FIRST THE ENERGY COMPANIES MAKE EXTRAORDINARY PROFITS, NOW IT'S THE BANKS

The reporting season for Q1 is in full swing on Wall Street. The banks have delighted the Street with profits that pleasantly surprised forecasts. Why the surprise? Making profits in this interest rate environment is easier than riding a bike with practise wheels on.

And the reason for this is found in the tables below taken from the Congressional Budget Office Monthly report. In Table 1 we note the budget deficit has increased 40%. This is due to a fall in receipts of 3% and a rise in expenditures of 12% yielding a difference in receipts and expenditure of 15%. The fall in receipts even accounting for a change in tax brackets is indicative of a contracting not an expanding economy.

Table 1.

Table 1.

Budget Totals, October–March

Billions of Dollars

	Actual, FY 2022	Preliminary, FY 2023	Estimated Change	Estimated Change With Adjustments for Timing Shifts in Outlays[a]	
				Billions of Dollars	Percent
Receipts	2,122	2,049	−73	−73	−3
Outlays	2,790	3,147	357	346	12
Deficit (−)	−668	−1,099	−430	−420	63

Data sources: Congressional Budget Office; Department of the Treasury. Based on the *Monthly Treasury Statement* for February 2023 and the *Daily Treasury Statements* for March 2023.

One of the primary reasons for this increase is the increase in interest payments which rose by $90 billion, a rise bigger than the combined rise in Medicare and Medicaid. It accounted for 34% of the increase in the deficit excluding the gain from the one-off *Spectrum Auction Receipts*. The increase of $90 billion is for 6 months and as interest rates have been steadily rising we may confidently assume that at least $50 billion is due to the last Quarter ended March, much of which ended up as profits to the banks.

Table 2.

Table 3.

Outlays, October–March

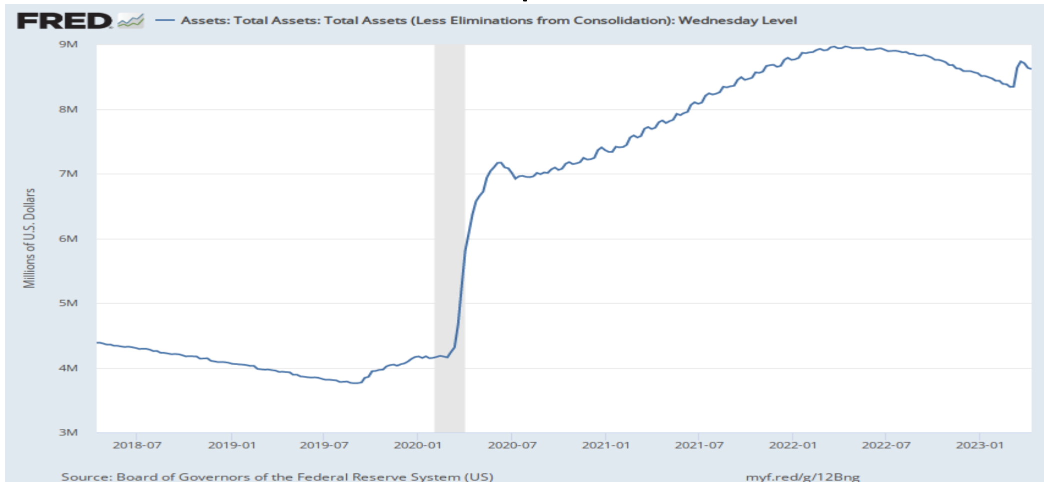
Billions of Dollars

Major Program or Category	Actual, FY 2022	Preliminary, FY 2023	Estimated Change	Estimated Change With Adjustments for Timing Shifts in Outlays[a]	
				Billions of Dollars	Percent
Social Security Benefits	590	652	61	61	10
Medicare[b]	346	403	58	49	14
Medicaid	288	310	22	22	8
Subtotal, Largest Mandatory Spending Programs	**1,224**	**1,365**	**141**	**132**	**11**
Refundable Tax Credits[c]	202	116	−86	−86	−43
PHSSEF	59	17	−42	−42	−72
Small Business Administration	18	1	−17	−17	−94
Spectrum Auction Receipts	−81	0	81	81	−100
Department of Education	70	123	53	53	75
PBGC	−1	37	38	38	n.m.
DoD—Military[d]	358	385	27	27	7
Net Interest on the Public Debt	219	308	90	90	41
Other	721	795	74	72	10
Total	**2,790**	**3,147**	**357**	**346**	**12**

Data sources: Congressional Budget Office; Department of the Treasury.

