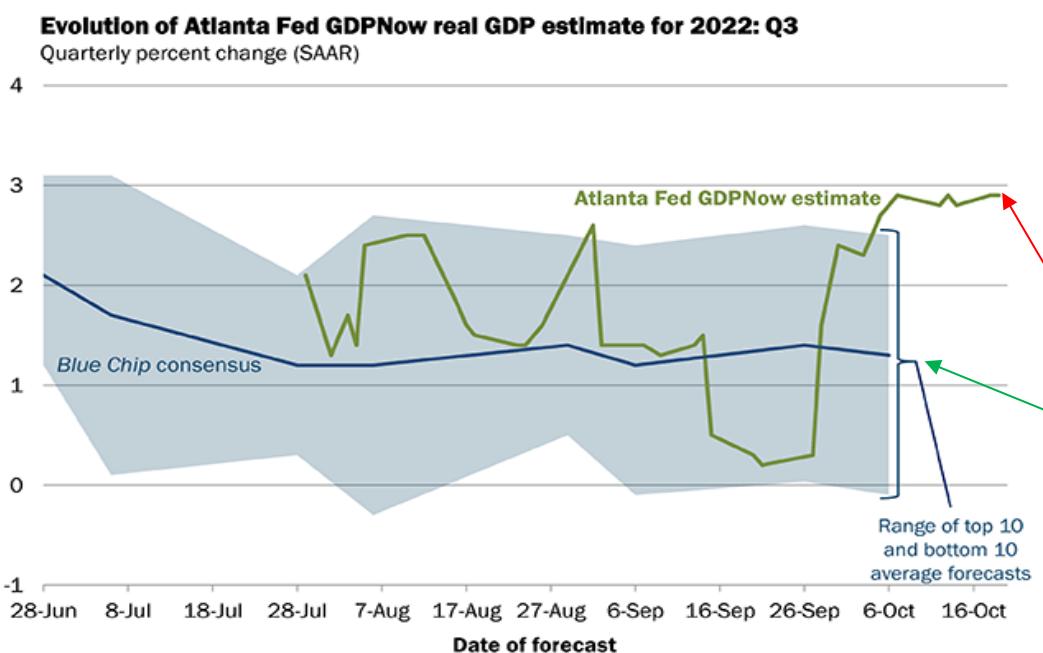


WHAT BANKING INCOME IN THE USA TELLS US ABOUT THE STATE OF THE US ECONOMY.

This article uses the financial performance of the top 10 banks in the USA in order to provide insight into the state of the economy compared to prospective GDP data.

Here is the [Atlanta Fed GDP](#) forecast for the third quarter with about 90% of the information in. It predicts a healthy rise of 2.9% in GDP. However, the Blue Chip consensus (economists) puts it at only 1.3% (green arrow). It is unusual for the Atlanta FED's prediction to exceed the maximum prediction of the Blue Chip economists. I wonder if Powell has been influenced by GDPNow. This elevated prediction by the FED seems incongruous when non-official data and surveys show this quarter to be actually weaker than the first half of the year when GDP was officially contracting.

Graph 1.



