



R&R Weekly Column
By Brunello Rosa



Banking Crisis Foregrounds The Conflict Between Price Stability And Financial Stability

The ongoing banking crisis claimed more victims last week. [The parent company of SVB filed for bankruptcy under chapter 11 rules](#) in order to protect its assets from creditors. Meanwhile, Silvergate has gone under, [and First Republic bank is also under stress](#). A group of 11 banks pooled resources to put together a rescue plan worth around \$30 billion, in an attempt to stop the slide on the banks' equity prices, which had collapsed by 90% from their peak of \$219 reached at the end of 2021. It is not yet clear whether this rescue plan will be effective, [as the fall in the banks' equity prices has not yet stopped](#).

Much more significantly, on the other side of the Atlantic, one of the major European lenders, Credit Suisse, also got into trouble. Credit Suisse's troubles started years ago, with very poor investment decisions, the most recent and insignificant of which have been [the financing given to Greensill and to Archegos](#), both of which resulted in heavy losses for the bank.

Credit Suisse also had to apply for public rescue, with the [Swiss National Bank providing emergency funds to it to the tune of €50 billion](#). During the weekend, the acquisition of Credit Suisse in its entirety by its historical rival, [UBS will likely put an initial end to this story](#). Its investment bank operations, which were supposed to be shut down anyway, remain the most problematic part of the sale, as they may conceal hidden losses.

The cases of SVB and Credit Suisse are very different. SVB had engaged in a [very conservative business model, based on re-investing in safe US Treasury bonds](#); its collapse was caused by the lack of basic risk management practices. Credit Suisse meanwhile had engaged in a series of risky operations, the losses from which ultimately eroded the bank's capital.

While this episode of financial instability was unfolding, central banks had to decide whether or not to continue their tightening cycles in order to combat still-elevated inflation rate. As we [discussed in our review](#), the European Central Bank decided to carry on with its pre-announced 50 basis point increase in interest rates, in part to address inflation but also to send a signal that the European banking system was solid and not involved in the ongoing banking crisis affecting US and Swiss banks.

This week, it will be the US Federal Reserve and [Bank of England's](#) turn to decide on their respective interest rates. As discussed in our previews, we expect both central banks to increase their policy rates by 25 basis points, unless new financial instability episodes emerge before their policy meetings take place.

But the genie is out on the box: it has become patently clear that a conflict exists between pursuing price stability and financial stability goals. We had discussed this at length in our [2023 Global Outlook](#), long before these episodes manifested themselves. During her press conference, Christine Lagarde attempted to provide assurances that such a conflict does not exist, as the ECB will use its interest rates primarily to fight inflation, and its liquidity tools to prevent financial instability from spreading. But the reality is likely to be much more difficult.

Central banks may need to stop their tightening cycles, and perhaps even start cutting rates or resuming QE, to make sure that the financial system is not in danger. The next few weeks will show whether or not central banks will have to resort to these kinds of measures to prevent further financial instability episodes.

Our Recent Publications

🔗 [Preview: In a Finely Balanced Decision, We Expect The BoE To Raise Rates In March, Financial Instability Permitting](#), by Brunello Rosa and Nato Balavadze, 17 March 2023

🔗 [Review: ECB Increases Rates and Confirms to Be Data Dependent, But Reiterates That "There's More Ground To Cover"](#), by Brunello Rosa and Nato Balavadze. 16 March 2023

🔗 [ECB Preview Update: Uncertainty On ECB Decision Increases](#), by Brunello Rosa and Nouriel Roubini, 14 March 2023

🔗 [Preview: ECB To Increase Rates But Condition Timing and Size of Further Rate Hikes on Financial Conditions](#), by Brunello Rosa, Nouriel Roubini and Nato Balavadze, 13 March 2023

Looking Ahead

The Week Ahead: UK Headline Inflation To Fall; Composite PMI To Stay The Same In EZ And Fall In UK; CBs To Increase Interest Rates

In the US, in March, according to flash estimates, S&P Global Services and Manufacturing PMIs are expected to increase to 50.8 (*p*: 50.6) and 47.6 (*p*: 47.3), respectively.

