M.M.WARBURG & CO BANK

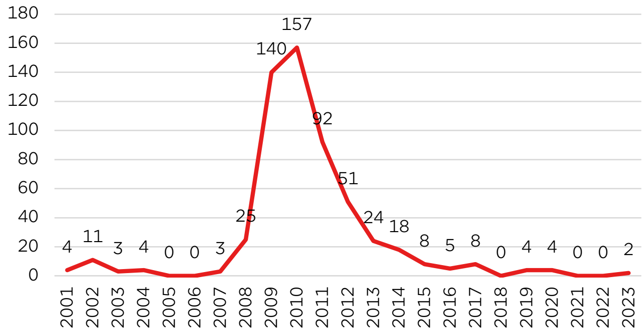
# Economic Situation and Strategy

23 MARCH 2023

## Is a new financial crisis looming?

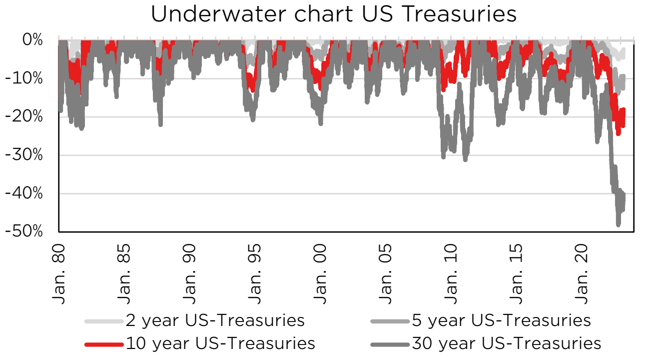
Within a few days, two banks in the USA went bankrupt or were closed (Silicon Valley Bank and Signature Bank), while in Switzerland, the emergency sale of Credit Suisse to UBS was initiated by the authorities and the financial market supervisory authority last weekend. No wonder that many investors are now asking themselves whether there will be a global financial and economic crisis like in 2008/2009. Although at first glance there may be certain parallels to the situation back then, the causes of today's developments are different. The fact that banks are becoming insolvent and closing down is not in itself an indication of failed or too lax regulation and thus of an imminent crisis in the financial system. In the USA, financial institutions have gone out of business almost every year for the past 100 years. According to the USA Deposit Insurance Corporation (FDIC), more than 3,500 banks have closed their doors since 1980 alone, and since 2001 there have been a good 570 closures. Most of the insolvencies occurred during the savings-and-loan crisis and in the aftermath of the financial and economic crisis of 2008/2009. After all, every bank - like any other company in principle - bears an entrepreneurial risk. Unlike most "normal" companies, however, a bank's insolvency has a higher likelihood of going under, with not only microeconomic but almost always macroeconomic repercussions. By contrast, since 2015, the number of closures has been extremely low, at less than ten per year, with not a single bank failing in 2018, 2021 and 2022. This certainly has something to do with the very low interest rates and the associated favorable refinancing conditions, but is perhaps also a sign that regulation is very much having an effect.

