	12.16	2.12	1.71B	0.58	2.25
Landmark Bancorp, Inc.	09/14	24.75	20.54	28.68	8.75	2.83	82.6M	0.76	3.05
Liberty Bancorp, Inc.	09/14	16.45	N/A	N/A	12.75	1.29	59.22M	0.15	1.00
Mackinac Financial Corp	09/14	10.40	9.95	12.75	19.22	0.54	64.89M	0.40	3.86
MidWest One Finl Group, Inc.	09/14	29.35	22.73	34.04	14.42	2.04	334.78M	0.60	2.06
Prosperity Bancshares, Inc.	09/14	50.31	43.76	61.52	11.71	4.30	3.52B	1.09	2.18
QCR Holdings, Inc.	09/14	21.97	16.91	23.23	17.70	1.24	257.42M	0.08	0.38
Southside Bancshares, Inc.	09/14	26.31	24.05	33.28	26.44	1.00	667.17M	0.92	3.50
Southwest Bancorp, Inc.	09/14	16.23	15.08	19	15.74	1.03	308.92M	0.24	1.46
Texas Capital Bancshares, Inc.	09/14	52.08	40.4	63.7	17.10	3.04	2.39B	N/A	N/A
UMB Financial Corporation	09/14	49.59	47.03	61	17.97	2.76	2.45B	0.94	1.92
West Bancorp Incorporated	09/14	18.72	14	20.99	14.11	1.33	300.62M	0.64	3.43
Zions Bancorp	09/14	28.23	23.72	33.03	26.21	1.08	5.76B	0.24	0.85

Source: Yahoo Finance (September 2015)

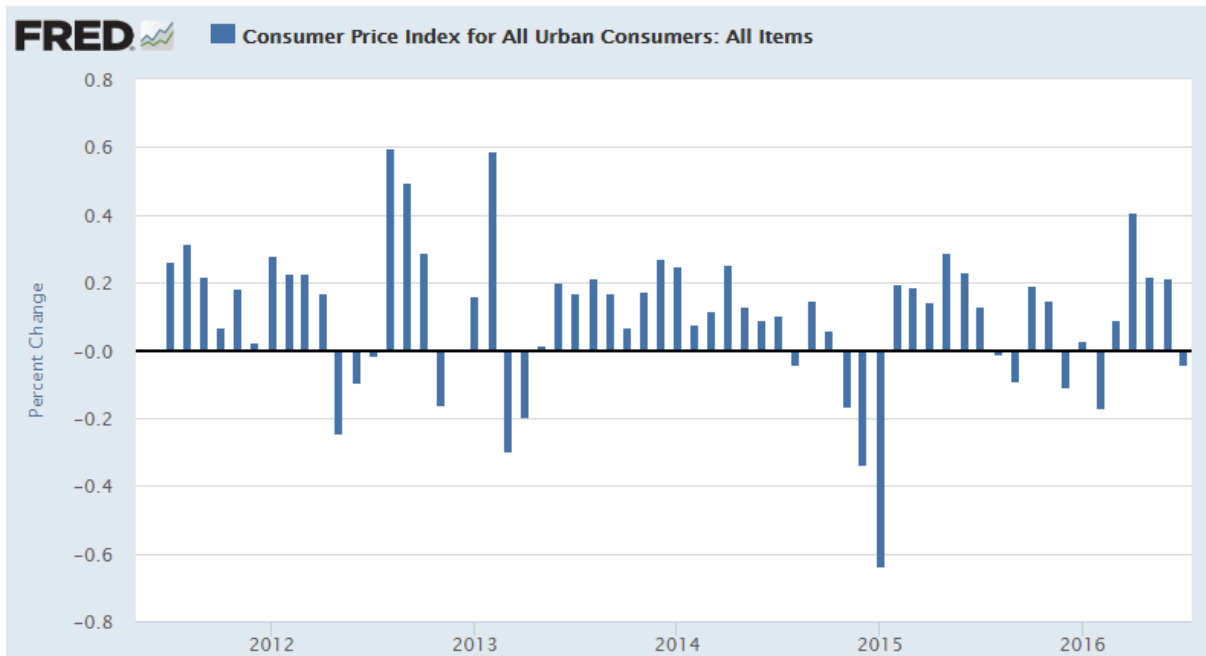
NA – Indicates information was not available.

