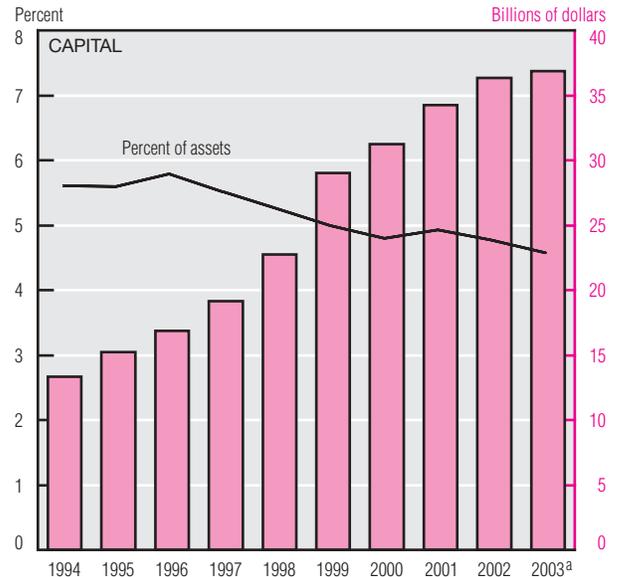
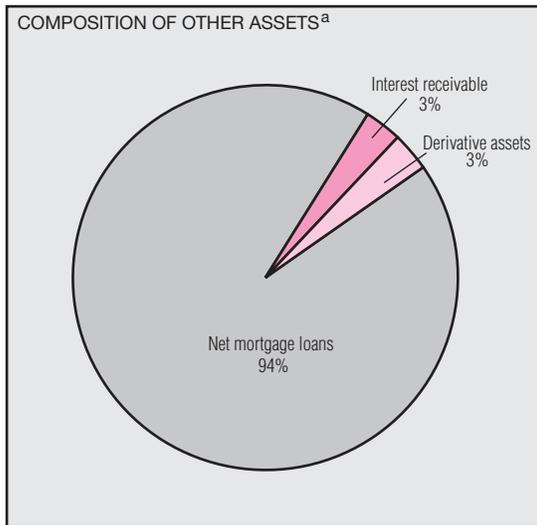
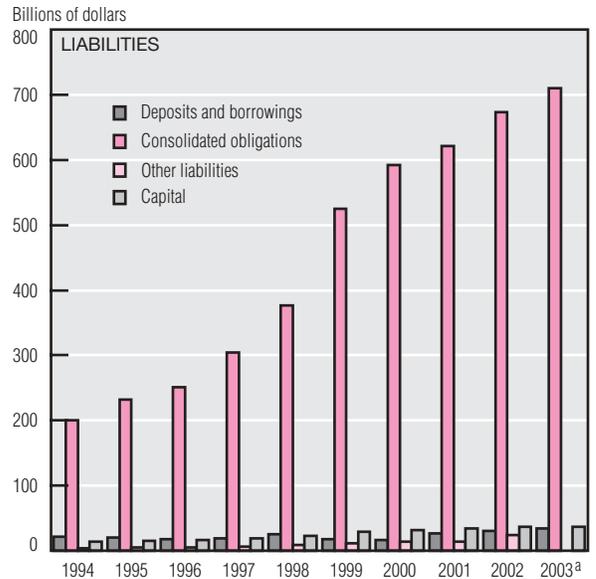
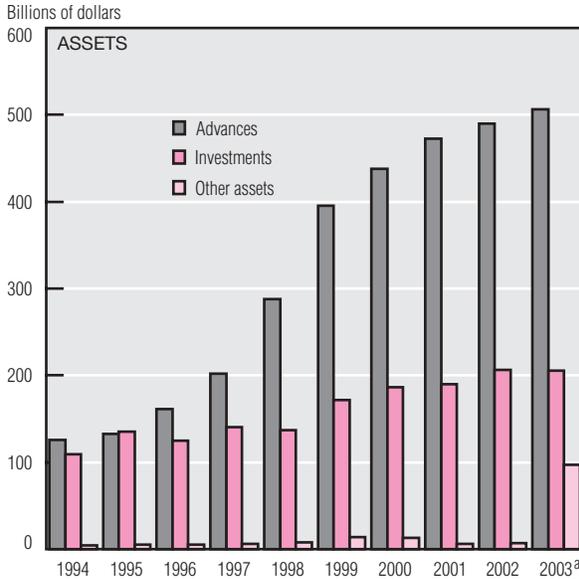


Federal Home Loan Banks



a. Data are through 2003:IIQ.
 SOURCES: Federal Home Loan Bank System, *Quarterly Financial Report*, August 13, 2003, and annual reports.