USA: number of bank failures




source: FDIC, as of 14.03.2023

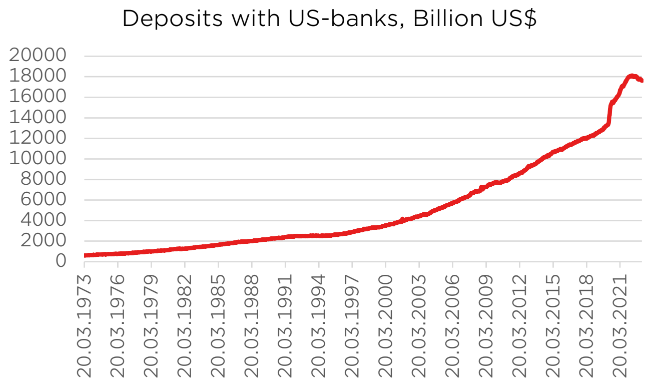
In the meantime, the situation on the international financial markets has calmed down again, after it still looked last weekend as if the financial markets could be in for a major disaster. With a bit of distance, it is now easy to summarize and classify what has happened over the past two weeks. The turmoil at Silicon Valley Bank (SVB) can be traced back to its special business model, which is, however, an absolute special case that is not representative for the entire US banking system. Due to its less granular customer base, SVB had a very high percentage of deposits that did not fall under the federal deposit insurance of $250,000 per customer. At the end of 2022, as many as 94 percent of deposits were above this coverage limit! At the same time, SVB had an extremely high proportion of its customer deposits invested in securities, especially bonds with long remaining maturities. While SVB benefited in recent years on the deposit side from the fact that start-ups could hardly save themselves from financing rounds and accordingly kept increasing their deposits, exactly the opposite happened last year: interest rates rose, financing rounds failed to materialize and the poor economy led to a high so-called cash burn rate and thus to an accelerated withdrawal of deposits. In order to meet its obligations, the SVB had to sell government bonds, which were still on the balance sheet at their maturity value of 100, at significantly lower market prices. Thus, "book losses" turned into real losses that eroded equity. A necessary capital increase failed, and word spread among customers that their deposits were not insured. The impending bank run became a self-fulfilling prophecy within a very short time. The central question now is whether this situation (which could also be observed in a mitigated form at some other regional banks) is symptomatic and thus representative of the US financial system.



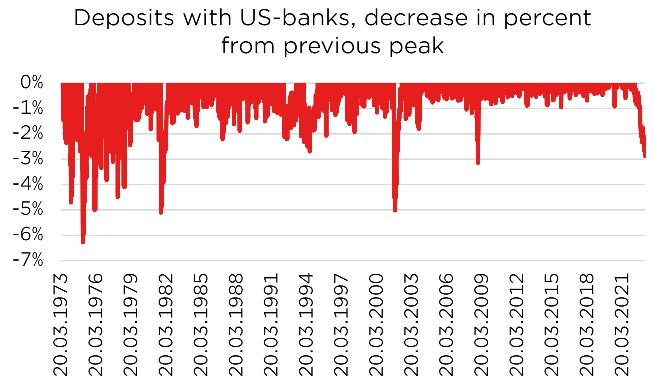

source: Refinitiv Datastream

## Bank deposits decline, but the worst is probably already over

To anticipate the result right away: We think that this is not the case. However, it cannot be pretended that there would not have been any stress in the US banking system otherwise. If we look at the development of deposits at US banks, for example, we can observe a significant decline at the current margin. This is due to the fact that deposits have been shifted from overnight deposit accounts, for example, into money market funds or ETFs as well as into other securities.




However, this decline looks more dramatic than it actually is. This is because it should not be overlooked that level effects play a role and sometimes lead to distorted perceptions that are only "rectified" when the time series is logarithmized. For this reason, we have shown in a second chart only the percentage declines in deposits compared with their previously reached peak. And here, at the latest, we can see that similar declines have been observed more frequently in the past, although the last similarly large decline occurred during the financial crisis.




But there is one piece of good news: In the past, the setbacks in deposits were always limited in time. In most cases, it took only a few weeks for a large part of the decline to be recovered. The recovery in deposits was generally accompanied by a calming of the markets. This time, too, there is much to suggest that things could turn out similarly.

## 2023 is not 2008!

In our view, here are the main reasons why the storm in the financial system is likely to subside soon:

- In 2008, there were huge uncertainties about how to value mortgage loans and, in some cases, insanely complex derivatives. In 2023, banks will also suffer from book losses, but this time it will generally be government bonds whose value is not in question.
- Central banks will be significantly more proactive in 2023 than in 2008, as evidenced by US deposit guarantees, the Fed's new Bank Term Funding Program, and the courageous intervention of Finma in Switzerland. Implicit guarantees and commitments by the ECB have also calmed the market in recent days. Obviously, lessons have been learned from the mistakes of previous years - in some cases, the actions are so proactive that regulatory questions are already arising. However, regulatory issues are less relevant for the short-term stability of the financial system.

