

Introduction to Bank Balance Sheets

Bank balance sheets report the assets, liabilities, and bank capital for an individual bank. The balance sheet identity is:

$$\text{Assets} = \text{Liabilities} + \text{Capital}$$

The assets are items that the bank owns. This includes loans, securities, and reserves. Liabilities are items that the bank owes to someone else, including deposits and bank borrowing from other institutions. Capital is sometimes referred to as “net worth”, “equity capital”, or “bank equity”. Bank capital are funds that are raised by either selling new equity in the bank, or that come from retained earnings (profits) the bank earns from its assets net of liabilities.

The following is an example of a bank balance sheet:

Assets		Liabilities	
Reserves & cash items	\$9,000	Checkable deposits	\$24,000
Securities	\$53,000	Nontransaction deposits	\$122,000
Loans	\$124,000	Borrowings	\$40,000
Other assets	\$14,000	Bank capital	\$13,000
TOTAL	\$200,000	TOTAL	\$200,000

First, note that the total on the left side **MUST ALWAYS** equal the total on the right side.

Also, the composition of this bank’s assets and liabilities is typical. To compare and to note any differences, compute the share of bank assets each item on the balance sheet accounts for and compare these figures to the ones shown in Table 1 (Chapter 9) of the text. Do the same for liabilities.

Often, we will be more interested in how a bank balance sheet is changing, rather than the total assets and liabilities on the balance sheet. To analyze changes in the balance sheet, we use T-accounts. These are tables that look similar to the bank balance sheet, except that they only record changes in the balance sheet, rather than the totals.

For example, consider the balance sheet above. Suppose that a bank customer, Cary, withdraws \$1,000 in cash from his checking account at the bank.

Assets		Liabilities	
Reserves (& cash items)	-\$1,000	Checkable deposits	-\$1,000
Securities	No change	Nontransaction deposits	No change
Loans	No change	Borrowings	No change
Other assets	No change	Bank capital	No change
TOTAL	-\$1,000	TOTAL	-\$1,000

On T-accounts, the items that do not change are often not included. It is understood that they are not changing:

Assets			Liabilities	
Reserves	-\$1,000		Checkable deposits	-\$1,000

Notice, that when Cary withdraws cash, this reduces the bank's vault cash (reserves = bank deposits with the central bank + vault cash). We could see this same change by looking at the bank's balance sheet after this transaction takes place:

Assets			Liabilities	
<i>Reserves</i>	<i>\$8,000</i>		<i>Checkable deposits</i>	<i>\$23,000</i>
<i>Securities</i>	<i>\$53,000</i>		<i>Nontransaction deposits</i>	<i>\$122,000</i>
<i>Loans</i>	<i>\$124,000</i>		<i>Borrowings</i>	<i>\$40,000</i>
<i>Other assets</i>	<i>\$14,000</i>		<i>Bank capital</i>	<i>\$13,000</i>
TOTAL	\$200,000		TOTAL	\$200,000

Suppose that instead of withdrawing cash, Cary writes a check for \$1,000 payable to a furniture store. When the furniture store deposits this check into its bank account, the furniture store's bank clear the check. This means that it reports to a clearing house, such as the Federal Reserve to verify that these funds are available in the account upon which the check is drawn (Cary's checking account). When the check clears, the clearing house will take these funds from Cary's bank and give them to the bank that received the check (the furniture store's check). This side of the transaction is recorded in reserves:

Assets			Liabilities	
Reserves	-\$1,000		Checkable deposits	-\$1,000

Note that for Cary's bank, this is identical to Cary withdrawing cash from his checking account.