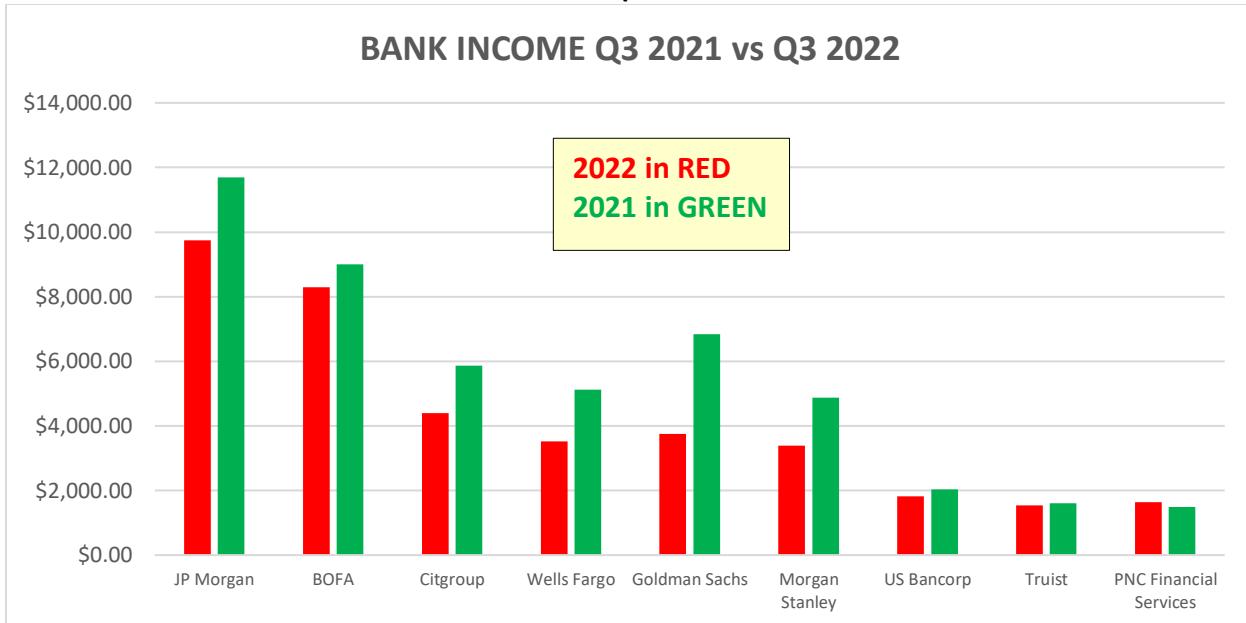
Sources: Blue Chip Economic Indicators and Blue Chip Financial Forecasts

Note: The top (bottom) 10 average forecast is an average of the highest (lowest) 10 forecasts in the Blue Chip survey.

This prediction of GDP growth needs to be tested, and the only test at this early stage of the Q3 corporate reporting season are the major banks. I have aggregated the revenue and gross income data for the top 10 US banks and the results can be found in the accompanying spreadsheet titled 'US BANKS REVENUE & INCOME'. Before proceeding to analyse the actual reported revenues and income it is worth looking at the comments of the various bank CEOs. Both JP Morgan and Wells Fargo declared the finances of individuals and businesses to be in rude health, despite Wells Fargo core business reporting a catastrophic 59% fall in new mortgages YoY. Solomon of Goldman Sachs fame eulogised about his company, saying the results showed the "*strength, breadth and diversification*" of the bank. You would think profits soared rather than crashed 43% YoY. Dimon of JP Morgan who had predicted a hurricane now downrated that to significant headwinds culminating in a recession in 6 – 9 months. The CEO of Citigroup on the other hand were more forthright, she expected a recession in this quarter.

Time to examine the actual revenues and income. In Nominal terms, comparing Q3 2022 with Q3 2021, revenue rose a paltry 3.8%. In real terms using a GDP deflator of 8%, they fell 4.5% despite the rise in interest rates. In terms of income (gross profit) they fell 21.2% in nominal terms and by 29.2% in real terms. This is higher than the figure provided by [FactSet](#) because its estimate uses adjusted profits per share. *“Despite the recent rise in interest rates, this industry is reporting a year-over-year earnings decline of -17.7% for Q3.”* Here are the individual bank results both nominal and real.

Graph 2.



