The Banking Crisis in Five Slides

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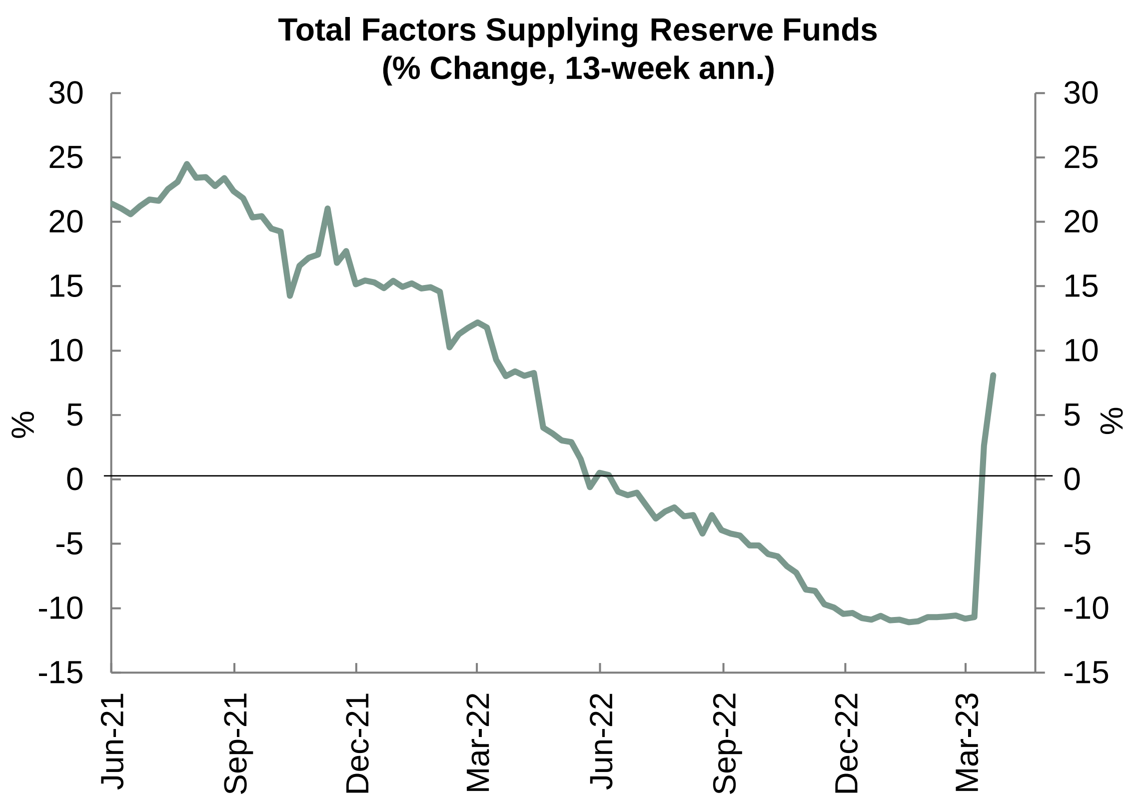
The Crux of the Problem

