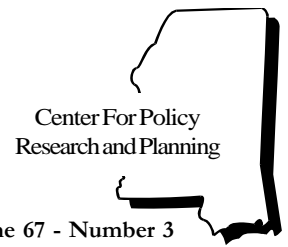


Mississippi's Business



March 2009

Monitoring the State's Economy

Volume 67 - Number 3

Mississippi employment data are currently being revised. Mississippi's Business will therefore not report the Mississippi Leading and Coincident Indicators in this issue. Instead, some general economic trends will be presented.

THE DETERIORATING ECONOMY

We are in the midst of the "Great Recession". That is the name being given to the current downturn. It is a name that will convey the severity of the crisis, yet make a distinction from the "Great Depression". The great depression was a decade long slump in which unemployment exceeded 25 percent of the workforce and GNP declined as much as 33 percent. No one expects this downturn to be that severe. Forecasters expect that before the economy turns around the Nation will have lost 3.9 and 4.8 percent of its gross domestic product (GDP). There is no official definition of a depression, but a general rule of thumb is a 10 percent decline in GDP. The current downturn is expected to be one third to one half as bad as a depression. On average, a recession lasts 10 months. The current recession is expected to last 24 months. The "Great Recession" will then be the deepest and longest lasting since the depression.

The Nation is seeing a deteriorating economy. We have lost over 4 million jobs in the last twelve months. As figure 1 reveals, the decline has intensified. In fact, of the

4.2 million jobs lost over the last twelve months, over 2.6 million or 62 percent have been lost in the last four months. Lately, any good economic news seems to come with a qualifier. Home sales rose 4.7 percent in February, but even with the monthly gain, sales were the worst since 1963. Durable goods orders were up an unexpected 3.6 percent. But like the boost in retail sales occurring last month, the gain is viewed as unsustainable in the deteriorating economy.

In Mississippi, employment declines have also intensified. There was a 66 percent increase in the number of continued unemployment claims in the fourth quarter of 2008, relative to the same period in 2007. The January seasonally adjusted unemployment rate reached 8.7 percent. Except for the months following Katrina, the rate has not been that high since the 1992 recession. The employment data are being revised, but it is likely that even after the revisions, the number of employed in Mississippi is on par with the lowest levels of 2003. Effectively, the current downturn has erased in one year, all employment gains that have been made since 2000-2003 downturn.

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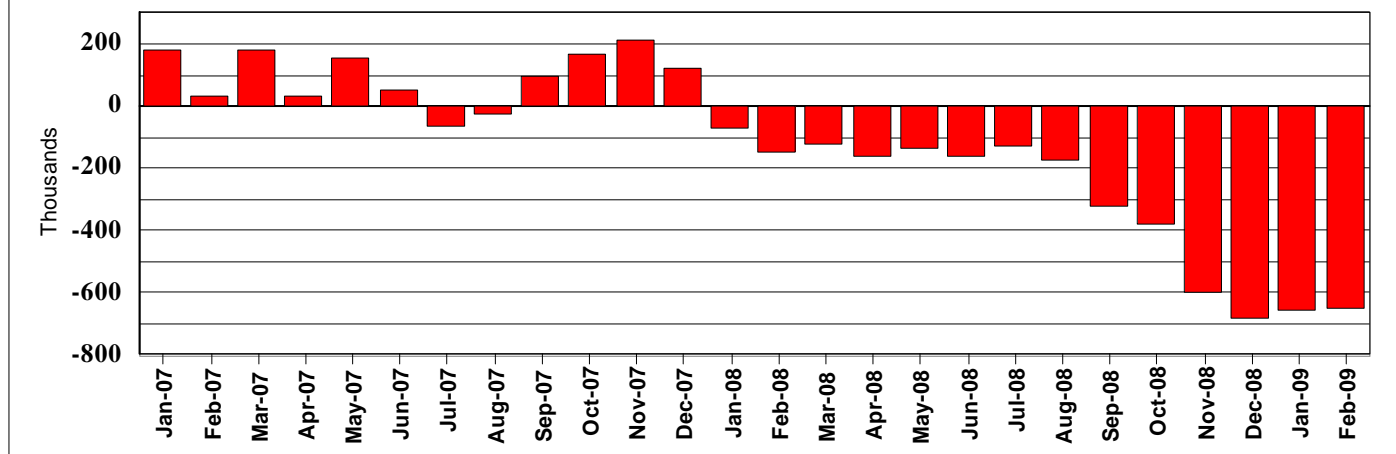
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The last twelve issues of Mississippi Business are available on our web site. On this web site you will also find copies of some of our other publications, including *Population Projections*, *Mississippi Economic Review and Outlook*, and *The Handbook of Selected Data*. You will also find links to other useful data sources.