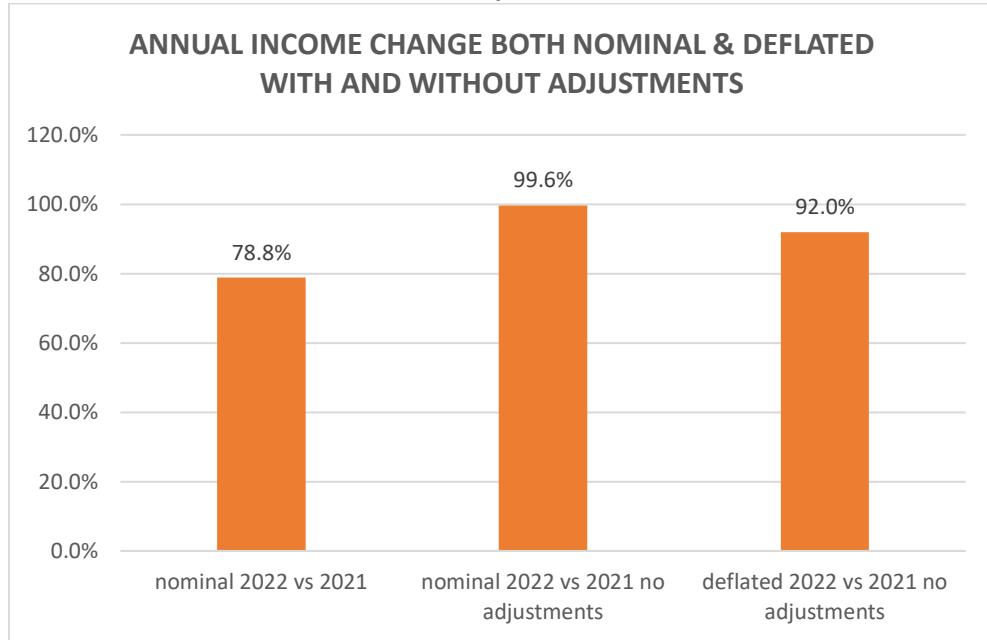
The next two graphs are based on aggregated data. Columns one and three immediately below refer to nominal income. \$48.5 billion in 2022 vs \$38.1 billion in 2021. Now it gets interesting. In column 2, I have added back the increased provisions (adjustments) for bad debts YoY. But even then when we compare it to column 3, it is still lower, and lower still when we adjust for inflation as found in column 4.

Graph 3.



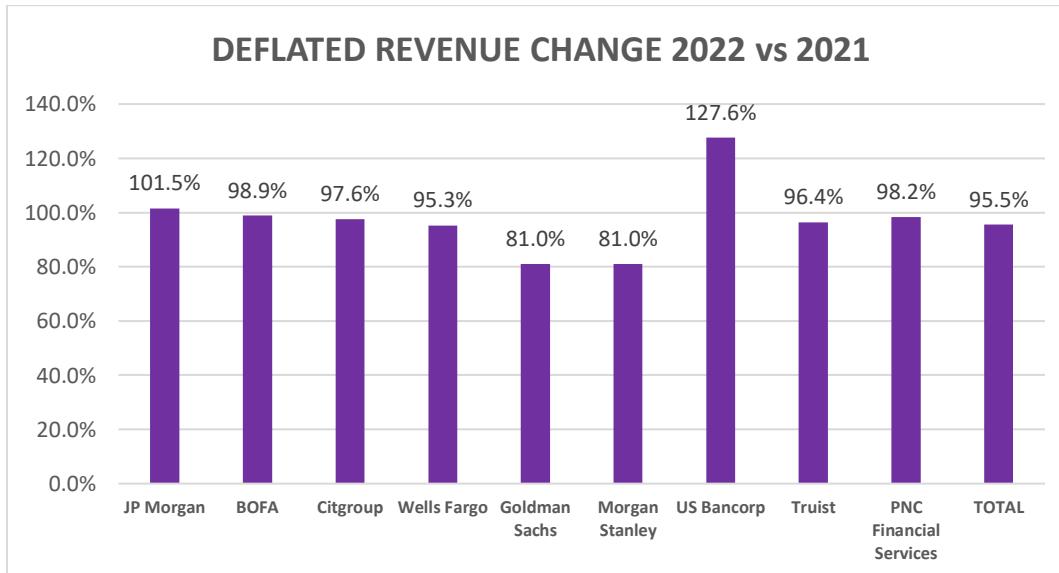
In fact, despite removing the provisions (adjustments) and factoring in inflation, real income for the banks in 2022 was down 8.6%.

