Investment Insight

Banking crisis or storm in a teacup?

SILICON VALLEY BANK COLLAPSE

The collapse of Silicon Valley Bank (SVB) - the US's 16th largest bank by deposits - last Friday was a shock to financial markets. As depositors fled the bank this led to SVB having a mismatch on its balance sheet between assets and liabilities which then prompted an attempt to raise capital.

The timing was unfortunate as Silvergate Capital (a banking platform for the digital currency industry) went into liquidation on the same day as SVB was dealing with its balance sheet problems.

As customers withdrew a huge U$42bn of deposits from SVB within 24 hours, SVB's share price fell and the capital raise failed, so the bank went into receivership on the Friday. On the following Sunday a New York based bank, Signature Bank, also failed and the share prices of all financials declined as the market tried to price in what was happening and the possible contagion effects. Was this another Global Financial Crisis in the making?

REGULATORS TO THE RESCUE

Unlike the 2008 Financial Crisis regulators acted with speed. Over the weekend; the US Federal Reserve, the Federal Deposit Insurance Corporation and the Treasury, announced that all depositors in SVB and Signature Banks would be fully protected for both their insured (up to U$250,000) and uninsured deposits. This meant that the technology businesses that banked with SVB would be able to meet their expenses, such as wage bills, and keep businesses alive this week.

Also the authorities introduced a new Bank Term Funding Program (BTFP) offering all types of financial institutions loans of up to one year. The financial institutions who wanted to use this facility have to pledge assets but they would be valued at a higher rate than normal. All of this was designed to increase liquidity into the banking system and remove financial stress.

SVB also had overseas subsidiaries and in the UK the Bank of England and Treasury followed suit. Over the weekend the UK monetary authorities were lobbied strongly by the technology sector fearful that they too would lose their deposits held in SVB and so have to cease trading this week potentially unable to meet expense payments to suppliers, employees etc.

The UK authorities also acted swiftly and also guaranteed all the deposits of these companies and then came the news that the UK branch of SVB was sold to HSBC for £1. Today HSBC announced that they would be injecting c£2bn into SVB UK, but in the context of their c£1.5tr deposit base this is de minimis and gives HSBC a ready-made technology growth platform.

So everyone is happy? Not quite – also today it has been announced that the US Department of Justice and Securities Exchange Commission will be investigating the share trades of SVB's executives prior to the collapse.

INVESTMENT IMPLICATIONS

One unintended consequence of these bank collapses is that the market began to price in a weaker economy, and so reasoned that interest rates might not rise as quickly as previously thought. Interest rate futures fell by a relatively large amount (c50-100bps depending on the region) and bond prices rose. All eyes are now on the Federal Reserve's interest rate decision next week to see if they react to the unfolding events and delay the pace of interest rate rises that they are using to combat inflation.

Our own portfolios do not have a significant exposure to financials overall (and we sold our one holding exposed to the US West Coast) but we are alert to the possibilities of contagion. In this case we do not think this likely. Why? Because SVB and Signature were overly concentrated on the technology sector and mismanaged their balance sheets. Also, these banks did not pose a systemic threat to the global financial system in the way Lehman Brothers did. Most importantly the authorities reacted very quickly to contain the collateral damage and restore confidence to the financial system.

What's important now for investors is still the pace and level of inflationary pressures and the authorities' interest rate response.