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Some Perspectives on the Banking Environment: 1988-1992

During the last half of the 1980s the banking industry experienced unprecedented losses and massive failures. Nowhere was the situation more dismal than in Texas. With over 11 percent of the nation's banks, the state accounted for roughly 57 percent of bank failures in 1988. However, in recent months bank profits, bolstered by low interest rates, have risen to record levels. The pace of failures has eased and the focus has shifted to troubled institutions in New England and California. With less than 5 percent of the nation's banks, New England accounted for 24 percent of 1992 failures.

Does improvement in bank profits and capital ratios signal a recovery in the *business* of banking? This article considers this question in a review of the banking environment in Texas and the nation over the last five years.[1]

A combination of factors created the banking problems of the 1980s. Deregulation raised the cost of funds dramatically. Shrinking profit margins caused many bankers to pursue higher risk loans in an effort to maintain profit margins. Regulatory changes extended to many new and inexperienced competitors the banking industry's exclusive right to issue interest-bearing checkable deposits. Many of these competitors, exempt from holding reserves, became the low-cost producer. Extension of the deposit insurance umbrella encouraged growth through brokered deposits. Cascading oil and gas prices worsened the situation in states with energy-based economies. Together, these factors resulted in high-risk lending not warranted by the industry's capital base.

Further, archaic inter- and intrastate branching laws prevented bank mergers, caused inefficiencies in an already overpopulated industry, and stifled the ability of domestic banks to compete internationally. Against a backdrop of mounting failures, Congress passed legislation to strengthen the industry's capital base. Regulators, armed with new risk-based capital guidelines and a mandate to reduce, if not eliminate, high-risk lending, proceeded with a "take no prisoners" mentality. The impact on the banking industry has been a considerable contraction in both the number of banks and the services they collectively offer.

The number of U.S. banks declined over 10 percent in the last five years. Over the same period the number of Texas and New England banks declined 26 and 18 percent, respectively.[2] Banks have not been uniformly affected by this reduction. In Texas and the nation, the number of banks with assets of less than $50 million has decreased while all other asset categories have increased. New England banks with less than $50 million in assets and those with more than $1-$5 billion in assets declined in number.

As the number of larger banks has increased so has their share of total bank assets. Nationally, banks with assets of $100 million or less hold a smaller percentage of total bank assets than in 1988. In Texas, banks with assets of $1 billion or less hold a smaller percentage of total bank assets than in 1988. In New England, all asset categories except the largest banks have a smaller share of total bank assets.

From 1988 to 1992 the annual growth rate of bank assets nationwide came to a halt and total bank loan growth declined. The reduction in the number of commercial and consumer loans was even more dramatic, falling 9.44 and 2.9 percent, respectively, in 1991. Not surprisingly, as lending declined, investment in securities grew from 17.61 to 20.95 percent of total assets during this period. These events, coupled with a monetary policy conducive to increasing net interest margins, have resulted recently in reports of improved earnings.[3]

The story is similar in Texas, with two notable exceptions. First, the contraction in deposits and loans preceded the national and New England experience. Consequently, it is not unexpected that Texas banks seem to be leading the rebound in these loan categories. Through the second quarter of 1992, total loans in Texas had increased 2.9 percent and consumer loans were up 1.29 percent. For the same period all commercial banks and New England banks experienced a decline in total lending (down 1.13 and 3.40 percent, respectively) and consumer lending (down 3.39 and 8.71 percent, respectively). Secondly, the overall decline in consumer lending in Texas from 1988 to 1992 has not been as severe as the decline in either the nation or New England. (See following table.) Commercial and industrial lending continues to suffer in both Texas and New England.

From 1988 to 1992 the loan-to-deposit ratio increased for all U.S. banks except those in the more than $50-$100 million category. The ratio increased for all categories of Texas banks. The securities-to-asset ratio increased for all asset categories of both U.S. banks and Texas banks. Return on assets (ROA) improved for all asset categories of Texas banks and all U.S. banks except those with more than $5 billion in assets. Return on equity (ROE) improved for all asset categories of Texas banks. Nationwide, banks with assets of more than $1 billion experienced a decline in ROE.[4]

A closer analysis of the Texas banking environment is warranted. As the following table with data on Texas commercial banks shows, the top five banks accounted for slightly less than half of total bank assets and deposits and about 54 percent of the loans in Texas in 1992. With the exception of NationsBank, the top five banks experienced a decline in asset, deposit, and loan growth over the 1988-1992 period. The impact of the recapitalization of the top five banks is evident: in 1992 these banks accounted for 42 percent of bank equity capital in the state, an increase of 9.8 percent from 1988.

