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MACROCOSM

One Year On, Bank Credit Finally Shakes Off Silicon Valley Bank

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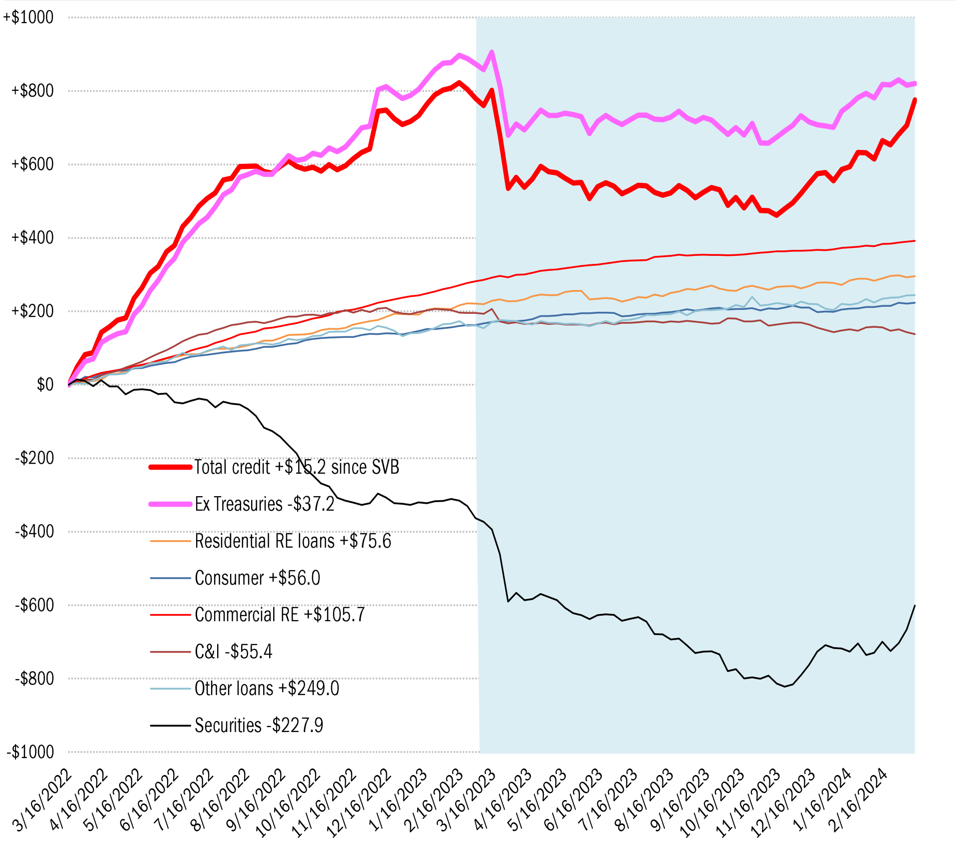
Donald Luskin

It's growing at a near-trillion dollar rate. Recessionistas have lost their last argument.

It's been a little more than a year since the failure of Silicon Valley Bank (see "It's Over For SVB – And the Fed" March 13, 2023). Today it's like being at the end of March in 2009, a year after Bear Stearns failed – but unlike then, Lehman, Fannie and Freddie, AIG, Washington Mutual and all the rest are still in business. *We said in the moment a year ago there would not be a systemic string of failures but warned that there would be a credit chill. After a year now with substantially no failures, we're delighted to report that the credit chill appears to be dissipating* (please see the chart below).

Commercial bank assets from Fed lift-off (cumulative, USD billions) ■ **Post Silicon Valley Bank failure**



Source: Federal Reserve H.8, TrendMacro calculations

Update to strategic view

US MACRO, US STOCKs, FEDERAL RESERVE: Silicon Valley Bank failed one year ago, and unlike Bear Stearns in 2008, it was not a harbinger of systemic collapse. A credit chill developed in the aftermath, which has now been entirely reversed, with total bank credit above the pre-SVB level, almost at an all-time high. Credit bottomed in October, the same week as the stock market, and two weeks before the November FOMC formally acknowledged "tighter financial and credit conditions." Credit has grown at a $917 billion annual rate since then, and stocks are up almost 30% with or without the Magnificent Seven. Thea eliminates our most significant recession worry, and makes the No Landing outcome so obvious that it has become in-consensus. Positive economic surprises no longer have the power to move markets higher. It feels like a good time for a correction in equities.

[Strategy dashboard]

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- After SVB failed, panicked *banks shrank their exposures by selling what they could sell – securities*. In the first month, total bank credit fell by $222 billion, virtually all in securities (more than half of it mortgage-backed securities, more than a quarter Treasuries).
- Total credit drifted lower for the next half-year, bottoming in mid-October $299 billion off from the pre-SVB level.
- *The stock market bottomed the same week as the October bottom in bank credit*. That was two weeks before the November FOMC, at which the Fed acknowledged for the first time in its official meeting statement that "Tighter financial and credit conditions for households and businesses are likely to weigh on economic activity, hiring, and inflation" (see "On the November FOMC" November 2, 2022). The committee forgot to say this was "transitory" (to cite their least favorite word) – but indeed it turned out very much to be. Once again, the Fed got the timing exactly wrong – since then, *bank credit has grown $299 billion, which is $917 billion at an annual rate*. *Now it has completely recovered, to $15.2 billion above the pre-SVB level, almost an all-time high* (again, please see the chart on the previous page). *The S&P 500 is now up almost 30% from the October bottom* (and don't write it off to the Magnificent Seven – the unweighted S&P 500 and the Russell 2000 have performed similarly).
- For the last year, the failure of bank credit to keep pace with the rapidly growing economy has been number one on our list of "what could possibly go wrong" for our long-standing No Landing prediction. It really looks like we'll have to find something else.
- *For the moment, our biggest worry is sentiment*. Our No Landing scenario is now realized sufficiently to the point that even the most die-hard recession believers have to see it. That doesn't mean we have to reverse our forecast, simply because it has become in-consensus. *But it does mean that positive economic news is no longer a surprise, and won't produce excess returns in markets.*
- *It feels like a good time for a long-overdue correction in US stocks. People need to get scared again.*

Bottom line

Silicon Valley Bank failed one year ago, and unlike Bear Stearns in 2008, it was not a harbinger of systemic collapse. A credit chill developed in the aftermath, which has now been entirely reversed, with total bank credit above the pre-SVB level, almost at an all-time high. Credit bottomed in October, the same week as the stock market, and two weeks before the November FOMC formally acknowledged "tighter financial and credit conditions." Credit has grown at a $917 billion annual rate since then, and stocks are up almost 30% with or without the Magnificent Seven. That eliminates our most significant recession worry, and makes the No Landing outcome so obvious that it has become in-consensus. Positive economic surprises no longer have the power to move markets higher. It feels like a good time for a correction in equities.

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