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CAPITAL ACCOUNTS

by

Tynan Smith

The story of what has happened to bank capital is well known. There are, however, two generalizations based upon the historical evidence which are worthy of note. One is the remarkably steady but slow growth in the amount of total capital accounts of all commercial banks over the 1909-1946 period. During this time total capital accounts increased moderately in each year except for the three depression years of 1931, 1932 and 1933. The other generalization is that the major fluctuations in the capital ratio, which is viewed as one of the significant indicators of the health of our banking system, are primarily dependent upon changes in the volume of total assets.

Total capital accounts. From 1909 to 1930 the growth in total capital accounts, as shown on the chart, was not only continuous, but was at a fairly steady rate. The rate of increase during the first world war was only slightly above that of the prewar period. There was some increase in the rate of growth in 1919 and 1920 and again in the period 1926 to 1930. In 1930 total capital accounts reached a peak of somewhat over $9 billion-a level not again reached until last year.

Over this same period from 1909 to 1930 it is interesting that the increase in capital stock was as consistent as that of total capital accounts. However, the growth in capital stock was not as rapid as that of surplus and undivided profits. As a result stock amounted to two-fifths of total capital accounts in 1930 as compared with over one-half of the total in 1909.

A substantial decline in total capital accounts accompanied the large number of bank liquidations and the asset shrinkage during the depression years 1931 to 1933. In those three years total capital accounts dropped by one-third while capital stock decreased one-fourth.

There was a very small increase in total capital accounts in the six years prior to World War II. During this period there were two factors at work which offset each other. First, about one billion dollars of RFC capital was put into the banks from 1933 to 1935. Second, not all of the shrinkage in asset values that occurred during the depression was written off immediately but rather absorbed gradually over the next few years. Notwithstanding the injection of the RFC capital the total amount of capital stock declined about 10 percent from 1934 to 1939.

During the first part of World War II, until 1943, the growth in total capital accounts was gradual - continuing the previous trend. From 1943 to 1946 the increase was accelerated, and in those three years capital accounts rose 25 percent, and in the middle of 1946 reached a point slightly above the peak of 1930. Nearly all of the increase in this period represented accumulations of surplus and undivided profits. Although the total amount of capital stock remained almost stationary, most of the RFC preferred stock was replaced by privately held capital stock.

In the last half of 1946, data for insured commercial banks show a further growth in capital accounts which may be expected to continue as long as the earnings picture is favorable and we can avoid a depression which would involve heavy asset liquidation.

Capital ratios. Since total capital accounts have not fluctuated but have shown a steady and gradual increase, with the exception of the decline from 1930 to 1933, changes in the ratio of capital to total assets have been chiefly the result of fluctuations in the amount of total assets.

Over the entire period from 1909 to 1946 there has been a persistent downward trend in the capital ratio because the expansion in bank assets has been relatively much larger than that of capital accounts. This general trend was accelerated in each of the two war periods. During World War I total assets increased by 85 percent while capital accounts rose about 25 percent, with the result that the ratio fell from 18 percent in 1914 to 12 percent in 1919. Again, in World War II the 150 percent increase in total assets far exceeded the 35 percent rise in total capital accounts; the capital ratio declined from 11 percent in 1939 to 6 percent on June 30, 1946. The low point was reached at the end of 1945 when the ratio was 5.5 percent. The decline in total assets which was responsible for the slight rise in the ratio during the first half of 1946 continued in the last half of the year. Consequently, the ratio has now moved up to about 6.3 percent.

It is also of interest to see what happened to the ratio of capital to assets other than cash and U. S. Government obligations. We hear a great deal about this ratio when it is going up but very little is said when it is going down. The movements of this ratio are dependent primarily upon changes in the loan volume, just as the movements in the ratio of capital to total assets are largely governed by changes in total assets.

The trend of the ratio of capital to assets other than cash and U. S. Government obligations was generally downward, and paralleled that of the ratio of capital to total assets until 1929. During the depression the liquidation of loans was relatively greater than the decrease in capital accounts; thereafter the recovery in the volume of loans was less rapid than that of capital accounts. Consequently, the ratio rose from 18 percent in 1929 to 26 percent in 1939. The ratio fluctuated around this level during the war. However, a sharp expansion of loans in the last half of 1946 brought a decline. From 25 percent in the middle of 1946 the ratio dropped to a little above 23 percent at the end of the year, significantly below the 1939 figure.