BUSINESS NEWS

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Instant View: Bank stocks tank, markets rethink rate-hike path

By Reuters Staff

(Reuters) - Bank stocks around the world plunged on Monday even as President Joe Biden vowed to take whatever action was needed to ensure the safety of the U.S. banking system, after Silicon Valley Bank and Signature Bank collapsed late last week.

People gather outside of the Silicon Valley Bank (SVB) headquarters in Santa Clara, California, U.S. March 10, 2023. REUTERS/Nathan Frandino

Biden's attempt to reassure markets and depositors came after emergency measures by the United States to guarantee deposits at tech-focused lender SVB failed to dispel investor worries about potential contagion to other banks worldwide.

In the United States, First Republic Bank tumbled by as much as 76.6% despite news it had secured fresh financing, while other regional banks also nosedived.

First Republic had been able to meet withdrawal demands on Monday with the help of extra funding from JP Morgan Chase, the mid-cap lender's Executive Chair Jim Herbert told CNBC, adding that it was not seeing a massive deposit outflow.

Europe's STOXX banking index closed 5.8% lower. The S&P 500 Banking Index was down 6.3%, while the SPDR S&P Regional Banking ETF was down 11.6%. The S&P 500 itself was up 0.26%.

Yields on safe-haven government bonds such as U.S. Treasuries and German Bunds fell sharply, while money markets quickly dialed back bets on the scope for further rate hikes from the Federal Reserve and the European Central Bank.

COMMENTS:

QUINCY KROSBY, CHIEF GLOBAL STRATEGIST, LPL FINANCIAL, CHARLOTTE, NORTH CAROLINA

"The problem is the Fed and government officials are doing everything they can in terms of liquidity and depositors being taken care of, but until these (bank) ETFs stabilize, what it indicates is that there's still a lack of confidence in the financial system. We're not seeing investors come in at these lower, perhaps compelling, valuations."

"The KBW and the KRE are the bellwethers for the regional financial system, and what we're seeing now is they're still tanking."

"You may hear an announcement from the Federal Reserve despite the fact that they are in a blackout period."

"But the biggest fear right now is contagion. Contagion is underpinned by fear and panic, and that's more difficult to control than providing liquidity and covering depositors."

"This is so far a regional bank issue. But I'm looking at the XLF (SPDR Financial Select fund) too. You have to see stability in the banks' ETFs - the regionals and the large - in order to restore confidence in the overall market. How do you have a banking system under pressure and then have the rest of the market positive? At the very core, you need a stable banking system."

MARCO TROIANO, HEAD OF FINANCIAL INSTITUTIONS RATINGS, SCOPE RATINGS

"The events unfolding are testing the post-crisis regulatory set-up. The only contagion threat I can see is if investors started to think that despite all the constraints banks have been subjected to post-GFC they are not the low-risk business we thought they had become"

"The situation is very different in Europe versus the United States. There the banks that have failed fell into a category of lenders with less 250 billion euros of assets that were not considered systemic so were not subject to a number of requirements on capital, liquidity. In Europe the corresponding asset threshold is of 30 billion euros and even lenders with fewer assets are still subject to those requirements."

GUY MILLER, CHIEF MARKET STRATEGIST, ZURICH INSURANCE GROUP, SWITZERLAND

"What we saw from the Fed was a quick and correct intervention, putting in some circuit breakers into the system."

"Is it enough to stop a repricing? No. What they did was significant but the risks are still there, particularly as we still face recession and rising defaults. The Fed and ECB are still moving rates higher."

"Right now I don't think the Fed will do more. They do need to acknowledge that they are being vigilant and are on top of the situation."

"Remember just a week ago markets were looking at a 50 bps rate hike in March. So they can move by 25 bps and acknowledge that they recognize the disruptions."

"The issues that face US and European banks are not dissimilar it's about rising interest rates and an inverted yield curve at a time of rising defaults."

"In terms of the European banking sector - it had been one of the best performing since October, with little if any risk being priced in."

"I do believe that European banks are in better shape than 15 years ago. I do think it's good that the ECB has taken oversight of banks but we do think there will be more strain on financials and the cost of doing business will go up, and that means pressure on margins."

KEN POLCARI, MANAGING PARTNER, KACE CAPITAL ADVISORS, BOCA RATON, FLORIDA

"It's pricing 50 (basis points) off the table for sure, I am not so sure that I would say 25 is off the table yet, that is going to depend on what happens tomorrow and Wednesday (with inflation data) in terms of it is really hot how is the Fed going to be able to back away even in the middle of this crisis. The banking crisis, I think they fixed, they made that very clear, how people will react will be another issue, but I don't think there is a risk of this contagion the way they thought it was. I do believe they are probably not going to raise but I don't think it is completely off the table and that is why the market is confused. Is it on? Is it off? One minute you talk to someone they say there is no way they are going to do it. The former Fed Chair today said you have to keep it on the counter because if inflation continues to get out of control they have to focus on inflation, the banking thing will resolve itself, so you have conflicting mouthpieces which is contributing to the nervousness. The minute there is nervousness, the path of least resistance is down not up, which is why you're seeing more pressure on the market right now.

