Banking Conditions Survey

Federal Reserve Bank of Dallas

May 2018

Data for this report were collected May 1–9, and 68 financial institutions—9 credit unions and 59 banks—responded.

Over the past six weeks, the Eleventh District financial sector has continued to strengthen and at a faster rate compared with the previous period. Banking leaders indicated that both loan volume and loan demand continued to expand and at a faster pace over the past six weeks. The loan volume index was 40.3, up from 18.3. The loan demand index moved up to 30.3 from 14.3.

While the survey suggests that nonperforming loans decreased over the past six weeks overall, residential real estate loans continued to experience an increase in nonperforming loans. Most of the decrease in nonperforming loans was concentrated in consumer loans according to respondents. Loan pricing continued to increase and at a faster pace, with an index of 43.1, up from 36.3. Overall, credit standards and terms continued to tighten, with most of the tightening seen in commercial real estate (CRE) and commercial and industrial (C&I) loans. General business activity expanded over the past six weeks and at a faster rate compared with the previous period, with a reading of 55.2, up from 40.8.

Increases in loan volume were seen across all loan categories, but there were large gains particularly in C&I, CRE, and residential real estate loans. All three categories experienced growth at a faster pace compared with the last report. The C&I loan volume index moved from 13.8 to 25.8; for CRE, 19.7 to 32.3; for residential real estate, 16.6 to 39.7.

Core deposit volumes and cost of funds continued to expand over the past six weeks, but at a slower rate. According to respondents, net interest margins have continued to increase and at a quicker pace. Noninterest income increased over the past six weeks.

The outlook for the Eleventh District financial sector is slightly more optimistic compared with sentiments six weeks ago. Expectations for total loan demand point to expansion and at a quicker rate compared with the previous period; nonperforming loans are still expected to decline six months from now and also at a quicker pace. Expectations for general business activity are still optimistic, with an index value of 53.0, slightly up from 51.4.

Next Release: July 18, 2018

The Federal Reserve Bank of Dallas conducts the Banking Conditions Survey twice each quarter to obtain a timely assessment of activity at banks and credit unions headquartered in the Eleventh Federal Reserve District. CEOs or senior loan officers of financial institutions report on how conditions have changed for indicators such as various loan types, deposits and loan pricings. Respondents are also asked to report on their banking outlook and how they perceive broader economic conditions to have changed (general business activity).

The answers serve a dual function: They provide supplemental anecdotal information for the Eleventh District Beige Book and supply timely information on banking conditions in preparation for monetary policy deliberations before the eight Federal Open Market Committee meetings each year.

Participants are asked whether they are seeing changes in a series of indicators. In addition, participants are given the opportunity to submit comments on current issues that may be affecting their business.

Survey responses are used to calculate an index for each indicator. Each index is calculated by subtracting the percentage of respondents reporting a decrease (or tightening or worsening) from the percentage reporting an increase (or easing or improvement). When the share of firms reporting an increase exceeds the share of firms reporting a decrease, the index will be greater than zero, suggesting the indicator has increased over the prior reporting period. If the share of firms reporting a decrease exceeds the share reporting an increase, the index will be below zero, suggesting the indicator has decreased over the prior reporting period. An index will be zero when the number of firms reporting an increase is equal to the number reporting a decrease. Note: Percentages may not add to 100 due to rounding.

1. Total loans: Over the past six weeks, how have the following changed?

Indicator	Current index	Previous index	Percent reporting increased	Percent reporting no change	Percent reporting decreased
Loan volume	40.3	18.3	55.2	29.9	14.9
Loan demand	30.3	14.3	45.5	39.4	15.2
Nonperforming loans	–6.4	–5.8	11.3	71.0	17.7
Loan pricing	43.1	36.3	50.8	41.5	7.7

Indicator	Current index	Previous index	Percent reporting eased	Percent reporting no change	Percent reporting tightened
Credit standards and terms	–6.2	–7.8	4.7	84.4	10.9

2. Commercial and industrial loans: Over the past six weeks, how have the following changed?

Indicator	Current index	Previous index	Percent reporting increased	Percent reporting no change	Percent reporting decreased
Loan volume	25.8	13.8	38.7	48.4	12.9
Nonperforming loans	0.0	–1.5	8.6	82.8	8.6

Indicator	Current index	Previous index	Percent reporting eased	Percent reporting no change	Percent reporting tightened
Credit standards and terms	–6.5	–7.7	3.2	87.1	9.7

3. Commercial real estate loans: Over the past six weeks, how have the following changed?

Indicator	Current index	Previous index	Percent reporting increased	Percent reporting no change	Percent reporting decreased
Loan volume	32.3	19.7	43.5	45.2	11.3
Nonperforming loans	0.0	–3.1	6.8	86.4	6.8

Indicator	Current index	Previous index	Percent reporting eased	Percent reporting no change	Percent reporting tightened
Credit standards and terms	–6.5	–9.1	6.6	80.3	13.1

4. Residential real estate loans: Over the past six weeks, how have the following changed?

Indicator	Current index	Previous index	Percent reporting increased	Percent reporting no change	Percent reporting decreased
Loan volume	39.7	16.6	48.3	43.1	8.6
Nonperforming loans	1.9	1.6	5.7	90.6	3.8

