



PRESS RELEASE

Silicon Valley Bank's failure highlights heightened financial stability risks amid monetary tightening

Hong Kong S.A.R, March 22, 2023 – On March 10, California and federal banking regulators shut down Silicon Valley Bank (SVB) and seized its deposits citing both illiquidity and insolvency. This is the 2nd largest failure of a U.S. financial institution after Washington Mutual in 2008. Although the bank was specialized in banking for tech startups in the Silicon Valley area, SVB was estimated to be the 16th largest commercial bank in the U.S. with about 209 billion USD in consolidated assets at the end of 2022. While its collapse doesn't appear to be systemic, it highlights the impact of rate hikes on financial stability and heightened risk in the US tech industry. The events are also a reminder that the impact of monetary tightening are still very much to come.

A failure attributed to an insufficiently diversified customer base, but also to the current monetary policy tightening.

SVB specialized in banking services for the tech & biotech industries. During the pandemic, as California's tech industry experienced a boom, SVB saw a significant increase in deposits (+86% in 2021) and substantially invested in Treasuries and mortgage-backed securities.

This business model made SVB vulnerable to interest rate increases on two fronts:

- First, higher interest rates have hit its tech customer base particularly hard. It triggered a fall in venture capital funding and elevated cash burns among tech companies. This led to outflows of SVB client's funds in 2022.
- Second, as the Fed raised interest rates, the price of U.S. securities fell, squeezing SVB's assets.

The deterioration of SVB's finances and the subsequent loss of its clients' and investors' confidence caused a run on the bank. On March 9, shares of the bank tumbled by about 60%. The same day, investors & depositors initiated withdrawal of about 42 billion USD. Subsequently, regulators had no choice but to shutter SVB. On March 12, authorities announced that all depositors will be protected and paid back in full, going beyond the guarantees that are normally provided by law.

The primary concern is the risk of contagion.

For now, SVB's troubles appear more idiosyncratic than systemic, even though the Federal Deposit Insurance Corporation estimates that U.S. banks have 620 billion USD of unrealized losses. Large U.S. banks are much more diversified than SVB. The concerns are much more over regional banks with similar profiles to SVB. Trading of stocks of several other banks including First Republic Bank, PacWest Bancorp, and Signature Bank were halted on March 10 and regulators announced they were closing Signature Bank, one of the main banks to the crypto industry on March 12.

To stem contagion, US regulators announced a new emergency lending facility aimed at ensuring "that banks have the ability to meet the needs of all their depositors." and stated they were prepared to address any liquidity pressures that may arise.

SVB's collapse highlights heightened risk in the US tech industry

Rising interest rates have eroded the easy access to capital that propelled startup valuations and funded ambitious projects in recent years. In addition, the industry also had to contend with a decline in advertising revenue linked to a more challenging macroeconomic environment. All this recently resulted in increased layoffs in the industry. We believe that higher interest rates and the disappearance of a major financing player could create additional turmoil for the U.S. tech industry.

A reinforced dilemma for central banks whose rates hike are just beginning to take effect

These events highlights a trilemma for the Fed: it needs to maintain price stability, to promote maximum employment, but also to ensure financial stability. The collapse of SVB contributed to a decline in investors' bet on a 50 basis points hike at its March 21-22 meeting. The events are also a reminder that the impact of monetary tightening are still very much delayed, not only from a macroeconomic standpoint but also, and even more dangerously, from a financial point of view.

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