We should also bear in mind that this is the net figure. It is arrived at by deducting the interest received from bonds held by the FED from the gross figure of interest paid out. Despite 9 months of Quantitative Tightening, the amounts of Treasury Bonds and Mortgage Bonds which earn interest for the FED has only fallen by $300 billion. Therefore the gross amount of interest paid out since October 2022 is far greater than the net amount of $308 billion recorded in Table 2.

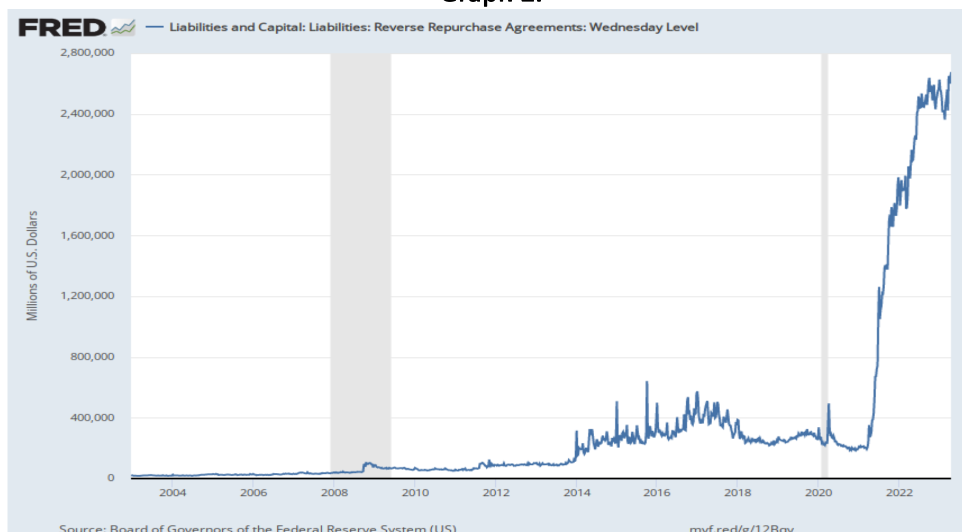
Graph 1.



Turning to the payment side. There are three recipients who receive interest payments on any public debt. Obviously there are those who own government treasuries with various durations or terms. The FED provides details of the terms of the treasuries it holds here. 56% of the $5.626 trillion in treasuries have a maturity of over 5 years which means the increase in interest rates over the last year will leave that element largely unaffected in respect of the interest paid by the FED. Thus we may conclude that the contribution to the surge in interest payments coming from traditional payments on treasuries held by the public both local and foreign, is smaller than assumed.

