Q2 2023 Earnings Call

Company Participants

- Jamie Dimon, Chairman and Chief Executive Officer
- Jeremy Barnum, Executive Vice President & Chief Financial Officer

Other Participants

- Betsy Graseck
- Charles Peabody
- Ebrahim Poonawala
- Erika Najarian
- Gerard Cassidy
- Glenn Schorr
- James Mitchell
- John McDonald
- Ken Usdin
- Matt O'Connor
- Mike Mayo
- Steven Chubak

Presentation

Operator

Good morning, ladies and gentlemen. Welcome to JPMorgan Chase's Second Quarter 2023 Earnings Call. This call is being recorded. Your line will be muted for the duration of the call. We will now go to the live presentation. Please stand by. At this time, I would like to turn the call over to JPMorgan Chase's Chairman and CEO, Jamie Dimon; and Chief Financial Officer, Jeremy Barnum. Mr.Barnum, please go ahead.

Jeremy Barnum {BIO 15409544 <GO>}

Thanks, operator. Good morning, everyone. Presentation is available on our website, and please refer to the disclaimer in the back. Starting on Page 1, the firm reported net income of $14.5 billion, EPS of $4.75 and revenue of $42.4 billion, and delivered an ROTCE of 25%. These results included the First Republic bargain purchase gain of $2.7 billion, a credit reserve build for the First Republic lending portfolio of $1.2 billion, as well as $900 million of net investment securities losses in corporate. Touching on a few highlights. CCB client investment assets were up 18% year-on-year. We had record long-term inflows in AWM, and we ranked number one in IB fee wallet share. Before giving you more detail on the financials, let me give you a brief update on the status of the First Republic integration on Page 2.

The settlement process with the FDIC is on schedule, the number of key milestones being recently completed. Systems integration is also proceeding at pace and we are targeting being substantially complete by mid-2024. First Republic employees have formally joined us as of July 2 and we're pleased to have had very high acceptance rates on our offers. And although it's still early days, as we get the sales force back in the market, we are happy to see that client retention is strong with about $6 billion of net deposit inflows since the acquisition. Now turning back to this quarter's results on Page 3. You'll see that in various parts of the presentation, we have specifically called out the impact of First Republic where relevant. To make things easier, I'm going to start by discussing the overall impact of First Republic on this quarter's results at the firmwide level. Then for the rest of the presentation, I will generally exclude the impact of First Republic in order to improve comparability with prior periods.

With that in mind, in this quarter, First Republic contributed $4 billion of revenue, $599 million of expense and $2.4 billion of net income. As noted on the first page, this includes $2.7 billion of bargain purchase gain, which is reflected in NIR and in the corporate segment, as well as $1.2 billion of allowance build. And remember that the deal happened on May 1, so the First Republic numbers only represent two months of results. You'll see in the line of business results that we are showing First Republic revenue and allowance in CCB, CB and AWM. And for the purposes of this quarter's results, all of the deposits are in CCB and substantially all of the expenses are in corporate. As the integration continues, some of those items will get allocated across the segments.

Now turning back to firmwide results, excluding First Republic. Revenue of $38.4 billion was up $6.7 billion, or 21% year-on-year. NII ex-markets was up $7.8 billion or 57% driven by higher rates. NIR ex-markets was down $293 million, largely driven by the net investment security losses I mentioned earlier, partially offset by a number of less notable items, primarily in the prior year. And markets revenue was down $772 million or 10% year-on-year. Expenses of $20.2 billion were up $1.5 billion or 8% year-on-year, primarily driven by higher compensation expense, including wage inflation and higher legal expense. And credit costs of $1.7 billion included net charge-offs of $1.4 billion, predominantly in card. The net reserve build included $389 million build in the commercial bank, the $200 million build in card and $243 million release in corporate, all of which I will cover in more detail later.

On to balance sheet and capital on Page 4. We ended the quarter with a CET1 ratio of 13.8%, flat versus the prior quarter as the benefit of net income less distributions was offset by the impact of First Republic. And as you can see in the two charts on the page, we've given you some information about the impact of the transaction on both RWA and CET1 ratio. And as you know, we completed CCAR a couple of weeks ago. Our new indicative SCB is 2.9% versus our current requirements of 4%, and it goes into effect in 4Q '23. The new SCB also reflects the Board's intention to increase the dividend to $1.05 per share in the third quarter.

On liquidity, our bank LCR for the second quarter ended at 129% in line with what we anticipated at Investor Day. About half of the reduction is associated with the First Republic transaction. And while we're on the balance sheet, as we previewed in the 10-K, we will be updating our earnings at risk model to incorporate the impact of deposit repricing lags. So when we release this quarter's 10-Q, you will see the up 100 basis point parallel shift scenario will be about positive $2.5 billion, whereas in the absence of the change, it would have been about negative $1.5 billion. Now, let's go to our businesses starting with CCB on Page 5. Both U.S. consumers and small businesses remain resilient and we haven't observed any meaningful changes to the trends in our data we discussed at Investor Day.

Turning now to the financial results, which I'll speak to excluding the impact of First Republic for CCB, CB and AWM. CCB reported net income of $5 billion on revenue of $16.4 billion was up 31% year-on-year. In Banking & Wealth Management, revenue was up 59% year-on-year, driven by higher NII on higher rates. End-of-period deposits were down 4% quarter-on-quarter, as customers continue to spend down their cash buffers, including for seasonal tax payments and seek higher-yielding products. Client investment assets were up 18% year-on-year, driven by market performance and strong net inflows across our advisor and digital channels. In Home Lending, revenue was down 23% year-on-year, driven by lower NII from tighter loan spreads and lower servicing and production revenue. Originations were up quarter-on-quarter, driven by seasonality, although still down 54% year-on-year.

Moving to Card Services & Auto, revenue was up 5%, largely driven by higher card services NII on higher revolving balances, partially offset by lower auto lease income. Card outstandings were up 18% year-on-year, which was the result of revolve normalization and strong new account growth. And in auto, originations were up $12 billion, up 71% year-on-year as competitors pulled back and inventories continued to slowly recover. Expenses of $8.3 billion were up 8% year-on-year, driven by compensation, predominantly due to wage inflation and headcount growth, as we continue to invest in our front office and technology staffing, as well as marketing.