Figure 1. Monthly Change in US Employment



Understandably, the effects of the recession are most evident in the level of housing construction. The real (inflation adjusted) value of Mississippi residential building permits by quarter is depicted in figure 2. While Mississippi did not experience a housing price bubble, and therefore is not experiencing the sharp decline in prices evident in other states, the housing industry in the state has contracted sharply. The value of permits has been on a declining trend since mid 2006. The average value of permits in the fourth quarter of 2008 was on par with that observed in spring of 1993. Data for the January and February indicate the first quarter of 2009 will show that the state has not yet hit bottom in building permits.

Figure 3 offers a picture of Mississippi's income situation. Monthly income data is not available. One of the best monthly indicators of income however is the level of income tax withholdings. After correcting for inflation, withholdings were below the year ago level for the second and third quarter of 2008. We expect declining withholdings for two reasons. First, the state saw a sharp increase in withholdings after Katrina. Withholdings will slow as we move toward more long-term patterns. If we take the average growth for the five years prior to Katrina and carry that forward then the withholdings levels remain well above "normal". Second, withholdings will slow with the slowing economy. It is a bit surprising that withholdings increased in the fourth quarter of 2008. The growth relative to the year ago was up as well. In January and

February, withholdings were also modestly above the year ago. While this is encouraging news, it is only a modest increase and has not been sustained long enough to suggest a turning point. Given the multitude of negative trends in the economy, we expect withholdings will not sustain the growth in the first quarter of 2009.

Figure 4 shows trends in Mississippi real retail sales. Like withholdings, retail sales rose substantially following Katrina and are trending down as expected. Sales in Mississippi have been below the year ago level since the fourth quarter of 2006. Despite the declines, retail sales remains above long-term trend, suggesting that even if the economy was not slowing, retail sales would be declining. With the contracting economy, retail sales are expected to decline in the coming months.

With a deteriorating economy, has come a deteriorating outlook. Six months ago forecasters were expecting the recession to be over by mid 2009. Recovery was expected to be mild but would be in full swing by the second half of 2009. Gross Domestic Product (GDP) for calendar year 2009 was expected to slow, but not decline. Now recovery is pushed out at least one year and perhaps longer. GDP growth for 2009 is expected to decline a staggering 3.7 percent. GDP for 2010 is expected to grow, but only by 1.4 percent. The stimulus package recently passed by Congress will not prevent further declines in jobs or income. In Mississippi we can expect the economy to worsen before it gets better.

