HongLeong Bank

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Global Markets Research

Research Alert

US: Impact and Implications of SVB Collapse

No systemic risk envisioned for now; but contagion effects on the markets
Expectations for dial-back in Fed policy tightening path to dampen USD outlook
Key beneficiaries from flight to safety: Gold, JPY and UST

History is repeating itself?

On March 10, 2023, regulators shut down Silicon Valley Bank (SVB) as there was inadequate funding to meet massive deposits withdrawal. SVB largely serves start-ups and venture capitalist and after a surprised filing from the firm saying it had sold \$21bn in assets and was unloading stocks, depositors scrambled to withdraw their money, hence causing a bank run. It is estimated that SVB had approximately \$212bn in total assets of which the bulk 55% was in fixed income securities and only 7% was in cash as at end-2022. Total deposits stood at \$175bn, of which approximately 95% were uninsured by Federal Deposit Insurance Corporation (FDIC).

Flashed back to September 15, 2008, Lehman Brothers filed for Chapter 11 after the investment bank was overwhelmed by mortgage-backed securities (MBS) that were mostly backed with subprime loans, many of which went into default. However, there was no bank run and no regulatory bailout.

For a more apple-to-apple comparison with SVB, Washington Mutual's (WaMu) banking operations were placed under receivership with the FDIC on September 25, 2008, within days after the Lehman's downfall. WaMu was the country's largest savings and loans bank at that time when it was facing significant losses from risky mortgage lending and a run by its depositors. Washington Mutual had over \$307bn in assets and \$188bn in deposits when it collapsed in 2008. No doubt, the WaMu fallout as well as the Global Financial Crisis was triggered by and was part of the contagion effect from the collapse of Lehman Brothers.

No systemic risk envisioned at this juncture

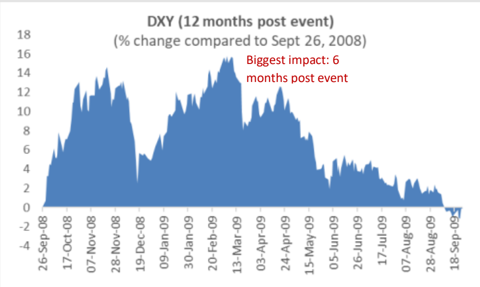
The collapse of SVB, Silvergate and Signature Bank is an indication of stresses in the financial markets, untimely given the concerns of a recession, and will have a contagion effect on markets, especially the banking sector as well as investors behaviour. Nevertheless, we believe that there is no systemic risk at this juncture as the US government has promptly stepped in and this note will be brief and just a gentle reminder on what happened and how bad it could go, using the past incidences of Lehman and WaMu as a guide.

Economy rebounded after three quarters; the Fed did cut rates

From history, we saw that the impact from WaMu's fallout was mostly felt within the 6-month time frame. The US economy was already in doldrum before the implosion, contracting by 2.1% in 3Q08. The economy remained contractionary at -8.5% in 4Q08, -4.6% in 1Q09 and -0.7% in 2Q09, but turned positive with a 1.5% growth in 3Q09. Bear in mind, this occurred amidst the Global Financial Crisis.

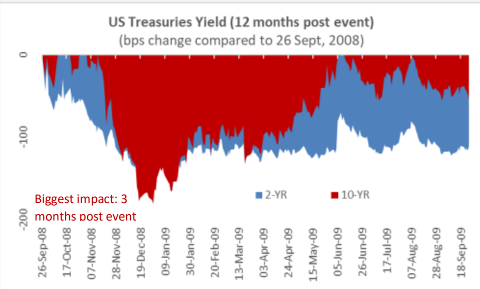
The quick rebound in economic growth could be due to Ben Bernanke, the-then Fed Chairman and his team, reacting swiftly. The Federal Reserve maintained the policy rate at 2.00% on 16 September 2008 but quickly slashed the fed funds rate by a cumulative 100bps in October (50bps each in scheduled and unscheduled FOMC

Figure 1: Impact on USD



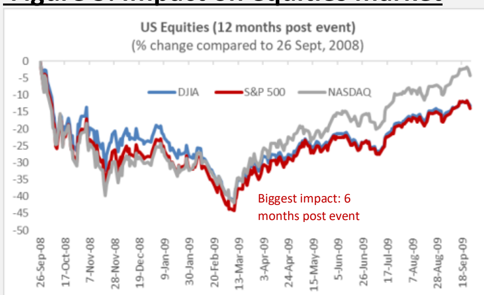
Source: Bloomberg, HLBB Global Markets Research

Figure 2: Impact on Treasuries



Source: Bloomberg, HLBB Global Markets Research

Figure 3: Impact on equities market



Source: Bloomberg, HLBB Global Markets Research meeting), and subsequently brought it down by 75bps to 0.25% in December 2008, a level maintained till November 2015. As such, expectations that the latest bank rout and market nervousness could potentially sway the Fed policy tightening path is realistic and we see risks to our house view for three more rate hikes in the quantum of 25bps each in the next three upcoming meetings. We are now looking at a pause at the upcoming March FOMC meeting next week.

