Is a Banking Crisis Coming Back to Haunt Us?

Vicky Pryce

We seem to be going from one crisis to another. Just as prospects for the world economy seemed to be improving after a shaky 2022 and inflation looks like coming down sharply as energy prices stabilise , a banking crisis threatens. First the Silicon Valley Bank(SVB), the 16th largest bank in the US was forced to close as clients, mostly tech firms and venture capital funds, withdrew money in large quantities. The bank had also been forced to sell government bonds and mortgage-backed securities at a massive loss while trying to boost its liquidity .

There was swift action from the US Federal authorities and support was given in the form of guaranteeing all deposits even those above the $250,000 legal maximum. A quick reaction was also seen by the Bank of England and the Treasury in the UK with the UK subsidiary sold overnight to HSBC for just £1.

A lot was made initially about the special characteristics of SVB and the extent, if any, of management failures contributing . But two other specialist regional banks were also closed- the cryprocurrency focussed Signature Bank and Silvergate Bank around the same time. And news has also come that in an effort to stem flow of deposits out of another institution, the First Republic Bank had to be helped by some the the US's biggest banks depositing $30 billion with it.

And then the problems of Credit Suisse surfaced as worries rose of the long-term sustainability of the bank, with losses in last two years , beset by management and other scandals and losing confidence of its investors. Nerves calmed when the Swiss National Bank quickly stepped in with a loan of $50b to boost liquidity.

Good that response has been quick this time. But are these isolated incidents? If so why this has this contagion spread. Two reasons- with the era of low interest rates now gone , earlier low interest rate loans are affecting balance sheets negatively. And with higher inflation and the end of Quantitative Easing, and in fact moving to Quantitative Tightening by a number of Central banks, this has increased yields on bonds that financial institutions had invested in. The losses realised when forced to sell them before maturity are hurting.

So while interest rates keep going up – as the ECB just did again by raising rates by a further 0.5% at its latest meeting- and central bank support in the form of QE all but gone, the stakes are high. Not surprising that Moody's has downgraded the entire US banking sector .

Will there be a rethink on interest rate policy? Perhaps it should. But what we are seeing clearly is that once again bank bailouts seem to be the name of the game.

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