Banks in the "all other" category experienced an increase in asset and deposit growth between 1988 and 1992. Likewise, their share of all assets and deposits increased. However, their share of total loans in Texas actually declined slightly. For these banks, loan growth between 1988 and 1992 decreased approximately 13 percent.

Several trends emerge from this discussion: (1) the banking industry is consolidating, either through acquisitions or failures; (2) large banks are gaining in both number and percentage of assets held at the expense of smaller banks; (3) growth in total assets, deposits, and loans has declined sharply; (4) commercial and industrial lending have declined more than consumer lending; (5) low interest rates have improved net interest margins and profits; and (6) the banking problems in Texas generally preceded the national experience, and Texas is apparently showing signs of leading the rebound with positive loan growth in 1992.

The evidence suggests that while bank profits have benefited from liberal monetary policies over the last twelve to eighteen months and capital ratios have improved, the business of banking has not recovered. Banks, with noted exceptions, are not making loans. As the name implies, commercial banks are in business to make commercial and industrial loans. So why is business lending lagging? One explanation lies with the way regulators have dealt with the industry's problems. Enforcing tough new regulations with an "iron hand" has seriously constrained otherwise profitable lending. Banking, like free enterprise, is not and should not be a "risk free" undertaking, and regulators who attempt to make it so are misguided. A growing economy needs dependable and flexible sources of funds. Bankers have traditionally filled that need.

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Notes

1. Data in the analysis are taken from the FDIC call reports for all commercial banks. W.C. Ferguson & Co. is the data source. For 1988-1991, data are based on year-end Dec. 31 reports; 1992 data reflect June 30 results. A table summarizing the total number of banks and failures for the U.S., Texas, and New England, as well as the changes in number and asset distribution of banks, from 1988-1992 is available upon request to the Bureau. Space limitations preclude their display in this publication.
2. New England banks are those in Federal Reserve District 1.
3. Selected balance sheet, profitability, and liquidity data for domestic commercial banks from 1988-1992 are available in table form upon request to the Bureau.
4. Selected data for U.S. and Texas commercial banks by asset size from 1988-1992 are available in table form upon request to the Bureau.

Selected Bank Data: Texas and New England, 1988-1992
(in thousands)

Texas	1988	1989	1990	1991	Jun 30 1992
Balance sheet					
Total assets	$171,102,385	$174,948,213	$170,830,718	$168,883,659	$169,021,214
Percentage change	-7.44	2.25	-2.35	-1.14	0.08
Total deposits	$143,395,714	$143,899,667	$145,642,746	$147,468,091	$145,911,824
Percentage change	-3.37	0.35	1.21	1.25	-1.06
Total loans	$88,907,983	$82,496,550	$77,888,464	$75,595,612	$77,785,426
Percentage change	-14.78	-7.21	-5.59	-2.94	2.90
Commercial and industrial loans	$29,326,854	$28,884,052	$26,064,779	$24,542,684	$24,017,020
Percentage change	-15.63	-1.51	-9.76	-5.84	-2.14
Commercial and industrial loans/ total assets (percentage)	18.00	16.82	15.89	14.90	14.37
Consumer loans	$13,365,872	$14,157,287	$14,498,255	$14,261,572	$14,445,210
Percentage change	-1.80	5.92	2.41	-1.63	1.29
Consumer loans/total assets (percentage)	7.58	7.95	8.29	8.47	8.50
Profitability					
Net interest margin (percentage)	2.83	2.93	3.45	3.73	4.11
Liquidity					
Securities/assets ratio (percentage)	18.78	21.47	24.71	29.29	31.82
Market value/book value (percentage)	97.93	100.31	100.80	103.11	102.20

New England	1988	1989	1990	1991	Jun 30 1992
Balance sheet					
Total assets	$298,521,635	$306,130,203	$279,373,133	$265,600,242	$261,829,077
Percentage change	15.84	2.55	-8.74	-4.93	-1.42
Total deposits	$230,606,558	$238,507,556	$229,634,469	$215,335,036	$212,089,458
Percentage change	13.87	3.43	-3.72	-6.23	-1.51
Total loans	$211,557,698	$215,608,293	$190,627,955	$167,724,216	$162,029,259
Percentage change	17.15	1.91	-11.59	-12.01	-3.40
Commercial and industrial loans	$48,059,237	$48,074,039	$41,066,929	$33,333,323	$33,312,142
Percentage change	12.24	0.03	-14.58	-18.83	-0.06
Commercial and industrial loans/ total assets (percentage)	16.34	15.90	15.22	13.65	12.64
Consumer loans	$23,221,754	$21,334,962	$17,014,305	$14,383,417	$13,131,029
Percentage change	8.50	-8.13	-20.25	-15.46	-8.71
Consumer loans/total assets (percentage)	8.02	7.37	6.55	5.76	5.22
Profitability					
Net interest margin (percentage)	3.64	3.37	3.16	3.35	3.85
Liquidity					
Securities/assets ratio (percentage)	16.16	14.32	14.28	17.58	20.4
Market value/book value (percentage)	98.47	100.30	100.27	103.61	102.59

