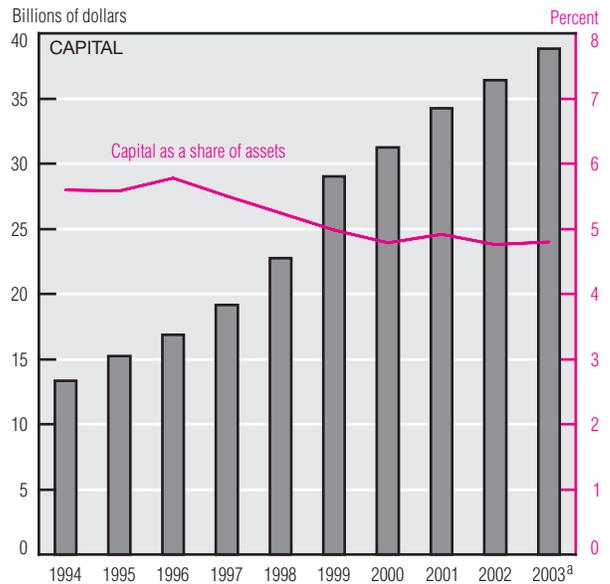
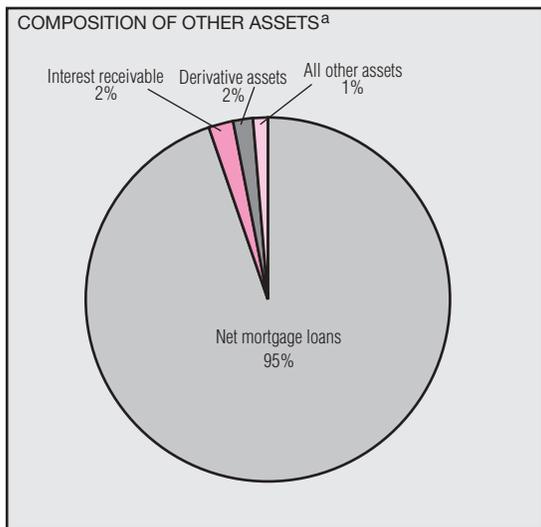
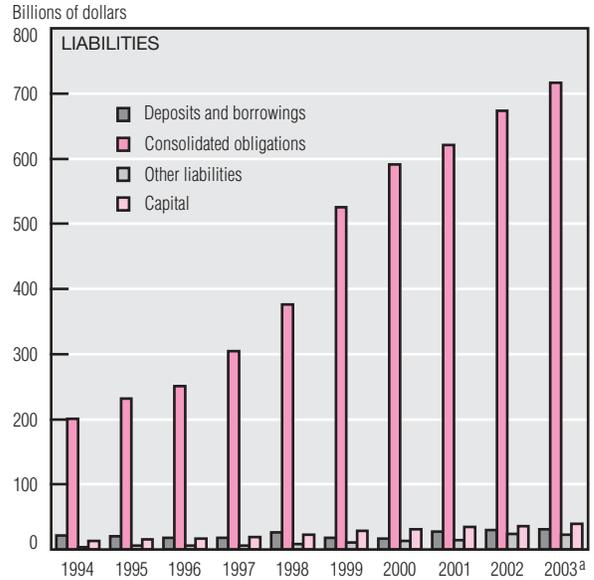
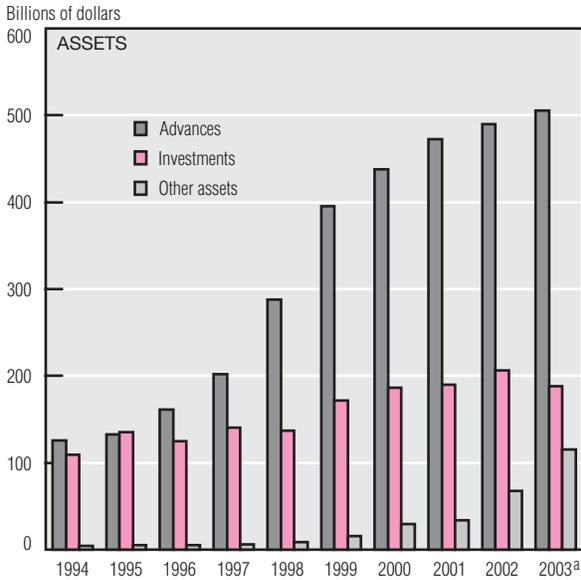


