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The implications of the SVB fallout on Asia

Craig Bell
Head of Multi Asset Solutions
Eastspring Investments

The collapse of SVB should have limited implications for Asia, although it could influence the Fed's rate decision in March. It also highlights the risk that the Fed's rate hiking cycle would ultimately surface fragilities within the global economy, reinforcing our investment teams' continued focus on quality profits and cashflows.

The collapse of Silicon Valley Bank (SVB), a leading lender for the tech start-up community in the US, and the subsequent closure of New York-based Signature bank have caused a sharp sell-off among the US regional banking stocks. US and European global banks were also affected, albeit to a more limited extent. With SVB's woes stemming from a USD1.8 bn loss on the sale of a portfolio of securities, investor concerns have risen over the value of banks' bond portfolios. The impact on Asian markets has been relatively muted.

Implications

US banking system. The systemic threat to the US banking system should be limited. The US regulators have responded swiftly to prevent any contagion risks to the US financial system:

- All depositors of SVB and Signature will be able to access their money on Monday (13 March), which should help keep depositors' faith in the banks in general
- Agreed emergency funding will allow any federally insured depository institution (including banks, savings associations or credit unions) to borrow against its held to maturity assets. These institutions can place these assets with the Federal Reserve Banks and borrow an amount based on the asset being priced at Par

The issue with Mark to Market for the held to maturity assets is a liquidity problem, not a solvency one. This mechanism immediately reduces the risk of a bank run where the Federal Reserve Banks are in effect backstopping all deposits in the US banking system by ensuring the liquidity problem is solved.

Furthermore, US banks that have been identified as systemically important financial institutions (SIFIs) have formidable capital buffers. These buffers have shielded them from the declines in the value of their held-to-maturity securities portfolios which have already been reflected on their balance sheets at the end of 2022.

Fed rate decision. The recent market developments have lowered the likelihood of a 50bp rate hike at the 21-22 March FOMC meeting. We believe that the odds are now split between a 25bp hike or a temporary pause. That said, barring any systemic contagion, jobs and inflation data will continue to dominate the Fed's interest rate decision over the longer term.

Asian banks. It was reported that due to weak loan demand, SVB's investment portfolio made up 57% of its total assets, a level that was significantly higher than other major US banks. This made it particularly vulnerable to a fall in the value of its securities' portfolio. With the 20 largest banks in Asia Pacific having an average loan to deposit ratio of 75%[1], securities should make up a much smaller share of assets.

Asian tech sector. While there has been some knock-on impact on the US tech sector, the impact on the listed Asian tech sector is likely to be far more modest given the limited reliance on SBV for funding.

We believe that this is a short-term market event which is unlikely to impact our long-term investment process. It should be expected that the Fed's rate hiking cycle, which started about a year ago, would surface fragilities within the global economy. We had highlighted this risk in our 2023 Market Outlook and our investment teams continue to focus on companies and sectors that produce strong cashflows.

Source: [1]As of 30 June 2022. Sample limited to the 20 largest Asia-Pacific banks in S&P Global Market Intelligence by total assets as of 30 June 2022. Loans/deposits ratio is calculated using total net loans and total deposits.

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