NATIONAL ECONOMIC TRENDS

Real GDP

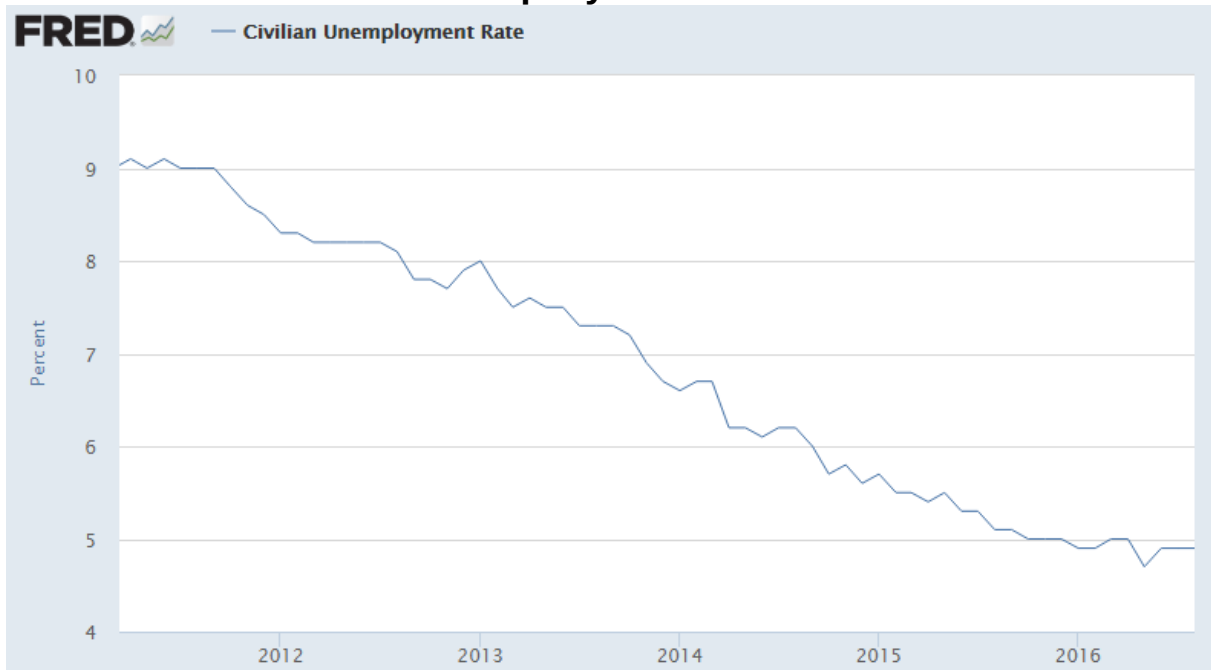


Consumer Price Index

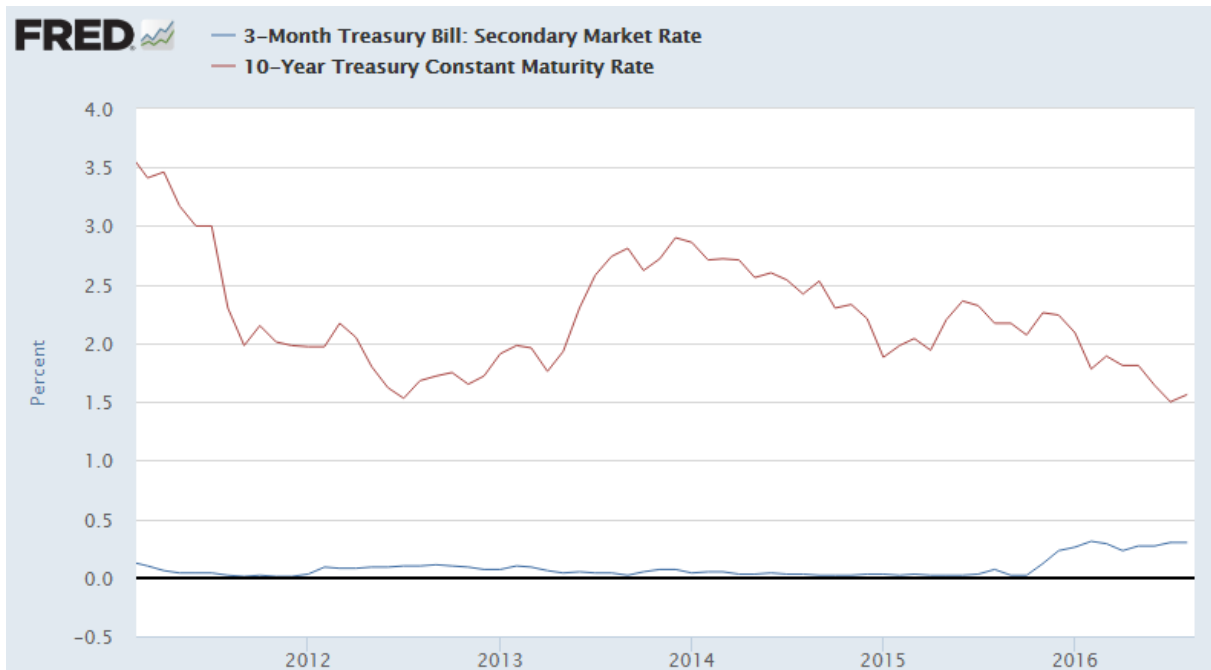


Source: Federal Reserve Bank of St. Louis, *National Economic Trends*, September 8, 2016.

Unemployment Rate



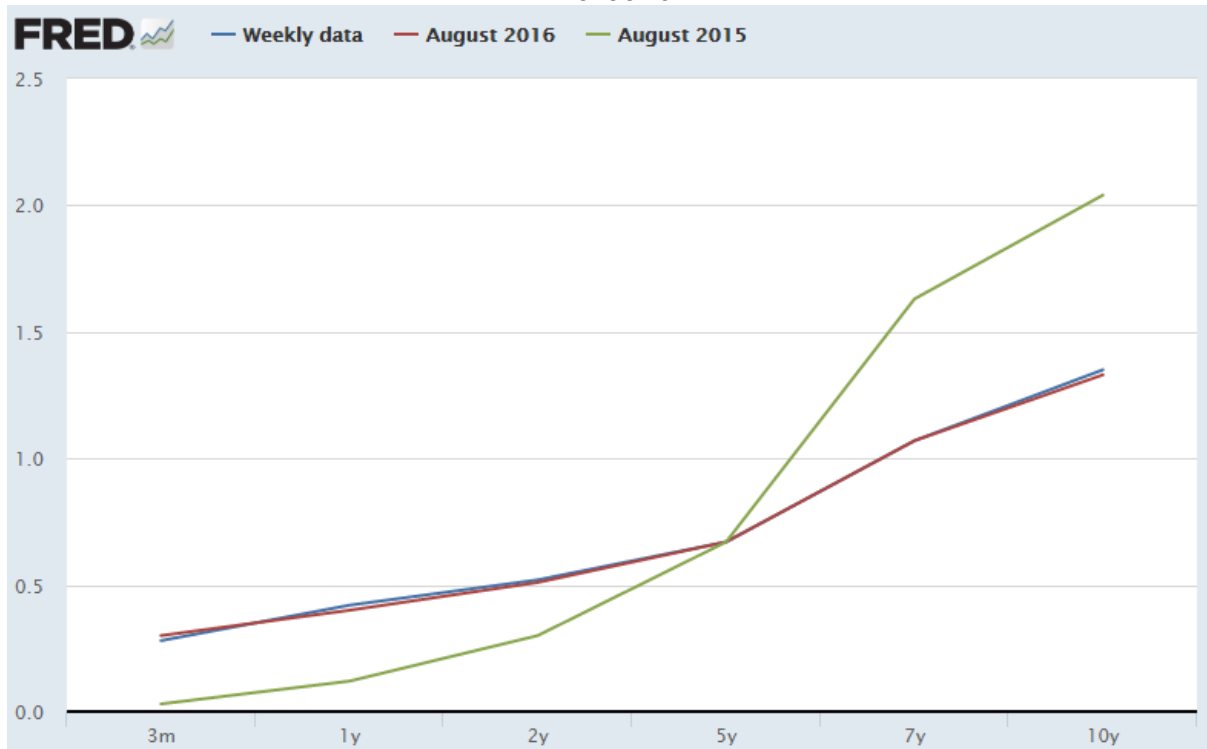
Interest Rates



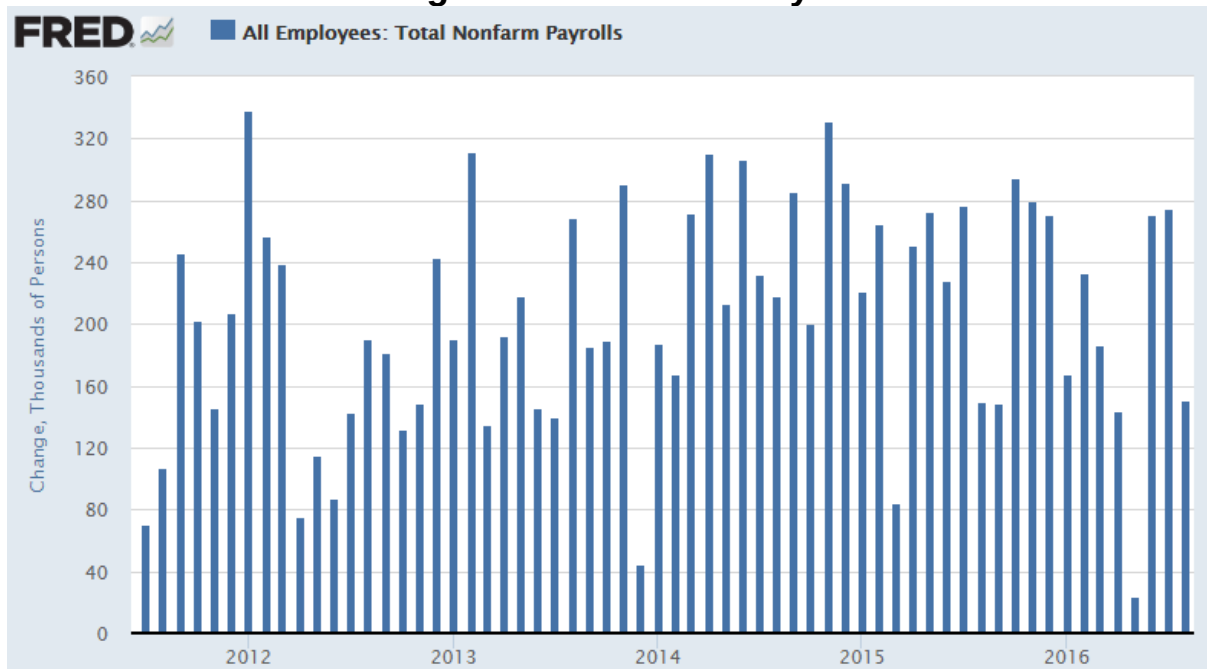
Source: Federal Reserve Bank of St. Louis, *National Economic Trends*, September 8, 2016.

