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Independent Thinking

Contagion risks from SVB failure

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- The failure of Silicon Valley Bank (SVB) seems to be the result of a few particular factors: reports suggest that a large proportion of its assets were in fixed income, and that its loan book was highly concentrated in emerging technologies, both of which have been negatively affected by rising US interest rates
- For healthy banks, higher rates are often a positive, widening net interest margins and increasing profitability — indeed, Fathom's Financial Vulnerability Indicator has been suggesting that banking risk is now declining for this very reason, after peaking late last year
- SVB also appears to have failed to hedge against a maturity mismatch — it held predominantly longer-dated assets, while its liabilities were largely short-term deposits
- As with any bank failure, there is a natural tendency to look around for who will be next, and for the failure of one institution to lead to bank runs on other vulnerable institutions
- A minimum spanning tree (MST) of 44 US banks suggests that SVB was close to the periphery of the US banking system, but does point to several other institutions where investors may look for signs of contagion: indeed, First Republic Bank and Western Alliance Corporation (the two nearest banks in the MST) have been among those most negatively impacted in today's trading
- If investors are right, the odds of direct contagion through financial linkages to the major banks may be small, but we must not be complacent — for now, we cannot rule out the possibility that other, larger lenders may be exposed to similar risks

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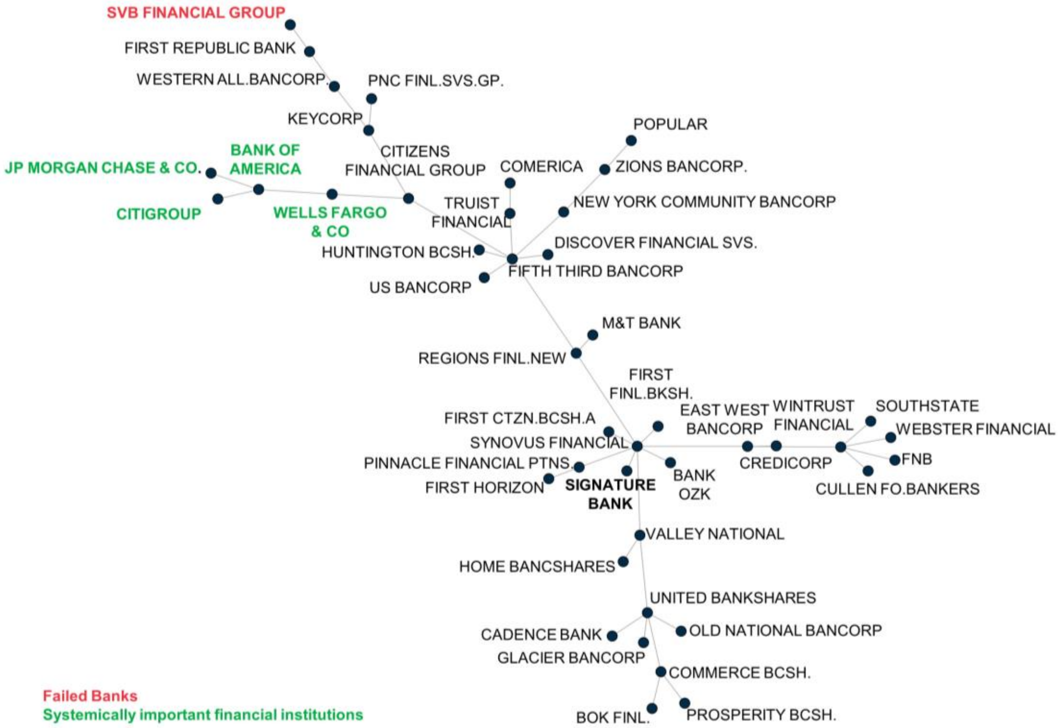
Equity price correlations in the Datastream US Banks index

Calculated since 1 January 2022



Source: Refinitiv Datastream / Fathom Consulting

- If this is purely a liquidity crisis, swift and convincing action by policymakers (such as guaranteeing deposits) should be enough to prevent SVB's failure from spiralling into a systemic crisis — Sunday's moves are a step in the right direction
- We will keep the situation under close review, and cover the topic in greater detail in upcoming editions of our weekly *Recession Watch* note

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Further reading

Recession Watch: flipflopping

Recession Watch: spotting European risks

Recession Watch: no landing… for now

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