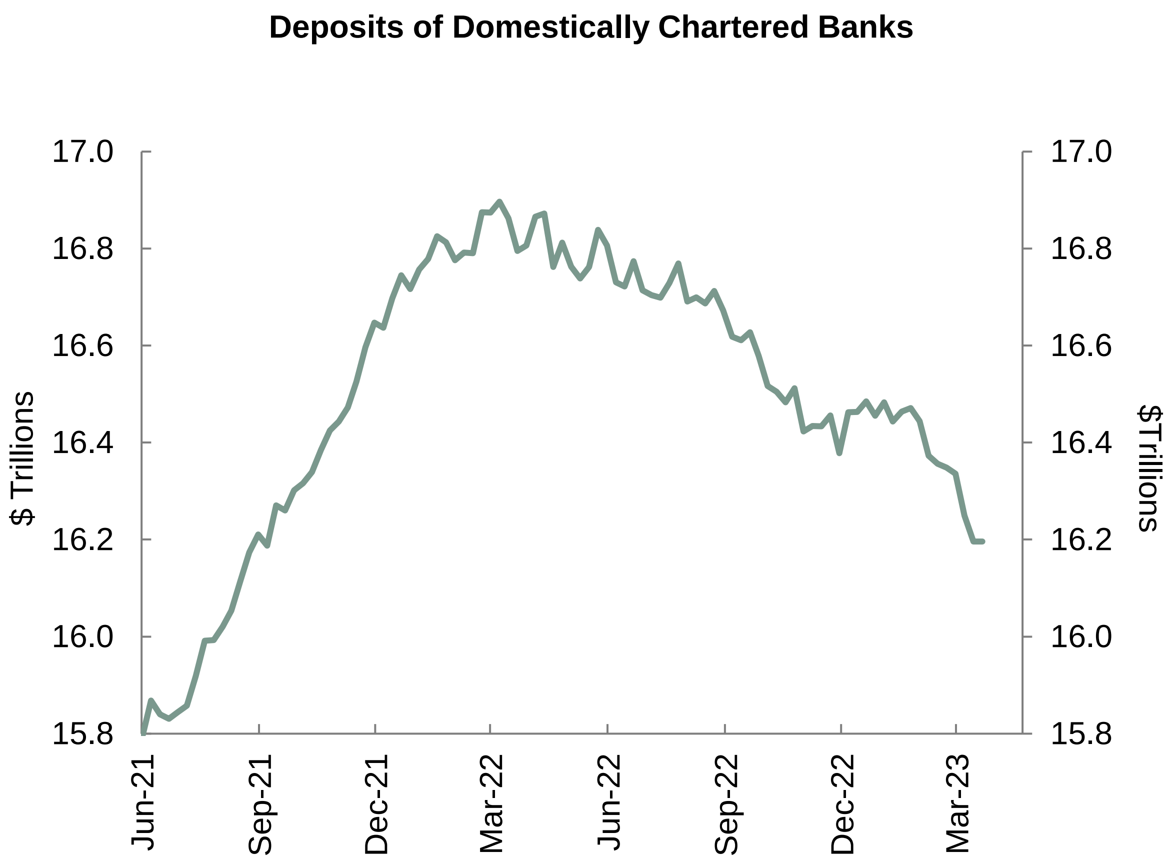
Over the past year, the Fed raised rates by 475 basis points. But after accounting for how low rates where when they started to rise, current Fed tightening has been the biggest and fastest on record. And do not forget about quantitative tightening. The Fed's balance sheet had been declining at an 11% annualized rate, shrinking commercial bank reserves in the process. No wonder we have a banking crisis!



Source: FRB, Haver, SMBC Nikko

Depositors on the run

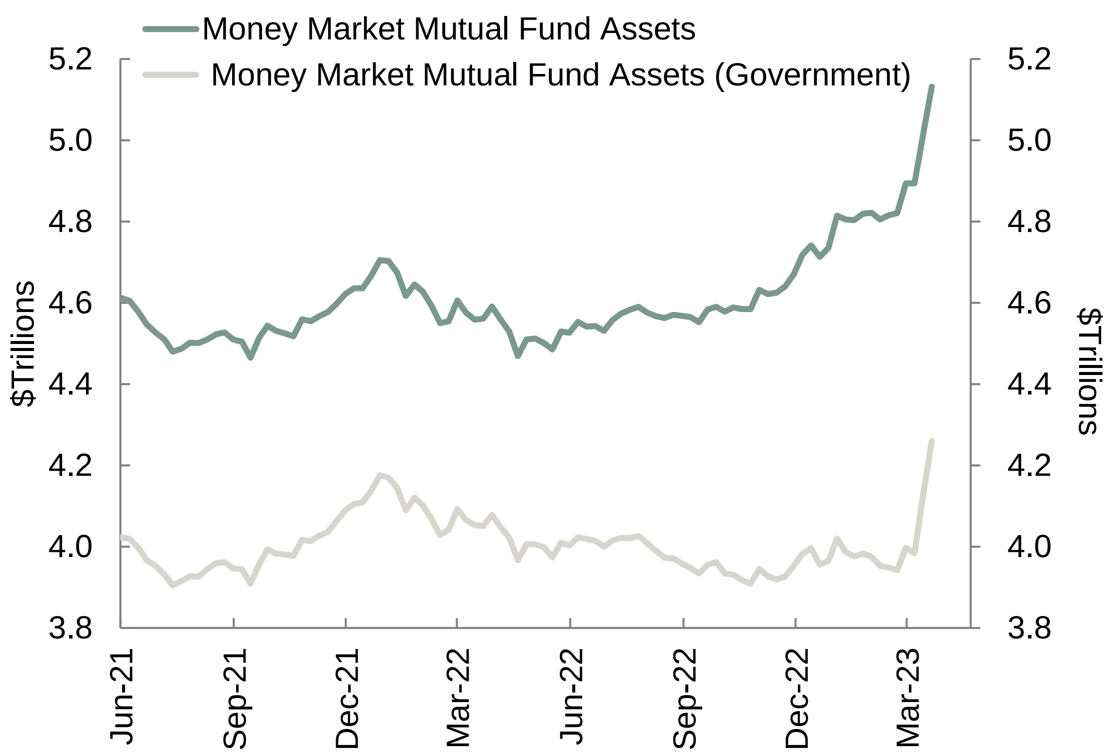
US commercial bank deposits peaked in March 2022 at just under $17 trillion. But since then, they are down $267 billion, split between large ($119B) and small banks ($148B). Worryingly, over the past several weeks, the outflow has accelerated because of old-fashioned bank runs.