Graph 4.



For information purposes I will also provide revenue data for the individual banks. Of the 10 only JP Morgan (barely) and US Bancorp increased their revenues. The aggregate fall was 4.5%

Graph 5.



JP Morgan is an interesting case study. Of all the major banks, it more than any, gains additional revenue by depositing hundreds of billions of dollars with the FED, either in the form of Reverse REPOS or on reserve. This has become a nice earner as the interest rate paid on these risk free do nothing deposits has

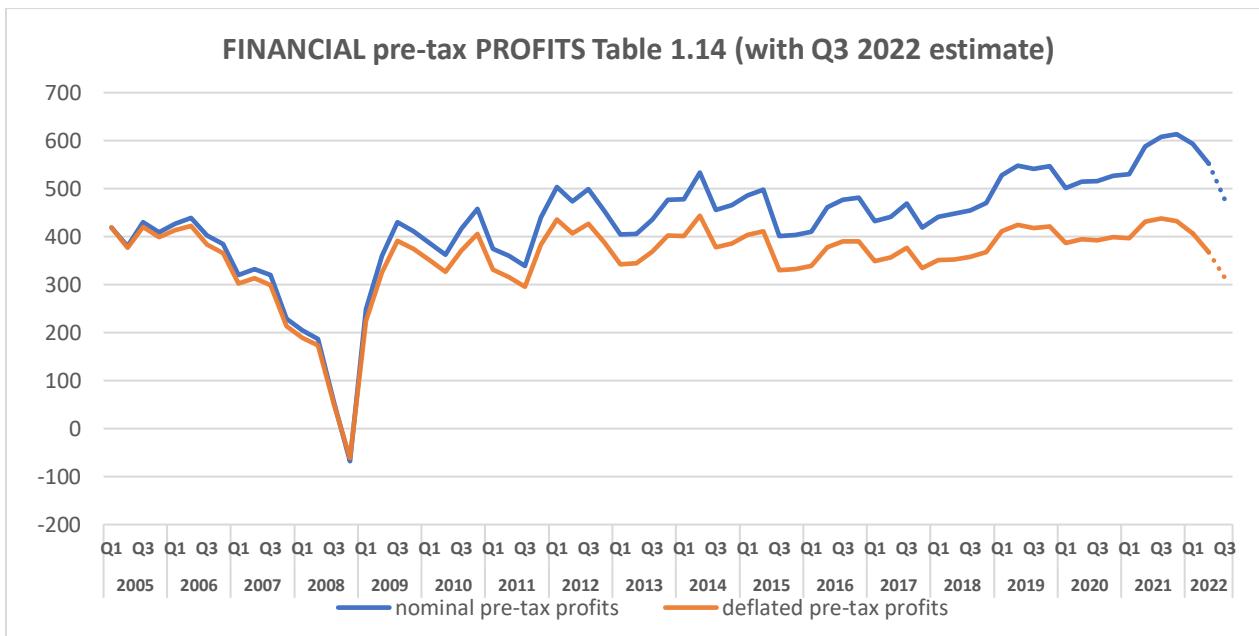
risen to 3.0% and beyond. In fact the FED is likely to have to pay >\$100 billion interest this year on these deposits. I suspect that it is this robust income rather than robust depositors which is supporting banks.

Graph 6. (Overnight Reverse REPO interest rate.)



Time now to look at the more long term picture. Here are the corporate financial pre-tax profits taken from NIPA Table 1.14. They are slightly anomalous because they include non-bank financial profits as well as FED profits. Nonetheless they still provide a stark picture. After reducing nominal profits by 21.2% and real profits by 29.2% the following trends emerge. Nominal profits are below 2019 levels when the economy stalled and real profits have fallen to levels not seen since 2011. This fall of >27% or >35% in real terms since the end of 2021 is the largest fall since the Financial Crash.

