After First Republic takeover, banking crisis deepens

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Throughout the latest phase of the US financial crisis, which started with the collapse of Silicon Valley Bank in mid-March, the Biden administration, regulators, and financial authorities have insisted the banking system is "sound" and "resilient" because their interventions, at least so far, have prevented a meltdown on the scale of 2008.

But reality is speaking louder. The past two months have seen three of the four largest banking failures in US history, eclipsed only by the failure of Washington Mutual in 2008.

In the wake of the deal to take over the failed First Republic bank—the second biggest collapse in history—Jamie Dimon, the chief executive of JPMorgan Chase, which bought the bank, said, "This part of the crisis is over" and the rescue operation "pretty much resolves them all."

Market response yesterday told a different story as the shares of significant regional banks plunged. The shares of PacWest dropped by 27.8 percent, and trading was briefly halted because the fall was so steep, and an index of regional bank stocks dropped 5.5 percent, its worst day since March 17 as the SVB crisis was spreading.

A chain reaction has been set in motion as the market "is focusing on the weakest links and looking for banks that are vulnerable" and going from "the weakest bank to the [next] weakest bank," one analyst told the *Financial Times*.

Another commented that it was "one domino after the next at the moment" with the bears in the market "moving on the next place to short." Short selling involves borrowing a stock and selling it in anticipation it will fall in price and then buying it back at the lower price and returning it to the lender, making a profit on the deal.

Other comments have focused on the longer-term situation for middle-sized and regional banks.

Mimi Duff, managing director of the wealth management firm GenTrust, said: "What's going on today is a flight to quality. We feel like the stresses in the banking system are not over."

According to Julian Wellesley, global banks analyst at the financial firm Loomis Sayles, "We may be moving into a chronic phase of the crisis. It's a difficult outlook for regional banks."

Those difficulties center on fears that depositors will withdraw their money and place it with safer larger banks and concerns that the value of loans made by regional and middle-sized banks, particularly in real estate and commercial property, are being hit hard by the Federal Reserve's rapid hike in interest rates.

The crisis at each bank has its own set of circumstances. For SVB it was set off by the loss in market value of the US Treasury bonds on which it gorged itself when interest rates were low, and it was flush with cash from high-tech start-up companies bankrolled by venture capitalists. In the case of the failed Signature Bank, it was its connection with crypto currencies.

For First Republic, it was the mortgages it had made at very low rates to high-wealth individuals. Others will be hit by the loss of value on commercial property and real estate.

But these problems have the same root cause: the Fed's escalation of interest rates from near zero just a year ago to around 5 percent, with a further rise expected to be announced tomorrow.

The interest rate hikes are the outcome of a protracted crisis of the American financial system which has been developing over the course of several decades, going back to the stock market crash of October 1987.

That crisis resulted in a major shift by the Fed in which it responded to the crash and every succeeding financial storm, arising from speculation, by pumping money into the financial system to fund the next round.

This policy was put on steroids after the crash of 2008, in the wake of which the Fed began its quantitative easing program, buying up government debt to keep interest rates at historical lows.

It was further accelerated after the crisis of March 2020 when the US Treasury bond market froze at the start of the COVID-19 pandemic and the Fed doubled its holdings of financial assets virtually overnight to around $8 trillion.

At the same time, the refusal of the US government and governments around the world to eliminate COVID, fearing that necessary public health measures would produce a stock market crash, created a supply chain crisis which set in motion the largest rise in inflation in four decades.

This created a situation with which the Fed and other central banks had not had to confront over the previous period—the upsurge of the working class for wage demands, striving to break out of the shackles imposed by the trade unions from the end of the 1980s.

The Fed, together with other major central banks, then turned to deal with what it considers the greatest danger of all—a resurgent working class—and initiated interest rate hikes to try and suppress it by inducing a major economic slowdown and recession if necessary.

This has now transformed the financial landscape, a transformation which was the subject of discussion involving top-level financiers organised by the Milken Institute in Los Angeles over the weekend.

Addressing the new conditions, Karen Karniol-Tambour, co-chief investment officer of the giant hedge fund Bridgewater Associates, took issue with market beliefs that the Fed will cut interest rates before the end of the year.

"It's time for the markets to fully digest how constrained central banks are going to be relative to the last 30, 40 years, when every time there was a tiny murmur of a problem, you could just lower rates [and] print money," she said.

IMF chief Kristalina Georgieva presented a picture of a financial system, bloated by the trillions of dollars pumped into it, that is out of the control of would-be regulators.

She blamed "complacency" for the US banks runs, saying there was unnecessary deregulation with a price to pay. "Supervision has not been up to par" as she pointed to the rapid pace of the US bank runs, the like of which has never been seen.

"It is the speed money can move from one place to another. It goes into the territory of the unthinkable," she said.

And the outlook is not for improvement but a worsening of conditions. The expected Fed interest increase has already produced warnings of recession as the number of job openings had fallen to its lowest level in two years, under conditions where the banking crisis is leading to a credit crunch.

Then there is the issue of the US debt ceiling. US Treasury Secretary Janet Yellen sent a letter to Congress on Monday warning if is not lifted, the Treasury may not be able to pay its bills by June 1. This could spark a default and cause serious harm to business and consumer confidence, raise short-term borrowing costs and "negatively impact the credit rating of the United States."

The latter issue has major significance.

One of the reasons the Fed has been able to turn on the financial taps every time a major problem emerges is because of the role of the dollar as the global currency.

But this is now being undermined both because of the continuing banking and financial crises and the ongoing war within the American political establishment manifested in the Trump coup attempt of January 6, 2021, a war which is being continued with the debt ceiling standoff in Congress.

Viewed in this context, the banking turmoil is a major component of a deep-seated crisis of American capitalism. It is not possible to predict the exact course of events. But one thing is clear: the response of the ruling class to this crisis will be to intensify its attacks on the working class to make it pay.

That attack must be met with an even more powerful counter-offensive based on the initiation by the working class of a political struggle for a socialist program.