In terms of credit performance this quarter, our credit costs were $1.5 billion, reflecting a reserve build of $203 million, driven by loan growth and card services. Net charge-offs were $1.3 billion, up $640 million year-on-year, predominantly driven by card, as 30-days-plus delinquencies have returned to pre-pandemic levels, in line with our expectations. Next, the CIB on Page 6. CIB reported net income of $4.1 billion on revenue of $12.5 billion. Investment banking revenue of $1.5 billion was up 11% year-on-year or down 7% excluding bridge book markdowns in the prior year. IB fees were down 6% year-on-year and we ranked number one with year-to-date wallet share of 8.4%.

In Advisory, fees were down 19%. Underwriting fees were down 6% for debt and up 30% for equity with more positive momentum in the last month of the quarter. In terms of the second half outlook, we have seen encouraging signs of activity in capital markets and July should be a good indicator for the remainder of the year. However, year-to-date announced M&A is down significantly, which will be a headwind. Moving to markets. Total revenue was $7 billion, down 10% year-on-year. Fixed income was down 3%. As expected, the macro franchise substantially normalized from last year's elevated levels of volatility and client flows. This was largely offset by improved performance in the securitized products group and credit. Equity markets was down 20% against a very strong prior-year quarter, particularly in derivatives. Payments revenue was $2.5 billion, up 61% year-on-year. Excluding equity investments, it was up 32%, predominantly driven by higher rates, partially offset by lower deposit balances.

Security services revenue of $1.2 billion was up 6% year-on-year, driven by higher rates, partially offset by lower fees. Expenses of $6.9 billion were up 1% year-on-year, driven by higher non-compensation expense, as well as wage inflation and headcount growth largely offset by lower revenue-related compensation. Moving to the Commercial Bank on Page 7. Commercial Banking reported net income of $1.5 billion. Revenue of $3.8 billion was up 42% year-on-year, driven by higher deposit margins. Payments revenue of $2.2 billion was up 79% year-on-year, driven by higher rates. Gross investment banking and markets revenue of $767 million was down 3% year-on-year, primarily driven by fewer large M&A deals. Expenses of $1.3 billion were up 12% year-on-year, predominantly driven by higher compensation expense, including front-office hiring and technology investments, as well as higher volume-related expense.

Average deposits were up 3% quarter-on-quarter, driven by inflows related to new client acquisition, partially offset by continued attrition in nonoperating deposits. Loans were up 2% quarter-on-quarter. C&I loans were up 2%, reflecting stabilization in new loan demand and revolver utilization in the current economic environment, as well as pockets of growth in areas where we are investing. CRE loans were also up 1%, reflecting funding on prior-year originations for construction loans and real estate banking, as well as increased affordable housing activity. Finally, credit costs were $489 million. Net charge-offs were $100 million, including $82 million in the office real estate portfolio, and the net reserve build $389 million was driven by updates to certain assumptions related to the office real estate market, as well as net downgrade activity in middle market banking. Then to complete our lines of business, AWM on Page 8.

Asset & Wealth Management reported a net income of $1.1 billion, with pretax margin of 32%. Revenue of $4.6 billion was up 8% year-on-year, driven by higher deposit margins on lower balances and higher management fees on strong net inflows. Expenses of $3.2 billion were up 8% year-on-year, driven by higher compensation, including growth in our private banking advisor teams, higher revenue-related compensation and the impact of global shares and JPMorgan Asset Management China, both of which closed within the last year. For the quarter, record net long-term inflows were $61 billion, positive across all channels, regions and asset classes, led by fixed income and equities. And in liquidity, we saw net inflows of $60 billion. AUM of $3.2 trillion was up 16% year-on-year, and overall client assets of $4.6 trillion were up 20% year-on-year, driven by continued net inflows, higher market levels, and the impact of the acquisition of Global Shares. And finally, loans were down 1% quarter-on-quarter, driven by lower securities-based lending, and deposits were down 6%.

Turning to corporate on Page 9. As I noted up front, we are reporting the First Republic bargain purchase gain and substantially all of the expenses in corporate. Excluding those items, corporate reported net income of $339 million. Revenue was $985 million, up $905 million compared to last year. NII was $1.8 billion, up $1.4 billion year-on-year due to the impact of higher rates. NIR was a net loss of $782 million and included the net investment securities losses I mentioned upfront. Expenses of $590 million were up $384 million year-on-year, largely driven by higher legal expense. And credit costs were a net benefit of $243 million, reflecting a reserve release as the deposit placed with First Republic in the first quarter was eliminated in this report.

Next, the outlook on Page 10. We now expect 2023 NII and NII ex-markets to be approximately $87 billion, the increase driven by higher rates coupled with slower deposit reprice than previously assumed across both consumer and wholesale. And I should take the opportunity to remind you once again that significant sources of uncertainty remain and we do expect the NII run rate to be substantially below this quarter's run rate at some point in the future competition for deposits plays out. Our expense outlook for 2023 remains approximately $84.5 billion, and on credit, we continue to expect the 2023 card net charge-off rate to be approximately 2.6%.

So to wrap up, we are proud of the exceptionally strong operating results this quarter. As we look forward, we remain focused on the significant uncertainties relating to the economic outlook, competition for deposits, and the impact on capital from the pending finalization of the Basel III rules. Nonetheless, despite the likely headwinds ahead, we remain optimistic about the company's ability to continue delivering excellent performance through a range of scenarios.

With that, operator, please open the line for Q&A.

Questions And Answers

Operator

(Question And Answer)

Please stand by. The first question is coming from the line of Jim Mitchell from Seaport Global Securities. You may proceed.

Q - James Mitchell {BIO 1972127 <GO>}

Thanks. Good morning. Hey, Jeremy, you talked about NII guidance up. Clearly, Fed funds futures are up, so it makes some sense. But maybe, I guess, first, could you kind of discuss, I guess, comment on deposit behavior broadly around betas and mix, and what you're seeing there, so far seems to be coming in a little better expected? And then secondly and probably more importantly, can you help us think about the implications of higher for longer rates on the outlook for NII next year and beyond, I guess, the intermediate term outlook that you guys have talked about?