Figure 2. Real Value of MS Residential Building Permits

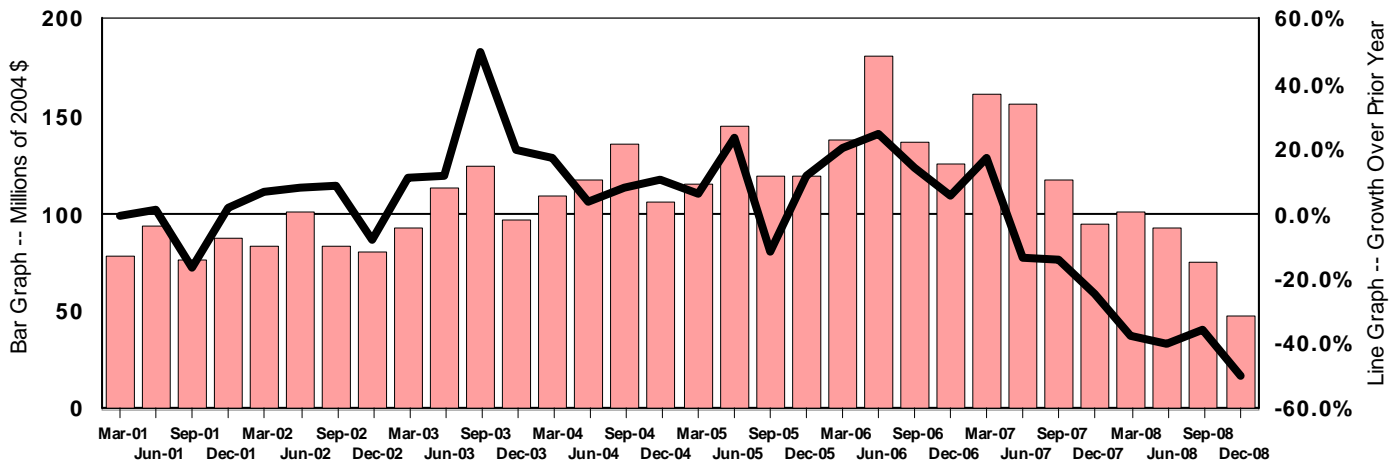


Figure 3. Real MS Individual Income Tax Withholdings

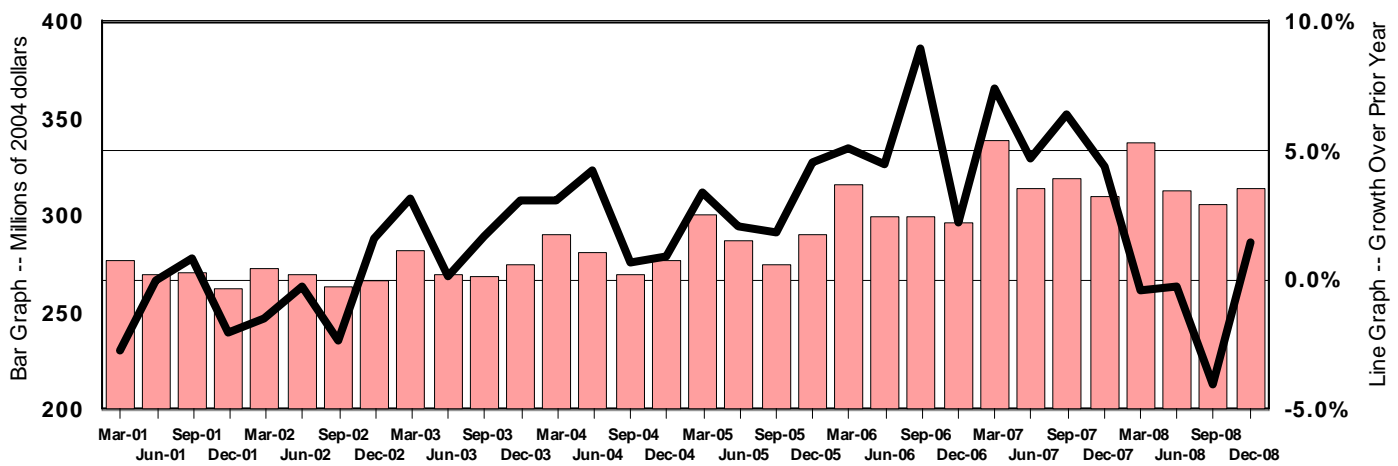
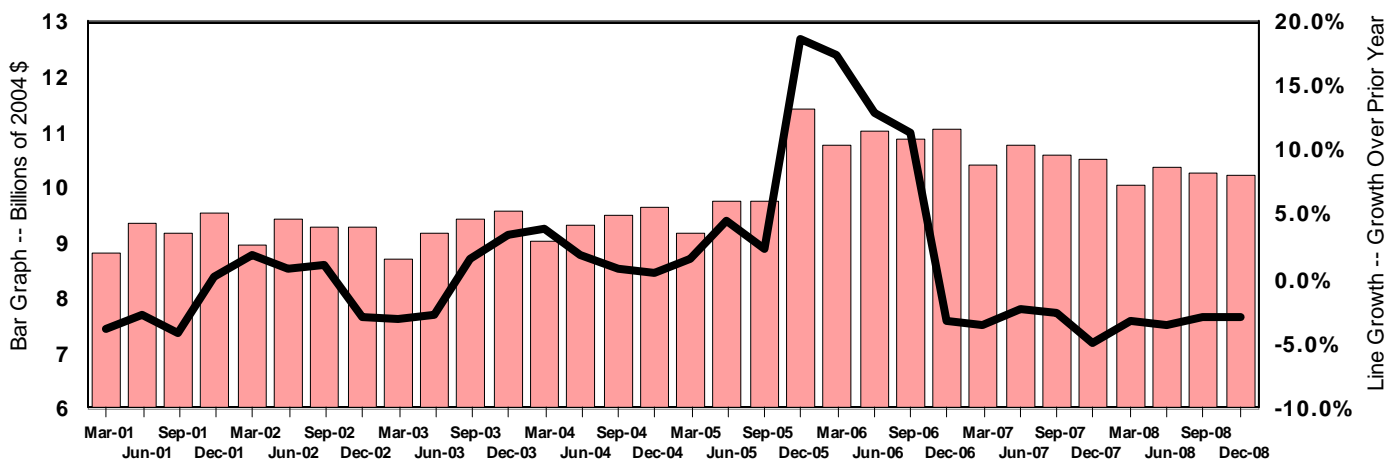