- The US economy is sufficiently solid. Employment and wages are rising, and the "excess savings" from the Corona crisis still provide a valuable risk buffer. In Europe, many economic data are already improving again - the risk of a (sharp) recession seems low. The risk of a downward spiral of negative financial and economic developments is low.
- The US real estate market shows no signs of longer-term weakness. Relative to the size of the US population, far too little is being built in the US, and the age of homes in the US is at its highest level since World War II. Vacancy rates are extremely low; consequently, real estate prices have risen again recently. Accordingly, the savings rate may fall again and the consumption rate rise, which will support the economy.
- In Europe and also the USA, the capital adequacy of banks has improved significantly since 2009, and at the same time the share of non-performing loans in total lending is low. Moreover, the loan-to-deposit ratio of US banks in particular is still significantly lower than in 2008, although the figure has risen somewhat in recent months.
- The furor over the handling of the so-called AT1 bonds was somewhat premature. The complete write-down of Credit Suisse's AT1 bonds cannot be transferred one-to-one to comparable bonds from the euro zone or other regions. The danger of a panic reaction in these securities seems to have been averted.

So is everything good again? It is certainly still too early to make this statement. A critical factor is that bank lending standards, i.e. the financing conditions for borrowers, have deteriorated significantly in both the USA and Europe. This will have a negative impact on the economy if fewer loans are granted - but on the other hand, this is precisely what central banks want in order to curb inflation. In the near future, markets will probably be caught between high inflation rates, weaker economic data and less efficient banks. This suggests higher volatility in the capital markets, but not necessarily a massive correction. Moreover, in the coming weeks and months, central banks will act cautiously and not give any reason to provoke a new bout of weakness in the markets. A good example of this is the latest Fed decision on March 22: Although the US central bank maintained its monetary policy course and raised the key interest rate by 25 basis points to a range of 4.75 to 5 percent, Fed President Jerome Powell struck moderate tones and formulated a more cautious monetary policy outlook. The market took the comments as an indication that rate hikes of 50 basis points are virtually out of question, that rate adjustment pauses will follow and that the Fed has almost reached its interest rate peak.

