Investment Insight
Banking crisis

SWISS BANKS

Yesterday evening the Swiss National Bank (SNB) and Swiss Financial regulator moved to bail out Credit Suisse, a 167 year old bank and Switzerland's second largest, with a U$55bn loan. What happened and was it in any way related to the collapse of the US banks last weekend?

The US banks (Silicon Valley Bank and Signature) collapsed for reasons connected with a mismatch between their assets and liabilities, which led to a crisis when depositors withdrew money which forced the banks to crystallise losses and led them to have to raise capital quickly in the markets which they failed to do. Hence their instant collapse and the US regulators stepping in to protect all depositors.

This sequence of events can be described as an issue of solvency, but this wasn't a problem at Credit Suisse which is a far bigger and more diversified institution.

Credit Suisse's problems have been many years in the making and connected with mistakes related to strategy, hedge fund and derivatives, restructurings, and low profitability.

In 2022 depositors lost patience and withdrew funds especially at the tail end of the year when interest rates increased. Yesterday their largest shareholder, the Saudi National Bank said they wouldn't stump up more capital as that would take them over 10% ownership and into a different regulatory regime.

The result was that Credit Suisse's share price fell c30% as investors worried that the bank would not have the liquid capital to match further deposits being withdrawn – this is a crisis of liquidity. A few hours later the Swiss National Bank and financial regulator gave Credit Suisse a massive loan to improve their liquidity position and ensure short-term survival.

NOW WHAT?

Entering the realm of speculation you could imagine that Credit Suisse is sold to a stronger bank (perhaps their Swiss counterpart UBS). Or, more likely, split up and sold piecemeal. Whatever happens the liquidity crisis has been averted and this was, potentially, a far more serious issue than what happened in the US. Credit Suisse is far larger, with far more global banking counterparties, with derivative structures and linkages to hedge funds. The ripple effects would have been global had the bank been allowed to fail.

Our portfolios have little exposure to banks so we are viewing this from the side lines and waiting to see whether share price movements present us with investment opportunities in other elsewhere.

CANARY IN THE COALMINE?

The real question is whether these recent bank failures signal the start of a contagion throughout the global financial system. We think not because banks are far less leveraged than in 2008 with much higher levels of liquidity. In addition, the regulators are acting faster to intervene and are scrutinising banks far more closely compared to 2008.

Nevertheless no bank is immune from a slowing economic cycle and higher interest rates and, as always happens in these situations, the strong banks take market share. So we now return to analysing the path of interest rates and economic growth and exploiting any market anomalies that arise to the benefit of our clients.