Treasury Yield Curve

Percent



Change in Nonfarm Payrolls



Source: Federal Reserve Bank of St. Louis, *National Economic Trends*, September 8, 2016.

ECONOMIC REPORTS AND FORECASTS UNITED STATES

FEDERAL RESERVE BANK, DALLAS NATIONAL UPDATE

August 2016 - www.dallasfed.org

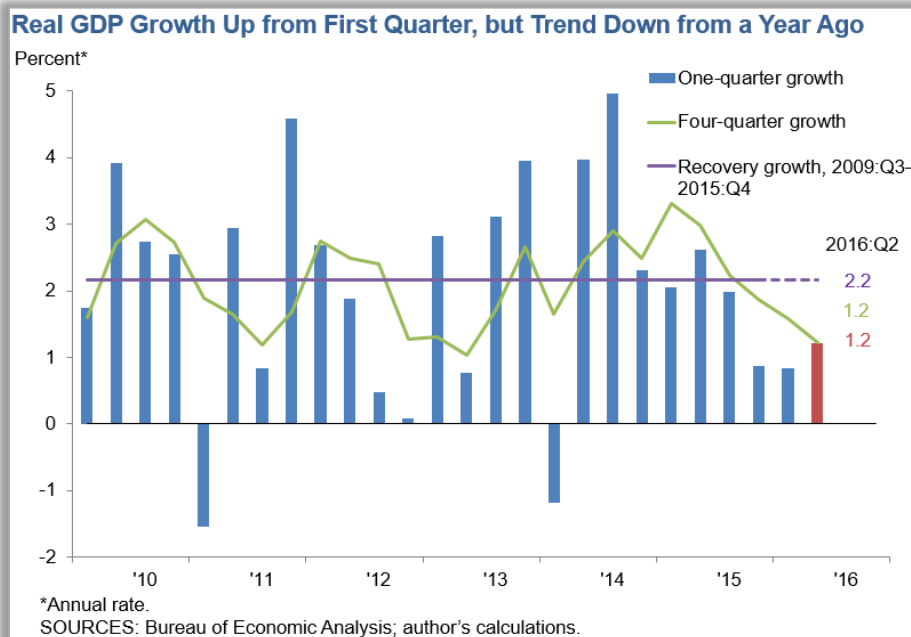
⇅ Economy

Indicators released over the past two months suggest a modest upturn in U.S. economic activity in the second quarter. Job growth has slowed but remains at a rate consistent with further declines in unemployment. Wage inflation has accelerated recently, and increasing tightness in the labor market signals more increases to come. Trimmed mean inflation looks to remain fairly steady over the coming four quarters.

⇅ Output Growth Strengthens Slightly, but Trend Slows

Initial data from the Bureau of Economic Analysis (BEA) showed that the economy shook off some of the weakness observed in the first quarter, with personal consumption expenditures (PCE) and net exports the only major contributors with 2.8 and 0.2 percentage points added to growth, respectively.

While the second quarter marked a slight improvement from the first quarter, it was significantly lower than the 2.2 average growth over the recovery. Moreover, the four-quarter rate—a measure of recent trend—slipped from 3.0% a year ago to 1.2% today. This is the largest year-to-year drop in the trend since 2011. However, a slow trend doesn't necessarily mean slow growth ahead: In 2013, growth accelerated to more than 3.5%, annualized, in the second half following a four-quarter rate that was even lower at 1.0%.



⇅ Hiring Wanes

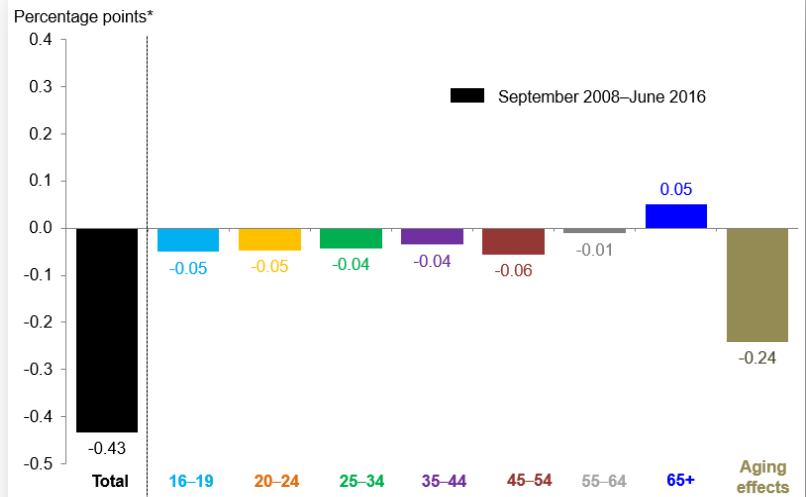
Nonfarm payroll employment only increased an average 147,000 per month from April through June, down from 196,000 from January through March, the lowest quarterly average rate since 2012.

Meanwhile, the unemployment rate bounced up to 4.9% in June, after falling to 4.7% in May, leaving the second-quarter average unchanged at 4.9%.

Movements in the unemployment rate occur due to changes in participation, hiring and population. The participation rate has mostly increased since October 2015. However, looking over a longer history going back to late 2008, it has fallen on net and has done so in large part because of aging. In other words, it has fallen because of factors independent of labor-market decisions. Consequently, unless firms incentivize higher rates of participation, for example, through much higher wage rates, it's likely that participation will continue falling over the medium term.

Assuming that the participation rate remains constant in the second half of 2016, the economy would need to add only 110,000 to 130,000 jobs per month to keep the unemployment rate steady. (Even fewer jobs would be needed assuming the participation rate falls.) Hence, a continuation of second-quarter job growth should easily further drive down the unemployment rate

Aging Responsible for Over Half the Decline in Participation Since Late 2008



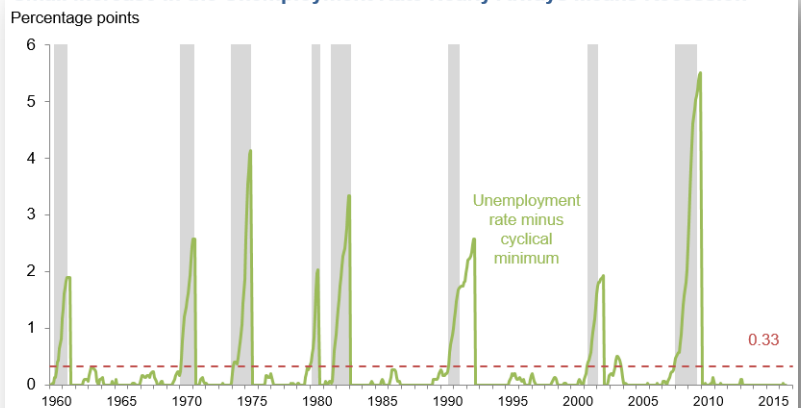
*Contribution to changes in labor force participation, seasonally adjusted, average per year.
SOURCES: Bureau of Labor Statistics; author's calculations.