A - Jeremy Barnum {BIO 15409544 <GO>}

Yes, sure. Thanks, Jim. So, yes, so when we talk about the drivers of the upward revision, as I said, its higher rates coupled with lower deposit reprice, hard to untangle the two drivers. And specifically, I think, when you look at consumer, the combination of the passage of time and the positive feedback we're getting from the field on the CD offerings in particular has meant that it's quite a kind of stable environment from that perspective, and similarly, in wholesale, we're just seeing slower internal migrations. You asked about mix. I think that, obviously, we're seeing CD mix increase, and we would continue to expect -- we would continue to -- we would expect that to continue to take place, probably even past the peak of the rate cycle into next year as we continue to capture money in motion.

But as you say, the most important point is the fact that, as I said earlier, we don't consider this level of NII generation to be sustainable, and we talked previously about a sort of medium-term run rate in the mid-70s. That was before First Republic and you could argue that maybe that number should be a little higher, but whatever it is, it's a lot lower than the current number. We don't know when that's going to happen. We're not going to predict the exact moment. That's going to be a function of competitive dynamics in the marketplace, but we want to be clear that we do expect it at some point.

Q - James Mitchell {BIO 1972127 <GO>}

Okay. But I guess just one follow-up on that just if we don't get rate cuts until middle of next year or later, does that sort of give some confidence to the outlook for next year? Or are you still worried about significant reprice?

A - Jeremy Barnum {BIO 15409544 <GO>}

I wouldn't necessarily assume that the evolution from the current run rate into that mid-70s number is that sensitive to the rate outlook in particular. When we put that number out there, we looked at a range of different types of rate environments and the reprice that we think would be associated with that, and it was really meant to capture more of what we consider to be a through-the-cycle sustainable number. So I wouldn't think of it as being particularly rate dependent.

Q - James Mitchell {BIO 1972127 <GO>}

Okay. Great. Thanks.

Operator

Next we'll go to the line of Erika Najarian from UBS. You may proceed.

Q - Erika Najarian {BIO 17048573 <GO>}

Hi. Good morning. Jeremy, and I'm just laughing to myself because I said to you at Investor Day, do you have any more NII rabbits to pull out of the hat and I guess you do. So I guess I want to ask a broader question really here, and maybe, Jamie, I'd like to get your thoughts. So you earned 23% ROTCE and 13.8% CET1. And we hear you loud and clear that your more normalized NII generation is not $87 billion. That being said and fully taking into account the potential haircut from Basel III endgame, is it possible that your natural ROTCE is maybe above that 17% through-the-cycle rate when rates aren't zero? Because when you first introduced that ROTCE target, we were in a different world from a rate scenario, and everybody's talking about even if the Fed cuts, the natural sort of bottom in Fed funds is not going to be zero. So any input on that would be great.

A - Jeremy Barnum {BIO 15409544 <GO>}

Yes. Thanks, Erika. I mean, it's a good question. There's a lot in there, obviously. I guess I would start by saying that when we've talked about the 17% through-the-cycle ROTCE, even though we may have introduced that in a moment where we brought the lower eurobond, it was always premised on a sort of normalized rate environment. And at some level, that remains true today. Furthermore, you didn't ask this explicitly, but in the context of the proposed Basel III endgame, one relevant question might be, if you have a lot more capital in the denominator, what happens to that target? So I think, as I said in my prepared remarks, we feel very confident about the company's ability to produce excellent returns in the cycle. There's a lot of moving parts right now in that. Some of them could be good, some of them could be bad.

Narrowly on the capital one, the one thing to point out is that the straight-up math of simply diluting down the ROTCE by expanding the denominator misses the possibility of reprice -- repricing of products and services, which of course goes back to our point that these capital increases do have impacts on the real economy. So we're not suggesting that we can price our way out of it, but we obviously need to get the right returns on products and services, and where we have pricing power, we will adjust to the higher capital. So a lot of moving parts in there, but I think the important point is that through a range of scenarios, we feel good about our ability to deliver good results and we'll see how the mix of all the various factors plays out, especially after we see the Basel III proposal and it goes through the common period.

A - Jamie Dimon {BIO 1484062 <GO>}

And Erika, I would say one thing, we have a mix of businesses that earn from like 0% ROTCE to 100%. We have some which are very capital intensive, so we look at kind of all of them, and I think 17 is a good number and a good target. The other thing we're always earning on is credit. We've been over-earning on credit for a substantial amount of time now, we're quite conscious about it. We know that's going to tick up just as it normalizes, it'd be considerably more than it is now. But we would consider credit card normalize to be close to 3.5%.

Q - Erika Najarian {BIO 17048573 <GO>}

And so my follow-up question there may be, Jeremy, could you remind us what unemployment rate is embedded in your ACL ratio as of the second quarter?

A - Jeremy Barnum {BIO 15409544 <GO>}

Yes, it's still 5.8%.

Q - Erika Najarian {BIO 17048573 <GO>}

Thank you.

Operator

Next, we'll go to the line of John McDonald from Autonomous Research. You may proceed.

Q - John McDonald {BIO 1972557 <GO>}

Hi. Good morning. Jeremy, wanted to ask about capital in the wake of the Barr speech. We don't have the details yet, but just kind of wanted to ask about options that you have and strategies for mitigation, both on RWA and potentially on the GSIB front as well as you contemplate what you heard recently.

A - Jeremy Barnum {BIO 15409544 <GO>}

Yes. Thanks, John. So obviously, we're thinking about that a lot. On the other hand, as much as there have been a lot of very detailed rumors out there that might lead you to start to try to do some planning. It does seem like this time it's real and we are actually going to get a proposal sooner or later sometime this month or something. So soon enough, we'll get to see something actually on paper and we can stop kind of the guesswork. Having said that, indulging in a little bit of guesswork, it does seem like the biggest single driver of the increase that people are talking about, including Chair Powell's 20% number or Vice Chair Barr's 2% of RWA, which ends up being roughly the same is just the way operational risk is getting introduced into the standardized pillar and that is a little bit of a straight up across-the-board tax on everything.

It's kind of hard to optimize your way out of that with the exception obviously of the fact that you can simply increase price, assuming you have pricing power, but that's obviously not what we want and that's what we sort of mean by impacts on the real economy. So there are details, there's a lot of the FRTB stuff. We can get way into the weeds there within the markets business, and we do have a good track record of adjusting and optimizing, but this time around it may be a more fundamental set of questions around business mix as opposed to the ability to sort of optimize in a very technical way.

