After SVB and Credit Suisse: Whither the financial system?

Nick Beams
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It is now just over a month since a crisis erupted in the financial system with the collapse of the Silicon Valley Bank (SVB), the takeover and selloff of the Signature Bank and the forced takeover of Credit Suisse by UBS.

The demise of SVB, the 16th largest American bank, was the second largest in monetary terms in US history.

It was taken over by the Federal Deposit Insurance Corporation (FDIC) after $42 billion was withdrawn in a single day with $100 billion to be withdrawn the day after.

The Biden administration, the Federal Reserve and the FDIC appear to have quelled the storm with their emergency intervention to extend FDIC insurance to cover deposits over $250,000, questions are being raised about whether this was just a passing phenomenon or the sign of much worse to come.

Fed chair Powell has offered the assurance that it was the former, because SVB was an outlier which had failed to secure adequate risk protection for its holdings of US Treasury bonds, the market value of which declined as the Fed lifted interest rates.

Others are not so sure because the SVB problems were set off by interest rate hikes, carried out at the fastest pace in four decades, that are impacting the entire US banking and financial system. In other words, SVB was the expression of general problems now emerging.

In an interview with the *Financial Times* (FT) last week, International Monetary Fund chief economist Pierre Olivier Gourinchas recalled the events leading up to the global financial crisis of 2008.

“We can all remember the long time between the failure of an individual institutions, whether it was Bear Stearns or Countrywide. Every time, this was treated like an isolated incident, until it wasn’t.”

In a comment piece for the FT last Friday, entitled “After the easy money: a giant stress test for the financial system,” long-time columnist John Plender wrote that after the collapse of SVB there is “no consensus on whether the ensuing stress in North America and Europe has run its course or is a foretaste of things to come.”

He pointed out that while the problems of SVB and Credit Suisse were not the same, yet, “in their different ways, they demonstrate how the long period of super-low interest rates since the great financial crisis of 2007–09 introduced fragilities into the financial system while creating asset bubbles.”

And the longer monetary policy stayed lax, the more systemic risk increased, together with growing dependence on money creation and low rates.

Plender also cited research by Raghuram Rajan and Viral Acharya, respectively the former governor and deputy governor of the Reserve Bank of India, which showed that banking regulations introduced after the 2008 crisis had caused problems because the stress tests applied to large institutions were not uniform.

“So these differential standards may have caused a migration of risky commercial real estate loans from larger, better-capitalised banks to weakly capitalised small and midsized banks.”

And, in a rather caustic comment, he added that, while the upsets of the past weeks had raised serious questions about the effectiveness of bank regulation and supervision, there was one area in response to the crisis that was highly effective.

“It has caused much traditional banking to migrate to the non-bank financial sector, including hedge funds, money market funds, pension funds and other institutions that are much less transparent than the regulated banking sector and thus capable of springing nasty systemic surprises.”

The IMF’s *Global Financial Stability Report* issued last week drew out that there were entire areas of the system, dominated by non-bank financial institutions of which regulators had virtually no knowledge, including their level of debt and interconnectedness with the rest of the financial system.

Plender noted that the crisis in the British pension system last September, which “destabilised a market at the core of the British financial system,” and posed “devastating risk to financial stability," had not been entirely unforeseen.

But the stress tests conducted by regulators on pensions did not allow for the extreme swings in the yields on long-term bonds, known as gilts, which took place.

An article by Rajan and Acharya, on which much of Plender's analysis was based, published on *Project Syndicate* at the end of March, noted that while the collapse of SVB and Signature was caused by uninsured deposits "the problem may be more systemic."

Together with co-authors, they had pointed to this problem in a paper presented to the conclave of central banks at Jackson Hole in August 2022. They noted that after the resumption of quantitative easing (QE)—the pumping of trillion of dollars by the Fed into the financial system after the start of the pandemic—the volume of uninsured deposits rose from about $5.5 trillion at the end of 2019 to over $8 trillion by the first quarter of 2022.

The authors explained that while many vulnerabilities were created by the bankers, the Fed also contributed to the problem.

"Periodic bouts of QE have expanded banks' balance sheets and stuffed them with more uninsured deposits, making the banks increasingly dependent on easy liquidity. This dependency adds to the difficulty of reversing QE and tightening monetary policy."

In an interview given in February, before the SVB crisis, William White, who was chief economist at the Bank for International Settlements, warned of the consequences of the 2008 crisis and pointed to the dilemma confronting central banks.

On the one hand they are pushing up interest rates in the so-called fight against inflation—in reality a fight to suppress the wages upsurge of the working class in response to price hikes—while on the other hand they are fearful the rate rises can set off a collapse, he said.

"We have a more inflationary environment future coming, so real rates should rise, that means nominal rates should rise quite significantly and that one of the worries central banks have is that they could cause instability in the financial system."

He noted the growing divorce between the value of financial assets and the underlying real economy, citing a McKinsey Global Institute study which showed that up until about 2000 broad measures of wealth tracked GDP or income.

"But since then, there's been a huge discrepancy, with wealth rising must faster than GDP. But if production hasn't gone up, while the wealth has, the conclusion you can come to is that it's not really wealth. It was merely a rise in the prices measuring that wealth."

While he did not make the point, the wealth to which he is referring is not that of the population as a whole but the assets, financial and otherwise, of the top echelons, the 1 percent and above. Many sections of the population have zero or negative wealth.

White noted that while major banks were well enough capitalised, "or maybe not," it was a different story in the rest of the system. The past period had seen a "massive movement out of bank credit into credit extended elsewhere; non-bank financial institutions, leveraged loans, private debt, you name it. Non-bank financial institutions are now bigger than the regulated banks, and we don't have the transparency and information to know what going on there in terms of systemic risks."

It was put to him by the interviewer that he had always been something of a doomsayer, yet policy makers had found a way of muddling through. White responded that in his view at some point markets would start to question not only financial stability but the fiscal stability of governments.

"I think now, perhaps for the first time markets are becoming concerned about the sustainability of the fiscal finances of large, advanced countries."

While granting this could be a rationalisation on his part, he continued: "All I do know is that each time you do have another crisis, it gets more difficult to crawl out of it. This whole kicking the can down the road thing, as the problem become more difficult, the solutions you have to offer become less effective."

White concluded with a warning that policymakers "really have to get this right."

"Because what if all of a sudden citizens become convinced that the government is not delivering on its promises? Where does that lead in democracy and faith in the system. The system screwed me, so screw you? These are dangerous things."

In fact, as a result of the bitter experiences going back to the 2008 crisis and beyond, billions of people are already drawing the conclusions White fears.

The key question, as the capitalist system lurches into one crisis after another, with no policy except economic deprivation and war, is the arming of this growing movement with revolutionary socialist perspective which will be the subject of the April 30 worldwide rally organised by the International Committee of the Fourth International to celebrate May Day.