↓ A Recession Rule of Thumb

Unemployment is close to most estimates of the longer-run sustainable rate, i.e., the rate consistent with full employment and price stability, and further job gains may bring unemployment below what's sustainable, setting the stage for it to increase later on.

Historical experience indicates that unemployment rate increases can be problematic. Over the past 50 years, with one exception, whenever the unemployment rate's three-month moving average has risen more than a few tenths of a percentage point, more increases follow and the economy enters recession. Consequently, if unemployment falls much below the longer-run sustainable rate, it will be difficult for it to reverse course upward without triggering an economic downturn.

Small Increase in the Unemployment Rate Nearly Always Means Recession



*The cyclical minimum is the lowest value of the unemployment rate's three-month moving average since its first postrecession decline.

NOTE: Shaded bars indicate U.S. recessions.

SOURCES: Bureau of Labor Statistics; National Bureau of Economic Research; author's calculations.

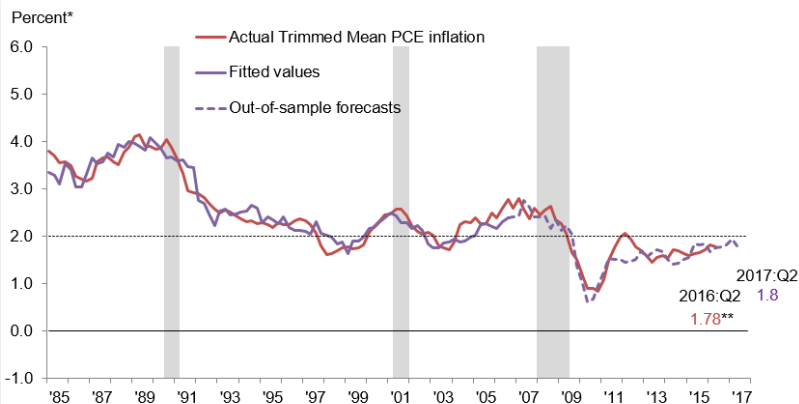
⇅ Wage Inflation Will Rise and Price Pressures to Remain Stable

How much further the unemployment rate can fall before wage and price pressures kick in is also of keen interest to many. For Federal Reserve policymakers, the Fed's dual mandate of full employment and price stability makes it especially important to understand the relationship between the unemployment rate and wage and price pressures.

The question of what wage measure to consider is a key one. Choosing a measure that is not robust to shifts in the composition of occupations or the exit and entry of low- and high-skilled workers can be misleading.

One measure highly resilient against such shifts is the Atlanta Fed Wage Growth Tracker (WGT). It measures the median 12-month wage growth of individuals continuously employed over the last 12 months. To forecast how wages will change over the coming year, the relationship between WGT (less lagged inflation expectations) and lagged values of the unemployment rate was estimated. There's strong intuition (validated by empirical studies) for this relationship, with one narrative among others stating that as the supply of available labor lessens, firms subsequently must bid up wages to attract the remaining job candidates. Assuming consistency with historical movements and 2% inflation expectations, the forecast calls for wage inflation to rise from its current four-quarter rate of 3.6% to 4.0% in second quarter 2017.

Trimmed Mean Inflation Likely to Hold Steady at 1.8 Percent Over Next Year



*Four-quarter percent change.

**2016:Q2 figure is an estimate based on incomplete data covering February through May.

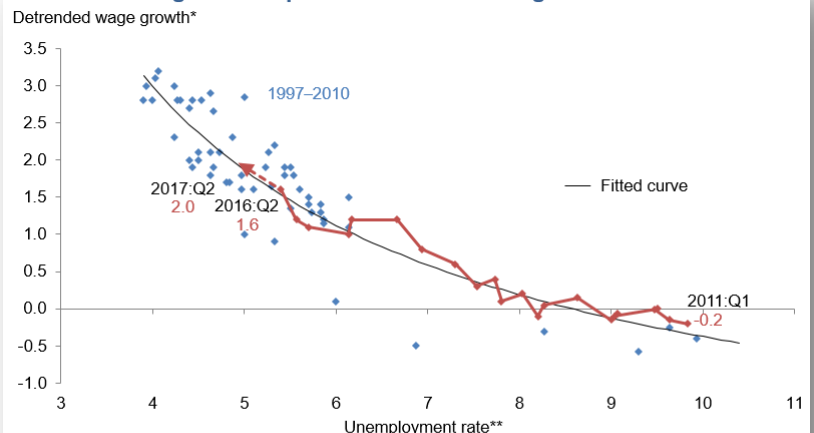
NOTE: Shaded bars indicate U.S. recessions.

SOURCES: Bureau of Economic Analysis; Federal Reserve Bank of Dallas; National Bureau of Economic Research; author's calculations.

Turning to price inflation, the Dallas Fed's preferred measure of inflation is the Trimmed Mean PCE price index, which excludes the greatest individual price movements (high or low) from a basket of items during a given month and consequently better captures the underlying trend. This gives Trimmed Mean PCE a tight association with labor-market slack. On a 12-month basis, Trimmed Mean PCE inflation was 1.78% in May—roughly unchanged from its levels so far this year but up from a year ago.

Just as was the case with wage inflation, one can anticipate future trimmed mean inflation using lagged values of the unemployment rate. Doing so suggests trimmed mean inflation will hold fairly steady, at about 1.8%, over the four quarters ending second quarter 2017.

Labor-Market Tightness Implies Acceleration in Wage Growth Over Next Year



*Atlanta Fed Wage Growth Tracker, minus Survey of Professional Forecasters four-quarter lagged 10-year personal consumption expenditures inflation expectations, four-quarter percent change.

**Lagged four quarters, seasonally adjusted.

SOURCES: Bureau of Labor Statistics; Federal Reserve Bank of Atlanta; Federal Reserve Bank of Philadelphia; author's calculations.

U.S. ECONOMY AT A GLANCE

U.S. BUREAU OF LABOR STATISTICS

Data Series	Mar 2016	Apr 2016	May 2016	June 2016	July 2016	Aug 2016
Unemployment Rate ⁽¹⁾	5.0	5.0	4.7	4.9	4.9	4.9
Change in Payroll Employment ⁽²⁾	186	144	24	271	(P) 275	(P) 151
Average Hourly Earnings ⁽³⁾	25.45	25.53	25.59	25.62	(P) 25.70	(P) 25.73
Consumer Price Index ⁽⁴⁾	0.1	0.4	0.2	0.2	0.0	0.2
Producer Price Index ⁽⁵⁾	-0.2	0.3	(P) 0.3	(P) 0.5	(P) -0.4	(P) 0.0
U.S. Import Price Index ⁽⁶⁾	0.4	0.7	1.2	(R) 0.7	(R) 0.1	(R) -0.2

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.
 (R) Revised.
 (P) Preliminary.

Data Series	2nd Qtr 2015	3rd Qtr 2015	4th Qtr 2015	1st Qtr 2016	2nd Qtr 2016
Employment Cost Index ⁽¹⁾	0.2	0.6	0.5	0.6	0.6
Productivity ⁽²⁾	1.2	2.0	-2.4	-0.6	(R) -0.6

Footnotes:

- (1) Compensation, all civilian workers, quarterly data, 3-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 on: September 16, 2016

THE FEDERAL RESERVE BOARD THE BEIGE BOOK – SEPTEMBER 7, 2016 EXCERPT



Reports from the twelve Federal Reserve Districts suggest that national economic activity continued to expand at a modest pace on balance during the reporting period of July through late August. Most Districts reported a "modest" or "moderate" pace of overall growth. However, Kansas City and New York reported no change in activity, and Philadelphia and Richmond noted that, while still expanding, activity slowed from the previous period. Contacts across the twelve Districts generally expect moderate economic growth in coming months. Overall consumer spending was little changed in most Districts, and auto sales declined somewhat but remained at high levels. Tourism activity was flat from the previous report but above year-earlier levels.