The impact on the Dollar, nevertheless, remained murky. Unlike history, the Dollar Index has lost 1.6% of its value within 2 days since the SVB implosion. In contrast, during the WaMu fallout, Dollar Index strengthened 0.7% d/d, 4.4% w/w and +13.0% m/m subsequent to that. This implies that the index could shoot up to 121 in the year but we do not believe that this is realistic at this juncture. Our wager is that the DXY will end 2023 at 102 instead, torn between Fed rate hike expectations and the USD's haven status as the world's reserves currency.

Financial market repercussion limited to two quarters

Mirroring history, the fallout was predominantly felt in the bond market. On Friday (10th March), the benchmark 10-year Treasury yield fell 21bps to 3.70%, while the 2-year Treasury yield fell 28bps to 4.59%. Yields continued to haemorrhage on the second day, with the yield on the 2-year Treasury posted its biggest 1-day plunge by 61bps at 3.98% as investors flocked to safety on the bank collapse-contagion fears. As it is, the 2-year yield has fallen more than 100bps, marking the largest 3-day decline since Black Monday although bond yields have since nudged back up somewhat at point of writing. During the WaMu crisis, the 2-year and 10-year fell as much as 145 and 180 bps. Comparing this to Thursday's closing, this means that the 2 and 10-year yields could stoop as low as 3.42% and 2.11%, ceteris paribus and bearing in mind that the yield curve was not inverted back in 2008.

In the same breath, Wall Street fell between 1-2% on Friday but more muted on the second day, dipping by less than 1% d/d and predominantly felt in financial stocks. In 2008, at a worst-case scenario, stocks collapsed between 41-44% within 6-months. Translating this to today's market, this means that the Dow Jones, S&P 500 and NASDAQ could fall to as low as 18,951; 2,185 and 6,588. However, we believe that this could be far-fetched this round given that: 1) It is not a Global Financial Crisis. 2) The knee jerk reaction in the past two days, and movement ahead could be more muted as regulators swifty implemented backstop measures. 3) Financial stocks currently account for approximately 11% of S&P 500, approximately halve of what it used to be.

Table 1: Impact of WaMu on the financial markets

	DXY	INDU	SPX	NASDAQ	USGG2Y	USGG10Y
25-Sep-08	77.0	11,022	1,209	2,187	2.1605	3.8540
26-Sep-08	77.0	11,143	1,213	2,183	2.0962	3.8520
29-Sep-08	77.5	10,365	1,106	1,984	1.6571	3.5776
1-week	80.3	10,325	1,099	1,947	1.5822	3.6031
1-month	86.9	8,176	849	1,506	1.5362	3.6874
3-months	80.9	8,516	873	1,530	0.8829	2.1318
6-months	84.2	7,925	833	1,587	0.9066	2.7389
12-months	76.8	9,665	1,044	2,091	0.9842	3.3184
			Change (%/bps)			
1-day	0.7	-7.0	-8.8	-9.1	-44	-27
1-week	4.4	-7.3	-9.4	-10.8	-51	-25
1-month	13.0	-26.6	-30.0	-31.0	-56	-16
3-months	5.1	-23.6	-28.0	-29.9	-121	-172
6-months	9.4	-28.9	-31.3	-27.3	-119	-111
12-months	-0.2	-13.3	-13.9	-4.2	-111	-53

Source: Bloomberg, HLBB Global Markets Research

Table 2: Impact of Lehman Brothers on the financial markets

	DXY	INDU	SPX	NASDAQ	USGG2Y	USGG10Y
12-Sep-08	79.0	11,422	1,252	2,261	2.2026	3.7187
15-Sep-08	78.9	10,918	1,193	2,180	1.7059	3.3868
1-week	77.7	11,388	1,255	2,274	2.1679	3.8105
1-month	81.4	9,311	998	1,779	1.8122	4.0772
3-months	83.6	8,630	880	1,541	0.7588	2.5705
6-months	87.4	7,224	757	1,432	0.9558	2.8902
12-months	76.7	9,627	1,049	2,092	0.9193	3.4208
			Change (%/bps)			
1-day	-0.1	-4.4	-4.7	-3.6	-39	-47
1-week	-1.6	-0.3	0.3	0.6	7	-4
1-month	3.0	-18.5	-20.3	-21.3	-28	23
3-months	5.9	-24.4	-29.7	-31.9	-134	-128
6-months	10.7	-36.8	-39.6	-36.7	-114	-96
12-months	-2.9	-15.7	-16.2	-7.5	-118	-43

Source: Bloomberg, HLBB Global Markets Research

Key beneficiaries: Gold, JYP

Having that said, one man's pain can be another's man's gain. In the flight for safety, we believe that the 2 key beneficiaries will be gold and JPY. Gold prices rose as much as 15.4% post the WaMu fall out, from $882.90/oz to as high as $1,019.20/oz within the 1-year time frame, suggesting that gold could stretch to $2,117/oz. In the same breath, JPY strengthened as much as 22.1% three months post the WaMu fallout (106.56 to 87.24), suggesting that JPY could strengthen to around 111.

Hong Leong Bank Berhad

Fixed Income & Economic Research, Global Markets
Level 8, Hong Leong Tower
6, Jalan Damanlela
Bukit Damansara
50490 Kuala Lumpur
Tel: 603-2081 1221
Fax: 603-2081 8936
Email: HLMarkets@hlbb.hongleong.com.my