Graph 7.



Whirlpool just announced its results. Sales in the USA by the world's biggest white goods manufacturer fell 7.4%. [MARTS](#) (the Excel file) provided by the Census Bureau on retail sales shows a fall for the household appliance sector of only 5.1%, a difference of 2.3% or nearly a third. More importantly taking the PPI Final Demand Index yielding an inflation rate of 9%, the quarterly volume fall for Whirlpool is in the region of 16% YoY. That does not occur in an expanding economy. I will have more to say on the official retail data in a couple of weeks' time when most large retailers have reported Q 3 results.

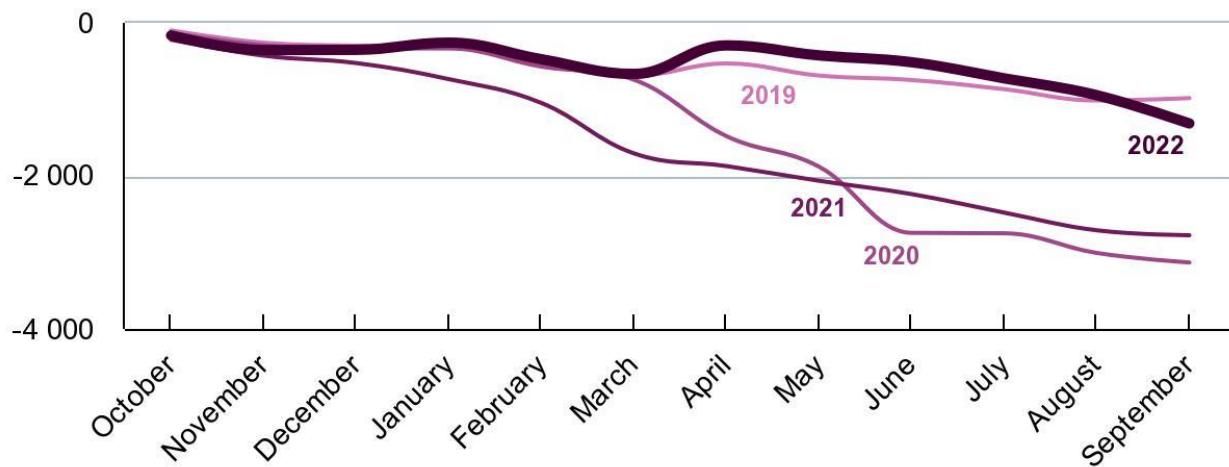
Nor are housing statistics commensurate with an expanding economy. [Housing starts](#) are down 7.4% in the third quarter vs 2021. [New single home sales](#) for the months of July & Aug 2022 are down 13.8% compared to the same two months in 2021. And it gets worse in September. "[Redfin reports](#) about 60,000 deals were called off, equal to 17% of homes that went under contract—the highest share on record aside from March 2020. Home sales and listings in September both slumped the most on record with the exception of the early months of the pandemic as rapidly rising mortgage rates prompted both buyers and sellers to stay put." [KPMG](#) was bolder declaring the housing market was now crashing. Could that be why whispers are resonating in Wall Street that the FED may be about to pause its rate rises.?

Nor is it likely that the economy will be significantly supported by rising [government spending](#). The graph below shows a 2022 deficit of \$1,315 billion compared to the just released final deficit figure of \$1,375 billion. The growing recent deficit is due to student debt forgiveness (positive) for the economy and the growing interest bill paid by the government on its debt (negative) as interest rates rise. As a share of GDP the deficit for the year is expected to rise from 4.6% to 5.2% when measured by expected Q3 GDP.

Graph 7.