Sales of nonfinancial services gained further momentum. Manufacturing activity rose slightly in most Districts. Activity in residential real estate markets grew at a moderate pace, but the pace of sales was constrained in a few Districts by shortages of available homes. Commercial real estate activity expanded further. Demand for business and consumer credit varied across Districts but appeared to expand at a moderate pace overall, with stable credit quality. Agricultural conditions were mixed, with price declines largely offsetting growing volumes. Overall demand for energy-related products and services weakened.

Labor market conditions remained tight in most Districts, with moderate payroll growth noted in general. Upward wage pressures increased further and were moderate on balance, with more rapid gains reported for workers with selected specialized skill sets. Price increases remained slight overall.

ECONOMIC REPORTS AND FORECASTS

STATE OF TEXAS

FEDERAL RESERVE BANK, DALLAS REGIONAL ECONOMIC UPDATE

July 2016 - www.dallasfed.org

⬆ Texas Economy

Texas employment grew at a 1.1% annualized rate in June; however, a big downward revision to first-quarter job growth resulted in a year-to-date decline of 0.1% on an annual basis. The Texas unemployment rate rose slightly to 4.5% in June from 4.4% in May. Texas real GDP growth slowed to a 0.3% annualized rate in the first quarter from 1.4% in fourth quarter 2015, in line with the deceleration observed in the labor market.

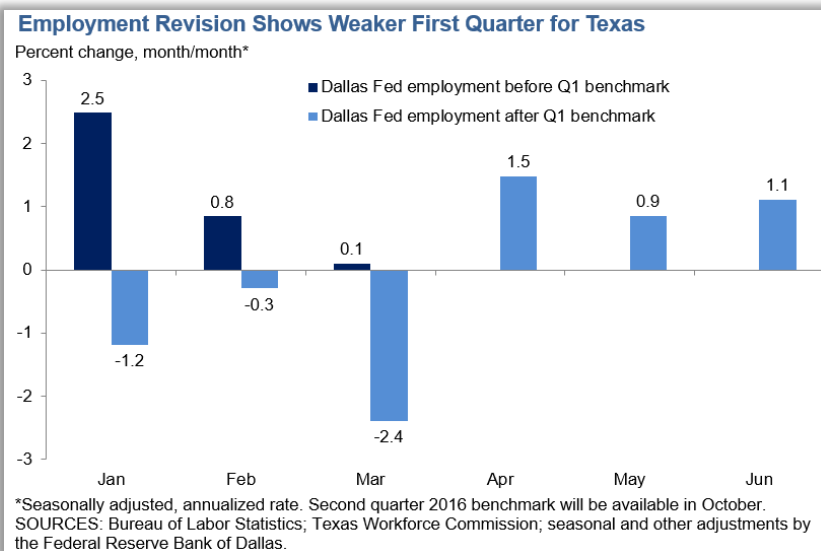
With the rig count ticking up and oil prices remaining around the \$45 range, sentiment in the oil and gas industry seems to have improved since the first quarter. The Texas Service Sector Outlook Survey (TSSOS) revenue index pointed to continued expansion in July. The Texas Manufacturing Outlook Survey (TMOS) production index was flat in July following negative readings in May and June, suggesting that output stopped falling this month.

The Texas Leading Index was essentially flat in June after declining 1.1% in May. Combined with the revised employment data, this resulted in the Dallas Fed lowering its forecast for 2016 employment growth to 0.5% (December/December) from 1.3%.

⬇ First Quarter 2016 Employment Data Drive Downward Revision

Each quarter, the Texas Workforce Commission releases a more comprehensive employment series called the Quarterly Census of Employment and Wages (QCEW). The Dallas Fed uses this to benchmark the monthly payroll employment data series. With the release of first quarter 2016 QCEW data, Texas nonfarm employment was revised downward in the first quarter.

The chart below shows both the Texas nonfarm employment series, benchmarked through 2015, and the Dallas Fed's early benchmarked employment series. The Dallas Fed series shows much sharper declines in the first quarter.



⇅ First-Quarter Weakness Spreads to the Service Sector

Service sector job growth—which, at 2.6%, had buoyed Texas employment in 2015—has slowed to an annualized 0.6% year to date in 2016. Only government and the education and health services subsector have shown strong growth.

The manufacturing sector, which has been losing jobs since the beginning of 2015, posted a 0.7% annualized gain in June. Year to date, employment in the sector is still down an annualized 2.8%. While Texas continues to see job losses in the oil and gas industry, the pace of decline has slowed from –23.9% in 2015 to an annualized –14.2% so far this year.

⇅ Employment Growth Weak in Most Metros Year to Date

Of the major metros, only San Antonio and Dallas showed positive job growth year to date through June, with 2.1% and 0.3% annualized gains, respectively. Austin, Fort Worth and Houston all declined.

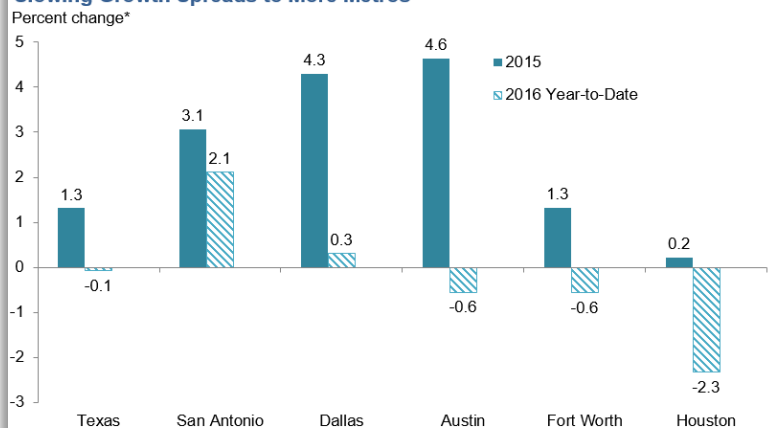
Houston saw its first employment increase of the year in June, although growth remains negative year to date. Employment in both Austin and Dallas grew more than 4% in 2015 but sharply decelerated in the first quarter, dragging down year-to-date growth. Only San Antonio posted strong job gains in the first quarter, and with continued growth in the second quarter, it has seen the fastest year-to-date growth of all of the metros.

↑ Rig Counts Recover Some Lost Ground

Rig counts, which bottomed out at 173 in late May, have climbed back up to 217 in August. Outlooks improved in second quarter 2016 from the pessimistic readings seen in the first quarter, according to the Dallas Fed Energy Survey. In addition, the business activity index—the survey’s broadest measure of sentiment among Eleventh District energy firms—turned positive at 13.8, up sharply from –42.1 in the first quarter. The majority of respondents said that business activity was stable relative to first-quarter levels, while nearly a third reported that activity had expanded.

This improved sentiment, along with oil prices in the \$45 range and a modest recovery in the rig count, suggests that the oil and gas slump may have moderated.

