Rodney's Take

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Jamie Dimon to Chair Powell, 'You Complete Me'

JPMorgan Chase Chairman and CEO Jamie Dimon has been sour on the economy for some time. He expects things to get ugly in the near future and is positioning the banking giant to withstand the downturn. In the latest JPMorgan earnings report, after noting that lending was doing okay but trading and underwriting had suffered, the company informed investors that it had suspended stock buybacks to further build its cash position against the calamities ahead. That makes sense, but does Dimon really need to worry about business? After all, Chair Powell and the other bankers at the Federal Reserve have his back. It's all about printed money.

When the Fed started printing gobs of cash in 2009, everyone worried about those new dollars entering the economy and creating runaway inflation, but the Fed had a plan. The central bank used its newfound power to pay interest on excess reserves (IOER, now just interest on reserve balances, IORB) to convince banks to hold the extra deposits, because they'd earn a bit of money on the cash as long as it was on deposit with the Fed. The banks didn't have to convert the deposits into loans to consumers or businesses and didn't have to lend it to other banks. They just had to sit on it. When the federal funds rate was at 0.00% to 0.25%, this wasn't much of an issue. Banks would pay depositors 0.01%, and then collect around 0.25% from the Fed.

Today, banks have more than $3 trillion on deposit at the Fed, where they are earning about 1.65%, and yet they are still paying depositors 0.01%. JPMorgan Chase issued a new rate sheet as of Friday, July 15, which shows that the bank pays basic savers 0.01%. Super-special-relationship clients who deposit more than $1 million are paid a bit more, 0.02%. It's hard to hold back the excitement.

Banks are earning net interest margin (NIM) of more than 1.5% for doing nothing, and they're about to earn more. When the Fed raises rates at the end of the month to at least 2.25% and possibly to 2.50%, banks with money on deposit at the Fed immediately will earn more interest, even though they likely won't raise the amount of interest they pay their customers for deposits. Even if the banks do increase what they pay customers, the jump won't match the increase they get from the Fed. This probably is the reason that the JPMorgan earnings report also included a forecast for higher NIM in the months ahead. Go figure.

The Fed doesn't have much choice. If the central bank wants to keep the extra trillions of dollars from entering the economy, where that money potentially will cause even more inflation than we have today, then it must pay banks a pretty penny to hold the money. But by doing so, the Fed crowds out consumers. By printing all of that money, much of which now sits on the books of banks as deposits, the Fed has made consumer deposits inconsequential at the margin. The banks don't need our next dollar on deposit because they have so much extra cash sloshing around, so they have no reason to pay us competitive deposit interest rates.

This also weakens the link between higher rates and inflation busting. As I recently wrote, part of the way the Fed fights inflation is by encouraging people to save, which happens only when we get paid more to keep our money in the bank. The Fed accomplishes this by raising the federal funds rate, which banks pass on to clients to attract deposits. Since banks don't need our money today, they aren't passing on the extra interest, so we have no motivation to save money in accounts where inflation will erode its value.

With inflation topping 9%, it might feel a bit frustrating to receive only 0.01%—or 0.02% if you're special—on deposits at banks like JPMorgan Chase that are raking in the dough from the Fed. But you can take solace in the fact that the Fed is making sure that banks stay healthy by earning hefty profits, which they regularly share within their ranks through bonuses, even if they don’t share the money with clients.

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Got a question or comment? You can contact us at info@hsdent.com.