MEETING PROBABILITIES

| MEETING DATE | 175-200 | 200-225 | 225-250 | 250-275 | 275-300 | 300-325 | 325-350 | 350-375 | 375-400 | 400-425 | 425-450 | 450-475 | 475-500 | 500-525 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 03.05.2023 | | | | | | | | 0,0% | 0,0% | 0,0% | 0,0% | 0,0% | 70,0% | 30,0% |
| 14.06.2023 | | | 0,0% | 0,0% | 0,0% | 0,0% | 0,0% | 0,0% | 0,0% | 0,0% | 0,0% | 39,5% | 47,4% | 13,1% |
| 26.07.2023 | 0,0% | 0,0% | 0,0% | 0,0% | 0,0% | 0,0% | 0,0% | 0,0% | 0,0% | 8,5% | 41,2% | 40,0% | 10,2% | 0,0% |
| 20.09.2023 | 0,0% | 0,0% | 0,0% | 0,0% | 0,0% | 0,0% | 0,0% | 0,0% | 7,2% | 36,3% | 40,2% | 14,7% | 1,5% | 0,0% |
| 01.11.2023 | 0,0% | 0,0% | 0,0% | 0,0% | 0,0% | 0,0% | 0,0% | 4,3% | 24,6% | 38,6% | 24,9% | 6,8% | 0,6% | 0,0% |
| 13.12.2023 | 0,0% | 0,0% | 0,0% | 0,0% | 0,0% | 0,0% | 3,5% | 20,9% | 36,1% | 27,4% | 10,1% | 1,7% | 0,1% | 0,0% |
| 31.01.2024 | 0,0% | 0,0% | 0,0% | 0,0% | 0,0% | 2,6% | 16,1% | 31,9% | 29,8% | 14,9% | 4,1% | 0,6% | 0,0% | 0,0% |
| 20.03.2024 | 0,0% | 0,0% | 0,0% | 0,0% | 2,0% | 13,1% | 28,4% | 30,3% | 18,2% | 6,5% | 1,3% | 0,1% | 0,0% | 0,0% |
| 01.05.2024 | 0,0% | 0,0% | 0,0% | 2,0% | 13,0% | 28,3% | 30,3% | 18,3% | 6,6% | 1,4% | 0,2% | 0,0% | 0,0% | 0,0% |
| 19.06.2024 | 0,0% | 0,0% | 0,8% | 6,4% | 19,1% | 29,1% | 25,5% | 13,6% | 4,5% | 0,9% | 0,1% | 0,0% | 0,0% | 0,0% |
| 31.07.2024 | 0,0% | 0,5% | 4,2% | 14,0% | 25,1% | 26,9% | 18,4% | 8,1% | 2,3% | 0,4% | 0,0% | 0,0% | 0,0% | 0,0% |
| 25.09.2024 | 0,4% | 3,6% | 12,6% | 23,4% | 26,6% | 19,6% | 9,7% | 3,2% | 0,7% | 0,1% | 0,0% | 0,0% | 0,0% | 0,0% |

source: CME Fed Watch Tool, as of 24.03.2023, 10:00

However, Jerome Powell once again emphasized at the last Fed meeting that it is too early for interest rate cuts this year and that market expectations with regard to US interest rate policy are too optimistic, pointing to further interest rate hikes if inflation and, in particular, core inflation do not fall as desired. It remains to be seen who will be proven right in the end.

