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Presentation to Economic Outlook & Revenue Assessment Committee
Idaho State Legislature
11:45 a.m. Thursday, Jan. 3, 2013

Industry Specific Questions:

1. What percentage of the Gross State Product does your industry contribute?

In 2011, Idaho's total current dollar gross domestic product was \$57,927 million. According the Bureau of Economic Analysis, the financial and insurance sector contributed to **5 percent of the state's GDP for a total of \$2,824 million.**

2. What is your forecast for growth in your industry for the current state fiscal year?

- Large National Banks – flat to down in Idaho
- Regional and Community Banks – Like Zions- Disciplined growth
- Non tax paying Financial Institutions –Credit Unions- rapid growth (not a source of tax revenues)

3. What is your forecast for growth in your industry for the upcoming state fiscal year?

- Modest growth similar to what we have seen the past year.

From Harris Simmons "As I See It," Zions News, December 2012:

- As we approach the conclusion of 2012, it's been another challenging year for the banking industry, though the picture is materially brighter than it's been in recent years. The economy has been in slow growth mode, unemployment remains high (though inching its way down) and interest rates remain at historically low levels, compressing banks' margins.
- We continue to adjust to a myriad of new regulations imposed under the Dodd-Frank Act, and an ever-higher set of expectations for compliance with older rules.
- I'm nevertheless very optimistic about our future. We're well prepared for what lies ahead. Slower growth won't be a permanent state of affairs. We're located in many of the nation's most dynamic markets, with a great deal of exposure to long-term growth. And as it occurs, we're uniquely positioned to benefit from it.

4. What is the current state of your industry? How do sales compare to a year ago?

Condition of the Banking Industry - Third Quarter 2012

- The third quarter was another strong one for the banking industry, with solid earnings, higher capital levels, lower losses and stable asset quality signifying an industry that continues to gain strength.
- Continuing uncertainty surrounding the fiscal cliff is slowing economic activity and businesses are hesitant to borrow.

- Decisions made in the month ahead will have a profound impact on our economic path and the outlook for all businesses – banks included.
- The industry reported a net income of \$37.6 billion in the third quarter of 2012, an increase of \$2.3 billion (6.6%) from a year earlier, due to reduced expenses for loan losses.
- More than half of all institutions reported improved earnings from a year ago. Over 89% of institutions were profitable, constant with the previous quarter.
- Revenues increased 3% (\$4.9 billion) from the previous year
- Assets grew \$192.1 billion (1.4%)
- Domestic deposits grew 1.6% and foreign deposits rose 2.5%.
- Net charge-offs were lower than year-ago levels, a \$4.4 billion (16.5%) decline.
- The number of institutions on the FDIC's Problem List fell to 694, the first time problem banks have been below 700 since the third quarter of 2009.
(Source: James Chessen, ABA chief economist)

5. How many people are employed by your industry? How does that compare to a year ago? How does payroll compare to a year ago?

- The banking industry employs 2.1 million wage and salary workers.
- Bank employment is projected to grow 8 percent from 2008 to 2018 (compared to 11 percent for all other industries).
(Source: US Department of Labor, Bureau of Labor Statistics.)

6. How much of the state's sales tax and income tax is due to your industry?

- Sales tax: \$689,918 (.08%) - through Sept. 30, 2012
- Income tax: N/A
(Source: Idaho State Tax Commission, Sales/Use Tax by Industry)

7. How does your industry impact other Idaho businesses?

- A major role of banks is serving as financial intermediaries, facilitating the exchange of payments between people, business and governments. Trillions of dollars flow through the banking system each day. (Source: ABA)
- Because banks provide funding to small businesses, we play a key role in the growth of the economy and in job creation.

8. Do you know of any companies that are planning on moving operations into or out of Idaho in the next 18 months?

- See Jeff Sayer's report.

9. Do you see the consolidation in your industry in the future and if so, do you anticipate impacts on the local economy?