Slowing Growth Spreads to More Metros

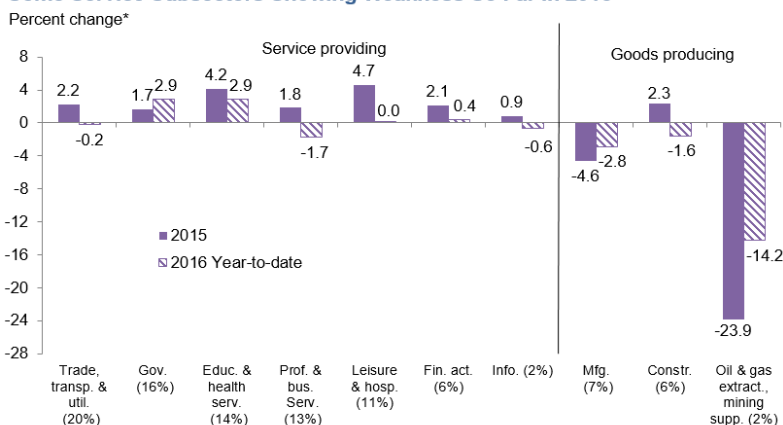


*Seasonally adjusted, annualized rate.

NOTE: Last data point is June 2016.

SOURCES: Bureau of Labor Statistics; Texas Workforce Commission; seasonal and other adjustments by the Federal Reserve Bank of Dallas.

Some Service Subsectors Showing Weakness So Far in 2016



*Seasonally adjusted, annualized rate.

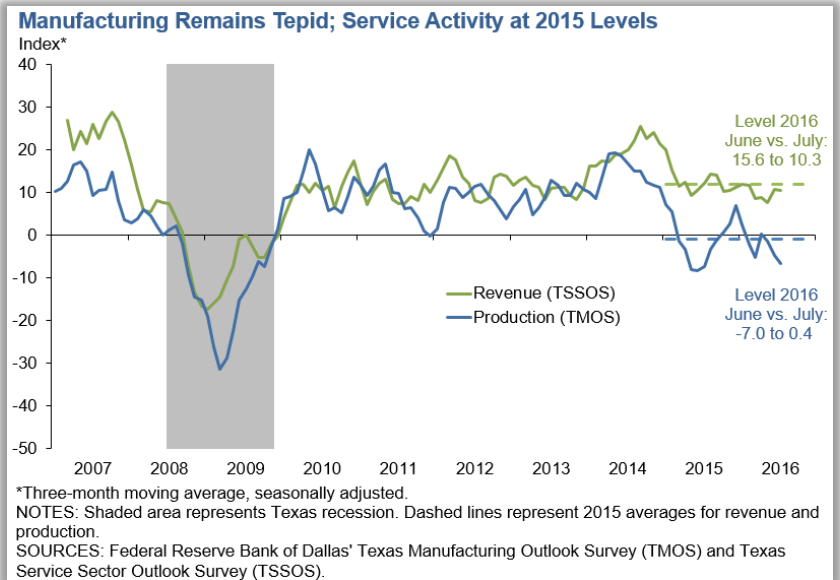
NOTES: Numbers in parentheses represent shares of total Texas employment and may not equal 100 due to rounding. Last data point is June 2016.

SOURCES: Bureau of Labor Statistics; Texas Workforce Commission; seasonal and other adjustments by the Federal Reserve Bank of Dallas.

↑ Manufacturing Improves, Services Continue to Grow

The TMOS production index was flat in July, though the three-month-moving average is still weak. TMOS indexes including company outlook and general business activity also saw improvement, but both remained negative in July.

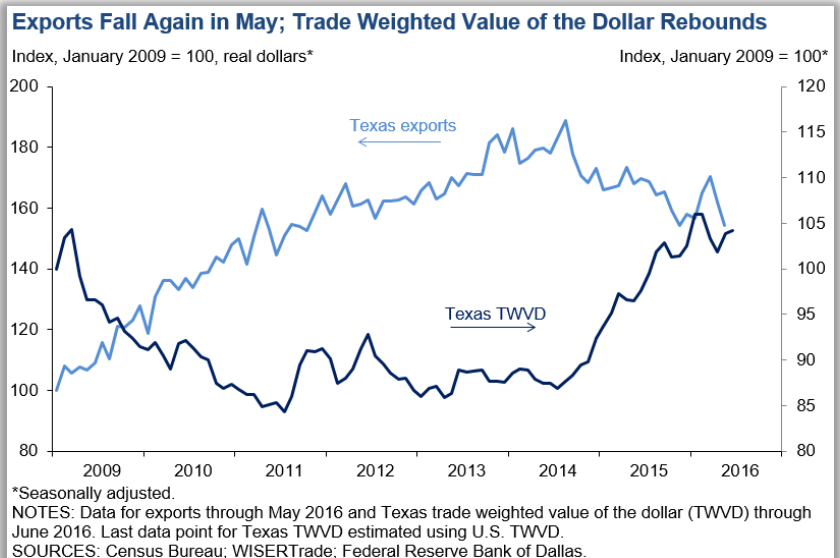
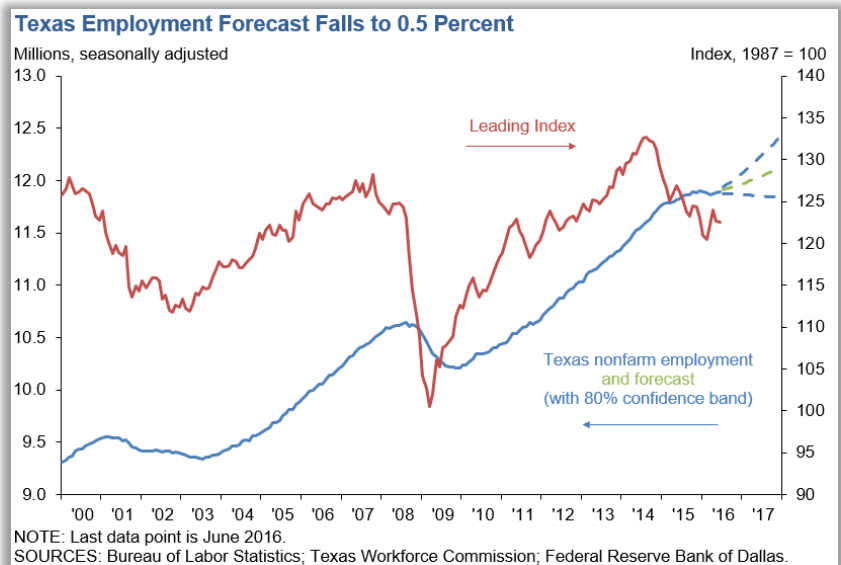
The three-month moving average in the TSSOS revenue index showed the service sector continuing to expand, hovering near its 2015 average. The point estimate, however, did dip slightly from 15.6 in June to 10.3 in July.



↑ Stronger Growth Expected in Second Half of Year

The Texas employment growth forecast is now 0.5% for 2016 (December/December), down from 1.3%. The large first-quarter employment revision was the main culprit in the forecast decline. That being said, the forecast still calls for the pace of job growth to pick up because Texas employment will have to increase over 1% in the second half to reach the 0.5% projected growth for the year.

The main risk factors going into the second half remain the possibility of even lower energy prices and the high value of the dollar along with its adverse impact on manufacturing. Steep increases in the value of the dollar since the middle of 2014 have weakened exports. The pullback in the dollar in early 2016 likely led to a spike in export activity, but with the dollar rising again, exports may be depressed further. Over 90% of exports from Texas are manufactured products, so further declines in exports could spell more weakness for the sector.