## Market data

| Stock marktes | As of 24.03.2023 10:19 | Change versus 17.03.2023 -1 week | 23.02.2023 -1 month | 23.12.2022 -3 months | 23.03.2022 -1 year | 30.12.2022 YTD |
|---|---|---|---|---|---|---|
| Dow Jones | 32105 | 0,8% | -3,2% | -3,3% | -6,6% | -3,1% |
| S&P 500 | 3971 | 1,4% | -1,0% | 3,3% | -10,9% | 3,4% |
| Nasdaq | 11787 | 1,3% | 1,7% | 12,3% | -15,3% | 12,6% |
| DAX | 15014 | 1,7% | -3,0% | 7,7% | 5,1% | 7,8% |
| MDAX | 26857 | 1,5% | -6,4% | 6,4% | -14,9% | 6,9% |
| TecDAX | 3265 | 1,2% | 0,3% | 12,4% | -0,4% | 11,8% |
| EuroStoxx 50 | 4149 | 2,1% | -2,6% | 8,7% | 7,2% | 9,4% |
| Stoxx 50 | 3800 | 1,6% | -3,3% | 3,3% | 3,2% | 4,1% |
| SMI (Swiss Market Index) | 10646 | 0,3% | -5,3% | -1,5% | -12,0% | -0,8% |
| Nikkei 225 | 27385 | 0,2% | 1,0% | 4,4% | -2,3% | 4,9% |
| Brasilien BOVESPA | 97926 | -4,0% | -9,0% | -10,7% | -16,6% | -10,8% |
| Russland RTS | 982 | 3,5% | 5,6% | 1,9% | 4,8% | 1,2% |
| Indien BSE 30 | 57640 | -0,6% | -3,3% | -3,7% | -0,1% | -5,3% |
| China CSI 300 | 4027 | 1,7% | -1,9% | 5,2% | -5,8% | 4,0% |
| MSCI Welt | 2697 | 1,5% | -1,5% | 3,5% | -10,5% | 3,6% |
| MSCI Emerging Markets | 978 | 2,8% | -1,0% | 2,4% | -14,3% | 2,2% |
| **Bond markets** | | | | | | |
| Bund-Future | 137,04 | -116 | 238 | 209 | -2276 | 411 |
| Bobl-Future | 119,45 | 16 | 337 | 311 | -1044 | 370 |
| Schatz-Future | 106,43 | 10 | 109 | 88 | -467 | 101 |
| 3 Monats Euribor | 3,00 | 60 | 60 | 110 | 350 | 111 |
| 3M Euribor Future, Dec 2023 | 3,38 | 18 | -31 | -17 | 236 | -23 |
| 3 Monats $ Libor | 5,08 | 8 | 12 | 35 | 411 | 31 |
| Fed Funds Future, Dec 2023 | 3,94 | 7 | -127 | -58 | 122 | -70 |
| 10 year US Treasuries | 3,34 | -9 | -56 | -41 | 102 | -50 |
| 10 year Bunds | 2,08 | -6 | -35 | -32 | 164 | -49 |
| 10 year JGB | 0,38 | 9 | -12 | 0 | 16 | -3 |
| 10 year Swiss Government | 1,10 | 15 | -30 | -41 | 63 | -51 |
| US Treas 10Y Performance | 609,05 | 0,4% | 4,5% | 4,4% | -6,2% | 5,0% |
| Bund 10Y Performance | 547,49 | -0,5% | 2,7% | 2,7% | -12,4% | 4,2% |
| REX Performance Index | 435,35 | 0,2% | 1,2% | 0,4% | -8,3% | 0,7% |
| IBOXX AA, € | 3,47 | -2 | -12 | 0 | 217 | -12 |
| IBOXX BBB, € | 4,44 | -6 | 0 | -15 | 241 | -26 |
| ML US High Yield | 8,83 | -15 | 18 | 13 | 254 | -14 |
| Convertible Bonds, Exane 25 | 6620 | 0,0% | 0,0% | -0,3% | -10,2% | 0,0% |
| **Commodities** | | | | | | |
| MG Base Metal Index | 408,58 | 1,6% | -4,1% | -1,0% | -23,3% | -2,3% |
| Crude oil Brent | 75,00 | 3,3% | -8,9% | -10,8% | -38,4% | -11,7% |
| Gold | 1987,81 | 1,4% | 9,2% | 10,3% | 3,0% | 9,5% |
| Silver | 23,08 | 4,0% | 8,2% | -3,0% | -7,3% | -2,8% |
| Aluminium | 2278,75 | 2,3% | -3,1% | -3,6% | -37,5% | -3,0% |
| Copper | 9033,00 | 5,4% | 1,7% | 8,5% | -13,5% | 8,0% |
| Iron ore | 126,66 | -2,6% | 0,6% | 14,6% | -15,3% | 13,8% |
| Freight rates Baltic Dry Index | 1484 | -3,3% | 81,9% | -2,0% | -42,4% | -2,0% |
| **Currencies** | | | | | | |
| EUR/ USD | 1,0787 | 1,5% | 1,6% | 1,6% | -1,8% | 1,1% |
| EUR/ GBP | 0,8804 | 0,4% | -0,1% | 0,0% | 5,7% | -0,8% |
| EUR/ JPY | 140,30 | -0,2% | -2,1% | -0,4% | 5,8% | -0,3% |
| EUR/ CHF | 0,9891 | 0,3% | 0,0% | 0,2% | -3,7% | 0,4% |
| USD/ CNY | 6,8685 | -0,3% | -0,5% | -1,8% | 7,8% | -0,5% |
| USD/ JPY | 130,83 | -0,8% | -2,9% | -1,5% | 8,0% | -0,2% |
| USD/ GBP | 0,82 | -0,9% | -1,8% | -1,5% | 7,9% | -1,8% |

Source: Refinitiv Datastream

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