



R&R Weekly Column
By Brunello Rosa



The Collapse of SVB Marks The Return of Financial Stability Concerns

At the end of last week, [the Silicon Valley Bank \(SVB\) collapsed](#), just a few days after a much smaller lender, Silvergate, announced a [plan to wind down its operations](#). The bank had USD 212bn in assets, a market valuation of around USD 16bn as recently as Wednesday last week, and a valuation of USD 44bn less than 18 months ago. At the end of December 2022, SVB had USD 173bn in deposits. However, on Thursday the bank suffered a USD 42bn withdrawal of deposits, after losing USD 1.8bn in a USD 21bn sale of part of its bond portfolio (made up of Treasuries and mortgage-backed securities).

[SVB tried to make a final, desperate attempt to shore up its capital](#) by issuing USD 1.25bn of its common stock, plus USD 0.5bn of mandatory convertible preferred shares (which are slightly less dilutive to existing shareholders), while private equity (PE) firm General Atlantic had previously agreed to buy 0.5bn of SVB's common stock in a separate private transaction. But this last attempt failed, and the bank was shut down by the Federal Deposit Insurance Corporation (FDIC), the US regulator that guarantees bank deposits of up to USD 250,000. Following that, [the Bank of England put the UK arm of SVB into insolvency as well](#).

Why did the bank fail? Being exposed to crypto trading ([Circle, the operator of one of the world's largest stablecoins, said that USD 3.3bn of its reserves were held at SVB](#)) and start-ups, including in the healthcare sector, one could think that the bank failed given the collapse in tech and crypto assets valuations over the last year. But the reality is much simpler, and to a certain extent is even more alarming.

The business model of SVB was surprisingly "conservative". The bank would receive large deposits from tech and crypto companies that had raised their funds through venture capitalists and PE firms. These deposits were reinvested into ultra-safe bonds – in particular Treasuries and mortgage-backed securities, both of them held in massive quantities by the Federal Reserve – and also foreign government bonds. [As of the end of 2022](#), the bank had \$26.1bn in available-for-sale securities and around \$91bn of securities in a held-to-maturity portfolio.

This business model would make money as long as policy interest rates were low, such that the cost of deposits would be minimal and the value of the bond portfolio would remain high. But as the Fed increased its policy rates by around 5% in one year, [the cost of deposits rose from 0.14% to 2.33% in the same time-span](#), while the value of the bond portfolio declined. For this reason, the bank had reported a loss of USD 15bn at the end of last year.

So, the bank didn't fail because it had invested in assets that were too speculative, or followed a business model that was too risky. It collapsed because the most basic risk management practices were not followed. Banks tend to have a diversified depositor base, with a number of small – fully insured – depositors. They would not run at the first bad news. [But the vast majority of SVB's depositors were not insured](#), so they wanted their money out as soon as they perceived an increased default risk. Furthermore, banks would normally invest in floating rate notes, which gain in value if interest rates go up, or they would enter into swap agreements to insure against rising interest rates. This didn't happen.

So, why this is scary? We discussed how recently the [New York Fed had defined an \$r^{**}\$ rate](#), a rate over which financial stability episodes could emerge. If r^{**} was below the neutral interest rate, r^* , or in any case if it was below the terminal rate, the central bank may be forced to stop its tightening cycle in order to prevent further episodes from emerging. So, as [Hyman Minsky predicted in his Financial Instability Hypothesis](#), downturns in financial markets occur when interest rates go up. SVB was a fragile bank, from a Minskian perspective, for the reasons exposed above. But other lenders may fall from similar difficulties if interest rates continue to increase at this speed. And all this is happening just days before the next FOMC meeting, in which [the Fed may decide to ratchet up the pace of its tightening cycle again, by 50bps](#), in response to the positive news from the labour market and the stubbornly high inflation rate.