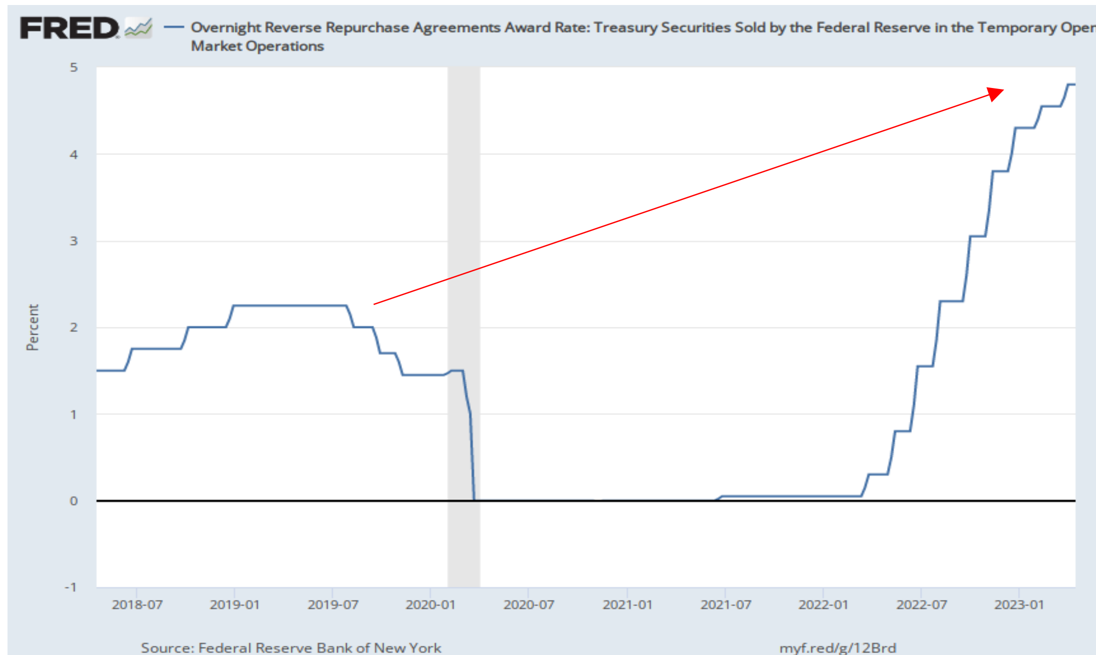
Not so, the second tranche of debt which comes from what is called *Reverse Repo* conducted by the New York Fed. This is where the banks shovel their excess cash over to the FED on a nightly basis to earn interest.

Graph 2.



The sums are very large, over $2.6 trillion. (So that's where the Covid funds ended up!) Talk about viral money. Not only has the amount parked in N.Y. shot up, so too has the interest rates paid on these funds.

Graph 3.



Now ain't that the staircase to banking heaven. Currently the interest paid is 4.8%. Who said being a banker was a difficult job? It is likely that over the course of the 2022/3 fiscal year, this major source of interest will amount to over $100 billion.

Thirdly, the same interest rates applies to commercial bank funds (reserves) deposited with the Federal Reserve, currently paying 4.9%. When the FED engaged in Quantitative Easing after the Financial Crash they elevated the price of treasuries through purchasing trillions of Dollars of these treasuries. Most of the sales occurred through banks who pocketed the profits. Then what to do with the cash received selling these treasuries? Would it go on productive investment? Clearly not, most of it was left with the FED to earn interest in the form of Reserves because that was more profitable and safer than the dearth of profitable investment opportunities which existed in the real economy. "*When the Fed purchases Treasury or agency securities from a dealer bank, it pays for the purchase by crediting the bank's Federal Reserve deposit account in the amount of the purchase. The bank can then use those funds to buy other assets if it chooses to do so, which moves the reserve balances to other banks. But unless and until the Fed removes reserve balances from the banking system, by selling bonds to a dealer bank, those balances will remain on the consolidated balance sheet of the entire banking system.*" Total reserves according to the FED as of April stood at £3.292 trillion. Some of these reserves represented the statutory 3% reserve requirement but that still left funds well in excess of $2.5 trillion held simply to earn interest of 4.9%

The cheek of it. Originally the banks made huge profits selling treasuries back to the FED. Now they will be earning over a $100 billion dollars a year on the money they received from the FED simply by handing it back to the FED for storage. Talk of double profiting. And who pays for all these profits. The US taxpayer of course. No wonder bank profits shot up in Q1 of 2023.

Analysing two banks.

I have chosen to analyse JP Morgan and Bank of America as the former is the largest bank in the US while the latter is the biggest retail bank. JPM's data can be found by following this link JP Morgan Q1 results. These results are broken down into banking activity. The most profitable segment is seen below. This segment accounted for 58% of the total year on year increase in revenue and 54% of the increase in profit. And this jump in profits resulted despite a fall in deposits of 4% and a below inflation rise in lending of 5% (with no growth over the last 6 months).

Table 3.

