

An Update on Emerging Issues in Banking

The Effects of the U.S. Economic Slowdown: Houston

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This is the first of a series of profiles that will highlight regional issues affecting FDIC-insured institutions. This FYI is a shorter version of a more detailed *Bank Trends* report available today on the FDIC website.

Forces driving the U.S. economy in 2001 intersected in the Houston metropolitan area¹. After racing ahead of the national economy early in the year, Houston faced weakening energy prices, layoffs at computer manufacturers and airlines, the bankruptcy of Enron, and the most costly tropical storm in U.S. history. The many FDIC-insured institutions that conduct business in this market, especially the 58 institutions headquartered in Houston, must adjust from a period of extraordinarily rapid growth to one in which the economic fundamentals seem to have changed.

A principal reason why Houston's economy has deteriorated since mid-year 2001, and may lag the national economy in 2002, is the shift in the energy outlook (see Chart 1). Energy firms are reporting lower fourth quarter earnings, dampening the outlook for profits and causing cutbacks in capital expenditures and exploration budgets. Soft demand for petroleum and natural gas-related products, the result of warmer than average weather and sluggish U.S. and global economic growth, is expected to continue to constrain energy prices.

Secondary economic effects arising from a less than robust energy sector are affecting other industries such as construction, retailing and business services. These spin-off effects are expected to dampen Houston's total nonfarm employment growth rate this year. The layoffs at Continental Airlines and Compaq Computer, and the collapse of Enron, have also affected the Houston economy. The ripple effects from these events are expected to contribute to a belated and slow recovery in trend employment growth in the Houston metro area in 2002.

The consequences of the slowing economy will present challenges to the 58 FDIC-insured institutions headquartered in the Houston metropolitan area. Through the first three-quarters of 2001 the median return on assets for FDIC-insured institutions headquartered in the Houston metropolitan area was 0.85 percent, significantly below the national median of 1.00 percent. Preliminary year-end 2001 data suggest that the performance of this group of institutions weakened further with a median return on assets of 0.66 percent.

Moreover, reserve coverage as a percentage of loans among Houston area banks as of September 30, 2001 was far below the national average (1.06 percent versus 1.61 percent). Financial performance has thus far been affected by tight interest margins and low fee-based revenues rather than loan-loss provisions. Provision expenses as a share of average assets for Houston area banks were less than one-third the average for all banks in the nation. Should asset quality deterioration materialize, a need for additional provisions will compound the earnings issues facing Houston area banks.

Analysis of regional economic conditions can help banks make informed risk-

management decisions. The FDIC provides a wide range of up-to-date economic information for the 50 states, for over 380 metropolitan areas and more than 3,100 U.S. counties on its website in RECON -Regional Economic Conditions).

For the full Bank Trends report, entitled "Houston's Downturn Comes Later but Will Linger Longer," go to:

<http://www.fdic.gov/bank/analytical/bank/index.html>

¹ References to Houston in this FYI are for the metropolitan statistical area and include the following counties: Chambers, Fort Bend, Harris, Liberty, Montgomery and Waller.

Chart 1. Oil and Natural Gas Prices Fell Throughout 2001

Date	West Texas Intermediate Crude (LS) Dollars Per Barrel	Henry Hub (RS) Dollars Per mmbtu
Jan 1997	\$25.17	\$3.32
Feb 1997	\$22.21	\$2.22
Mar 1997	\$20.99	\$1.89
Apr 1997	\$19.72	\$2.03
May 1997	\$20.83	\$2.24
Jun 1997	\$19.17	\$2.20
Jul 1997	\$19.63	\$2.19
Aug 1997	\$19.93	\$2.48
Sep 1997	\$19.79	\$2.85
Oct 1997	\$21.26	\$3.04
Nov 1997	\$20.17	\$3.02
Dec 1997	\$18.32	\$2.33
Jan 1998	\$16.71	\$2.10
Feb 1998	\$16.06	\$2.22
Mar 1998	\$15.02	\$2.24
Apr 1998	\$15.44	\$2.43
May 1998	\$14.86	\$2.15
Jun 1998	\$13.66	\$2.17
Jul 1998	\$14.08	\$2.17
Aug 1998	\$13.36	\$1.85
Sep 1998	\$14.95	\$2.02
Oct 1998	\$14.39	\$1.89
Nov 1998	\$12.85	\$2.11
Dec 1998	\$11.28	\$1.73
Jan 1999	\$12.47	\$1.85
Feb 1999	\$12.01	\$1.78
Mar 1999	\$14.66	\$1.79
Apr 1999	\$17.34	\$2.15

May 1999	\$17.75	\$2.26
Jun 1999	\$17.89	\$2.31
Jul 1999	\$20.07	\$2.31
Aug 1999	\$21.26	\$2.79
Sep 1999	\$23.88	\$2.54
Oct 1999	\$22.64	\$2.73
Nov 1999	\$24.97	\$2.36
Dec 1999	\$26.08	\$2.36
Jan 2000	\$27.18	\$2.42
Feb 2000	\$29.35	\$2.66
Apr 2000	\$25.74	\$3.04
May 2000	\$28.78	\$3.58
Jun 2000	\$31.83	\$4.29
Jul 2000	\$29.77	\$3.96
Aug 2000	\$31.22	\$4.41
Sep 2000	\$33.88	\$5.06
Oct 2000	\$33.08	\$5.02
Nov 2000	\$34.40	\$5.54
Dec 2000	\$28.46	\$8.95
Jan 2001	\$29.58	\$8.18
Feb 2001	\$29.61	\$5.62
Mar 2001	\$27.24	\$5.16
Apr 2001	\$27.41	\$5.17
May 2001	\$28.64	\$4.21
Jun 2001	\$27.60	\$3.71
Jul 2001	\$26.45	\$3.11
Aug 2001	\$27.47	\$2.96
Sep 2001	\$25.88	\$2.15
Oct 2001	\$22.21	\$2.45
Nov 2001	\$19.67	\$2.37
Dec 2001	\$19.33	\$2.42
Jan 2002	\$19.67	\$2.26
Feb 2002	\$20.74	\$2.31