Figure 1.
Cumulative Monthly Deficits
Fiscal Years 2019 to 2022

Billions of Dollars



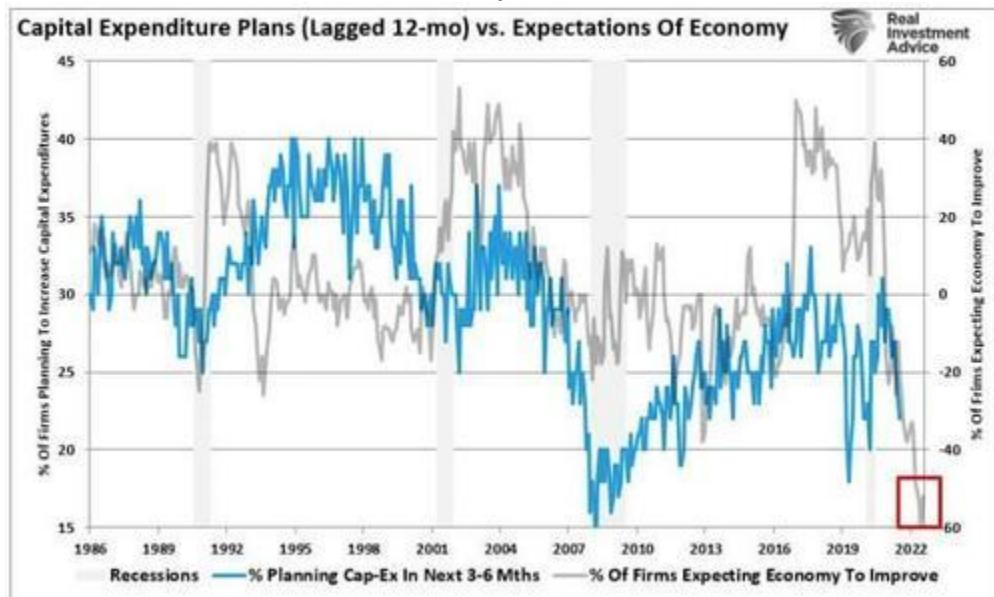
Data Sources: Congressional Budget Office; Department of the Treasury.

The value shown for September 2022 is CBO's estimate.

Values for all months have been adjusted to exclude the effects of timing shifts.

Nor is it likely that capital spending will support the economy. Most companies reporting for the quarter have cut or are planning to cut investment and employment. In fact pessimism about the economy has fallen to levels last seen in the Financial Crash as the graph below shows focusing on smaller businesses. The most recent GDPNow forecast for Q3 investment is -3.3%

Graph 8.



(Source: National Federation of Independent Businesses.)

And finally it is not only workers wages being destroyed by inflation, so too are the gains by the top 1%, the main losers from the nearly \$20 trillion losses in fictitious capital. Funnily though, despite the collapse in capital gains the luxury goods market remains buoyant. Must be all those gains accruing from 2009.

Graph 9.



[FactSet](#) marginally increased its quarterly earnings on Friday. *“If 1.5% is the actual growth rate for the quarter, it will mark the lowest earnings growth rate reported by the index since Q3 2020 (-5.7%). Looking ahead, analysts expect earnings growth of 2.7% for Q4 2022.”* In fact, given the rate of inflation today, in real terms that 1.5% rise in profits when adjusted is similar to the fall of 5.7% in the index two years ago.

Conclusion.

Quarter 3 objectively is the weakest quarter of the year though this will not be revealed by the GDP data to be released on the 27th October. More specifically it was in September that the pace of contraction noticeably quickened, meaning this quarter is likely to be weaker than even the third quarter. The Conference Board’s index of leading indicators fell 0.4% in September continuing the 6 month downward trend. The [NY FED](#) weekly survey showed retail sales continuing to fall in October. The Empire State Manufacturing Index for September fell 9.1% instead of the expected -2.5% while the more important Philadelphia Index fell by 8.7% instead of the expected -5.0%. This did not stop the FED Beige book, its bible, declaring that conditions were stable.

In summation, the banking results for the third quarter only occur during recessionary conditions.

Brian Green, 22nd October 2022.