Q - John McDonald {BIO 1972557 <GO>}

Okay. That's helpful. And with a number of years for this to phase in and you generating capital at a high level, even if the ROTCE comes down a bit, how should we think about your pace of building capital for these new changes versus doing your everyday course of investing and buybacks and things like that over the next couple of years?

A - Jeremy Barnum {BIO 15409544 <GO>}

Yes. I mean, I guess, I'm sort of tempted to give you our standard capital hierarchy here. I mean we're not going to stack investments, right? That won't come as a surprise to you. Generally speaking, we're always going to try to comply with new requirements early. So when we know the requirements and when we have visibility, obviously given how much organic capital we're generating right now, whatever the answer winds up being, it'll be pretty easy to comply, narrowly speaking, but that's not the same saying that there won't be consequences to returns or to pricing. And if for whatever reason things aren't exactly as we're anticipating, I don't see us sacrificing investments that we see as strategically critical in order to comply with higher capital requirements ahead of the formal timing or whatever.

Q - John McDonald {BIO 1972557 <GO>}

Okay. And there's some room for buyback?

A - Jeremy Barnum {BIO 15409544 <GO>}

Unlikely, obviously. That would be an unlikely outcome.

Q - John McDonald {BIO 1972557 <GO>}

Okay. Thank you.

A - Jeremy Barnum {BIO 15409544 <GO>}

Sorry, John. Go ahead. Did you have a follow-up?

Q - John McDonald {BIO 1972557 <GO>}

Yes. No, just do buybacks play a role in the next couple of years strategically, just episodically buyback?

A - Jeremy Barnum {BIO 15409544 <GO>}

I mean, capital hierarchy again, right? In the end, when we have nothing else to do with the money, we'll do buybacks. And we've talked about the $12 billion for this year. Obviously, a lot of new moving parts there, although all else equal given what we've done so far, that's still probably a reasonable number for the full year. But yes, that's always going to be at the end of the list. But yes.

Q - John McDonald {BIO 1972557 <GO>}

Got it. Okay. Thank you.

Operator

Next, we'll go to the line of Ken Usdin from Jefferies. You may proceed.

Q - Ken Usdin {BIO 3363625 <GO>}

Thanks. Good morning. I just wanted to ask a little bit about how you're feeling about the trade-off between like the commercial economy and what might come through in terms of future loan growth versus the kind of green shoots that people are talking about in the investment banking pipeline? And just how it feels in terms of like reopening of markets and the trade-off between getting some more of those fees in and versus what's happening on the loan demand side? Thanks.

A - Jeremy Barnum {BIO 15409544 <GO>}

Sure. Good question, Ken. So I think in terms of investment banking and markets, yes, some slightly better than expected last month, a lot of talk about green shoots, especially in capital markets generally, still definitely some headwinds in M&A, lower announced activity, some regulatory headwinds there. So we'll see. I think it's a little too early to call a trend there based on recent results, but we'll see.

In terms of the broader economy and loan growth expectations, generally we do still expect reasonably robust card loan growth. But away from that for a variety of different reasons and different products, whether it be mortgage or C&I after revolver normalization, and especially if we see a little bit of a cooling off of the economy, I would expect loan demand to be relatively modest there, so we're not really expecting meaningful growth away from card. But of course, we're there for the right deals, right products, right terms we lend through-the-cycle. So I see that as more of a demand-driven narrative, which will be a function of the economy rather than any tightening on our side.

Q - Ken Usdin {BIO 3363625 <GO>}

That makes sense. And as a follow-up to that, on the consumer side, you mentioned that consumers continue to spend albeit a little more slowly, and you mentioned that consumers are also using their excess deposits a little bit more as well. Can you just elaborate a little bit more on just your feeling about the state of the consumer? And is that card growth continued to be driven by people needing to revolve as opposed to wanting to have more in their deposits? Just kind of what the trade-off on that side, too?

A - Jeremy Barnum {BIO 15409544 <GO>}

Yes. I mean, to us, I think we still see this as a normalization, not deterioration story when we talk about consumer credit. Actually, revolve per account has still not gotten to pre-pandemic levels actually. So I would definitely say that it's a wanting rather than needing, at least for our portfolio at this point. And yes, I think the consumer continues to surprise on the upside here.

Q - Ken Usdin {BIO 3363625 <GO>}

Got it. Okay. Thank you.

Operator

Next, we'll go to the line of Gerard Cassidy from RBC Capital Markets. Please go ahead.

Q - Gerard Cassidy {BIO 1505265 <GO>}

Good morning, Jeremy. Good morning, Jamie. Jeremy, can you give us your view on how you're measuring the treasury functions and the asset liability of your balance sheet as we go forward versus the way you guys were positioning and managing it a year ago in view of the fact that it looks like maybe we're approaching the terminal rate on Fed funds rates?

A - Jeremy Barnum {BIO 15409544 <GO>}

Yes. Gerard, I would say, honestly, not much change there, actually. We've been pretty consistently concerned about the risk of higher rates. Of course, we always try to position things to produce reasonable outcomes across a broad range of scenarios. But at the margin, we've been biased towards higher rates, and that may be a little less true at these levels than it was before, although a lot of that is just the consequence of positive convexity playing out in the modeling.

But in any case, all else equal, I think we are going to continue to focus on making sure we're fine in a higher rate scenario, while staying balanced across a range of scenarios. So not really a lot of change in our positioning, and that's obviously including the fact that we took on First Republic, which even that of some of the liabilities had a long structural interest rate position, we did not actually want to get longer as part of the deal. And so as a result, we took actions to ensure that net-net, we were still about the same as we were last quarter.

Q - Gerard Cassidy {BIO 1505265 <GO>}

Very good. And then as a follow-up, you mentioned in giving us the read through on the Commercial Banking segment of the business that you had some reserve building tied to some office real estate and also some downgrades in the middle market area. Can you go a little deeper? What are you guys seeing in this area of both commercial real estate, but also the C&I loans, what's happening in that segment as well?