Figure 4. Real MS Total Retail Sales



THE FINANCIAL CRISIS AND MISSISSIPPI'S BANKS

Guest Columnist Brandon Roberts, Ph.D.

The financial sector remains the focal point of the nation's current economic woes. The FDIC reported losses at commercial banks and savings institutions of over \$32.1 billion in the fourth quarter of 2008, the first aggregate quarterly loss since 1989. Nearly 1/3 of all institutions nationwide reported a loss in the fourth quarter of 2008. So how are Mississippi banks faring through the turmoil? An examination of key figures suggests that, thus far, Mississippi's financial institutions are weathering the storm better than their counterparts across the nation and in neighboring states.

Income and Earnings

Of banks in Mississippi, 90% reported a profit in 2008 compared to less than 80% of banks nationwide. Banks in Mississippi had an aggregate Return-On-Assets (ROA) that was twice the national average (.87% compared to .44%). See Figure 1 below. Mississippi banks reported an aggregate net income of \$490 million in 2008 compared to losses for the year in both Alabama and Tennessee (See Figure 2.)

In Tennessee, banks reported a ROA of -0.28% in 2008 which equaled an aggregate loss of \$260 million. In Alabama, aggregate losses were a staggering \$6.7 billion, with over 80% of these losses from banking giant Regions Bank. Regions Financial Corporation, the bank's holding company, is the 12th largest financial institution in the nation just behind CapitalOne.

Mississippi has benefited from the smaller sizes of its institutions. Community banks were only mildly affected by the subprime crisis while larger institutions had considerably more exposure.

Asset Quality

Current data further suggest that the declines in earnings for banks in Mississippi are related more to deteriorating economic conditions than poor lending practices. Loans as of the fourth quarter that were 30 – 89 days past due were less than 1.00% of all loans in Mississippi compared to 1.09% nationwide, and 1.29% in Tennessee.

