

# What you need to know about the Credit Suisse crisis and the collapse of US banks

17 March 2023



## Two US banks collapse and one of Europe's largest banks is bailed out – what does this mean for the banking system and markets?

Chaos reigned across global markets this week as investor concerns became sharply elevated due to the collapse of three small banks in the US and the Credit Suisse crisis that saw the bank bailed out.

However, a closer look at the specific situations shows that investors could be creating connections that aren't there – meaning, this isn't a systemic issue likely to lead to widespread system instability.

In short, we're not facing into the next Global Financial Crisis.

### **What's happened?**

Within days, it seemed a banking crisis was on the horizon with the collapse of Silicon Valley Bank (SVB) and Signature Bank, with First Republic Bank on the brink. The heavyweight in global banking, Credit Suisse, then amped up this sentiment with a crisis of its own. So, what happened?

SVB hit troubled waters when a significant proportion of its venture capital clients asked for their deposits to be returned. This meant SVB was forced to sell some bond holdings which resulted in a US\$1.5 billion loss on those investments. When this loss was revealed, SVB's stock price fell 60% as the bank tried to raise capital to cover those losses. The stock fell another 60% the following day before the company stock was suspended from trading and regulators and the Federal Deposit Insurance Company closed the bank.

Signature Bank faced a similar problem to SVB when many customers wanted to withdraw their deposits. Like SVB's focus on tech, Signature Bank specialised in one sector, crypto. It was also found that the composition of assets held by these banks was not in line with industry averages, for example, cash was significantly lower. This presented a liquidity risk.

Next to be hit by a crisis of confidence was First Republic Bank which teetered on the brink of collapse.

The outcome? In a move designed to protect confidence in the country's banking system, the government announced that all deposits with SVB and Signature Bank will be guaranteed regardless of dollar value. For First Republic Bank, a group of large US institutions stepped in and pledged US\$30 billion in deposits.

In contrast to the US banks, the situation for Credit Suisse did not emerge as suddenly. Credit Suisse has been hit by a series of corporate scandals in recent years, including a huge trading loss from the implosion of Archegos Capital and the closure of US\$10 billion of investment funds linked to collapsed finance firm Greensill.

Credit Suisse's share price plunged 24.2% after its largest shareholder, Saudi National Bank, declined to make any further investment. This came after the bank announced a delay in the publication of its annual report due to a last-minute request from the US Securities and Exchange Commission that revealed 'material weaknesses' in their reporting. When the report was published on 14 March, Credit Suisse posted its fifth consecutive quarterly loss. A sharp decline in the level of assets under management in its asset management division alarmed investors and its Swiss banking unit, normally a reliable cash cow, also reported disappointing results.

The Swiss National Bank then stepped up and announced Credit Suisse will borrow over US\$50 billion under a Covered Loan Facility and a short-term liquidity facility which are fully collateralised by high quality assets.

The latest news is that UBS will take over Credit Suisse, as we predicted. The Swiss National Bank brokered the deal over the weekend to restore confidence and contain the contagion risk.

## **Is this a signal of a crisis to come?**

Commentators and investors have been quick to look for parallels with the Global Financial Crisis (GFC) of 2008.

However, we do not see this as a systematic global banking or financial crisis. The issues facing these banks are very different. For SVB, it is the nature of their client base and of the balance sheet. Credit Suisse is a large global bank which has not been managed well for years and has been bleeding customers, depositors and assets under management.

There are a variety of other reasons that indicate that this is not a re-run of the 2008 crisis. For one, central banks are taking action quickly to restore confidence and stability, as evidenced by the US Federal Reserve protecting deposits and the Swiss National Bank lending to Credit Suisse.

Also, the lessons learned from the GFC mean that regulations have tightened ensuring the banks are better capitalised.

For Australians, our banks operate in a tighter regulatory environment with stricter oversight. Regardless, our banks are well-capitalised with strong liquidity. This was confirmed by ratings agency Moody's this week.

## **What can we expect to see next?**

Off the back of this banking instability, credit will be harder to come by as banks will be reticent to lend. This will result in further tightening in the economy.

We also expect a period of higher volatility will likely persist.

The issues that have emerged in the last two weeks have their origin in the period of ultra low interest rates and 'easy money' in the aftermath of the GFC, and more recently the significant central bank intervention at the start of COVID.

Central banks have under-estimated the significant increase in inflation brought about by pent up demand after COVID, higher energy prices resulting from the invasion of Ukraine, and tight labour markets in many developed economies. Developed economy central banks are draining excess liquidity from the global financial system to combat inflation. In doing so, they have exposed poor lending and investment decisions that were made in the period of 'easy' money.

Inflation data remains stubbornly high in many economies. This will mean continued volatility in the short term as markets continue to digest the highest levels of inflation for over three decades and interest rates not seen since prior to the GFC. This adjustment period was never going to be smooth and there may be further 'surprises' to come.

In general, large banks globally have much more robust capital ratios and better liquidity than at any time in the last 30 years. This is particularly true of Australian banks which have some of the highest capital ratios in the world. However, the speed of adjustment in monetary policy means that the market will be very discerning in the short term and punish those organisations that have weak or unsustainable business models or those that are not financially robust. This is to be expected at the end of an economic cycle but will offer attractive investment opportunities for long term, patient investors.

Source – Colonial First State