A - Jeremy Barnum {BIO 15409544 <GO>}

Yes. So I would caution you from drawing too broad a conclusion from this. I mean, I think that when we talk about office, for example, our portfolio as you know is quite small and our exposure to sort of so-called urban-dense office is even smaller. The vast majority of our overall portfolio is multi-family lending. And so as a result, like our sample size of observed valuations on office properties is quite small. But we'd like to be sort of ahead of the cycle, and based on everything that we saw this quarter, it just felt reasonable to build a little bit there to get to what felt like a comfortable coverage ratio. Across the rest of the -- yes, in the middle market segment, we saw downgrades and excessive upgrades, but I don't see that as sort of necessarily indicative of anything terribly significant in the broader read across.

Q - Gerard Cassidy {BIO 1505265 <GO>}

Thank you.

Operator

Next we'll go to the line of Steve Chubak from Wolfe Research. Please go ahead.

A - Jamie Dimon {BIO 1484062 <GO>}

Steve, are you there?

Operator

It looks like his line dropped. So next we'll go to the line of Ebrahim Poonawala from Bank of America. You may proceed.

Q - Ebrahim Poonawala {BIO 17612305 <GO>}

Good morning. I guess just first question following up on the outlook for the economy, like we've all been worried about a recession for a year and there's a debate about the lagged effects of the Fed rate hike cycle. When you think about, Jeremy, I think you mentioned your unemployment outlook relatively similar today versus a quarter ago. How worried should we be in terms of the credit cycle 6 to 12 months from now? Or are you leaning towards concluding that maybe U.S. businesses, consumers have absorbed the rate cycle a lot better than we expected a year ago?

A - Jeremy Barnum {BIO 15409544 <GO>}

Yes, so I mean I'm sure Jamie has some views here, but in my view, I would just caution against jumping to too many super positive conclusions based on a couple of recent trends. And I think generally, our point is less about trying to predict a particular outcome and more about trying to make sure that we don't get too much euphoria that over-concentrates people on one particular prediction when we know that there's a range of outcomes out there. So obviously, people are talking a lot about the potential for soft lending right now, no lending, immaculate disinflation or whatever. And whether our own views on that have changed meaningfully, I don't know. But the broader point is that we continue to be quite focused on Jamie's prior comments that loss rates still have time too -- have room to normalize even post-pandemic, so we're probably over-earning on credit a little bit.

Obviously, we've talked about the expectation that the NII is going to come down quite a bit. So even forgetting about whether you got some surprisingly negative outcomes on the economy from where we stand today, even in the central case you just need to recognize that there should be some significant normalization.

A - Jamie Dimon {BIO 1484062 <GO>}

Yes, and I would just add, the 5.8% is not our prediction. That is the average of the unemployment under multiple scenarios that we have to use, which are hypothetical for CECL. If the asset prediction is going to look something different and we don't know the outcome, we're trying to be really clear here. The consumer's in good shape. They're spending down their excess cash. That's all tailwinds. Even if we go into a recession, they're going in with rather good conditions, low borrowings and good house price value still. But the headwinds are substantial and somewhat unprecedented. This war in Ukraine, oil and gas, quantitative tightening, unprecedented fiscal needs of governments, QT, which we've never experienced before. I just think people should take a deep breath in that. And we don't know what those things are going to put us in a soft lending, a mild recession or a hard recession. And obviously, we should all hope for the best.

Q - Ebrahim Poonawala {BIO 17612305 <GO>}

Got it. And just to follow up on the upcoming Basel reforms, two questions. You've talked about the impact to the U.S. economy, like others have said the same. At this point, is that falling on deaf ears? And secondly, maybe Jeremy, if you can touch upon just structural changes that you expect to make in the capital markets business because of FRTB. Thank you.

A - Jeremy Barnum {BIO 15409544 <GO>}

Yes. So, on your first point, I mean I think you can just read Vice Chair Barr's speech, right? He addressed that point fairly directly. He clearly doesn't agree, as is his right. So we'll see what happens. We continue to feel that all else equal, higher capital requirements definitely are going to increase the cost of credit, which is bad for the economy. So we'll see what happens on that.

On FRTB, it's really very nuanced. It's probably like too much detail for this call, to be honest. But just to give you like one immaterial and insignificant, but useful example, one product under FRTB is yield curve spread options. And if the FRTB proposal goes through as currently written, that product just becomes not viable. So obviously, if we need to stop doing that product, no one really cares. But it's just one example of the way sometimes when you're really disciplined about allocating capital thoroughly all the way down to individual products and responding accordingly, you can wind up having to change your business mix.

There are obviously more significant products that matter much more for the real economy, like mortgage where the layering on of the operational risk and the way it's being proposed, especially if some of the other beneficial elements of the proposal don't come through, you're once again making that product even harder to offer the homeowner. So we'll see what happens.

A - Jamie Dimon {BIO 1484062 <GO>}

And I would just add to that, so the product -- even if you have a product that doesn't make money, you might do it for clients who are great clients. They're going to manage by product, by client and by effectively business mix, and those are the adjustments. Roughly, loans don't make sense when you balance it as a whole, almost any loan. And people have to recognize that and we just have to manage through all of the various complications here and figure out what the hell to do.

Q - Ebrahim Poonawala {BIO 17612305 <GO>}

Thank you.

Operator

Next we'll go to the line of Mike Mayo from Wells Fargo Securities. You may proceed.

Q - Mike Mayo {BIO 1494617 <GO>}

Hi, I had another question on Vice Chair Barr's speech from this week. To the extent that capital ratios do go up 20% for you and perhaps others, to what degree would you think about changing your business model in terms of remixing? Where you do business, repricing or simply removing activities that you used to do? It's kind of ironic, or maybe it's not ironic, but Apollo hits an all-time stock price high the same week as the speech, so how much business leaves JPMorgan or the industry if capital ratios do go up, as much as potentially proposed?

A - Jeremy Barnum {BIO 15409544 <GO>}

Yes. Mike, I mean --

A - Jamie Dimon {BIO 1484062 <GO>}

Wait, before Jeremy answers that question, I just want to say this is great news for hedge funds, private equity, private credit, Apollo, Blackstone and there's debts in the streets.

A - Jeremy Barnum {BIO 15409544 <GO>}

Yes, exactly, and I was going to say, Mike, yes to everything. So meaning, repricing, yes, definitely, to the extent that we have pricing power and the higher capital requirements mean that we're not generating the right returns for shareholders, we will try to reprice and we'll see how that sticks and how that flows into the economy and how that affects demand for products. And if the repricing is not successful, then in some cases, we will have to remix and that means getting out of certain products and services. And as Jamie points out, that probably means that those products and services leave the regulated perimeter and go into elsewhere. And that's fine. And as Jamie points out, those people are clients. And I think that point was addressed also in Vice Chair Barr's speech. So -- but traditionally, having risky activities leave the regulated perimeter has had some negative consequences. So these are all important things to consider.