Federal Home Loan Banks



a. Data through 2003:IIIQ.
 SOURCES: Federal Home Loan Bank System, *Quarterly Financial Report*, September 30, 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, using funds that those institutions deposited. 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 2003:IIIQ, easily outstripping all their other investments and assets.

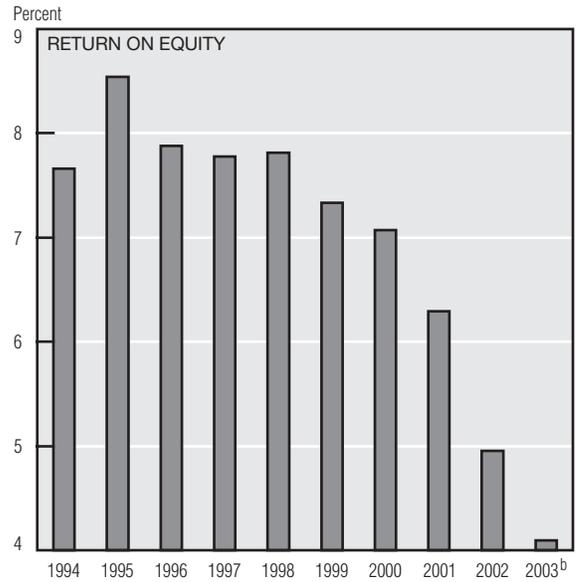
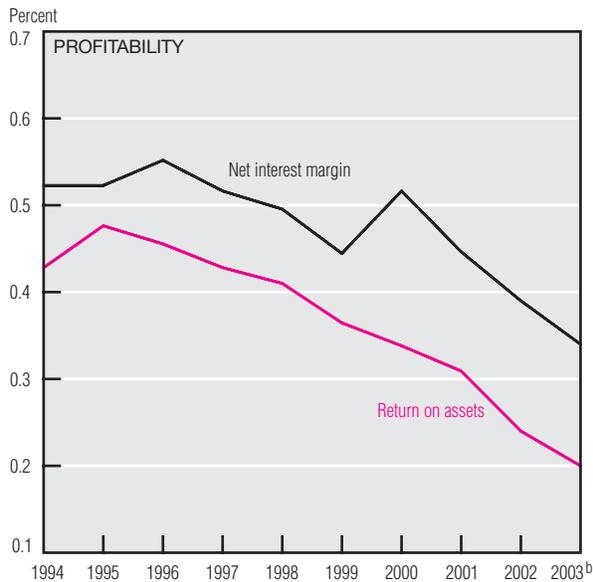
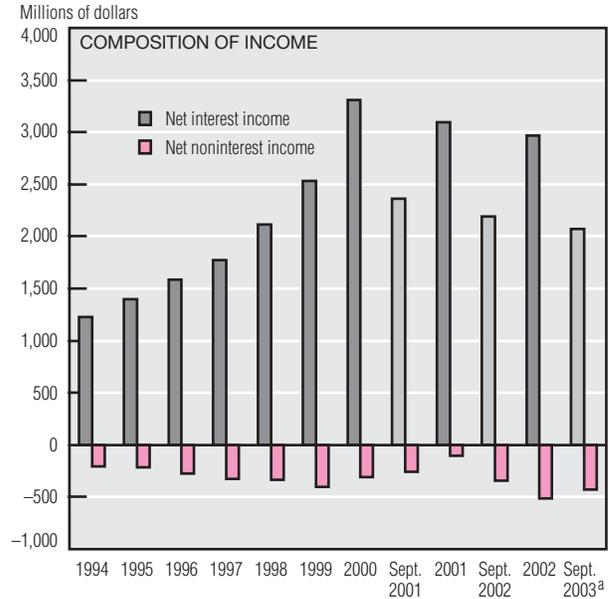
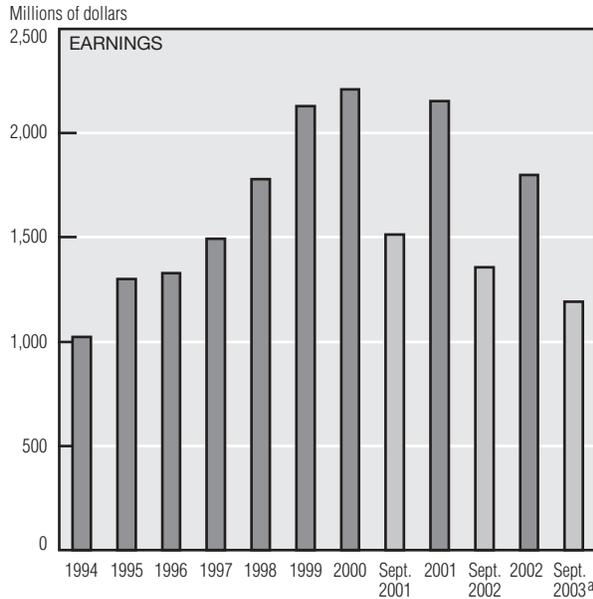
By far the largest share of funding for FHLBs' assets came from \$717 billion of consolidated obligations of the Federal Home Loan Bank System—bonds issued on behalf of the 12 FHLBs collectively. The market considers these bonds to be implicitly backed by the U.S. government; consequently, FHLBs can 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 minuscule share of funds. FHLBs have added to their capital as they have grown, but asset growth has outstripped capital growth, and the capital-to-assets ratio fell from 5.8% in 1996 to 4.8% at the end of 2003:IIIQ.

