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Bailout Helps Fuel a New Era of Wall Street Wealth

By GRAHAM BOWLEY

Even as the economy continues to struggle, much of Wall Street is minting money — and looking forward again to hefty bonuses.

Many Americans wonder how this can possibly be. How can some banks be prospering so soon after a financial collapse, even as legions of people worry about losing their jobs and their homes?

It may come as a surprise that one of the most powerful forces driving the resurgence on Wall Street is not the banks but Washington. Many of the steps that policy makers took last year to stabilize the financial system — reducing interest rates to near zero, bolstering big banks with taxpayer money, guaranteeing billions of dollars of financial institutions' debts — helped set the stage for this new era of Wall Street wealth.

Titans like Goldman Sachs and JPMorgan Chase are making fortunes in hot areas like trading stocks and bonds, rather than in the ho-hum business of lending people money. They also are profiting by taking risks that weaker rivals are unable or unwilling to shoulder — a benefit of less competition after the failure of some investment firms last year.

So even as big banks fight efforts in Congress to subject their industry to greater regulation — and to impose some restrictions on executive pay — Wall Street has Washington to thank in part for its latest bonanza.

"All of this is facilitated by the Federal Reserve and the government, who really want financial institutions to get back to lending," said Gary Richardson, a research fellow at the National Bureau of Economic Research. "But we have just shown them that they can have the most frightening things happen to them, and we will throw trillions of dollars to protect them. I have big concerns about that."

Not all banks are doing so well. Giants like Citigroup and Bank of America, whose fortunes are tied to the ups-and-downs of ordinary consumers, are struggling to turn themselves around, as are many regional banks.

But the decline of certain institutions, along with the outright collapse of once-vigorous competitors like Lehman Brothers, has consolidated the nation's financial power in fewer hands. The strong are now able to wring more profits from the financial markets and charge higher fees for a wide range of banking services.

"They are able to charge more for all kinds of services because companies need banks and investment banks more now, and there are fewer strong ones to help them," said Douglas J. Elliott of the Brookings Institution.

A year after the crisis struck, many of the industry's behemoths — those institutions deemed too big to fail — are, in fact, getting bigger, not smaller. For many of them, it is business as usual. Over the last decade the financial sector was the fastest-growing part of the economy, with two-thirds of growth in gross domestic product attributable to incomes of workers in finance.

Now, the industry has new tools at its disposal, courtesy of the government.

With interest rates so low, banks can borrow money cheaply and put those funds to work in lucrative ways, whether using the money to make loans to companies at higher rates, or to speculate in the markets. Fixed-income trading — an area that includes bonds and currencies — has been particularly profitable.

"Robust trading results led the way," said Howard Chen, a banking analyst at Credit Suisse, describing the latest profits.

To prevent a catastrophic financial collapse that would have sent shock waves through the economy, the government injected billions of dollars into banks. Some large institutions, like Goldman and Morgan, have since repaid their bailout money. But most of the industry still enjoys other forms of government support, which is helping to stoke profits.

Goldman Sachs and its perennial rival Morgan Stanley were allowed to transform themselves into old-fashioned bank holding companies. That switch gave them access to cheap funding from the Federal Reserve, which had been unavailable to them.

Those two banks and others like JPMorgan were also allowed to issue tens of billions of dollars of bonds that are guaranteed by the Federal Deposit Insurance Corporation, which insures bank deposits. With the F.D.I.C. standing behind them, the banks could borrow the money on highly advantageous terms. While some have since issued bonds on their own, they nonetheless enjoy the benefits of their cheap financing.

Granted, banks are also benefiting from a stabilizing economy. The fear that gripped the markets earlier this year, when doomsayers predicted a second Great Depression, has largely dissipated. Stocks, corporate bonds, even risky corporate i.o.u.'s — have all rallied from their bear market lows, some spectacularly so. The Dow Jones industrial average has soared 50 percent this year, and touched 10,000 this week for the first time since the crisis.

Banks that had marked down the value of the assets on their books during the dark days of the crisis are now enjoying a rebound in the value of many of those assets.

"Confidence has returned," said Shubh Saumya, a financial services specialist at the Boston Consulting Group. "Some of the assets that bankers wrote down last year in the midst of the crisis, now they have got some of that back."

As the number of banks has dwindled, the survivors are moving into the void left by rivals that are either dead or limping and unwilling to take risks.

A big reason for Goldman Sachs's blowout profits this year has been the willingness of its traders to take big risks — they have put more money on the line while other banks that suffered last year have reined in such moves. Executives say there are big strategic gaps opening up between banks on Wall Street that are taking on more risks, and those that are treading a safer path.

Banks that have waded back into the markets have been able to exploit large gaps in the prices of various investments, a feature of the postcrisis financial markets. The so-called bid-ask spreads — the difference between the price at which banks are willing to buy things like bonds, and the price at which they are willing to sell — are roughly twice what they were two years ago.

Still, the newfound success is largely limited to the big securities houses on Wall Street. This week, Citigroup and Bank of America reported losses from credit card delinquencies and mortgage defaults — a sign of the lingering pain on Main Street.