Following up on our **Q4 prediction piece**, earnings from the largest banks fell in the fourth quarter, as revenue growth failed to outstrip the increases in loss provisioning and expenses. Investors were disappointed in the weaker-than-expected results, with a decline in non-interest revenue of particular concern. Market reaction was negative, with share prices falling on the news.

Aggregate earnings for the four banks fell by 10.6% from the fourth quarter of 2021. Earnings in Q4 2021 had been boosted by pandemic-driven impacts, most notably negative loss provisioning and an increase in non-interest revenue. Expenses were up in Q4 2022, further depressing the year-on-year comparison.

Total Revenues for the Four Banks Rose by 8.5% from Q4 2021

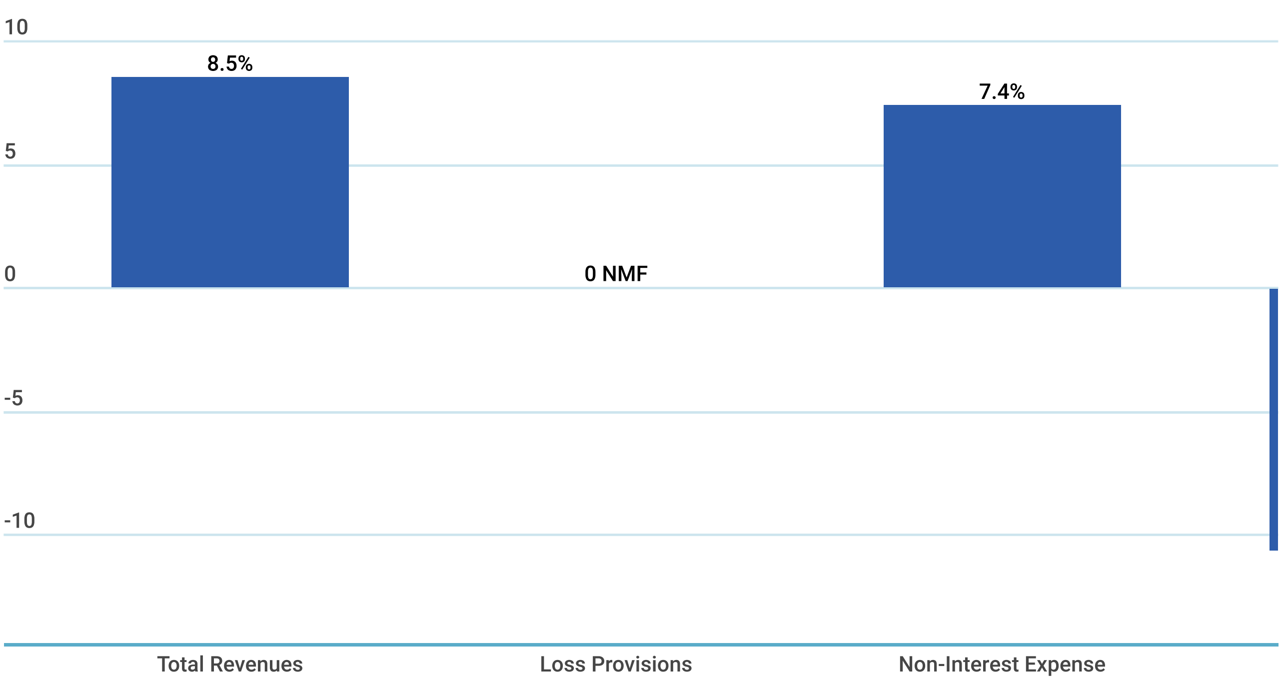
Net interest income jumped by 36.6% from Q4 2021. Higher long-term interest rates and increased loan production are driving the increases (see "Net Interest Margins" below).

Noninterest income was down by 20.2% from Q4 2021. This has been a volatile source of revenues for banks. Investment banking fees suffered in the fourth quarter – debt and equity underwriting shrank – while trading revenues were not as strong. One positive is continued increases in consumer spending have driven credit card fees up.

Loss provisions continued to increase, reflecting increased concerns about consumer loan performance, an area of growth for banks during 2022. More on loss provisions and reserves are below.

Non-interest expenses increased by 7.4% from Q4 2021, as inflation is impacting compensation and other costs. Wells Fargo incurred higher expenses in the quarter which included charges related to a settlement of customer accounts with the CFPB.