CONSUMER & COMMUNITY BANKING (CCB)							
Results for CCB				4Q22		1Q22	
($ millions)	1Q23	4Q22	1Q22	$ O/(U)	O/(U) %	$ O/(U)	O/(U) %
Net revenue	$ 16,456	$ 15,793	$ 12,182	$ 663	4 %	$ 4,274	35 %
Banking & Wealth Management[11]	10,041	9,582	6,015	459	5	4,026	67
Home Lending	720	584	1,169	136	23	(449)	(38)
Card Services & Auto	5,695	5,627	4,998	68	1	697	14
Noninterest expense[11]	8,065	7,912	7,655	153	2	410	5
Provision for credit losses	1,402	1,845	678	(443)	(24)	724	107
Net income	$ 5,243	$ 4,556	$ 2,908	$ 687	15 %	$ 2,335	80 %

It certainly did not come from investing in the real economy. Here net revenue was flat yoy and profits were only up 1% or by -5% in real terms.

Table 4.

CORPORATE & INVESTMENT BANK (CIB)							
Results for CIB				4Q22		1Q22	
($ millions)	1Q23	4Q22	1Q22	$ O/(U)	O/(U) %	$ O/(U)	O/(U) %
Net revenue	$ 13,600	$ 10,598	$ 13,576	$ 3,002	28 %	$ 24	— %
Banking[11]	4,223	3,832	4,279	391	10	(56)	(1)
Markets & Securities Services	9,377	6,766	9,297	2,611	39	80	1
Noninterest expense[11]	7,483	6,495	7,363	988	15	120	2
Provision for credit losses	58	141	445	(83)	(59)	(387)	(87)
Net income	$ 4,421	$ 3,314	$ 4,372	$ 1,107	33 %	$ 49	1 %

So where did the profits really come from. Besides parking trillions with the FED, the bank forgot to raise its saving rates for depositors. This link provides JP Morgan deposit rates. Most rates are well below 1%. Unless a depositor ties up their deposit for at least 30 months they will not receive an interest rate above 1%. Elsewhere JP Morgan reveals that 46% of the increase in its revenue was due to higher interest earned whereas it paid out 10% less in interest. Scandalous.

Of course it treats it richer clients differentially and with kid gloves. In its *Wealth and Asset Management Department* it looks after $3 trillion of their funds, and despite the sheer volume of these assets it makes less than a quarter the amount of profit it makes in the Community Section of the bank. Clearly it is paying a much higher rate of interest to these deserving folk.

Aside from this it is important to note that total deposits were down 6%. Thus JP Morgan made 52% more profit with only 94 cents in dollar given the fall in deposits. I want to be a banker.

Turning to Bank of America. It too had an improvement in revenue and profit but not to the same degree as JP Morgan. In fact in the consumer side as we can see below, profits only went up 4.4% despite revenue rising 20%. Unlike JPM, BOFA had a sharp increase in expenses. The lower profit margin was definitely not due to paying depositors more for their savings as Table 6 shows. Cartel anyone?

Table 5.

Financial Results

($ in millions)	Three months ended 3/31/2023	12/31/2022	3/31/2022
Total revenue[2]	**$10,706**	$10,782	$8,813
Provision for credit losses	**1,089**	944	(52)
Noninterest expense	**5,473**	5,100	4,921
Pretax income	**4,144**	4,738	3,944
Income tax expense	**1,036**	1,161	966
Net income	**$3,108**	$3,577	$2,978

Business Highlights[(B)]

($ in billions)	Three months ended 3/31/2023	12/31/2022	3/31/2022
Average deposits	**$1,026.2**	$1,047.1	$1,056.1
Average loans and leases	**303.8**	300.4	284.1
Consumer investment assets (EOP)[3]	**354.9**	319.6	357.6

Table 6.