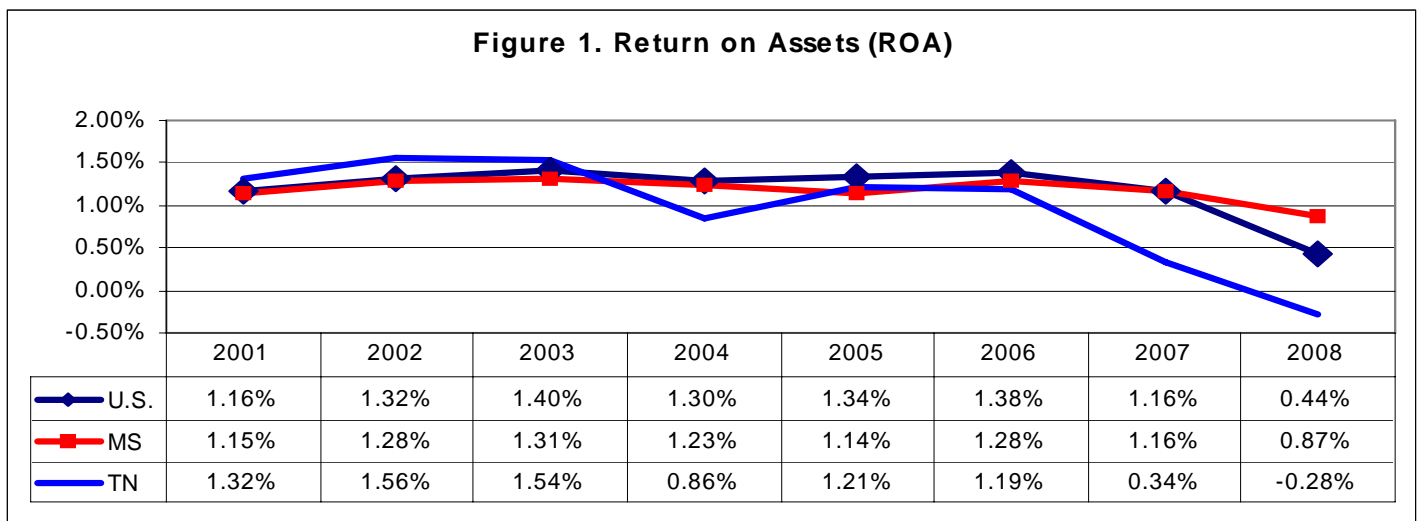
The percentage of all loans that were in serious delinquency (90 days or more past due or no longer accruing interest) was less than half of both the national average and the average for Tennessee. Loans in serious delinquency were 1.25% of loans for Mississippi, 2.90% for the nation, and 3.09% for Tennessee (see Figure 3).

Additionally, the percentage of loans that had been charged off was over 2 times higher for the nation and banks in Tennessee compared to Mississippi. Charged-off loans were 0.58% of all loans for Mississippi institutions, 1.31% nationwide, and 1.34% for institutions in Tennessee (see Figure 4.)

Outlook

Mississippi banks outperformed institutions nationwide with regard to earnings and asset quality in 2008.

Figure 1. Return on Assets (ROA)



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Figure 2. Bank Earnings by State in Millions

