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The Silicon Valley Bank crisis

Student Research Internship Report

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The Silicon Valley Bank Crisis

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The second largest financial crises since 2008, or the Silicon Valley banking crisis. The Silicon Valley Bank is a commercial bank and this bank caters to the needs of the technological sectors. It holds more than 50% of the market share of the Silicon Valley.

Before dwelling more into the mainstream crisis of the Silicon Valley, let us take a look at the banking sector as a whole. Under the orthodox view, banks have been known for their role of being an intermediate between lenders and borrowers and provide avenues for saving and help investors find their financing needs. Thus, to summarize, banks are the intermediaries between the households and the firms, when we look at the circular flow of income. They channelize the savings of the households to the firms in the form of investment. But this is not true, according to the Modern Money Theory banks create money through the simultaneous exchange of assets and liabilities i.e., *ex-nihilo*.

Now talking about the Silicon Valley Banking crisis, most people might look at it as a credit crisis. A credit crisis is one which develops mainly due to a large amount of credit not being repaid. This can also be seen as a change of an asset to a non performing asset. This leads to a solvency crisis, i.e., the value of a bank's assets falls below that of its liabilities, creating financial losses which then need to be borne. This lose is either borne by the depositors or by the Central bank in most cases. In this case it was the FDIC (Federal Deposit Insurance Corporation). The FDIC is an independent agency created by the Congress to maintain stability and public confidence in the United States' financial system. It has four basic functions to perform, the first being to insure deposits. The second function is to examine and supervise the financial institutions for safety, soundness, and consumer protection. Thirdly, it helps make large and complex financial institutions resolvable. Lastly, it manages receiverships.

They think that the main reason for the banking crisis, was that the Silicon Valley Bank had focused on providing loans mainly to the technology and science sector. That approximately 40% of the British Biotech firms used the bank. Which is not the case, the Silicon Valley banks had played it safe. It had overinvested in the government securities.

[1] The author is a student at NMIMS, Bangalore. This article was written as part of the author's research internship at Foundation to Aid Industrial Recovery – Macroeconomic Analysis and Policy Studies. I, Bhavika Mahajan, declare that the contents of this article have not been plagiarized by me. The views expressed in this article are mine.

Now the question arises that what could have gone wrong with the safest assets i.e. the government securities?

The problem was that after the pandemic when the money supply was increased a lot. The fed tried to curb the persistent inflation by simultaneous increase in the interest rates as there is an inverse relationship between the interest rates and the inflation rate. Records prove that the interest rate in march 2023 was the highest since August 2007 ranging from 5%-5.25%. This continuous increase in the interest rates lead to a decrease in the price of the bond (as it is known that an increase in the yield leads to the decrease in the prices of the bond and vice-versa). This fall of the price of government securities hit hard the Silicon Valley Bank which had over-invested in these securities. With a fall in prices the assets of the bank decreased by the same value leading to a mismatch in the balances. Furthermore, the depositors of the bank wanted to withdraw their deposits as they were unsure. This led to the downfall of the Silicon Valley Bank.

Post the SVB being closed, within the next 2 days Signature Bank failed this happened because of lack of liquidity in the bank. The collapse of such big banks has rung a bell in the ears of many banks and majorly in the ears of investors and depositors. This can be seen in the falling of stock prices of many banks which were seen as sharing some risk with the SVB. Thus, the entire banking sector has been hit badly. Both these collapses have made some kind of pressure on the Fed to reduce the interest rates even though inflation persists. But it has been noticed that the Fed has kept the hike of interest rates on hold.

The Fed has held the interest rates and is prevented it to hike so as to prevent the spreading of this crisis. The Fed has made the funding available to many such institutions to help their assets column. But the markets in USA are still reacting strongly. Investors are still investing in bonds as they believe it is the safest security and because the yields were so high. This impact was seen mostly in the 2-year treasury bills, the impact was so much that the yield dropped from 5% to 4%. The market had expected the interest rates to be increased but after the crisis the Fed has kept the rates at a hold.