

# DBRS U.S. Financial Institutions Weekly

Volume 4, Issue 33, November 18, 2009



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## IT'S DIFFERENT THIS TIME - REGIONAL DIVERGENCE IN DOWNTURN

### What's Different and Challenging

With unemployment widespread and elevated, popular perception is that this downturn in the U.S. is the worst since the Great Depression. For many states, however, unemployment rates were higher in the downturns in the 1980's than they are today. That was the last time that the U.S. unemployment rate topped 10%. For ten months between September'82 and June'83, the U.S. rate was over 10%, reaching 10.8% in December 1982. For some states, however, particularly in the South, this downturn has been more substantial than the 1980's downturn. What is different this time is that faster growing regions have generally been impacted more, as their growth trend has reversed. Experience indicates that such a reversal is bad for credit, particularly construction and other real estate lending, which expands more rapidly in growing markets based on the expectation that growth will be sustained. In evaluating the prospects for banks, DBRS pays attention to the considerable regional divergence in economic developments across the U.S. regions and its impact on credit performance.

Banks with exposure to Southern states, especially Florida, are generally struggling more in this downturn; reflecting the more extensive economic deterioration in these states (See Exhibit 1). [To illuminate regional patterns, our regional definitions differ somewhat from the census definitions.] Historically, southern states fared better than the U.S. average, but not this time. In many of these states, the unemployment rate has risen more than the U.S. average and unemployment has more than doubled since 2007. Unemployment rates are well above past peaks, especially in Florida where unemployment is 11.0%. DBRS considers the abrupt downturn and dashed expectations combined with the collapse of housing markets as important drivers of the challenging conditions for credit in the region.

In the West, states such as California, Nevada, and to a lesser extent Arizona are also struggling with the reversal in growth and the collapse of real estate markets. Scale matters. With 15.1% of the unemployed, California is a key component of the deterioration in the U.S. and the prospects for the U.S. recovery.

What is surprising in this downturn, is that states in the Midwest, despite their manufacturing base, are generally doing better than the U.S. and are still below their past peak rates of unemployment. The major exception is Michigan. With the auto industry restructuring, Michigan has the highest unemployment rate at 15.3%. States along the Atlantic coast from Virginia to New England (MidAtlantic-New England Region) are also generally faring better than the U.S. Doing notably better are states in the oil patch (Alaska, Wyoming, Colorado, Texas and Louisiana) with smaller increases in their unemployment rates than the U.S. These states experienced their worst unemployment rates in the late 1980's with the collapse of the oil boom. To the West of the Mississippi river, the Plains states area also generally faring better with much lower unemployment rates.

