

Understanding Recent Bank Failures: Is the Financial System at Risk?

In recent weeks, the United States witnessed its most significant bank failure since the 2008 global financial crisis, with Silicon Valley Bank and Signature Bank becoming the second and third largest bank failures in American history. Concerns have arisen about the potential for another global banking crisis, especially in light of the government-engineered takeover of Credit Suisse by UBS. However, an analysis of the failed banks suggests that the odds of a widespread crisis are low.

Why Silicon Valley Bank and Signature Bank Failed

Both Silicon Valley Bank (SVB) and Signature Bank (SB) shared a common vulnerability – a lack of diversification. Their heavy reliance on the fortunes of the technology start-up sector, which proved successful during the COVID boom, became their downfall when the start-up industry faced a downturn. SVB, in particular, had a unique structure with few individual customers, mainly relying on deposits from venture capital funds and tech start-ups. The bust in the tech sector led to a significant withdrawal of funds, causing a bank run and eventual failure. SB faced similar challenges due to its exposure to the crypto industry.

Credit Suisse: A Mismanaged Bank

Credit Suisse faced longstanding issues, with exposures to the collapse of hedge funds Archegos Capital and Greensill Capital in 2021, resulting in substantial financial losses. Litigation provisions due to scandals further contributed to a significant loss in 2022. The forced delay of its annual report by the US Securities and Exchange Commission was the final blow, leading to a takeover by UBS.

Isolation and Healing Psychology

While caution among depositors and investors in US banks is expected during such times, the healthier and more diversified banks are benefiting from deposit inflows. The risk of a nationwide bank run is low, thanks to proactive measures by authorities to provide liquidity funding and, if necessary, take over struggling banks. However, the high volatility in the shares of US regional banks indicates that confidence has not fully returned. An improvement in confidence would likely lead to decreased volatility and a rally in banking stocks.



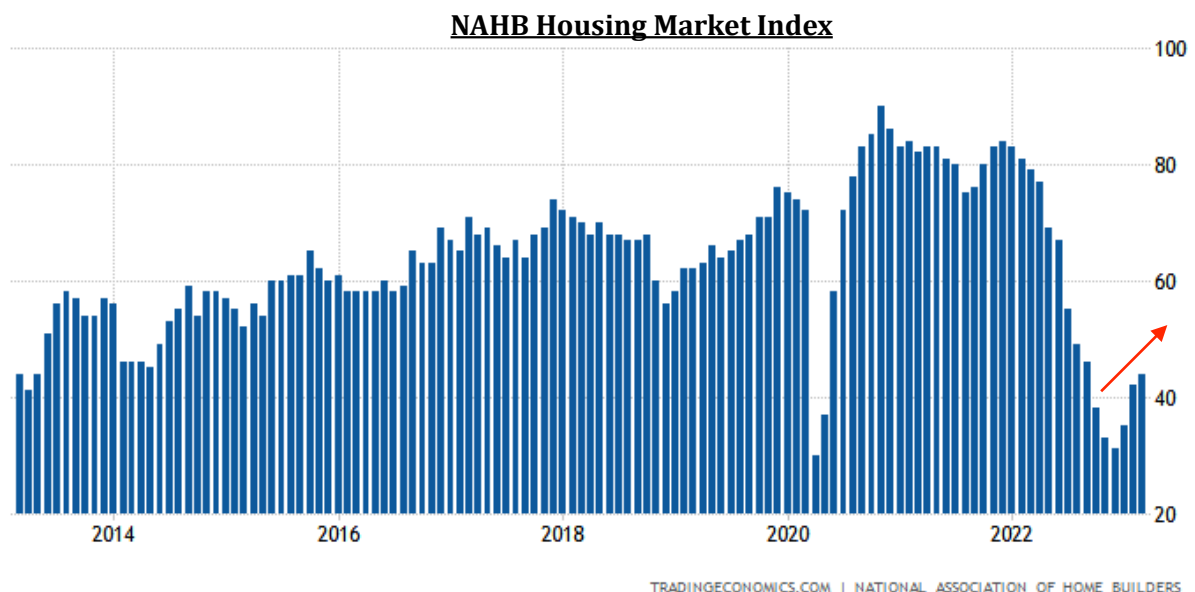
Challenges for the Federal Reserve (FED)

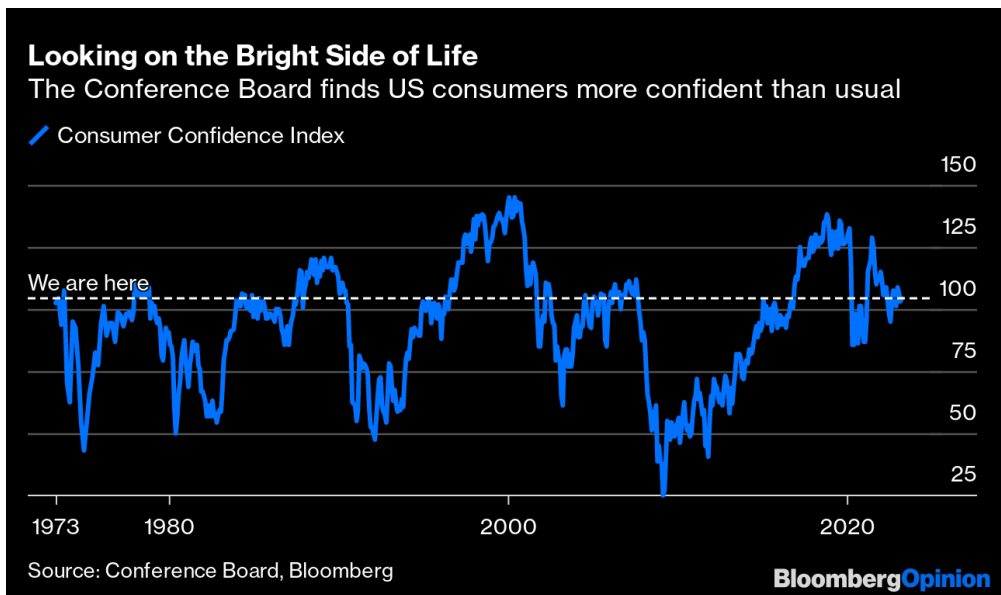
Despite recent bank failures, the FED raised rates but hinted that the banking turmoil might affect its rate hike cycle. Balancing the stabilisation of the banking system with the need to control inflation presents a challenge for the FED. The impact of higher rates on banks may force the FED to tolerate higher inflation temporarily, potentially slowing the rate hike cycle.



Economic Resilience and Consumer Confidence

Despite aggressive rate hikes and banking troubles, the US economy has remained relatively robust. The housing market, a key pillar of the economy, is absorbing rate increases well, and consumer confidence has edged higher. This resilience lowers the risk of a systemic shock to the banking system, lowering the odds of a recession.





Risk Management: Watch Banking Stocks

While the initial panic in the US banking system has subsided, the damage to bank stocks persists. Stabilisation and improvement in bank stocks are crucial for a positive outlook for risk assets. If weakness in bank stocks continues, it may signal a loss of confidence among banks, potentially leading to reduced lending and economic slowdown.

Conclusion: Risk assets favoured

While recent bank failures point to stresses in the financial system, they appear to be isolated incidents. The FED's response to these stresses, along with the performance of the remaining banks, will likely shape market dynamics. Investors should anticipate elevated volatility, but there's a good chance that risk assets will remain favoured in the coming months. Confidence is crucial, and monitoring how banks respond will be key to understanding the broader economic outlook.