I. Condition of the National Banking System

1975 found the U.S. economy in the severest recession since 1938. The negative movement of income and employment factors exerted the expected influence on the condition of the National Banking System. In the United States, as gross private investment fell, total loans made by National banks decreased for the first time in recent years, by 1.8 percent. With the decrease in loan opportunities and in light of prevailing economic conditions, banks converted their funds into security holdings which, by year-end, showed an increase of 17.2 percent. The total asset figures for National banks were bolstered by a 2.0 percent increase in demand deposits, compared to an 0.8 percent increase in 1974, but 1975's 5.2 percent increase in time and savings deposits was only about 30 percent of the previous year's increase. Despite the small increase in total time and savings deposits, the proportion of such deposits relative to total deposits continued to increase to a new high of 78.3 percent. In 1972, that figure was only 54.5 percent.

For the third consecutive year, the rate of increase in total assets was less than the prior year. At year-end 1975, total assets of National banks had reached $553,427 million, a figure 3.6 percent above the December 1974 amount. The three previous year-end increases were 9.2 percent (1974), 12.6 percent (1973), and 15.5 percent (1972).

The most striking change in the composition of National bank assets was in the securities category. For the first time in many years, National bank holdings of United States Treasury securities increased substantially; holdings in Treasury securities increased 60.9 percent from year-end 1974 to year-end 1975. Of the $18,405 million increase in total securities, $17,723 million or 96.3 percent was in U.S. Governments. Holdings of state and local securities actually fell by a small amount from previous year-end figures. As the recession brought about a slackening of loan demand, the need for purchased funds correspondingly fell. As a result, Federal funds purchased and securities sold under agreements to repurchase increased only a nominal 4.8 percent.

The impact of the recession can be readily seen in the composition of National bank assets for 1975. Loans relative to total assets were 52.9 percent, down from 55.7 percent in 1974. Securities rose from 20.0 to 22.7 percent of total assets.

Despite the difficulties that National banks faced in the recession year, total loan reserves rose 1.3 percent. Since loans had actually fallen, the loan reserve rose to 1.8 percent of loans outstanding as compared to 1.7 percent the previous year. Total capital of National banks reached $38,979 million at year-end 1975, reflecting an 8.8 percent increase over the prior year's figure of $35,830 million. Capital notes and debentures increased $33 million during this relatively poor year for bank securities in the open market. Despite the difficult times, total capital accounts of National banks increased to 7.0 percent of total assets compared to the 1974 figure of 6.7 percent. The recession and the increasingly conservative position of banks resulted in a capital relative to risk assets—total assets minus cash, Treasury securities, and other U.S. Government agencies—ratio of 9.5 percent in 1975 compared to 8.7 percent a year earlier.

I. Condition of the National Banking System

The operations of national banks reflected the steady recovery the U.S. economy experienced during 1976. Loans were well over $300 billion. This figure is not directly comparable to 1975's because of changes in the balance sheet reporting. Deposit growth reflected the recovery; total deposits grew by 4.8 percent, 1 percent more than the 1975 rate of 3.8 percent. IPC demand deposits grew 2.5 percent while IPC time and savings deposits increased 9.1 percent, reflecting the somewhat improved state of the economy. Total time and savings deposits relative to total deposits continued to increase, to reach 59.9 percent in 1976. The 1972 figure was 52.0 percent.

Total book assets grew more than 5.4 percent in 1976. The actual growth was closer to 7.3 percent if provision is made for the new exclusion of loan reserves and unearned income in 1976. That is significant because it shows a reversal of the previous trend of declining asset growth. The four previous increases were 3.6 (1975), 9.2 (1974), 12.6 (1973) and 15.5 (1972) percent.

National banks' securities holdings (including those held in trading accounts) increased by $10,527 million. Holdings of U.S. Treasury securities for investment purposes increased more than 17 percent over year-end 1975. State and local government holdings also increased slightly. The total increase in securities holdings was 8.4 percent, about half the 17.2 percent increase from 1974 to 1975.

Reserves for possible loan losses reached over $3,589 million. That figure is equivalent to 1.2 percent of total loans. Total loans represented 52 percent of total assets.

