April 2023
Economic Newsletter

SPEKTRA MAKELAARS

Global Banks Falter (and Some Fall)

The collapse of Silicon Valley Bank (SVB) in March marked the second largest bank failure in US history, overshadowed only by the 2008 failure of Washington Mutual which triggered the start of the 2008 banking crisis.

Founded over 40 years ago, SVB grew its business primarily through the funding of tech startups, whilst also providing lending to venture capital and private equity firms. By the start of 2023, SVB had grown to the 16th largest bank in America, with assets of close to $209 billion.

As the bank grew its footprint, its depositors became significantly less diversified, with a much larger and more concentrated exposure to the technology industry. It is estimated that 44% of all venture-backed technology and health care initial public offerings (IPOs) that took place in the US in 2022 were clients of Silicon Valley Bank.

Whilst SVB's concentrated book of investments posed a potential threat to the bank's balance sheet, a greater issue stemmed from the riskiness of the assets in which the bank had invested its clients' deposits. Following the tech boom of the early 2020's, many of SVB's depositors, flush with cash, placed significant sums of money into the bank, thereby considerably increasing SVB's assets. Rather than holding these assets in relatively low-yielding, but highly liquid, cash-like instruments, management instead used most of the excess funds (an estimated $91bn in deposits) to buy longer-dated securities such as US Treasuries and mortgage bonds in an effort to eke out additional yield.

SVB's management did not anticipate, however, the US Federal Reserve aggressively hiking interest rates, which subsequently drove up the yields of these long-term debt securities. Due to the inverse relationship between bond yields and bond prices, the higher rates significantly decreased the value of the long-term debt instruments SVB had placed their clients' deposits into.

Timeline of the Silicon Valley Bank Collapse in 2023:

8th of March: Silicon Valley Bank announced an $1.8bn loss on its bond portfolio, along with a planned stock sale to raise $2.25bn. Following the announcement, rating agency Moody's immediately downgraded both SVB's deposit and issuer ratings.

9th of March: SVB's share price crashed 60% as markets opened, resulting in attempted withdrawals of $42bn in the day's trading.

10th-11th of March: Trading of SVB stock was halted to avoid an all-out bank collapse. The Federal Deposit Insurance Corporation (FDIC) stepped in and guaranteed protection of up to $250,000 per account held. Many accounts far exceeded $250,000 and were at risk of losing a portion of their deposits above this threshold.

12th of March: The Federal Regulator announced emergency measures which would allow SVB customers to recover all funds, including those that were uninsured. Rattled by the SVB collapse, depositors of rival Signature Bank withdrew $10bn, leading federal regulators to similarly take control of Signature Bank. The fall of Signature Bank marked the third largest US bank collapse in history.

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13th of March: Fearing a broad-based run on US banks, US President Joe Biden assured American citizens the US banking system, along with all bank deposits, was safe. Despite the message, US bank stocks continued to fall, with First Republic Bank dropping 65% before trading was stopped, whilst Charles Schwab, the 8th largest US bank, fell 11%.

26th of March: First Citizens Bank purchased all of SVB assets (an estimated $72bn worth of assets, at a discount of $16.5bn). The deal excluded $90bn in securities that will remain in FDIC receivership.

Credit Suisse

The collapse of SVB was not confined to US banks, but correspondingly put the global banking system into question, creating significant investor uncertainty and bank share volatility. In European Markets, attention was concentrated primarily on the Swiss banking behemoth Credit Suisse. After surviving the 2008 financial crisis relatively unscathed, Credit Suisse has since been embroiled in a long string of financial scandals, each one causing damage to the bank's reputation and placing the share price on a steady decline.

Over the last 12 months Credit Suisse shares have lost close to three quarters of their value, leading the bank to announce plans in early 2023 to borrow $54bn in an effort to increase liquidity and raise investor confidence. This injection is in addition to the significant investment into Credit Suisse by Saudi National Bank in late 2022, which quickly made it Credit Suisse's largest investor. With the additional funding expected to come from Saudi National Bank, Credit Suisse's future looked far more secure.

However, by mid-March, following the collapse of SVB, the chairman of the Saudi National Bank announced that they would not offer further funding to Credit Suisse due to regulatory barriers. The share price of Credit Suisse subsequently fell 24% to a record low. In the same day of trading the Swiss Central Bank, in an effort to prevent a banking catastrophe, convened a meeting with the top Credit Suisse executives, detailing a SFr50bn liquidity line to prevent a bank run. The funding, however, was conditional on Credit Suisse merging with their long-time rival UBS, and doing so before the end of the week, leaving them a mere four days to negotiate the deal. The Swiss Central Bank gave both Credit Suisse and UBS an ultimatum to come to an agreement and announce the deal on Sunday evening before Asian Markets opened for trading.

By Sunday evening, 19 March, UBS had agreed to purchase Credit Suisse for $3.3bn, a price equivalent to 1% of Credit Suisse's all-time high value in 2007. The 166 year old bank will become fully absorbed by UBS, with the stock likely being delisted by the end of 2023.

The March volatility experienced by the global banking sector highlights the systemic risk present in bank stocks. Even well-run and reputable banks can be shaken by general investor panic in the banking sector. This does, however, also bring with it opportunity. Our local banks, which are wholly independent of both SVB and Credit Suisse, also experienced a drop in share price during the month of March. This provides investors with an attractive entry price to purchase selected local banking stocks, most of which have very attractive balance sheets and earnings growth.