## Exhibit 1. Unemployment Data

Region	State	A			B		C		D		E		F		G		H			I			J			K			L			M		
		Unemployment Rate (%) Sept '09			Change in UnE Rate Sept '07 - '09		Trends in UnE Rate Sep'08 - Sep '09		Performance vs Past Peak			Change in Unemployed ('000) Sept'07 - '09																						
		Current Rate	Above U.S. Rate	Below U.S. Rate	Extent Above U.S.	Extent Below U.S.	Increase where UnE rate >	Increase where UnE rate <	Peak Jan'76-Aug'07	Current Peak > Prior Peak	Delta in UnE rate from Peak	Delta in '000	% of Sept-07	% of Shar																				
MidAtlantic/New England	Maine	8.50	-	(1.3)	-	(1.4)	-	2.9	9.00	-	(0.1)	26	77%	0.3%																				
	New Hampshire	7.20	-	(2.6)	-	(1.3)	-	3.3	7.70	-	-	29	115%	0.4%																				
	Vermont	6.70	-	(3.1)	-	(2.4)	-	1.9	9.00	-	(0.7)	10	69%	0.1%																				
	Massachusetts	9.30	-	(0.5)	-	(0.2)	3.7	-	10.90	-	-	169	112%	2.2%																				
	Rhode Island	13.00	3.2	-	2.5	-	4.5	-	9.70	3.3	-	43	139%	0.6%																				
	Connecticut	8.40	-	(1.4)	-	(1.4)	-	2.4	10.00	-	-	72	84%	0.9%																				
	New York	8.90	-	(0.9)	-	(0.8)	-	3.1	10.50	-	-	430	98%	5.6%																				
	New Jersey	9.80	-	-	0.4	-	4.0	-	10.60	-	-	253	132%	3.3%																				
	Pennsylvania	8.80	-	(1.0)	-	(0.7)	-	3.2	12.90	-	-	280	100%	3.6%																				
	Delaware	8.30	-	(1.5)	-	(0.2)	-	3.1	8.20	0.2	(0.1)	21	140%	0.3%																				
Midwest	Maryland	7.20	-	(2.6)	-	(1.5)	-	2.6	8.30	-	-	106	99%	1.4%																				
	DC	11.40	1.6	-	0.7	-	4.0	-	11.40	-	-	19	106%	0.3%																				
	Virginia	6.70	-	(3.1)	-	(1.5)	-	2.6	7.80	-	(0.4)	150	119%	2.0%																				
	West Virginia	8.90	-	(0.9)	-	(0.7)	4.6	-	18.20	-	(0.2)	34	94%	0.4%																				
	North Carolina	10.80	1.0	-	0.8	-	4.0	-	10.20	0.9	(0.3)	273	125%	3.5%																				
	South Carolina	11.60	1.8	-	0.9	-	4.1	-	11.40	0.7	(0.5)	133	113%	1.7%																				
	Florida	11.00	1.2	-	1.6	-	4.3	-	9.70	1.3	-	616	156%	8.0%																				
	Georgia	10.10	0.3	-	0.3	-	-	3.5	8.30	2.0	(0.2)	253	111%	3.3%																				
	Alabama	10.70	0.9	-	2.1	-	5.3	-	14.40	-	-	146	190%	1.9%																				
	Kentucky	10.90	1.1	-	0.3	-	4.0	-	12.10	-	(0.3)	113	101%	1.5%																				
South	Tennessee	10.50	0.7	-	0.3	-	-	3.6	12.40	-	(0.3)	163	106%	2.1%																				
	Mississippi	9.20	-	(0.6)	-	(2.1)	-	1.8	13.70	-	(0.5)	37	45%	0.5%																				
	Michigan	15.30	5.5	-	3.0	-	6.4	-	16.90	-	-	377	104%	4.9%																				
	Ohio	10.10	0.3	-	-	(0.7)	-	3.3	13.80	-	(1.1)	254	75%	3.3%																				
	Indiana	9.60	-	(0.2)	-	(0.0)	-	3.5	12.80	-	(1.1)	157	108%	2.0%																				
	Illinois	10.50	0.7	-	0.1	-	3.8	-	12.90	-	-	345	98%	4.5%																				
	Wisconsin	8.30	-	(1.5)	-	(1.4)	-	-	11.80	-	(0.7)	112	78%	1.5%																				
	Minnesota	7.30	-	(2.5)	-	(2.5)	-	1.9	9.00	-	(1.1)	80	58%	1.0%																				
	Iowa	6.70	-	(3.1)	-	(2.2)	-	2.5	8.50	-	-	50	79%	0.7%																				
	Missouri	9.50	-	(0.3)	-	(0.9)	-	3.2	10.50	-	-	125	77%	1.6%																				
Plains	Kansas	6.90	-	(2.9)	-	(2.2)	-	2.3	7.40	0.1	(0.6)	46	77%	0.6%																				
	Arkansas	7.10	-	(2.7)	-	(3.1)	-	1.9	10.20	-	(0.3)	27	39%	0.4%																				
	North Dakota	4.20	-	(5.6)	-	(4.1)	-	0.9	6.90	-	(0.1)	3	29%	0.0%																				
	South Dakota	4.80	-	(5.0)	-	(3.1)	-	1.6	5.90	-	(0.2)	9	70%	0.1%																				
	Nebraska	4.90	-	(4.9)	-	(3.3)	-	1.5	6.80	-	(0.1)	18	58%	0.2%																				
	Alaska	8.40	-	(1.4)	-	(3.0)	-	1.7	11.50	-	-	8	35%	0.1%																				
Oil Patch	Wyoming	6.80	-	(3.0)	-	(1.1)	-	3.6	10.10	-	-	12	150%	0.2%																				
	Colorado	7.00	-	(2.8)	-	(2.2)	-	2.0	9.10	-	(0.8)	77	70%	1.0%																				
	Oklahoma	6.70	-	(3.1)	-	(2.4)	-	2.7	9.40	-	(0.1)	50	72%	0.7%																				
	Texas	8.20	-	(1.6)	-	(1.3)	-	3.1	9.30	-	-	485	97%	6.3%																				
	Louisiana	7.40	-	(2.4)	-	(1.4)	-	1.8	12.90	-	(0.4)	77	103%	1.0%																				
	Montana	6.70	-	(3.1)	-	(2.0)	-	2.0	8.70	-	-	15	86%	0.2%																				
Mountain	Idaho	8.80	-	(1.0)	0.6	-	-	3.4	9.40	-	(0.1)	43	180%	0.6%																				
	Utah	6.20	-	(3.6)	-	(1.8)	-	2.8	9.70	-	-	45	113%	0.6%																				
	New Mexico	7.70	-	(2.1)	-	(0.9)	-	3.3	9.90	-	-	40	122%	0.5%																				
	Arizona	9.10	-	(0.7)	0.2	-	-	3.1	11.50	-	(0.1)	173	150%	2.2%																				
	Nevada	13.30	3.5	-	3.3	-	6.0	-	10.70	2.6	-	121	185%	1.6%																				
	Hawaii	7.20	-	(2.6)	-	(0.7)	-	2.8	10.20	-	(0.2)	29	161%	0.4%																				
Pacific	Washington	9.30	-	(0.5)	-	(0.5)	3.8	-	12.20	-	-	172	108%	2.2%																				
	Oregon	11.50	1.7	-	1.2	-	4.7	-	12.10	0.1	(0.7)	124	123%	1.6%																				
	California	12.20	2.4	-	1.5	-	4.4	-	11.00	1.3	(0.1)	1,232	121%	16.0%																				
United States		9.80	-	-	5.1	5.1	3.6	3.6	10.80	-	-	7,684	110%	100.0%																				