In 1997, the Federal Home Loan Bank of Chicago initiated the Mortgage Partnership Finance Program, through which it began to invest directly in mortgages besides supporting members' own mortgage portfolios through advances. FHLBs now

(continued on next page)

Federal Home Loan Banks (cont.)



a. Data through 2003:IIIQ.

b. The data for 2003:IIIQ are annualized.

SOURCES: Federal Home Loan Bank System, *Quarterly Financial Report*, September 30, 2003, and annual reports.

hold \$108 billion in mortgages, more than double what they held a year ago, and mortgage portfolios are projected to be a major source of asset growth in the future.

FHLBs' earnings grew steadily from 1994 through 2000 before declining in 2001 and 2002. Their net interest income of \$1,192 million for the first nine months of 2003 was lower than the \$1,356 million earned during the same period in 2002.

FHLBs' net interest income rose from \$1,230 million in 1994 to \$3,311 million at the end of 2000. The trend since then has been downward. For

the first nine months of 2003, their net interest income of \$2,075 million was down from \$2,194 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 1994 is the steady increase in FHLBs' operating expenses, especially in the area of employee compensation.

Improvements in earnings and net interest income have resulted from strong asset growth rather than greater underlying profitability. Return on assets fell from 43 basis points (bp) in 1994 to 24 bp at the

end of 2002. The annualized return on average assets through 2003:IIIQ was 20 bp. Profitability was hurt by the net interest margin's decline from 39 bp at the end of 2002 to an annualized 34 bp for the first nine months of 2003.

Finally, despite continued increases in leverage since 1996, return on average equity fell from 4.9% at the end of 2002 to 4.1% in the first nine months of 2003. These persistently weak returns on assets and equity further pressured FHLBs to undertake non-traditional lines of business in search of higher returns.