In the EZ, in March, consumer confidence is seen shrinking by -18.2 (*p*: -19). In March, according to flash estimates, S&P Global Services PMI is expected to increase to 49 (*p*: 48.5), while Manufacturing PMI is likely to fall slightly to 52.5 (*p*: 52.7). The Composite PMI is seen remaining the same at 52.

In the UK, in February, headline inflation rate is expected to ease off to 9.8% y-o-y (*p*: 10.1%), while core inflation is likely to stay unchanged at 5.8% y-o-y. In March, Consumer Confidence is seen falling to -37 (*p*: -38). February's retail sales are expected to contract by 4.7% y-o-y (*p*: -5.1%). In March, according to flash estimates, S&P Global Manufacturing PMI is expected to increase to 50 (*p*: 49.3), while Services PMI is likely to fall slightly to 53 (*p*: 53.5). Composite PMI is seen decreasing to 52.7 (*p*: 53.1).

CBs are expected to raise interest rates. In the US, the Federal Reserve is likely to increase its target Fed funds range by 25 bps to 4.75% - 5.00%. In the UK the Bank of England is seen increasing its Bank Rate (BR) by 25 bps to 4.25%.

The Quarter Ahead: SVB Seeks Bankruptcy Protection; First Republic Shares Tank; ICC Issued Arrest Warrant For Putin

Silicon Valley Bank seeks bankruptcy protection. The company filed for a court-supervised reorganization under Chapter 11 bankruptcy protection to seek buyers for its assets. The move comes as emergency measures intended to shore up confidence have so far failed to dispel worries about a financial contagion.

First Republic shares fell almost 33% despite \$30 bl support. First Republic secured \$30 bl rescue from large banks. The lender also said it had borrowed up to \$109 billion from the U.S. Federal Reserve and an additional \$10 billion from the Federal Home Loan Bank.

The International Criminal Court (ICC) issued an arrest warrant for Vladimir Putin over war crime allegations. The claims focus on the unlawful deportation of children from Ukraine to Russia since Russia's invasion of Ukraine. Biden welcomed ICC's decision.

Last Week's Review

Real Economy: US Inflation Fell; EZ Headline Inflation Eased, While Core Rose; ECB Increased Interest Rates

In the US, in February, both headline and core inflation fell to 6.0% y-o-y (*p*: 6.4%) and 5.5% y-o-y (*p*: 5.6%) as expected. In February, retail sales decelerated to 5.4% y-o-y (*p*: 7.7%).

In the EZ, in February, headline inflation decreased to 8.5% y-o-y (*p*: 8.6%), while core inflation edged to 5.6% y-o-y (*p*: 5.3%) as expected. January, IP recovered to 0.9% y-o-y (*p*: -2.0%).

Among the largest EZ economies, inflation rate: i) increased in France to 6.3% y-o-y (*c*: 6.2%; *p*: 6.0%); and ii) eased off in Italy to 9.1% y-o-y (*c*: 9.2%; *p*: 10.0%).

Still in the EZ, the ECB raised 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 remained unchanged at 3.7% (*c*: 3.8%).

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

Market Drivers: Banking worries weighed on stocks. In spite of the support actions designed to shore up investor confidence, this has not been restored yet. Yields fell, as a result of lower growth expectations and higher risk aversion.

Global Equities: Decreased w-o-w (MSCI ACWI, -0.7%, to 612.1) dragged down by the fall in bank equity prices. The US S&P 500 index edged up (+1.4% w-o-w, to 3,916.64). In the EZ, share prices were down (Eurostoxx 50, -3.9% w-o-w, to 4,064.99). In EMs, equity prices moved down (MSCI EMs, -0.9%, to 946.87). Volatility rose to 25.8 (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 (-27 bps to 3.44%). The 2-year US Treasury yields fell (-75 bps to 3.85%). The German 10-year bund yield decreased (-39 bps to 2.11%).

FX: w-o-w, the US Dollar Index fell (DXY, -0.7%, to 103.9; EUR/USD +0.2%, to 1.07). In EMs, currencies increased (MSCI EM Currency Index, +0.3% w-o-w, to 1,671.44).

Commodities: w-o-w, oil prices decreased (Brent, -12.5% to 72.47 USD/b). Gold prices rose w-o-w (+6.8% to 1,993.70 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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