Bank of America	0.01%	0.03% for all balance tiers
Chase	0.01%	0.02% for balances under $10,000, then 0.05%
Wells Fargo	0.15%	0.01%-1.50%
Ally Bank	3.75%	4.50%
Vio Bank	1.10%	4.65%
Marcus by Goldman Sachs	3.90%	4.50%

It is not only the smaller banks that have lost deposits, all the banks have lost deposits. In the case of Bank of America the loss in nominal deposits ignoring inflation was $162 billion year on year or 8% of its total deposits. We will see in the next section how these loss of deposits has reduced the money supply. It is likely in the case of the larger banks that this was not due to depositor flight but simply due to consumers exhausting their savings because prices are outpacing earnings. A tangential proof of this is that both banks provided data which showed that balances outstanding on credit cards had increased significantly as had the provisions set aside by the two banks to cover credit card defaults.

Table 7.

Balance Sheet, Liquidity and Capital Highlights ($ in billions except per share data, end of period, unless otherwise noted)[B]

	Three months ended		
	3/31/2023	**12/31/2022**	**3/31/2022**
Ending Balance Sheet			
Total assets	**$3,194.7**	$3,051.4	$3,238.2
Total loans and leases	**1,046.4**	1,045.7	993.1
Total loans and leases in business segments (excluding All Other)	**1,036.6**	1,035.5	978.1
Total deposits	**1,910.4**	1,930.3	2,072.4
Average Balance Sheet			
Average total assets	**$3,096.1**	$3,074.3	$3,207.7
Average loans and leases	**1,041.4**	1,039.2	977.8
Average deposits	**1,893.6**	1,925.5	2,045.8

A more updated view of evaporating deposits is provided by the FED's Table H8. We find in this table that deposits fell by 4.9% yoy in Q1 2023. Moreover this fall accelerated towards the end of March following the banking turbulence facing the smaller banks (see arrow).

Table 8.

	Account	2018	2019	2020	2021	2022	2021 Q4	2022 Q1	2022 Q2	2022 Q3	2022 Q4	2023 Q1	2022 Dec	2023 Jan	2023 Feb	2023 Mar
Liabilities																
34	Deposits	2.8	6.1	20.9	11.8	-0.7	10.2	4.2	-0.4	-1.7	-5.0	-4.9	-0.5	-2.4	-5.8	-21.8
35	Large time deposits	5.1	8.6	-16.9	-6.6	12.4	2.2	-5.4	14.1	23.3	16.0	41.4	44.0	36.1	44.0	35.8
36	Other deposits	2.4	5.7	26.9	13.7	-1.9	10.9	5.1	-1.6	-3.9	-6.9	-9.4	-4.9	-6.4	-11.1	-28.3
37	Borrowings	-5.2	-1.9	-13.2	-1.8	8.1	4.4	-11.7	0.4	18.5	25.4	52.7	23.8	23.1	27.0	249.8
39	Other liabilities including trading liabilities [25]	2.7	2.8	12.7	4.1	15.9	7.4	-5.3	28.8	14.4	23.2	-13.1	-18.6	-18.2	-21.5	-16.9
40	**Total liabilities**	**0.6**	**3.6**	**16.6**	**11.2**	**1.6**	**11.7**	**2.2**	**1.2**	**3.8**	**-0.7**	**1.3**	**-1.9**	**4.5**	**-3.1**	**3.1**