The 12 Federal Home Loan Banks are stock-chartered, government-sponsored enterprises whose original mission was to provide short-term advances to member institutions, funded with those institutions' deposits. Membership was open to specialized housing-finance lenders, mostly savings and loan associations and mutual savings banks. With continued shrinkage of their traditional clientele and ongoing consolidation of the financial system, the FHLBs have been reinventing their role in financial markets. Their advances, which now represent an important source of funding for member

institutions' mortgage portfolios, rose to \$506 billion at the end of 2003:IIQ, far outstripping all their other investments and assets.

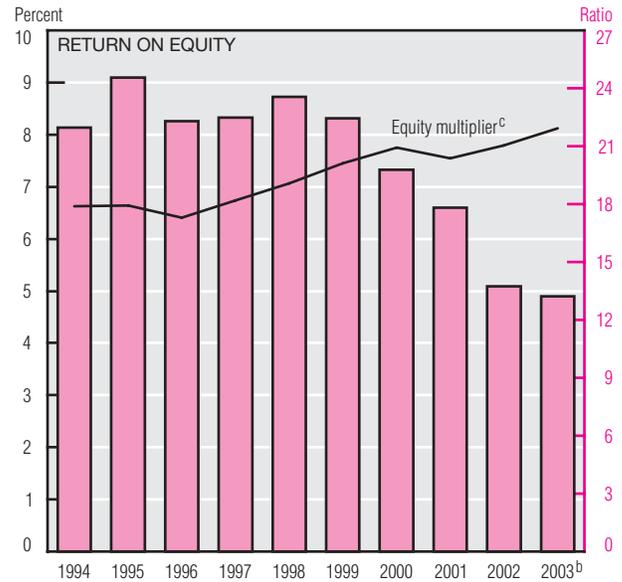
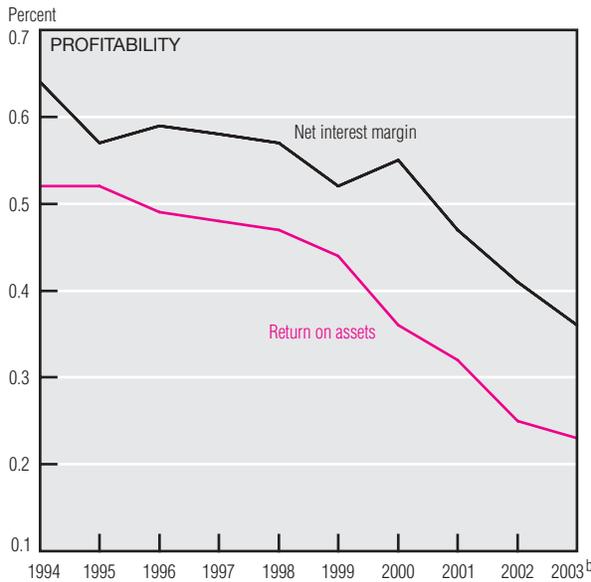
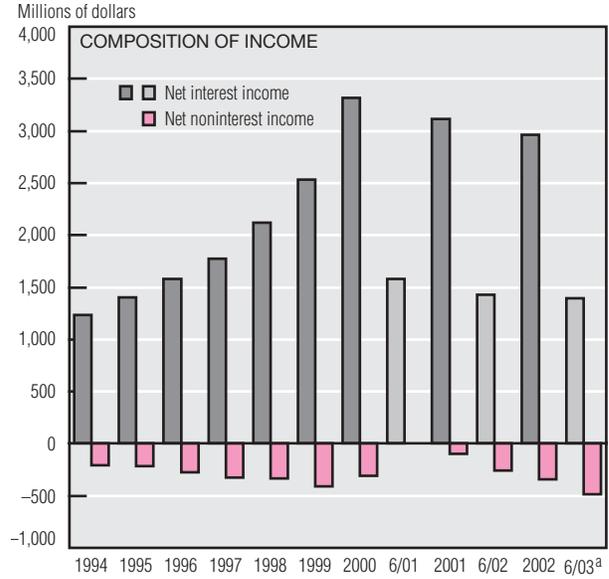
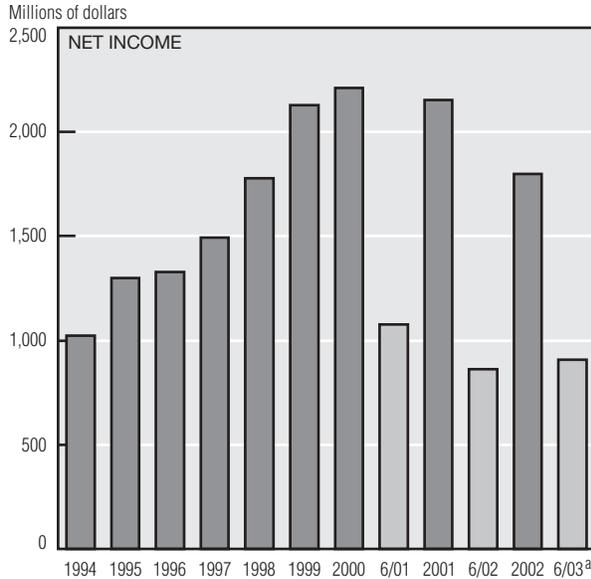
By far the largest share of FHLBs' assets came from the \$710 billion of consolidated obligations of the Federal Home Loan Bank System—bonds issued on behalf of the 12 FHLBs collectively. The market considers these bonds to be implicitly backed by the U.S. government; consequently, the FHLBs can raise funds at lower rates of return than AAA-rated corporations. Member institutions' deposits and short-term borrowings, along with other liabilities,