"Do I think the market is going to reprice further – I do because the banking thing is an issue, or was an issue, for the most part it is resolved, but I suppose the fear is now you have First Republic this morning, welcome to the social media world of run on the banks."

"European markets are all down 2.5%-3% on account of the nervousness here so I wouldn't be surprised if we saw our markets down another 1%-1.5% on top of where it was last week just until they get through this. There was a lot of different views on what happened over the weekend – was it a bailout, it wasn't a bailout, who gets saved – it's the rich again. I don't think anyone has a choice, you could not let the system fail and then penalize all those depositors that did nothing but deposit money at the bank and that would've created a whole new dynamic. They had to do what they did but they let the bank fail, equity holders lost, bondholders lost, it was the depositors that got saved which in the end was the right thing to do."

CHRISTOPHER MCGRATTY, HEAD OF U.S. BANK RESEARCH, KBW, NEW YORK

"Things are moving at warp speed. The market seems to think there is going to be more stress. The question is at what point do they become self-fulfilling? When you start seeing lines outside of banks."

"I've seen this narrative play out in 2008 and markets can be unwound fairly quickly."

"Another interesting thing is the bond market. It's generally a read of the future. They're usually early and right. In the last couple of days bond yields have collapsed and that's telling you there is a long of stress on the financial system and expectations for additional rate hikes are getting pulled back pretty quickly."

"Right now we're dealing with liquidity as the primary risk to the industry. "

"(The Regulators) implicitly guaranteed the deposits of all insured and uninsured depositers are going to be made whole and that's a great sign."

"But the issue is people are panicking and moving money between the banks and my guess is a lot of it ends up with larger banks. Even though liquidity measures have significantly improved overnight, there could be additional stress."

("First Republic) has a strong capital position and liquidity position which got stronger overnight but the real issue for the industry is that there is a crisis of confidence in the stickiness of deposits. When that becomes dislocated, things can move very quickly."

RICHARD SAPERSTEIN, CHIEF INVESTMENT OFFICER, TREASURY PARTNERS, NEW YORK

"While the Fed has historically cut interest rates following major negative financial events, such as a bank failure, efforts by regulators to bail out SVB depositors and provide loans to struggling banks will reduce systemic risk and enable the Fed to continue raising interest rates in an effort to keep fighting inflation."

"Going forward, we expect tighter bank lending standards, cautious investing on the part of private equity and venture capital funds and a further decline in economic activity as a result of this incident."

"SVB was not subject to the Federal Reserve's stress tests. However, the Fed was the primary regulator of SVB and the bank's obvious balance sheet duration mismatch and overconcentration of its loan book calls into question the Fed's regulatory prowess."

"Bailing out depositors will have long run political ramifications. The implementation of the new Bank Term Funding Program, which provides loans to struggling banks, shows that regulators are prepared to take decisive action to prevent systemic risk. However, in the long run, markets will question the Federal Reserve's reputation as the banking system regulator."

ART HOGAN, CHIEF MARKET STRATEGIST, B. RILEY WEALTH, NEW YORK

"I think the authorities moved rapidly to shore up confidence and that was the right thing to do."

“So with that as a backdrop and in a market that was pretty jittery coming up to its worst week of the year, certainly the potential for us to bounce a bit especially in the sectors outside of financials is there.”

“But remember, it’s also a week that is going to be littered with economic data which will likely shape our opinion of what the Fed will do at its next meeting.”

“So we’ll be keeping a close eye on things like CPI, which comes out on Wednesday, and PPI and then and a host of other pieces of economic data and all of that will be seen through the lens of what it means for monetary policy. It’s going be a busy week for sure.”

“There’s another full week of data to look at as well, think that’s most likely why they’ll stick to their 25 basis point cadence because a lot of that data largely got ignored last week because of the SVB situation.”

“I think what’s really going on is we’re finding out in real time what the risk of rising interest rates at such a fast pace can do to the balance sheets of some of the regional banks.”

“Every regional bank has sort of its own unique exposure to different part of the market and that’s why they are set up that way.”

“For example, if you’re a regional bank that’s exposed to commercial real estate, well, then office real estate isn’t a positive right and back in the selloff in the energy crisis you saw all the regional banks in Texas come under pressure because of their exposure to oil.”

“So right now investors are trying to look at the whole group and see which one has the most potential for the most negative exposure. SVB obviously had exposure to VCs which are under pressure now due to a rising rate environment and low dealmaking environment. But it is going to be case by case for regional banks.”