Earnings Drivers – Change, Q4 2022 vs. Q4 2021, Four Largest



Source: Company Filings

Share

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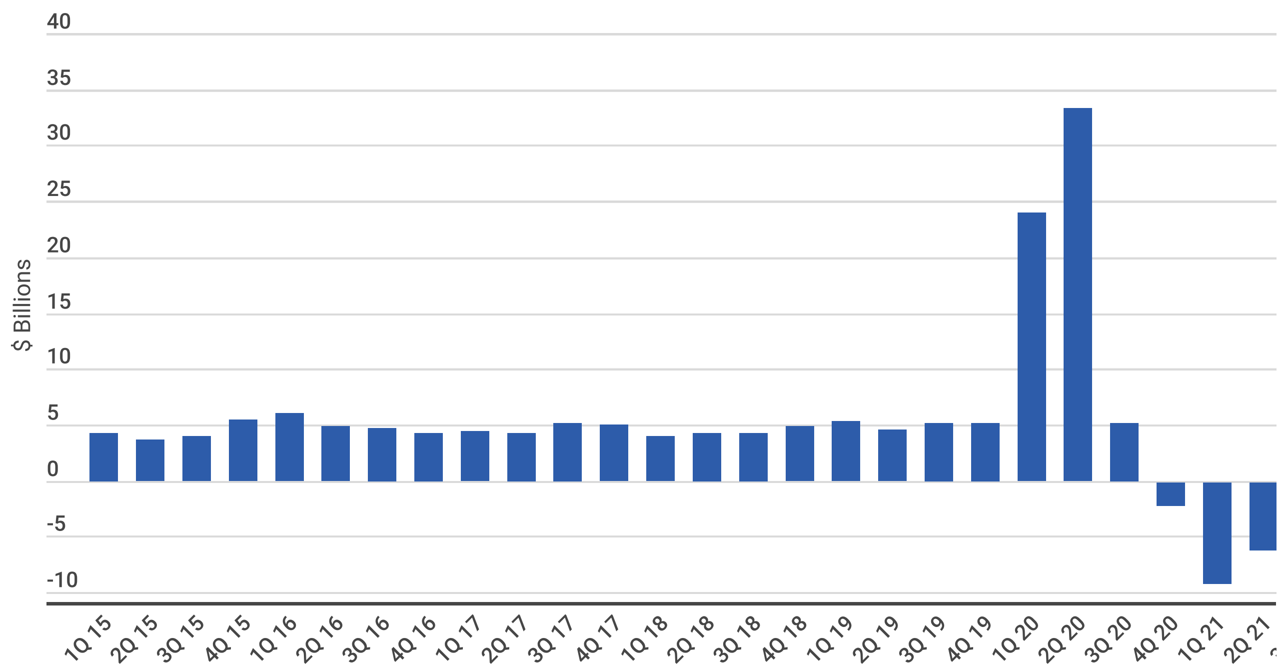
Loss Provisions – Getting Back to Normal

Loss provisioning increased to $6.2 billion in the fourth quarter, up from $4.6 billion in the third quarter and -$2.7 billion in Q4 2021. The recent increases in loss provisioning partly reflect loan growth overall – as the banks need to add to loss reserves as their loan portfolios grow – and partly reflect that consumer credit card borrowing has been the source of some of that loan growth. Credit card delinquency rates have increased with higher interest rates and a slowing economy and appear to be headed higher.

In another sense, the loss provisions in the fourth quarter can be seen as a return to a normal pace. When the pandemic hit in 2020, banks anticipated a surge in defaults and losses, which caused them to boost loss reserves aggressively. But the defaults and losses were much lower than expected, so loss provisioning turned negative, which in turn provided an extra boost to earnings from 4Q 2020 through 4Q 2021. Loss provisions turned slightly positive in Q1 2022 and have been trending upward since then. The $6.2 billion in 4Q 2022 loss provisions is only slightly ahead of the average of $4.7 billion from 2015 to 2019.

Loss Provision-- Quarterly Four Large Banks



Source: Company filings

Share

Net Interest Margins – Back to Pre-Pandemic Levels

Interest margins increased substantially during 2022 and are now at the highest level since before the pandemic hit in 2020.

Despite an inverted yield curve, banks have kept deposit yields low, which has enabled them to reap the benefit of higher interest rates for longer-term lending. **Loan growth** has also been a contributor to the rise in net interest margins. Bank loans outstanding grew by 12% in 2022, after low single-digit **growth rates in 2020 and 2021.**

The recovery in net interest margins during the last year may have largely run its course. Despite rising interest rates, many banks have been able to keep their cost of funds low by holding down the yields they pay on deposits. But those rates have been rising. Also, longer-term interest rate benchmarks have fallen recently, with the 10-year Treasury yield currently about 80 basis points below its recent peak in October. And loan growth may taper off if the economy slows or falls into recession.

Net Interest Margin – Four Large Banks

Source: Company Filings

Share

Looking Ahead – Recession Risk… or Potential for Higher Profits

Although revenues have been supported by the surge in interest income, the lack of investment banking and trading activity has been a drag on non-interest income. A recovery in the stock market seems unlikely in the short term, with the possibility of a **recession looming**. If a recession does take hold, bank earnings will also suffer from higher loss provisioning as default rates rise.

If a recession is avoided, banks will be poised for strong growth. Non-interest revenues would recover and add to the already-strong interest income. Loss provisioning would be low, further boosting profits. And year-on-year comparisons would look good, after the lackluster earnings during 2022.

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