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Looking Ahead

The Week Ahead: US Inflation To Fall; EZ Headline Inflation To Ease, While Core Rises; ECB To Increase Interest Rates

In the US, in February, both headline and core inflation are expected to fall to 6.0% y-o-y (p: 6.4%) and 5.5% y-o-y (p: 5.6%). In February, retail sales are likely to shrink by 0.3% m-o-m (p: 3.0%).

In the EZ, in February, headline inflation is seen decreasing to 8.5% y-o-y (p: 8.6%), while core inflation is seen edging up to 5.6% y-o-y (p: 5.3%). January, IP is seen recovering to 0.2% y-o-y (p: -1.7%).

Among the largest EZ economies, inflation rate is expected to: i) increase in France to 6.2% y-o-y (p: 6.0%); and ii) ease off in Italy to 9.2% y-o-y (p: 10.0%).

Still in the EZ, the ECB is expected to raise its main policy rate by 50bps, thus i) interest rate on the 'main refinancing operations' to 3.5%; ii) interest rate on the 'marginal lending facility' to 3.75%; and iii) 'deposit facility' to 3.0%.

In the UK, in January, the unemployment rate is likely to edge up to 3.8% (p: 3.7%).

The Quarter Ahead: SVB Collapses And Regulators Take Over; Li Qiang Becomes China's Premier; War In Ukraine

Silicon Valley Bank collapses after failing to raise capital. California regulator closed Silicon Valley Bank (SVB) and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver for later disposition of the assets. SVB collapsed suddenly, following 47 hours of bank run and capital crisis, leading to the second-largest failure of a financial institution in US history after Washington Mutual in 2008. SVB focused on lending to start-ups and tech companies. As a result, bank shares fell in the US and Europe.

Li Qiang becomes China's premier, replacing retiring Li Keqiang. As Xi Jinping is elected President of The Republic for the third time, Li Qiang, the former Communist Part chief of Shanghai, was behind the 2-month COVID-19 lockdown of Shanghai. Li Qiang was also president of Xi Jinping's chief of Staff in the early 2000s.

War in Ukraine. Nationwide outages continue after strikes. As Ukrainian Deputy Defence Minister reported that the fights in Bakhmut "escalated", as Russian forces renew their push. Meanwhile, Zelensky rejected Russian claims that Ukraine was behind Nord Stream's explosions that damaged gas pipelines running between Russia and Germany.

Last Week's Review

Real Economy: EZ QoQ GDP Stalled And YoY GDP Slowed Down; US Unemployment Rose And Non-Farm Payroll added 311K

In the US, In February, the unemployment rate increased to 3.6%. NFPs increased by 311K (p: 504K).

In the EZ, in Q4, GDP stalled on a quarterly basis (p: 0.3%) and decelerated to 1.8% y-o-y (c: 1.9%; p: 2.4%). In January, retail sales contracted by 2.3% y-o-y (c: -1.8%; p: -2.8%) and advanced by 0.3% m-o-m (c: 1.0%; p: -1.7%).

Among largest EZ economies, in February, in Germany, the inflation rate stood unchanged at 8.7% y-o-y as expected.

In the UK, in January IP shrank by 0.3% m-o-m (c: -0.1%; p: 0.3%) and 4.3% y-o-y (c: -4.0%; p: -4.0%).

Financial Markets: Stock Prices, the Dollar, Oil prices and Bond Yields Fell, while Gold Prices Edged Up On a Weekly Basis

Market Drivers: Investors worried about rate hikes. Over the renewed hawkishness from Powell, stocks pulled back. Concerns rose also due to the collapse of SVB Financial. As a result, treasury yields plunged, with the 2Y UST yield posting its biggest 2-day drop since 2008, as investors sought safety after the shutdown of SVB.

Global Equities: Decreased w-o-w (MSCI ACWI, -3.6%, to 616.60). The US S&P 500 index edged down (-4.5% w-o-w, to 3,861.59). In the EZ, share prices were down (Eurostoxx 50, -1.5% w-o-w, to 4,229.53). In EMs, equity prices moved down (MSCI EMs, -3.3%, to 955.28). Volatility rose to 23.85 (VIX S&P 500, 52w avg.: 26.1; 10y avg.: 18.5).