Source: FRB, Haver, SMBC Nikko

Into the Safety of Government Assets

Money market accounts have been paying higher rates than banks and thus have attracted inflows over the past year. However, the recent flight to quality has spawned a surge into government-sponsored money market funds. Over the last six weeks, these funds have attracted a staggering $327 billion. Therefore, commercial banks have been forced to turn elsewhere for funds, exacerbating funding flight.

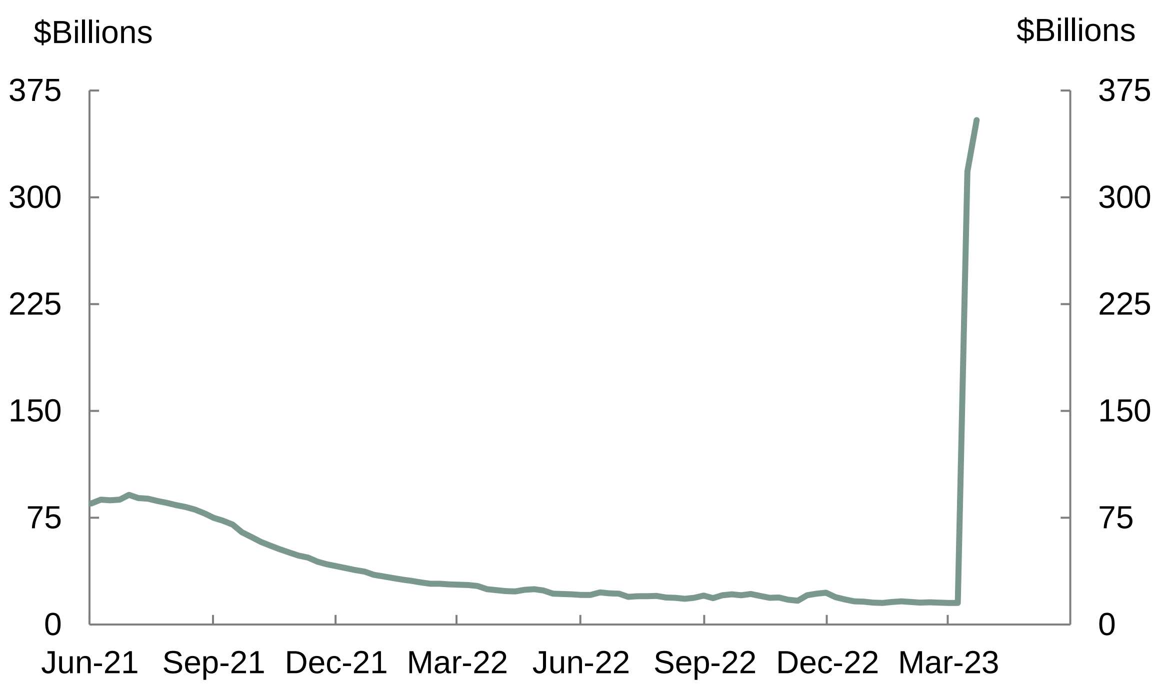


Source: FRB, Haver, SMBC Nikko

Turning to the Lender of Last Resort

Commercial banks have turned to the Fed for funding. Over the last two weeks, discount window borrowing has increased $339 billion, effectively matching the decline in deposit