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Special Coverage:

Addressing market fears: a credit or banking crisis remains unlikely

Key takeaways

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- Cash burn in the US VC technology sector caused customers of SVB (Silicon Valley Bank) to withdraw deposits, which forced the bank to sell its assets. As US authorities have guaranteed deposits and the Federal Reserve has given banks broader access to liquidity, the risk of a bank run should be sharply reduced. The Swiss National Bank (SNB) also pledged to provide additional liquidity to Credit Suisse if necessary.
- US delinquencies are very low, across mortgages, credit cards, commercial & industrial and other loans. US and European banks' capital ratios are also very healthy and they are generally enjoying strong profits. We think the current market turmoil is a consequence of rate volatility triggered by SVB, but not a harbinger of a credit crisis or a banking crisis.
- Investors should not be panic but remain invested with a sharp focus on quality across asset classes. Investment grade has seen positive returns since the start of the turmoil. Equities should rebound once markets grow more comfortable that a credit or banking crisis will be averted.

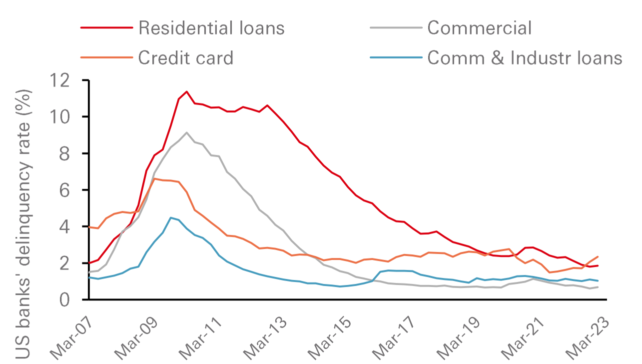
What happened?

- Since the end of last week, markets have been very jittery. Cash burn in the US VC technology sector caused customers of SVB to withdraw deposits, which forced the bank to sell some of its bonds and other assets and to crystallise losses on them. Since then, US authorities have guaranteed deposits and the Federal Reserve has given banks broader access to liquidity. This should sharply reduce the risk of a bank run, and therefore the risk that other banks need to crystallise losses on their bond portfolios.
- To ease market fears of a banking crisis, the Swiss National Bank (SNB) pledged to provide additional liquidity to Credit Suisse if necessary and stated the bank "meets the capital and liquidity requirements" imposed on systemically important banks".

Investment summary

- US delinquencies are very low, across mortgages, credit cards, commercial & industrial and other loans. US and European banks' capital ratios are also very healthy, and well above the regulatory minimum. What's more, banks are generally enjoying strong profits, which allows them to further build those capital buffers. All of this should limit fears of a credit crisis. And indeed, when we look at credit default swaps (CDS), they signal that apart from one or two outliers, banks' default risk is very low.

Delinquencies are still very low, so the current environment does not look ripe for a credit crisis



Source: Federal Reserve, HSBC Global Private Banking as at 11 March 2023.

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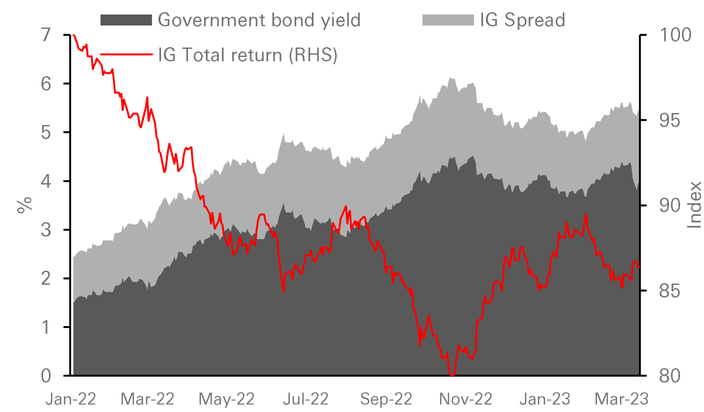
- Outside of the banking sector, credit spreads widening is limited. And in equities, there is only a mild move from cyclical to defensive sectors. This suggests that the market, like us, believes the negative impact of the recent turmoil on economic growth should remain limited.
- Unsurprisingly, investment grade has been the sweet spot: the mild widening of credit spreads is more than compensated by the fall in Treasury yields, and IG investors have in fact seen positive returns since the start of the turmoil. Our focus on quality has proven to be quite useful, and amid the uncertainty and tail risks, we emphasise it even more than before.
- But investors should not panic: once markets grow more comfortable that a credit or banking crisis will be averted, risk appetite should recover. Equities should rebound and the Fed could go back to its inflation fighting mission. That mission may now have become easier, in our view, with fewer rate hikes ahead than markets were anticipating a few weeks ago.
- So to every episode of market turmoil, there is a silver lining. Our strategy is to remain invested with a sharp focus on quality across asset classes.

Investment grade bonds have seen some mild widening of credit spreads, but this is more than compensated by the fall in government bond yields. So, IG investors have made small gains since the start of the turmoil.



Source: Bloomberg, HSBC Global Private Banking. Past performance is not a reliable indicator of future performance.

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