Fixed Income: w-o-w, the 10-year US treasury yields were down (-25 bps to 3.70%). The 2-year US Treasury yields fell (-27 bps to 4.59%). The German 10-year bund yield decreased (-25 bps to 2.46%).

FX: w-o-w, the US Dollar Index decreased (DXY, +0.1%, to 104.6; EUR/USD +0.1%, to 1.06). In EMs, currencies fell (MSCI EM Currency Index, -0.5% w-o-w, to 1,666.38).

Commodities: w-o-w, oil prices decreased (Brent, -3.7% to 82.64 USD/b). Gold prices rose w-o-w (+1.0% to 1,872.70 USD/Oz).



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Abbreviations, Acronyms and Definitions

a	Actual	LN	Northern League, Italy
AKP	Justice and Development Party, Turkey	MSS	Five Star Movement, Italy
ann.	annualized	m-o-m	Month-on-month
ARS	Argentinian Peso	mb	Million barrels
avg.	Average	mb/d	Million barrels per day
bn	Billion	MENA	Middle East and North Africa
BoC	Bank of Canada	MHP	Nationalist Movement Party, Turkey
BoE	Bank of England	mn	Million
BoJ	Bank of Japan	MPC	Monetary Policy Committee
bpd	Barrels per day	NAFTA	North-American Free Trade Agreement
bps	Basis points	NATO	North Atlantic Treaty Organization
BS	Balance sheet	OECD	Organization for Economic Cooperation and Development
c	Consensus	Opec	Organization of Petroleum Exporting Countries
C/A	Current account	p	Previous
CB	Central bank	P2P	Peer-to-peer
CBB	Central Bank of Bahrain	PBoC	People's Bank of China
CBK	Central Bank of Kuwait	PCE	Personal Consumption Expenditures
CBT	Central Bank of Turkey	PE	Price to earnings ratio
CDU	Christian Democratic Union, Germany	PM	Prime minister
CNY	Chinese Yuan	PMI	Purchasing managers' index
CPI	Consumer Price Index	pps	Percentage points
DJIA	Dow Jones Industrial Average Index	pw	Previous week
DJEM	Dow Jones Emerging Markets Index	QCB	Qatar Central Bank
d-o-d	Day-on-day	QAR	Qatari Riyal
DXY	US Dollar Index	QE	Quantitative easing
EC	European Commission	q-o-q	Quarter-on-quarter
ECB	European Central Bank	RE	Real estate
ECJ	European Court of Justice	RBA	Reserve Bank of Australia
EIA	US Energy Information Agency	RRR	Reserve Requirement Ratio
EM	Emerging Markets	RUB	Russian Rouble
EP	European Parliament	SWF	Sovereign Wealth Fund
EPS	Earnings per share	tn	Trillion
EU	European Union	TRY	Turkish Lira
EUR	Euro	UAE	United Arab Emirates
EZ	Eurozone	UK	United Kingdom
Fed	US Federal Reserve	US	United States
FOMC	US Federal Open Market Committee	USD	United States Dollar
FRB	US Federal Reserve Board	USD/b	USD per barrel
FX	Foreign exchange	UST	US Treasury bills/bonds
FY	Fiscal Year	VAT	Value added tax
GCC	Gulf Cooperation Council	VIX	Chicago Board Options Exchange Volatility Index
GBP	British pound	WTI	West Texas Intermediate
GDP	Gross domestic product	WTO	World Trade Organisation
IMF	International Monetary Fund	w	Week
INR	Indian Rupee	w-o-w	Week-on-week
IPO	Initial public offering	y	Year
IRR	Iranian Rial	y-o-y	Year-on-year
JPY	Japanese yen	y-t-d	Year-to-date
k	thousand	ZAR	South African Rand
KSA	Kingdom of Saudi Arabia	2y; 10y	2-year; 10-year



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