- Consolidation of the industry is a large concern. Only 25 years ago there were **18,344** banking institutions across the U.S. Today this number has fallen by more than 50 percent, to fewer than **7,800** banks.
- However, Federal Reserve data show that measured on the local level, where competition takes place, markets have actually experienced more banking competition, not less, in the past decade.
- Because mergers generally are motivated by a bank's desire to gain access to a new market, commitment to the community often is actually enhanced.
- Today there are 16 FDIC-insured banking institutions headquartered in Idaho (**two fewer than a year ago**). As of the third quarter of 2012, these banks employed 1,959 FTEs, accepted over \$5 billion in deposits, and helped spur economic growth by supplying \$3.7 billion in loans.
- However, with the current economic conditions, these banks have been shrinking. **In the past year these 16 banks have shrunk their assets by 17 percent.**
(Source: Keith Leggett, ABA)

General Economy Questions:

10. How will the Idaho economy perform in the remainder of FY 2013 (January 2013 to June 2013) and FY 2014 (July 2013 to June 2014), and what impact will this likely have on state tax revenues?

Idaho – Real GDP

- 2012 – \$53 billion (+2.5%)
- 2013 – \$54 billion (+3.3%)
- 2014 – \$56 billion (+3.6%)

Nonfarm employment – Job Count

- 2012 – 617,847 (+1.3%)
- 2013 – 623,900 (1.0%)
- 2014 – 632,053 (1.3%)

- Idaho's economy has mirrored many of the same trends as the national economy in the past year. Growth has been very slow, but is forecast to speed up gradually, supported in part by the energy industry. The state's job market is likely to echo the same theme.
- **In terms of economic output**, Idaho has outpaced the national economy and is recovering at a higher elevation than the national economy. Idaho is expected to continue to fare better than the national economy in 2013.
- **In employment growth**, Idaho should pace the national economy, leveraging its robust energy assets. Unemployment is forecasted to continue to decline through 2018.
- Inflated house prices have corrected and are back to historically normal alignments. Prices are stabilizing in most real estate markets. New home building activity, which appears to have bottomed, is likely to remain depressed in 2013.

(Source: JP Morgan Chase Idaho Economic Outlook, Nov. 29, 2012)

11. How will the national economy perform in the remainder of FY 2013 (January 2013 to June 2013) and FY 2014 (July 2013 to June 2014), and how will this affect Idaho?

- Short term economic growth is dependent upon how congress and the President deal with the current fiscal cliff negotiations. If no deal is struck and the full impact of higher taxes and lower federal spending occurs, Macroeconomic Advisers, and economic forecasting firm, projected US GDP growth to turn negative first quarter 2013 but rebound to approx. just below 3% by 4th quarter 2013. Growth for 2014 was projected be 3%.

12. What areas of the economy will be strong over the next 18 months? Which areas will be weak?

- The U.S. economy is growing but continues to face considerable headwinds. Uncertainty about the fiscal cliff is making both consumers and businesses reticent about spending.
- The manufacturing sector was the bright spot of the economy coming out of the recession. But business investment spending has slowed in recent quarters. Spending on business equipment will remain roughly flat in the near term. Until the direction of U.S. fiscal policy becomes clearer, businesses are likely to remain cautious about future hiring and spending plans.
- A recession in Europe, weaker growth in Asia and a stronger dollar have all weighed on demand for U.S.-made goods abroad this year.
- Although consumer spending has improved this year, it still is below pre-recessionary levels. Households are continuing their process of repairing their balance sheets. The reduction in debt load and lower debt servicing payments will support greater consumer spending in the future.
- Also, the uncertainty associated with the fiscal cliff, sluggish job growth and slowing real disposable income will keep consumer spending restrained.
- The U.S. housing recovery, which started in 2012, will gain further momentum in 2013. New and existing home sales are up – fueled by extremely low mortgage rates and housing affordability.
- Idaho's farm economy is expected to show lower total returns due to lower Potato prices. Dairy receipts are higher but higher feed costs are keeping most dairy operators near break-even.

(Source: Keith Leggett, ABA)

13. At what rate do you expect the population of Idaho to grow or decline over the next 18 months?

- Continued growth is expected in the 1.5-2% range with higher rates of growth in metropolitan areas.

14. What are the impacts of the U.S. trade and budget deficits on the U.S. and Idaho economies?

Trade represents a significant opportunity for Idaho businesses to increase sales and create wealth in Idaho. Zions is investing in this area seeking to help Idaho Businesses safely deal with customers outside of the USA.

