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Bank Portfolios and Earnings

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Banks are profit maximizing businesses that are constrained by the peculiar nature of thier liabilities to holding portfolios that are liquid and protected against a fall in thier value. This attribute of banks is shown by the fportfolio of banks and by thier income and expense statement. In addition an examination of these statements shows how banks have earned thier way in different circumstances and how they have adjusted their portfolio's to changing market conditions. If the assets of banks can be considered as their product mix, the changes in the portfolios of banks show that banks have a great deal of flexibility in shifting their product from one market to another.

This section will deal almost entirely with the behavior of the member banks.

Banks were heavily invested in U.S. Government bonds is misleading. As far as the liquidity that is available to the banks through their government debt holdings. Available data for all commercial banks indicates that even though 33½ billions were invested in government marketable bonds, only 12 billions of these had more than five years to maturity. Of the total commercial bank holdings of government debt on December 31 1957, approximately 25% had less than one year to maturity. Such relatively short term securities are readily marketable

Member Bank Earnings, 1957

FOR THE YEAR 1957 member banks reported $2,549 million of net current earnings before income taxes, $150 million more than in 1956.[1] The increase in net profits after taxes was $142 million. Larger provisions for State and Federal income taxes were nearly offset by smaller net transfers to valuation reserves on loans and smaller net losses and charge-offs on loans and securities. Higher net profits together with a moderate rise in total capital accounts resulted in an increase from 7.7 to 8.3 per cent in the ratio of net profits to average total capital accounts. Cash dividends declared amounted to $604 million, $57 million more than in 1956.

The ratio of average total capital accounts to average total assets advanced from 7.6 to 7.9 per cent, and the ratio of average total capital accounts to average total assets other than cash and United States Government securities rose from 14.6 to 14.7 per cent in

NOTE.—This article was prepared by Theodore A. Veenstra, Jr., of the Board's Division of Bank Operations.

[1] Net current earnings are gross current operating earnings less gross current operating expenses, before adjustments for losses, profits on sales of securities, recoveries, and transfers to and from valuation reserves, and before taxes on net income.

MEMBER BANK EARNINGS, 1946-57

[Dollar amounts in millions]

Item	1946	1947	1948	1949	1950	1951	1952	1953	1954	1955	1956	1957
Earnings	$2,403	$2,579	$2,828	$2,986	$3,265	$3,669	$4,120	$4,590	$4,826	$5,343	$6,078	$6,771
On U. S. Government securities	1,054	921	855	859	865	832	929	1,011	1,066	1,118	1,101	1,168
On other securities	148	149	158	169	190	211	235	252	273	296	308	339
On loans	772	1,044	1,308	1,427	1,634	2,003	2,306	2,632	2,711	3,083	3,725	4,208
Service charges on deposit accounts	100	119	141	158	172	187	198	219	252	274	310	354
Other earnings	328	346	367	373	403	436	452	477	523	572	634	702
Expenses	1,469	1,650	1,795	1,889	2,020	2,232	2,501	2,782	2,999	3,265	3,680	4,222
Salaries and wages	699	797	876	926	1,000	1,125	1,244	1,371	1,463	1,571	1,735	1,877
Interest on time deposits	212	236	250	261	271	306	365	425	494	543	650	927
Taxes other than income	82	88	90	96	109	115	118	125	140	149	157	172
Other expenses	476	529	579	605	640	686	775	860	902	1,002	1,138	1,246
Net current earnings before income taxes	934	929	1,033	1,097	1,245	1,437	1,619	1,809	1,828	2,077	2,398	2,549
Profits on securities	183	90	55	64	82	52	29	35	375	51	28	57
Recoveries[1]	173	142	135	91	93	87	84	86	117	113	124	102
Losses and charge-offs[2]	247	251	195	166	149	202	226	332	254	426	577	468
Net increase in valuation reserves	(3)	(3)	173	125	121	128	68	40	165	139	229	177
Profits before income taxes	1,043	910	854	961	1,150	1,247	1,437	1,558	1,900	1,676	1,744	2,063
Taxes on net income	285	257	234	275	369	491	608	692	804	691	718	895
Net profits	758	653	621	686	781	756	829	865	1,096	985	1,027	1,169
Cash dividends declared[4]	267	281	294	313	346	371	390	419	456	501	547	604
Ratio of net profits to average total capital accounts (per cent)	9.6	7.9	7.2	7.6	8.3	7.6	7.9	7.8	9.3	7.9	7.7	8.3
Number of banks at end of year	6,900	6,923	6,918	6,892	6,873	6,840	6,798	6,743	6,660	6,543	6,462	6,393

[1] Beginning with 1948, includes recoveries credited either to undivided profits or to valuation reserves; see footnote 3.

[2] Beginning with 1948, includes losses charged either to undivided profits or to valuation reserves; see footnote 3.

[3] Not reported separately; transfers to these reserves were included with losses, and transfers from these reserves were included with recoveries. Such amounts are estimated to have been relatively small prior to 1947.

[4] Includes interest on capital notes and debentures.

SOURCE FEDERAL RESERVE BULLETIN
JUNE 1958 p 648

Table I

Loans and Investments of Member Banks
(in millions of dollars)
Dec 31 1947 and Dec 31 1957

	Dec 31 1947	Dec. 31 1957
Loans – Total	32,628	80,950
Commercial, including open market paper	16,962	37,868
Agricultural	1,046	2,472
for purchasing or carrying securities	1,876	3,857
to brokers and dealers	811	2,448
to others.	1065	1409
Real estate loans	7130	18,231
Other loans to individuals	4662	16,775
Other Loans	952	3,316
Investments Total	65,218	61,403
U.S. Government Obligations – Total	57,914	47,079
Treasury Bills	1,987	3,948
Certificates of Indebtedness	5,816	3 534
Notes	4,815	8,560
Bonds	45,286	31,031
U.S Guaranteed Issues	10	7
State and Political Subdivision Issues	4,199	11,235
Other Securities	3,105	3,089
Total Loans and Investments	97,846	142,353

Source Federal Reserve Bulletin June 1958 p 670 with no significant capital loss, and hence provide commercial banks with an asset whcih can be sold to offset clearing drains.

At the end of 1947, two-thirds of the assets of commercial banks were in investments and ninety per cent of the investments were obligations of the United States Government. In spite of this preponderance of investments in the banks portfolio, the earnings from loans were almost as large as the earnings from investments. This is reflected in the fact that the average earnings on loans was 3.2 % while the average earned on U.S. Government obligations was 1.0%.

In looking at the government debt owned by member banks, it is important to recognize that government debt is both an income earning asset for a bank and a means by which an individual bank can acquire liquidity. The entry in the loans and investment account which indicates that Member.

The most deamatic evidence from table 1 deals with the growth of the lending busines by banks since World War II. In the decade 1947-57 total loans by member banks increased by 2½ times. The largest dollar increae in loans was in the commercial loan category, although the market rate of growth was in other loans to individuals which includes consumer installment credit. In addition Real Estate Loans, which includes a large amount of mortgages on residences represent loans to households.

If we add to total of real estate loans and other loans to individuals it becomes apparent that loans to households are becoming an increasingly important part of banks portfolios.

Both consumer installment credit and real estate loans on residences generate large cash flows to the bank. Even though these loans have terms which are relatively long, the fact that these loans are amortized by monthly payments, means that each month the lending institution receives a large aash flow due to the payments made by the borrower. These large and predictable cash flows provide the bank with liquidity, even though the asset may only have a limited marketability.