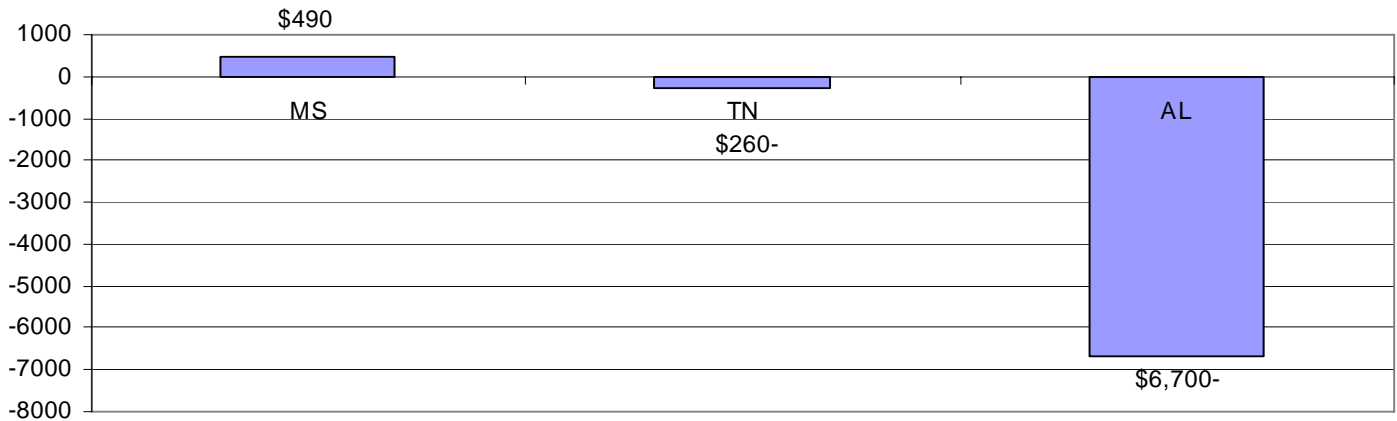


Figure 3. Loans 90 Days or More Past Due or in Non-Accrual Status

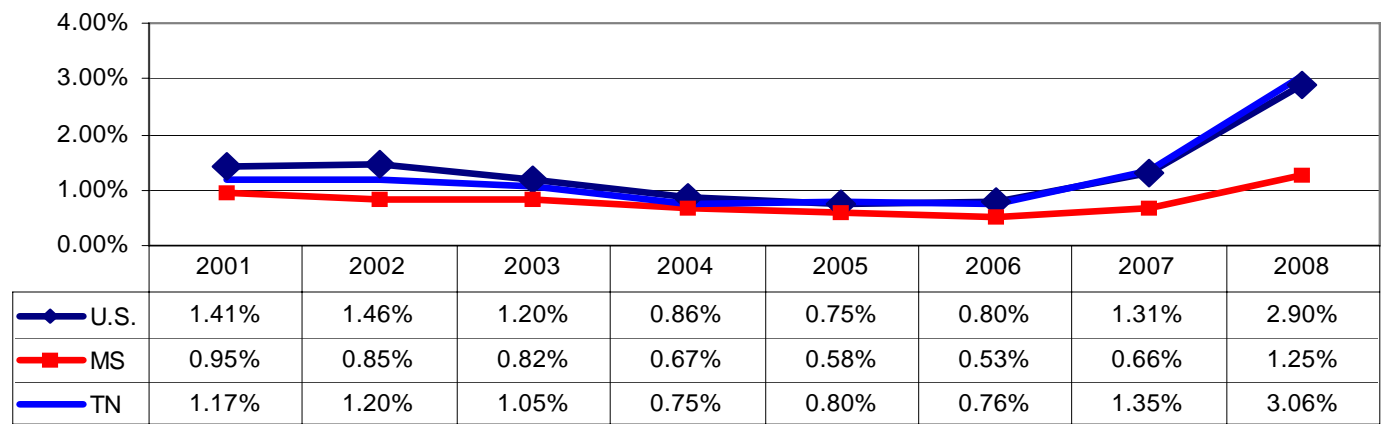
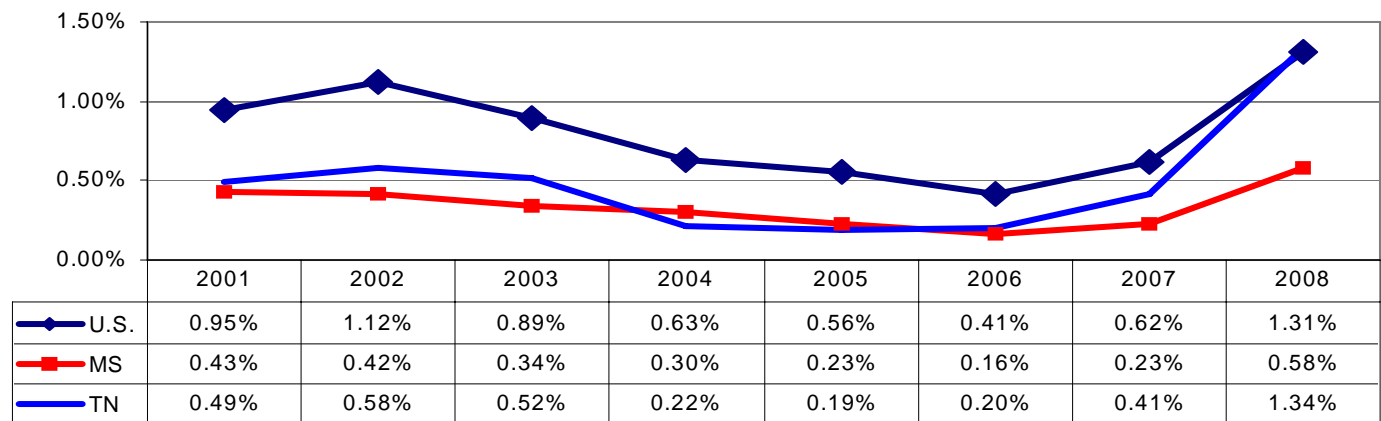