Texas Commercial Banks, Segmented by Five Largest and All Others, 1988-1992

Total assets (percentages)

	1988	1989	1990	1991	1992
Top five					
NationsBank	14.99	19.29	19.16	19.23	19.44
Texas Commerce	12.11	11.82	10.76	10.66	10.19
First City	7.66	8.81	8.54	5.99	5.09
Bank One/Team Bank	12.32	9.45	11.34	11.42	10.88
First Interstate	3.98	3.72	3.08	3.25	3.18
Total top five	51.02	53.09	52.88	50.56	48.78
All others	48.98	46.91	47.12	49.44	51.22

Total loans (percentages)

	1988	1989	1990	1991	1992
Top five					
NationsBank	13.14	15.61	16.51	18.81	20.88
Texas Commerce	11.73	10.89	11.76	12.23	11.63
First City	8.68	10.41	10.60	7.70	6.53
Bank One/Team Bank	14.73	12.20	12.60	12.16	11.38
First Interstate	5.19	5.02	4.06	3.53	3.27
Total top five	53.47	54.13	55.53	54.43	53.69
All others	46.53	45.87	44.47	45.57	46.31

Total deposits (percentages)

	1988	1989	1990	1991	1992
Top five					
NationsBank	14.33	17.81	18.26	18.13	17.75
Texas Commerce	10.13	10.10	10.03	9.83	9.46
First City	7.07	7.96	7.29	6.09	5.40
Bank One/Team Bank	11.62	8.88	11.35	11.60	10.96
First Interstate	4.29	4.15	3.28	3.37	3.30
Total top five	47.44	48.90	50.21	49.02	46.87
All others	52.56	51.10	49.79	50.98	53.13

Equity capital (percentages)

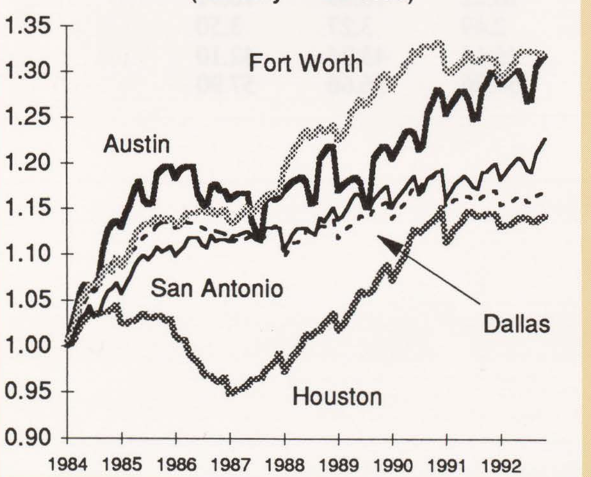
	1988	1989	1990	1991	1992
Top five					
NationsBank	13.13	18.25	16.66	15.57	15.14
Texas Commerce	13.41	13.85	10.36	10.14	9.98
First City	8.66	9.42	5.41	3.47	2.57
Bank One/Team Bank	-5.31	-6.16	10.22	10.89	10.91
First Interstate	2.41	1.14	2.49	3.27	3.50
Total top five	32.30	36.51	45.14	43.34	42.10
All others	67.70	63.49	54.86	56.66	57.90