Total equity capital of national banks was $41,325 million. Capital notes and debentures increased $436 million, showing the continued weak position of bank stock in the open market. Total equity capital to assets was 7.1 percent, while equity capital to risk assets, that is total assets less cash, U.S. Treasuries, and securities of other U.S. government agencies, was 9.4 percent. Those ratios are not exactly comparable to those for earlier years because of the reporting changes.

I. Condition of the National Banking System

National bank assets grew rapidly during 1977, increasing 11.7 percent, to more than $651 billion. That growth reflects the continuing growth of the economy as a whole through the year. The rate of increase was the greatest since 1973, when assets increased 12.6 percent. The intervening year-end increases were 9.2 percent for 1974, 3.6 percent for 1975, and 7.3 percent, on an adjusted basis, for 1976.

Rapid growth in total assets was sparked by a resurgence in loan demand, which had been slow recovering from the severe recession which ended in early 1975. Increased loan demand is seen in the 13.6 percent increase in loans (net of reserves), to $340.6 billion, during 1977 and in the steady rise of interest rates during the year. Although that $41 billion increase in net loans accounted for more than 60 percent of the year's growth in total assets, the asset category showing the greatest rate of increase was customers' liability on acceptances outstanding, which jumped 33.6 percent. Acceptances are widely used in the financing of international trade.

During the previous 2 years, when loan demand was weak, national banks rapidly increased their holdings of securities, particularly issues of the U.S. Treasury, in an effort to maintain their earnings and improve their liquidity. In 1977, that trend was reversed, with total holdings of securities increasing only 1.7 percent, as compared to 8.4 percent in 1976 and 17.2 percent in 1975. As a result of that relatively slow growth, securities declined to 21.2 percent of total assets, from 23.3 percent the previous year. The change was more marked in investment holdings of U.S. Treasury issues. Such holdings actually declined 5.1 percent during 1977, after increasing 17.4 percent in 1976 and 63.3 percent in 1975. National banks, however, showed a greater willingness to invest in the tax-exempt issues of states and political subdivisions.

The rapid growth in national bank assets was made possible by a correspondingly rapid increase, 10.8 percent, in total deposits, which reached more than $520 billion. For the first time since 1969, demand deposits grew at a faster rate than time and savings deposits. Therefore, the proportion of time and savings deposits to total deposits declined slightly, from the 1976 peak of 59.9 percent to 59.3 percent at year-end 1977. That increase in banks' traditional deposit base was complemented by an even more rapid increase in purchased funds. A relatively small source of those funds, liabilities for borrowed money, increased 41.6 percent. That increase reflects the relatively favorable rates available on borrowings from the Federal Reserve Banks. Federal funds purchased and securities sold under agreements to repurchase also increased at the substantial rate of 14.8 percent, down sharply from the 35.8 percent increase experienced in 1976.

Total equity capital of national banks increased 8.9 percent during 1977, to $45 billion. Despite that $3.7 billion increase, approximately 85 percent of which came from retained earnings, the ratio of equity capital to total assets declined slightly, to 6.9 percent, from 1976's level of 7.1 percent. Similarly, the ratio of equity capital to risk assets, that is total assets less cash and investment holdings of U.S. Treasury and U.S. government agency issues, was 9.2 percent, down slightly from 9.4 percent the previous year. Reserves for possible loan losses increased 8.5 percent, to $3.9 billion. Those reserves, which may be used to absorb loan losses, were equal to 1.1 percent of total loans.

In addition to the domestic assets and liabilities detailed in this section, 99 national banks operated foreign branches and subsidiaries, including Edge Act subsidiaries in the U.S., which held an additional $145 billion in assets on a consolidated basis. Those assets and liabilities, which are detailed in Table B-30 in Appendix B, continued to increase at a substantially greater rate than those in the domestic National Banking System. During 1977, the increase was 20.2 percent, which followed an increase of 20.6 percent in 1976.

I. Condition of the National Banking System

National bank assets continued to grow rapidly during 1978, increasing 12 percent, to more than $892 billion. Foreign office assets, including those held by Edge Act subsidiaries, continued to grow at an even more rapid rate, increasing 17 percent during the year to $170 billion. That reflects continuing inflation and the growth of the economy as a whole through most of the year, although at a slower pace than in 1977. Assets increased at a rate somewhat lower than 1977's 13.1 percent, the fastest growth since 1973, when assets jumped 16.4 percent. The intervening year-end increases were 10.6 percent for 1974, 3.8 percent for 1975, and 9.3 percent, on an adjusted basis, for 1976. National banks' foreign assets have consistently grown more rapidly than their domestic assets and, as a result, now account for 19 percent of total assets, compared to 14 percent 5 years ago.

