What's Behind Those Mysterious Billions in Bank Profits

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These last couple of days, my inbox has been filling up with news alerts announcing glistening second-quarter profits at the banks everyone loves to hate: $3.4 billion at Goldman Sachs, $2.7 billion at JP Morgan, $3.2 billion at BofA.

I like a good economic recovery as much as the next guy, but it seems a little too good to be true, doesn't it? Where's this money coming from? How are the banks doing so swell when they haven't come close to clearing out all the trash inventory that sank them in the first place?

Viral Acharya, a finance professor at the New York University Stern School of Business, has some thoughts:

A large number of banks borrowed government debt in October or November of last year. It basically allowed the banks to borrow at a low fee, so effectively the banks became riskless. Once they got the large capital injections, suddenly the issue of them failing in the short term was gone. The bank earnings now seem a lot rosier. I'm happy for the banks, but I'm cautious in saying that this does not necessarily mean that banks are back to being profitable.

There's more on TARP issues and profit-imitating trading strategies in the rest of Nancy Cook's interview with Acharya. It's an important read.

By Katie Paul