Q - Mike Mayo {BIO 1494617 <GO>}

All right. And separate question. Yes, I appreciate the Investor Day, it gives a little bit more color on the degree that your investment may or may not pan out. We are still all watching that closely. Having said that, you just increased revenue guidance by $10 billion for NII between this quarter and the first quarter without changing expense guidance by even $1. Aren't you tempted to spend a little bit more? Why not spend more if you're gaining share? And I'm not saying you should, I'm just wondering like aren't you tempted to do so? You have $10 billion more revenues, you're not spending $1 more of expenses, like why not?

A - Jeremy Barnum {BIO 15409544 <GO>}

Mike, let me get this right. You're actually complaining that our expenses aren't high enough, is that right?

Q - Mike Mayo {BIO 1494617 <GO>}

Wait, wait, just to be clear, it's just the flip side of the question I asked for two years going back to that.

A - Jeremy Barnum {BIO 15409544 <GO>}

Fair enough, I appreciate the balance. Now, in all seriousness, we've always been pretty clear, right, that our spending is through-the-cycle spending based on through-the-cycle investment, through-the-cycle spending, based on our through-the-cycle view of the earnings generating power of the company and the goal to produce the right return. So broadly speaking, NII tends to flow straight through to the bottom line, both when it's going up, and by the way, when it's going down, too. And we've been through those moments, as you well remember. So whether or not there are opportunities to deploy some more dollars into marketing and stuff like that, we have actually looked at that recently. I don't see that being a meaningful item this year, which is part of why we have not revised the expense guidance so far. But this is about investing through-the-cycle and being honest and disciplined about which revenue items flow carry expense loading and which of them don't.

Q - Mike Mayo {BIO 1494617 <GO>}

And then last quick follow-up--

A - Jamie Dimon {BIO 1484062 <GO>}

I think we're kind of running as fast as we can. So if you actually set down credit compliance, audit marketing, bankers, recruiters, trainers, this thing like this is it. We're at full effort right now, and we want to make sure we get things right and get things thoughtful and careful. So it's not just the money, it's the people and how many things can you change all at once and add to all at once.

Q - Mike Mayo {BIO 1494617 <GO>}

And then one quick follow-up to that. Your efficiency ratio this quarter is the lowest we've seen in a long, long time, and I guess, you're saying don't extrapolate this efficiency ratio because NII will come down at some point. But when you just simply look at, you benchmark yourself against the low-cost providers. Where do you think you're there now and where can you still go because if you extrapolate this quarter, you're getting closer?

A - Jeremy Barnum {BIO 15409544 <GO>}

Yes, I mean, you said it yourself, right, you definitely can extrapolate the current numbers. But I think more broadly on benchmarking ourselves to low-cost providers, it sort of speaks to an area that you've been interested in for a long time, which is all of the investment that we're doing in technology to improve generally scalability and get more of our cost base to be variable versus fixed in terms of how we respond to volumes. That's a big part of the reason that we're doing the investments that we're doing and modernization and cloud and AI and all the type of stuff that we talked about a lot. So I think we feel really good about our efficiency as a company, but there definitely is room for improvement.

Q - Mike Mayo {BIO 1494617 <GO>}

All right. Thank you.

Operator

Next we'll go to the line of Steven Chubak from Wolfe Research. You may proceed.

Q - Steven Chubak {BIO 18457976 <GO>}

All right. Thanks for taking the question and apologies for the technical issues earlier. I wanted to ask on the deposit outlook, just with signs that recent liquidity drawdown has come predominantly out of RRP versus industry deposits. Just wanted to get your thoughts on what expectations you have for deposit growth in the second half, both for you and even the broader industry, especially as treasury issuance really begins to ramp in earnest?

A - Jeremy Barnum {BIO 15409544 <GO>}

Yes, good question, Steve. So let me tell you a couple of things about this. So obviously, our deposit numbers have bounced around a little bit as a function of some of the turmoil that we saw in regional banks, as well as obviously the First Republic transaction. But now, if you look at our kind of end-of-period deposits this quarter and you project forward, our core view is that we would expect a sort of modest downward trend to reassert itself from this higher starting point, broadly as a function of QT playing to the system, but noting that we do have some hope for offsets by taking shares. Just to give a couple of examples, like in consumer, we've got some of our branch expansion markets seasoning and so their shareholders increase there. And then wholesale, we've obviously invested a lot in products and services, and so we think we have compelling offerings that are helping us with mandates, and so there are potentially some share offsets there. But broadly, our core view remains modest deposit declines across the franchise.

Within that, you note the same thing we've noted that as we got through the debt ceiling and the TGA bill has come into effect and you've seen a lot of bill issuance, big question in the market about whether that was going to come out of reserves or come out of RRP. And so far, with most of the TGA build, I guess the targeting 600 and they're at 550 or something, so they're almost done. More of it than some people feared has come out of RRP. So as you say, I think that's a relatively good sign and highlights how the system works better when you've got ample supply of short-dated collateral in the front end of the yield curve. So that whole RRP, TGA bank reserve dynamic is going to continue to be significant, but it is good to see RRP coming down a little bit.

Q - Steven Chubak {BIO 18457976 <GO>}

And helpful color. And just a follow-up on card income, revenues were muted in the quarter. I was hoping you could unpack just the sources of pressure, maybe more specifically how much of the drag is associated with FAS 91 versus some other factors.

A - Jeremy Barnum {BIO 15409544 <GO>}

Yes. So actually, that card income number, Steve, is a little bit of a one-off thing. So we had a reward liability adjustment this quarter, kind of a technical thing, so that's just a temporary headwind. And also the sequential comparison is also getting hurt by a small positive one-off item in the prior period. So -- and obviously, I know you guys look at it, but card income isn't sort of a thing we look at that much ourselves.

Q - Steven Chubak {BIO 18457976 <GO>}

Can you size the reward liability impact?

A - Jeremy Barnum {BIO 15409544 <GO>}

Why don't you get Michael to give that to you? It's not that significant, but it's enough to just make the sequential number look a little bit lumpy.

