Weekly Market Flash

Uneasy Calm as Banks Report Earnings

April 14, 2023

More than one month has passed since the Silicon Valley Bank failure gave investors something new to worry about. The health of the banking sector at large was in question, and the worries compounded as more problematic institutions trickled into the news: Signature Bank of New York, First Republic Bank, Credit Suisse. The good news is that conditions have stabilized since that first spate of failures. Deposit outflows have slowed, and banks have reduced their emergency borrowing activity at the Fed's discount window and the Bank Term Funding Program that was set up to provide liquidity in the wake of the Silicon Valley Bank nosedive. But there is an element of unease to the calm, with a sense that more trouble lies ahead. Not so much of the systemic bank failure variety of trouble, but more about what the likelihood of sharply reduced credit creation means for the general economy.

The Big Get Bigger

One of the first things many people did after SVB hit the news was to pull their money out of their local mom-and-pop banks and put it into one of the banking giants. Today we got some hard data about this trend as the largest banks kicked off the first quarter earnings season with their results. JPMorgan Chase recorded deposit growth of $37 billion in the first quarter, with much of that coming in the last three weeks of March. The institution's net interest income (the difference between what they earn from loans & other assets and what they pay on deposits) grew 49 percent year-on-year, and net earnings per share of $4.10 far exceeded the $3.39 EPS expected by analysts covering the company. Other leading banking institutions including Citi, Wells Fargo and PNC also exceeded analysts' earnings estimates. This is an important bit of good news, since these are the institutions that would be at the core of a genuine systemic failure. Their strength is a sign of health for the system at large.

Storm Clouds

JPMorgan Chase head Jamie Dimon is fond of the phrase "storm clouds," which he often invokes in the same paragraph as "healthy footing" in talking about the economy. As in: healthy footing today but storm clouds on the horizon. Those clouds may be nearer and darker than they were the last time Dimon used the phrase, three months ago. In today's earnings report the bank noted a reserve build of $1.1 billion to provision for potential credit losses. The recent turmoil in the banking sector will likely result in tighter credit conditions as banks curtail lending and focus on maintaining adequate liquidity and capital reserves. Less access to credit is in turn likely to accelerate the slowdown in consumer activity that we saw evidence of even before the SVB failure. And as we know – all together now – consumer spending drives the US economy, so when it slows so does everything else.

In summation, our main takeaway from what we have seen so far of bank earnings underscores the fundamental difference between the current environment and the 2008 crisis – this is not a systemic event that threatens the system's core infrastructure. We expect conditions will continue to stabilize. But the slowdown in credit will likely be an accelerant to already-slowing consumer activity. Interest rates are not likely to come down any time soon (no matter what the bond market thinks), which will further deter credit creation. The growth cycle will resume, but likely not before we have a few slow months.

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