



Rate Hike Caused Losses to Banks

Banks survive on confidence to remain in business, as they take short-term deposits and lend them out on longer-term at higher interest rates. Hence, any mismatch of duration means any substantial withdrawal by depositors will put a stress on banks to repay depositors immediately. As such, any sound bank will collapse under a bank run, if there is no support from the central bank. The trigger of recent collapse of Silicon Valley Bank (SVB) in the US was basically due to news that the bank is facing major losses and will become insolvent. The bigger fear of such event is the contagious fear that such rumour may spread to other healthy banks and that may lead to systematic risk.

After the Fed (US Federal Reserve) increased interest rates aggressively from zero to 4.75% in the past 12 months, the higher bond yield has caused bond prices to fall sharply. Consequently, holders of bonds will have to shoulder these losses and banks being regular investors of government bonds will also suffer some losses. If the proportion invested in bonds is not substantial, the bank is able to offset such losses from the profits gained through loans it lends out.

One of the biggest casualties of Fed rate hike is SVB, which was set up to take deposits from venture capitalists and other tech companies. During the pandemic, there were little activities among new start-ups and SVB received more deposits than it can lend out. Besides this, SVB had also invested its huge surplus of funds in "safe" US treasuries/mortgage-backed securities. To cover for the cost of deposits, SVB chose higher yield longer-term bonds. This turned out to be a big mistake as long-term bonds have high duration risk especially when at the bottom of interest rate cycle (i.e. at the peak of bond market).

A single day withdrawal of US\$42bn or 24% of the SVB total deposits of US\$175bn will cause any bank to collapse.

Other than SVB which took on "higher risk" long-term bonds, there were also a few other banks that suffered other forms of losses (see *Exhibit 1*). To avoid systemic risk from the onslaught of social media such as *Tik Tok*, *Facebook*, etc., which may create fear within hours, the US authorities have been forced to throw in lifelines to save insolvent banks by getting another bank to take over the defunct bank or guarantee the deposits on top of the US\$250k deposit insurance per account.

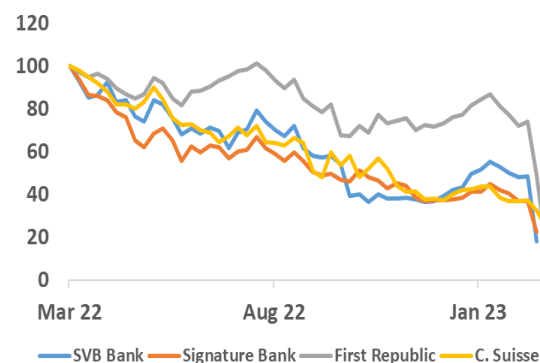
As a result, share prices of some of the troubled banks plunged sharply (see *Exhibit 2*). Nonetheless, our banks are not affected as our rate hike is much lesser than that in the US.

Exhibit 1: List of failure banks (March 2023)

Banks	Location	Problems
Silicon Valley Bank	US	Huge unrealized losses
Signature Bank	US	Liquidity crunch
First Republic Bank	US	Liquidity crunch
Silvergate Bank	US	Crypto industry's meltdown
Credit Suisse	Switzerland	Liquidity crunch

Source: Various, PCM, Mar 23

Exhibit 2: Failure banks cumulative return (%) - 1 year



Source: Bloomberg, PCM, Mar 23

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