Figure 4. Charged-off Loans as a Percent of All Loans



The national economic outlook, however, remains dim in the short-term, and there is considerable uncertainty in capital markets. It is difficult to predict the subsequent impact of these forces on the financial industry - but at this point, financial institutions in Mississippi appear positioned to persevere. Only about 10% of commercial banks in Mississippi have accepted TARP funds, suggesting directors and management have confidence in their current cash positions and their ability to raise additional capital if needed.

There are still a number of challenges financial institutions must overcome. The first of these is the weakening economy. A slowing economy dampens loan demand, which will take a toll on earnings. In addition, loan performance is deeply affected by these forces because of declining business revenues and job losses. As shown in Figure 5, the state's unemployment rate and loan losses at institutions within the state are highly correlated. In this series (1966 – 2007) the percentage of loans charged-off increased on average 0.05 percentage points for each 1.0 percentage point increase in the unemployment rate. At current lending volume, such an increase would equal roughly \$19 million or about 4% of 2008 earnings. The state's unemployment rate is expected to rise at least another 2.0 percentage points from its current level.

Second, although Mississippi banks have fared better than the nation overall, loan losses as a percentage of all loans increased 43% between 2006 and 2007 and doubled between 2007 and 2008. This has caused reserves for loan loss allowances to fall below recent levels, suggesting additional loan loss provision set-asides will again lower bank profits in the coming year. This has the potential to further weaken bank stock prices which then in turn makes raising capital more costly.

Third, the FDIC recently announced a new deposit insurance assessment for FDIC insured banks. The fee is substantial and provides another hurdle for an industry that is still reeling nationwide. Although the actual amount is still being debated, the annual total cost for Mississippi banks at a minimum will range from \$40 - \$85 million. The FDIC also left open the prospect for additional smaller assessments on a quarterly basis in the future. Depending on the final amount, this expense at a minimum will constitute 8% - 16% of last year's aggregate earnings. Although the industry statewide should be able to bear this expense, this could prove to be of grave consequence to a small number of individual institutions that may be struggling.

Finally, there remains considerable uncertainty with regard to regulatory changes and how these will affect the banking industry. Commercial banks are facing conflicting priorities from various governing and regulatory bodies. There is pressure at the governing and policy level to make loans and "get the credit flowing again", but an even greater pressure at the regulatory-agency level to only book loans with superior credit quality. This is a difficult balancing act, especially when faced with softening loan demand and a rapidly weakening economy. These pressures are combined with a number of renewed compliance demands on institutions, including alleged discriminatory practices.

We now are two years removed from the beginnings of the subprime mortgage collapse, the aftermath of which brought down some of the largest and most prominent financial institutions in the world and left many others mortally wounded. Although no one knows what the future holds, it is encouraging that the banking industry in our state has remained on stable footing.