outflow. This version of “QE-lite” has offset 60% of the Fed’s quantitative tightening. The current situation makes it more difficult for the Fed to further lift rates and continue QT.

Federal Reserve Discount Window Lending



Source: FRB, Haver, SMBC Nikko

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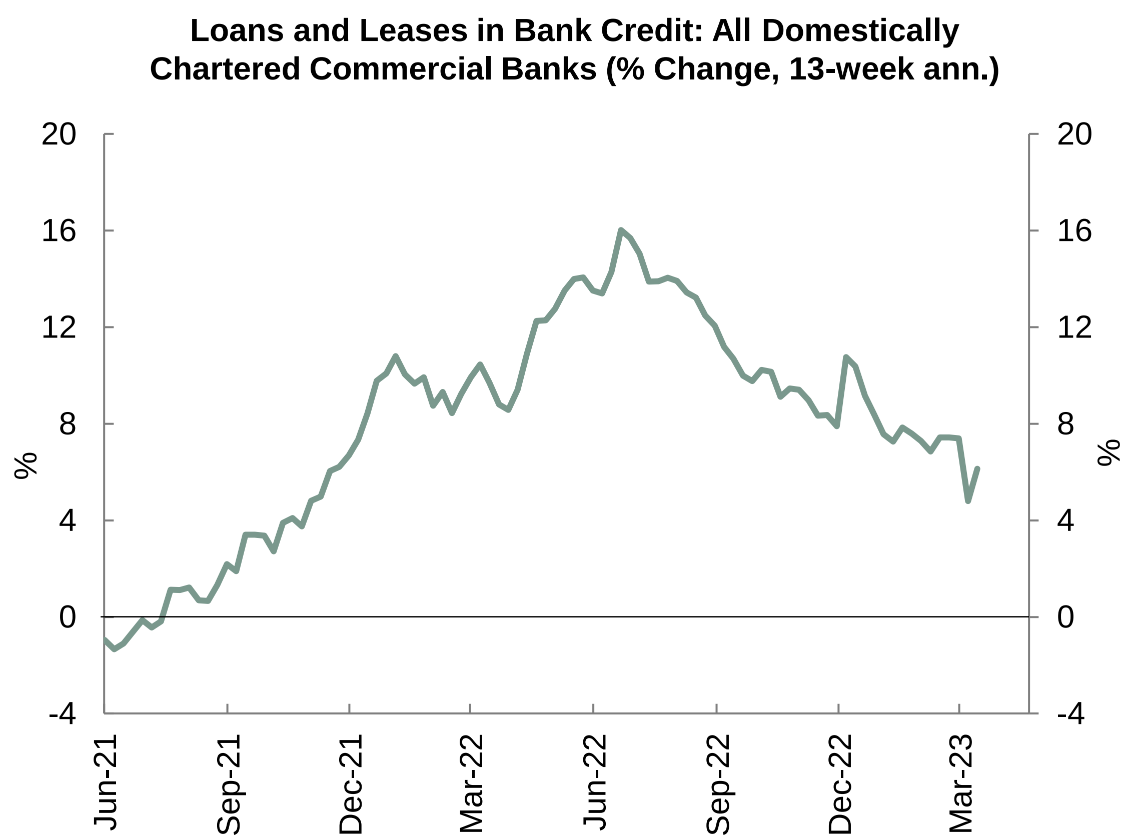
Looming Credit Crunch

The mechanics of a deep credit crunch are in place. Fewer deposits mean fewer loans. Less lending means less credit. Less credit means less financing for businesses and consumers to produce, hire and spend. Commercial bank lending which has been slowing should slow much more going forward.



Source: FRB, Haver, SMBC Nikko

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