Free fall of First Republic Bank in US signals deepening of financial crisis

Nick Beams
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The plunge in the shares of First Republic Bank continued yesterday, bringing to 95 percent the total loss which began after the bank revealed it had lost $100 billion in deposits as a result of the fallout from the bankruptcy of Silicon Valley Bank (SVB) and Signature Bank last month.

The bank's shares dropped 30 percent on Wednesday after their value was halved the day before, as last month's rescue operation, in which 11 major banks headed by JPMorgan Chase deposited $30 billion, disintegrated.

First Republic's announcement Tuesday that it planned to slash 20–25 percent of its workforce and sell off assets did not stave off a second day of panic selling.

At the start of March, the share price of First Republic was $115. At the close of trade yesterday it was down to $5.69. Trading in the bank's shares had to be halted several times over the past two days because of the rapidity of the plunge.

Throughout the banking crisis, the official story line from regulatory authorities and Biden administration officials has been that the problems are confined to "outliers." According to this narrative, the collapse of SVB was a result of "mismanagement," and the US banking system is "sound" and "resilient."

That piece of fiction was exposed when the bailout of uninsured SVB and Signature depositors, estimated to have cost around $22.5 billion so far, was organised by invoking a "systemic exemption" provision that allowed the Federal Deposit Insurance Corporation (FDIC) to bail out those with more than $250,000 in deposits.

The official story was left in tatters following this week's First Republic share plunge. According to a report in the *Financial Times* (FT) published under the headline "Share sell-off in First Republic shares causes alarm in Washington," the bank was "in touch with the US government, which is on high alert" following the failure of SVB and Signature.

The FT said officials from the White House, the Federal Reserve and the US Treasury had been in contact with First Republic, and the Biden administration was becoming "increasingly concerned" that the bank was running out of time to reassure depositors and investors.

According to the report, an unnamed official maintained that "the government was not concerned about contagion beyond First Republic." If that were the case, then it would be possible for the market to carry out its verdict that, in the words of the *Wall Street Journal*, "First Republic is nearly worthless in its current state."

However, it appears that any bank of almost any size is "too big to fail." This is because the issues leading to their demise are present throughout the financial system. While each bank has its own particular circumstances, the underlying cause is the rise in interest rates at the fastest rate in 40 years.

In the case of SVB, it was the losses on the market value of its Treasury bonds, which it had piled into during the years of ultra-easy money under the quantitative easing program of the US Federal Reserve.

First Republic was heavily into the high-end mortgage market loans, amounting to $173 billion at the end of March, of which around $100 billion were to single buyers, many of them wealthy, whom the bank attracted by offering low rates.

The *Economist* reported that Mark Zuckerberg took out a 30-year mortgage for his $59 million Palo Alto home at 1.05 percent. The value of such loans has now plunged as interest rates have risen.

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As part of the low-rate deal, rich customers agreed to move their deposits to the bank, but they are now moving out. To try to bolster its financial position, First Republic has had to borrow money from the Fed at 4.5 percent interest.

The net interest rate margin—the difference between what First Republic receives on loans and what it pays for money—has contracted, with the result, as the article noted, that the bank earned next to nothing on net interest in March and is essentially paying as much for money as it is receiving.

In some ways, the impending collapse of First Republic may be of greater concern than that of SVB. The California bank operated in a specialised area of the market—high-tech companies and start-ups backed by the inflow of money from venture capital firms.

According to an analysis conducted by the FT, SVB operated what, in many ways, was a Ponzi scheme—a business model in which money and profit are generated by the inflow of more money.

SVB provided money to what it called "fragile start-ups," which meant its deposit base was vulnerable to a drought in venture capital funding.

"It also lent freely to them, expecting to be repaid not from the cash flows of the business, but from the eventual bonanza when new investors supplied another round of capital."

But when this supply dried up because of the tightening of monetary policy by the Fed and cash was withdrawn, SVB had to sell off bonds it had purchased, turning a book loss into a realised loss because the interest rate hikes had lowered the bonds' market value below their purchase price.

First Republic may have far greater significance than SVB because its operations are replicated more broadly by other medium-sized banks in both the home mortgage and commercial real estate markets, which are being hit by the interest rate rises.

The FT cited comments by Sam Stovall, chief investment strategist at the financial intelligence firm CRA Research, who pointed to the possibility of more stress for regional banks.

"I think that in general investors believe [First Republic] is an isolated event, but at the same time, the minute they say that they're then looking over their shoulder to make sure that no other bank is sneaking up on them. It's like the cockroach theory: if you see one, you're going to see more than one," he said.

In the case of commercial real estate, the market problems caused by higher interest rates are being compounded by COVID, because the prevalence of at-home working means the demand for office space is contracting.

Federal officials are now reported to be trying to bring the major banks together to hammer out a deal. But after the failure of the $30 billion major bank rescue operation organised by Treasury Secretary Janet Yellen and JPMorgan chief Jamie Dimon, there appears to be no great appetite for acquiring First Republic because of its parlous financial position.

This has raised the question of whether the "systemic risk exception" to enable the FDIC to guarantee all uninsured deposits should be invoked. But this could lead to a further shift of deposits from small and medium-sized banks.

One way of meeting such a danger would be for the FDIC to guarantee all deposits without limit at all banks, and such a prospect is being canvassed.

But this raises major political problems. First, it would ignite still further deep-going popular hostility and anger, revealing, as workers struggle under ever worsening conditions, that the financial authorities have moved in, yet again, to bail out Wall Street.

Furthermore, it would raise the following issue: If the so-called free market produces one disaster after another in the financial system, with major social and economic consequences for working people, as the 2008 crash revealed, and if it can only survive with the endless pouring in of society's resources, then surely the private ownership of the financial system should be ended and replaced by the establishment of a public ownership system under democratic control.

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