Employment and Unemployment Rate by Metropolitan Area

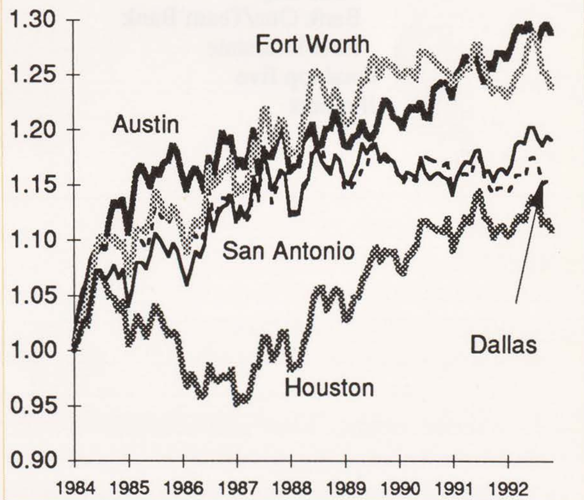
Area	Total nonagricultural employment (thousands) Nov. 1992	Nov. 1991	Percentage change	Total employment (thousands) Nov. 1992	Nov. 1991	Percentage change	Unemployment rate Nov. 1992
Abilene	50.8	49.4	2.8	49.4	47.8	3.3	6.8
Amarillo	80.6	80.4	0.2	92.2	92.0	0.2	5.7
Austin	403.9	398.0	1.5	437.4	431.2	1.4	5.2
Beaumont-Port Arthur	156.6	153.3	2.2	164.8	161.0	2.4	10.0
Brazoria	73.5	73.0	0.7	88.8	88.5	0.3	8.0
Brownsville-Harlingen	83.2	79.1	5.2	100.6	95.4	5.5	12.4
Bryan-College Station	60.1	58.7	2.4	64.9	63.1	2.9	4.0
Corpus Christi	137.9	136.5	1.0	152.0	150.5	1.0	9.6
Dallas	1,387.3	1,385.5	0.1	1,342.4	1,344.3	-0.1	7.1
El Paso	217.3	211.2	2.9	229.9	224.2	2.5	11.0
Fort Worth-Arlington	592.0	589.0	0.5	683.1	682.4	0.1	7.0
Galveston-Texas City	81.1	79.4	2.1	106.7	104.1	2.5	9.0
Houston	1,643.1	1,646.5	-0.2	1,647.2	1,650.0	-0.2	7.6
Killeen-Temple	79.3	75.7	4.8	94.5	90.1	4.9	8.0
Laredo	50.9	48.1	5.8	52.9	50.3	5.2	10.2
Longview-Marshall	70.8	70.7	0.1	73.8	73.6	0.3	9.7
Lubbock	99.1	98.1	1.0	108.4	107.3	1.0	6.5
McAllen-Edinburg-Mission	111.2	106.0	4.9	140.8	134.4	4.8	17.0
Midland	46.0	47.0	-2.1	45.7	46.7	-2.1	8.0
Odessa	45.0	46.0	-2.2	48.7	49.8	-2.2	10.3
San Angelo	39.2	38.4	2.1	43.3	42.7	1.4	6.1
San Antonio	547.0	533.0	2.6	579.7	566.1	2.4	6.6
Sherman-Denison	37.2	37.2	0.0	43.0	43.4	-0.9	7.5
Texarkana	47.9	46.8	2.4	53.2	52.8	0.8	7.3
Tyler	64.0	63.3	1.1	69.5	69.1	0.6	8.3
Victoria	30.9	30.8	0.3	36.4	36.4	0.0	6.4
Waco	84.2	83.9	0.4	87.9	87.0	1.0	6.7
Wichita Falls	50.6	50.2	0.8	50.8	50.5	0.6	7.1
Total Texas	7,276.2	7,185.3	1.3	8,056.3	7,979.8	1.0	7.7
Total United States	109,582.0	109,106.0	0.4	118,239.0	117,110.0	1.0	7.0

Note: Data are not seasonally adjusted. Figures for 1991 have undergone a major revision; previously published 1991 figures should no longer be used. Revised figures are available upon request. All 1992 figures are subject to revision.
Sources: Texas Employment Commission and U.S. Department of Labor, Bureau of Labor Statistics.

Nonagricultural Employment in Five Largest Texas Metropolitan Areas
(January 1984=1.00)



Total Employment in Five Largest Texas Metropolitan Areas
(January 1984=1.00)



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The Bureau of Business Research serves as a primary source for economic and demographic data on the state of Texas. An integral part of UT Austin's Graduate School of Business, the Bureau is located on the sixth floor of the College of Business Administration building.

Announcement

At press time, Bureau staff were completing entry verification, editing, and categorizing of information from the annual survey of manufacturing firms that will be published as the **1993 Directory of Texas Manufacturers.** More than 60 percent of the entries from the 1992 edition were updated as a result of responses to the survey, and our data indicate 909 companies have been dropped and 1,000 added, for a total of more than 17,000 manufacturers.

The **Directory,** which has been the primary resource for information on Texas manufacturers since 1933, is supplemented monthly by reports on new and expanding firms in **Texas Industrial Expansion.** In early March the two-volume directory should be ready for release to the public. Purchase price for the **Directory,** which includes twelve issues of **Texas Industrial Expansion,** is $125 plus tax for Texas residents.

To order the **Directory** and **Texas Industrial Expansion,** call (512) 471-1616 or fax (512) 471-1063. If you need company information on diskettes or mailing labels, call (512) 471-1616 for more information.

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