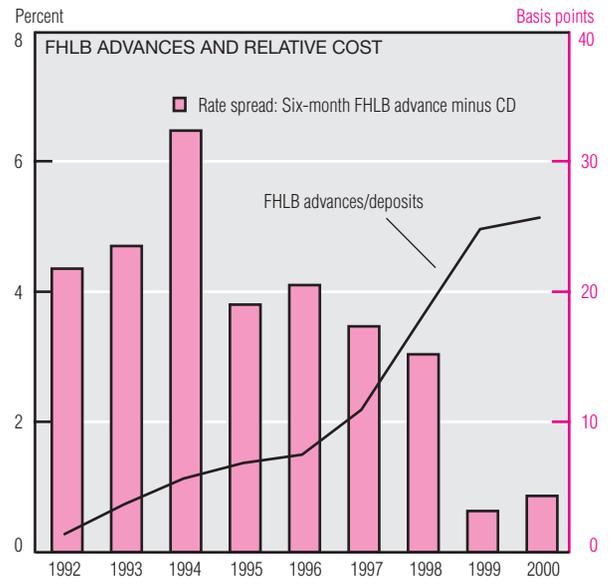
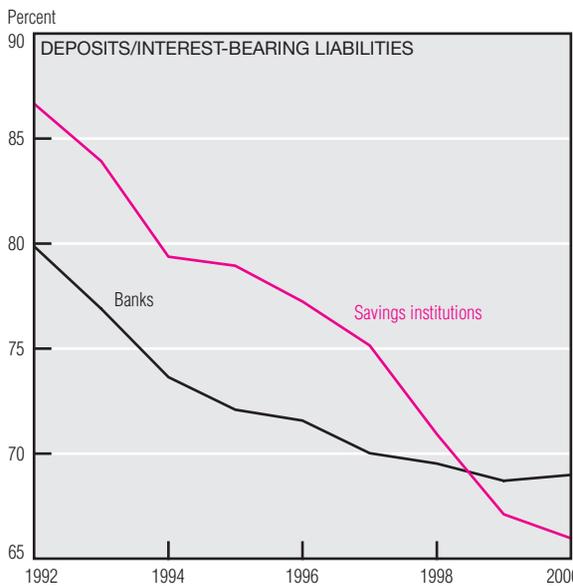
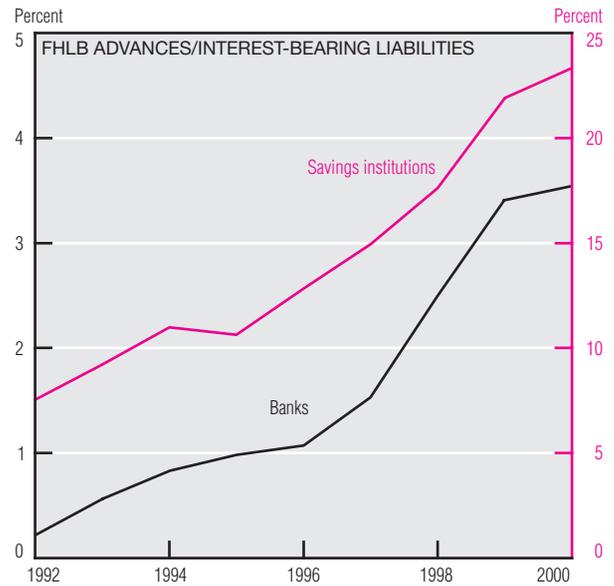
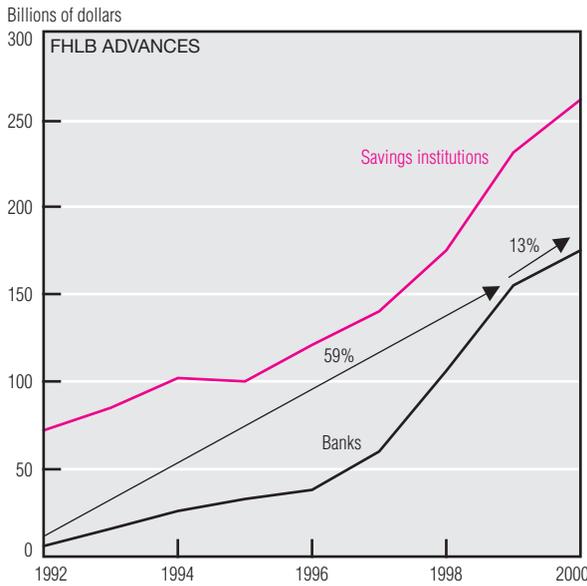


FHLB Advances to Depository Institutions



SOURCES: Board of Governors of the Federal Reserve System, "Selected Interest Rates," *Federal Reserve Statistical Releases*, H.15; Federal Deposit Insurance Corporation, *Quarterly Banking Profile*, various issues; and Bloomberg Financial Information Services.

Federal Home Loan Banks (FHLBs) were established to lend to federally chartered thrift institutions and member banks having at least 10% of their assets in mortgages. FHLB advances had to be collateralized by borrowing institutions' mortgage portfolios. The Financial Modernization Act of 1999 enabled FHLBs to depart from their traditional role of providing housing finance. They now can lend outside the housing sector to community banks, accepting banks' loans to small businesses, small farms, and small agribusinesses as collateral.

FHLB advances to commercial banks increased from almost zero in the early 1990s to \$175 billion in 2000. However, advances' growth rate declined from 59% (annualized) in 1992–99 to 13% in 2000. During the same period, FHLB advances to savings institutions rose from \$72 billion to \$261 billion. As of 2000, these FHLB advances constituted 3.5% of banks' and 23% of savings institutions' interest-bearing liabilities.

Banks and savings institutions increased the share of FHLB advances in their liabilities at the expense of interest-bearing deposits. In 1992,

deposits constituted 87% of savings institutions' liabilities, but this share fell to 66% in 2000. Similarly, commercial banks' deposit-to-liability ratio dropped from 80% in 1992 to 69% in 2000.

One explanation for this shift from deposits to FHLB advances is the decline in advances' cost relative to deposit rates. The average rate spread between the six-month FHLB (New York) advance and the CD fell from 32 basis points (bp) in 1994 to 4 bp in 2000. Including the cost of deposit insurance, which varies between zero and 27 bp, the FHLB advance is clearly a lower-cost funding alternative.