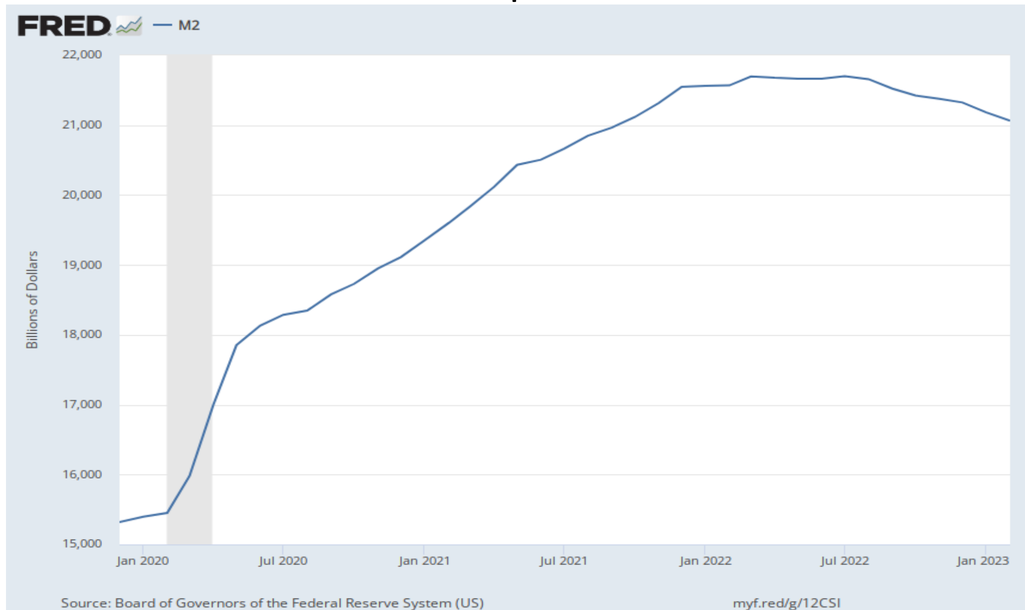
Taking a longer view we note that deposits began to fall in H2 of 2022, and in fact, the Q1 2023 outflows which includes March, was no higher than in Q4 2022. This indicates that depositors were using up their savings, whereas in 2020 and 2021 covid funds endowed their savings.

The money supply (M2)

In the graph below we note that the money supply has shrunk by 3%. In real terms that amounts to 9% when inflation is taken into account. As GDP is currently growing in nominal terms by 7% this fall in the money supply of 3% versus the rise in GDP implies a significant increase in the velocity of circulation of money. However, there is a caveat to this. M2 does not take into account the migration of deposits which make up M2 to money market funds and investments in short dated treasuries. If these were taken into account the velocity of circulation would be slower but still significant, because a sizeable amount of these deposits have simply been spent on higher prices.

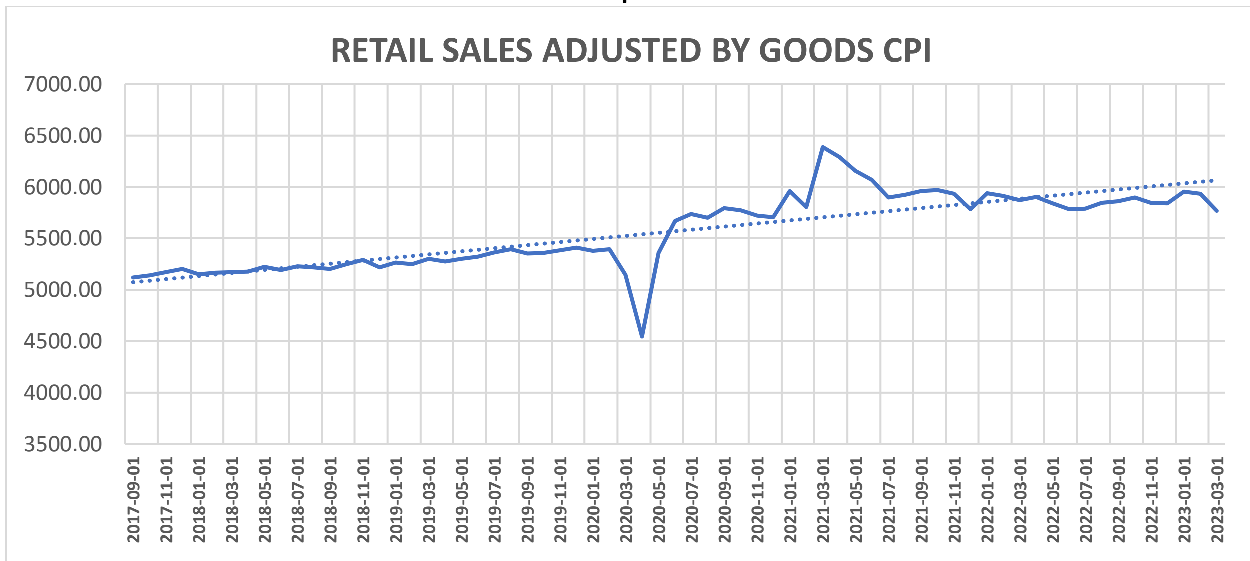
Which brings us to the composition of money as I have analysed by means of *Modern Marxist Monetary Theory* on this site. (If you want to read up on this theory there is a search feature on the site and by inputting the above *four words* the articles will come up.) Normally around 90 – 92% of M2 is provided by unspent revenues emanating from legacy value produced in previous cycles of production. The balance of <10% is mainly bank credit (temporary money) and fiscal deficits (permanent money). Bank credit growth has been listless around 2% in H2 2022. But the fiscal deficit has been much stronger, around 7% of GDP which is $150 billion more than the amount permanent money removed by Quantitative Easing to date.

