**Balance sheet of banking system:**

Banks publish balance sheets in their annual reports. The balance sheet contains particulars of a bank’s current assets and current liabilities. Assets items refer to all credit items in indicating the wealth and claims possessed by the bank. Liability items refer to all debit items indicating the obligations of the bank. Thus, the balance sheet indicates the manner in which the bank has raised funds and invested them in various types of assets. In a balance sheet, it is customary to state the liabilities on the left and assets on the right. The liabilities of the bank are the items which are to be paid by it either to its shareholders or depositors.

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**Portfolio Management of a Commercial Bank**

The main aim of a commercial bank is to seek profit like any other institution. Its capacity to earn profit depends upon its investment policy. Its investment policy, in turn, depends on the manner in which it manages its investment portfolio. The manner in which banks manage their portfolios, that is acquiring and disposing of their earning assets, can have important affects on the financial markets, on the borrowing and spending practices of households and businesses, and on the economy as a whole. There are three main objectives of portfolio management which a wise bank follows: **liquidity, safety and profitability**.

**1. Liquidity:**

A commercial bank needs a higher degree of liquidity in its assets. The liquidity of assets refers to the ease and certainty with which it can be turned into cash. The liabilities of a bank are large in relation to its assets because it holds a small proportion of its assets in cash. But its liabilities are payable on demand at a short notice. Therefore, the bank must hold a sufficiently large proportion of its assets in the form of cash and liquid assets for the purpose of profitability. Many types of assets are available to a commercial bank with varying degrees of liquidity. The most liquid of assets is money in cash. The next most liquid assets are deposits with the central bank, treasury bills and other short-term bills issues by the central and state governments and large firms, and call loans to other banks, firms, dealers and brokers in government securities.

**2. Safety:**

A commercial bank always operates under conditions of uncertainty and risk. It is uncertain about the amount and cost of funds it can acquire and about its income in the future. Moreover, it face two types of risks. The first is the market risk which results from the decline in the prices of debt obligations when the market rate of interest rises. The second is the risk by default where the bank fears that the debtors are not likely to repay the principle and pay the interest in time.

**3. Profitability:**

One of the principle objectives of a bank is to earn more profit. It is essential for the purpose of paying interest to depositors, wage to the staff, dividend to shareholders and meeting other expenses. It cannot afford to hold a large amount of funds in cash for that will mean forgoing income. But the conflict between profitability and liquidity is not very sharp. Liquidity and safety are primary considerations while profitability is subsidiary for the very existence of a bank depends on the first two.