The Real Banking Crisis

April 24, 2023

The March collapse of two regional banks, Silicon Valley Bancshares and Signature Bank triggered an emergency response from the Federal Deposit Insurance Corporation (FDIC), a federal government agency that effectively took over both banks. The insurance on deposits at banks is set at $250,000 per depositor but, since these banks had many depositors with more than that amount, the FDIC also provided insurance for all these accounts. As a result of this action, interest rates plummeted (the 10-yr government bond fell from a current yield of 4.08% on March 2nd to 3.30% on April 6th for a decline of 19%) as fears spread that there would be more banks with financial troubles and a rush to withdraw monies. The question arose as to how far both the FDIC and the Federal Reserve would go to ensure the solvency of all financial institutions.

The decline in interest rates was accompanied by a decline in the prices of many bank stocks, especially regional banks, where there continued to be a flight of deposits to other safer instruments. The regulators were chastised by Congress for not catching the decision by some banks to extend the maturities of their investment portfolio where the regulations allow them to price that portfolio at the purchase price, not requiring them to mark that portfolio to market i.e., to current prices. The sudden rise in interest rates in 2022 and earlier this year depressed the market value of these securities leading to a run on those two banks where savers saw the risk of not being able to get their money out.

Even though the markets were rattled by these events, volatility only lasted a couple of weeks and equity markets were mixed. These actions by the regulators seemed to have calmed the financial climate for the time being but the residual effects are concerning. The impact on banks' ability and willingness to lend has been undermined by these events. Interviews with several bank CEOs on various media indicate that the motivation for them to lend has declined. Also, fears of new regulations regarding the handling of bank assets have risen. Investors will be extra careful when reviewing bank balance sheets to ensure that there is minimal exposure to a volatile interest rate environment.

If banks are unwilling to lend, there are ramifications across the economy such as companies that need financing may find no bank willing to lend in a risky environment. More importantly, commercial real estate loans that are coming due over the next 18 months may not be renewed, and getting new loans to finance commercial real estate with high vacancy rates may add to the mayhem. Unless the regulators can step up and encourage banks to resume their normal lending practices, then there may be a series of bankruptcies in the real estate market that could add to the prospect of further market volatility and the possibility that such events could lower economic activity to a point where a recession is unavoidable.

109 East Bay Street, #1E, Charleston, SC 29401
843-342-3044 www.vcm.us.com