Rapid growth in total assets resulted from continuing strong loan demand, which had been slow in recovering from the severe recession which ended in early 1975. That is shown by the 14.2 percent increase in loans net of reserves, to $490 billion, and in the continued high level of interest rates during the year. Although that $61 billion increase in net loans accounted for more than 60 percent of the year's growth in total assets, the asset category showing the greatest percentage increase was lease financing, which jumped 25.2 percent.

During and immediately following the last recession, when loan demand remained weak, national banks rapidly increased their holdings of securities, particularly U.S. Treasury issues, in an effort to maintain their earnings and improve their liquidity. In 1977, that trend was reversed, with total holdings of securities increasing only 2.7 percent, compared to 8.8 percent in 1975. In 1978, holdings of securities increased only 2.8 percent. That relatively slow growth has caused securities to decline to 16 percent of total assets, from 20 percent in 1976. The change has been more marked in investment holdings of U.S. Treasury issues. Such holdings actually declined 9.5 percent in 1978, following a 4.9 percent drop in 1977. In 1976, they had increased 17.7 percent, which followed a 62.6 percent increase, in 1975.

The continuing rapid growth in national bank assets was made possible, largely, by a continuing increase, 9.6 percent, in total deposits, which reached $717 billion. Domestic office deposits increased at a lower rate, 7.9 percent, to $561 billion. That increase is actually understated by nearly $8 billion because of the initiation of interest-bearing demand notes issued to the U.S. Treasury which now account for virtually all of what were previously U.S. government demand deposits. In part, because of that change, demand deposits in domestic offices increased only 4.3 percent, compared to a rapid increase of 12.5 percent last year. However, 1977 was the only year since 1969 that domestic demand deposits grew at a faster rate than domestic time and savings deposits. In 1978, the proportion of time and savings deposits to total domestic office deposits reached a new peak of 60.7 percent. Foreign office deposits and other purchased funds continued to grow more rapidly than the banks' traditional domestic deposit base. That is expected during a period of high interest rates because of the limitations on interest which can be paid to attract other than very large deposits and because of the desire to avoid the additional cost of holding non-interest bearing reserves.

The largest increase in what are generally considered purchased funds was the $21.7 billion increase in deposits at foreign offices. However, a relatively small source of those funds, borrowed money, jumped 44.9 percent to $12.9 billion, which followed a 51.3 percent increase last year. Although federal funds purchased and securities sold under agreements to repurchase increased 9.1 percent, it was significantly below the rate of increase for total liabilities and below the previous years' rates of 15.0 percent, in 1977, and 34.7 percent, in 1976.

Total equity capital of national banks increased at a slower rate than total assets in 1978 as in 1977. Despite a $4.2 billion increase, most of which resulted from retained earnings, the ratio of equity capital to total assets declined slightly, to 5.5 percent, from 1977's level of 5.6 percent. As the average size of national banks has increased substantially over the years, that ratio has tended to decline. However, due to the slow growth of assets following the last recession it did increase in 1975 and 1976 to the recent peak of 5.9 percent. Similarly, the ratio of equity capital to risk assets, that is total assets less cash and investment holdings of U.S. Treasury and U.S. government agency issues, was 7.5 percent, down from 7.8 percent the previous year. Subordinated debt, which is considered a close substitute for equity capital for some regulatory purposes, continued to increase moderately to $3.1 billion, an increase of 9.1 percent compared to 11.2

percent the previous year. The allowance for possible loan losses, however, increased 17.5 percent to $4.6 billion. Those reserves, which may be used to absorb loan losses, were equal to 1.0 percent of total loans.

At the end of 1978, the 104 national banks which operated foreign branches and subsidiaries, including Edge Act subsidiaries in the U.S., accounted for more than 60 percent of all national bank assets. More detail on their holdings of assets and liabilities is provided in Table B-27, in the Appendix. Also, domestic office assets and liabilities are detailed by state in Appendix Tables B-18 and B-19.