TEXAS ECONOMIC STATISTICS

U.S. BUREAU OF LABOR STATISTICS

Data Series	Feb 2016	Mar 2016	Apr 2016	May 2016	June 2016	July 2016
Labor Force Data						
Civilian Labor Force ⁽¹⁾	13,215.90	13,273.50	13,302.60	13,314.80	13,299.20	^(P) 13,291.5
Employment ⁽¹⁾	12,641.10	12,696.50	12,715.60	12,724.80	12,706.00	^(P) 12,682.4
Unemployment ⁽¹⁾	574.9	577.1	587	590	593.3	^(P) 609.2
Unemployment Rate ⁽²⁾	4.3	4.3	4.4	4.4	4.5	^(P) 4.6
Nonfarm Wage and Salary Employment						
Total Nonfarm ⁽³⁾	11,971.00	11,961.60	11,973.50	11,980.10	11,997.90	^(P) 12,021.5
12-month% change	1.5	1.6	1.6	1.5	1.5	^(P) 1.5
Mining and Logging ⁽³⁾	244.5	236.6	230.4	227.4	225.5	^(P) 224.8
12-month% change	-19.6	-19.8	-17.9	-16.8	-16.5	^(P) -14.9
Construction ⁽³⁾	688.00	688.50	689.90	686.8	685.4	^(P) 693.2
12-month% change	1.2	1.7	2.1	1.3	0.5	^(P) 1.6
Manufacturing ⁽³⁾	856.7	852.7	848.2	845.4	846.4	^(P) 844.0
12-month% change	-4.30	-4.40	-4.40	-4.3	-3.8	^(P) -3.8
Trade, Transportation, and Utilities ⁽³⁾	2,423.90	2,430.10	2,431.80	2,430.00	2,434.20	^(P) 2,437.2
12-month% change	2.2	2.3	2.2	1.9	1.8	^(P) 1.6
Information ⁽³⁾	201.3	200.4	200	202.7	203.7	^(P) 201.3
12-month% change	0.6	0.1	-0.2	0.7	1.3	^(P) -0.1
Financial Activities ⁽³⁾	731.7	730.1	731.4	735.6	737.5	^(P) 738.5
12-month% change	2.5	2.2	2	2.4	2.4	^(P) 2.4
Professional & Business Services ⁽³⁾	1,615.40	1,609.70	1,614.20	1,610.20	1,605.20	^(P) 1,615.2
12-month% change	1.7	1.7	1.8	1.4	0.9	^(P) 1.2
Education & Health Services ⁽³⁾	1,623.80	1,621.10	1,633.20	1,643.30	1,646.90	^(P) 1,654.5
12-month% change	4	3.7	4.1	4.3	4.3	^(P) 4.3
Leisure & Hospitality ⁽³⁾	1,291.40	1,289.90	1,288.70	1,284.80	1,291.00	^(P) 1,295.3
12-month% change	5.5	5.9	5.0	4.3	4.4	^(P) 4.1
Other Services ⁽³⁾	421.2	423.5	424.8	425.9	425.6	^(P) 421.9
12-month% change	1.7	2.2	2.3	2.5	1.8	^(P) 0.5
Government ⁽³⁾	1,873.10	1,879.00	1,880.90	1,888.00	1,896.50	^(P) 1,895.6
12-month% change	1.7	1.9	2.0	2.0	2.6	^(P) 2.1
Footnotes		⁽³⁾ Number of jobs, in thousands, seasonally adjusted.				
⁽¹⁾ Number of persons, in thousands, seasonally adjusted.		^(P) Preliminary.				
⁽²⁾ In percent, seasonally adjusted.						

Data extracted on: September 6, 2016

FEDERAL RESERVE BANK

SENIOR LOAN OFFICER OPINION SURVEY

The July 2016 Senior Loan Officer Opinion Survey on Bank Lending Practices (SLOOS) addressed changes in the standards and terms on, and demand for, bank loans to businesses and households over the past three months. This summary discusses the responses from 71 domestic banks and 23 U.S. branches and agencies of foreign banks.

Regarding loans to businesses, the July survey results indicated that, on balance, banks tightened their standards on commercial and industrial (C&I) and commercial real estate (CRE) loans over the second quarter of 2016. The survey results indicated that demand for C&I loans was little changed, while demand for CRE loans had strengthened during the second quarter on net.

Regarding loans to households, banks reported that standards on all categories of residential real estate (RRE) mortgage loans were little changed, on balance, except for those eligible for purchase by government-sponsored enterprises (known as GSE-eligible mortgage loans), for which a moderate net fraction of banks reported having eased standards, and for subprime residential mortgages, for which a moderate net fraction of banks reported having tightened standards. Banks also reported, on net, that demand for most types of RRE loans strengthened over the second quarter. In addition, banks indicated that changes in standards on consumer loans were mixed, while demand strengthened across all consumer loan types.

Responses to a set of special annual questions on the approximate levels of lending standards suggested that banks' lending standards for all categories of C&I loans are currently easier than the midpoints of the ranges that have prevailed since 2005 (explained more fully below), except for syndicated loans to below-investment-grade firms. However, banks also generally indicated that standards on all types of CRE loans are currently tighter than the midpoints of their respective ranges. Compared with the July 2015 SLOOS, fewer banks reported easier levels of standards and more banks reported tighter levels of standards for all business loan types.

In addition, banks continued to report in the July 2016 SLOOS that the levels of standards for all types of RRE loans are currently tighter than the midpoints of the ranges observed since 2005. Moreover, banks indicated that consumer loans to subprime borrowers are currently still tighter than their midpoints, while consumer loans to prime borrowers are currently easier than those reference points. Finally, the July 2016 SLOOS introduced a new question on the current level of standards on loans to nondepository financial institutions. A modest percentage of banks indicated that the current level of standards on these loans is tighter than the midpoint of the range that has prevailed since 2005.

BUSINESS LENDING

Commercial & Industry (C&I) Loans

Modest fractions of domestic banks reportedly tightened C&I lending standards for large and middle-market firms and for small firms, on balance, in the second quarter of 2016. Changes to terms on C&I loans for large and middle-market firms were mixed. Specifically, a modest percentage of banks reportedly narrowed spreads of loan rates over the cost of funds, while moderate fractions of banks reportedly increased the premiums charged on riskier loans, on net. Banks also reported that changes in the terms of loans to small firms were mixed: Whereas moderate shares of banks reported having narrowed spreads of loan rates over the cost of funds and

having decreased the use of interest rate floors, on net, modest percentages of banks reportedly increased the premiums charged on riskier loans and tightened loan covenants on net.

Most domestic respondents that reportedly tightened either standards or terms on C&I loans over the past three months cited as important reasons a less favorable or more uncertain economic outlook, worsening of industry-specific problems, and reduced tolerance for risk. In addition, most domestic banks that reported having eased either their standards or terms on C&I loans pointed to more aggressive

competition from other banks or nonbank lenders as an important reason for doing so.

Regarding the demand for C&I loans, domestic banks reported that demand from large and middle-market firms and from small firms was little changed, on balance, during the second quarter. Most banks that reported stronger loan demand cited the following as important reasons: increases in customer inventory financing needs, customer accounts receivable financing needs, and customer investment in plant or equipment. Conversely, half or more of the banks that reported weaker loan demand cited as important reasons decreases in these same three categories.