Export Update					
	\$ Billions		Percent Change		
	YTD Oct '12	2011	YTD Oct '12	2011	2010
Idaho	2.7	4.1	-20.4	14.5	41.5
Nevada	7.3	7	28.5	37.6	1
Utah	14.5	18.4	-4.3	39.3	31.1

Source: Federal Reserve Bank of San Francisco Economic Research Department



Source: Bureau of Labor Statistics, Bureau of Economic Analysis



15. How is Idaho faring compared to other states?

- Total nonfarm employment growth on the rise

- Single family home permits showing strong gains (double digit percentage increases)
- Nonbusiness bankruptcy filings on the decline
- Idaho's economy has mirrored many of the same trends as the national economy in the past year. Growth has been very slow, but is forecast to speed up gradually, supported in part by the energy industry. The state's job market is likely to echo the same theme.
- In terms of economic output, Idaho has outpaced the national economy and is recovering at a higher elevation than the national economy. Idaho is expected to continue to fare better than the national economy in 2013.
- In employment growth, Idaho should pace the national economy, leveraging its robust energy assets.

16. What role do the capital markets have in predicting the state's economic vitality? (Example of public finance and the Idaho Bond Bank – saved rate payers \$1.2MM in financing costs and restored \$66.3MM to the IDEQ's Revolving Loan fund.)

- Access to capital at competitive rates is an important component of any developed economy. Fortunately Idaho has adequate access to markets and is expanding venture capital funding via efforts of private groups and the Dept. of Commerce.
- Access to low cost capital can stimulate economic activity for both the private sector and the public sector. U.S. Treasury securities, and, hence, municipal bond rates, are currently at generational lows. Low interest rates coupled with depressed construction prices make this an optimal time to finance new infrastructure for entities that have the income streams to service repayment. And, that is the rub. The revenues for almost all entities, public and private, have also been depressed, leading many public entities to forgo investment in new infrastructure, even though the capital markets are willing to lend.
- The capital markets have handled a 30% increase in the volume of municipal debt issuance throughout 2012 without any problems. Much of this volume has come from refinancing outstanding debt into lower rates. Investors have continued to purchase highly-rated, fixed income securities in order to lower risk in their portfolios. Higher tax rates that may come with the elimination of the Bush tax cuts will only intensify this trend.
- The actions of the Federal Reserve through its continued "quantitative easing" measures have helped keep rates low, especially on the short end of the yield curve. The Fed's second round of "operation twist" wherein they intend to trade shorter-term paper for longer-term securities should lower the longer term rates and flatten the yield curve.

17. What effect will federal austerity (fiscal cliff) measures have on Idaho's economy?

- Idaho is slightly higher than the national average for federal grants, federal spending on procurement and federal nondefense spending, so in that way the

state could be vulnerable to scheduled reductions in federal spending. (*Source: Pew Center on the States*)

- Banks, for their part, have the wherewithal to weather a drop in earnings that a resulting recession could cause if the cliff isn't avoided. (*Source: Moody's*)
- Banks have a much stronger capital position today than they did entering the financial crisis. In addition, they have cleaner balance sheets, so despite higher credit costs that would come about through a recession, as well as pressure on profitability, for the most part the banks have the capital to absorb the hit. (*Source: Moody's*)
- Consumer sentiment is extremely vulnerable to the debate taking place in Washington. During the debt ceiling debate at the end of 2011, consumer sentiment dropped to levels lower than the middle of the most recent depression. (*Source: ABA*)

18. Is there any potential federal legislation that you are aware of that could impact the Idaho economy? If so, what is the likely impact?

OCC Report Highlights Risks Facing Banks

- Threats to business models from low rates, sluggish economic growth and the historic volume of new banking regulations are among the top risks facing banks, according to the Office of the Comptroller of the Currency's Semiannual Risk Perspectives report released yesterday.
- The report also noted that underwriting standards remain under pressure as banks compete aggressively for limited, high-quality loans.
- "Standards for leveraged loans have weakened over the past 18 months and yields on high-risk assets are at record lows," the report said. "The underwriting of middle market commercial and industrial lending also shows signs of slipping as banks compete for new business."

