Trend Macrolytics, LLC
Donald Luskin, Chief Investment Officer
Thomas Demas, Managing Director
Michael Warren, Energy Strategist

MACROCOSM

Two Months After SVB, So Far So Good

Friday, May 19, 2023

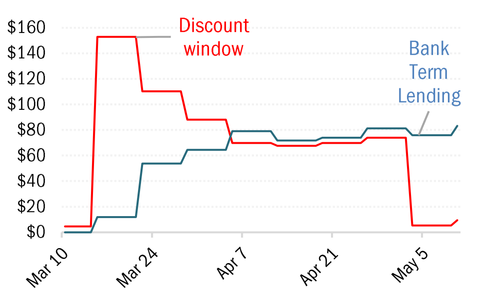
Donald Luskin

No systemic contagion, and the feared hard-freeze in credit activity hasn't happened.

Our hot take when Silicon Valley Bank and Signature Bank failed was that it would not lead to a contagious systemic crisis, and that a likely chill in borrowing and lending activity in the aftermath would not be sufficient to tip the economy into recession (see "It's Over For SVB – And the Fed" March 13, 2023). Two months on, so far so good.

- Out of more than 4,000 US banks, there has been only one further failure.

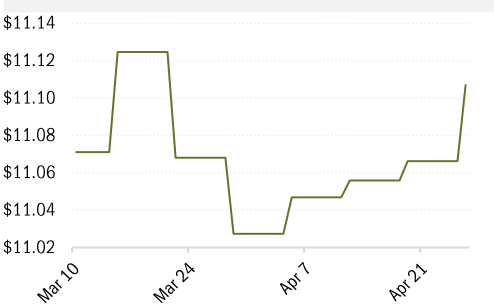
Fed lending to banks since SVB (USD billions)



Source: FRB H.8, TrendMacro calculations

- We know from sources that *the initial record surge in discount window borrowing by banks was driven not by true need*, but by regulatory panic – the top banks were all commanded by their regulators to pledge assets whether they needed to or not (in part to disguise the identities of the few banks who did need to). Those loans have all been retired already. The new Bank Term Lending Program, designed to lend at par value against marked-down Treasuries and MBS was custom-built specifically to respond to the duration risks that brought down SVB, and it has found significant utilization. As we have explained, in some sense this a form of quantitative easing (again, see "It's Over For SVB – And the Fed").

Bank lending since SVB (USD trillions)



Source: FRB H.8, TrendMacro calculations

- *Overall bank lending is up $19.7 billion since SVB*. To be sure, the internal composition of the gain is mixed. Nevertheless, there has not been, on net, a lending contraction.
- *This is critical not only because the economy needs access to sufficient bank credit. It is also urgent for banks to write new loans at today's higher interest rates in order to bring up the average return on assets and*

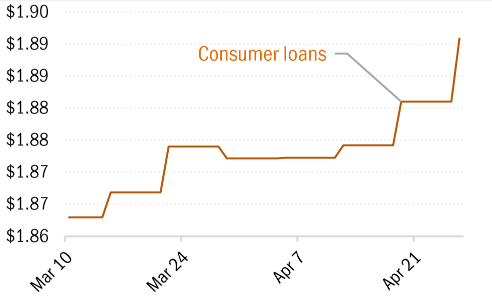
Update to strategic view

US MACRO: Only one more bank has failed in the two months following Silicon Valley Bank and Signature Bank. Forced discount window borrowing has now been retired, and the new Bank Term Lending Program has kicked in as a version of QE to liquify banks with marked-down Treasuries and MBS. Bank lending is up since SVB. Consumer lending has steadily grown, led by revolving credit, showing that even if banks are hesitant to lend consumers are not hesitant to borrow. Real estate lending is higher after a dip. C&I loans are down, but have recovered from the worst. The feared credit hard-freeze has not materialized, and increased lending allows banks to rehabilitate their crushed net interest margins. We stand by our no-landing call.

[Strategy dashboard]

thereby begin to rehabilitate net interest margins that were crushed by rising cost of deposits driven by the Fed's rate-hiking campaign over the last year.

Bank lending since SVB (USD trillions)



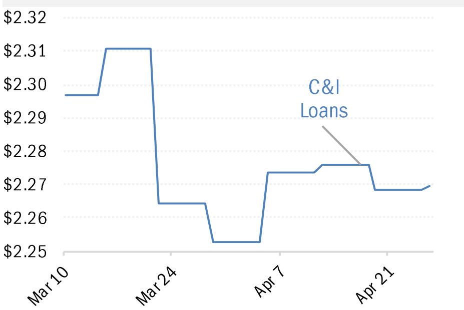
Source: FRB H.8, TrendMacro calculations

- *Consumer lending is up $25.7 billion, having never taken a dip*. Four-fifths of that is growth in revolving credit, mostly credit cards. From a bank's perspective that is a strictly demand-driven form of lending, so even if it doesn't speak to the banking system's willingness to lend, it does speak to the consumer's willingness to borrow. In a true banking panic, both the demand to lend and the demand to borrow evaporate.

Bank lending since SVB (USD trillions)

Source: FRB H.8, TrendMacro calculations

Bank lending since SVB (USD trillions)



Source: FRB H.8, TrendMacro calculations

- *Real estate lending is up $26.4 billion since SVB*. Arguably some of this was pre-committed, but two months on it continues to grow after an initial drop.
- *Commercial and industrial lending is off $32.3 billion since SVB*. This is the weak point. It is an outlier, and it has shown some recovery. But there's no avoiding the fact that it is not giving us the constructive signal that the other categories are, at least not yet.

A potential hard-freeze in credit could have been the straw that broke the business cycle's back. We've stuck with our no-landing call throughout this banking crisis, and so that still looks like the right position.

Bottom line

Only one more bank has failed in the two months following Silicon Valley Bank and Signature Bank. Forced discount window borrowing has now been retired, and the new Bank Term Lending Program has kicked in as a version of QE to liquify banks with marked-down Treasuries and MBS. Bank lending is up since SVB. Consumer lending has steadily grown, led by revolving credit, showing that even if banks are hesitant to lend consumers are not hesitant to borrow. Real estate lending is higher after a dip. C&I loans are down, but have recovered from the worst. The feared credit hard-freeze has not materialized, and increased lending allows banks to rehabilitate their crushed net interest margins. We stand by our no-landing call.