

WisdomTree MINDS ON THE MARKETS



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The Regional Banking Crisis: One Year Later

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Thus far in 2024, investors have been laser-focused on a resilient U.S. economy, firmer-than-expected inflation and a Fed policy backdrop that has become less dovish than what the money and bond markets were anticipating. Certainly, you'll get no argument from us on these key market inputs, but one topic that has essentially been flying under the radar a bit is the state of the regional banking situation.

Yes, headlines pop up from time to time to remind investors that issues have not been completely eliminated on this front, but for the most part, the markets have been taking their cues from the aforementioned macro/Fed backdrop. The reason we bring this topic up for discussion in this week's publication is that we are at the one-year anniversary of the Silicon Valley Bank (SVB)-related headlines that shook the investment community up in a significant way last March. Just like now, in March 2023, the macro view was also dominating the landscape, albeit rate hikes were all the rage, not rate cuts.

So, where exactly are we a year later into the process? There's no question the monetary authorities were caught off guard a year ago and had to scramble to come up with some solution that would hopefully avoid a systemic crisis. Looking back at the markets' reactions to the March 2023 headlines, it is fascinating to see where sentiment lies at the present time. Remember, this wasn't just a U.S.-based concern. Indeed, issues spilled over into Europe, where the second-largest Swiss bank, Credit Suisse, had to be "forced" into a merger with UBS.

Here in the U.S., arguably the most important tool to avert a systemic crisis came from the Federal Reserve. Specifically, the Fed implemented its Bank Term Funding Program or BTFP. Fortunately, or perhaps unfortunately, the Fed had gotten used to creating various facilities that had been effectively utilized in the aftermath of the financial crisis and COVID-19-related periods. So, when the regional banking crisis hit, the policy maker once again went to this playbook.

There is no question that BTFP was highly successful in its mission. What exactly was at its core, you might ask? As you may recall, banks were having difficulty getting funding because their collateral of Treasuries, U.S. Agency and U.S. Agency MBS were depressed in value due to the surge in interest rates. As a result, BTFP provided loans for up to one year for eligible depository institutions where the aforementioned collateral would be valued at par. History has shown us that this facility helped to "unlock" the funding dislocations and provided assurances to the markets that the worst could be avoided.

As we reflect on this one-year timeframe, you may be wondering if the BTFP is still operating. The answer is no. In fact, the Fed ceased making new loans for this program on March 11 of this year. Interestingly, this was exactly a year from the BTFP's announcement date on March 12, 2023.

The program itself picked up momentum through the spring of last year and kind of leveled off at roughly \$100 billion to \$115 billion through year-end. However, as Q1 of 2024 has rolled along, the pace of usage picked up in a somewhat noticeable fashion, with the latest amount coming in at \$167 billion as the program came to a close, which is essentially the peak reading.

With BTFP no longer making new loans, the Fed has been trying to get eligible depository institutions that need funding to utilize the discount window. However, we have seen, time and time again, a reluctance to use "the window" because of a negative stigma attached to it. The Fed has been trying to change the narrative on this front, with Chairman Powell recently testifying to Congress that "we need to do more to eliminate the stigma problem, and we need to make sure that banks are actually able to use [the Discount Window] when they need to use it."

Hopefully, we don't get to a point where we have to find out if the stigma has been removed.

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Glossary

Bank Term Funding Program (BTFP): Created to support American businesses and households by making additional funding available to eligible depository institutions to help ensure that banks have the ability to meet the needs of all their depositors.

Dovish: Description used when stimulation of economic growth is the primary concern in setting monetary policy decisions.

Federal Reserve (Fed): The Federal Reserve System is the central banking system of the United States.

Treasury (UST): Debt obligation issued by the U.S. government with payments of principal and interest backed by the full faith and credit of the U.S. government.

U.S. Agencies: Loans to government agencies or federally backed private corporations.

U.S. agency mortgage-backed securities (MBS): Pools of securitized residential mortgage loans that are issued and guaranteed by U.S. government agencies.

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