Q - Steven Chubak {BIO 18457976 <GO>}

Great. Thanks for taking my questions.

Operator

Next we'll go to the line of Glenn Schorr from Evercore ISI. You may proceed.

Q - Glenn Schorr {BIO 22910225 <GO>}

Thank you. Just want to follow-up on this pricing power conversation because you've been consistent over time that you have a limited ability to sustain pricing power due to the competitive landscape. But I guess my question is, if not now, when? Meaning a lot has changed on the institutional side, the European bank side, the regional bank side. And I would think that there'd be certain businesses that you have a greater ability and willingness to push price on. And then maybe you could tie that to your comments in the press release on what are the material -- what are the real-world consequences for markets and end users that you're referring to when talking about material regulatory changes? Thanks a lot.

A - Jeremy Barnum {BIO 15409544 <GO>}

Sure. So look, on pricing power, you're right. It really depends on the product and it depends on the competitive landscape across different banks. And so it's very granular. It's very product specific. And in some cases, we'll have more pricing power than in other cases. I think the overall point that we're trying to make in connection with Basel III endgame is just that, like we think the capital increases are excessive. It puts pressure on returns all else equal. That obviously puts pressure on us to increase price where we can. That is generally a bad thing for the real economy. And how all of that plays out in detail across different products and services remains to be seen. Importantly, since we don't actually have the proposal yet, so we need those details. I'm sorry, Glenn. I forgot the second half of your question. What was it?

Q - Glenn Schorr {BIO 22910225 <GO>}

Actually, I think you hit on it, so I'll just do a follow-up on a related. So the notion of private credit doing large traditional investment-grade lending activity is maybe part of the competitive landscape that limits the ability to push price. In Jamie's letter, you talked about the downsides, or my question is, what's the downside if more of the mortgage credit asset-backed intermediation business is pushed out of the banking system?

A - Jeremy Barnum {BIO 15409544 <GO>}

I mean, I guess it depends on what you mean by downside, but I just think societally speaking, I think we've seen in recent history that when home lending is happening outside the regulated perimeter and things get bad, when you have economic downturns, it produces bad outcomes for individuals and homeowners and society as a whole. So I mean, Jamie has written about this extensively. Beyond that, financially, we've talked about how mortgage lending, I mean, the profitability swings obviously is reasonably cyclical and in the recent past, it's actually been very profitable then it was less so, like the correspondent channel right now is actually picking up a little bit.

But it's a thin margin business, it's challenging and when you increase the capital requirements, it makes it even harder. So that just becomes one of the areas where you're in that tension between remixing versus pricing power that we talked about a second ago. And it might, in fact, mean that we do less credit available for homeowners and more regulatory risk as the activity moves outside the perimeter.

Q - Glenn Schorr {BIO 22910225 <GO>}

Appreciate that, Jeremy.

Operator

Next we'll go to the line of Betsy Graseck from Morgan Stanley. You may proceed.

Q - Betsy Graseck {BIO 4799503 <GO>}

Hi. Good morning.

A - Jeremy Barnum {BIO 15409544 <GO>}

Hi, Betsy.

Q - Betsy Graseck {BIO 4799503 <GO>}

I just wanted to unpack a little bit more the drivers of the change you outlined that's coming in the 10-Q, Jeremy, regarding the asset sensitivity going from liability sensitive to asset sensitive. At least that's the way I read it. I just wanted to understand what the drivers of that is?

A - Jeremy Barnum {BIO 15409544 <GO>}

Yes, sure. No problem, Betsy. I mean, as you know, that's always been a challenging number. You know, it's meant as a risk management measure of sorts, although it's also somewhat limited in that respect. And it has been of uneven usefulness in terms of being a tool to be able to predict our NII trajectory when rates change. But as we looked at that and tried to improve it and spoken to all of you through this latest rate hiking cycle, we've come to the conclusion that it would improve the usefulness of the disclosure if we include it in the modeling the effect of deposit repricing lags.

And so we've done that and that just has the effect that I talked about. It increases the ARR number by about $4 billion from minus $1.5 billion, which is roughly what it was last quarter and what it would have been this quarter without the change to something more like $2.5 billion. But in the end, all the usual caveats apply, right? I mean it's never -- the answer is going to always, for any given change in rates, the change in our NII is always going to be for one reason or another different from what that disclosure shows. But we do our best to make the use.

Q - Betsy Graseck {BIO 4799503 <GO>}

Okay. And so is it fair for me to think about that change as a mark-to-market to where we are today? And when I think about your forward guide here, longer term you're saying, look, deposit betas are accelerating. So as I go through the 10-Qs over the next four or five quarters, I should expect that, that $2.5 billion should come down because deposit betas you're anticipating are going to be accelerating from here. I'm just trying to put those two things together.

A - Jeremy Barnum {BIO 15409544 <GO>}

Yes. It's a good question. It's quite a technical issue. So I think in the past, the way this number was constructed was to assume through-the-cycle betas on all the deposits. And so your notion that like the number would include deposit beta acceleration would not have been the case because it would have been using essentially terminal deposit betas based on the forward curve and then based on a 100% shock to the forward curve. The nuance that we've introduced now is to recognize that given the shock, the reprice that the beta predicts will not be instantaneous. And so you get sort of just the mathematical consequences of that. But I think translating that into a statement about our expectation for beta, for the next 12 months relative to our NII guide, might be a bridge too far. I'm not sure you can actually go looking for it.

Q - Betsy Graseck {BIO 4799503 <GO>}

Right. But the -- but you were saying earlier deposit betas you do anticipate are going to be accelerating from here, and that's part of the outlook for NII longer term to normalize in the mid-70s. Is that right?

A - Jeremy Barnum {BIO 15409544 <GO>}

Yes. But let me exercise that. Yes, go ahead, Jamie.

A - Jamie Dimon {BIO 1484062 <GO>}

I mean, basically, yes. If you have -- if the next round is going to be the beta build from 30 to 40 to 50, I mean, whatever the product is, yes, that's the lag. And the $2.5 billion will go down over time if that actually happens, if rates actually go up. If rates don't actually go up, that $2.5 billion may be exactly $2.5 billion again.

Q - Betsy Graseck {BIO 4799503 <GO>}

Got it.

