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"The worst shock since 2008 global financial crisis"

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Remember the words of the soothsayer to the Roman dictator: "Beware the Ides of March." The Ides of March in the ancient Roman Calendar were associated with death

and doom. On March 15 in 44 BC, Caesar was assassinated . The soothsayer's words are immortalized in William Shakespeare's play, *Julius Caesar.*

Last month there were three notable bank failures: first in USA with two, Silicon Valley Bank (SVB) on March 8, which was followed by a week later, Signature Bank and the third one was in Switzerland, Credit Suise, which had nothing to do with SVB crisis. The fourth one was a plunge on March 25 in share prices of the largest bank, Deutsche Bank, of Germany, but a kind of reaction to all these financial crises.

These failures reminded the world how the *karma* of a recent past, would not have to wait for decades. They can any time haunt the economy. The deeds related to the efforts of the so called quantitative easing, and buying bad debts of banks by central banks for saving banking industry from the subprime mortgage crisis of 2008. On the three crises, the Reuters reported that investors were fretting that regulators and central banks have yet to contain "the worst shock to the sector since the 2008 global financial crisis".

That raises the following questions: Do the investors look upon state sponsored bank rescues "a must" whenever banks go under? They seem to claim banks are not responsible. In these days of free enterprise with an envisaged, greater role of private sector as an engine of growth, it is indeed strange that the private sector looks to public sector institutions for survival.

From Invisible hand to intervention

In the Great Depression of last century, US President Hoover did not intervene but let the mismanaged banks "to liquidate themselves", as as part of the self- correcting mechanisms of capitalism. He gave full hand to "the invisible hand" to operate. It was left to President Roosevelt to adopt the Keynesian remedies.

Recently, Ruchir Sharma in a hard hitting article wrote: " It is no longer possible for governments not to stage rescues, but this is a snowballing problem of their own". The blame rests on "easy money which was resorted to for rescuing financial institutions. The past and present bank failures are due to risks which arise from adverse selection and moral hazard, which are part of the text books for students of monetary economics. The adverse selection is due to asymmetry of information available to lender and borrower about each other; and moral hazard risks arise from ignorance of one about the other what they do with loan amount once disbursed. The risks are: (i) credit risks, where borrowers do not return loans. NBF Saga of last century in Fiji is a well known case. In the 2008 sub-prime mortgage crisis, defaults occurred after housing prices crashed; and (ii) banks borrow funds on a short term term basis at low interest and invest in long term bonds with high interest. Risk here is mismatch of time frame.

In the current context , the prevailing interest rate being higher, when banks are holding long term government bonds, which were issued at low interest rate, we have both interest rate and duration risks. In the next section below, we see result of the two combined risks

How it all started

It started with Silicon Valley Bank (SVB), America's 16th largest commercial bank. Its clients were US venture-backed technology and life science companies and others spread over from Canada to China, Denmark, Germany, Ireland, Israel, Sweden and the United Kingdom.

The Covid 19 pandemic, which resulted in immense loss of lives and livelihoods, led to one of the sharpest contractions in 2020. An expansionary fiscal policy with pumping in about US$1.5 trillion to save the economy averted the tragedy. Those who lost jobs received monthly income support.Thanks to an aggressive money injections in the US economy for matching with fiscal spending, commercial banks were flush with funds. An accommodative monetary policy, with interest rates close to zero helped the established firms and start-ups in Information and technology (ICT) sector.

The SVB's bank's assets tripled from $71 billion at the end of 2019 to a peak of $220 billion at the end of March 2022. . Deposits rose from $62 billion to $198 billion over that period, as thousands of ICT startups kept their cash as deposits with the lender. The SVB management thought of playing safe and kept most of the incremental increase in deposits in the US Treasury bills. As interest rate was low, the bond prices were high. Had they sold them they would have realized good money. The SVB management failed to foresee signs of inflation.

The Covid-19 injection of US$1.5 trillion led to steady increase in inflation, from around 4% in 2021 rose to 7.0% in 2021, reaching the peak in June 2022 at 9.1%, a 40-year high. The Fed had to wake up and began to tighten only from March 2022 from the low rate of 0.25%. It raised the rate 0.5% in April and thereafter each month. In June 2022 it was increased to 2.5% and now in March 2023 was 4.75%.. It looks there might be a pause in April 2023.

The one year US Treasury rate rose from 1% to almost 5% in early March 2023. That meant the value of the bonds that SVB was holding in its portfolio fell, fell by 60%. Firms found their borrowing costs were getting higher as they had to pay their short term debts. That forced companies to draw down their deposits from SVB to fund their operations and growth. That is not the final straw. The final straw was when SVP announced on Wednesday, March 8 that it sold bonds at a loss to add to their cash holdings to enable the customers get the needed cash. .

That triggered the panic: SVB's stock fell by 60% Thursday and dragged other bank shares down with it. Fear gripped as the news of a likely repeat of another global financial crisis 15 years ago.On Friday, March 10, the California regulators shut down the bank and brought it under the receivership of Federal Deposit Insurance Corporation. That is the end: liquidating the bank's assets to pay back depositors and creditors.

The SVB closure saga had ripple effects on banking industry: In addition to Signature Bank, smaller banks were also hit. It is not full story. SVB is not the only financial institution whose investments into government bonds and other assets have fallen dramatically in value.The Federal Deposit Insurance Corporation (FDIC) says at the

end of 2022, US banks were sitting on $620 billion in unrealized losses, as some of them decreased in prices but haven't been sold yet.

All these are due to high interest policy by the Fed, which is now fighting two evils: inflation on one hand and likely recession (because of slowing down of growth because of tightening monetary stance) on the other hand, same time. A seemingly impossible mission.

No intervention

The US Treasury Secretary Janet Yellen told the media: "Let me be clear that during the last financial crisis, there were investors and owners of systemic large banks that were bailed out … and the reforms that have been put in place mean that we're not going to do that again," Her focus is on " depositors and trying to meet their needs."

In a sign that regulators have concerns about wider financial chaos, the Fed assured by in late month March that it would make funding available for eligible financial institutions by providing loans against the Treasuries at original face value , not the depreciated value of long tenure due to rise in Fed interest rate with some minimal penal interest rate.

The U.S. Senate Banking Committee held a preliminary meeting on the collapse of Silicon Valley Bank and Signature Bank last week on March 28.. Top officials, including Fed Deputy Governor Michael Barr, FDIC Chair Martin Gruenberg, and Nellie Liang, an under secretary at the U.S. Treasury Department faced the wrath of the Senate.

Senate Banking Chair Sherrod Brown, a Democrat said. "And we're left with many questions—and justified anger—toward bank executives and boards, toward venture capitalists, toward federal and state bank regulators, and toward policymakers.".

The preliminary hearing ended with an unanimously agreed indication the executives will have to be punished. There will be a new legislation to "ratchet up penalties for executives at failed banks and ban them from the industry- the folks specifically and uniquely responsible for the failure of these banks – the folks who manage them,". The Republican Senator,a possible Presidential candidate, Tim Scott Scott said. "By all accounts, this is a classic tale of negligence, and it started with the banks themselves. Without any question, that's where the buck stops.".

Soon, SVB and Signature Bank executives will appear before the Committee.

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