Source: U.S. Bureau of Labor Statistics via Economy.com, DBRS

There are some positive signs. The focus on the gloomy trends in the national unemployment picture overlooks signs of recovery at the state level. In many states, unemployment rates are lower than their past peaks. Moreover, many states are now experiencing declines in their unemployment rates from the peaks reached in this cycle. In the Midwest in particular, these declines have been significant in most of these states. It is still early for these improvements to show up in credit trends, but the deterioration does appear to be slowing.

### Divergence in Regional Patterns of Unemployment - The Numbers

Indicative of the relative weakness in the South, the current unemployment rate for these states is generally above the 9.8% U.S. average for September (See Exhibit 1, Column A & B). The major exceptions among the states outside the South are the large problem states: Michigan at 15.3% and California at 12.2%, as well as a few smaller states. In the majority of states, however, the unemployment rate is below the U.S. (see Column C).

For the states that appear to be suffering more in this downturn, the pace of deterioration has generally been faster than the U.S., contributing to the distress in their economies and deterioration in credit. Between

September 2007 and September 2009, these states generally saw their unemployment rate increase by more than the 5.10 percentage point increase in the U.S. rate (See Column D). Florida, for example, saw its unemployment rate increase by 1.2% more than the U.S. rate. Those states that are doing better had rates that increased by less than the U.S. (see column E). In the Midwest, for example, Ohio, Wisconsin and Minnesota had smaller increases in their unemployment rates.

Credit problems are exacerbated by a rapid economic slowdown, especially after a sustained period of growth. Indicative of this slowdown for the Southern states is the extent of the increase in the unemployment rate since September 2008. Most states in the South saw a greater increase in their unemployment rate than the U.S. increase of 3.6% (See Column F). Such elevated declines were also evident in the Western states of California, Oregon, Washington and Nevada. Michigan saw the biggest decline of 6%. On the other side, many states have seen unemployment increase by less than 2% over this period, especially in the Plains.

While this downturn has been sustained and particularly disruptive, most states have yet to experience unemployment rates that match the peaks that they reached in the 1980's, a period equally plagued by macro economic gyrations and the infamous stagflation. Indicative of past stress, many states experienced double digit unemployment rates at their peak with Michigan reaching 16.9% (see Column H). In only ten states is this cycle's peak above the peak reached over 1976 – 2007, and four of these are in the South (North and South Carolina, Georgia and Florida).

Positive signs are emerging, despite the rising national unemployment rate. In many states, the unemployment rate in September was below its peak in this cycle (see Column J). Many of these declines are still modest. But, in some states, the decline is more substantial. In three states in the Midwest, Ohio, Indiana and Minnesota, the rate is down 1.1% and it's down 0.7% in Wisconsin.

The sheer size of the increase in the number of unemployed is nevertheless daunting. The number is up 7.7 million or 110% between Sept '07 and Sep '09. California, the largest state, is the biggest contributor to this increase adding 1.2 million unemployed or 16% of the increase (See Column K). The number of unemployed in this state was up 121%, more than doubling in two years. The next highest contributor was Florida with an increase of 616,000, which was up 156% and contributed 8.0% to the U.S. growth. Most of the other states in the South have seen increases of more than 100%. About 21.4% of the country's unemployment is in the South, but it contributed 23% to the increase in unemployment over Sept'07-'09.

The MidAtlantic/New England region's share in the increase in unemployment is about the same as its share of overall unemployment. In other regions, (Midwest, Plains, Oil Patch) the region's share in the increase in unemployment is below its share of overall unemployment. While in prior cycles, the strength of the more rapidly growing regions could be counted on to generate growth for the U.S. as a whole. In this downturn, some of the slower growing regions appear closer to regaining momentum.

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