B- Economic Activity

Neil Shah, December 21, 2012 Wall Street Journal

"Businesses are slowing their investment amid a pile up of unsold goods and uncertainty over the billions of dollars in spending cuts and tax increases known as the fiscal cliff. Consumers are worrying about the prospect of more taxes. ... Economists in the latest Wall Street Journal survey predict the nation's gross domestic product will grow just 1.3% on an annualized basis in the final three months of 2012 and 1.7% in the first quarter of 2013."

Ken Goldstein, economist at The Conference Board:

"Based on current trends, the economy will continue to expand modestly through the early months of 2013."

E-2 Existing Home Sales

Lawrence Yun , National Association of Realtors chief economist:

"Momentum continues to build in the housing market from growing jobs and a bursting out of household formation. With lower rental vacancy rates and rising rents, combined with still historically favorable affordability conditions, more people are buying homes."

G-5 Pending Homes Sales Index

Lawrence Yun , National Association of Realtors chief economist

"We've had very good housing affordability conditions for quite some time, but we're seeing more impact now from steady job creation, and rising consumer confidence about home buying now that home prices have clearly turned positive."

General Comments:

This information is gathered from many different sources, the interpretation of the data for forecasting future economic conditions is opinion, no matter the source.

Idaho job growth is projected to be better than the national rate with unemployment rates dropping in 2013 and 2014. The national job forecast is moderate growth with an increasing rate of improvement. The employment growth according to the Idaho Division of Financial Management (DFM) forecast: 2.3% in 2013, 2.5% in 2014, and 2.7% in 2015. According to a Chase Bank forecast the change will be 1.3% in 2012, 1% in 2013 and 1.3% in 2014. The recent history of Idaho job growth history suggests the DFM would be more accurate, although that forecast is 6 months old.

Idaho's November unemployment rate was 6.8%, which is better than the national average and the third lowest rate within the Bancorp footprint.

According to DFM and Chase forecasts, GDP in Idaho is projected to grow at a similar rate to the national GDP change in 2013 and 2014, this continues a trend that goes back to 2004. According to Chase Bank, Idaho GDP will grow 3.3% in 2013 and 3.6% in 2014 compared to national GDP growth projections of 3.4% in 2013 and 4% in 2014. U.S. and Idaho GDP history: (billions of dollars)

Energy, food processing, mining and construction are projected to perform well with slower growth in computers and electronics, financial activities. Idaho's financial activities employment is doing worse than the surrounding states.

Construction has shown signs of improvement in the U.S. with construction permits and spending on the increase. Home prices are also increasing in most of the country as the inventory of homes for sale is lower than it has been for over 5 years. In Idaho the trend of the number of building permits issued has increased considerably over the past 2 years.

All indicators seem to validate the general view that the bottom has been reached in the real estate market prices and a recovery is underway. According to the FHFA Housing Price Index (HPI), Idaho had a long-term trend of plummeting house prices starting in 2007 until the last half of 2011 when the trend was reversed with increasing prices through the 3rd quarter of 2012. The Idaho pricing trend has followed the national trend, except the quarter-to-quarter increases in Idaho have been roughly 2x the national index. The HPI year-over-year changes (as of 3rd Q 2012) in the Bancorp footprint states:

Another positive trend is the number of foreclosures filed in Idaho:

The trend of foreclosure filing and bankruptcies are downward. Both are coincident indications of improved economic health in Idaho and in the country.

The fiscal cliff was avoided without a comprehensive agreement that would settle all of the uncertainty. The large questions of entitlement reform, tax reform and spending cuts still need to be addressed, meaning the impact on the economy is still largely unknown. The fight over raising the debt limit ceiling is also still ahead which will cause more economic insecurity.

The “dairy cliff” caused by the expiration of the farm bill was also not settled beyond a simple extension of the current law for a year (from September 2011) which is a cause of more uncertainty for the large Idaho dairy industry. The resolution of the farm bill will not likely be as generous to farmers given the current cost-cutting mindset in Washington.

Given all of this, it likely means that conditions, at least as they are impacted by government policies, will continue as they have been for the past year with uncertainty that has caused constraints on economic growth as business and consumers wait and see the eventual impact to them will be.