I. Condition of the National Banking System

During 1979, accelerating inflation, declining U.S. economic growth, sharply higher imported crude oil prices and an abrupt shift in U.S. monetary policy induced some important changes within the financial system. Most importantly, there was a large increase in the demand for short-term, liquid financial instruments with higher yields, such as money market certificates of deposit and money market mutual funds. The rapid growth of the innovative instruments not only demonstrated the pervasiveness of inflationary expectations but substantially diminished the importance of traditional deposit instruments.

While the effects of inflation, policy changes and financial innovation varied among banks, the aggregate asset, liability and capital accounts of the national banking system reflected some structural changes the banking system made to accommodate a more volatile and uncertain economic environment. Many of the changes in the national banking system during 1979, however, were simply continuations of trends already evident in previous years.

The total assets of the national banking system, both foreign and domestic, grew by 11.7 percent in 1979 to $996.3 billion. The rate of growth was slightly below the 12 percent growth of 1978. Most of the growth in total assets during 1979 was in the form of loans, as net loans increased by $57.3 billion, an 11.7 percent rate of growth. The growth in loan assets was slightly below the $60.8 billion of new lending in 1978, which reflected the slowing of the national economy during the second and fourth quarters of 1979. While lending activity increased in line with the growth of total assets in 1979, the provision for possible loan losses increased somewhat faster at a rate of 14.7 percent.

Though national banks purchased $9.2 billion in new securities during 1979, a substantial increase from $2.9 billion in security investment for 1978, the importance of securities within the asset portfolios of national banks has diminished in recent years. At the end of 1979, securities comprised 15.6 percent of total assets. Two years earlier, securities accounted for 18 percent of total assets.

The fastest growing identifiable asset category during 1979 was lease financing receivables which grew by nearly $1.5 billion, an annual rate of 22.7 percent. Conversely, national banks reduced their holdings of real estate by $261 million, a decline of 16.6 percent. That reflects the continuing workout of problem real estate lending encountered in the last recession.

The effects of rising inflation on the national banking system were most readily indentifiable on the liability side of the balance sheet. Most importantly, there was a decline in the importance of traditional deposit instruments and an increase in the use of purchased funds. Though total domestic deposits grew by $34 billion in 1979, the ratio of domestic deposits to total assets declined from 62.9 to 59.7 percent. In contrast, purchased funds, which include deposits at foreign offices, federal funds, repurchase agreements and other liabilities for borrowed money increased by $53.4 billion. As a percent of total assets, purchased funds increased from 26.2 to 28.9 percent in 1979. Further, total deposits in foreign offices increased by 21.9 percent, a rate more than three times as fast as the growth of total deposits in domestic offices.

The growth in all deposit categories, other than deposits at foreign offices, was slower than the 11.8 percent increase in total liabilities. Most notably, demand deposits at domestic offices grew by only 6.5 percent. During 1979, 26-week certificates of deposit grew from just $12 billion, or 2 percent of domestic deposits, to $55 billion, more than 9 percent of domestic deposits. So in addition to the relatively slow growth of domestic deposits, there was a significant shift in those deposits to higher interest-bearing types. Indeed, savings accounts at national banks actually declined more than 7 percent to $111 billion. The deposits of federal, state and local governments also declined.

The fastest growing liability categories reflected the shift towards increasing reliance on short-term market rate funds. Other liabilities for borrowed money grew by 37.8 percent while federal funds purchased and securities sold under agreements to repurchase increased by 22 percent. A year earlier the growth of federal funds and repurchase agreements was 9.1 percent.

The aggregate capital asset ratio for the national banking system declined slightly in 1979 from 5.51 to 5.45 percent. In recent years, there has been a steady erosion of the capital asset ratio as total assets have grown faster than total equity capital. The influence of inflation is readily apparent in that decline of the capital asset ratio. While the value of bank stocks and the return on equity have remained relatively low for several years, as it has for most stocks, inflation has accelerated the increase in the nominal value of bank assets.

The effects of inflation and of the national economy approaching its cyclical peak could be discerned from the aggregate balance sheet accounts of the national banking system. A rise in loan demand induced a shift of national bank assets away from securities and into loan assets. At the same time, the effects of inflation caused banks to rely more heavily on purchased funds and less on traditional instruments.