Meanwhile, foreign banks reported that C&I lending standards remained about unchanged, on balance, in the second quarter of 2016. However, modest net fractions of these banks reportedly raised the cost of credit lines and tightened collateralization requirements, while a moderate net fraction reported having increased premiums charged on riskier loans. A modest fraction of foreign banks reported stronger demand for C&I loans on net.

Commercial Real Estate Lending

On net, domestic survey respondents generally indicated that their lending standards for CRE loans of all types tightened during the second quarter. In particular, a moderate net fraction of banks reported tightening standards for loans secured by nonfarm nonresidential properties, whereas significant net fractions of banks reported tightening standards for construction and land development loans and loans secured by multifamily residential properties.

Domestic banks generally indicated that they had experienced stronger demand for all three types of CRE loans during the second quarter on balance. A modest net fraction of banks reported stronger demand for loans secured by multifamily residential properties, and moderate net fractions of banks reported stronger demand for construction and land development loans and loans secured by nonfarm nonresidential properties. Meanwhile, all foreign banks reported leaving CRE lending standards basically unchanged, while a modest net fraction of these banks reported experiencing stronger demand for such loans.

LENDING TO HOUSEHOLDS

Residential Real Estate Lending

During the second quarter, a moderate net fraction of banks reported having eased standards on GSE-eligible loans, while a moderate net fraction of banks reported having tightened standards on subprime residential mortgages. Meanwhile, banks left lending standards basically unchanged for all other categories of RRE loans on net.

Over the second quarter of 2016, banks reported stronger demand for most categories of RRE home-purchase loans. Significant net fractions of banks reported stronger demand for GSE-eligible, government, qualified mortgage (QM) non-jumbo non-GSE-eligible, QM jumbo residential, and non-QM jumbo residential mortgages, and a moderate net fraction of banks reported stronger demand for non-QM non-jumbo residential mortgages. Credit standards were reportedly little changed for approving applications for revolving home equity lines of credit (HELOCs), and a significant fraction of banks reported that demand for revolving HELOCs had strengthened on net.

Consumer Lending

A modest net fraction of banks indicated that they were more willing to make consumer installment loans during the second quarter compared with three months prior. A modest net fraction of banks reported easing lending standards on credit cards, and a modest net fraction reported tightening lending standards for auto loans, whereas standards on other consumer loans remained basically unchanged.

Regarding terms on consumer loans, modest net fractions of banks reportedly widened spreads of interest rates charged on outstanding credit card balances over their cost of funds and reduced minimum required credit scores for credit card loans, while a moderate net fraction of banks widened spreads of loan rates over their cost of funds on auto loans over the second quarter. Banks also reported that terms on consumer loans other than credit card and auto loans remained basically unchanged.

Banks generally reported that demand for consumer loans had strengthened in the second quarter: A modest net fraction reported that demand for credit card loans strengthened, while moderate net fractions of banks reported stronger demand for auto loans and consumer loans other than credit card and auto loans during the second quarter.

CURRENT LEVELS OF LENDING STANDARDS

The July survey included a set of special questions that asked respondents to describe the current level of lending standards at their bank rather than changes in standards over the survey period. Specifically, for each loan category surveyed, respondents were asked to consider the range over which their bank's standards have varied between 2005 and the present and then to report where the current level of standards for such loans resides relative to the midpoint of that range.

Domestic banks reported that lending standards on all categories of C&I loans remained at levels that are easier than or near the midpoints of their ranges since 2005, except for syndicated loans to below-investment-grade firms, for which a moderate net fraction of banks reported that standards are currently tighter than the respective midpoints. A significant net fraction of domestic banks reported that standards are currently easier than the respective midpoints on non-syndicated loans to large and middle-market firms, while moderate net fractions of domestic banks gave that characterization of syndicated loans to investment-grade firms and non-syndicated loans to small firms. However, the fraction of domestic banks reporting standards are easier decreased, and the fraction of banks reporting standards are tighter increased for all C&I loan types compared with the July 2015 SLOOS. Meanwhile, a significant net fraction of foreign banks reported that levels are currently easier than the midpoints of their ranges since 2005 for syndicated loans to investment-grade firms, while a significant net fraction of foreign banks reported that levels are currently tighter than the respective midpoints on non-syndicated loans to small firms in the July 2016 SLOOS.

Regarding the levels of standards for CRE loans, domestic banks reported that the current levels of standards on all major categories of these loans are tighter than the midpoints of the ranges that have prevailed since 2005. Moreover, similar to banks' responses regarding C&I lending standards, fewer domestic banks reported easier levels of standards and more reported tighter levels of standards, relative to the respective reference points, for all CRE loan types compared with the July 2015 SLOOS. A significant percentage of domestic banks reported, on balance, that current levels of standards are tighter than the respective midpoints on loans for construction and land development purposes, while moderate net fractions of domestic banks reported that current levels of standards are tighter than the respective midpoints on loans secured by nonfarm nonresidential properties and multifamily residential properties in the July 2016 SLOOS. Meanwhile, a major percentage of foreign banks reported, on balance, that levels of standards are currently tighter than the respective midpoints on loans for construction and land development purposes, while significant net fractions of foreign banks reported that levels of standards are currently tighter than the respective midpoints on loans secured by nonfarm nonresidential properties and multifamily residential properties.

With respect to RRE loans, on balance, domestic banks reported that lending standards for all five categories included in this survey question (GSE-eligible mortgages, government-insured mortgages, jumbo mortgages, subprime mortgages, and HELOCs) remained tighter than the midpoints of the ranges observed since 2005. Of note, a major net fraction of banks reported that the current level of standards on subprime residential mortgage loans is tighter than the reference point.

On balance, current levels of standards on consumer loans to subprime borrowers were reported to be tighter than the midpoints of the ranges since 2005. In particular, a moderate net fraction of banks reported that levels of standards are currently tighter than the midpoints of the respective ranges for credit card loans to subprime borrowers, and a significant net fraction of banks gave such a characterization of the current level of standards on auto loans to subprime borrowers. However, moderate net fractions of banks reported that levels of standards are currently easier than the respective midpoints on credit card and auto loans to prime borrowers and on consumer loans other than credit card and auto loans. Moreover, the net fraction of banks reporting that standards are easier than the midpoints of the respective ranges increased for all consumer loan types, except for subprime credit card loans and subprime auto loans, compared with the July 2015 SLOOS.

The July 2016 SLOOS introduced a new special question about the current level of standards on loans to nondepository financial institutions. A modest net fraction of domestic banks and a significant net fraction of foreign banks reported that the current level of standards on these loans is tighter than the midpoint of the range of standards that has prevailed since 2005.

ACKNOWLEDGEMENTS AND RESOURCES

American Petroleum Institute, Washington, D.C

CNBC, New York, New York

Dallas Morning News, Dallas, TX

Department of Savings and Mortgage Lending, Austin, TX

Federal Deposit Insurance Corporation, Washington, D.C.

Federal Reserve Bank of Dallas, Dallas, TX

Federal Reserve Bank of St. Louis, St. Louis, MO

Federal Reserve Board, Washington D.C.

MarketWatch, Inc., New York, New York

Real Estate Center at Texas A&M University, College Station, TX

RealtyTrac, Irvine, CA

Texas Comptroller of Public Accounts, Austin, TX

Texas Department of Banking, Austin, TX

Texas Railroad Commission, Austin, TX

Texas Workforce Commission, Austin, TX

The New York Times Company, New York, NY

U.S. Bureau of Labor Statistics, Washington, D.C.

U.S. Energy Information Administration, Washington, D.C.

Wall Street Journal, New York, NY

Yahoo Finance, online