Graph 4.



A contraction in the money supply is always ominous for the economy. If it is a product of consumers having exhausted their savings, and/or, their income in real terms is falling, then it is clear that potential demand is on it way out. Already this can be seen in the form of retail sales where even the volume of new car sales is falling. After another fall of this magnitude in April, highly likely, and the volume of sales will be back to 2019 levels.

Graph 5.



Add in bank tightening together with the increased obstacles to raising fresh capital on the wholesale credit markets, and the outlook for the economy is even darker. To restore balance to this analysis there is one bright spot. In order to prepare its war economy and build industrial resilience the USA needs to replicate production onshore for critical items previously produced in China and Taiwan. This means chips, car batteries and the like. A recent article this week in the Financial Times found that companies had

committed over $200 billion to invest in chip and clean industries to take advantage of federal subsidies amounting to a total of $432 billion and state subsidies of an unknown quantity, as often the bidding to attract investment is hidden. That $200 billion is 20 times the amount set aside for investment in 2019.

In case US workers are under the misapprehension that this will create lots of jobs, it won't. That $200 billion will only create 82,000 jobs at roughly $2.5 million a job (and this excludes the subsidies). That is how elevated the composition of capital is in these industries. Are you taking note Dr Jeffries? And despite all these subsidies, at least in the chip sector, production there will be globally uncompetitive, but then the primary purpose of this misplaced investment is to ride out a war.

Who says imperialists cant be cheeky? Remember the accusation levelled at China that the state subsidizes and supports Chinese Industry at the expense of its competitors. That this was one of the reasons for the embargoes alongside dual use, i.e. commercial and military. Well now it is the turn of the EU to accuse the US of engaging in exactly the same practises.

Insolvencies and Bankruptcies.

The rise in insolvencies in March coincided with the tightening in bank standards for lending due to the turbulence that month. Like consumers who had worked through their savings, many companies have worked through the liquidity provided by the covid funds and easy borrowing. Here is a summation of the rise in insolvencies and the prospective fall in the zombies. The same trend can be found in the UK as well.

Table 9.

Type of filing	March 2022	March 2023	Increase
All bankruptcy filings	36,068	42,368	17%
Chapter 11	306	548	79%
Commercial filings	1,854	2,305	24%

(Source: American Bankruptcy Institute)

It is likely the deluge has begun.

Conclusion.

The banks always lead the reporting season and they have had a good quarter. However, what is good for the banks is not necessarily good for the rest of the economy, because while high interest rates help the banks it also hurts the rest of the economy. In a couple of weeks the rest of the large corporations will have reported on their earnings during Q1 2023. Corporations like Apple will provide insights into the state of the world economy. I will report in greater detail at that time as firmer conclusions can then be drawn. In addition it will be interesting to see how Wall Street has responded to these earnings as it remains deranged by the direction of interest rates, rather than focusing on the real economic world which determines the direction. Finally, it will be clearer what progress has been made to raise the debt ceiling which may arrive by June rather than September. One thing is sure, should the debt ceiling be breached, it will bring forward the day when the Dollar ceases to be the world's reserve currency. Already jitters about the debt ceiling have driven up bid prices at Treasury Auctions reversing the fall in interest rates.

In the meantime we have just discussed another example of how governments and central banks enrich the underserving in a rigged system.

Brian Green, 19th April 2023.