IAN LYNGEN, HEAD OF RATES STRATEGY, BMO CAPITAL MARKETS, NEW YORK

"Given the severity of the recent developments (i.e. largest bank failure since 2008) as well as the pace, if the FOMC were meeting today (which it is not), it would most likely pause to give the situation time to stabilize and allow regulators and investors time to reassess. However, there is more than a week until Powell announces the Fed's next move – as well as Tuesday's CPI release. While our baseline cynicism leaves us skeptical that the situation will quickly resolve in favor of enough stability to allow the Fed's to immediately continue with a 25 bp hike next week, we're certainly of the mind that if the Committee wants to signal its inflation fighting resolve, staying the course is the most prudent approach. That being said, taking a breather in March to gain a better understanding of the contagion risk with the intention to restart the journey to terminal in May has its merits as well. We're leaning toward the latter at the moment."

RANDY FREDERICK, MANAGING DIRECTOR OF TRADING AND DERIVATIVES, CHARLES SCHWAB, AUSTIN, TEXAS.

"I think there's concern out there that what happened to SVB could spillover to other banks and when there's uncertainty like this, people get scared and when people get scared the natural reaction tends to be to hit the 'sell' button."

"Regional banks are obviously smaller and not as well capitalized and the failures we've seen so far have been more regional than global. If you are going to have contagion fears then it tends to be against companies that investors rightly or wrongly have perceived to fail."

"We haven't seen a major bank like a Citigroup or Wells Fargo or JPM fail so I think smaller banks are likely the most vulnerable."

"We've seen substantial decline in the probabilities of what kind of rate hikes we are going to get. Last week, I was expecting a half percent rate hike but those odds have now dropped all the way down to only a 50% probability of a one quarter point hike, which at this point means that we're probably not going to get any rate hike."

"At the moment, the odds are that there won't be a hike next week. But that could change and it all depends on how the fallout goes, if the banking system calms down, the markets settle

down then I think those probabilities could go back up.”

“Guaranteeing depositors is important, I think that’s probably the most important thing.”

“What I think would probably be on the table is perhaps increasing the amount of FDIC insurance on cash deposits. That $250,000 level has been set for a very very long time and it has not increased given changes in inflation and the value of the dollar over many years so I’m frankly surprised that it has been so low.”

“So I would expect that they would at least review that number down the road, not that would necessarily prevent what has happened but would give people the confidence that they could hold larger cash deposits. Not sure that would happen but possibly something that will be discussed.”

MARK DOWDING, CHIEF INVESTMENT OFFICER, BLUEBAY ASSET MANAGEMENT, LONDON:

“We don’t think that a lot of the issues that are impacting U.S. banks are ones that will be manifested in European banks.

“Because of the funding and accounting practices in Europe compared with the U.S., we are less concerned.

“However, there is a sense of contagion and where we see a repricing around financials is leading to a repricing across markets.

“We are not changing our positioning on banks across our funds, and tend to be more constructive on European banks versus the U.S.”

JEROME LEGRAS, HEAD OF RESEARCH AT AXIOM ALTERNATIVE INVESTMENTS, PARIS

“Market moves are a bit exaggerated because European banks have a much better interest rate risk management framework than regional U.S. banks. But it’s also a good thing that people are waking up to interest-rate risk. It’s definitely something that has to be monitored and some investors were a bit complacent, especially in the U.S. or Japan.

“We’ll see how it changes the Fed path, but I definitely can’t escape the feeling that one reason for ditching the moral hazard rhetoric and offering the facility to banks is that the Fed wants to be free to continue to hike should it want to and not be constrained by banks’ balance sheets.”

JAN VON GERICH, CHIEF ANALYST, NORDEA, FINLAND

“The ECB certainly is not going to stop on the basis of what we know now. If the markets aren’t cooled down, then maybe they will have to reconsider.

“I think on the margin the Fed will press ahead by 25 basis points next week. But the discussion of whether they will hike by 25 or 50, that is gone.

“The rate hikes will continue. Of course, what happens further out, if it’s right to take out some of the pricing further out, there is of course a case for that.

“If markets remain in a crisis mood, or in a very volatile set up, then the Fed doesn’t want to increase that volatility even further. But for now I think that 25 bps next is a reasonable baseline.”

PIET CHRISTIANSEN, CHIEF ANALYST, DANSKE BANK, COPENHAGEN:

“This move we’re seeing right now is more of a stress indication that anything else.

“Markets are definitely saying well, there’s liquidity stress in the system right now.

“I think investors generally just sit back and see where the dust settles here. Because these moves seem so strong that… I really question how much liquidity there is behind it.

“I think the (ECB) communication on Thursday is still going to be for a 50 basis point rate hike, the underlying inflation problem is still there.

“But I think there’s going to be much more emphasis on the outlook from Lagarde on Thursday than if SVB hadn’t happened.

“So I think the risks are definitely bigger now than before.

“You never know after the ECB but for now, I don’t see a reason to change the 4% rate call.”

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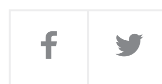

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