Indicator	Current index	Previous index	Percent reporting eased	Percent reporting no change	Percent reporting tightened
Credit standards and terms	0.0	–8.3	1.7	96.6	1.7

5. Consumer loans: Over the past six weeks, how have the following changed?

Indicator	Current index	Previous index	Percent reporting increased	Percent reporting no change	Percent reporting decreased
Loan volume	3.1	–6.0	15.6	71.9	12.5
Nonperforming loans	–12.9	–9.2	1.6	83.9	14.5

Indicator	Current index	Previous index	Percent reporting eased	Percent reporting no change	Percent reporting tightened
Credit standards and terms	–3.1	–6.1	0.0	96.9	3.1

6. Other banking developments: Over the past six weeks, how have the following changed?

Indicator	Current index	Previous index	Percent reporting increased	Percent reporting no change	Percent reporting decreased
Volume of core deposits	6.0	18.6	33.3	39.4	27.3
Cost of funds	71.2	75.7	77.3	16.7	6.1
Net interest margin	21.5	10.0	36.9	47.7	15.4
Noninterest income	15.1	–5.7	22.7	69.7	7.6

7. Banking outlook: What is your expectation for the following items six months from now?

Indicator	Current index	Previous index	Percent reporting better	Percent reporting no change	Percent reporting worse
Total loan demand	47.0	45.6	56.1	34.8	9.1

Indicator	Current index	Previous index	Percent reporting more	Percent reporting no change	Percent reporting fewer
Nonperforming loans	–19.7	–13.1	7.6	65.2	27.3

8. General business activity: What is your evaluation of the level of activity?

Indicator	Current index	Previous index	Percent reporting improved	Percent reporting no change	Percent reporting worsened
Over the past six weeks	55.2	40.8	61.2	32.8	6.0
Six months from now	53.0	51.4	62.1	28.8	9.1

9. Issues of concern: Please feel free to comment on any issue that may be affecting your business.

These comments are from respondents' completed surveys and have been edited for publication.

- Appreciate the changes being made at the former Consumer Financial Protection Bureau!
- As a small community institution, the risk of accelerated rising deposit rates is one of my top concerns.
- Competition for deposits has materially increased—impacting not only cost but also general availability of funding. The largest banks, presumably in response to the Fed's withdrawing excess liquidity from the banking system and/or such bank's presumption that system liquidity will be reduced in the near future, have re-entered the market for commercial deposits and are aggressively soliciting those funds.
- Compliance component has decreased our ability to make consume loans. On-line mortgage companies have impacted the local mortgage business. New beneficial ownership rule is creating havoc and rancor with our customers.
- Costs associated with regulatory compliance and competition from credit unions.
- Drought conditions continue to worsen. Cotton farmers must plant cotton seed, purchase fuel, pay labor, while hoping for something other than total disaster at this point. Crop insurance continues to be in the top three expenses.
- Growth in deposits continue to be a challenge for all community banks.
- We are concerned with increased rate uncertainty.
- We are concerned with market competition that has weakened pricing and pushed credit standards down.
- Regulations like Community Reinvestment Act need to be quantified.
- Regulatory overkill continues to be the main issue weighing down profits and time to take care of our customers. Very hopeful we will see some changes filter down to the local examiners to be more reasonable in their exams. Our small bank with one office was required to have a capital plan that never quite measured up to the Federal Reserve Bank's expectations. Hours were needlessly spent on this project. By the way, charge-offs for the past 20 years did not exceed $50,000 cumulative.
- We are seeing more interest on the part of out-of-state applicants for positions. While hiring pool is getting smaller, we seem to be able to attract qualified candidates without messing with wages. Large deposit inflows from Hurricane Harvey are starting to be withdrawn for repairs, paying contractors, etc. Homes for sale have very low prices by local historical standards. Banks and credit unions have been good about not raising deposit rates yet.
- The cost of compliance with regulations and "best practices" makes it very difficult for smaller banks (under $250,000) to operate. The cost of personnel as well attracting and

retaining qualified personnel is not possible in smaller communities. Qualified personnel do not want to be involved with compliance activities that have no value to the bank. Examples are the number of third party reviews required by regulation and/or "best practices" for IT, Bank Secrecy Act, asset/liability monitoring, etc. At all times the bank is being audited, examined by Federal Deposit Insurance Corporation and/or Texas Department of Banking or third parties for something. In the rare times when one is not in process, the bank personnel are responding to inform request for one that is upcoming.

- We are seeing some inconsistencies in shared national credit (SNC) exams. At a conference, one of our senior credit folks was in a room where the question was asked if that question was asked—banks in the room who have SNC all raised their hands and said they were surprised by their SNC grades.
- We have seen several paydowns or payoffs of loans within the past month, particularly within the commercial loan and 1–4 family real estate categories. Rates continue to creep up. Within the deposit area, we are seeing competition for interest bearing deposits, particularly in the certificate of deposit area. Consumers seem to hear of rate hikes that the Fed has performed and expect a higher rate when a certificate of deposit matures. Senior management has noticed the year-over-year shock with the bank's unrealized gain or loss on the bond portfolio and continues to adjust as necessary. Rates are being monitored closely for any inversion or sudden rate movements.