UOB Asset Management

Research Note

SVB-induced panic selling expected to calm down

- Contagion to the global financial sector is likely to be contained
- The US Fed is now expected to slow or suspend rate hikes
- Investors should continue to focus on fixed income opportunities

Global contagion

Global markets, and especially financial sector stocks, have been badly hit by Silicon Valley Bank's (SVB's) failure last week. Billions have been wiped off the market value of some of the world's largest banking stocks including HSBC and Citigroup.

Meanwhile, over in Asia, the Bloomberg Asia Pacific Banks Index suffered a one-day decline of 2.3 percent on Friday, the largest single day drop in 11 months with Japanese Banks the hardest hit.

What was the leadup?

After enjoying a big runup in tech company deposits during the post-pandemic period, SVB saw some of these deposits start to drain over the past few months. Losses on SVB's hold-to-maturity government bond holdings also depressed depositor confidence.

However, we would note SVB's capital ratios remained high and recent rating agency downgrades were relatively minor. For example, in downgrading SVB one-notch to a3 from a2, Moody's explained that a3 is the current median for US banks.

What sparked the sell-off?

The SVB crisis is what we would term a “modern-day” bank run. In general, central banks over the years have learned how to deal with bank runs.

However, once this bad news emerged, SVB’s client base. comprised largely of tech-savvy companies, rushed to withdraw their deposits in bulk. At the same time, social media contributed to the panic going viral faster than we have seen before. This took down an otherwise solvent bank in a couple of days.

Not all bad news

The current panic selling may have further to run, especially as more banks get caught up in the chaos. Today US regulators pre-empted a similar fate for New York-based Signature Bank and shut it down. They also sought to stem the crisis by reassuring depositors that they would be made whole.

It is hard to say whether these moves will be enough to reassure investors in the short term. Nevertheless, we believe that the contagion will be limited and the current market turmoil will dwindle before too long, for the following reasons:

• **Limited global impact -** the issues of government bond losses and declining deposits are not issues that point to a structural weakness in the banking sector. We still conclude that the global banking system is in remarkably good shape, even in the event of a widespread recession.

• **Potential pause in rate hikes -** We think the only thing more important to the Fed than fighting inflation is ensuring the stability of the US banking system. As such, it seems to us that a 50bp hike is now unlikely and the chance of no hike has increased significantly. Given our view that inflation is anyway under control, this decision is even more tenable.

• **Soft landing -** Although we expect to see a US recession in 2023, we expect this to be shallow and for investors to turn back to equities even before the recession ends. However, the negative news flow (including potentially more bank scares) causes us to be neutral on equities for the time being.

• **Fixed income tailwinds -** We retain our positive outlook for fixed income which has been further boosted by the likely slowdown or suspension of further rate hikes. Spreads in the Asian financial sector widened only slightly over the weekend, and less than in November 2022, pointing to still-sound investor confidence.

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