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Fragility of US Banking Sector: Is it reverberating to the World?

Dr. Dilpreet Kaur

A big collapse of two biggest banks i.e., Silicon Valley Bank of US and Signature Bank of New York has led the whole world economy to a shock as it has led to a fear that dreadful 2008 financial crisis and its ripple effects may repeat itself and once again create a global recession as, a crash in US banking system can be disastrous for the whole world.

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Silicon Valley Bank, established in 1983, was giving loans to technological start-ups funded by venture capitalists giving due consideration to its location in Silicon Valley which is a hub for these start-ups. But, unlike other banks which diversify their portfolios, this bank was further investing its deposits in focussed areas of real estate in 1992 and mortgage-backed securities or bonds in 2020. As technology and IT sector was at its peak in 2020 (raised $300 billion) due to pandemic and lockdown restrictions, SVB observed a clear jump in its deposits due to this boom in tech start-ups. In March 2021, the deposits of SVB bank increased from $62 billion to $124 billion. The bank invested these deposits in government and corporate bonds in majority at the times of low prevailing interest rates in the US market. In the post pandemic times, Federal Bank of US raised the interest rates to control the inflation, created due to aftermath of Russia-Ukraine War, as a part of their monetary policy. With this increase in interest rates, bond prices fell sharply as both of these have inverse relationship. The reason behind this inverse relationship is that customers are diverted towards fixed deposits due to increased interest rates. Also, the tech start-ups could not afford expensive loans and started to withdraw their deposits with SVB banks. These sudden withdrawals due to increased interest rates led SVB to sell its bond investments at losses of around $1.8 billion. This led to fall in share prices of SVB that led to its collapse. SVB was a case

Figure 1
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of bad decision making and less robust investment portfolios which could not bear interest rate fluctuations. But, in any case this was not a scam or fraudulent practice by this bank. After this crash, Federal Deposit Insurance Corporation (FDIC) came to the immediate rescue of this bank and ensured the safety of the insured ($250000 dollars per customer) as well as uninsured deposits to the customers. A new bank was created by FDIC known as National Bank of Santa Clara. The final solution in any of such situation is a merger as opted in Indian bank crashes also. SVB bank will also be merged finally to resolve this issue completely.

The impact of this banking crisis is not as severe as collapse of Lehman Brothers in 2008 as the rescue mechanism is far more effective and cushioned now and moreover the global financial crisis was due to the burst of housing bubble i.e., the irresponsible lending to housing sector that could not be recovered which cannot be compared with SVB in any case. The stringent capital adequacy norms in India and other countries have further added a layer to absorb these kinds of shocks. But yes, reverberations can be seen after this big collapse of banks in terms of downfall in stock markets in Europe and other developing countries due to sentimental effect. Many companies that invested in this bank like Roku, Y combinatory and many Tech start-up in Silicon Valley who had Indian founders directly faced the hardships and after effects of this collapse. But these reverberations and ripple effects will be very short term in nature and cannot create a global financial havoc in future.

About Author

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Dr. Dilpreet Kaur is double gold medallist in MBA and BBA and has qualified UGC Net/ JRF. With 5 years of research experience and 4 years of teaching experience, she has delved deep into her area of expertise. She has ABDC/Scopus/UGC Care listed publications accredited to her name. Besides her academic achievements, she has administrative capabilities as she has organised International/National Seminars, Courses and FDPs/Webinars. She has received 5 International Felicitations like International Excellence Award, Global Youth Icon Award, Ekalavya Award. She has been affiliated as Editorial Board Member in National/ International forums and has edited four research books. Adding another milestone, she has delivered lectures as Resource Person authorised by NSDL at Colleges and have Life Membership of various professional bodies like ICA, IAA and ICERT. She has presented papers in more than 60 conferences and attended more than 110 FDPs/ Workshops/ Webinars.