A - Jeremy Barnum {BIO 15409544 <GO>}

And what I was going to say Betsy is just the projection of 87 coming down to a significantly lower number contains both the element of internal migration as well as the potential, which is by no means guaranteed of product level reprice, and furthermore, then obviously the dynamics are a little bit different in the different business segments as you move from large corporate wholesale to consumer.

Q - Betsy Graseck {BIO 4799503 <GO>}

Okay. All right. Thank you. Appreciate it.

A - Jeremy Barnum {BIO 15409544 <GO>}

Yes.

Operator

Next we'll go to the line of Matt O'Connor from Deutsche Bank. You may proceed.

Q - Matt O'Connor

Good morning. So I mean in your camp that eventually consumers will want more deposit rate sensitivity here, but I guess what would make you change your rates meaningfully? So the top two banks have about 50% consumer market share, loan-to-deposit ratios are low, your outlook for loan growth, and I think others, it's fairly sluggish, at least outside of card. So I get that it's common sense and that's what we've seen historically, but there really is this kind of big divergence among big banks and everybody else where the big banks just don't need to pay that much for deposits for a slew of reasons. So what would make you change that?

A - Jeremy Barnum {BIO 15409544 <GO>}

Yes. In the end, Matt, it's just feedback from the field. It's competition and feedback from the field. We --

A - Jamie Dimon {BIO 1484062 <GO>}

I think every bank is in a different position about what they need. And so you have a whole range of outcomes. But remember, we do this also by city. So you have different competition in Arizona and Phoenix than you have in Chicago, Illinois. And we do have high interest rate products. So it's a combination of all those things. I wouldn't call it a big bank or a small bank. And you're going to see whenever we report who kind of paid up a little bit more for things and who didn't and things like that. So look, guys, I would take it as a given. I think it's a mistake. There is very little pricing power in most of our business and betas are going to go up. You take it as a given. There is no circumstance that we've ever seen in the history of banking where rates didn't get to a certain point that you had to have competing products. And rates go from migration or direct rates or movement to CDs or money market funds and we're going to have to compete for that. You already see it in parts of our business and not in other parts.

A - Jeremy Barnum {BIO 15409544 <GO>}

Yes, I don't know -- Matt is just that it's really just about primary bank relationships in the end, that's the core of the strategy.

Q - Matt O'Connor

Yes, I mean again, I 100% agree, but we've never seen kind of loan-to-deposit ratios for banks like yours this low. So you could just let deposits run off at a modest amount for quite some time and make the decision not to pay up. I mean, I assume that's the trade-off that eventually you'll.

A - Jamie Dimon {BIO 1484062 <GO>}

But that's a little more complicated because a lot of that loan to value ratio is lower because of regulatory stuff, LCR, capital ratio, et cetera.

Q - Matt O'Connor

Got it. Okay. All right. Thank you.

A - Jamie Dimon {BIO 1484062 <GO>}

Thanks.

Operator

And for our final question, we'll go to Charles Peabody from Portales Partners. You may proceed.

Q - Charles Peabody {BIO 2346511 <GO>}

Good morning. Jeremy, on Page 4 of your presentation, you show some liquidity metrics and there's been a meaningful deterioration, or I shouldn't say deterioration depletion of some of that excess liquidity, obviously for First Republic primarily. So my question is, how quickly do you want to rebuild that liquidity? Because as I look out towards '24, there's probably a half dozen variables that are going to make liquidity a premium event to have, excess liquidity. So that's my first question, what's your plans for replenishing that liquidity?

A - Jeremy Barnum {BIO 15409544 <GO>}

Yes, Charles, so I know we talked about this a little bit at our Investor Day, right? So as I said in my prepared remarks, yes, when we think about half of the change in the bank LCR number is a consequence of First Republic. And the rest of it is just the expected decrease in system-wide deposits falling through into our HQLA balances and the bank LCR ratio. So that's all entirely as expected. And therefore, I think that the replenishing notion is not correct, in fact. Obviously, we still have ample liquidity. Now, if you want to project trends forward, that's a different story. But that's sort of the business of banking. We'll adjust accordingly in terms of our asset and liability mix across different products and to ensure compliance of the ratios and fortress balance sheet principles as you would expect from us.

A - Jamie Dimon {BIO 1484062 <GO>}

And I would just add, just look at the top of the page in the press release, $1.4 trillion of cash and marketable securities. Even if we get down to no excess, we're going to have, like, I've got the exact number $1.2 trillion. I think we have excess liquidity and the liquidity ratio is slightly some difference. I think there's plenty of liquidity in the system, and of course, we can do multiple things to change this overnight if we wanted to.

Q - Charles Peabody {BIO 2346511 <GO>}

So sort of wrapped into that as a follow-up, if you take your $87 billion forecast for NII this year, and that implies at least one quarter of maybe $22 billion of NII, and you take your eventual forecast of mid-$70 billion of NII at some point in the future, that would imply at least one quarter of $18 billion of NII. So that's about an 18% drop. And if you hold the balance sheet steady, you're talking about a 30 basis point drop in your margin, your NIM to get to that -- from $22 billion to $18 billion. I mean what is driving, is it really the deposit or are you thinking in terms of interest reversals as credit deteriorates or is it rebuilding of liquidity? I'm just trying to get a better sense of what the big impact is.

A - Jeremy Barnum {BIO 15409544 <GO>}

Yes, hey, Charlie, I would think about that as being really entirely a deposit story, it's just not that complicated, right? I think we did this, I think it was either in the fourth quarter and the first quarter, but we put a little chart on the page just very simple terms. This shows like what the dollar consequences are of whatever like 10 basis point change and deposit rate paid in terms of an NII run rate. So whether it's as a consequence of migration from lower yielding to higher yielding, going from 0% to a 4% CDs, obviously a big impact on margin or whether it's because savings reprices relatively, small changes in rate there are kind of a lot of money when you've got a couple trillion dollars of deposits. So it's really not any more complicated than that and that's why we're being so forceful about reminding people about what we expect that trajectory to be.

Q - Charles Peabody {BIO 2346511 <GO>}

Thank you.

Operator

And we have no further questions at this time.

A - Jeremy Barnum {BIO 15409544 <GO>}

Thank you very much.

Operator

Thank you all for participating in today's conference. You may disconnect at this time and have a great rest of your day.