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Banks Reap $56 Billion Interest Income on Zero Borrowing Costs
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By David Henry

Feb. 4 (Bloomberg) -- U.S. banks received a windfall of $56.2 billion over a two-year period as borrowing costs declined to almost zero and interest rates paid to depositors fell to their lowest level since 2003.

The increase in net interest income at Bank of America Corp., Citigroup Inc. and other banks came even as lending revenue, an indicator of loan volume, dropped by 23 percent in the two years ending Sept. 30, 2009, according to data compiled by SNL Financial, a bank-research firm.

Net interest income is the difference between what banks pay to borrow money and what they get back when they lend or invest it, before loan losses or taxes. The increase, reported by Bloomberg BusinessWeek in its Feb. 15 issue, is a hidden subsidy at the expense of consumers, according to Joseph R.
Mason, a finance professor at Louisiana State University in Baton Rouge.

"We are all funding the bailouts, whether we want to or not, both as taxpayers and depositors," Mason said.

The U.S. government spent $320 billion to rescue banks with its Troubled Asset Relief Program, $167 billion of which has been paid back, according to a Jan. 30 report by the TARP special inspector general.

SNL, based in Charlottesville, Virginia, made the calculation at Bloomberg's request by comparing the amount of net interest income earned by the nation's more than 8,000 banks in the 12 months before the credit crisis with what they made after Sept. 30, 2007. Banks saw their cost of money fall after the Federal Reserve began ratcheting down its interest-rate target for overnight loans between banks to zero to 0.25 percent in December 2008 from 5.25 percent in September 2007.

Fed Rate Drop

The drop in Fed rates coincided with a decline in rates banks offered for deposits. The average rate paid to savers fell to 1.55 percent in September 2009 from 4.23 percent in September 2007, according to Market Rates Insight, an Anselmo, California, firm that collects deposit data for banks. The rate dropped to
1.41 percent as of Feb. 1, the lowest level in at least 10 years, as far back as Market Rates has calculated the average.

Even as rates paid to depositors fell, individuals shifted money out of stock and bonds and into banks to get federal protection. Savers deposited an additional $534 billion in government-guaranteed accounts from June 2008 through June 2009, according to the Federal Deposit Insurance Corp., a 7.6 percent increase. Deposit rates dropped a full percentage point during the same period.

'Looking for Safety'

“They were looking for safety,” said Dan Geller, executive vice president of Market Rates Insight.

The rates banks paid to depositors fell further than those banks charged for loans or received on investments. Rates paid on six-month certificates of deposit fell 2.88 percentage points over the two years ending Sept. 30, 2009, more than twice as much as the 1.24 percentage-point decline in 30-year fixed-rate mortgages in the same period, according to Bankrate.com, a financial Web site.

The widened gap between borrowing and lending rates allowed New York-based Citigroup, the third-largest U.S. bank by assets, to take in an estimated $13.7 billion in additional interest income in the two years ending Sept. 30, 2009, according to company reports. That figure includes some Citigroup operations not counted in the SNL numbers.

Jon Diat, a spokesman for Citigroup, declined to comment.

Bank of America

Other big banks provide annual, not quarterly, estimates of the impact of lower borrowing rates. In 2008, the first full year of low rates, Bank of America, based in Charlotte, North Carolina, made an estimated $5.51 billion in additional interest income, according to company filings. New York-based JPMorgan Chase & Co. booked an estimated $6.2 billion in extra interest income, while Wells Fargo & Co. in San Francisco got a $1.01 billion boost.

Figures for 2009 will be disclosed in annual reports due by March 1.

“When rates go down, we benefit from the rate cut, but we do lose revenue from the volume,” said Jerry Dubrowski, a spokesman for Bank of America.

Jennifer Zuccarelli, a spokeswoman for JPMorgan, and Julia Tunis Bernard, a spokeswoman for Wells Fargo, declined to comment.

The additional interest income helps to explain why banks’ stocks have surged even as more of their loans went bad.

‘Making More Money’

“The banks are making more money than they have ever made,” aside from the costs of soured loans, said David Bianco, head of U.S. equity strategy at Bank of America Merrill Lynch Global Research in New York.

Bank stocks have risen more than 150 percent from the low of March 6, 2009, as measured by the 24-member KBW Bank Index.

How long the money continues to roll in could depend on the Fed, said Bianco. After its Jan. 27 meeting, the central bank said it would keep rates low for an “extended period.” Policy makers won’t begin raising rates until the third quarter, according to the median estimate of analysts in a Bloomberg News survey.

“If you really get the Fed on hold all through 2010,” said Bianco, banks could see “explosive earnings growth” this year.

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