“There May Be Trouble Ahead”: Another Banking Crisis in the Making

By BFI Capital Group

Last month marked the one-year anniversary of the latest global banking crisis. To refresh the readers’ memory, it started in March 2023 in the US, with the fatal bank run on Silicon Valley Bank (SVB), followed by the failure of Signature Bank and First Republic, and it culminated in the spectacular collapse of Credit Suisse in Switzerland. From where we stand today, most investors seem no longer concerned over more bank failures, and even less so over a looming global banking crisis. Are you convinced?

The quick and decisive reaction of the US government and of the nation’s central bank successfully averted much-feared global domino effects and contagion scenarios at that time: Once again, the State came to the rescue and ostensibly reassured investors, as well as the general public, that their deposits and savings were safe and guaranteed. Senior members of the Biden administration, including the President himself and Treasury Secretary Janet Yellen, passionately insisted and repeatedly promised that this was very different from the last recession and that there would be no bailouts for the troubled banks.

However, even though taxpayer money was not directly used to save them, the bankrupt lenders were still spared from the consequences of their actions and of all the reckless risks they took with no regard for the livelihoods and life savings of their clients. As Anil Kashyap, economics professor at the University of Chicago, concisely put it at the time: "Saying that the taxpayer won't pay anything ignores the fact that providing insurance to somebody who didn't pay for insurance is a gift.”

The Credit Suisse crisis was handled and contained equally effectively, albeit through the use of very different tools. In this case, the Swiss government orchestrated, engineered, and sponsored the acquisition (i.e., rescue) of the failed lender by its former competitor, UBS. This level of aggressive state interference in a supposedly free market raised serious concerns, as it set a dangerous precedent, pushing the boundaries of governmental authority further than many citizens of our alpine nation were comfortable with.

From where we stand today, a year later, most investors seem no longer concerned over more bank failures, and even less so over a looming global banking crisis. This confidence is arguably defensible when it comes to international banking giants, for the moment at least. The higher interest rate environment has clearly benefited big lenders, as did the inflationary wave that forced many households to turn to credit to cover their basic expenses. According to a Debt.com survey,“ 35% of Americans said they have maxed out their credit cards in recent years. Of those who had maxed out their credit cards, 85% said they were pushed to use their cards to the limit because of price increases from inflation. Approximately 22% of Americans said they now owe between $10,000 to $20,000 in credit card debt, and 5% have more than $30,000.”

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Worrying as these figures may be for the average American household and for the economy at large, there is little doubt these trends represent a significant boost for big lenders. Unfortunately, it might still not be enough for a great many US regional banks to remain afloat.

American regional banks find themselves navigating turbulent waters, grappling with a myriad of challenges that could potentially reshape the dynamics of the entire sector, or even of the entire economy. A recent CNBC article delved into the multifaceted pressures confronting regional banks and dampening their prospects.

The article pointed out that the aforementioned higher rate environment is not benefiting these smaller banks the same way it does the global banking conglomerates. In fact, in many cases, it actually weighs them down. Higher rates mean they must pay more interest on deposits, but more alarmingly, it also means that many of their borrowers could face difficulties in repaying their loans. Clearly this monetary policy shift has also presented challenges for big banks as well. However, their size, their risk diversification strategies, and their resources render problems like these much less threatening than they are for regional banks.

Additionally, as our colleagues at BFI Infinity accurately predicted a year ago in their May 2023 **InSights** report, many US regional banks are faced with an existential threat posed by their heavy exposure to Commercial Real Estate (CRE) loans. Office loans are especially problematic. As highlighted by a recent Reuters report, "office loans have been hit as many employees still work from home after the pandemic, leaving vacancies that make it tougher for building owners to repay their mortgages." By the end of last year, non-performing CRE loans as a percentage of U.S. banks' portfolios have more than doubled compared to 2022, while commercial property foreclosures surged this March by 117% from the same time last year.

Regional banks are already bracing themselves for painful and substantial write-offs, but they have also been pivoting towards more conservative and cautious strategies. As explained in the aforementioned issue of BFI Infinity's InSights: "As struggling regional banks keep tightening their lending standards, small and medium sized businesses will face either higher costs or just lose access to financing. The same is true for households, as they are bound to lose their credit lines too. All this is bound to have a seriously detrimental impact on the economy."

>> Read BFI Infinity's May 2023 InSights here.

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