provided only a miniscule share of funds. The FHLBs have added to their capital as they have grown, but asset growth has outstripped capital growth; the capital-to-asset ratio fell from 5.8% in 1996 to 4.6% at the end of 2003:IIQ.

In 1997, the Chicago FHLB initiated the Mortgage Partnership Finance Program, through which it began investing directly in mortgages in addition to supporting members' own mortgage portfolios through advances. All FHLBs currently purchase mortgages directly from member institutions. The FHLBs now hold \$90 billion in mortgages, more than double what

(continued on next page)

Federal Home Loan Banks (cont.)



a. Data are through 2003:IIQ.
 b. Data for 2003:IIQ are annualized.
 c. The equity multiplier is the ratio of total assets to equity.
 SOURCES: Federal Home Loan Bank System, *Quarterly Financial Report*, August 13, 2003, and annual reports.

they held a year ago, and mortgage portfolios are projected to be a major source of their asset growth in the future.

FHLBs' earnings grew steadily from 1994 through 2000 before declining in 2001 and 2002. However, their net income of \$907 million for the first six months of 2003 exceeds the \$862 for the same period in 2002.

FHLBs' net interest income (interest income less interest expense) rose from \$735 million in 1992 to \$3,311 million at the end of 2000. For the first six months of 2003, their net interest income of \$1,392 million was down

from \$1,433 million for the same period in 2002. The most important reason for the increasingly negative spread between non-interest income and non-interest expense since 1993 is a steady increase in FHLBs' operating expenses, especially for employee compensation and benefits.

Improvements in earnings and net interest income have resulted from strong asset growth rather than greater underlying profitability. Return on assets fell from 75 basis points (bp) in 1991 to 31 bp at the end of 2001. The annualized return on average assets through 2003:IIQ is 23 bp.

Profitability has been hurt by the net interest margin's decline from 45 bp at the end of 2001 to an annualized 36 bp for the first six months of 2003. Moreover, FHLBs' net interest margins are far lower than the 300 bp to 400 bp typical of depository institutions.

Finally, despite continued increases in leverage since 1996, return on average equity fell from 6.3% at the end of 2001 to 4.9% in the first six months of 2003. These persistently weak returns on assets and equity put further pressure on the FHLBs to undertake nontraditional lines of business in search of higher returns.