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MARKETS

Big Banks Find Sweet Spot in Higher Rates

Rising interest rates from the Federal Reserve have aided the profitability of bank lending units

A Washington, D.C., branch of JPMorgan Chase, whose lending business helped the bank report higher earnings Tuesday.
PHOTO: KEVIN WOLF/ASSOCIATED PRESS

By Peter Rudegeair and Emily Glazer

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America's banks are loving higher interest rates.

Rising rates lifted lending revenue for JPMorgan Chase JPM **0.73%** ▲ & Co. and Wells Fargo WFC **-1.55%** ▼ & Co. in the fourth quarter, the banks said Tuesday.

Higher rates mean banks can charge more for loans. In theory, they also have to pay more to depositors. But in practice, banks have been quicker to raise rates for borrowers than pay more to customers for their deposits.

Many of those customers seem content, at least for now, to leave cash in low-yielding accounts instead of moving it elsewhere for higher returns. In effect, they are leaving money on the table that translates into bigger bank profits.

JPMorgan's net interest income—the gap between what it earns on loans and what it pays on deposits—rose 10% in the fourth quarter to $14.4 billion. That helped push overall net income up by two-thirds to $7.07 billion. The bank's profit in the fourth quarter of 2017 was hurt by accounting charges related to that year's tax overhaul.

Wells Fargo enjoyed a 3% boost to net interest income, but profit fell 1.4% to $6.06 billion due to weak consumer results, especially in its key mortgage business.

So far, many big banks have held off raising their deposit rates too much, even though the Federal Reserve raised short-term interest rates four times last year. The average yield on savings accounts has held steady at 0.09% since January 2018 while average credit-card rates have gone up 1.09 percentage point to 17.41%, according to Bankrate.com.

Markets have been on edge in recent weeks after investors revised their outlook around global economic growth, the pace of future Fed rate increases and the effect of the partial U.S. government shutdown on the economy. That change in sentiment has weighed on bank stocks: Over the past three months, the KBW Nasdaq Bank Index is down 7%, more than the decline in the S&P 500 index in that same span.

But bank executives said Tuesday that despite the market turbulence, underlying business performance and economic trends remain favorable.

"There's nothing we see in the data…that suggests the economy is rolling over or a recession is imminent," said Jason Ware, chief investment officer of Albion Financial Group, which owns around 137,000 shares in JPMorgan. "That's underpinned by a healthy consumer, still-low interest rates, rising confidence and a healthy jobs market."

Improved lending revenues helped offset an end-of-year slowdown in banks' trading businesses, where bouts of volatility prompted many Wall Street clients to step back from the markets and sapped one of banks' biggest sources of fees. A tepid period of new bond issuance helped keep investment-banking fees roughly flat with a year earlier.

Banks' consumer units were the biggest beneficiaries of higher lending income. JPMorgan profit in that unit was $4.03 billion in the fourth quarter, up 53% from $2.63 billion in the year-earlier period, driven largely by better margins and an increase in credit-card balances.

At Citigroup Inc., which reported earnings on Monday, net interest revenue from the bank's U.S. branded-card business rose 6% from a year earlier to $2 billion in the fourth quarter.

Meanwhile, the rates banks paid out on deposits, while rising, lagged behind the uptick in loan yields. At JPMorgan, the average interest rate on its loan book in the fourth quarter rose 0.59 percentage point to 5.26% while the average rate on its interest-bearing deposits increased 0.37 percentage point to 0.72%.

Banks saw weakness in mortgage lending, where rate increases are felt most acutely as borrowers refrain from refinancing their home loans when interest costs rise. JPMorgan said that mortgage volume fell 30% in the fourth quarter, which contributed to mortgage revenue declining 8% to $1.32 billion. Wells Fargo's mortgage volume fell by a similar percentage in the fourth quarter and refinancing activity fell by more than 50%.

Smaller banks also reported similar results. Shares of First Republic Bank had a record rise of 12% Tuesday, according to Dow Jones Market Data, after the bank reported earnings and net interest income that beat analysts' estimates. The bank's net interest margin, which measures how profitably it can lend out depositors' funds, was higher than its own expected range.

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A number of factors could alter the trajectory for the U.S. economy and interest rates. Investors are betting that there is a high chance that the Fed either keeps rates stagnant or cuts them by the end of the year. And JPMorgan CEO James Dimon said on a conference call with reporters that if the government shutdown lasts through the first three months of 2019, that could send U.S. economic growth to zero.

Mr. Dimon urged analysts to look at the underlying reasons behind any interest-rate move to determine how it would affect big banks.

"The why is equally if not more important than the what," said Mr. Dimon. "If it is a pause because you are going to go to recession [and] you're going to reduced rates, that obviously is very different than it's a pause, economy strong and they raise rates."

Corrections & Amplifications

Lending revenue rose at Wells Fargo & Co. in the fourth quarter but its total revenue fell. An earlier version of this article incorrectly said revenue rose at the bank. (Jan. 15, 2019)

—Telis Demos and Allison Prang contributed to this article.

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